

**Department of Legislative Services
Maryland General Assembly
2005 Session**

FISCAL AND POLICY NOTE

Senate Bill 469 (Senator McFadden)
Budget and Taxation

Correctional Officers' Retirement System - Benefits

This pension bill creates a Deferred Retirement Option Program (DROP) for members of the Correctional Officers' Retirement System (CORS).

The bill takes effect July 1, 2005. DROP would go into effect if and when the Internal Revenue Service (IRS) issues an affirmative determination letter on DROP's effect on the pension system's tax qualified status.

Fiscal Summary

State Effect: State pension liabilities would increase by approximately \$176.3 million, resulting in increased employer pension contributions of \$10.9 million beginning in FY 2007 and increasing thereafter based on actuarial assumptions. Special fund expenditures increased by \$217,900 in FY 2006, including one-time information technology expenses of \$100,000. Future years reflect salaries and inflation.

(in dollars)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Revenues	\$0	\$0	\$0	\$0	\$0
SF Expenditure	217,900	161,700	171,500	182,100	193,500
GF/SF/FF Exp.	0	10,900,000	12,400,000	13,900,000	15,600,000
Net Effect	(\$217,900)	(\$11,061,700)	(\$12,571,500)	(\$14,082,100)	(\$15,793,500)

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

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: The three major components of the bill are as follows:

- creates a DROP;
- adds correctional dietary, maintenance, and supply workers to CORS; and
- provides a 2.5% benefit multiplier on service accrued after July 1, 2005.

Deferred Retirement Option Program

- DROP allows CORS members to retire from CORS 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 (COLA) 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 COLAs) as well. The specifics of DROP are as follows:
 - a member must have at least 20 years of service but less than 25 years of eligibility service and be less than 60 years old;
 - participation may not to exceed the lesser of: (1) five years; (2) the difference between the member's age and age 60; or (3) a term selected by the member;
 - a participant is officially a retiree of CORS even though the member continues to work; participants continue to be eligible for all other fringe benefits (such as health insurance) available to regular State employees;
 - a member earns 6.0% (compounded monthly) on the member's retirement allowance paid during the DROP period;
 - upon termination, the member or designated beneficiary receives the DROP amount in a lump sum; and
 - a member is eligible for death and accidental disability benefits even though the member has retired from CORS.

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 CORS).

CORS members who have 25 or more years of eligibility service as of July 1, 2005 will be provided a one-time, six-month window of opportunity to elect to participate in DROP for a period not to exceed five years. The window closes December 31, 2005.

Current Law: CORS is a “20 and out” plan that provides for 1.8% of average final compensation for each year of service. Members contribute 5% or 7% of pay, depending on the COLA elected.

The State Police Retirement System includes a four-year DROP beginning at 22 years of service. The Law Enforcement Officers’ Pension System (LEOPS) includes a five-year DROP beginning at 25 years of service.

State Expenditures: As of June 30, 2004, there were 6,697 active members of CORS. There are 614 officers with 20 to 25 years of service who are under age 60 and 183 officers with 25 or more years of service who are under age 60. Their average salary as of June 30, 2004 is \$36,650.

The State’s actuary informally estimates that the bill would increase State pension liabilities by approximately \$176.3 million. Amortizing these liabilities over 25 years would result in increased State pension contributions of \$10.9 million beginning in fiscal 2007. CORS pension costs are not reflected in a separate contribution rate; rather, they are subsumed within the employees’ system. Also, because CORS costs are subsumed in the general employees’ rate, the additional costs will be dispersed among all State agencies.

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 \$217,910 in fiscal 2006, which accounts for the bill’s July 1, 2005 effective date. This estimate reflects the cost of an information technology contract and hiring two advanced accountants and one benefits administration personnel in the State Retirement Agency to process and compute the DROP retirement applications and information requests. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Salaries and Fringe Benefits	\$117,606
Information Technology Contract	100,000
Other Operating Expenses	<u>304</u>
Total FY 2006 State Expenditures	\$217,910

Future year expenditures reflect: (1) full salaries with 4.6% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

Additional Information

Prior Introductions: HB 1453 of 2002, a similar bill, was unfavorably reported by the Appropriations Committee.

Cross File: HB 830 (Delegate Jones, *et al.*) – Appropriations.

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

Fiscal Note History: First Reader - March 9, 2005
ncs/jr

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