

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



DRAFT

January 2015



Prepared By
Sheri S. Scurr, Research Analyst
Montana Legislative Services Division

Published By
Montana Legislative Services Division
P.O. Box 201706
Helena, MT 59620-1706
<http://leg.mt.gov>
(406) 444-3064 FAX: (406) 444-3036

STATE ADMINISTRATION AND VETERANS' AFFAIRS

INTERIM COMMITTEE 2013-2014

Under section 5-5-228, Montana Code Annotated, the State Administration and Veterans' Affairs Interim Committee provides legislative oversight of Montana's Public Employee Retirement System. This guide is published pursuant to their duties.

MEMBERS

Senators	Representatives
Dee L. Brown (R) – Hungry Horse Presiding Officer	Bryce Bennett (D) - Missoula Vice-Presiding Officer
Larry Jent (D) – Bozeman	Joanne Blyton (R) – Joliet
Dave Lewis (R) – Helena	Doug Kary (R) – Billings

Staff

Sheri Scurr, Research Analyst
K. Virginia "Ginger" Aldrich, Staff Attorney
Kristina Liming, Secretary



PO Box 201706
Helena, MT 59620-1706
Phone: (406) 444-3064 FAX: 444-3036 Web: <http://leg.mt.gov>

TABLE OF CONTENTS

INTRODUCTION

Why read this?

Montana's public employee retirement systems affect public employer, nearly all public employees, and have significant long-term implications for state and local government finances. These systems are established by state statute, so benefit levels and contribution rates are determined by the legislature. Thus, each legislative session, legislators examine the fiscal health of the retirement systems and engage in policy debates about benefit and funding levels.

As of June 30, 2014, the actuarial value of trust fund assets in Montana's 9 Defined Benefit (DB) public employee retirement plans totaled about \$9.2 billion. Total liabilities amounted to about \$13 billion. Figure 1 below provides additional big picture information.

Figure 1 - Scope of Systems

Number of participating public employers (i.e., cities, counties, school districts, state agencies, and other public entities)	1,033
Active members (i.e., working employees)	50,434
Benefit recipients	35,885
Average annual retirement benefit for the largest of these systems, the Public Employees' Retirement System (PERS)	\$15,205

Source: June 30, 2014, Actuarial Valuations

Interim committee role

This guide is published to provide legislators with basic background information about Montana's public employee retirement systems pursuant to statutory duties assigned to the State Administration and Veterans' Affairs Interim Committee (SAVA). Under section 5-5-228, Montana Code Annotated, SAVA is to:

"(a) consider the actuarial and fiscal soundness of the state's public employee retirement systems, based on reports from the teachers' retirement board, the public employees' retirement board,

and the board of investments, and study and evaluate the equity and benefit structure of the state's public employee retirement systems;

(b) establish principles of sound fiscal and public policy as guidelines;

(c) as necessary, develop legislation to keep the retirement systems consistent with sound policy principles; and

(d) publish, for legislators' use, information on the public employee retirement systems that the committee considers will be valuable to legislators when considering retirement legislation."

System or plan?

Throughout this guide, the term retirement "system" and retirement "plan" are used interchangeably most of the time. Nearly all of the public employee retirement plans are named "systems" in Montana statute. All but one of these systems consists of a single plan. However, one system, the Public Employees' Retirement System (PERS), actually consists of two different retirement plans, a DB plan and a Defined Contribution (DC) plan. Therefore, with respect to PERS, the term "system" refers to both plans.

CHAPTER 1

PRIMER ON RETIREMENT PLANS

What's the purpose?

Pension plans started as an alternative method for employers to compensate their employees for services rendered. Employer contributions to pension funds were cheaper than pay increases. Later, employers used pension plans as a recruiting and retention tool that supplemented pay. This rationale, too, evolved to a point where employer-sponsored retirement plans were simply viewed as the socially responsible thing to do. As pension plans evolved, so did government regulation to ensure the plans remained financially sound, that contracts were honored, and that people were not discriminated against. Ultimately, employers and the Internal Revenue Code shifted the focus to providing retirement plans so that employees would have a tax-deferred means of attaining financial security in retirement. Thus, employer-sponsored pension plans became cost-sharing plans that allowed and then required employees to also make contributions to the plans. With this historical perspective in mind, retirement plans are usually viewed as a method for employers to compensate and recruit and retain employees, while employees view retirement plans a primary way to save for retirement.¹

How much income is needed?

Experts seem to agree that to live comfortably in retirement, today's retiree needs a monthly income of at least 70% to 80% of the salary earned during the retiree's final years of work.^{2,3} Clearly, serious long-term planning is required to replace 80% of preretirement income for the rest of a person's life. More than one financial plan or vehicle is necessary. Many types of retirement plans and a variety of insurance and investment products make retirement planning a complex affair. Social security, employer-sponsored

¹ Bleakney, Thomas P., F.S.A., *Retirement Systems for Public Employees*, Pension Resource Council, University of Pennsylvania Press, 1991 edition, p. 10 and p. 33. National Conference of State Legislatures, *Public Pensions: A Legislator's Guide*, NCSL, Washington D.C., July 1995.

² "How much money will I need in retirement?", in "The Ultimate Guide to Retirement" from *Money* magazine at <http://money.cnn.com>

³ "How much do you need to retire?", from *msn.money*. Originally printed in *Kiplinger's Personal Finance Magazine*.

retirement plans, deferred compensation plans, and personal investments are all part of the equation in achieving a secure and adequate retirement income.

How are contributions made?

Contributions to tax-qualified retirement plans are made on a pre-tax basis during each pay period. Employee contributions, which are a percentage of the employee's compensation, are withheld from the employee's paycheck and paid directly to the pension plan. Employer contributions are also made each pay period as a percentage of an employees pay and are also paid directly to the retirement plan.

Two types of plans

There are two types of retirement plans, defined benefit (DB) plans and defined contribution (DC) plans. There are also a range of hybrid plans that combine different aspects of DB and DC plans. Each type of plan must manages risk and responsibility differently, as discussed later in this guide. Nevertheless, whether a plan is a DB, DC, or hybrid, one equation is universal to them all:

$$\text{Benefits} = \text{Contributions} + \text{Investment Earnings} - \text{Expenses}$$
$$\text{(B = C + I - E)}$$

Public versus private plans

Private sector employers have switched from primarily offering DB plans to primarily providing DC plans. In 1979, 62% of private sector employers with retirement plans offered DB plans, while only 16% offered DC plans. However, by 2005, only 10% offered DB plans compared to 63% offering DC plans. The number of private sector employers offering a both a DB and a DC plan has remained fairly stable at 22% in 1979 to 27% by 2005.⁴

⁴ Employee Benefit Research Institute, "Retirement Trends in the United States Over the Past Quarter-Century", June 2007, available at <http://www.ebri.org/pdf/publications/facts/0607fact.pdf>

Defined benefit plans are the predominate plan type in the public sector. According to the U.S. Bureau of Labor Statistics, in 2010, DB retirement plans were available to 87% of state employees and 83% of local government employees. However, DC plans were offered to only 43% of state employees and 24% of local government employees.⁵

Defined benefit plans

Benefit formula

Defined benefit plans provide a predicable formula-driven monthly benefit for life, and sometimes for the life of a beneficiary. Benefits within a DB plan often also provide disability and death benefits.

The traditional formula used to calculate the benefit amount paid in a DB plan is:

a multiplier (%) x years of service x final average salary⁶

Pooled assets

To pay for the defined benefit, contributions are deposited into a pooled pension trust fund. The trust fund's assets are invested. As the investments yield returns, the trust fund grows and must ultimately be sufficient to pay for the defined benefits members as they retire and the monthly defined benefits come due. In short, in a DB plan, benefits are known, but costs must be estimated.

⁵ U.S. Bureau of Labor Statistics, "State and Local Government Benefits", Program Perspectives, Vol. 3, Issue 1, January 2011, available at <http://www.bls.gov/opub/btn/archive/program-perspectives-on-state-and-local-government-benefits-pdf.pdf>

⁶ Sometimes the term "highest average compensation" or "final average compensation" is used. These terms all mean that an average salary is calculated and the average may be calculate on the final years of employment or based on the highest consecutive years of salary. Each plan's statutes define the parameters for the calculation.

Actuarial valuations and cost determinations

An actuarial valuation is a mathematical investigation by an actuary to estimate costs and assess the financial condition of the plan at a particular point in time. Montana law requires that actuarial valuations be conducted annually for each of Montana's DB plans. When estimating costs, actuaries evaluate whether current and expected contributions are sufficient to cover the estimated cost of benefits as they are expected to accrue and be paid in the future. This cost estimate is called the normal cost. Other costs accrue when or if the experience of the plan is different from the actuarial projections, which are based on actuarial assumptions. These unexpected costs are called actuarial unfunded liabilities. Assumptions and actuarial unfunded liabilities are discussed below.

Actuarial assumptions

When making the projects that help determine the expected normal cost of benefits, an actuary makes various demographic and economic assumptions about future experience.

Key demographic assumptions involve questions about:

- ▶ how many people will retire and when;
- ▶ what will be their age at retirement;
- ▶ will they have beneficiaries beneficiaries;
- ▶ how many plan members will become disabled before retirement; and
- ▶ when will members and beneficiaries die and benefit payments will cease.

Key economic assumptions involve questions about:

- ▶ inflation and its impact on the value of contributions and investment earnings;
- ▶ salary growth, which affects expected contribution amounts; and
- ▶ investment returns, which are the primary source of income to the retirement plan.

Actuarial gains and losses

If actual experience is different than the assumed experience, the DB plan will have an actuarial gain or loss. For example, if investment returns are better than projected by the actuary, the actuarial valuation will show an

actuarial gain equal to the amount that actual investment returns exceeded the actuarial assumed rate of return. If experience is worse than expected, then the retirement plan will have an actuarial loss. For example, if more members become disabled earlier and draw disability benefits for longer than projected, the actuarial valuation will show an actuarial loss equal to the difference between the expected costs for disability benefits and the actual cost for disability benefits. These gains and losses are figured in to the actuary's assessment of costs compared to assets and whether the plan is fiscally sound.

Experience studies

Because actuarial assumptions need to be adjusted from time to time, experience studies are conducted about every 5 years. An experience study examines the actual history and experience of the system. Assumptions about mortality, disability, investment returns, etc., can then be adjusted accordingly. Outside actuaries may also periodically audit an actuary's work, methodologies, or other elements integral to assessing the financial status of the plan. These peer reviews ensure professional actuarial standards are being followed.

Montana law requires regular experience studies be conducted to compare actual experience with the actuarial assumptions. If actuarial assumptions are not on track with actual experience, then they may be adjusted accordingly for future valuations. The adjustments are made by the administrative boards overseeing the systems. Actuaries do not actually set the assumptions. The boards, who are the fiduciaries of the systems, set the assumptions after receiving recommendations from the actuary. Fiduciaries are legally and ethically accountable for their decisions.

Unfunded liabilities

When benefits cost more than expected, then a DB plan will have an actuarial unfunded liability. Unfunded liabilities are typical in DB plans because projections, no matter how good, cannot perfectly predict the future. The road into the future is bumpy and, like a shock absorber on a car, the amount of these actuarial unfunded liabilities fluctuate with the road conditions. Because these liabilities are typical, contributions to DB

retirement plans should cover more than the normal cost of benefits. This allows the "extra" contributions to be made available to fund the liabilities. Thus, although these liabilities are called "unfunded", if contributions are sufficient to pay more than just the normal cost of benefits, the contributions left after normal cost is used to fund (i.e., pay off) the actuarial unfunded liabilities over time, much like a mortgage is paid off over time. However, unlike a mortgage, the "loan amount" (i.e., the actuarial liability) fluctuates with the experience of the plan.

Amortization period

The amount of time it takes to pay off a DB plan's actuarial unfunded liabilities is called the amortization period. A plan is considered actuarially sound if the unfunded liabilities are being paid off within a reasonable amount of time. The most commonly accepted standard for actuarial soundness is if the unfunded liabilities amortize in 30 years or less according to the latest actuarial valuation. Again, because the road of experience is bumpy, the amortization period, like the system's actuarial unfunded liabilities, will go up and down like a shock absorber; and again, the ultimate goal is for contributions to be sufficient to cover the normal cost of benefits as well as pay for a good shock absorber so that even when road conditions are worst, the amortization period does not exceed 30 years.

Employer risk and responsibility

Because DB plans define benefits and costs are estimated, it is the employer who bears the risk. The risk is that if costs are higher than expected and the trust fund's assets are not sufficient to pay the defined benefits, the employer may still be obligated to pay the benefits and make up the shortfall. However, there are complex constitutional and contractual legal issues involved, which are beyond the scope of this guide.

In summary

To summarize, in DB plans:

- ▶ benefits are defined, but costs are estimated;
- ▶ contributions are pooled and invested as a whole;

- ▶ unfunded liabilities are typical because long-term assumptions usually differ from short-term experience, therefore the long-term trend is what matters most; and
- ▶ in general, to be actuarially sound, contributions must be sufficient to allow the amortization period to absorb the ups and downs of road conditions and stay within a 30-year period for paying off the actuarial unfunded liabilities.

