Department of Legislative Services
Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

Senate Bill 747 (Senator McFadden, *et al.*)
Budget and Taxation

Teachers' and Local Employees' Retirement Enhancement Act of 2004

This pension bill creates an Alternate Contributory Pension System (ACPS) with enhanced benefits for members of the Teachers' Pension System (TPS), certain members of the Teachers' Retirement System (TRS), and certain members of the Employees' Pension System (EPS) who are employed by participating governmental units (PGUs).

The bill is effective June 1, 2004.

Fiscal Summary

State Effect: State pension liabilities could increase $1.1 billion, resulting in increased State pension employer contributions for teachers (general funds) of $201.8 million beginning in FY 2006. Future year pension expenditures reflect actuarial assumptions. Special fund expenditures would increase $1.6 million for the State Retirement Agency (SRA) to implement ACPS. Future year administrative expenditures reflect annualization and inflation.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Revenues	$0	$0	$0	$0	$0
GF Expenditure	0	201.8	209.9	218.2	226.9
SF Expenditure	1.6	1.0	1.1	1.1	1.2
Net Effect	($1.6)	($202.8)	($211.0)	($219.3)	($228.1)

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

Local Effect: Teacher pension costs are borne by the State. Significant increase in local government pension liabilities and employer contributions for the 95 PGUs that elected into the enhanced EPS system on or before April 1, 1999.

Small Business Effect: None.

Analysis

Bill Summary: The bill creates an ACPS in TPS and for PGUs that elected into the contributory pension system in 1999. The major provisions of ACPS are as follows:

- *Membership* – Individuals hired on or after July 1, 2004 who become members of TPS; individuals hired on or after July 1, 2004 who become members of EPS and are employees of a PGU that elected into the contributory system; members of TPS as of June 30, 2004 who elect to participate; TRS Selection C members as of June 30, 2004 who elect to participate; and members of EPS as of June 30, 2004 who are employees of a PGU that elected the contributory pension. Members of a pension system that transferred after April 1, 1998 are excluded.

  Eligible members of TRS/TPS who are members on June 30, 2004 may elect to join ACPS. There is no time limit placed on the election. Eligible members of TPS employed on or after July 1, 2004 are members of ACPS.

  Eligible members of the Employee Retirement System (ERS)/EPS employed by PGUs on June 30, 2004 may elect to join ACPS between July 1, 2004 and December 31, 2004. Eligible members of ERS/EPS who are employed by a PGU on or after July 1, 2004 are members of ACPS.

- *Employee Contributions* – The mandatory employee contribution increases from 2% to 5% as of July 1, 2004.

- *Retirement Eligibility* – Members of ACPS are authorized to retire with 30 years of service or at age 60 with five years of eligibility service; 61 with four years; 62 with three years, and 63 or older with two years.

- *Retirement Benefit* – The benefit calculation would be:
  - 2.0% of the average final compensation (AFC) for creditable service between one and 15 years on or after July 1, 2004;
  - 2.2% of AFC for creditable service over 15 years on or after July 1, 2004;
  - 1.4% of AFC for creditable service on or after July 1, 1998, and prior to July 1, 2004; and
  - the greater of 1.2% of AFC or the original pension system benefit of .008 and 1.5% against AFC for creditable service on or before June 30, 1998.

The early service benefit reduction is also reduced. Members continue to be eligible to retire early at age 55 with 15 years of eligibility service. The 0.5% monthly reduction is lowered to 0.4% for each month retirement precedes the members' age 60, rather than the current age 62. The maximum reduction drops from 42% to 33.6%.

- *Purchase of Service* – Members would be permitted to purchase service credits in ACPS for periods of employment as a member of TRS/TPS for which the member is not otherwise entitled to service credit. For previous employment while members of TRS/TPS, members would be permitted to purchase this service by making a single payment equal to the employee contributions that would have been made plus 5% interest. Payment must occur at retirement; however, the bill authorizes members to reduce the cost by electing a minimum 2% annual contribution.

  If the member dies in membership, the surviving spouse may finalize the purchase under specified circumstances. Members may not purchase credit for any period in which the employee participated in the optional retirement program.

  The maximum total service a member is entitled to purchase is 10 years.

- *Retirees Benefit Adjustment* – For retirees of TPS who have been retired prior to July 1, 2004, a benefit adjustment would be paid as follows:

  - retired not more than 5 years – $100 per month ($1,200);
  - retired more than 5, less than 10 – $125 per month ($1,500);
  - retired more than 10, les than 15 – $150 per month ($1,800); and
  - retired more than 15 years – $175 per month ($2,100).

  On this adjusted amount, SRA is required to develop a new cost-of-living adjustment (COLA) factor.

- *Cost-of-living Adjustments (COLA)* – The COLA for ACPS increases from 3% compounded to an annual maximum of 5% compounded.

