Report and Recommendations
on
Enhancements To The

Core Benefit Structure
and
Supplemental Plans and Features
of the
IPERS Defined Benefit Plan

Buck Consultants, Inc.
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BUCK CONSULTANTS

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INTRODUCTION AND EXECUTIVE SUMMARY

The Report that follows represents the logical outgrowth and, in effect, the next phase of a comprehensive review of the IPERS benefit structure undertaken in 1995 by Buck Consultants. (See Report on the Benefit Enhancement Study for Iowa Public Employees' Retirement System, September 1995).

The 1995 Study generally reviewed the core benefit structure of IPERS. The Study was conducted in consultation with several of IPERS constituent groups as well as with IPERS staff members. In October, 1995, Buck's report and recommendations together with those developed by the IPERS staff and constituent group representatives were submitted to the Legislature's Interim Committee on Public Employee Retirement Plans. Based on the recommendations of the Interim Committee, the Iowa General Assembly, at its 1996 session, enacted several benefit enhancements to the IPERS plan. These amendments were subsequently signed into law by the Governor.

In enacting the benefit enhancements, the General Assembly directed IPERS to conduct several follow-up studies on outstanding benefit issues that had been brought to the attention of the General Assembly in the course of their deliberations and action at the 1996 session.

This Report considers, in more detail and in light of the 1996 legislation, several benefit issues dealt with in the 1995 Buck Study. It also addresses issues not previously dealt with and which are of concern to the Legislature.

The thrust of the Report -- and indeed its purpose in a nutshell -- is to develop a comprehensive master plan of the IPERS core benefit structure which might be used into the next century. To understand why this review is being done at the present time, it is necessary to reflect upon the legislative process and environment in which IPERS benefit enhancements historically have been enacted by the General Assembly. It is also helpful to reflect on how IPERS benefits have been financed historically, in particular, how a financial compact between employees and employers -- blessed by the Legislature and Governor -- has provided the basis for funding IPERS "benefit enhancements."

First, with respect to the legislative process: grounded in statute, rules and regulations, custom and practice, the General Assembly normally considers proposals for IPERS benefit enhancements and other statutory changes affecting IPERS biennially. By designing a master plan for a full IPERS core benefit structure -- showing each of the benefit components that are in need of augmentation and strengthening -- it is intended that this Report will be of material assistance to the General Assembly for the remainder of this decade and into the next century.

By using a "building block" approach and prioritizing each of our recommendations, we are, in effect, providing an agenda , or at least "benchmarks", for the Interim Committee, the General Assembly, and the Governor, to use in implementing their long-standing, bipartisan commitment to improving IPERS' benefits while preserving the financial integrity of the Fund.

It is intended, then, that by developing a master plan -- with the input and support of the IPERS staff and IPERS constituent groups as well as the legislative staff, the General Assembly at its 1998 and 2000 sessions -- and beyond, if required -- will have the opportunity to enact a permanent, fully-developed IPERS core benefit structure. Although amendments will, as a matter of course, always be required in any complex retirement system, whether pertaining to investment policies and procedures, actuarial funding and methodology, system administration or benefits themselves, it is intended that once a master plan has been adopted, future benefit legislation will essentially be "fine tuning." Even if the Legislature, in its wisdom, declines to enact a fully-developed master plan -- because of design considerations, federal legislation, or financial reasons -- we believe the Report that follows will serve as a useful benchmark as the Legislature considers proposals on a benefit-by-benefit basis.

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The second major consideration to be kept in mind in reading this Report is how IPERS benefit enhancements have been financed historically and how this arrangement will be applied in the future.

Benefit enhancements -- and indeed the entire IPERS core benefit structure or "pension plan" -- as well as the IPERS administration are financed by three sources: employer contributions, employee contributions and earnings on fund investments.

Employer and employee contributions are fixed by statute. When a benefit enhancement is enacted into law, the IPERS actuary recognizes the additional cost of the benefit enhancement and calculates a fiscal note showing the cost expressed as a total dollar amount and as a percentage of annual payroll. In order to keep the System on a sound actuarial basis, the cost not only must be recognized or paid either by (a) increased employer and/or employee contributions or (b) by using existing plan assets that represent "excess" earnings over earnings otherwise anticipated by the IPERS actuary, e.g., under current actuarial assumptions, earnings in excess of the investment return assumption of seven and one-half percent.

Historically, the Legislature has used the latter approach -- application of the fund's excess earnings or other favorable actuarial experience of a demographic nature -- to finance benefit enhancements, thereby relieving participating public employers, employees and ultimately the taxpayers from paying for needed benefit improvements. In effect, benefit enhancements have been funded internally, much in the same way earnings from an endowment or trust fund are used to defray or finance expenses of educational institutions, thereby eliminating the need for higher tuition payments.

A forecasting and planning study can be conducted by the IPERS actuary to estimate the future likelihood, or probability, of "excess earnings" or surplus and how the earmarking of such earnings to fund benefit enhancements would impact on the overall funded status of the IPERS plan over time.

It is the hypothesis of this Study that over time -- whether during the next two or three, or perhaps more, biennial sessions of the Legislature -- all of the enhancements to the core benefit structure that we believe should be made will have been enacted and IPERS will have a mature, fully developed pension plan.

We believe it is incumbent on us to address the longer-term issue -- what next? -- by incorporating into the present benefit structure a feature to insure that the IPERS plan -- although fully developed -- will nevertheless not become static and unresponsive to future retiree needs.

As the Report explains, the greatest and most urgent need for IPERS members -- present and future -- is the development of a program to help retirees to cope with the costs of post-retirement medical coverage. For this reason, we are proposing:

-- enactment of enhancements to the IPERS core benefit structure

and

-- enactment of legislation to provide a "Post-retirement Supplement Fund" to assist IPERS retirees in meeting the costs of purchasing post-retirement health insurance or for other unanticipated post-retirement expenses.

Funding alternatives include:

-- Benefit enhancements could be funded by application of "excess earnings" in the IPERS fund or favorable demographic experience as determined by the IPERS actuary in the annual valuation of the System;

-- Benefit enhancements could be funded by maintaining the current employer/employee contribution rates over time to the extent that these rates would otherwise be reduced absent such benefit improvements;

- Benefit enhancements could be funded by increased employee contributions to the extent required to fund the enhancements, retaining the same rate of employer contributions;

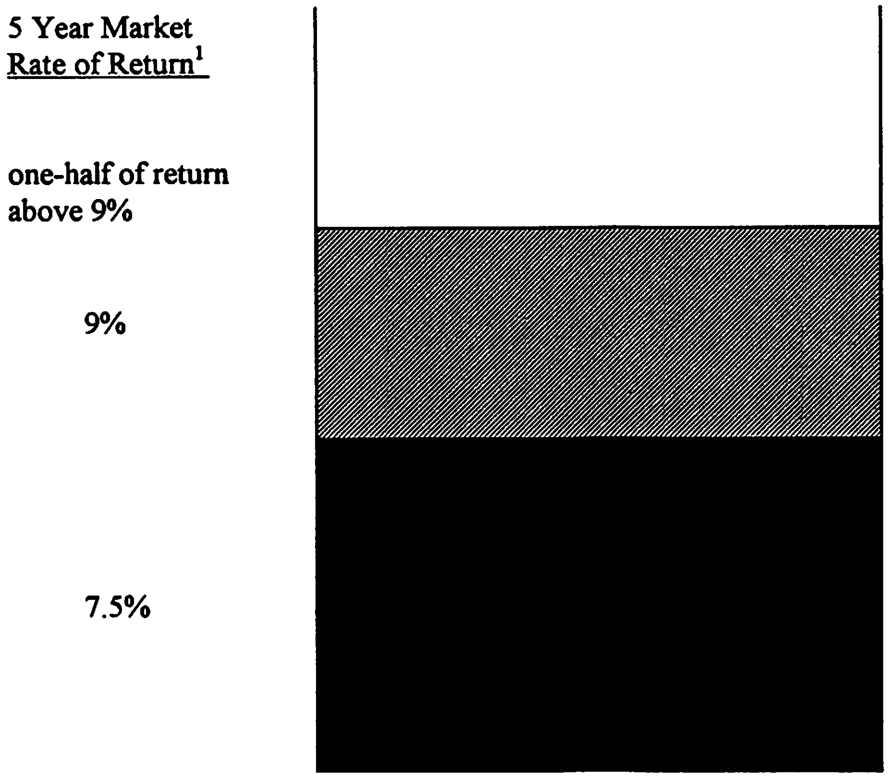
- Benefit enhancements could be funded by increased employer contributions to the extent required to fund the enhancements, retaining the same rate of employee contributions;

- Benefit enhancements could be funded by increased employer and increased employee contributions;

- Finally, benefit enhancements could be funded solely by additional employee contributions; under this arrangement present and future IPERS members could be given the option to elect benefit enhancements, or benefit enhancements could be made optional for current members and mandatory for new members.

With respect to a method of funding a "Post-retirement Supplement Fund," a portion of fund earnings in excess of the actuarial investment return assumption (currently 7.5%) could be dedicated as a funding source. The table on the following page illustrates an example of how such a program could be funded.

Illustration of an IPERS Post-retirement Supplement Fund.



ACTUARIAL ASSUMPTION (7.5%, i.e., what is required to meet present and future obligations of IPERS).

Contribution for Post-retirement Supplement Fund

Dedicated to funding post-retirement dividend COLA program or otherwise funding enhancements to the IPERS core benefit structure.

[1] The five year rate of return for IPERS was 10.33% as of September 30, 1996.

In summary, we are recommending:

- -- Adoption of benefit enhancements over the next two biennial legislative sessions in order to more fully develop the IPERS defined benefit plan;
- -- Adoption of a Post-retirement Supplement Fund to help retirees meet the cost of post-retirement health care or for other unanticipated post-retirement expenses.

SCOPE AND METHODOLOGY OF REPORT

In 1996, the Iowa General Assembly directed IPERS to consider various alternatives for establishing a defined contribution option for its members in addition to the current IPERS defined benefit plan. In order to carry out this directive, IPERS has asked Buck to prepare this Report. IPERS has charged Buck to report in writing its findings and make prioritized recommendations concerning steps IPERS should consider in order to improve its total plan offerings. The report is required to consider current trends and developments in other public plans, the Congress and federal regulatory agencies which may affect the IPERS current defined benefit plan.

The various elements in the study are set forth below, followed by an explanation of how each is addressed in the Report.

1. **Examination of the various alternatives in Supplemental Plans in order to assist IPERS in considering the addition of such plans to its current Defined Benefit Plan**.

   In Part II of this Report, we discuss alternatives in supplemental plans that could be added to the current IPERS defined benefit plan. The thrust of this portion of the Report is to identify retirement income programs which would not replace the IPERS defined benefit plan, but "supplement it." As requested, this Report identifies those vehicles for a supplemental plan deemed most feasible for IPERS' members. In a subsequent study for

IPERS we will consider the issue of replacing the IPERS defined benefit plan, in whole or in part, with a defined contribution pension plan.

2. **A Refinement of the IPERS "Core Plan"**

In our Report on the Benefit Enhancement Study For Iowa Public Employees' Retirement System submitted in 1995, we reviewed the elements of the IPERS core plan and made recommendations for several changes. We recommended enhancements in service retirement, disability and death benefit provisions, including benefit formulas and eligibility requirements. In this Report we have been requested to review the IPERS core plan in light of the changes made by the General Assembly in 1996 in order to identify features of the IPERS Plan that are not competitive with those of other statewide public plans.

In refining the IPERS core plan, we have been asked to "...hone... IPERS own recommendations for desirable additional elements." IPERS' recommendations for additional elements to the core plan were contained in a Report to the Governor and General Assembly, dated October, 1995. This report analyzes each of the provisions of the core plan and includes recommendations from the IPERS staff for benefit enhancements. In addition to revisiting our own recommendations and the recommendations made by IPERS for enhancements of the core plan, in this Report we have identified other benefits of the core plan that should be improved to make the Plan more equitable and competitive with other statewide plans.

In order to assist the readers of the Report, our Report has the following format:

-- first, we revisit our 1995 recommendations with respect to each core benefit;

-- second, we revisit IPERS recommendations with respect to each core benefit;

-- third, we note action taken, if any, on each core benefit by the General Assembly in 1995-1996;

-- last, we give our current recommendation on each core benefit.

3. **Consideration of the impact of each recommendation on IPERS' membership by demographic characteristics**

In the Report we consider the impact of our recommendations on the IPERS membership in terms of income, age, employer, gender, longevity, career employee status, those who retire under IPERS and those who do not retire under IPERS. Where it is pertinent, demographic data made available by IPERS is referenced with respect to each recommendation.

4. **Consideration of financial consequences**

The Report considers the financial risks borne by IPERS members if our recommendations are adopted. The Report also considers how such changes would financially affect the system and its employers. The Report does not include actuarial calculations estimating the annual cost of each proposal. As noted above, additional costs associated with benefit enhancements may be financed out of favorable investment or other favorable actuarial experience or by increased employer and/or employee contributions.

With respect to assessing the financial impact of recommendations on employees, the Report explains that employees bear the burden of risk in a defined contribution plan. If investment performance is unfavorable, benefits will be lower. In a defined benefit plan, on the other hand, the employer bears the financial risk: if investment performance is not as good as expected, the employer must make additional employer contributions to make up for any shortfall.

5. <u>Consideration of Legal Issues</u>

The Report includes a legal commentary on each of our recommendations, where significant, particularly with respect to the tax-exempt status of IPERS under the Internal Revenue Code.

6. <u>Consideration of Member Education</u>

Member education will be especially needed in connection with our recommendation for increased participation in defined contribution plans. As our Report explains, a defined benefit plan, like the IPERS plan, provides a floor of protection for all employees. Membership is mandatory, and although the member is required to make (pre-tax) employee contributions, the employer alone directs the investment of fund assets. Member education is needed for choices with respect to selecting options and evaluating whether an individual can, in fact, "afford" to retire at a particular age. These matters are beyond the scope of this Report. However, we do urge increased attention be given to member education with respect to strengthening participation in deferred compensation plans made available to IPERS members (see page 54 in this Report). Member education is especially important in selecting investment options and in deciding on "how much" to voluntarily contribute to such a plan over one's career. A full explanation of a member education program is beyond the scope of this Report.

7. <u>Consideration of Views of IPERS constituent groups and IPERS staff</u>

The Appendix contains a series of graphs showing priorities given to each benefit enhancement by IPERS constituent groups and IPERS staff.

8. <u>Consideration of other issues</u>

The adequacy of retirement, disability and other benefits provided by IPERS should take into account Social Security, personal savings and benefits provided by other qualified plans to IPERS members. Recognition that Social Security benefits will replace a portion of an IPERS member's pre-retirement income is implicitly found in the IPERS benefit formula.

The IPERS service retirement benefit formula provides that for each year of service a member will receive a benefit equal to 2% of final average compensation. A member with 30 years of service would receive a benefit equal to 60% of final average compensation. At age 62, Social Security benefits would be payable on a reduced basis. Assuming an average Social Security benefit equal to 24% of a member's final average compensation (with retirement at age 62), total retirement income for such a retiree would equal approximately 84% of final average compensation.[2] A member with 25 years of service at retirement age 62 would receive total retirement income (pension plus Social Security) equal to approximately 75% of final average compensation. Since the member contributes employee Social Security contributions equal to those contributed by his or her employer, one can attribute one-half of Primary Social Security benefits (in this example a benefit equal to approximately 12% of salary to the employer and one-half to the employee). Accordingly, a 25 year retiree retiring at age 62 would have total retirement income, including employer-financed Social Security, equal to approximately 62% of final average compensation, and a 30 year retiree retiring at the same age would have total income equal to approximately

2 Primary Social Security benefits equal to 30% of a member's final average compensation at normal retirement age are reduced to approximately 24% at early retirement age (<u>e.g.</u>, from age 65 to age 62).

72% of final average compensation. A goal of between 70% and 80% of preretirement income is often recommended by pension experts. IPERS itself has suggested 70% as an appropriate replacement goal.

In addition to Federal Social Security benefits, the IPERS retirement benefit is also supplemented by private savings and distributions from deferred compensation programs, such as Section 457 and Section 403(b) deferred compensation plans. We have emphasized the significance of these plans in our Report and encourage expanded participation in them by IPERS members.

PART I: ANALYSIS OF THE IPERS CORE BENEFIT STRUCTURE AND RECOMMENDATIONS FOR FURTHER BENEFIT ENHANCEMENTS

Overview

The findings and recommendations that follow are based on a review of the IPERS core benefit structure. In some instances, we are recommending benefit enhancements; in other instances we believe a particular benefit is currently meeting the needs of IPERS members and therefore need not be enhanced.

We have prioritized our recommendations and have recommended that they be considered over the next two biennial legislative sessions of the Iowa General Assembly. Our prioritization is based on the sequence in which we recommend benefit enhancements be considered and adopted. We do not rank benefit enhancements by their value on a relative basis. In other words, "priority level one" indicates a particular benefit recommendation should be addressed first before a priority level two recommendation. We recommend that enhancements to the core plan's primary provisions, i.e., service retirement benefit formulas and eligibility requirements, be considered before enhancements to ancillary benefits, such as disability and death benefit provisions. Once changes have been made to the core benefit program, supplemental features can be considered.

Our current recommendations take into account the findings and recommendations made in our Report on the Benefit Enhancement Study for Iowa Public Employees' Retirement System, dated September 11, 1995. In addition to revisiting this Report, we have taken into account the recommendations of the Retirement System contained in a Report to the Governor and General Assembly, dated October, 1995, and the subsequent benefit enhancements enacted by the General Assembly at its 1996 session.

