Review of the Pension Plan Administered by the Maryland Transit Administration



DEPARTMENT OF LEGISLATIVE SERVICES 2017

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Department of Legislative Services
Annapolis, Maryland

December 2017

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF POLICY ANALYSIS
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Executive Director

December 2017

The Honorable Thomas V. Mike Miller, Jr., President of the Senate
The Honorable Michael E. Busch, Speaker of the House of Delegates
Honorable Members of the Maryland General Assembly

Ladies and Gentlemen:

During the 2017 interim, the Department of Legislative Services (DLS) conducted an analysis of the Maryland Transit Administration (MTA) Pension Plan. Since 2010, pension plans administered by the State Retirement Agency (SRA) have received considerable scrutiny and were reformed substantially. The MTA Pension Plan has not received the same level of scrutiny in recent years. The resulting report includes:

- a description of the MTA Pension Plan's benefits and costs;
- a comparison of the transit pension plan's benefits, financial health, and collective bargaining arrangement to plans administered by SRA; and
- recommendations to improve the funding status of the MTA Pension Plan.

Patrick S. Frank of the Office of Policy Analysis wrote the report, which was reviewed by Michael C. Rubenstein. Maureen R. Merzlak was responsible for production of the manuscript. Your questions and comments are welcomed.

Sincerely,

David C. Romans
Coordinator, Fiscal and Policy Analysis

DCR/PSF/mrm

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Purpose of the Study

This decade has been one in which employee pension policies have consistently been scrutinized, and substantial changes have been made to most State pensions. In 2010, the Maryland General Assembly formed a commission to review the State's pension policies. The goal was to improve the affordability and sustainability of pensions administered by the State Retirement Agency (SRA). SRA-administered pensions have remained under considerable scrutiny since the commission made its recommendations.

Most of the commission's recommendations were enacted into law. In 2011, the General Assembly enacted major reform that reduced pension multipliers, reduced cost-of-living adjustments (COLA), increased vesting periods, and increased employee contributions. In 2015, the State modified its funding methodology to implement an actuarially approved methodology.

The Maryland Transit Administration (MTA) Pension Plan has not received the same level of scrutiny as the SRA-administered plans in recent years. The actuarially determined contribution increased from $45 million in fiscal 2016 to $62 million in fiscal 2017, an increase of $17 million. This additional liability was not met by an increase in appropriations into the MTA pension fund. While extraordinary steps have been taken to reduce unfunded liabilities in the SRA-administered pensions, growing liabilities in the MTA pension have not been similarly addressed.

The purpose of this study is to examine the benefits and costs associated with the MTA pension, compare these benefits and costs to the SRA pensions (in which almost all State employees and teachers participate), and make recommendations to improve the transparency and funded status of MTA pensions.

Description of the MTA Pension Plan

MTA is an agency within the Maryland Department of Transportation (MDOT). MTA consists of three programs with employees in the MTA plan. Transit administration provides executive direction and support services for MTA. Bus operations manages bus services in Baltimore City and surrounding counties. These services include the operation of fixed route and paratransit lines and contracts with commuter and paratransit service providers. Rail operations includes the Baltimore Metro heavy rail line and the Baltimore-area light rail line as well as the management of the Maryland Area Regional Commuter contracts with Amtrak and Bombardier.

MDOT employees are required to participate in a pension plan administered by SRA or MTA. Most participate in a pension plan for regular employees. For sworn law enforcement officers, there is the Law Enforcement Officers Pension System. MTA administers its own pension plan for employees that are members of the Amalgamated Transit Union, Local 1300 or Office and Professional Employees International Union, Local 2 and who are not participating in the standard State employees' pension plans. Union employees are required to join the MTA plan, and nonunion employees are required to join the SRA plan. All of these plans are defined benefit plans.

Members of defined benefit pension plans who qualify for a normal service retirement benefit receive a lifetime annuity based on their length of service and salary. Specifically, the annual benefit that a retiree receives is the product of the:

- multiplier, which is 1.7% for the MTA pension;
- the average annual compensation, which is the average of the highest 3 years of the last 10 years that an eligible MTA employee has worked; and
- the number of years of employment in the plan.

