LC No. _____
HB/SB _____[1]

REPORT AND RECOMMENDATION OF THE STATE ADMINISTRATION AND VETERANS' AFFAIRS INTERIM COMMITTEE (SAVA) TO THE 2013 LEGISLATURE AS OF NOVEMBER 2012[2]

Proposal No. 2
Proposing Entity: Association of Montana Retired Public Employees (AMRPE)
Short Title: Funding From Coal Severance Taxes for Actuarially Unsound Retirement Systems

Retirement system(s) affected
Public Employees' Retirement System (PERS)
Teachers' Retirement System (TRS)
Game Wardens' and Peace Officers' Retirement System (GWPORS)
Sheriffs' Retirement System (SRS)

Proposal summary
This proposal would require a portion of the expendable portion of the coal severance tax revenue to be deposited to the trust funds for the pension systems listed above. This is a reiteration of Rep. Janna Taylor's bill from the 2011 legislative session: HB 632.

Fiscal implications
A detailed fiscal analysis of the coal severance taxes as a viable source of revenue is needed. According to estimates by the governor's budget office with respect to Governor Schweitzer's pension proposal for PERS only, about $18 to $20 million would be available in the first year from the coal severance taxes and would be diverted from the general fund to the retirement systems. This amounts to about 1.2% of payroll in PERS only. PERS alone has a funding shortfall as of the FY 2012 actuarial valuation of 6.53% of payroll.

As of the FY 2012 actuarial valuations, the following table shows which MPERA systems are considered actuarially unsound and the shortfall of funding, as a percentage of payroll and as a flat dollar amount (using the covered payroll as of June 30, 2011), that needs to be paid in order to amortize the systems' unfunded liabilities in 30 years.

[1] This report summarizes SAVA's recommendation to the Legislature as of November 2012. The report is not a summary of a bill, but of a retirement proposal as presented to SAVA during the interim. The specifics of the proposal summarized may have changed during the subsequent drafting and legislative processes.

[2] Report issued pursuant to 5-5-228, MCA.

System	Percent funded (ratio of assets to liabilities)	Shortfall as % of payroll each year	Shortfall as rounded dollar amount needed each year - not counting salary inflation factors
PERS	67.60%	6.53%	$ 70,600,000
SRS	74.30%	5.85%	$ 3,500,000
GWPORS	75.80%	3.64%	$ 1,400,000
HPORS	58.00%	5.780%	$ 720,000
TRS	59.24%	4.89%	$ 36,000,000
Total			$112,220,000

<u>Effect on other Montana retirement systems</u>
At the time HB 632 was introduced last session, the above listed retirement systems were the only actuarially unsound systems. Since that time, unfunded liabilities in the Highway Patrol Officers' Retirement System (HPORS) also cannot be amortized within 30 years.

<u>Soundness of the proposal as matter of retirement policy</u>
Article VIII, Sec. 15, of the Montana Constitution requires the retirement systems to be funded on an actuarially sound basis. In 1997, the legislature enacted Section 19-2-409, Montana Code Annotated (MCA), which interpreted "actuarially sound basis" to mean that any unfunded liabilities be amortized in 30 years or less for each of the retirement systems administered by the Montana Public Employee Retirement Administration (MPERA).

The proposal relates to the following policy principle and policy guideline adopted by SAVA:

- Principle II - pension funding should be a contemporary obligation; and
- Guideline E - the legislature should require contemporaneous funding of pension benefits to ensure that pension costs are not shifted to future taxpayers.

If unfunded liabilities amortize in 30 years or less, a system is considered to be actuarially sound because the debt is being funded within the working life of the members. However, a stricter interpretation of contemporary obligation is that all liabilities should be paid for so that the system is 100% funded and there are no unfunded liabilities to be amortized. In either case, if unfunded liabilities are not being amortized within 30 years, contemporaneous funding is not being provided.

<u>Comparison with other states</u>
According to a study by the Pew Center on States: "Experts such as those with the Government Accountability Office advise states to have at least an 80 percent funding level. In 2010, 34

states were below the 80 percent threshold, up from 31 in 2009 and just 22 in 2008. Connecticut, Illinois, Kentucky, and Rhode Island were the worst among the states, all under 55 percent funded in 2010. Four states were funded at 95 percent or better: North Carolina, South Dakota, Washington and Wisconsin. However, because these numbers are from 2010, they do not reflect reforms made since then, such as in Rhode Island."[3]

According to Bloomberg, as of October 24, 2011, the median funded ratio of state pension plans was about 75% in 2010, and Montana's PERS had the 19th lowest funded ratio at 70%. Wyoming, Utah, and South Dakota were listed among the 11 states with the highest funded ratios, which ranged from 86% to 101%.[4]

Legal implications[5]
This proposal does not raise any legal or contract impairment concerns.

Testimony received
The proposal was presented by Russell Wrigg, president of AMRPE. He said the bill would have to be tweaked to include the HPORS and any other unsound pension systems. Mr. Rigg said that because it was still unclear whether the governor was going to forward a proposal using coal severance taxes to fund the pension shortfalls, AMRPE thought it was prudent to present its proposal so that it would be considered as part of the mix of bills that will be forwarded. He said AMRPE members remain very concerned about their retirement benefits and that AMRPE wants to protect the benefits of current and future retirees.

Melanie Symons, legal counsel for MPERA, said that the legislative committee of the PERS board voted to approve and support this proposal and agrees that HPORS should be added.

David Senn, Executive Director of TRS, said the TRS Board supports the proposal and believes that it properly uses funding sources other than employer contribution increases first.[6]

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[3] Pew Center on States, "The Widening Gap Update", June 18, 2012. See http://www.pewstates.org.

[4] Bloomberg, "Under/Overfunded Pension Funds By State", October 24, 2011. See http://media.bloomberg.com/bb/avfile/rGvLr4jNCpxE.

[5] David Niss, Legal Memorandums dated May 21, 2012, January 5, 2012, August 14, 2009, August 28, 2009 (Addendum), and February 27, 1998, Montana Legislative Services Division, (406) 444-3064, or visit www.leg.mt.us and contact staff for the State Administration and Veterans' Affairs Interim Committee.

[6] State Administration and Veterans' Affairs Interim Committee meeting on August 8, 2012. Audio/video and summary minutes available from the Montana Legislative Branch website at http://www.leg.mt.gov.

Committee discussion and recommendations

Senator Dave Lewis questioned why the proposal did not just take the money from the general fund instead of using the "smokescreen" of the coal severance taxes. Committee discussion then turned to whether the proposal used only expected increases in coal production. In response to a question by Rep. Blyton, the committee discussed the fact that this proposal was one piece to what would need to fit with other pieces to make the system's goal. Sen. Lewis noted that there were technical concerns in the fiscal note about how the coal severance taxes were apportioned among the systems and that there would have to be some technical work on the bill before it was introduced as proposed.[7]

[7] Ibid.