Funding Policy and Montana's Public Pensions

MARCI LEWANDOWSKI, LEGISLATIVE FISCAL DIVISION
SAM SCHAEFER, LEGISLATIVE FISCAL DIVISION
SHERI SCURR, LEGISLATIVE SERVICES DIVISION

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MONTANA LEGISLATIVE FISCAL DIVISION
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PURPOSE

This report is intended to brief the reader on the funding of Montana's public pensions and the status of analysis regarding funding. It also allows the reader to learn more about the subject through the many links to documents from legislative staff, pension systems, actuaries, rating agencies, and academics.

OVERVIEW

Montana's public employee retirement systems consist of nine defined benefit (DB) plans and two defined contribution (DC) plans. These systems cover nearly all state, local government, and school district employees. All but one of the systems are cost-sharing plans, meaning that both employees and employers contribute to the plans.

MPERA SYSTEMS

Nine of Montana's retirement plans (8 DB plans and 1 DC plan) are administered by the Montana Public Employees' Retirement Administration (MPERA) including:

- Public Employees' (PERS) – DB plan and optional DC plan
- Judges' (JRS)
- Highway Patrol Officers' (HPORS)
- Sheriffs' (SRS)
- Game Wardens' and Peace Officers' (GWPORS)
- Municipal Police Officers' (MPORS)
- Firefighters' (FURS)
- Volunteer Firefighters' Compensation Act (VFCA)

More information about MPERA is available at http://mpera.mt.gov/.

TEACHERS' RETIREMENT SYSTEM

Teachers in school districts and some state institutions, not including the faculty of the University System, are covered by the Teachers' Retirement System (TRS), which is also a DB plan. More information about TRS is available at https://trs.mt.gov/.

MONTANA UNIVERSITY SYSTEM RETIREMENT PROGRAM

Faculty of state-funded higher education institutions belong to the Montana University System Retirement Program (MUS-RP). This is a DC plan. The fiduciary body governing the MUS-RP is the

Board of Regents. This plan was originally called the Optional Retirement Program (ORP) because when it was first established in 1987, faculty could choose between TRS or the optional DC plan. However, to stabilize plan membership and the financial impact on TRS, the ORP became a mandatory plan in 1993. More information is available at: https://mpera.mt.gov/MEMBERS/MUSRP.

MONTANA BOARD OF INVESTMENTS

The Montana Board of Investments oversees the Unified Investment Program and the In-State Investment Program. The board sets the asset allocation policy and oversees the investment of all the DB pension funds. More information about the Montana Board of Investments can be found here: https://investmentmt.com/.

LEGISLATIVE HISTORY AFFECTING FUNDING

Before 1997, retirees received cost-of-living increases provided in PERS and TRS by spending investment returns above the actuarially assumed rate of return. The legislature also provided periodic one-time ad hoc increases for retirees.

In 1997, strong financial markets created investment earnings exceeding the actuarial assumed rate of return of 8.0%. During this time, PERS was calculated by the system's actuaries to be more than 100% funded. The 1997 Legislature enacted a 1.5% Guaranteed Annual Benefit Adjustment (GABA) in systems administered by MPERA, which included all defined benefit pension systems other than TRS. Employer and employee contributions were also increased in HB 170.

In 2000, financial markets peaked, and investment earnings showed historic returns. During this time, PERS was calculated by the actuaries to be 125% funded, while other state pension plans were calculated by the actuaries to also be very well funded. The 2001 Legislature increased the GABA for MPERA plans from 1.5% to 3.0%.

After the 2001 legislative session, financial downturns in the market caused pension fund investments to begin a sharp decline, which significantly increased the actuarial unfunded liabilities. By 2004, the unfunded liabilities in PERS and SRS did not amortize in any amount of time. The TRS amortization schedule was beyond 70 years. In the December 2005 Special Session, the legislature in HB 1 approved general fund cash infusions of $25 million to the PERS DB plan and $100 million to TRS. The TRS board reduced its actuarially assumed rate of return from 8.0% to 7.75% effective July 1, 2005.

In 2007, the legislature in HB 131 decreased the 3.0% GABA in PERS, HPORS, SRS, GWPORS, MPORS, FURS, and JRS to 1.5% for new hires. An employer contribution increase was enacted with phased in increases beginning July 1, 2007. A state supplemental contribution from the general fund was used to offset the contribution increases for local governments and school districts. HB 63 appropriated $50 million from the state general fund as a second cash infusion to TRS.

In 2011, the legislature reduced benefits and increased contributions for new hires in the PERS DB plan. HB 116 allowed for certain benefit provisions in TRS to be adjusted to improve actuarial soundness.

