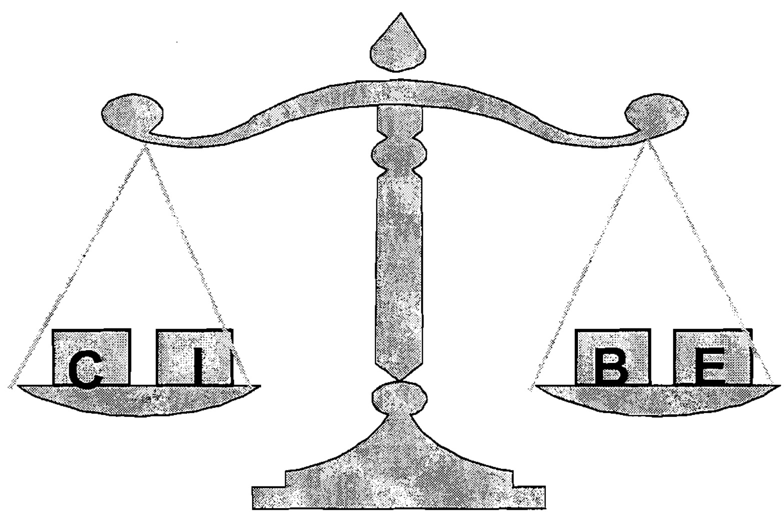
STATE ADMINISTRATION AND VETERAN'S AFFAIRS COMMITTEE

April 21, 2006

OVERVIEW OF PRINCIPLES, POLICY GUIDELINES, AND POLICY STATEMENTS FOR PUBLIC RETIREMENT SYSTEMS



C = Contributions **B = Benefits**
I = Investment Income **E = Expenses**

Presentation by:
David L. Senn
Executive Director
Teachers' Retirement System

STATE ADMINISTRATION & VETERANS' AFFAIRS
APRIL 21, 2006 MEETING
EXHIBIT 3

1997 Legislator's Guide to Montana Public Retirement Systems

The Teachers' Retirement Board supports the four principles on pension policy recommended by NCSL and adopted by the CPERS and SAIC committees:

1. Pension should provide a base (CPERS committee modified the NCSL recommendation of Pensions should provide financial security in retirement)
2. Pension funding should be a contemporary obligation
3. Pension investments should be governed by the "prudent expert rule"
4. Pension benefits should be equitably allocated among beneficiaries

1995 NCSL recommend policies

Implementation of the NCSL recommended policies can be seen in the policy statements contained in Part 1 of the CPERS report to the 2001 Legislature.

1. **State legislatures bear ultimate responsibility to voters and beneficiaries for the financial security and wellbeing of state retirement systems. Therefore, state legislatures should approve all changes of benefits and funding of retirement systems, and should regularly review their management and investment policies.**

   The Montana Constitution, state laws, interim committees

2. **State legislatures should establish permanent pension review bodies to analyze the problems of their retirement systems on an ongoing basis and to make recommendations for state legislative action.**

   SAVA and its predecessor committees dating back to 1991-92 biennium

3. **State legislatures should require advance funding of pension benefits to ensure that pension costs are not shifted to future taxpayers.**

   Legislation has generally been funded using a combination of employee and employer contribution rate increases, and extending the amortization period to pay for additional unfunded liabilities. Approximately 62% of the TRS benefits are funded by investment earnings.

   1999 TRS GABA

   Did increase employee contribution rate and Sate contribution rate. System had only 9.15 years amortization period, so we used current rates to fund balance over 25 years. This proposal was approved by the CPERS.

   2001 PERS 3.0% GABA

   If sold all assets would have had cash in the bank funding, and had been bought back the same or a similar portfolio we would be in the same or worse funded position today.

4. **State legislatures should require fiscal impact statements (fiscal notes) when establishing or amending pension plan benefit provisions.**

   Current fiscal note is currently under review by the Finance Committee and the Governor's Budget Office

5. **The full, long-term costs of early retirement programs and incentives should be calculated before such a program is adopted in order to allow legislatures to provide for the costs.**

   It's almost impossible to calculate the "full" lone-term cost of any early retirement incentive program. Generally, these incentive programs end up costing the employer more than they save. The exception may be in school districts where teachers retire at the top of the salary matrix and new teachers are hired at the bottom of the salary matrix, or because of declining enrollment, new teachers are not hired at all.

