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MEMORANDUM

To: Members of the Public Retirement Systems Committee
From: Jennifer Acton
Date: January 12, 2010
Re: Fiscal Impact of Public Retirement Systems Recommendations

The following is a summary of the fiscal impact of each of the recommendations to the Public Retirement Systems.

Peace Officers Retirement System (PORS)

Recommendation: Overtime pay counted as wages for retirement benefit purposes beginning July 1, 2010.

Background

Under current law, overtime is not included as covered wages for PORS. In FY 2009, the Department of Public Safety paid approximately $1.9 million in overtime. In FY 2008, the Department paid approximately $2.3 million in overtime. A supervisor assigns overtime hours to be worked. The time earned can be paid within the same time period (overtime) or at a later date (compensatory time). Pursuant to the collective bargaining agreement, compensatory time is paid quarterly except for the State Patrol which, if insufficient funds are available to pay compensatory time, the employee may be required to take time off for any accumulated compensatory time exceeding 24 hours. Fire Inspectors are allowed to carry up to 240 hours of overtime.

Assumptions

1. The PORS actuary looked at this proposal two ways: 1) current behavior and 2) behavior resulting in spiking.
2. Spiking could occur in two ways: favoritism in the assignment of overtime and banking of hours that are cashed as a person nears retirement.
3. As calculated by the PORS actuary, the addition of overtime pay with no spiking to the wages of the active membership is estimated to increase the contribution rate and dollars as follows:
   - 0.29% increase in the contribution rate.
   - $1.1 million estimated increase in the contribution amount.
4. As calculated by the PORS actuary, an assumption that spiking of wages would occur for the active membership is estimated to increase the contribution rate and dollars as follows:

- 5.05% increase in the contribution rate.
- $2.1 million estimated increase in the contribution amount.

5. If the current behavior of members was to change and spiking was to occur, the increase could cost the System a total of approximately $3.2 million and a total increase in the contribution rate of 5.34%.

Fiscal Impact

Overtime Pay Included as Wages Beginning July 1, 2010

	Current Valuation (7/1/09)	Inclusion of Overtime
Covered Payroll	$41.9 million	$44.0 million
Total Contribution Rate	44.53%	44.82%
Annual Contribution Dollars	$18.6 million	$19.7 million
Change in Annual Contribution Amount		$1.1 million

Notes:
The PORS actuary noted that if current behavior of the members changes and spiking occurs, it could cost the System an additional $2.1 million.

Recommendation: Increase the employee contribution rate by 0.5% each year for four years beginning July 1, 2010.

Assumptions

1. As of July 1, 2009, there were 662 active members in the PORS and 538 retired members and beneficiaries.
2. For FY 2010, the contribution rate is 21.00% for the employer and 9.35% for the employee.
3. Under current law, the employer's contribution rate for the PORS is as follows:
   - FY 2011 – 23.0%
   - FY 2012 – 25.0%
   - FY 2013 – 27.0% or the normal contribution rate, whichever is less, for each year on or after July 1, 2012.
4. For FY 2010, the employer/employee contribution split is 69.19% employer and 30.81% employee.

Fiscal Impact

The increase in the employee contribution rate by 0.5% for four years beginning July 1, 2010, is an estimated increase in contributions of $210,000 per year for a total of $840,000 by FY 2014.

0.5% Employee Contribution Rate Increase

Fiscal Year	Contribution Rate	Increase
2010	9.35%	$ 0
2011	9.85%	$ 210,000
2012	10.35%	$ 420,000
2013	10.85%	$ 630,000
2014	11.35%	$ 840,000

The impact on an individual, not including any wage increases, will cost approximately an additional $1,300 a year by FY 2014. The employer/employee split in FY 2014 will be 70.40% employer/29.60% employee.

Iowa Public Employees' Retirement System (IPERS)

Recommendation: Increase the vesting requirement from four years to seven years. Calculate retirement benefits using a member's high five years of salary instead of the current three years. Implement a 6.0% per year reduction in retirement benefits for each year a member retires and receives a retirement allowance prior to normal retirement.[1] These changes take effect July 1, 2012.

