GL.00
Maryland Supplemental Retirement Plans

Operating Budget Data

($ in Thousands)

	FY 01 Actual	FY 02 Working	FY 03 Allowance	Change	% Change Prior Year
Special Fund	$1,426	$1,468	$1,464	($4)	(0.3%)
Total Funds	**$1,426**	**$1,468**	**$1,464**	**($4)**	**(0.3%)**

- Agency personnel costs increase as a result of statewide salary increases and reinstatement of prior year's turnover cut.
- Other agency costs decrease as part of effort to balance expenditures to available revenues.

Personnel Data

	FY 01 Actual	FY 02 Working	FY 03 Allowance	Change
Regular Positions	16.50	16.50	16.50	0.00
Contractual FTEs	0.00	0.00	0.00	0.00
Total Personnel	**16.50**	**16.50**	**16.50**	**0.00**
Vacancy Data: Regular Positions				
Budgeted Turnover: FY 03	1.89	11.44%		
Positions Vacant as of 12/31/01	0.00	0.00%		

- There is no change in agency regular positions.

Note: Numbers may not sum to total due to rounding.

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Analysis in Brief

Issues

Agency Has Structural Fiscal Imbalance and Ended Fiscal 2001 with a Positive Fund Balance Using One-time Revenues: The agency's special fund fee revenues have significantly undershot its appropriated expenditures for the past two years, with little likelihood of near-term recovery to fiscal balance. The agency was able to end fiscal 2001 in surplus only due to questionable one-time revenue adjustments, and the projected deficits for fiscal 2002 and 2003 will be even harder to close.

$125 Million in 401(k) Transfer Account Assets Administered by In-house Staff: The board continues to administer the 401(k) Transfer Plan even though it could be administered more safely and efficiently by the outside administrator.

Many of the Agency's Activities Are Redundant: The primary operational functions of the State's payroll deferral retirement savings programs are handled by the agency's third-party administrator. Many of the functions that are performed by the agency – member education and communications and selection of investment options – could be handled either by the outside administrator or by another State agency. Hence, the agency's operations could be scaled back with virtually no impact on member services and with reduced member fees.

Recommended Actions

		Funds	Positions
1.	Delete 10 positions and associated expenditures.	$ 756,860	10.0
2.	Add budget bill language reducing the agency's responsibilities to eliminate duplication with the administrator and other agencies.		
	Total Reductions	**$ 756,860**	**10.0**

Updates

Federal Tax Law Changes Increase Member Contribution Limits and Provide for Greater Portability: The federal Economic Growth and Tax Reconciliation Act of 2001 ("EGTRA") took effect on January 1, 2002 and provides changes to the federal provisions governing the supplemental retirement plans by increasing contribution limits, providing for greater portability, and easing service purchase rules.

Deferred Compensation Matching Program Participation Continues to Increase, Albeit at a Slower Rate: The State's $600 employer match program to the payroll deferral programs for State employee members of the Employees' Pension System (EPS) continued to increase the participation of EPS members in these deferral programs. The rate of growth in participation, however, is slowing.

GL.00
Maryland Supplemental Retirement Plans

Operating Budget Analysis

Program Description

The board was created to enable State employees and teachers to participate in voluntary tax-sheltered income deferral, tax-deferred annuity, profit sharing, and salary reduction plans. These plans offer members certain tax advantages as provided in the Internal Revenue Code. The plans are overseen by a board of trustees and its supporting agency staff. Agency staff provides communications programs and materials to State employees, supports the activities of the board of trustees in selection of investment options and other activities, and manages the 401(k) transfer plan.

The board finances its operations through a fee imposed on the employee-participants, based as a percent of assets in the plans. As of January 1, 2000, the board imposes a six basis-point (0.06%) fee (reduced from eight basis points) on assets in the 457, 403(b), and 401(k) deferral plans and a 16 basis-point (0.16%) fee on assets in the 401(k) transfer plan, which it self-administers. The board has contracted out the management of the 457, 403(b), and 401(k) deferral plans to PEBSCO, a private administrator. The administrator currently imposes a 28 basis-point (0.28%) fee on assets in those plans. Member fees are capped at $1,400 per member for the payroll deferral programs and $450 for the 401(k) transfer plan.

