

Department of Legislative Services
 Maryland General Assembly
 2011 Session

FISCAL AND POLICY NOTE

Senate Bill 735 (Senators Pipkin and Brinkley)
 Budget and Taxation

State Retirement and Pension System - Optional Retirement Program - New Employees

This bill closes all of the State’s defined benefit (DB) pension plans to new State employees and teachers hired after June 30, 2011, except for the Governor’s and Legislative Pension Plans. State employees and teachers hired on or after July 1, 2011, are members of the Optional Retirement Program (ORP), a defined contribution (DC) plan, as a condition of their employment.

The bill takes effect July 1, 2011.

Fiscal Summary

State Effect: State pension contributions for new employees decrease by approximately \$3.6 million in FY 2012, reflecting the combined difference between the ORP contribution rate and normal cost rates for the State’s DB plans. Those savings are assumed to be allocated 84% general funds, and 8% each for special and federal funds. The savings are also assumed to increase annually according to actuarial assumptions. No effect on revenues.

(\$ in millions)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	(3.0)	(6.1)	(9.5)	(13.1)	(17.0)
SF Expenditure	(.3)	(.6)	(.9)	(1.2)	(1.6)
FF Expenditure	(.3)	(.6)	(.9)	(1.2)	(1.6)
Net Effect	\$3.6	\$7.3	\$11.3	\$15.6	\$20.2

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

Local Effect: Under the bill, participating governmental units (PGUs) are eligible to elect to participate in ORP, but unless they do so, the bill has no fiscal or operational effect on them.

Small Business Effect: None.

Analysis

Bill Summary: The bill applies to members of:

- the Employees' and Teachers' Pension Systems (EPS/TPS);
- the State Police Retirement System (SPRS);
- the Law Enforcement Officers' Pension System (LEOPS);
- the Correctional Officers' Retirement System (CORS); and
- the Judges' Retirement System (JRS).

Employees hired after June 30, 2011, by PGUs remain eligible for EPS, CORS, and/or LEOPS if the PGU became a participating employer before July 1, 2011. PGUs may not become participating employers of State DB plans on or after that date, but they may elect to participate in ORP under specified conditions. The bill authorizes annuity contracts under § 401(a) of the Internal Revenue Code to be offered under ORP.

Current Law: State Troopers and State Police cadets are members of SPRS as a condition of their employment. Uniformed police officers employed by numerous State agencies are members of LEOPS as a condition of their employment. Correctional officers in the first six classifications and other specified correctional employees are members of CORS as a condition of their employment. State judges, including all circuit court and District Court judges, and other specified judicial personnel are members of JRS as a condition of their employment.

Membership in EPS is a condition of employment for most regular State employees (*i.e.*, those who are not public safety employees, legislators, or judges) who were hired on or after January 1, 1980. Membership in TPS is a condition of employment for teachers and certain employees of local boards of education, community colleges, and libraries hired on or after January 1, 1980, with the exception of designated employees of:

- the University System of Maryland (USM);
- Morgan State University;
- St. Mary's College;
- the Maryland Higher Education Commission; and
- community colleges or regional community colleges in the State, including Baltimore City Community College.

Only the following employees of those institutions are eligible to join ORP:

- faculty members;
- professional employees of community colleges or regional community colleges;
- exempt employees of USM;
- professional or administrative employees of Morgan State University; and
- professional employees of St. Mary's College.

ORP is authorized under § 403(b) of the Internal Revenue Code, which applies only to employees of educational institutions and specified nonprofit organizations. A decision to join ORP is a one-time, irrevocable decision that must be made within one year of becoming eligible to join ORP. ORP members may not to participate in any of the DB plans offered by the State.

Background: **Exhibit 1** summarizes the key characteristics of the State's DB plans; due to space constraints and because they are not affected by the bill, the Governor's and Legislative Pension Plans are not included.

ORP is a DC plan that provides an employer contribution of 7.25% of earnable compensation; there is no employee contribution. Vesting is immediate, member accounts are portable, and members may invest their accounts in any of many investment options offered by the plan administrators, which are selected by the Board of Trustees of the State Retirement and Pension System (SRPS). Current plan administrators are TIAA-CREF and Fidelity Investments. Upon retirement, members may elect to purchase annuities with their accumulated funds.

