

## Changes on Your January Retirement Check

When you receive your 2006 January retirement check/check stub the net amount may look different due to changes in withholding tables and Guaranteed Annual Benefit Adjustment (GABA).

The federal income tax tables changed effective January 1, 2006. In addition, eligible retirees will receive a 1.5% GABA increase in their January 2006 benefit. Your January 2006 retirement check/check stub will reflect these changes.



“And in the end it’s not years  
in your life that count.  
It’s the life in your years.”

*Abraham Lincoln*

## Teachers' Retirement System 2006 Newsletter

The TRS newsletter is published with budgeted TRS Funds to update members and benefit recipients on news and to provide general information about benefits that affect them. Specific information is available in the Summary of Information handbook or by contacting the TRS office.

If you need this document in an alternative format such as large print, Braille, audio tape, or computer diskette, or you need any other disability-related accommodation, please contact Alison Peterson at 406 444-3134 or TTY or Relay Service number, 711.

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# Montana Teachers' Retirement System



## 2005 Special Session - TRS Unfunded Liability

### Introduction

The Governor's special session call included three items related to the public employee retirement systems:

- An appropriation of \$100 million from the general fund to the Teachers' Retirement System to both reduce the unfunded liability of the system and to help improve Montana's ability to recruit and retain qualified teachers;
- An appropriation of \$25 million from the general fund to the Public Employees' Retirement System to help reduce the unfunded liability of the system and;
- Assign to the State Administration and Veterans' Affairs Interim Committee responsibility for monitoring the public retirement plans and reviewing legislative proposals.

The following sections, primarily focus on the Teachers' Retirement System (TRS), provide background information, a description of the legislative actions, and a discussion of what was accomplished and what remains to be done.

### Background

#### Unfunded Liabilities

Biennially an Actuary performs a study, called an Actuarial Valuation, to determine the financial position of the TRS. The Actuary calculates the System's liabilities and determines if the current contribution rates are sufficient to amortize any under funded liabilities [referred to as Unfunded Actuarial Accrued Liabilities (UAAL)] over no more than 30 years. The issue before the Legislature in the special session was that the UAAL in the following retirement systems could not be amortized over 30 years or less:

PERS – Public Employees Retirement System

TRS – Teachers' Retirement System

SRS – Sheriffs' Retirement System

GWPORS – Game Wardens' and Peace Officers' Retirement System

An "unfunded actuarial accrued liability" refers to the excess of a retirement plan's *actuarial liability* over the *actuarial value of assets*. *Actuarial liability* is the amount that the retirement system expects to pay out over the long-term not provided for by future contributions. *Actuarial value of assets* is the market value assets, adjusted for a five-year phase in of investment gains and/or losses in excess of the actuarial assumed rate of 7.75%, as used by the actuary for the purpose of an Actuarial Valuation. Both components of the equation are based upon many assumptions and represent the Actuary's best estimates of the plan's financial position and what it will take to keep the plan on solid ground.

Article VIII, Section 15 of the Montana Constitution provides that "Public retirement systems shall be funded on an actuarially sound basis". This constitutional requirement drives the

need for the state to address the issue of an unfunded liability in the 2007 Session to find a long-term solution to the current under funding condition. In addition, public employee retirement benefits are protected under the Montana Constitution and therefore, current members and retirees are in no danger of losing their benefits or having benefits reduced.

#### Scope of the Problem

The four retirement systems listed above have actuarial accrued unfunded liabilities that, as of July 1, 2005, can not be amortized over 30 years or less, as the Montana Constitution requires for the retirement plan to be actuarially sound. As of July 1, 2005, the total unfunded actuarial accrued liability for the TRS was about \$903.3 million, while the TRS had assets of over \$2.5 billion.

To satisfy the 30-year amortization requirement, the legislature does not need to provide the entire \$903.3 million. What is needed is a plan to reduce the unfunded liability to a level that can be amortized within the 30 years, either by increasing the system's assets (cash infusion), and/or increasing the revenue into the system (contributions or investment earnings). The solution must provide a plan to pay down the unfunded liability within 30 years, and the retirement systems could then be viewed as "actuarially sound". The 2005 Special Session addressed only a portion of the problem, an infusion of \$440 million was necessary to pay down the unfunded liability to a level that could be amortized within 30 years. The Legislature appropriated \$100 million to the TRS during the special session.

### Where did the Unfunded Liability Come From?

Investment losses are the primary reason for the current unfunded liability problem. In the period of 2001 through 2003, those returns were much lower than the actuarial assumptions, and in two of the three years were negative. Asset gains or losses result when the return on the actuarial value of assets differs from the actuarial investment return

assumption of 7.75% (8.0% before July 1, 2004). Under state law, all assets are invested by the State Board of Investments.

