SB 141

Department of Legislative Services
Maryland General Assembly
1999 Session

FISCAL NOTE
Revised

Senate Bill 141 (The President, *et al.*)
(Administration)
Budget and Taxation

State Police Retirement System - Benefits

This Administration pension bill enhances retirement benefits for active members and retirees of the State Police Retirement System. The bill is effective July 1, 1999, although one aspect of the bill is contingent on approval under federal tax law.

Fiscal Summary

State Effect: Total increase in pension liabilities of $91.2 million, resulting in an increase in total expenditures for employer retirement contributions of $9.7 million beginning in FY 2001, of which $7.8 million are assumed to be general funds and $1.9 million are assumed to be special funds. Future year expenditures reflect 5% growth consistent with actuarial assumptions. Special fund expenditures for the State Retirement Agency to implement the program will increase by approximately $396,100 in FY 2000, of which approximately $140,900 will be ongoing costs. Revenues would not be affected.

($ in millions)	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
GF Revenues	$0.0	$0.0	$0.0	$0.0	$0.0
GF Expenditures	$0.0	$7.8	$8.1	$8.6	$9.0
SF Expenditures	$0.4	$2.0	$2.1	$2.2	$2.4
Net Effect	($0.4)	($9.8)	($10.2)	($10.8)	($11.4)

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

Local Effect: None.

Small Business Effect: A small business impact statement was not provided by the

Administration in time for inclusion in this fiscal note. A revised fiscal note will be issued when the Administration's assessment becomes available.

Fiscal Analysis

Bill Summary: This pension bill alters several aspects of the State Police Retirement System.

- Members may retire with a normal service retirement allowance with at least 22 years of service (or age 50), versus current law, which requires 25 years of service (or age 50).

- Benefits are calculated at the rate of 2.55% of average final compensation for each year of service. Under current law, members receive 2.2% of average final compensation per year for their first 25 years of service and 1.1% per year thereafter.

- A member's normal service retirement would be capped at 71.4% of average final compensation (or 28 years of service).

- Employee contributions are set at 8% of pay throughout membership; under current law members contribute 8% for their first 25 years and 4% thereafter.

- A Deferred Retirement Option Program (DROP) is created that, in general, allows State Police members to "retire" from the State Police Retirement System but continue to be employed by the Department of State Police in the same position with the same rank and status for a fixed period of time. The member's benefit payments (based on service credit and salary at "retirement") are maintained by the State retirement system in a fictional account where the member earns interest and receives any cost of living adjustments to the basic retirement allowance. The member does not accrue any additional service during the DROP period. At the end of the fixed period, the member terminates employment and receives the value of the DROP account and begins to receive the normal retirement allowance as well. The specifics of the DROP are as follows:

    - To be eligible for the DROP, a member must have at least 22 years of service but be less than 60 years old. (The age restriction would not apply to the Secretary of State Police.)

    - The maximum period of the DROP is four years, with constraints that limit total seniority to 28 years and age to 60.
    - When applying for the DROP, the member must sign a binding letter of resignation specifying the member's date of termination.

- A DROP participant is officially a retiree of the State Police Retirement System even though the member continues to work.

- The DROP member earns 6.0% (compounded monthly) on the member's retirement allowance paid during the DROP period, versus the current statutory regular interest of 4%.

- Upon termination of the DROP, the member or designated beneficiary receives the DROP amount in a lump sum.

- The DROP member is eligible for death and special disability benefits, even though the member has "retired" from the State Police Retirement System.

- Implementation of the DROP is contingent on an affirmative private letter ruling from the Internal Revenue Service (indicating, among other things, that the DROP does not harm the tax-qualified status of the State Police Retirement System).

The bill also increases the retirement allowances of State Police Retirement System members who are retired or who retire before June 30, 1999 by providing annual lump sum payments, as follows:

- $1,200 for retirees who have been retired not more than 5 years;
- $1,500 for retirees who have been retired more than 5 but less than 10 years;
- $1,800 for retirees who have been retired more than 10 but less than 15 years; and
- $2,100 for retirees who have been retired more than 15 years.

The lump sum would apply to all normal service and disability retirees and their beneficiaries. Retirees will receive a prospective annual unlimited cost of living adjustment (COLA) on this annual lump sum in addition to their existing benefit and COLA.

State Expenditures: There are three types of costs associated with this bill: (1) additional employer pension contributions resulting from the enhancement, including the DROP; (2) an indeterminate impact on personnel expenditures associated with the DROP; and (3) additional administrative expenditures by the State Retirement Agency to implement the new pension formula.

Additional Employer Pension Contributions

There were 1,635 active members of the State Police Retirement System on June 30, 1998, with a total payroll of $70.7 million. Under the bill members will be able to retire at 22 years with 56.1% of average final compensation. Alternatively, they could retire at 25 years of service with 63.8% of average final compensation versus the current full retirement of 55% of average final compensation at 25 years (a 16% increase in the accrual rate). The DROP also affects pension costs by shortening the average age and years of service until retirement. There is also an actuarial cost associated with member eligibility for special disability benefits during the period when the member has "retired" but continues to work; however, the actuary estimates that this cost is not material.

The State's actuary advises that the enhancement for active members will increase total actuarial liabilities by a net present value of $67.5 million, amortized over 19 years until the year 2020. The first-year amortization payment in fiscal 2001 would be $8.2 million, increasing 5% per year thereafter.