6. **Post-retirement adjustments should be independently funded and have a ceiling on the percentage of increase for a single year.**

   The CPERS and SAIC committees did not agree that there should be a ceiling on increases. This position was reflected in the Legislative Policy Statements contained in their 1999-2000 report to the 2001 Legislature regarding GABA increases for PERS and TRS retirees.

7. **State and local pension plans should provide strict guidelines for disability coverage and should provide follow-up periodic screenings of disabled retirees.**

   This is currently required by statute in all Montana public pension plans.

8. **Legislatures should use extreme care in developing health insurance provisions for retired employees, and preferably should provide for separate accounting and funding from retirement programs.**

   Montana has not yet developed a health insurance plan for retirees.

9. **State legislatures should establish strict fiduciary standards and conflict of interest laws to govern the conduct of trustees as they manage the assets of the retirement system.**

   Montana has established strict fiduciary standards and conflict of interest laws and Constitutional provisions. The Boards and the Legislature are subject to a constitutional fiduciary duty to fund retirement benefits (Article VIII, Sections 13 & 15 of the Montana Constitution). The Board, the staff and the Legislature are prohibited from diverting the assets or the actuarially required contributions of the Retirement System to any other purpose. No Employee or member of the Retirement System may have an interest in plan assets, borrow or use fund assets, or act as surety, obligor or endorser on loans to or by the system. Investments are governed under the "prudent expert" standard as defined in §17-6-201(1), MCA.

10. **State legislatures should move toward requiring annual actuarial reports using uniform actuarial assumptions to evaluate the financial soundness of state and local retirement systems.**

    We agree annual actuarial reports based on uniform actuarial "methods" are needed, particularly in times when funding is tight and legislative action is required. We do not agree with using uniform actuarial assumptions between all systems because not all experience is similar i.e., mortality, work history, withdrawal and retirement. TRS annual reports follow the standards required by the Governmental Accounting Standards Board.

11. **State and local retirement plans should provide for reciprocity of benefits for workers who shift jobs within the state and its political subdivisions and portability for those who shift jobs across state lines.**

    Montana provides full reciprocity between TRS and PERS. Members transferring from out of state may roll over their account balance with another qualified plan into the Montana systems to purchase additional service. TRS caps the maximum service a member may purchase at 5 years.

12. **Pension plan participants should be fully informed of plan provisions including benefits, service and vesting requirements, assets and liabilities, investment performance and risk, actuarial assumptions and data, fiduciary requirements and selection of plan trustees.**

    Teachers' Retirement publishes annual reports, handbooks, and newsletters. In addition, a variety of information is available on the Web, including a retirement calculator.

13. **State legislatures should support coordination of state and local retirement systems.**

    Examples from 1999-2000 presession report, i.e. Legislative Policy Statements on cost of living increases, plan membership changes, changes in formulas and eligibility criteria and return to work limits.

14. **Legislators should encourage and support the efforts of state retirement system administrators to comply with the principles of pension system administration established by the Public Pension Coordinating Council.**

    - Comprehensive Benefit Program. The system must provide a comprehensive benefit program including service retirement benefits, in-service death benefits, disability benefits, vesting, and provisions for granting a cost-of-living adjustment.

    - Funding Adequacy. The system must have at least a 100% funded ratio or the actual contribution rates are at a level equal to or greater than 100% of the Annual Required Contributions.

    - Actuarial. An Actuarial Valuation must be completed at least every two years using generally recognized and accepted actuarial principles and practices.

    - Audit. The system must obtain an unqualified opinion from an independent audit conducted in accordance with government auditing standards generally accepted in the United States.

    - Investments. The system must follow written investment policies and written fiduciary standards and the system must obtain an annual investment performance evaluation from an outside investment review entity.

    - Communications. Members must be provided a handbook or summary plan description, regular updates to the documents, and an annual benefit statement. Meetings of the governing board of the system are conducted at least quarterly with adequate public notice.