The 2013 Legislature passed two bills to increase contributions and reduce future benefits in PERS-DB in HB 454 and TRS in HB 377.

Read the full report by Sheri Scurr, Legislative Services Division at: https://leg.mt.gov/content/Committees/Interim/2019-2020/State-Administration-and-Veterans-Affairs/Committee-Topics/Pensions/Where%20weve%20been%20-%202018%20update.pdf

HISTORY OF SUPPLEMENTAL GENERAL FUNDING

Since 1997, supplemental general fund appropriations to the PERS/TRS systems include the following legislation:

- **HB 170 (1997 Session):** HB 170 created the guaranteed annual benefit adjustment (GABA) for members of the public employees' retirement systems except in TRS. The legislation created a general fund statutory appropriation which contributes 0.1% of all compensation for local government and school district employees in PERS

- **HB 72 (1999 Session):** HB 72 created the guaranteed annual benefit adjustment for members of TRS. The legislation created a general fund statutory appropriation for the system equal to 0.11% of the compensation of the system's members

- **HB 1 (2005 Special Session):** HB 1 approved general fund cash infusions of $25 million to the PERS-DB plan and $100 million to TRS

- **HB 131 (2007 Session):** HB 131 increased employer contributions to PERS. Pursuant to the legislation, a general fund statutory appropriation equal to 0.27% of compensation paid to all employees of school districts who are PERS members

- **HB 63 (2007 Session):** HB 63 increased contributions to TRS and provided a one-time $50 million general fund appropriation to the system. The legislature also created an ongoing general fund statutory appropriation equal to 2.38% of total earned compensation of TRS members

- **HB 454 (2013 Session):** HB 454 created a general fund statutory appropriation that diverted coal severance tax revenues as well as coal trust revenues to PERS. It has averaged $31.4 million since its creation

- **HB 377 (2013 Session):** HB 377 created a general fund statutory appropriation of $25 million per year to TRS

Read the full memo by Sam Schaefer, Legislative Fiscal Division at:
https://leg.mt.gov/content/Committees/Interim/2019-2020/Local-Government/Meetings/Nov-2019/Pensions/Pens-general-fund-to-pensions.pdf

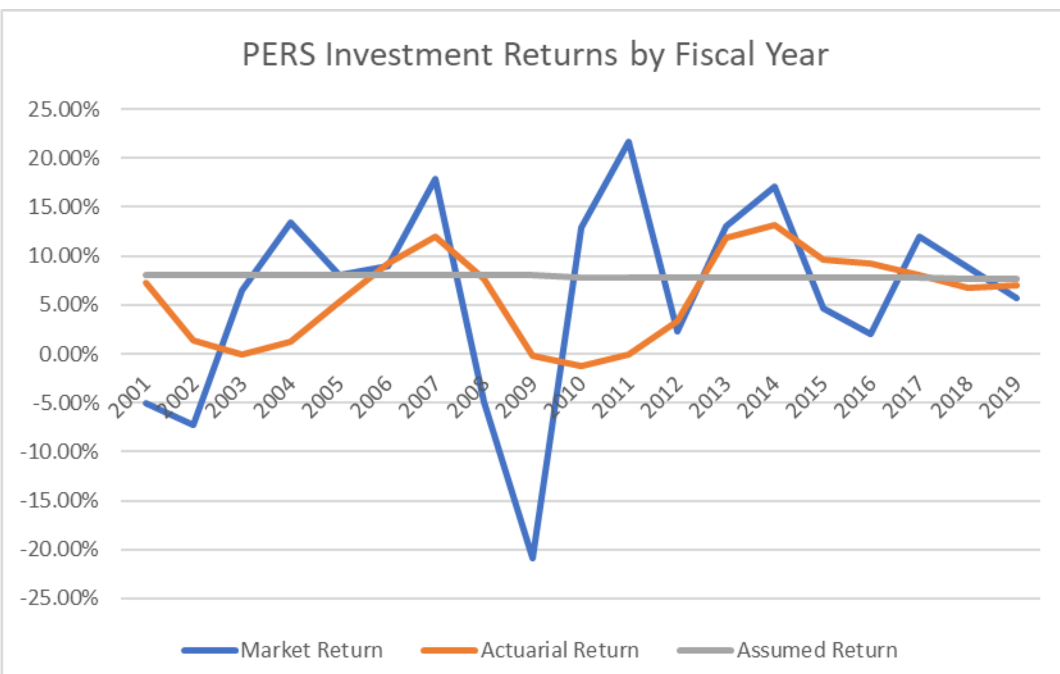
HB 454 (2013) Impact on Local Governments

In HB 454 (2013), the sunset dates of coal severance tax dollars to the Treasure State Endowment Program (TSEP) Fund and the TSEP Regional Water System Fund were accelerated, ending in FY 2016 rather than the original sunset date in FY 2020. As a result, the trust balances have not grown since FY 2016 and the interest income for TSEP has remained relatively flat. If the TSEP Fund and the TSEP Regional Water System had retained the FY 2020 sunset date, the interest income of approximately $3 million per year would have been used for local government infrastructure projects rather than to help fund PERS.