In this Report we are recommending further benefit enhancements which are consistent with the overall guiding principles adopted by IPERS, namely, to foster benefit equity and fiscal soundness. In particular, we have been guided by the goals of Section 97D.1 of the Iowa Code, summarized as follows:

Subject	Goal
1. Benefit Enhancements	Select those benefit enhancement options which most successfully deliver the greatest good to the greatest number of employees
2. Kinds of Benefits to be Selected	Choose those options which best correct existing inequities between and among the various retirement groups in the state
3. Guiding Twin Objectives	Determine those options which most ably serve the twin objectives of attracting and retaining quality employees
4. Benefits to be avoided	Avoid enacting further incentives toward earlier retirement with full benefits
5. Equity among groups	Avoid further splintering of benefits by disproportionate enhancement of benefits for one group beyond those available to another

In addition to the foregoing goals, the Public Retirement Systems Committee is charged to consider "... proposals to achieve greater portability of pension benefits between the various public retirement systems in the state." The Code also charges the Committee to give special attention to "...the actuarial cost of transfers of value from one system to another."

In considering each IPERS benefit provision, we took into account, where appropriate, how possible enhancements would affect different categories of IPERS members by income, age, service, gender, longevity and employer. As requested, we considered how each proposed benefit enhancement could impact on two particular categories of IPERS members: career employees who retire from IPERS and employees who terminate public service before they are eligible to receive a service retirement benefit from IPERS. The latter group of employees terminate with a vested benefit and at a later age become eligible to receive a service retirement benefit from IPERS, or leave service before they become vested and are eligible to receive a return of their employee contributions only.

We have also addressed the issue of how benefit enhancements might be financed, including their fiscal impact on IPERS, the State of Iowa and other participating employers. Where relevant, we address tax implications and tax-qualification issues affecting IPERS.

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In order to identify and develop conceptually benefit enhancements that will allow IPERS to more fully realize its goals of benefit equity consistent with fiscal soundness, we have addressed each of the recommendations contained in our 1995 Report to IPERS, noting the action taken by the Governor and General Assembly on each of these recommendations as well as the recommendations made by the IPERS staff. This is followed by our current recommendations and a discussion of the rationale for each recommendation.[3]

A. Recommendations for Core Benefit Enhancements

1. Service Retirement Benefit Formula

a. *Buck 1995 Recommendation:*

Change benefit formula by removing salary cap and amending the service cap (to be phased in over a five- to seven-year period).

[3] Report on the Benefit Enhancement Study for Iowa Public Employees' Retirement System, Buck Consultants, September 11, 1995.

b. *IPERS 1995 Recommendation:*

IPERS recommended lifting the service cap and covered wage ceiling and that greater contributions be assessed, on an actuarial basis, to those persons receiving disproportionate value from the removal of the covered wage ceiling.

c. *Action by the 1996 General Assembly:*

The General Assembly eliminated the covered wage ceiling effective with the calendar year beginning January 1, 1997, and provided for smoothing the impact over a seven-year period. The years of service cap was amended, but not removed.

d. *Current Recommendation:*

We believe the current benefit formula, as modified by the 1996 legislation, provides fair and equitable service retirement benefits for IPERS members at all salary levels. However, we note that IPERS members retiring between January 1, 1997 and December 31, 2003 will not fully benefit by the removal of the salary cap because the removal is phased in over a seven-year period. In our 1995 Report, we recommended, as did IPERS, a phase-in over a five- to seven-year period "...so as to smooth the impact on the funded status of the plan." We also noted that "there could also be a corresponding phase-in of uncapped member contributions which would help finance the benefit enhancement."

Relief should be provided to those members who will be retiring within the next seven years and whose benefits will be adversely affected by the continued application of a portion of the salary cap limitation. Accordingly, we are recommending that these members be permitted to elect, on a voluntary basis and during a window period, to make additional member contributions to remove the salary cap on their retirement benefits. We recommend that the IPERS actuary should determine, on an individual basis, the additional amount of employee contributions that should be assessed to each such member to finance the benefit enhancement. After the member receives this information, he or she will be in a more informed position to decide whether or not to elect the benefit.

e. *Evaluation Criteria for our Recommendation:*

➤ **Conformity with the guidelines in Section 97D of the Iowa Code:** According to IPERS, changing the benefit formula by removing the salary cap and service cap (to be phased in over a five- to seven-year period) generally conforms to the guidelines of 97D[4].

We concur with IPERS' observations that removing the salary cap meets the criteria of "greatest good to greatest number," corrects existing inequities, and serves to attract and retain quality employees. IPERS also points out that the covered wage ceiling discriminates against higher waged members. We also believe by requiring members to make additional employee contributions to finance the removal of the salary cap, the recommendation better conforms to the spirit of Section 97D.

4 Report to Governor and General Assembly, IPERS, October, 1995, p.17.

- **Consideration of the impact of the recommendation on IPERS' membership by demographic characteristics:**

  IPERS has observed that over time all members will benefit from removal of the salary cap. We have asked IPERS to provide data about the number of members estimated to retire each year from 1997 through 2003 who will be impacted by a remaining portion of the salary cap. A demographic profile of these members follows:

➤ **Profile of IPERS membership with salary in excess of $44,000**

IPERS
SALARY $75,000 AND OVER[5]

Age Group	Count	Average Age	Average Service	Average Salary
60+	56	63.4	24.6	93,456
50-59	166	54.0	20.3	92,355
40-49	161	45.2	12.8	92,020
30-39	36	36.6	6.4	102,794
20-29	1	26.0	1.3	110,793
	420			

SALARY $55,000 TO $74,999

Age Group	Count	Average Age	Average Service	Average Salary
60+	268	62.1	28.1	61,768
50-59	1,032	54.0	23.7	61,847
40-49	1,141	45.3	16.8	61,951
30-39	268	36.6	10.0	60,922
20-29	4	29.0	3.0	59,114
	2,713			

SALARY $44,000 TO $54,999

Age Group	Count	Average Age	Average Service	Average Salary
60+	630	62.0	26.2	48,714
50-59	2,683	54.0	23.5	48,311
40-49	3,370	45.1	17.0	48,464
30-39	1,024	35.6	9.7	47,791
20-29	45	27.9	3.7	47,550
	7,752			
	10,885			

As of 1995-96, the foregoing data shows that 954 IPERS members who attained age 60 earned over $44,000 and, therefore, could be affected by lifting the salary cap. An analysis by the IPERS actuary should be done for each member showing the cost of electing the benefit enhancement.

[5] Data compiled by IPERS actuary in 1995-96. While not current, data includes members who would be affected by removing salary cap. The increased covered wage ceiling only impacts persons with reportable 1997 wages in excess of $59,000.

> **Consideration of financial consequences**

As previously stated, we are recommending that the members affected be permitted to elect coverage after they have been provided with a cost estimate of increased member contributions necessary to finance the benefit enhancement.

> **Consideration of legal issues**

Section 415 of the Internal Revenue Code places limitations on contributions (25% of compensation up to $30,000 annually) and benefits (100% of compensation ($125,000 in 1997)) in tax-qualified retirement benefit plans. The treatment of employee contributions for purposes of Section 415 differs significantly depending on whether or not such employee contributions are treated as "pick-ups" under Section 414(h)(2) of the Internal Revenue Code. These rules are quite complex, and the IPERS actuary should make individual calculations for each member to ascertain that the Section 415 limitations will not be exceeded by a member who elects this benefit.

2. Normal Retirement Age:

a. *Buck 1995 Recommendation:*

Change Normal Retirement Age and Service Requirements to age 65, or age 62 with 20 or more years of service, or "age 55 and age plus service equal 85."

b. *IPERS 1995 Recommendation:*

IPERS did not recommend adopting an "age 55 and age plus service equals 85" normal retirement provision or allowing normal retirement at age 62 within 20 instead of 30 years of service. IPERS proposed, instead, to allow members to cancel, at the time of their retirement, otherwise applicable early retirement reductions by paying in a lump sum the cost of that reduction to the System. The additional member contribution would be calculated on an actuarially determined basis.

c. *Action by the 1996 General Assembly:*

The General Assembly replaced the "Rule of 92[6]" with the "Rule of 90[7]." Legislation provided that if the IPERS actuary verified that the additional cost associated with the new benefit could be absorbed by the Fund without any increase in the IPERS contribution rates, the Rule of 90 would be reduced to a Rule of 88[8] on July 1, 1997. The IPERS actuary has made this verification, and the Rule of 88 will be effective July 1, 1997.

6 Age 55 and age plus service equals 92.
7 Age 55 and age plus service equals 90.
8 Age 55 and age plus service equals 88.

d. *Current Recommendation:*

As we recommended in our 1995 study, we are recommending that the "age 62/30 years of service" requirement for full benefits be modified to permit an IPERS member who has attained age 62 and who has 20 or more years of credited service -- but less than 30 years of credited service -- to retire with unreduced benefits. We also again recommend that an IPERS member who has attained age 55 and whose age plus service equals 85 be permitted to retire with unreduced benefits.[9] Our recommendation is based on the same reasoning as set forth in our 1995 Report. In our 1995 Report we noted that IPERS age and service requirements for payment of unreduced (normal) retirement benefits were not favorably competitive with those of other PERS, both on a national and regional level. In fact, of the regional retirement plans we studied in our 1995 Report, all but two provided a more favorable combination of normal age and service retirement provisions.[10]

e. *Evaluation Criteria for our Recommendation:*

- **Conformity with the guidelines in Section 97D of the Iowa Code:**

  In its 1995 Report, IPERS stated that our recommendations' conformity to the guidelines of Section 97D was, in IPERS' words "...mixed, at best." In order to further explore the impact of our recommendations in response to IPERS' comments, we address below each of the five goals set forth in Section 97D individually in relation to our recommendations:

9 The 1996 Legislature did enact legislation to provide for a normal retirement age of age 55 and age plus service equals 87.

10 See Report on the Benefit Enhancement Study for Iowa Public Employees' Retirement System , op.cit., pp. 62-64.

1. **<u>Benefit Enhancements</u> (the greatest good to the greatest number)** Reducing the number of years of service required for full benefits at age 62 and permitting a member to retire at age 55 if age plus service equals 85 would benefit between 30% and 40% of retiring IPERS members.[11] The current requirement that an IPERS member who attains age 62 must have 30 or more years of service to retire with unreduced benefits serves only a small percentage of IPERS members. Current provisions preclude the average IPERS retiree -- who leaves public service with just under 20 years of service -- from retiring with unreduced benefits even if he or she has attained age 62. The IPERS demographic profile as affected by this proposal is discussed in more detail below.

Looking at IPERS members between ages 55 and 65, they are broken down as follows:

Schools	52.2%
Counties	16.2%
State	15.5%
Cities	12.2%
Other	3.9%

This breakdown generally follows the breakdown of the total IPERS membership. Adopting a "62/20" rule and the "age 55 and age plus service equal 85" rule would benefit employees between age 55 and 65.

11 Report to Governor and General Assembly, IPERS, op.cit.

2. <u>Kinds of Benefits to be Selected</u>

This guideline provides for the selection of those options that best correct existing inequities between and among the various retirement groups in the State. The present normal retirement provisions favor those employees who have long years of service (30 years), and do not favor members who have shorter years of service (less than 30) even though they have attained age 62. The current rule of age 55 and age <u>plus</u> service equals 88 favors the employee who is age 55 with 33 years of service over the employee who is age 55 with 30 years of service. The only justification would seem to be one of cost.

3. <u>Twin Objectives: Attracting and Retaining Employees</u>

The third guideline provides that those options should be selected that most ably serve the twin objectives of attracting and retaining quality employees. Adoption of a "62/20" provision and an "age 55 and age plus service equals 85" rule would make IPERS more competitive with other public pension systems and, we believe, would help to attract and retain quality employees. The fact that these benefit enhancements were made available does not necessarily mean that eligible employees would elect to exercise their option of retiring with full benefits at an earlier age. However, the fact that benefit is made available could attract quality employees.

4. **Benefits to be Avoided**

The fourth guideline declares the Legislature should avoid enacting further incentives toward earlier retirement with full benefits. The proposed benefits would seem to contradict this guideline. The Legislature has currently enacted a "rule of 88" (age 55 and age plus service equals 88). We believe a "rule of 85" (an age 55 and age plus service equals 85 provision) is fundamentally of the same character as a rule of 88. In this regard, the General Assembly adopted a rule of 88, upon certification by the IPERS actuary that the additional cost of the enhancement can be funded by IPERS from favorable actuarial experience. Putting aside the cost differential, is there any fundamental policy difference between a rule of 85 and a rule of 88? We do not think so.

As we explained in our 1995 Report, comparing the IPERS normal retirement benefit provisions to 85 other nationwide PERS, the IPERS normal service retirement provisions are not favorably competitive. On a national level, 52 of the 85 plans included in the survey permit normal retirement with full benefits at age 62 with 10 or more years of service -- not with 30 or more years. Of the regional plans we studied in our 1995 Report, all provided a more favorable combination of normal retirement age and service requirements than IPERS, except for two Minnesota systems.

Are we encouraging members to have two careers by lowering the normal retirement age and service requirements from a "rule of 88" to a "rule of 85," or by permitting IPERS members to retire at age 62 with 20 years of service instead of 30 years of service? The answers to these questions depend, of course, on the particular individuals who may elect to retire earlier than they otherwise would have done. We believe it is unlikely that IPERS members who have attained age 62 with 20 or more years, but less than 30 years of service, would be any more likely to undertake a "second career" at age 62 than those who had 30 years of credited service at retirement. The same logic applies to individuals who have attained age 55 and whose age plus service equals 85. We do not believe these individuals would be any more likely to start a second career than IPERS members who are age 55 and currently have 33 years of service and who can now retire with full unreduced benefits. A second career situation is usually more associated with police and firefighter pension plans where members may retire with full benefits after 20 or 25 years of service, regardless of age. In these plans, retirement as early as age 40 with full benefits is permitted in order to maintain a "young and vigorous force."

5. __Equity Among Groups__

The fifth guideline warns against further splintering of benefits by disproportionate enhancement of benefits for one group beyond those available to another. The proposed changes in normal retirement age and service requirements would apply in the same manner to all IPERS members.

➢ **Consideration of the impact of the recommendation on IPERS' membership by demographic characteristics:**

The Appendix contains profiles of demographic features of the membership prepared by IPERS. We have already noted some of the demographic features of IPERS that relate to the proposed benefit enhancements. As previously mentioned, the average years of service remains at just under 20 years for the typical retiree. Only 22.7% of IPERS retirees have 30 or more years of service. The bulk of IPERS members (58%) currently retire after age 62. If "62/20" replaced "62/30", we would anticipate a greater number would retire at age 62. Only 4.4% of the IPERS population is reported as being between ages 60 and 65 and only 9% of the population is between ages 55 and 60. Therefore, the policy of requiring 20 or 30 years of service at age 62 affects only a relatively small number of IPERS members. Graph 2C from the IPERS Report shows the IPERS distribution of active membership by age and is included in the Appendix.

Looking at the impact of the proposed benefit enhancements on IPERS members by gender, improving normal retirement age requirements would benefit nearly twice as many females as males at the same age with the same years of service. Graph 7 in the Appendix shows that females in the 20-29 years of service group number 9,717 whereas males in the same service group number only 5,084.

- **Consideration of financial consequences**

  Benefit enhancements, including replacing a rule of 88 with a rule of 85, and lowering the service requirement from 30 years to 20 years for receipt of unreduced benefits at age 62, would, of course, result in additional costs to IPERS. Age and service requirements for normal retirement benefits are a primary provision of a defined benefit pension plan. The IPERS actuary, in costing out the proposed enhancements, may also want to take into account possible payroll savings that could result where older, higher paid employees are replaced by younger employees at lower salary levels. This could be particularly of interest with respect to public school teachers.

- **Consideration of legal issues**

  We do not anticipate any legal issues in connection with these recommendations.

3. **Minimum COLA Program**

a. *Buck 1995 Recommendation:*

Increase minimum COLA program for retirees to provide a minimum benefit of $200 a month (with 10 years of service) to $400 a month (with 30 years of service) (prorated).

b. *IPERS 1995 Recommendation:*

IPERS supported the proposal.

c. *Action by the 1996 General Assembly:*

The General Assembly increased the minimum COLA program from $50 to $200 a month for retirees who retired prior to July 1, 1990 with at least 10 years of service. The minimum payment is adjusted an additional $10 for each year of service beyond 10 years, up to a maximum of $400 per month for persons with 30 or more years of service. The minimum benefit is calculated in the same manner as the regular COLA dividend benefit: monthly benefit paid, multiplied by 12 multiplied by last year's dividend payment.

d. *Current recommendation:*

We recommend that the minimum COLA program benefit program be amended so as to cover low-income retirees regardless of their years of service according to the following schedule:

Years of Service	Minimum Monthly Benefit	Years of Service	Minimum Monthly Benefit
1	$ 100	16	260
2	120	17	270
3	130	18	270
4	140	19	270
5	150	20	270
6	160	21	270
7	170	22	270
8	180	23	270
9	190	24	270
10	200	25	270
11	210	26	270
12	220	27	270
13	230	28	270
14	240	29	270
15	250	30 or more	400

We recommend that the minimum COLA program be amended to include all eligible retirees who have been retired for one year, e.g. retired prior to July 1, 1996, effective July 1, 1997.

In order to further supplement low income retirees, we recommend that all members who have been retired one or more years and who receive monthly benefits of $500 or below be given a one-time 10% across-the-board increase. We recommend this be applied to retirees covered by the minimum benefit program for at least one year.

e. *Evaluation Criteria for our Recommendation:*

➢ **Conforming with the guidelines in Section 97D of the Iowa Code:**

1. **Benefit Enhancements**

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

Our 1995 recommendation, increasing the COLA program for long-time, low-income retirees to provide a benefit of $200 to $400 a month for retirees with 10 to 30 years of service, benefited approximately 40% of the retired membership. We have asked IPERS to provide us with the number of retirees who would benefit from the current proposals. We anticipate that approximately 70% of the retired membership would benefit from the 10% across-the-board increase.

2. **Kinds of Benefits to be Selected**

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

In response to this guideline we agree with the statement in IPERS' 1995 Report which follows:

> "Comparative inequities, yes. This is a case where individual equity would be violated, while a compassionately motivated inter-generational equity would be served."[12]

[12] IPERS Report to Governor and General Assembly, October , 1995, p. 25.