Background

Currently members vest at four years of completed service or at age 55 if active (making contributions to the plan). A vested member, meeting retirement eligibility requirements, is entitled to a lifetime retirement benefit based on a formula. Vested members also may purchase service credits. Vested members that leave IPERS covered employment and take a refund receive a portion of the employer's contributions made on their behalf plus interest. A member is always entitled to 100.0% of their own contributions and interest earnings.

The Committee recommendation maintains a spiking control included in current law by adjusting it for the change to a five-year final average salary. Spiking occurs when wages are inflated and, as a result, the retirement benefit increases beyond what it would have been if wages increased incrementally as expected. The spiking control works by comparing the average wage with the wages for next highest year that is outside the average. Currently, the final average wage is compared to 121.0% of the fourth highest year's wages. The recommended change compares the final average wage to 134.0% of the sixth highest year. The benefit calculation uses whichever figure is lower. This continues to allow a wage increase of 10.0% a year.

Current law reduces the benefits of anyone that retires before meeting one of the normal retirement eligibility requirements by 3.0% a year. The current 3.0% a year reduction is figured from the nearest normal retirement eligibility. The recommendation proposes a reduction in benefits of 6.0% per year for a member that retires before

[1] Normal retirement requirements are a) age 65 b) age and years of service total 88 or c) at least age 62 with at least 20 years of service.

meeting one of the normal retirement eligibility requirements. The reduction is applied from age 65.

<u>Assumptions</u>

1. Benefit changes apply only to regular class IPERS members. Regular members include most IPERS members, but do not include sheriffs, deputies, and employees in protection occupations such as correctional officers, town police and firefighters, jailers, emergency medical service providers, and others.
2. Benefit changes are effective July 1, 2012, and are based on a June 30, 2012 estimated valuation using a current valuation model.
3. All actuarial assumptions adopted by the IPERS investment board also apply, such as longevity, the percentage retiring at various ages, and salary increases for active members.
4. A 6.0% adjustment for early retirement reflects the actuarial cost to the system.

<u>Fiscal Impact</u>

1. The changes:
   - (a) Reduces the present value of future benefits by $1.2 billion.
   - (b) Reduces the normal cost rate by 90 basis points or 0.9%. The normal cost rate funds the increase in the present value of benefits that have accrued for service during a year.
   - (c) Reduces the unfunded actuarial liability (UAL) by $750.0 million. The UAL is the difference between the actuarial liability, that portion of the present value of future benefits that will not be paid by future normal costs, and the actuarial value of assets at the same date.
2. IPERS cannot provide cost savings for each benefit variable individually as the variables interact with each other and were estimated as a package.

Recommendation: Extend the bona fide retirement exception for licensed health care professionals for two years.

<u>Background</u>

Federal tax law requires qualified retirement plans to have a bona fide retirement period, a set time period when retirees demonstrate they ended employment and are entitled to retirement benefits. The standard bona fide retirement period for IPERS is four months. For the first month, a retiree must not work for an IPERS-covered employer, regardless if the job is IPERS-covered. A retiree also must stay out of an IPERS-covered job for an additional three months.

Current law allows licensed health care professionals to retire with IPERS benefits and return to work in one month. The exception sunsets June 30, 2010. This recommendation extends the exception.

Assumptions

1. A shortened bona fide retirement period may encourage earlier retirements by making it easier for retirees to return to work.
2. Funding is affected when older members re-enter the system compared to younger members with more years to contribute before retirement.
3. The IPERS actuary must complete an experience study of employment and retirement behaviors to determine impact. The study will compare what licensed health care professionals did to the actuarial assumptions of expected behavior.

Fiscal Impact

1. Of the 14,748 active IPERS members employed by public hospitals, 7,245 are licensed health care professionals (5,348 active and 1,897 inactive). Of the active members, 1,406 are age 55 or older.
2. Based on a study period from July 1, 2004, through June 30, 2009, of the 491 licensed health care professionals that retired, 117 (23.8%) returned to work.
    a. Of the 117 retirees that returned to work, 84 (71.8%) did so in less than four months.
    b. Of the 84 that returned to work in less than four months, the median age at retirement was 60 with a median final average salary before retirement of $46,732 and a median annual retirement benefit of $24,447.
3. The IPERS actuary conducts an experience study every four years. The next study will be completed in the summer of 2010. IPERS actuary will examine the shortened bona fide retirement period for licensed health care professionals.

