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ISSUE REVIEW

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IPERS Retirement Dividend Payments

ISSUE

The Iowa Public Employees' Retirement System (IPERS) does not apply a traditional cost-of-living adjustment to retirement benefits. A retiree's monthly benefit payment is determined by formula at the time of retirement and the amount does not change. Instead of adjusting the monthly benefit for inflation, the General Assembly created two separate once-a-year payments for retirees: the November Dividend (for pre-1990 retirees) and the Favorable Experience Dividend (FED) for 1990 and later retirees. Available funding for the FED is estimated to be depleted within the next three years.

AFFECTED AGENCIES

IPERS

CODE AUTHORITY

Iowa Code Chapter 97B

Iowa Administrative Rules Chapter 495

BACKGROUND

The creation of the November Dividend and the FED were efforts by the General Assembly to move away from the practice of periodically identifying a group of retirees and creating an ad hoc cost-of-living adjustment to alleviate the effects of inflation. Four groups were approved by the General Assembly for ad hoc dividend payments and eventually became a part of the November Dividend group. These include persons that retired:

- Between July 1953 and December 1975.
- Between January 1976 and June 1982.
- Between July 1982 and June 1986.
- Between July 1986 and June 1990.

Cost-of-Living Dividend (November Dividend)

The November Dividend was a replacement program for the pre-1990 ad hoc dividend payment program. The November Dividend was first paid in November 1997 (FY 1998) and is a guaranteed yearly payment for life. Each year, the cost-of-living dividend is funded from the IPERS Trust Fund and based on a statutory formula that applies a multiplier to a base payment. Each year's base payment equals the previous year's amount. IPERS pays the dividend at the same time as the regular monthly benefit in November.

IPERS does not have discretion over the base dividend payment. The base is guaranteed by statute and is factored into the actuarial valuation.[1] However, the statute does not require increases. The IPERS' actuary must certify the System can afford an increase, not to exceed 3.0%, without causing an increase in contribution rates. If the actuary determines in a particular year that a dividend increase is not affordable, the retiree will still receive the same November dividend amount as received in the previous year. The dollar amount of an individual retiree's November dividend payment has been the same since FY 2002 (November 2001). The median payment for each year from FY 2002 through FY 2012 has ranged from a low of $647 to a high of $664. It has been very stable over the years and only fluctuates because of retiree deaths.

Favorable Experience Dividend (FED or January Dividend)

The General Assembly provided for the FED payment by creating a FED Reserve Account within the IPERS Trust Fund in July 1998. Money was transferred from the IPERS Trust Fund to the Reserve Account for the purposes of creating an annual payment to IPERS members that retired on or after July 1, 1990, and were retired for at least one year. Beneficiaries that have received a monthly death benefit allowance for at least one year are also eligible. The first payments were issued January 1, 1999.

In 1998, the General Assembly passed legislation (HF 2496, Public Retirement Systems Act) authorizing a transfer of funds during FY 1999 from the IPERS Trust Fund to the FED Reserve Account to be used as "seed money." The actuary determined $229.0 million should be transferred. This represented an estimated five years of dividend payments. In FY 2000 and again in FY 2001, there was a favorable actuarial experience so additional funds were transferred into the FED Reserve Account. There has not been a favorable earning experience as defined in Iowa Code Section 97B.49F(2), since that time, so no additional transfers have been made. Due to the cessation of transfers, the recent market conditions, and an increasing number of FED payments, the Reserve Account will support between two and three more years of dividend payments (January 2012, 2013, and possibly 2014). **Table One** below shows the funding and payment history and the estimated year-end balance of the Reserve Account.

Table One

January FED Reserve Account

Fiscal Year	FED Transfer	FED Payments	Net Investment Income	Fiscal Year-End Balance
1999	$ 229,000,000	$ (12,152,683)	$ 29,523,325	$ 246,370,642
2000	264,908,935	(18,797,522)	38,522,151	531,004,206
2001	108,440,545	(46,219,145)	(22,197,795)	571,027,811
2002		(57,890,007)	(26,518,247)	486,619,557
2003		(25,570,783)	26,210,587	487,259,361
2004		(31,067,817)	67,497,454	523,688,998
2005		(37,178,186)	56,650,354	543,161,166
2006		(43,988,077)	58,021,055	557,194,144
2007		(51,378,132)	86,964,919	592,780,931
2008		(59,512,875)	(8,301,373)	524,966,683
2009		(68,463,353)	(85,779,297)	370,724,033
2010		(78,080,966)	46,466,138	339,109,205
* 2011		(88,557,286)	63,794,588	314,346,507
* 2012		(99,263,800)	23,128,956	238,211,663
	$ 602,349,480	$ (718,120,632)	$ 353,982,815	

* estimates

[1] Iowa Code Sections 97B.49F(1) and 97B.49G(5)

By law, the money in the Reserve Account cannot be used for any purpose other than FED payments. The FED payments are made at the same time as the regular monthly benefit in January. The FED amount is calculated by multiplying a retiree's December benefit by 12, by the number of years retired, and by a percentage multiplier (as determined by IPERS), not to exceed 3.0%. The percentage multiplier has been frozen at 1.07% since FY 2003.

