Agenda Item 3.1
April 6, 2010
Introduction

MEMORANDUM

TO: County Council

FROM: Robert H. Drummer, Senior Legislative Attorney

SUBJECT: **Introduction:** Expedited Bill 16-10, Personnel – Retirement – Imputed Compensation Limit

Expedited Bill 16-10, Personnel – Retirement – Imputed Compensation Limit, sponsored by Councilmember Andrews, is scheduled to be introduced on April 6, 2010. A public hearing is tentatively scheduled for April 27 at 1:30 p.m.

Although the general wage adjustments for FY10 negotiated with each of the 3 County employee unions representing police, fire, and general government workers were "postponed" last year, Expedited Bill 18-09 required that the calculation of regular earnings used to determine a retirement benefit include the FY10 general wage adjustment as if the employee had received it on July 1, 2009.[1] This imputed compensation is scheduled to carry over into the calculation of regular earnings used to calculate a defined benefit pension for the rest of an employee's County career. Expedited Bill 16-10 would amend the retirement laws to limit the effect of the imputed compensation to the calculation of regular earnings for FY10 only.

The County's actuary, Mercer, estimated that this imputed compensation would require the County to increase its annual contribution to the Employees Retirement System Trust Fund by $8.589 million per year for the next 40 years. A copy of Mercer's report is at ©5-7 and a memorandum reviewing it from the Council's actuary, Bolton Partners, Inc., is at ©8. The actual savings from limiting this imputed compensation to FY10 is currently estimated to be $7.2 million for FY11. Annual savings would continue for a total of 40 years.

[1] Employees of the Montgomery County Public Schools also agreed to "postpone" a negotiated general wage adjustment for FY10, but did not receive this imputed compensation.

Expedited Bill No. 16-10
Concerning: Personnel - Retirement – Imputed Compensation Limit
Revised: April 1, 2010 Draft No. 2
Introduced: April 6, 2010
Expires: October 6, 2011
Enacted: ______
Executive: ______
Effective: ______
Sunset Date: None
Ch. _____, Laws of Mont. Co. ______

COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND

By: Councilmember Andrews

AN EXPEDITED ACT to:

(1) amend the definition of regular earnings to limit certain imputed compensation under the employees' retirement system to FY10 only; and
(2) generally amend the law regarding the employees' retirement system.

By amending
Montgomery County Code
Chapter 33, Personnel and Human Resources
Sections 33-35

Boldface	*Heading or defined term.*
Underlining	*Added to existing law by original bill.*
[Single boldface brackets**]**	*Deleted from existing law by original bill.*
Double underlining	*Added by amendment.*
[[Double boldface brackets**]]**	*Deleted from existing law or the bill by amendment.*
* * *	*Existing law unaffected by bill.*

The County Council for Montgomery County, Maryland approves the following Act:

Sec. 1. Section 33-35 is amended as follows:

Sec. 33-35 Definitions

In this Article, the following words and phrases have the following meanings:

* * *

Regular earnings: Except as otherwise provided, gross pay for actual hours worked, not including overtime. To calculate regular [Regular] earnings, for FY10 only, a Group A, E, or H member who is employed on July 1, 2009 and participates in the integrated or optional plan must include amounts as if the member had received an increase of 4.5% in the member's gross pay as of July 1, 2009, except for the purpose of calculating a member's contribution under Section 33-39. To calculate regular [Regular] earnings, for FY10 only, for a Group F member who is employed on July 1, 2009 and participates in the integrated or optional plan must include amounts as if the member had received an increase of 4.25% in the member's gross pay as of July 1, 2009, except for the purpose of calculating a member's contribution under Section 33-39. To calculate regular [Regular] earnings, for FY10 only, for a Group G member who is employed on July 1, 2009 and participates in the integrated or optional plan must include amounts as if the member had received an increase of 4% in the member's gross pay as of July 1, 2009, except for the purpose of calculating a member's contribution under Section 33-39. Regular earnings for an elected official is gross pay for services rendered to the County. Regular earnings must not exceed the limit under Internal Revenue Code Section 401(a)(17), as adjusted by the Internal Revenue Service. Gross pay must be used to determine benefits even if the County implements a pick-up plan under Section 414 of the Internal Revenue Code. Gross pay must be used to determine benefits even if a member has agreed to a reduction in earnings under:

(a) the County's deferred compensation plan under Section 457 of the Internal Revenue Code; or

(b) any statutory fringe benefit program sponsored by the County and permitted by the Internal Revenue Code.