Defined contribution plans

Costs defined, benefits fluctuate

Defined contribution plans define contribution amounts (i.e., costs), but do not define the benefit paid. Members have individual accounts to which they contribute, and they direct their own investments.⁷ However, the investment options available depend on what the plan sponsor provides. Each participant's account balance at retirement depends on total contributions plus investment earnings (or losses) to that point in time. When the participant retires, the balance of his or her account may be reinvested or converted to a monthly annuity. Investment risk and expenses are, therefore, born entirely by the employee. A DC plan has no unfunded liabilities and does not rely on actuarial projections about the future.

Employee risk and responsibility

In a DC plan, the employee is responsible for making investment choices and takes the risk of contributions plus investment earnings being insufficient to provide adequate income in retirement.

In summary

In summary, in DC plans:

- ▶ costs are known, but benefits fluctuate;

⁷ Defined contribution plans have a "default" investment that is used whenever an employee fails to direct the investment of the contributions made to his or her account. The investment options are limited to a menu of options composed most often of stock mutual funds, bond mutual funds, and money market funds.

- ▶ members direct their own investments among a provided menu of investment options; and
- ▶ benefits at retirement depend on individual account balances based on the individual's contributions plus investment earnings (or losses).

Hybrid plans

As previously mentioned, hybrid plans combine different elements of a DB and DC plan. For example, in Montana's PERS, a member's benefit is calculated under both a DB formula and a DC (money purchase) formula. The member is paid the higher of the two benefit amounts.

There are two broad categories of hybrid plans:

- ▶ cash balance plans; and
- ▶ combination plans.

Cash balance

Under a cash balance plan, members have individual retirement accounts. Contributions, like in a DB plan, are set as a percentage of pay. Then, each account is credited with a certain amount of interest, as defined by the plan, depending on plan goals. The benefit ultimately paid, like in a DC plan, depends on the individual's account balance at retirement. However, like in a DB plan, the individual's account balance is a guaranteed amount based on the contributions and interest credited to the account, not on actual investment earnings.

The U.S. Department of Labor explains:

"A cash balance plan is a defined benefit plan that defines the benefit in terms that are more characteristic of a defined contribution plan. In other words, a cash balance plan defines the promised benefit in terms of a stated account balance. In a typical cash balance plan, a participant's account is credited each year with a "pay credit" (such as 5 percent of compensation from his or her employer) and an "interest credit" (either a fixed rate or a variable rate that is linked to an index such as the one-year treasury bill rate). Increases and decreases in the value of the plan's investments do not directly

affect the benefit amounts promised to participants. Thus, the investment risks are borne solely by the employer." ⁸

There are numerous variations of cash balance plans, such as having the interest credited indexed to actual investment returns, or setting an interest rate depending on the employee's years of service, to name just two.

Combination DB/DC plans

The most common hybrid plan is a combination DB/DC plan. Under this type of plan, part is a traditional DB plan, while the other part is a traditional DC plan. For example, the plan may provide that the employer contribution is deposited to pooled DB plan trust fund, which guarantees a floor benefit to the member. Meanwhile, the employee's contributions are deposited the DC portion of the plan, which is an individual account invested by the employee in the investment options provided by the plan. At retirement, the member's benefit is the floor DB benefit plus the member's DC account balance.⁹ Again, there are a variety of different ways to design a DB/DC hybrid plan.

Risk and responsibility

There are different perspectives concerning the pros and cons of DB, DC, and hybrid plans. Although the risks are the same with any plan, the plan's design dictates how risk is managed and the extent to which the employer and employee share the responsibility for managing the risks.

Any retirement plan will have to cope with:

- ▶ investment risks - market volatility;
- ▶ longevity risks - whether the benefit will last to the end of a retiree's life; and
- ▶ inflation risks - whether the benefit's value will be eroded with time.¹⁰

⁸ Employee Benefits Security Administration, U.S. Department of Labor, "Cash Balance Pension Plans", January 2014. Frequently Asked Questions webpage at http://www.dol.gov/ebsa/faqs/faq_consumer_cashbalanceplans.html.

⁹ National Conference on Public Employee Retirement Systems, "The Evolution of Public Pension Plans: Past, Present and Future", March 2008, pg. 10.

¹⁰ Paul Zorn, "Alternative Retirement Plan Designs: Hybrid Plans", *Government Finance Review*, April 2011.

Also, DB, DC, and hybrid plans will offer different approaches about how to provide:

- ▶ sufficient benefits in retirement;
- ▶ flexibility; and
- ▶ portability.¹¹

Which type of retirement plan is "best" depends on the sponsor's policy goals.

Figure 2 compares DB, DC, and hybrid plans types based on various perspectives of risks and goals.

¹¹ National Conference on Public Employee Retirement Systems, "The Evolution of Public Pension Plans: Past, Present, and Future", March 2008.

Figure 2 - Comparison: DB, DC, and Hybrid Retirement Plans

Issue	DB Plans	DC Plans	Hybrid Plans
Philosophical perspective	Employer responsibility. Employer is obligated to provide a base retirement benefit. Contributions are pooled and debts or gains, usually caused by market fluctuations, are shared by employers in the pool. Unfunded liabilities are typical. Reasonable amortization schedule provides financial security and "shock absorber".	Employee responsibility. Employer responsibility ends with contribution to the plan. Employee bears investment risks and responsibilities. No gains or losses to a shared plan so no amortization schedule and no actuarial valuations.	Shared responsibility. The employer guarantees a certain defined benefit amount, which alone is not sufficient. However, depending on the plan's design, the employee's benefit will depend also on the employee's individual account balance, so the employee also has responsibility and bears a risk.
Flexibility	Less. A DB plan usually provides only the option of how the defined benefit is to be paid out, e.g., as a single life annuity, joint and survivor annuity, term certain, etc.	More. Depending on design, the plan may allow participants to choose contribution amount, investment options, and form of payout.	Less or more. Flexibility will depend on plan features, but the DB portion will be less flexible, while the DC portion will add some flexibility.
Portability	Less. Employer contributions are not made to individual accounts so if an employee leaves employment before vesting, the employee is usually not eligible for a retirement benefit or to "take" or "transfer" employer contributions.	More. Employer contributions are made to individual accounts. Money in the account may not be accessible until retirement, but the employee can continue to manage the account. Actual portability depends on the specific provisions of the plan, which may or may not limit transferability.	Less or more. Portability will depend on plan features, but the DB portion will be less portable, while the DC portion will add some portability.
Investment risk & return	Risk is assumed by the employer. To the extent that assumptions or projections differ from actual experience, the pension funds may experience gains or losses. Pension assets are pooled. Gains and losses are smoothed over a long-term period. Risk is therefore minimized.	Risk is assumed by the employee. Employees may select a risk/return tradeoff to fit personal circumstances.	Shared risk. How this risk is shared will depend on the actual plan's design.

Issue	DB Plans	DC Plans	Hybrid Plans
Who benefits	Career employee. Typically, longer-term or older employees benefit most.	Short-term employee. Typically, shorter-term and younger employees benefit most (depending on investment choices and realization of assumptions.)	Depends on actual plan design.
Unfunded liabilities	Typical. Current guidelines say that amortization in 30 years or less is an acceptable amortization schedule.	None.	Typical. The DB portion of the plan will involve unfunded liabilities.
Pension security/longevity risk	Higher. The benefit amount is guaranteed and can be counted on for a lifetime.	Lower. The actual benefit amount is not known in advance and a retiree could outlive the benefit.	DB - Higher. DC - Lower. Actual pension security will depend on the plan's features.
Inflation risks	Depends on whether the plan offers some sort of cost-of-living or benefit increase after retirement.	Depends on whether the plan offers some sort of cost-of-living or benefit increase after retirement.	Depends on whether the plan offers some sort of cost-of-living or benefit increase after retirement.
Administrative costs	Paid by plan sponsors.	Paid by plan participants.	Paid by both employer and employees, depending on plan features.

Pension regulation and tax treatment

Sections 400 through 419 of Title 26, U.S.C.—Title 26 is the Internal Revenue Code (IRC)—and attendant federal administrative regulations govern public and private pension plans. Plans may be referred to according to the IRC section under which the plan is qualified (e.g., a 401(k) plan, a 403(b) plan, a 457 plan, etc.). Qualified pension plans are plans that comply with the IRC and applicable provisions of the Employee Retirement Income Security Act of 1974 (ERISA). The ERISA specifies nondiscrimination standards and regulates reporting and accounting procedures, etc. Qualified plans receive favorable tax treatment; nonqualified plans do not. Except for certain administrative and accounting standards, ERISA does not apply to public pension plans. However, public plans must be qualified under various sections of the IRC in order for employee contributions and accruing benefits to be tax-deferred.

Supplemental plans

Like many employees in medium and large private companies, Montana's public employees may also voluntarily participate in DC plans to supplement their retirement savings. Montana law allows state and local employees to join a 457 deferred compensation plan, if the employer has provided for the plan.¹² School districts and universities may establish 403(b) plans (i.e., a tax-sheltered annuity plan) for their employees, and many Montana school districts and the University System have done so.

An individual public employee may also establish a traditional IRA (Individual Retirement Account) or Roth IRA.¹³ Contributions to a traditional IRA are tax deductible if the employee's income does not exceed a certain threshold established in the IRC (\$46,000 for 2008).

¹² See Title 19, ch. 50, MCA.

¹³ Contributions to a Roth IRA are "after tax" whereas contributions to a traditional IRA are "before tax". Distributions from a Roth IRA are not taxable if the account holder meets certain conditions.

Social Security

The 1935 Social Security Act did not originally allow state and local government employees to participate in Social Security. However, in 1950, the act was amended to make coverage optional for certain state and local government employees, but still left many public employee groups uncovered. The option for states to allow certain public employees to participate was expanded in subsequent amendments to the act. Congress made Social Security coverage mandatory, starting in July 1991, for most state and local government employees not already covered by a public pension plan. Coverage is provided to these employees through individual agreements with state and local governments. The net effect of how Social Security coverage has evolved federally and these various agreements is that coverage for public employees varies greatly from state to state.¹⁴

In Montana, as in many states and localities, public safety employees typically do not participate in Social Security because these professions were not allowed to participate when the Social Security Act was first enacted. According to the Congressional Research Service, 10.5% (9,800) of Montana's state and local government employees are not covered by social security.

Three-legged stool

In the final analysis, to achieve the recommended 70% to 80% income replacement in retirement, employees in the public and private sector must rely on a three-legged stool to save for retirement:

- ▶ a primary employer-sponsored retirement plan;
- ▶ personal savings through an IRA, a deferred compensation plan, or other vehicle; and
- ▶ Social Security, if available.

¹⁴ Congressional Research Service, "Social Security: Mandatory Coverage of State and Local Government Employees", 7-5700, www.crs.gov, R41936, July 25, 2011.

CHAPTER 2

MONTANA'S RETIREMENT PLANS

Overview

Montana's public employee retirement systems consist of nine DB plans and two DC plans. These systems involve many different types of employers and employees. All but one of the systems are cost-sharing, meaning that both employees and employers contribute to them. Also, although there are a few special exceptions, employees are required to be members.

MPERA systems

Nine of Montana's retirement plans (8 DB plans and 1 DC plan) are governed by the 7-member, governor-appointed Public Employees' Retirement Board (PER Board). Administrative staff for the PER Board are organized as the Montana Public Employees' Retirement Administration (MPERA). The retirement plans governed by this board are often referred to as MPERA systems. These MPERA systems are listed in Figure 3.

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. The TRS is governed by a separate board -- the 6-member governor-appointed Teachers' Retirement Board.

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 the TRS or the optional DC plan.¹⁵ However, the ORP became a mandatory plan in 1993,

¹⁵ Ch. 494, Laws of Montana, 1987.

to stabilize plan membership and the financial impact on TRS.¹⁶ It was not until 2013 that the legislature enacted a bill to change the program's name to the University System Retirement Program and thus eliminate the word "optional".¹⁷

At-a-glance summary tables

The Legislative Services Division, in collaboration with the staff of the retirement systems and Board of Investments, has developed summary tables to provide an "at-a-glance" view of benefits, membership, funding status, and investment returns, for each of Montana's public employee retirement systems. These tables have become known as the "green sheets" and are available from the Montana Legislative Services Division research staff for the State Administration and Veterans' Affairs Interim Committee, and are posted online under the topic of "pension oversight" on the following webpage, www.leg.mt.gov/sava.

¹⁶ Ch. 178, Laws of Montana, 1993.

¹⁷ Ch. 282, Laws of Montana, 2013.

