M E M O R A N D U M

January 19, 2011

TO: Councilmembers

FROM: Karen Orlansky, Director
Office of Legislative Oversight

SUBJECT: **Follow-up to OLO Report on Achieving a Structurally Balanced Budget: Questions related to the County Government s retirement plans**

This memorandum addresses questions and requests for additional information from Councilmembers about the County Government s pension/retirement benefit plans. The table below lists the four questions addressed in this memo, with respective page references:

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If you have any questions about information in this memo, please contact Leslie Rubin in OLO at x77998 or leslie.rubin@montgomerycountymd.gov.

c: Steve Farber

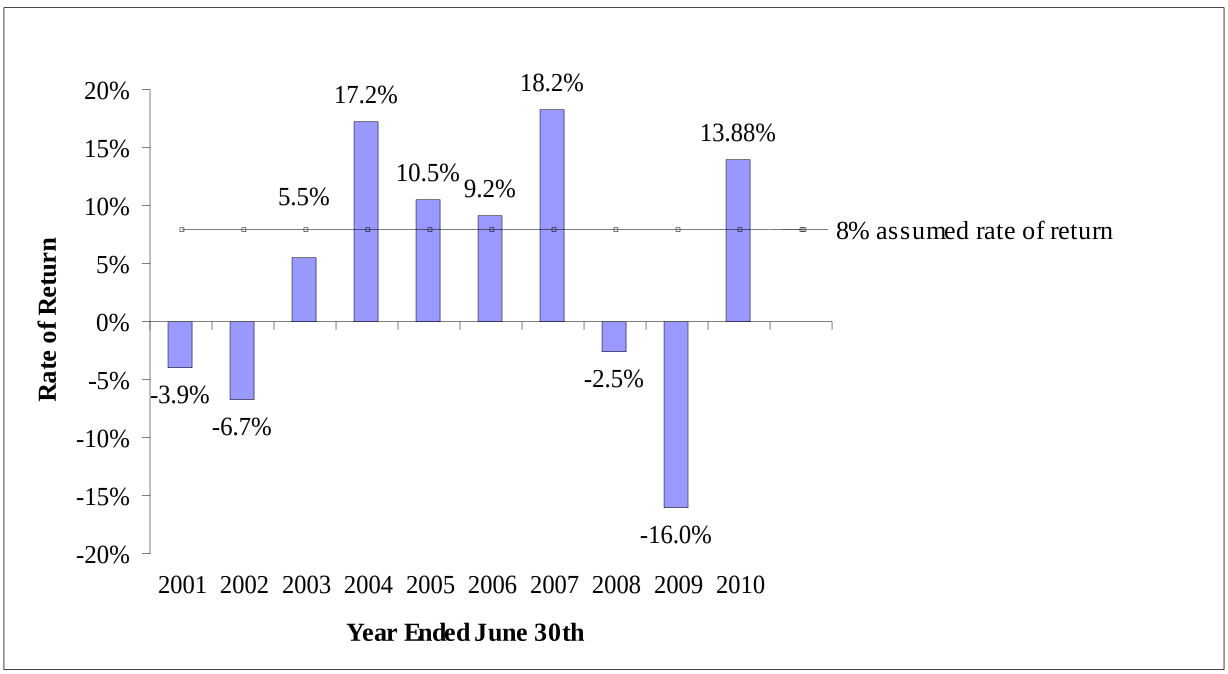
A. What have been the historical rates of investment returns in the County Government s defined benefit retirement plan (the Employees Retirement System)?

Between 2001 and 2010, the County Government and the County s actuaries assumed that the Employee Retirement System (ERS) investments would earn 8% annually. This rate of return is one of the key assumptions that directly affects the actuaries annual calculation of the recommended County Government contribution to the ERS.

The exhibit below summarizes the ERS actual rates of investment returns from 2001 through 2010. As the data show, the ERS met its projected rate of return in half of the years during the decade. In four of the years, the ERS had negative returns, i.e., the investments lost money during the year. According to Mercer (the firm that provides actuarial services to the County), from 2001 to 2010, the average annual rate of return was approximately 3.6%.

In December 2010, the County Government adjusted the assumed rate of investment return in the ERS downward from 8% to 7.5% annually. Lowering this assumption will increase the County Government s annual contributions to the ERS.