The 2005 Actuarial Valuation indicates that the actuarial return on assets has under performed the assumption by over 20% in the last five years (combined). Over these five years, the asset losses have increased the UAAL by about \$500 million. The drop in value of the equity market (stocks) is the major culprit. In addition, the passage of TRS 1.5% per year Guaranteed Annual Benefit Adjustment (GABA) in 1999, funded with increases in contributions (0.106% employee and 0.11% State) and extending the amortization period to pay off the UAAL from 9.2 years to 25.5 years, contributed to the present situation. The 1999 present value cost of the GABA was approximately \$216.4 million.

The GABA legislation had its roots in the 1991 session when the Legislature created an interim committee to examine public retirement issues and **especially** to develop a proposal to provide post-retirement adjustments to public retirees. A bill to provide post-retirement increases was introduced in the 1993 Session and in the 1995 Session, but each failed. In 1997, the Legislature adopted HB 170, which provided a 1.5% GABA for the eight public retirement systems administered by the Public Employees' Retirement Board. In 1999, the Legislature adopted HB 72 granting TRS retirees a 1.5% GABA.



It should be pointed out that investment gains, contribution rate increases, and increasing the amortization periods have historically been used by legislatures all across the country to fund benefit enhancements. Montana is not alone in funding benefits using enhanced market values, nor is it alone in having experienced significant investment losses. Montana is also not the only state seeking solutions to actuarially fund its public pension plans.

### Special Session Legislative Action

The Governor's special session call presented a fairly straightforward first step approach toward resolving the unfunded liability issue. Two retirement related proposals were enacted.

First, the special session enacted legislation, HB 2, to give the State Administration and Veterans Affairs (SAVA) interim committee the additional duties and responsibilities for monitoring all public employee retirement systems and reviewing any proposed legislation. It includes an appropriation of \$5,000 general fund to finance a couple of additional meeting days for the SAVA committee during the 2005-2006 interim. The SAVA committee meeting schedule is available at: [http://leg.state.mt.us/css/committees/interim/2005\\_2006/st\\_admin\\_vet\\_affairs](http://leg.state.mt.us/css/committees/interim/2005_2006/st_admin_vet_affairs).

Second, the Legislature appropriated \$125 million general fund to reduce the unfunded liability of the TRS and PERS. This appropriation was included in HB 1, the bill that was also the vehicle for the school funding appropriations. The Legislature appropriated \$100 million from the general fund to the Teachers' Retirement System, and an additional \$25 million from the general fund to the Public Employees Retirement System.

### What Remains to Be Done?

The fact that unfunded liabilities continue to exist in excess of the level that can be amortized over 30 years or less means that there is still work for the Legislature to do. Between now and the 2007 Session, the Teachers' Retirement Board looks forward to working with the TRS active and retired members, the Governor and the Legislature to consider all alternatives to restore the TRS to a sound actuarial funding position as required by the Montana Constitution. In the mean time the TRS has over \$2.5 billion in assets and no one is in danger of losing their benefits or having benefits reduced. While this is a problem that must be addressed during the 2007 Session, we have the advantage of solving this problem over a long period of time.



### What Your Beneficiary Needs to Know

If you die, would your beneficiary know what to do or whom to contact regarding your TRS retirement. Is your beneficiary aware that you designated him or her? Or, perhaps you have named someone other than your beneficiary to handle your affairs. In the event of your death, your beneficiary or other designated person should follow these simple steps:

- Contact the TRS Retired Payroll Department at 406 444-3185;
- Telephone your employer's personnel office and;
- Be prepared to provide a copy of your death certificate to TRS.

The Retired Payroll Department will respond to the notification of your death with all the information your beneficiary will need to proceed.

### What Working Retirees Need to Know

House Bill 104 passed during the 2005 Session changing when benefits are cancelled for working retiree's in a part-time position. This legislation also adds a dollar-for-dollar benefit reduction when a working retiree exceeds the maximum amount they are allowed to earn.

# SUMMARY INFORMATION

## Montana Teachers' Retirement System

June 30, 2005

### Member Information

The Montana Teachers' Retirement System (TRS) provides retirement and other benefits to teachers and administrators of more than 350 school districts, state agencies, and the university system. The TRS is a defined benefit plan qualified under Section 401(a) of the Internal Revenue Code. Members and employers both contribute to the TRS, with members contributing 7.15% of their salary and employers contributing 7.47% of all wages reported each month.

