GOVERNOR'S PROPOSAL TO ADDRESS THE TRS UNFUNDED LIABILITY (LCSA06)

A Report Prepared for the

Legislative Finance Committee

By

Joe Triem

Assistant Principal Fiscal Analyst

November 13, 2012

LFD

MONTANA LEGISLATIVE FISCAL DIVISION

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 TRS estimate of the Actuarially Required Contribution (ARC) to amortize the TRS unfunded liability over a 30 year period is approximately $36 million per year greater than the current level of contributions to the system. This equates to an additional contribution of 4.89% of covered payroll, above the current statutory rate of 9.96%. 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.

LCsa06 is proposed legislation by the Governor's Office to specifically address the unfunded liability and actuarial soundness of the TRS retirement plan. 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

LCsa06 uses a combination of three funding strategies to reduce the existing TRS ARC shortfall, and creates a second tier membership for employees hired after July 1, 2013. The proposal would:

- Increase employee contribution rate 1% for employees, to a new total of 8.15% of compensation
- Statutorily appropriate $25 million annually from the public school fund guarantee account to the teachers' retirement system
- Decrease the cap on school district retirement fund operating reserves, from 35% to 20%, and require a one-time-only transfer of excess school district retirement fund operating reserves to the teachers' retirement system
- Create a new membership tier for employees hired after July 1, 2013, called "tier two members', with different retirement plan terms and conditions than current members

Figure 1 shows the estimated dollar values of the fund increases required by LCsa06:

Figure 1

Fund Source	Amount (1)	Reduction in Shortfall
1% Increase in Employee Contribution Rate - continuing	$6,226,376	0.81%
Statutory Approp. from Public School Fund Guarantee Acct - ongoing	25,000,000	3.25%
Excess School District Retirement Fund Operating Reserves - OTO	14,700,000	oto
Grand Total	$45,926,376	4.06%

(1) - Employee contribution estimated by LFD. Excess School District Retirement Fund Operating Reserves estimated by OBBP.

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					
	OTO	Ongoing Expenditures			
Funding Sources	Local	Employee	Local	State	Total
K-12					
Federal Funds Schools (11.9%)					-
GTB State Average (24.7%)					-
Local Schools (63.5%)					-
Statutory Appropriation					-
SD Retirement Fund Reserves (1)	$14,527,640				$14,527,640
K-12 Total	14,527,640	-	-	-	14,527,640
Local					
Community Colleges (Ret Fund Res)	172,360				172,360
Local Government					-
Statutory Appropriation					-
Local Total	172,360	-	-	-	172,360
MUS					
Current Unrestricted					-
Other					-
MUS Total	-	-	-	-	-
State					
Federal Funds					-
General Funds (2)					-
Other					-
Proprietary Funds					-
State Special Revenue				$25,000,000	25,000,000
State Total	-	-	-	25,000,000	25,000,000
Subtotal Employer Contributions	$14,700,000	$0	$0	$25,000,000	$39,700,000
Subtotal Employee Contributions		$6,226,376			$6,226,376
Total All Contributions	$14,700,000	$6,226,376	$0	$25,000,000	$45,926,376
Ongoing Funding each year →				**$31,226,376**	
State General Fund Impact →				**$25,000,000**	

(1) - School District and Community College Retirement Funds are generated with a combination of fund sources including local, state, and federal funds.

(2) - State Special Revenue shown is from the Public School Fund Guarantee Account. A shortfall in public school funding caused by this expenditure will be backfilled from the State General Fund.

How far does this bill go in addressing the TRS unfunded liabilities?

This bill provides significant, additional contributions into the trust fund for the TRS retirement plan; however, the projected value of those contributions in total does not provide the ARC amount required to fully amortize the TRS unfunded liability within a period of 30 years using current pension board assumptions. According to the system's actuarial analysis, the amortization schedule for the plan's unfunded liabilities will be reduced from "does not amortize" to amortizing the unfunded liabilities in 45 years. An additional annual contribution of approximately 2.02% of payroll, which equals $14.9 million per year, will be necessary to fund the system on a 30 year amortization schedule.

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. This bill would create a second tier of retirement system membership, with statutory terms and conditions that do allow for some increase in future employee contribution rates of "tier two members". 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:

- School district retirement fund reserve accounts
- Community college district retirement fund reserve accounts
- State general fund costs to replace the reduction in the Public School Fund Guarantee Account disbursements

What are the major issues with funding?

- A significant portion of the ongoing funding proposed by this bill comes from the State general fund
- The statutory cap on school district retirement fund reserves will be reduced from 35% to 20% of the final retirement fund budget for the school fiscal year. Should school district retirement fund reserves fall below levels sufficient for short term cash flow obligations of the system, some districts may have to borrow against other district accounts to meet short term cash flow needs.

What portion of the funding would statutorily require an increase in taxes or fees? None anticipated.

Does this bill amortize the unfunded liability within 30 years using current pension board assumptions? No. According to the TRS 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 45-year amortization schedule beginning July 1, 2013.

Does the bill allow for contingencies if the return on investment (ROI) and other key assumptions are not met? The bill contains triggers to reduce or eliminate the 1% increase for "tier one" employees if ROI is better than actuarially assumed. In the case of ROI being worse than assumed, the bill has statutory triggers to increase "tier two" employee contributions by up to 0.5% after 2023 if matched with a corresponding employer increase, however there are no provisions that allow for a similar increase in "tier one" rates.

Does the bill just rely on state resources? No. This bill requires one time participation from local governments and school districts and an increase in employee contributions.

What portion of the increased contribution is funded with general fund in this bill? $25.0 million for approximately 80% of ongoing funding.

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