TRS
Horizons
Volume 1, No. 1, 2012
Montana Teachers' Retirement System

TRS Needs Your Input

The previous issue of *TRS Horizons* apparently caught people's attention. Readers are sending us their insights on how best to address TRS' unfunded liability and resulting $633 million shortfall. We're still in the early stages of gathering input, and we encourage you to keep sending us your comments and suggestions. But we want to share a snapshot of what we've heard to date (given the non-representative sample size).

Share in Lifting the Load—The most common response we've heard so far is "We can live with some changes if we all share in lifting the load." For example, many people say they support the idea of increasing contributions to the fund if the load is fairly divided among members, employers, and the state. Most also say they could live with raising the age members become eligible for regular retirement as long as it doesn't apply to those now nearing retirement.

People agree—any proposed changes should be carefully phased in to avoid adversely affecting retirees and those nearing retirement.

We're also seeing fairly uniform opposition to reducing either the 1.5% Guaranteed Annual Benefit Adjustment (GABA) or the multiplier (1.667% of salary) for calculating retirement benefits. Several people noted that these rates have long been at the low end of the scale compared to other pension systems.

Most of the comments reference the list of alternatives we provided in the November *TRS Horizons.* You'll find those alternatives in the table on page 3 of this newsletter as well, with our actuary's calculation of the impacts each alternative would have on reducing TRS' current 71-year amortization period and 3.53% funding shortfall due to the unfunded liability.

Some people hoped better investment returns would whittle away at the unfunded liability, although they frowned on moving to a higher-risk portfolio. Several respondents looked "outside the box" for their suggestions. Two particular suggestions surfaced repeatedly, so we'll address them here.

Use the Montana Lottery to Fund TRS— A widespread belief is that Montana Lottery revenues are earmarked to help fund the Teachers' Retirement System. They are not. When the lottery was established in 1986, revenues were directed to counties to reduce property taxes, which in turn fund the retirement costs of school districts. Those costs include Social Security, the Montana Public Employee Retirement System, TRS, and Workers Compensation. (For accounting purposes, many counties labeled this line item as "Teachers' Retirement Fund.") In 1995, the legislature decided to put all net lottery revenues into the state general fund, as it does today under 23-7-402, MCA. There the money becomes part of the general appropriation process with no strings attached. Over the past decade, lottery transfers to the general fund averaged $8.8 million a year. Even if they were earmarked for TRS, lottery revenues would cover only a portion of the $28-$30 million needed each year to pay down TRS' unfunded liability.

The mission of the TRS Board is to promote long-term financial security for our membership while maintaining the stability of the fund.

THIS ISSUE

Just Fund It— Several people have suggested that the state should simply contribute the total amount needed to put TRS back on actuarially sound footing—about $633 million. Even if that were possible, by itself such a move doesn't fully stabilize the fund over the long term. The reality is that some modest structural changes are needed to better align TRS with current demographic and economic trends. For example, people are living longer, in some cases drawing retirement benefits for more years than they were employed. Raising the eligible age for early and regular retirement to match longevity trends, and perhaps requiring 30 years of service instead of the current 25, would help stabilize TRS assets and prevent a relapse to where we stand today. As with other possible changes, any increase in retirement age can be phased in to avoid affecting people nearing retirement.

See page 3 for a chart of alternatives and their estimated effect on reducing TRS' 3.53% funding shortfall. Then let us know which alternatives you can live with by taking our easy online survey at:

www.surveymonkey.com/s/R82MJSQ

Tell us what you think!

Debunking Recent Rhetoric

Tall tales and distortions continue to percolate through conversations about public pensions. Let's examine some of these claims and shed light on the facts that debunk them.

Claim: Public employee pensions are bankrupting Montana.

Facts: In Montana, taxpayer contributions to public pensions account for 2.27% of all state and local government spending. That's below the national average of 2.89%. (For comparison, health and human services costs make up 40% of state spending.) The vast majority of TRS' revenues—about 70%—come not from state coffers but from investment returns and monthly contributions from teachers' paychecks. Also, retirement benefit payments are subject to taxation, so a portion of benefits returns to the state general fund.

Claim: Expecting investment returns of nearly 8% is unrealistic.

Facts: TRS' expected rate of return on investments (7.75%) is based on the professional advice of our actuaries and fund managers at the Montana Board of Investments. As a pension plan, TRS invests over a much longer term than the typical individual investor. Short-term losses may reduce the asset pool, but markets rebound and, over time, replenish assets. Over the past 20 years (a span that includes the market collapse of 2008-2009 and two other recessions), TRS' average annual rate of return was 8.03%, exceeding our expected rate of 7.75%. TRS invests for the long haul, not for short-term gains over 5 or 10 years. Established 75 years ago, TRS typically looks 50 years down the road to ensure today's teachers will have a secure retirement.