Governor's Proposed Budget

As shown in **Exhibit 1**, the Governor's fiscal 2003 allowance reflects a $4,061 decrease versus the fiscal 2002 working appropriation. This change reflects increases in personnel costs of approximately 11% offset by decreases in other agency costs. The personnel costs reflect both statewide salary initiatives as well as reinstatement of a $100,000 turnover reduction by the General Assembly in the agency's fiscal 2002 legislative appropriation. Agency cost reductions include decreases in postage, printing, bank custodial charges, computer equipment, and office assistance. The net reduction in the agency's budget reflects the agency's effort to balance expenditures to available revenues. Nevertheless, agency expenditures represent a 2.7% increase over actual fiscal 2001 spending.

Exhibit 1

Governor's Proposed Budget
Maryland Supplemental Retirement Plans
($ in Thousands)

How Much It Grows:	Special Fund	Total
2002 Working Appropriation	$1,468	$1,468
2003 Governor's Allowance	1,464	1,464
Amount Change	($4)	($4)
Percent Change	(0.3)%	(0.3)%

Where It Goes:	
Personnel Expenses	
Fiscal 2003 increments	10
Annualize fiscal 2002 general salary increase	16
Employee and retiree health insurance cost increase	6
Retirement contribution cost increase	8
Other adjustments (including turnover)	56
Subtotal Personnel Expenses	**$95**
Nonpersonnel Expenses	
Communications	(18)
Printing	(38)
Bank custodial charges	(29)
Computer equipment	(7)
Office assistance	(9)
Other Changes	2
Total	**($4)**

Note: Numbers may not sum to total due to rounding.

Performance Analysis: Managing for Results

Two years ago, the Department of Legislative Services (DLS) made two recommendations regarding the agency's Managing for Results (MFR) efforts, and the agency incorporated both those recommendations into its MFR program. First, DLS recommended that the agency measure participation in the payroll deferral savings programs by dividing **actively deferring employees** by the total number of eligible State employees. Previously, the agency counted all accounts, including duplicate and dormant accounts, which produced an artificially high level of participation. Participation among all active State employees is approximately 54% (up from 42% in 1999), and the agency has set a goal of 85% participation.

DLS also recommended that the agency measure the performance of its investment options compared to the universe of similar funds over an appropriate time period. Previously, the agency had cited the change in plan assets (versus the prior year) as a key performance indicator. Asset growth (or decline), however, is affected by a variety of factors, including overall market performance over which the agency has no control. In response, the agency has set as its performance indicator the average rate of return for all the plan's investment options versus the average for all investment indices. The new indicator should be a more accurate measure of the agency's effectiveness in selecting funds by showing the relative performance of these funds versus their indices. The data provided by the agency suggests that over a ten-year period, the board's investment options have provided annual returns three percentage points higher than the indices (14.0% versus 11.0%).

Other program measurement data reflect significant negative changes in the agency's fiscal circumstances, even though participation continues to grow. The total assets of plan members actually declined from fiscal 2000 to 2001, due to poor investment market performance. Future asset growth is anticipated to be a rate much lower than that which occurred in the late 1990s. Members continued to open accounts and increase deferrals, even in the face of the market decline. PEBSCO fees declined slightly because they are based on member assets. Board fee revenues also grew only minimally. Future year projections by the agency for revenues appear to be very optimistic; this is discussed subsequently as a budget issue.