To IPERS' comments we would add that by recommending that the minimum COLA be applied to low-income retirees with less than 10 years of service, inequities in the current program are smoothed out. Moreover, by recommending that a 10% increase be applied across-the-board to all retirees (with monthly benefits of $500 or below), the benefits of over 70% of the retired membership will have been improved.

3. **Guiding Twin Objectives**

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

Our recommendations are geared toward providing a minimum benefit level. To the extent these recommendations evidence a System commitment to providing a floor level of retirement income for low-income retirees, we believe that the recommendations, if enacted, will contribute to the twin goals of attracting and retaining quality employees. More specifically, IPERS will gain the reputation of recognizing a need within its membership and acting upon that need. In the same manner that the Federal Social Security system provides a greater benefit, expressed as a percentage of final salary, for low-income workers, so too, IPERS will have provided a greater benefit for its low-income retirees, particularly those who retired many years ago.

4. **Benefits to be Avoided**

Avoid enacting further incentives toward earlier retirement with full benefits.

Not applicable.

5. **Equity Among Groups**

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

It is a fact that the recommendations would provide benefit enhancements for one group (retirees with monthly benefits of less than $500) not available to all retired members. However, as noted above, approximately 70% of the retired membership receives monthly benefits of $500 or less.

- **Consideration of the impact on IPERS' membership by demographic characteristics:**

As stated above, approximately 40% of the retired membership benefited from the upgrading of the minimum COLA program by the Legislature in 1996. We anticipated that another 10% to 15% of the retired membership would benefit by providing a minimum COLA to retirees with less than 10 years of service. We are requesting IPERS to confirm these figures.

Application of a 10% across-the-board increase to all members with monthly benefits of $500 or less would benefit approximately 70% of the retired membership. We are requesting IPERS to confirm these figures.

➢ **Consideration of financial consequences:**

We recommend that the IPERS actuary prepare a fiscal note establishing the additional employer costs of each of these proposals. After establishing the cost of the 10% across-the-board increase for retired members with monthly benefits of $500 or less, IPERS may also wish to obtain the costs of increases below 10%, e.g., 7% and 5%.

➢ **Consideration of legal issues.**

We do not anticipate any legal issues in connection with these recommendations.

4. <u>**Interest Credited on Members' Contributions**</u>

a. *Buck 1995 Recommendation:*

Modify interest credited to members' contribution accounts to the rate used in the valuation to estimate the investment return on the funds as a whole.

b. *IPERS 1995 Recommendation:*

IPERS supported the thrust of the Buck proposal, but suggested a target rate of 1/2 to 1% over comparable one-year interest rates for certificates of deposit.

c. *Action by 1996 General Assembly:*

Beginning January 1, 1997, IPERS will begin applying to member accounts an annual interest rate of 1% above the one-year rate for certificates of deposit.

d. *Current Recommendation:*

None.

5. **Ordinary Death Benefit**

a. *Buck 1995 Recommendation:*

We recommended that the survivor income benefit be increased to provide greater protection for the younger, shorter-service employee. As an appropriate benefit we recommended salary times years of service (maximum 3 years) for non-service connected (ordinary deaths). A member's accrued normal retirement benefit, payable as a 100% joint-and-survivor annuity, will be paid if greater than three times salary. In our 1995 Report we noted that when an IPERS member dies in active service, IPERS currently provides a benefit equal to the return of member contributions plus one year's salary for a member with 30 or more years of service. For members with less than 30 years of service, the benefit is proportionately reduced. Eligibility is immediate, and there are no age or service requirements.

b. *IPERS 1995 Recommendation:*

IPERS recommended that this issue, together with the Accidental Death Benefit proposal and Disability Benefits, be deferred for further study.

c. *Action by 1996 General Assembly:*

Based on IPERS' recommendation, the matter was deferred for further study.

d. *Current Recommendation:*

We recommend that the survivor benefit be increased to provide greater protection for the younger, shorter-service employee. In our analysis of 85 PERS as compared to IPERS, we noted that most PERS provide an ordinary death benefit of 1, 2 or 3 times salary. An appropriate benefit would be equal to salary times years of service (maximum 3 years) for non-service connected (ordinary) deaths. This benefit would be payable according to the following schedule:

Service	Benefit
Upon employment	1 year salary
1-2 years of service	2 years salary
3 or more years	3 years salary

For longer service members, the members' accrued normal retirement benefit would be payable as a 100% joint-and-survivor annuity, if greater.

6. Accidental Death Benefit

a. *Buck 1995 Recommendation:*

Modify the Death Benefit to provide that 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% of final average salary payable to a surviving spouse, dependent children or dependent parents and subject to the COLA. In our 1995 Report we recommended that where a member's death is the result of an accident incurred in the performance of duty, a survivor pension be payable equal to 50% of the member's final average salary, provided that the regular death benefit would be payable if greater. The service-connected death benefit would be reduced by survivor benefits received under Social Security, Workers' Compensation or other employer-financed insurance benefits where total benefits exceed 80% of final average salary. The benefit would be payable only to a surviving spouse, dependent children or dependent parents. The benefit would be automatically indexed under the new COLA program.

b. *IPERS 1995 Recommendation:*

IPERS recommended that this issue, together with that relating to disability, be subject to further study.

c. *Action by the 1996 General Assembly:*

None.

d. *Current Recommendation:*

A review of accidental death benefit coverage will be included in our Report on Disability Retirement Benefits.

7. **Disability Benefit**

a. *Buck 1995 Recommendation:*

Modify the Disability Benefit to provide a minimum benefit equal to 33 1/3% of final average salary, coordinated with other employer-financed disability benefits and insurance.

b. *IPERS 1995 Recommendation:*

IPERS recommended that the matter be deferred for further study.

c. *Action by 1996 General Assembly:*

None.

d. *Current Recommendation:*

Recommendations will be included in a study of Disability Retirement Benefits.

8. **Reemployment of Retired Public Employees**

a. *Buck 1995 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.

b. *IPERS 1995 Recommendations:*

IPERS supported the recommendation.

c. *Action by 1996 General Assembly:*

Retired members under age 65 who are reemployed by an IPERS covered employer will be able to continue to receive IPERS benefits at a reduced rate once they have passed the IPERS earnings cap placed on reemployment wages (which reflects a comparable cap used by Social Security). In the past, such members had their benefits curtailed entirely for the remainder of the calendar year.

d. *Current Recommendation:*

None.

9. **Post-retirement COLA**

a. *Buck 1995 Recommendation:*

In 1995 we recommended that COLA adjustments in IPERS be funded on an actuarial basis. We also recommended that the COLA program should be based on a recognized standard, such as the Consumer Price Index (CPI), subject to an annual maximum cap, e.g., 80% of increases in the CPI, limited to 3% of a retiree's or beneficiary's retirement allowance.

b. *IPERS 1995 Recommendation:*

IPERS did not support the Buck proposal for pre-funding a COLA. However, IPERS did support the use of the CPI with a percentage cap.

c. *Action by the 1996 General Assembly:*

Effective calendar year 1997, IPERS will adjust COLA dividends annually to members who retired prior to July 1, 1990. From 1997 forward, IPERS will calculate the dividend payable in November at 80% of the CPI, up to a maximum of 3%. The increase is applied to total benefits paid the preceding calendar year, including the existing dividend amount.

d. *Current Recommendation:*

As stated above, in our 1995 Report we recommended that COLA adjustments be calculated at the rate of 80% of the annual increase in the Consumer Price Index (CPI), subject to an overall cap of 3% per year. The 80% limitation was essentially made for cost considerations. In our current Report we are recommending two modifications: first, we recommend that the 80% limitation be removed; second, also subject to cost considerations, we recommend that coverage be expanded to include all retired members after they have been in receipt of retirement benefits for a one-year period.

With respect to our first recommendation, a COLA reflecting 100% of CPI increases up to a cap of 3% of a retired member's benefit would better allow retirees to maintain their pre-retirement standard of living. The proposal would also better support the IPERS policy goal of providing career employees with a retirement allowance, plus Primary Social Security, equal to approximately 80% of their pre-retirement income. For example, if the CPI should rise by 3% annually, the 80% limitation would effectively reduce the COLA to 2.4%. While a 2.4% increase would provide some relief to a retiree, a 3% COLA over time would better ensure that the purchasing power of an IPERS retirement allowance is maintained.

Our second recommendation is to expand the coverage of the COLA Program to include all retired members after they have been in receipt of their retirement allowance for a one-year period. This means that the purchasing power of post-July 1, 1990 retirees has been eroded by inflation by the same percentage.

e. *Evaluation Criteria for our Recommendation:*

➢ **Conformity With The Guidelines In Section 97D Of The Iowa Code:**

1. **Benefit Enhancements:**

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

Increasing the percentage of COLA from 80% to 100% of the CPI and expanding coverage to include all members one year after receipt of retirement benefits would benefit all retired members.

2. **Kinds of Benefits to be Selected:**

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

The current COLA program does not include IPERS retirees who retired on and after July 1, 1990. The proposal would correct an existing inequity, specifically by removing the distinction between pre-and post-July 1, 1990 retirees, treating all classes of retirees in the same manner once they have been retired for one year.

3. **Guiding Twin Objectives:**

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

By adopting a more responsive COLA program and incorporating all retired members one year after retirement, IPERS would be better able to attract and retain quality employees.

4. **Benefits to be Avoided:**

Avoid enacting further incentives toward earlier retirement with full benefits.

Not applicable.

5. <u>Equity Among Groups:</u>

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

Not applicable.

- **Consideration of the impact on IPERS' membership by demographic characteristics:**

  We have asked IPERS to establish the number of retired members who would be covered by the COLA Dividend Program, effective July 1, 1997, if the program is expanded to include all post-July 1, 1990 retirees who have completed one year in retirement as of July 1, 1997. Increasing the COLA payments would apply to all retired members over time.

- **Consideration of financial consequences**

  The IPERS actuary should be requested to prepare a fiscal note estimating the costs of these two changes. Alternatively, IPERS may wish to request the actuary to estimate the cost of covering all retired members two or three years after retirement, instead of one year after retirement.

- **Consideration of legal issues:**

  We do not anticipate any legal issues other than the application of Section 415 limitations on the increased benefits. The IPERS actuary should make individual calculations as necessary to ascertain that the Section 415 limitations will not be exceeded by benefits payable to members to whom the COLA applies.

B. Additional Recommendations made by IPERS in 1995

In its October, 1995 Report to the General Assembly, IPERS made additional recommendations to the Governor and General Assembly on benefit enhancements not addressed in the Buck Study. Our comments and recommendations on these benefits follow.

1. **Indexed Vested Benefit**

   a. *1995 Recommendation made by IPERS:*

   IPERS recommended that a terminated vested member would be given the right to have the value of his or her benefit at time of termination indexed in the same manner as the IPERS dividend program, for each year between date of termination and retirement. IPERS recommended that the terminated vested member be required to contribute 9.45% of the indexed increase in the member's highest covered salary year.

   b. *Action by 1996 General Assembly:*

   None

   c. *Current Recommendation:*

   In order to make the IPERS vested benefit more responsive to inflation, we propose that the IPERS vested benefit be escalated in the same manner as the IPERS Dividend COLA recommendation (by CPI increases up to 3% annually).

A weakness in the current IPERS vested benefit is the erosion of the vested benefit's purchasing power in the years between separation from service and the actual receipt of a retirement allowance. This erosion in purchasing power results from the fact that the vested benefit is, in effect, frozen, based on the member's salary at termination of employment, whereas increases in the cost-of-living (in past years) have eroded the purchasing power of the frozen benefit. As the following table illustrates, vested benefits may be substantially eroded by inflation in the years between termination and receipt of benefits:

Age at Termination	Years of Service	Benefit At Termination (% of FAS)	"Value" at 65[13] (% of FAS)
31	5	10%	3.7%
41	15	30%	14.8%
46	20	40%	22.8%

As shown above, escalation (here assuming an annual increase of 3%) would double the purchasing power of a vested benefit of an employee who terminated service at age 41 (with 15 years of credited service) and who began receiving vested benefits 24 years later at age 65. We recommend that the IPERS actuary prepare a fiscal note showing the additional cost of this benefit. We also recommend that the benefit be made applicable to the vested retirement allowances of all terminated vested members.

13 Assumes an annual increase in the CPI of 3% from separation of service to receipt of benefit.

We also recommend that a terminated vested member be permitted to elect to roll over the actuarial present value of his or her vested benefit into another tax-qualified retirement plan or Individual Retirement Account (IRA) under the rules of the Internal Revenue Code. If a member made the rollover election prior to termination, a member could request the IPERS actuary to calculate the value of the actuarial reserve established to fund future benefit payments (without the indexation feature). If a member did not make this election, his or her terminated vested benefit would be indexed, as discussed above, and would be payable at normal retirement age without reduction or at early retirement age with reductions as provided in the IPERS plan.

We believe that by providing an enhanced vested benefit with a portability option, IPERS will contribute to making public service in Iowa more attractive to young and mid-career employees. As stated in the Milbank Memorial Fund's 1996 report on pension portability:

> Pension portability is a topic we need more frequently discussed in public policy debates as our workforce becomes increasingly mobile. Most of the discussion to date has focused on how to increase portability in the private sector. However, there is a growing need to enhance the portability of public sector pension and savings programs that has gone largely unrecognized.[14]

According to the author of the Milbank Report, there are three dimensions to pension portability:

[14] • Pension Portability for State and Local Government. Milbank Memorial Fund, Gary I. Gates, 1996, p.1.

> ...ensuring that individuals have the right to take their vested benefit with them when they change employers. This means that they have the right to rollover any vested pension benefit amount from their old employer's plan into a qualified plan, typically a defined contribution plan, maintained by their new employer; second, ensuring that individuals have a benefit to take with them when they change jobs; this is primarily a function of the vesting provisions under the employer's plan; third, ensuring that the value of an individual's projected benefit does not erode solely because he or she has changed jobs.[15]

The authors of the Milbank report explain that the third dimension of pension portability "...relates to the failure of most employers to index the value of a person's pension benefit on separation of employment to take account of inflation."[16] By adopting an indexed vested benefit with a portability feature, IPERS would be in the forefront of public employee retirement systems. Several PERS have similar arrangements. The following table outlines some of these plans:

[15] Ibid.

[16] Ibid.

Retirement System	Indexed Vested Benefit and/or Portability Feature
Washington Teachers	Pension payable to a vested member with 20 or more years of service at termination will be increased by 3% annually from date of separation until date of retirement eligibility
Oregon Public Employees	Employee contributions of terminated vested members are credited with market rate of return earned on pension plan assets during period from termination to receipt of benefits
Wisconsin	Floor offset plan arrangement provides employees with the greater of defined benefit or defined contribution plan benefits; during terminated vested period employee and employer contributions are credited with interest, thereby guaranteeing that the mobile employee's benefits will not be frozen at salary levels many years prior to actual retirement.

e. Evaluation Criteria for our Recommendation:

➢ **Conformity with the guidelines in Section 97D of the Iowa Code**

1. **<u>Benefit Enhancements:</u>**

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

5.6% of IPERS members are reported as of June 30, 1995 to have terminated with a vested benefit to be payable at a later date. While a relatively small percentage of IPERS members would benefit from an indexed vesting provision and the rollover option, the new benefits would be available to all IPERS members once vested.

2. **Kinds of Benefits to be Selected:**

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

Under current provisions, terminated vested members are provided with retirement benefits based on their final average salary at termination of service. Since benefits may be payable five, ten and even 20 or more years after termination from IPERS covered service, their ultimate retirement allowances will lose value when compared to retirement allowances of members who receive benefits immediately upon retirement. As IPERS pointed out in its 1995 Report to the Governor and General Assembly, between termination from covered employment and receipt of retirement benefits, "...IPERS has had the use of the member's own money, but the member's benefit did not increase at all."[17]

3. **Guiding Twin Objectives:**

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

We agree with IPERS that an enhanced vested benefit would have the effect of attracting and retaining quality employees. In IPERS words:

> ...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.[18]

17 Report to the Governor and General Assembly, IPERS, October, 1995, p.31.
18 Ibid

4. **Benefits to be Avoided:**

Avoid enacting further incentives toward earlier retirement with full benefits.

Not applicable.

5. **Equity Among Groups:**

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

Not applicable.

➢ **Consideration of the impact on IPERS' membership by demographic characteristics:**

Inactive vested members constituted 15,835, or 5.6% of the total membership in 1995 (see Graph 2a in the Appendix). Because these persons were vested when they terminated, their accounts continue to draw interest on the amounts contributed by themselves and their employers. In this regard, IPERS had noted:

Under 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;

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.)[19]

- **Consideration of fiscal consequences:**

  We recommend that the IPERS actuary prepare a fiscal note showing the cost of adding escalation to vested benefits of terminated members between separation from service and receipt of retirement benefits. The transfer of an actuarial reserve equal to the present value of future benefits should not result in a direct cost to the System since it should be an actuarial equivalent.

- **Consideration of legal issues:**

  If terminated vested members are to be permitted to roll over the actuarial present value of their vested benefits into another tax-qualified retirement plan, IRA notices and election forms meeting IRS requirements must be provided to such members. In addition, the IPERS actuary should perform calculations to ascertain that the COLA increases do not result in violations of the Section 415 limitations.

19 Ibid., p.37.

2. **Benefit To Assist Members In Meeting Health Care Costs In Retirement**

a. *1995 recommendation by IPERS:*

Proposal for assisting members in meeting anticipated health care costs in retirement.[20] 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 or to any specific premium for health services; they would represent accumulating dollar value for members' eventual use in best meeting health care costs as they choose.[21]

b. *Action by the 1996 General Assembly:*

None

20 Approximately two-thirds of the States provide some employer-financed health insurance to retired employees.

21 1995 IPERS Report to the Governor and General Assembly, op.cit., pp. 32-33.

c. *Current Recommendation:*

We concur with IPERS' observation that growing health care costs will continue to put pressure on IPERS retirees who, in turn, continue to pressure IPERS for assistance in meeting those costs. We also concur with IPERS that a separate fund is needed to assist retirees in meeting the costs of post-retirement health care. Our recommendation for such a fund is presented in Part II of this Report.