Thus, plan members earn a portion of their final benefit each year that they work. The cost of this incremental annual benefit is referred to as the normal cost. If the value of a plan's assets are sufficient to support all accrued benefits, a plan is considered to be 100% funded. If the value of these assets is less than the benefits that have been earned, there is an unfunded liability. If there is an unfunded liability, the actuary calculates the additional contributions required to bring a plan to 100% funding over a particular period. This period is referred to as the amortization period, and the payment is the amortization payment.

As of July 1, 2017, 2,654 MTA employees participated in the MTA pension. The actuary advises that the plan had the following members:

- 2,654 active employees;
- 1,397 service retirements and beneficiaries;
- 429 disability retirements;
- 509 vested terminations; and
- 18 Qualified Domestic Relations Order (QDRO)[1] participants.

Exhibit 1 shows the MTA pension's key provisions.

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[1] In Maryland divorces, retirement assets can be transferred from one spouse to another. The most common order for a private pension is called a QDRO. A QDRO is a specific type of domestic relations order that recognizes the right of an "alternate payee" to receive all or part of a retirement or pension plan, which belongs to another person.

Exhibit 1
Key Attributes of the Mass Transit Administration Pension Plan
Fiscal 2017

Vesting Period	100.0% with 5 years for employees hired before July 1, 2012. 100.0% with 7 years for Local 1300 employees hired on or after May 18, 2013, and Local 2 employees hired between July 1, 2012, and June 30, 2016. 100.0% with 10 years for Local 2 and Local 1300 employees hired after June 30, 2016.
Normal Retirement Date	Attainment of age 52 with 30 years of service. Attainment of age 65 and fully vested.
Normal Retirement Benefit Multiplier	1.7%.[1]
Average Annual Compensation	The average of a member's pensionable earnings for 3 years over the last 10 years of credited service. This may include overtime. Effective July 1, 2016, credited earnings may not exceed 2,392 pay hours in any year.
Cost-of-living Adjustment	Consumer Price Index, U.S. City Average, but not greater than 3.0%.
Early Retirement Eligibility	Attain age 55 with age plus years of service at least equal to 85.
Early Retirement Benefits	Calculate benefits as of DOR and reduce by 4/12% for each month preceding 65 if DOR is less than or equal to 60 and 5/12% for each month of DOR is greater than 60.
Disability Retirement Eligibility	Vested and certification by the State Medical Director.
Disability Retirement Benefits	Normal retirement benefit based on Average Annual Compensation but not less than $200 per month, $360 per month with 10 years of service, and $720 per month with 20 years of service.
Termination Benefits	Vested participants receive calculated benefits beginning at age 65 if they do not retire from MTA service.
Employee Contributions	Effective July 1, 2016, employees contribute 2.0% of pensionable earnings to the MTA Pension Plan; prior to that, the plan was noncontributory.
Amortization Period	Open up to 25 years.

DOR: Date of retirement

[1]There also is a minimum per month benefit that was eliminated effective July 1, 2016. It was $80 per month times years of service, $85 for retirements after June 30, 2012, $90 for retirements after June 30, 2013, $92 for retirements after June 30, 2014, and $95 for retirements after June 30, 2015.

Source: Bolton Partners' *Maryland Transit Administration Pension Plan Actuarial Valuation as of July 1, 2017*

Every fall, the MTA actuary provides an annual valuation of the pension plan. This valuation calculates the effect of economic and demographic experience from the most recent fiscal year on the pension plan. The valuation provides a status report on the pension that examines contributions, investment earnings, benefit payments, inflation, retirement and disability rates, and other factors affecting the accrued actuarial liability. These reports provide a thorough review of the MTA plan and almost all of the data used in this report is derived from these actuarial valuations.

The valuation also estimates the actuarially determined contribution (ADC) and calculates the plan's funded ratio. The ADC is the annual employer contribution recommended by the actuary to achieve or maintain the pension's full funding over a prescribed amortization period. With respect to SRA-administered pensions, the budget is prepared so that it includes appropriations sufficient to fund the ADC. The funded ratio is the ratio of the actuarial value of the fund's assets expressed to the fund's actuarially accrued liabilities. The actuary advises that the MTA pension's funded ratio was 40.9% at the end of fiscal 2017. Since the MTA plan is not fully (100.0%) funded, the ADC includes amortization payments to reduce the unfunded liability.