Exhibit 2

Program Measurement Data
Maryland Supplemental Retirement Plans
Fiscal Years 1999 through 2003

	Actual 1999	Actual 2000	Est. 2001	Actual 2001	Est. 2002	Est. 2003	Ann. Chg. 99-01	Ann. Chg. 01-03
Plan Assets ($ in millions)	$1,484.8	$1,646.1	$1,892.7	$1,617.3	$1,750.0	$1,900.0	4.4%	8.4%
Deferrals/Transfers ($ in millions)	$81.1	$121.2	$136.8	$128.1	$135.0	$143.0	25.7%	5.7%
Active Accounts	34,176	42,073	50,000	43,766	45,000	46,500	13.2%	3.1%
PEBSCO Fees ($ in thousands)	$3,487.1	$3,626.1	$4,423.0	$3,617.3	$4,000.0	$4,500.0	1.9%	11.5%
Board Fees ($ in thousands)	$1,077.1	$985.0	$1,400.0	$1,019.9	$1,600.0	$1,600.0	-2.7%	25.3%

Source: Maryland Supplemental Retirement Plans for 1999-2001 data and 2002-2003 board fee estimates. DLS cannot verify board fee estimates. Other out-year estimates by DLS.

Issues

1. Agency Has Structural Fiscal Imbalance and Ended Fiscal 2001 with a Positive Fund Balance Using One-time Revenues

Fiscal 2001 Gap Between Revenues and Expenditures Equals 27% of Agency Budget

For the second straight year, board fee collections in fiscal 2001 fell significantly short of covering the board's annual costs. Despite an increase of 3.5% in board fee collections in fiscal 2001, the board's expenditures for fiscal 2001 still exceeded total revenue by almost $400,000, or about 27% of the agency's budget. The board's expenditures were $1,396,226, while total revenue was $1,019,819. This shortfall can be attributed to: (a) the board's lowering of its fee from eight basis points to six basis points (a 25% fee decrease) in January 2000; (b) its continued decision to absorb fees for members with large assets whose fees would have otherwise exceeded the cap; and (c) significant market declines in fiscal 2001 that reduced the asset base upon which fees are based.

Fiscal 2001 Deficit Closed Using One-Time Revenues

By the calculations of DLS, the supplemental plans should have ended fiscal 2001 slightly in the red. As illustrated in **Exhibit 3**, the agency's operating deficit for fiscal 2001 was $376,407, or $157 more than the reserve with which the agency started the fiscal year. According to the agency and the State accounting system, however, the agency ended fiscal 2001 with a reserve of $154,251.

The agency ended fiscal 2001 with a reported $154,000 fund balance. Even after lengthy discussions with agency staff, however, DLS staff are not able to reconcile this closing balance estimate. DLS is aware, however, of at least two sources of one-time revenue for the agency that likely comprise some or all of this balance. In both cases, the justification for the revenue is questionable, and in any event the revenues are nonrecurring.

Exhibit 3

Participants' Fees and Operating Budgets: Fiscal 1997 through 2001

	FY 1998	FY 1999	FY 2000	FY 2001	Projected FY 2002	Projected FY 2003
Board Fee Revenues	$1,115,585	$1,077,391	$985,000	$1,019,819	$992,978	$1,600,000*
As % of Assets	0.11/0.10%	0.10/0.08%	.08/0.06%	0.06%	0.06%	0.06%
Operating Expenses	$1,009,917	$1,126,742	$1,363,858	$1,396,226	$1,468,152	$1,464,091
Carryover Balance Surplus/(Deficit)	$804,458	$755,108	$376,250	$154,251*	($320,923)	($184,514)*

*Figure based on agency data. DLS cannot reconcile this figure. Carryover balance equals prior year balance plus revenues less operating expenses.
Source: Maryland Supplemental Retirement Plans

First, the agency received $108,496 in fiscal 2001 from PEBSCO, the outside contractor that

administers the plans on behalf of the agency. According to the agency, the additional funds received from PEBSCO were "a contract concession negotiated in lieu of substantial services performed by the agency over and above what was contemplated at the time of the original contract." The agency argues that these services, which included communications to plan members about retirement planning and recent federal tax law changes, reduced PEBSCO expenses and thus created an agency right to some form of additional compensation in lieu of PEBSCO hiring additional local personnel. DLS questions the agency's contention that the agency's activities saved PEBSCO any money. PEBSCO provides retirement investment services for hundreds of employers around the country and likely has access to any communications materials it needs regarding retirement savings and federal tax law implications. In any event, it is not clear that PEBSCO will provide such financial assistance recurringly.