PART II: SUPPLEMENTAL PLANS AND FEATURES

A. Objectives and Goals

We have been asked to consider alternative supplemental plans and features that could be added to the current IPERS defined benefit plan. In a future Report we will prepare a separate study for IPERS evaluating defined contribution and defined benefit alternatives that could be adopted to replace or modify the current IPERS defined benefit plan. In this study we are limiting our discussion to a review of supplemental plans and features that could be added to the current IPERS defined benefit plan. For this reason, we will not consider core defined contribution plans or hybrid plans in the current study.

Our objective here is to discuss supplemental plans and features in addition to -- not in place of -- the core defined benefit plan. One of the most significant ways of strengthening the IPERS core defined benefit plan was previously discussed in this Report, namely, the enactment of an enhanced vested benefit with portability provisions.

In this section of the Report we are recommending that IPERS consider establishing a new deferred compensation plan under Section 457 of the Internal Revenue Code to be open to all state and local employees who are members of IPERS. We are also recommending the enactment of a Post-retirement Supplement Fund.

B. Alternative Supplemental Plans and Features that could be added to the Current IPERS Defined Benefit Plan

1. **<u>Establishing a Deferred Compensation Plan Under Section 457 of the Internal Revenue Code</u>**

IPERS members who are state employees are currently eligible to participate in a non-qualified deferred compensation arrangement pursuant to Section 457 of the Internal Revenue Code. IPERS members who are not state employees are not included in the 457 Plan. For this reason, we recommend that IPERS either establish a separate Section 457 Plan to cover all of its members or, alternatively, seek legislation to broaden the current Section 457 Plan to include all state and local government employees in Iowa. It should not be overlooked that IPERS members who are employed by public schools are eligible for membership in tax-deferred annuity programs (TDAs) pursuant to Section 403(b) of the Internal Revenue Code. Participation in a Section 457 Plan may not be as attractive as participation in 403(b) programs for these employees for various reasons. However, the existence of a statewide Section 457 Plan would provide an umbrella of retirement protection for all public employees in the State, ensuring that every individual be provided with an option to save for retirement on a voluntary tax-deferred basis. Section 457 of the Internal Revenue Code was recently substantially improved by amendments made by the Small Business Job Protection Act of 1996. These changes include the requirement that the assets be held in a trust in the future. This change will make Section 457 Plans more attractive to public employees.

2. **Establishing a Post-retirement Supplement Fund**

IPERS should consider developing a program to help retirees cope with the costs of post-retirement health care coverage. We believe that once a comprehensive master plan for the IPERS core defined benefit structure is put in place, the next priority is to address the issue of assisting IPERS retirees in meeting the costs of post-retirement health insurance coverage not otherwise covered by Medicare or employer-sponsored arrangements. Because there are approximately 2,500 employers who participate in IPERS, post-retirement employer-sponsored or financed health care arrangements vary from employer to employer. A study of these arrangements is not within the scope of this Report. However, IPERS itself has stated, based on available information, that the costs of post-retirement health care coverage are significant enough to require IPERS to address the issue. For these reasons, we are recommending the development of a Post-retirement Supplement Fund to be funded by IPERS and to be made available to all retirees -- present and prospective.

The precise methodology, formula and design of this Fund should not be finalized until the IPERS actuary prepares a fiscal analysis showing the estimated additional cost of each of the benefit enhancements recommended in Part I, and a determination is made of how these benefit enhancements will be financed. Once these calculations have been made and IPERS makes a determination of which enhancements should be adopted, a determination could then be made as to the precise design and manner in which IPERS could establish a Post-retirement Supplement Fund. As previously stated, in order to be able to better make a decision about funding this new benefit, IPERS should commission a comprehensive actuarial asset/liability (forecasting and planning) study to determine the impact of the costs of current benefits and benefit enhancements on future employer/employee contribution rates under alternative demographic and economic scenarios. Such a study should include an analysis of the actuarial probability, under alternative assumptions, of achieving "excess earnings", i.e., earnings in excess of the actuarial valuation interest rate. Once this is done, IPERS will be in a better position to determine how much can be set aside within IPERS to fund a Post-retirement Supplement Fund.

As one example of how a Post-retirement Supplement Fund might be funded, a portion of the IPERS' earnings in excess of the actuarial investment assumption (currently 7.5%) could be dedicated to fund the new benefit. As suggested in the beginning of this Report, one-half of the annual return in excess of 9% could be earmarked to fund a Post-retirement Supplement Fund. Under this scenario, the other one-half of the investment earnings in excess of 9% could be dedicated to financing benefit enhancements to the IPERS core defined benefit plan structure. A program could include safeguards to prevent a diminution of IPERS' funded status by providing that only in any year that the five year market rate of return exceeds 9% could a portion of the excess be used to produce a payment to eligible retirees from the Post-retirement Supplement Fund.

Favorable investment results over five years will cause employer contributions to decline even when a portion of the return over 9% is used to provide a payment from the Post-retirement Supplement Fund. The program would remove a portion of investment gain, but could still leave a considerable amount for funding benefit enhancements to the defined benefit plan core structure, thereby contributing to the stability of the current statutory contribution rates and maintaining the funded status of IPERS.

As previously stated, the maximum amount dedicated to this program could be limited to one-half of the earnings above 9% over a five-year market rate on the assets of IPERS. As of September 30, 1996, the IPERS Fund earned 10.33% over 5 years. One-half of the excess over 9%, or .67%, would have provided approximately $67 million in 1996.

Payments from the Post-retirement Supplement Fund would be in addition to the current COLA Dividend Program and the Minimum COLA Program. Eligibility requirements should be the same for the Post-retirement Supplement Fund, i.e., any retiree eligible for COLA payments from IPERS would also be eligible to receive payments from the Post-retirement Supplement Fund. If the Post-retirement Supplement Fund is enacted as a permanent program, it would benefit both retirees and current members (future retirees).

Under our proposal, a payment from the Post-retirement Supplement Fund would be triggered when the five-year market rate of return exceeds 9%. One-half of the investment earnings over 9% would provide a fund for payments to eligible retirees and beneficiaries. Payments could be calculated and paid in an annuity form so that such payments would continue for life, regardless of future investment performance.

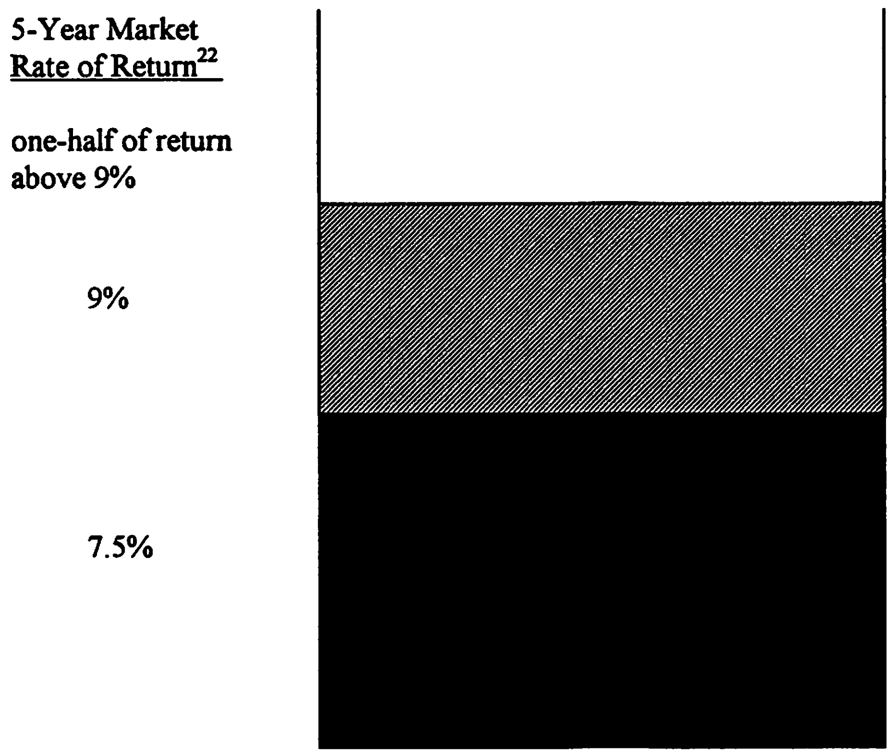
In summary, the concept of a Post-retirement Supplement Fund offers flexibility to IPERS in determining the amount of earnings that ought to be dedicated to the Fund and the terms, conditions and prerequisites for payment. Importantly, it provides a means of allowing IPERS to address a need of many of its retirees, and it permits IPERS retirees to share in any unusually good earnings of the Fund. Needed benefit enhancements can be enacted over the next two biennial sessions of the General Assembly. A forecasting and planning study could determine the extent to which IPERS could also prudently fund a Post-retirement Supplement Fund without adversely affecting the well-funded status of the System.

It is noteworthy that several statewide plans provide post-retirement COLAs based in whole or part on excess investment earnings. While these programs are earmarked for COLAs, the same design could be applied to a fund to be used to help finance post-retirement health care insurance or other or other post-retirement needs.

System	Benefit and Design
Arizona SRS	CPI up to 3%. COLA paid from reserve of "excess investment earnings"; no excess earnings, no COLA paid; excess earnings defined as rate of return greater than 9%.
Connecticut TRS	Ad Hoc. CPI with 3% minimum and 5% maximum for retirees prior to 9/1/92; thereafter ad hoc depending on adequacy of "excess earnings account."
Minnesota TRA/PERF/SERF	CPI to 3.5% + investment surplus. The formula provided for a benefit increase of 6.3954% for eligible retirees, effective 1/1/96; this increase consisted of a 3.1% inflation component and a 3.2954% excess earnings component.
St. Paul SPTRFA	Adjustment when investment returns above 6%;.
Minneapolis MTRFA	Annual 2% + investment surplus.
Montana PERS/TRS	Investment returns above 8%.
Wisconsin RS	Investment surplus increases.

The following table illustrates one design for an IPERS Post-retirement Supplement Fund.

Illustration of an IPERS Post-retirement Supplement Fund.



ACTUARIAL ASSUMPTION (7.5%, i.e., what is required to meet present and future obligations of IPERS).

Contribution for Post-retirement Supplement Fund

Dedicated to funding post-retirement dividend COLA program or otherwise funding enhancements to the IPERS core benefit structure.

[22] The five-year rate of return for IPERS was 10.33% as of September 30, 1996.

PART III: PRIORITIZATION OF RECOMMENDATIONS

In assigning priority levels to each of our recommendations, we have given the highest priority to those recommendations we believe, if enacted, would materially strengthen the core benefit structure.

A. Enhancements to Core Benefit Structure

Recommendations	Priority Level
Modify 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	# 1
Permit members to elect to make additional member contributions to remove the salary cap on their retirement benefits	#1
Modify minimum COLA program for long-time, low-income retirees to provide a benefit of $100 to $400 a month for retirees with 10 to 30 or more years of service (prorated) and increase all monthly benefits of $500 or below by 10%.	# 1
Modify the Death Benefit to provide that benefits be paid according to the following schedule: Service (years): — Benefit (multiples of salary): up to one — one year's one to two — two years' three or more — three years' or, if greater, the member's accrued normal retirement benefit payable as a 100% joint-and-survivor annuity	# 1

Recommendations	Priority Level
Modify Post-retirement COLA to provide: • a fixed, automatic adjustment based on 100% of the CPI and subject to a 3% per year cap; • to be applied to retirees one year after retirement;	# 2
Provide an indexed vested benefit and to permit terminated vested members, upon their termination of employment, to elect to have their pension reserves rolled over to a tax-qualified employer-sponsored pension plan or IRA.	# 2

B. Section 457 Deferred Compensation Plan

Recommendation	Priority Level
Expand to cover all IPERS members	# 1

C. Post-retirement Supplement Fund

Recommendation	Priority Level
Provide a Post-retirement Supplement Fund to eligible retirees and beneficiaries funded by a portion of investment returns in excess of the actuarial interest assumption	# 3

D. Enhancements to be Given Further Study

Recommendations	Priority Level
Modify the service-connected Death Benefits	Defer to Disability Study
Modify the Disability Benefits	Defer to Disability Study

APPENDIX

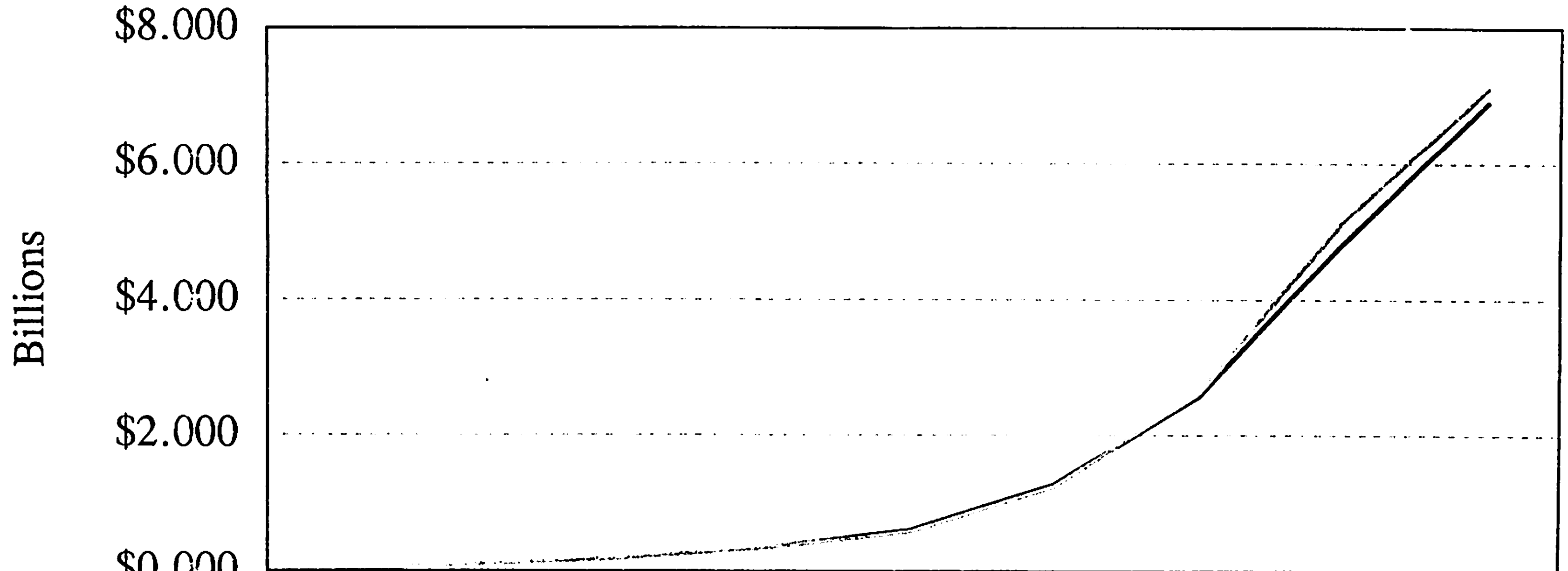
PROFILES OF

DEMOGRAPHIC FEATURES

OF THE MEMBERSHIP

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	$7.126
Actuarial Value	$0.029	$0.106	$0.194	$0.347	$0.618	$1.288	$2.581	$4.830	$6.927