* * *

Sec. 2. Expedited Effective Date. The Council declares that this Act is necessary for the immediate protection of the public interest. This Act takes effect on July 1, 2010.

Approved:

Nancy Floreen, President, County Council Date

Approved:

Isiah Leggett, County Executive Date

This is a correct copy of Council action.

Linda M. Lauer, Clerk of the Council Date

LEGISLATIVE REQUEST REPORT

Expedited Bill 16-10

Personnel-Retirement-Imputed Compensation Limit

DESCRIPTION:	Bill 18-09 required that the calculation of regular earnings used to determine a retirement benefit include the general wage adjustment for FY10 as if the employee had received it on July 1, 2009. This imputed compensation is scheduled to carry over into the calculation of regular earnings used to calculate a defined benefit pension for the rest of an employee's County career. Expedited Bill 16-10 would amend the Retirement Laws to limit the effect of the imputed compensation to the calculation of regular earnings for FY10 only.
PROBLEM:	The County has experienced a severe reduction in revenue and must reduce its FY11 expenditures in order to balance the budget.
GOALS AND OBJECTIVES:	The estimated savings of $7.2 million for FY11 would partially offset the need to use furloughs or a reduction-in-force to reduce expenditures.
COORDINATION:	Human Resources, County Attorney
FISCAL IMPACT:	To be requested.
ECONOMIC IMPACT:	To be requested.
EVALUATION:	To be requested.
EXPERIENCE ELSEWHERE:	To be researched.
SOURCE OF INFORMATION:	Robert H. Drummer, Senior Legislative Attorney
APPLICATION WITHIN MUNICIPALITIES:	Not applicable.
PENALTIES:	Not applicable

Douglas L. Rowe, FSA, MAAA, EA
Principal

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MERCER

MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

April 27, 2009

Mr. Wes Girling
Montgomery County Government
101 Monroe Street, Seventh Floor
Rockville, MD 20850-2589

Confidential
Via Electronic Mail

Subject: Imputed Compensation Pension Cost

Dear Wes:

This letter summarizes the cost calculations you requested for the imputed compensation bill. The calculations are based on the July 1, 2008 actuarial valuation data for group A, E, F, G and H members. The actuarial assumptions and methods and plan provisions are the same as those used in our July 2008 actuarial valuation report except for the assumptions and incentive provisions noted below. Please note that actual cost of the imputed compensation will differ based on the number of individuals that are active as of July 1, 2009.

We have projected all costs from the July 1, 2008 valuation date to the effective date of July 1, 2009 using standard actuarial approximation techniques. By cost/savings, we mean the change in Normal Cost and an amortization of any changes in unfunded liability unless otherwise indicated. Cost/savings will change over time as experience develops.

Cost Calculated From Two Viewpoints

We have calculated the cost of imputing pay from two viewpoints – just the legislation (which increases benefits by imputing pay) that we were provided, and as a package which takes away previously negotiated pay increases, but then calculates pensions as if those pay increases had occurred. The cost for the second viewpoint is that employee contributions are not made on the imputed pay.

Other Considerations – Legislation Only Viewpoint

We have recommended that the County consider a shorter amortization period for future plan improvements in order to restore the funded ratio more quickly following a benefit improvement and in order to better align the cost of the improvement with the service of participants receiving an increase for service already performed. Applying that concept to this retirement program might result in a 10 to 20 year amortization period. We show detailed results below for the County's traditional 40 year amortization period.

The dollar impact of the Normal Cost increase on the County's contribution will tend to increase as employees near retirement, but decrease as the number of affected employees decreases over time. Please let me know if you would like a projection to quantify this pattern. Everything else being equal, the cost impact will increase (decrease) if actual future pay increases exceed (trail) assumed pay increases. The amortization payment will remain level for the chosen period – 40 years unless a shorter period is chosen.

Other Considerations – Package Viewpoint

Lower employee contributions also reduce "refund" benefits (e.g., the return of employee contributions to nonvested terminated employees) but this impact is negligible compared to the contributions themselves. Employee contributions are subtracted from the total required contribution each year to determine the County's contribution. The reduced subtraction (which results in a higher County contribution) due to the package will decrease over time as employees on July 1, 2009 leave employment.

