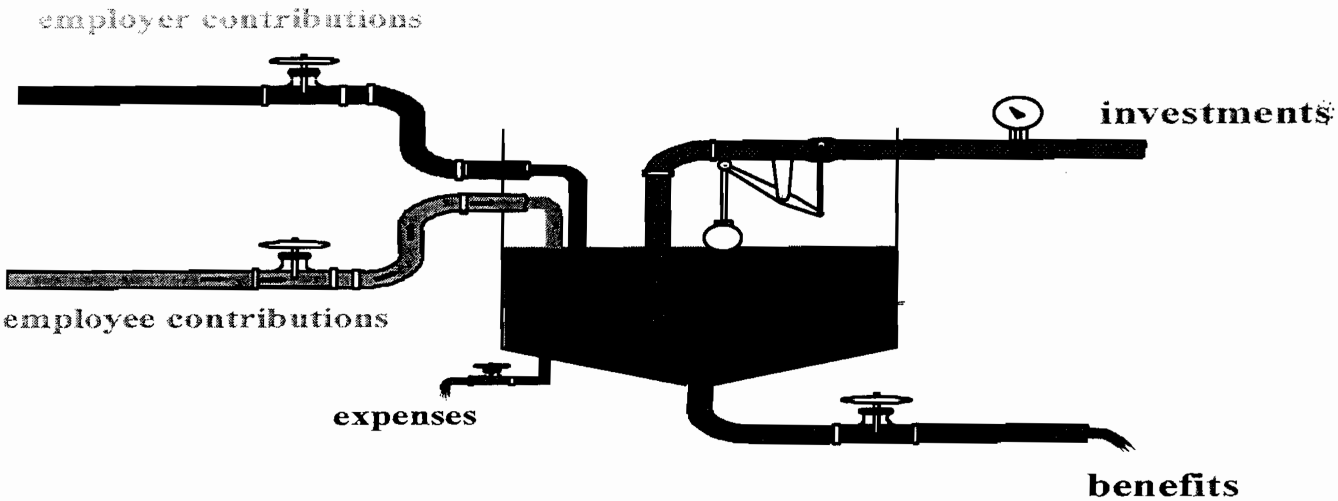
Montana Teachers' Retirement System

State Administration and Veteran's Affairs Interim Committee

FUNDING PROPOSALS



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	13.4%	> 30.0 years
June 30 2005	8.04	> 30.0 years

* 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.

STATE ADMINISTRATION/VETERANS' AFFAIRS
OCTOBER 6, 2005 MEETING

Prepared by David L. Senn, Executive Director
Teachers' Retirement System

EXHIBIT 3

TEACHERS' RETIREMENT SYSTEM
FUNDING PROPOSALS

Actuarial Funding - The Montana Constitution, Article VIII, Section 15, requires that the legislature actuarially fund all public retirement systems. 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 Board's Funding Policy, adopted in May 2002, 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. The following proposals have been suggested by the Governor and the TRS Board.

- **Lump sum cash infusion to reduce the current unfunded liability**

  The Governor has suggested that $100 million of the current fund balance be used to help reduce the unfunded liabilities of the TRS.

- **Close loopholes that create additional unfunded liabilities, for example;**

  End Of Career Pay Raises - Percentage or flat dollar increases are granted in the last 2 or 3 years of employment and in return, the TRS member gives notice they will retire. Montana's statutes are clear that these kinds of raises are not reportable to TRS, however to the extent these practices get past us, they contribute to the under funded problems of the system.

  Bona Fide Separation From Service - Without a true termination and a break in service, the TRS is in danger of violating IRS restriction on in-service distributions. In addition, members who are rehired without any break in service raise questions regarding termination and eligibility for benefits. During any school year 500 – 600 retirees return to work in a part-time position, most only for a few days, but a few work the entire year in positions paying the maximum they can earn under TRS statutes, plus additional fringe benefits excluded from the definition of earned compensation under §19-20-101(6), MCA. Its entirely possible these "fringe benefits" could have been paid in cash before retirement and converted to non-reportable employer benefits after retirement. This practice results in benefits being paid before a member actually terminates and retires thus increasing the unfunded liabilities of TRS.

  Benefit Swaps for Additional Salary – Adding salary to the contract in lieu of employer paid benefits for the purpose of enhancing a member's benefit is at the very least unethical and probably illegal. The TRS statutes clearly state that if an employer converts employer paid benefits, e.g. insurance or housing, to cash compensation that they must: one, do so for all employees, and two converted benefits must be reported to the TRS for at least 5 years before the additional earnings can be used in the calculation of average final compensation. To the extent these practices get past us, they contribute to the under funded problems of the system

- **Eliminate the statutory minimum rate of interest that may be credited by the Board**

  Given market declines of the past few years, this rate should be set by the Board using a prudent standard related to market return. It is not reasonable to credit 4.0% interest, if the system is losing money, or making less than 4.0%.

- **Increase the Montana university system optional retirement program supplemental contribution rate**

  The University System's supplemental contribution rate must increase to ensure the University System's past service liability that existed when the ORP was created is fully amortized by July 1, 2033, as required by 19-20-621, MCA. The rate increase required will be determined after the 2005 actuarial valuation is complete.

- **Increase the employer contribution rate to fund the balance of the required rate increase not covered by the above changes**

  The cost savings of the above changes will reduce the required increase in the employers' contribution rate. The TRS employer contribution rate needs to increase 4.06% effective July 1, 2006; however, anticipate the infusion of cash and closing loopholes will reduce the required employer contribution rate increase below 3.0%. The System's Actuary will have the final number available as soon as possible.