HB 1344

Department of Legislative Services

Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE
Revised

House Bill 1344 (Delegate Serafini, *et al.*)
Appropriations

State Retirement and Pension System - Guaranteed Retirement Income Plan and Retirement Savings Plan

---

This bill freezes benefits for current members of the Teachers' Pension System (TPS) and Employees' Pension System and terminates their membership in the plans; closes both plans and the Optional Retirement Program (ORP) to new members; and requires current members of TPS/EPS as well as all new employees to make an irrevocable choice between participating in a Guaranteed Retirement Income Plan (GRIP) or a Retirement Savings Plan (RSP) established by the bill. The bill does not apply to participating governmental units (PGUs), although they may elect to terminate their participation in EPS and join either of the new plans.

The bill takes effect June 1, 2011.

Fiscal Summary

State Effect: State pension liabilities decrease by between \$5.1 billion and \$7.2 billion, depending on the plan selections of current and future members of TPS and EPS, which cannot be predicted. Similarly, the normal cost decreases by between \$392 million and \$645 million. In FY 2012, State pension contributions may increase by as much as \$706 million due to additional contributions made to RSP. Beginning in FY 2013, State pension contributions decrease by between \$758 million and \$264 million, again depending on the plan selections of current TPS/EPS members. Even though the RSP generates greater reductions in accrued liabilities and normal cost, the net savings in employer contributions under GRIP are larger than for RSP due to the additional State contributions necessary to fund members' individual RSP accounts. Those savings continue to accrue in the out years according to actuarial assumptions and are assumed to be allocated 60% general funds, 20% special funds, and 20% federal funds.

Local Effect: No effect on PGUs that elect to remain in EPS. PGUs that elect to participate in RSP/GRIP likely experience reduced employer contributions, but the savings cannot be estimated without knowing which PGUs elect to leave EPS.

Small Business Effect: None.

Analysis

Bill Summary: Current members of TPS/EPS as of June 1, 2011, must elect between GRIP and RSP by June 15, 2011; membership in TPS/EPS terminates as of July 1, 2011. New employees of participating employers hired after June 1, 2011, have 150 days to make a choice between GRIP and RSP, and their participation begins on the first pay period after 180 days of full-time employment. Employees who do not make an active choice are automatically enrolled in GRIP.

GRIP

GRIP is a cash balance plan administered by the Board of Trustees of the State Retirement and Pension System (SRPS), which is responsible for deciding the eligibility and rights of any participating employee, computing the benefits payable to an employee or beneficiary, and authorizing disbursement of benefits. Board decisions on these matters are final. The board must develop regulations to implement the program.

Member contributions to GRIP are 4% of earnable compensation below the Social Security wage base and 8% of earnable compensation above the wage base. The State credits a member's account for the amount that the member and the State would have contributed for military service that interrupts membership. Members receive 5% annual interest on all member contributions, subject to requirements of the Internal Revenue Code (IRC). Interest is credited on a monthly basis.

The State contribution to GRIP is 8% of regular earnings, which earn 5% annual interest, subject to IRC requirements. Members vest in the employer contributions after three years of service. Members must be age 62 with at least 3 years of service to qualify for a normal service retirement. There is no eligibility for early retirement. Benefits are payable as a lump-sum cash payment, a rollover distribution, a single life annuity, or a joint and survivor annuity.

RSP

RSP is a defined contribution plan administered by the SRPS board, which is responsible for deciding the eligibility and rights of any participating employee, computing the benefits payable to an employee or beneficiary, and authorizing disbursement of benefits. Board decisions on these matters are final. However, any written decision of the board in response to a request from a member or beneficiary is subject to appeal to the Office of Administrative Hearings. The board must develop regulations to implement the program. The bill also establishes ethical standards and reporting requirements for the board.

RSP includes investment options designated by participating employees. Employee and State contributions for RSP are the same as for GRIP, and are allocated to investment vehicles as specified by the employee. Employees can make additional contributions, and total contributions to RSP are governed by IRC limits. A participating employee vests in the employer contributions to RSP after three years of credited service.

The State has to make contributions to RSP, subject to appropriation.

The board is authorized to deduct operating expenses from realized and unrealized gains of the plan, but State funds may also be used to pay operating expenses. A participating employer must pay its share of operating expenses for the plan.

RSP benefits are payable as a lump-sum distribution, a 50% joint and survivor annuity, a single life annuity, a period-certain annuity, as installment payments, or as a rollover distribution. If an annuity option is selected, the board must purchase the annuity from an insurance company authorized to do business in the State.

For both GRIP and RSP, the bill establishes rules for the calculation of credited service, including credit for military service. It also establishes disability benefits and death benefits for surviving beneficiaries of active members.

Current Law: With a few exceptions, membership in EPS is a condition of employment for regular State employees hired since January 1, 1980, and whose compensation is provided by State appropriation or paid from State funds, as well as other individuals designated in statute. Membership in TPS is a condition of employment for most employees of a day school under the supervision of a county board of education, faculty employees of educational institutions supported by and under the control of the State, professional and clerical employees of local community colleges, librarians or clerical employees of public libraries, and other education-related employees designated in statute and hired since January 1, 1980. Membership in TPS is optional for designated employees of:

- the University System of Maryland (USM);
- Morgan State University;
- St. Mary’s College;

- the Maryland Higher Education Commission; and
- community colleges or regional community colleges in the State, including Baltimore City Community College.

