SB 633

Department of Legislative Services

Maryland General Assembly
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FISCAL AND POLICY NOTE
First Reader

Senate Bill 633 (Senator Serafini)
Budget and Taxation

State Employees' Retirement Savings Plan

This bill establishes the State Employees' Retirement Savings Plan (SERSP) as an optional alternative defined contribution (DC) retirement plan for individuals eligible for the Employees' Pension System (EPS), including those employed by participating governmental units (PGUs), who are hired on or after July 1, 2016.

The bill takes effect July 1, 2016.

Fiscal Summary

State Effect: State pension contributions decrease by $17.0 million in FY 2017 due to fewer new employees enrolling in EPS. Beginning in FY 2018, State pension contributions increase by $33.0 million and then according to actuarial assumptions. Beginning in the eighth year of the SERSP program (FY 2024), actuarial savings begin to accrue due to lower employer contributions for SERSP relative to EPS. Those savings escalate in the long term and are assumed to be allocated 60% general funds, 20% special funds, and 20% federal/other funds. General fund expenditures by the Comptroller's Office increase, potentially significantly, in FY 2017 to meet the bill's timeline. No effect on revenues.

(in dollars)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Revenues	$0	$0	$0	$0	$0
GF Expenditure	(10,200,000)	19,800,000	19,800,000	18,600,000	18,600,000
SF Expenditure	(3,400,000)	6,600,000	6,600,000	6,200,000	6,200,000
FF Expenditure	(3,400,000)	6,600,000	6,600,000	6,200,000	6,200,000
Net Effect	$17,000,000	($33,000,000)	($33,000,000)	($31,000,000)	($31,000,000)

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

Local Effect: PGU pension liabilities and contribution rates are anticipated to follow a similar pattern as State finances, with a first-year savings followed by modest increases for several years, and then eventual long-term savings. However, PGUs were not included in the actuarial analysis for this bill, and their status as employers needs to be addressed in the bill (see Additional Comments at the conclusion of this analysis).

Small Business Effect: None.

Analysis

Bill Summary: The plan is administered by the Board of Trustees of the Maryland Teachers and State Employees Supplemental Retirement Plans (MSRP), and it consists of retirement savings plans already offered by MSRP under sections 401(k), 457, and 401(a) of the Internal Revenue Code (IRC).

Members of EPS prior to July 1, 2016, are not eligible to participate in SERSP unless they (1) first withdraw accumulated member contributions from EPS and (2) become a new employee with a participating EPS employer on or after July 1, 2016. An eligible employee must elect to participate in SERSP in writing within one year of becoming eligible, and the decision is a one-time irrevocable election.

Employee contributions to SERSP begin at 3% of earnable compensation in the first year, and grow by 1% annually until they reach a maximum level of 7% of earnable compensation in the fifth year. However, an employee may elect to contribute at a different rate, including not contributing at all, up to the maximum employee contribution allowed under the IRC. Any request to contribute at a different level must be submitted in writing to MSRP. Employee contributions are immediately vested for the exclusive benefit of the employee, and they may be distributed only at the times, in the manner, to the extent, and to the individuals allowed by the IRC.

The bill requires that the State make a contribution of 7% of each employee's earnable compensation on behalf of each participating employee. As drafted, the bill requires that the State make employer contributions for all participating employees, including those employed by PGUs. For State employees, the State contribution on their behalf is charged to the agency that employs them. If the employee's salary is paid from special or federal funds, those funds are used to pay the employer contribution. For employees not paid by the State's Central Payroll Bureau, MSRP must develop regulations specifying how employee and employer contributions are to be made. Employer contributions are vested after three years, and they may be distributed only at the times, in the manner, to the extent, and to the individuals allowed under the IRC.

The Governor must include in the annual State budget an appropriation that is sufficient to pay the required employer contributions for SERSP members.

A retiree of SERSP as well as the retiree's spouse and dependent children are eligible to participate in the State health plan if the retiree:

- retires directly from State service with at least 10 years of service with a periodic distribution of benefits;
- ends State service with at least 25 years of service; or
- ends State service with at least 10 years of service and is at least 57 years old.