Figure 3 - MPERA systems

System	Description
Public Employees' Retirement System (PERS) - PERS-DB plan; and - PERS-DC plan	Consists of two plans: a DB plan and a DC plan. Covers most of the general classified positions in state agencies and participating local governments, including school districts. Local governments and school districts contract with MPERA to participate in PERS. The PERS-DC plan was implemented on July 1, 2002, as an optional plan. Newly hired PERS-eligible employees have 12 months to decide whether to remain in the DB plan, the default plan, or to transfer to the DC plan. Largest of Montana's public employee retirement systems.
Judges' Retirement System (JRS) - DB plan	Covers District Court Judges, the Supreme Court Justices, and one Chief Water Judge employed by the state Judicial Branch.
Highway Patrol Officers' Retirement System (HPORS) - DB plan	Covers state highway patrol officers.
Sheriffs' Retirement System (SRS) - DB plan	Covers sheriffs, sheriffs' deputies, certain others employed in the county sheriff's office, and state investigators employed by the Montana Department of Justice
Game Wardens' and Peace Officers' Retirement System (GWPORS) - DB plan	Covers game wardens employed by the state and specified state law enforcement positions, including campus security officers.
Municipal Police Officers' Retirement System (MPORS) - DB plan	Covers police officers employed by participating cities, towns, and municipalities.
Firefighters' Unified Retirement System (FURS) - DB plan	Covers paid firefighters employed by participating cities, towns, and municipalities.
Volunteer Firefighters' Compensation Act (VFCA) pension trust fund - DB plan	Covers the volunteer (uncompensated) firefighters of qualifying volunteer fire companies organized in unincorporated areas.

Investment management

For the MPERA and TRS DB plans, assets are managed and invested by the Montana Board of Investments (BOI) as part of the state's unified investment program.

For the PERS-DC plan, MPERA contracts with several retirement fund companies to provide a menu of investment options for plan members.

For the MUS-RP, the Board of Regents contracts with the Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA–CREF) for plan administration and investment options.

Why so many plans?

Most of Montana's statewide public employee retirement systems originated as local government and school district plans. For example, in 1899, only 10 years after Montana achieved statehood, the Sixth Legislature authorized each municipality to establish a fire department. Each municipality that established a fire department was required to establish a "disability fund", to be used to compensate firemen¹⁸ disabled in the line of duty only, i.e., there weren't any specific provisions for firefighters killed in the line of duty or who had worked as firefighters for years (until at least age 45 at which time they were forced into retirement). By 1911, however, the system had metamorphosed into a disability plan and a retirement system.¹⁹

In the meantime, state employee retirement systems initially covered only state employees. Gradually, local governments were given the option of merging their local plans into a statewide system. As compliance with federal tax regulations and management of pension fund investments become more complex, local governments found themselves struggling to keep their funds solvent and in compliance with regulations. Gradually, more and more local jurisdictions opted to join the state's plans or to combine their local plans into one statewide plan, such as was done with respect to the municipal police officers' and firefighters' unified retirement plans.

¹⁸ "Firemen", not "firefighter", is the term used in the law and in 1899, the force of a fire department was likely to be composed of men only. The law also lists as "qualifications of firemen": qualified voter of the city or town; less than 45 years of age; and having passed a physical examination by a practicing physician. (See Sec. 5, HB 17, p. 74, L. 1899.)

¹⁹ For a more complete discussion of the history and development of Montana's public employee retirement systems see *An Overview of the Development and Status of Montana's Public Employee Retirement Systems* by David D. Bohyer and David S. Niss, October 2007, Legislative Services Division.

The following is a list of the year each plan was formed:

- ▶ 1935 VFCA
- ▶ 1937 TRS
- ▶ 1945 PERS and HPORS
- ▶ 1963 GWPORS
- ▶ 1967 JRS
- ▶ 1974 MPORS and SRS
- ▶ 1987 MUS-RP

While a few localities continue to sponsor their own local plans (for police or for firefighters), the majority of local government employees are members of one of the statewide systems. As an aside, a local government is statutorily authorized to secede from the state system provided that the withdrawing entity pays the actuarial cost of withdrawing, which is one reason that such withdrawals are increasingly rare.

Constitutional protections

Retirement plan assets, which include contributions and investment earnings, are constitutionally protected trust funds. Each plan's governing board members are the plan's responsible fiduciaries, which means they must act only in the best interest of plan members and their beneficiaries. Also, pension funds must be invested based on the "prudent expert" rule.²⁰ Montana's constitution also provides that retirement system funding may not be diverted or encumbered for any other purpose.²¹

Article VIII, Section 13, of the Montana constitution reads in part:

"Section 13. Investment of public funds and public retirement system and state compensation insurance fund assets. ...

(3) Investment of public retirement system assets shall be managed in a fiduciary capacity in the same manner that a prudent expert acting in a fiduciary capacity and familiar with the circumstances would use in the conduct of an enterprise of a similar character with similar aims. Public retirement system assets may be invested in private corporate capital stock. ..."

²⁰ Art. VIII, sec. 15, Montana Constitution.

²¹ Art. VIII, sec. 15, Montana Constitution.

Article VIII, Section 15, of the Montana constitution reads:

"Section 15. Public retirement system assets. (1)

Public retirement systems shall be funded on an actuarially sound basis. Public retirement system assets, including income and actuarially required contributions, shall not be encumbered, diverted, reduced, or terminated and shall be held in trust to provide benefits to participants and their beneficiaries and to defray administrative expenses.

(2) The governing boards of public retirement systems shall administer the system, including actuarial determinations, as fiduciaries of system participants and their beneficiaries."

CHAPTER 3

HOW DO MONTANA'S PLANS STACK UP?

National overview

Nationwide, in 2012, 77% of public sector retirement plans were DB plan, down from 94% in 1998. Public sector DC and hybrid plans have increased from 6% in 1998, to 23% in 2012.²²

States with DC plans

Alaska, Michigan, Nebraska, and the District of Columbia each designate a DC plan as the default mandatory retirement plan for their public employees (or in some cases, the only plan). West Virginia had a mandatory DC retirement plan for teachers until July 1, 2005.²³ Five other states have, in recent years, created defined contribution plans as the primary coverage for elected officials and political appointees, sometimes including legislative staff. These states include Colorado, Louisiana, Nevada, Vermont and Virginia.²⁴

States with hybrid plans

The list of states with some type of hybrid plan is growing and includes the following 16 states: California, Georgia, Indiana, Kansas, Kentucky, Michigan, Nebraska, North Dakota, Ohio, Oregon, Rhode Island, Tennessee, Texas, Utah, Virginia, and Washington.²⁵ Because Montana's PERS-DB plan

²² Texas Pension Review Board, "Retirement Benefits in the Public and Private Sectors - A Comparison of Trends, Regulatory Environments, and Related Issues", Research Paper No. 13-002, August 2013, p. 4.

²³ From *Defined Benefit and Defined Contribution Retirement Plans*, NCSL, February 2005; found at URL <http://www.ncsl.org/programs/fiscal/defineretire.htm>. NOTE: The NCSL document was written prior to the WV teachers' DC plan closing to new members (July 1, 2005). Teachers in WV hired after June 30, 2005, are required to become members of the WV Teachers' Retirement System. Source: "TRS Frequently Asked Questions", West Virginia Consolidated Public Retirement Board, URL <http://www.wvretirement.com/Questions%20TRS.html>.

²⁴ *Ibid.* NOTE: Alaska is not cited in the NCSL paper because the paper was prepared in February 2005 and Alaska converted to a mandatory DC plan later that year.

²⁵ National Association of State Retirement Administrators, "NASRA Issue Brief: State Hybrid Retirement Plans", September 2013.

has a money purchase (defined contribution) feature, it is technically a hybrid plan and Montana could be included in the states with hybrid plans.

Comparisons with other plans

Benefit formula multiplier

As previously mentioned, the basic pension benefit formula used to calculate the normal retirement benefit in all but one of Montana's state-sponsored define benefit plans²⁶ is expressed as:

a multiplier (%) x years of service x final average salary²⁷

The percentage used in the benefit formula is sometimes referred to as the "escalator" or "multiplier".

General employee plans

According to a 2012 Wisconsin report comparing 87 public employee retirement systems among all 50 states, the multiplier used most frequently in retirement plans for general employees is between 1.5% and 1.7%. The next most frequent range of multipliers was 1.9% to 2.1%. The third most frequent range was 1.7% to 1.9%.²⁸

Legislation passed by the 2011 Legislature changed the multiplier for PERS members hired after on or July 1, 2011, to create a tiered system as follows:

- ▶ for members with less than 10 years of service, 1.5% per year;
- ▶ for members with 10 to 29 years of service, 1.786% per year; and
- ▶ for members with 30 or more years of service, 2% per year.

²⁶ The formula is not applicable to members under the Volunteer Firefighters Compensation Act. See section 19-17-404, MCA. The current monthly benefit is $\$7.50 \times \text{years}$, with a maximum monthly benefit of \$150.

²⁷ Some systems use the term "highest average compensation".

²⁸ *2012 Comparative Study of Major Public Employee Retirement Systems*, by Daniel Schmidt, Principal Analyst, Wisconsin Legislative Council, December 2013, pg. 25.

A hybrid feature of PERS is that the retirement benefit is also calculated according to a money purchase formula, which is double the member's contributions, plus regular interest as determined by the PERB. The regular interest credited in PERS for 2015 is 0.25%.²⁹ A PERS retiree receives whichever benefit amount is greater between the two calculations.

Teachers' plans

Data collected by the National Education Association (NEA) shows that the most frequent multiplier among the large pension plans surveyed for teachers was between 2.0% and 2.24%. The second most frequent multiplier was between 1.5% and 1.74%.³⁰

In Montana's TRS, the multiplier is 1.667%. However, for members hired on or after July 1, 2013, and who retires with 30 or more years of service and is at least age 60, the multiplier is 1.85% per year of service.

Public safety plans

Retirement benefits for public safety personnel are generally higher in most states than for general employees. Potential reasons for the higher benefits include: (1) the benefits provide compensation for the higher risk in public safety professions; (2) public safety professionals tend to have shorter lives and are entitled to the actuarially determined higher benefit; and (3) public safety positions are often not covered by Social Security.

In Montana, most positions covered by MPORS, FURS, and HPORS are not covered by Social Security. In 1997, the Legislature equalized the multipliers among MPORS, FURS, SRS, AND HPORS by raising the sheriffs' and firefighters' multipliers to 2.5%. In 2001, the legislature increased the multiplier for the GWPORS to 2.5% as well.

According to an NCSL report, this 2.5% multiplier is within the 2.5% to 2.99% range found in 49% of other statewide public safety retirement plans where

²⁹ The interest credit is set by the PERB annually.

³⁰ National Education Association, *Characteristics of Large Public Pension Plans*, December 2010, pg. 60

their officers are not covered by Social Security and in 35% of the retirement plans where employees are covered by Social Security.³¹

Final average compensation

According to the 2012 Wisconsin report previously noted, the most frequently used period for determining a final average compensation is 5 years, which is up from the 3 years that was most frequently used in 2010. Fiscal pressures caused by investment losses in 2001 and 2008, prompted Montana's 2011 Legislature to join several other states in increasing the final average compensation period in PERS, SRS, and GWPORS from 3 years to 5 years for new hires. This increase in the number of years used to calculate an average compensation results in lower benefits. Montana's other DB plans remain at a 3-year-average period for computing the final average compensation used in the benefit formula.

Years of service and age

In most DB plans, a person must work a certain number of years or attain a certain age, or both, to be eligible for normal retirement benefits (i.e., benefits calculated under the normal benefit formula). Early retirement eligibility allows for retirement with fewer years of service or at a younger age, but with under a benefit formula that includes an actuarial reduction in the benefit.

General employee plans

According to the Wisconsin report, the most frequent retirement eligibility criteria for general classified employees is 30 years of service and age 55 or older. However, a significant number of plans have "X years and out" provisions, which allow members to receive normal benefits at any age if the member has served a certain number of years, regardless of age.³²

Montana's PERS for members hired before July 1, 2011, provides for normal retirement at:

- ▶ 30 years any age;
- ▶ 5 years and age 60; or

³¹ Ronald Snell, "State Retirement Plans for Public Safety Employees", National Conference for State Legislatures, August 2012.

³² 2012 Comparative Study of Major Public Employee Retirement Systems, by Daniel Schmidt, Wisconsin Legislative Council, Dec. 2012, pp. 11-17.

- ▶ age 65 regardless of years of service.

If hired on or after July 1, 2011, Montana's PERS provides normal retirement at:

- ▶ age 65 with age least 5 years of service; or
- ▶ age 70 regardless of years of service.

Teachers' plans

According to the previously cited NEA report, the most common normal retirement age for teachers' public retirement plans is age 60 or 62, while the most common years of service requirement of retirement at any age was 30 years of service. There are wide-ranging differences among teachers' retirement plans when age and service requirements are combined.³³

Public safety plans

In public safety professions, there is an occupational incentive to leave the profession when age and "burn out" begin to affect job performance. Thus, years of service and age requirements for normal retirement eligibility are typically lower than for general employees.

An NCSL study reports that the most frequently used age criteria among the studied public safety retirement plans was age 50.³⁴ Twenty years of service is also a norm and many plans provide for normal retirement with 20 years of service regardless of age.

There are age and service eligibility differences among Montana's public safety plans as follows:

- ▶ HPORS and SRS provide a 20-year retirement at any age;
- ▶ MPORS and FURS provide a 20-year retirement at any age, or 5 years and age 50; and

³³ National Education Association, *Characteristics of Large Public Pension Plans*, December 2010, pp. 29-39.

³⁴ Ronald Snell, "State Retirement Plans for Public Safety Employees", National Conference for State Legislatures, August 2012.

- ▶ GWPORS provides a 20-year retirement at any age, or 5 years and age 55.