Exhibit 1
Key Characteristics of State Retirement and Pension Plans

	<u>Employees and Teachers</u>	<u>State Police</u>	<u>Correctional Officers' System</u>	<u>Law Enforcement Officers' System</u>	<u>Judges</u>
Participation	Condition of employment	Condition of employment	Condition of employment	Condition of employment	Condition of employment
Vesting	5 years of service	5 years of service	5 years of service	5 years of service	Immediate
Employee Contribution	5% of salary	8% of salary	5% of salary	4% of salary	6% of salary (for 16 years)
Service Retirement Conditions	Age 62 or 30 years (Age 55 with 15 years reduced benefit)	Age 50 or 22 years of service	20 years service, with at least the last 5 years as correctional officer	Age 50 or 25 years of service	Age 60
Allowance	1.8% per year of service after 7/1/98; plus 1.2% per year of service prior to 7/1/98	2.55% per year of service	1.8% per year of service	2.0% per year if subject to the LEOP's modified pension benefit; otherwise 2.3% for first 30 years and 1.0% for each year thereafter	2/3 of active judge's salary at 16 years
Post Retirement Adjustments	Limited to 3% annual COLA	Unlimited annual COLA	Unlimited annual COLA	Limited to 3% annual COLA	Based on salary of active judges

COLA = cost-of-living adjustment
Source: Department of Legislative Services

State Fiscal Effect: It is assumed that State pension costs for current members of DB plans who remain in those plans remain unchanged because neither their benefits nor the system’s funding model are affected. Over time, SRPS asset allocation may move away from long-term strategies to ensure sufficient liquid assets to pay benefits to current members. That would likely reduce the system’s investment returns and put upward pressure on State contribution rates. However, that shift is not likely to happen within the five-year timeframe covered by this analysis, until enough current members have retired and begun drawing benefits from the system’s diminishing reserves.

For new employees hired after the bill’s effective date, the State may recognize some savings compared to the normal cost payments that it would have made for those employees if they had joined a DB plan instead of ORP. Normal cost is the component of the employer contribution that pays for benefits accrued by members in the current year. **Exhibit 2** compares normal cost rates for fiscal 2010 through 2012 with the ORP contribution rate of 7.25%. Normal cost rates can fluctuate, depending on the demographic characteristics of plan members and plan experience. The General Assembly’s consulting actuary further advises that normal cost rates vary by member, with younger members typically having lower normal cost rates. As shown in Exhibit 2, in fiscal 2012 the State will pay substantially less for members of EPS than for ORP members, slightly more for TPS members, and substantially more for members of all other DB plans.

Exhibit 2
Normal Cost Rates and ORP Contributions
Fiscal 2010-2012

	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
EPS	6.91%	6.10%	6.14%
TPS	6.85%	7.26%	7.27%
CORS	NA	9.04%	9.06%
State Police	24.02%	25.51%	25.48%
Judges	28.54%	31.30%	31.79%
LEOPS	17.10%	18.06%	17.30%
ORP	7.25%	7.25%	7.25%

Source: Cheiron; Gabriel, Roeder, and Smith

To determine the bill’s fiscal effect with regard to future employees hired after June 30, 2011, the General Assembly’s consulting actuary assumed that the number of future hires and their normal cost rates are consistent with the numbers and normal cost rates for current members with fewer than five years of service, calculated separately for each system.

Based on that assumption, State pension contributions decline by \$3.6 million in fiscal 2012. However, as Exhibit 2 demonstrates, normal cost rates can vary from year to year. This reflects the combined difference between the ORP's 7.25% contribution rate and the projected normal cost rates if new hires had become members of their respective DB plans. To the extent that projected normal cost rates for new hires do not resemble those of recent new employees, the fiscal effect may be slightly higher or lower. Those savings are assumed to grow based on the actuarial assumption that payroll grows 3.5% annually. Employer contributions for teachers and judges are paid entirely from general funds; contributions for all other State employees are assumed to be allocated 60% general funds, 20% special funds, and 20% federal funds. Overall, 84% of State contributions are assumed to be general funds.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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