The bill specifies the manner in which years of service are to be calculated. A retiree of SERSP is entitled to the same premium subsidy under the same conditions as other State retirees, with one exception. Although their spouses and dependent children can participate in the State health plan, they are not eligible for a premium subsidy unless the retiree has at least 25 years of service with the State. (This is the same eligibility criteria that applies to retirees of the Optional Retirement Program.)

Current Law:

Employees' Pension System

EPS is a defined benefit pension (DB) plan administered by the State Retirement and Pension System (SRPS). 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. Local governments can elect to participate in EPS as PGUs under conditions specified in statute.

All EPS members pay a member contribution of 7% of earnable compensation, but vesting, eligibility, and benefits under EPS differ for members hired before July 1, 2011, and those hired on or after that date. **Exhibit 1** summarizes the benefits provided under the 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 62 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 Service

EPS retirees are also entitled to annual cost-of-living adjustments (COLAs) to their retirement benefits, which are calculated based on the Consumer Price Index for all Urban Consumers (CPI-U). For service credit earned prior to July 1, 2011, COLAs are equal to CPI-U, up to a maximum adjustment of 3%. For service credit earned on or after July 1, 2011, COLAs are contingent on the performance of the SRPS investment portfolio. For years in which the investments earn the target rate of return (currently 7.75%), the COLA is equal to CPI-U, up to a maximum of 2.5%. For years in which investments do not meet the target, the COLA is equal to CPI-U, up to 1.0%.

Maryland Supplemental Retirement Plans

Title 35 of the State Personnel and Pensions Article establishes the Teachers' and State Employees' Supplemental Retirement Plans and a board of trustees to administer them. The board of trustees has the responsibility of administering the State's:

- Deferred Compensation Program pursuant to IRC Section 457;
- Tax-deferred Annuity Program for Educational Employees under IRC Section 403(b);

- Savings and Investment Program under IRC Section 401(k); and
- Employer Matching Plan under IRC Section 401(a).

MSRP staff provides education programs and support information to State employees and human resources personnel in State agencies. These efforts are designed to create awareness among State employees of the need and mechanisms available to save for their own retirement. Staff also supports the board's work in selecting investment options and overseeing the operation.

MSRP finances operations through a fee imposed on members' accounts based on a percentage of assets in the plans and a flat-rate monthly charge. For fiscal 2016, the board fee is composed of two parts: a fee of 0.05% of assets and a monthly per account charge of $0.50 on every account with at least $500 in the 401(k), 457(b), and 403(b) plans; there is no $0.50 charge on 401(a) match plan accounts. In addition, the board contracts with Nationwide Retirement Solutions, Inc., (Nationwide) for administration of all four plans. The Nationwide contract, renewed for five years as of January 1, 2013, provides for a management fee of 0.09% of assets. The reported total participant fee includes the $0.50 charge on specified accounts, plus up to 0.14% of assets on an annual basis.

Retiree Eligibility for the State Health Plan

In general, a retiree who is receiving a retirement allowance from SRPS is eligible to enroll in the State health plan under specified circumstances. If the retiree began State service on or before June 30, 2011, or is a retiree of the Judges' Retirement System, the retiree, the retiree's spouse, and any dependent children can enroll in the plan if the retiree:

- retires directly from State service with at least 5 years of creditable service;
- retires directly from State service with a disability allowance;
- ends State service with at least 16 years of creditable service; or
- ends State service with at least 10 years of creditable service and within 5 years of normal retirement age.

These retirees, their spouses, and their dependent children are eligible for the same premium subsidy that the retiree received as an active State employee if the retiree is receiving a disability allowance or has 16 years of creditable service; if the retiree has between 5 and 16 years of service credit, the retiree and family members receive a prorated premium subsidy at the rate of 1/16 for each year of service.

If the retiree began State service on or after July 1, 2011, the retiree, spouse, and dependent children can enroll in the plan if the retiree:

- retires directly from State service with at least 10 years of creditable service;
- retires directly from State service with a disability allowance;
- ends State service with at least 25 years of creditable service; or
- ends State service with at least 10 years of creditable service and within 5 years of normal retirement age.

These retirees, their spouses, and their dependent children are eligible for the same premium subsidy they received when the retiree was an active State employee if the retiree is receiving a disability allowance or if the retiree has 25 years of creditable service; if the retiree has between 10 and 25 years of service credit, the retiree and family members receive a prorated premium subsidy at the rate of 1/25 for each year of service.

