Department of Legislative Services

Maryland General Assembly
2002 Session

FISCAL NOTE

House Bill 1447 (Chairman, Appropriations Committee)
Appropriations

Employees' Retirement System and Employees' Pension System - Deferred Retirement Option Program

This pension bill creates a Deferred Retirement Option Program (DROP) for State employee members of the Employees' Retirement System (ERS) or the Employees' Pension System (ERS).

The bill takes effect July 1, 2002. The DROP would go into effect if and when the Internal Revenue Service (IRS) issues an affirmative determination letter on the DROP's effect on the pension system's tax qualified status.

Fiscal Summary

State Effect: State pension liabilities would increase by approximately $11.0 million, resulting in increased employer pension contributions of $1.1 million beginning in FY 2004 and increasing 5% per year thereafter. One-time administrative expenses by the State Retirement Agency are estimated at $500,000 in FY 2003; ongoing administrative expenses are estimated at $50,000 per year.

(in dollars)	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Revenues	$0	$0	$0	$0	$0
SF Expenditure	500,000	50,000	50,000	50,000	50,000
GF/SF/FF Exp.	0	1,106,000	1,161,000	1,219,000	1,288,000
Net Effect	($500,000)	($1,156,000)	($1,211,000)	($1,269,000)	($1,338,000)

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

Local Effect: None. ERS and EPS members of participating governmental units are not eligible.

Small Business Effect: None.

Analysis

Bill Summary: The bill creates a DROP that, in general, allows State ERS or EPS members to retire from the ERS or EPS but continue to be employed by the State in the same position for a fixed period of time. The member's benefit payments (based on service credit and salary at "retirement") are maintained by the State pension 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 (including accrued cost-of-living adjustments (COLAs)) as well. The specifics of DROP are as follows:

- To be eligible for DROP, a member must have at least 30 years of service but less than 35 years of eligibility service.
- A member may participate in DROP for a period not to exceed the lesser of: (1) 5 years; (2) the difference between 35 years and the member's eligibility service as of the date of the member's election to participate in the DROP and retire from the ERS or EPS; or (3) a term selected by the member.
- 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 ERS or EPS even though the member continues to work. DROP participants would continue to be eligible for all other fringe benefits (such as health insurance) available to permanent State employees.
- The DROP member earns 6.0% (compounded monthly) on the member's retirement allowance paid during the DROP period.
- 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 accidental disability benefits even though the member has retired from the ERS or EPS.

Implementation of DROP is contingent on an affirmative determination letter from the IRS (indicating, among other things, that DROP does not harm the tax-qualified status of the ERS or EPS).

The bill also provides that ERS or EPS members who have 30 or more years of eligibility service as of July 1, 2002 will be provided a one-time, 6-month window of opportunity to elect to participate in DROP for a period not to exceed 5 years. The window of opportunity will commence on the first day of the month after the State Retirement Agency receives a favorable determination letter from the IRS.

Current Law: None applicable.

Background: This bill is the product of collective bargaining. The State Police Retirement System includes a 4-year DROP beginning at 22 years of service. The Law Enforcement Officers' Pension System (LEOPS) includes a 5-year DROP beginning at 25 years of service.

State Expenditures: There are approximately 3,000 State employee members of the ERS and EPS who will have 30 years of eligibility service as of July 1, 2002. In addition, each year approximately 1,300 additional members would reach 30 years and become eligible.

The State's actuary informally estimates that the proposal would increase State pension liabilities by approximately $11.0 million. Amortizing these liabilities over 25 years plus additional normal costs would result in increased State pension contributions of $1.1 million beginning in fiscal 2004 and increasing 5% per year thereafter based on actuarial liabilities.

Unlike DROPs for the State Police and LEOPS, which are sufficiently small to be processed manually, this program will require considerable computer programming, communications costs, and additional personnel expenditures. Special fund expenditures could increase by an estimated $500,000 in the first year following the IRS approval. This estimate reflects the cost of hiring approximately ten contractual fiscal personnel for six months to handle the initial surge of applications. It includes salaries, communications materials and postage, overtime expenses, computer reprogramming, and member seminars. Future year expenditures of approximately $50,000 per year reflect additional overtime and/or contractual personnel expenditures for ongoing administration of DROP.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): State Retirement Agency, Milliman USA, Department of Legislative Services

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