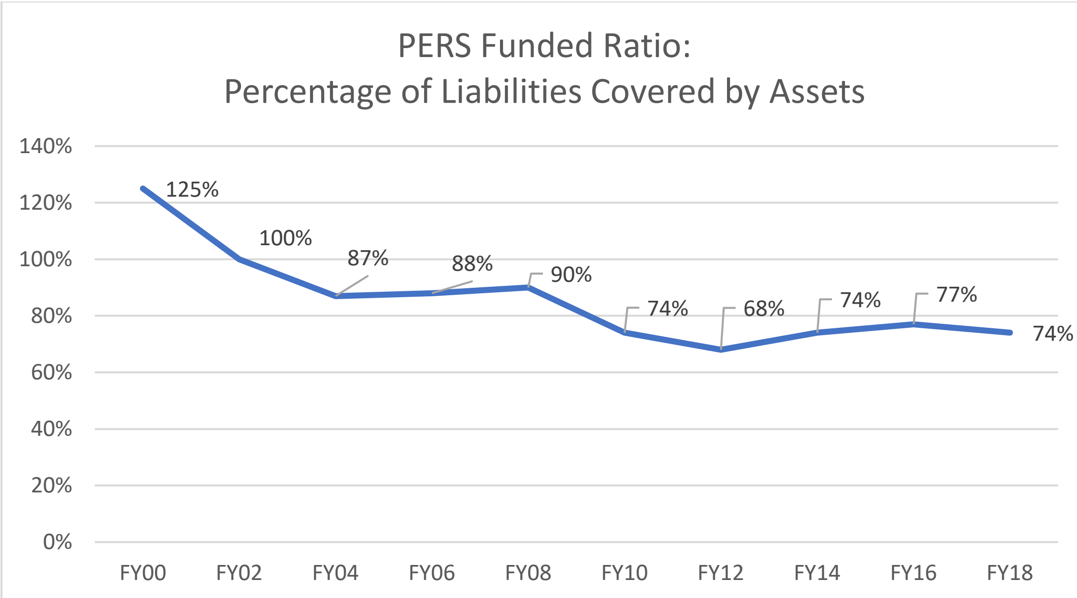
Read the full memo by Sam Schaefer, Legislative Fiscal Division at:

https://leg.mt.gov/content/Committees/Interim/2019-2020/Local-Government/Meetings/Nov-2019/Pensions/Pens-hb-454_17.pdf