Example:

Monthly IPERS Benefit For December	Mulitipled By 12	Percentage Multiplier	Number Of Calendar Years Retired	Equals The FED Payment Amount
$625	x 12	x 1.07%	x 5	= $401.25

Despite the name, the FED is not tied directly to annual investment performance. In order to transfer funds into the Reserve Account, there has to be a favorable actuarial experience and the retirement system has to remain 100.0% fully funded. The Reserve Account is invested with the Trust Fund, and investment gains and losses are applied to the account balance. The FED payments are not included in the actuarial liabilities because it is not a statutorily guaranteed payment. Statute does not require IPERS to transfer additional funds to the FED; rather it allows IPERS to determine the dollar amount of the FED payments based on several criteria including prior payments, the current and projected Reserve Account balance, and the number of individuals eligible for a dividend payment.

The Benefits Advisory Committee makes recommendations to the IPERS System and the General Assembly concerning benefits and services to members of the retirement system. Membership of the group includes representatives of employers, active members, and retired members. The Benefits Advisory Committee voted at the August 1, 2011 meeting to maintain the multiplier at 1.07% for the January 2012 (FY 2012) payments.

CURRENT SITUATION

Cost-of-Living Dividend (November Dividend)

The number of November dividends paid each year has decreased as members of this group have passed away. In 1999, there were 33,414 recipients totaling approximately $14.1 million. For 2010, there were 14,496 recipients totaling $11.4 million. This is a decrease of 18,918 payments made to recipients (56.6%) and $2.7 million (19.0%). For FY 2012, an estimated 11,647 recipients will receive approximately $9.1 million. The median payment for the November dividend is $652. The average age of the November dividend recipient is 88. There are currently 121 retirees that have reached 100 years of age. **Table Two** shows the payment and recipient history since FY 1999.

Favorable Experience Dividend (FED or January Dividend)

The total amount of the FED payments continues to increase as more baby boomers retire with increased wages and longer years of service and people continue to live longer in retirement. In FY 1999, IPERS made 26,993 FED payments totaling approximately $12.2 million. In 2010, there were 72,707 FED payments totaling approximately $78.1 million. This is an increase of 45,714 payments to recipients (169.4%) and an increase in payments of $65.9 million (542.5%). For 2012, the estimated number of recipients is 84,255 at a cost of $99.3 million. The median amount for the FED is $761. The average age of the recipient is 70. Because of early-retirement incentive programs offered by the State and many other IPERS-covered employers (cities, counties, and schools) in 2010, approximately 8,000 retirees will receive their first FED payment in January 2012. **Table Two** shows the payment and recipient history since FY 1999.

Table Two

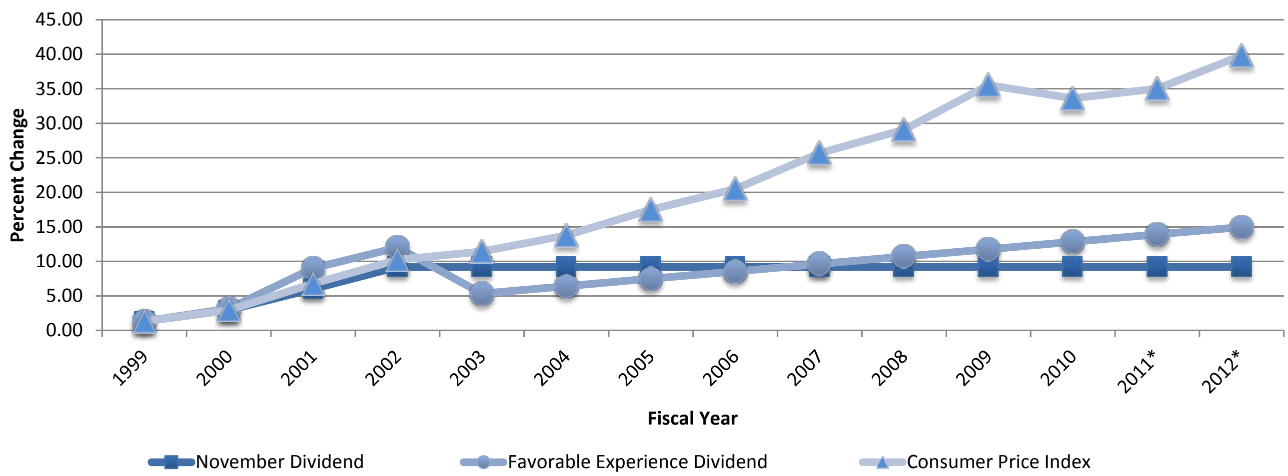
November Dividend and FED Payment History

