Department of Legislative Services

Maryland General Assembly
2000 Session

FISCAL NOTE
Revised

House Bill 604 (Chairman, Appropriations Committee)
(Departmental - Budget and Management)

Appropriations

Law Enforcement Officers' Pension System - Benefits

This departmental pension bill enhances retirement benefits for active members and retirees of the Law Enforcement Officers' Pension System (LEOPS). The bill is effective July 1, 2000, although one aspect of the bill is contingent on approval under federal tax law and another aspect of the bill is retroactive to July 1, 1996.

Fiscal Summary

State Effect: Pension liabilities and normal costs would increase by $62.0 million as a result of the enhancement, resulting in additional State pension contributions of $4.4 million in fiscal 2002, increasing 5% per year thereafter based on actuarial assumptions. Revenues would not be affected.

(in millions)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
All Revenues	$0.0	$0.0	$0.0	$0.0	$0.0
GF Expenditures	0.0	3.1	3.3	3.4	3.6
SF Expenditures	0.0	1.3	1.4	1.5	1.5
Net Effect	$0.0	($4.4)	($4.7)	($4.9)	($5.1)

Note: ( ) = decrease; GF = general funds; FF = federal funds; SF = special funds; - =indeterminate effect
Numbers may not total due to rounding.

Local Effect: None.

Small Business Effect: The Department of Budget and Management has determined that this bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment. (The attached assessment does not reflect amendments to the bill.)

Analysis

Bill Summary: The bill changes the provisions of LEOPS as follows:

Employee Contributions

- Most LEOPS members will be required to contribute 4% of salary.

Enhanced Benefit Structure

- These members will receive 2% of average final compensation for each year of service.

- With a maximum normal service retirement allowance not to exceed 60% of average final compensation.

Cost-of-Living Adjustment (COLA)

- 3% compound COLA (versus current 3% simple COLA).

- New COLA would also apply to current retirees and former vested members.

Liberalized Accidental Disability Provisions

- A LEOPS member will be eligible for an accidental disability retirement benefit if the member is totally and permanently incapacitated for duty arising out of or in the course of the actual performance of duty. The bill therefore allows LEOPS members to qualify for accidental disability based on occupational diseases (such as heart condition, hypertension) if the disability arises out of or in the course of the actual performance of duty (similar to the provisions for the State Police system).

Deferred Retirement Option Program (DROP)

- The DROP allows LEOPS members to “retire” from LEOPS but continue to be employed by their current employer 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 25 years but less than 30 years of service.

  - The maximum period of the DROP is five years, with constraints that limit total seniority to 30 years.

  - 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 LEOPS even though the member continues to work.

  - The DROP member earns 6% (compounded monthly) on the member's retirement allowance paid during the DROP period, versus the current statutory regular interest of 5%.

  - 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 LEOPS.

  - Implementation of the DROP is contingent on receipt of an affirmative determination letter from the Internal Revenue Service indicating that the DROP does not harm the tax-qualified status of LEOPS.

Employees' Retirement "Old" System Members Who Transferred to LEOPS

- LEOPS members who transferred from the "old" Employees' Retirement System have a six-month window (through December 2000) to select the enhanced LEOPS benefit or to continue under their current structure.

- If the member participates in the "retirement system" option of LEOPS, the member continues to pay the retirement system contribution rate of 5% or 7%.

Miscellaneous Technical Provisions

- The bill introduces some technical provisions similar to that proposed for the

Employees' Pension System by the Joint Committee in HB 421, including:

  - four year break-in-service rule;

  - termination of membership upon withdrawal of contributions, but the right to repurchase past service with redeposit of contributions (plus interest);

  - two years after termination of membership to file a disability application (for a total of six years from termination of employment); and

- LEOPS members may now transfer service from other public pension plans into LEOPS (existing law prohibits such transfers). This provision is retroactive to July 1, 1996.

Current Law: LEOPS members, upon reaching age 62, currently receive 1% of average final compensation up to the Social Security Integration Level and 1.7% of average final compensation in excess of the integration level, for each year of service. From the period from retirement to age 62, the member receives a supplement so that the total benefit equals 1.7% of average final compensation for each year of service until the member reaches age 62 (and becomes eligible for Social Security).

The integration level in calendar 2000 is $33,000. The average salary for a LEOPS member is $43,277; based on that salary, the annual benefit for 25 years of service would be $12,625 and for 30 years would be $15,141 (or about 1.2% of average final compensation for each year of service).

Members are eligible for normal service retirement at 25 years of service or age 50 (not changed under the bill). Members pay no employee contribution for salary up to the Social Security Wage Base (currently $76,200) and 5% of compensation above the wage base. LEOPS members participate in Social Security, and this would not change under the bill. LEOPS members receive a 3% simple COLA.

