Joint Committee on Pensions

Senator Verna Jones-Rodwell, Senate Chair
Delegate Melony G. Griffith, House Chair

Wednesday, December 12, 2011, 2:00 p.m.
Room 120, House Office Building

Agenda

I. Call to Order and Chairs' Opening Remarks

II. Decisions

- Phillip S. Anthony, Policy Analyst, Department of Legislative Services
- R. Dean Kenderdine, Executive Director, State Retirement and Pension System
- Anne E. Gawthrop, Director of Legislative Affairs, State Retirement and Pension System

III. Chairs' Closing Remarks and Adjournment

Joint Committee on Pensions
2012 Interim Report (DRAFT)

Over the course of two meetings during the 2012 interim, the Joint Committee on Pensions addressed two pension topics and five legislative proposals requested by the Board of Trustees for the State Retirement and Pension System (SRPS).

Pension System Funding Study

During the 2011 interim, the Board of Trustees for the SRPS made a proposal to the Joint Committee on Pensions (JCP) to change the amortization of unfunded pension liabilities and to phase out the corridor funding method. The 2012 *Joint Chairmen's Report* required the Department of Legislative Services (DLS) and the State Retirement Agency (SRA) to examine the funding method, amortization of unfunded liabilities, and the actuarial assumptions of the SRPS, and to develop a plan to phase out the corridor funding methodology in light of the board's 2011 proposal and the goals of the 2011 pension reform.

Joint Study Proposal

Over the interim, DLS and SRA requested the system actuary to run projections based on the structure of the board's prior proposal and also to account for changes in the demographic assumptions adopted by the board as well as potential economic assumption changes. Under the change to the amortization, all current unfunded liabilities would be amortized over a 25-year closed period. At the end of the 25-year period, all unfunded liabilities are expected to be paid off, with the system at 100% funded status.

The corridor method would be phased out over a 10-year period. The corridor method currently requires the prior year's rate plus 20% of the difference between the prior year's rate and the actuarial rate. The first year of the 10-year phaseout would use the prior year's rate, plus 28% of the difference between the prior year's rate and the actuarial rate. After 10 years, the contribution rate would be the actuarially determined rate.

The board updated the demographic assumptions over the interim, and these are incorporated into the projections run by the actuary. The board did not make any changes to the economic assumptions but did indicate that the matter would be taken up again for the 2013 valuation. In anticipation of any potential changes to the economic assumptions, the projections assumed that for the fiscal 2015 budget, the board would have lowered the inflation assumption to 2.8% to coincide with changes made by Social Security. Additionally, the projections assume that the board would lower the investment return assumption from 7.75 to 7.55% by five basis points over a four-year period. The projections also assume that any legislative changes to phase out the corridor methodology and to change the amortization would begin in fiscal 2015, to coincide with any changes to the economic assumptions.

Board Requested Legislation

45-day Break in Service – Reemployment

Each of the several systems provides, under various provisions of the State Personnel and Pensions Article, that an individual who is receiving a normal service retirement allowance may not be reemployed within 45 days of the individual's retirement if the individual is reemployed by the same employer from which the individual retired. These provisions were added to the State Personnel and Pensions Article to protect the SRPS's tax qualified status under the Internal Revenue Code (IRC) by ensuring that there has been a bona fide break in service between employment and retirement in instances when the individual has retired prior to reaching normal retirement age. In addition, these provisions were added to protect a reemployed retiree from receiving a 10% premature distribution tax in instances when a retiree begins receiving benefits prior to age 59½. Section 72(t) of the IRC provides that in those instances, regardless of whether the individual has reached normal service retirement age, this penalty may be imposed if an individual retires prior to age 59½ and cannot show that there has been a clear separation from employment for the retiree.

Based on various cases, revenue rulings, and information letters from the Internal Revenue Service (IRS), it is unlikely that, without a significant break in service between retirement and reemployment, IRS would consider a retiree as separating from employment if there was no change in services rendered or a reduction in work schedule. In light of this interpretation of "separation from employment," tax counsel for the SRPS has advised that the more differences there are between the individual's last job before retirement and the job being performed when the person is rehired, and the longer the break between the date of retirement and date of rehire, the more likely it is that IRS will consider it a bona fide retirement. Accordingly, this will protect the SRPS's tax qualified status and the retiree from incurring a 10% premature distribution tax when there has not been a legitimate separation from employment.