Paid In Fiscal Year	November Dividend	Number of Recipients	Median Payment Amount	Percent Multiplier	FED	Number of Recipients	Median Payment Amount	Percent Multiplier	Actual Consumer Price Index
1999	$ 14,086,374	33,414	$ 327	1.33	$ 12,152,683	26,993	$ 317	1.33	1.33
2000	15,451,127	31,462	391	1.59	18,797,522	29,590	425	1.59	1.59
2001	19,010,893	29,644	524	3.00	46,219,145	35,152	915	3.00	3.73
2002	22,282,087	27,861	664	3.00	57,890,007	39,445	1,014	3.00	3.25
2003	20,835,973	26,106	662	0.00	25,570,783	44,619	392	1.07	1.07
2004	19,300,657	24,262	658	0.00	31,067,817	48,347	445	1.07	2.11
2005	17,911,022	22,554	657	0.00	37,178,186	52,712	491	1.07	3.27
2006	16,542,558	20,870	655	0.00	43,988,077	56,509	537	1.07	2.53
2007	15,231,083	19,227	654	0.00	51,378,132	60,329	588	1.07	4.32
2008	13,937,278	17,604	653	0.00	59,512,875	64,518	619	1.07	2.69
2009	12,613,373	15,982	651	0.00	68,463,353	68,797	674	1.07	5.02
2010	11,407,690	14,496	650	0.00	78,080,966	72,707	729	1.07	-1.43
2011*	10,265,166	13,098	647	0.00	88,557,286	76,872	782	1.07	1.05
2012*	9,131,338	11,647	652	0.00	99,263,800	84,255	761	1.07	3.56

*FY 2011 and FY 2012 numbers are estimates.
Note: The November dividend was first paid in November 1997 (FY 1998) to 34,215 retirees; however, the FY 1998 CAFR did not separately report the dividend payment from the benefits paid that year.
Consumer Price Index - All Urban Consumers

Chart 1 below compares the Consumer Price Index (CPI) to the November Dividend and Favorable Experience Dividend illustrating the percentage change in annual payments for a hypothetical retiree under the specified plans from 1998 through estimated 2012. The chart demonstrates the compounding nature of the CPI compared to the non-compounding nature of the two dividend programs.

Chart 1



* Years 2011 and 2012 are estimates.

The November Dividend is determined by adding to the dividend paid in the preceding year an additional dividend amount based on a percentage tied to inflation.

The FED amount is calculated by multiplying a retiree's annual benefit, by the number of years retired, and by a percentage multiplier (as determined by IPERS), not to exceed 3.0%. The example is based a person who retired in 1998.

In the example, the Consumer Price Index (CPI) reflects the impact of inflation on the purchasing power of a 1998 dollar.

BUDGET IMPACT

Cost-of-Living Dividend (November Dividend)

The statutorily required contribution rate for FY 2012 is 13.45%. This is less than the actuarially required contribution rate of 13.71%, based on the June 30, 2010, actuarial valuation. There will be no adjustment made for the November 2011 dividend. The November 2011 payment is estimated to be $9.1 million and will be distributed to an estimated 11,647 retirees. The IPERS' actuary must certify the Fund can absorb an increase in dividend payments without requiring an increase in the employer and employee contributions. Due to IPERS ability to adjust the contribution rate up or down by one percentage point, there is a chance, in the future, that the statutory contribution rate will be equal to the actuarially determined rate and, at that time, the IPERS' actuary may certify an increase in the multiplier rate.

Favorable Experience Dividend (January Dividend)

As of June 30, 2010, IPERS was 81.4% funded. The value of the Reserve Account as of June 30, 2010, was $339.1 million. The January 2012 payment is estimated to be $99.3 million and will be distributed to 84,255 retirees. Based on the funds currently available in the Reserve Account, IPERS estimates sufficient funds remain to make payments for two additional years (January 2013 and January 2014). Additional transfers to the Reserve Account before it is depleted are highly unlikely since the Trust Fund must be fully funded before a transfer is allowed. IPERS does not anticipate becoming fully funded by January 2014.

ALTERNATIVES

Cost-of-Living Dividend (November Dividend)

The November dividend is paid to retirees (or their beneficiaries) that retired before July 1, 1990. The number of recipients is a fixed group of people that continue to decrease due to deaths and will eventually end, so no alternatives are recommended at this time.

Favorable Experience Dividend (January Dividend)

The January dividend payment applies to retirees (or their beneficiaries) that retired after July 1, 1990. It is a growing group.