Vesting

A member becomes entitled to receive some retirement benefits—i.e., he or she "vests" or becomes "vested"—when the member has contributed to the system for a certain number of years. According to the Wisconsin report, 52% of the plans required 5 years of service to vest, while 30% require 10 years of service.³⁵

Montana's Legislature has enacted laws to establish a 5-year vesting period uniformly among Montana's public retirement plans. However, in 2013, the legislature increased the vesting period in the HPORS to 10 years in an effort to reduce the normal cost of benefits going forward and thereby improve the actuarial funding of the plan.³⁶

Postretirement benefit increases

Prior to 1997, Montana's legislatures were periodically persuaded to provide *ad hoc* increases to the monthly benefits of existing retirees to mitigate the effects of inflation, which seriously erode the value of the retirement benefits over time. However, *ad hoc* increases are not prefunded by contributions or investment earnings. Therefore, these increases added significantly to the unfunded actuarial liabilities of the plans.

In 1997, Montana's legislature enacted a 1.5% "guaranteed annual benefit adjustment" (GABA) for retirees in all MPERA systems, except the VFCA.³⁷ A similar 1.5% GABA was enacted for TRS in 1999. In 2001, the Legislature increased the 1.5% GABA for the MPERA systems to 3%.³⁸ However, after market losses significantly hurt the pension plans, the 2007 Legislature reduced the GABA for new hires in PERS, HPORS, SRS and GWPORS

³⁵ 2012 Comparative Study of Major Public Employee Retirement Systems, by Daniel Schmidt, Wisconsin Legislative Council, Dec. 2012, p 23.

³⁶ Ch. 272, Laws of Montana, 2013

³⁷ As a money purchase DC plan, the ORP cannot provide for a postretirement benefit increase. The PERS/DC plan did not exist in 1997 but, had it existed, also could not provide a postretirement increase.

³⁸ Ch. 149, Laws of Montana, 2001.

back to 1.5%.³⁹ The GABA in JRS, MPORS, and FURS, continues to be 3.0%.

Most of the plans (92%) included in the Wisconsin study provide some sort of cost-of-living adjustment (COLA). According to the study:

- ▶ 34% of the plans index the adjustments to the Consumer Price Index (CPI);
- ▶ 28% provide set percentage automatic adjustments, similar to Montana's GABA;
- ▶ 24% of the plans still provide *ad hoc* adjustments; and
- ▶ 6% spend investment earnings above the assumed rate of return on the adjustments.⁴⁰

The Social Security COLA, which is indexed to the CPI, ranged from a between 0% in 2009 and 2010 to 5.8% in 2008. The average Social Security COLA from 2000 through 2013 was 2.47%.⁴¹

In summary

Figures 4 and 5 below provide an "at-a-glance" summary of the benefit features in PERS and TRS compared to the most frequently found features in a nationwide survey of similar public plans.

³⁹ Ch. 371, Laws of Montana, 2007.

⁴⁰ *2012 Comparative Study of Major Public Employee Retirement Systems*, by Daniel Schmidt, Wisconsin Legislative Council, Dec. 2012, pp. 30-35.

⁴¹ *Ibid.*

Figure - PERS benefits compared to other plans⁴²

Feature	Montana PERS	Most frequent in other plans
Multiplier (% x yrs of service)	< 10 yrs of service, 1.5% 10 to 29 yrs of service, 1.786% 30 + yrs of service, 2%	1.5% to 1.7%
Period for calculating final avg. comp.	5 years (hired on or after 7/1/11)	5 years
Age and yrs of service for normal benefit formula	age 65 with at least 5 yrs service; or age 70 regardless of service.	age 55 with at least 5 yrs service; or 30 yrs service regardless of age
Vesting period	5 years	5 years
Postretirement benefit increases/COLA	If hired on or after 7/1/07 - 1.5% ⁴³	Indexed to CPI

Figure - TRS benefits compared to other plans⁴⁴

Feature	Montana TRS	Most frequent in other plans
Multiplier (% x yrs of service)	1.667%; or if hired on or after 1/7/13, and with at least 30 yrs service and age 50, 1.85%	2.0% to 2.24%
Period for calculating final avg. comp.	5 years (hired on or after 1/7/2013)	5 years
Age and yrs of service for normal benefit formula	25 yrs service any age; or age 60 with at least 5 yrs service.	age 65 regardless of service, 30 yrs service regardless of age, or combination of both (varies widely)
Vesting period	5 years	5 years
Postretirement benefit increases/COLA	1.5% ⁴⁵	Indexed to CPI

⁴² 2012 Comparative Study of Major Public Employee Retirement Systems, by Daniel Schmidt, Wisconsin Legislative Council, December 2012.

⁴³ House Bill No. 454 from the 2013 Session provided that this be reduced 0.1% for each 2% the plan's funded ratio is below 90%. However, a lawsuit was filed alleging a breach of contract rights for current members and the district court enjoined the reduction.

⁴⁴ National Education Association, *Characteristics of Large Public Pension Plans*, December 2010.

⁴⁵ House Bill No. 377 from the 2013 Session provided that this be reduced 0.1% for each 2% the plan's funded ratio is below 90%. However, a lawsuit was filed alleging a breach of contract rights for current members and the district court enjoined the reduction.

CHAPTER 4 INVESTMENT RETURNS

This chapter discusses investment returns for Montana's PERS and TRS and offers some comparisons with similar public pension plans in other states. The investment portfolios for the other DB plan and their investment earnings may be slightly different, but generally track with PERS and TRS investment portfolios and returns.

Investment return assumption

Because investment income is the primary source of funding for any pension plan, as illustrated for TRS and PRS in Figures 6 and 7 below, the most significant actuarial assumption is the assumed rate of return on DB plan investments.

Figure 6 - TRS Income in FY2014

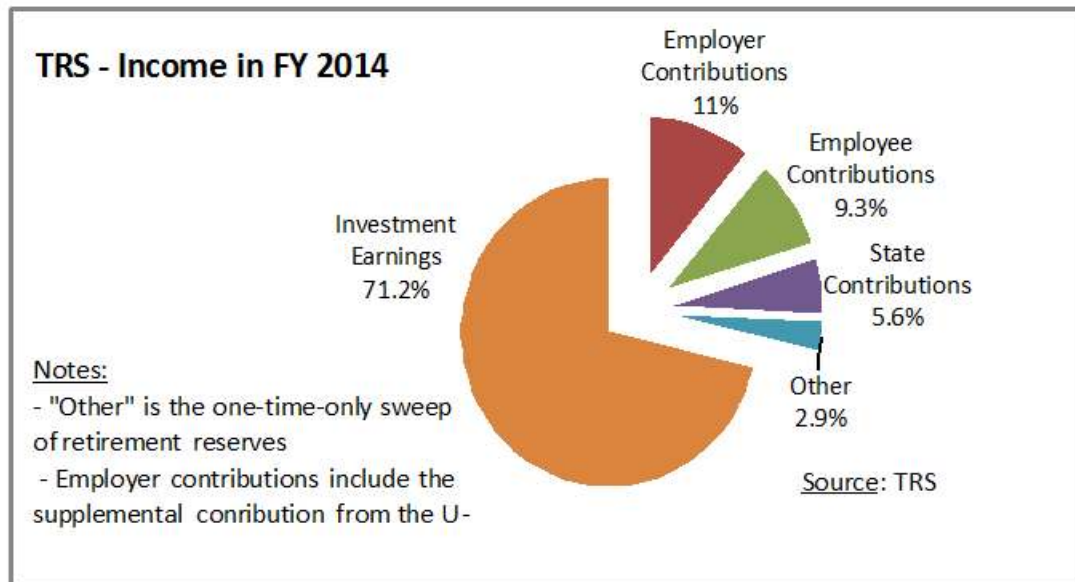
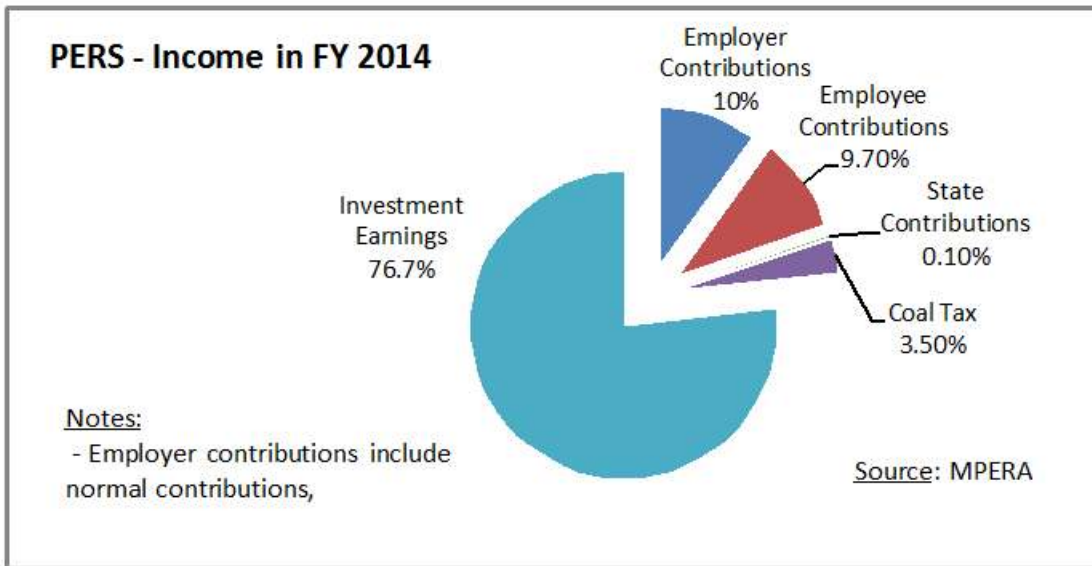


Figure 7 - PERS Income in FY2014



Since 2008, many state retirement plans have reduced their rate of return assumptions because of the significant market losses in 2001 and 2008, which obviously affected the actual experience of the pension plans. The National Association of State Retirement Plan Administrators reports that the median investment rate of return assumption among 126 public pension plans surveyed in October 2014 was 7.5%.⁴⁶

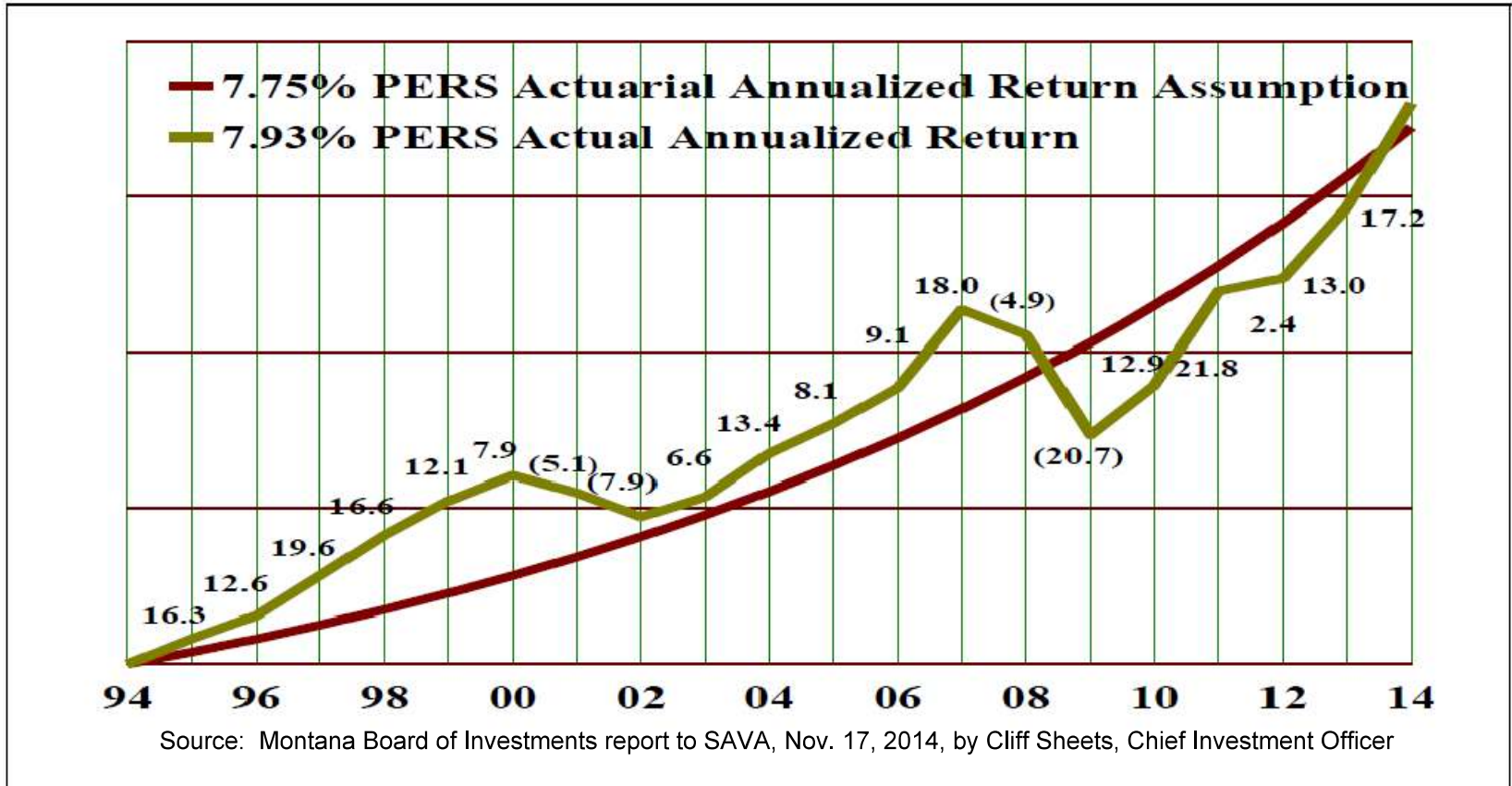
Investment performance

Figure 8 on the following page shows the actual investment return experience of PERS for the last 20 years compared to the actuarial assumed rate of return of 7.5% adopted by the PER Board. The graph shows that the annual investment return on PERS investments has averaged 7.93% since 1994.