The actuary also prepares experience studies to review actuarial assumptions. Experience studies compare the actuarial assumptions used to assess the plan's funding levels with actual results over a limited period of time (usually four or five years). The purpose is to adjust assumptions if actual results vary from the assumptions in order to improve future actuarial valuations. The studies evaluate economic assumptions, such as investment returns, inflation, salary scales, and payroll growth. In addition, experience studies examine demographic assumptions, including mortality rates, disability rates, employment termination rates, and marital status. The assumptions were updated in 2016. The fiscal 2017 valuation includes these latest updates.

MTA Pension Plan Costs

The MTA pension's benefit payments are expected to increase in the out-years. These increases are attributable to demographic and economic factors and increased costs for pension enhancements.

Pension Costs Are Expected to Increase

The MTA actuary projects that annual benefit payments will be increasing between 3.0% and 4.0% over the next decade. **Exhibit 2** shows that costs are expected to increase from $37 million in fiscal 2019 to $48 million in fiscal 2027. In the short term, there is not much the State can do to change these growth rates. They are largely based on benefits earned by plan members as well as economic and demographic factors. In the long term, changes to the plan can slow the growth. The reforms enacted in 2011 were designed to slow the growth of SRA pensions. These reforms have been effective. In 2010, total employer contributions were projected to reach

$2.7 billion by fiscal 2018, and the funded ratio was projected to be 64.4%. Instead, actual employer contributions in fiscal 2018 are $1.9 billion, and the funded ratio is 70.9%.

Exhibit 2
Projected MTA Plan Benefit Payments
Fiscal 2019-2027
($ in Millions)

Fiscal Year	Projected Benefit Payments	Increase	% Increase
2019	$36.5	$1.3	3.8%
2020	37.8	1.4	3.8%
2021	39.2	1.4	3.7%
2022	40.8	1.5	3.9%
2023	42.4	1.6	3.9%
2024	43.8	1.5	3.5%
2025	45.3	1.4	3.2%
2026	46.8	1.5	3.3%
2027	48.2	1.5	3.2%

MTA: Maryland Transit Administration

Source: Bolton Partners' *Maryland Transit Administration Pension Plan Actuarial Valuation*

Actual MTA Pension Contributions Have Been Less Than the Actuarially Determined Contribution in Recent Years

To fully fund the pension contribution, the actuary estimates that the MTA pension's fiscal 2017 ADC is $67 million. **Exhibit 3** shows only $49 million was included in the 2017 budget for pension contributions. As a result, the State only funded 71% of the actuarially determined amount. Exhibit 3 also shows that the normal cost, which is the annual benefit earned in fiscal 2017, was just under $8 million. The remaining share of the contribution was $55 million to reduce the unfunded liability. This amortization payment is substantially larger than the normal cost amount because the MTA pension is only 41% funded, so significant additional payments are necessary to bring it to full funding.

Exhibit 3
Summary of Actuarial Costs and Actual Contributions
Fiscal 2016-2017
($ in Millions)

