A REPORT TO THE GOVERNOR AND GENERAL ASSEMBLY

REGARDING GUIDING PRINCIPLES OF,

AND RECOMMENDATIONS FOR BENEFIT ENHANCEMENTS TO,

THE IOWA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

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ACKNOWLEDGEMENT

We also wish to acknowledge the significant contributions made to this effort by the constituent representatives[1] who, together with members of the IPERS staff, worked in tandem to: 1) review the Request for Proposals for a benefits enhancement and governance review study before it was published last winter; 2) screen responding firms for interviews by this entire team; 3) interview final candidates; 4) select the winning firm (Buck); and 5) work with Buck, over a period of many months, to respond to the consultants' questions and to review their ongoing work which has resulted in their final report. It was an extraordinary venture from the beginning, marked by heartening cooperation and mutual respect. The insights, questions and feedback of these constituent representatives greatly enhanced the process and the report itself.

Our special thanks are due to: Jim Maloney (Association of Counties), Walt Galvin (Retired School Personnel Association), Lowell Dauenbaugh (Iowa State Education Association), Dr. Gaylord Tryon (Association of School Administrators), and Andi Stewart (League of Iowa Municipalities).

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[1] Selected by their respective organizations.

EXECUTIVE SUMMARY

We have the challenge - and the opportunity - to shape the plan design of the Iowa Public Employees' Retirement System (IPERS) for years to come. More than ever, however, it is incumbent upon us to choose wisely. Significant demographic shifts, the troubled future of Social Security, the increasing importance of allocating some portion of private savings for retirement, and determining the appropriate role for government sponsored pension plans all combine to make the stakes of plan design very high indeed. **If we are not careful, our efforts to grant even greater benefits to segments of our members retiring today may force us in the future to offer a more costly, less beneficial plan to younger generations of public employees decades from retirement.** These generations already face the likelihood of paying higher contributions for reduced Social Security benefits. We to not want to inadvertently create the same situation for them within IPERS.

In this report, IPERS does more than just "respond" to the Buck Consultants' study. We also offer a clear and compelling vision for the future of our Plan, state the values upon which this vision is based, and propose those benefit enhancements which will most favorably affect - in a financially sustainable manner - the greatest number of our members.

We caution that to consider enhancement proposals without reference to this larger vision and its underlying values is to risk unintended adverse impact.

To assist in evaluating the recommendations proposed by Buck, we assess how each of their suggestions conforms to the guiding goals established in Chapter 97D of the Iowa Code. We also recommend using these additional guiding principles in evaluating Buck's proposals:

- Total retirement payout from public sources should not exceed 100% of a member's pre-retirement income.

- Those members who receive the value of benefit enhancements should pay their proportionate share for that value.

- Inter-generational equity must be preserved and protected: our benefit program must be designed with all of our members in mind.

- Weigh proposed enhancements as to their value for a sound plan design ten years from now.

IPERS' recommendations for Plan improvements are:

1) **Remove the salary cap, allow a maximum payout of 70% for those with 35 or more years of service, but reduce the formula multiplier by indexed, incremental amounts for those with salaries exceeding $55,000; require**

persons retiring with added value from these changes to pay their proportional share of that increased value.

2) **Increase the minimum benefits being paid to persons who retired with at least 10 years of service and who currently are receiving very low monthly payments from IPERS.**

3) **Change our existing <u>dividend</u> program to an annually adjusted, ad hoc COLA program.**

4) **Raise the interest credited to members' accounts to a target rate of 1/2% to 1% over comparable one year interest rates for certificates of deposit.**

5) **Allow retired members who wish to resume employment with IPERS' covered employers the right to elect non-coverage for that reemployment period.**

6) **Index the value of terminated vested members' benefits from the day of termination over time until those members' eventual retirement.**

7) **For those persons who wish to have an unreduced monthly benefit even though they are choosing to take an "early retirement", allow them to purchase the cost of that reduction at the time of their retirement.**

8) **Study Buck's recommendations regarding death benefit and disability payouts to determine interplay with similar benefits offered by IPERS' covered employers.**

9) **Formulate a solution acceptable to IPERS which will provide post-retirement health care assistance to members while maintaining the Fund's actuarial integrity.**

IPERS is also currently investigating alternative formula and Plan design features which would target greater accrual value to our average member. We anticipate having a report on these options, together with possible recommendations, by November or December of this year.

SECTION ONE: BENEFIT ENHANCEMENTS

INTRODUCTION

With the summary review of other statewide public pension plans provided us by Buck Consultants, together with their various recommendations for benefit and governance enhancements, we have the challenge - and the opportunity - to shape the Plan design of the Iowa Public Employees' Retirement System (IPERS) for years to come.

More than ever, however, it is incumbent upon us to choose wisely. Significant demographic shifts, the troubled future of Social Security, the increasing importance of allocating some portion of private savings for retirement, and determining the appropriate role for government sponsored pension plans all combine to make the stakes of Plan design very high indeed. **If we are not careful, our efforts to grant even greater benefits to segments of our members retiring today may force us in the future to offer a more costly, less beneficial plan to younger generations of public employees decades from retirement.** These generations already face the likelihood of paying higher contributions for reduced Social Security benefits. We to not want to inadvertently create the same situation for them within IPERS.

In this report, IPERS intends to do more than to just "respond" to the useful Buck Consultants' study. Rather, we believe that it is our responsibility to take clarify a clear and compelling vision for the future of our Plan, state the values upon which this vision is based, and propose those benefit enhancements which will most favorably affect - in a financially sustainable manner - the greatest number of our members.

We caution that to consider enhancement proposals without reference to this larger vision and its underlying values is to risk unintended adverse impact.

PART ONE: BACKGROUND CONTEXT
THE NATIONAL DIMENSIONS OF RETIREMENT PLANNING

Demographic Shifts

The "baby boomers", those born in the immediate post-World War II years, are aging. As they near retirement they are beginning to focus on what they will need to financially survive during this extended period. Their sheer numbers will place intense strain on all pension systems, public and private, for three major reasons. First, they represent such a major demographic "bulge" that they will markedly swell the numbers of those retired, from 12.6% of the population in 1990 to an estimated 16.3% in 2020[2]. Second, because people are living longer in retirement, their "draw down" of pension benefits will likely have a significant impact on retirement fund reserves and, possibly, even on the financial markets themselves.[3] Third, they are followed in the work force by significantly fewer younger workers. The result is a projected decrease in worker-to-retiree ratios from the present 2.9 persons to only 2.1 in 2020[4]. This will mean the financial "carrying power" burden of the working young for the retired elderly will increase. It is crucial that retirement systems at all levels incorporate these realities into future Plan design.

Crisis of Social Security

As is increasingly apparent, whether something will be done to Social Security as presently structured is no longer the question. Rather, it is what will be done when, and how far will those adjustments go.

Social Security's chief difficulty is that it is structured as a "pay as you go" system, and not one which uses "your investments" to pay for "your retirement."[5] Social Security,

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[2] Percentages expressed are for those 65 years of age and older. Source: World Population Prospects, 1992 edition, U.N. publication. Cited in "A Global Trend: Privatization and Reform of Social Security Pension Plans," by William G. Poortvliet and Thomas P. Laine, Benefits Quarterly, Vol. 11; No. 3; 1995; p. 67.

[3] The surge in dollars pouring into mutual funds in the 1990s represents, to no small degree, the baby boomers' efforts to salt away sufficient resources for their retirement. Once they attain retirement age, the dollar flow may reverse as they begin to liquidate those savings in order to maintain their purchasing power in retirement.

[4] "A Global Trend...", Benefits Quarterly, op. cit., p. 69.

[5] Actually, this is a feature, to a greater or lesser degree, of all defined benefit plans. A *defined benefit* plan, such as IPERS, uses a formula which is designed to reflect a combination of years of service and recent wage in order to determine monthly lifetime benefits. Its eventual

however, is an extreme example because most of the revenue stream from today's workers is used to pay for current retirees. Once younger workers retire, it will be up to those following them to pay for their retirement. The problem, however, is that the baby boomers must be "supported" by fewer active workers. Without substantial changes, the present system will become insolvent around 2025.[6] The most likely modifications will probably entail reduced benefits and/or higher contribution rates. The conclusion is inescapable: those generations following the baby boomers will have an even more difficult time of providing for their own retirement, let alone helping to pay for the retirement of the baby boomers[7]. State pension plans must be conscious of this factor in refining their own plan designs.

Inadequate Private Savings

Funding for retirement has long been thought to involve the "three-legged stool" of Social Security, an employer-sponsored pension plan, and individual savings. Because of the growing problems involving Social Security, the role of work place pension plans and private savings loom even larger.

> If Social Security benefits are reduced to bring the system into actuarial balance, then the other two sources of retirement income - personal savings and employer-sponsored retirement plans - will have to be increased....Many experts fear that the U.S. savings rate is far too low to take on that burden, however. The U.S. national savings

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payout is not intended to precisely mirror total contributions made by members and employers (plus accumulated interest). Investment (market) risk is entirely assumed by the Plan, not the employee. A *defined contribution* plan, on the other hand, typical of the newer private plans, is truly a "what you see is what you get" plan; a person at retirement can draw down only that paid in plus accumulated interest. Investment (market) risk is entirely assumed by the employee. Debate continues over which type plan is more favorable. In general, consensus appears to favor using a *defined benefit* plan as the core plan while providing *defined contribution* plans as supplemental offerings. In Iowa, IPERS is the core *defined benefit* plan for the bulk of our public employees, while the State's deferred compensation program and the tax sheltered annuities offered by school districts are examples of supplementary plans and are *defined contribution* in nature.

[6] Source: Office of the Actuary, Social Security Administration. Cited in Who Will Pay for Your Retirement: The Looming Crisis, a Statement by the Research and Policy Committee of the Committee for Economic Development, New York; 1995; p. 3.

[7] For "almost all individuals who currently receive [Social Security] benefits, the annuity value of their benefits exceeds their contributions paid (plus interest)....However, the return for all new retirees is falling rapidly and will become negative for higher-income individuals (particularly men) later in this decade. Single individuals retiring early in the next century face deeply negative returns." Who Will Pay..., op.cit., p. 33.

> rate...held fairly steady at approximately 8 percent of gross domestic product (GDP) from the 1950s through the 1970s. But in the early 1980s, the national savings rate declined substantially, hitting an all-time low of less than 2 percent of GDP in the period 1990 to 1993....The level of personal savings declined from nearly 6 percent of GDP in the early 1970s to slightly more than 3 percent of GDP in the early 1990s.[8]

In 1970, the source of retirement benefit payments was 62% from Social Security, 22% from government pensions, and 16% from private pensions. By 1992, the ratio had changed to 49.9% from Social Security, 18.7% from government pensions, and 31.4% from private pensions.[9] A recent report from the Rand public policy think tank showed that the median retired household contributes only 10.9% in private savings to help with total post-retirement costs.[10] The median white household with members between the ages of 51 and 60 has "less than $18,000 in personal wealth" excluding real estate, whereas the "typical black and Hispanic couple in the same age range has less than $500 in liquid assets."[11] Rand further notes that "wealth disparity in the United States is several times greater than differences in income and the implications should set off alarm bells for the retirement prospects of baby boomers and the generations that come after them...." The top 5 percent of white families with at least one spouse older than 70 have accumulated wealth of $655,000 - seven times the $90,000 in wealth held by median white households. The bottom 10 percent of white households has managed to accumulate less than $800.[12]

As we look to restructure elements of IPERS' plan design, we must be aware of the disparity between the growing importance of private savings as an element of financial security in retirement and the evidence that many persons will have little in the way of private savings to devote to retirement. Furthermore, the growing wealth gap between the relatively small number of persons who have comfortable savings and the large (and apparently growing) number of persons with little private resources suggest that this must also be factored in to our plan design.

THE IOWA CONTEXT

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[8] U.S. Retirement Policy: The Sleeping Giant Awakens, The Wyatt Company, 1994; p. 21.

[9] Source: Employee Benefit Research Institute; cited, U.S. Retirement Policy...., op. cit. p. 27.

[10] Source: Rand Report on Wealth and Savings, cited in "Middle-Aged, Elderly Have Fewer Assets Than Expected," The Wall Street Journal, July 25, 1995.

[11] "Middle-Aged, Elderly...", op. cit.

[12] "Disparity in Wealth Bodes Ill for Future Generations, Rand Says," BNA [Bureau of National Affairs] Pension & Benefits Reporter, Vol. 22, p. 1766, July 31, 1995.

Our Demographics Similar to the Nation's

The demographic profile of our membership is not significantly different than the national scene. We have a large number of persons (22,466) who are in the prime retirement ages between 55 and 65. The pool of younger workers behind them is devoid of any similar grouping or "bulge". Just as at the national scene, also, IPERS will see a growing number of retirees supported by a declining ratio of active workers. Understandably, those already retired, and those nearing retirement, are eagerly pressing for enhancements that are seen as to their benefit. A key question which must be asked is: And what of the effect on younger generations following behind?

Pressures for Short-Term Fixes vs. Long Term Solutions

Legislators and retirement system administrators alike are besieged by various constituent groups who make a passionate case for "their" most desired benefit. In isolation, many of these proposals are attractive. However, unless **all** of them are viewed in the context of the whole system and the entire membership, it is impossible to assess the value of them in attaining - or maintaining - the Plan's goals of achieving and maintaining benefit equity and fiscal soundness. Some proposals also are advanced because they address peculiarities of today's demographic bulge; while legitimate, today's solution may well not be the best plan design feature on an ongoing basis.[13] Lastly, proposals for IPERS' plan must also be weighed as to their impact - immediate or potential - upon the plans of the other retirement systems funded by the State and its various political subdivisions.

Guidelines Established in Chapter 97D of the Iowa Code

Only a few years ago the General Assembly established long-term goals by which each retirement system was to guide itself and by which proposals for benefit enhancements should be measured. This was done precisely because the "hue and cry" of constituent groups through successive legislative sessions could often obscure the long-range goals by which our system should be guided.

Chapter 97D addresses **goals** forthrightly in its first section.

1. The general assembly declares that legislative proposals for changes in specific public retirement systems should be considered within the context of all public retirement systems within the state, with emphasis on equity and equality among the systems. The following list of guiding goals shall apply to the consideration of proposed changes:

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[13] We must also be sensitive to efforts by employers to shift a portion of their employment costs **today** to become part of our retirement Plan's burden **forever**.

a. Select those benefit enhancement options which most successfully deliver the greatest good to the greatest number of employees.

b. Choose those options which best correct existing inequities between and among the various retirement groups in the state.

c. Determine those options which most ably serve the twin objectives of attracting and retaining quality employees.

d. Avoid enacting further incentives toward earlier retirement with full benefits.

e. Avoid further splintering of benefits by disproportionate enhancement of benefits for one group beyond those available to another.

