

Department of Legislative Services
 Maryland General Assembly
 2007 Session

FISCAL AND POLICY NOTE

Senate Bill 345 (Senator McFadden)
 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, 2007. 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: State accrued pension liabilities would increase by \$33.6 million and pension normal costs would increase by \$60,000. Amortizing the liabilities over 25 years and adding the increased normal cost results in a \$2.1 million increase in State pension contributions in FY 2009. Future year costs increase according to actuarial assumptions.

(in dollars)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	0	1,276,800	1,394,400	1,519,200	1,651,800
SF Expenditure	0	425,600	464,800	506,400	550,600
FF Expenditure	0	425,600	464,800	506,400	550,600
Net Effect	\$0	(\$2,128,000)	(\$2,324,000)	(\$2,532,000)	(\$2,753,000)

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 with at least 25 years of service may participate in DROP for up to 5 years. Members have to meet the eligibility criteria and submit a binding letter of resignation announcing their intention to participate in DROP and specifying their date of termination. 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;
- die;
- terminate their employment with a participating employer;
- 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, including unlimited cost-of-living adjustments (COLAs) based on the Consumer Price Index for all Urban Consumers. 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 determining their average final compensation for the purpose of calculating their normal retirement benefits.

Upon exiting DROP, participating members receive the amount accrued in DROP in their name in a single lump-sum payment. They also receive ongoing normal service retirement benefits calculated using their years of service and average final compensation at the time they began participating in DROP. DROP participants or their beneficiaries may request that their lump-sum DROP payments be deposited directly into individual retirement accounts or other eligible annuity pension plans.

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

If a DROP participant receives an accidental disability retirement allowance while enrolled in DROP, the participant receives the accumulated balance in his or her DROP account at the time the participant begins receiving an accidental disability allowance, but waives his or her right to all future DROP benefits.

On or before July 1, 2007, the State Retirement Agency (SRA) must submit a request for a determination letter from the IRS.

Current Law: There is no DROP program for CORS members, but both the State Police Retirement System (SPRS) and Law Enforcement Officers' Pension System (LEOPS) offer DROP programs. SPRS members must be less than 60 years old and have between 22 and 28 years of service to qualify for DROP. LEOPS members must have between 25 and 30 years of service to qualify.

Background: DROP programs are a common tool used to retain experienced personnel, particularly veteran law enforcement officers. Although DROP participants forego earning additional years of service credit while enrolled in DROP, the benefits of participating in DROP include:

- continuing to earn regular compensation while earning full retirement benefits, including annual COLAs, in the DROP account;
- earning generous interest rate payments on DROP accounts, almost double the rates available from banks; and
- maintaining health benefits. However, this is not a factor in Maryland because vested retirees retain the same health coverage and premium subsidy as active members.

The SPRS DROP program has 107 participants and the LEOPS DROP program has 116 participants.

State Fiscal Effect: As of June 30, 2006, there were 7,170 active CORS members. Of those, approximately 300 have 25 or more years of service and would be immediately eligible to participate in DROP. An additional 500 have between 20 and 25 years of service; these individuals are already eligible to retire under CORS, but will be eligible for DROP if they remain in their jobs for a few more years.

The General Assembly's actuary estimates that State pension liabilities would increase by \$33.5 million and that pension normal costs would increase by \$60,000. Amortizing the new liabilities, combined with the increased normal cost, over 25 years yields a \$2.1 million increase in State pension contributions in fiscal 2009. Pension contributions

increase thereafter according to actuarial assumptions. They are assumed to be split 60% general funds, 20% special funds, and 20% federal funds.

This analysis is based on the following assumptions:

- 60% of eligible CORS members will participate in DROP, based on experience with the SPRS and LEOPS DROP programs;
- DROP participants spend an average of three years in DROP;
- 350 new members join CORS each year, based on actual turnover rates in CORS.

Although the DROP program has the potential to increase retention among veteran correctional officers, it would not likely reduce costs for recruiting and training new correctional officers. The Division of Correction reports that it currently has more than 100 vacant correctional officer positions, so it is constantly recruiting for new positions already. Entry level training for new correctional officers is conducted internally by the Department of Public Safety and Correctional Services (DPSCS). Given frequent turnover among correctional officers, DROP would have to lead to a dramatic decrease in the number of new correctional officers in order for DPSCS to realize any savings from its training budget. Based on the assumed participation rates given above, the Department of Legislative Services estimates that only 100-200 veteran CORS members will participate in DROP, which would not be sufficient to reduce fixed training costs.

Based on the assumptions and membership profile given above, the Department of Legislative Services (DLS) estimates that between 100 and 200 CORS members will participate in DROP at the outset. This represents fewer members than currently participate in the State Police and LEOPS DROP programs combined, which are administered manually by SRA. Under the assumption that the number of CORS members who participate in DROP will be substantially larger than the number of participants from the other two systems, SRA estimates that it will need to automate DROP administration for CORS at a cost of approximately \$200,000.

Given that the initial participation rates should not be overwhelming, DLS believes that, at the outset, SRA can incorporate administration of the CORS DROP into its current business processes using existing resources. However, DLS notes that over time, CORS DROP participation is likely to grow. Therefore, SRA should begin planning for automating DROP administration in conjunction with the implementation of its new information technology system, the Maryland Pension Administration System.

Additional Information

Prior Introductions: SB 396 of 2006, a similar bill, was heard by the Senate Budget and Taxation Committee but no further action was taken.

Cross File: None.

Information Source(s): Mercer Human Resources Consulting, Maryland State Retirement Agency, Department of Legislative Services

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