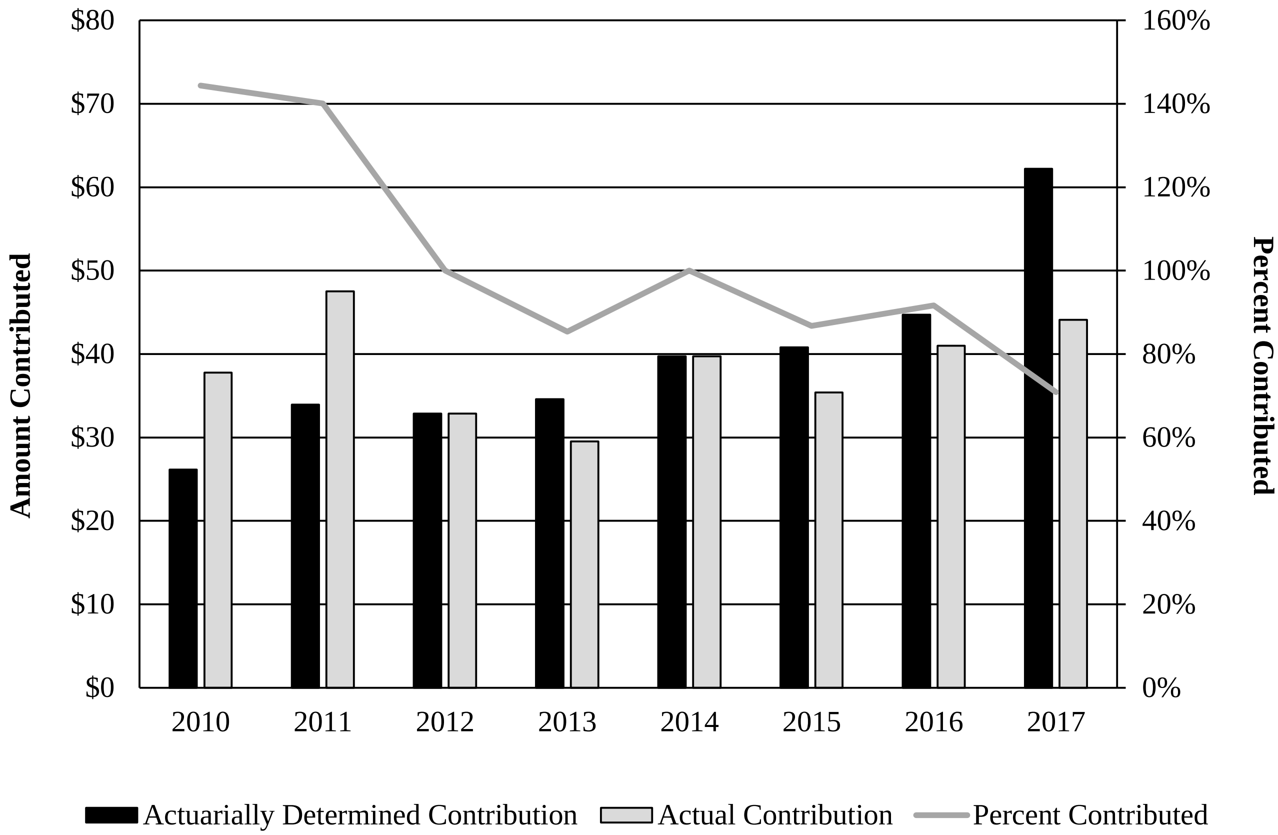
Contributions	**2016**	**2017**
Employer Normal Cost	$7.0	$7.8
Amortization Payment	37.7	54.5
Actuarially Determined Contribution	**$44.7**	**$62.2**
Actual Contribution	**$41.0**	**$44.1**
Underpayment	**$3.7**	**$18.1**
Percent Paid	**91.6%**	**70.9%**
Amortization as a Percent of Actuarially Determined Contribution	**84.4%**	**87.5%**

Source: Bolton Partners' *Maryland Transit Administration Pension Plan Actuarial Valuation*

When a plan is underfunded, the amount by which it is underfunded is treated as a loss. This loss is then amortized over 25 years, which increases the out-year ADC. In the fiscal 2017 valuation, the actuary recognizes a $41.0 million loss, which adds $3.5 million to the fiscal 2018 ADC. Almost half of this loss in the fiscal 2018 ADC is attributable to underfunding in fiscal 2017.

In recent years, the trend has been to underfund the MTA pension. **Exhibit 4** shows that from fiscal 2010 to 2017, the ADC was overfunded twice (fiscal 2010 and 2011), 100% funded twice (in fiscal 2012 and 2014), and underfunded four times (including every year since fiscal 2015). Unless there is a substantial deficiency appropriation or budget amendment, fiscal 2018 will be underfunded by about $20 million.