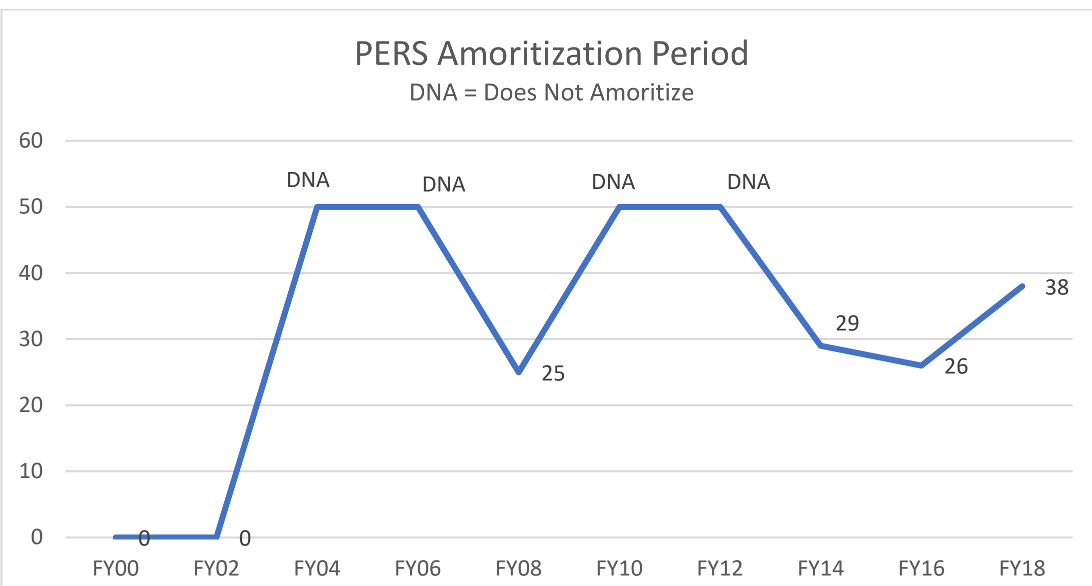
HISTORY OF PENSION FUNDING IN MONTANA



Source: PERS Actuarial Valuation Data



Actuarial Valuations as of June 30



Actuarial Valuations as of June 30

NATIONAL PERSPECTIVE

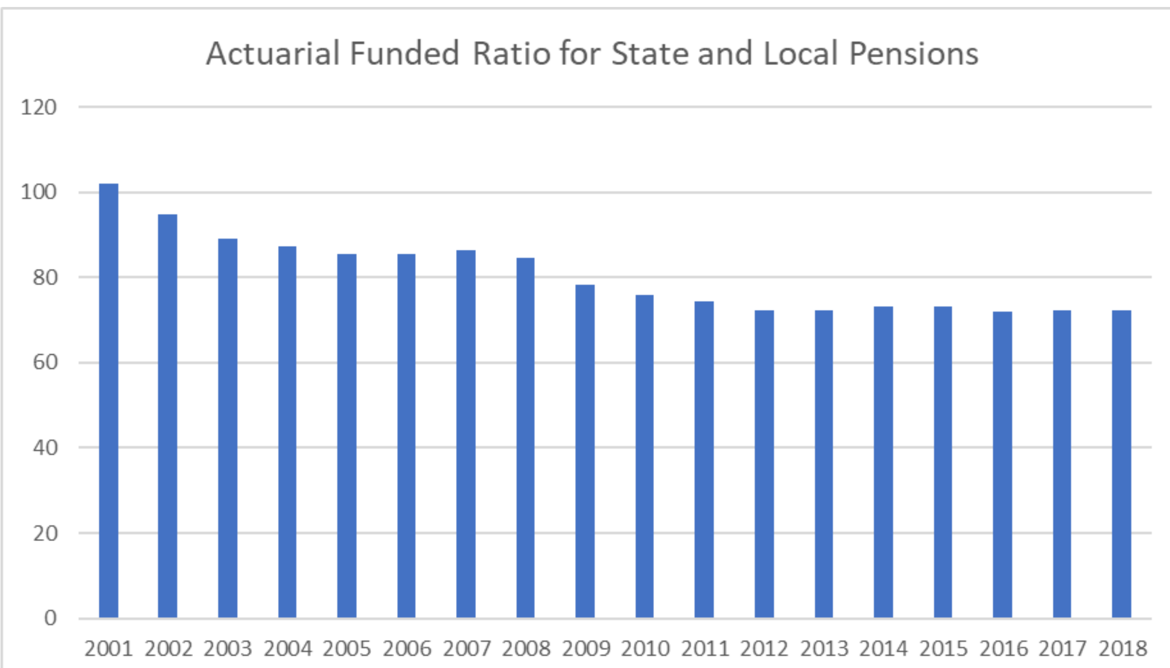
Montana Pension Funding Compared to Other States

Collectively, in 2017, states had 69% of the assets they needed to fully fund their pension liabilities (Pew Research, 2019). At the end of FY 2019, Montana's two largest systems, PERS and TRS had funded ratios of 74% and 69% respectively. Given this, it is no surprise that Montana's overall pension health is in line with many other states. In FY 2016, Montana ranked 25th in terms of funded ratios (Tax Foundation).

National Pension Systems Funding Ratios Last 20 Years

The chart below provides national data on state and local pensions across the United States. This includes the actuarial funded ratios from 2001-2018.

Source: https://publicplansdata.org/quick-facts/national/



Note: National data averages are weighted by plan size.

The pension funding gap, or the difference between a retirement system's assets and its liabilities, for all 50 states remains at more than $1 trillion. Greater disparity exists between well-funded pension systems and those with the largest unfunded liabilities than it did in the past (Pew Research, 2019). According to Pew Charitable Trusts, while all states experienced a loss in the Great Recession, the eight states with the best-funded retirement systems were on average 95% funded by 2017, while the 20 states with the lowest funded pensions plans saw their plans decline from 76% funded in 2007 to 56% funded in 2017 (Pew Research, 2019).

