SB 735

Department of Legislative Services

Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 735 (Senator Serafini)
Budget and Taxation

State Employees and Teachers - Cash Balance Plan

This bill establishes a cash balance plan to be administered by the Board of Trustees of the State Retirement and Pension System (SRPS). Participation in the cash balance plan is optional and available only to individuals hired on or after July 1, 2020, into positions otherwise eligible for membership in the Employees' Pension System (EPS) or the Teachers' Pension System (TPS). Employer and member contributions are each 5% of earnable compensation, and contributions earn 5% interest compounded annually. For employees of local school boards or community colleges, the local employer pays 80% of the employer contribution and the State pays the remaining 20%. The Governor must include sufficient funds in the budget to pay the State's share of employer contributions. **The bill takes effect July 1, 2019.**

Fiscal Summary

State Effect: No effect on State pension liabilities, but State pension contributions increase by $24.7 million in FY 2023 and grow thereafter according to actuarial assumptions. The State's share of employer contributions for employees of local school boards and community colleges is paid entirely with general funds; contributions for State employees are allocated 60% general funds, 20% special funds, and 20% federal/other funds. The State Retirement Agency may incur costs to establish the plan, but those cannot be reliably estimated. No effect on revenues.

(in dollars)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Revenues	$0	$0	$0	$0	$0
GF Expenditure	0	0	0	17,116,000	22,092,000
SF Expenditure	0	0	0	3,792,000	4,874,000
FF Expenditure	0	0	0	3,792,000	4,874,000
Net Effect	$0	$0	$0	($24,700,000)	($31,840,000)

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

Local Effect: Pension contributions for local school boards and community colleges increase by $7.65 million in FY 2023 and are assumed to grow annually according to actuarial assumptions. No effect on local revenues.

Small Business Effect: None.

Analysis

Bill Summary:

Participation in the Cash Balance Plan

An election to participate in the cash balance plan must be made at the beginning of employment and is irrevocable. Members of participating governmental units are not eligible to participate in the cash balance plan. TPS members who are otherwise eligible to participate in the Optional Retirement Program (ORP) may instead participate in the cash balance plan. An individual who elects to participate in the cash balance plan is prohibited from participating as a member in EPS or TPS.

Plan Administration and Benefits

Employees are immediately vested in their own contributions, and they are vested in employer contributions after three years. A participating employee may retire from the plan at age 62 with at least 10 years of service. If the employee retires before eligibility, the employee may not receive any distribution until July 1 following the next actuarial valuation of the plan. Benefits are payable as a lump sum or as an annuity with specified survivor benefit options. Benefits may be paid to employees and retirees only in a manner that allows the plan to maintain its tax-qualified status under the federal Internal Revenue Code.

The SRPS board must adopt, implement, and maintain the cash balance plan and must adopt regulations to implement the plan. Regulations must specify the manner by which employer and employee contributions are made on behalf of employees who are not paid through the State's Central Payroll Bureau.

Current Law:

Employees' Pension System/Teachers' 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. Membership in TPS is a condition of employment for most employees of a day school under the supervision of a local 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.

In general, TPS/EPS members hired before July 1, 2011, are subject to the Alternate Contributory Pension Selection (ACPS), a benefit tier within TPS/EPS. Chapter 397 of 2011 added the Reformed Contributory Pension Benefit (RCPB) as a new benefit tier to TPS/EPS. In general, an individual who becomes a member of TPS/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 + 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

Optional Retirement Program

ORP is a tax-favored defined contribution retirement savings plan available to designated employees of the institutions listed below as an alternative to membership in SRPS:

- University System of Maryland (USM);
- Morgan State University (MSU);
- Saint Mary's College of Maryland (SMCM);
- the Maryland Higher Education Commission (MHEC); and
- community colleges or regional community colleges in the State, including Baltimore City Community College.

To join ORP, individuals in employing institutions must be eligible for membership in SRPS and be:

- members of the faculty of an employing institution;
- professional employees of a community college;
- employees of USM exempt from the federal Fair Labor Standards Act (FLSA);
- executive or professional administrative employees of MSU;
- employees of SMCM exempt from FLSA; or
- professional employees of MHEC.

A decision to join ORP is a one-time, irrevocable decision that must be made at the time of employment. ORP members are not eligible to participate in any of the defined benefit plans offered by the State. The State contributes 7.25% of members' earnable compensation to ORP; there is no employee contribution. Based on surveys of participating institutions, the Department of Legislative Services estimates that 72% of eligible members elect to join ORP and the remaining 28% participate in TPS.

Local Employer Contributions

Chapter 1 of the first special session of 2012 required local school boards to pay the normal cost for their employees who are members of TPS (or the Teachers' Retirement System), phased in over five years. The phase-in period is complete so, since fiscal 2017, local school boards pay the normal cost for their employees.

