HB 748

Department of Legislative Services

Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 748 (The Speaker, *et al.*) (By Request - Administration)
Appropriations

State Retirement Choice for the 21st Century Workforce

This Administration bill establishes the defined contribution (DC) State Retirement Choice Plan (SRCP) as an alternative to the Employees' Pension System (EPS) for State employees and employees of participating governmental units (PGUs) hired on or after July 1, 2018. It also allows retirees of SRCP to participate in the State Employees and Retirees Health and Welfare Benefits Program (State health plan) and receive the same premium subsidy as other eligible retirees, with some exceptions.

The bill takes effect July 1, 2018.

Fiscal Summary

State Effect: State pension contributions increase by $2.2 million in FY 2019 due to an estimated 40% of new State employees opting to join SRCP instead of EPS. Those costs grow annually based on more new employees joining SRCP and are assumed to be allocated 60% general funds, 20% special funds, and 20% federal funds. Additional unquantifiable costs are likely over time as the choice leads to an increase in employer contributions for the defined benefit plan. To the extent that more or fewer new employees elect SRCP, State contributions increase or decrease, respectively. No practical effect on State retiree health liabilities or expenditures. No effect on revenues.

(in dollars)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Revenues	$0	$0	$0	$0	$0
GF Expenditure	0	1,320,000	2,514,000	3,660,000	4,782,000
SF Expenditure	0	440,000	838,000	1,220,000	1,594,000
FF Expenditure	0	440,000	838,000	1,220,000	1,594,000
Net Effect	$0	($2,200,000)	($4,190,000)	($6,100,000)	($7,970,000)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: Pension contributions for PGUs increase by $750,000 in FY 2019 and continue to grow based on increased participation in SRCP. Those costs are distributed across approximately 120 PGUs. No effect on local revenues. **This bill imposes a mandate on a unit of local government.**

Small Business Effect: The Administration has determined that this bill has minimal or no impact on small business (attached). The Department of Legislative Services concurs with this assessment.

Analysis

Bill Summary:

State Retirement Choice Plan

SRCP is a DC plan authorized under Section 401(a) of the Internal Revenue Code (IRC) and is administered by the Board of Trustees of the State Retirement and Pension System. The board must adopt regulations to implement the bill.

Members of EPS on or before June 30, 2018, are not eligible to join SRCP. State and PGU employees hired after that date must make a one-time irrevocable decision to join either EPS or SRCP at the commencement of employment; an employee who does not make an election is automatically enrolled in EPS.

Employer and Employee Contributions for the State Retirement Choice Plan

Employees who participate in SRCP contribute 5.0% of annual earnable compensation; contributions are made by payroll deduction or by a reduction in salary in accordance with IRC. Employee contributions are held in trust for the employee, and the employee is immediately 100% vested in the employee contributions and any interest earned on those contributions.

Employer contributions are also 5.0% of earnable compensation. Employees are 100% vested in the employer contributions including earned interest after three years of SRCP participation. For employees who are paid through the Central Payroll Bureau (CPB), contributions are deducted as payrolls are paid and charged against the units that employ the participating member. If a participating employee is paid with special or federal funds, or both, the employer contribution is also paid from the same funds. For employees who are not paid through CPB, the Board of Trustees must specify in regulations how their employer contributions are to be made. The Governor is required to include in the annual State budget sufficient funds to pay the State's contribution to SRCP.

Benefit Payments

Retirement benefits paid by SRCP may be distributed only at the times, in the manner, to the extent, and to the individuals that allow the plan to maintain its tax-qualified status under IRC.

Retiree Health Benefits

A retiree of SRCP may enroll and participate in the State health plan if the individual retired from SRCP and:

- had at least 10 years of State service and was at least 57 years old;
- had at least 25 years of State service; or
- retired directly from State service and had at least 10 years of State service with a periodic distribution of benefits on or after July 1, 2018.

A year of service is defined as a period of 12 months during which an employee participated in SRCP and the employee's employer made contributions on his or her behalf.

An enrollee in the State health plan is eligible for the same subsidy as other retired State employees. However, the subsidy applies only to the retiree and not to dependent family members, unless the retiree has at least 25 years of State service. The surviving spouse or dependent child of a deceased individual who was eligible to enroll and participate in the State health plan may enroll and participate as long as the spouse or child is receiving a periodic distribution of benefits from SRCP.

Current Law:

Employees' Pension System

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. In general, EPS members hired before July 1, 2011, are subject to the Alternate Contributory Pension Selection (ACPS), a benefit tier within EPS. Chapter 397 of 2011 added the Reformed Contributory Pension Benefit (RCPB) as a new benefit tier to EPS. In general, an individual who becomes a member of EPS on or after July 1, 2011, is automatically enrolled in RCPB (subject to limited exceptions). **Exhibit 1** compares the benefit structures under ACPS and RCPB.

