Department of Legislative Services

Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE
Revised

House Bill 1049 (Delegate Jones, *et al.*)
Appropriations

Teachers' and Local Employees' Retirement Enhancement Act of 2005

This pension bill provides a benefit enhancement to members of the Teachers' Pension System (TPS) and Teachers' Retirement System (TRS), as well as members of the Employees' Pension System (EPS) and Employees' Retirement System (ERS) who are employed by a participating governmental unit (*i.e.,* a local jurisdiction participating in the State pension system).

The bill is effective June 1, 2005.

Fiscal Summary

State Effect: Overall State pension liabilities would increase by $2.3 billion, with a first-year amortized cost of $131.5 million in FY 2007, increasing annually based on actuarial assumptions for the next 24 years. Increased earnable compensation levels will result in costs of $2.0 million in FY 2006 only.

(in dollars)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Revenues	$0	$0	$0	$0	$0
GF Exp.	1,963,500	0	0	0	0
GF/SF/FF Exp.	0	131,496,000	136,676,900	142,219,600	147,922,200
Net Effect	($1,963,500)	($131,496,000)	($136,676,900)	($142,219,600)	($147,922,200)

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

Local Effect: The State pays the pension contributions for teachers in the State. Expenditures for participating governmental units could increase significantly.

Small Business Effect: None.

Analysis

Bill Summary:

The Alternate Contributory Pension Selection

This bill provides increased pension benefits for service after July 1, 2005 for members of TPS and TRS by establishing the Alternate Contributory Pension Selection (ACPS). The bill also provides increased pension benefits for members of EPS and ERS employed by a participating local governmental unit (PGU) that has elected the contributory pension benefit established in 1998.

ACPS is mandatory for the following individuals:

- members of TPS who become employed on or after July 1, 2005; and
- members of EPS who become employed by a PGU on or after July 1, 2005.

ACPS is optional for the following individuals:

- members of TPS who are employed on June 30, 2005;
- members of EPS who are employed by a PGU on June 30, 2005, who may elect to join ACPS until December 31, 2005; and
- members of TRS Selection C-Combination formula employed on June 30, 2005.

Beginning July 1, 2005, until a member has 15 years of total creditable service, including current service, future pension benefits are calculated using a 2.0% multiplier (Average Final Compensation (AFC) x 2.0% x years of service). After 15 years of service, future benefits are calculated using a 2.2% multiplier.

For example, a teacher with 10 years of creditable service on July 1, 2005 would have benefits based on the next 5 years of service (through 2010) calculated using the 2.0% multiplier. All benefits based on service earned beyond 2010 would be calculated using the 2.2% multiplier. If this example teacher retired in 2025 with 30 years of service, the final benefit would be calculated as follows:

1995-1998: 1.2% x AFC x 3 years
1998-2005: 1.4% x AFC x 7 years
2005-2010: 2.0% x AFC x 5 years
2010-2025: 2.2% x AFC x 15 years

A teacher with 15 years of service on July 1, 2005 would have all benefits based on future service calculated using a 2.2% multiplier. The final pension allowance would be based on the following calculation:

1990-1998: 1.2% x AFC x 8 years
1998-2005: 1.4% x AFC x 7 years
2005-2020: 2.2% x AFC x 15 years

ACPS participants must make a 5% employee contribution, up from the current 2% contribution.

The retirement eligibility criteria for ACPS participants are set at current TPS/EPS levels: full service retirement is available with 30 years of service; or age 62 and 5 years of service.

For eligible members who do not elect ACPS, the benefits remain at the current formula:

- 1.2% x AFC x years of service prior to June 30, 1998; and
- 1.4% x AFC x years of service after June 30, 1998.

Retirement System Employees

The bill also alters the benefit formula for members of TRS and ERS who are employed by a PGU. Instead of the current benefit formula (1.8% x AFC x years of service), the benefit multiplier increases to 2.2% for all service earned after July 1, 2005.

Earnable Compensation – "Coaches' Pay"

The bill includes in the definition of "earnable compensation" for a member of TRS or TPS the compensation for participating as a coach or an advisor for any extracurricular activity or any stipend the member receives for participating in the National Teacher Certification Program.

Miscellaneous Provisions

The bill provides that (1) for members employed by a PGU to be eligible to participate in ACPS, the PGU must have elected the contributory pension as of July 1, 1999; and (2) the governing body of any county (or Baltimore City) offering supplemental retirement plans or allowances may not reduce or eliminate retirement benefits provided as of January 1, 2005.

Current Law/Background: TPS is composed of all State and local teachers, as well as certain employees of county boards of education and community colleges. The system has 88,765 active employees. The average member is 43.6 years old, with 10.5 years of service. TRS, which was closed to new membership in 1980, has 7,197 members, averaging 56.1 years old and 29.3 years of service.