Market Value — Actuarial Value

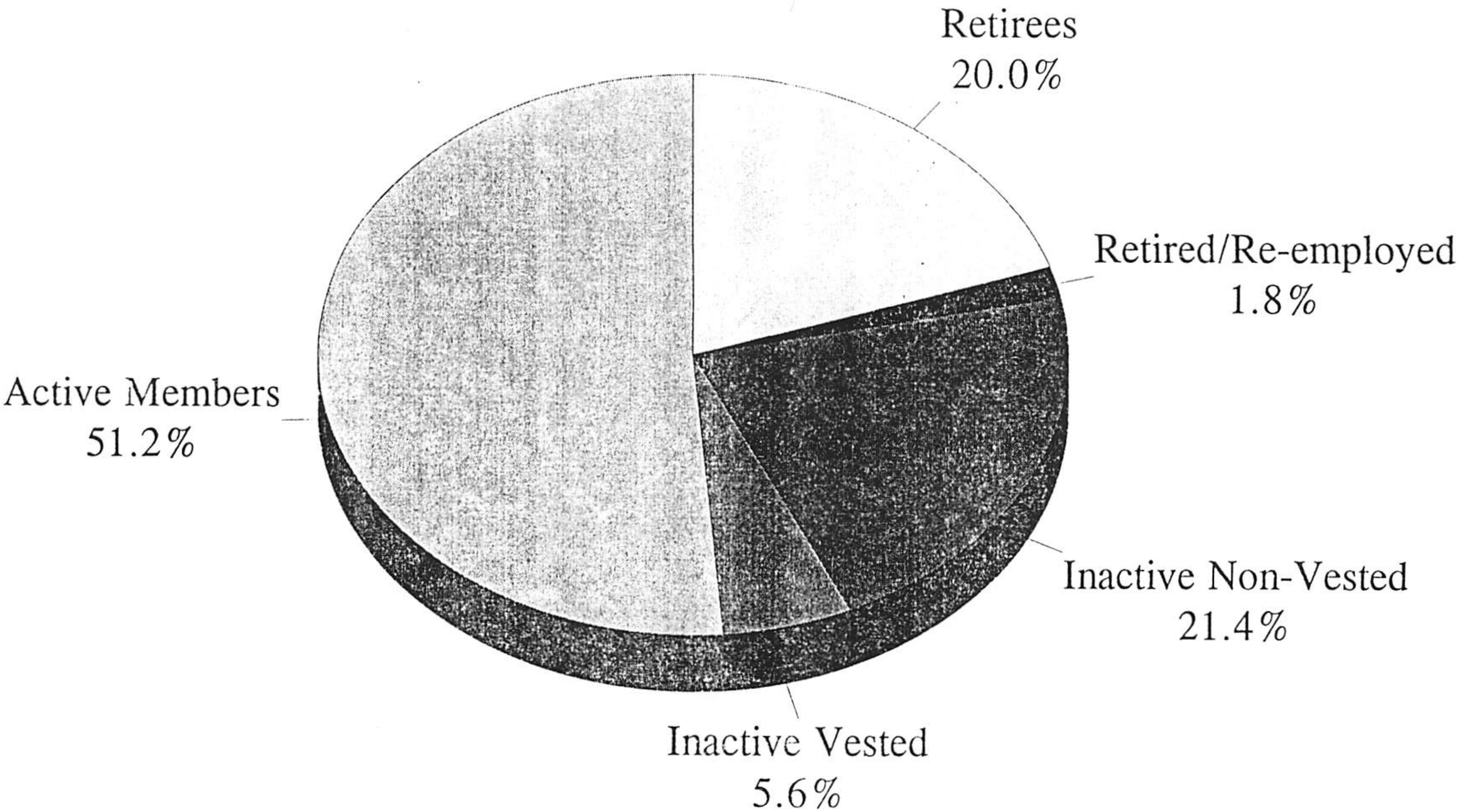
Securities valued at par prior to 1970

Graph 1

BUCK CONSULTANTS

Membership Profile

June 30, 1995



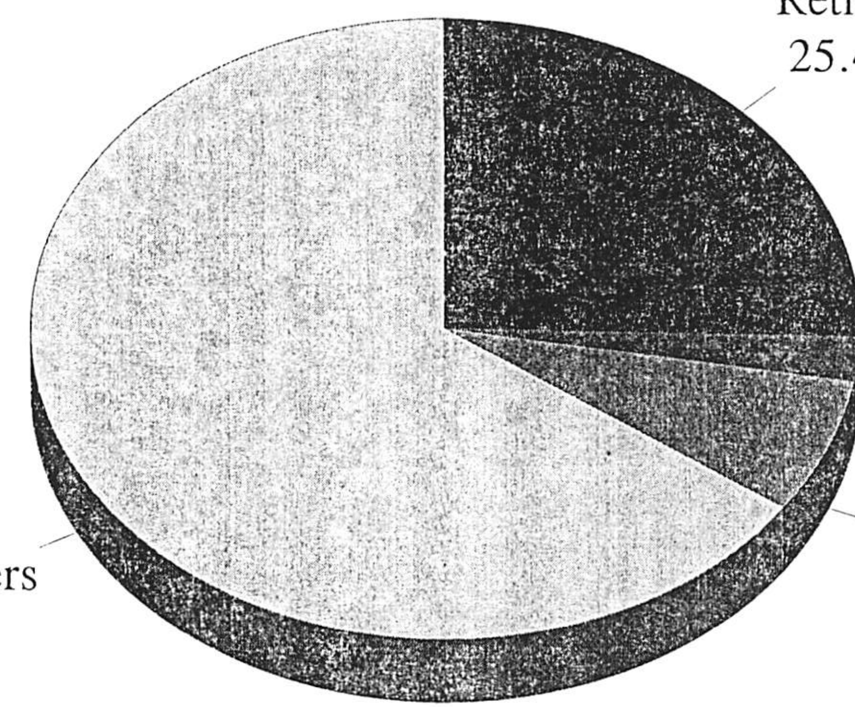
Total Membership: 282,759

Graph 2a

BUCK CONSULTANTS

Membership Profile Without Non-Vested

June 30, 1995

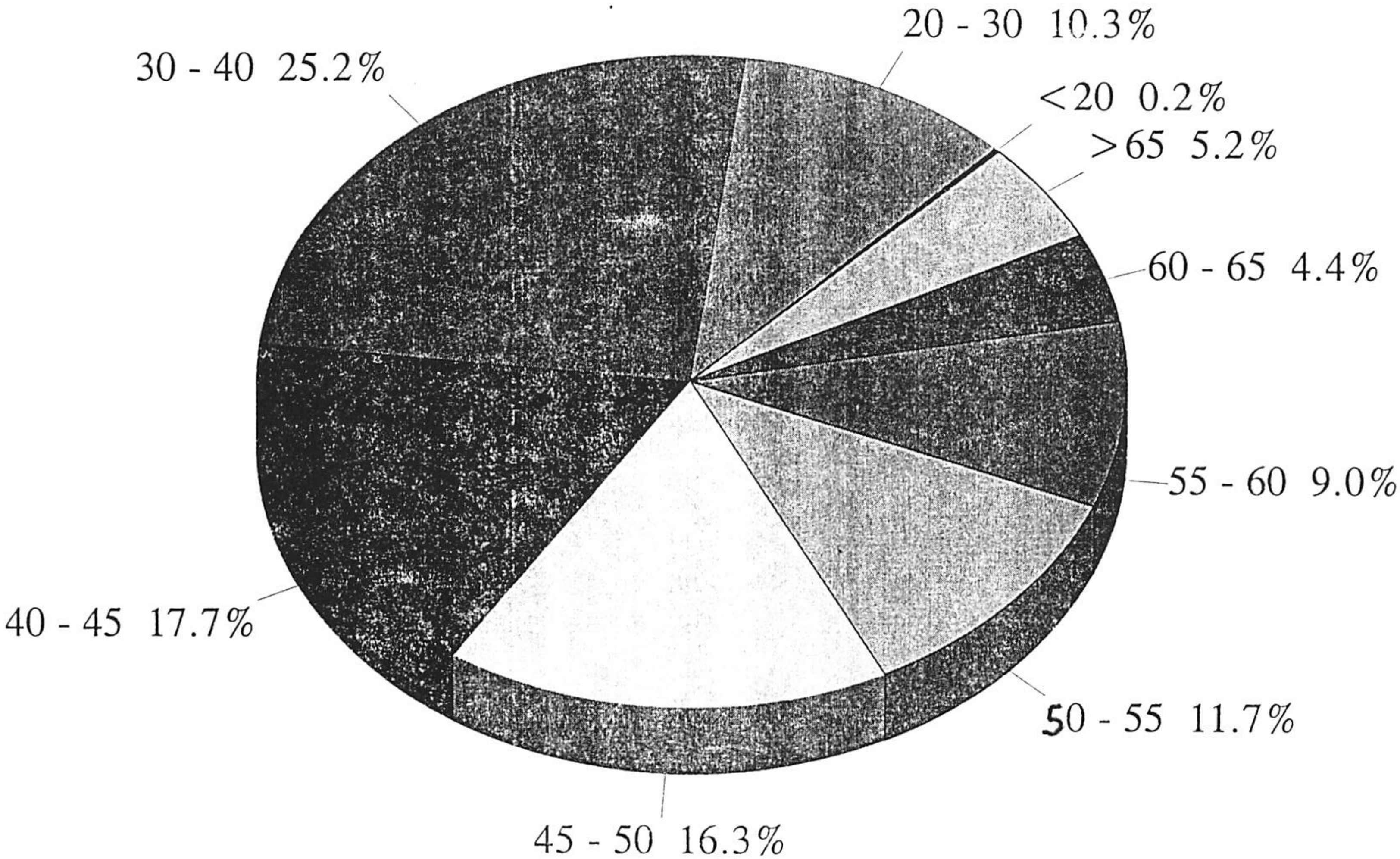


Total Membership: 221,120

Graph 2b

Active Members by Age

June 30, 1995



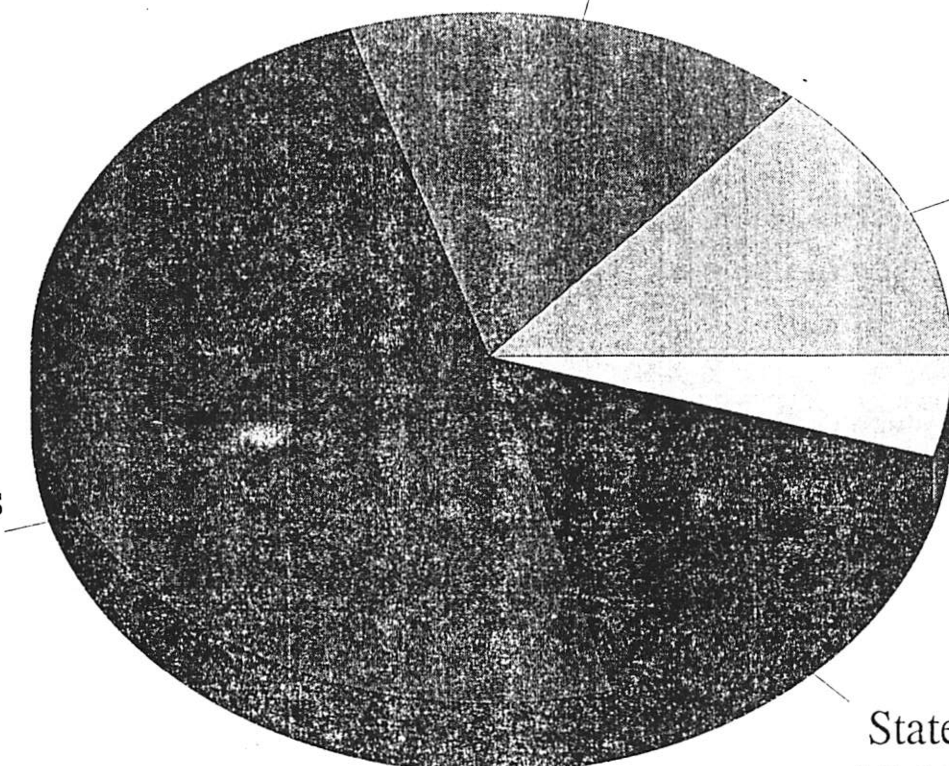
Total Active Members: 144,756

Graph 2c

BUCK CONSULTANTS

Active Members by Employer Group

June 30, 1995



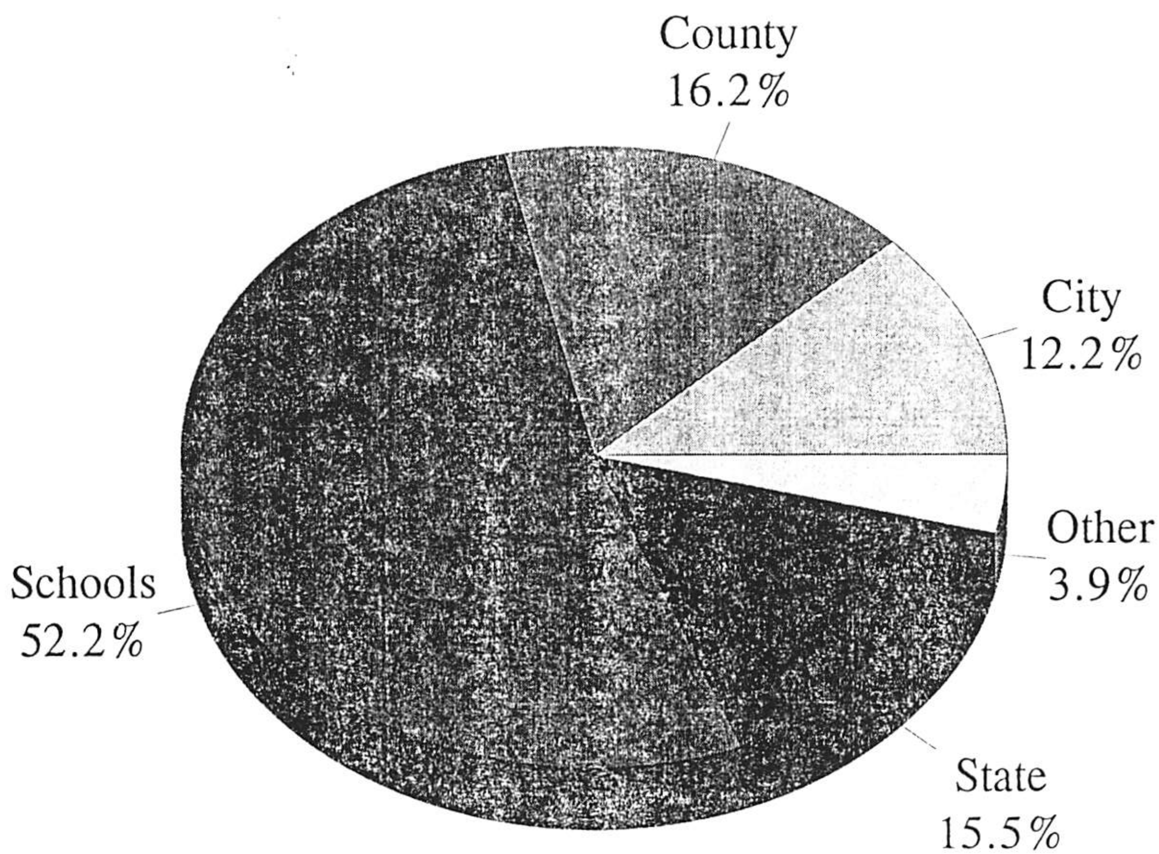
Total Active Members: 144,910

Graph 3

BUCK CONSULTANTS

Active Members Age 55 - 65 Per Employer Group

June 30, 1995

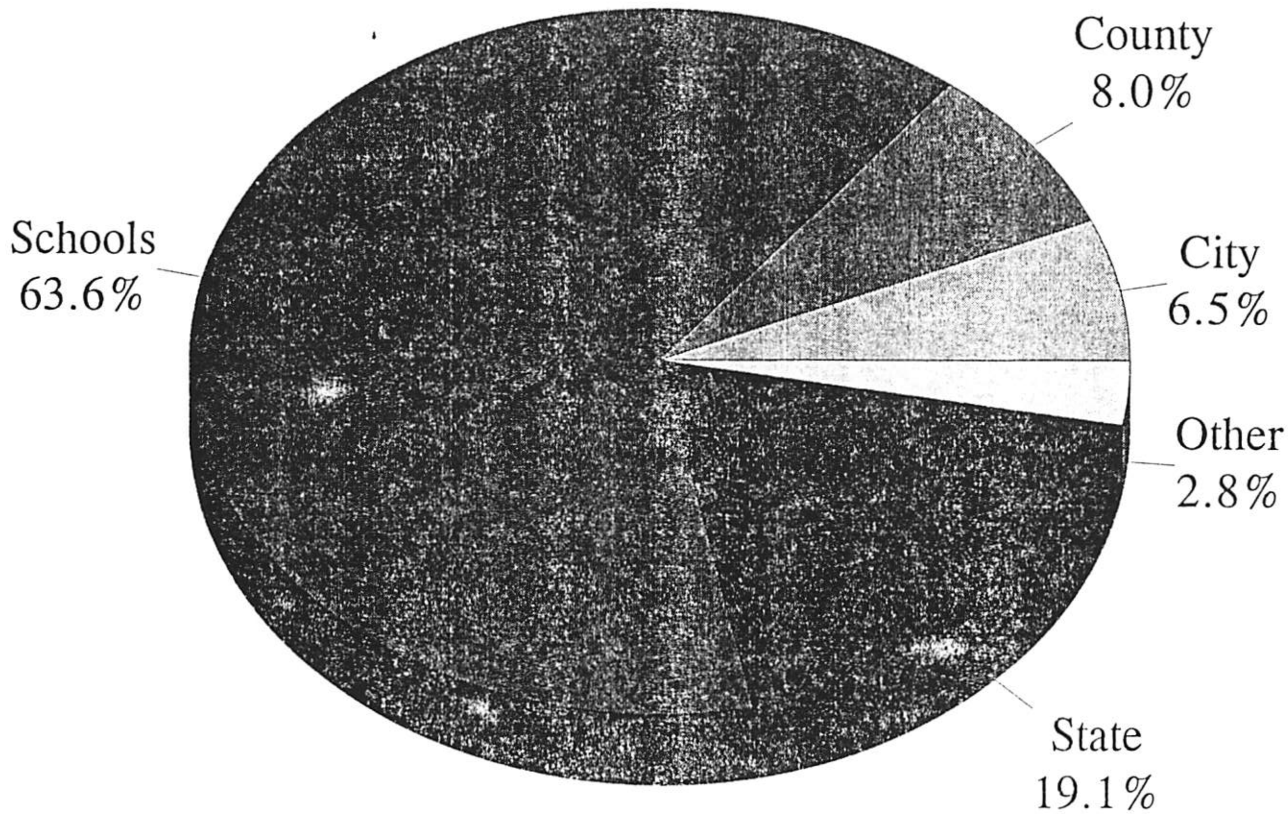


Total in Group: 22,466

Graph 4

Active Members Eligible for Rule of 92 by Employer Group

June 30, 1995