In 2007, the Benefits Advisory Committee requested four FED cost studies to consider ways to extend the expected number of years the FED could make payments. Since 2007 when these studies were completed, the number of retirees receiving FED payments has increased and the funds in the Reserve Account are less than half the value in 2007. The following four items were suggested by the studies:

- Reduce the FED percentage rate from 1.07% to 0.82% for 2012 and later. At the time the study was done, this option extended the FED payments to 2017.
- Impose a minimum age for eligibility for FED payments. The proposal was to impose a minimum age of 65 for eligibility. At the time the study was done, this option extended the FED payments to 2022.
- Add an age reduction penalty to the formula for all retirees that begin benefits prior to age 65. The penalty was 0.25% for each month that benefits prior to age 65 were received regardless of whether the person retired under the Rule of 88, 62 and 20 years of service, or from the Special Services groups. At the time the study was done, this option extended the FED payments to 2017.

- Provides a different multiplier for the first nine years of receipt of the FED. The first year of the payment would be based on a multiplier of 0.1%. Each year thereafter, the multiplier would increase by 0.1%, until the tenth year when the retiree would receive a 1.07% multiplier (equal to the current multiplier percent). At the time the study was done, this option extended the FED payments to 2017.

The General Assembly may wish to consider the following options:

- Maintain current law. Under current law, once the funds in the Reserve Account are exhausted, the dividend payment ceases.
- Modify the current FED payment to delay the depletion of the fund.
- Create an ongoing funding mechanism to provide a cost-of-living adjustment for those that retired after July 1, 1990.

Other States

In retirement plans, ad hoc cost-of-living adjustments (COLA) require the approval of the plan sponsor whereas automatic cost-of-living adjustments are based on a fixed annual rate or on the consumer price index, which is generally capped at 3.0%. The National Association of State Retirement Administrators and the National Council on Teacher Retirement recently completed a Public Fund Survey of approximately 119 large public pension systems. The retirement systems surveyed differed in how plans funded COLAs. Of the systems surveyed, approximately 45 based their increases on the Consumer Price Index (which is often capped at 3.0%), 27 used ad hoc plans approved by the plan sponsor, and an additional 32 used an automatic fixed rate (often at 3.0%). Of the remaining plans surveyed, 15 based a COLA solely on investment returns, partially based on investment returns, or another approach.

The following chart shows a comparison of postretirement increase provisions for public employment retirement systems in States surrounding Iowa.

State	Post-Retirement Increase Provisions
Illinois State	In 2010, passed legislation stating the COLA will become available one year after the beneficiary begins receiving benefits or age 67, whichever is later. The COLA was lowered from a fixed 3.0% rate to the lesser of 3.0% or one-half of the CPI, but not less than zero.
Iowa IPERS (Regular Members)	Nonguaranteed postretirement payment from a Reserve Account established from excess investment earnings.
Kansas PERS	Ad hoc as approved by legislature; automatic 2.0% beginning at age 65 or the 2nd July 1 after retirement date, for those hired after 6/30/09.
Minnesota PERF	1.0% until the plan funding reaches 90.0% on a market basis; 2.5% thereafter.
Minnesota State	Based on investment performance; COLAs include a cost of living component and an investment component.
Minnesota Teachers	Per legislation approved in 2010, no COLA thru 2012; automatic 2.0% thereafter.
Missouri State	80% of Consumer Price Index (CPI) up to 5% compounded; members hired before 8/28/97 receive a minimum of 4.0% and a maximum of 5.0% compounded, up to 65.0% of the original benefit.
Missouri Local Government	Contingent upon investment return; max the lower of 4.0% or cumulative CPI since retirement.
North Dakota PERS	Ad hoc as approved by legislature.
North Dakota Teachers	Ad hoc as approved by legislature.
Nebraska Schools	Based on CPI, up to 2.5%; compounded.
South Dakota PERS	In 2010, passed legislation linking the COLA to the System's funded ratio based on the market value of assets. If the South Dakota Retirement System (SDRS) funded status is 100.0% or more: 3.1% COLA; if SDRS funded status is 90.0% - 99.9% COLA is 2.8%; if SDRS funded status is 80-89.9% COLA is 2.4%; of SDRS funded status is below 80.0%, the COLA is 2.1%.
Wisconsin Retirement System	Based on investment returns. Have to be higher than 5.0% for a dividend to occur and investment returns are smoothed over a five-year period.

Retirement factor is a multiplier used in the formula that determines the amount of a retiree's pension.
Formulas also include salary and years of service.
CPI = Consumer Price Index
COLA = Cost of Living Adjustment
PERF = Public Employee Retirement Fund
Source: Public Funds Survey, National Association of State Retirement Administrators and National Council on Teachers Retirement

According to the most recent National Center for State Legislatures (NCSL) report dated September 30, 2011, (http://www.ncsl.org/default.aspx?tabid=22763) eleven states made changes in 2011 to their post-retirement benefit increases or cost-of-living adjustments.

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