The State pays all the required employer pension contributions for members of the teachers' systems. In fiscal 2005, the State paid $411 million for teacher pensions. As TRS members generally have more service credit, TRS requires a disproportionate share of the total pension costs.

There are 22,776 members of the EPS employed by 114 municipal corporations. These members average 46.7 years old with 9.8 years of service. Finally, there are 670 members of the ERS employed by a PGU. These members average 56.1 years old with 12.7 years of service. The employing PGUs are responsible for making all required employer pension contributions for members of these two systems.

The current required employee contribution is 2% of earnable compensation for all members of the TPS and EPS. For members of the TRS and ERS, the employee contribution is 5% (5% maximum COLA) or 7% (unlimited COLA) of the member's annual earnable compensation.

TRS Selection C

Legislation enacted in 1984 required TRS members who wished to remain in the system to select one of three available modified benefits: (1) Selection A – pay additional employee contributions for an unlimited COLA; (2) Selection B – receive a limited COLA; or (3) Selection C – receive a benefit based on a combined formula from both the TRS and the then-new TPS. At retirement, a selection C benefit is calculated as a TRS benefit for all service credit accrued prior to the election of Selection C and as a TPS benefit for all service accrued after the selection.

Earnable Compensation – "Coaches' Pay"

"Earnable compensation" is used to calculate the member's AFC, which is part of the formula to calculate a member's retirement benefit. For TPS and EPS, AFC is calculated as the average earnable compensation during the three consecutive years that provide the highest average earnable compensation. For TRS and ERS, AFC is calculated as the average earnable compensation for the three years of employment during which the member's compensation was highest.

Stipends for coaching and other extracurricular activities vary depending on the nature and demands of the activity and the terms of the agreement between the teachers' representatives and the local board of education. The stipends can range from a few hundred dollars to several thousand dollars, but coaching stipends are on average $3,500 per year. Five-thousand, five-hundred teachers receive such stipends, at a cost of $19.25 million. Statistics on the number of teachers receiving stipends for noncoaching extracurricular duties are not available. The State and school boards also provide bonuses for national certification, and again, the level of those stipends can vary; the average is $3,524. Four-hundred and ninety-eight teachers are currently receiving such bonuses, at a cost of $1.75 million.

State Fiscal Effect:

ACPS Benefit Enhancement

The State's actuary estimates that the proposed changes to the benefit structure for teachers will result in increased liabilities of $2.3 billion. Amortized over 25 years, these new benefits result in a first-year (fiscal 2007) State cost of $126.4 million, most of which is general funds, increasing 4% annually thereafter based on actuarial assumptions.

The increase in the employee contribution from 2% to 5% of payroll pays for approximately 54.2% of the required contributions to amortize $2.3 billion in increased liabilities. The first-year State contribution would require an additional $149.9 million without any increase in the employee contribution.

As noted earlier, the bill provides for a 2.0% multiplier for up to 15 years of service (starting July 1, 2005) and a 2.2% multiplier on all subsequent service. Since the demographics of the current teacher population are heavily weighted toward older teachers, approximately 78%, or $1.8 billion, of the total $2.3 billion in liabilities is attributable to the 2.2% multiplier on all future service.

"Coaches' Pay"

The total earnable compensation that would be associated with coaching ($19.25 million) and certification stipends ($1.75 million) is $21 million. Based on a 9.35% teacher contribution rate, State pension contributions would increase by $2.0 million in fiscal 2006.

It is estimated that net actuarial liabilities will increase by approximately $53.1 million as a result of employees' increased AFC. Amortizing these liabilities over 25 years will result in a first-year increase in State pension contributions of $5.2 million beginning in fiscal 2007 (including the payroll effect noted above) and increasing 4% per year thereafter based on actuarial assumptions.

Total State Cost

The change in earnable compensation will result in $53.1 million in new pension costs, while the enhanced benefit structure will result in $2.3 billion in additional costs. Amortized over 25 years, this results in a first-year (fiscal 2007) cost of $131.5 million, increasing 4% annually.

Local Fiscal Effect: The local governments that participate in EPS and ERS are responsible for all employer pension contributions for members. The members of these systems receive the same benefits as State employees. The bill provides a substantial benefit enhancement for these members, and as such, the contribution rate for these jurisdictions will increase to reflect the increased benefits promised and liabilities incurred. These municipalities are currently required to contribute 4.8% of payroll for contributions to EPS and 9.8% of payroll for ERS. While the actual effect on the contribution rate is not known, for illustrative purposes a 1% increase in the contribution rate would require the local jurisdictions to contribute a pro rata share of an additional $7.8 million to EPS and $325,000 to ERS (based on current payroll levels).

Additional Information

Prior Introductions: None.

Cross File: SB 623 (Senator McFadden, *et al.*) – Budget and Taxation.

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