The Montana Public Employees' and Teachers' Retirement boards have each adopted a 7.5% investment rate of return assumption to be used for actuarial valuations.

⁴⁶ National Association of State Retirement Administrators, "Public Pension Plan Investment Return Assumptions", NASRA Issue Brief, October 2014.

Actual Investment Return Versus Actuarial Assumption (Through FY14)



Montana's DB plan pension funds are invested by investment officers supervised by an executive director under the oversight of the Montana Board of Investments (BOI).

Comparison with peers

Outside consultants for the BOI reported to the BOI in August 2014 that:

- ☞ Montana's 4-year net return of 11.3% was above the U.S. public median of 10.4% and was above the peer median of 10.2%;
- ☞ Montana's total investment expenses were slightly lower than the peer average;⁴⁷ and
- ☞ Montana's pension investment portfolio, when analyzed based on risk vs. return were found to be less risky than the median for comparable public pension plans and the rate of return compared to the risk was close to but slightly less than the median.⁴⁸

DB plans compared to DC plans

According to an outside consultant report for the BOI, the 17-year average investment return (ending in 2013) for large DB and DC plans in the United States was:

- ▶ 7.92% for DB plans; and
- ▶ 6.85% for DC plans.⁴⁹

⁴⁷ Mike Heale, CEM Benchmarking, presentation to the Montana Board of Investments (BOI), August 20, 2014. Available at the BOI website, www.investmentmt.com, under Board Meeting Materials for August 20, 2014.

⁴⁸ RVK Inc., Investment Performance Report to the BOI, August 20, 2014. Available at the BOI website, www.investmentmt.com, under Board Meeting Materials for August 20, 2014.

⁴⁹ Mike Heale, CEM Benchmarking, presentation to the Montana Board of Investments (BOI), August 20, 2014. Available at the BOI website, www.investmentmt.com, under Board Meeting Materials for August 20, 2014.

CHAPTER 5

ASSESSING A DB PLAN'S FISCAL HEALTH

Are contributions sufficient?

Because contribution rates are set in statute by the legislature and are key to the fiscal soundness of a DB plan, an important question for legislators to ask when examining DB plan funding is:

☞ Are contributions sufficient to cover the cost of benefits as they accrue (i.e., the normal cost) and to amortize unfunded liabilities in a reasonable amount of time?

A contribution rate that is sufficient to cover normal cost and amortize unfunded liabilities in less than 30 years⁵⁰ is referred to in this guide as the Annual Required Contribution (ARC). Government Finance Officer Association guidelines state that failure to contribute the ARC undermines a DB plan's fiscal health because it compromises the trust fund's ability earn investment returns and pay benefits as they come due.⁵¹

As of the latest actuarial valuations (FY2014) of Montana's DB retirement plans, three of Montana's DB plans have ARC shortfalls. See Figure 10 on the next page. The remainder of the Montana's DB plans do not have an ARC shortfall because, at this point in time, contributions are sufficient to cover normal cost and amortize unfunded liabilities in these plans in 30 years or less.

⁵⁰ A 30-year amortization period is an accepted actuarial standard. This standard is based on the principle that retirement benefits should be paid for during an employee's working career under the system. Traditional public DB plans historically have required employees to work at least 30 years to qualify for normal retirement benefits.

⁵¹ Government Finance Officers Association, "Sustainable Funding Practices of Defined Benefit Pension Plans", GFOA Best Practices, October, 2009.

Figure 10 - Montana's DB Plans With Contribution Shortfalls

System	ARC shortfall (% of pay)	Shortfall in FY 2014 dollars	Amortization period
SRS	4.01%	\$ 2,583,401	does not amortize in any amount of time
GWPORS	2.41%	\$ 975,040	does not amortize in any amount of time
HPORS	0.14%	\$ 19,462	30.3 years

Is adequate progress being made?

Another key question legislators should ask is:

Is the plan making steady progress toward the goal of becoming 100% funded (i.e., when assets are sufficient to pay 100% of the plan's benefit obligations and there are no unfunded liabilities?)

Although a plan's funded ratio and amortization schedule will fluctuate as investment returns and other plan experience fluctuates, the Government Finance Officers Association notes that the most important indicator of fiscal health is long-term progress toward 100% funding.⁵²

Funded ratio vs. amortization schedule

A plan's funded ratio and amortization schedule are two different measures of fiscal health, so do not necessarily track with each other. A plan could have a high funded ratio, but contributions above normal cost may still not be sufficient to amortize unfunded liabilities within 30 years. Conversely, a plan may have a low funded ratio, but contributions may be sufficient to cover normal cost and amortize unfunded liabilities in less than 30 years. Therefore, legislators should consider both indicators when assessing a plan's fiscal health. Also, it is important to keep in mind that the amortization schedule is the shock absorber for ups and downs, so although funded ratios may remain relatively stable, the amortization schedule may fluctuate more drastically.

⁵² Ibid.

Historical trends in TRS and PERS

Figures 11 through 14 below illustrate the historical trend of funded ratios and amortization periods for TRS and PERS.

Figure 11

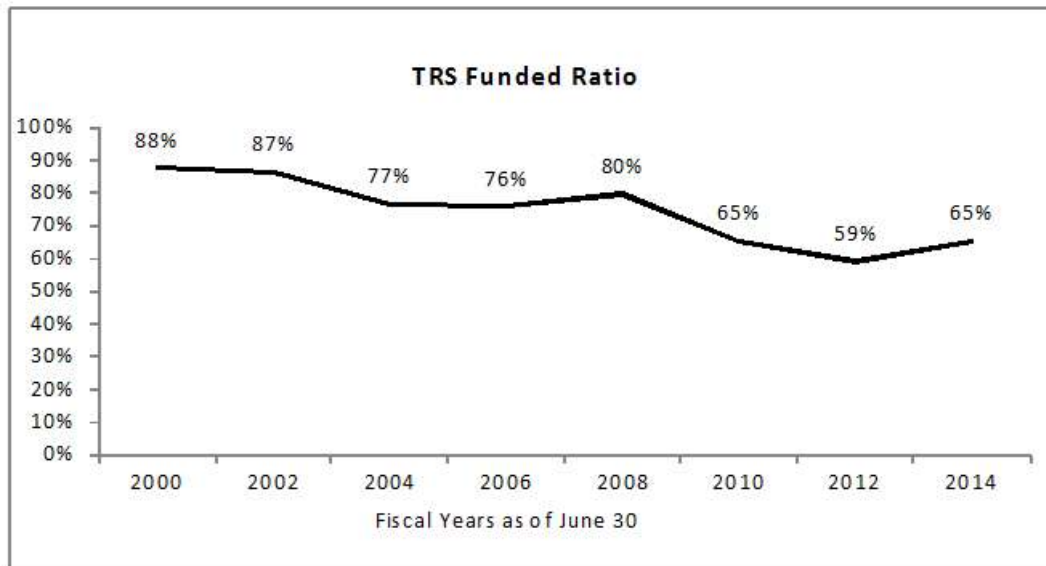
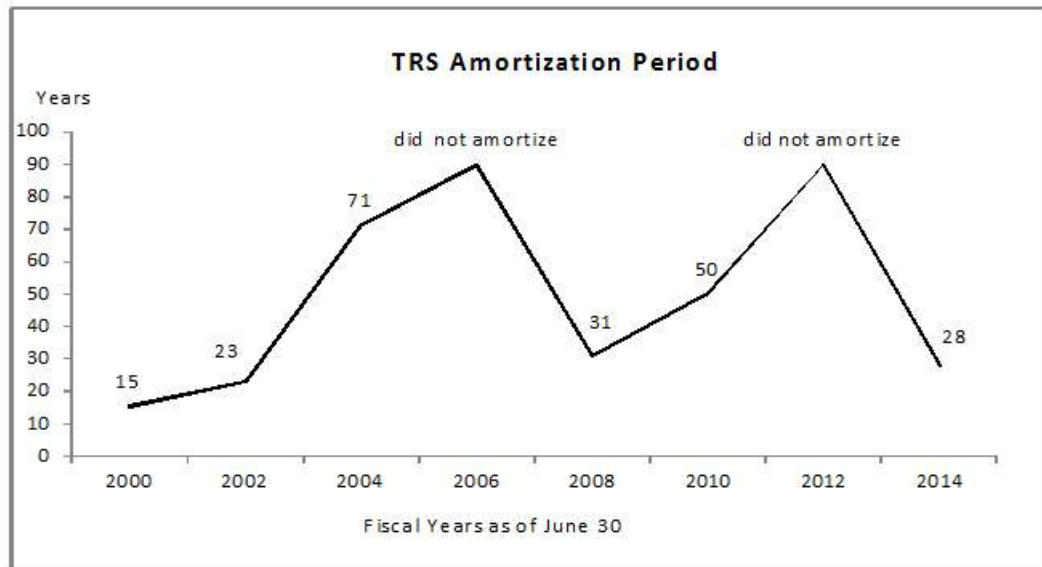


Figure 12



Note: The "did not amortize" data points in the above graph is actually an infinite number of years, but was set at 90 years for the purposes of developing this graph.

Source: TRS Actuarial Valuations

Figure 13

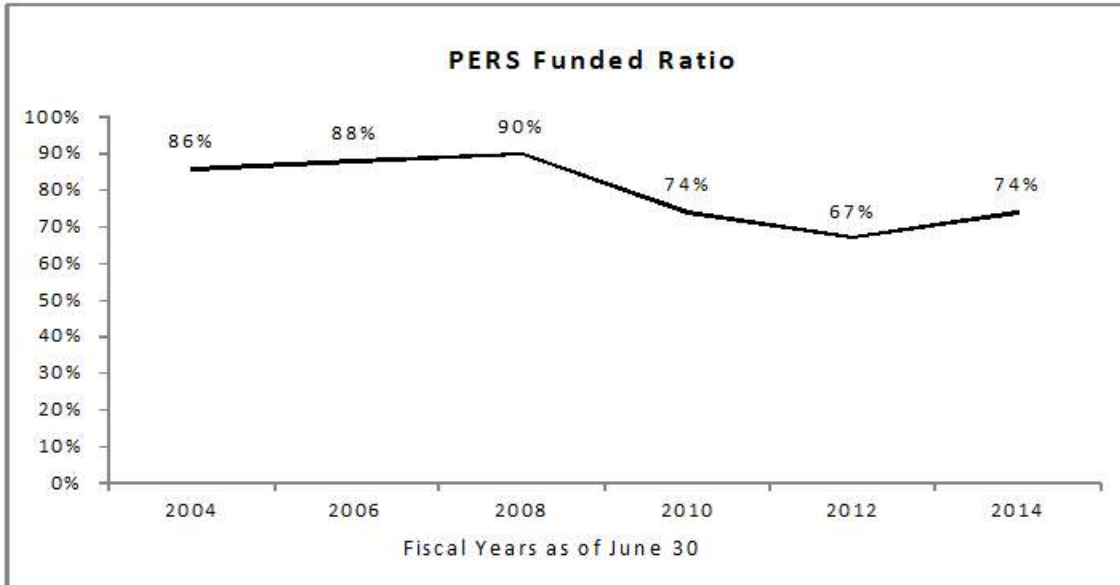
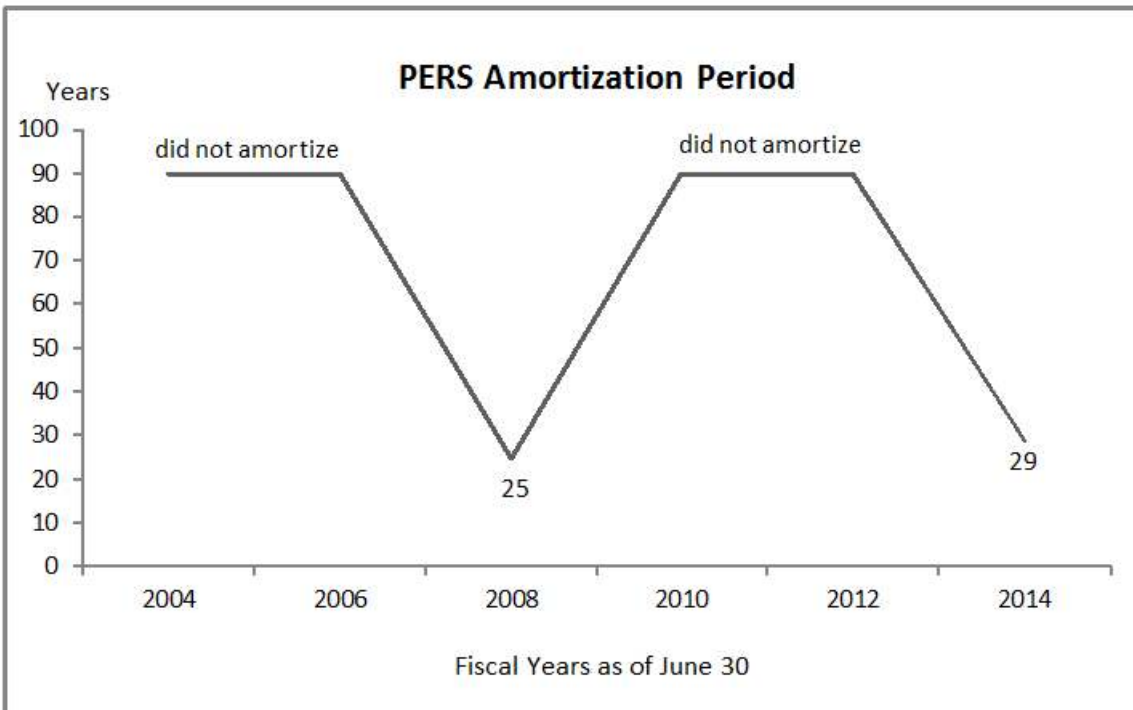


Figure 14



Note: The "did not amortize" data points in the above graph is actually an infinite number of years, but was set at 90 years for the purposes of developing this graph.

