

Part I

Pension Funding

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LFC chose to study pensions

- LFC brainstorming determined that there was significant interest in the Pension issue
- SAVA has studied – generally not from a financial perspective
- LFC Financial perspective



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Financial Understanding Highlights

- Financial Analysis Changes (September)
- Allocation of liabilities (September)
- Assumptions regarding Return on Investment (September and December)
- Financial weight of the liabilities (December)
- Legal limits (December)
- Montana comparison to other State and Local governments (March)

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Example of Pension Change Impacts

- In HB 122 many changes were implemented
- One change was added in the Senate that affected early retirees
 - Prior to the passage of HB 122, early retirees had a formula in statute for reducing benefits
 - Effective October 1, 2011, HB 122 changed from the formula to be an actuarially calculated amount
- Impact concerned many over the summer and changed retirement decisions

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State Administration and Veterans Affairs

Megan Moore, Research Analyst, Legislative Services Division

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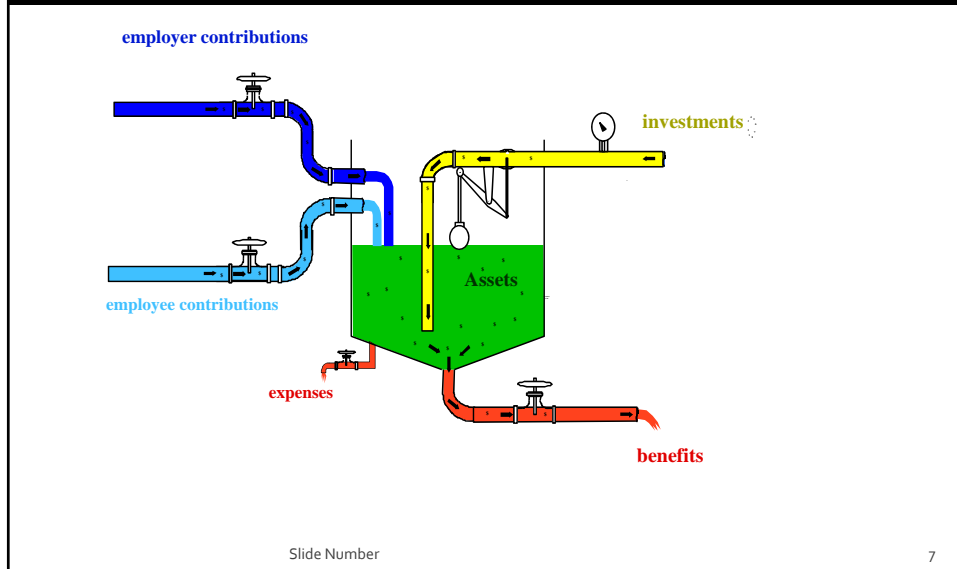
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Definitions and Concepts

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Plumbing diagram



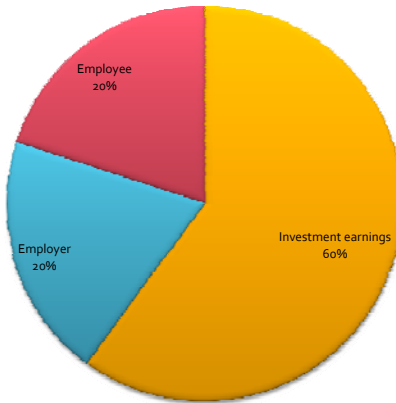
Pipes Key Concepts

- Revenues to the system come from
 - Employers ~20%
 - Direct employers
 - State contributions on behalf of employers
 - Employees ~ 20%
 - Investment earnings from the trust assets ~60%
- Spending from the system go to
 - Retirees
 - Cost of managing the system
- Pool of assets to draw from

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Investment earnings are the lions share of funding

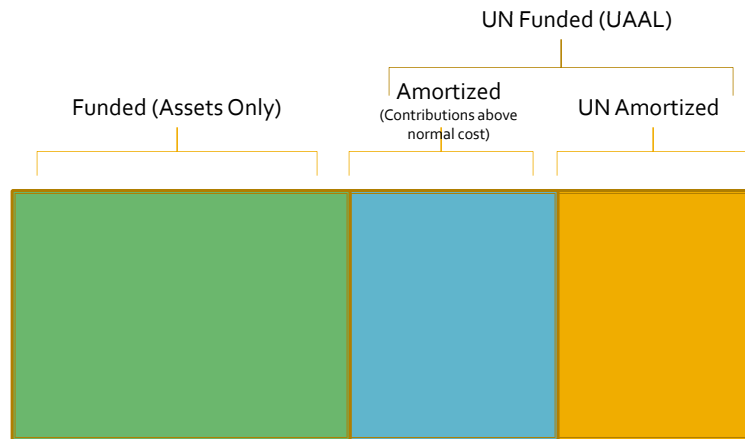


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"Actuarially Funded System" - - - An Example - - -

- Size of the box = liabilities



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Pew State to State Comparison