Claim: TRS' unfunded liability is a millstone around taxpayers' necks. We should close the Defined Benefit (DB) plan and move to a Defined Contribution (DC) plan.

Facts: Closing the DB plan and moving to a DC plan would reduce contributions into the DB plan and do nothing to pay down the unfunded liability. The state would still be liable for benefits payable until the last benefit recipient under the DB plan is gone. The state and school districts would also have to fund contributions into the new DC plan. Taxpayers would be funding two retirement systems, and overall costs (paid from tax dollars) would skyrocket. Dismantling the existing DB plan would almost certainly trigger lawsuits, adding yet another layer of costs. Finally, such a move would impair Montana's ability to recruit and retain the best career-minded teachers. A hybrid DB/DC or cash-balance plan for new hires might make sense if carefully designed.

Claim: Taxpayers working in the private-sector don't have lavish retirement plans. Neither should teachers.

Facts: The Montana Teachers' Retirement System is designed to provide retirement *security*, not lavish wealth. In 2011, the average annual benefit for a TRS retiree was $24,785, or $2,065 a month. That money is subject to income tax, and it also ripples back into Montana's economy, each $1 supporting $5 to $7 in economic activity. The rub shouldn't be that teachers pay into and receive retirement benefits, but that a third of American workers ***don't*** have access to an employer-sponsored retirement plan, and less than half participate in a retirement plan at all. Retirees without pensions are nearly 7 times as likely to live at or below the federal poverty level (annual income of $14,710 for a household of two)—and are 3 times as likely to receive public assistance. In short, taxpayers end up bearing the costs for many private-sector retirees. Far from helping taxpayers and private-sector workers, dismantling retirement security for public employees would only drive down economic trends for all Montanans.

"Happy is the person who knows what to remember of the past, what to enjoy in the present, and what to plan for in the future."

~ Arnold H. Glasow

TRS Receives Excellence Award

For the fifth consecutive year, TRS has again been awarded a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association of the United States and Canada. The award recognizes government agencies for financial reporting that fulfills the "spirit of transparency and full disclosure."

TRS earned the latest certificate for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2010. "Receiving this award for five years running reflects the professionalism and conscientiousness of TRS' accounting staff, in particular our Fiscal Manager, Dan Gaughan," said David Senn, TRS Executive Director. "Dan goes above and beyond to deliver outstanding service to our members." The most recent CAFR and other reports on the 43,000-member retirement system are available online at www.trs.mt.gov.

TRS also recently received a Public Pension Standards Award from the Public Pension Coordinating Council. The award acknowledges that TRS meets professional standards for plan administration.

Take the quick survey on TRS Funding Alternatives at www.surveymonkey.com/s/R82MJSQ

Stabilizing the TRS Fund: Exploring the Alternatives

The Montana Teachers' Retirement System has a $1.8 billion unfunded liability.

Current statutory contribution rates already fund two-thirds of that liability, leaving a shortfall of about **$633 million.**

Based on the 2011 actuarial valuation, this represents a **3.53%** gap between current contribution rates and being actuarially funded over a 30-year amortization period. That's about $60 million for the 2015 biennium.

How to erase that 3.53% shortfall?

- Increase contribution rates,
- Reduce benefit rates,
- Secure a new source of revenue, or
- Find a workable combination of all three.

The challenge for Montana is far less dire than in Rhode Island, Illinois, or California. Those states are just now tackling issues that Montana addressed years ago.

However, unless the 2013 Legislature enacts corrective measures, the unfunded liability will grow, doubling in the next 20 years, and the TRS pension fund will run out of money by 2055.

Prudent, relatively small changes now can avert the need for more drastic measures later.

Changes can be phased in to avoid harming those nearing retirement. The system can also be made more resilient to financial and demographic trends.

Based on strategies adopted in other states, TRS has identified the following alternatives for consideration as we explore ways to pay down the unfunded liability. Actuaries Cavanaugh MacDonald, LLC, calculated the impact each alternative would have on reducing TRS's current 3.53% funding shortfall (as of July 1, 2011). **These effects are not necessarily additive.** Also, as time passes, the actual numbers may change due to market gains or losses and other factors. Nevertheless, the information given here provides a reasonable basis for weighing the alternatives. AS YET, NO CHANGES HAVE BEEN MADE OR PROPOSED. Any such changes would require legislative action.