Source: Actuarial valuations for MPERA systems

When will PERS and TRS reach 100% funding?

Although there will be short-term ups and downs along the way, as the above graphs illustrate, actuaries for PERS and TRS estimate that over the long-term, according to the June 30, 2014, actuarial valuations:

- ✓ PERS will be 100% funded in 2043; and
- ✓ TRS will be 100% funded in 2042.

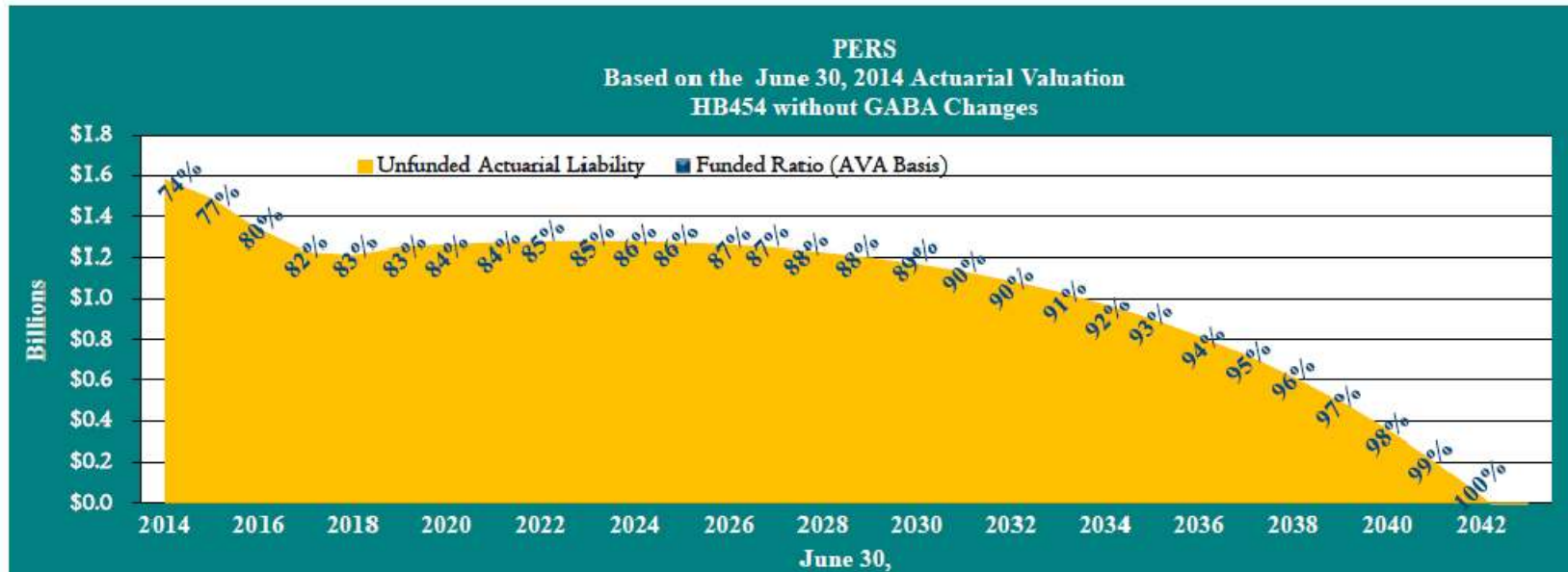
Figure 15 on the next page presents a graph with explanations provided to MPERA by Cheiron, the actuarial consultants that conduct the actuarial valuations for PERS. The graph illustrates how the actuaries project PERS to progress toward 100% funding by 2043, assuming the 2013 HB 454 reductions in the GABA are never implemented.

Figure 16 presents a similar graph prepared by TRS by their actuarial consultants, Cavanaugh Macdonald Consulting, LLC. However, the graph for TRS uses the dollar amount of the plan's unfunded liability rather than the funded ratio to illustrate the progress. The graph assumes the 2013 HB 377 reductions in the GABA are never implemented.

It is important to note that these are actuarial projections based assumptions. The trend lines will change if actual experience differs from expectations and/or the legislature enacts changes to plan provisions.

Figure 15 - Projected progress toward 100% funding in PERS, as of June 30, 2014

Projection from June 30, 2014 Actuarial Valuation Report

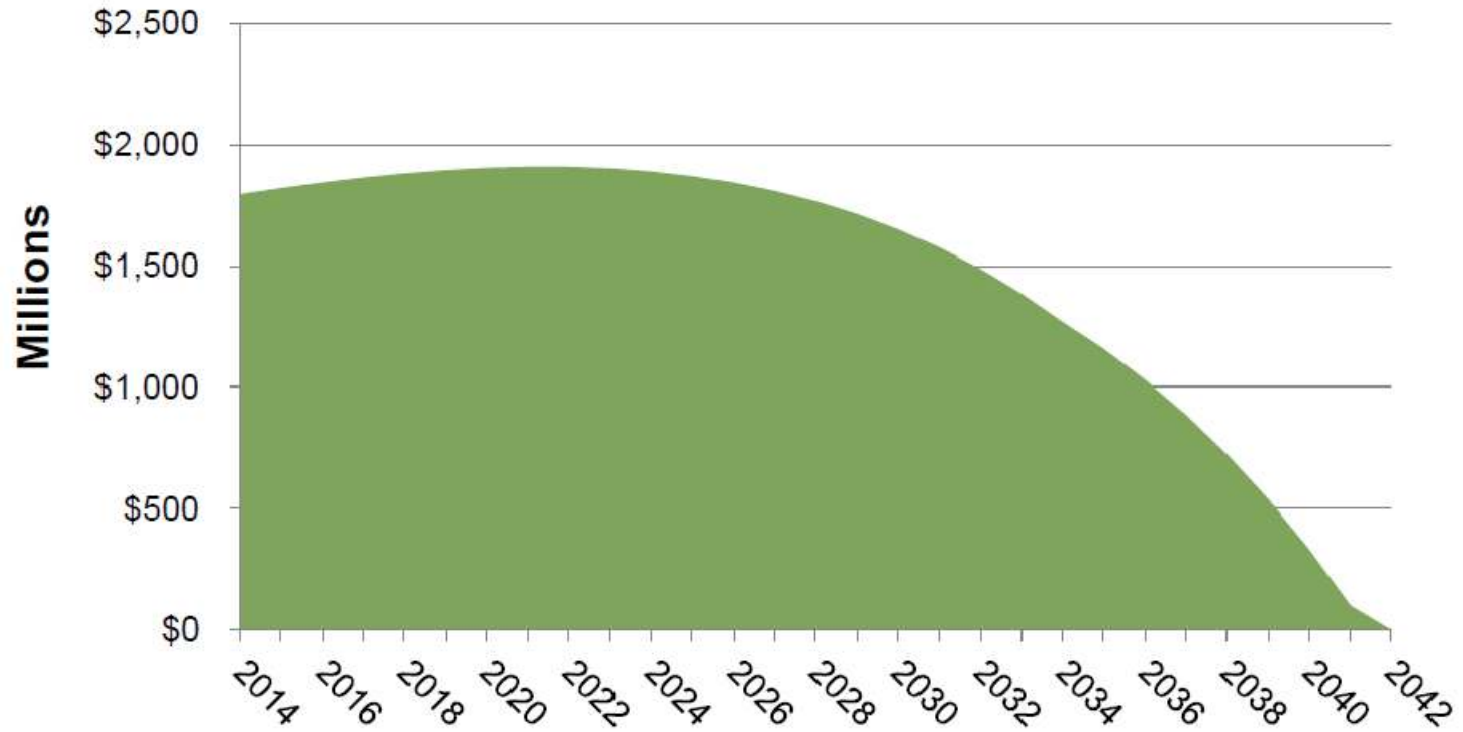


In preparing these projections, we relied on information (some oral and some written) supplied by the staff of the Public Employee Retirement Administration. This information includes, but is not limited to, plan provisions, employee data, and financial information. We performed an informal examination of the obvious characteristics of the data for reasonableness and consistency in accordance with Actuarial Standard of Practice No. 23.

Plan provisions, assumptions, methods and participant valuation data are outlined in the June 30, 2014 Actuarial Valuation Report for the Public Employees' Retirement System (PERS) of the State of Montana, including all provisions of House Bill 454 (HB454) except for any changes to future GABA increases. To the extent that the actual plan experience deviates from the underlying assumptions and methods, or there are any changes in plan provisions or applicable laws, the results would vary accordingly.

To the best of our knowledge, these projections and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices that are consistent with the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to

Figure 16 - Expected progress toward 100% funding in TRS, as of June 30, 2014.



Comparison with other states

According to data collected in 2011, 21 states have at least one public employee pension plan with a funded ratio of less than 70%. The majority of public employee plans in other states continues to experience a decline in their funded levels, although this is expected change as the actuarial valuations of the plans begin to realize the investment gains of the past few years. As previously mentioned, when conducting actuarial valuations, actuaries smooth investment losses and gains over 4 or 5 years in order to minimize short-term volatility when estimating long-term benefit costs.⁵³

In 2011, Wisconsin's public employees' retirement system had the highest funded ratio among the statewide systems: 99.8%. Illinois had the lowest funded ratio: 59.2%.⁵⁴

Figure 17 shows the funded ratios for Montana's PERS and the pension plans for general public employees in the surrounding states.

Figure 17
Funded Ratios in Montana PERS and Selected Other States⁵⁵

State	Funded Ratio in 2011 (Plan for General Employees)
Idaho	90%
Montana	70% (74% in 2014)
North Dakota	71%
South Dakota	96%
Utah	85%
Wyoming	82%

⁵³ Rachel Barkley, "The State of State Pension Plans: A Deep Dive Into Shortfalls and Surpluses", Morningstar Inc., November 26, 2012.

⁵⁴ Ibid.

⁵⁵ Ibid.

CHAPTER 6

IMPLICATIONS OF BENEFIT ENHANCEMENTS IN DB PLANS

Legislators considering bills to change benefits in DB plans may find it helpful to consider some of the funding and policy implications of benefit enhancements in DB plans.

Past-service liability

Additional liability for past service is created whenever a benefit is enhanced and the enhanced benefit applies to years of service already performed. The liability occurs because the contribution rates for past service were set based on the projected costs of the previous benefits. A benefit enhancement increases the normal cost of the system going forward. But, if it also applied by legislation to service that was performed in the past, a past-service liability is created.⁵⁶

One way to avoid liability for past service is to make a benefit enhancement applicable only to new service or to new members. However, this creates a two-tiered benefit structure and results in unequal treatment of members within the same retirement system.

Ratchet effect

Another policy issue involves what is termed the "ratchet effect". Just as a ratchet can be tightened but not loosened, legal protections related to contract rights often mean that once a retirement benefit is promised to members, it cannot be withdrawn from or reduced for those members.

Although the legislature has reduced benefits of future employees, equity and fairness arguments have, in the some past legislatures to reinstate the higher benefits for all employees. As mentioned above, this creates a past-service liability and costs that may be beyond would have been the cost if the benefit had never been reduced.

⁵⁶ A good, recent example of a benefit enhancement that applied to past service but for which past contribution rates were not actuarially sufficient to cover the normal cost of the benefit was the increase in 2001 of the GABA from 1.5% to 3% annually for PERS/DB members and retirees. See Ch. 149, L. 2001.)