Exhibit 4
Comparison of Actuarially Determined Contributions And Actual Contributions to the MTA Plan
Fiscal 2010-2017
($ in Millions)



MTA: Maryland Transit Administration

Source: Bolton Partners' *Maryland Transit Administration Pension Plan Actuarial Valuation*

The most substantial recent increase in the ADC since fiscal 2010 was the increase from fiscal 2016 to 2017, when the ADC increased by $17.5 million. The primary reason for this change was that a limit on the maximum monthly benefits was eliminated. **Exhibit 5** shows that this increased the ADC in fiscal 2017 by $11.1 million. The total liability for eliminating the monthly maximum increased by $91.2 million. A second key factor was providing additional retiree COLAs from fiscal 2014 to 2017, which increased the total liability by $9.3 million and the fiscal 2017 liability by $4.9 million. Experience losses, which included the underfunding from fiscal 2016, added another $1.1 million to the ADC.

Exhibit 5
Changes to the Actuarially Determined Contribution for the MTA Plan
Fiscal 2016-2017
($ in Thousands)

	2016	2017	Difference
Normal Costs	$6,997	$7,760	$763
Prior Years' Amortization	37,739	37,653	-86
Plan Changes Removing Monthly Limit[1]	0	11,122	11,122
Cost-of-living Increases – Fiscal 2014 to 2017[2]	0	4,876	4,876
Experience Study Assumption Changes	0	-321	-321
Experience Loss	0	1,127	1,127
Total	**$44,736**	**$62,217**	**$17,481**

[1] The actuary assumed a 12-year amortization, which is the average expected future working lifetime of the employees.
[2] The actuary assumed this amortized over the remaining duration of the union contract, which is 2 years.

Source: Bolton Partners' *Maryland Transit Administration Pension Plan Actuarial Valuation*

Comparing the MTA Pension Plan to the Standard State Employee Pension Plan

This section compares the benefits, financial health, and collective bargaining arrangements of the MTA plan to the State plans administered by SRA.

Benefits

Exhibit 6 compares key MTA pension benefits with the standard State employee's pension benefits. Areas in which the benefits diverge substantially are:

- ***Average Annual Compensation Salary Calculations:*** In the MTA pension, employees are allowed to include up to 2,392 hours of work in each year. This is over seven weeks of overtime. According to the actuarial valuation, the average employee salary is approximately $55,000. Adding over seven weeks of overtime at time and a half could increase the salary as much as $12,000 for the average employee. In fiscal 2017, overtime payments were approximately 17% of regular earnings. If the average employee earns the average amount of overtime, about $9,000 is added to the employee's annual earnings.

- ***Employee Contributions:*** MTA employees contribute 2% of their salaries and overtime earnings while State employees contribute 7% of their salaries. If an MTA employee earns

$67,000 in salary and overtime, the contribution is $1,340. For a State employee earning $67,000, the contribution is $4,690, which is $3,350 more than the MTA employee.

Exhibit 6
Comparing MTA Pension Benefits to the Standard State Employee Pension
Fiscal 2017

Benefit	MTA Pension	Standard Employee Pension
Vesting Period	100.0% with 5 years for employees hired before May 18, 2013. 100.0% with 7 to 10 years for employees hired on or after May 18, 2013.	100.0% with 5 years for employees hired before July 1, 2011. 100.0% with 10 years for employees hired on or after July 1, 2011.
Multiplier	1.7%.	For employees hired before July 1, 2011, 1.8%. For employees hired since July 1, 2011, 1.5%.
Cost-of-living Adjustments	Consumer Price Index, U.S. City Average, but not greater than 3.0%.	Consumer Price Index, U.S. City Average, but not greater than 2.5% if the fund's return is equal to or greater than the actuarially assumed return and 1.0% if the fund's return is less than the actuarially assumed return.
Average Annual Compensation	The average salary 3 highest earning years over last 20 years, limited to 2,392 hours in any year, including overtime.	For employees hired before July 1, 2011, the average of the 3 highest earning years. Overtime is excluded. For employees hired since July 1, 2011, the average salary for the 5 highest years. Overtime is excluded.
Normal Retirement Age	Age 52 with 30 years of service. Age 65 and fully vested.	For employees hired before July 1, 2011, age 62 with 5 years of service or 30 years of service regardless of age. For employees hired since July 1, 2011, age 65 with 10 years of service or years of service and age adding to 90.
Employee Contribution	2.0% of pensionable salary.	7.0% of pensionable salary.

