GOVERNOR'S PROPOSAL TO ADDRESS THE PERS UNFUNDED LIABILITY (LCSA07)

A Report Prepared for the

Legislative Finance Committee

By

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LFD

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INTRODUCTION

Five of Montana's eight public pension systems face significant unfunded liabilities due in combination to a prolonged period of low investment earnings and the lack of sufficient contribution levels to stabilize the systems in times of economic downturn. The two largest, the Teachers' Retirement System (TRS) and Public Employees' Retirement System (PERS), are responsible for over 90% of the state's FY 2012 unfunded pension liability.

As of June 30, 2012, the PERS estimate of the Annual Required Contribution (ARC) to amortize the PERS unfunded liability over a 30 year period is approximately $70.6 million per year greater than the current level of contributions to the system. This equates to an additional contribution of 6.53% of covered payroll, above the current statutory rate of 14.183%. This shortfall in funding of the ARC is the responsibility of the State of Montana through the Governor and Legislature to resolve. This public pension serves all levels of government in Montana and all levels of government share in this unfunded liability.

LCsa07 is proposed legislation by the Governor's Office to specifically address the unfunded liability and actuarial soundness of the PERS defined benefit plan (PERS-DB). This brief report is meant to convey to legislators an understanding of this proposed bill including identification of funding levels, funding sources, potential issues, and overall effectiveness of addressing the unfunded liability.

Proposal Summary

LCsa07 uses a combination of four funding strategies to reduce the existing PERS ARC shortfall. The proposal would:

A. Increase employee contribution rate 1% for employees hired prior to July 1, 2011, resulting in all employees contributing 7.9% of compensation
B. Increase employer contribution rate 1% (from 7.17% to 8.17% of total compensation)
C. Appropriate all non-dedicated revenue from coal severance taxes to the trust fund for the PERS-DB plan
D. Appropriate $3.0 million of Coal Severance Tax Permanent Fund Interest from the general fund
E. Require local government employers annually to contribute an additional "actuarially determined" amount equivalent to that employer's share of the remaining ARC

Figure 1 shows the estimated dollar values of the fund increases required by LCsa07:

Figure 1

FY 2014 Contribution Increases to PERS (as Proposed by LCsa07)		
Fund Source	LFD Estimate (1)	PERS/OBPP (1)
A) 1% Increase in Employee Contribution Rate	$9,143,308	$9,143,308
B) 1% Increase in Employer Contribution Rate (2)	11,245,397	12,106,510
C) Non-Dedicated Coal Severance Taxes (3)	14,845,000	16,874,000
D) Coal Severance Tax Permanent Fund Interest (4)	0	3,000,000
E) Add'l Local Gov't Actuarial Contribution	14,796,000	14,796,000
Grand Total	$50,029,705	$55,919,818
Percent of Payroll	4.25%	4.76%

(1) - Two differing estimates of the bill's fiscal impact are shown. The values in the left column represent the LFD estimate of the bill's fiscal impact as drafted. The technical issues identified in footnotes 2 and 4 must be corrected to allow for the fiscal results intended by OBPP, which are the values shown in the right column.

(2) - Technical note: 19-3-316(1), MCA, requires employer contributions for members of the defined contribution plan proposed by this bill to be allocated as provided in 19-3-2117(2), MCA. As currently drafted, the contributions related to the defined contribution payroll are not allocated for any purpose in 19-3-2117(2), MCA, and is therefore not included in the LFD estimate. If those contributions do become allocated to the defined benefit plan as part of the DC plan choice rate allocation, the LFD estimate of 1% employer contributions will increase by approximately $1 million.

(3) - Estimate difference: As of the date of this report there is a difference between LFD and OBPP (used by PERS) revenue estimates of the non-dedicated coal severance taxes of approxamately $2.0 million.

(4) - Technical note: Amendments to 15-35-108, MCA, proposed by this bill reduce statutory appropriations from the GF by $3 million, related to interest income from the coal severance tax permanent fund, with the intention to have them flow into the PERS trust. The bill, as drafted, is missing language to re-direct those funds to the trust fund for the PERS-DB plan.

Figure 2 shows the funding breakout of employer contributions for each governmental entity, as well as the associated source of funds used to pay for the employer contribution increases.