Alternative	Existing Plan	Change to:	Reduces Shortfall By:
Raise Employee Contribution Rate	7.15%	7.65% (+0.5%)	0.37%
		8.15% (+1.0%)	0.81%
Raise Employer Contribution Rate	7.47%	8.47% (+1.0%)	1.0%
Raise State General Fund Rate	2.49%	3.49% (+1.0%)	1.0%
Raise Average Final Compensation	3 years	5 years	0.91%
Reduce Multiplier	1.667%	1.50%	2.17%
Reduce Guaranteed Annual Benefit Adjustment	1.50%	1.25%	0.39%
Raise Vesting	5 years	10 years	0.10%
Raise Early Retirement	Age 50 & 5 yrs	Age 55 & 5 yrs	0.05%
Raise Regular Retirement	Age 60 w/5 yrs, or 25 yrs	Age 60 w/5 yrs, or 30 yrs	0.87%
		Age 65 w/5 yrs, or 30 yrs	1.94%

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How Might Possible Changes Affect TRS Members?

We're asking you, as a TRS member, to consider what sorts of possible changes to the pension plan you might accept. To help inform your thoughts on the matter, the table on page 3 shows the effect each alternative would have on the TRS system as a whole. But how might possible changes to contribution and benefit rates impact ***you*** as an individual member?

Let's look at the numbers, based on a salary of $40,000 and an annual benefit of $20,000. ***These numbers are for informational purposes only. Actual results would vary depending on each member's actual salary and benefit amounts. AS YET, NO SUCH CHANGES HAVE BEEN MADE OR PROPOSED.***

Alternative	Effect on "Average" TRS Member
Raise employee contribution 0.5%	Pay $200 a year more into TRS fund
Raise employee contribution 1.0%	Pay $400 a year more into TRS fund
Reduce GABA to 1.25%	Reduces GABA from $300 to $250, a loss of $50 for the year
Reduce multiplier to 1.5%	Reduces future annual retirement benefit by $2,000

Possible Changes to New Hires: Creating a Two-Tier Plan

To stabilize long-term funding, other states have adjusted contribution and benefit rates and modified other plan elements for new hires. Such changes may be easier to enact because new hires do not have pre-existing contract rights. TRS may consider changes that affect new hires to make the system more cost-efficient and sustainable over the long term. Possible changes may include:

- Increase employee contribution rate
- Increase employer contribution rate
- Raise Average Final Compensation from 3 to 5 years
- End 25-year retirement at any age
- Raise regular retirement to 30 or 35 years
- Raise regular retirement to age 60 or 65
- Set regular retirement on a "rule of 90" where age and years of service sum to 90.
- Raise early retirement to age 55
- Change the multiplier (currently at 1.667%)
- Increase vesting period to 7 or 10 years
- Suspend or reduce cost-of-living adjustments

A small number of new hires enroll in TRS each year, typically at the low end of the pay scale. Small numbers mean that any changes to new hires will have a small impact on TRS' fiscal status.

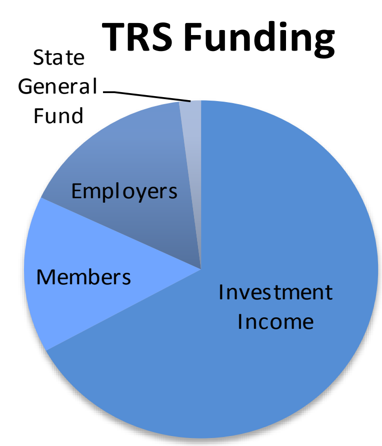
Changes to new hires alone will not pay down the unfunded liability before TRS runs out of money.

TRS Funding Sources

TRS is funded through contributions from the following sources:

- 7.15% of members' monthly paychecks
- 7.47% of employer monthly TRS-reportable payroll
- 2.49% of TRS-reportable payroll from state general fund
- 4.72% of total university system Optional Retirement Program payroll

Investment income makes up 60% to 70% of TRS' revenues. Over the last 20 years, TRS' average annual rate of investment return has been 8.03%, exceeding its expected rate of 7.75%.



In compliance with the Americans with Disabilities Act of 1992, alternative accessible formats of this newsletter will be provided upon request.

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Understanding Your Retirement Plan: A TRS Glossary

At TRS, we encourage you to take ownership of your retirement. This is never more important than when changes to the plan are being considered, as they are now. You can help shape those changes. The more you know about how your pension plan works, the better you can advocate for your interests. Let's define some key concepts.

