Report to the Maryland General Assembly
Financial Health of the Maryland State Retirement and Pension System
January 1, 2017

Reporting requirements in the Budget Reconciliation and Financing Act of 2011 direct the Department of Budget and Management (DBM) to report biennially, beginning on January 1, 2013, to the Governor and the General Assembly on the financial health of the Maryland State Retirement and Pension System (SRPS). DBM has reviewed the most recent actuarial valuation results, available as of June 30, 2016, and finds that trends in the financial health of the system are generally positive several years into reforms passed during the 2011 Legislative Session. The Department has no recommendations concerning modifications to the system's funding methodology or benefits structure at this time.

1.0 Background

2011 Pension Reforms

Pension changes adopted during the 2011 session in Chapter 397 of 2011 (the Budget Reconciliation and Financing Act (BRFA) of 2011) altered the benefits for State employees and teachers and created a new budgeting mechanism to tackle the challenge of sustainable long-term system funding. Major components of the reform include:

- Current Members in the Teachers' Pension Systems (TPS), Employees' Pension System (EPS), State Police Retirement System (SPRS), and Law Enforcement Officers' Pension System (LEOPS)
  - Future service COLA capped at 2.5%, or 1% if 7.75% investment return target is not met.
  - TPS employee rate increased from 5% to 7%.
  - EPS employee rate increased from 5% to 7%.
  - LEOPS employee rate increased from 4% to 6% to 7%.
- Funding
  - Deducts $120M from reform savings reinvestment in FY 2012 and FY 2013 and caps the reform savings reinvestment to $300M per year thereafter.
- New Hires under Alternate Contributory Pension Selection (ACPS)
  - Benefit accrual rate decreased from 1.8% to 1.5%.
  - Future service Cost of Living Adjustment (COLA) capped at 2.5% or 1% if 7.75% investment return target is not met.
  - Final average compensation period increased from 3 to 5 years.
  - Vesting period increased from 5 to 10 years.
  - Normal retirement eligibility at age 65 with 10 years of service or Rule of 90.

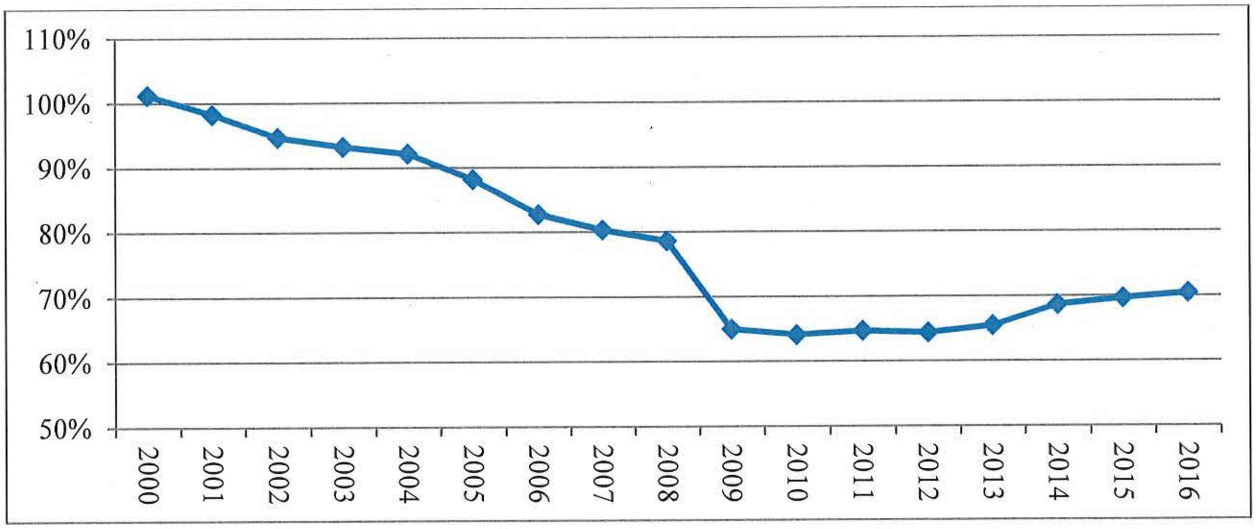
In addition, Chapter 485 of 2012 revised the Judges' Retirement System (JRS), increasing the member contribution rate from 6% to 8% and adding a 5-year vesting requirement for members hired on or after July 1, 2012.