Only the following employees of those institutions are eligible to join ORP:

- faculty members;
- professional employees of community colleges or regional community colleges;
- exempt employees of USM;
- professional or administrative employees of Morgan State University; and
- professional employees of St. Mary's College.

ORP is authorized under 403(b) of the Internal Revenue Code, which applies only to employees of educational institutions and specified nonprofit organizations. A decision to join ORP is a one-time, irrevocable decision that must be made within one year of becoming eligible to join ORP. ORP members are not eligible to participate in any of the defined benefit (DB) plans offered by the State. The State contributes 7.25% of members' earnable compensation to ORP.

EPS/TPS members pay a member contribution equal to 5% of earnable compensation. They are eligible for a normal service retirement after 30 years of service or upon reaching 62 years of age with 5 years of service. A normal service retirement allowance is equal 1.8% of average final compensation (AFC) multiplied by years of service credit earned after June 30, 1998, plus 1.2% of AFC multiplied by years of service before that date.

The State pays the full employer contribution on behalf of members of TPS who are employed by local governments, including local school boards, community colleges, and public libraries.

Background: As of June 30, 2010, there were 103,162 active members of TPS, all but 1,906 of whom were employed by local governments. As of the same date, there were 77,660 active members of EPS, of whom 52,292 were State employees and the remaining members were employed by PGUs.

State Fiscal Effect: Freezing accrued benefits for current members of EPS and TPS and ending their membership in the plans has the effect of reducing accrued pension liabilities. Accrued benefits are based on projections of a member's salary growth and accrual of additional service credit in the pension systems. By freezing benefits at current levels, the bill eliminates the portion of accrued liabilities based on those projections.

Neither the Department of Legislative Services (DLS) nor the General Assembly's consulting actuary can determine which of the two plans (RSP or GRIP) current or future members will select. Therefore, the analysis is based on two scenarios: in the first scenario, all members select RSP, and in the second scenario all members select GRIP. Actual selections are likely to be a mixture of the two plans, so the net savings to the State is likely to be somewhere between the results for the two scenarios.

DLS notes that the bill does not eliminate the State's contribution to TPS/EPS for fiscal 2012, which was already included in the Governor's budget for that year. Therefore, as with most pension benefit changes, any reduction in the State's contribution is subject to a one-year lag and not reflected until fiscal 2013. For the RSP analysis, the analysis shows an increase in State costs in fiscal 2012 due to the additional contributions made to members' individual RSP accounts (rather than the State pension fund). For the GRIP analysis, it is assumed that State contributions to the State pension fund can be applied to GRIP instead of EPS/TPS, so there is no increase in State contributions for fiscal 2012 under the GRIP scenario.

RSP Scenario

State pension liabilities decrease by $7.2 billion and the normal cost decreases by $645 million. Amortizing the reduced liabilities over 25 years and adding the normal cost savings results in State pension contributions decreasing by $994 million in fiscal 2013. DLS notes that the amortization of the RSP savings is based on a level dollar amount instead of the current methodology, which is based on a level percent of pay. The actuary advises that the Governmental Accounting Standards Board requires the use of level-dollar amortization when a defined benefit plan is closed and members are transitioned to a defined contribution plan. The use of level-dollar amortization reduces the first-year savings under the RSP scenario by an estimated $222 million from what it would otherwise be under current amortization practices.

Under the RSP scenario, the State must make additional employer contributions to individual RSP accounts. In fiscal 2012, the additional contribution is $706 million, which grows annually according to payroll growth. As noted above, this amount represents a net increase in State contributions for fiscal 2012; in succeeding years, it reduces the total savings. In fiscal 2013, the net savings, after accounting for the additional State contribution to individual RSP accounts, is $264 million.

GRIP Scenario

State pension liabilities decrease by $5.1 billion and the normal cost decreases by $392 million. Amortizing the reduced liabilities over 25 years and adding the normal cost savings results in State pension contributions decreasing by $758 million in fiscal 2013. Level-dollar amortization is not required in this instance because cash balance plans are considered defined benefit plans, and level-dollar amortization is required only when transitioning to a defined contribution plan.

The net savings generated by the GRIP scenario is greater than under the RSP scenario because of differences in the normal cost calculation. Under RSP, the State contributes 8% of an employee's compensation each year. Under GRIP, the normal cost is estimated to be between 8.0% and 8.5%, but the employee contribution of 4% is credited against the normal cost, so the employer share is only between 4.0% and 4.5%.

The actuary advises that, over time, transitioning to a cash balance plan like GRIP may result in the need for more liquid and less risky investments. Initially, cash balance accounts represent a very small portion of the overall benefits payable by SRPS. As current members retire, however, and the membership increasingly consists of individuals only with cash balance accounts, the system may need greater access to cash to pay lump sum distributions and vested benefit withdrawals. Changing the system's asset allocation may result in a lower anticipated investment return used to value the system's assets and liabilities. Ultimately, that may significantly reduce the savings shown in this analysis.

Additional Information

Prior Introductions: None.

Cross File: None.

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

Fiscal Note History: First Reader - March 15, 2011
ncs/rhh Revised - Updated Information - May 19, 2011

Analysis by: Michael C. Rubenstein

Direct Inquiries to:
(410) 946-5510
(301) 970-5510