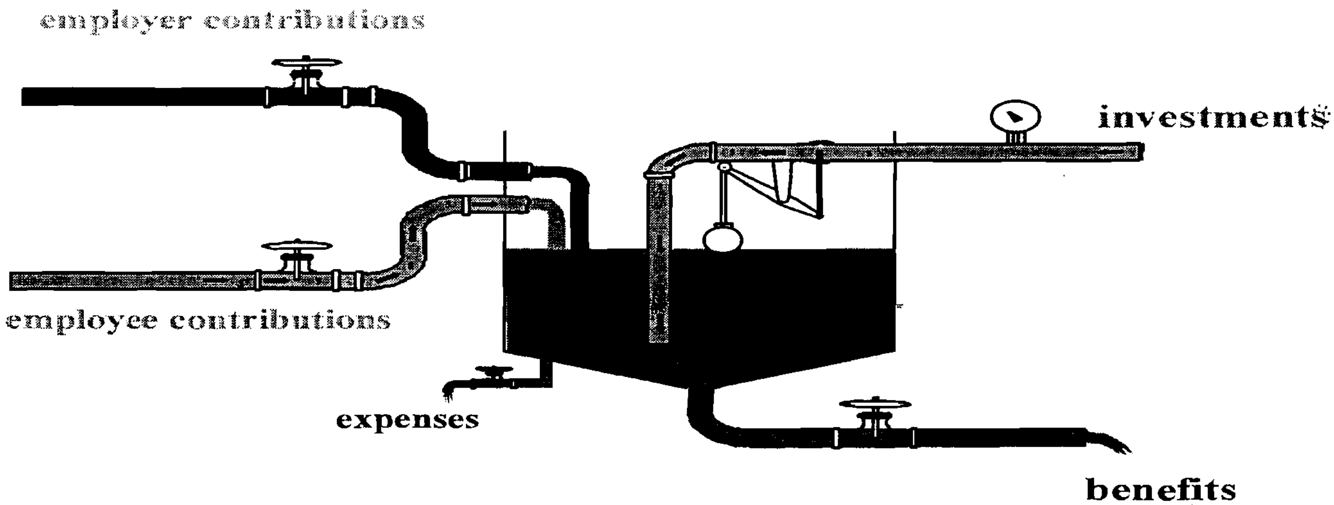
MONTANA TEACHERS' RETIREMENT SYSTEM

Report to the
State Administration and Veterans' Affairs Interim Committee
June 24, 2005

FUNDING PRINCIPLE



Historical Investment Returns*

Fiscal Year Ending	*Market Returns*	*Amortization Period*
June 30, 1996	*12.4%*	*27.20*
June 30, 1997	*19.4%*	
June 30, 1998	*16.6%*	*9.20*
June 30, 1999	*11.9%*	
June 30, 2000	*7.8%*	*15.10*
June 30, 2001	*(5.1)%*	
June 30, 2002	*(7.3)%*	*23.4*
June 30, 2003	*6.46%*	
June 30, 2004	*13.3%*	*> 30.0 years*

* Effective July 1, 2004 the annual investment rate of return is assumed to be 7.75% per year, compounded annually. Anything less is a loss, and will eventually increase the amortization period if not offset by future gains, contribution increase, or reduction in benefits. Gains and losses are "smoothed" over 5 years.

David L. Senn, Executive Director
406/444-3376
E-Mail dsenn@mt.gov

Tammy Rau, Deputy Director
406/444-3432
E-Mail trau@mt.gov

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Exhibit 7

MONTANA TEACHERS' RETIREMENT SYSTEM

THE TEACHERS' RETIREMENT BOARD

- Governed by a six-member Board appointed by the Governor.
- Four members are appointed from the teaching profession,
  - One must be an active classroom teacher
  - One a retired member
- Two members are appointed as representatives of the public sector.
- The Board is responsible for the administration of the system and hires a staff of 17 to carry out these duties on a daily basis. The Board Of Investments (BOI) is responsible for investing assets of the Teachers' Retirement System.

Board Members	Term Expires
TIM RYAN - Public Member Big Fork, MT Chair	July 1, 2009
SCOTT DUBBS - Active Member Lewistown, MT Vice Chair	July 1, 2008
KARI PEIFFER - Active Classroom Teacher Kalispell, MT	July 1, 2007
DARRELL LAYMAN - Retired Member Glendive, MT	July 1, 2006
MONA BILDEN - Active Member Miles City, MT	July 1, 2006
JAMES TURCOTTE - Public Member Helena, MT (Also a member of BOI)	July 1, 2005

OVERVIEW OF THE TEACHERS' RETIREMENT SYSTEM

- Established by the Legislature effective July 1, 1937.
- Initial membership of 3,367, to over 18,200 active members,
- Over 10,000 retired members or their beneficiaries
  - Currently receiving benefits of approximately $160 million per year.
- Assets of over $2.4 billion
- Unfunded Liabilities as of July 1, 2004 were over $757 million

The TRS Summary of Information handbook and the 2004 Annual Report are available at: http://www.trs.mt.gov/publications/Publications.htm

FUNDING RETIREMENT BENEFITS

Retirement benefits are funded over time. The acceptable period of time to fund unfunded liabilities or benefits improvements, as established by the Governmental Accounting Standards Board (GABS), is 30 years. One of the purposes of an actuarial valuation is to calculate the period of time required to amortize the system's unfunded liabilities. The goal is to spread the cost of funding benefits over the generation of taxpayers who will receive the benefit of the public service.