There were 1,234 retirees and beneficiaries of the State Police Retirement System as of June 30, 1998. The actuary estimates that the annual lump sum payments and attendant COLAs will increase the system's actuarial liabilities by $23.7 million, amortized over the 19 years until 2020. The first year amortization payment in fiscal 2001 will be $1,496,000, increasing 5% per year thereafter.

In total, employer contributions will increase by $9.7 million in fiscal 2001, increasing 5% per year thereafter. As a percentage of payroll, the employer contribution rate would increase from 1.26% (fiscal 2000) to 13.26%. (This rate is based on the assumption that the State makes contributions for all system members, including those in the DROP.) It is assumed that 80% of the pension expenditures will be general fund and the remainder special fund (Transportation Trust Fund). The Governor's proposed fiscal 2000 budget included $8 million contingent on enactment of this bill. The additional pension costs resulting from this bill, however, would not be realized until fiscal 2001, so the General Assembly cut the fiscal 2000 funds.

Additional Personnel Costs of DROP

While State Police Retirement System members "retire" when they enter DROP, they continue to work and receive pay increases. Moreover, the DROP provides a significant incentive to continue working for the full four-year DROP period because the gross lump sum upon termination would be approximately $125,000 after four years.

Over the past five years, the average years of service at retirement of State Police members has ranged between 25.4 years and 27.6 years. The average years of service could increase under the bill due to the strong incentive to stay for between 26 and 28 years. Twenty-six years is the point at which DROP eligibility ends for those who elect DROP at 22 years. Twenty-eight years is the maximum years of service pension accumulation for those who do not choose DROP. (For pension purposes, the "average years of service at retirement" will drop because of the DROP and its associated "retirements.")

If the average seniority of the workforce increases and remains higher, this would result in higher average salaries and an increase in personnel expenditures (excluding pension costs). The incentive to State troopers to continue working created by the DROP may be offset, however, by the change in full retirement benefits from 25 years to 22 years, which may cause some troopers to leave earlier than they would currently. The net effect on personnel expenditures thus cannot be reliably estimated at this time.

State Retirement Agency Administrative Expenses

The State Retirement Agency will be required to implement the new benefit structure, including the DROP. The new structure would coincide with the agency's transition to a new data processing system and therefore require changes both to the old computer system and the new one.

Legislative Services' estimate -- based on information provided by the agency -- for additional special expenditures is set forth below. Fiscal 2000 expenditures total $396,063.

State Retirement Agency: Additional FY 2000 Special Fund Expenditures

New Benefit Formula		**One-Time or Ongoing**
Member communications and additional counseling	$6,500	one-time
Manual adjustments to existing computer system	$50,000	ongoing
Contractual costs from changing parameters of new computer system	$75,000	one-time
DROP		
Full-time permanent accountant/auditor 3 (salary and fringe benefits) and supplies	$35,563	ongoing
Outside tax counsel	$4,000	ongoing
Additional computing resources to track DROP	$50,000	ongoing
Contractual costs from changing parameters of new computer system	$175,000	one-time
Total	**$396,063**	

The agency argues that an outside programming consultant is needed to adjust the existing computer system, at a cost of approximately $236,000. Legislative Services believes that this estimate is excessive given the small number of State Police Retirement System members and the short time until the transition to the new computer system. Legislative Services estimates that agency staff can manually calculate the new benefit formula (via a spreadsheet or otherwise) until the new system is on-line, with an additional $50,000 per year for overtime or contractual personnel expenditures (as reflected above).

The actual contractual costs of changing the parameters of the new computer system may vary significantly from the estimates above; the contractor was not able to give a precise cost estimate in time for the preparation of this fiscal note.

Out-year expenditures of approximately $140,900 reflect ongoing personnel and contractual services expenditures to administer the DROP and additional personnel expenditures to implement the new benefit formula until the new computer system is operational. Future year increases reflect assumed 3.5% salary growth for personnel costs.

Additional Comments: Several issues associated with the bill should be noted:

- In addition to the appropriation process, the agency's annual spending authority for administrative and operational expenses is capped by Section 21-315(c) of the State Personnel and Pensions Article at 0.2% of the payroll of members. The Governor's proposed fiscal 2000 budget for the agency is extremely close (within $700) of the statutory administrative expenditure cap.

- The Board of Trustees of the State Retirement and Pension System is currently considering a change in its actuarial funding methodology to make contribution rates less volatile as the overall system approaches full funding. If the board makes such a change, the cost of the State Police enhancement could vary significantly from the estimate provided here.

  A change in the actuarial funding method will not alter the total additional liabilities of $91.2 million under the enhancement. The funding method, however, will alter the annual cost of the enhancement by altering the distribution of when those costs are paid. The actuary estimates that the annual costs in the initial years of the enhancement would go down under an alternate funding method. Such a funding method would increase the State Police system's contribution gradually from the current rate of 1.26% up to the system's new normal cost. In that case, the first-year contribution rate could be lower than the 13.26% estimate above.

Information Source(s): Department of State Police; State Retirement Agency; Milliman & Robertson, Inc.; Department of Legislative Services

Fiscal Note History:	First Reader - February 9, 1999
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