OUR CHALLENGE: TO "DO IT RIGHT"

While it is useful to know how other statewide retirement systems are designed, and about which enhancements they have found desirable to add or change, this does not call for an automatic, lemming-like, non-thoughtful response on our part. While it is fair to look closely at those important features where IPERS differs from its sister systems, it is also important to look closely at what Iowa has "done right" in the design and subsequent enhancement of the IPERS plan. Above all, our final product must reflect the needs of <u>all</u> of our members.

<u>National Retirement Income Policy</u>

In working with the able Buck consultants, it is even more apparent that the United States sorely needs a national retirement income policy within which public and private system designers can construct the kind of plan most needed by their members.

Unfortunately, such a national policy does not yet exist, although elements of what might eventually emerge as the initial outlines of such a policy as a consequence of wrestling with the Social Security dilemma suggest no lessening of the importance of both work place pension plans <u>and</u> private savings.

Key elements of what we believe should be the foundational pillars of such a retirement policy will be found in our <u>Orienting Principles</u> section following.

<u>How Much Is Too Much?</u>

This is an important, but usually avoided, question. Yet it must be posed, especially as a central thrust of the Buck report is to recommend that the existing benefit cap of 60%, set just in 1990 by the General Assembly and only achieved last year, be raised even further to a "floating" cap[14]. While the proposal is intriguing, it begs the larger question: How much is too much? We believe that public plans have a special responsibility to our citizenry to find the balance point: providing fair and equitable, but not excessive, benefits.[15] At some date in the future, when we have achieved our major (and costly) goals regarding eliminating the covered wage ceiling and providing more adequately for our retirees, we may even wish to consider lowering our statutory contribution rate rather than spending available dollars "just because they are available".

While there may not be a fixed answer to this question, we should always consider requests for enhancements with it in mind as a "reality check."

The Danger of "Backing Into" a Two-Tier Plan

Projecting dependable costs of various benefit enhancements decades into the future is an inexact science, requiring as it does our actuary to not only get demographic developments "right", but also to correctly forecast asset growth into that distant time. If we estimate wrong, or saddle the System with improvements for a relative few, but the costs of which are to be paid by all members, there is the distinct possibility that future generations will pay higher contribution rates for diminished benefits. Such two (or even three) "tier" plans were adopted by some State systems in the '80s and early '90s when the carrying cost of already enacted benefits[16] became too great for those Systems to bear. While no one would advocate that IPERS intentionally adopt such a tiered system, we must guard against unintentionally creating the need for it.

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[14] Effectively "indexed" to an individual member's anticipated benefit from Social Security, but with a maximum payout limited to 80% of a member's average highest three years of covered salary.

[15] According to the Employee Benefit Research Institute of Washington, D.C., a worker in the private sector making $45,000 a year who retires after 20 years will have a replacement ratio of 21% ($9,450), while after 30 years this rises only to 30% ($13,500). Source: "Public Pensions: Are Congressional pensions and public funds in need of reform," Pension Management, October, 1995, p. 5.

[16] Such as retiree health care and guaranteed Cost of Living Adjustments for retirees.

PART TWO:
ORIENTING PRINCIPLES FOR A BALANCED AND FISCALLY SOUND SYSTEM

Because we believe sound retirement policy inherently incorporates *social* policy as well, we believe it important to state such principles openly. Social Security, for example, the wisdom of its funding mechanism aside, deliberately skews benefits towards the lower income.[17] As national debate focuses on how to "fix" Social Security it is imperative that this fundamental value also be addressed, either for adjustment or reaffirmation. Certain similar values have been part of IPERS from the beginning. A like bias toward the lower income (and, one can argue, <u>against</u> those of higher income) is central to why we have a covered wage ceiling. The Plan also rewards persons in hazardous occupations such as police and fire work with formulas which allow them to retire without any "early retirement" reduction before the vast majority of IPERS' members. IPERS was also designed to channel the bulk of its benefit accrual and payout to career employees; this is the reason why persons terminating public employing and taking a refund receive none of the contributions made by their employer on their behalf.

Therefore, in addition to those *guiding principles* found in <u>Iowa Code Chapter 97D</u>, we also affirm the following to be of fundamental importance to a balanced, and soundly funded, retirement plan.

1) For other than lower income members[18] **total retirement payout from public sources** (Social Security and IPERS, for example) **should not exceed <u>100%</u> of a member's pre-retirement income.**

2) **Those members who receive the value of benefit enhancements should pay their proportionate share for that value.** The discomforting trend of providing benefit enhancements which favor some elements of our membership while the cost of those enhancements are to be paid for by all of the membership must <u>stop</u>. Even where members are to pick up the additional cost themselves, we must be sensitive to how easily improvements for some quickly become goals for others. If not tightly controlled, this becomes Plan design of the worst kind by incrementally adding uncoordinated elements.

3) ***Inter-generational equity* must be preserved and protected: our benefit**

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[17] See table on pp. 20 & 21.

[18] For our purposes, a member earning $25,000 or less in today's dollars. We recognize that these members face daunting challenges in terms of setting aside a significant amount of their private savings for retirement.

program must be designed with <u>all</u> of our members in mind - the already retired, those nearing retirement, and those many years from retirement. Unfortunately, in deliberations surrounding retirement policy the youngest element of our membership is largely absent, even though in many ways they have the greatest stake in our decisions.[19] Nonetheless, <u>we</u> must be aware of them and of their future expectations of a sound retirement. As it is difficult to find the precise standard by which inter-generational equity can be achieved, we will attempt - in our assessment of the various proposals in the Buck study - to give each an *"inter-generational equity"* ranking so that the issue is at least "on the table."

4) ***Individual equity* is not the best indicator of plan design balance.** Many members seeking benefit enhancements of one kind or another typically argue for *individual* equity. "I deserve this. I have paid for it." The problems with strict *individual* equity are many. It mirrors the "me-first", individualistic ethic all too common today. It is also absent any sense of the larger <u>total</u> retirement system community. Nonetheless, a retirement system is a <u>pool</u> of many different kinds of people, of great divergence of ages and, also, unfortunately, of health and income. *Individual* equity, ironically, ultimately is of little protection to the individual, either, as - sooner or later - a person will need assistance beyond that which he or she has "paid" for.

To illustrate: retirees will often argue for either the institution of a Cost of Living Adjustment (COLA) within IPERS or for increased dividend payouts on the basis of "I deserve it because you're gaining interest on my money." In fact, the average retiree has used up **all** contributions paid in on his or her behalf, including accumulated interest, within the first ten years following retirement. *Individual* equity would have us say, "Sorry, but you've already used up <u>your</u> share."

Those not yet retired often make similar arguments. "Look, I've worked under IPERS for 35 years. I <u>deserve</u> credit for those additional years of service." *Individual* equity **would** support giving additional formula recognition to these years of service, **but** would <u>not</u> support either a COLA or a dividend for this person once they had retired.

Individual equity - by itself - falls far short of giving us a useful measuring stick for over-all Plan design. *Inter-generational* equity, on the other hand, puts into play the interests of <u>all</u> of our members. For example, in the two hypothetical cases above, *inter-generational* equity would argue that the retired person, <u>regardless</u> of whether or not they have exhausted all that was put in on their

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[19] As do even younger persons who will be hired by public employers in the future.

behalf nonetheless have some claim on the rest of us - as part of the larger community - for compassion and assistance. This is the reason, for example, why we should consider Buck's recommendation to raise the minimum benefit payment for retirees: **not** because of *individual* equity, which would deny them any more increases, but because of larger "fairness" and "justice" concerns.

For the person about to retire, *inter-generational* equity would ask, "At what cost to the whole - including your own future as a retired person - should we grant extra credit for years of service beyond 30? Or unreduced benefits through a "Rule of 85?" What if the cost of doing this in the aggregate for all who qualify means fewer benefits, or a more tenuous financial future, for the younger persons following you? Or what if doing this means that we cannot provide either COLAs or dividend adjustments in the future? Is it still then a good idea?

Individual equity is, admittedly, easier to calculate for it is, after all, a more determinable number. But we believe *inter-generational* equity to be a far better - and, ultimately, much more satisfying - measure of a retirement plan's balance and fairness.

5) **Weigh proposed enhancements as to their value for a sound plan design ten years from now.** Many proposals for benefit enhancement result from the latest "great idea" enacted by several states or proposed by an influential constituent group. Others are also fueled by demographic pressures which may be relatively time specific. We must weigh benefit proposals according to not only how they would affect our total membership today, but also as to how well they will serve us tomorrow.

PART THREE: RECOMMENDATIONS FOR BENEFIT ENHANCEMENTS (with reference to the Buck Study)

In the following, we address the Buck recommendations in the priority they assigned them. Following our response to their suggestions, however, we include recommendations that are not addressed in the Buck study but which are issues IPERS believes deserve attention.

Priority Level # 1

Buck's First Recommendation: Change benefit formula by removing salary cap and removing service cap (to be phased in over a five to seven year period) and imposing cap of 100% of final average salary including one-half of Primary Social Security

Equity Scale:

1) **Conforms to guidelines of 97D**: Generally, yes. Specifically:

a) *Greatest good to greatest number*: over time, removing the covered wage ceiling cap will serve most of our members, while lifting the service year cap will aid up to 30% of those retiring;

b) *Corrects existing inequities:* Yes, as we are the only retirement system **in Iowa**, as well as in the **nation**, to have a covered wage ceiling. Also, only a few other systems retain a cap on service years (as contrasted with caps on maximum benefits payable).

c) *Serves to attract and retain quality employees:* Yes, as this makes our system more competitive with others in Iowa and around the country.

d) *Avoids offering further incentives toward earlier retirement with full benefits:* Does not apply.

e) *Avoids splintering benefits by disproportionately rewarding one group over the general membership:* Yes. The covered wage ceiling discriminates against higher waged members. In addition, members with more than 30 years of service contribute beyond 30 years but receive no formula multiplier value as a result of it.

2) **Equity**: It may seem to be of greater **individual** equity value, in the short term, for those with wages above the covered wage ceiling and/or with years of service greater than 30. However, as it would allow for full-funding of the

System to provide for inflation's effect on salaries over decades, it supports our goal to begin to pay today for the full cost of tomorrow's retirement benefits. In addition, it provides some additional cushion for younger members in the case that Social Security becomes seriously weakened in the future.

3) **Cost:** Insignificant for the costs of higher benefits for the small minority of IPERS' members currently above the covered wage ceiling. Significant insofar as it allows us to - for the first time - prefund the true cost of retirement benefits for younger generations.

4) **Demographic group(s) affected:** Salary ceiling: All over time; service year ceiling: 25% to 30% of retiring members.

5) **Future Plan Design:** It is essential that IPERS be able to fully estimate and fund true future liabilities. Lifting the covered wage ceiling does this.

Conclusion: IPERS supports the thrust of the recommendation with some qualifying conditions and modifications.

The Cap on Years of Service

Actually, it is the removal of the service year cap which causes us the greater concern, as it would mean a significantly higher maximum payout for some members. On the one hand, it does directly address what has been perceived to be an *individual* equity injustice for many years by persons with more than 30 years of service. On other hand, however, it vaults beyond the goal set by the 1990 General Assembly that 60% was to be our maximum payout.[20] We just attained that goal in July 1994.

In 1990, the Legislature declared that a 20% increase in benefits was an attractive way to deliver a substantial benefit to all future retirees[21], especially so because the average retiree (then as well as today) departs with 20 years of service. With the 60% goal attained, average retirees now leave with 40% of their average highest three years of covered service versus only 33 1/3% in 1990.

While all of our members appreciated and applauded this change, it did not address the concerns of those desiring further accrual for years of service beyond 30. However, even the

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[20] At 2% per year of service, this maximum can only be realized currently by persons with 30 or more years of service.

[21] A payout of 2% per year of service is 20% greater than that of 1.67%, which was what the formula multiplier had been. An increase in the formula multiplier favorably affects all retirees, whether they are leaving with 15, 20, or 30 years of service.

Buck report does not suggest allowing unlimited accrual.[22] Therefore, wherever the maximum cap on benefit payout is placed, a long-serving member could still complain about *individual* equity not being met.

The more central issue to this discussion, however, is really the most basic of all: **what is an adequate retirement pension, and what share of that obligation ought to be borne by the public sector**.

An Adequate Public Pension

As discussed above, retirement policy has long relied upon three elements as integral to a sound retirement: Social Security, work place pension plans (government or private), and private savings. We reaffirm the importance of all three elements.

However, in light of the clear problems faced by Social Security, and the likely reduction in future benefits and/or increase in contribution rates, as well as the continuing problem many citizens are having in accumulating private savings of any significance for retirement, it is appropriate to reexamine the relative weighting we assign to each factor in bearing the cost of retirement.

Our central problem with the Buck recommendation is that it makes no provision for private savings. Rather, it ignores this "third leg" of the retirement planning stool. Given the growing disparity of wealth in this country, and allowing for the fact that persons who enjoy higher incomes have greater discretionary dollars and, consequently, more opportunities for private savings, it is important that we continue to express our expectation that individuals must assume some degree of responsibility for their own retirement relative to their ability to save. We acknowledge this to be a troublesome area, as "sufficiency of income" is a subjective call.

To overcome this quandary, therefore, we are recommending a modification of the Buck recommendation:

1) The maximum payout from IPERS should be no greater than 70%[23].

2) In computing the member's retirement benefit, IPERS will mirror, albeit less stringently, Social Security's bias toward those of lower income, by incrementally reducing the multiplier applied to salary above the current

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[22] Buck's suggestion that the cap on maximum benefits be set at 80% would effectively value years of service up to a maximum of 40.

[23] This maximum would be attained (@ 2% for each year of service) only if a person had 35 or more years of service.

statutory ceiling of $55,000[24]. For persons earning above $55,000 at time of retirement:

- o covered wages between $55,000 and $65,000 would have a formula multiplier of 1.9% applied;
- o covered wages between $65,000 and $75,000 would have a formula multiplier of 1.8% applied;
- o covered wages between $75,000 and $85,000 would have a formula multiplier of 1.7% applied;
- o covered wages between $85,000 and $95,000 would have a formula multiplier of 1.6% applied;
- o covered wages above $95,000 would have a formula multiplier of 1.5% applied.

We believe such a system would reflect the reality that persons enjoying a relatively higher income have an increased obligation to support themselves in retirement.

The following table serves to illustrate how our proposal would function:

Projected Formula Reflecting 2% per Year of Service[25], No Covered Wage Ceiling, with a Maximum Payout Limited to 70%[26]

Income before Retirement	IPERS maximum benefit percentage	Social Security benefit percentage	Formula Multiplier Used	Retirement Wage Replacement Ratio (public sources)
15,000	70%	49%	2%	119%
20,000	70%	38%	2%	108%
25,000	70%	35%	2%	105%
30,000	70%	30%	2%	100%
35,000	70%	26%	2%	96%
40,000	70%	23%	2%	93%

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24 We propose that these amounts be indexed going forward.

