Department of Legislative Services

Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE

Senate Bill 540 (Senator Colburn)
Budget and Taxation

State Retirement and Pension System - Optional Allowances and Designated Beneficiaries - Changes to Elections

This bill allows a retiree of the State Retirement and Pension System (SRPS) who retired on or before June 30, 2005, and, at the time of retirement, selected a reduced allowance under either Option 2 or Option 5 to change their selection to either Option 3 or Option 6, respectively, and to change the designated beneficiary. The retiree's allowance is then recomputed based on the value of the balance in the retiree's annuity and pension reserves when the change is made.

The bill takes effect July 1, 2011, and terminates December 31, 2011.

Fiscal Summary

State Effect: Potential significant increase in State pension liabilities and contribution rates beginning in FY 2014, but a reliable estimate of the increase cannot be determined. Potential minimal increase in special fund expenditures by the State Retirement Agency (SRA) in FY 2012 to hire temporary labor to assist in processing a likely surge in benefit recalculation estimates for retirees.

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: Most SRPS members who file retirement applications may choose from among six alternatives to the basic allowance in order to provide a survivor benefit for a surviving spouse, child, or other beneficiary. The basic allowance provides the maximum, unreduced benefit payment to the retiree but offers no survivor benefit so all payments stop when the retiree dies. In most State plans, retirees who select one of the six survivor options are subject to an actuarially determined reduction in their monthly benefit payments to account for the additional payments that will be made following their death. The allowance reductions are calculated based on the ages of both the retiree and the beneficiary.

However, retirees of the State Police Retirement System (SPRS), Law Enforcement Officers' Pension System (LEOPS), and Judges' Retirement System (JRS) who have spouses at the time of retirement receive an automatic joint and survivor option with no reduction to the maximum benefit. SPRS surviving spouses receive 80% of the unreduced allowance, and LEOPS and JRS surviving spouses receive 50% of the unreduced allowance. The survivor options are available to retirees of SPRS and LEOPS only if they do not have a spouse at the time of retirement, and to JRS retirees if they do not have a spouse or dependent child at the time of retirement.

The six options are as follows:

- **Option 1** pays the balance of the actuarial equivalent present value of the retiree's basic allowance at the time of retirement in a lump-sum payment to the beneficiary or the retiree's estate.
- **Option 2** provides a 100% joint and survivor benefit in which the beneficiary receives 100% of the reduced benefit payment the retiree had been receiving prior to death.
- **Option 3** provides a 50% joint and survivor benefit in which the beneficiary receives half of the reduced benefit payment.
- **Option 4** pays the balance of the retiree's accumulated contributions at the time of retirement, if any, in a lump-sum payment to the beneficiary or the retiree's estate.
- **Option 5** provides a 100% survivor benefit, except that if the beneficiary predeceases the retiree, the retiree begins receiving the basic allowance (also called a "pop-up" option).
- **Option 6** provides a 50% "pop-up" survivor benefit.

Once a retiree makes a selection of the basic allowance or one of the six options, the selection may not be changed after the first retirement payment is made.

Except for JRS retirees, a retiree may change a designated beneficiary at any time. Except for a retiree who has selected Option 5 or Option 6, the allowance is recomputed based on the balance in the retiree's annuity and pension reserves at the time of the change. However, if a retiree has selected either of the pop-up options and selects a new beneficiary after the death of the original beneficiary, the benefit is recalculated based on the retiree's basic allowance at the time of the change in beneficiaries.

Under both federal and State law, a retiree who chooses either Option 2 or Option 5 may not designate a beneficiary who is neither a spouse nor a disabled child and who is more than 10 years younger than the member.

Background: SRA is aware of one individual who meets the criteria specified in the bill who wishes to change her option selection and designated beneficiary. The individual known to the agency retired in 2004, selected Option 2, and designated her husband as her beneficiary. She has requested to change her beneficiary to her son, but is barred from doing so because her son is more than 10 years younger and is not disabled. Therefore, she would like to change her option selection to Option 3, which does not have the same age restriction regarding the beneficiary.

State Fiscal Effect: Although SRA is aware of just the one individual, the bill has the potential to affect thousands of retirees. As of June 30, 2010, 20,507 SRPS retirees were subject either to Option 2 or Option 5, of which 81% had selected Option 2. SRA estimates that about 15,000 of the total number retired before 2005 and therefore are subject to the bill.

Although switching from Option 2 to Option 3 and from Option 5 to Option 6 provides a reduced survivor payment, it results in an increase in the retiree's annual benefit payment because of the reduction to the survivor benefit. The State's consulting actuary advises that the net effect of the switch is typically an increase in the system's accrued liabilities, requiring either larger contributions by the retiree or larger reductions to the retiree benefit, neither of which are required by the bill. However, an estimate of the effect on State pension liabilities cannot be reliably estimated for two main reasons. First, there is no reliable method to predict how many of the 15,000 eligible retirees will decide to make the switch. Second, the recalculation of the retiree's benefit is based on their age and the age of the beneficiary at the time of the switch, so any calculation would vary based on the ages of the people involved. For many retirees, the allure of a higher annual benefit resulting from a switch may be tempting, generating a meaningful increase in pension liabilities. Any increase in pension liabilities would be reflected in June 30, 2012 valuation and amortized over 25 years, so even with the bill's termination date, State expenditures to pay for the increase continue from fiscal 2014 to 2039.

SRA notes that the bill may result in a large increase in the number of retirees requesting an estimate of the change to their benefit if they switch options before the bill's termination date. Those estimates are provided by a limited number of trained benefit counselors employed by the agency. It is unlikely that the agency would be able to process a large increase in benefit recalculation requests in a timely fashion and may have to employ temporary labor to assist with the process. Therefore, special fund expenditures by the agency may increase slightly in fiscal 2012 if the volume of benefit recalculation requests increases significantly.

Additional Comments: The bill's provisions likely result in an increase in the benefit payable to a retired member, which may violate federal regulations requiring that annuity payments must not increase over the lifetime of a retiree, except in limited circumstances that are not applicable to this bill.

Additional Information

Prior Introductions: None.

Cross File: HB 951 (Delegate Eckardt) - Appropriations.

Information Source(s): Mercer Human Resources Consulting, Maryland State Retirement Agency, Department of Legislative Services

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