Department of Legislative Services

Maryland General Assembly
2001 Session

FISCAL NOTE
Revised

Senate Bill 247 (Senator Kasemeyer)
(Chairman, Joint Committee on Pensions)

Budget and Taxation Appropriations

Retirement and Pensions - Withdrawing Participating Governmental Units - Return of Assets and Liabilities

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This bill changes the terms under which a participating governmental unit of the State Retirement and Pension System (SRPS) may withdraw from the "municipal pool" of the SRPS. Withdrawing governmental units are entitled to take their share of any overfunded assets if the municipal pool is overfunded by 110% or more and governmental units that did not elect the enhancement under Chapter 176 of 1999 will receive their share of assets and liabilities calculated on a pre-enhancement basis.

The bill takes effect July 1, 2001.

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 units withdraw.

Small Business Effect: None.

Analysis

Current Law: Currently, 98 local governmental units participate in the employees' systems of the SRPS. (In addition, there are 29 local governmental units that have withdrawn from the SRPS.) Chapter 661 of 1996 made several changes to the operation of the "municipal pool" of participating employers.

- 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, based on an "active participant funding ratio" (APFR).

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 the funding level for the pool exceeds 100%.

- 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 (one – APFR). When the APFR is equal or greater than one (as is currently the case), no withdrawal liability payments are due.

Bill Summary: This bill changes the terms of withdrawal for participating employers as follows. Under the bill, withdrawing governmental units will be entitled to take their share of any overfunded assets if the municipal pool were overfunded by 110% or more and governmental units that did not elect the enhancement under Chapter 176 of 1999 will receive their share of assets and liabilities calculated on a pre-enhancement basis.

The pool's funding ratio will be calculated based on the assets and liabilities associated with all members and retirees of the participating governmental units; under current law, only actively employed members' assets and liabilities are factored.

Also, this funding ratio will be calculated under two scenarios, depending on whether the withdrawing unit elected the enhancement or not. If the unit had elected the enhancement, the funding ratio is calculated as under current law (except as noted above, the assets and liabilities associated with all members, not just active employees, would be included). If the unit had not elected the enhancement, the funding ratio is calculated as if none of the participating units had elected the enhancement.

Under each of these scenarios, for enhancement or nonenhancement withdrawing employers, the withdrawal rules would vary based on the level of funding of the municipal pool.

Employers that Elected the Enhancement

If an employer that elected the pension enhancement later elects to withdraw from the municipal pool, then the amount of assets that employer may take upon withdrawal will vary according to three scenarios:

1. If the participant funding ratio is less than 100%, then the withdrawing employer receives a share of the pool assets proportionate to its liabilities.

2. If the participant funding ratio is between 100% and 110%, then the withdrawing employer receives a share of the pool assets proportionate to its liabilities, but no more than its liabilities.

3. If the participant funding ratio is 110% or greater, then the withdrawing employer receives a share of the pool assets proportionate to its liabilities, plus a proportionate share of the assets above 110%.

Employers that Did Not Elect the Enhancement

If an employer that did not elect the pension enhancement later elects to withdraw from the municipal pool, then the amount of assets that employer may take upon withdrawal will vary according to the same three scenarios, but using a funding ratio calculated as if none of the participating units had elected the enhancement.

Background: 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. By 1996 it was clear that insufficient contributions were being made by some employers and that the existence of separate asset accounts could encourage some employers to withdraw to the detriment of the pool, so the terms were changed to those described above.

The current rules, however, did not sufficiently anticipate the system being fully funded so far ahead of the statutory schedule. They therefore do not provide for any distribution of excess assets to an employer that elects to withdraw. The current rules also did not anticipate the pension enhancement under Chapter 179 of 1999, under which the participating employers could elect whether or not to provide the enhancement to their members.

Last year's SB 643 and HB 1036 would have altered the method for determining the amount of assets that a participating employer would receive if the employer withdrew from the municipal pool. As part of the pension board's study of actuarial changes for the State pool, the board asked Milliman & Robertson to study the funding structure of the municipal pool and examine the changes that were proposed in SB 643/HB 1036.

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 lose the benefit of the additional assets that would be paid out to a withdrawing member when the funding ratio is greater than one. The pool participant would absorb and share in that cost through the annual employer contribution rate.

The impact on the withdrawing employer would also depend on the circumstances of that employer. 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.

Based on the latest actuarial valuation for the municipal pool (as of July 1, 1999), the State's actuary informally estimates that, in the case of Prince George's County, the actuarial accrued liability for Pension System members was $150 million, the outstanding balance of the deficit payments was $28.9 million and the outstanding balance of the transition amount was $36 million, resulting in an approximate asset transfer of $92.6 million. (Because the municipal pool is overfunded, the current APFR is by definition capped at 100%.)

Under this legislation, the active participant funding ratio of 100% would be replaced with a Participant Funded Ratio (PFR) reflecting the funded level of the entire system liability. Because the county did not elect to participate in the enhanced pension structure, it will not be penalized by having the PFR calculated with respect to benefits provided under that system. The resulting Non-Contributory PFR as of July 1, 1999 is calculated to be 114.36%. The legislation, however, establishes a 10% “buffer” on the system’s funding so only the excess of this ratio over 110% can be used in calculating the asset transfer. Thus, the effective PFR used in the calculation would be 104.36% (114.36% - 110% + 100%). The asset transfer amount would therefore increase from $92.6 million under current law to $99.7 million. The additional $7.1 million transfer would result in a corresponding loss to the employers remaining in the municipal pool.

The actuary advises that it is likely that the PFR will be higher than the 114.36% under the June 30, 2000 valuation to be completed shortly. The actuary advises that the market value-to-actuarial value ratio will be slightly lower, but the net result should be an increase in expected withdrawal values.

Additional Information

Prior Introductions: None.

Cross File: None.

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Analysis by: Matthew D. Riven

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