

**Department of Legislative Services**  
 Maryland General Assembly  
 2008 Session

**FISCAL AND POLICY NOTE**

Senate Bill 374 (Senator McFadden, *et al.*)  
 Budget and Taxation

**Employees' Retirement and Pension Systems - Purchase of Contractual Service Credit**

This bill allows members of the Employees' Retirement System and Employees' Pension System to purchase service credit for periods of contractual full-time employment with the State.

The bill takes effect July 1, 2008.

**Fiscal Summary**

**State Effect:** State pension liabilities increase by \$29.4 million and normal costs increase by \$1.5 million. Amortizing the liabilities over 25 years and adding the normal cost results in State pension contributions increasing by \$3.4 million in fiscal 2010. Those costs are assumed to increase according to actuarial assumptions, and to be divided 60% general funds, 20% special funds, and 20% federal funds.

(in dollars)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	0	2,044,200	2,176,800	2,316,600	2,463,600
SF Expenditure	0	681,400	725,600	772,200	821,200
FF Expenditure	0	681,400	725,600	772,200	821,200
Net Effect	\$0	(\$3,407,000)	(\$3,628,000)	(\$3,861,000)	(\$4,106,000)

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

**Local Effect:** Total pension liabilities for participating governmental units (PGUs) increase by \$9.4 million and normal costs increase by \$523,000. Amortizing liabilities over 25 years and adding the normal cost results in combined pension contributions for 113 PGUs increasing by \$1.1 million in fiscal 2010.

**Small Business Effect:** None.

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## **Analysis**

**Bill Summary:** At any time prior to retirement, ERS members may purchase up to 10 years of service credit for periods of contractual full-time employment with the State that occurred prior to membership in ERS. Members pay 5% of their earnable compensation at the time of purchase for each year of service they purchase, without interest. The purchased credit is applied to the member's allowance at the accrual rate in effect at the time the member purchases the service credit. Legislative Services notes that the ERS accrual rate of 1.8% has never changed.

At any time prior to retirement, EPS members with at least five years of service credit may purchase up to 10 years of eligibility credit for periods of contractual full-time employment that occurred prior to membership in EPS. Members pay 5% of their earnable compensation at the time of purchase for each year of service they purchase without interest. The purchased credit is applied to the member's allowance at the accrual rate in effect at the time the member purchases the service credit.

**Current Law:** At any time before retirement, ERS members may purchase service credit at member cost at the time of employment plus 4% interest each year to the date of purchase for employment:

- with the State or a participating governmental unit (including contractual employment);
- as a member of the State Police Retirement System for which the member did not vest with that pension plan;
- when the member was on employer-approved leave not exceeding two years;
- with the Department of Legislative Services, the Office of the Attorney General, or as secretary to either the Speaker of the House of Delegates or the President of the Senate during a session of the General Assembly;
- as a member of the Senate or House of Delegates or the Office of the Secretary of the Senate or the Chief Clerk of the House of Delegates;
- as a member of ERS or the Teachers' Retirement System for which the member had withdrawn all accumulated contributions after a prior termination of membership; or
- when membership was mandatory but for which member contributions were not made.

EPS members may purchase service credit at full cost (both employee and employer share) for prior employment with the State (including contractual employment), a political subdivision of the State or of another state, the federal government, or a school or postsecondary institution. However, EPS members who are State employees pay only 50% of the full cost of the purchase, meaning that only employees of PGUs pay the full cost. All EPS service credit purchases may be made only in the year of retirement.

The accrual rate for EPS members is 1.2% for service that occurred prior to June 30, 1998. For service that occurred after that date, the accrual rate is 1.8%.

**Background:** The cost of service purchases varies according to the employment history of each member who makes a purchase, but examples can help to illustrate the effect of this proposal on certain members. For ERS members, this proposal could very likely increase the cost of their service purchases. Since ERS closed to new members in 1980, any prior contractual service would have occurred before then. Under current law, if the member's compensation was \$10,000 during the first year of contractual employment, and \$11,000 for the second year, the member would pay \$3,028 for two years of contractual service ( $\$10,000 \times 0.05$  plus  $\$11,000 \times 0.05$ , with 27 years of 4% annual inflation). Under this bill, if the member's current salary is \$50,000, the member would pay \$5,000 ( $\$50,000 \times 0.05 \times 2$ ) for the same two years.

For EPS members, the bill could dramatically reduce the cost of buying past contractual service, especially if the purchased service alters eligibility for retirement. In an example provided by the State Retirement and Pension Service (SRPS), the cost of purchasing five years of contractual service that changes eligibility for retirement could decrease from \$71,450 under current law to \$10,250 under this bill, assuming an average final compensation of \$40,000. The reduction in cost to the member would become the responsibility of the State.

**State Expenditures:** There is no reliable way to estimate the number of current ERS/EPS members who were previously employed as contractual employees by the State. SRPS only maintains employment records for members; since contractual employees are not members, it has no records of their past contractual employment. Therefore, for the purpose of this analysis, Legislative Services assumes that 5% of active ERS and EPS members were previously employed as contractual employees and, in the case of EPS members, have at least five years of service credit. For EPS, it is assumed that 0.5% of those members would have purchased past contractual service anyway, so the cost generated by their service purchase under this bill is the difference between the current cost and the new cost. The remaining 4.5% of EPS members would not have purchased past service due to the prohibitive cost of paying either full cost or 50% of full

cost. Finally, Legislative Services assumes that, on average, an eligible member will purchase two years of past contractual service.

Based on these assumptions, the General Assembly's actuary estimates that State pension liabilities would increase by \$29.4 million and normal costs would increase by \$1.5 million. Amortizing the liabilities over 25 years and adding the normal cost results in a first year cost of \$3.4 million in fiscal 2010. That cost is assumed to increase annually based on actuarial assumptions. It is also assumed to be divided 60% general funds, 20% special funds, and 20% federal funds.

**Local Expenditures:** ERS/EPS members employed by PGUs would also be eligible to purchase service credit under the terms of this bill for past contractual employment with the State. Since PGU employees who are members of EPS currently pay full cost rather than 50% of full cost for service purchases, the savings to the employees are even greater, so the cost to the PGU for each purchase is also greater. The General Assembly's actuary estimates that total PGU pension liability would increase by \$9.4 million and the normal cost would increase by \$523,000. Amortizing the liability over 25 years and adding the normal cost results in a first year cost to PGUs of \$1.1 million, spread over the 113 current PGUs. Those costs also increase annually according to actuarial assumptions.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** HB 698 (Delegates Haynes and Valderrama) – Appropriations.

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

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