SB 31

Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 31 (Senator Bates)
Budget and Taxation

State Retirement and Pension System - State Employees and Teachers - Benefits

This bill establishes the State Employees' and Teachers' Integrated Pension System (IPS) as a new benefit tier for current and future members of the Employees' Pension System (EPS) and Teachers' Pension System (TPS), as well as Selection C members of the Employees' Retirement System (ERS-Selection C) and Teachers' Retirement System (TRS-Selection C). **The bill has a delayed effective date of June 1, 2019, and applies to current and future EPS/TPS and ERS/TRS-Selection C members beginning July 1, 2019**.

Fiscal Summary

State Effect: State pension matching contributions increase by $398.6 million in FY 2020, which are assumed to be allocated 84% general funds, 8% special funds, and 8% federal/other funds. Out-year costs reflect actuarial assumptions. No effect on revenues.

(in dollars)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Revenues	$0	$0	$0	$0	$0
GF Expenditure	0	334,807,200	349,885,200	354,841,200	366,450,000
SF Expenditure	0	31,886,400	33,322,400	33,794,400	34,900,000
FF Expenditure	0	31,886,400	33,322,400	33,794,400	34,900,000
Net Effect	$0	($398,580,000)	($416,530,000)	($422,430,000)	($436,250,000)

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

Local Effect: Local employer contributions for pensions decrease by $42.6 million in FY 2020. The net savings reflects local school boards no longer paying the normal cost for their employees who are members of TPS, somewhat offset by increased costs to community colleges and libraries, which have to pay employer matching contributions for their employees. Savings for local school boards and costs for community colleges and libraries continue to accrue in the out-years according to actuarial assumptions. No effect on local revenues. **This bill imposes a mandate on a unit of local government.**

Small Business Effect: None.

Analysis

Bill Summary: Beginning July 1, 2019, all current and future members of EPS and TPS, as well as current members of ERS-Selection C and TRS-Selection C, participate in IPS and pay a member contribution rate of 3.0% of earnable compensation. The benefit multiplier for service credit earned on or after July 1, 2019, is 1.0% of average final compensation. Members continue to be eligible for early retirement, disability benefits, and cost-of-living adjustments (COLAs), subject to the lower benefit level.

IPS members are also members of a new defined contribution (DC) plan, the State Employees' and Teachers' IPS Savings Plan (Savings Plan), as a condition of employment. The Savings Plan is administered by the Board of Trustees of the State Retirement and Pension System (SRPS), which is required to adopt regulations to implement the new plan. As the administrator of the Savings Plan, the board must establish DC supplemental plans that include a salary reduction plan or a tax-sheltered annuity plan that qualify under the Internal Revenue Code (IRC).

Employee contributions to the Savings Plan are not established, but employees are 100% vested in their contributions immediately. The employer then matches 100% of an employee's contribution to the Savings Plan, up to 3.0% of the employee's earnable compensation, and 50% of the employee's contributions between 3.0% and 5.0% of earnable compensation. Employees' interest in the employer's contributions to the Savings Plan begins after three years, when they become 100% vested in the benefits.

Benefits from the Savings 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 IRC requirements and are not payable by the State. Benefits paid from the Savings Plan are not subject to COLAs, but they also are not subject to early retirement reductions.

For members paid through the Central Payroll Bureau, the bureau is required to make the appropriate employer contributions as payrolls are paid and to charge each payment to the unit employing a member. If a member'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 for State employees.

Participating employees with at least $2,000 in the Savings Plan may borrow up to 50% of the account balance, not to exceed $50,000. The loan must be repaid within five years, unless the loan is applied to a primary residence.

Beginning in fiscal 2020, each local school board must continue to pay the normal cost for members of TRS.

Current Law:

Employees' Pension System/Teachers' Pension System

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.

In general, TPS/EPS members hired before July 1, 2011, are subject to the Alternate Contributory Pension Selection (ACPS), a benefit tier within TPS/EPS. Chapter 397 of 2011 added the Reformed Contributory Pension Benefit (RCPB) as a new benefit tier to TPS/EPS. In general, an individual who becomes a member of TPS/EPS on or after July 1, 2011, is automatically enrolled in RCPB (subject to limited exceptions). **Exhibit 1** compares the benefit structures under ACPS and RCPB.