Second, the agency received $84,739 from the Treasurer's office at the close of fiscal 2001, for "lost interest" that the State should have paid to the agency on past carryover surpluses. For much of the 1990s, the agency carried a surplus equal to almost an entire year's budget (and was consistently criticized for the excessive surplus). Though that surplus is exhausted now, the agency asked the Treasurer for reimbursement of interest that should have accrued to the agency when the surplus existed. The Treasurer agreed and apparently calculated the monthly interest earned on the board's monthly reserve balance (per available records) for 36 months ending June 2001 and credited the board with $84,739 at the closing of fiscal 2001. Again, this is a one-time revenue source that the agency will not have access to again. In the past, the board has argued that the interest earned by the general fund on the surplus implicitly compensated the State (and certain agencies such as the Comptroller's Office, Treasurer's office, and DBM) for its costs in administering the plan. Moreover, it is not clear whether State law provides for transfer of general fund interest to the agency.

The Agency's Fiscal Position Is Unlikely to Improve in the Near-term and the Board Continues to Consider Further One-time Revenue Adjustments

Over the next several years, the agency's fiscal position is likely to worsen. For fiscal 2002, the agency is projected to have an operating deficit (revenues less expenditures) of $491,174 and an ending fiscal 2002 balance shortfall of $336,923. The agency's operating deficit is approximately one-third of its total operating budget; its projected balance shortfall is approximately one-fifth of its total budget. Again, this shortfall is due to past decisions by the board to lower its fee rates combined with lower-than-expected asset values upon which the fee rates are based.

The Comptroller's Office will require the agency to find some way to avoid a negative fund balance at the end of fiscal 2002. Absent a decision by the board to raise its ongoing fees or substantially cut expenses, the board will be forced to rely on one-time revenue sources to balance its books at the close of fiscal 2002. One option would be to charge members their full calendar 2002 fee prior to the close of fiscal 2002. (Normally, fees are charged and collected quarterly.) Such an option would balance the fiscal 2002 books by drawing forward revenue that will be needed in fiscal 2003 and hence does not address the ongoing imbalance.

Even if the agency manages to balance its books for fiscal 2002, the financial picture for fiscal 2003 will likely be no better. The agency projects revenue of $1.6 million but can provide no basis for this revenue estimate. At this time, the board has approved no changes in its existing revenue structure. It is optimistic to assume that growth in the stock market and member deferrals will account for revenue growth in fiscal 2003 that is 60% higher than fiscal 2002. The agency states frankly that its revenue projection is based simply on the amount necessary to cover its expenditures – although to the extent that it draws revenue from fiscal 2003 to cover its fiscal 2002 deficit, this deficit may simply be transferred to fiscal 2003.

The Board Believes That Current Structure Is Sound in the Long-term and Wishes to Avoid Any Structural Changes. . . But Can It Make It Until Then?

In the long-term, the board believes that agency expenses will grow slower (at a rate of approximately 3% per year that is typical of historical State government growth) than will the plans' asset base (at a rate of approximately 13%, using the pension board's actuarial assumption of 8% plus growth in member deferrals of approximately 5%). Assuming this long-term projection is correct, it will still take several years for this projected growth differential to overcome the agency's structural deficit that equals approximately one-third of its operating budget. DLS estimates that the agency's operating balance would not be positive until fiscal 2007, and in the meantime, it is not clear how the agency would cover its negative balances. Moreover, if the agency's long-term projections are overly optimistic, particularly regarding revenue growth, then it could be much longer before the agency "grows its way out" of its current financial difficulties.

In the annual review of the agency's operations that DLS prepares for the Joint Committee on Pensions, DLS noted that the agency would need to make structural changes – either via increased fees or substantially reduced expenditures – to solve its fiscal imbalance. Similar concerns were raised by DLS as part of last year's budget analysis of the agency. Yet the board consistently refuses to make any structural reforms, even after being aware of its financial difficulties for almost 18 months. At its December 2001 board meeting, agency staff presented options for the board to increase revenues, but the board refused to approve any the options. The board met in closed session to consider expenditure reductions, but any such reductions have not been announced and would need to be substantial given the size of the fiscal imbalance in relation to the agency's budget.

