HB 1049

Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

House Bill 1049 (Delegate B. Barnes)

Appropriations Budget and Taxation

State Police Retirement System - Deferred Retirement Option Program - Alterations

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This bill allows members of the State Police Retirement System (SPRS) to remain in the Deferred Retirement Option Program (DROP) for up to one additional year. SPRS members already participating in DROP may elect to extend their time in DROP in accordance with the bill's limitations. **The bill takes effect July 1, 2018.**

Fiscal Summary

State Effect: State pension contributions (general funds) *decrease* by $170,000 in FY 2020. Out-year savings reflect actuarial assumptions. Revenues are not affected.

(in dollars)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Revenues	$0	$0	$0	$0	$0
GF Expenditure	0	(170,000)	(180,000)	(180,000)	(190,000)
Net Effect	$0	$170,000	$180,000	$180,000	$190,000

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

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary:

Hired Before July 1, 2011

SPRS members who became employed before July 1, 2011, are eligible for DROP if they:

- have at least 22 years and fewer than 30 years (instead of 28) of eligibility service; and
- are younger than 60 years old.

Hired On or After July 1, 2011

SPRS members who became employed on or after July 1, 2011, are eligible for DROP if they:

- have at least 25 years and fewer than 30 years (instead of 29) of eligibility service; and
- are younger than 60 years old.

Regardless of when members are employed, current and future participants in DROP may participate in DROP for not longer than the lesser of:

- five years; or
- the difference between 30 years and the member's eligibility service when they entered DROP

Current Law: An SPRS member is eligible to retire at age 50 or after accumulating 22 years of eligibility service (if hired before July 1, 2011) or 25 years of eligibility service (if hired on or after July 1, 2011). A member must retire at age 60. The retirement allowance is equal to 2.55% of average final compensation (AFC) multiplied by the number of years of creditable service. The retirement allowance is subject to a cap of 71.4% of AFC (the equivalent of 28 years of service).

SPRS members are eligible to participate in a DROP program. Members hired before July 1, 2011, are eligible to participate if they have at least 22 years of eligibility service but fewer than 28 years. Members hired on or after July 1, 2011, are eligible if they have at least 25 years of eligibility service but fewer than 29 years. Regardless of their date of hire, their time in DROP cannot exceed four years (some members are subject to shorter limits if their time in DROP will cause them to pass age 60 or their maximum number of years of service). During the DROP period, members continue employment at their regular salary but are deemed to be retired and do not earn any additional service credit. The retirement allowance is placed in an account earning 4% annual interest. At the end of the DROP period, the lump sum held in the DROP account is paid to the member, who must then terminate employment and receive a regular retirement allowance.

Background: The State Retirement Agency advises that, as of January 31, 2018, there were 91 members of SPRS enrolled in DROP. Members of the Law Enforcement Officers' Pension System can remain in DROP for up to five years.

DROPs have become increasingly common in law enforcement pension plans as a mechanism to encourage members who might otherwise be eligible to retire to remain on the job for a few more years to reduce turnover. They can be designed to be cost-neutral, but in many cases they encourage members to "retire" sooner than they otherwise would by entering DROP when they are first eligible to retire (in the case of SPRS, with either 22 or 25 years of service). Their time in DROP may carry them past when they originally intended to retire (thus fulfilling the human resources goal of DROP), but by allowing them to "retire" sooner, DROPs can increase pension costs since the plan pays benefits longer than it otherwise would.

State Expenditures: Although DROPs are perceived to increase costs, adding a year to DROP eligibility for SPRS actually results in general fund savings, as discussed below.

The bill allows SPRS members to remain in DROP for up to one additional year, but it does not allow them to enter DROP sooner than they can under current law. Therefore, the bill is not expected to have a meaningful effect on retirement rates, which is often the biggest factor in calculating the cost of DROP plans.

Although the bill allows SPRS members to remain in DROP for up to one additional year, it does not result in the average tenure in DROP increasing by one full year. The actuary advises that some members enter DROP too late to remain in for the full four years currently allowed, so those individuals do not benefit from the extension. Therefore, the bill increases the average time in DROP by slightly less than one full year.

DROP participants earn 4% annually on their DROP accounts, but the system assumes that assets earn approximately 7.5% annually. Therefore, the actuary advises that additional time in DROP (assuming no change in retirement rates) translates into a minimal net actuarial savings to the system. As a result, State pension liabilities decrease by $1.44 million, and the normal cost decreases by $60,000. Amortizing the liability decrease over the remaining years of the system's closed 25-year amortization period, and adding the normal cost reduction results in State pension contributions decreasing by $170,000 in the first year.

The bill's changes are first recognized during the June 30, 2018 actuarial valuation, which determines State pension contributions for fiscal 2020. As compensation for State troopers is paid almost entirely with general funds, general fund expenditures decrease by $170,000 in fiscal 2020. Out-year savings reflect actuarial assumptions.

Additional Information

Prior Introductions: None.

Cross File: SB 895 (Senator Guzzone) - Budget and Taxation.

Information Source(s): Bolton Partners, Inc.; Department of State Police; State Retirement Agency; Maryland Supplemental Retirement Plans; Department of Legislative Services

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Analysis by: Michael C. Rubenstein

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