Exhibit 1
Comparison of ACPS and RCPB Benefits

	ACPS	RCPB
Vesting	5 years	10 years
Normal Retirement	30 years of service, or age 62	age plus service add to 90, or age 65
Benefit Multiplier	1.8%/year since 1998 1.2%/year before 1998	1.5%/year
Member Contribution	7.0% of pay	7.0% of pay

ACPS: Alternate Contributory Pension Selection
RCPB: Reformed Contributory Pension Benefit

Source: Department of Legislative Services

Local Employer Contributions

Chapter 1 of the first special session of 2012 required local school boards to pay the normal cost for their employees who are members of TRS/TPS, phased in over five years. The phase-in period is complete, so beginning in fiscal 2017, local school boards pay 100% of the normal cost. Beginning in fiscal 2013, Chapter 1 also requires county governments and Baltimore City to adjust their maintenance of effort payments to local school boards to compensate them for teacher pension costs. Beginning in fiscal 2017, the fiscal 2016 payments by the counties are included in subsequent years' per pupil maintenance of effort calculations. Depending on enrollment trends in each county, some local school boards may be responsible for a portion of any increase in normal cost payments between fiscal 2016 and each succeeding year.

Chapter 1 also established Teacher Retirement Supplemental Grants to provide financial support to local jurisdictions with limited capacity to pay their share of the normal cost. Under the grant program, nine local governments receive a total of $27.7 million annually in supplemental grants. In addition, Chapter 1 repealed the requirement that local school boards reimburse the State for their TRS/TPS employees paid with federal funds beginning in fiscal 2015.

"Normal contributions" (or "normal cost") is an actuarial term that is not defined in statute, but it refers to the actuarial value of pension benefits earned by an active member or group of active members in a given year. Statute defines the "normal contribution rate" as a fraction that has as its numerator the sum of all normal contributions, net of member contributions, and as its denominator, the aggregate annual earnable compensation of members of the State system.

Background: As of June 30, 2017, there were 105,765 active members of TPS, all but 8,915 of whom were employed by local governments. As of the same date, there were 74,455 active members of EPS, of whom 50,049 were State employees and the remaining members were employed by participating governmental units.

TRS was closed to new members in 1980; it currently has 537 active members, of whom 413 are employed by local governments. A reliable count of ERS members is not available as it includes members of the Correctional Officers' Retirement System. Selection C provides a bifurcated benefit that includes ERS benefits for service prior to electing EPS benefits. Very few members of TRS/ERS remain in Selection C.

The Federal Employees' Retirement System (FERS), enacted in 1986, closely resembles the IPS proposed by this bill. Besides Social Security benefits, FERS includes both a defined benefit (DB) and DC component. The DB component requires an employee contribution of approximately 6.0% and provides a 1.0% benefit multiplier for each year of service. However, FERS members who retire at or after age 62 with at least 20 years of service receive a 1.1% benefit multiplier. The DC component, titled the Thrift Savings Plan, provides a 1.0% employer contribution for all members. Employee contributions are then matched 100% for the first 3.0% of compensation, and 50% for contributions between 3.0% and 5.0% of compensation.

State Fiscal Effect: For the purposes of this analysis, the General Assembly's consulting actuary makes the following assumptions:

- Employees pay 4.0% of compensation to the Savings Plan, thereby keeping their total contribution at the current total level of 7.0% of compensation (3.0% of compensation for the DB component and 4.0% to the Savings Plan).
- The State pays the normal cost for all members of TPS, including those employed by local school boards, while local school boards, community colleges, and libraries each pay the employer match (3.5% of compensation, based on the assumption that employers match 100% of the first 3.0% and 50% of the remaining 1.0% of compensation under the 4.0% of compensation employee contribution to the Savings Plan) for their employees in the Savings Plan, as required by the bill.
- There is no change in the rate at which employees eligible for the Optional Retirement Program elect to participate in that program.

