

A Primer on TRS Funding

Are you concerned about the financial health of the Teachers' Retirement System?

Do you worry about your future benefits as a member?

This primer is for you!



Did you know? Montana's public pensions are required by state law to be funded on an *actuarially sound basis*.

While the concept of actuarial soundness is too complex to address here, you can rest assured the TRS governing board, executive director, actuary, and others constantly monitor the financial health of TRS on behalf of all members.

An *actuarial valuation* is the primary tool for determining whether the retirement system is funded on an actuarially sound basis. TRS contracts with an experienced actuarial firm to produce an annual valuation of the system. This valuation provides a snapshot of TRS's *funded ratio*, which can be expressed as a simple math equation:

$$C + I = B + E$$

Contributions (C) + Investment Income (I) =
Benefit payments (B) + Expenses (E)

Let's examine each variable in the equation.

(C) Contributions are paid by members, their employers, and the State of Montana at rates set forth in statute.

All educators in Montana's public school system, including teachers, administrators, specialists, and others, are required to participate in TRS and currently contribute 8.15% of their earned compensation on a tax-deferred basis through payroll deduction. These contributions are deposited into the member's individual TRS account, earning interest each month. However, the balance in the account at retirement does *not* determine the member's monthly benefit amount.¹

As of fiscal year 2024, school district employers contribute 9.47% of earned compensation for active members, with the State of Montana contributing another 2.49% for those employees. The State of Montana also contributes \$25 million annually from the general fund. These employer and state contributions are pooled and invested to ensure the retirement system has the assets necessary to pay lifetime benefits to eligible members.

(I) The Montana Board of Investments (BOI) – not TRS – invests the pooled employer and state contributions. One member of the TRS Board also serves on the BOI Board to ensure clear communication and transparency. The TRS Board uses the annual actuarial valuations and the actual history of TRS investment returns to set an assumed rate of return on investments (currently 7.30%).

The actual rate of return on TRS investments may differ from the assumed rate of return in any given year due to market conditions. However, for all years under the BOI's investment authority, TRS's average rate of return has exceeded the current investment return assumption, thanks to the BOI's conservative, long-term investment approach.

(B) TRS pays lifetime benefits to all retired members and may provide benefits to their eligible survivors. The role of the actuary is to examine current benefit amounts, retirement trends, economic factors, average lifespan, and many other demographic factors to predict the annual cost of paying benefits to current and future retirees.

(E) The Expenses category accounts for all TRS administrative costs, including staff compensation, investment fees, and operating costs (office space, supplies, computer systems, legal and actuarial services, and so forth). State law defines an allowable limit for expenses, and TRS consistently stays well below that limit.

The "Funded Ratio" and Unfunded Liability

When the annual valuation shows that (C + I) is expected to be less than (B + E), the retirement system has a *funded ratio* of less than 100% and is said to have an *unfunded actuarial liability*.

¹ For more information, watch the "TRS 101: Retirement System Basics" presentation, available on the TRS website: <https://trs.mt.gov/TrsInfo/Workshops>

To understand what this means, imagine a hypothetical scenario in which every TRS member retired at once and in which no new educators were hired. Contributions (C) would cease while benefit payments (B) would dramatically increase. If TRS had an unfunded liability in this imaginary scenario, the fund would run out of money before making all payments owed until the last retiree or survivor passed away.

Of course, members do not all retire at once and educators continue to enter the profession and join TRS. Contributions continue to be collected from members, employers, and the State of Montana. The perpetual nature of a pension plan means that it is natural to have some unfunded liability. The key is to keep close tabs on all funding factors and to make adjustments as required to help ensure TRS's funded ratio can continue to grow, not shrink, over time.

As of the July 1, 2023 actuarial valuation of TRS, the funded ratio was 72.49%. So long as contributions and income continue to grow as anticipated, the funded ratio also will increase, gradually paying down (*amortizing*) the unfunded liability over a reasonable timeframe.

