
Accelerate Actuarial Funding of Retirement Programs

**Presentation to the
Senate Budget and Taxation Committee
and the
House Appropriations Committee**

**Department of Legislative Services
Office of Policy Analysis
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For further information contact: Michael C. Rubenstein

Phone: (410) 946-5510

Analysis of the FY 2016 Maryland Executive Budget, 2015

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Corridor Funding Method and Supplemental Pension Contribution Should Both Be Repealed

The corridor funding method for the State Retirement and Pension System (SRPS) was enacted during the 2002 legislative session. It specifies that employer contribution rates for the Teachers' Combined Systems (TCS) and the Employees' Combined Systems (ECS) are frozen at fiscal 2002 levels as long as each system's funding level is between 90% and 110%. When a system's funding level falls out of that "corridor," the contribution rate increases by 20% of the difference between the previous year's rate and the "full actuarial rate" necessary to fully fund future payments. The ECS fell out of the corridor in fiscal 2005, and the TCS followed in fiscal 2006. Chapters 475 and 476 of 2013 phase out the corridor funding method over 10 years; by fiscal 2025, both systems will be restored to full actuarial funding.

Pension reform provisions of Chapter 397 of 2011 established a goal that SRPS would achieve an actuarial funding level of 80% within 10 years, in part by reinvesting savings generated by the pension reforms into the pension trust fund in the form of a "supplemental contribution." The original intent of the supplemental contribution was to narrow the gap between the amount contributed under the corridor method and the much higher amount that would have been contributed under full actuarial funding. In fiscal 2012 and 2013, the supplemental contribution equaled all but \$120 million of the savings generated, or roughly \$190 million each year. The supplemental contribution was supposed to increase permanently to \$300 million beginning in fiscal 2014, but Chapter 464 of 2014 altered the amounts. For each of fiscal 2014 and 2015, the supplemental contribution was set at \$100 million. Beginning in fiscal 2016, Chapter 464 increased the supplemental contribution by \$50 million each year until it reaches the original amount of \$300 million in fiscal 2019. It will then remain at that level until the corridor funding method is fully phased out and the pension fund reaches an actuarial funding level of 85%.

A combination of factors, including higher than assumed investment returns, the effects of the 2011 pension reforms, and the corridor phase out have substantially narrowed the gap between the amount that the State contributes under the corridor method and the amount that it would contribute under full actuarial funding. In fact, the \$150 million supplemental contribution in fiscal 2016 exceeds the gap by about \$70 million. As a result, it is no longer necessary to narrow that gap because that goal has already been achieved.

Repealing corridor funding and the supplemental contribution accomplishes two significant positive outcomes. First, it restores full actuarial funding of the State Retirement and Pension System, which not only places the system on solid financial footing but also will be seen as a positive factor by the credit rating agencies. Second, it reduces State expenditures by \$71.3 million in fiscal 2016 and by increasing amounts in the out-years. In fiscal 2016, the total savings is assumed to be allocated

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\$59.9 million in general funds and \$5.7 million in each of federal and special funds. **Therefore, the Department of Legislative Services recommends that a provision be added to the Budget Reconciliation and Financing Act of 2015 (SB 57/HB 72) that repeals the corridor funding method and the supplemental contribution.**

Recommended Actions

1. Add the following section:

Section XX Reduce Pension Reinvestment Funds Contingent on Enactment of Legislation to Accelerate Full Actuarial Funding of Retirement Program

SECTION XX. AND BE IT FURTHER ENACTED, That, the following amounts of appropriations for the pension systems for the employees (Comptroller Object 0161), State Police (Comptroller Object 0165), law enforcement officers (Comptroller Object 0169) and teachers (Comptroller Object 0163) shall be reduced, contingent upon the enactment of HB 72 or SB 57 to accelerate full actuarial funding of the pension plans:

<u>Programs</u>	<u>Fund</u>	<u>Amount</u>
<u>Aid for Local Employee Fringe Benefits.....</u>	<u>General</u>	<u>\$37,106,455</u>
<u>Aid to Community Colleges – Fringe Benefits</u>	<u>General</u>	<u>\$2,043,052</u>
<u>General Assembly.....</u>	<u>General</u>	<u>\$396,540</u>
<u>Judiciary.....</u>	<u>General</u>	<u>\$1,333,629</u>
<u>Executive Branch.....</u>	<u>General</u>	<u>\$18,990,323</u>
<u>Executive Branch.....</u>	<u>Special</u>	<u>\$5,530,118</u>
<u>Judiciary.....</u>	<u>Special</u>	<u>\$174,882</u>
<u>Executive Branch.....</u>	<u>Federal</u>	<u>\$5,705,000</u>

Explanation: Contingent on the enactment of HB 72 or SB 57, which repeal the corridor funding method and the supplemental contribution, general fund contributions to the State Retirement and Pension System decrease.