25 Not to exceed 70% or 35 years of service.

26 An effective cap on years of service of 35.

45,000	70%	21%	2%	91%
50,000	70%	19%	2%	89%
55,000+	<70%	17%	2,1.9%	87%
65,000+	68%	15%	2...1.8%	83%
75,000+	67%	15%	2...1.7%	82%
85,000+	66%	15%	2...1.6%	81%
95,000+	65%	15%	2...1.5%	80%

NOTE: Social Security data is taken from Pension Planning, Sixth Edition, by Everett Allen et al; Irwin: Homewood, Illinois; 1988; pp. 33 & 36, and presumes an individual whose final pay is the level indicated. IPERS' figures assume a person has otherwise qualified through age and years of service for the maximum benefit payment of 2% per year of service, to a maximum of 35, times the member's average of the highest-three years' salary.]

However, as we know that the average member retires with just under 20 years of service, and not 35, the following table gives a much better illustration of how IPERS and Social Security together will impact most retirees.

Projected Formula Reflecting 2% per Year of Service, No Covered Wage Ceiling, with Average Years of Service at Retirement at 20

Income before Retirement	IPERS maximum benefit percentage	Social Security benefit percentage	Formula Multiplier Used	Retirement Wage Replacement Ratio (public sources)
15,000	40%	49%	2%	89%
20,000	40%	38%	2%	78%
25,000	40%	35%	2%	75%
30,000	40%	30%	2%	70%
35,000	40%	26%	2%	66%
40,000	40%	23%	2%	63%
45,000	40%	21%	2%	61%
50,000	40%	19%	2%	59%
55,000+	<40%	17%	2,1.9%	57%
65,000+	39%	15%	2...1.8%	54%
75,000+	38%	15%	2...1.7%	53%
85,000+	38%	15%	2...1.6%	53%
95,000+	37%	15%	2...1.5%	52%

NOTE: Social Security data is taken from Pension Planning, Sixth Edition, by Everett Allen et al; Irwin: Homewood, Illinois; 1988; pp. 33 & 36, and presumes an individual whose final pay is the level indicated. IPERS' figures assume a person has otherwise qualified through age and years of service for the maximum benefit payment of 2% per year of service times the member's average of the highest-three years' salary.]

The Covered Wage Ceiling

We believe that in the preceding context, the issue of lifting the covered wage ceiling becomes much less of an issue. As we have reasoned for some time in pleading for lifting this ceiling, the primary purpose for doing so is the actuarial integrity of the System. The greatest long term beneficiaries of this action will be our younger members whose average salaries will, over decades, rise substantially above the existing covered wage ceiling. It is imperative that we begin to fully anticipate now those tremendous future costs. As long as we continue to use a covered wage ceiling, the true value of future liabilities is drastically understated in actuarial projections of future liabilities for the System. This both serves to inflate the apparent dollars we have available for existing benefit enhancements[27] and to make the eventual cost of paying for higher benefits even greater as we will have fewer years to pre-fund those costs.

Greater Contributions Should be Assessed, on an Actuarial Basis, to Those Persons Receiving Disproportionate Value from The Removal of the Covered Wage Ceiling

Currently, members nearing retirement, with wages above the covered ceiling, are receiving tremendous benefit from the $3,000 annual hikes in the covered ceiling. At the time of their retirement the full value of recent increases in the covered wage ceiling will be used in calculating their retirement benefit, yet they will have contributed on that higher amount for a very short period of time. By comparison, a younger person with a similar wage will pay full value on wages earned for his or her entire IPERS' coverage. The younger person will be contributing a greater value toward his or her retirement than the person just about to retire. **Therefore, we believe an individually determined, actuarially assessed additional amount of contributions should be assessed to those members who retire within ten years of wage ceiling increases which affect them.**

Buck's Second Recommendation: Change Normal Retirement Age and Service Requirements to Age 65, or Age 62 with 20 or more years of service, or Age 55 or older if age plus service equals 85.

Equity Scale:

1) **Conforms to guidelines of 97D**: Mixed, at best. Specifically:
a) *Greatest good to greatest number*: it would potentially benefit between 30%

[27] With our true future liabilities suppressed, present assets appear more than sufficient for existing liabilities.

and 40% of our retiring members[28], while the **cost** of this subsidy would be borne by our total membership.

b) *Corrects existing inequities:* No. While IPERS may not be as competitive vis-a-vis other systems in this area, our existing standards for normal retirement are not inequities.

c) *Serves to attract and retain quality employees:* Attract, yes, retain, no.

d) *Avoids offering further incentives toward earlier retirement with full benefits:* No. Directly violates this provision.

e) *Avoids splintering benefits by disproportionately rewarding one group over the general membership:* No. By having the costs paid for by our total membership, while the value is received by a minority of those retiring, it is an early retirement incentive for aging baby boomers.

2) **Equity**: It is unequitable to require all to pay for the benefits of some.

3) **Cost**: Significant.

4) **Demographic group(s) affected**: Approximately 30% to 40% of current demographic slice of persons nearing retirement could benefit either from the "Rule of 85" or changing normal retirement at age 62 from 30 years to 20 years.

5) **Future Plan Design:** Demographics suggest that this is a "solution" being driven by the large number of baby boomers who are just beginning to enter, or ponder entering, retirement. The generations following them are both less numerous and less likely to have such career life-time experience with the same employer. This proposal could have dire effects for us in the future when we will likely be trying to find ways to keep people working longer to flesh out a thinning work force.

IPERS' Position: IPERS strongly resists this proposal as long as it remains subsidized by the general membership.

We are not insensitive to the plight felt by many career employees, especially many teachers, who feel "burnt out" by the time they enter their 50s. IPERS sympathizes, too, with their felt need to try "new paths". To assume that a public retirement system, however, has a duty to fund this option is another issue entirely.

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[28] Not everyone eligible for early retirement elects to participate. Currently, less than 20% of those eligible for the "Rule of 92" actually retire upon attaining it.

IPERS <u>already</u> subsidizes every member who takes "early" retirement. While members taking "early" retirement receive an age reduction adjustment of 3% for each year their retirement precedes "normal" retirement[29], the cost to the System is actually <u>6% per year</u>.

The majority of those currently eligible for the "Rule of 92" do not take it. While there are many reasons, the one we hear most frequently is that they cannot afford the cost of medical premiums, especially as Social Security cannot be begun until age 62 and Medicare at age 65.

It is significant that this proposal goes in exactly the <u>opposite</u> direction from trends within Social Security, trends propelled not just by current financial problems with that system but also by demographics: people are living much longer, their "productive" years can easily extend through their 60s as long as they enjoy good health, and they are living longer after retirement. The 30 year standard was set years ago as one which reflected the then current concept of a "career employee"; it also reflected the mortality experience of that generation.

> **IPERS proposes, instead, to allow members to cancel at time of retirement the otherwise applicable early retirement reduction by paying in a lump sum the cost of that reduction [30]. While allowing those members who feel "burned out" the opportunity to leave without permanently reduced benefits, our proposal would not threaten future plan design nor have the total membership subsidize more benefits for a minority.**

Buck's <u>Third Recommendation</u>: <u>Increase minimum COLA program for long-time, low-income retirees to provide a benefit of $200 to $400 a month for retirees from 10 to 30 years of service (prorated).</u>

Equity Scale:

1) **Conforms to guidelines of <u>97D</u>:** Mixed. Specifically:

a) *Greatest good to greatest number*: it would benefit approximately 40% of our <u>retired</u> members, many of whom receive our current minimum benefit of $50 per month, while the **cost** of this subsidy would be borne by our total membership.

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[29] We have three "normal" retirement windows: 1) age 62 for those with 30 or more years of service; 2) age 65 for those with fewer than 30 years of service; and 3) the "Rule of 92" for those whose age and years of service equal or exceed "92".

[30] To be computed at an actuarially determined rate.

b) *Corrects existing inequities:* Comparative inequities, yes. This is a case where *individual* equity would be violated, while a compassionately motivated *inter-generational* equity would be served.

c) *Serves to attract and retain qualified employees:* Neutral.

d) *Avoids offering further incentives toward earlier retirement with full benefits:* Does not apply.

e) *Avoids splintering benefits by disproportionately rewarding one group over the general membership:* No. A general consensus will need to be achieved as to whether this proposal reflects a "disproportionate rewarding" of one group to the detriment of others. Of our entire membership, this group is the most in need.

2) **Equity**: It is *individually* inequitable to require all to pay for the benefits of some. A good case can be made in this instance, however, for *inter-generational* equity.

3) **Cost**: Potentially significant, though declining over time.

4) **Demographic group(s) affected**: Approximately 40% of current retirees.[31]

5) **Future Plan Design:** Neutral. The reason for the existence of this group is the past structure of IPERS: fewer years of service at a time when the formula, and covered wage ceilings, were lower. Over time, those with benefits this low will die and this subsidy will vanish.

IPERS' Position: IPERS supports this proposal.

Buck's Fourth Recommendation: Modify interest credited to member's contribution accounts to the rate used in the valuation to estimate the investment return on the funds as a whole.[32]

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[31] While 70% of all current retirees receive benefits under $500/month, and 40% under $200/month, 17% of all retirees also retired with under 10 years of service. These would be ineligible for any increase in the minimum benefit under the terms of Buck's proposal.

[32] Buck is not recommending that we apply a rate equal to that actually earned by the Fund, but rather one that reflects the interest rate assumption used by the System. This is currently 6.75%. See Buck, Report, p. 75.

Equity Scale:

1) **Conforms to guidelines of 97D**: Yes. Specifically:

a) *Greatest good to greatest number*: it would benefit those active members who terminate and take a refund or who die before retirement.

b) *Corrects existing inequities:* Yes.

c) *Serves to attract and retain qualified employees:* Neutral to slightly positive. We do not believe this to be a major factor.

d) *Avoids offering further incentives toward earlier retirement with full benefits:* Does not apply.

e) *Avoids splintering benefits by disproportionately rewarding one group over the general membership:* Yes. If anything, it restores to active members more of the value that is otherwise being diverted to the rest of the membership.

2) **Equity**: Yes.

3) **Cost**: Insignificant.

4) **Demographic group(s) affected**: Two-thirds of total membership.[33]

5) **Future Plan Design:** Neutral.

IPERS' Position: IPERS supports the thrust of this proposal, but suggests instead a target rate of from 1/2 to 1% over comparable one year interest rates for certificates of deposit.

The Investment Unit within IPERS was already investigating proposing to change the law to more accurately reflect current reality. The existing law dates from a time when the Trust Fund was largely invested in fixed income instruments.

Priority Level #2

Buck's Sole Recommendation: Modify the Death Benefit to provide that

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[33] Excluding inactive, non-vested persons who have no claim upon the System for any kind of retirement benefit. See appendix on demographics for more detail.

where death is the result of an accident incurred in the performance of duty the regular death benefit will be payable, or, alternatively, a survivor pension equal to 50% FAS payable to surviving spouse, dependent children or dependent parents and subject to the COLA.

IPERS recommends that this issue, together with that relating to *disability* in Priority Level # 3, be subject to further study. We believe it will require careful communication and coordination with our 2,700 employers around the state to ensure that what we propose IPERS do is both supportive of, and integrated with, their efforts.

Priority Level # 3

Buck's First Recommendation: Change [to a] Post-Retirement COLA....

Equity Scale:

1) **Conforms to guidelines of 97D**: As proposed, mixed. Specifically:

a) *Greatest good to greatest number*: it would benefit all retirees over time.

b) *Corrects existing inequities:* This is a good case of "in the eye of the beholder." IPERS does not believe that not having a COLA program is an inequity. We know that many of our retired members would disagree. Comparatively, the vast majority of other statewide retirement systems have **either** a COLA or an ad hoc program to increase retiree benefits over time.

c) *Serves to attract and retain qualified employees:* Neutral to positive. Typically, members become concerned about their ability to maintain purchasing power after they retire.

d) *Avoids offering further incentives toward earlier retirement with full benefits:* Does not apply.

e) *Avoids splintering benefits by disproportionately rewarding one group over the general membership:* No. On an *individual* equity basis, this represents a transfer of value from those not yet retired to those who already are. For younger members of the system, if a program were initiated, they would be paying for at least a portion of their own increased benefits through pre-funding. On an *inter-generational* equity basis, it could be argued that since virtually all retirees will experience a significant decline in their purchasing power because of IPERS' fixed monthly benefits such a proposal would benefit all retirees over time.

2) **Equity**: A mixed bag. See above.

3) **Cost**: Very significant.

4) **Demographic group(s) affected**: All current retirees, who are 25% of total membership, and all who retire in the future.

5) **Future Plan Design:** Significant. On the other hand, it would introduce a level of financial security that would be welcomed by all retirees, now and into the distant future.

IPERS' Position: IPERS does not support this proposal as recommended. However, we do support extending the principles of the proposal to our existing *dividend* program and, for liability projection purposes, valuing dividend payment levels - once granted - as permanent expenses of the Fund.

The difference, legally significant, is that if the System ever encountered a year -or a series of years - when it could not afford to hike the benefit payments of retirees, a COLA program would compel us to spend the money anyway while our *dividend* program - which takes regular legislative enactment - would not.

The dividend program, begun in the early 1980s, was initially intended to direct some Fund surplus toward the most needy (because they had the lowest benefits) of our retirees. From its inception, the dividend program has, however, identified members by chronological groupings denoted by when they retired, and not actually by the amount of monthly benefits received.[34] What is interesting is how succeeding groupings of retirees have come to expect that, at some point, the **right** of dividends will also be extended to them. While people can reasonably differ about whether or not this should be so, our dividend program has come to be seen as a semi-permanent feature of our System which all retirees, over time, will receive.

Despite this significant (and legally vital) difference, we believe that the effect - for all practical purposes -would be the same. Already both retirees and legislators view our dividend program as a "given." Only the most dire circumstances would warrant us not paying them and, even under our existing program, this too would take legislative concurrence.[35] Once we bring the least well-off among the retirees up to a higher minimum benefit level (as

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[34] The effect has been roughly similar, however, as the longest retired overwhelmingly tend to have the lowest benefits.

[35] Twice in recent years the Legislature has directed us to put aside money for future dividend payments **before** we considered monies in our *available margin* for any other purpose.

recommended by Buck), there is no reason why - from that point on - further increases could not be both annual in nature and equal as a percentage of monthly benefit. We believe that referencing a useful price index would be desirable and that a cap should be placed on the amount of any such annual increase.

Buck's Second Recommendation: Modify the Disability Benefit to provide a minimum benefit equal to 33 1/3 FAS; coordinated with other employer-financed disability benefits and insurance by reducing benefit when total equals 80% of FAS.

