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Testimony in Support of House Bill 948
State Retirement and Pension System - Pension Benefits – Calculation
House Appropriations Committee
February 25, 2020
1:00 P.M.

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Director of Legislative Affairs
State Retirement Agency

The Board of Trustees for the State Retirement and Pension System (System) wishes to express its support for House Bill 948, State Retirement and Pension System - Pension Benefits - Calculation. House Bill 948 is legislation sponsored by the Joint Committee on Pensions at the request of the Board.

House Bill 948 codifies the State Retirement Agency's existing practice that if a member's annuity exceeds the member's statutorily calculated normal service retirement allowance, the member's normal service retirement allowance shall equal the member's annuity.

Generally, the annual basic allowance for a retiree of the several systems who is receiving a normal service retirement is calculated in accordance with a statutorily provided benefit formula for the appropriate system. With the exception of the Judges' Retirement System, the formula is:

average final compensation x creditable service x benefit multiplier for the member's system

The member's retirement allowance calculated above is funded from both the member's and employer's contributions made on behalf of the member that are separately accounted for in the "annuity reserve" and "pension reserve" funds, respectively. Sections 20-101(f) and (gg) of the State Personnel and Pensions Article define these terms as the present value of an annuity and pension computed on the basis of actuarial assumptions adopted by the Board of Trustees. To calculate the present value of the annuity reserve portion of the member's retirement allowance, staff for the Agency determines the member's total member contributions and interest and divides this amount by an actuarially determined annuity factor based primarily on the life expectancy of the member at the time of retirement. Staff then determines the pension reserve portion of the retirement allowance by reducing the statutorily calculated retirement allowance by the portion of the retirement allowance allocated to the annuity reserves. The System's actuary confirms these practices as acceptable calculations for determining the annuity and pension reserves for members at the time of retirement.

While most accounts have an annuity reserve and a pension reserve component in calculating the retirement allowance, there are occasional instances where the present value of the annuity reserve is greater than the statutorily determined benefit. For situations where there may not be a pension reserve component to a member's benefit, the Committee should consider the following example. At the time of retirement, a member may have a statutorily calculated benefit equal to $1,000, annually. Based on the member's total accumulated contributions (member contributions and interest), the member's annuity reserve is determined to be $1,100, annually. In accordance with the accepted practices for determining the pension reserve, the statutorily calculated benefit is then reduced by the member's annuity reserve. This now results in a pension reserve equal to -$100.

The State Retirement Agency has identified 34 accounts that currently have annuity reserves in excess of their statutorily determined benefit. The example provided above delineates the process for determining how a member's retirement allowance is calculated. Prior to July 1, 2010 and continuing through today, the first three steps of that process generally include: (1) calculating the member's statutorily determined benefit; (2) determining the member's annuity reserve; and (3) determining the member's pension reserve, if any. Prior to July 1, 2010, if the member's annuity reserve exceeded the statutorily determined benefit, the member's benefit was capped at the value of the statutorily determined benefit. Beginning July 1, 2010, based on these calculations, the Agency's Maryland Pension Administration System (MPAS) was programmed to perform the basic allowance calculation different from the statutorily provided basic allowance calculation, for those accounts with only an annuity reserve component to their benefit. The MPAS programming provided that in instances where a member's annuity reserves exceeded the member's basic allowance calculated on years of service, average final compensation, and benefit multiplier, the benefit would not be capped using the statutorily provided benefit formula for the appropriate system. Instead, in instances where the annuity reserve was in excess of the statutorily determined benefit, the retiree's allowance was based solely on the member's annuity reserves. In other words, the programming provided that a member's annuity reserves as determined at the time of retirement, will be the minimum benefit a member will receive at retirement.

To address this issue for the 34 retirees and beneficiaries affected by the 2010 MPAS programming and any future similarly situated accounts, House Bill 948 codifies this type of benefit calculation for instances when a member's annuity reserve exceeds the statutorily provided benefit formula for the appropriate system at the time of retirement. The System's actuary has reviewed the Agency's existing practice and has determined that this calculation for accounts with annuity reserves in excess of the statutorily provided benefit conforms to most other public plans. Additionally, the actuary believes House Bill 948 would have a minimal impact to the plan. This is due in part to the initial benefit being funded entirely by the member's accumulated contributions, excluding any cost of living adjustments. The employer contributions that were made on behalf of the member remain with the System, in effect subsidizing (in very small part) the retirement benefits of the retirees whose annuity reserve does not exceed the statutorily defined benefit. The actuary would likely consider this a de minimis gain to the System.

Therefore, on behalf of the Board of Trustees, I would request a favorable report on House Bill 948.