Exhibit 1
Comparison of ACPS and RCPB Benefits

	ACPS	RCPB
Vesting	5 years	10 years
Normal Retirement	30 years of service, or age 62	Age plus service add to 90, or age 65
Benefit Multiplier	1.8%/year since 1998 1.2%/year before 1998	1.5%/year
Member Contribution	7.0% of pay	7.0% of pay

ACPS: Alternate Contributory Pension Selection
RCPB: Reformed Contributory Pension Benefit

Source: Department of Legislative Services

Retiree Health Benefits:

If a State employee who began State service on or after July 1, 2011 retires, the retiree, spouse, and dependent children can enroll in the State health plan if the retiree:

- retires directly from State service with at least 10 years of creditable service;
- retires directly from State service with a disability allowance;
- ends State service with at least 25 years of creditable service; or
- ends State service with at least 10 years of creditable service and within 5 years of normal retirement age.

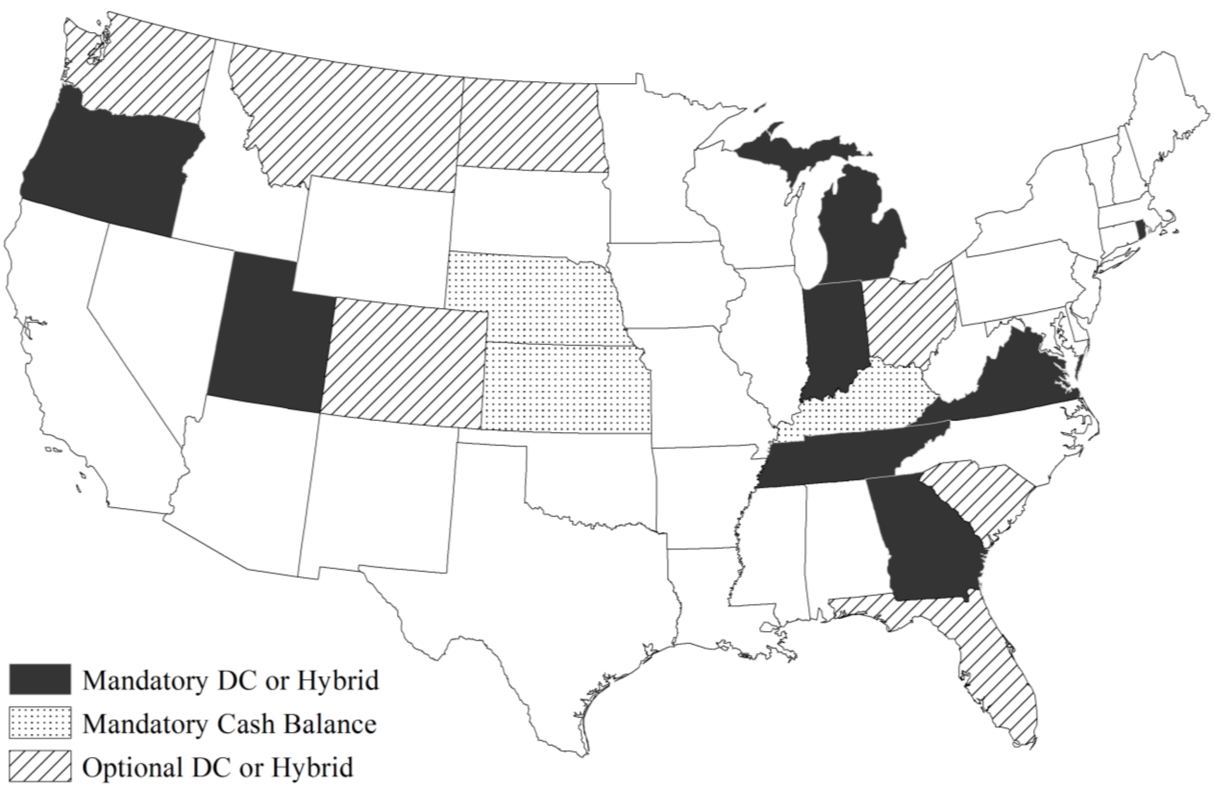
These retirees, their spouses, and their dependent children are eligible for the same premium subsidy they received when the retiree was an active State employee if the retiree is receiving a disability allowance or if the retiree has 25 years of creditable service; if the retiree has between 10 and 25 years of service credit, the retiree and family members receive a prorated premium subsidy at the rate of 1/25 for each year of service.

Background: As of June 30, 2016, there were 50,234 EPS members employed by the State and 24,468 EPS members employed by approximately 120 PGUs.

Most states offer their employees defined benefit (DB) retirement plans, but over the past two decades, about one-third of states have either closed those plans in favor of DC or hybrid plans or offered their employees a choice between different plan types. A DB plan, like the Maryland State Retirement and Pension System, provides a retiree with a guaranteed benefit for life that is determined by a formula that takes into consideration the individual's years of service and compensation at the time of retirement. By contrast, under a DC plan, an employer provides a specific contribution that each employee invests in an individual account; the benefit is determined by the value of the investments in the individual account at the time of retirement. A hybrid plan, including cash balance plans, contains elements of both a DC and a DB plan

Exhibit 1 summarizes the states that require or offer DC, hybrid, or cash balance plans to state employees, teachers, or both. With the exception of Indiana's hybrid plan (1955), all of the DC, hybrid, and cash balance plans reflected in Exhibit 1 took effect after 1995. As Exhibit 1 shows, seven states currently offer their employees and/or public school teachers a choice between a DB plan and either a DC or hybrid plan.

