MONTANA PUBLIC EMPLOYEES' RETIREMENT BOARD

TITLE: Funding and Benefit Policy

POLICY NO: BOARD Admin 01 EFFECTIVE DATE: 12/12/24

I. PURPOSE

The purpose of this Funding and Benefit Policy is to record the funding objectives and general principles governing the funding and benefits as set by the Montana Public Employees' Retirement Board (the Board) for the retirement systems under its jurisdiction. The Board is responsible for maintaining actuarially sound retirement systems and plans. As part of this responsibility, the Board must retain actuarial services from a competent actuary who is a Member of the American Academy of Actuaries and is familiar with public pension systems.

This policy is only a statement of intent and general approach. These are not precise rules that bind the Board to certain and specific actions.

II. POLICY REQUIREMENTS

A. The Board is charged with administrating the retirement systems in accordance with the provisions of Title 19 of the Montana Code Annotated. The Board is required to approve or disapprove all expenditures of the systems, prepare an annual actuarial valuation of the assets and liabilities of the systems, and perform other duties and functions as are required to properly administer and operate the retirement systems.

B. As fiduciaries the Board must administer its retirement systems and trust funds acting in the best interests of the members and beneficiaries.

C. Board members are subject to a constitutional fiduciary duty to fund retirement benefits, Article VIII, 15 of the Montana Constitution. The Constitution prohibits anyone from diverting the assets or the actuarially required contributions of the retirement systems. No employee or member of the retirement systems may have an interest in plan assets, borrow or use fund assets, or act as surety, obligor or endorser on loans to or by the systems.

D. The Montana Board of Investments (BOI) is charged with investing the Board's retirement systems' assets in accordance with state law and the state Constitution. The Constitution requires that the Board and the BOI operate under the "prudent expert principle". The Board's retirement systems have long-term horizons well beyond normal market cycles.

E. An actuarial experience study shall be completed by the Board's actuary at least every 5 years. The Board will adopt actuarial funding methods and assumptions based on the results of the experience study, the advice and recommendations of the Board's actuary, and in consultation with the MPERA executive team.

F. An actuarial audit report shall be prepared by an actuarial firm, other than the retained actuary, selected by the Board. The purpose of this report is to provide the Board with an independent assessment of the quality of the work of the retained actuary with respect to both process and reasonableness of assumptions and results and the reasonableness of the related fees. Such an audit shall be conducted in the fiscal year following the fiscal year each experience study has been completed.

III. FUNDING OBJECTIVES

The primary objectives are to: 1) ensure that the systems are financially sound and pay all benefits promised using assets accumulated from required employer and member contributions and investment income; and 2) achieve a well-funded status with a range of safety to absorb market volatility without creating a UAL.

IV. FUNDING REQUIREMENT

The Board's annual funding requirement is comprised of a payment on the Normal Cost (NC) and a payment on the Unfunded Actuarial Accrued Liability (UAAL). The Normal Cost and amount of payment on UAAL are determined by the following three core elements.

Actuarial Cost Method – the technique to allocate the cost/liability of retirement benefit to a given period. The Entry Age Normal Cost Method shall be applied to the projected benefits in determining the Normal Cost and Actuarial Accrued Liability (AAL).

Asset Valuation (Asset smoothing) - the technique that spreads the recognition of investment gains or losses over a period of time for the purpose of determining the Actuarial Value of Assets (AVA) used in the actuarial valuation process. The investment gains or losses of each valuation period result from the difference of the actual market return to the expected return on market value. The Board uses four year smoothing.

Amortization - the decisions on how, in terms of duration and pattern, to reduce the difference between the Actuarial Accrued Liability (AAL) and the Actuarial Value of Assets (AVA) in a systematic manner. The systems unfunded actuarial accrued liability should be amortized over a reasonable period of time and should not exceed 30 years on a rolling basis. Generally, the funding period should be constant or decreasing.

V. <u>GENERAL PRINCIPLES</u>

These general principles are established by the Board to provide a framework for the consistent evaluation of legislative proposals. The Board's position on proposed changes to benefits or systems will be determined on a case-by-case basis using these principles as guides. Some principles may not apply to the Public Employees' Retirement System's Defined Contribution Retirement Plan.

A. Legislation

1. **Proposals for increases or changes to retirement benefits must include an actuarially sufficient funding mechanism.** Proposals must provide funding from sources sufficient to cover future costs in perpetuity. Additional benefits may not be added to a defined benefit system unless the system amortizes in 30 years or less.

2. **Pension funding should be a contemporary obligation.** Whenever possible, pension funding should be the responsibility of the public employers, taxpayers and employees at the time services are provided. The Board will promote advanced funding of all benefits to ensure costs are not shifted to future taxpayers or contributors.

3. **Benefit enhancements should be equitably allocated among members, including retirees.** Any increased cost should be distributed among the generation of employers, taxpayers, and active members who receive the greatest benefit. Proposals should not discriminate against certain groups of members, including retirees, in favor of others or expend system assets disproportionately.

4. **A primary goal of a retirement system must be to provide a portion of financial security in retirement.** "Financial security in

retirement" refers to basic financial protection for those who are beyond their normal working years and whose ability to be gainfully employed and earn other income is limited or non-existent.

5. **Public retirement plans should provide portability of benefits for workers who change jobs within the state and its political subdivisions.** Portability provisions must assure that actuarial costs will be paid for by the member when transferring service between the systems.

6. **The level of benefits and eligibility for benefits should be equitable across the state's public employee retirement systems.** Differences in benefit levels and eligibility criteria should be based on objective differences in the nature of the covered occupations or differences in coordination with other benefits such as social security.

7. **Proposals should promote consistent administration of public retirement systems.**

8. **The Board supports steps to improve the Board's ability to evaluate and review disabilities and the eligibility for disability benefits.**

9. **The Board supports steps to promote informed legislative involvement and decision-making in the formulation of Montana's public pension policy.**

10. **Requests for Actuarial Information**
    To secure an actuarial contract at a reasonable rate, the Board will negotiate a provision limiting the cost the actuary will charge for calculating the actuarial impact of prospective legislation. To avoid unnecessary costs to the Montana Public Employee Retirement Administration (MPERA), MPERA will only request the actuary to calculate the actuarial impacts of legislative proposals that may have an actuarial impact on a system when:

    a) They are introduced as a formal House or Senate bill during a legislative session; or

    b) Legislative committees formally request an actuarial study of identified legislative changes they intend to pursue during a legislative session; or

    c) Deemed necessary by MPERA staff.

11. **Individual Requests for Actuarial Present Value**

a) Individuals requesting the present value of the retirement benefit will be encouraged to obtain the information themselves from an independent actuary or other competent professional; and,

b) Individuals who must obtain the present value of their retirement benefit from the Board's actuary will be billed the actual cost of obtaining that information.

B. Other Policy Considerations

1. **The Board aspires that the retirement systems it administers become 100% funded.** Once a system has achieved this goal, there needs to be a range of safety to absorb market volatility without creating unfunded actuarial liabilities.

2. **The Board will review existing funding levels for retirement systems with a funded ratio in excess of 120%.** The Board will consider a wide range of factors, both historical and prospective, in determining the range of safety required. Surplus funds that may become available may be applied toward the cost of benefit enhancements and/or contribution reductions provided sufficient reserves are retained to reasonably allow for adverse experience.

3. **It is the responsibility of the Board to report the financial solvency of the funds to the Legislature.** A single year's funded ratio, by itself, does not provide a measure of the direction the funding of the system is headed. However, either a trend which results in decreasing the funded ratio or the inability of the system to reduce the amortization period by one, for each passing year, may cause the Board to consider recommending rate increases and or system changes to address financial sustainability. It is desirable that the funded ratio improves over time, allowing for a decrease in the ratio following benefit enhancements.

4. **It is the obligation of the Board to recommend funding increases.** Whenever, through the use of long term cash flow projections, the amortization period of a system's unfunded liabilities is projected to exceed 30 years for two consecutive valuations and the Board can not reasonably anticipate that the amortization period would decline without an increase in funding sources, it is the obligation of the Board to recommend to the Legislature that funding be increased and/or

system changes to address financial sustainability.

VI. GLOSSARY OF FUNDING TERMS

ACTUARIAL ACCRUED LIABILITY (AAL) also referred to as ACTUARIAL LIABILITY: The portion of the Present Value of Benefits which will not be paid by future Normal Costs. It represents the value of past Normal Costs with interest to the valuation date. This is the amount of assets the plan would have today if the current plan provisions, actuarial assumptions and participant data had always been in effect, contributions equal to the Normal Cost had been made and all actuarial assumptions came true.