IPERS' Position: We recommend that this issue, together with that relating to *death benefits* in Priority Level # 2, be subject to further study. We believe it will require careful communication and coordination with our 2,700 employers around the state to ensure that what we propose IPERS do is both supportive of, and integrated with, their efforts.

Buck's Third Recommendation: Modify the Death Benefit to provide that benefits be paid according to [a suggested] schedule....

IPERS' Position: We recommend that this issue, together with that relating to *death benefits* in Priority Level # 2 and to *disability benefits* also in Priority Level # 3, be subject to further study, for reasons cited above.

Buck's Fourth Recommendation: Modify the Reemployment of Retired IPERS Members under age 65 to increase the amount an IPERS retiree can earn without a reduction in the retiree's pension.

Equity Scale:

1) **Conforms to guidelines of 97D**: Yes. Specifically:

a) *Greatest good to greatest number*: it would benefit those retirees who wish to return to covered employment and who earn above the current statutory allowed limit of $7440 without imposing costs on anyone else.

b) *Corrects existing inequities:* The issue is one of legality and policy, we believe, more than "inequity". Certainly, many who need additional income feel the current law "penalizes" them (for, if they exceed the limit, their IPERS' benefits are suspended for the remainder of the calendar year, or the duration of their employment, whichever is shorter).

c) *Serves to attract and retain qualified employees:* Positive, as it offers employers an opportunity to utilize skilled senior talent (often at a much reduced cost over retaining a permanent, full-time worker).

d) *Avoids offering further incentives toward earlier retirement with full benefits:* In general, it does not apply, although it is possible some individuals might regard retiring as a more viable option if they knew they could return to employment without significant penalty.[36]

e) *Avoids splintering benefits by disproportionately rewarding one group over the general membership:* Yes.

2) **Equity**: Yes.

3) **Cost**: Very small.

4) **Demographic group(s) affected**: All retirees could utilize this provision, but at present only 2% do.

5) **Future Plan Design:** Positive. Demographics suggest that it will be to all employers' benefit to be able to either continue more senior workers in employment or, as this recommendation would favor, entice them back into partial or full time re-employment following their retirement. Anything we can do to make the plan more "neutral" on this option would be desirable.

IPERS' Position: Subject to resolving certain important legal questions, IPERS supports this proposal as recommended. Further, we recommend allowing members considering re-employment with a covered employer to elect not to be covered under IPERS during any period of employment subsequent to initial retirement.[37] It is consistent with recommendations made by a multi-agency special committee on retirement policy established a couple of years ago, the conclusions of which are supported by the Department. **IPERS also favors changing our present policy towards wages covered in reemployment from the present law which cuts off all benefits once a certain ceiling has been surpassed to one where benefits are**

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[36] Always assuming, of course, that they otherwise met the conditions of attaining a *bona fide retirement* first.

[37] Subject to verification that this does not run afoul of any applicable federal laws.

reduced by \$.50 on each dollar earned in reemployment once the ceiling is reached.[38] We believe the policy of cutting off all benefits to be too harsh.

IPERS Additional Recommendations on Areas Not Addressed by Buck

IPERS' First Additional Recommendation: Upon retirement, a vested terminated member would have the right to have the value of his or her benefit at time of termination indexed - with reference to the same instrument used in assessing increases for IPERS *dividend* program - for each year between date of termination and eventual retirement, provided that the member pay to IPERS an amount equivalent to 9.45% of the indexed increase in the member's highest covered salary year.

Equity Scale:

1) **Conforms to guidelines of 97D**: Yes.

a) *Greatest good to greatest number*: it would benefit the 10% of our members who have terminated from covered employment but who have not yet retired, while having them bear their proportionate cost share.

b) *Corrects existing inequities:* Yes. At present IPERS has the use of their money over time but the member's benefit does not increase at all.

c) *Serves to attract and retain qualified employees:* Positive in attracting employees, as it would add a feature of "value retention of actual benefit earned" comparable to defined contribution plans offered by the private sector, and currently enjoyed by Iowa participants in TIAA-CREF.

d) *Avoids offering further incentives toward earlier retirement with full benefits:* Yes.

e) *Avoids splintering benefits by disproportionately rewarding one group over the general membership:* Yes.

2) **Equity**: Yes.

3) **Cost**: Significant.

4) **Demographic group(s) affected**: Presently 7% of total membership. The

[38] This is similar to the approach used by Social Security.

number would likely grow in the future if this proposal were enacted because it would serve as an incentive to keep money in the system, rather than to withdraw it as a refund.

5) **Future Plan Design:** Positive. This is an element of our membership which IPERS has long identified as "under-served".

IPERS' Position: We support consideration and enactment of this proposal.

IPERS first advanced the genesis of this proposal in 1989. We continue to recommend that our primary focus on the career employee be broadened to include those employees whose termination from public employment does not coincide with their retirement. This position is consistent with existing efforts to provide a sound retirement for all employees, and can serve both to keep more money in the System and allow IPERS to provide an equitable portion of what could be an eventual sound retirement for the thousands of vested, but terminated, employees. Consistent with our approach throughout this report, we recommend that the terminated vested member be required to pay an amount representing the increased contributions they would have made had they remained in service.

IPERS' Second Additional Recommendation: That IPERS, together with interested constituent and employer groups, develop a proposal for assisting members in meeting anticipated health care costs in retirement.[39] This proposal would incorporate the following principles:

1) **This additional benefit would be paid for on a pre-funding basis through either employee only, or a combination of employer-employee, contributions;**

2) **Monies would flow to a trust fund separate from that used by IPERS to pay retirement benefits;**

3) **This separate trust fund would be structured as a *defined contribution* plan; payouts could not exceed accumulated contributions plus interest.**

4) **Monies in this fund would not be tied to any existing health plan nor to any specific premium for health services; they would represent accumulating**

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[39] In early meetings with Buck's representatives, the committee of IPERS' staff and constituent representatives [see Acknowledgement section at beginning of this report] concurred that this issue should, for the time being, be "taken off the table" for purposes of Buck's review.

dollar value available for members' eventual use in best meeting health care costs as they chose.

IPERS understands that growing health care costs will continue to put pressure on our retirees who will, in turn, continue to pressure us for assistance in meeting those costs. We believe it is our responsibility to take a leadership role in favorably resolving this issue. Our recent many months long experience of working closely with constituent and employer groups in interviewing candidates for, and then working with the selected consultant on, this benefits study gives us renewed confidence that - together, and with all our cards on the table - we will be able to arrive at an equitable and mutually supported solution.

<u>IPERS' Second Additional Recommendation:</u> We are also currently investigating alternative formula and Plan design features which would target greater accrual value to our average member. We anticipate having a report on these options, together with possible recommendations, by November or December of this year.

APPENDIX ONE: SYSTEM DEMOGRAPHICS

An Overview of Some Key Indices [40]

o *Profile of Total Membership: [Graph 2]*

- **Active members**[41] constitute 65.23% of total[42] membership (221,120);
- **retirees** 25.39%;
- **retired, reemployed** members 2.28%; and
- **inactive vested** members 7.07%.

o *Profile of Active Members: [Graph 3]*

- **State employees** continue to shrink in number as a percentage of active workers: down to 16.3% in fiscal year 1995 as compared to 18.9% just two years ago;
- **school personnel** have long been the largest segment by far, and their numbers have surged from 45.7% two years ago to 49.3% of active employees today;
- **city** and **county** numbers are holding roughly the same as a percentage of total membership (13.6% and 16.1% respectively);

o *Annual Terminations from Service:*

Quite a bit of churning occurs each year among the active employees, as between 8,000 and 10,000 employees annually terminate covered employment and take a refund of their contributions and accumulated interest (which completely severs their relationship with the System);

[40] All data used, unless otherwise noted, is from the first calendar quarter of 1995.

[41] (i.e., currently employed)

[42] These figures exclude a large number of members (60,639, or 21.4% of total membership) - the **inactive, non-vested** - who have no claim upon IPERS for any retirement benefit. These persons left IPERS' covered employment before attaining vesting status, the vast majority of them with very little service. Although not required to do so, we have kept them identified in our data base even as we continue to attempt to locate them in order to let them know they still have money in the system. If these inactive, non-vested members are factored into our total membership (which would then swell to 282,759), then the percentages of the various groups are as follows: **active,** 51.2%; **retired,** 19.95%; **retired, reemployed** 1.79%; **inactive, vested** 5.55%; and **inactive, non-vested** 21.4%.

o *Profile of Those Nearing Retirement:*

In the key demographic group of ages 55-65 (those **eligible to retire**), school employers are slightly overweighted (52.2%) as compared to their percentage of all active members; and their numbers balloon dramatically (as does the State's employees) in the group **eligible for the Rule of 92**: 63.6% and 19.1% respectively (out of a total eligible population of 3,190 persons);[43]

o *Age at Retirement:*

- 20% of all members retire **at age 62**[44];
- 22% leave **before age 62**; and,
- 58% leave **after age 62.**

o *Profile of Retirees: [Graph 6]*

By Employer Group:

- Former **school personnel** (51.4%);
- Former **state workers** (18.8%);
- Former **county employees** (16.5%); and,
- Former **municipal staff** (11%).

By average years of service:[Graph 7]

- remain at **just under 20 years** for the typical retiree;
- 51% have **less than 20 years of service**;
- 26.2% retired with **from 20 to 29 years of service**; and,
- only 22.7% of all retirees have **30 or more years of service.**

o *Monthly Benefit Amounts by retirees:[Graph 11]*[45]

- Average benefit paid has finally risen above **$400 per month;**
- 40% receive **less than $200 per month;**
- 30% **between $200 and $500 per month;**
- 8% above $1,000 per month.

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[43] Less than 25% of those eligible for the Rule of 92 actually take advantage of it.

[44] This is the earliest year for which a person can qualify for Social Security benefits.

[45] The highest possible monthly benefit which can be paid in 1995, factoring in the multiplier and covered wage ceiling increases, will be **$1,900** ((2% X 30 years X $38,000)/12).

Years of Service at Retirement

The IPERS plan gives *full benefits* [60% of a person's highest three covered salary years] to those who retire at a normal retirement age (62) and who have 30 or more years of service.[46] As the "average" retiree leaves with just under 20 years of service, such a member will receive only "40%" of the average of his or her highest three covered wages, <u>not</u> 60% [47]

The Covered Wage Ceiling

From its inception, IPERS has imposed a "covered wage ceiling" on the amount of a person's salary for which contributions to IPERS will be made. While very low originally, this cap has been gradually raised by successive Legislatures. At $41,000 for calendar year 1995 (and going to $44,000 on January 1, 1996), it is scheduled by law to increase annually each January 1 by $3,000 until it reaches the statutory limit of $55,000.

Under a defined benefit plan such as IPERS, the amount of one's pension depends upon a number of factors, including years of service, age upon retirement, and the average of the highest three years' covered salary. During the 1950s, the IPERS covered wage ceiling was $4,000. It did not rise above $20,000 (at which level it had remained for several years) until 1984. Many persons now retired left public employment in the 1950s, 1960s, and early 1970s. Their pension compensation is low compared to those who have retired in more recent years due to the fact that their covered wage ceiling (as well as the formula multiplier) was much lower. Consequently, both their contributions and average salary used for benefit computations during those years were also much lower. ***[Graphs 8, 9, & 10]***

Dividends Paid to Retired Members *[Graph 12]*

The Legislature has regularly adjusted the pensions received by those in IPERS' earliest years. Since 1984, for example, the Legislature has approved annual dividend payments (expanded over time to include **all** those who retired before July 1, 1990[48]) based upon a percentage of their monthly benefit checks. These adjustments, together with the indexing

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[46] The *"Rule of 92"* does not, in itself, convey <u>full</u> benefits, unless the member has **30 or more years of service**. The *"Rule of 92"* <u>does</u> cancel any "early retirement penalty" that otherwise would have applied.

[47] "60%" means 2% for each year of service. Therefore, the average retiree leaving at 20 years of service will receive 20 X 2%, or 40%.

[48] Effective with dividends to be paid in November of 1996, members who retired between July 1, 1986 and July 1, 1990 will begin to receive supplementary payments.

aspects of federal Social Security payments, have helped many[49] of IPERS' retirees to cope with the eroding impact of inflation on their purchasing power. ***[Graphs 13, 14, & 15]***

Inactive, Vested Members

Another, although less prominent, group within IPERS is that of the inactive, vested members (15,708, or 5.5% of the **total** membership). ***[Graph 2]*** These are persons who had worked at least long enough to become vested, but who are no longer active, contributing employees. When they left public employment, these persons elected to leave their money in IPERS rather than withdrawing it as a refund.

Because these persons were vested when they terminated, their accounts continue to draw interest on the amounts contributed by themselves and their employers on their behalf. Under the present law, their choices are limited to:

a) returning to IPERS covered employment, which would allow them to continue to build upon their contributions and quarters of service already attained;

b) taking a refund of their own contributions, plus accumulated interest; or,

c) applying for retirement when they reach either early or normal retirement age. (*However, the amount of their earned benefit will not increase one penny from the day of their termination from public employment until their eventual retirement because they receive no benefit credit for interest earned on their money and their benefit is based upon their average high three covered wage which does not increase after they leave public employment.*)

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[49] Almost 30% of IPERS' retirees have retired since July 1, 1990 (16,137 of 56,414).