Accrued Liabilities and Normal Cost

The goal of actuarial funding of pension benefits is to pay for the benefits – into a trust fund – as they accrue so that future generations do not have to bear the burden of paying for benefits to retirees. The normal cost is an actuarial calculation that reflects the value of benefits earned in a given year, based on actuarial assumptions. In theory, payment of the normal cost into the trust fund should cover the cost of benefits accrued in that year. However, liabilities accrue when actual experience does not conform to the assumptions used to calculate the normal cost. The most common factor is when investments do not earn as much as projected, but other factors, such as actual rates of retirement, actual inflation, etc., can generate liabilities when they differ from the assumptions. Accrued liabilities are amortized, with the annual amortization payments added to the normal cost to generate an annual employer contribution (net of employee contributions). As of June 30, 2017, TPS/EPS had combined unfunded accrued liabilities of $17.6 billion.

By lowering the DB benefit multiplier from either 1.5% or 1.8% to 1.0%, the bill reduces future liabilities. Had the bill been in effect in fiscal 2017, the actuary estimates that unfunded accrued liabilities would have decreased by $2.7 billion combined for TPS/EPS.

The opposite is true for normal cost, which increases under the bill, as shown in **Exhibit 2**. Under the fiscal 2017 actuarial valuation, the employer normal cost is 4.41% of compensation for TPS and 3.83% for EPS, compared with a projected employer contribution of 9.96% for TPS and 9.14% for EPS under the bill. The higher figure includes an employer matching contribution of 3.5% for the Savings Plan; it also reflects the reduction in the employee contribution from 7.0% to 3.0% as the employer has to make up the difference in normal cost. Under current law, the State pays the full normal cost for all EPS members and for TPS members who are not employed by local school boards (including those employed by community colleges and libraries). Under the bill, the State pays the normal cost for all members of TPS, which results in an increase in its contributions for every group.

Exhibit 2
Normal Cost – Employer Contributions

	State Contributions		Local Contributions	
	Current	**The Bill**	**Current**	**The Bill**
EPS Members	3.83%	9.14%	n/a	n/a
State TPS Members	4.41%	9.96%	n/a	n/a
Local School Board TPS Members	0%	6.46%	4.47%	3.50%
Community College and Library TPS Members	4.41%	6.46%	0%	3.50%

EPS: Employees' Pension System
TPS: Teachers' Pension System

Source: Department of Legislative Services

Net Fiscal Effect

SRPS conducts annual actuarial valuations of the DB plan as of June 30 of each year. The valuation conducted as of June 30, 2018, determines contribution rates for fiscal 2020. As participation in the new DB benefit tier does not take effect until July 1, 2019, any change in the DB benefits does not get reflected until the June 30, 2019 valuation, which affects contributions for fiscal 2021. However, employer matching payments to the Savings Plan begin July 1, 2019, so the increase in those payments is reflected in fiscal 2020.

Overall, *net* employer costs increase by $356.0 million in fiscal 2020 because the cost of the additional benefits (matching payments) in the DC Savings Plan is not fully offset by a reduction in liabilities in the DB plan. However, *State* costs increase while local costs decrease based on the cost splits shown in Exhibit 2. In fiscal 2020, State costs increase by $398.6 million due to the higher normal cost contributions. Changes in State contributions are assumed to be allocated 84% general funds, 8% special funds, and 8% federal and other funds.

Local Fiscal Effect: As shown in Exhibit 2, local school boards pay less in normal cost payments due to the bill, while community colleges and libraries, which pay no employer costs under current law, pay the employer matching contributions (3.5%) under the bill.

As the savings to local school boards are considerably higher than the additional contributions by community colleges and school boards, net local contributions decrease by $42.6 million in fiscal 2020; those savings are shared among the 24 local governments and school boards.

Additional Comments: The local maintenance of effort (MOE) requirement for education funding may also be affected by the bill. Under current law, the MOE calculation reflects the required full normal cost payment by local school boards for their TPS employees. Reducing the normal cost payments for local school boards should reduce the required MOE funding level that counties are required to appropriate to their school boards; however, absent legislation specifically altering the MOE law to reflect the changes proposed in the bill, the MOE calculation is not affected.

Additional Information

Prior Introductions: SB 602 of 2017, a similar bill, receiving a hearing in the Senate Budget and Taxation Committee, but no further action was taken on the bill.

Cross File: None.

Information Source(s): Bolton Partners, Inc.; Maryland Association of Counties; Maryland State Department of Education; Maryland State Library Agency; State Retirement Agency; Department of Legislative Services

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