NCTR PRINCIPLES

Advocated by the National Council on Teacher Retirement (NCTR). As a member of NCTR, this retirement system is committed to the NCTR Principles and WE PLEDGE:

1. Courteous Service
To give members prompt and courteous service and provide complete and accurate information.

2. Member Statements
To provide each active member with an annual statement that includes the member's accrued service credit, employee contributions, and other related information.

3. Information
To provide new participants in the system a summary plan description that clearly and simply summarizes the benefit provisions of the plan. The system will make available information on changes made in benefits.

4. Annual Reports
Full disclosure of financial, actuarial and investment information in a detailed annual report that will be available for members, elected officers and the public.

5. Financial Audits
To prepare or cause to be prepared an annual financial statement in accordance with generally accepted accounting principles and have an annual audit of the system's financial statement in accordance with generally accepted auditing standards.

6. Actuarial Studies
To have an annual or biennial actuarial valuation performed by an enrolled actuary in accordance with actuarial standards and an actuarial experience study at least every 5 years.

7. Adequate Funding
To work to obtain adequate funding of all promised benefits and to ensure the financial integrity of this system.

8. Independence of Retirement Systems
To work for a retirement system which functions as an independent retirement trust, separate from state and local government. Such independence to include the power of trustees to set actuarial assumptions, appoint professionals such as actuaries and attorneys on whom they must rely to carry out their responsibilities, and to establish a budget for the system which ensures the delivery of high quality, cost-effective service to their members.

9. Exclusive Benefit
To act for the exclusive benefit of our members as fiduciaries entrusted with the management and payment of retirement benefits.

10. Prudent Investments
To adopt comprehensive objectives, methods for evaluation of performance, and policies which will ensure both the prudent investment of plan assets and the attainment of the highest possible investment return.

11. Ethical Conduct
To adhere to the highest standards of conduct set out in the terms of the trust, state statute or other law.

12. State and Local Government Authority
To support the continuation of state and local pension plan oversight by the respective state or local government to ensure that decisions are made at the appropriate level of government.

FUNDING & BENEFITS POLICY
Teachers' Retirement System

It is the mission of the Teachers' Retirement Board to promote long-term financial security for our membership while maintaining the stability of the fund.

This policy provides general guidelines and may not be applicable to all situations.

CONSTITUTIONAL/STATUTORY LIMITS

The Teachers' Retirement Board (TRB) is charged with administrating the system in accordance with the provisions of Title 19, Chapter, 20 of the Montana code annotated. The Board is required to approve or disapprove all expenditures of the system, prepare an annual actuarial valuation of the assets and liabilities of the system and perform other duties and functions as are required to properly administer and operate the retirement system. Board members are subject to a constitutional fiduciary duty to fund retirement benefits (Article VIII, Sections 1 & 15 of the Montana Constitution). The Board, the staff and the Legislature are prohibited from diverting the assets or the actuarially required contributions of the Retirement System to any other purpose. No Employee or member of the Retirement System may have an interest in plan assets, borrow or use fund assets, or act as surety, obligor or endorser on loans to or by the system.

The Montana Board of Investments (BOI) is charged to invest the assets of the Teachers' Retirement System in accordance with state law and the state Constitution. State law requires that the Board operate under the "prudent expert principle". The Teachers' Retirement System has a long-term horizon well beyond normal market cycles. The goals and objectives of the BOI are included in investment policy statement adopted by the Board of Investment for each individual fund. Objective and constraints have been defined and approved by the Board of Investments for each individual pool under management.

FINANCIAL SOLVENCY

The Montana Constitution delineates the duties of the Board and assigns to the Board, as fiduciaries of system participants and their beneficiaries, the responsibility to establish all actuarial determinations, including actuarial assumptions. As such, it is the responsibility of the Board to report the financial solvency of the fund to the Legislature. To assist the Board in their analysis of the system's solvency, an annual actuarial valuation will be prepared by an Enrolled Actuary. While the amortization period and funded ratio on any given date may not provide a complete measure of financial solvency, a trend, which results in increasing the amortization period or decreasing the funded ratio, may cause the Board to consider recommending funding enhancements. It is desirable that the amortization period decreases over time and that the funded ratio increase. A review of the actuarial valuation shall be conducted by an independent actuary at least every 5 years.