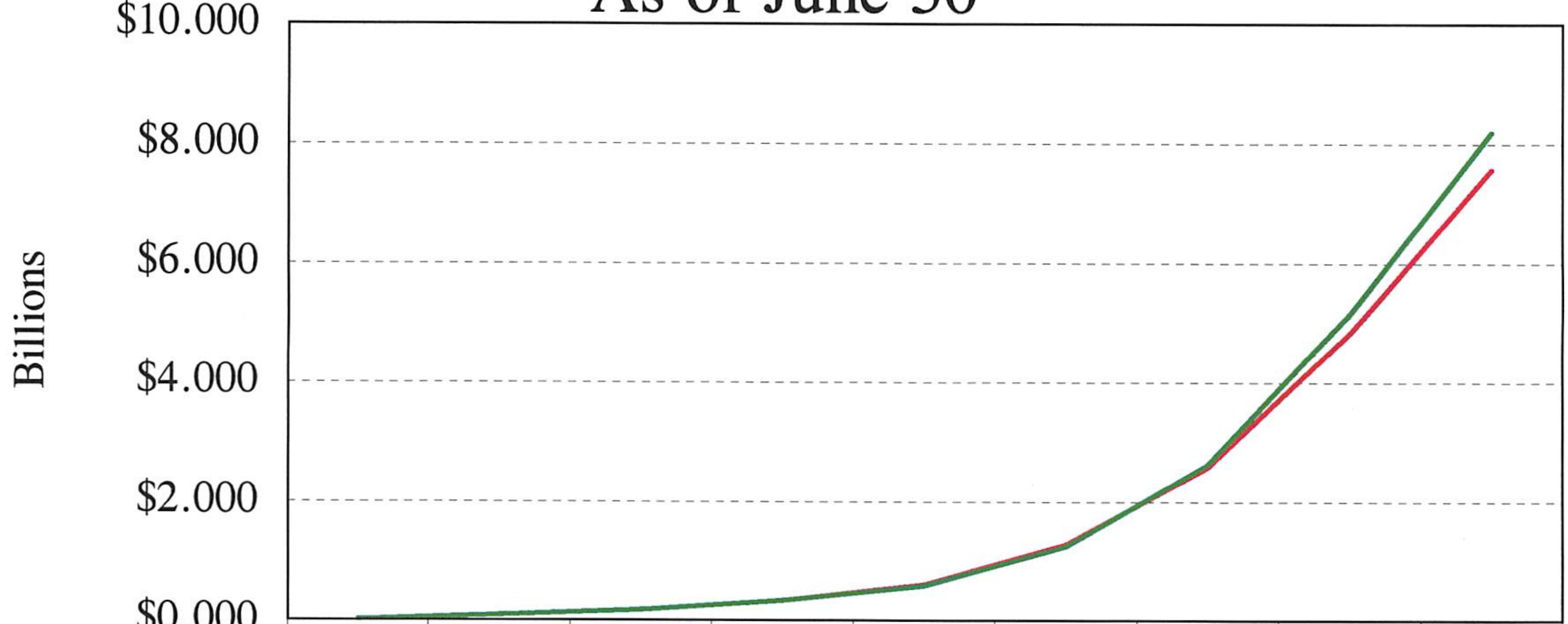
APPENDIX TWO: GRAPHS AND CHARTS

This is the order of the following tables:

- o Net Assets & Market Value
- o Membership Profile
- o Active Members by Age
- o Active Members by Employer Group
- o Active Members Age 55-65 Per Employer Group
- o Active Members Eligible for Rule of 92 by Employer Group
- o Retirees by Employer Group
- o Retirees by Years of Service
- o Retirees by Age
- o Retirees by Years Retired
- o Age at Retirement by Employer Group
- o Retirees by Monthly Benefit
- o Retirees by Dividend Group
- o Average Benefit Per Dividend Group
- o Average Years of Service Per Dividend Group
- o High Monthly Benefit Per Dividend Group

System Assets
Market Value & Actuarial Value

As of June 30



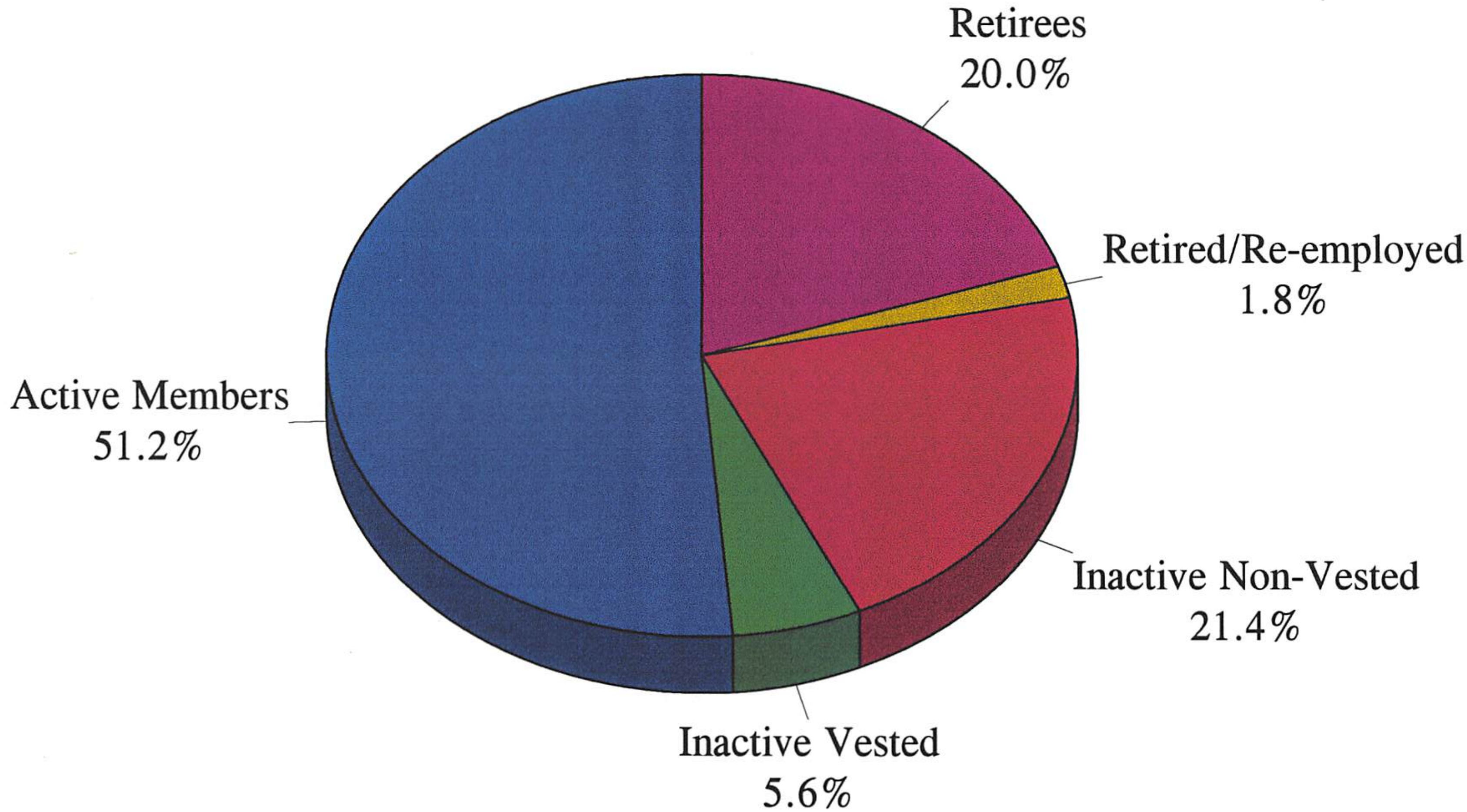
	1954	1960	1965	1970	1975	1980	1985	1990	1995
Market Value	$0.029	$0.106	$0.194	$0.349	$0.596	$1.259	$2.622	$5.155	$8.201
Actuarial Value	$0.029	$0.106	$0.194	$0.347	$0.618	$1.288	$2.581	$4.830	$7.575