Recommendation: Create a bona fide retirement exception for members called to State active duty with the National Guard with a retroactive effective date of May 25, 2008.

Assumptions

To date there have been no known bona fide retirement violations as a result of the National Guard calling up members for State Active Duty.

Fiscal Impact

The fiscal impact for the bona fide retirement exception for members called to State Active Duty with the National Guard is anticipated to be minimal.

Recommendation: Increase the total contribution rate to 13.45% beginning July 1, 2011, and allow the system to adjust the rate up or down by no more than one percentage point per year.

Background

Under current law, the contribution rate will increase to 11.95% on July 1, 2011, and the maximum annual change is limited to 0.5 percentage point.

Assumptions

1. The contribution rate of 13.45% applies only to regular IPERS members. Regular members include most IPERS members, but do not include sheriffs, deputies, and employees in protection occupations such as correctional officers, town police and firefighters, jailers, emergency medical service providers, and others.
2. The FY 2011 contribution rate for regular membership is set at 11.45%. Under current law, the FY 2012 contribution rate for regular members effective July 1, 2011, would increase 0.5 % to 11.95%, shared between employer and employee as follows:

Employer	7.25%
Employee	4.70%
Total	11.95%

3. The percentage point limit on the annual contribution rate changes would increase from 0.5% to 1.0% and apply to all IPERS membership classes.
4. All active member counts are based on FY 2009 actuarial data and include all members active anytime during the year.
5. The expected FY 2010 total wages are from the FY 2009 IPERS valuation report completed by Milliman (the IPERS actuarial firm). Fiscal year 2011 through FY 2016 total wages are compounded by 4.0% annually per actuarial assumptions.

Fiscal Impact

Comparison of 11.95% and 13.45% Rate for FY 2012

EMPLOYER TYPE	ACTIVE MEMBER	TOTAL WAGES	MEMBER CONTRIBUTION 4.70%	EMPLOYER CONTRIBUTION 7.25%	COMBINED RATE 11.95%
STATE	21,108	$1,259,627,970	$ 59,202,515	$ 91,323,028	$150,525,542
BOARD OF REGENTS	2,179	55,065,704	2,588,088	3,992,264	6,580,352
COUNTY	23,272	956,766,600	44,968,030	69,365,579	114,333,609
CITY	23,002	874,168,045	41,085,898	63,377,183	104,463,081
SCHOOL	87,734	3,386,540,773	159,167,416	245,524,206	404,691,622
COMM. COLLEGE	3,409	158,313,898	7,440,753	11,477,758	18,918,511
OTHER	5,535	192,729,963	9,058,308	13,972,922	23,031,231
	166,239	$6,883,212,953	$ 323,511,009	$ 499,032,939	$822,543,948
Member Averages		$ 41,406	$ 1,946	$ 3,002	$ 4,948

EMPLOYER TYPE	ACTIVE MEMBER	TOTAL WAGES	MEMBER CONTRIBUTION 5.30%	EMPLOYER CONTRIBUTION 8.15%	COMBINED RATE 13.45%
STATE	21,108	$1,259,627,970	$ 66,760,282	$ 102,659,680	$169,419,962
BOARD OF REGENTS	2,179	55,065,704	2,918,482	4,487,855	7,406,337
COUNTY	23,272	956,766,600	50,708,630	77,976,478	128,685,108
CITY	23,002	874,168,045	46,330,906	71,244,696	117,575,602
SCHOOL	87,734	3,386,540,773	179,486,661	276,003,073	455,489,734
COMM. COLLEGE	3,409	158,313,898	8,390,637	12,902,583	21,293,219
OTHER	5,535	192,729,963	10,214,688	15,707,492	25,922,180
	166,239	$6,883,212,953	$ 364,810,286	$ 560,981,856	$925,792,142
Member Averages			$ 2,194	$ 3,375	$ 5,569