Background: As of June 30, 2015, there were 75,228 active members of EPS, including almost 25,000 employed by PGUs.

State Fiscal Effect:

Employer Pension Costs

Several states now offer employees a choice between a defined benefit plan like EPS and a defined contribution plan like SERSP, and research on employee selections has generally shown that about 20% of employees opt for the DC option. For instance, 17% of members of the Florida Retirement System are members of the DC option, with the remaining members choosing the DB option. Therefore, this analysis assumes that 20% of new employees choose SERSP.

The Governor's fiscal 2017 budget, as submitted, assumes full participation in EPS by any new employees. With the expectation that 20% of new employees hired on or after July 1, 2016, opt for SERSP, State contributions for EPS decline by $21.0 million but are partially offset by contributions to SERSP of $4.0 million, for a net first-year savings of $17.0 million.

The consulting actuary advises that SERSP has little to no effect on State pension liabilities in the early years. However, EPS payroll is projected to grow at a slower pace because fewer contributions are being made by and on behalf of new employees. As liabilities are spread over the existing payroll, any reduction in payroll growth causes the amortization of those liabilities to accelerate. Thus, beginning in fiscal 2018, State pension contributions to EPS increase by $25.0 million; this is added to the expected $8.0 million in State contributions to SERSP, for a total combined increase of $33.0 million. **Exhibit 2** summarizes the changes in State contributions for the first five years of SERSP.

Exhibit 2
State Pension Contributions with SERSP
($ in Millions)

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Current EPS	$643	$666	$677	$693	$721
EPS with SB 633	622	691	699	710	734
Net EPS	**-21**	**25**	**22**	**17**	**13**
SERSP	4	8	11	14	18
Total State Effect	**-$17**	**$33**	**$33**	**$31**	**$31**

Source: Cheiron; Department of Legislative Services

The actuary advises that by the eighth year of the program (fiscal 2024), the State will recognize a net savings due to the lower State contributions for SERSP relative to EPS. The savings are modest at first but accelerate as membership in SERSP expands.

Any costs or savings associated with SERSP and EPS are assumed to be allocated 60% general funds, 20% special funds, and 20% federal/other funds, based on the approximate distribution of State employee payroll expenses.

Administrative Costs

MSRP advises that it can implement the bill with existing resources, assuming implementation is not immediate. It enrolls approximately 4,000 new State employees annually in the deferred compensation supplemental plans that it already operates, and it does not anticipate any additional burden associated with enrolling many of them in SERSP. In any case, fees paid by the new SERSP members would cover increased costs. Further, as enrollment in the plans grows over time, any additional costs for outreach and retirement counseling will be addressed through the plan fees collected by MSRP.

The Central Payroll Bureau within the Comptroller's Office advises that it will need about six months to make necessary adjustments to its payroll processing system to allow for automatic deferrals and employer contributions to SERSP. Most of the expenses related to that endeavor could be absorbed with existing resources, given sufficient time to make the changes prior to implementation of the bill. There may be additional costs, only in fiscal 2017, for information technology services that cannot be absorbed. Although a reliable estimate of those expenses is not available, they are potentially significant.

Additional Comments: As drafted, the bill makes PGU employees who are eligible for membership in EPS and who are hired on or after July 1, 2016, eligible for SERSP. However, it also requires the State to make employer contributions for *all* members of SERSP, including those employed by PGUs. The Department of Legislative Services (DLS) believes this is an oversight in the bill, and the analysis does not reflect any State payments on behalf of PGU employees.

MSRP advises that the bill expands eligibility for existing plans it administers (most notably for employees of PGUs), but that federal law prohibits such expansions for governmental 401(k) plans. Therefore, any employees not already authorized to participate in the 401(k) plan will have access only to the 457(b) and 401(a) plans.

DLS notes that, although this fiscal and policy note assumes SERSP is implemented beginning in fiscal 2017, MSRP and the Comptroller's Office both advised that additional time would be needed to prepare for implementation. The Comptroller's Office advises that January 1, 2018, is the earliest date the payroll processing system could be operational.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Department of Budget and Management, Maryland State Retirement Agency, Maryland Supplemental Retirement Plans, Cheiron, Department of Legislative Services

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