The agency should be prepared to present to the budget committees a plan to rectify its structural imbalance. Such a plan should address both revenues and expenditures and should involve structural changes rather than one-time revenue adjustments.

2. $125 Million in 401(k) Transfer Account Assets Administered by In-house Staff

The 401(k) transfer account was created in the early 1990s to allow members of the Employees' Retirement System to withdraw their member contributions and transfer them to another tax-qualified retirement plan without tax penalty. The account is currently self-administered by the supplemental board, while the other three plans are administered by a private administrator under contract with the agency.

There are currently 520 such accounts with a total asset value of $125 million. The average account value is $240,000.

The agency's original justification for self-administration of the 401(k) transfer account was that it would be simple and inexpensive for the staff to administer and that the agency could pass these savings on to the members. Since the account was created, however, the savings that the agency offers these members (versus using PEBSCO) declined, while the level of services and security expected by members has increased. In 1993, payroll plan members paid four times the level of fees that transfer account members paid (80 basis points of combined fees for payroll plan members versus 20 basis points in agency fees for transfer account members). Currently, payroll plan members pay approximately only twice what transfer account members pay (34 basis points of combined fees for payroll plan members versus 16 basis points in agency fees for transfer account members).

While transfer account members pay lower fees, they also receive fewer services. Unlike payroll plan members, who have separate accounts maintained and tracked by PEBSCO, the transfer account is maintained by the agency in a single custodial account. The agency then maintains the value of each individual account. From inception, these accounts were tracked with a simple spreadsheet program, and they have only recently been transferred to a database program.

Transfer account members receive quarterly statements generated internally by agency staff, while payroll plan members receive statements generated by PEBSCO's mainframe computer. Payroll plan members can access their account anytime via PEBSCO's telephone automation system and via the Internet. They can make transactions at any time. Transfer account members may only make transactions once a month.

Transactions within the transfer account follow accounting rules in that they require steps by two authorized State employees. The agency's outside accounting firm and the Office of Legislative Audits have reviewed the agency's procedures and found no deficiencies. Given the large amount of funds at stake, however, DLS believes that it would be more appropriate for the account to be managed by an outside, professional plan administrator such as PEBSCO. Plan members – who, given their average account size, have a great deal at stake – would receive a higher level of services. The agency could potentially negotiate a fee structure with the administrator that is equivalent to the fees currently paid by transfer account members. Finally, this would free up agency staff and resources to perform other functions or reduce agency expenditures.

3. Many of the Agency's Activities Are Redundant

The board currently employs a staff of 16.5 positions to oversee the three payroll deferral plans and the 401(k) transfer account. Almost all of these oversight functions, however, are either duplicative with activities currently undertaken by the State Retirement Agency or the agency's outside administrator.

***Program Administration*:** The three payroll deferral plans – 401(k) deferral, 403(b), and 457 plans – are currently administered by PEBSCO, an outside administrator that operates under a five-year contract with the board and is compensated via an asset fee charged to member accounts. The outside

administrator is responsible for enrolling new State employee members, consulting with individual members about retirement planning transactions, processing any such transactions (including changes to deferral amounts, payout amounts, or investment choices), and mailing out quarterly statements. The 401(k) Transfer Plan is currently administered in-house by the agency (see discussion above). This plan could be more efficiently administered by PEBSCO.

Communication: The board's current communication functions are split between PEBSCO and the agency. The board prepares member newsletters and other communications materials that PEBSCO distributes for the board via its statement mailings. PEBSCO representatives visit State agencies and make presentations about deferred compensation. In addition, the agency employs field staff to make similar presentations to State employees and to distribute communications materials. The agency continues to expand its field staff even though there is significant overlap between its educational efforts and the presentations made by PEBSCO. The agency's communications functions could be assumed by PEBSCO. In addition, to the extent that the State Retirement Agency expands its retirement counseling operations, this counseling could (and should) include discussion of deferred compensation.

Investment Oversight: The board is responsible for determining the number and type of investment options available to participants, including the removal of underperforming options. The board is assisted in this oversight by agency staff and an outside investment consultant. These responsibilities could be transferred to the State Retirement Agency, which currently oversees the investment options of the Optional Retirement Program, the deferred compensation option for State university faculty.