Securities valued at par prior to 1970

Graph 1

Membership Profile

June 30, 1995

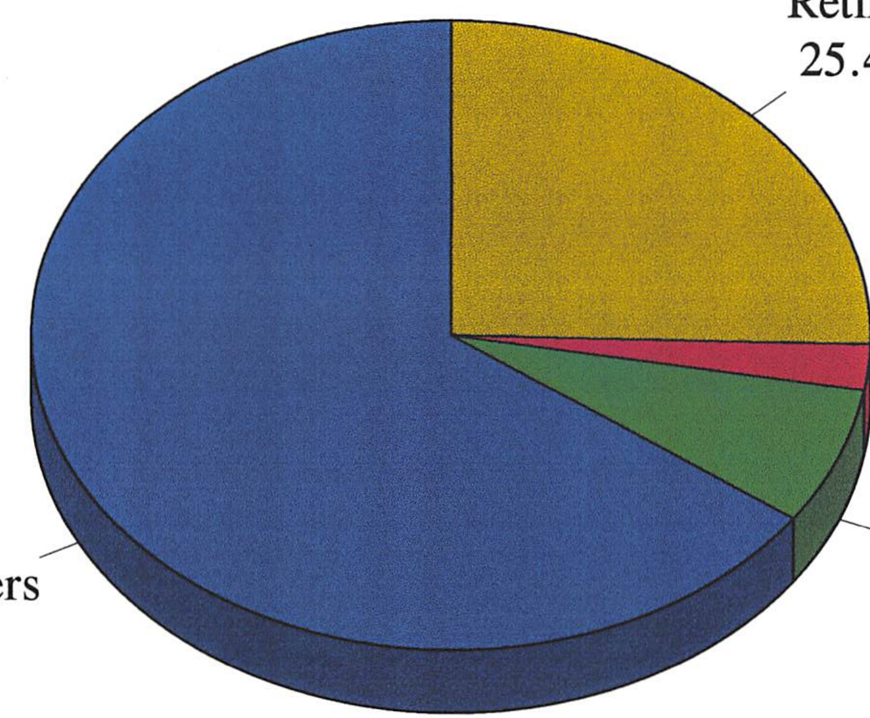


Total Membership: 282,759

Graph 2a

Membership Profile Without Non-Vested

June 30, 1995

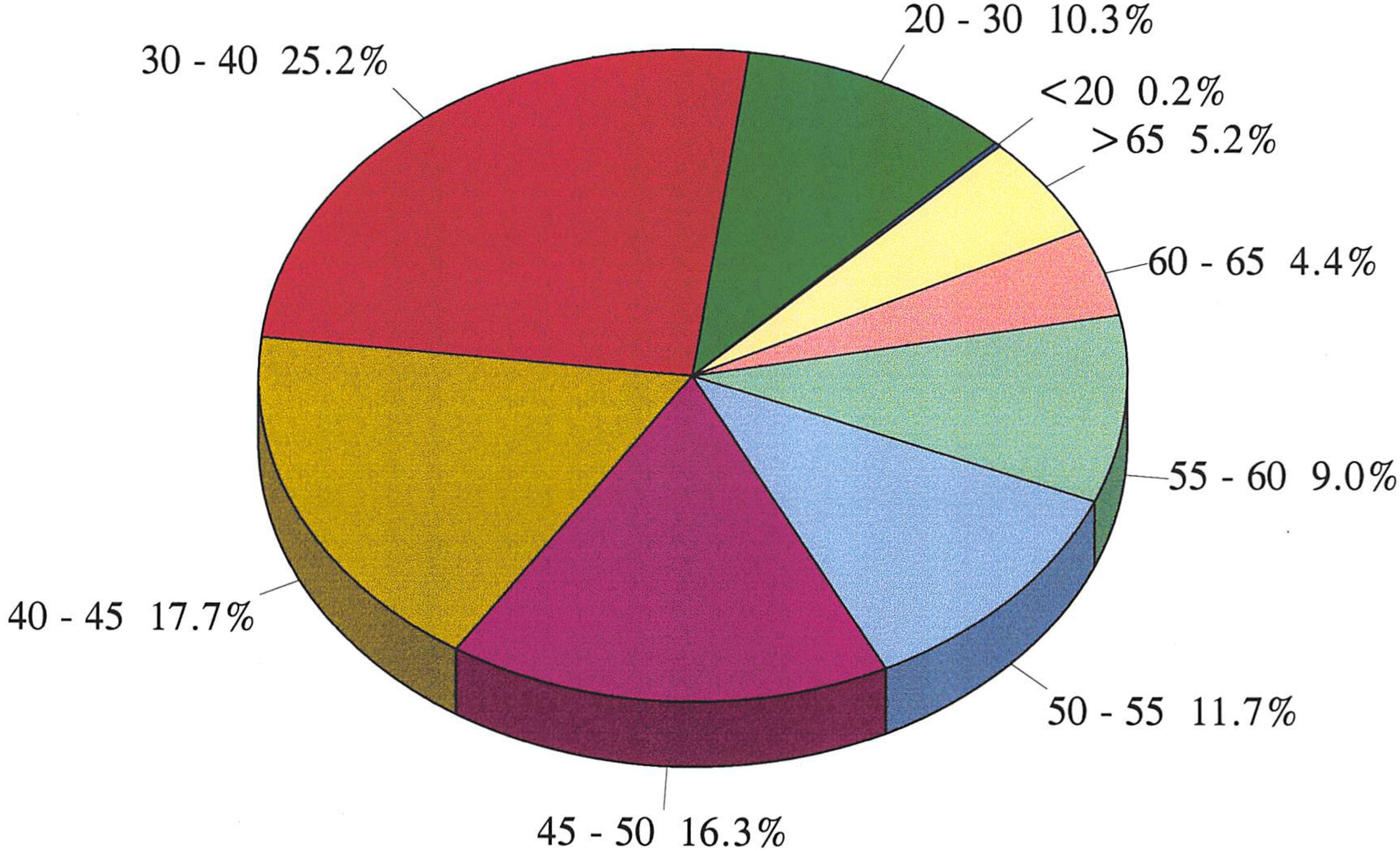


Total Membership: 221,120

Graph 2b

Active Members by Age

June 30, 1995

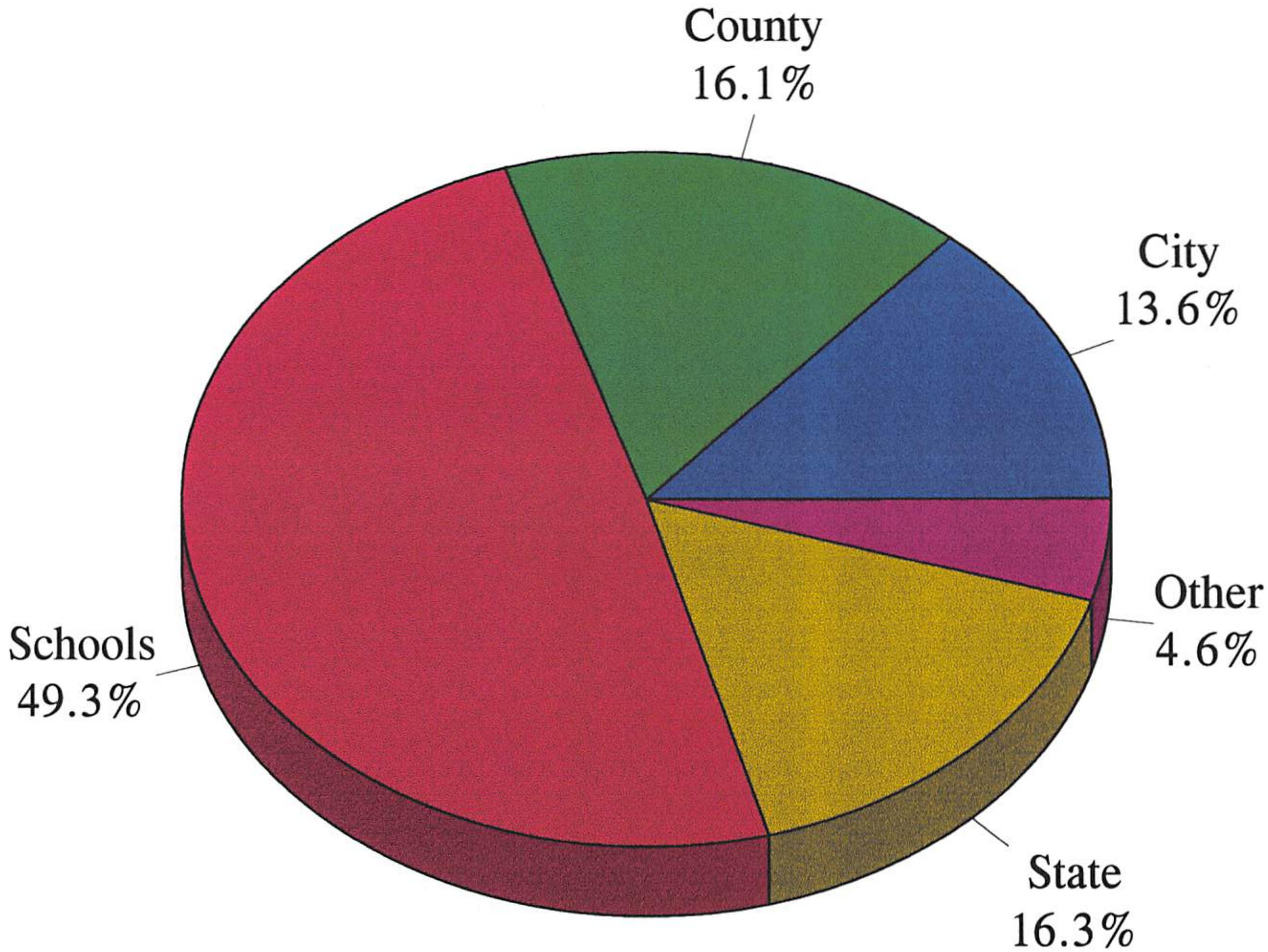


Total Active Members: 144,756

Graph 2c

Active Members by Employer Group

June 30, 1995

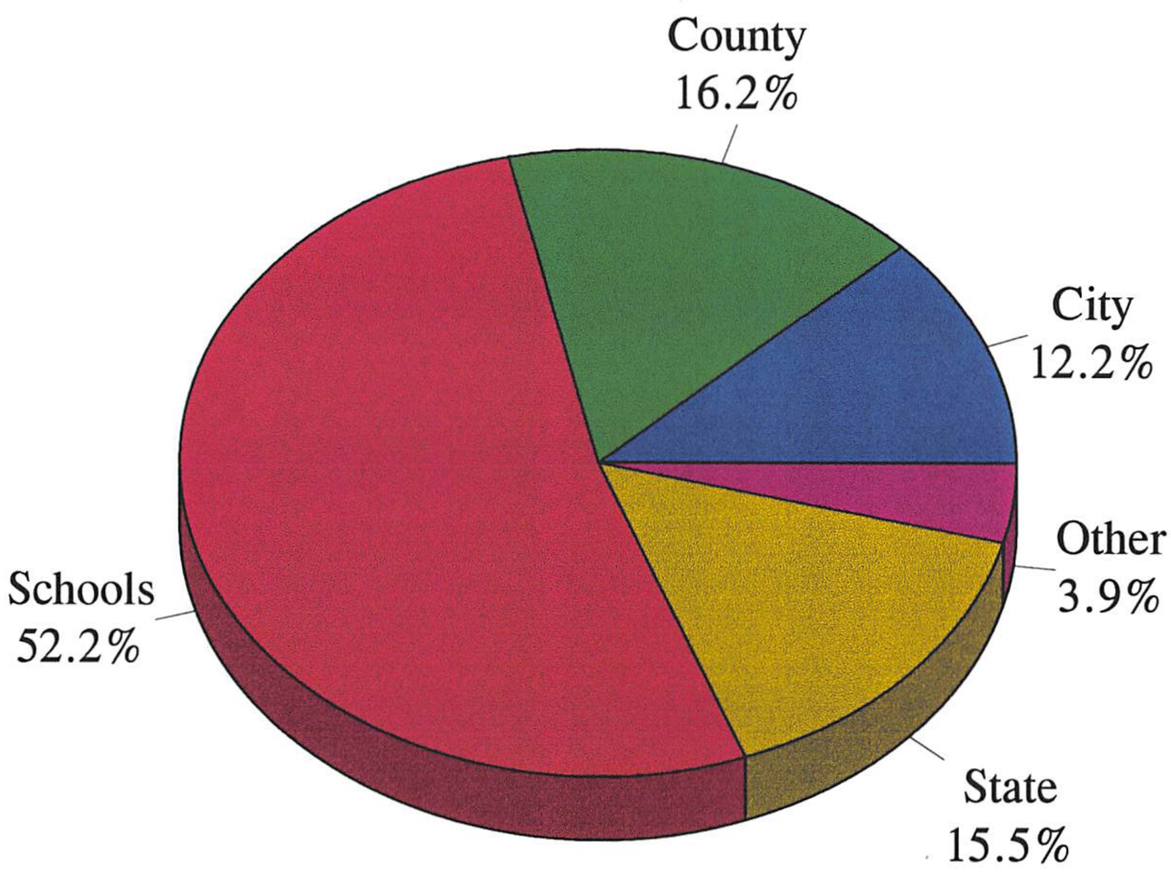


Total Active Members: 144,910

Graph 3

Active Members Age 55 - 65 Per Employer Group

June 30, 1995

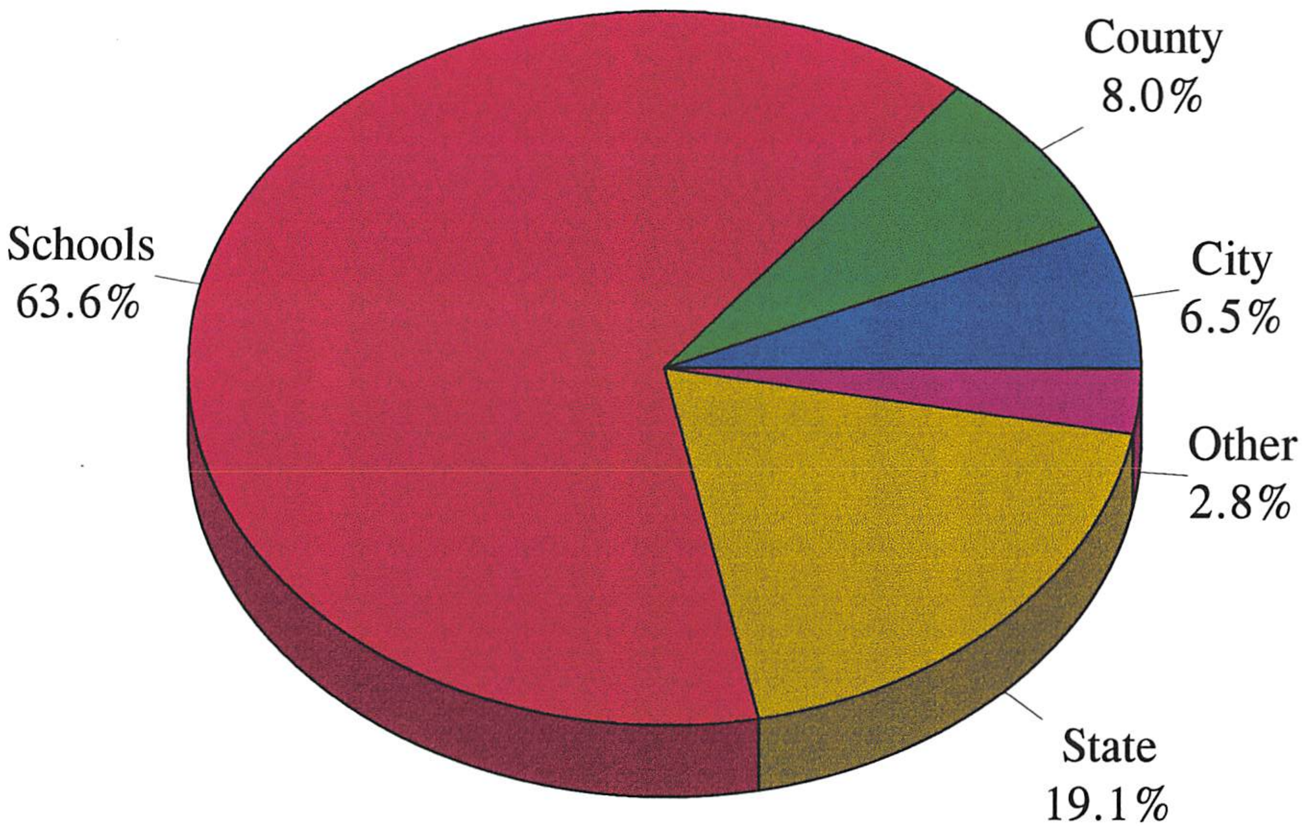


Total in Group: 22,466

Graph 4

Active Members Eligible for Rule of 92 by Employer Group

June 30, 1995

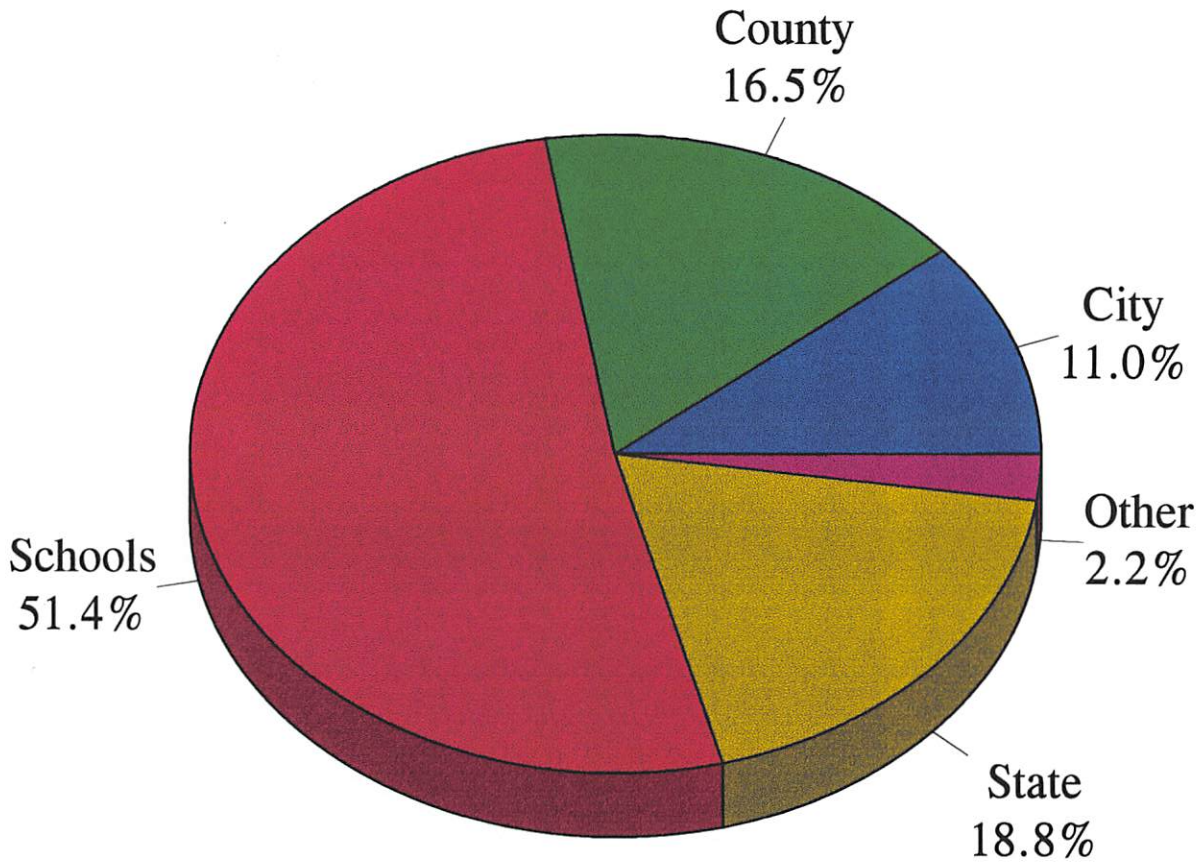


Total Eligible: 3,190

Graph 5

Retirees by Employer Group

June 30, 1995

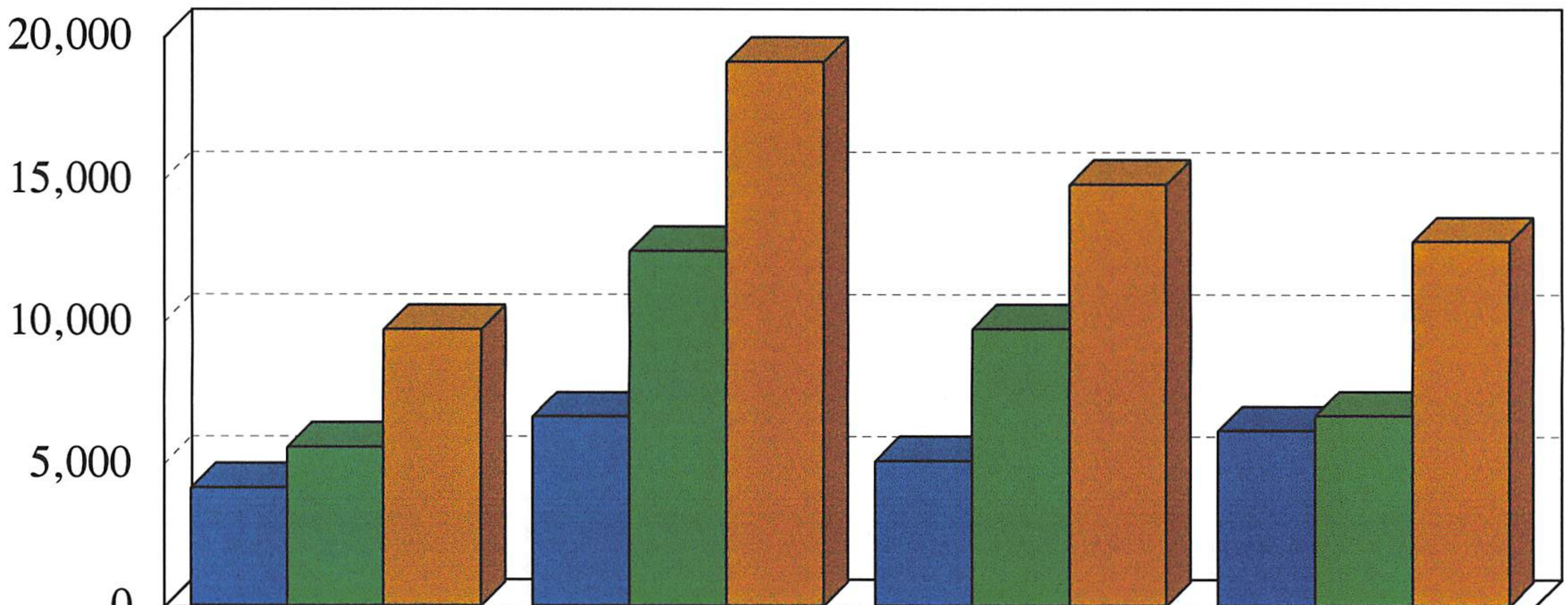


Total Retirees: 56,414

Graph 6

Retirees by Years of Service

June 30, 1995

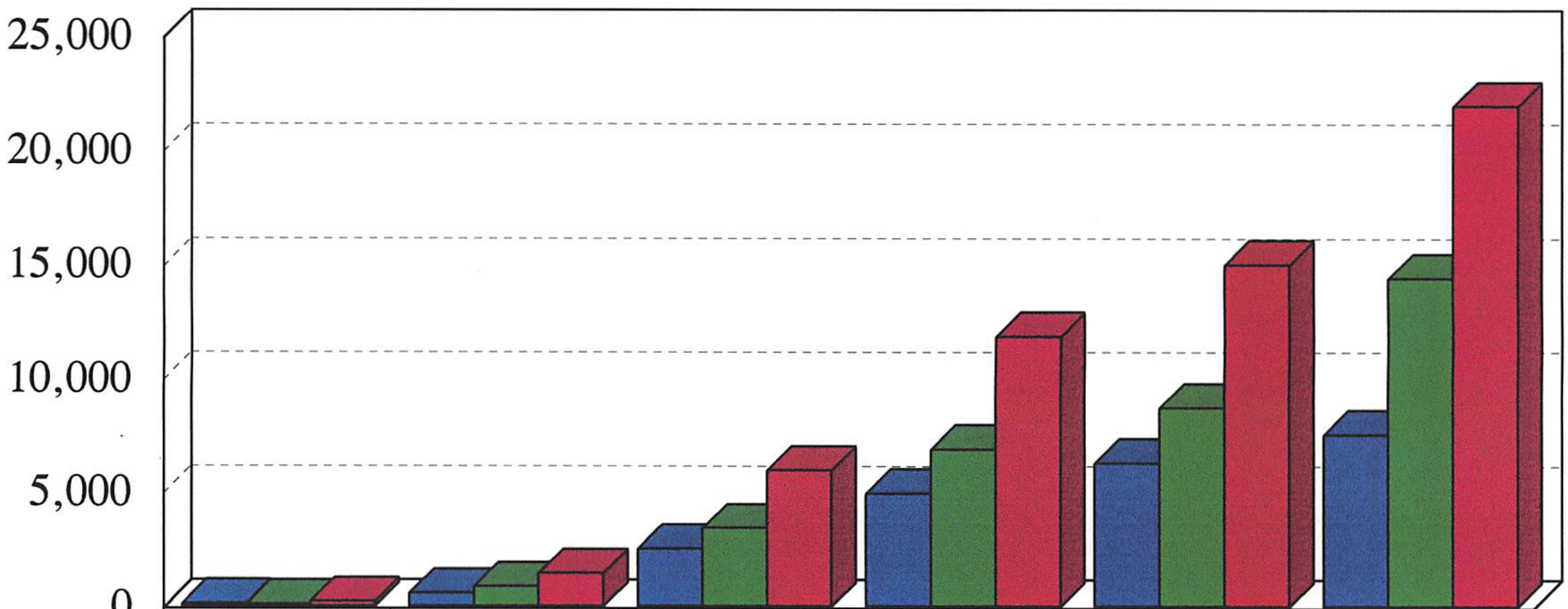


	<10	10-19	20-29	>30
Males	4,144	6,624	5,084	6,132
