Department of Legislative Services

Maryland General Assembly
2000 Session

FISCAL NOTE
Revised

Senate Bill 643 (Senators Currie and Exum)
Budget and Taxation

Employees' Retirement and Pension Systems - Participating Governmental Units - Withdrawal Liability Payments

This pension bill alters the method of computing assets that are to be transferred to a local governmental unit that withdraws its participation in the "municipal pool" of the State Retirement and Pension System (SRPS). The bill repeals the requirement that a transition amount be deducted from assets that are transferred to the local pension system and alters the method of computing the withdrawal liability contribution that is to be paid by the governmental units that withdraw their participation.

The bill takes effect July 1, 2000.

Fiscal Summary

State Effect: Administrative expenditures (special funds) by the State Retirement Agency will decline slightly if participating local governments withdraw from the SRPS.

Local Effect: Pension assets transferred to a local governmental unit upon withdrawal from the SRPS will increase, while annual pension contributions by the remaining local governments in the municipal pool will increase versus such a withdrawal under current law. The magnitude of this effect will depend on which, if any, local governmental unit withdraws.

Small Business Effect: None.

Analysis

Background: There are currently 98 local governmental units that participate in the employees' systems of the SRPS. In addition, there are 29 local governmental units that have withdrawn from the SRPS.

Prior to 1984, participating local governments paid their pension costs on a pay-as-you-go basis. They funded only the actual retirement benefits payable to retirees during that particular year. There was no pre-funding of current, past, or future liabilities.

In 1984, the State's actuary, at the request of the SRPS, developed a plan to implement full actuarial funding for past and future obligations of the participating governmental units. The plan also stabilized the employer rates for the participating employers. Only liabilities of this "municipal pool" were pooled. At the insistence of the participating governmental units, assets were reported separately.

Current Law: Chapter 661 (HB 1338) of 1996 made several changes to the operation of the "municipal pool."

- All participating governmental units pay a shared normal cost and unfunded liability cost.

- Governmental units with active members in the Employees' Retirement System (ERS) pay an extra 5% surcharge on their ERS payroll.

- Governmental units that were identified as having assets in excess of the amount necessary to fund all benefits of their employees receive a credit, or reduction to their future billings (amortized to 2020), while governmental units that were identified as not having enough ERS assets to fund the ERS present value of the accrued benefits for their participants are subject to a deficit surcharge, which is paid in addition to the other components of the annual billings.

- Individual accounting of assets ceased, creating a true pool for funding benefits.

- For governmental units withdrawing after June 30, 1995, withdrawals are calculated on the pooled basis rather than an individual basis. At the time, the municipal pool had unfunded liabilities, and there was a concern that a withdrawal by some employers would leave the remaining employers with these unfunded liabilities. To avoid this outcome, the new rules provided for an "active participant funding ratio" (APFR).
  Essentially, the APFR matches municipal pool assets to a governmental unit's liabilities, but by a ratio based on the pool's funded status. This ratio ensures that the

withdrawing governmental unit will only receive assets proportional to the pool's funding level. By definition, this ratio can never be less than zero; by law, it cannot exceed one. In other words, the municipal pool cannot return to the withdrawing governmental unit more than 100% of pooled value even when funding level for the pool exceeds 100%. The actuary estimates the pool is currently 108% funded, based on the pending results of the 1999 valuation (and reflecting the enhancement benefits for those local governments that elected it).

- Many governmental units did not make sufficient contributions prior to 1995 (because the uniform contribution rate did not sufficiently account for the demographics of that unit). The deficit surcharge discussed above only covers a portion of the total shortfall. The 23 governmental units with the largest individual shortfalls are subject to a "transition amount." The transition amount represents the governmental unit's unfunded liabilities in 1995, less the amount that the unit is repaying through its deficit surcharge (in addition, the governmental unit may be subject to a withdrawal liability; see discussion below).

- For these 23 governmental units, this transition amount is written down over 25 years (from 1995 through 2020), eliminating the shortfall by 4% per year, so long as they stay in the pool. If a governmental unit with a deficit withdraws prior to 2020, however, that remaining transition amount comes due and is deducted from any assets transferred to the unit upon withdrawal. This mechanism ensures that if one of these 23 governmental units leaves prior to 2020, the remaining pool members will not be forced to absorb the shortfall.

Upon application to withdraw by a participating governmental unit, the actuary calculates a preliminary estimate of: (1) the liabilities of the unit's employees who are assumed to transfer to the local system (currently, all Employees' Pension System (EPS) members are assumed to transfer and no ERS members are assumed to transfer); (2) the level of assets that can be transferred out of the SRPS to the new plan on behalf of withdrawing members, based on the APFR; and, (3) the necessary adjustments to this asset amount by any remaining balance of deficit surcharge and the remaining portion of the transition amount.

Upon withdrawal, once it is determined which participants of the withdrawing governmental unit actually elect to withdraw from the SRPS, the actuary makes a final calculation based on the three steps described above, and appropriate assets are transferred out of the municipal pool to the local system.

The withdrawing governmental unit continues to make normal cost and ERS surcharge payments for members who remain. In addition, the withdrawing governmental unit may be required to make payments toward a withdrawal liability to fund the unfunded liability of its members who elect to remain in the pool. The withdrawal liability for any withdrawing governmental unit is equal to the actuarial liabilities remaining in the pool on behalf of remaining active participants, multiplied by the complement of the APFR (1 - APFR). When the APFR equals one (as is currently the case), no withdrawal liability payments are due.