	FY 2005	FY 2004	FY 2003	FY 2002	FY 2001
Active Members	18,247	18,257	18,285	17,262	18,530
Inactive Vested Members	1,640	1,607	1,519	1,611	1,359
Benefit Recipients	10,299	9,970	9,682	9,342	9,016
Average Age at Retirement	58.26	57.95	57.2	57.14	57.01
Average Benefit	\$1,392.50	\$1,283.33	\$1,187.00	\$1,082.92	\$987.00

### Financial Information

TRS is subject to very strict operational controls. Well established internal controls are in place, segregation of duties is maintained, and an annual external audit is performed and the results are reported to the Legislative Audit Committee. The auditor's opinion was unqualified for the year ended June 30, 2005. The table below summarizes TRS's revenues and expenses for the current and prior fiscal years:

	FY 2005	FY 2004	\$ Increase (Decrease)	% Increase (Decrease)
Investments (market value)	\$ 2,540,556,693	\$ 2,362,541,002	\$ 178,015,691	7.53%
Total Assets (1)	\$ 2,594,384,124	\$ 2,464,034,432	\$ 130,349,692	5.29%
Employer Contributions	\$ 57,150,364	\$ 55,773,716	\$ 1,376,648	2.47%
Employee Contributions	\$ 52,900,262	\$ 51,494,174	\$ 1,406,088	2.73%
State General Fund Contribution	\$ 655,812	\$ 659,146	\$ (3,334)	(0.51%)
Appreciation (Depreciation) in Market Value of Investments	\$ 112,888,982	\$ 152,473,601	\$ (39,584,619)	(25.96%)
Net Investment Earnings	\$ 188,734,373	\$ 281,792,993	\$ (93,058,620)	(33.02%)
Total Additions (2)	\$ 299,440,909	\$ 389,720,281	\$ (90,279,372)	(23.17%)
Benefit Payments & Withdraws	\$ 165,587,748	\$ 156,113,866	\$ 9,473,882	6.07%
Administrative Expenses	\$ 1,560,820	\$ 1,506,694	\$ 54,126	3.59%
Total Deductions (3)	\$ 167,148,568	\$ 158,510,342	\$ 8,638,226	5.45%

1. Total assets increased primarily due to the increase in the number of investment units held and an increase in the market value of investments held.
2. Additions decreased due to a decrease in net investment earnings and a decrease in the appreciation of investments.
3. Deductions increased because the average benefit increased from the previous year, as did the number of retirees receiving benefits throughout the year.

### FY 2005 Financial Highlights

- The TRS plan net assets increased by \$132.3 million representing a 5.6% increase for the fiscal year ended June 30, 2005.
- Total contributions to the plan also increased by 2.6% from the previous year from \$107.9 million to \$110.7 million.
- Net investment income (fair value of investments plus investment income less investment expense) showed a decrease of \$93.1 million from the previous year. Representing a decrease of approximately 33%.
- Pension benefits and withdrawals paid to beneficiaries and plan members totaled \$165.6 million for the fiscal year, an increase of 6.1% from the previous year.

# SUMMARY INFORMATION

## Montana Teachers' Retirement System

June 30, 2005

### Investments

The TRS investment portfolio posted an overall return of 8.04%, resulting in an increase in the fair market value of its investments. The System's total annualized rate of return over the last 5 and 10 years was 2.81% and 7.36% respectively. This rate of return compares with an actuarial assumed rate of 8% through June 30, 2004 and 7.75% effective July 1, 2004. The Board of Investments (BOI) invests the TRS and other pension portfolios for the long-term. Performance in any given year is dependent not only on the BOI's investment performance and the asset allocation they have adopted, but also on the performance of the markets themselves, which are impacted by domestic and global economic conditions, interest rates, and government policies. The following table illustrates the net annual returns realized by the BOI since 1990.

Fiscal Year Ending	Market Returns	Fiscal Year Ending	Market Returns
June 30, 1990	9.6%	June 30, 1998	16.6%
June 30, 1991	9.4%	June 30, 1999	11.9%
June 30, 1992	14.3%	June 30, 2000	7.8%
June 30, 1993	11.1%	June 30, 2001	(5.1%)
June 30, 1994	2.3%	June 30, 2002	(7.3%)
June 30, 1995	15.7%	June 30, 2003	6.2%
June 30, 1996	12.4%	June 30, 2004	13.3%
June 30, 1997	19.4%	June 30, 2005	8.04%

The asset losses over the last five years have increased the Unfunded Actuarial Accrued Liability (UAAL) by about \$500 million. The root of these losses is the negative market returns of 5.1% and 7.3% in the years ending June 30, 2001 and June 30, 2002.