Females	5,557	12,462	9,717	6,669
Total	9,701	19,086	14,801	12,801

Graph 7

Retirees by Age

June 30, 1995



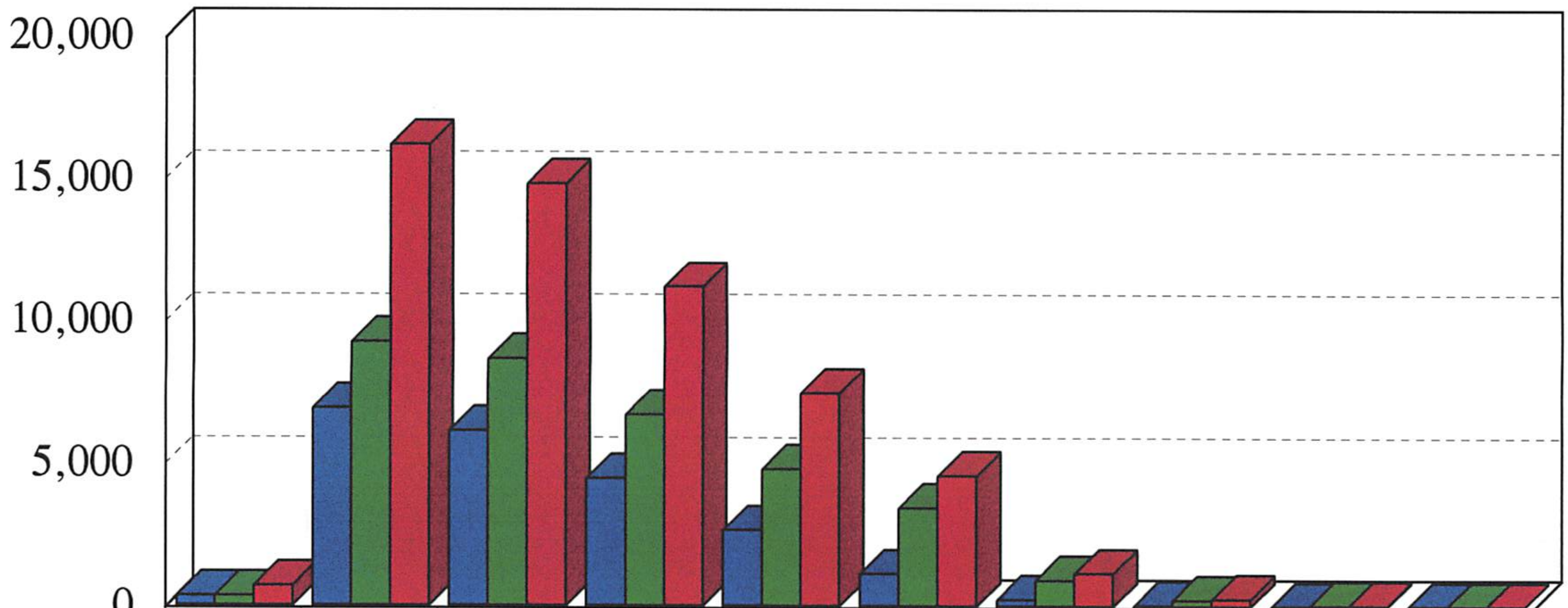
	< 55	55 - 59	60 - 64	65 - 69	70 - 75	76 & Up
Males	114	573	2,530	4,952	6,286	7,529
Females	99	868	3,427	6,887	8,719	14,405
Total	213	1,441	5,957	11,839	15,005	21,934

Males Females Total

Graph 8

Retirees by Years Retired

June 30, 1995



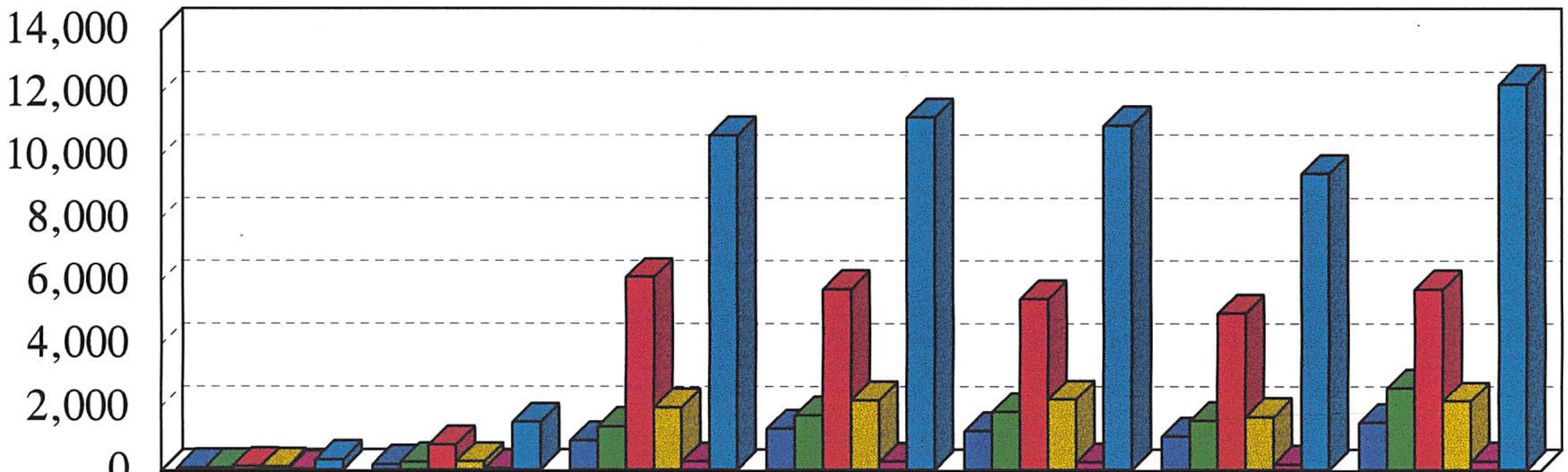
	<01	1-5	6-10	11-15	16-20	21-25	26 - 30	31 - 35	36 - 40	>40
Males	346	6,936	6,146	4,478	2,666	1,132	235	38	4	1
Females	348	9,256	8,667	6,709	4,810	3,451	914	223	28	1
Total	694	16,192	14,813	11,187	7,476	4,583	1,149	261	32	2

Males Females Total

Graph 9

Age at Retirement by Employer Group

June 30, 1995

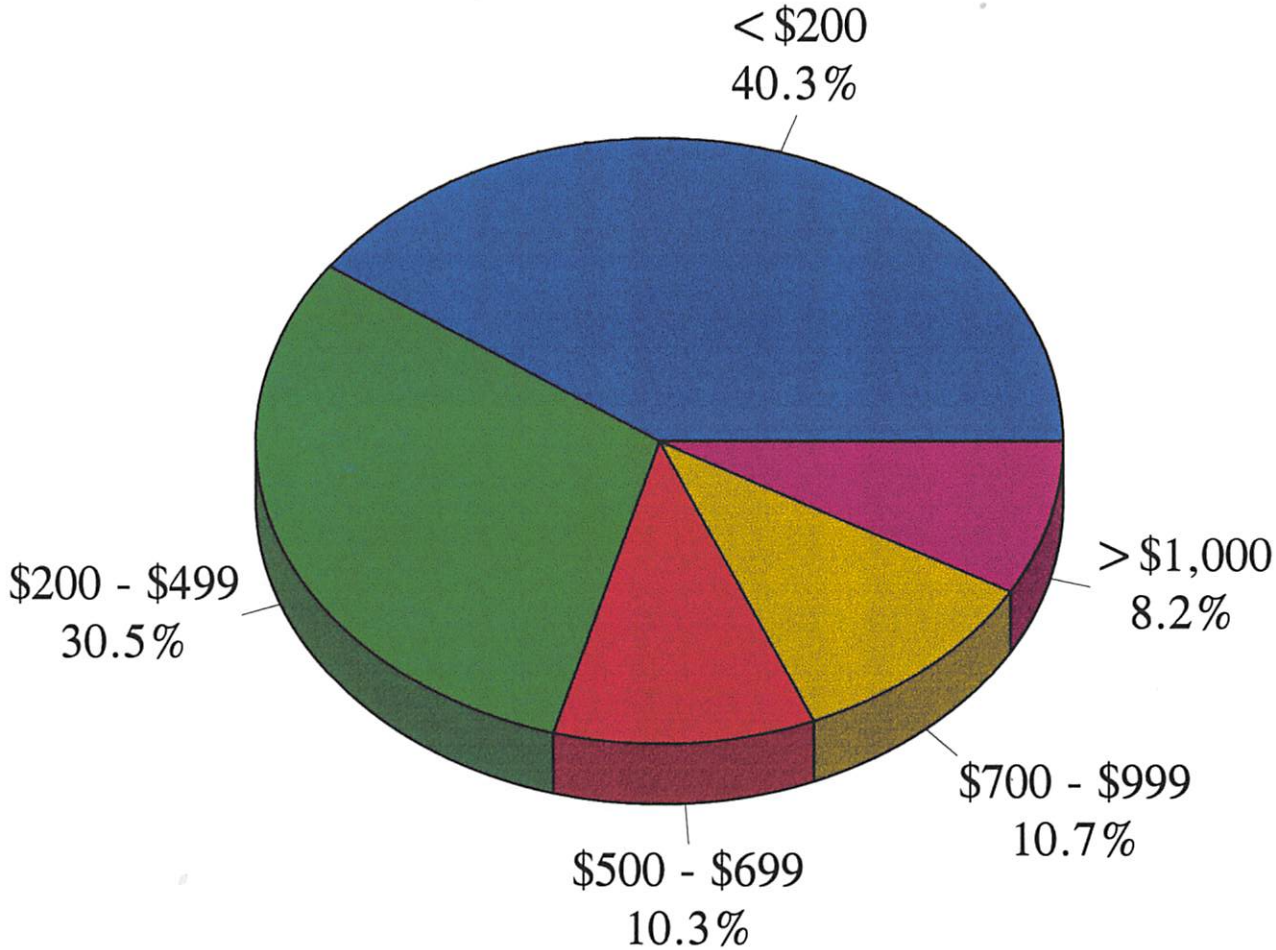


	< 55	55	56 - 61	62	63 - 64	65	> 65
City	58	173	920	1,305	1,223	1,057	1,493
County	60	250	1,367	1,714	1,838	1,552	2,591
Schools	108	790	6,115	5,725	5,419	4,961	5,729
State	89	258	1,972	2,200	2,234	1,670	2,179
Other	8	39	258	263	245	175	269
Total	323	1,510	10,632	11,207	10,959	9,415	12,261