Figure 2

FY 2014 Estimated Increases in Contributions by Entity and Fund Source (1)				
	Contributing Entities			
Funding Sources	**Employee**	**Local**	**State**	**Grand Total**
K-12				
Federal Funds Schools (11.9%)		$179,015		$179,015
GTB State Average (24.7%)			$374,718	374,718
Local Schools (63.5%)		963,344		963,344
Additional Actuarial Contribution (2)		3,872,888		3,872,888
Statutory Appropriation				0
K-12 Total	-	5,015,247	374,718	5,389,965
Local				
Community Colleges		71,963		71,963
Local Government		4,110,938		4,110,938
Additional Actuarial Contribution (3)		10,923,112		10,923,112
Statutory Appropriation				0
Local Total	-	15,106,013		15,106,013
MUS				
Current Unrestricted (CUR)				
> Non-State Portion (tuition)			427,057	427,057
> GF Portion			284,705	284,705
Other (non-CUR)			305,041	305,041
MUS Total	-	-	1,016,803	1,016,803
State				
Federal Funds			836,347	836,347
General Fund			2,033,604	2,033,604
Other			90,716	90,716
Proprietary Funds			601,572	601,572
State Special Revenue			1,827,437	1,827,437
Coal Severance Taxes (4)			14,845,000	14,845,000
CST Permanent Fund Interest			3,000,000	3,000,000
State Total	-	-	23,234,676	23,234,676
Subtotal Employer Contributions	$0	$20,121,260	$24,626,197	$44,747,457
Subtotal Employee Contributions	$9,143,308			$9,143,308
Total All Contributions	$9,143,308	$20,121,260	$24,626,197	$53,890,765
Ongoing Funding each year →			**$53,890,765**	
State General Fund Impact →			**$20,538,027**	

(1) - The values in this table use the LFD coal severance tax estimate, which is approximately $2 million lower than the OBPP revenue estimate, and assume the technical fixes outlined in the footnotes to Figure 1 are implemented in the final version of the bill.

(2) - Source of funding for K-12 Additional Actuarial Contribution is unknown by LFD at this time.

(3) - Source of funding for Local Government Additional Actuarial Contribution is unknown by LFD at this time.

(4) - The non-dedicated coal severance taxes appropriated by this bill to the PERS Trust would have otherwise flowed directly into the State General Fund.

How far does this bill go in addressing the PERS-DB unfunded liabilities?

This bill provides significant, additional contributions into the trust fund for the PERS defined benefit plan; however, the projected value of those contributions in total does not provide the ARC amount required to fully amortize the PERS unfunded liability within a period of 30 years using current pension board assumptions. An additional annual contribution of approximately 2.3% of covered payroll, which equals $28,239,000 per year, will be necessary to fund the pension system on an actuarially sound basis.

LFD/LSD Issues and Comments:

In the June 2012 report presented by staff of the Legislative Services and Legislative Fiscal Divisions, staff examined several different funding scenarios using a series of questions designed to examine the various aspects of pension challenges "through legal, policy, funding, and fiscal lenses". The following applies these questions to the Governor's proposal:

Does this bill raise contract impairment questions? Yes. Any pension legislation that increases employee contribution rates with no corresponding increase in benefits raises potential contract impairment concerns from stakeholders. LSD staff attorneys have and will continue to provide guidance to policymakers related to enactment or serious analysis and consideration of non-impairing alternatives prior to adopting any impairing alternative.

What are the major funding assumptions made in this LFD analysis? The proposed bill, as currently written, would cause additional costs to be paid through the following sources:

- Local costs through a combination of property tax and user fees such as water/sewer, or reductions in services
- Montana University System (MUS) costs through a combination of general fund and tuition increases
- Community college costs through mandatory levy
- School district costs through a combination of mandatory county mill levies and state guaranteed tax base aid (GTB), and possibly other undetermined sources

What are the major issues with funding?

- Some state and federal funding sources may not be able to absorb the increase without service reductions and/or increased fees
- Local governments may require a property tax increase in excess of current limits or otherwise have to put in place service reductions
- School districts may have to increase mandatory county mill levies
- MUS may have to enact a tuition increase

What portion of the funding would statutorily require an increase in taxes or fees? Mandatory county mill levies may have to be increased to pay for the school district increases. The additional local government contributions will cause budget pressure within counties, cities and schools. This budget pressure is likely to increase permissive levies to the extent possible and will require either reduced services or higher voted taxes.

Does this bill amortize the unfunded liability within 30 years using current pension board assumptions? No. According to the PERS actuarial analysis of this proposal, and assuming no additional contributions from other legislation, the amortization schedule for the state share of the plan's unfunded liabilities will be reduced from "does not amortize" to a 52-year amortization schedule beginning in FY 2014 and decreasing to a 30-year amortization schedule by 2027; and the local share of the plan's unfunded liabilities decreases from "does not amortize" to a rolling 30-year amortization. The PERS actuary estimates that an additional $28,239,000 of contributions (or an additional 2.3% of covered payroll) will be necessary to amortize the unfunded liability within 30 years, using current pension board assumptions.

Does the bill allow for contingencies if the return on investment (ROI) and other key assumptions are not met? The bill contains triggers to lower contributions if ROI is better than actuarially assumed. In the case of ROI being worse than assumed, the bill does not have statutory triggers to increase contributions across the board, however there is a potential that the local "actuarially determined" contribution will be required to increase if ROI is worse than assumed.

Does the bill just rely on state resources? No. This bill requires participation from local governments, school districts, and the MUS.

What portion of the increased contribution is funded with general fund in this scenario? Assuming technical fixes to the bill are made, as outlined in the footnotes to Figure 1, the general fund amount will be approximately $20.5 million or 38% of the total.

Does the scenario share the cost among all employers? Yes. Refer to Figure 2 for funding estimates by entity and fund source.