Actuarial Method: Actuaries are "social math" experts. They study data on how many years we work, how long we live, how much we earn, and other trends. Based on this information and carefully calculated assumptions, they then predict the effect of future events on the pension plan. No one knows for certain what the future will bring, but time-tested methods help ensure that actuarial forecasts are as accurate as possible.

Actuarial Accrued Liability (AAL): A pension's liability is the money (benefits) promised to its members. That liability accumulates or *accrues* as members and employers pay into the plan with the expectation of receiving benefits at some future date. As such, the liability is a natural feature—not a pitfall—of a defined benefit pension plan. "Actuarial" simply means that actuaries estimate the amount of the accrued liability by taking into account trends in longevity, retirement age, salary and contribution rates, investment earnings, total plan assets, and other factors.

Unfunded Actuarial Accrued Liability (UAAL): The portion of the AAL that exceeds current assets. The unfunded liability does not come due all at once and can be paid down over time.

Amortization: To gradually pay down or *amortize* a debt (such as a home mortgage or pension liability), experts calculate the amount that must be paid on a regular (often monthly) basis over the life of the debt. This spreads payments evenly over time. A pension's liability differs from a mortgage in that the liability typically grows to reflect rising salary trends. The Governmental Accounting Standards Board (GASB) recommends unfunded liabilities be amortized over 30 years or less.

Guaranteed Annual Benefit Adjustment (GABA): Retirees living on a fixed income often struggle to make ends meet as the cost of living rises from year to year. To adjust for this, TRS benefit recipients get a small yearly increase known as a GABA. To qualify, you must have received benefits for at least 36 months before January 1 of each year. The current GABA is 1.5% of your annual benefit amount.

Normal Cost: Active members earn benefits each year, which becomes a liability for the pension fund—a cost that must be met in the future. Actuaries call this the *normal cost.* The *total* normal cost is the value of benefits expected to accrue in the current fiscal year. TRS members pay 7.15% of the normal cost and employers pay 7.47%.

Still with us? Hang in there—just two more definitions to go.

Statutory Contributions: The TRS pension fund receives contributions from several sources, as set out in state law (see the pie chart on page 4). Members contribute 7.15% of their gross monthly paycheck, employers (mainly school districts) contribute 7.47% of their monthly payroll, and the state general fund contributes 2.49% of monthly earned compensation within TRS, for a total of 17.11%. In addition, the university system contributes 4.72% of total monthly payroll of university system employees who are in the Optional Retirement DC Program. This supplemental rate offsets the funding lost when certain university system members were allowed to leave TRS and enroll in a DC plan. These contributions, as percentage rates, are set by the legislature and specified in Title 19, Chapter 20, of the Montana Code Annotated.

"To be 70 years young is sometimes far more cheerful and hopeful than to be 40 years old."
~ Oliver Wendell Holmes

Vesting: A member becomes *vested*—entitled to ownership of his or her benefits—by working a specified period of time. Currently, TRS members are vested after 60 months (5 years) of service in a position reportable to TRS.

TRS Board Members

Member	Term Expires	Email
Kari Peiffer, chair *Active classroom teacher, Kalispell*	July 1, 2012	KPeiffer@mt.gov
Darrell Layman, vice chair *Retired teacher, Glendive*	July 1, 2016	DLayman@mt.gov
Jeff Greenfield *Active member, Shepherd*	July 1, 2016	JGreenfield@mt.gov
Scott Dubbs *Active member, Lewistown*	July 1, 2013	SDubbs@mt.gov
Robert Pancich *Public member, Great Falls*	July 1, 2014	RPancich@mt.gov
James Turcotte *Public member, Helena*	July 1, 2015	JTurcotte@mt.gov

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Teachers and students at Adobe Town School, near Virginia City, MT, 1866.

Upcoming Events

March 1, 2012 — TRS Outreach Forum, Billings Public Schools
May 11 — TRS Board meeting, Helena

RETIREES! PLEASE KEEP TRS UP TO DATE!

If you've moved, we need your current mailing address. Go to www.trs.mt.gov and print Change-of-Mailing-Address Form 116. Send us the completed ORIGINAL form (we cannot accept copies).

Historic Dates in Montana Education

1862 - Montana's first formal school holds classes at Fort Owen in the Bitterroot Valley

1863 - Schools welcome students in Nevada City and Bannack

1875 - The Madison County Teachers' Institute, Montana's first professional educators' training organization, established

1876 - A three-year high school program begins in Helena

1878 - The Montana Collegiate Institute, the Territory's first institution of higher education, opens its doors in Deer Lodge

1879 - Montana's first graduating high school class (three young women) receives diplomas in Helena

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