SB 1061

Department of Legislative Services

Maryland General Assembly
2010 Session

FISCAL AND POLICY NOTE

Senate Bill 1061 (Senator Madaleno)
Budget and Taxation

State Retirement and Pension System - Funding

This bill makes several changes to the funding method for the combined employees' and combined teachers' plans under the State Retirement and Pension System (SRPS).

The bill takes effect July 1, 2010, with some provisions terminating June 30, 2016.

Fiscal Summary

State Effect: State pension contributions increase by $13.2 million in FY 2012 under the new funding method phased in from FY 2012 through 2016. Those costs increase in future years according to actuarial assumptions. First-year costs are assumed to be allocated 60% general funds, 20% special funds, and 20% federal funds because the full effect is experienced in the combined employees' plans. In future years, the effect is more heavily weighted toward general funds because contributions for the combined teachers' plans also increase, and those contributions are generally paid entirely by general funds.

($ in millions)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Revenues	$0	$0	$0	$0	$0
GF Expenditure	0	7.92	47.71	108.28	152.88
SF Expenditure	0	2.64	4.54	10.31	14.56
FF Expenditure	0	2.64	4.54	10.31	14.56
Net Effect	$0.00	($13.20)	($56.80)	($128.90)	($182.00)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None. The bill affects only State pension contributions, not those of participating governmental units.

Small Business Effect: None.

Analysis

Bill Summary: The bill repeals the current "corridor" funding method for the combined employees' plans and combined teachers' plans, and establishes a "partial funding rate" of 90% of the full actuarial funding rate as the new default contribution rate. The bill requires the SRPS Board of Trustees to annually calculate a new corridor funding rate using the new partial funding rate as the base contribution. It also extends the amortization period for new unfunded liabilities accrued each year from 25 to 30 years.

For each fiscal year from 2012 through 2015, the board must compare the partial funding rate with the new corridor rate. If, in a given year, the partial funding rate exceeds the new corridor rate, the employer contribution for that year equals the corridor funding rate plus 20% of the difference between the two rates for each year since 2011 (*i.e.,* 20% in fiscal 2012, 40% in fiscal 2013, etc.). By fiscal 2016, the partial funding rate is fully phased in, and the corridor rate provisions expire at the end of the fiscal year. If, in any of the intervening years from 2012 through 2015, the partial funding rate is less than or equal to the recalculated corridor funding rate, the partial funding rate becomes the employer contribution rate each year going forward.

Current Law: In general, teachers in the State hired before 1980 belong to the Teachers' Retirement System (TRS) as a condition of their employment, while teachers hired since 1980 belong to the Teachers' Pension System (TPS). Similarly, regular State employees hired before 1980 generally belong to the Employees' Retirement System (ERS) as a condition of their employment, and employees hired since 1980 belong to the Employees' Pension System (EPS). For actuarial purposes, TRS/TPS are combined and the employer contribution is identical for both plans. Similarly, ERS/EPS are combined and the employer contribution is identical for both plans.

Chapter 440 of 2002 (the Budget Reconciliation and Financing Act) established the "corridor" funding method to mitigate the effects of fluctuations in market returns on the State's pension contribution rates by spreading out those effects over five years. In fiscal 2001, investment returns for SRPS fell 9.4%, prompting projected employer contribution rates for fiscal 2003 to increase for the first time in five years. Instead, the corridor method froze employer contribution rates for TRS/TPS and ERS/EPS, the two largest State pension plans, at their fiscal 2002 levels as long as the two systems remained actuarially funded between 90% and 110%. Under the corridor method, when the plans' funded levels drop below 90%, the employer contributions increase by an amount equal to one-fifth of the difference between the prior year's contribution and the "true" actuarial rate required to fully fund the systems (100%). The employees' systems fell out of the corridor in fiscal 2005, and the teachers' plans fell out of the corridor in fiscal 2006. As of June 30, 2009, the employees' systems are 61.2% funded and the teachers' systems are 66.1% funded; neither are projected to reach 90% funding for at least 10 years.

Any new unfunded liabilities accrued each year due to experience gains and losses, actuarial assumption changes, or legislative changes are amortized over 25 years.