Plan Provisions

- Employees on July 1, 2009 in groups A, E, and H would receive benefits as if their gross pay increased 4.50% on July 1, 2009 and remained 4.50% higher than actual pay for the remainder of their careers. This does not include benefits that are based on employee contributions.
- Employees on July 1, 2009 in group F would receive benefits as if their gross pay increased 4.25% on July 1, 2009 and remained 4.25% higher than actual pay for the remainder of their careers. This does not include benefits that are based on employee contributions.
- Employees on July 1, 2009 in group G would receive benefits as if their gross pay increased 4.00% on July 1, 2009 and remained 4.00% higher than actual pay for the remainder of their careers. This does not include benefits that are based on employee contributions.
- This legislation does not apply to Retirement Savings Plan or Guaranteed Retirement Income Plan participants.

Estimated Costs of Proposed Changes

Annual Costs using 40-year amortization for represented and non-represented members.

	Legislation Alone	Package
Group A	$1,656,000	$155,000
Group E	$ 975,000	$ 90,000
Group F	$2,233,000	$185,000
Group G	$1,938,000	$190,000
Group H	$1,787,000	$155,000
Total	$8,589,000*	$775,000

Numbers may not add up due to rounding.

* The total would increase to $10,673,000 if a 15 year amortization period is used.

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MERCER

MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Presumably, you want to use one column above or the other, depending on the viewpoint. You would not want to add the columns.

Increase in Actuarial Accrued Liability for represented and non-represented members

	Legislation Alone	**Package**
Group A	$14,166,000	Insignificant Decrease
Group E	$ 7,094,000	
Group F	$16,968,000	
Group G	$14,962,000	
Group H	$15,058,000	
Total	$68,248,000	

Numbers may not add up due to rounding.

Please let me know if you have any questions or need any further information. I can be reached at 410 347 2806. I meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this letter. I am not aware of any direct or material indirect financial interest or relationship, including investments or other services that could create a conflict of interest that would impair the objectivity of our work

Sincerely,

Douglas L. Rowe

Douglas L. Rowe, FSA, MAAA, EA
Principal

Copy:
Aquil Ahmed, Mercer

The information contained in this document (including any attachments) is not intended by Mercer to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code that may be imposed on the taxpayer.

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MEMORANDUM

DATE: May 6, 2009

TO: Management and Fiscal Policy Committee

FROM: Thomas Lowman, Bolton Partners, Inc. TL

SUBJECT: Comments on the Pension Amendment/definition of compensation

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I have reviewed the May 4th memo from Joseph Beach to Phil Andrews, and Mercer's April 27th letter to Wes Girling. These both addressed the pension cost associated with changing the definition of compensation due to elimination of previously negotiated wage increases. The higher annual pension cost of $8.589 million looks reasonable, given that the active liability is about $1.5 billion.

I was asked to comment on the amortization period. I agree with the fourth paragraph of Mercer's April 27th letter that a 10-20 year amortization period would be more appropriate. Basically, there is no good reason to fund this beyond the time when those benefiting from the change will be working. Thus, Mercer's 15 year amortization cost of $10.673 million is more appropriate.

My understanding is that this change is permanent for all current employees; this means that someone retiring 20 years from now, will have their pension based on a higher pay amount then they actually will be receiving in 17-20 years (however, someone hired on 7/1/09 will not have such an advantage). There are reasons to argue an alternative position: any change of this sort should apply as an add-on but only to pay earned during the duration of the union contract (when the additional pay increase was eliminated). This more limited design would have a materially lower cost and can legitimately be said to addresses the same issue (even if leaving open the need to have future negotiations over whether the pay levels have "returned" to the appropriate level).

My understanding is that Montgomery County is not alone in considering this issue. Anne Arundel County has also prepared proposed legislation. However, Anne Arundel County's proposal only increases compensation in FY10. If someone's final average pay does not include pay in FY10 (most will leave far enough into the future that it will not include FY10), there would be no impact on their pension. This makes the cost materially less than what Mercer determined for the more generous proposal.

My main concern is over the funded status of the plan and the projected contribution increases. The plan's recent serious investment losses will start showing up in FY11 contributions and be fully reflected by FY15. The current FY10 contribution of $115 million, will likely climb by tens of millions. I appreciate the reason for passing a bill of this nature, but it should not be passed without a full appreciation of the future funding demands that will arrive shortly (and ideally a belief that these increases can be handled).