Department of Legislative Services

Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE

House Bill 1211 (Delegates F. Turner and Serafini)
Appropriations

Employees' Pension System and Teachers' Pension System - Benefits - Eligible Rollover Distributions

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This bill allows a member of the Teachers' Pension System (TPS) or Employees' Pension System (EPS) who has 15 years of eligibility service in either system or a combined total of at least 15 years in both systems to terminate membership and receive an eligible rollover distribution. The rollover distribution may be paid only to an eligible retirement plan defined in statute. The amount of the rollover distribution is equal to the sum of all member contributions with interest and annual employer contributions of 7% of earnable compensation with interest. A member's decision to terminate membership and receive the rollover distribution is a one-time irrevocable election.

The bill takes effect July 1, 2011.

Fiscal Summary

State Effect: Based on a "worst-case" scenario, the State's accrued pension liabilities increase by a total of $37.6 million and the normal cost increases by $19.5 million. After amortizing the liabilities over 25 years and adding the full normal cost, State pension contributions increase by $22.7 million in fiscal 2013, of which $8.7 million is for EPS and $14.1 million is for TPS (the individual amounts do not sum to the total due to rounding). The costs are assumed to grow annually according to actuarial assumptions. TPS contributions are paid entirely from general funds, and EPS costs are assumed to be allocated 60% general funds, 20% special funds, and 20% federal funds. To the extent that individual selections by EPS/TPS members deviate from the assumptions used, State pension costs may increase by a lesser amount.

($ in millions)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Revenues	$0	$0	$0	$0	$0
GF Expenditure	0	19.3	20.0	20.7	21.4
SF Expenditure	0	1.7	1.8	1.9	1.9
FF Expenditure	0	1.7	1.8	1.9	1.9
Net Effect	$.0	($22.7)	($23.5)	($24.4)	($25.2)

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

Local Effect: Using the same "worst-case" assumptions as the State analysis, total pension liabilities for participating governmental units (PGUs) increase by $6.8 million and the normal cost increases by $2.8 million. After amortizing the liabilities over 25 years and adding the full normal cost increase, PGU pension contributions increase by $3.4 million in fiscal 2013. Those costs are assumed to increase annually according to actuarial assumptions and are shared by approximately 120 PGUs. To the extent that individual selections deviate from these assumptions, PGU pension costs may increase by a lesser amount.

Small Business Effect: None.

Analysis

Current Law: Membership in EPS is a condition of employment for regular State employees hired since January 1, 1980, and whose compensation is provided by State appropriation or paid from State funds, as well as other individuals designated in statute. Membership in TPS is a condition of employment for employees of a day school under the supervision of a county board of education, faculty employees of educational institutions supported by and under the control of the State, librarians or clerical employees of public libraries, and other education-related employees designated in statute and hired since January 1, 1980. EPS/TPS members pay a member contribution equal to 5% of earnable compensation. A normal service retirement allowance is equal 1.8% of average final compensation (AFC) multiplied by years of service credit earned after June 30, 1998, plus 1.2% of AFC multiplied by years of service before that date.

A member of TPS/EPS is entitled to any of the following benefit allowances (not including disability allowances):

- a vested benefit at age 62, if the member leaves State service prior to retirement with at least five years of service and does not withdraw member contributions from the system;
- a normal service retirement allowance at age 62 (with at least five years of service) or after 30 years of service regardless of age; or

- a reduced early retirement benefit if the member is at least 55 years old and has between 15 and 30 years of service. The early retirement allowance is reduced 0.5% for each month that the early retirement date precedes the member's sixty-second birthday.

Statute defines eligible retirement plans that can receive rollover distributions from a State plan as:

- Individual Retirement Accounts (IRAs);
- individual retirement annuities under § 408(b) of the Internal Revenue Code (IRC);
- qualified trusts under IRC § 401(a);
- annuity plans under IRC § 403(a);
- annuity plans under IRC § 403(b); and
- deferred compensation plans under IRC § 457.

The regular interest rate for both TPS and EPS is 5%, compounded annually.

Employees of PGUs are eligible to participate in EPS if the legislative body of the governmental unit elects to participate. The PGU pays the full employer contribution for its employees.

Background: As of June 30, 2010, there were 103,162 active members of TPS and 77,660 active members of EPS.