MTA: Maryland Transit Administration

Note: Standard State Employee Pension refers to the Employees' Pension System established on January 1, 1980. All employees hired since this date are required to participate in this plan. Prior to this date, employees participated in the Employees' Retirement System. For public school teachers, there are the Teachers' Retirement System and Teachers' Pension System that offer the same plan as that which is offered to State employees.

Source: Bolton Partners' *Maryland Transit Administration Pension Plan Actuarial Valuation;* State Retirement Agency

Both plans have also reduced benefits for recently hired employees. The State plan has a new tier for employees hired after June 30, 2011. As shown in Exhibit 6, these employees have a longer vesting period, smaller multiplier, and later retirement eligibility. The MTA plan has extended the vesting period for employees hired after May 17, 2013.

Financial Health

The State's pension plan is in better financial health than the MTA plan. **Exhibit 7** shows that the State's funded ratio is 71%, compared to 41% for the MTA plan. The State is also overfunding the SRA administered pensions. The State appropriates the ADC and an additional supplemental payment, which totaled $75 million in fiscal 2017. The MTA plan's contribution is 46% of payroll, compared to 18% for SRA plans. As discussed earlier in this report, the amortization payment is 88% of the ADC. Another concern is that the MTA plan has adopted an open actuarial system, and the SRA pensions have a closed system. This is significant because the open system understates the ADC. Each approach is discussed in the Issues and Recommendations section of this report. Bringing the MTA plan to full funding will require a substantial increase in funding.

Exhibit 7
Comparing the MTA Pension's Financial Health to the State Pension System
Fiscal 2017

Indicator	MTA Pension	State Pension System[1]
Funded Ratio	40.9%	70.9%
Percent of Actuarial Determined Contribution Budgeted	70.9%	104.1%
Actuarial Determined Contribution Percent of Payroll	45.7%	17.6%[2]

[1] State Pension System includes the Employees' Combined System, Teachers' Combined System, State Police, Judges, and Law Enforcement Officers' Pension System. Data is State only and excludes participating governmental units.
[2] The contribution rate is used for the State pension system.

MTA: Maryland Transit Administration

Source: Bolton Partners' *Maryland Transit Administration Pension Plan Actuarial Valuation*; State Retirement Agency

Collective Bargaining

Another key difference between the State and MTA pensions is collective bargaining rights. MTA union employees have binding arbitration while other State employees do not.

The services provided by MTA were previously provided by the Baltimore Transit Company, who established a pension plan in 1950. By the early 1960s, transit services were in decline. The systems were caught in a cycle of rising costs and declining ridership. At the time, private transit systems were being forced to increase fares, trim services, and defer maintenance. The result was a further loss in ridership, which exacerbated the problem. To ameliorate this problem, the U.S. Congress enacted legislation to provide capital grant assistance to transit providers. To enlist the support of organized labor, the legislation included a provision that prohibited the diminution of labor rights as a condition for receiving federal grants.

In 1970, the Baltimore Transit Company was absorbed into what is now MTA. Since these employees enjoyed the rights of collective bargaining with binding arbitration, the State cannot take away this benefit without losing a substantial amount of federal funds. Consequently, the MTA Local 1300 and Local 2 employees have binding arbitration with their collective bargaining rights.

State law does not require binding arbitration for unions whose employees are in SRA pension plans. One consequence of this is that the State was able to reform pensions in 2011 by reducing benefits without bargaining with unions. Unions were able to testify at hearings, but the law changes enacted by the General Assembly and approved by the Governor were final.

If the State were to enact legislation to reduce MTA union employees' benefits, this would either require collective bargaining with binding arbitration or risk the loss of federal transit funds. This makes it more difficult to reduce pension benefits or increase MTA employee contributions and, at least in part, explains why MTA union employees have been able to obtain benefit enhancements, such as eliminating a cap on monthly benefits, while State employees' benefits have been reduced.