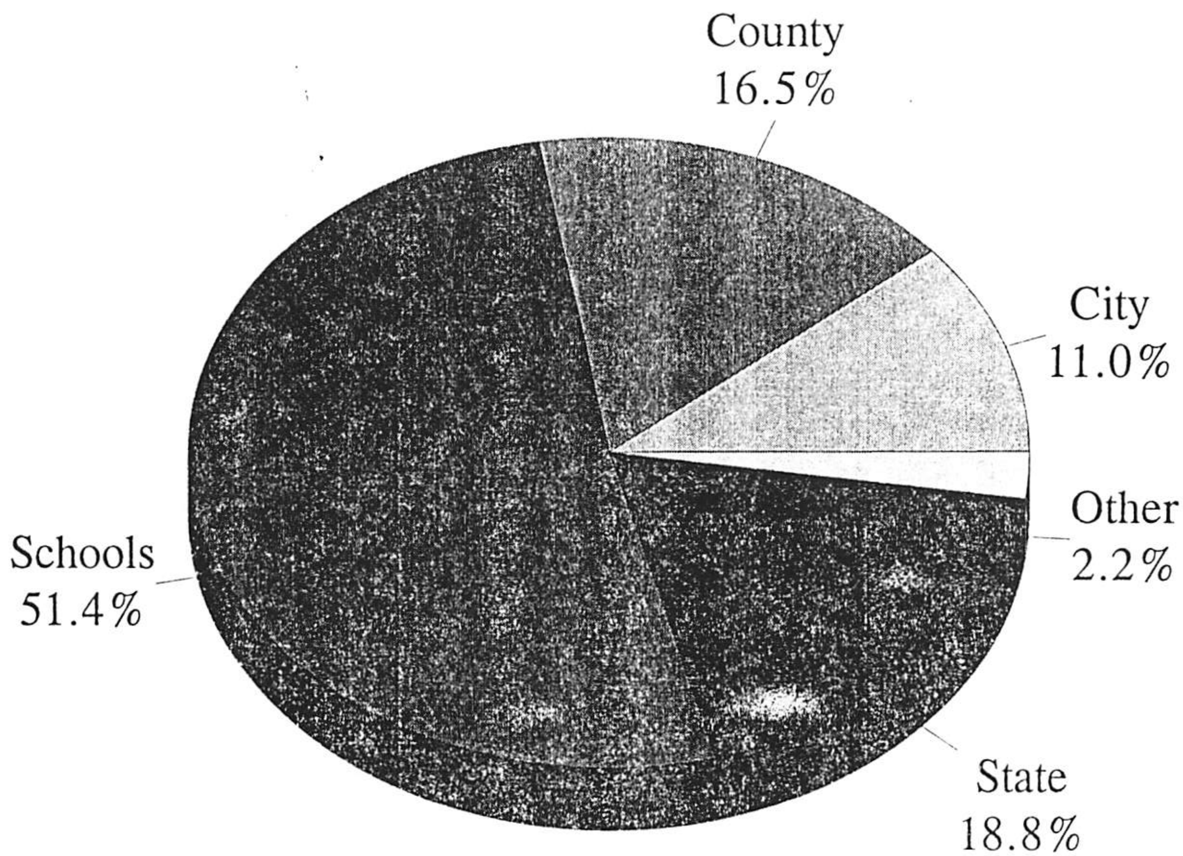


Total Eligible: 3,190

Graph 5

Retirees by Employer Group

June 30, 1995



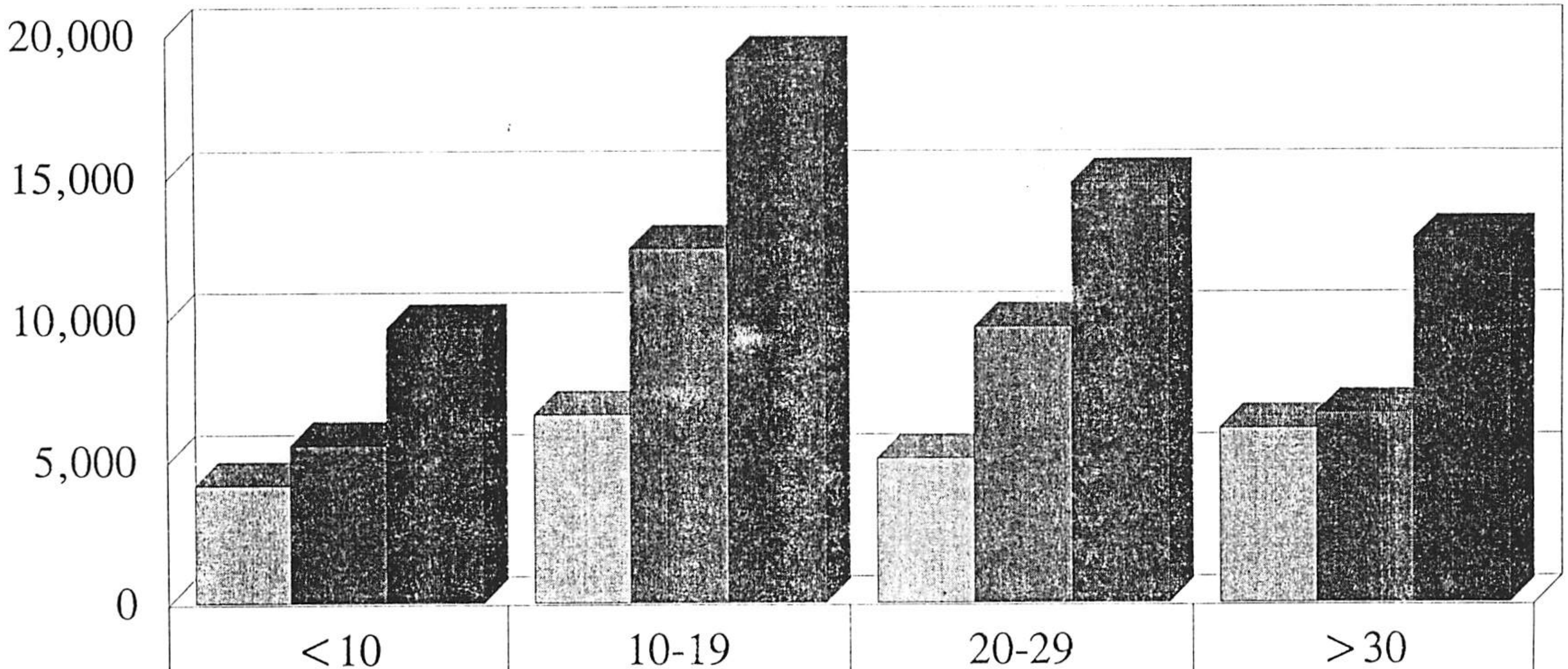
Total Retirees: 56,414

Graph 6

BUCK CONSULTANTS

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

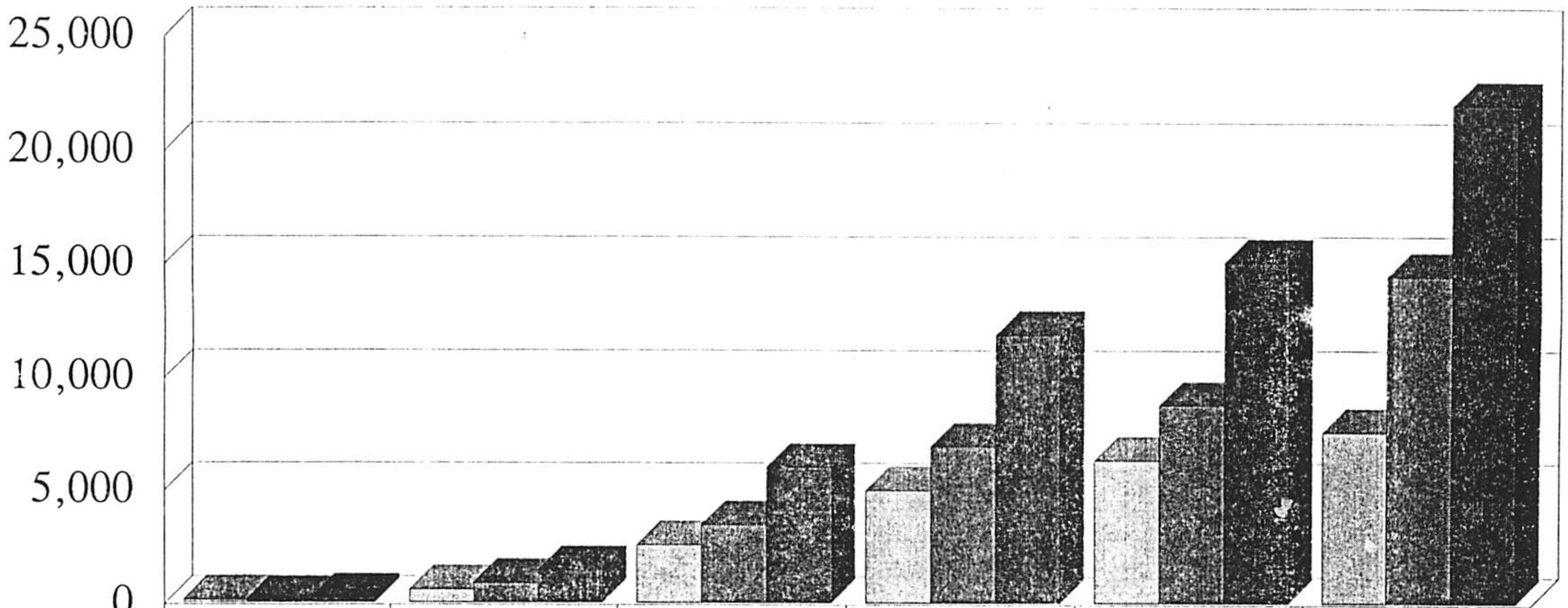
Males Females Total

Graph 7

BUCK CONSULTANTS

Retirees by Age

June 30, 1995

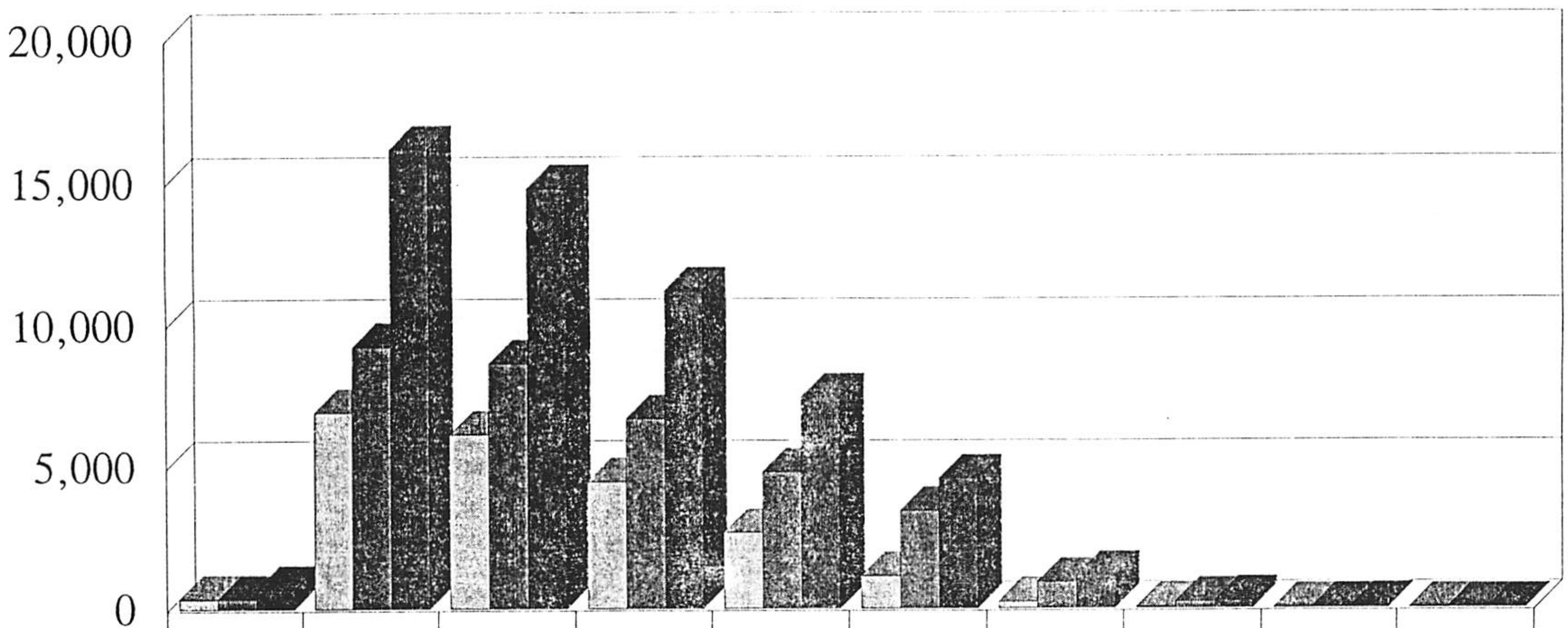


	<55	55 - 59	60 - 64	65 - 69	70 - 75	76 & Up
Males	114	573	2,530	4,952	6,286	7,529
Females	99	868	3,427	6,887	8,719	14,405
Total	213	1,441	5,957	11,839	15,005	21,934

Graph 8

Retirees by Years Retired

June 30, 1995



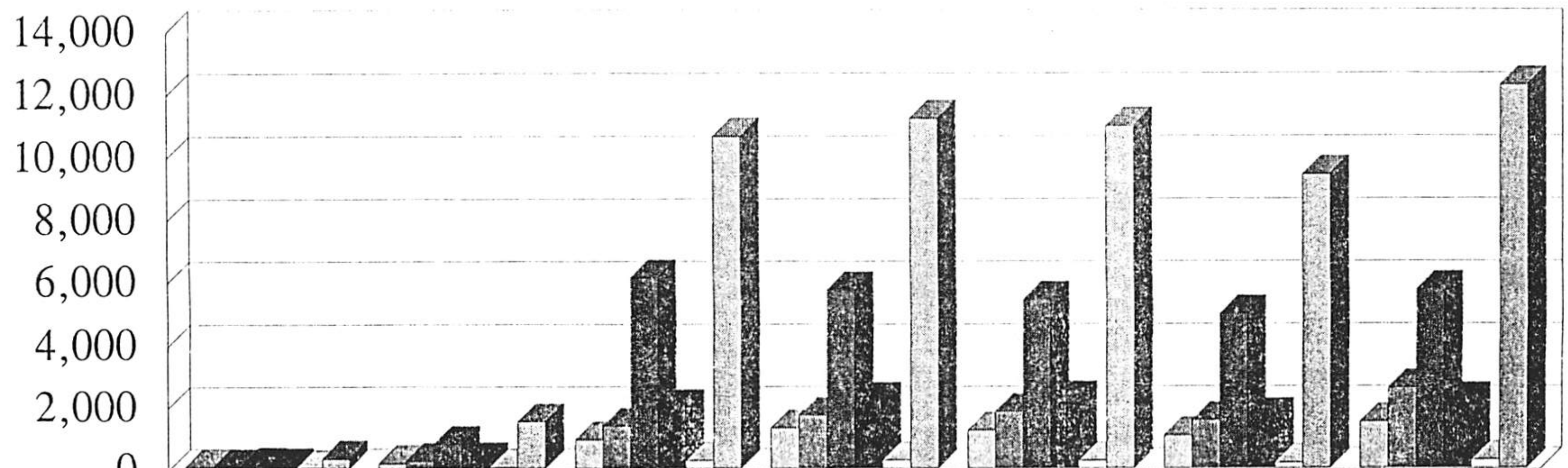
	<01	1-5	6-10	11-15	16-20	21-25	26 - 30	31 - 35	36 - 40	>40
Males	346	6,936	6,146	4,478	2,666	1,132	235	38	4	1
Females	348	9,256	8,667	6,709	4,810	3,451	914	223	28	1
Total	694	16,192	14,813	11,187	7,476	4,583	1,149	261	32	2