EMPLOYER TYPE	ACTIVE MEMBER	TOTAL WAGES	DIFFERENCE BETWEEN 11.95% AND 13.45%
STATE	21,108	$1,259,627,970	$ 18,894,420
BOARD OF REGENTS	2,179	55,065,704	825,986
COUNTY	23,272	956,766,600	14,351,499
CITY	23,002	874,168,045	13,112,521
SCHOOL	87,734	3,386,540,773	50,798,112
COMM. COLLEGE	3,409	158,313,898	2,374,708
OTHER	5,535	192,729,963	2,890,949
	166,239	$6,883,212,953	$ 103,248,194

Note - OTHER employer type includes municipal utilities, 28E organizations, Area Education Agencies, and miscellaneous small local entities.

One Percentage Point Increase Per Year

	EMPLOYER TYPE	ACTIVE MEMBER	TOTAL WAGES	MEMBER CONTRIBUTION 5.70%	EMPLOYER CONTRIBUTION 8.75%	COMBINED RATE 14.45%
FY2013	STATE	21,108	$ 1,310,013,089	$ 74,670,746	$ 114,626,145	$ 189,296,891
FY2013	BOARD OF REGENTS	2,179	57,268,332	3,264,295	5,010,979	8,275,274
FY2013	COUNTY	23,272	995,037,264	56,717,124	87,065,761	143,782,885
FY2013	CITY	23,002	909,134,767	51,820,682	79,549,292	131,369,974
FY2013	SCHOOL	87,734	3,522,002,404	200,754,137	308,175,210	508,929,347
FY2013	COMM. COLLEGE	3,409	164,646,454	9,384,848	14,406,565	23,791,413
FY2013	OTHER	5,535	200,439,161	11,425,032	17,538,427	28,963,459
		166,239	$ 7,158,541,471	$ 408,036,864	$ 626,372,379	$ 1,034,409,243
Member Averages			$ 43,062	$ 2,455	$ 3,768	$ 6,222

	EMPLOYER TYPE	ACTIVE MEMBER	TOTAL WAGES	MEMBER CONTRIBUTION 6.10%	EMPLOYER CONTRIBUTION 9.35%	COMBINED RATE 15.45%
FY2014	STATE	21,108	$ 1,362,413,613	$ 83,107,230	$ 127,385,673	$ 210,492,903
FY2014	BOARD OF REGENTS	2,179	59,559,065	3,633,103	5,568,773	9,201,876
FY2014	COUNTY	23,272	1,034,838,755	63,125,164	96,757,424	159,882,588
FY2014	CITY	23,002	945,500,157	57,675,510	88,404,265	146,079,774
FY2014	SCHOOL	87,734	3,662,882,500	223,435,832	342,479,514	565,915,346
FY2014	COMM. COLLEGE	3,409	171,232,312	10,445,171	16,010,221	26,455,392
FY2014	OTHER	5,535	208,456,728	12,715,860	19,490,704	32,206,564
		166,239	$ 7,444,883,130	$ 454,137,871	$ 696,096,573	$ 1,150,234,444
Member Averages			$ 44,784	$ 2,732	$ 4,187	$ 6,919

	EMPLOYER TYPE	ACTIVE MEMBER	TOTAL WAGES	MEMBER CONTRIBUTION 6.50%	EMPLOYER CONTRIBUTION 9.95%	COMBINED RATE 16.45%
FY2015	STATE	21,108	$ 1,416,910,157	$ 92,099,160	$ 140,982,561	$ 233,081,721
FY2015	BOARD OF REGENTS	2,179	61,941,428	4,026,193	6,163,172	10,189,365
FY2015	COUNTY	23,272	1,076,232,305	69,955,100	107,085,114	177,040,214
FY2015	CITY	23,002	983,320,164	63,915,811	97,840,356	161,756,167
FY2015	SCHOOL	87,734	3,809,397,800	247,610,857	379,035,081	626,645,938
FY2015	COMM. COLLEGE	3,409	178,081,604	11,575,304	17,719,120	29,294,424
FY2015	OTHER	5,535	216,794,997	14,091,675	21,571,102	35,662,777
		166,239	$ 7,742,678,455	$ 503,274,100	$ 770,396,506	$ 1,273,670,606
Member Averages			$ 46,576	$ 3,027	$ 4,634	$ 7,662

