HB 251

Department of Legislative Services

Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

House Bill 251 (Delegate Donoghue)
Appropriations

Correctional Officers' Retirement System - DROP

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

The bill takes effect July 1, 2006. The proposed DROP takes effect only if the Internal Revenue Service issues an affirmative determination letter regarding DROP's effect on CORS' status as a qualified plan under the Internal Revenue Code.

Fiscal Summary

State Effect: State pension liabilities would increase by approximately $35.1 million, resulting in increased State pension contributions of $2.2 million beginning in FY 2008 and increasing thereafter based on actuarial assumptions. Special fund expenditures increase $57,300 in FY 2007 to implement the provisions of the bill. Future year expenditures reflect annualization and inflation until the need for additional staff ends after three years.

(in dollars)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Revenues	$0	$0	$0	$0	$0
SF Expenditure	57,300	74,500	78,000	0	0
GF/SF/FF Exp.	0	2,200,000	2,400,000	2,600,000	2,700,000
Net Effect	($57,300)	($2,274,500)	($2,478,000)	($2,600,000)	($2,700,000)

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

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: The bill creates a DROP program that allows veteran CORS members to officially retire while continuing to work and earn salary and health benefits in their current jobs for a fixed period of time. A CORS member who is under age 62 and has 20 to 25 years of service may participate in DROP for up to 5 years or until age 62. To participate, a member has to meet the eligibility criteria, submit a binding letter of resignation announcing an intention to participate in DROP and specifying the date of termination. Current CORS members with more than 25 years of service have a one-time opportunity to elect to participate in DROP for up to 5 years by December 31, 2006. A decision to participate in DROP is irrevocable. A DROP member must end participation when the member:

- has participated for five years or for a shorter amount of time specified in their letter of resignation;
- reaches age 62;
- dies;
- terminates employment with a participating employer; or
- specifies in writing to shorten the time period for participation in DROP.

During participation in DROP, a member earns the same retirement benefits that they would have received if they had fully retired. Those benefits are deposited into DROP on behalf of the member and earn 6% interest, compounded monthly. During participation in DROP, a member does not earn service or eligibility credit in CORS, and does not make employee contributions to CORS. Also, compensation earned while participating in DROP is not used in calculating average final compensation for the purpose of calculating normal retirement benefits. Upon exiting DROP, a participating member receives the amount accrued in the DROP in a single lump-sum payment. A member also receives normal service retirement benefits calculated using years of service and average final compensation at the time participation in DROP began.

The bill designates a participating member's spouse as beneficiary if the DROP participant dies before completing his or her DROP term. If there is no surviving spouse, the bill designates contingent beneficiaries, beginning with any children of the participant who are under the age of 18 and followed by a beneficiary designated in writing by the DROP participant. If a DROP participant dies before completing the DROP term, the beneficiaries are entitled to full payment of the participant's accrued DROP balance and 50% of the DROP participant's normal service retirement benefits.

The bill allows a DROP participant to elect to receive a disability retirement allowance instead of finishing DROP participation.

Current Law: Both the State Police Retirement System (SPRS) and Law Enforcement Officers Pension System (LEOPS) offer a DROP program.

CORS members may designate a beneficiary other than their spouse, and may choose from among six survivor benefit options (including the 50% option specified in the bill) when they die.

Background: DROP programs are an increasingly common tool used to retain experienced personnel, particularly veteran law enforcement officers. In exchange for earning benefits and a higher interest rate for five years toward their lump-sum payment, DROP participants forego larger normal service monthly retirement benefits that they would have earned if they had continued working but not participated in DROP.

State Fiscal Effect: As of June 30, 2005, there are 6,530 active members of CORS. Of those, 378 have 20 to 25 years of service and are less than 60 years old. Their average salary is $45,087. Another 161 members have more than 25 years of service and would be eligible to participate in DROP if they elected to do so before December 31, 2006. Their average salary is $46,692.

The State's actuary estimates that the bill would increase State pension liabilities by about $35.1 million. This assumes that 50% of eligible CORS members will elect DROP, which is based on experience from the SPRS and LEOPS DROP programs. Amortizing these liabilities over 25 years results in increased State pension contributions of $2.2 million beginning in fiscal 2008. Since CORS is not an independent system but rather is subsumed within the combined employees' systems, the additional costs associated with the CORS DROP program would be shared among all State agencies.

Special fund expenditures could increase by $58,847, which accounts for the bill's July 1, 2006 effective date. Special fund expenditures could increase by as much as $750,000 if the agency is required to automate its processing of DROP benefits. The State Retirement Agency (SRA) currently uses manual processes to administer the SRPS and LEOPS DROP programs, with a combined total of 227 participants. However, its internal auditors have expressed concern that manual processing of lump-sum DROP payments is not desirable because of the difficulty in tracking those payments. The auditors are encouraging the agency to cease manual processing and reprogram its Legacy Pension System (LPS) to administer DROP benefits. The agency is not confident that LPS can be reprogrammed to administer DROP, but estimates that if it can, the cost of reprogramming could be as high as $750,000.

Setting aside the concerns of the agency's internal auditors and the limitations of the LPS, the Department of Legislative Services (DLS) projects that manual processing of the CORS DROP is feasible. Based on a 50% participation rate, a CORS DROP program would have about 270 participants in the first year and about 150 new participants in each successive year. This participation level is only slightly higher than the combined LEOPS and SRPS DROP programs, so SRA should be able to use the same manual processes for the CORS DROP program. The DLS estimate reflects the cost of hiring two contractual employees (one Grade 16 and one Grade 12), including salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses, to manually process the CORS DROP program. Future year expenditures reflect full salaries with 4.6% annual increases and 6.8% employee turnover, as well as 1% annual increases in ongoing operating expenses.

Agency expenditures are deleted after three years because the agency should have a new computer system in place that will allow for automated administration of DROP. SRA is in the process of replacing the LPS with an updated computer system capable of more complex processes. The new system should be in place within three years, after which the agency will no longer need contractual employees to manually process the DROP program.

Additional Comments: It is unclear whether current CORS members who are over age 62 and have more than 25 years of experience may elect to participate in DROP for 5 years by December 31, 2006. For this analysis, DLS assumed they could elect to participate in DROP.

Additional Information

Prior Introductions: Similar bills, HB 830 of 2005 and HB 1453 of 2002, both were unfavorably reported by the Appropriations Committee.

Cross File: SB 396 (Senator McFadden, *et al.*) – Budget and Taxation is designated as a cross file but is not identical.

Information Source(s): Milliman USA, Maryland State Retirement Agency, Department of Public Safety and Correctional Services, Department of Legislative Services

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Analysis by: Michael C. Rubenstein

Direct Inquiries to:
(410) 946-5510
(301) 970-5510