In 1994, at the request of the budget committees, the former Department of Budget and Fiscal Planning (DBFP) studied the issue of consolidating the two agencies. DBFP identified little cost savings from consolidation and expressed concerns that the deferred compensation plans might receive less focus. In fact, the report understated the potential savings at the time, and those cost savings have increased since the time of the report as board's staff and expenditures have increased. Given these redundancies, and the current inability of the agency to sustain its operations without eventually increasing charges to participants or seeking State subsidy, the following is recommended:

- Staffing of the agency be reduced from 16.5 to 6.5 positions and limit its direct operations to monitoring investment plan selection and contractor performance.

- Plan promotion, investment counseling, and like activities should be performed through the State personnel management system, the State Retirement Agency, or the plan contractor. Up to $250,000 of the agency appropriation should be restricted by the agency to defray the cost of any necessary inter-agency reimbursement or contractor payments required.

- Administration of the 401(k) plan should be handled by the contractor under an appropriate agreement.

- The board should be instructed to adjust fees assessed to members to recognize any resulting reduction in program cost.

Recommended Actions

		Amount Reduction		Position Reduction
1.	Delete 10 positions and associated expenditures related to communications, field staff, and 401(k) transfer plan administration.	$ 756,860	SF	10.0

2. Add the following language:

, provided that:

(a) the Board of Trustees of Maryland Teachers' and State Employees' Supplemental Retirement Plans retain responsibility for administering the contract with its outside administrator and selecting mutual fund investment options and transfer all other responsibilities, including communications and member education, to the State Retirement Agency, the State Personnel Management System, or the outside administrator;

(b) the $250,000 of the agency appropriation may be used only to defray the cost of any necessary interagency reimbursements or contractor payments;

(c) no later than October 1, 2002, the board issue a Request for Proposals soliciting an outside administrator for the 401(k) Transfer Plan and that the agency transfer responsibility to such administrator no later than January 1, 2003;

(d) the board adjust fees assessed to plan members to recognize any resulting reduction in program costs.

It is the further intent of the General Assembly that it in reducing its staff, the agency attempt to assist terminated employees in transferring to vacant positions with its plan administrator, the State Retirement Agency, or the Department of Budget and Management.

Explanation: This language will reduce the responsibilities and activities of the Supplemental Retirement Plans agency and transfer certain responsibilities to the outside vendor and other State agencies.

Total Special Fund Reductions	**$ 756,860**	**10.0**

Updates

1. Federal Tax Law Changes Increase Member Contribution Limits and Provide for Greater Portability

The Economic Growth and Tax Reconciliation Act of 2001 ("EGTRA") was signed into law by President George Bush on June 7, 2001, took effect on January 1, 2002. This legislation will provide numerous changes to the Internal Revenue Code provisions governing all of the State's supplemental retirement plans by increasing contribution limits, providing for greater portability, and easing service purchase rules.

New Contribution Limits

Participants in the 457, 403(b), and 401(k) plans face certain federal tax limitations with respect to the contributions they may make into their plans each year. Prior to January 1, participants were subject to a maximum annual pretax contribution limit and a maximum percentage-of-pay contribution limit. At that time, participants in these supplemental plans could only contribute the lesser of 25% of their annual gross salary, or $8,500 annually for 457 plan participants and $10,500 annually for 403(b) and 401(k) deferral plan participants. Since January 1, 2002, these limits are increased to the lesser of $11,000 annually for participants in the 457, 403(b), and 401(k) deferral plans, or 100% of these participants' compensation. The $11,000 limitation will increase by $1,000 annually until 2006, when it will be $15,000. At that time, the dollar limit will be indexed to increase with inflation in $500 increments a year.

In addition, employees who are currently participating in more than one plan may now contribute more. Previously, members who participated in both the 457 plan and the 403(b) or the 401(k) deferral plans faced a maximum combined total contribution limit that could not exceed $8,500 annually. If a participant was a member of just the 403(b) and 401(k) deferral plan, this limitation was $10,500. EGTRA removes these limitations, allowing participants to contribute the maximum amount in each plan. Consequently, a member participating in all three plans can now contribute as much as $33,000 annually.