Issues and Recommendations

After reviewing the MTA pension and comparing it to the SRA-administered pension plans, the Department of Legislative Services (DLS) raises the following issues and makes recommendations.

Annual Appropriations Are Less Than the Actuarially Determined Contribution

One reason that the MTA pension has such a low-funded ratio is that its budget does not fully fund the ADC. Since fiscal 2015, MTA has consistently underfunded its pension plan. This is treated as a loss and increases the ADC in the out-years. By contrast, the State pension system has begun to overfund pensions administered by SRA. The State pension system's actuary also prepares an estimate of the ADC for each year's budget. For example, in fall 2017, the actuary estimated the ADC for fiscal 2019. This rate, including the supplemental payment, will be used to prepare the fiscal 2019 budget that the Governor submits to the General Assembly in

January 2018. **DLS recommends that the MTA actuary estimate the actuarially determined contribution each fall for the budget year and that MTA fully fund that amount when preparing the budget.**

Open and Closed Amortization Periods

When there is a pension loss or gain, an increase or diminution in benefits, or a change attributable to demographic or economic assumptions, the actuary amortizes the increase or decrease over a specified period. In both the SRA and MTA pension plans, this period is 25 years.

While the amortization period is the same length, how it is applied is different between the SRA and MTA plans. SRA has adopted a closed period. This means that all increases and decreases are amortized to the same fixed year. For State pensions, this is fiscal 2039. The result is that the number of years over which losses are amortized is reduced each year, resulting in higher payments, which gets the State to full funding sooner.

By contrast, the MTA pension has an open amortization period. Under this approach, every gain or loss in amortized over 25 years. For example, the fiscal 2017 contribution was $17 million less than the ADC. This loss is amortized over 25 years in the MTA plan. In the State plan, this would be amortized from fiscal 2019 to 2039, which is 21 fiscal years. Since the amortization period is shorter, this State approach results in higher payments and reduces the unfunded liability more quickly.

The key question is which approach, open or closed, is better. The SRA actuary, among many others, recommends the closed approach. The problem with the open approach is that the plan never achieves 100% funding by a specific date; in fact, the MTA plan never gets to 100% since every loss is amortized over 25 years. The losses from fiscal 2016 will be fully amortized by fiscal 2041, but over the next quarter century, there will be additional losses that will still be amortized, so that by 2041, the plan still will not be 100% funded. Unless the plan experiences a quarter century without any losses, it cannot achieve full funding in an open system.

One concern about the closed approach is that gains and losses are magnified as the State gets closer to the closing fiscal year. This can result in substantial swings in the ADC that complicate budgeting. In spite of this concern, SRA has adopted a closed system so that the unfunded liability is reduced more quickly.

DLS recommends that the MTA Pension Plan adopt a closed amortization period.

Have the General Assembly's Joint Committee on Pensions Review MTA Pensions Annually

Pension issues are reviewed by the General Assembly's Joint Committee on Pensions. This committee is comprised of eight members of the Maryland Senate and eight members of the Maryland House of Delegates. Each chamber has a co-chair of the committee. In recent years, this committee has been active examining pension issues, but it has not reviewed the MTA pension. **To provide consistent transparency, DLS recommends that the Joint Committee on Pensions review MTA pension issues annually.**

Enhancements Have Been Made to the MTA Pension Plan While Other Pension Plans Benefits Were Reduced

Another reason for the MTA plans low-funded rate is that benefits collectively bargained have increased liabilities in recent years at a time that other pension plans are reducing benefits. For example, removing a monthly limit on pension payments added $91 million. The plan also includes overtime earnings in the salary calculations, which can add as much as $12,000 to the average employee's annual average compensation. The employee contribution is also less than one-third of the contribution paid by State employees on the State plans. In recent years, the State has implemented reforms to reduce the multiplier, increase the vesting period, increase the employee contributions, and increase State contributions. Slowly, these reforms are improving the funded status of SRA-administered pensions while maintaining viable retirement benefits for State employees. The reforms did not affect the MTA plans. **DLS recommends that the State seek similar concessions through collective bargaining with MTA unions. The State should avoid making concessions that add to the unfunded liability.**