Benefit swaps

Benefit-for-benefit "swaps" can sometimes be designed and are legal, provided the new benefit is of equal or greater value than the old benefit. Such swaps were used to help fund a portion of the costs of the 1.5% GABA granted to certain PERB-governed plans' members by the Legislature in 1997.⁵⁷

Leapfrog effect

Another benefit enhancement is may arise if the legislature passes a benefit enhancement in one system, but not to members of other similar systems, such as the public safety systems. The next session, the legislature is likely to see a bill to grant that benefit, or a better benefit, in the other systems as well.

Granting benefit enhancements by allowing the retirement plans to play leapfrog with each other can lead to inconsistent and inequitable retirement policy as well as additional costs and unfunded liabilities. To help prevent leapfrogging, legislators may want to ask proponents of benefits enhancements the question: "If the proposed benefit enhancement is appropriate for members of this system, is it appropriate and should it be granted for members of other systems?"

Funding options

A legislator who is asked to support a benefit enhancement may also be asked to support one of the following funding mechanisms:

- ▶ *Increase contributions to sufficiently fund the enhancement:*
Contributions should be sufficient to fund both the normal cost of the enhancement and to amortize in 30 years or less any unfunded past service liability. Raising employer contributions in a retirement system places an additional burden on the employer's budgets. Furthermore, where local governments are the employers, increasing employer contributions may be considered an unfunded mandate. On the other hand, employees cannot legally be asked to contribute more than the

⁵⁷ Ch. 287, L. 1997. The Statement of Intent attached to the legislation (HB 170) read, in part, "the bill provides that the GABA be substituted for other benefits in cases in which the GABA is as valuable or more valuable to members. The resulting actuarial savings will reduce the additional funding required for the GABA."

normal cost of their benefits, so the employer contribution must be the only source of funding for the system's unfunded liabilities.

- ▶ *Extend the amortization schedule:* If contributions are not raised enough to cover costs of enhancing benefits, the system's unfunded liability will compound. A system's liabilities may be "refinanced" by extending the amortization schedule. Policymakers asked to extend the amortization period should consider sound policy principles to determine how far the amortization period can be extended before the system is no longer responsibly funded.⁵⁸
- ▶ *Apply the enhancement to new service only:* Applying an enhancement to future service only will help control costs because no debt for past service is created. (Sound retirement policy requires concurrent funding of benefits, so increased contributions or a one-time cash infusion is assumed.) However, this future-application-only option results in a tiered system in which members of the same plan will receive different benefits (thus abrogating the "equal treatment" principle).

Fiscal notes

The Governor's Office of Budget and Program Planning (OBPP), assisted by retirement system staff, prepares the final fiscal notes for all retirement legislation with fiscal implications. Each fiscal note is required to show anticipated costs over the next biennium. However, the financial obligations incurred when retirement legislation is passed will be ongoing; i.e., as long as benefits are to be paid, which can extend for the life of a retired member and to that member's beneficiary.

In an effort to provide legislators and others with information necessary to make an informed assessment, the OBPP has developed a specialized format for fiscal notes prepared on retirement system-related legislation.

⁵⁸ As previously noted, the MCA defines "actuarially sound basis" as requiring amortization of unfunded liabilities in 30 years or less. Section 19-2-409, MCA.

Among the key information that legislators should look for in a fiscal note is: How does the legislation affect:

- ▶ *the normal cost of benefits?*
 - ▶ *contribution rates?*
 - ▶ *the system's unfunded liabilities?*
 - ▶ *the amortization period?*
 - ▶ *the funded ratio?*
-

Whenever retirement legislation with a fiscal impact is passed and the future of the affected retirement system is changed, an actuarial calculation is required in order to project the long-term costs. Thus, when legislators seek to amend retirement legislation, new fiscal information can be made available only after the system's actuary has run the numbers.

CHAPTER 7

POLICY PRINCIPLES AND RECENT HISTORY

NCSL recommendations

In 1995, the Public Pension Working Group of the National Conference of State Legislatures (NCSL) adopted and recommended to state legislatures four principles for sound and consistent retirement policy.⁵⁹

- I. *Pensions should provide financial security in retirement.*
- II. *Pension funding should be a contemporary obligation.*
- III. *Pension investments should be governed by the "prudent expert rule".*
- IV. *Pension benefits should be equitably allocated among beneficiaries.*

The interim committee that in 1997 was providing legislative oversight of the pension plans initially adopted these NCSL, but with one modification to the first principle, adding the words "the base for" in front of "financial security".⁶⁰ Since these principles were first adopted, they have survived several iterations, the latest by the SAVA, in November 2014.

Interim committee recommendations

Pursuant to its duties under section 5-5-228, MCA, SAVA discussed and adopted policy principles that it recommends legislators keep in mind when acting on DB plan retirement bills. The policy principles SAVA adopted are the same as the NCSL principles above, except that Principle I. was modified to be as follows:

⁵⁹ National Conference of State Legislatures, *Public Pensions: A Legislator's Guide*, NCSL Working Group on Pensions, 1995.

⁶⁰ *Legislative policy objectives for Montana's Public Employee Retirement Systems : 1999-2000 Interim*, by Sheri Heffelfinger, State Administration, Public Retirement Systems, and Veterans' Affairs Interim Committee, 1999-2000.

- I. *Pensions should provide the base of financial security in retirement. Retirement is the statutorily-defined years of service and age to be attained for a full retirement benefit.*

Timeline of major events

The following is a basic chronology of significant events for Montana's public employee retirement plans.

- 1997 A 1.5% GABA enacted for MPERA⁶¹ plans. Interim study results in recommendation to establish a DC plan within PERS by 2001.
- 1999 A 1.5% GABA enacted for TRS.
- 2000 The PERS-DB, SRS, and GWPORS were either more than 100% funded or nearly 100% funded. Financial markets peaked.⁶²
- 2001 The GABA for MPERA plans was increased from 1.5% to 3%. PERS-DC plan implemented as an optional plan. Market began a sharp decline.⁶³
- 2002 Market hit bottom.⁶⁴
- 2004 The unfunded liabilities in PERS and SRS did not amortize in any amount of time, so systems were actuarially unsound.
- 2005 The TRS unfunded liabilities did not amortize (system actuarially unsound). Dec. 2005 special session, the legislature appropriated from the general fund \$25 million to PERS-DB and \$100 million to TRS. Market slowly recovering.⁶⁵

⁶¹ Montana Public Employee Retirement Administration, which administers all of the retirement systems except TRS and the University Systems' Optional Retirement Program.

⁶² E-Trade Market Data Express for S&P 500 index.

⁶³ Ibid.

⁶⁴ Ibid.

⁶⁵ E-Trade Market Data Express for S&P 500 index.

- 2006 During the 2005-06 interim, SAVA study examined pension funding and investments.
- 2007 Legislature reduced the 3% GABA in PERS, HPORS, SRS, HPORS, and GWPORS, to 1.5% for new hires. Modest employer contribution increases were passed for TRS and MPERA systems but were phased-in over two bienniums beginning July 1, 2007. A state supplement contribution from the general fund was used to offset the contribution increases for local government and school district employers. The legislature also appropriated \$50 million from the general fund to TRS as a second cash infusion. Interim study of pension plan funding and plan design alternatives, but no recommendations.
- 2008 Market began another a sharp decline.⁶⁶
- 2009 SAVA interim study of retirement plan design and funding options. Outside actuarial consulting firm hired. The study produced two competing bill recommendations concerning only TRS. One bill failed. A bill establishing a cash balance plan tier in TRS was passed by the legislature but vetoed by the governor.
- 2011 Legislature passed contribution increases and reduced benefits for new hires in PERS-DB, SRS, and GWPORS, also closed certain loopholes and tightened provisions in TRS to improve actuarial soundness.
- 2013 Legislature raised HPORS vesting period from 5 years to 10 years, raised period to calculate highest average salary from 3 years to 5 years, raised benefit multiplier from 2.5% per year of service to 2.6%. In PERS, increased employer and employee contributions, provided for contributions from coal tax revenue, and reduced the GABA.⁶⁷ In TRS, raised employee contributions, increased GF supplemental contributions, reduced the GABA⁶⁸, increased benefit multiplier for members with 30 years of service and who are at least age 60.

⁶⁶ Ibid.

⁶⁷ The GABA reduction in HB 454 was challenged as a breach of contract and a district court has enjoined implementation of the reduction.

⁶⁸ The GABA reduction in HB 377 was challenged as a breach of contract and a district court has enjoined implementation of the reduction.

Previous reform proposals

Bills establishing a new DC or hybrid plan or requiring new hires to join the PERS-DC plan have been introduced in each session since 2007, but none have become law.

- 2007 HB 827 (Himmelberger) - Establishing a new mandatory DC plan for future TRS and PERS members

- 2009 HB 679 (Stahl) - Freezing DB plans and moving to a DC plan

- 2011 HB 608 (Stahl) - Freezing DB plans and moving to an annuity benefit program

- SB 54 (Balyeat) - Establishing a TRS cash balance hybrid tier for new hires

- SB 328 (Lewis) - Requiring new hires under PERS to join PERS -DC plan

- 2013 HB 338 (Regier) - Requiring all new public employees join a revised and expanded PERS-DC plan

- SB 82 (Lewis) - Requiring new hires under PERS to join DC plan

- SB 333 (Arthun) - Establishing a cash balance tier in PERS and TRS

- SB 406 (Brown) - Statutory referendum requiring new hires in PERS and TRS to join a DC plan

GLOSSARY

"401(k) plan" or "401(k)": a defined contribution plan governed by section 401(k) of the IRC that is offered to employees and in which they may voluntarily participate on an individual basis. A 401(k) allows an employee to set aside tax-deferred income for retirement purposes. In some 401(k) plans, the employer will match an employee's contributions dollar-for-dollar.

"403(b) plan" or "403(b)": a retirement plan governed by section 403(b) of the IRC that is similar but not identical to a 401(k) plan and is offered by non-profit organizations, such as universities and some charitable organizations.

"457 plan" or "457": a tax-exempt deferred compensation program, governed by section 457 of the IRC, that is made available to employees of state and federal governments and agencies. A 457 plan is similar to a 401(k) plan, except there are never employer matching contributions and the IRS does not consider it a qualified retirement plan.

"Accrued benefit": a retirement, pension, or disability benefit that an employee has earned based on his or her years of service. Accrued benefits are often calculated in relation to the employee's salary and years of service.

"Accumulated contributions": the sum of all the regular and any additional contributions made by a member in a defined benefit plan, together with the regular interest on the contributions.

"Active member": a member who is a paid employee making the required contributions and is properly reported for the most current reporting period.

"Actuarial assumption": an estimate made for the purposes of calculating benefits. Possible variables include life expectancy, return on investments, interest rates, and compensation.

"Actuarial cost": the amount determined to represent the present value of the benefits to be derived from the additional service to be credited based on the most recent actuarial valuation for the system.

"Actuarial equivalent": a benefit of equal value when computed upon the basis of the mortality table and interest rate assumptions of the retirement plan. It reflects the condition in which two or more payment streams have the same present value based on the appropriate actuarial assumptions.

"Actuarial liabilities": the excess of the present value of all benefits payable under a defined benefit retirement plan over the present value of future normal costs in that retirement plan.

"Actuary": a highly trained professional of a special area of finance who deals with the financial impact of risk and uncertainty. Actuaries have a deep understanding of financial-security systems, their reasons for being, their complexity, their mathematics, and the way they work.

"Additional contributions": contributions made by a member of a defined benefit plan to purchase various types of optional service credit as allowed by the applicable retirement plan.

"After-tax contributions": contributions to a retirement plan that are subject to federal income tax prior to deposit in the plan. They are also called "voluntary contributions".

"Annuity": in the case of a defined benefit plan, equal and fixed payments for life that are the actuarial equivalent of a lump-sum payment under a retirement plan and as such are not benefits paid by a retirement plan and are not subject to periodic or one-time increases. In the case of the defined contribution plan, an annuity is a payment of a fixed sum of money at regular intervals, which may or may not be for life.

"Beneficiary": an individual, institution, trustee, or estate which receives, or may become eligible to receive, benefits under a will, insurance policy, retirement plan, annuity, trust, or other contract.

"Benefit" or "retirement benefit": (a) the service retirement benefit, early retirement benefit, or disability retirement or survivorship benefit payment provided by a defined benefit retirement plan; or (b) a payment or distribution under a defined contribution retirement plan for the exclusive benefit of a plan member or the member's beneficiary, or an annuity if one is purchased by the member.

"Book value": the value of an asset or liability which value might be higher or lower than the market value of the asset or liability. The book value reflects depreciation or appreciation accruing to the asset or liability. Contrast with "market value".

"Contribution": a payment to a retirement plan. The contribution can be made by an employee or an employer and may be either pre-tax or after tax.

"Contingent annuitant": a person designated to receive a continuing monthly benefit after the death of a retired member.

"Cost of Living Adjustment" or "COLA": annual increase in prior year's benefit amount, usually a percentage and based on national economic data, e.g., consumer price index; similar to "Guaranteed Annual Benefit Adjustment" or "GABA".

"Death benefit" or "survivorship benefit": a payment made to a beneficiary from a retirement plan, an annuity, or an insurance policy when the plan member, annuitant, or policyholder dies.

"Deferred compensation": an arrangement, subject to IRC conditions and requirements, in which a portion of an employee's income is paid out at a date after which that income is actually earned. The primary benefit of most deferred compensation is that any taxes due on the income is deferred until funds are withdrawn under the arrangement.