Whenever the amortization period of the unfunded liabilities for two consecutive valuations are projected to exceed 30 years through the use of long term cash flow projections, or the funded ratio is less than 80%, and the Board cannot reasonably anticipate that the amortization period would decline or the funded ratio improve without an increase in funding sources, it is the obligation of the Board to recommend to the legislature that funding be increased and/or liabilities be reduced.

The System does not currently meet the requirements of actuarial soundness because current contribution rates will not amortize the Unfunded Actuarial Accrued Liability (UAAL) over 30 years or less. To stay financially sound in the future, the System will need either: (1) future gains such as asset returns well over the actuarial assumption, (2) an increase in the employer contribution rate, (3) changes in future experience that reduce the funding stressors on the system, or a combination of all three. Contribution rate increases could be scheduled as either a one time event, or graded over a number of years.

The dramatic decline in domestic equity markets that occurred from 2000 through 2002 is the single largest factor influencing the recent growth in unfunded liabilities. From 2000 through 2002, domestic stocks lost about 40 percent of their value, the largest market decline since the Great Depression. As a result, the TRS funded ratio fell from 88.1 percent to about 73 percent as of July 1, 2005.

It is the Goal of the Teachers' Retirement Board to secure passage of legislation during the 2007 regular legislative session that will actuarially fund the TRS. It is the ultimate goal of the TRB to eliminate the current Unfunded Actuarial Accrued Liability and to establish a Stabilization Reserve equal to at least 10% of the Actuarial Accrued Liability. Once the system has achieved this goal, any surplus funds that become available may be applied toward the cost of benefit enhancements and/or contribution reductions, provided, sufficient reserves are retained to reasonably allow for adverse experience.

BENEFIT ENHANCEMENTS/LEGISLATION

The Board's position on proposed legislation will be made on a case-by-case basis using this policy, actuarial funding standards and the resources of National Council on Teacher Retirement as decision guides. Benefit enhancements should be equitably allocated among active members and retirees with any increased cost distributed among the generation of employers, taxpayers, and employees who receive the greatest benefit. Proposed benefit enhancements must include additional funding sufficient to cover any increase in the normal cost and to amortize any increase in unfunded liabilities over a period not to exceed 25 years. In addition, as of the most recent actuarial valuation, the funded ratio must be 80% or greater before the Board will support legislation to enhance benefits. Legislation that would cause the amortization of unfunded liabilities to exceed 25 years may be opposed by the Board.

In 2001, the Legislature authorized the Board to increase the Guaranteed Annual Benefit Adjustment (GABA) from 1.5% to a maximum of 3.0%, provided any increase made by the Board would not cause the amortization period to exceed 25 years as of the most recent valuation. This action by the Legislature effectively committed all future actuarial gains to eventually funding a 3.0% GABA. Until the GABA has been increased to a maximum of 3.0%, any actuarial gains realized by the system cannot be used for any other purpose.

The Board recognizes the increased impact of asset returns, positive and negative, on a mature retirement system such as TRS. In view of the potential impact of asset returns, and in order to maintain a financially sound system, it is the goal of the Board to attain an amortization period of the UAAL at close to 15 years before increasing the GABA.

CHANGES TO THE FUNDING AND BENEFITS POLICY

Changes in this policy may be made at any Board meeting by a majority vote provided a quorum is present and provided that notice of the change has been proposed to the Board members 7 days prior to the meeting. At a minimum, this policy will be reviewed by the Board in each even numbered year.

CROSS REFERENCE GUIDE

Art VIII, § 13, Montana Constitution
Art VIII, § 15, Montana Constitution
Section 19-20-104, MCA
Section 19-20-201, MCA
Section 19-20-206, MCA
Section 19-20-501, MCA
Section 19-20-502, MCA
Section 19-20-701, MCA
Section 19-20-719, MCA

HISTORY

Adopted May 2002
Amended May 2006

Chair, Teachers' Retirement Board　　　　Date