The TRS Actuary prepares an Actuarial Valuation to determine the funded status of the system at the valuation date and the employer contributions that are necessary, along with investment returns and employee contributions, to fund the promised pension benefits. The Valuation is based upon assumptions adopted by the Board, pursuant to 19-20-201, MCA. All assumptions are based on the experience of the Teachers' Retirement System, which is reviewed through periodic experience studies, cash flow analysis to determine the future cash flow needs of the system, and comparisons with peer retirement systems. Each Year, investment gains or losses are smoothed over five years, i.e., only one fifth of each year's investment gain or loss is recognized in the actuarial valuation to smooth any material impact on the funded status over more than just the past two years.

Actuarial Funding - The Montana Constitution, Article VIII, Section 15, requires that all public retirement systems be funded on an actuarially sound basis. Montana TRS, like most other public and private pension plans, has seen a significant decline since 2001 in the fair market value of its' pension assets. The TRS Board's Funding Policy states that 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, and the Board cannot reasonably anticipate that the amortization period would decline without an increase in funding sources, it is the obligation of the Board to recommend to the legislature that funding be increased.

TRS July 1, 2005 Actuarial Valuation – The Board will be completing an actuarial valuation as of July 1, 2005, which will be available in early October, 2005. This valuation will provide an update to the July 1, 2004 valuation, and will include the $131 million in unrecognized losses. If the investment return for fiscal year 2005 is at least equal to the actuarial assumed rate of 7.75%, and there are no other material differences, we anticipate that the contribution rate required to actuarially fund the TRS will now be larger than the increase requested in HB 181.

Prior to the 2005 Session the Legislative Audit Division, and the Teachers' Retirement Board authorized an independent actuarial review of the Teachers' Retirement System. The actuarial audit included a full reproduction of the July 1, 2004 actuarial valuation results prepared by the TRS actuary, Milliman, and a review of recent experience studies, actuarial assumptions and methods used in the valuations. Mellon was selected to perform the actuarial review. Mellon concurred with the results of the July 1, 2004 actuarial valuation. Mellon's full report is available on the TRS Website: www.trs.mt.gov

The Board regularly conducts experience studies to compare the actuarial assumptions with actual experience and future expectations. Recently the Board reduced the investment return assumption from 8.0% to 7.75%. While we found the average return over at least the long run had exceeded the 8.0% assumption, a cash flow needs analysis of the TRS, based on the aging of the TRS membership and the expected increase in the number of retirees, coupled with the fact that the average return over the past 3 and 5 years has been considerably less than 8.0%, and the continued volatility and uncertainty of the markets, the Board believed it prudent to reduce the investment return assumption.

<u>The Following State Retirement Systems Enacted Funding Changes in 2004:</u> *(Past benefit increases, declining investment returns and changing demographics of the plan membership are factors that helped require the increases.)*

Alaska. State, municipalities and school districts will pay substantially higher percentages to fund benefits. The mandatory employer contributions started climbing in 2004 at about $100 million total for the state, municipalities and school districts, with an additional $100 million boost set for 2005 and likely the next couple of years.

Arizona. On October 1, the Arizona Retirement System announced an increase in employee and employer contribution rates from 5.2% to approximately 7.75%.

Colorado. Each PERA employer in the State Division will pay to PERA an amount equal to 0.5% of the salaries paid to all employees who are PERA members. This is called the Amortization Equalization Disbursement (AED). The AED payment begins January 1, 2006. The AED will increase each year to a maximum of 3% of salary by 2012 (employer rates were also increased in FY 2003, from 1.04% to 1.15%).

Kansas. SB 520 raised the statutory caps on contributions from local government employers to the Kansas Public Employee Retirement System (KPERS) to ensure the long term stability of retirement system funding. The increases will mean about $3.3 million additional expense for local governments in CY 2006, an additional $8.2 million in CY 2007 and an additional $15 million in CY 2008, with further increases in the following years (rates were also increased in FY 2003, from 4.58 percent for FY 2004 to 7.58 percent for FY 2010).

Louisiana. The Public Retirement Systems' Actuarial Committee has recommended that the employer contribution rate for the Louisiana School Employees' Retirement System be set at 18.8% of payroll for FY 2005, up from 11.2% for FY 2004.

Mississippi. The Mississippi State Employees' Retirement System will increase the employer contribution rate from 9.75% to 10.75% effective July 1, 2005.

Nebraska. LB 514 increased contribution rates for employees and employers from 11% of salary to 12% of salary for one year to redress poor investment returns.

Oklahoma. Currently, all participating state agencies pay a contribution rate of 10%, beginning July 1, 2005, state agencies will contribute 11.5%. This percentage will increase by 1.0% annually beginning July 1, 2006, and each year thereafter, through the fiscal year ending June 30, 2011, when it tops out at a rate of 16.5% (rates were also increased 1.0% in FY 2003).

Rhode Island. The state's contribution for state employees will increase from 11.51% of payroll this year, to 16.96% in FY 2006. That for teachers will increase from .84% this year to 20.01% of payroll next year.