The participants that are most likely to benefit from these changes in contribution limits will be those who have already reached the maximum contribution either based on the dollar limit or the percentage-of-pay limit. For example, a participant in the 457 plan earning $20,000 annually, who is also a member of a "two-earner family," was previously limited to contributing $5,000 annually. Beginning January 1, 2002, this participant may now contribute $11,000 – a $6,000 increase in savings.

Portability

Another significant EGTRA change is one that allows participants in the 457, 403(b) and 401(k) deferral plans to now roll over plan money from their current plan into another 457, 403(b), or 401(k) deferral plan or an IRA if the participant changes jobs. These rollovers are tax-free and not limited to employment changes only within the public sector. For example, a 401(k) deferral plan participant working in the private sector will be entitled to rollover the participant's account into any of the State's plans.

Catching Up

Participants in the 457 and the 403(b) plans have long been able to make extra "catch-up" contributions in the years immediately preceding retirement in order to make up for missed savings opportunities earlier in their careers. EGTRA, however, greatly expands a member's ability to "catch up" on their contributions. The catch-up provisions for 457 plan participants are changed to allow participants to contribute a maximum of $22,000 annually ($11,000 in regular contributions and $11,000 in catch-up). The additional $11,000 in catch-up contributions can be made only in the last three years prior to the calendar year of the employee's normal retirement age. This increase in catch-up provisions will increase in $2,000 increments until it reaches $30,000 in 2006. For 403(b) plan participants, the existing catch-up provisions remain in effect; however, those members who are age 50 or older who are participating in the 403(b) plan also are now able to make additional catch-up contributions of $1,000 annually on top of the normal $11,000 maximum contribution limit. This catch-up limit will rise $1,000 a year over four years until it reaches $5,000 in 2006 and will then be indexed annually to inflation. In addition, participants in the 457 and 401(k) deferral plans are now entitled to take advantage of the "50 or older" catch-up provision; however, 457 plan participants within three years of retirement are not eligible to make the "50 or older" catch-up contribution.

Purchasing Service Credit

Another notable change for 457 and 403(b) plan participants is that these members may now buy additional service credit in their State retirement or pension system using their 457 or 403(b) savings. This provision will be helpful to those State employees who may not be comfortable with managing their own investments for their retirement and would prefer the security of the guaranteed payments provided for by the State's retirement and pension systems.

Income Tax Credits

Another benefit included in EGTRA that will directly impact low- and moderate- income savers is a non-refundable tax credit on the first $2,000 of savings to a 457, 403(b), or 401(k) deferral plan. This credit will only be available for the 2002 through 2006 tax years. Individuals earning up to $15,000 a year in adjusted gross income and couples filing jointly earning up to $30,000 in adjusted gross income are eligible for a 50% credit. Individuals earning between $15,001 and $16,250 and couples filing jointly earning between $30,001 and $32,500 are eligible for a 20% credit. Individuals earning between $16,251 and $25,000 and couples filing jointly earning between $32,501 and $50,000 are eligible for a 10% credit. This credit is in addition to the actual tax deduction the participants already receive on their contributions, and participants are entitled to apply this credit toward reducing the amount of taxes they currently owe.

2. Deferred Compensation Matching Program Participation Continues to Increase, Albeit at a Slower Rate

The establishment of the $600 employer match program to the three payroll deferral programs for State employee members of Employees' Pension System (EPS) continued to encourage participation of EPS members in these deferral programs. Prior to commencement of the matching program (in June 1999), 41% of the approximately 47,000 State EPS members were participating in one of the three payroll deferral programs. **Exhibit 4** shows the increase in deferred compensation participation by EPS members – to a current level of 76.1% because of the matching program. The exhibit also shows participation among all State employees. Prior to the matching program, EPS members had a significantly lower participation rate than other State employees. Given that their defined benefit pension plan provided a lower benefit than other State plans, an increase in deferred compensation participation by EPS members will make it more likely that they have an adequate retirement.