Employees Retirement System Rates of Return, 2001-2010



Source: Montgomery County Employee Retirement Plan CAFRs, 2001-2010

B. What is the funded ratio of the Employees Retirement System?

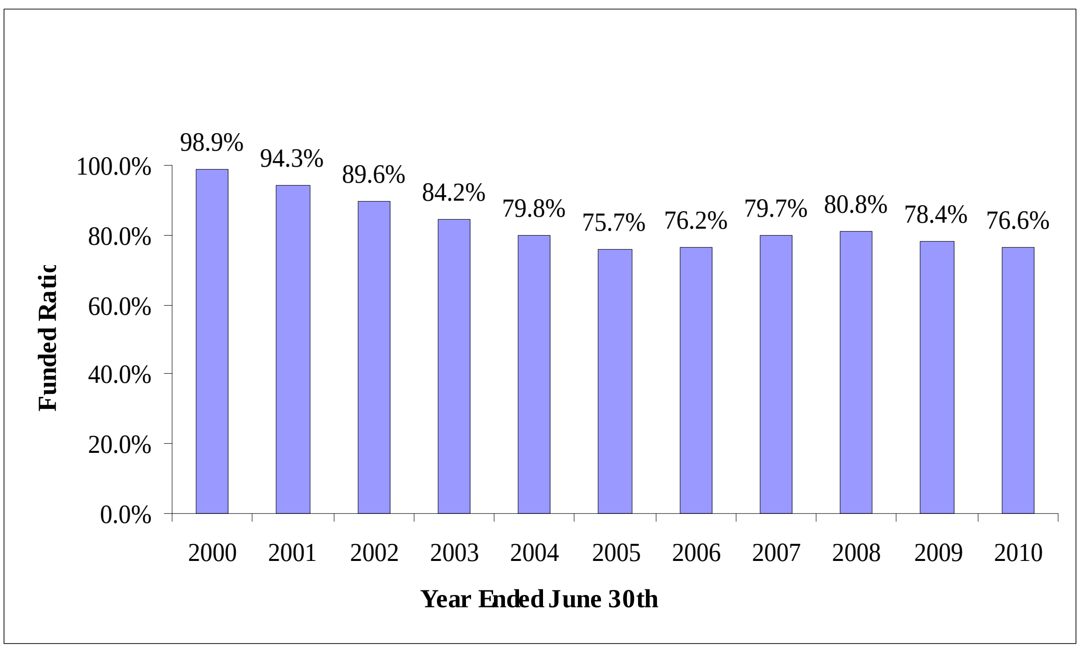
The amount of money that a pension plan has to pay for its long-term liabilities is generally expressed as a percentage, which is referred to as a pension system s funded ratio. A ratio of 100 percent means a pension fund has 100 percent of the assets needed to pay for its projected liabilities (the cost of pensions) for current members.

A pension fund with pension liabilities that exceed its current assets has what is known as an unfunded liability; a pension fund with an unfunded liability has a funded ratio below 100 percent. Experts generally assert that a pension fund is healthy if it has a funded ratio of at least 80%.[1]

During the past decade, the ERS funded ratio has declined. In FY00 the ERS had sufficient funds to pay for 98.9% of its future pension liabilities; by FY10 that percent declined to 76.6% due to investment losses, changes in plan assumptions[2] by the County s actuaries, and increased liabilities due to salary and pension benefit enhancements. Between the end of FY09 and the end of FY10, the ERS unfunded liability increased approximately $100 million, from $751 million to $854 million, primarily due to changes in plan assumptions.

The exhibit below shows the ERS funded ratio at the end of each fiscal year, from FY00 to FY10.

Employees Retirement System Funded Ratio, 2000-2010



Source: ERS Actuarial Valuation Reports, 2000-2010

[1] See, e.g., Munnell et al., *The Funding of State and Local Pensions: 2009-2013,* Center for Retirement Research at Boston College at p.4 (April 2010); *The Trillion Dollar Gap: Underfunded State Retirement Systems and the Road to Reform*, The Pew Center on the States at p.3 (February 2010).

[2] Plan assumptions include many types of data, including employee retirement rates, life expectancy, projected rate of investment return, and inflation.

C. What would be the cost savings of rolling back the County Government s contribution to the defined contribution plan (Retirement Savings Plan) and hybrid retirement plan (Guaranteed Retirement Income Plan) from 8% to 6% of plan members salaries?

Currently, the County Government contributes 8% of salary towards retirement for most members of the County s RSP (defined contribution plan) and GRIP (hybrid retirement plan). In FY11, the County Government will contribute approximately $13.8 million to employee retirement accounts in the RSP and GRIP for approximately 4,200 employees. If the County Government contributed 6% of employees salary, the contribution would have been $10.3 million, a savings of $3.0 million.

	FY11 RSP/GRIP Contribution		**Difference**
	Actual (8% of Salary)*	**6% of Salary**	
Employees' Retirement Savings Plan (RSP)	$11.2 million	$8.4 million	$2.8 million
Guaranteed Retirement Income Plan (GRIP)	$2.6 million	$2.4 million	$0.2 million
Total	**$13.8 million**	**$10.8 million**	**$3.0 million**

*Note: based on actuarial calculations, in FY11 the County Government contributed 6.53% of salary toward retirement for members of the GRIP.
Source: Executive s FY11 Proposed Operating Budget and OLO calculations

OLO was also asked to estimate the savings if the County Government switched from an 8%-4% employer-employee contribution split to a 6%-6% split. In such a scenario, the savings to the County would be the same $3.0 million identified above. However, a 6%-6% split would require RSP/GRIP employees to contribute an additional 2% of their salaries towards retirement. This would result in an employee contribution that is higher than employee contributions in the integrated pension plan (all ERS members hired after 1978), who are required to contribute between 4% and 5.5% of salary towards their retirement.

D. What would be the cost savings from disallowing employees who are initially hired into defined benefit plan positions to remain in the defined benefit plan even when they move to County jobs classified as defined contribution or hybrid plan positions?

Currently, the County Government allows public safety employees (hired on or after October 1, 1994) to remain in the Employees Retirement System if they move to a position that is only eligible for the RSP or GRIP retirement plans. With the exception of these public safety employees who transfer into other County Government positions, non-public safety employees hired after October 1, 1994 are not eligible to participate in ERS. This practice is allowed based on current interpretation of County law.

If the Council amended the law and ended this practice and, going forward, required ERS members to move to the RSP or GRIP if they transfer to non-ERS-eligible positions, the County Government would save the difference between what it contributes to the RSP or GRIP and what it would have contributed to the ERS. In FY12, the County will contribute 25.17% of salary for each ERS member compared to 8% of salary for the vast majority of RSP or GRIP members a difference of 17.17%.

At the end of FY10, there were 125 members of the ERS who were in positions eligible for the RSP or GRIP. In FY12, the County Government will contribute $2.1 million to the ERS for these members. If these employees were RSP/GRIP members, the County Government would contribute approximately $230,000 toward their retirement in FY12, a difference of $1.4 million.

Note: based on advice from the County Attorney, there is a question of whether the County Government could retroactively require these 125 employees to switch retirement plans. The County Government may only be able to change this policy for employees who switch positions in the future.