Department of Legislative Services
Maryland General Assembly
1999 Session

FISCAL NOTE
Revised

Senate Bill 363 (Senator Kasemeyer) (Chairman, Joint Committee on Pensions)
Budget and Taxation

Employees' and Teachers' Systems - Inclusion in Contributory Pension Benefit Program - Participating Governmental Units and Selection C (Combination Formula) Members

This pension bill provides participating local governments with the option to offer the pension enhancement enacted under Chapter 530 of 1998 (HB 987) to their members of the Employees' Pension System. The bill also includes in the pension enhancement Selection C members of the Employees' Retirement System who were inadvertently excluded and makes certain other technical changes to pension systems.

The bill takes effect July 1, 1999.

Fiscal Summary

State Effect: FY 2000 personnel expenditures (all funds) would increase by $124,200 (for the deferred compensation matching program) and FY 2001 expenditures would increase by $1,640,760 (for the matching program and the pension enhancement), with pension costs increasing by 5% per year thereafter based on actuarial assumptions. One-time administrative expenditures (special funds) for the State Retirement Agency could increase by $116,000 per year, of which $66,000 would be for including the local governments (not included in table). These latter expenses are eventually recouped from the participating governmental units through employer pension contributions.

(in dollars)	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
GF/SF/FF Revs	$0	$0	$0	$0	$0
GF/SF/FF Exps	124,200	1,640,800	1,715,800	1,794,500	1,877,200
Net Effect	($124,200)	($1,640,800)	($1,715,800)	($1,794,500)	($1,877,200)

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

Local Effect: For local governmental units that participate in the State Retirement and

Pension System of Maryland (SRPS) and that elect the enhancement, the aggregate employer pension contribution rate would increase by 2.42% (before adjusting for differences among individual units). If all 98 participating governmental units elected the enhancement, annual pension contributions would increase by $13.8 million beginning in FY 2000, increasing 5% per year thereafter based on actuarial assumptions.

Small Business Effect: None.

Fiscal Analysis

Background: Local governmental units that participate in the SRPS were not included in HB 987's pension enhancement. During the interim, the Joint Committee on Pensions studied the cost impact to the participating governmental units participating in the enhancement. The vast majority of participating local governments that expressed an opinion to the joint committee were in favor of expanding the pension benefit enhancement to include them. The few jurisdictions that opposed enhancement for their own systems (primarily for cost reasons) did not oppose expansion of the enhancement to other jurisdictions.

The participating governmental units are part of a "pool" of assets and liabilities, but each unit pays a slightly different rate to account for historical under-contributions and different demographic patterns.

Bill Summary: The bill gives local governments that participate in the SRPS the option to participate in the pension enhancement under HB 987. The enhancement is optional on the part of the local employer, but once an election is made it is irrevocable. The employers have a six-month window period beginning July 1, 1999 in which to elect the enhancement. The bill takes effect July 1, 1999, but the benefits and employer and employee costs are retroactive to July 1, 1998 to make them consistent with the enhancement granted to other pension system members. Employers joining the SRPS would do so under the enhanced benefit structure. Employees would have a grace period to pay back the missed employee contributions without interest.

The bill also makes three technical changes related to HB 987.

Selection C Members

The bill includes Selection C members of the retirement systems who are State employees or teachers in the pension enhancement. Selection C members, also referred to as "bifurcated" members, currently accrue service in the pension systems, but maintain service credit in the retirement systems for their years of service prior to electing to bifurcate. Because Selection C members are members of the retirement systems, they are currently not eligible for the enhancement under HB 987.

Covered employees will receive 1.4% of average final compensation for each year of service after July 1, 1998. Service before July 1, 1998 will earn 1.2% or the existing formula, whichever is higher, for each year of service. These employees must contribute 2% of pay toward their pension benefit. They will receive a compound cost of living adjustment (COLA) capped at 3%, versus the current simple COLA (also capped at 3%).

The bill applies retroactively, granting eligibility and creditable service for affected members as of July 1, 1998 (including for those who have retired since July 1, 1998) and includes the compound COLA since that date.

The bill also makes Selection C members who are State employees eligible for the deferred compensation matching program created under HB 987.

Nomenclature Change

Most pension system members are now eligible for the enhanced benefit under HB 987. Certain pension system members, however, -- for example those members who transferred from the retirement systems after April 1998 and members who are employed by participating local governments (assuming no legislative changes) -- will receive the pre-enhancement benefit formula. To distinguish between the two benefit formulas, the bill identifies the enhanced benefit as the "contributory pension benefit."

Sick Leave and Military Credit

The bill clarifies that service credit earned from uncredited military service or unused sick leave is to be credited at 1.4% per year of service (the accrual rate that is effective for service earned after July 1, 1998) even if some or all of the military service or unused sick leave took place prior to July 1, 1998, for which the accrual rate is 1.2% per year of service. For active military duty that interrupts membership, the actual dates of military service will determine the accrual rate. The retirement board's policy has been that uncredited military service does not "accrue" until the member files for and receives military service credit. Similarly, unused sick leave is granted only at the time of retirement, when it is first reported to the retirement agency.

State Expenditures: State expenditures could be affected in three ways as a result of the bill: (1) additional pension liabilities and resulting employer contributions; (2) additional deferred compensation matching costs; and (3) administrative costs.

Pension Costs

The change in nomenclature has no fiscal impact. The clarification on military service and unused sick leave credit has no fiscal impact because it codifies existing practice by the State Retirement Agency.