Graph 9

BUCK CONSULTANTS

Age at Retirement by Employer Group

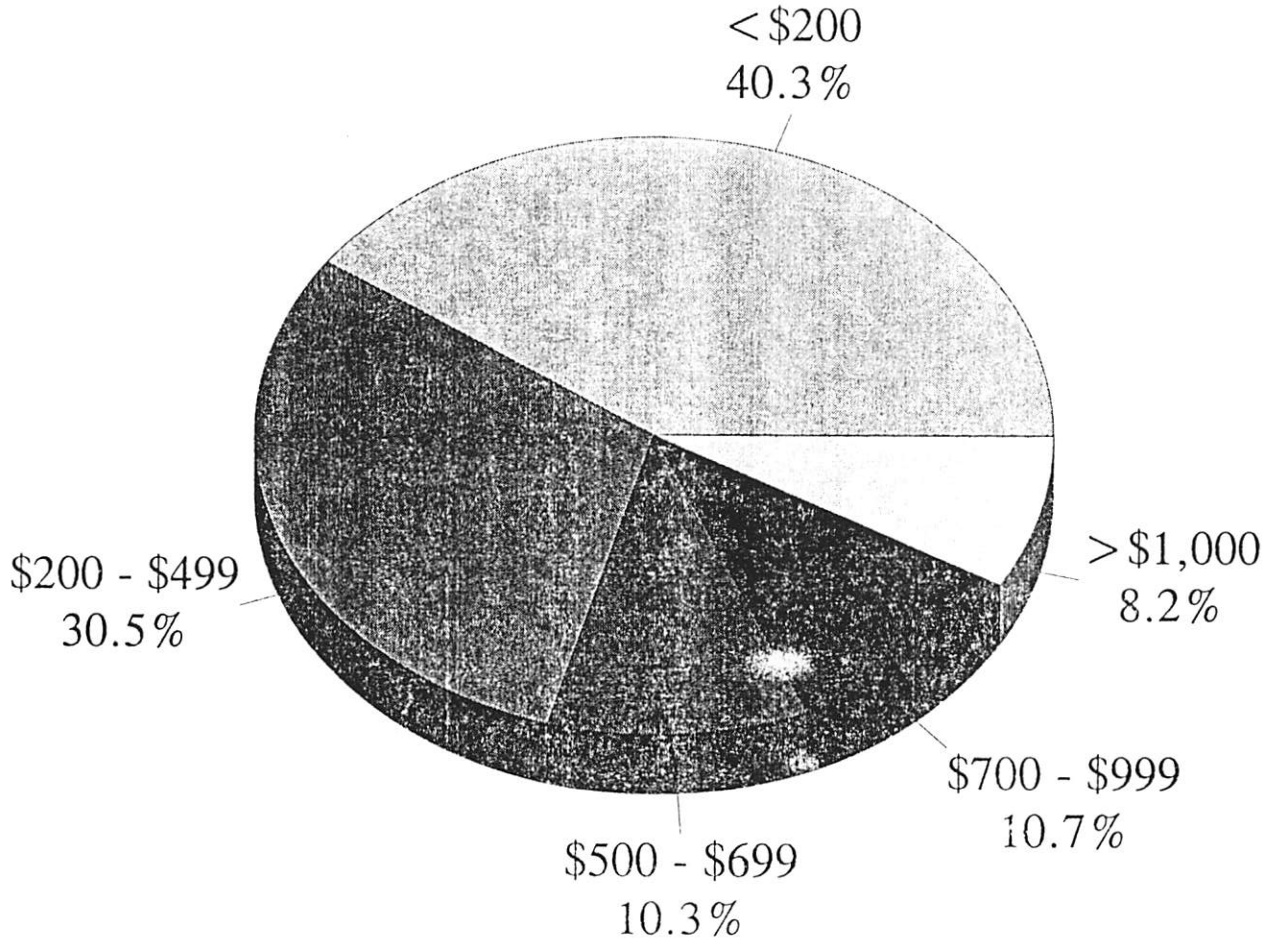
June 30, 1993



	<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

Retirees by Monthly Benefit

June 30, 1995



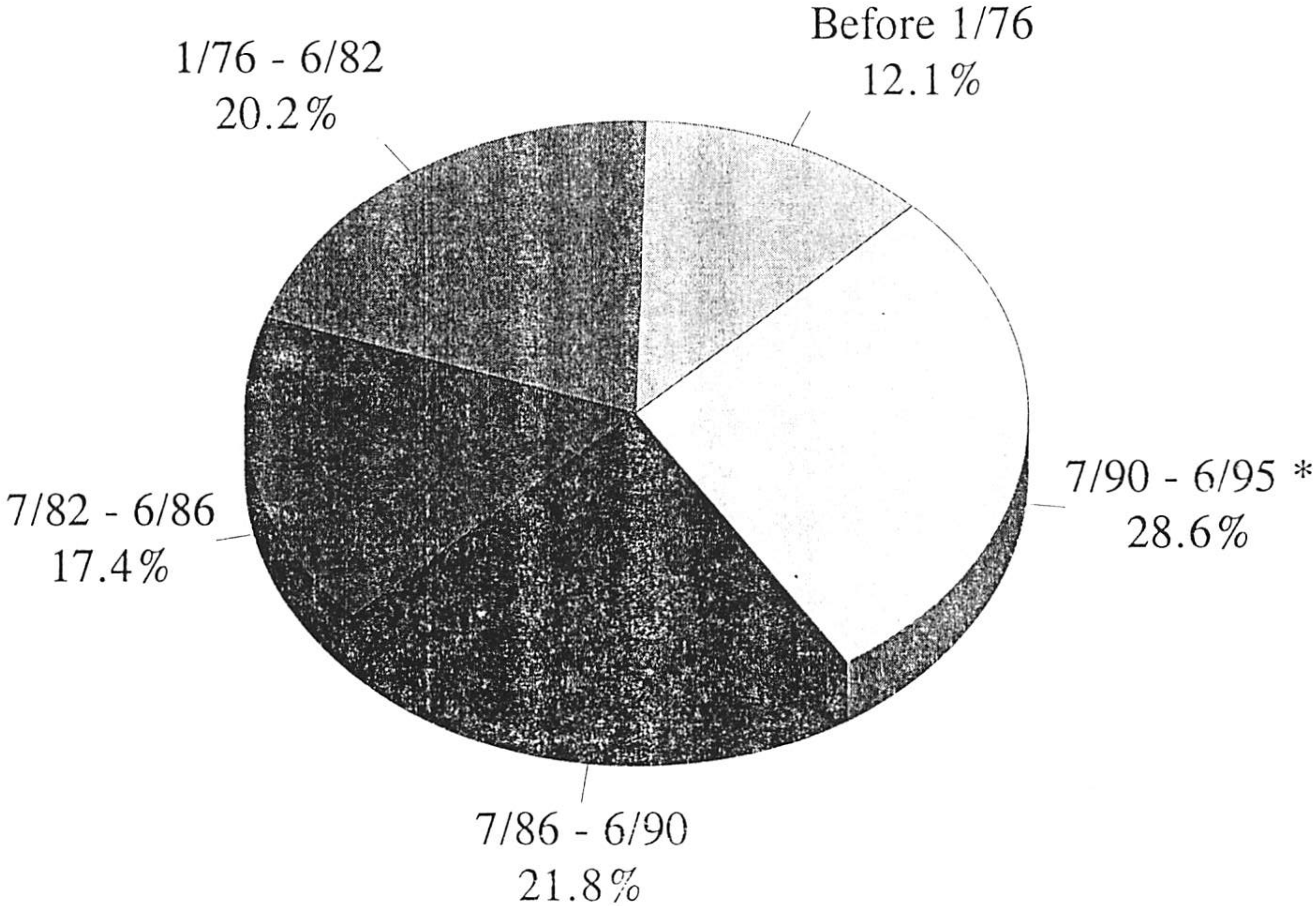
Total Retirees: 56,414

Graph 11

BUCK CONSULTANTS

Retirees by Dividend Group

June 30, 1995



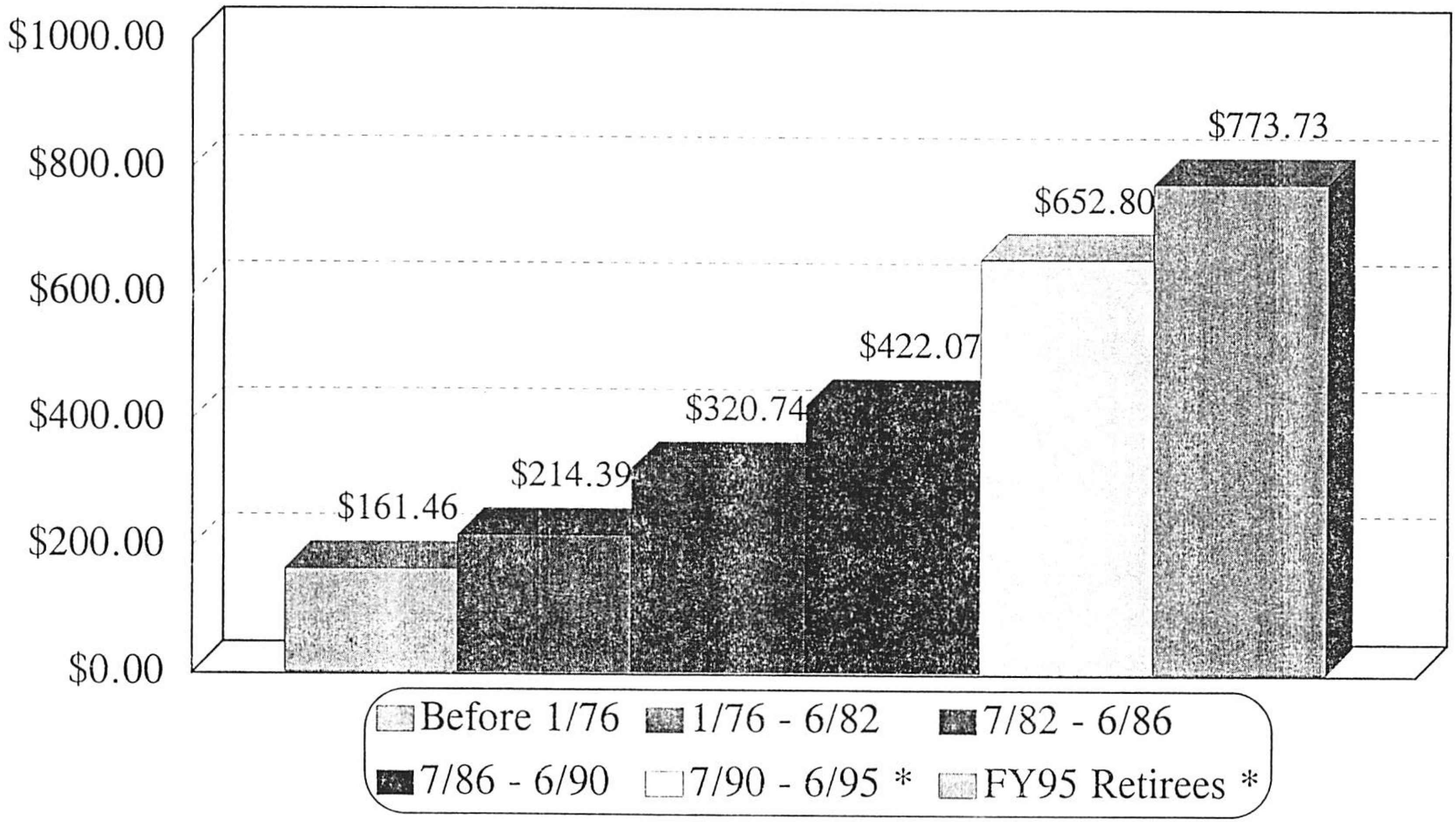
* Non-Dividend Group

Graph 12

BUCK CONSULTANTS

Average Benefit Per Dividend Group

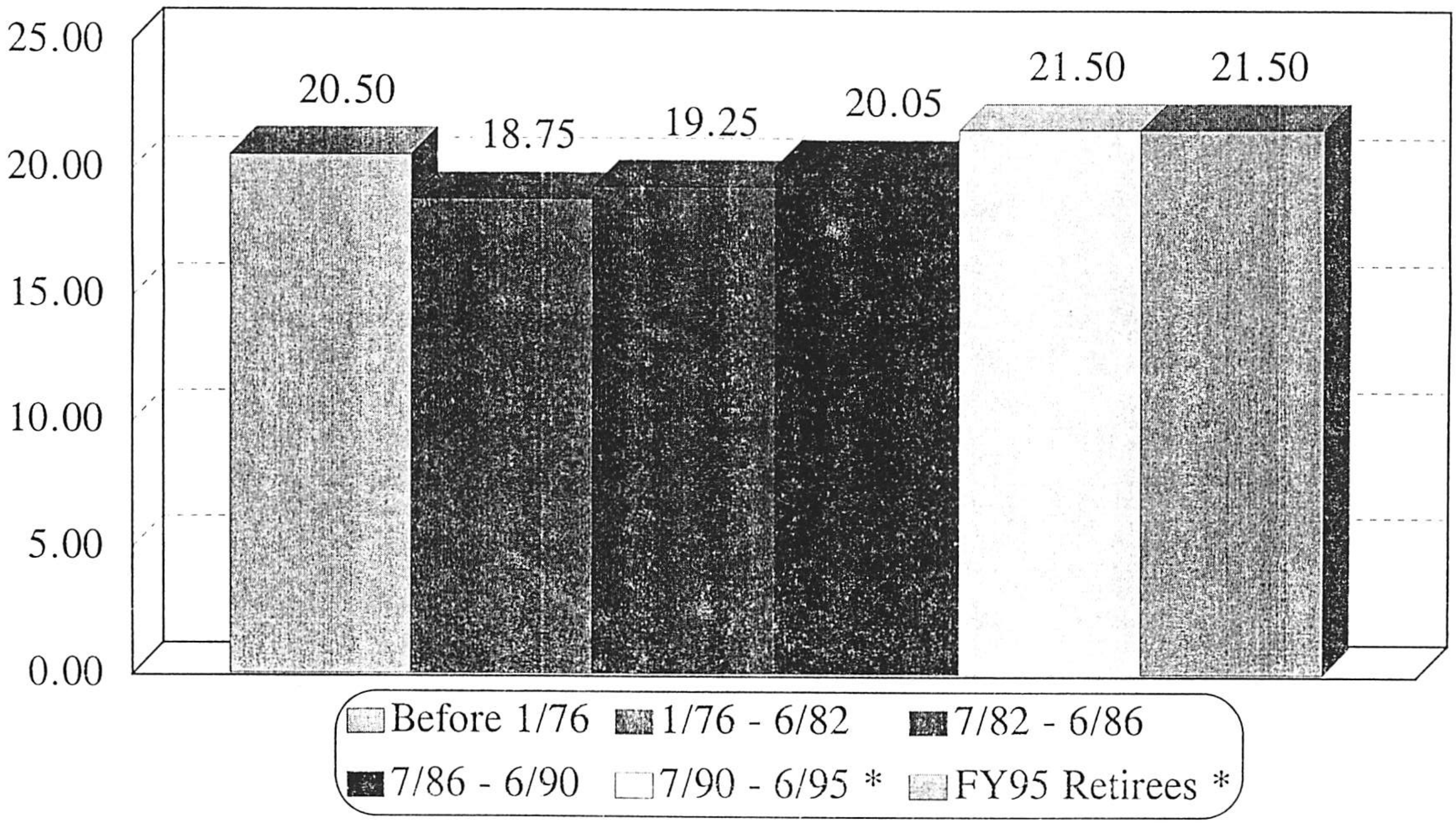
June 30, 1995



* Non-Dividend Groups

Average Years of Service Per Dividend Group

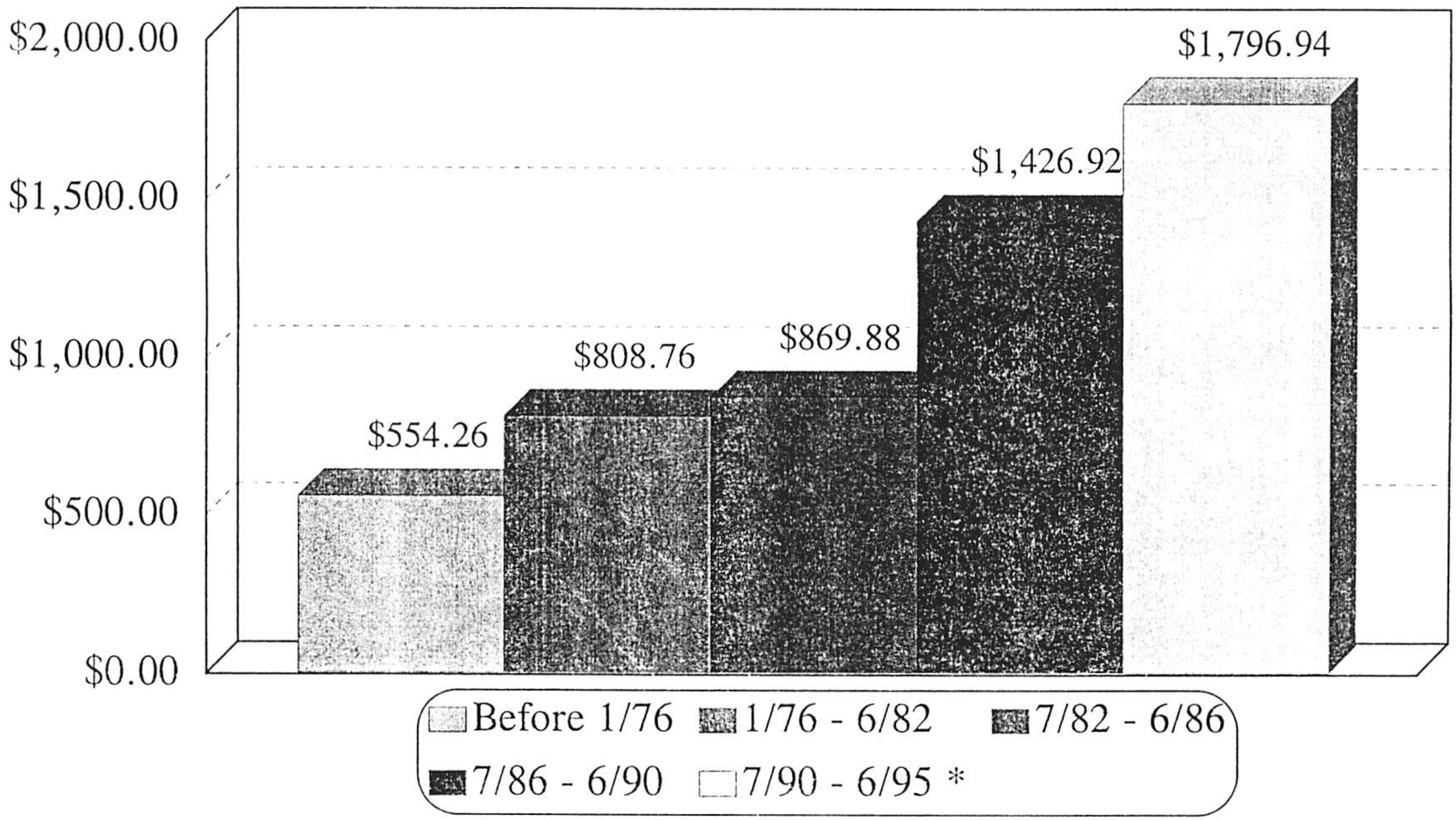
June 30, 1995



* Non-Dividend Groups

High Monthly Benefit Per Dividend Group

June 30, 1995



* Non-Dividend Group

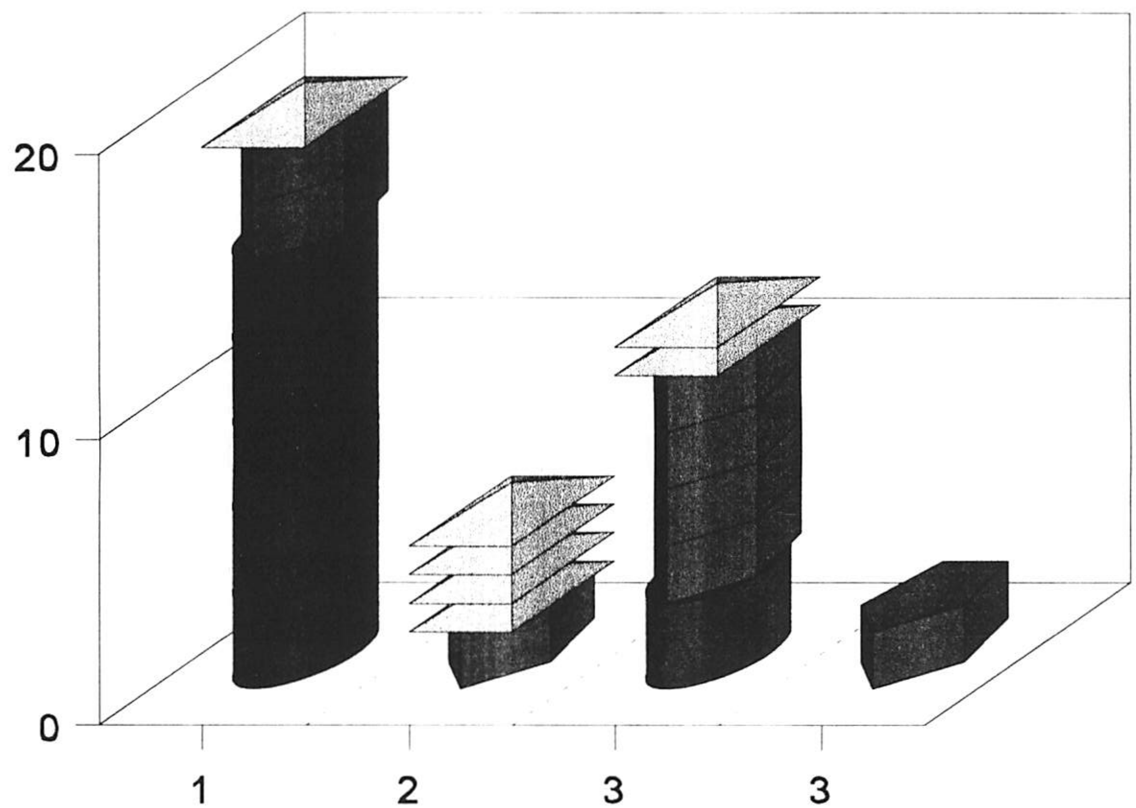
Graph 15

BUCK CONSULTANTS

RANKING:
Green = 3
Blue = 2
Gray = 1

Results of Second Poll, August 27, 1996

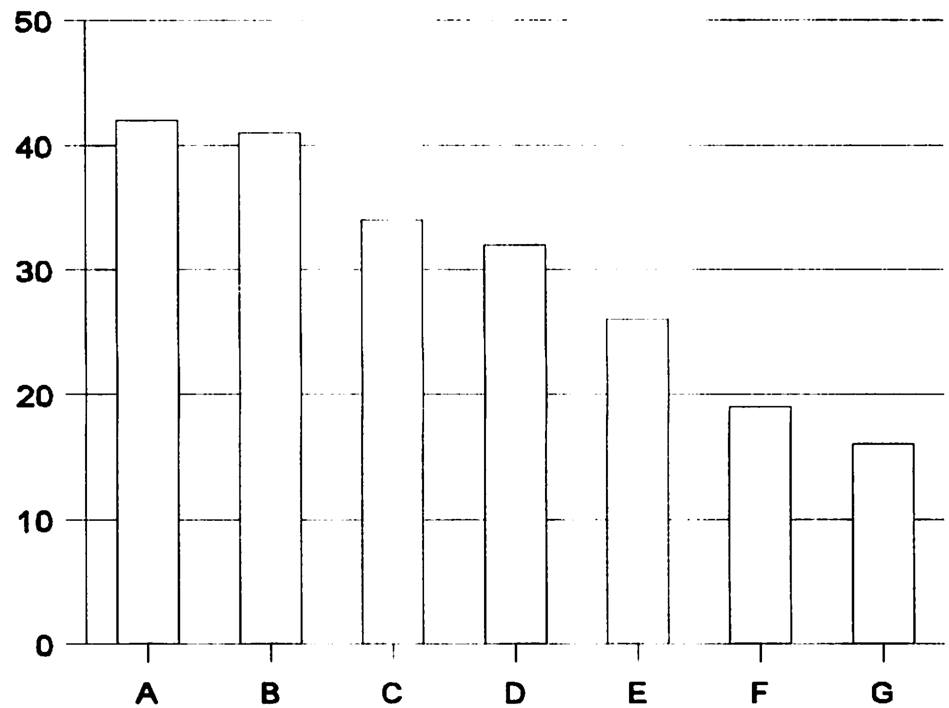
Ranking of Major Issues: Top Three -- CONSTITUENTS



1 = Extending the Colas	3 = Health Care Assistance
2 = Portability/Refunds/Frozen Benefits	3 = Additional Savings Options

LEGEND: Each geometric shape and color shading represents one persons vote.

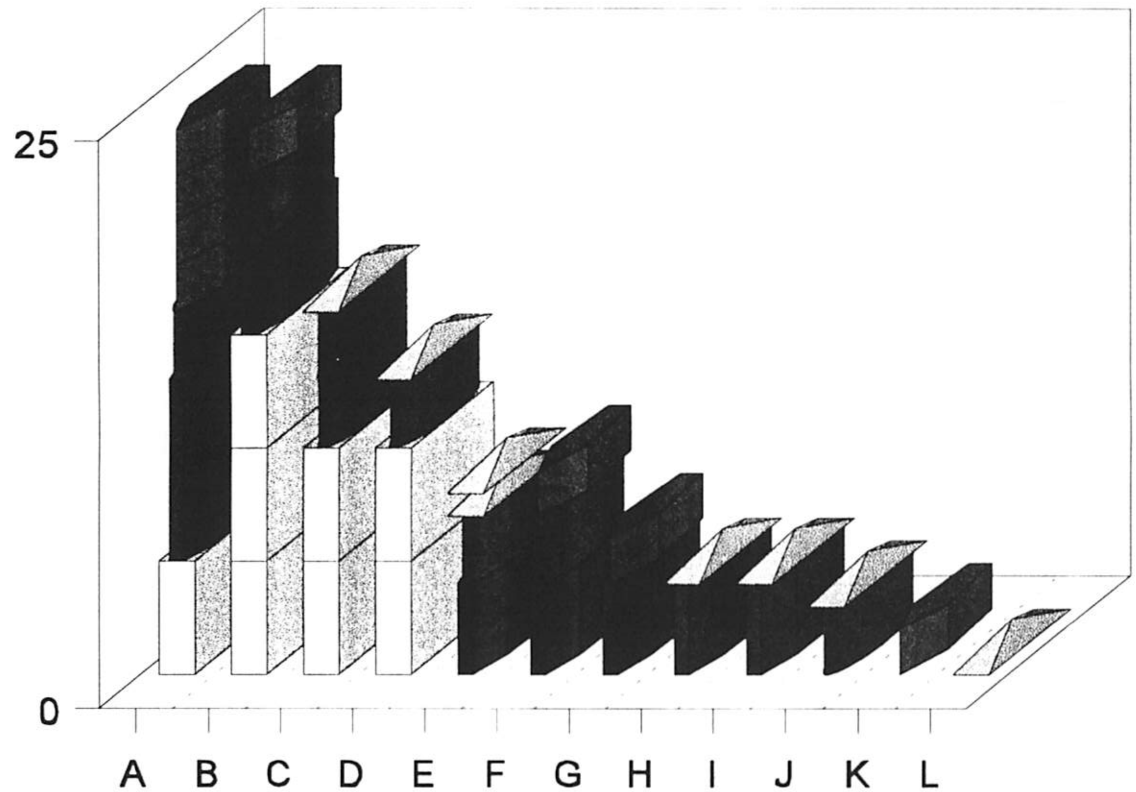
COMPOSITE NUMBER SCORE



A = Cola B = Health Care Assistance C = Portability D = Death Benefits	E = Additional Savings Options F = Early Retirement G = Frozen Benefits

RANKING:
Yellow = 5
Red = 4
Green = 3
Blue = 2
Gray = 1

CONSTITUENTS

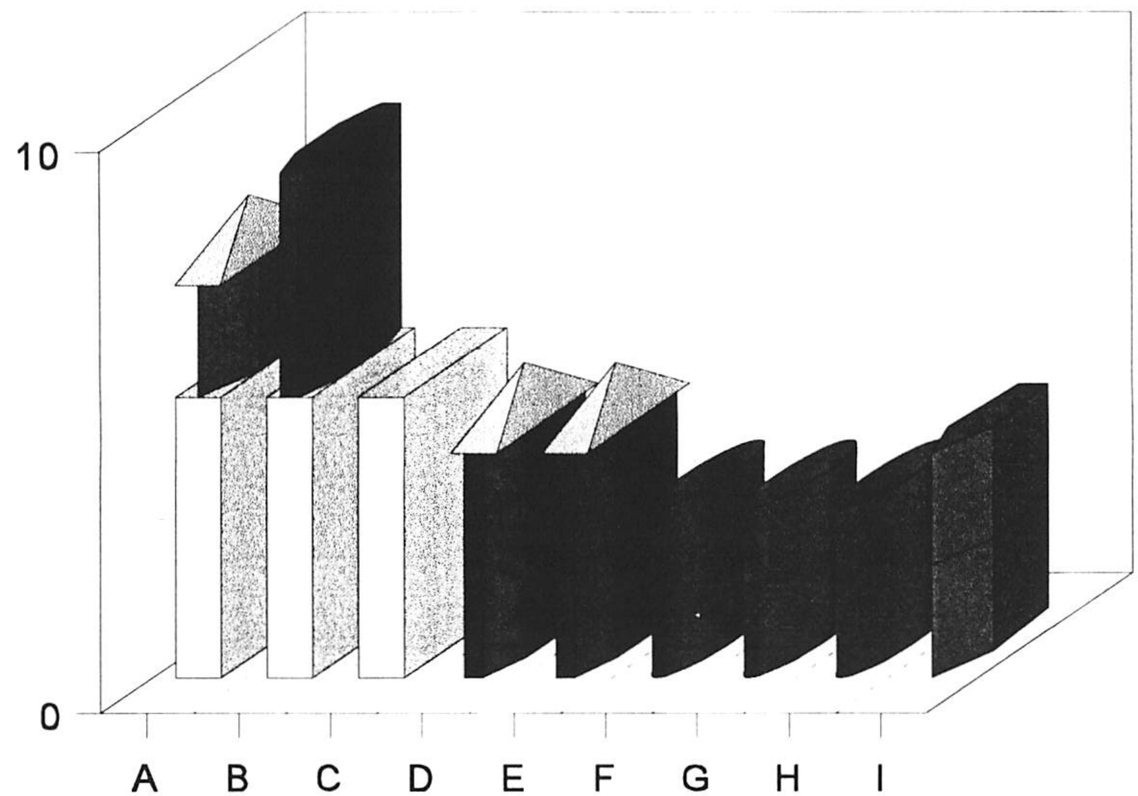


A	=	Cola	E	=	Cap on Years of Service	I	=	Antispiking