ACTUARIAL COST METHOD: allocates a portion of the total cost (PVB) to each year of service, both past service and future service, usually in the form of a Normal Cost and an Actuarial Accrued Liability.

ACTUARIAL GAINS AND LOSSES: A measure of the difference between actuarial experience and that expected based upon a set of Actuarial Assumptions during the period between two Actuarial Valuation dates, as determined by a particular Actuarial Cost Method. For example, if during a given year the assets earn more than the investment return assumption, the amount of earnings above the assumption will cause an unexpected reduction in UAAL, or “actuarial gain” as of the next valuation. Actuarial gains and losses include contribution gains and losses that result from actual contributions made being greater or less than the level determined under the policy.

ACTUARIAL VALUE OF ASSETS (AVA) OR SMOOTHED VALUE: The value of cash, investments and other property belonging to a pension plan as used by the actuary for the purpose of an actuarial valuation. The purpose of an Actuarial Value of Assets is to smooth out fluctuations in market values. This way long-term costs are not distorted by short-term fluctuations in the market.

ACTUARIAL VALUE FUNDED RATIO: the ratio of the AVA to the AAL.

ACTUARAL VALUATION: The determination, as of a specified date, of the Normal Cost, Actuarial Accrued Liability, Actuarial Value of Assets, and related Actuarial Present Values for a pension plan.

ENTRY AGE NORMAL ACTUARIAL COST METHOD: a funding method that usually calculates the Normal Cost as a level percentage of pay over the working lifetime of the plan’s members. VFCA calculates the Normal Cost as a level dollar amount over the expected service period.

MARKET VALUE OF ASSETS (MVA): the fair value of assets of the plan as reported in the plan’s audited financial statements.

MARKET VALUE FUNDED RATIO: the ratio of the MVA to the AAL.

NORMAL COST (NC): The portion of the Present Value of Benefits which is allocated to a valuation year by the Actuarial Cost Method.

PRESENT VALUE OF BENEFITS (PVB) OR TOTAL COST: the "value" at a particular point in time of all projected future benefit payments for current plan members. The "future benefit payments" and the "value" of those payments are determined using actuarial assumptions as to future events. Examples of these assumptions are estimates of retirement patterns, salary increases, investment returns, etc. Another way to think of the PVB is that if the plan has assets equal to the PVB and all actuarial assumptions are met, then no future contributions would be needed to provide all future service benefits for all current members, including future service and salary increases for current active members.

SURPLUS: If the UAAL is negative, this is usually referred to as a Surplus**.**

UNFUNDED ACTUARIAL ACCRUED LIABILITY (UAAL) also referred to as UNFUNDED ACTUARIAL LIABILITY (UAL): the excess of the AAL over the AVA.

VALUATION DATE: June 30 of every year.

VII. CROSS REFERENCE GUIDE

The following laws, rules or policies may contain provisions that might modify a decision relating to the Funding and Benefit Policy. The list should not be considered exhaustive - others may apply.

Montana Constitution Article VIII, Sections 13 and 15
Section 19-2-303, MCA
Section 19-2-403, MCA
Section 19-2-405, MCA
Section 19-2-408, MCA
Section 19-2-409, MCA
Title 19, Chapter 2, Part 5, MCA
ARM 2.43.1306

VIII. HISTORY

G9-92 General Principles Governing the Board's Evaluation of Legislative Proposals
Originally approved September 1992
Amended March 24, 2005

O8-93 Actuarial Experience Studies
Originally approved August 1983
To be Amended
O4-94 Actuarial Assumptions
Originally approved April 1994
Amended December 27, 2000 (O1-01)
O1-01 Actuarial Assumptions
To Be Amended
08-08 Annual Actuarial Evaluations
Originally approved 08-08
10-08 Financial Solvency
Originally Approved September 1992
Board Admin 02 Request for Actuarial Information
Originally Approved February 1989
Amended November 2012
Board Admin 01 Funding and Benefit Policy
Amended 06 2014
Amended May 2017
Amended August 2020
Amended December 2024