The State Retirement Agency advises that there are 1,734 Selection C members, of whom 1,626 are State employees or teachers. Covered employees will receive 1.4% of average final compensation for each year of service after July 1, 1998. Service before July 1, 1998 but after their election of Selection C will earn 1.2% or the existing formula, whichever is higher, for each year of service. These employees will be required to contribute 2% of pay toward their pension benefit. They will receive a compound cost of living adjustment (COLA) capped at 3%, versus the current simple COLA (also capped at 3%) for the pension system portion of their benefit.

The bill applies retroactively, granting eligibility and creditable service for affected members as of July 1, 1998 (including for those who have retired since July 1, 1998) and includes the compound COLA since that date.

The State's actuary estimates that including these 1,626 Selection C members in the enhancement will increase the system's liabilities by $25.3 million. Amortizing these liabilities over the 19 years until 2020 results in a first-year payment in fiscal 2001 of $1.5 million. Future year payments would increase by 5% per year based on actuarial assumptions. The additional amortization payment is equal to about 0.03% to the aggregate State contribution rate of 10.7%.

Deferred Compensation Costs

There are 276 Selection C members who are State employees and will be eligible for the $600 match to deferred compensation. Participation in deferred compensation by these employees, who have worked for the State for at least 19 years, is likely to be higher than the general population. It is assumed that 75% of them will take advantage of the full $600 match in fiscal 2000, increasing to 85% in fiscal 2001 and beyond. This will result in fiscal 2000 costs of $124,200 and fiscal 2001 costs of $140,760.

In total, State fiscal 2000 expenditures will increase by $124,200 (for the deferred compensation matching program) and fiscal 2001 expenditures will increase by $1,640,760 (for the matching program and the pension enhancement), increasing by 5% per year thereafter based on actuarial assumptions.

Administrative Expenses

The State Retirement Agency will need approximately $66,000 to administer the enhancement for the participating governmental units, including $24,000 in communications costs for conferences with local employers, mailings, and counseling services for local employees and $42,000 for two contractual employees (for eight months) to implement the mandatory 2% payroll deduction. There may also be an indeterminate increase in contractual costs if the agency must have its pending computer system reprogrammed for the enhancement.

The agency also advises that three permanent fiscal specialists (at a total of $85,965, including fringe benefits) and an outside programming consultant (at $48,000) are necessary to implement the enhancement. Legislative Services disagrees with this assessment; the agency has recently reprogrammed its systems to provide the enhancement to State employees and teachers, who make up the majority of system members. (The agency received budget amendments totaling $934,000 to implement the enhancement.) By offering local employees the same benefit as most other system members, the agency's ongoing administrative costs should go down by an indeterminate amount, not up. Any additional programming should result in minimal additional costs, given that identical reprogramming has just been done.

To implement the enhancement for Selection C members, the agency advises that administrative costs could increase by approximately $147,000 to implement the bill, including additional communications costs, a full-time contractual accountant/auditor, and an outside computer consultant to reprogram the existing mainframe computer.

Legislative Services estimates, however, that administrative expenses for the agency could increase by approximately $50,000 per year to implement the new formula manually with the system's current mainframe computer system for the 1,626 Selection C members until the pending computer system is available. Programming the new formula into the system's pending computer system will require indeterminate costs to change the procurement specifications.

Local Expenditures: The bill allows members of the Employees' Pension System (or Selection C or "bifurcated" members of the Employees' Retirement System) who are employed by a participating governmental unit that elects the enhancement to receive the improved pension benefit formula under HB 987.

Covered employees will receive 1.4% of average final compensation for each year of service after July 1, 1998. Service before July 1, 1998 will earn 1.2% or the existing formula, whichever is higher, for each year of service. These employees will be required to contribute

2% of pay toward their pension benefit. They will receive a compound cost of living adjustment (COLA) capped at 3%, versus the current simple COLA (also capped at 3%).

The bill applies retroactively, granting eligibility and creditable service for affected members as of July 1, 1998 (including for those who have retired since July 1, 1998) and includes the compound COLA since that date.

The State's actuary estimates the following aggregate cost (as a percent of payroll) to participating governmental units if they are included in the benefit enhancement:

Participating Local Governments: Aggregate Rates

FY 2000 Base Rate (including impact of investment assumption change to 8%):	3.70%
Aggregate Cost of Enhancement:	2.42%
Total Aggregate FY 2000 for Employers Electing Enhancement:	6.12%

The actuary notes that these aggregate rates do not reflect adjustments for individual local governments relating to the Retirement System surcharge, any surplus or deficit adjustment, and new employee costs.

The 98 participating governmental units employ 19,743 members of the Employees' Pension System and 78 Selection C members of the Employees' Retirement System. (Members of the "old" Employees' Retirement System would not be affected.) If all 98 participating local governments participate in the enhancement, then liabilities for the municipal pool will increase by $133 million. Amortizing these liabilities over the same 20 years (until 2020) as HB 987 results in an increase in annual payments of $13.8 million in fiscal 2000, increasing by 5% per year based on actuarial assumptions.

The bill does not include the participating governmental units in the deferred compensation matching program, which is open to State employees only. (Local governments can establish their own deferred compensation programs and some have done so.) Individualized costs for the participating local governments will be provided to the local governments prior to the beginning of the window period.

The actuary does not anticipate any adverse selection costs in which inclusion of some, but not all, of the participating employers adversely affects the cost of the enhancement.

Additional Comments: 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.

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

Fiscal Note History: First Reader - February 22, 1999
lnc/jr Revised - Senate Third Reader - March 23, 1999

Analysis by: Matthew D. Riven

Direct Inquiries to:
John Rixey, Coordinating Analyst
(410) 946-5510
(301) 970-5510