Department of Legislative Services

Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE

House Bill 655 (Delegate Barkley, *et al.*)
Appropriations

State Retirement and Pension System - Member Contribution Rate - Reduction

This bill reduces the member contribution rate from 7% to 6% of earnable compensation for members of the Teachers' Pension System (TPS), Employees' Pension System (EPS), and Law Enforcement Officers' Pension System (LEOPS).

The bill takes effect July 1, 2014.

Fiscal Summary

State Effect: State pension contributions increase by $95.0 million in FY 2016 as the State absorbs the full effect of reduced member contributions. In FY 2017, State contributions increase by only $38.3 million as local school boards are responsible for most of the increase in employer normal cost payments for TPS members. State contributions increase annually from the FY 2017 levels according to actuarial assumptions and are assumed to be allocated 60% general funds, 20% special funds, and 20% federal funds. No effect on revenues.

($ in millions)	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Revenues	$0	$0	$0	$0	$0
GF Expenditure	0	57.0	23.0	23.7	24.5
SF Expenditure	0	19.0	7.7	7.9	8.2
FF Expenditure	0	19.0	7.7	7.9	8.2
Net Effect	$.0	($95.0)	($38.3)	($39.6)	($40.9)

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

Local Effect: Normal cost payments by local school boards increase by $59.8 million in FY 2017 and increase annually thereafter according to actuarial assumptions. Contributions by participating governmental units (PGUs) increase by an estimated $1.0 million in FY 2016 and annually thereafter according to actuarial assumptions.

Small Business Effect: None.

Analysis

Current Law/Background: The Budget Reconciliation and Financing Act of 2011 (Chapter 397), which included comprehensive pension benefit reform, raised the member contribution rate for EPS and TPS members from 5% of earnable compensation to 7%. It also phased in over two years an increase in the LEOPS member contribution rate from 4% to 7%. Chapter 397 established different benefit structures for existing members of EPS and TPS and those hired after June 30, 2011, as shown in **Exhibit 1**; nevertheless, the increased member contributions applied both to existing and future members of both plans.

Exhibit 1
EPS/TPS Plan Characteristics

	Date of Hire	
	Before July 1, 2011	**On or After July 1, 2011**
Member Contribution	7% of earnable compensation	
Vesting	5 years	10 years
Retirement Eligibility	Age 62 with 5 years of service, or any age with 30 years of service	Age 65 with 10 years of service, or age plus years of service adding to 90
Average Final Compensation	3 highest consecutive years	5 highest consecutive years
Benefit Multiplier	1.2% for service credit prior to 1998; 1.8% for service credit after 1998	1.5%

Source: Department of Legislative Services

Chapter 397 also included pension funding reforms designed to improve the financial stability and sustainability of the pension trust fund. Chief among these reforms was the provision requiring that a portion of the savings generated by the benefit reform be reinvested in the trust fund in the form of an excess contribution made annually. In fiscal 2012 and 2013, all but $120.0 million of the savings was reinvested. Beginning in fiscal 2014, the reinvestment was capped at $300.0 million, with total savings projected to exceed that much each year. For the first two years, the vast majority of the savings generated by the benefit reforms was generated by the higher member contribution rates, which helped reduce required State contributions by almost $200.0 million. However, after fiscal 2015, the increased member contributions will account for less than half of the total savings and continue to diminish in proportion to total savings as more new members join under the reformed pension benefits.

Member contribution rates for EPS/TPS have undergone multiple changes since the plans originated in 1980. **Exhibit 2** shows the EPS/TPS member contribution rates over time. Prior to the 2011/2012 increase, the LEOPS member contribution rate had always been 4% (except for members who transferred from the Employees' Retirement System before fiscal 2000).

Exhibit 2
EPS/TPS Member Contribution Rates

Fiscal Year	Member Contribution
1980-1998	0% for compensation below the Social Security wage base; 5% for compensation above the wage base
1999-2006	2% of earnable compensation
2007	3% of earnable compensation
2008	4% of earnable compensation
2009-2011	5% of earnable compensation
2012 – present	7% of earnable compensation

Source: Department of Legislative Services

Chapter 1 of the first special session of 2012 requires local school boards to pay a portion of the normal cost for their employees who are members of TPS or the Teachers' Retirement System (TRS, a closed system). Prior to fiscal 2013, the State paid 100% of the annual employer contribution on behalf of teachers in the State. Local school board payments of the normal cost were phased in over five years. In fiscal 2016, local school boards pay 100% of the *projected* normal cost at the time the change was made. Beginning in fiscal 2017, they pay 100% of the *actual* normal cost, which is now projected to be $73.3 million more than was originally projected when Chapter 1 was enacted.

State Fiscal Effect: Actuarially, member contributions are credited fully against the normal cost, which is the value of retirement benefits that members earn in the current year. Any portion of the normal cost that remains after the member contribution is the responsibility of the employer. Therefore, intuitively, it seems that a 1.0 percentage point reduction in the employee contribution would result in exactly a 1.0 percentage point increase in the employer normal cost payment. However, this does not account for reduced member refunds. Members who separate from employment prior to retirement are entitled to a refund of their member contributions, plus interest. By reducing the amount of member contributions, the system is making smaller refund payments; the difference is reflected in higher asset levels, which results in slightly lower employer contributions than would otherwise be necessary. The General Assembly's consulting actuary advises that a general rule of thumb is that a 1.0 percentage point decrease in member contributions results in a 0.95 percentage point increase in employer contributions, which is used in this analysis.

As noted above, the bill's full effect is reflected in the employer's normal cost rate and, therefore, affects local school boards. Even though the bill's reduction of employee contribution rates begins in fiscal 2015, there is no effect on fiscal 2015 employer contributions because the reduced employee contributions are not reflected until the June 30, 2014 valuation, which determines contribution rates for fiscal 2016. In fiscal 2016, local school boards pay a fixed amount based on the *projected* normal cost that was estimated in 2012. Therefore, in fiscal 2016, there is no effect on local school boards, and the State absorbs the full amount of the increase in the TPS/TRS normal cost rate. Beginning in fiscal 2017, local school boards pay 100% of the *actual* normal cost, so they bear the full effect of the increase in the employer normal cost rate as a result of member contributions decreasing.

State pension contributions for EPS, TPS, and LEOPS increase by $95.0 million in fiscal 2016; in fiscal 2017, they increase by only $38.3 million as local school boards pay the difference. State contributions continue to increase from fiscal 2017 levels according to actuarial assumptions and, since most of the increased State payments are for EPS and LEOPS, are assumed to be allocated 60% general funds, 20% special funds, and 20% federal funds.

Local Fiscal Effect: Local school boards' pension contributions for TPS/TRS members increase by $59.8 million beginning in fiscal 2017, and continue to grow annually according to actuarial assumptions. Those increases are divided proportionally among the 24 local school boards based on their membership in TPS/TRS. County governments are required to include the *fiscal 2016* local board pension contribution in the calculation of the required fiscal 2017 maintenance of effort (MOE) amount; therefore, the increase in the *fiscal 2017* local board pension contribution required by the bill will not be included in the MOE calculation.

In addition, pension contributions for PGUs also increase as a result of their members contributing less to EPS and LEOPS. Based on a total PGU payroll of $1.1 billion, it is estimated that PGU pension contributions increase by $1.0 million; this figure is likely somewhat overstated because a portion of PGUs remain in noncontributory EPS and, therefore, are not affected by the bill. That increase is divided proportionally among the approximately 115 remaining PGUs based on their membership in EPS and LEOPS.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Cheiron, Department of Legislative Services

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