HB 1247

Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE
Revised

House Bill 1247 (Delegate Conway, *et al.*)
Appropriations Budget and Taxation

Postretirement Health Benefits Trust Fund - Clarification

This bill requires the transfer of certain funds to the Postretirement Health Benefits Trust Fund and authorizes the transfer of other funds to the trust fund for the purpose of funding accrued liabilities associated with retiree health benefits under the State Employee and Retiree Health and Welfare Benefits Program. It also authorizes transfers from the trust fund in future years. The bill restructures the Blue Ribbon Commission to Study Retiree Health Care Funding Options enacted in 2006.

The bill takes effect July 1, 2007.

Fiscal Summary

State Effect: No net fiscal impact resulting from the authorized transfer of $200 million in the Dedicated Purpose Account to the Post Retirement Health Benefits Trust Fund. The State Retirement Agency could prepare a request for a ruling from the Internal Revenue Service (IRS) with existing resources.

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: The bill authorizes the transfer of funds allocated to the Dedicated Purpose Account in the fiscal 2007 and 2008 budgets for the purpose of reducing the State's accrued liabilities for retiree health care to the Postretirement Health Benefits

Trust Fund. It also requires that all future budgetary allocations for the purpose of reducing the State's accrued liabilities for retiree health care be deposited in the trust fund. Beginning in fiscal 2009, the Board of Trustees of the State Retirement and Pension System is authorized to transfer funds from the trust fund to the Department of Budget and Management to assist in the payment of the State's postretirement health care subsidy. Finally, it limits administrative expenses of the board paid from the trust fund to $100,000 annually.

By August 1, 2007, the State Retirement Agency (SRA) must request a ruling from the IRS that confirms that the trust fund is a tax-exempt trust in accordance with Section 115 of the Internal Revenue Code. SRA is authorized to adopt a trust document and regulations to carry out the bill's provisions.

Current Law/Background: A retiree may enroll in the State's Health and Welfare Benefits Program and receive the same health benefits and premium subsidies provided to a State employee if the retiree:

- ended State service with at least 10 years of creditable service and within 5 years before the age at which he/she would be eligible to retire;
- ended State service with at least 16 years of creditable service;
- ended State service on or before June 30, 1984;
- retired directly from State service with a State retirement allowance on or after July 1, 1984 and had at least 5 years of creditable service; or
- retired directly from State service with a State disability retirement allowance on or after July 1, 1984.

The surviving spouse or dependent child of a deceased retiree may also participate in the program as long as the spouse or child receives a regular survivor's pension payment from the State. Depending on the health plan selected, the State subsidizes 80% or 85% of the premium for all retirees with at least 16 years of service credit; retirees with between 10 and 16 years receive a pro-rated subsidy.

Chapter 466 of 2004 established the Postretirement Health Benefits Trust Fund to assist the State in financing the postretirement health insurance subsidy paid by the State. The fund is a tax-exempt trust in accordance with § 115 of the Internal Revenue Code or any other applicable federal statute. Beginning in fiscal 2006, any subsidy received by the State that is provided to employers as a result of the federal Medicare Prescription Drug, Improvement, and Modernization Act of 2003 or other similar federal subsidy was to be deposited into the fund. However, Chapter 444 of 2005 (the Budget Reconciliation and Financing Act) diverted the Medicare Part D subsidy from the fund to pay for employee and retiree health premiums in fiscal 2006 and 2007. Proceeds from the Medicare Part D federal subsidy will be restored to the Postretirement Health Benefits Trust Fund beginning in fiscal 2008.

The trust fund's assets must be invested to the extent possible in the same manner as those of the other systems of the State Retirement and Pension System. For fiscal 2008 through 2017, no payments may be made from the fund. For fiscal 2018 and each fiscal year thereafter, the board must transfer to the general fund, for the sole purpose of assisting in the payment of the State's postretirement health insurance subsidy, the lesser of: (1) one-quarter of the prior year's investment gains; or (2) the amount necessary to pay the annual health insurance premium and other costs that constitute the State's postretirement health insurance subsidy. If for any reason the State discontinues the postretirement health insurance subsidy, the fund's assets must be transferred to the general fund.

Chapter 298 of 2005 created the Task Force to Study Retiree Health Care Funding Options and required the task force to commission an actuarial valuation of the liabilities associated with Government Accounting Standards Board (GASB) Statement 45. Chapter 298 provides that the task force was specifically charged to:

> develop options for addressing the unfunded liability associated with State retiree health care that will have to be included on the State's financial statements … as a result of Governmental Accounting Standards Board Statement 45, and evaluate the costs associated with each option.

The GASB standards will require governmental employers to account for liabilities associated with the employers' commitment to what is referred to as Other Post Employment Benefits (OPEB) such as retiree health insurance. Moreover, under these standards, Maryland will be required to account for these OPEB liabilities on its balance sheet in fiscal 2008. If the State carries large unfunded OPEB liabilities on its balance sheet, bond raters could downgrade the State's bond rating from its long-held AAA status, costing the State millions of dollars in interest payments on its general obligation bonds.

The actuarial valuation commissioned by the task force determined that the State's unfunded liability for retiree health benefits was as high as $20.4 billion, requiring an annual State contribution of approximately $1.6 billion to avoid carrying unfunded OPEB liabilities on its balance sheets. In its final report, issued in January 2006, the task force recommended that the State begin by paying its annual normal costs, which is the present-day value of the future retiree health benefits incurred by current employees. That normal cost payment is approximately $600 million in fiscal 2008, with the State already paying about $300 million annually toward retiree health benefits. The fiscal 2007 budget set aside $100 million in fiscal 2007 toward the recommended fiscal 2008 normal cost payment, plus an additional $51.5 million from excess funds budgeted for State employee health insurance for future retiree benefits. The fiscal 2008 budget, as enacted, includes an additional $100 million toward the normal cost payment.

The task force also recommended the establishment of a blue ribbon commission to further study the issue and make recommendations regarding strategies for funding the State's current retiree health liabilities and reducing future liabilities. Chapter 433 of 2006 established the Blue Ribbon Commission to Study Retiree Health Care Funding Options and authorized it to commission annual valuations of the State's OPEB liabilities. Chapter 433 set forth six principles to guide the commission's work, most notably that it must find an alternative to pay-as-you-go funding for retiree health care and that it should treat employees, retirees, and taxpaying citizens fairly. It also required the commission to:

- review the State's legal obligation to provide retiree health benefits;
- study the factors contributing to the rising cost of retiree health benefits;
- review current benefit levels for State employees and retirees;
- review the eligibility requirements for retiree health benefits;
- review alternatives for providing health benefits to State retirees; and
- recommend a multi-year plan to fully fund State obligations for retiree health benefits.

A 2006 valuation conducted by Buck Consultants concluded that the State's unfunded liability for retiree health benefits was lower than the liability estimated by the 2005 valuation. Buck estimated the State's OPEB liability to be as high as $14.5 billion, requiring an annual State contribution of approximately $1.1 billion to avoid carrying unfunded OPEB liabilities on its balance sheets.

Additional Information

Prior Introductions: None.

Cross File: SB 780 (Senator Currie, *et al.*) – Budget and Taxation.

Information Source(s): Department of Legislative Services

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