Staff for SRA has encountered many situations where individuals retire from one of the several systems and without incurring any break in service, return to work within days of retirement for a different participating employer of the SRPS, performing essentially the same duties the individual was performing prior to retirement. However, because technically these individuals are not returning to work for the same employer from which they retired, SRA may not require they assume a bona fide break in service of 45 days.

The board is requesting legislation that would amend provisions in each of the several systems addressing reemployment of retirees to impose a 45-day break in service for all retirees, including disability retirees, who are reemployed by a participating employer in the SRPS. The board indicates these changes would protect the SRPS's tax qualified status and retirees from incurring a 10% premature distribution tax.

Overpayments

Section 21-113(b) of the State Personnel and Pensions Article provides that the Board of Trustees of the SRPS may recover the amount of any improper payment. This provision further provides the process the board is required to follow in order to recover any overpayment. Specifically, § 21-113(b)(2)(ii) provides that "the Board of Trustees may adjust any future monthly payments of that person's allowance to recover the amount owed."

SRA recently encountered a situation where, following the death of a retiree, the agency discovered that prior to the retiree's death, the retiree had received improper payments from the SRPS in excess of what he was entitled. In accordance with § 21-113(b) and in following its past practice, SRA attempted to recover the overpayment from the benefits paid to the deceased retiree's beneficiary. However, in this instance, the designated beneficiary's attorney argued that under § 21-113(b)(2)(ii), SRA may only offset the retiree's benefit, not the beneficiary's benefit.

The board is requesting that § 21-113(b) be amended to allow the board to recover from the survivor benefit paid to a designated beneficiary of a deceased retiree, any improper payments made to that retiree but not discovered until after the retiree was deceased.

In addition, the board is also requesting that § 21-113(a) be clarified that the board is required to correct any error that results in a retiree or beneficiary receiving a benefit that differs from the benefit to which they are entitled. Presently, § 21-113(a) states that the board may only correct an error in the records of the several systems.

Draft Committee Recommendation:

Option A: The joint committee will sponsor the requested legislation.

Option B: The joint committee will not sponsor this requested legislation.

Unused Sick Leave Calculation

Section 20-206 of the State Personnel and Pensions Article provides that at the time of retirement, a member may receive creditable service for unused sick leave. This section further states that a member may not earn more than 15 days of sick leave per year as an active employee with a participating employer and that if a participating employer provides more than 15 days of sick leave per year, the board shall reduce the member's accumulated sick leave by the lesser of:

- the days of sick leave used by the member in that year; or
- the number of days of sick leave provided by the participating employer for that year, less 15 days.

Participating employers that provide more than 15 days of sick leave per year are generally the local boards of education. However, because these employers only report total cumulative sick leave to SRA, SRA indicates it is not possible to perform the calculation provided under § 20-206(e)(3)(iii). Instead, SRA determines based on the total number of years of service the member has earned, what the maximum amount of service credit the member could have received at a rate of 15 days per year. Based on this number, SRA then determines that amount of creditable service to which the member is entitled.

Because the current calculation required under § 20-206(e)(3)(iii) is not possible for the agency to perform, to avoid confusion for members who are employed by participating employers who provide more than 15 days of sick leave per year, the board is requesting legislation to amend this subparagraph to clarify the calculation that SRA actually performs. The board indicates there is no cost associated with this proposal because it will codify existing agency practice.

Draft Committee Recommendation:

Option A: The joint committee will sponsor the requested legislation.

Option B: The joint committee will not sponsor this requested legislation.

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Bill No.: ____________________ Drafted by: Anthony

Requested: ____________________

Committee: ____________________

By: **Leave Blank**

A BILL ENTITLED

AN ACT concerning

State Retirement and Pension System – Funding Method and Amortization of Unfunded Liabilities or Surpluses

FOR the purpose of altering the amortization periods to be used for certain unfunded liabilities or surpluses of the State Retirement and Pension System; phasing out a certain method for determining certain employer contribution rates for the employees' and teachers' retirement and pension systems; and generally relating to the funding of the State Retirement and Pension System.