	EMPLOYER TYPE	ACTIVE MEMBER	TOTAL WAGES	MEMBER CONTRIBUTION 6.90%	EMPLOYER CONTRIBUTION 10.55%	COMBINED RATE 17.45%
FY2016	STATE	21,108	$ 1,473,586,564	$ 101,677,473	$ 155,463,382	$ 257,140,855
FY2016	BOARD OF REGENTS	2,179	64,419,085	4,444,917	6,796,213	11,241,130
FY2016	COUNTY	23,272	1,119,281,597	77,230,430	118,084,209	195,314,639
FY2016	CITY	23,002	1,022,652,970	70,563,055	107,889,888	178,452,943
FY2016	SCHOOL	87,734	3,961,773,712	273,362,386	417,967,127	691,329,513
FY2016	COMM. COLLEGE	3,409	185,204,869	12,779,136	19,539,114	32,318,250
FY2016	OTHER	5,535	225,466,797	15,557,209	23,786,747	39,343,956
		166,239	$ 8,052,385,593	$ 555,614,606	$ 849,526,680	$ 1,405,141,286
Member Averages			$ 48,439	$ 3,342	$ 5,110	$ 8,453

1. All active member counts are based on FY 2009 actuarial data and include all members active anytime during the year.
2. Expected FY 2010 total wages are from Exhibit 11, FY 2009 Valuation report.
3. The FY 2011 through FY 2016 total wages are compounded by 4.0% annually per actuarial assumptions.
4. OTHER employer type includes municipal utilities, 28E organizations, Area Education Agencies, and miscellaneous small local entities.

Starting in FY 2012, a 0.5% cap on the contribution rate increase to the sheriffs and deputies special service group and the protection occupation special service group will take effect. This recommendation increases that cap by an additional 0.5% to 1.0%.

The 1.0% cap may result in a cost savings to the employers and members since no cap is currently in place. However, the cap could result in a cost increase since the contribution rates are set by the actuary and current law limits future rate changes to 0.5% a year.

Recommendation: Extend the current wage purchase credit rules relative to furloughs for IPERS members for an additional year and allow the rules to apply to union bumping rights with a retroactive effective date of January 1, 2009.

Background

This provision allows IPERS members with reduced wages because of a furlough or mandatory unpaid days, or because of bumping within a layoff plan, to make up both the employer and employee contributions to IPERS for that time. When they make up the contributions, IPERS records the wages at the level they would have been without the loss of pay.

Assumptions

1. Employees near retirement would make up contributions to preserve the wages used in the retirement benefit formula and thus maintain the level of retirement benefits they would have received without the reduction in pay.
2. Employees that are not near retirement will not make up IPERS contributions.

Fiscal Impact

The cost of extending the current wage purchase credit for furloughs for an additional year and applying it to union bumping rights cannot be determined because IPERS does not know how widespread furloughs will be beyond State government. IPERS does not anticipate major additional costs.

There is a related cost to furloughs because IPERS loses contributions from everyone that is taking a furlough and not retiring. Only those employees retiring will make up lost contributions and will receive a higher benefit because of it.

Municipal Fire and Police Retirement System (411 System)

Recommendation: Overtime pay included as wages beginning July 1, 2010.

Background

Under current law, overtime is not included as covered wages for 411 System. In FY 2008, an estimated $14.0 million was paid in overtime to members of the 411 System.

Assumptions

1. As calculated by the 411 System's actuary, the addition of overtime pay to the wages of the active membership is estimated to increase the contribution rate and dollars as follows:
   - 5.68% increase in the contribution rate.
   - $19.0 million estimated increase in the contribution amount.

