HB 239

Department of Legislative Services

Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE

House Bill 239 (Delegate Kipke)
Appropriations

Full Pension Funding Act

This bill phases out over 10 years the corridor funding method for the State Retirement and Pension System (SRPS).

The bill takes effect July 1, 2013.

Fiscal Summary

State Effect: State pension contributions increase by $50.0 million in FY 2015 due to the implementation of the phase-out of the corridor funding method and increase each year thereafter as the phase-out continues. The increased contributions are assumed to be allocated 84% general funds, 8% special funds, and 8% federal funds. In FY 2024, when the phase-out is completed, employer contributions are projected to be $19.0 million less than currently projected under the corridor method. No effect on revenues.

(in dollars)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Revenues	$0	$0	$0	$0	$0
GF Expenditure	0	42,000,000	94,920,000	134,400,000	159,600,000
SF Expenditure	0	4,000,000	9,040,000	12,800,000	15,200,000
FF Expenditure	0	4,000,000	9,040,000	12,800,000	15,200,000
Net Effect	$0	($50,000,000)	($113,000,000)	($160,000,000)	($190,000,000)

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

Local Effect: None. The bill affects only the employer amortization payment to SRPS, not the normal cost. Therefore, there is no effect on local school board payments to SRPS. Also, the corridor method affects only State plans, not participating governmental units.

Small Business Effect: None.

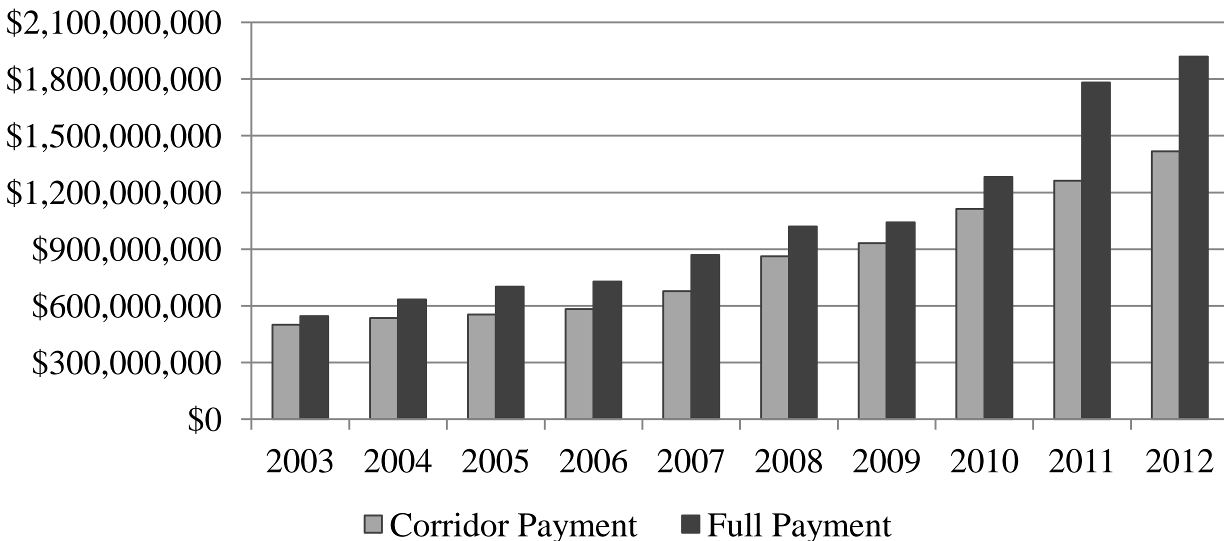
Analysis

Current Law/Background: Chapter 440 of 2002 (SB 323) enacted the corridor funding method, which sought to mitigate the effects of fluctuations in market returns on employer contribution rates to SRPS by spreading out those effects over five years. The corridor method froze employer contribution rates for the employees' and teachers' combined systems at their fiscal 2002 levels as long as the two systems remained actuarially funded between 90% and 110%. As the plans fall out of their corridors, the employer contributions increase by an amount equal to one-fifth of the difference between the prior year's rate and the "true" actuarial rate required to fully fund the systems. The employees' combined systems fell out of their corridor in fiscal 2005, followed by the teachers' combined systems in fiscal 2006.