"Normal contributions" (or "normal cost") is an actuarial term that is not defined in statute but refers to the actuarial value of pension benefits earned by an active member or group of active members in a given year. Statute defines the "normal contribution rate" as a fraction that has as its numerator the sum of all normal contributions, net of member contributions, and as its denominator, the aggregate annual earnable compensation of members of the State system.

Background: As of June 30, 2018, there were 106,428 active members of TPS, all but 8,951 of whom were employed by local governments. As of the same date, there were 48,995 active members of EPS employed by the State.

Cash balance retirement plans are a relatively new plan type, with the first one established in the mid-1980s. Since then, they have become common in the private sector, with more than 1,000 employers currently providing retirement benefits through a cash balance plan. However, they remain fairly rare in the public sector, with only three states (Kansas, Nebraska, and Kentucky) requiring participation in a cash balance plan by specified state or local employees or teachers. California and Texas offer optional cash balance plans to specified state and/or local employees. In 2009, Montgomery County established a cash balance plan (the Guaranteed Retirement Income Program) as part of its Employees' Retirement System. The optional plan provides an 8.0% employer contribution and guaranteed annual interest of 7.25%, credited monthly; regular employees contribute 4.0% of compensation up to the Social Security wage base and 8.0% of compensation that exceeds the wage base; public safety employees pay 3.0% up to the wage base and 6.0% on any amounts above the wage base.

State Expenditures: The cash balance plan does not begin operation until fiscal 2021, so its initial effect will be measured by the July 1, 2021 actuarial valuation, which determines State pension contributions for fiscal 2023. Thus, any fiscal effect is delayed until then.

The cash balance plan allows only new employees to enroll, so it has no initial effect on the system's unfunded liabilities. Over time, unfunded liabilities may develop to the extent that investment returns are not at least 5% to cover the plan's guaranteed annual return (and from other demographic and economic factors). But for the five-year period covered by this analysis, the plan affects only the normal cost.

This analysis assumes that 60% of incoming EPS members choose the cash balance plan each year. This assumption is based on turnover rates in both EPS and TPS. Both plans have a 10-year vesting requirement for incoming members, so the analysis assumes that individuals who are not likely to stay for 10 years opt for the cash balance plan instead (which also has a lower member contribution). To the extent that the proportion of incoming members who choose the cash balance plan differs from this assumption, State expenditures are adjusted proportionally.

State expenditures increase for two reasons:

- the normal cost payment for State employees who select the cash balance plan is higher than the normal cost paid for members of EPS; and
- the State pays one-fifth of the normal cost for members of TPS employed by local school boards, whereas now it pays none of their normal cost.

With respect to EPS, the employer normal cost in fiscal 2019 was 3.85%. The actuary notes, however, that the normal cost is a composite rate that includes a small number of members in the Employees' Retirement System (which was closed in 1980 and provided more generous benefits than EPS) as well as a substantial number of members in ACPS. Together, those more generous plans drive up the composite normal cost rate. Incoming EPS members have a smaller normal cost because they are younger than the broader membership and are all in RCPB, a less generous plan. The gap between the EPS normal cost for incoming members and the 5% employer contribution required by the plan results in an increase in the State employer contribution.

The other factor is that, under the bill, the State pays 1% of compensation (or 20% of the employer contribution) for TPS members employed by local school boards but currently pays none of their normal cost. By contrast, under the bill, the State pays only 1% of compensation for TPS members employed by community colleges but currently pays the full employer contribution for those employees. Thus, with respect to community college employees, the bill represents a savings for the State.

As a result, the actuary advises that State pension contributions increase by $24.7 million in fiscal 2023; of that, $5.74 million is for the teacher normal cost payments and is paid entirely with general funds, and the remaining $18.96 is for EPS members and is assumed to be allocated 60% general funds, 20% special funds, and 20% federal and other funds.

Local Expenditures: The July 1, 2018 actuarial valuation measured the employer normal cost rate for TPS at 4.38% of compensation. The actuary notes that, like EPS, the normal cost rate for new TPS members is lower for the same reasons listed above. In fact, it is lower than 4%, which is the rate that local school boards are required to pay for their employees (with the State paying the remaining 1%). Thus, the gap between the employer normal cost rate for incoming TPS members and the 4% rate paid by local employers for members of the cash balance plan results in local pension costs increasing for TPS members employed by local school boards.

The increase is even greater for TPS members employed by community colleges. Currently, community colleges do not pay any part of the employer contribution for their employees in TPS because it is paid by the State; however, under the bill, the local governments (community colleges) pay 4% of compensation for those employees.

The total increase for local employers is $7.65 million in fiscal 2023, which is assumed to grow annually according to actuarial assumptions.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Bolton; Maryland Association of Counties; Comptroller's Office; Department of Budget and Management; State Retirement Agency; Department of Legislative Services

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