SB 444

Department of Legislative Services
Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

Senate Bill 444 (Senator Colburn)
Budget and Taxation

Optional Retirement Program - State Employees and Teachers - Participation

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This bill expands eligibility for the State's Optional Retirement Program (ORP) to include most current and future members of the State Retirement and Pension System (SRPS). Members of participating governmental units (PGUs), the Judges' Retirement System (JRS), and the Legislative Pension Plan (LPP) are not eligible for ORP under the bill; the Governor also is excluded.

The bill takes effect July 1, 2012.

Fiscal Summary

State Effect: Potential increase or decrease in State pension costs (all funds), depending on the number and characteristics of current SRPS members who opt to join ORP, which cannot be determined, and how their accrued benefits are calculated. No effect on revenues.

Local Effect: None. PGUs are not affected by the bill.

Small Business Effect: None.

Analysis

Bill Summary: The bill applies to current and future members of the:

- Employees' Retirement System (ERS);
- Employees' Pension System (EPS);
- Teachers' Retirement System (TRS);

- Teachers’ Pension System (TPS);
- State Police Retirement System (SPRS);
- Correctional Officers’ Retirement System (CORS); and
- Law Enforcement Officers’ Pension System (LEOPS).

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 who are eligible to participate in ORP:

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

Eligible employees of employing institutions have the option of joining ORP rather than enrolling in an SRPS plan. ORP is a defined contribution (DC) program that provides an employer contribution of 7.25% of a member’s compensation, which is paid by the State. Unlike SRPS plans, there is no mandated employee contribution in ORP; in fact, employee contributions are not authorized. Instead, employing institutions are authorized to establish supplemental retirement plans in accordance with §§ 401(a), 403(b) or 457 of the Internal Revenue Code, which allow employees to contribute to retirement accounts on a tax-deferred basis. Vesting in ORP 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 SRPS. Current plan administrators are TIAA-CREF and Fidelity Investments. Upon retirement, members may elect to purchase annuities with their accumulated funds.

To join ORP, individuals in employing institutions must be eligible for membership in SRPS and be:

- eligible (professional) employees of MHEC;
- members of the faculty of an employing institution;
- professional employees of a community college;
- nonclassified employees of USM;
- professional or administrative employees of Morgan State University; or
- professional employees or faculty members of St. Mary's College of Maryland.

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 defined benefit (DB) plans offered by the State.

Background: **Exhibit 1** summarizes the key characteristics of the State's DB plans; in cases where the benefits are different for members hired on or after July 1, 2011, and those who were members before that date, the exhibit shows benefits for those who were members prior to that date. Due to space constraints and because they are not affected by the bill, JRS and LPP are not included.

According to the National Conference of State Legislatures, 36 states offer regular employees only a DB plan, and 43 states offer teachers only a DB plan. Six states offer regular employees a choice between a DB or DC plan (like this bill), and just one state offers teachers the same choice.

As noted above, seven state pension plans have provided their new members with a choice between a DB plan or a DC plan. In each case, the DB plan is the default option if a member does not make an active choice. Only the two Ohio plans give members the option of choosing a hybrid plan that includes elements of both types. **Exhibit 2** shows that the percentage of employees who chose DC plans instead of DB plans under these conditions ranged from a low of 3% for Ohio state employees to a high of 26% in Florida.

Exhibit 1
Key Characteristics of State Retirement and Pension Plans
(for members employed before July 1, 2011)

	Employees and Teachers	State Police	Correctional Officers' System	Law Enforcement Officers' System
Participation	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
Employee Contribution	7% of salary	8% of salary	5% of salary	6% of salary in FY 2012; 7% of salary thereafter
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
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
Post Retirement Adjustments	Limited to 3% annual COLA	Unlimited annual COLA	Unlimited annual COLA	Limited to 3% annual COLA

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

Exhibit 2
Other State Pension Plans that Provide Members with a Choice between Defined Benefits and Defined Contributions