BY repealing and reenacting, with amendments,
Article – State Personnel and Pensions
Section 21-304(d), (e), and (f)
Annotated Code of Maryland
(2009 Replacement Volume and 2012 Supplement)

SECTION 1. BE IT ENACTED BY THE GENERAL ASSEMBLY OF MARYLAND, That the Laws of Maryland read as follows:

Article – State Personnel and Pensions

21–304.

(d) [(1)] Beginning July 1, [2001] **2013**, each year the Board of Trustees shall set contribution rates for each State system that shall amortize:

EXPLANATION: CAPITALS INDICATE MATTER ADDED TO EXISTING LAW.
[Brackets] indicate matter deleted from existing law.

funding ratio for the employees' systems is below 90%,] the employees' system contribution rate shall be the sum of:

(i) the employees' system contribution rate for the previous fiscal year; and

(ii) 1. 20% of the difference between the full funding rate for the current fiscal year and the employees' system contribution rate for the previous fiscal year; or

2. for a fiscal year for which an adjustment to normal cost or accrued liabilities for a new legislative change is first determined as a result of an actuarial valuation under § 21–125(b) of this title, 20% of the difference between the preliminary funding rate for the current fiscal year and the employees' system contribution rate for the previous fiscal year.

[(3) Subject to paragraph (4) of this subsection, when the funding ratio for the employees' systems is above 110%, the employees' system contribution rate shall be the difference between:

(i) the employees' system contribution rate for the previous fiscal year; and

(ii) 1. 20% of the difference between the employees' system contribution rate for the previous fiscal year and the full funding rate for the current fiscal year; or

2. for a fiscal year for which an adjustment to normal cost or accrued liabilities for a new legislative change is first determined as a result of an actuarial valuation under § 21–125(b) of this title, 20% of the difference between the employees' system contribution rate for the previous fiscal year and the preliminary funding rate for the current fiscal year.]

[(4)] **(2)** For a fiscal year for which an adjustment to normal cost or accrued liabilities for a new legislative change is determined as a result of an actuarial valuation under § 21–125(b) of this title, the contribution rate for the employees' systems under paragraph [(2) or (3)] **(1)** of this subsection shall be adjusted to fully reflect the cost or savings of the new legislative changes that result in changes in normal contributions or accrued liabilities and to amortize over [25 years] **THE TIME REMAINING UNTIL JUNE 30, 2038,** any changes in accrued liabilities of the employees' systems.

(ii) 1. 20% of the difference between the full funding rate for the current fiscal year and the teachers' system contribution rate for the previous fiscal year; or

2. for a fiscal year for which an adjustment to normal cost or accrued liabilities for a new legislative change is first determined as a result of an actuarial valuation under § 21–125(b) of this title, 20% of the difference between the preliminary funding rate for the current fiscal year and the teachers' system contribution rate for the previous fiscal year.

[(3) Subject to paragraph (4) of this subsection, when the funding ratio for the teachers' systems is above 110%, the teachers' system contribution rate shall be the difference between:

(i) the teachers' system contribution rate for the previous fiscal year; and

(ii) 1. 20% of the difference between the teachers' system contribution rate for the previous fiscal year and the full funding rate for the current fiscal year; or

2. for a fiscal year for which an adjustment to normal cost or accrued liabilities for a new legislative change is first determined as a result of an actuarial valuation under § 21–125(b) of this title, 20% of the difference between the teachers' system contribution rate for the previous fiscal year and the preliminary funding rate for the current fiscal year.]

[(4)] **(2)** For a fiscal year for which an adjustment to normal cost or accrued liabilities for a new legislative change is determined as a result of an actuarial valuation under § 21–125(b) of this title, the contribution rate for the teachers' systems under paragraph [(2) or (3)] **(1)** of this subsection shall be adjusted to fully reflect the cost or savings of the new legislative changes that result in changes in normal contributions or accrued liabilities and to amortize over [25 years] **THE TIME REMAINING UNTIL JUNE 30, 2038,** any changes in accrued liabilities of the teachers' systems.

(3) THE PERCENTAGES USED IN PARAGRAPH (1)(II) OF THIS SUBSECTION SHALL BE:

(I) 28% FOR THE RATE FOR FISCAL YEAR 2015;

(II) 36% FOR THE RATE FOR FISCAL YEAR 2016;