"Defined benefit retirement plan" or "defined benefit plan": a pension plan in which a retired employee is entitled to receive upon retirement a regular, periodic, specific amount based on the retiree's salary history and years of service.

"Defined contribution retirement plan" or "defined contribution plan": a retirement plan in which the employee is required to or elects to defer some amount of salary into an individual account over which the employee has limited control for investing the assets and limited options when making withdrawals at retirement.

"Direct rollover": a distribution from a qualified pension plan, 401(k) plan, 403(b) plan, etc., that is remitted directly to the trustee, custodian, or issuer of the receiving retirement plan or IRA and is reported to the IRS as a rollover.

"Disability" or "disabled": a total inability of the member to perform the member's duties by reason of physical or mental incapacity. The disability must be incurred while the member is an active member.

"Early retirement": a retirement plan provision that allows an employee to retire before the normal retirement age.

"Early retirement benefit": the retirement benefit payable to a member following early retirement and is the actuarial equivalent of the accrued portion of the member's service retirement benefit.

"Earned benefit": a benefit contingent on how long an employee has worked for an employer or been a member of a retirement plan

"Employee contribution": an individual's contribution to his or her own retirement plan, often tax-deferred.

"ERISA" or "Employee Retirement Income Security Act": the federal law enacted in 1974 that established legal guidelines for private pension plan administration and investment practices. Public retirement plans generally are not subject to ERISA.

"Final average compensation" or "FAC": with respect to the MPORS, the monthly compensation of a member averaged over the last 36 months of the member's service or, in the event a member has not served at least 36 months, the total compensation earned divided by the number of months of service.

"Firefighters' Unified Retirement System" or "FURS": the retirement system provided for in Title 19, chapter 11, MCA. The FURS is a defined benefit retirement plan in which all full paid firefighters employed by the state or municipalities are members. Firefighters employed by the Montana Air National Guard may also be members.

"Guaranteed Annual Benefit Adjustment" or "GABA": annual increase in prior year's benefit amount, usually as a percentage of benefit; similar to "Cost of Living Adjustment" or "COLA"

"Game Warden and Peace Officers Retirement System" or "GWPORS": the retirement system provided for in Title 19, chapter 8, MCA. The GWPORS is a defined benefit retirement plan in which all Montana game wardens and selected other law enforcement-related employees are members.

"Highest average compensation": a member's highest average monthly compensation during any 36 consecutive months of membership service.

"Highway Patrol Officers Retirement System" or "HPORS": the retirement system provided for in Title 19, chapter 6, MCA. The HPORS is a defined benefit retirement plan in which all Montana Highway Patrol officers are members.

"Inactive member": a member who terminates service and does not retire or take a refund of the member's accumulated contributions.

"Individual retirement account" or "IRA": a tax-deferred retirement account for an individual that permits the individual to set aside money each year, with earnings tax-deferred until withdrawals begin. Also see "Roth IRA".

"Internal Revenue Code" or "IRC": Title 26 of the United States Code. It is also known as the "federal tax code".

"IRA rollover": a tax-free reinvestment of a distribution from a qualified retirement plan into an IRA or other qualified plan within a specific time frame, usually 60 days.

"Judges Retirement System" or "JRS": the retirement system provided for in Title 19, chapter 5, MCA. The JRS is a defined benefit retirement plan in which all District Court Judges, Supreme Court Justices, and the Chief Water Judge are members.

"Keogh plan" or "Keogh": a tax-deferred, qualified retirement plan for self-employed individuals and unincorporated businesses.

"Lump sum distribution": a single distribution all at once, rather than as a series of payments over time.

"Market value": the price at which an asset is trading and could presumably be purchased or sold.

"Member": a person: (a) who has accumulated contributions and service that are credited within a defined benefit retirement plan or who receives a retirement benefit on account of the person's previous service credited in a retirement system; or (b) who has a retirement account in a defined contribution plan.

"Membership service" or "service": the periods of service that are used to determine eligibility for retirement or other benefits. The term is usually used in the context of years, months, etc.

"Money purchase pension plan" or "money purchase plan": a defined contribution plan in which the amount of contributions made annually is in proportion to that employee's wages and is mandatory every year.

"Montana Board of Investments" or "Board of Investments" or "BOI": the board established in section 2-15-1808, MCA, to carry out the constitutional requirement for a unified investment program for public funds and public retirement system assets. The terms are sometimes applied to the administrative structure and staff employed by the Board.

"Municipal Police Officers Retirement System" or "MPORS": the retirement system provided for in Title 19, chapter 9, MCA. The MPORS is a defined benefit retirement plan in which all police officers employed by participating municipalities are members. Some police officers are members of retirement systems for which the municipal employer, rather than the state, is the plan sponsor.

"Montana Public Employees' Retirement Administration" or "MPERA": the administrative structure and staff through which the PERB administers the retirement systems under its control.

"Montana University System" or "MUS": the university system governed by the Montana Board of Regents and administered under the direction of the Commissioner of Higher Education.

"Normal cost" or "future normal cost": an amount calculated under an actuarial cost method required to fund accruing benefits for members of a defined benefit retirement plan during any year in the future. Normal cost does not include any portion of the supplemental costs of a retirement plan.

"Normal retirement age": the age at which a member is eligible to immediately receive a retirement benefit based on the member's age, length of service, or both, as specified under the member's retirement system, without disability and without an actuarial or similar reduction in the benefit.

"OASDI" or "Old Age, Survivors, and Disability Insurance": the official name for Social Security.

"Office of Budget and Program Planning" or "OBPP": the administrative office within the office of the governor responsible for developing the executive branch's budget and allocating funds appropriated by the Legislature.

"Optional Retirement Program" or "ORP": the optional retirement program retirement plan sponsored by the Montana University System pursuant to Title 19, ch. 21, MCA.

"Pension" or "pension benefit": benefit payments for life derived from contributions to a retirement plan made from employer-controlled funds. Sometimes referred to as an "annuity", although an annuity is typically a life insurance product.

"Pension plan": a qualified retirement plan set up by a corporation, labor union, government, or other organization for its employees.

"Pension trust fund" or "pension fund": a fund established to hold the contributions, income, and assets of a retirement system or plan in a legally-recognized trust.

"Plan asset": an asset in a retirement plan that serves as an investment vehicle for participating employees. Plan assets are categorized within asset classes, are managed by an investment manager, and are chosen to maximize risk-adjusted returns for the purpose of maintaining actuarial soundness.

"Plan choice rate": the amount of the employer contribution as a percentage of payroll covered by the defined contribution plan members that is allocated to the public employees' retirement system's defined benefit plan to actuarially fund the unfunded liabilities and the normal cost rate changes in a defined benefit plan resulting from member selection of the defined contribution plan.

"Plan sponsor": the employer who sets up a pension or retirement plan for employees.

"Portability": the ability of an employee to retain benefits, such as in a pension plan or insurance coverage, when switching employers.

"Public Employees' Retirement Board" or "PERB": the governing entity for the public employee retirement systems and plans enumerated in Title 19, chapters 3, 5 through 9, and 13, MCA, basically, the: PERS/DB and PERS/DC plans; JRS; HPORS; SRS; GWPORS; MPORS; FURS; and VCFA.

"Public Employees' Retirement System" or "PERS": the public employees' retirement system provided for in Title 19, chapters 2 and 3, MCA. The PERS is composed of both a defined benefit plan and a defined contribution plan.

"Qualified retirement plan" or "qualified plan": a plan that meets the applicable requirements of the Internal Revenue Code and, if applicable, the Employee Retirement Income Security Act, and is thus eligible for favorable tax treatment.

"Regular contributions": contributions required from members, employers, or both under a retirement plan.

"Regular interest": interest at rates set from time to time by the governing board.

"Retirement", "retire", or "retired": the status of a member who has terminated from service and who has received and accepted a retirement benefit from a retirement plan.

"Retirement account": an individual account within a defined contribution retirement plan for the deposit of employer and member contributions and other assets for the exclusive benefit of the member or the member's beneficiary.

"Retirement benefit" or "benefit": (a) the service retirement benefit, early retirement benefit, or disability retirement or survivorship benefit payment provided by a defined benefit retirement plan; or (b) a payment or distribution under a defined contribution retirement plan for the exclusive benefit of a plan member or the member's beneficiary, or an annuity if one is purchased by the member.

"Retirement plan" or "plan" or "retirement system" or "system": either a defined benefit plan or a defined contribution plan.

"Roth IRA": a type of IRA, established under the Taxpayer Relief Act of 1997, which allows taxpayers, subject to certain income limits, to save for retirement while allowing the savings to grow tax-free. Taxes are paid on contributions, but withdrawals, subject to certain rules, are not taxed at all.

"SAVA": the State Administration and Veterans' Affairs Interim Committee provided for in section 5-5-228, MCA, and commissioned as the Legislature's liaison between session in matters relating to public retirement issues. The SAVA is the successor committee to the SAIC which is the acronym previously ascribed to the State Administration and Veterans' Affairs Interim Committee. The SAIC was the successor to the CPERS or Committee on Public Employee Retirement Systems.

"Service": employment of an employee in a position covered by a retirement system and is usually used in context of years, months, etc.

"Service credit": the periods of time for which the required contributions have been made to a retirement plan and that are used to calculate retirement benefits or survivorship benefits under a defined benefit retirement plan.

"Service retirement benefit" or "normal retirement benefit": the retirement benefit that the member may receive at normal retirement age. Also known as "full benefit".

"Sheriffs' Retirement System" or "SRS": the retirement system provided for in Title 19, chapter 7, MCA. The SRS is a defined benefit retirement plan in which all county sheriffs, sheriff deputies, and various other employees of sheriffs' offices are members.

"Social Security": the comprehensive federal program of benefits providing workers and their dependents with retirement income, disability income, and other payments.

"Superannuation plan" or "superannuation": a pension plan or a pension, somewhat archaic.

"Survivorship benefit": payments for life to the statutory or designated beneficiary of a deceased member who died while in service under a defined benefit retirement plan. Also called "death benefit".

"Tax deferral" or "tax deferred": paying taxes in the future on income earned in the current period.

"Teachers' Retirement Board" or "TRS Board": the governing entity for the retirement system established in Title 19, chapters 21, MCA, i.e., the Teachers' Retirement System.

"Teachers' Retirement System" or "TRS": the retirement system provided for in Title 19, chapter 20, MCA. The TRS is a defined benefit retirement plan in which all K-12 public school teachers and administrators are members..

"Underfunded pension plan" or "underfunded": a pension plan whose liabilities exceed its assets. Also referred to as an "actuarially unsound plan" or the state of being "actuarially unsound".

"Unfunded actuarial liabilities" or "unfunded liabilities": the excess of a defined benefit retirement plan's actuarial liabilities at any given point in time over the value of its cash and investments on that same date. Also known by the acronyms "UAAL" and "UAL".

"Vested account": an individual account within a defined contribution plan that is for the exclusive benefit of a member or the member's beneficiary. A vested account includes all contributions and the income on all contributions in the member's contribution account, the vested portion of the employer's contribution account, and the member's account for other contributions.

"Vested member" or "vested": a member or the status of a member who meets the minimum membership service requirement of the system or plan to which the member belongs.

"Voluntary contribution": an employee contribution to a retirement plan made on an after-tax basis for the purpose of deferring tax on future earnings derived from the contribution. All retirement plans do not allow voluntary contributions.

"Volunteer Firefighters Compensation Act" or "VFCA": the retirement system provided for in Title 19, chapter 17, MCA. The HPORS is a defined benefit retirement plan in which the unpaid, volunteer members of rural fire districts are members.

LIST OF RETIREMENT-RELATED ACRONYMS

- DC:** Defined Contribution, as in defined contribution retirement plan.
- DB:** Defined Benefit, as in defined benefit retirement plan.
- ERISA:** Employee Retirement Income Security Act of 1974, a federal law.
- FAC:** Final Average Compensation
- FAS:** Final Average Salary
- FURS:** Firefighters' Unified Retirement System
- GASB:** Governmental Accounting Standards Board
- GWPORS:** Game Warden and Peace Officers Retirement System
- HAC:** Highest average compensation
- HAS:** Highest average salary
- HPORS:** Highway Patrol Officers Retirement System
- IRA:** Individual retirement account; (rarely: Individual retirement arrangement)
- IRC:** Internal Revenue Code
- JRS:** Judges Retirement System
- BOI:** Montana Board of Investments or Board of Investments
- MPORS:** Municipal Police Officers Retirement System
- MPERA:** Montana Public Employees' Retirement Administration
- OBPP:** Office of Budget and Program Planning
- ORP:** Optional Retirement Program or (inaccurately) Optional Retirement Plan
- PCR:** Plan choice rate

PER Board: Public Employees' Retirement Board

PERS: Public Employees' Retirement System

SAVA: State Administration and Veterans' Affairs Interim Committee (2003-present)

SRS: Sheriffs' Retirement System

TRS Board: Teachers' Retirement Board

TRS: Teachers' Retirement System

UAAL: Unfunded actuarially accrued liability

UAL: Unfunded actuarial liability

VFCA: Volunteer Firefighters Compensation Act