The rate of increase in participation is slowing now that most employees who are interested and able to enroll have done so. The remaining non-participating employees have chosen not to do so for financial or personal reasons. Thus, it is likely that participation will begin to plateau at or near the 85% level originally forecasted by DLS.

Exhibit 4

401(a) Matching Program Participation – At Various Points in Time

	June 1998	June 1999	June 2000	June 2001
Total Eligible	47,000	49,128	49,128	49,586
Total Participation	19,411	28,887	35,389	37,725
Match-eligible Participation Rate	41.3%	58.8%	72.0%	76.1%
Participation Rate Among All State Employees	54.5%	67.5%	76.5%	78.9%

Note: Program open to EPS members and employees of the Northeast Maryland Waste Disposal Authority only.

Source: Maryland Supplemental Retirement Plans

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets

Maryland Supplemental Retirement Plans

($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reims. Fund	Total
Fiscal 2001					
Legislative Appropriation	$0	$1,359	$0	$0	$1,359
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	0	67	0	0	67
Reversions and Cancellations	0	0	0	0	0
Actual Expenditures	**$0**	**$1,426**	**$0**	**$0**	**$1,426**
Fiscal 2002					
Legislative Appropriation	$0	$1,484	$0	$0	$1,484
Budget Amendments	0	(16)	0	0	(16)
Working Appropriation	**$0**	**$1,468**	**$0**	**$0**	**$1,468**

Note: Numbers may not sum to total due to rounding.

Object/Fund Difference Report
Maryland Supplemental Retirement Plans

Object/Fund	FY01 Actual	FY02 Working Appropriation	FY03 Allowance	FY02 - FY03 Amount Change	Percent Change
Positions					
01 Regular	16.50	16.50	16.50	0	0%
Total Positions	**16.50**	**16.50**	**16.50**	**0**	**0%**
Objects					
01 Salaries and Wages	$ 995,278	$ 854,202	$ 949,452	$ 95,250	11.2%
02 Technical & Spec Fees	9,561	13,000	9,700	(3,300)	(25.4)%
03 Communication	27,339	55,937	37,628	(18,309)	(32.7)%
04 Travel	43,077	46,500	46,500	0	0%
07 Motor Vehicles	12,555	14,580	16,915	2,335	16.0%
08 Contractual Services	220,665	371,199	288,122	(83,077)	(22.4)%
09 Supplies & Materials	26,471	15,560	21,400	5,840	37.5%
10 Equip - Replacement	2,547	2,400	2,500	100	4.2%
11 Equip - Additional	10,807	11,847	4,500	(7,347)	(62.0)%
13 Fixed Charges	77,906	82,927	87,374	4,447	5.4%
Total Objects	**$ 1,426,206**	**$ 1,468,152**	**$ 1,464,091**	**($ 4,061)**	**(0.3)%**
Funds					
03 Special Fund	$ 1,426,206	$ 1,468,152	$ 1,464,091	($ 4,061)	(0.3)%
Total Funds	**$ 1,426,206**	**$ 1,468,152**	**$ 1,464,091**	**($ 4,061)**	**(0.3)%**

Note: Full-time and contractual positions and salaries are reflected for operating budget programs only.

Fiscal Summary
Maryland Supplemental Retirement Plans

Unit/Program	FY01 Actual	FY02 Legislative Appropriation	FY02 Working Appropriation	FY01 - FY02 % Change	FY03 Allowance	FY02 - FY03 % Change
Maryland Supplemental Retirement Plans	$ 1,426,206	$ 1,484,152	$ 1,468,152	2.9%	$ 1,464,091	(0.3)%
Total Expenditures	**$ 1,426,206**	**$ 1,484,152**	**$ 1,468,152**	**2.9%**	**$ 1,464,091**	**(0.3)%**
Special Fund	$ 1,426,206	$ 1,484,152	$ 1,468,152	2.9%	$ 1,464,091	(0.3)%
Total Appropriations	**$ 1,426,206**	**$ 1,484,152**	**$ 1,468,152**	**2.9%**	**$ 1,464,091**	**(0.3)%**