Background:

History of LEOPS

The LEOPS system was created in 1994 as the "Natural Resources Pension System" for sworn law enforcement officers and rangers of the Department of Natural Resources. It has since been expanded to other State and local law enforcement officers and was renamed in 1996. The current membership of LEOPS is illustrated below.

Membership in Law Enforcement Officers' Pension System		

Group	Inclusion Legislation	Members
DNR Rangers and Police	Chapter 6 of 1994	387
Comptroller's Office - Maryland Investigative Services Unit	Chapter 438 of 1996	10
Baltimore City Deputy Sheriffs	Chapter 162 of 1997	84
Maryland Transportation Authority	Chapter 149 of 1997; Chapter 514 of 1998 (for Port Police, merged into MdTA)	345
State Fire Marshal and Deputy Fire Marshals	Chapter 554 of 1998	33
University System of Maryland	Chapter 390 of 1998 (but effective 7/1/99)	220
Morgan State University	Chapter 10 of 1999	25
Retirees, Former Vested Members, and Miscellaneous	- -	203
Total		**1,307**

Comparison versus other State pension systems

Currently, sworn law enforcement officers employed by the State are in three different pension systems. The table below compares the employer costs and employee benefits of each of the three plans.

Comparison of State Pension Systems for Law Enforcement Officers					
System	**Member-ship**	**Employee Contribution**	**FY 2001 Employer Contribution**	**Benefit at Retirement (assuming 25 years**	**Benefit at Age 62**

				and age 55) as % of AFC*	
State Police Retirement System	2,962	8%; no Social Security	8.44%; no Social Security	64% of AFC	64% of AFC
LEOPS (includes DNR Police and Rangers; Baltimore Deputy Sheriffs; MdTA Police; Comptroller's Investigators; University Police)	1,307	No Contribution up to Social Security Wage Base ($33,000), 5% thereafter; plus 6.2% Social Security Contribution	23.38%; plus 6.2% Social Security	43% of AFC	30% of AFC plus Estimated 20% of AFC from Social Security
HB 604 LEOPS Enhancement	**1,307**	**4%**	**31.97%; plus 6.2% Social Security**	**50% of AFC**	**50% of AFC plus 20% of AFC from Social Security**
Employees' Pension System	78,923	2%; plus 6.2% Social Security	5.71%; plus 6.2% Social Security	20% of AFC (after early retirement reduction)	20% of AFC (after early retirement reduction) plus 20% of AFC from Social Security

* AFC = Average Final Compensation

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 are approximately 1,100 active members of the LEOPS, with a total payroll of approximately $45.8 million. Under the bill, LEOPS members will be able to retire at 30 years of service with 60% of average final compensation, the maximum benefit allowed. Alternatively, they could retire at 25 years of service with 50% of average final compensation, versus 42.5% under current law. 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 accidental 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 net present value of the additional pension benefits under the enhancement would be $62.0 million, including additional unfunded liabilities and increased normal costs. The additional liabilities are amortized over 19 years from fiscal 2002 through fiscal 2020. The first-year cost in fiscal 2002 (including increased normal costs and the additional amortization payments associated with the increased liabilities) would be $4.4 million, increasing 5% per year thereafter.

As a percentage of payroll, the employer contribution rate would increase from 23.38% (fiscal 2001) to 31.97% (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 the fund split of the additional expenditures will be approximately 70% general fund and 30% special fund.

Additional Personnel Costs of DROP

While LEOPS 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 five-year DROP period because the gross lump sum upon termination would be approximately $150,000 after five years.

The average years of service could increase under the bill due to the strong incentive to stay for 30 years, either to accrue the maximum benefit or to participate in the DROP from year 25 of employment through year 30 for pension purposes, the "average years of service at retirement" will drop because DROP participants are technically "retired." 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 created by the DROP for LEOPS members to continue working may be offset, however, by the increased accrual rate, which may cause some LEOPS members to retire sooner than they would have otherwise based on the additional retirement benefits. The net effect on personnel expenditures thus cannot be reliably estimated at this time.

State Retirement Agency Administrative Expenses

The State Retirement Agency advises that it will require at least $260,800 in additional special fund expenditures to implement the program, including $236,050 for computer programing for its existing computer system, plus several hundred thousand dollars more to reprogram the agency's new computer system. Legislative Services believes that this estimate is excessive given the small number of LEOPS members and the short time until the transition to the new computer system. Legislative Services estimates that an additional

$50,000 per year for overtime or contractual personnel expenditures will be sufficient.

Additional Comments: This bill was the product of collective bargaining negotiations between the Governor and the employees' representatives. Another bill, HB 605, was also developed as part of collective bargaining and would expand the membership of LEOPS to include other State law enforcement officers and fire/rescue personnel. If that bill is enacted, the costs associated with providing the enhanced LEOPS benefit would increase. Based on the additional payroll under HB 605, it is estimated that the cost of this bill would increase by an additional $1.8 million per year beginning in fiscal 2002, and increasing 5% per year based on actuarial assumptions.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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