

Department of Legislative Services  
 Maryland General Assembly  
 2009 Session

FISCAL AND POLICY NOTE

House Bill 1231 (Delegate Haynes, *et al.*)  
 Appropriations

Employees' Pension System - Purchase of Contractual Service Credit

This bill allows State employees who are vested members of the Employees' Pension System (EPS) to purchase service credit at reduced cost for periods of contractual full-time employment with the State that occurred immediately prior to membership in EPS.

The bill takes effect July 1, 2009.

Fiscal Summary

**State Effect:** State pension liabilities increase by \$26.7 million. Amortizing the liabilities over 25 years results in State pension contributions increasing by almost \$1.8 million in FY 2011. Those costs are assumed to increase according to actuarial assumptions, and to be allocated 60% general funds, 20% special funds, and 20% federal funds.

(in dollars)	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	0	1,070,400	1,144,800	1,224,000	1,306,800
SF Expenditure	0	356,800	381,600	408,000	435,600
FF Expenditure	0	356,800	381,600	408,000	435,600
Net Effect	\$0	(\$1,784,000)	(\$1,908,000)	(\$2,040,000)	(\$2,178,000)

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

**Local Effect:** None.

**Small Business Effect:** None.

## Analysis

**Bill Summary:** Within five years after vesting in EPS, a State employee may purchase up to 10 years of eligibility credit for periods of contractual full-time employment that occurred immediately prior to membership in EPS. A member must pay 5% of earnable compensation at the time of the purchase for each year of service purchased. The purchased credit is applied to the member's retirement allowance at the accrual rate in effect at the time the contractual employment occurred.

An EPS member who vests before June 30, 2009, has until June 30, 2014, to purchase credit for contractual service under this bill.

**Current Law:** Contractual employees are not eligible for membership in any State retirement or pension plan, and do not accrue service credit in any plan.

Members of EPS vest after five years of service.

Only in the year of retirement, 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 may purchase service credit for periods of employment with the State for which they are not entitled to service credit, including contractual service, at 50% of the full cost.

Prior to 1998, the accrual rate for EPS members was 1.2%. Between 1998 and 2006, the accrual rate was 1.4%, but Chapter 110 of 2006 increased the accrual rate retroactively for that period (and prospectively) to 1.8%.

**Background:** The cost of service purchases varies according to the employment history of each member who makes a purchase, and whether the purchase changes the member's eligibility for benefits, but examples can help to illustrate the effect of this proposal on certain members. For EPS members, the bill could dramatically reduce the cost of buying past contractual service, especially if the purchased service alters eligibility for retirement. Under the bill, a member can purchase past credit by paying 5% of current compensation after just five years of service. Assuming a member's compensation is \$40,000 after five years of service, the purchase price is calculated on the basis of that salary. For five years of past service credit, the member pays \$10,000 (5% of \$40,000 for five years).

However, that same individual's compensation, assuming 3.5% annual growth, will be \$88,245 in 24 years, when the individual is one year short of retirement eligibility. Under current law, if the member sought to purchase five years of past service credit, the purchase price would be calculated based on the higher salary. Moreover, the price would be substantially higher because the additional years change the member's eligibility for benefits (crossing the 30 years of service threshold for a normal service retirement under EPS). The State Retirement Agency (SRA) estimates the member would pay approximately \$71,000 for the same five years. Therefore, the member saves about \$61,000; that difference in the member's cost becomes the responsibility of the State in the form of pension liabilities.

**State Expenditures:** There is no reliable way to estimate the number of current Employees' Retirement System/EPS members who were previously employed as contractual employees by the State. SRA maintains employment records only 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 the following:

- 5% of active EPS members are vested and were previously employed as contractual employees;
- 0.5% of those members would have purchased past contractual service anyway;
- 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;
- most EPS members purchase service credit for contractual employment that occurred prior to 1998, so the credit is applied at the 1.2% accrual rate; and
- 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 increase by \$26.7 million. Amortizing the liabilities over 25 years results in a first year cost of \$1.78 million in fiscal 2011. That cost is assumed to increase annually based on actuarial assumptions. It is also assumed to be allocated 60% general funds, 20% special funds, and 20% federal funds.

**Additional Comments:** It is not clear which of the two accrual rates, 1.4% or 1.8%, should be applied for service that occurred from 1998 to 2006 under the bill.

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## Additional Information

**Prior Introductions:** None.

**Cross File:** None.

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

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Analysis by: Michael C. Rubenstein

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