Exhibit 1 provides the TPS and EPS employer contribution rates since fiscal 2000. As the exhibit shows, TPS employer contribution rates have exceeded 7% every year since then, and EPS contribution rates exceeded 7% in fiscal 2000 and each year since fiscal 2008.

Exhibit 1
TPS/EPS Employer Contribution Rates
Fiscal 2000-2012

	TPS	EPS
FY 2000	12.54%	7.15%
FY 2001	10.95	5.71
FY 2002	9.35	4.73
FY 2003	9.35	4.73
FY 2004	9.35	4.73
FY 2005	9.35	4.73
FY 2006	9.35	5.76
FY 2007	9.71	6.83
FY 2008	11.60	8.86
FY 2009	11.70	8.73
FY 2010	13.15	9.93
FY 2011	14.34	11.69
FY 2012	15.45	13.40

Source: Department of Legislative Services

State Fiscal Effect: The costs or savings generated by the bill are based on the extent to which the value of the benefit provided by the bill is different from the value of the benefit to which a member would be entitled in the absence of the bill. For the purpose of this analysis, it is assumed that EPS and TPS members who are eligible for retirement or early retirement when they leave State service will opt for those benefits and not the benefit provided by the bill, so they are excluded from the analysis. Therefore, the bill is assumed to apply to individuals who otherwise would end membership with a vested benefit that they would not be eligible to claim until age 62. Instead, under the bill, these individuals would be eligible to receive a lump-sum rollover distribution. In most cases, the rollover distribution includes an employer contribution that is smaller than the contribution made on the employee's behalf, but the smaller contribution is partially offset by the employee being able to claim the benefit at a younger age than the deferred benefit.

The General Assembly's consulting actuary has no way to determine whether an individual who leaves TPS/EPS with a vested benefit would opt to keep the vested benefit or choose the rollover distribution. However, based on actuarial models of the value of benefits under both scenarios, the actuary has determined that EPS members younger than age 53 and TPS members younger than age 50 typically derive a greater benefit from the rollover distribution than from the vested benefit; the opposite is true for members older than those respective ages.

As a result, for the purpose of this analysis, the actuary assumes that all EPS members who leave TPS/EPS younger than age 50 or 53, respectively, choose the rollover option, and all members who leave after those ages choose to keep the deferred benefit. Based on that assumption, the State's accrued pension liabilities increase by a total of $37.6 million and the normal cost increases by $19.5 million. After amortizing the liabilities over 25 years and adding the full normal cost, State pension contributions increase by $22.7 million in fiscal 2013, of which $8.7 million is for EPS and $14.1 million is for TPS (the individual amounts do not sum to the total due to rounding). The costs are assumed to grow annually according to actuarial assumptions. TPS contributions are paid entirely from general funds, and EPS costs are assumed to be allocated 60% general funds, 20% special funds, and 20% federal funds.

To the extent that individual selections deviate from the assumptions used above, State costs may be less. The assumptions used above represent the "worst-case" scenario for the State because they assume that all individuals act to provide themselves with the greatest benefit. To the extent that individuals select an option that does not give them the greatest benefit, State costs decline. For instance, if half of the members below the respective "cutoff" ages keep the deferred benefit and 25% of members above the cutoff age (but before retirement eligibility) take the rollover distribution, total State expenditures on pensions are reduced by more than half, from $22.7 million in fiscal 2013 to $10.8 million.

Local Fiscal Effect: Using the same assumptions used above, total PGU pension liabilities increase by $6.8 million and the normal cost increases by $2.8 million. After amortizing the liabilities over 25 years and adding the full normal cost increase, PGU pension contributions increase by $3.4 million in fiscal 2013. Those costs are assumed to increase annually according to actuarial assumptions and are shared by approximately 120 PGUs. To the extent that individual selections deviate from these assumptions, PGU pension costs may be less.

Additional Comments: The State Retirement Agency advises that its outside tax counsel has notified the agency that the bill's provisions may violate federal regulations governing qualified defined benefit plans. Specifically, federal regulations prohibit in-service distributions prior to a member reaching normal retirement age under the plan. The agency therefore advises that the bill should be made contingent on an IRS ruling with respect to allowing an in-service distribution prior to retirement eligibility.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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ncs/rhh

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