SB 92

Department of Legislative Services

Maryland General Assembly
2001 Session

FISCAL NOTE

Senate Bill 92 (Senator Kasemeyer)
(Chairman, Joint Committee on Pensions)

Budget and Taxation

State Retirement and Pension System - Optional Forms of Allowance - Recalculation of Allowance

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This pension bill changes the calculation of certain annuity payment options (Options 2 and 3) under the State Retirement and Pension System (SRPS) in order to provide a more generous benefit for a retiree's beneficiary under those options where that beneficiary is named after the death of the initially designated beneficiary. In doing so, the bill creates an exception to the existing requirement that all the optional forms of allowance be the actuarial equivalent of the member's basic allowance, because Options 2 and 3 would no longer be actuarially equivalent under the above circumstances.

The bill takes effect July 1, 2001.

Fiscal Summary

State Effect: Pension liabilities would increase by approximately $524.1 million, resulting in increased pension costs of approximately $45.6 million in FY 2003, increasing 5% per year thereafter based on actuarial assumptions.

($ in millions)	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Revenues	$0	$0	$0	$0	$0
GF/SF/FF Exp.	0	45.6	47.9	50.3	52.8
Net Effect	$0	($45.6)	($47.9)	($50.3)	($52.8)

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

Local Effect: For local governments that participate in the SRPS, pension liabilities would increase by approximately $33.3 million, resulting in increased pension costs of approximately $3.1 million in FY 2003, increasing 5% per year thereafter based on actuarial assumptions.

Small Business Effect: None.

Analysis

Bill Summary: The bill requires the Board of Trustees of the State Retirement and Pension System (SRPS) to recompute the reduced allowance payable to a retiree and the retiree's new designated beneficiary using the same methodology that the board adopts for recomputing the reduced allowance payable to a retiree and the retiree's new designated beneficiary if the retiree files an election to change the designated beneficiary when the beneficiary originally designated by the beneficiary is living.

Current Law: Members of the employees' and teachers' systems have the ability, at their retirement, to elect an optional form of payment that is actuarially equivalent to their basic, or maximum, allowance. In lieu of electing their basic benefit, which provides no protection to beneficiaries, retirees may elect one of seven optional forms of payment that may provide some beneficiary protection. If a retiree elects an optional allowance, the retiree receives a reduced basic allowance to actuarially fund the cost of the beneficiary protection.

Background: These seven options are statutorily required to be actuarially neutral and the State's actuary has provided methodology to the retirement agency to ensure that they are calculated neutrally. Among the seven available options, two options (Options 2 and 3, based on 100% or 50% of the retiree allowance, respectively) provide a monthly survivor benefit to a designated beneficiary in the event that the retiree dies before the designated beneficiary.

The beneficiary, however, could predecease the retiree. In that event, the retiree may retain the existing benefit or may redesignate a beneficiary. Also, a retiree may redesignate a living beneficiary due to a change in the retiree's personal circumstances (e.g., change in marital status) where the prior beneficiary is still alive. The actuarial calculation made when a retiree redesignates a beneficiary differs depending on whether the redesignation is due to: (1) a redesignation where the prior beneficiary is still alive; or (2) the predeceasing of the prior beneficiary.

In the former instance, the recalculation of the Option 2 or Option 3 allowance is made from the retiree's **original** calculation of the basic benefit, prior to any option factor being applied. The appropriate Option 2 or Option 3 factor is then applied to the original basic benefit, with the factors based on the retirees' and new beneficiaries ages at time of recalculation.

In the latter instance, the recalculation of the Option 2 or Option 3 allowance is made from the original calculation of the basic benefit, prior to any option factor being applied. The appropriate Option 2 or Option 3 factor is then applied to the retiree's **reduced** allowance, with the factors based on the retirees' and new beneficiary's ages at time of recalculation. As a result, the annuity benefit for this beneficiary will be lower than for a beneficiary if the initial beneficiary remains alive but was deselected by the retiree.

The actuary has certified that these two calculations, while different from each other, both provide a benefit that is actuarially equivalent to the benefit being received by the retiree at the time of redesignation. The actuary attributes the difference in the two calculations to the insurance aspect of these options.

In the event of a deselection of a living beneficiary in favor of a new beneficiary, the insurance component of the option never activates (neither the retiree nor the beneficiary dies). Instead the insurance component is halted, and a new beneficiary is essentially substituted for the old beneficiary.

In the event of the death of the beneficiary, however, the insurance component of the option has been activated (in favor of the SRPS) and the insurance terminates. Selection of a new beneficiary constitutes a new insurance "policy." The actuary advises that the two methods of calculation are in accordance with actuarial and insurance principles.

State Expenditures: Approximately 28% of the system's 81,000 service retirees elect Option 2 or 3. It is assumed that approximately 40% of beneficiaries predecease the retiree. It is estimated that when these affected retirees redesignate a new beneficiary, the new benefit calculation will be approximately 6% higher than current law under Option 2, and approximately 3.4% higher than current law under Option 3. As a result, the State's actuary informally estimates that the new calculations would increase system liabilities by approximately $524.1 million. Amortizing these liabilities over 18 years (through fiscal 2020) would result in additional pension contributions of $45.6 million in fiscal 2003. Future year payments would increase by 5% per year based on actuarial assumptions.

This estimate does not adjust for the fact that the more generous calculations may encourage more retirees to elect Options 2 or 3, which would proportionally raise the fiscal effect described above.

Additional Comments: The system currently offers two additional forms of payment, Options 5 and 6, which provide protection in case a spouse predeceases the member. A member who elects Option 5, for example, would pay slightly more in "insurance" through benefit reduction than a member electing Option 2. Both forms would continue to pay 100% of the benefit to a surviving spouse if the member dies first; however, Option 5 would provide a benefit which "pops up" to the unreduced level in cases where the spouse predeceases the member. If enacted, this legislation would provide essentially the same benefit to members electing Option 2 as to those who paid additional premiums to elect Option 5.

Additional Information

Prior Introductions: None.

Cross File: None.

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

Fiscal Note History: First Reader – January 23, 2001
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