Graph 10

Retirees by Monthly Benefit

June 30, 1995

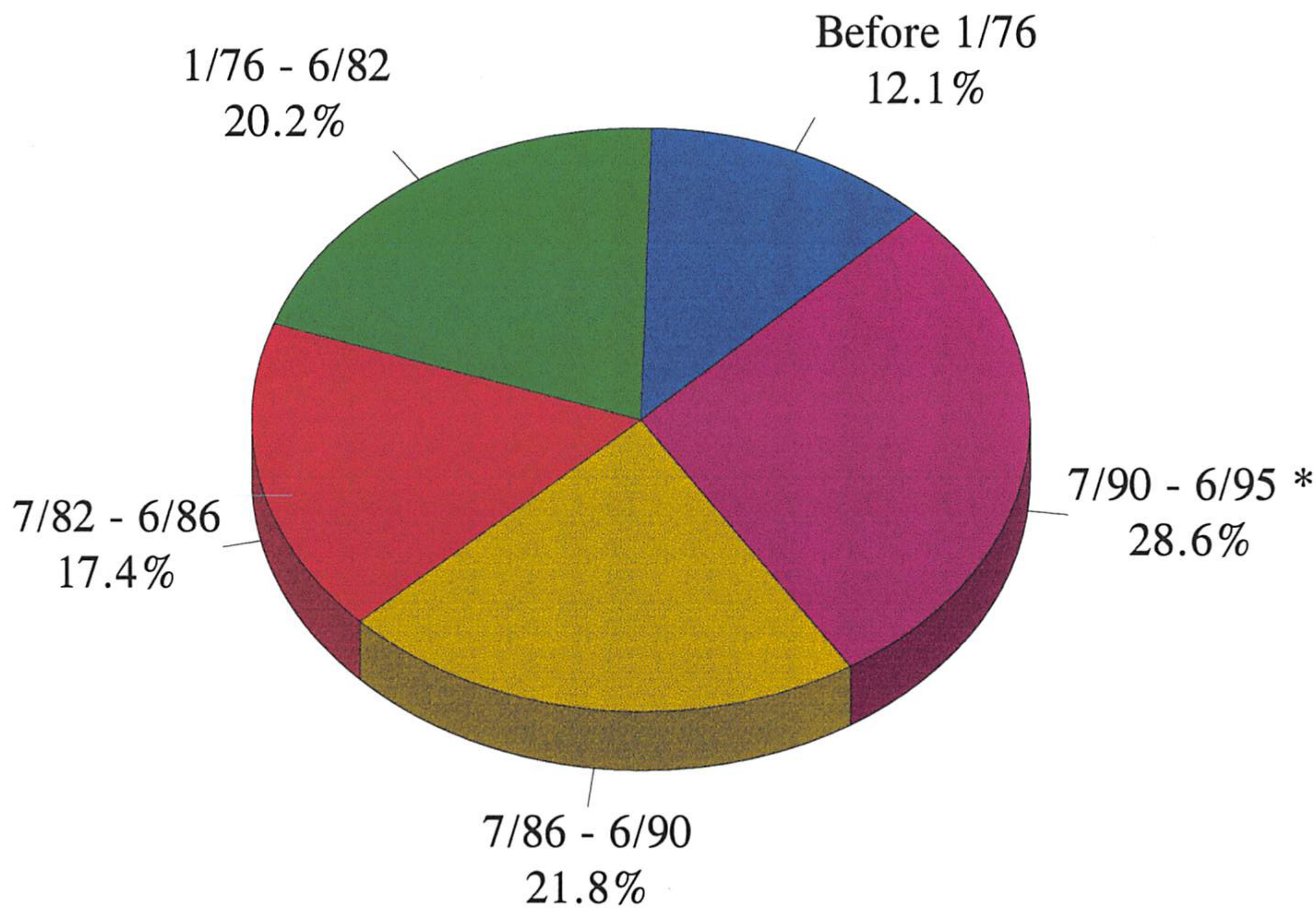


Total Retirees: 56,414

Graph 11

Retirees by Dividend Group

June 30, 1995

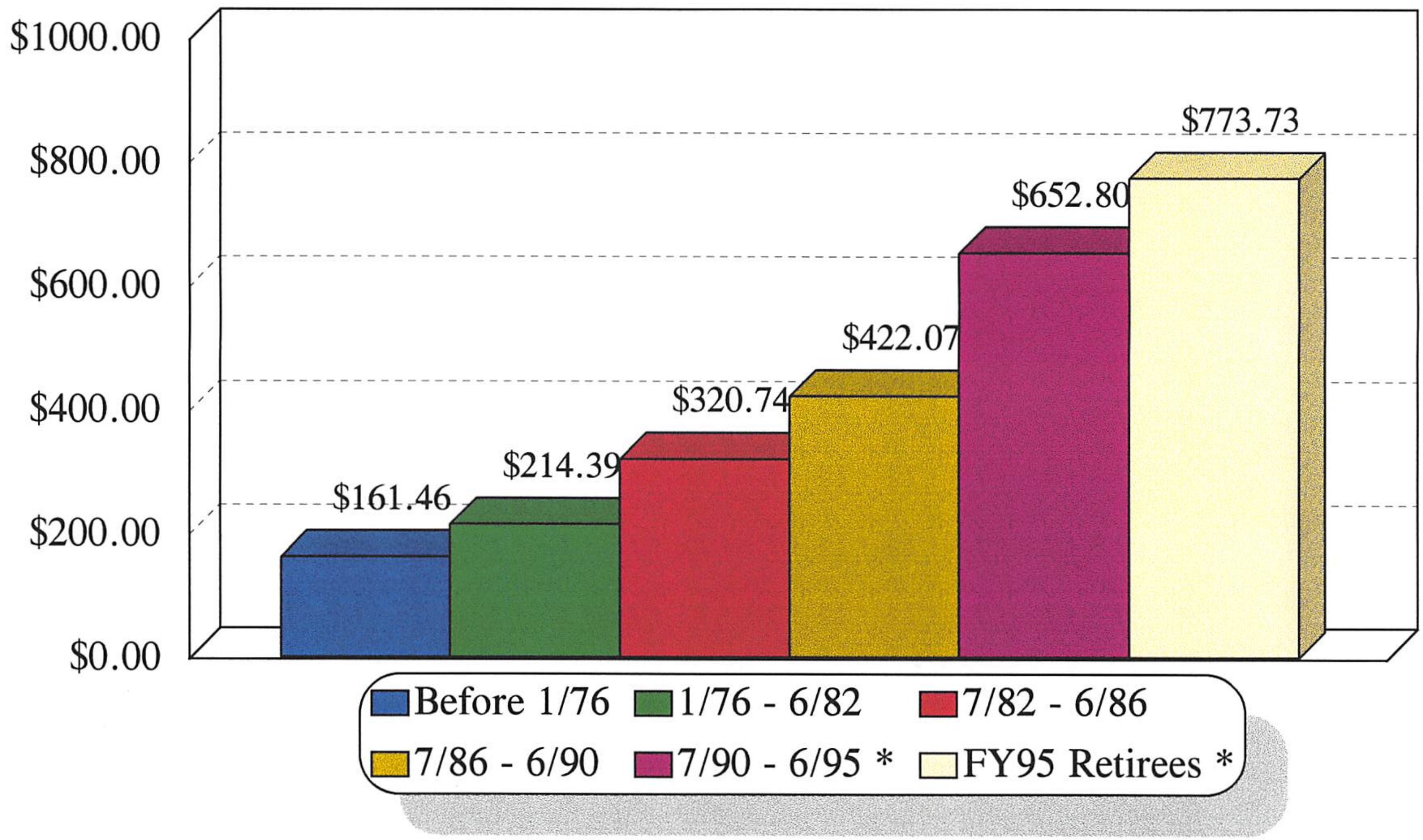


* Non-Dividend Group

Graph 12

Average Benefit Per Dividend Group

June 30, 1995

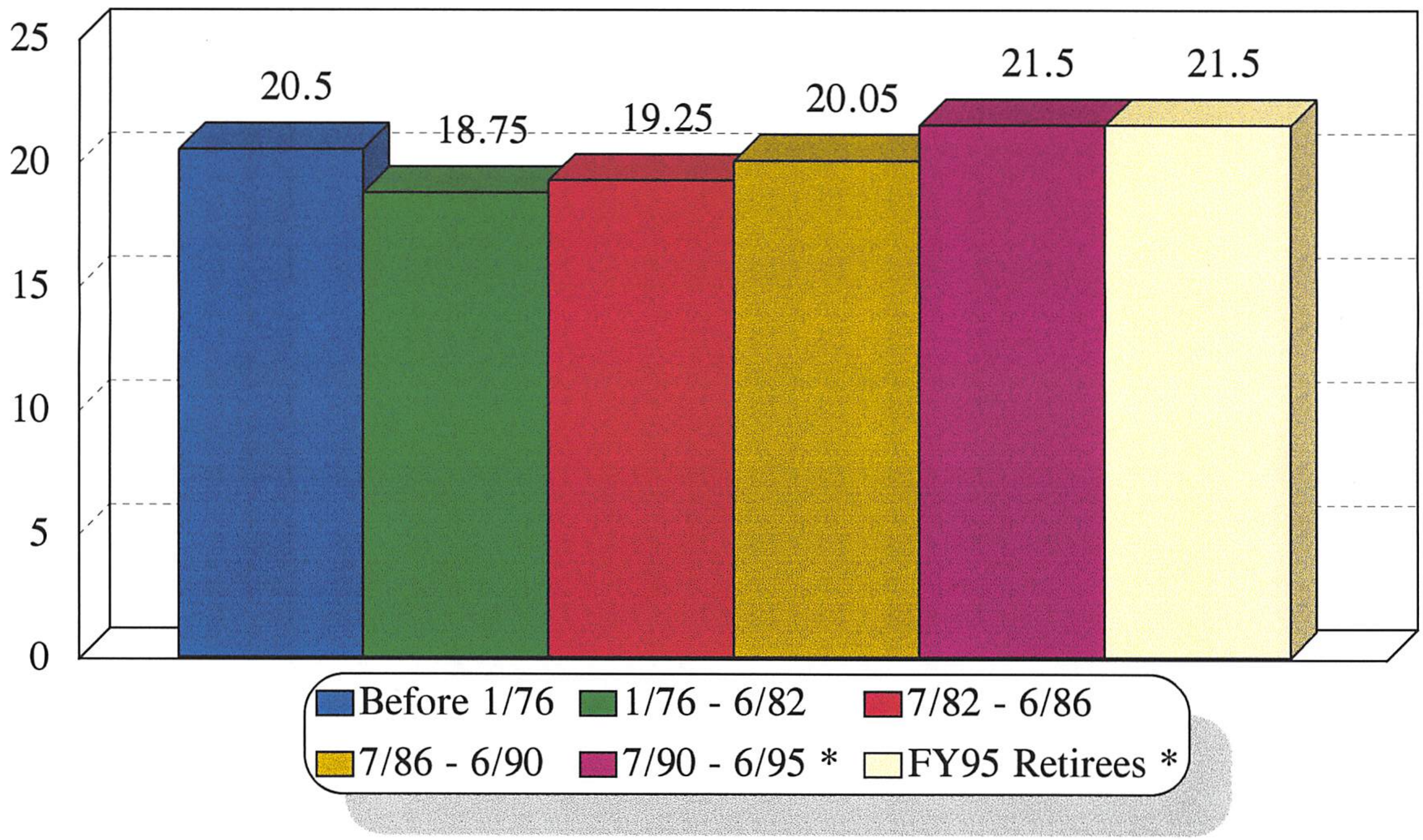


* Non-Dividend Groups

Graph 13

Average Years of Service Per Dividend Group

June 30, 1995

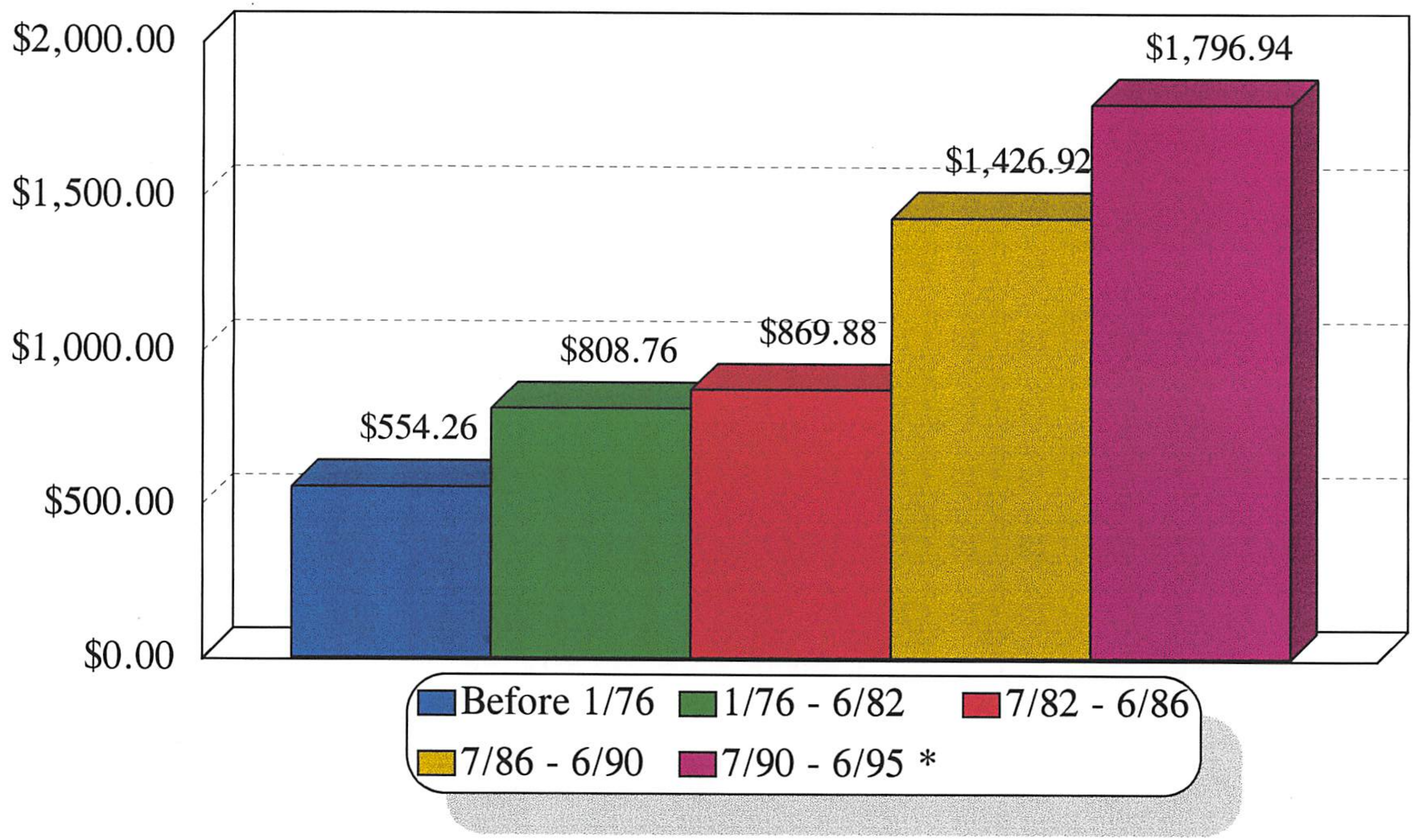


* Non-Dividend Groups

Graph 14

High Monthly Benefit Per Dividend Group

June 30, 1995



* Non-Dividend Group