- *Impact on Other Benefits* – The governing body of a county or of Baltimore City may not reduce any supplemental retirement allowance offered to members of TRS/TPS.

- *Notification* – SRA is required to inform the membership of TPS and the governing bodies of PGUs about the elections members are entitled to make under the provisions of this bill.

- *Additional Salary Provision* – The bill adds salary received for coaching or advising any extracurricular activity, and/or any stipend paid for participation in the National Teacher Certification Program to the definition of earnable compensation.

Current Law: Members of TRS/ERS may retire after accruing 30 years of creditable service or reaching age 60. Early retirement is available after accruing 25 years of service, regardless of age. The benefit formula provides for 1.8% of AFC times total creditable service. Early retirement benefits are reduced 0.5% for each month retirement precedes age 60 or 30 years, whichever produces the smaller reduction. The maximum reduction of benefits is 30%.

Members of TPS/EPS may retire after 30 years of service or at age 62 with five years. Early retirement is available after 15 years of service and at least age 55. The benefit under the contributory system established in 1998 provides for 1.4% of AFC on all service accrued after July 1, 1998. For the majority of members, a 1.2% multiplier applies to service accrued prior to July 1, 1998. A reduction of 0.5% is applied to the early retirement benefit for each month retirement precedes age 62. The maximum reduction of benefits is 42%.

For all systems, AFC is based on earnable compensation, which is defined as one-twelfth of the members' annual salary rate payable for working the normal time in the members' position. Additional payments such as bonuses, stipends, overtime, etc. is excluded.

Background: The proposed legislation would impact on the entire membership of TRS and TPS, plus impact the employees of PGUs that elected the enhanced pension system benefits in 1999. Only State employees and employees of the 10 participating governmental units that did not elect the enhanced benefits would be excluded from the higher benefit payments and provisions offered under this proposal.

As of June 30, 2003, there were 97,298 active members of TRS/TPS and 43,675 retirees and beneficiaries. Within the PGUs, SRA estimates that there are 21,350 active members and 9,148 retirees.

State Expenditures:

Pension Liabilities

The State's actuary advises that State pension liabilities would increase $1.1 billion, resulting in increased State general fund contributions of $201.8 million beginning in fiscal 2006; $68.0 million of the increased contribution is attributable to the liability increase and $133.8 million is attributable to the increased "normal cost" (*i.e.* ongoing prospective cost) of TPS. Future year costs reflect actuarial assumptions. The State's actuary has assumed 100% of eligible members will elect to participate in ACPS.

Chapter 440 of 2002 provides that for the employees' and teachers' systems (the two largest subsystems of the State Retirement and Pension Systems), the State will maintain a constant employer contribution rate so long as those systems remain from 90% to 110% funded on an actuarial basis. The corridor methodology does not apply to benefit enhancements. The actuary will determine the corridor level contribution rate for fiscal 2006 without the enhanced benefits and then add costs of this proposal to that.

Administrative Costs

Special fund expenditures could increase in SRA by an estimated $1,574,837 in fiscal 2005, which accounts for the bill's June 1, 2004 effective date. This estimate reflects the cost of hiring 10 accountants to process selection forms, certify participation in ACPS, and handle ongoing estimates related to the new system. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses. The information and assumptions used in calculating nonpersonnel expenditures are stated below:

- $297,000 for several special newsletters with a multipart selection form (return postage paid) for active members and an insert to affected retirees with their benefit checks; and

- $750,000 to modify the agency's existing benefits administration processing system which dates to the 1970s with $500,000 in annual ongoing system maintenance costs. The system has limited additional computing and testing capabilities.

Salaries and Fringe Benefits	$526,537
System Upgrades and Communications	1,047,000
Operating Expenses	1,300
Total FY 2005 State Expenditures	**$1,574,837**

Future year expenditures reflect: (1) full salaries with 4.6% annual increases and 3% employee turnover; (2) 1% annual increases in ongoing operating expenses; and (3) the removal of one-time upgrade and communications expenditures.

Local Fiscal Effect: The State's actuary informally estimates that PGU liabilities and employer contributions could increase approximately 40% due to the provisions of this bill. For illustrative purposes, a local jurisdiction with annual contributions into the current EPS of $10 million could expend an additional $4 million in fiscal 2006.

There are currently 106 PGUs participating in the systems. SRA advises that 11 of those units did not elect to accept the 1998 enhancement, and would therefore not be impacted by this bill. The other 95 PGUs would be required to participate in ACPS. The Department of Legislative Services advises that Prince George's County, the largest PGU, did not elect into the 1998 enhancement, and will therefore not be affected by ACPS.

Additional Information

Prior Introductions: None.

Cross File: HB 1060 (Delegate Jones, *et al.*) – Appropriations.

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

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ncs/jr

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