MONTANA LEGISLATIVE BRANCH

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Legislative Fiscal Analyst
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DATE: December 2, 2005

TO: Senator Rick Liable

FROM: Jon Moe, Fiscal Specialist

RE: Retirement System Options, and Cost Factors

This memo is prepared in response to questions you submitted relative to the public employee retirement systems unfunded actuarial liability situation. You asked three questions:

1. What other states are doing to resolve this fiscal problem? Oregon?, Washington?, etc.
2. Fiscal impact to "funds" if all new hire pension funds were "defined contribution" instead of current defined benefit.
3. Fiscal impact to state if the state paid an additional 1%, 3% and 5% as the employer contribution to the various funds.

As you know, there are four retirement plans that are currently reporting an unfunded actuarial liability: the Public Employees Retirement System (PERS), the Sheriffs Retirement System (SRS), the Game Warden and Peace Officer Retirement System (GWPORS), and the Teachers Retirement System (TRS). PERS currently has both a define benefits plan and a defined contribution plan. The other three are strictly define benefits plans at this point in time.

Question 1 - What other states are doing to resolve this fiscal problem?

The National Conference on State Legislatures (NCSL) prepared a report titled “Pension and Retirement Plan Enactments in 2005 State Legislatures”. From this report, I have identified several different actions taken by various states, which the Montana legislature might consider. These actions are intended to either increase the money going into the system to pay down the unfunded liability or reduce the unfunded liability by lowering the cost of benefits paid in the future.

Potential action include:

- Shift from a defined benefit plan to a defined contribution plan for new hires.
- Modify retirement eligibility and benefit calculations for new hires, such as increasing age and service requirements, or reducing the multiplier applied in the calculation to arrive at the benefit level.
- Increase the number of years used for the final average salary calculation for new hires.
- Limit the percent increase in salary allowed for the benefit calculation for new hires.

- Increase the employee contribution for new hires.
- Increase the employer contribution for all active members.
- Avoid early retirement incentives.
- For early retirement incentives, have the employer pay the resulting unfunded liability.
- Have retirement system members contribute an additional percentage toward an early retirement plan (refundable if not used).
- Close loopholes, such as salary spiking and creative return to work provisions.

Some states have made changes to reduce benefits or increase employee contributions, but Legislative Services Division legal staff has indicated on different occasions that the Montana Legislature does not have this option, based upon a constitutional argument concerning the existence of an employment contract which the legislature cannot alter by passing a law (see Article II, Section 31 of the Montana Constitution).

Question 2 - Fiscal impact to "funds" if all new hire pension funds were "defined contribution" instead of current defined benefit?

An action to replace the defined benefits plan with the defined contribution plan for all new hires would not change the unfunded liability that exists. It does however remove from the defined benefits plan those new members that would be contributing to reducing the unfunded liability. It has the effect of increasing the “normal costs” of paying benefits because without new employees to replace the retiring employees, fewer and fewer active employees are contributing to the system. Therefore, actuarial assumptions would have to change, resulting in a need for another revenue source, most likely employer contribution increases.

The Montana Legislature has twice offered a DC option to public employees. First in 1987 when it created the Optional Retirement Plan (ORP) for University administrators and factuality covered under TRS. The second plan was created in 1999 and covered all eligible PERS members. As a result of the University ORP, the employer contributions for the university system is greater than that paid by K-12, in order to make up for the lost contributions required to amortize their fair share of the UAAL. University system employers contribute a total of 8.996 % of salary for each ORP participant, while K-12 employers contribute only 7.47%. Under the PERS plan, the employer contribution rate did not increase to pay for the UAAL; however, the maximum amount available to DC plan participants was reduced to cover all of the employers’ portion of the systems unfunded liabilities.

Question 3 - Fiscal impact to state if the state paid an additional 1%, 3% and 5% as the employer contribution to the various funds?

The four retirement plans with unfunded liabilities that cannot be amortized within a 30-year period do not have the same requirements for fixing the problem. In addition, these plans have different funding issues as each represents a different constituency and has different funding sources. There is no cut-and-dry way to estimate the costs to the state. However, the table in Attachment A provides a rough estimation of the cost of the incremental increases in the contribution rate, both in total and by retirement plan. The value of this table is to simply show the magnitude of such increases in dollars. Note that this is presented as all funds.

Attachment A

State Cost of Retirement Funding Increases
Based upon FY 2006 Estimated Payroll
All Funds - Dollars in Millions

Retirement System/ Payroll Location		Payroll Amount	Contribution Rate Increase 1 Percent	3 Percent	5 Percent
PERS					
State		$418.38	$4.18	$12.55	$20.92
University System	[a]	90.83	0.91	2.72	4.54
Local Government	[b]	434.66	3.91	11.74	19.56
SRS					
State		1.84	0.02	0.06	0.09
Local Government		28.26	0.28	0.85	1.41
GWPORS					
State		23.30	0.23	0.70	1.17
TRS					
State		5.21	0.05	0.16	0.26
University System	[a]	41.35	0.41	1.24	2.07
Local Government	[b]	555.74	5.00	15.01	25.01
Total		$1,599.59	$15.01	$45.02	$75.03

Notes: [a] 39 percent of the University System costs would be paid by the state through the lump sum distribution
[b] 27 percent of the local government costs are estimated state costs via school distributions

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