For the first eight years that the corridor method was in existence, it accomplished its primary purpose of mitigating the effects of fluctuations in market returns on contribution rates while having only a minimal detrimental effect on pension funding levels. Between fiscal 2003 and 2010, the difference between employer contributions calculated under the corridor method and the employer contributions necessary to fully fund the pension system fluctuated between $46.0 million and $192.0 million, as shown in **Exhibit 1**. This level of underfunding, when amortized over 25 years, resulted in minimal annual increases in State contribution rates in succeeding years, typically a fraction of a percentage point each year. However, in fiscal 2011 and 2012, the gap surpassed $500.0 million each year. This level of underfunding has a more detrimental effect on pension funding levels and makes the corridor method unsustainable over the long term.

Because of its detrimental effects on the funded status of the system, which is currently funded at 64% of its actuarial liabilities, the SRPS Board of Trustees has repeatedly called on the General Assembly to repeal the corridor method and restore full actuarial funding. It proposed several different approaches to accomplishing that goal, but each time the General Assembly found the proposals to be too costly, especially during a time when State budgets were strained by declining revenues and slow economic growth. A proposal made to the Joint Committee on Pensions (JCP) during the 2011 interim, however, promised to accomplish the goal of repealing the corridor while generating potentially substantial cost savings. The proposal, however, did not account for several potential changes to actuarial assumptions under consideration by the board, which could have made the proposal more costly to participating employers.

Exhibit 1
Corridor vs. Actuarial Employer Contributions
Fiscal 2003-2012



Sources: State Retirement Agency, Department of Legislative Services

In response, the 2012 *Joint Chairmen's Report* required the Department of Legislative Services (DLS) and the State Retirement Agency (SRA) to develop a collaborative proposal that took into consideration potential changes to actuarial assumptions, which were ultimately adopted by the board in summer 2012. The board's original 2011 proposal was to serve as the basis for the joint plan. DLS and SRA presented their joint plan to JCP in November 2012, which consists of four components:

- phase out the corridor funding method over 10 years;
- replace the current tiered amortization method with a closed, 25-year amortization period;
- reduce the board's inflation assumption from 3.0% to 2.8%; and
- lower the board's investment return assumption from 7.75% to 7.55% over four years (five basis points each year).

JCP endorsed all of the recommendations and has introduced legislation implementing the first two recommendations. This bill implements the first recommendation.

State Fiscal Effect: By phasing out the corridor calculation over 10 years, the bill gradually closes the gap between the lower employer contribution required under the

corridor method and the higher employer contribution required to fully fund the pension system. This results in a slightly higher employer contribution each year until the corridor method is fully phased out in 10 years. Although the bill takes effect July 1, 2013, it is assumed that the phase-out begins with the June 30, 2013 valuation, which determines the employer contribution rates for fiscal 2015. It has been standard practice that SRPS actuarial valuations reflect enacted legislation at the earliest feasible time. Therefore, increased employer contributions begin in fiscal 2015.

The General Assembly's consulting actuary estimates that State (employer) pension contributions increase by $50.0 million in fiscal 2015 and continue to increase annually through fiscal 2023 due to the continued phase-out of the corridor, although the rate at which employer contributions grow begins to decelerate in fiscal 2019 due to the accumulation of larger plan assets resulting from the bill. Beginning in fiscal 2024, when the phase-out is complete, employer contributions are less than those currently projected under the corridor; total savings in fiscal 2024 are $19.0 million.

The State pays 100% of the amortization payments on behalf of members of the Teachers' Retirement System and Teachers' Pension System from general funds; payments for State employees are assumed to be allocated 60% general funds, 20% special funds, and 20% federal funds. Therefore, the total increase in employer contributions is assumed to be allocated 84% general funds, 8% special funds, and 8% federal funds.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Cheiron, Maryland State Retirement Agency, Department of Legislative Services

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ncs/rhh

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