HB 1441

Department of Legislative Services

Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

House Bill 1441 (Delegate McMillan)
Appropriations

Teachers' and Employees' Retirement and Pension Systems Improvement Act

This bill allows teachers and State employees to make additional employee contributions toward their pensions, up to 5% of their annual compensation, beyond the contributions required as a condition of their employment. Those additional contributions would earn annual compounded interest. At retirement, teachers and State employees could use those accumulated contributions to purchase at full cost additional creditable service toward their retirement benefit.

Fiscal Summary

State Effect: None. Employees would pay the full actuarial cost of additional service credit purchased under this bill.

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: Members of the Teachers' Pension System and Employees' Pension System (TPS/EPS) contribute 2% of their annual compensation toward their retirement as a condition of their employment. Members of the Teachers' Retirement System and Employees' Retirement System (TRS/ERS) contribute 7%, 5%, or 2% of their annual compensation, depending on the benefit level they have chosen to receive upon retirement. Members' retirement benefits are calculated by multiplying their years of creditable service by their average final compensation and a benefit multiplier that varies by system. Thus, purchasing additional service credit would increase members' retirement benefits.

Members of the State Retirement and Pension System may purchase service credit for specific types of prior service or employment, including prior teaching service and employment with a political subdivision of the State. When purchasing that type of service credit, members must pay both the employee and employer share of the actuarial cost of that credit at the time of their retirement. If they choose to do so, members may defer up to an additional 2% of their annual compensation during their employment to offset the cost of purchasing prior service credit at retirement. However, there is no mechanism that allows members to purchase service they have not earned in some other capacity, as this bill would allow.

Employee and teacher contributions are deposited into an annuity savings fund. Contributions made in TRS/ERS earn 4% annual compound interest, while contributions made in TPS/EPS earn 5% annual compound interest.

In addition to their pension contributions, State employees may defer a portion of their annual compensation to a tax-deferred defined contribution plan administered by the Maryland Supplemental Retirement Plan (MSRP). These plans allow employees to set aside a portion of their pre-tax annual compensation toward their retirement, subject to federal caps on their contributions. Employees control how those funds are invested, choosing from among various stock and bond mutual funds as well as a contract pool that offers a guaranteed rate of return. The State matches employee contributions to MSRP accounts up to $400 in fiscal 2006; the State match will increase to $600 in fiscal 2007, its statutory limit. Teachers are not eligible to participate in MSRP, but some may have access to supplemental plans offered by their employers. Withdrawals from the supplemental plans are subject to income taxes.

State Fiscal Effect: The bill specifies that employees would pay the full actuarial cost (employer and employee share) of additional service credit, so there would be no increase in State pension liabilities or additional cost to the State. The State's actuary notes that the interest rates and mortality rates, codified in State regulations, that are used to calculate the cost of additional service have not been updated since the 1970s, so the actual costs of the additional service credit may be under-calculated. However, the State Retirement Agency notes that its board of trustees has studied changing those rates and determined that changes were not needed.

Additional Comments: Employees and teachers would derive different levels of benefits from this bill, based on their average final compensations and the amount they chose to save over their careers. For instance, a State employee with a starting salary of

$25,000, an annual cost-of-living adjustment (COLA) of 2%, and who set aside 2% of pay each year would reach retirement age with a balance of $43,935. That individual could purchase 6.95 additional years of service credit and receive an annual retirement benefit increase of $4,235. A teacher with a starting salary of $30,000, an annual COLA of 3%, and who set aside 5% of pay each year would reach retirement with a balance of $149,206. That individual could purchase 14.96 additional years of service credit and receive an annual retirement benefit increase of $14,380.

The State's actuary notes that these figures only apply if teachers and employees retire at full retirement age (typically after 30 years of service). A study done in Florida by the actuarial firm found that the cost of a single year of service credit purchased before full retirement age would be approximately 60% of average final compensation.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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