SB 860

Department of Legislative Services

Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 860 (Chairman, Anne Arundel County Senators)
Budget and Taxation Appropriations

Local Government - Investment of Other Postemployment Benefits Funds

This bill allows local governments to invest, redeem, sell, exchange, and reinvest funds dedicated to paying post-employment benefits in the same manner that they invest funds for employee pensions. Post-employment benefits are defined as health care benefits for retirees and all other post-employment benefits except pensions. Funds dedicated to paying for post-employment benefits are excluded from the statutory definition of "public funds" for the purpose of restricting their investment.

Fiscal Summary

State Effect: None.

Local Effect: Local government revenues from investment earnings could increase by an indeterminate amount. Local government expenditures would not be affected.

Small Business Effect: None.

Analysis

Current Law: Local government investment policies must abide by the same restrictions applied to investments made by the State Treasurer. Therefore, they may invest only in low-risk investment options, including:

- United States Treasury bills;
- bonds and commercial paper with the highest quality letter and numerical rating by at least one rating agency;

- money market funds; and
- the Maryland Local Government Investment Pool.

However, local governments that establish pension funds for the purpose of pre-funding their pension liabilities are authorized to invest those monies in equities and other investment options that carry higher risk and higher potential yields than the more secure options listed above.

Background: Statements 43 and 45 from the Government Accounting Standards Board (GASB) require governmental employers to include in their 2008 financial statements any liabilities associated with the commitments they have made to provide post-employment benefits other than pensions. These other post-employment benefits (OPEB) include health insurance for retirees, as well as any life insurance or long-term care insurance paid by the employer. For public employers that offer subsidized health insurance to their retirees, OPEB liabilities can be substantial. For instance, a 2005 actuarial analysis found that the State of Maryland's OPEB liabilities exceed $20 billion, and local governments are currently conducting similar actuarial analyses to determine their respective OPEB liabilities.

Most employers pay for OPEB on a pay-as-you-go basis, which means that they only pay for actual costs (*e.g.,* insurance premiums) incurred by their retired members in a given year. However, if they have made a commitment to provide health insurance or other post-employment benefits to current employees when they retire, the employers continue to accumulate liabilities to pay for those benefits in the future. Unless the employers set aside money now to cover those future costs (known as pre-funding), those liabilities add up each year, and GASB is now requiring employers to calculate the value of those future liabilities and account for them on their financial statements. Although GASB is not requiring employers to pre-fund OPEB liabilities, OPEB liabilities that appear on public employers' accounting statements can hurt their bond ratings, making it more expensive for them to borrow money.

Therefore, many public employers are exploring options for pre-funding their OPEB liabilities, including establishing separate OPEB funds similar to their pension funds. Since the early 1990s, when GASB changed the accounting rules for pension funds, most public employers have been pre-funding their pension liabilities. Typically, they set aside money in a pension fund each year to cover all or most of the liability they incur each year for the future pension benefits of their current employees. This allows them to invest that money in the hopes of earning a significant return to help them cover their future costs. By allowing public employers to assume higher rates of return if they set up similar OPEB funds, GASB is facilitating the pre-funding of OPEB liabilities in a similar fashion.

Local Fiscal Effect: By allowing local governments to invest their OPEB funds in the same way that they invest money in pension funds, this bill would enable local governments to earn higher returns than they would by investing OPEB funds only in short-term, low-risk securities. For instance, the most recent rate of return for the Maryland Local Government Investment Pool was 4.33%, whereas the State Retirement and Pension System, which is free to invest in the types of options this bill makes available to local OPEB funds, earned 9.5% in fiscal 2005. However, local governments would incur somewhat greater risks by seeking higher investment returns in equities or real estate.

Additional Information

Prior Introductions: None.

Cross File: HB 642 (Anne Arundel County Delegation) – Appropriations.

Information Source(s): Cecil County, Washington Suburban Sanitary Commission, Maryland-National Capital Park and Planning Commission, Maryland State Retirement Agency, Department of Legislative Services

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