Background: **Exhibit 1** projects the difference between the corridor funding rates required by current law, the full (actuarial) funding rates, the partial funding rate established by this bill, and the recalculated funding rates required by the bill for fiscal 2012 to 2015. The partial funding rate is fully phased in by fiscal 2016, although the impact is beyond the five-year horizon of the fiscal note and the actuarial analysis. These projections are based on the following assumptions made by the General Assembly's consulting actuary:

- the pension trust fund earns 15% in market returns on its investments in fiscal 2010 and 7.75% in each subsequent year (fiscal year-to-date returns as of January 30, 2009, were 13.9%);
- State employee payroll grows by 1% in fiscal 2010 and 3.5% in each subsequent year;
- teacher payroll grows by 2% in fiscal 2010 and 3.5% in each subsequent year; and
- except as noted, the State implements the bill's funding mechanism.

Exhibit 1
State Contribution Rates

	Corridor Rate[1]	Full Funding Rate	Partial Funding Rate	"New" Corridor Rate	"New" Required Contribution Rate
			Teachers' Combined Systems		
Fiscal 2012	15.12%	18.31%	16.48%	14.77%	15.11%
Fiscal 2013	16.11%	19.98%	17.98%	15.41%	16.44%
Fiscal 2014	17.31%	21.77%	19.59%	16.25%	18.26%
Fiscal 2015	18.53%	22.90%	20.61%	17.21%	19.91%
			Employees' Combined Systems		
Fiscal 2012	12.99%	18.24%	16.42%	12.64%	13.40%
Fiscal 2013	14.39%	19.85%	17.87%	13.68%	15.35%
Fiscal 2014	15.90%	21.53%	19.38%	14.82%	17.55%
Fiscal 2015	17.37%	22.58%	20.32%	15.92%	19.44%

[1]Corridor rates are based on current funding methodology
Source: Mercer; Gabriel, Roeder, and Smith

State Fiscal Effect: As Exhibit 1 demonstrates, the partial funding rate exceeds the "new" corridor rate calculated under the bill for each year covered by the analysis, so the partial funding rate is phased in according to the bill. As a result, the actual contribution rates calculated under this bill increase modestly at first compared with corridor contribution rates projected under current law. By fiscal 2015, however, the contribution rates are significantly higher than current projected funding rates under the corridor method. As a result, State pension contributions increase by $13.2 million in fiscal 2012, with contributions for the combined employees' plans increasing by $13.8 million and contributions for the combined teachers' plans actually decreasing by $600,000. In future years, State contributions continue to increase (in both plans) relative to current projected corridor funding rates according to actuarial assumptions.

Exhibit 2 shows that the bill has little or no effect on the SRPS-funded status relative to current projected funding ratios. The funded status continues to decline steadily under both scenarios. This can be attributed to the continued effect of negative investment returns in 2008 and 2009, which are smoothed over five years, and the continued funding of the system below full funding (the partial funding rate is still 10% less than the full funding rate).

Exhibit 2
Funding Ratios
Fiscal 2010-2013

	Teachers' Combined		Employees' Combined	
	Current Law	Under the Bill	Current Law	Under the Bill
FY 2010	70.8%	70.8%	65.1%	65.1%
FY 2011	66.7%	66.7%	60.9%	60.9%
FY 2012	62.6%	62.6%	56.7%	56.8%
FY 2013	60.6%	60.7%	54.6%	54.9%

Source: Mercer Human Resources Consulting

Additional Comments: This fiscal estimate assumes that the intent of the legislation is to continue to use the partial funding rate in fiscal 2017 and thereafter. This results in savings compared to the full funding rate of 100% that would otherwise take effect in fiscal 2017 under the bill as drafted. To the extent this is not the bill's intent, there would be no savings after fiscal 2016.

Additional Information

Prior Introductions: None.

Cross File: HB 1379 (Delegate Schuh) - Appropriations.

Information Source(s): Mercer Human Resources Consulting; Gabriel, Roeder, and Smith; Maryland State Retirement Agency, Department of Legislative Services

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