### Funding Status

The overall objective of a pension fund is to accumulate sufficient funds to meet all expected future obligations to participants. The member contribution rate 7.15%, the employer contribution rate 7.47% and the State General Fund Contribution 0.11% are established by statute. The rates are intended to be sufficient to pay TRS's normal cost and to amortize TRS's UAAL over a period of 30 years from the valuation date. As of July 1, 2005, the existing rates are **not** sufficient to amortize the UAAL over 30 years. A 30-year period is the maximum amortization period allowed by the Governmental Accounting Standards Board (GASB) Statement 25 in computing the Annual Required Contribution (ARC). The 30-year period is in common use for public-sector plans and is considered reasonable by the Board.

In order to determine the adequacy of the statutory contribution rates, it is compared to the GASB Statement 25 ARC. The ARC is equal to the sum of (a) the normal cost, and (b) the level percentage of pay required to amortize the UAAL over a 30-year period. For this calculation, payroll is assumed to increase 4.50% per annum. As of July 1, 2005, the ARC is 18.79%. This is more than the 14.73% rates currently required by law. The shortfall (the negative margin) between the rates mandated by law and the rate necessary to fund the UAAL in 30 years is 4.06%.

The funded ratio (the ratio of the actuarial value of assets to the actuarial accrued liability) decreased from last year. The funded ratio at July 1, 2004, was 76.6%, while it is 73.4% as of July 1, 2005. This decrease is due primarily to the two factors, recognition of unrealized losses resulting from market declines in fiscal years 2000, 2001 and 2002, and retirement experience losses caused by more retirees retiring earlier and at younger ages than expected.

The following table summarizes the 2005 Actuarial Valuation of the TRS. A detailed discussion of funding is provided in the TRS Annual Report. This report can be found on the TRS website at [www.tris.mt.gov](http://www.tris.mt.gov), or by calling the TRS, 406 444-3134 and requesting a copy.

	July 1, 2005 (in millions)	July 1, 2004 (in millions)
Actuarial Accrued Liability	\$3,400.8	\$3,243.5
Actuarial Value of Assets	\$2,497.5	\$2,485.7
Unfunded Actuarial Accrued Liability	\$ 903.3	\$ 757.8
Funded Ratio	73.4%	76.6%

# Attention Benefit Recipients...Understanding Your 1099-R

In January, the TRS will mail your 1099-R form. You will need this form to file your income tax return. The 1099-R provides the following information for the 2005 calendar year:

- Total gross distribution (the gross amount you received from the TRS in 2005);
- Taxes withheld and;
- Total taxable amount.

The graphic below outlines important sections of your 1099-R form. If you have questions regarding your form, you must contact your tax advisor.

**1**  
The total amount paid to you by TRS for calendar year 2005.

**2a**  
The portion of your total benefit received during calendar year 2005 that should be considered taxable income.

**4**  
The total amount of federal income tax (FIT) withheld during calendar year 2005.

**5**  
Difference between Box 1 and Box 2a. Cost basis (taxed contributions) recovered during calendar year 2005.

Form 1099-R		<input type="checkbox"/> CORRECTED (if checked)		2005	
1 Gross distribution		2a Taxable amount		Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.	
\$		\$			
2b Taxable amount not retained		Total distribution			
PAYER'S name, street address, city, state, and ZIP code					
TEACHERS' RETIREMENT SYSTEM 1500 E 6 <sup>TH</sup> AVE PO BOX 200139 HELENA MT 59620-0139					
PAYER'S Federal identification number			RECIPIENT'S identification number		
81-6024912					
3 Capital gain (included in box 2a)		4 Federal income tax withheld		5 Employee contribution (cost basis)	
\$		\$		\$	
6 Net unrealized appreciation in employer's securities		7 Distribution code		8 Other	
\$		IRASEPT SIMPLE <input type="checkbox"/>		\$	
9a Your percentage of total distribution			9b Total employee contributions		
			% \$		
RECIPIENT'S name and Street address (including apt. no.) city, state, zip code					
Account Number (optional)				10 State tax withheld	
				\$	
11 State/Payer's state number				12 State distribution	
MT 321021				\$	
13 Local tax withheld		14 Name of locality		15 Local distribution	
\$				\$	
Department of the Treasury Internal Revenue Service					
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**7**  
Code identifying the type of benefit being paid - normal, disability, death, ect. Codes are listed on the back of Copy C.

**9b**  
Total cost basis (taxed contributions). Listed for new benefit recipients only.

**10**  
The total amount of Montana state income tax (SIT) withheld during calendar year 2005.

**Account Number** (optional)  
Total health insurance premiums deducted from benefit payments during calendar year 2005.

## Contact Information

**Internal Revenue Service**  
Phone: 800 829-1040  
[www.irs.gov](http://www.irs.gov)

**Montana Department of Revenue**  
Phone: 406 444-6900  
[www.mt.gov/revenue](http://www.mt.gov/revenue)