	DB by Default or Active Choice	DC Active Choice	Combined Plan
Colorado	82%	18%	Not Offered
Florida	74%	26%	Not Offered
Montana	90%	10%	Not Offered
North Dakota	88%	12%	Not Offered
Ohio Employees	95%	3%	2%
Ohio Teachers	86%	11%	4%
South Carolina	80%	20%	Not Offered

Source: Milliman, January 2009

State Fiscal Effect: As noted above, State law requires members who are eligible for ORP to make a selection within one year of becoming eligible. The bill's effective date is July 1, 2012, so it is assumed that all current SRPS members who are affected by the bill have one year from that date to make a selection. Future employees will have one year from the date of hire to make a selection. Legislative Services cannot predict which or how many current and future employees will select ORP instead of a DB plan. As shown above, when DB plan members are given a choice, the percentage who choose DC can vary tremendously. Moreover, the characteristics of those members greatly affects the likely cost or savings, so a reliable estimate of the bill's fiscal effect is not possible. The following discussion addresses the factors that will ultimately determine the bill's fiscal effect.

The State employer pension contribution consists of two components: an amortization payment that pays off a portion of the liabilities that current members of the plans have already accrued, and a "normal cost" payment that covers the cost of the liabilities that current members accrue in the current year. The amortization payment includes projections of members' future liabilities based on turnover and mortality rates and other factors.

The bill does not specify how SRPS should calculate the benefits for members who are vested in a DB plan before switching to a DC plan. Clearly, the member's years of service credit are frozen when the member switches to ORP, but it is not clear from the bill whether the average final compensation used to calculate the member's benefit allowance is based on compensation at the time the member makes the switch or at the time the member retires. That distinction may have a significant effect on State costs. If the State uses compensation at the time of the switch, that choice will almost certainly yield a significant reduction in accrued liabilities, which are based on an assumption that a member's compensation continues to grow by 3.5% annually until retirement. If the State uses compensation at the time of retirement, it likely has no effect on accrued liabilities or the State's amortization payment of those liabilities.

The State may recognize some savings from its normal cost payments, the second component of the employer contribution, depending on the distribution of current employees who select ORP. **Exhibit 3** compares normal cost rates for fiscal 2013 with the ORP contribution rate of 7.25%. Normal cost rates can fluctuate, depending on the demographic characteristics of plan members and plan experience, and they can also vary by member, with younger members typically having lower normal cost rates. As shown in Exhibit 3, in fiscal 2013 the State will pay substantially less for members of EPS and TPS than for ORP members, slightly more for members of CORS, and substantially more for members of SPRS and LEOPS. Again, the distribution of members who choose ORP determines the short-term fiscal effects for the State. If the group that switches to ORP is heavily weighted to EPS and TPS members, State expenditures increase significantly, due to the higher ORP contribution compared to the EPS normal cost. If younger members favor ORP, which is likely given the portability of DC plans and the immediate vesting of ORP benefits, the expenditure increase is even larger because of their lower normal cost rates.

Exhibit 3
Employer Normal Cost Rates and ORP Contributions
Fiscal 2013

EPS	4.17%
TPS	4.62%
State Police	20.44%
CORS	7.87%
LEOPS	12.35%
ORP	7.25%

Source: Gabriel, Roeder, and Smith

Additional Comments: The State Retirement Agency advises that the process for obtaining Internal Revenue Service approval for a parallel tax-qualified DC plan for State employees can take several years. Therefore, the Department of Legislative Services advises that the bill cannot be implemented as introduced. Because ORP is authorized only for employees of educational institutions, only teachers and university faculty and staff are eligible to join ORP. State employees who are not employed by a college or university are not eligible to join the current ORP.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Baltimore and Garrett counties, Baltimore City Community College, Comptroller's Office, Judiciary (Administrative Office of the Courts), Cheiron, Department of State Police, Morgan State University, Maryland State Retirement Agency, Maryland Supplemental Retirement Plans, Maryland Department of Transportation, Department of Legislative Services

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