

Department of Legislative Services
Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE
Revised

House Bill 1317
Appropriations

(Delegate Serafini)

State Employees and Teachers - Cash Balance Plan

This bill freezes benefits for current members of the Teachers' Pension System (TPS) and Employees Pension System (EPS), closes TPS/EPS and the Optional Retirement Program (ORP) to new members, and requires current members of TPS/EPS whose membership is terminated to participate in a cash balance plan established by the bill as a condition of employment. All new employees hired on or after July 1, 2011, who would otherwise be eligible for EPS, TPS, or ORP must participate in the cash balance plan. The bill does not apply to participating governmental units (PGUs).

The bill takes effect July 1, 2011.

Fiscal Summary

State Effect: State pension liabilities decrease by \$5.9 billion and the normal cost decreases by \$516 million, effective June 30, 2011. Amortizing the decrease in liabilities over 25 years and adding the normal cost reduction results in State pension contributions decreasing by \$943 million in FY 2013. Those savings are assumed to continue to accrue based on actuarial assumptions and are assumed to be allocated 84% general funds, 8% special funds, and 8% federal funds. Additional State contributions for the cash balance plan are not shown for FY 2012 because they are incorporated into the calculation of the normal cost. The State recognizes additional savings beginning in FY 2017, when the bill begins phasing in a requirement that local governments pay the employer contribution for their employees who are members of the cash balance plan, including teachers and principals, community college faculty, and librarians. No effect on revenues.

(in dollars)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	0	(792,120,000)	(828,240,000)	(866,880,000)	(905,520,000)
SF Expenditure	0	(75,440,000)	(78,880,000)	(82,560,000)	(86,240,000)
FF Expenditure	0	(75,440,000)	(78,880,000)	(82,560,000)	(86,240,000)
Net Effect	\$0	\$943,000,000	\$986,000,000	\$1,032,000,000	\$1,078,000,000

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

Local Effect: Local expenditures increase by \$171.6 million in FY 2017 due to the phasing in of the requirement that local governments pay the employer contribution for their employees who are members of the cash balance plan. Those costs increase by 20% of the total employer contribution for local employees until local employers pay the full contribution. No effect on local government revenues. **This bill imposes a mandate on a unit of local government.**

Small Business Effect: None.

Analysis

Bill Summary: The cash balance plan is a defined benefit (DB) plan administered by the Board of Trustees of the State Retirement and Pension System (SRPS), which is required to adopt regulations to implement the plan.

Under the cash balance plan, the State and member contributions are each 5% of earnable compensation, and members earn 5% interest compounded annually on account balances. A member vests in the plan after three years of membership, and is eligible to retire upon reaching age 62 with at least 10 years of service credit. A member who retires before that time may not receive payments from the plan until the July 1 following the next actuarial valuation of the plan. Benefits from the cash balance plan are payable as a lump sum or as an annuity beginning at the time of retirement with either (1) no survivor benefit; (2) a 100% joint and survivor benefit; or (3) a 50% joint and survivor benefit. The benefits must be paid in accordance with Internal Revenue Code (IRC) requirements and the plan's requirements.

Beginning in fiscal 2017, local employers of cash balance plan participants (including local boards of education, community colleges, and public libraries) must begin paying a portion of the employer contribution on behalf of their employees. In fiscal 2017, local employers are responsible for 20% of the employer contribution on behalf of their employees, which increases by 20% each year until it reaches 100% in fiscal 2021 and each year thereafter.

For employees paid through the Central Payroll Bureau, the bureau is authorized to make the appropriate employer contributions as payrolls are paid, and to charge each payment to the unit employing a participant. If an employee's salary is paid from special or federal funds, the employer contribution must be made from the same source. The board must issue regulations to establish a process for the payment of employer contributions for members not paid through the Central Payroll Bureau. The Governor must include sufficient funds in the annual budget to pay the necessary employer contributions.

A vested former member of EPS and TPS is entitled to the benefits accrued prior to the termination of membership, in accordance with existing pension law. A nonvested member of EPS or TPS may either receive a return of member contributions, with interest, or convert accrued benefits to an equivalent benefit in the cash balance plan.

Current Law: With a few exceptions, 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 most 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, professional and clerical employees of local community colleges, librarians or clerical employees of public libraries, and other education-related employees designated in statute and hired since January 1, 1980. Membership in TPS is optional for 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 are not eligible to participate in any of the DB plans offered by the State. The State contributes 7.25% of members' earnable compensation to ORP.

EPS/TPS members pay a member contribution equal to 5% of earnable compensation. They are eligible for a normal service retirement after 30 years of service or upon reaching 62 years of age with 5 years of service. 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.

The State pays the full employer contribution on behalf of members of TPS who are employed by local governments, including local school boards, community colleges, and public libraries.

Background: As of June 30, 2010, there were 103,162 active members of TPS, all but 1,906 of whom were employed by local governments. As of the same date, there were 77,660 active members of EPS, of whom 52,292 were State employees and the remaining members were employed by PGUs.

Cash balance retirement plans are a relatively new plan type, with the first one established in the mid-1980s. Since then, they have become common in the private sector, with more than 1,000 employers currently providing retirement benefits through a cash balance plan. However, they remain fairly rare in the public sector, with no states providing cash balance plans to their employees or teachers. However, in 2009, Montgomery County established a cash balance plan entitled the Guaranteed Retirement Income Program as part of its Employees' Retirement System. The plan provides an 8% employer contribution and guaranteed annual interest of 7.25%, credited monthly; members pay 4% of compensation up to the Social Security Wage Base, and 8% of compensation that exceeds the wage base.

State Fiscal Effect: For the purposes of this analysis, the General Assembly's consulting actuary assumes that all nonvested members of TPS/EPS convert their accrued balances in those plans to an opening account balance within the new cash balance plan rather than receive a refund of member contributions. Also, the actuary assumes that all vested members of the cash balance plan who terminate employment, whether retirement-eligible or not, choose a lump sum distribution; the actuary advises that similar results are obtained if the annuity options are actuarially adjusted to be equivalent to the lump sum distribution, which would likely occur.

Based on these assumptions, and the plan provisions described above, the actuary estimates that the State's unfunded pension liabilities decrease by \$5.9 billion as of June 30, 2011, and the normal cost decreases by \$516 million. Amortizing the reduction in liability over 25 years and adding the reduced normal cost results in State pension contributions decreasing by \$943.0 million in fiscal 2013. Those savings continue to accrue according to actuarial assumptions and are assumed to be allocated 84% general funds, 8% special funds, and 8% federal funds.

The bill does not reduce or eliminate the State's employer contributions toward TPS/EPS in fiscal 2012 that are based on the contribution rates certified by the SRPS Board of Trustees and included in the Governor's proposed fiscal 2012 budget. Therefore, it is assumed that those contributions are still made in addition to the employer contribution for the new cash balance plan. However, the actuary advises that the 5% State contributions that would need to be made in fiscal 2012 for the cash balance plan are reflected in the reduced normal cost rates as of June 30, 2011, and should not be reflected as increased costs in fiscal 2012. Therefore, although the State will be making both the mandated TPS/EPS contributions and the 5% cash balance contribution in fiscal 2012, the additional costs for the cash balance plan (estimated to be approximately \$418 million in fiscal 2012) are not shown in fiscal 2012 because they are incorporated into the reduced normal cost rate, which is included in the calculation of State savings for fiscal 2013. Showing the cash balance contribution as an increased expenditure in fiscal 2012 would result in double counting its effect on State payments.

Local Fiscal Effect: Beginning in fiscal 2017, local governments begin paying a share of the employer contribution for their employees who are members of the cash balance plan. In the absence of the bill, the total TPS/EPS contribution is projected to be \$2.4 billion in fiscal 2017, but the actuary estimates a total savings of \$1.1 billion for that year, bringing the total contribution under the cash balance plan down to \$1.3 billion. Assuming that two-thirds of that amount is attributable to members of TPS employed by local governments (based on the current membership distribution), total contributions for cash balance plan members employed by local governments are projected to be approximately \$858 million in fiscal 2017. Under the bill, local governments are responsible for 20% of that amount, or \$171.6 million.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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