- 31 states were below the 80% funded threshold for a well-funded pension system
- Montana is at 74% and paid 92% of the ARC in FY 2009
- Lowest funded state is Illinois at 51% and paid 71% of the ARC
- Highest is New York at 101% and paid 100% of the ARC (note comparability is poor)

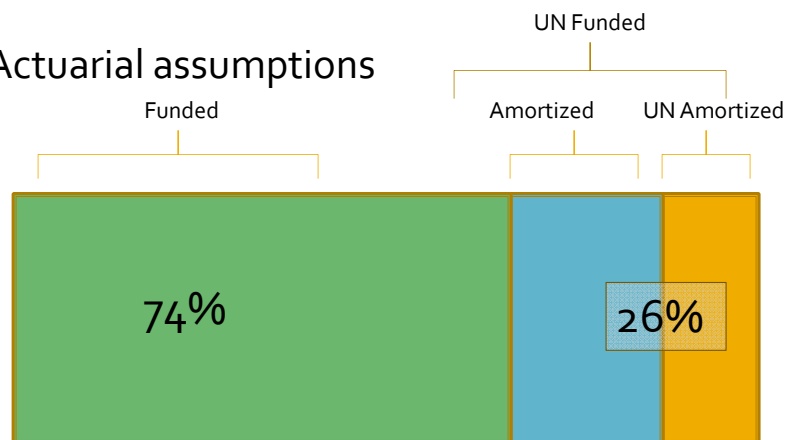
http://www.pewcenteronthestates.org/initiatives_detail.aspx?initiativeID=85899361051
 FY 2009 data

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Montana's Funding Status

- Actuarial assumptions



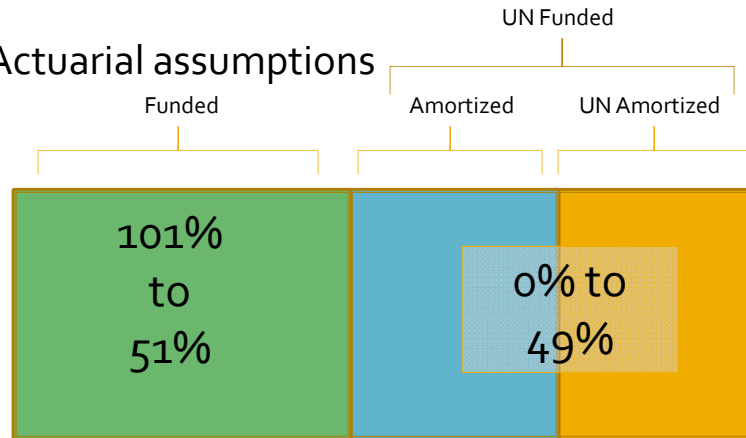
Source: Pew Center on the States: The Widening Gap, data from FY 2009
 Note: Due to different state choices, actuarial assumptions are not consistent.

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National Funding Status

- Actuarial assumptions



Source: Pew Center on the States: The Widening Gap, data from FY 2009
 Note: Due to different state choices, actuarial assumptions are not consistent.

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Example of Poor Comparability

New York Times: no consensus on use of public pension actuarial methods

August 27, 2006 MARY WILLIAMS WALSH and MICHAEL COOPER

...The debate, being waged among actuaries, accountants and economists, is more than theoretical. Last week The New York Times reported that while officials usually describe New York City's pension plans as close to fully funded, an alternate calculation in the back of the plans' annual reports shows a \$49 billion shortfall. If the alternate calculation has merit, the city will probably be forced to raise taxes or cut services at some point, to provide all the money promised to its retirees. ...

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Reporting

More Scrutiny of Pensions

Disclosures: Mark R. Zehner, of the U.S. Securities and Exchange Commission, warned that federal regulators have stepped up scrutiny of state and local governments' disclosure of financial information – particularly pension liabilities – to investors in government bonds. Zehner cautioned against the use of legislative “gimmicks” that might obscure the full extent of pension obligations and their effects on state budgets. The SEC recently settled a security fraud suit filed against for New Jersey for failing to fully disclose in bond offerings that its pension plans were underfunded.

Pew Center on the States
http://www.pewcenteronthestates.org/initiatives_detail.aspx?initiativeID=85899361091

- Investors demanding more consistent information from state and local governments
- SECC has stated that if governments do not resolve this issue that it will.
- GASB changes are the government accounting attempt to resolve issues.