Exhibit 1
States with Defined Contribution, Hybrid, or Cash Balance Retirement Plans



DC: defined contribution
Source: National Association of State Retirement Administrators; National Conference of State Legislatures; Pew Charitable Trusts

State Expenditures:

Accrued Liabilities and Normal Cost

The goal of actuarial funding of pension benefits is to pay for the benefits – into a trust fund – as they accrue so that future generations do not have to bear the burden of paying for benefits to retirees. The normal cost is an actuarial calculation that reflects the value of benefits earned in a given year, based on actuarial assumptions, and is often expressed as a percentage of pay. In theory, payment of the normal cost into the trust fund should cover the cost of benefits accrued in that year. However, liabilities accrue when actual experience does not conform to the assumptions used to calculate the normal cost. The most common factor is when investments do not earn as much as projected, but other factors, such as actual rates of retirement, actual inflation, etc., can generate liabilities when they differ from the assumptions. Accrued liabilities are amortized, with the annual amortization payments added to the normal cost to generate an annual employer contribution (net of employee contributions). As of June 30, 2016, EPS had unfunded accrued liabilities of $6.96 billion. The EPS normal cost rate for fiscal 2018 is 3.86%, which decreased from 3.94% in fiscal 2017 and is projected to continue to decrease slightly as more members join under RCPB. The normal cost rate is even lower for new entrants to EPS: 2.87%, which reflects the lower benefit levels for RCPB compared with ACPS.

Plan Costs

Under the bill, accrued liabilities are unaffected in the short term because all current members remain in EPS and all retirees continue to be paid their EPS benefits. Therefore, in the short term, the bill's only effect is the difference between the employer normal cost for EPS and the employer contribution for SRCP members who otherwise would have been in EPS. As the SRCP employer contribution of 5.0% is greater than the normal cost rate of 2.87% for new entrants, the bill creates higher costs for the State for the period covered by this fiscal and policy note.

Therefore, the actuary advises that State pension contributions increase by $2.2 million in fiscal 2019, when the first cohort of new EPS members can elect to participate in SRCP. The increase reflects the higher employer contributions that are paid for members who elect SRCP over EPS, with the State continuing to pay for accrued liabilities of current EPS members. This increase is based on the assumption that 40% of new employees elect SRCP, consistent with selection rates in Florida, which offers a similar choice to its employees. For every 10% increase or decrease in the participation assumption, the actuary advises that the costs increase or decrease correspondingly by 25%. Out-year increases reflect additional new employees opting for SRCP rather than EPS. Any increase in State pension costs is assumed to be allocated 60% general funds, 20% special funds, and 20% federal and other funds.

Over time, the normal cost may increase and, therefore, increase the cost of the existing plan, due to new employees who do not expect to work for the State for 10 years opting for SRCP, thereby driving up the normal cost for EPS. Similarly, accrued liabilities may decrease and offset the increased employer contributions to the extent that more new employees opt for SRCP and do not accrue new benefit liabilities. Any such effect is likely well into the future and depends on the proportion of new employees who opt for SRCP.

Retiree Health Liabilities and Costs

The eligibility criteria for SRCP retirees to participate in the State health plan are roughly comparable to those for retirees of EPS. The most significant difference is that spouses and dependent children are not eligible for a prorated subsidy, only a full subsidy if the retiree has at least 25 years of service. Therefore, State retiree health liabilities likely decrease, but only slightly. As the State continues to pay for retiree health benefits on a pay-as-you-go basis, and any retiree costs associated with retirements from SRCP are not likely to materialize for at least 10 years (the earliest that SRCP participants can become eligible for retiree health benefits), the bill has no practical effect on State retiree health liabilities or expenditures.

Local Expenditures: New employees of PGUs are also eligible to select SRCP over EPS when they are hired. Therefore, assuming a 40% selection rate for SRCP, PGU pension contributions also increase by $750,000 in fiscal 2019 and increase annually based on participation in SRCP. Those costs are distributed across approximately 120 PGUs.

Additional Information

Prior Introductions: None.

Cross File: SB 540 (The President, *et al.*) (By Request - Administration) - Budget and Taxation.

Information Source(s): Bolton Partners; Department of Budget and Management; State Retirement Agency; National Association of State Retirement Administrators; National Conference of State Legislatures; Pew Charitable Trusts; Department of Legislative Services

Fiscal Note History: First Reader - March 2, 2017
md/rhh

Analysis by: Michael C. Rubenstein

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

ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: State Retirement Choice for the 21st Century Workforce

BILL NUMBER: SB540/HB748

PREPARED BY: GLO
(Dept./Agency/GLO)

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

__X__ WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

OR

_____ WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS