Department of Legislative Services

Maryland General Assembly
2001 Session

FISCAL NOTE
Revised

Senate Bill 222 (Senator Kasemeyer)
(Chairman, Joint Committee on Pensions)

Budget and Taxation Appropriations

Retirement and Pensions - Funding - Accrued Liability

This pension bill requires the State Retirement and Pension System (SRPS) to amortize all actuarial liabilities accrued on or after July 1, 2001 over a "layered" 25-year period, with each future year's liabilities or surplus amortized over 25 years. Existing actuarial liabilities would continue to be amortized over the current fixed schedule that ends at the end of fiscal 2020. The bill also requires the "municipal pool" of local governments that participate in the SRPS to amortize all such new actuarial liabilities over the same 25-year layered period; existing liabilities would remain on the municipal pool's existing fixed schedule that ends at the end of fiscal 2020.

The bill takes effect July 1, 2001.

Fiscal Summary

State Effect: State pension contribution rates would become less volatile than under current law, resulting in increased State costs (versus current law) when contribution rates are trending downward and decreased State costs when rates are trending upward. For illustrative purposes, State pension contributions would have decreased by $72 million for FY 2002 under the proposed methodology versus $87 million under current law, but a comparable increase in State liabilities would result in a comparable reduction in impact to the State.

Local Effect: For local governments that participate in the SRPS, pension contribution rates would become less volatile than under current law, resulting in increased employer costs (versus current law) when rates are trending downward and decreased employer costs when rates are trending upward.

Small Business Effect: None.

Analysis

Current Law: Current law requires amortization of SRPS actuarial liabilities by fiscal 2020, with certain exceptions.

Background: As of the valuation date of June 30, 2000, the SRPS was 101% funded on an actuarial basis, as compared to a low of 34% funding in 1984. The system achieved full funding approximately 20 years ahead of the statutory schedule requiring full funding by the year 2020. With the absence of any actuarial liabilities in aggregate (some subsystems of the SRPS are still underfunded), the State contributes only the normal cost -- the cost of funding ongoing pension liabilities as they are accrued. Changes in the system's investment portfolio (or any other changes that affect the system's actuarial assets and liabilities), however, may cause the system to become over- or under-funded and these surpluses or deficits must be amortized to 2020 under current law.

That statutory schedule, however, will cause employer contribution rates to become more volatile. As the period to 2020 gets shorter, there will be fewer years to amortize actuarial gains and losses. Several years of actuarial losses, for instance due to market declines, would cause the contribution rate to spike up, resulting in increased State expenditures. These increased expenditures would likely be simultaneous with a decrease in State tax revenue due to the market declines.

To address the volatility problem, the pension board proposed three changes in actuarial methodology to the Joint Committee on Pensions to take effect July 1, 2001. First, unfunded actuarial liabilities as of June 30, 2001 would continue to be amortized through the year 2020 (as under current law), while all future liabilities would be amortized over a rolling 25-year period. Second, the employer contribution rate for each system would continue to fluctuate from year to year, but under no circumstance would it be below the employee contribution (which ranges from 2% to 8% by system). Third, the current method of "smoothing" by which market assets above or below the actuarial benchmark are recognized over a three-year period would change to five-year smoothing. The joint committee agreed to introduce the first proposal but rejected the second proposal. The third proposal -- to increase the smoothing period for market assets -- can be implemented by board policy.

A survey by DLS found that a 25-year amortization period is in line with that used by other states, which had an average amortization period of 26 years.

State Expenditures: The proposal is intended to reduce the expected volatility in contribution rates by shifting to a rolling 25-year amortization period for all actuarial gains and losses accrued after July 1, 2001. This amortization schedule will reduce contribution rate volatility by spreading gains or losses over a longer period and rolling that period from year to year.

This new actuarial methodology will reduce volatility by amortizing gains or losses over a longer period, and requiring that period to remain constant. The exact impact of the proposal in any given year cannot be precisely estimated and would depend on the change in liabilities and the amount of time to amortize such change. The actuary informally estimates that applying this new method to the most recent valuation would result in a hypothetical 8.21% aggregate rate, versus 7.98% under the current methodology. At that rate, the State savings would equal $72 million (versus $87 million under current method). (Smoothing market assets over five years rather than three years, which is not included in the bill but which is proposed as a matter of board policy, would make the hypothetical rate 8.62%.) Conversely, in a year in which the contribution rate increased (rather than decreased) from the prior year, the upward impact on the contribution rate (and hence State costs) would be less under the bill than under current law, by a corresponding amount to the above example.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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