Bill Summary: The bill makes two changes to the current withdrawal rules. First, the transition amounts that were established for the 23 under-funded participating governmental units are eliminated. Transition amounts, therefore, are forgiven, and are not to be used in determining the assets to be transferred from the municipal pool to the withdrawing governmental unit's new plan.

Secondly, the APFR is allowed to exceed one. Thus if the municipal pool is more than 100% funded, the withdrawing governmental unit would receive assets based on the overfunded level of the pool. As noted above, the actuary estimates the pool is currently 108% funded.

Local Expenditures: The potential costs for this proposal depend on which, if any, participating governmental units elect to withdraw after these changes occur. The remaining governmental units within the municipal pool must incur a cost because they would be required to assume the funding of the remaining transition amount that had been assigned to the withdrawn governmental unit, but which would be forgiven under this proposal. The remaining pool members would also lose the benefit of the additional assets that would be paid out to a withdrawing member when the APFR is greater than 1. The pool participant would absorb and share in that cost through the annual employer contribution rate.

The fiscal impact on a withdrawing governmental unit and the remaining members of the municipal pool will depend on whether the withdrawing unit has a deficit or credit. The following estimates are based on the impact if Prince George's County were to withdraw. Prince George's County is the largest participating employer in the municipal pool and has expressed interest in the past in withdrawing from the SRPS.

If Prince George's County were to withdraw under current rules, the State's actuary preliminarily estimates that the county would receive net assets from the municipal pool of approximately $92.6 million. These assets would be immediately transferred to the county's local pension system to fund the benefits of county employees who transfer from the EPS (or ERS) of the SRPS to the new county system. Under the bill, the State's actuary preliminarily estimates that the county would receive net assets from the municipal pool of approximately $145.8 million, or an increase of $53.2 million. The actuary estimates that approximately $14.1 million of the $53.2 million change is attributable to the change in the APFR, and the remaining $39.1 million is attributable to elimination of the transition amount.

The increase in assets to Prince George's County under the bill, however, would result in a corresponding decrease in the assets of the municipal pool. Under current law, if the county were to withdraw, the base contribution rate for the remaining employers in the municipal pool would decrease by approximately 1.02% from the rate the governmental units pay today in the absence of such a withdrawal. There are three reasons why the rate for the other governmental units would decline if the county left under current rules: (1) the county's transition amount, which would have been absorbed by the pool and ultimately forgiven if the county had remained in the municipal pool, will now become payable by the county (and deducted from the assets transferred to the county); (2) under the APFR rule, the county will forego its share of the municipal pool's surplus; and (3) the county's demographics, including service and salary, are more expensive than the average for the municipal pool, resulting in decreased liabilities if the county withdraws.

Under the bill, however, the contribution rate for the remaining employers in the municipal pool will not decline by as much as it would under a withdrawal under current rules. The base rate would decline by 0.38%. This is because: (1) the county's transition amount is forgiven, lowering the municipal pool's funding level from what it would be under a withdrawal under current rules; and (2) the county will receive a portion of the municipal pool's current surplus, which under current rules would be kept with the pool. The pool would still benefit, however, from the county's withdrawal because of the county's more expensive demographics. In net effect, if the county withdraws, the pension costs for the remaining members of the municipal pool will be 64 basis points higher under the bill versus withdrawal under current law (1.02% minus 0.38%).

The table below illustrates the impact on Prince George's County and the remaining members of the municipal pool if the county were to withdraw, both under current rules and under the bill.

	Asset Transfer to Prince George's County	Change versus Withdrawal Under Current Law	Base Rate - Municipal Pool	Change versus 3.7% Current Rate
Current Law - No Withdrawal	--	--	3.70%	--
Withdrawal Under Current Law	$92.6 million	--	2.68%	1.02%
SB 643/ HB 1036	$145.8 million	$53.2 million	3.32%	0.38%

Prince George's County advises that it does not intend to withdraw under current rules. The county therefore believes the more appropriate comparison is between the municipals' current rate of 3.7% versus their rate under the bill of 3.32%.

Additional Comments: The State's actuary includes in its valuation the cost of the pension enhancement elected by some participating local governments under Chapter 176 of 1999. Prince George's County did not elect the enhancement. The county notes that the valuation is as of June 30, 1999, while the bill took effect July 1, 1999 (but benefit credit was retroactive to July 1, 1998). Election into the enhancement took place between July 1, 1999 and December 31, 1999. The county argues that the 1999 valuation should therefore not reflect the enhancement costs. Under this methodology, the State's actuary advises that the APFR would be 1.27 for the municipal pool, versus the 1.08 reported above. (The transition amount would not be affected.) The assets transferred to the county under this methodology would be $176 million, and the corresponding base rate for the remaining municipal pool members would be 3.63%.

Additional Information

Prior Introductions: None.

Cross File: HB 1036 (Delegate R. Baker, *et al.*) - Appropriations.

Information Source(s): State Retirement Agency; Milliman & Robertson, Inc.; Department of Legislative Services

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Analysis by: Matthew D. Riven

Direct Inquiries to:
John Rixey, Coordinating Analyst
(410) 946-5510
(301) 970-5510