Corridor Funding Method Phase-out

Chapter 440 of 2002 established the corridor funding method to mitigate the effects of fluctuations in market returns on employer contribution rates by spreading those effects over five years. The corridor method froze employer contribution rates for the employees' and teachers' systems at their fiscal 2002 levels as long as the two systems remained actuarially funded between 90% and 100%. Once the plans fall out of these "corridors," employer contributions increase by one-fifth of the difference between the prior year's rate and the true actuarial rate required to fully fund the systems.

While this change did result in significant savings and prevented large oscillations in retirement contributions, once the systems began to fall out of the corridor they continued to fall since only one-fifth of the gap was made up per year. **Exhibit 1** shows that over the next decade the funding status of the systems dropped substantially, due in large part to the corridor method and to the pension benefit enhancement enacted in 2006. For reference, pension experts state that the funding ratio should be at least 80% for a healthy fund.

Exhibit 1. Maryland Pension System Funding Ratio, FY 2000-16



During the 2012 Session, the General Assembly reacted to these concerns by passing legislation:

- phasing out the corridor funding method over 10 years;
- adopting a 25-year closed amortization schedule for all current and future liabilities (which helped to pay for the increased contributions related to the phase out);
- reducing the system's inflation assumption from 3.0 to 2.8% to reflect market trends; and
- decreasing the system's investment return assumption from 7.75 to 7.55% over four years to reflect more reasonable investment expectations.

During the 2015 Legislative Session, the General Assembly passed Chapter 489 which fully phased out the corridor funding method as of FY 2017.

Pension Reform Reinvestment

The 2011 pension reform required that $300 million of the reform savings be reinvested in the system each year beginning in fiscal 2014 to accelerate the system's return to financial health. This reinvestment amount was revised by Chapter 464 of 2014, reducing it to $100 million in fiscal 2014 and 2015 and then increasing it by $50 million annually until it reaches $300 million in fiscal 2019. Finally, Chapter 489 of 2015 Legislative Session reduced the reinvestment contribution to $75 million annually until the system reaches 85% funded. An additional supplemental contribution is required from fiscal 2017 through 2020, equaling one-half of any unappropriated general fund balance in excess of $10.0 million be paid to the pension fund, up to a maximum of $50 million annually. In FY 2017, Governor Hogan included $150 million in the budget for pension reinvestment beyond what was actuarially required.

2.0 System Progress Following Reforms

Exhibit 2 below compares the funding status of the various Maryland retirement systems as of June 30, 2016 to projections made when the reforms were passed. The table also compares current projections for when the system will be 80 percent and 100 percent funded to estimates made during the 2011 Legislative Session.

Exhibit 2. Comparison of Funded Ratio Experience and Projections

	Teacher's	Employee's	Police	Judges	LEOPS	Total
Funded Ratio as of June 30, 2016						
Actual	72.7%	67.7%	63.3%	82.2%	62.1%	**70.5%**
2010 Projected*	65.5%	58.6%	58.8%	70.7%	64.9%	**63.2%**
Difference	7.2%	9.1%	4.5%	11.5%	-2.8%	**7.3%**
Projected Year 80% Funded is Reached						
2016 Projected	2026	2031	2032	2013	2030	**2028**
2010 Projected*	2023	2025	2027	2021	2022	**2024**
Difference	3	6	5	-8	8	**4**
Projected Year 100% Funded is Reached						
2014 Projected	2039	2039	2039	2039	2039	**2039**
2010 Projected*	2032	2031	2034	2036	2031	**2031**
Difference	7	8	5	3	8	**8**

*Projected figures from the General Assembly Reform study conducted by Gabriel Roeder Smith & Company (GRS), dated April 12, 2011. Based on the June 30, 2010 valuation.

Actual experience that differed from actuarial assumptions, combined with corridor and reinvestment changes, has resulted in the June 30, 2016 funded ratio exceeding projections from 2010 by 7.3 percent. With the slight exception of LEOPS, every member system's funded ratio in FY 2016 exceeded 2010 projections.

The two less positive trends are (a) the projected year in which the system will reach 80 percent funding status has increased by four to 2028 and (b) the year in which 100 percent funding status will be achieved has increased by eight. Both changes are largely tied to the 25-year amortization schedule and corridor funding ending.

3.0 Conclusion and Recommendations

Based on these generally positive results, and the inherent long-term nature of pension system financing, DBM has no recommendations concerning modifications to the system at this juncture.