Comparison of Employer Contribution Rates

Montana's pensions are funded through a combination of employer/employee contributions, general fund, and investment earnings. Montana's employer contributions are far lower than many states. Examining other states pension data shows that the nationwide median employer contribution for public employees' systems is 13%, whereas Montana's PERS employer contribution level is currently 8.77%. A recent report from NASRA compares state and local government contributions as a percentage of direct general spending. According to this report, the nationwide average is 4.71%, whereas Montana's contributions total 2.92%.

Risk Assessments and Funding Policy

Different Perspectives

The significant investment losses during the 2001 recession and the Great Recession and the impact on public pension plans gave rise to a public policy debate about how to better inform policymakers about pension funding risks. One aspect of the debate is about how the current value of pension liabilities for future benefits should be calculated and reported and what amortization period that these liabilities should be paid off, if ever. These perspectives are not necessarily exclusive ways of looking at pension funding. Each offers one lens through which pension funding may be viewed.

Public Finance Perspective

The public finance perspective is that as long a pension fund has sufficient cashflow to pay current benefits, maintains sufficient assets to earn investment income, and the liability does not grow relative to the economy, a public plan can eventually recover from significant short-term investment losses.

For a discussion on the public finance perspective, see https://www.brookings.edu/wp-content/uploads/2019/07/lenney_lutz_sheiner_MFC_Final.pdf.

Financial Economist Perspective

Financial economists bring another perspective to the public policy debate where the current value of liabilities for benefits owed should be determined using a risk-free or low risk discount rate (i.e., current market rates of interest on relatively secure fixed-income instruments) and amortize over shorter time frame.

For a discussion on the public financial economist perspective, see https://www.hoover.org/sites/default/files/research/docs/rauh_debtdeficits_36pp_final_digital_v2revised4-11.pdf

Bond Rating Perspective

A third perspective is related to how public bond rating agencies view pension liabilities when evaluating the creditworthiness of state and local governments. Pension debt is only one factor in their evaluations and different rating agencies have different methodologies for assessing pension debt. For example, S&P Global states that, in its most recent advice, the most sustainable pension plans use a 6.5% discount rate when determining pension liabilities and amortize unfunded liabilities in no more than 20 years.[1]

For more information about the credit effects of public pension funding policies and the different rating agency methodologies, see https://www.nasra.org/crediteffects

Actuarial Reporting Changes

Another aspect of the public policy debate about pension funding relates to how best to disclose financial risks and inform policymakers.

In the fall of 2017, the Actuarial Standards Board (ASB) adopted the Actuarial Standard of Practice No. 51 (ASOP 51), *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions.* This new practice requires actuaries to identify potential future risks to the system. Some examples of these potential risks are investment risk, demographic risks, and contribution risks.

Stress Testing Montana's Pension Funds

Recently, multiple states have adopted pension stress-testing analyses for their pension systems. This practice evaluates how robust a pension system is to a variety of future scenarios.

For more information on stress testing activities in different states, see https://www.ncsl.org/research/fiscal-policy/public-pension-stress-testing.aspx

As articulated in a memo presented to the LFC in December of 2018 and in HB 715, Montana's legislature has requested full stress testing of Montana's two largest public pension plans, PERS and TRS. As a result, in addition to the actuarial valuations usually provided to Montana's legislature in the fall, in February 2020 a full stress-test study of these systems will be provided by the two pension boards. The study will be used to educate the legislature on how different economic futures may impact pension funding and the potential cost to state and local governments if contributions must be increased to keep the systems solvent.

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[1] S&P Global Ratings, "Assessing U.S. Public Finance Pension and Other Postemployment Obligations for GO Debt, Local Government GO Ratings, and State Ratings", Oct. 7, 2019.

Ultimately, the intent is that this new stress-test analysis will be a tool to better understand potential future risks to the health of the pension plans, as well possible solutions in the context of the state budget.

Additional Resources

Resources from Legislative Services:

Green Sheets on Summary Tables of Actuarial and Investment Data

Green Sheet FY 2019 Summary Update

Legislator's Guide to Montana's Public Employee Retirement Systems

Montana's Public Pensions: Where We've Been

Bill Histories by Session—Benefits & Contributions

Bill Histories by Session—Reform

Resources from Legislative Fiscal Division:

History of Supplemental General Funding

2013 Pension Funding from Coal Tax

MPERA Resources:

MPERA Summary of FY 2019 Actuarial Valuations

Full MPERA Reports

TRS Summary of FY 2019 Actuarial Valuations

Full TRS Reports

Montana's Public Employee Retirement Administration website

Teacher's Retirement System website

National Data on Pensions:

Public Plans Data

National Association Retirement Data

Bond Rating Agencies:

Fitch Ratings

Moody's Corporation

S&P Global