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Prospect for Changes in Financial Analysis

GASB and Rating Agencies revisit reporting and analysis of pensions

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GASB Proposed Accounting Changes

Cindy Jorgenson, CPA, Deputy Financial-Compliance Auditor; Legislative Audit Division

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Comparison

ACTUARIAL - CURRENT

- Varying assumptions make comparisons difficult
- Intended to be used for funding
- Maximum 30 year amortization periods for funding
- Liability not distributed to employers

GASB EXPOSURE DRAFT

- Comparability is key
- Not intended to be used for funding
- Accounting amortization periods may be different and shorter
- Distribution of liability to all levels of government
- Will not take effect until FY 2014

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Ratings Agencies

Rating Agencies are attempting to equalize with current information



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Rating Agencies - Changes

FITCH - ENHANCING THE ANALYSIS OF U.S. STATE AND LOCAL GOVERNMENT PENSION OBLIGATIONS - FEBRUARY 2011

- Combine retirement liabilities with bonded indebtedness in evaluation
- Allocation of liability among government entities responsible
- Re-evaluate all systems with 7% discount rate and 5 year smoothing

MOODY'S COMBINING DEBT AND PENSION LIABILITIES OF U.S. STATES ENHANCES COMPARABILITY - MARCH 2011

- Combine retirement liabilities with bonded indebtedness in evaluation
- Will revise data of allocation of liability as they receive it
- Continuing with currently reported valuations, though recognizes limitations

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Fitch Change in Funded Ratios

CURRENT - 2009

- PERS – 83.5%
- TRS - 66.2%
- New York Employees – 101.0%
- West Virginia Teachers – 41.3%

FITCH - PROPOSED

- PERS – 72.3%
- TRS – 61.7%
- New York Employees – 92.9%
- West Virginia Teachers – 32.9%

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Summary of Changes

- All changes appear to be a work in progress
- All seem to be moving closer to private accounting of pension liabilities
- While it is important to pay attention to the potential to affect of these changes, do not worry too much about the details as they are continuing to change

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Financing Pensions

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Investment earnings are the lions share of funding



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Carroll South

Executive Director of the Board of Investments

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From Funding to Liability

FUNDING

- Key assumption is the rate of return
- Outside pressure to keep the rate consistent across states and potentially lower

LIABILITY

- How are pensions funded today?
- What entities generate the liabilities?

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Funding and Allocations

Stephanie Morrison, PhD; Fiscal Analyst; Legislative Fiscal Division

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Wages

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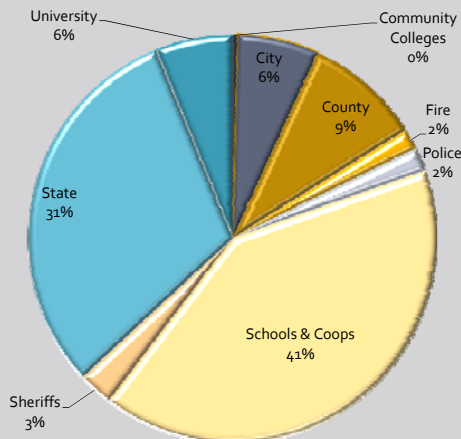
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Schools comprise 41% of the wages of state and local employment

Total Local share is 63%

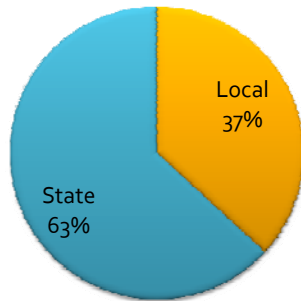
Total State share is 37%

FY 2010 Wages of Active Members of State Retirement System

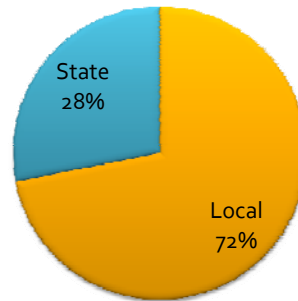


A Range of Funding Options

FY 2010 Funding of State Retirement Systems



Implied Unfunded Liability of State Retirement Systems



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LFD Assumptions During Session

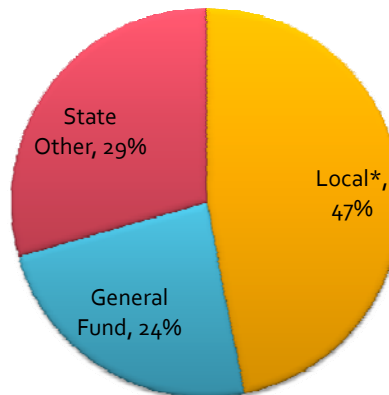
Assumptions used during session result in the following allocations of funding.

The assumptions were based on an increase in employer contributions only with current laws governing funding.

There were no shifts of funding between state and local except the GTB component of K-12.

These assumptions would require significant property tax increases.

*Note: the Local share includes 10% of the costs funded with federal funds in school districts.



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At the End of the Day: Policy Choices

- Revenues
 - Employer: taxes/spending reductions
 - State
 - Local
 - State on behalf of local
 - Employee: contributions or benefits
 - Earnings: limits of the market
- Spending: Retiree benefits



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Next Steps

- December Meeting: if possible
 - Update on Actuarial Analysis
 - Perspective on the rate of return
 - Allocation of liability as a portion of balance sheet state and local
 - ARC shortfall relative to annual spending for state and local
 - Local property tax implications
 - Legal status: can the state shift the liability to employees/retirees?
 - Additional direction from the LFC
- March Meeting
 - Follow up
 - Comparisons to other states funding status
 - What other states have done
 - Additional direction from the LFC



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