Achieving a funded ratio of 100% is the goal of any defined benefit pension, and the annual actuarial valuation of TRS allows the Board to monitor progress toward that goal.

Who Serves on the TRS Board, and What is Their Role?

Six dedicated individuals, four of whom are current or former Montana educators, comprise the TRS Board. Each member must be appointed by the Governor to serve a five-year term. For a current list of members and officers, visit the TRS website: <https://trs.mt.gov/trs-info/board>

Among other duties, members of the TRS Board monitor the health of the pension fund, set the interest rate for member contribution accounts, oversee the work of the TRS Executive Director, and review TRS's annual operating budget.

The Board has created an effective Funding and Benefit Policy that guides their conduct related to funding of the retirement system. If annual TRS valuations indicate the funded ratio may decline year over year, this policy provides clear direction for the TRS Board to make recommendations to the Governor and Legislature for incremental changes that will improve the funded status of the system. According to a recent actuarial audit conducted by an independent firm:

"The [TRS] Board's Funding and Benefit Policy is a thorough document that thoughtfully monitors the health of [TRS] from many perspectives. We believe that this funding policy continues to serve as a model to other retirement systems."
(Gabriel, Roeder & Smith, 2020)

² Learn more about Tier One vs. Tier Two membership in "TRS 101: Retirement System Basics," available at: <https://trs.mt.gov/TrsInfo/Workshops>

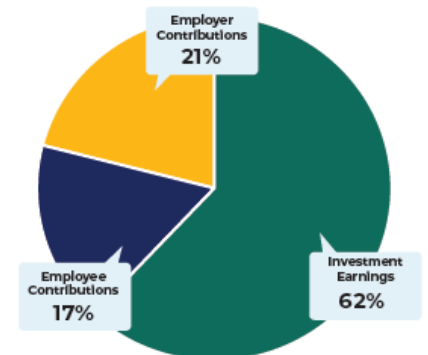
Can the Legislature Reduce or Eliminate TRS Benefits?

The Montana Legislature, subject to approval or veto by the Governor, is legally authorized to set contribution rates and to define the benefits paid by TRS. While it is impossible to predict what future governors and legislatures will do, there are laws and legal precedents aimed at protecting the benefits of TRS members. Two legal "standards" are fairly clear:

- Benefits already accrued by and promised to existing members may not be substantially reduced or terminated *unless* the State is able to demonstrate that such a change is "reasonable and necessary." The courts previously have found that a reduction is only "necessary" if the State and/or the retirement system are projected to be insolvent. TRS currently has approximately \$4.9 billion in assets to pay benefits and is far from insolvency.
- A reduction of TRS benefits would almost certainly be imposed against new hires first. For example, the 2013 Montana Legislature created a new eligibility tier for those whose TRS membership began on July 1, 2013 or later (*Tier Two* members). Compared with Tier One members (those already enrolled as of June 30, 2013), Tier Two members generally must accrue more years of creditable service to be eligible for retirement and their monthly benefit is calculated using a different formula.² These "benefit reductions" helped return TRS to financial health in the wake of the 2008-2009 market collapse.

Are Montana's Public Pensions a Drain on Taxpayers?

Evidence tells us they are not. A 2023 study by the National Institute on Retirement Security (NIRS) showed that nearly two-thirds of Montana's public pension fund receipts come from investment earnings, not taxpayer-based contributions.



Source: Pensionomics 2023: Montana Fact Sheet, available at nirsonline.org

The NIRS report also estimated that in 2020, each taxpayer dollar "invested" by Montana taxpayers in these pension plans supported \$6.79 in total economic activity in the state, and each dollar paid out in benefits supported \$1.44 in economic activity.

In fiscal year 2023, TRS paid nearly \$360 million in benefits to 14,505 Montana residents. Those dollars have a significant impact on your state and local economy!

The Bottom Line: TRS continues to do what it has done successfully since 1937 – pay a modest but reliable income to eligible retirees for the rest of their lives. **Questions?** Call us at (406) 444-3134 or (866) 600-4045. We're here for you!
