Reforming Maryland’s Pension System:
A Path to Sustainability

Governor Martin O’Malley
January 21, 2011
Maryland’s unfunded liabilities associated with benefits for retirees total $35 billion.
- Pension Liability = $19 B
- Retiree Health Liability = $16 B

Maryland compares unfavorably to other states.
- Maryland’s pension funded level of 64% ranks 30th among all states.
- Maryland’s Retiree Health liability is the 13th highest nationally.
- Maryland’s retiree health liability is only 1% funded.

According to the Pew Center on the States, “Many experts in the field, including the U.S. Government Accountability Office, suggest that a healthy system is one that is at least 80% funded.”
- Maryland is 64% funded.
Pension Liability – Contributions Increase but Funded Status Declines

- Maryland to contribute about $1.5 billion to the pension system in FY12, nearly tripling the $555 million contributed in FY03.

- In each year of the first term, the O’Malley-Brown Administration fully funded the State’s required pension contribution.

- Despite rapid increases in the State contribution, the funded status of the pension system dropped precipitously over the last decade.
  - 95% funded in FY 2002
  - 64% funded in FY 2010
  - 59% funded in FY 2012 (projected)
State Retirement contributions increased 178% from Fiscal Year 2003 to Fiscal Year 2012.

Funded Status Falls from 93% to 59%
Almost half of the unfunded liability associated with retiree health benefits relates to Maryland’s prescription drug benefit.

Maryland’s prescription drug cost sharing requirements are more generous than many states:
- Maryland requires a $5 co-pay for generic drugs.
  - More than half of state plans nationally require a co-payment of $10-19. (Segal Company, 2011)
- Maryland requires a $25 co-pay for non-preferred drugs.
  - 87% of State plans apply co-pays of $30 or more and 68% require co-pays in excess of $40. (Segal Company, 2011)
- Maryland is one of only 11 states with an out-of-pocket cap on drug costs. (Department of Legislative Services)
Sustainable Retirement Benefits

Goals of Benefit Reform

- Preserve Defined Benefit for State Workers
- Ensure Access to Medical/Rx Benefit
- Reduce Unfunded Liabilities
- Increase System Funding Level
- Ensure Sustainable Pension Funding
Proposal to Preserve Retirement Benefits Pension Changes

- No impact on current retirees
- No impact on benefits already earned by active or former employees/teachers
- For benefits earned for service in FY 2012 and future years, active employees/teachers to make one-time choice:
  - Continue to pay 5% of salary towards retirement with adjusted benefit (1.5% benefit multiplier for each future year of service rather than current 1.8% benefit multiplier);
    OR
  - Increase contribution to retirement from 5% to 7% of pay and continue to earn benefits at the current level (1.8% benefit multiplier for each future year of service)
- How does benefit multiplier work?
  - Employee earning multiplier of 1.8% for 30 years would receive a benefit = 54% of salary (1.8 multiplier x 30 years)
  - Employee earning multiplier of 1.5% for 30 years would receive a benefit = 45% of salary (1.5 multiplier x 30 years)
Proposal to Preserve Retirement Benefits - Pension Changes

New Employees/Teachers

- Adjusted benefit
  (7% contribution & 1.5% benefit multiplier)
- Tighter eligibility criteria
  (vesting at 10 rather than 5 years)
- Early Retirement age increased from 55 to 60
- Benefit calculated on highest 5 years of salary rather than highest 3 years
- Adjusted retiree COLAs if investment goals of system not achieved
Proposal to Preserve Retirement Benefits - Pension Changes

Other pension changes:

- Close DROP Program to future law enforcement participants
- Increase employee contribution for new judges from 6% to 8%
- Direct Compensation Commissions to review pensions for elected officials for sustainability and fairness
Proposal to Preserve Retirement Benefits - Health Changes

Changes for retirees

- Transition Retirees to Medicare Part D drug coverage in 2020 when the Part D “coverage gap” is phased-out
- Establish a State run Medicare Part D look-alike program in FY 2012 that mirrors Medicare Part D but fills in the “coverage gap”
- Under new plan, state will subsidize 75% of retiree drug costs after a $310 deductible.

Changes for active employees

- Align co-pays with national trends. New co-pays range from $10 for generic drugs to $40 for non-preferred drugs.
- Out-of-Pocket Cap raised from $700 to $1,000 for individuals and $1,500 for couples/families
Proposed health changes will reduce unfunded retiree health liability by about $7 billion.

Reinvest reform impacts into retirement system to reduce the unfunded liability.

- State will reinvest more than $1 billion of savings from reform in retirement system over next 6 years.

Achieve 80% funding of pension system by FY 2023.

- Annual report on funded status required from pension system.
- Dept of Budget & Management (DBM) required to prepare bi-annual report assessing financial health of pension system.
  - Report to include recommendations concerning adjustments to state funding and/or future benefits.
Unfunded Liability for Retiree Health Insurance Drops by Almost 50%

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<tr>
<th>Current</th>
<th>After Proposed Reforms</th>
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<tr>
<td>Unfunded Liability = $16B</td>
<td>Unfunded Liability = $9B</td>
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$ in Billions

- $18
- $16
- $14
- $12
- $10
- $8
- $6
- $4