

Department of Legislative Services
 Maryland General Assembly
 2006 Session

FISCAL AND POLICY NOTE

Senate Bill 396 (Senator McFadden, *et al.*)
 Budget and Taxation

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 DROP takes effect only if the Internal Revenue Service (IRS) 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: Total State pension liabilities would increase by approximately \$35.1 million, resulting in increased 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 bill. Future year expenditures reflect salary adjustments 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. CORS members who are under age 62 and have between 20 and 25 years of service may participate in DROP for up to 5 years. To participate, members have to meet the eligibility criteria, submit a binding letter of resignation announcing their intention to participate in DROP and specifying their 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. DROP participants must end their participation when:

- they have participated for five years or for a shorter amount of time specified in their letter of resignation;
- they reach age 62;
- they die;
- their employment with a participating employer is terminated;
- they specify in writing that they choose to shorten the time period for their participation in DROP; or
- accept an accidental disability retirement allowance.

During their participation in DROP, members earn 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 their participation in DROP, members do not earn service or eligibility credit in CORS and do not make employee contributions to CORS. Also, their compensation earned while participating in DROP is not used in calculating their average final compensation for the purpose of calculating their normal retirement benefits. Upon exiting DROP, participating members receive the amount accrued in the DROP in their name in a single lump-sum payment. They also receive normal service retirement benefits calculated using their years of service and average final compensation at the time they began participating in DROP.

If a DROP participant dies before completing the DROP term, their beneficiary is entitled to full payment of the participant's accrued DROP balance and any death benefit selected by the DROP participant.

If a DROP participant receives a disability retirement allowance while enrolled in DROP, the participant must waive his or her right to all DROP benefits.

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

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 CORS members. Of those, 388 have between 20 and 25 years of service with an average salary of \$45,072. 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 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 \$200,000 if the agency is required to automate its processing of DROP benefits. The State Retirement Agency (SRA) currently uses manual processes to administer the State Police 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 the LPS can be reprogrammed to administer DROP, but estimates that if it can, the cost of reprogramming could be as high as \$200,000.

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 State Police DROP program, 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 FTEs (one Grade 16 and one Grade 12), including salary, fringe benefits, one-time start-up costs, and ongoing operating expenses, to manually process the CORS DROP program. Future year expenditures reflect full salary 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 calculations. 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 Information

Prior Introductions: SB 469 of 2005, a similar bill, was not acted upon by the Budget and Taxation Committee.

Cross File: HB 251 is designated as a cross file, but it 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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