Fiscal Impact

Overtime Pay Included as Wages
Beginning July 1, 2010

	Current Valuation (7/1/09)	Inclusion of Overtime
Covered Payroll	$ 232,872,388	$ 249,276,260
Cities		
Contribution Rate	19.90%	25.58%
Contribution Dollars	$ 46,341,605	$ 63,816,027
Increase		$ 17,474,422
Members		
Contribution Rate	9.40%	9.40%
Contribution Dollars	$ 21,890,604	$ 23,450,768
Increase		$ 1,560,164

Including overtime as part of earnable compensation increases the total covered payroll amount and will result in an increased cost to the employer of approximately $17.5 million and a contribution rate increase of 5.68%. The increased cost to the employee is approximately $1.6 million. The employee contribution rate would remain at 9.40%.

Recommendation: Increase the employee contribution rate by 0.5% for each year for four years beginning July 1, 2010.

Assumptions

1. As of July 1, 2009, there are 3,886 active members in the 411 System and 3,670 retired members and beneficiaries.
2. The July 1, 2009, covered payroll for the 411 System is $232.9 million.
3. For FY 2010, the contribution rate is 17.00% for the cities and 9.40% for the employee for a total contribution rate of 26.40%.
4. For FY 2011, the contribution rate for the cities will be 19.90%.
5. For FY 2010, the employer/employee contribution split is 63.31% cities, 1.08% State, and 35.61% employees.

6. On a stand alone basis (no other provision enacted to offset this change), this provision would increase the employee (member) contribution as shown on the following table and would cause a corresponding decrease in the employers (cities) contribution.

Fiscal Impact

0.5% Employee Contribution Rate Increase

	Current Law			Proposal		
Fiscal Year	**Estimated Covered Payroll**	**Member Rate**	**Contribution Amount**	**Member Rate**	**Contribution Amount**	**Increase**
2010	$232,872,388	9.40%	$ 21,890,004	9.40%	$ 21,890,004	$ 0
2011	$243,351,645	9.40%	$ 22,875,055	9.90%	$ 24,091,813	$ 1,216,758
2012	$254,302,469	9.40%	$ 23,904,432	10.40%	$ 26,447,457	$ 2,543,025
2013	$265,746,080	9.40%	$ 24,980,132	10.90%	$ 28,966,323	$ 3,986,191
2014	$277,704,654	9.40%	$ 26,104,237	11.40%	$ 31,658,331	$ 5,554,094

The approximate fiscal impact to an individual, not including any wage increases, will be an additional cost of $1,400 a year by FY 2014.

In FY 2011, this provision will reduce the cities' contribution rate from 19.90% to 19.40%. The city contribution rate will be reduced by 0.5% for FY 2012, FY 2013, and FY 2014.

Recommendation: Phase-out or eliminate the State's contribution to the 411 System.

Background

In 1976, the General Assembly enacted benefit improvements under Chapter 411 and provided the improvements be paid for by the following:

- Additional member contributions at the rate of 1.21%.
- State of Iowa contributions to pay for the cost of benefits above the 1.21% to be determined by an actuarial valuation of cost to each of the 87 local systems.

In 1979, the contribution rate paid by the State of Iowa was calculated at an average for all local systems instead of individual city valuations. The rate was set at 3.79% of earnable compensation.

The Standing Appropriation is capped in the Code.[2]

Assumptions

1. If the State's contribution to the benefit plan is eliminated, the city contribution rate and dollars will increase by the corresponding amount.

[2] Iowa Code Section 8.59

2. The FY 2010 General Fund contribution was $2,503,510 (1.08%). After the 10.0% across-the-board reduction, the amount is $2,253,159.

Fiscal Impact

Phase Out of the State Contribution to the 411 System

	411 System Standing Appropriation	**General Fund Appropriation Reduction**
FY 2010	$ 2,253,159	$ 0
FY 2011	$ 1,500,000	$ 753,159
FY 2012	$ 750,000	$ 750,000
FY 2013	$ 0	$ 750,000

The fiscal impact to the city contribution rate will increase by the corresponding amount.