B	=	Health Care Assistance	F	=	Disability	J	=	Contribution Rates
C	=	Death Benefits	G	=	Portability	K	=	Frozen Benefits
D	=	Early Retirement	H	=	Additional Savings Options	L	=	Minimum Benefits

LEGEND: Each geometric shape and color shading represents one persons vote.

RANKING:
Yellow = 5
Red = 4
Green = 3
Blue = 2
Gray = 1

LEGISLATIVE STAFF



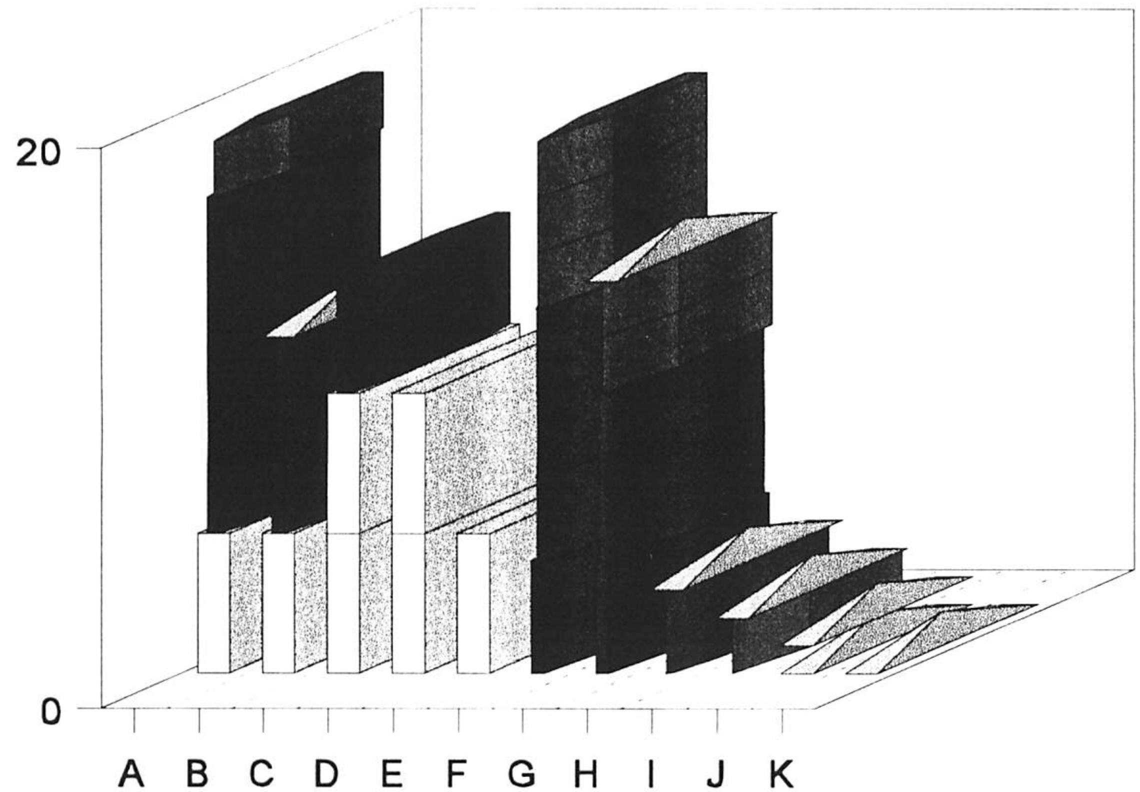
A = Additional Savings Options	D = Contribution Rates	G = Health Care Assistance
B = Portability	E = Cap on Years of Service	H = Minimum Benefits
C = Antispiking	F = Cola	I = Frozen Benefits

LEGEND: Each geometric shape and color shading represents one persons vote.

BUCK CONSULTANTS

RANKING:
Yellow = 5
Red = 4
Green = 3
Blue = 2
Gray = 1

IPERS' STAFF



A = Portability		E = Early Retirement		I = Cap on Years of Service			
B = Additional Savings Options		F = Cola		J = Minimum Benefits			
C = Health Care Assistance		G = Death Benefits		K = Refunds			
D = Frozen Benefits		H = Disability					

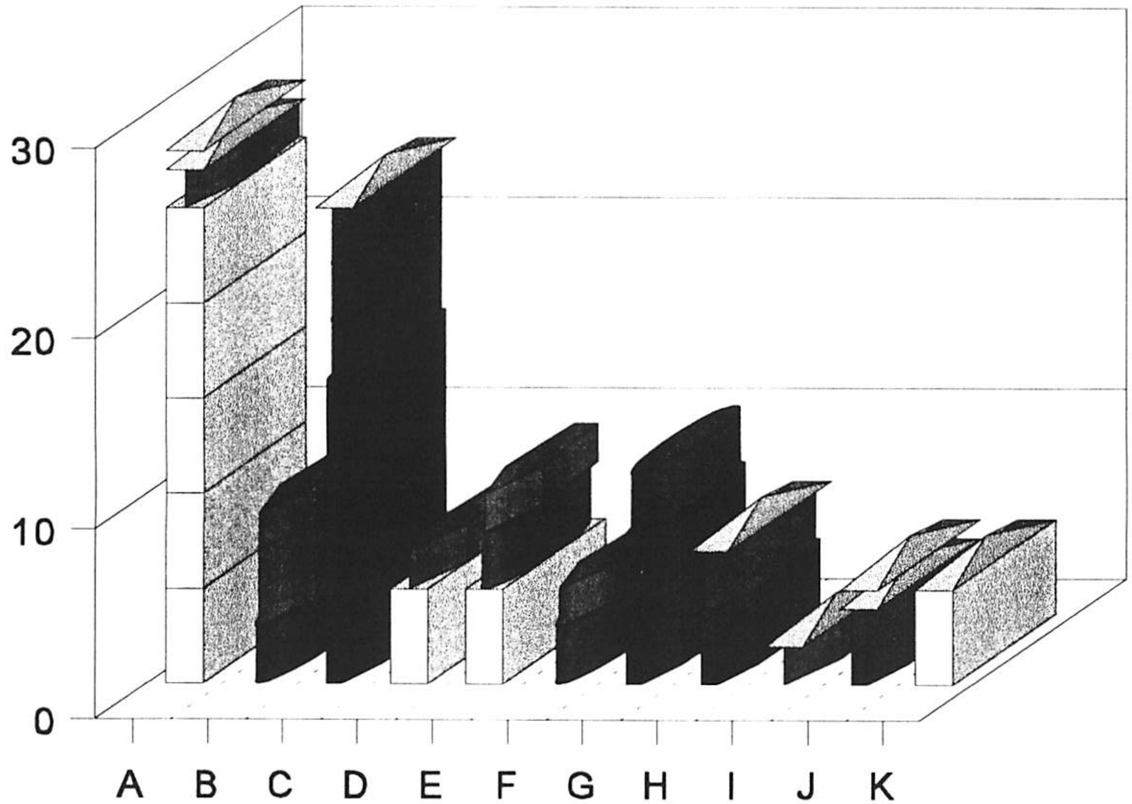
LEGEND: Each geometric shape and color shading represents one persons vote.

BUCK CONSULTANTS

RANKING:
Yellow = 5
Red = 4
Green = 3
Blue = 2
Gray = 1

Results of Poll, August 27, 1996

Ranking of Major Issues: First Poll of Day -- CONSTITUENTS



A = Extending the Colas	E = Earlier Retirement Options	I = Adjusting Contribution Rates
B = Portability/Refunds/ Frozen Benefits	F = Increased "Active Death" Benefits	J = Extending Minimum Benefits
C = Health Care Assistance	G = Removing Cap on Years of Service	K = Reinstating 3 Year Final Average
D = Additional Savings Options	H = Disability	

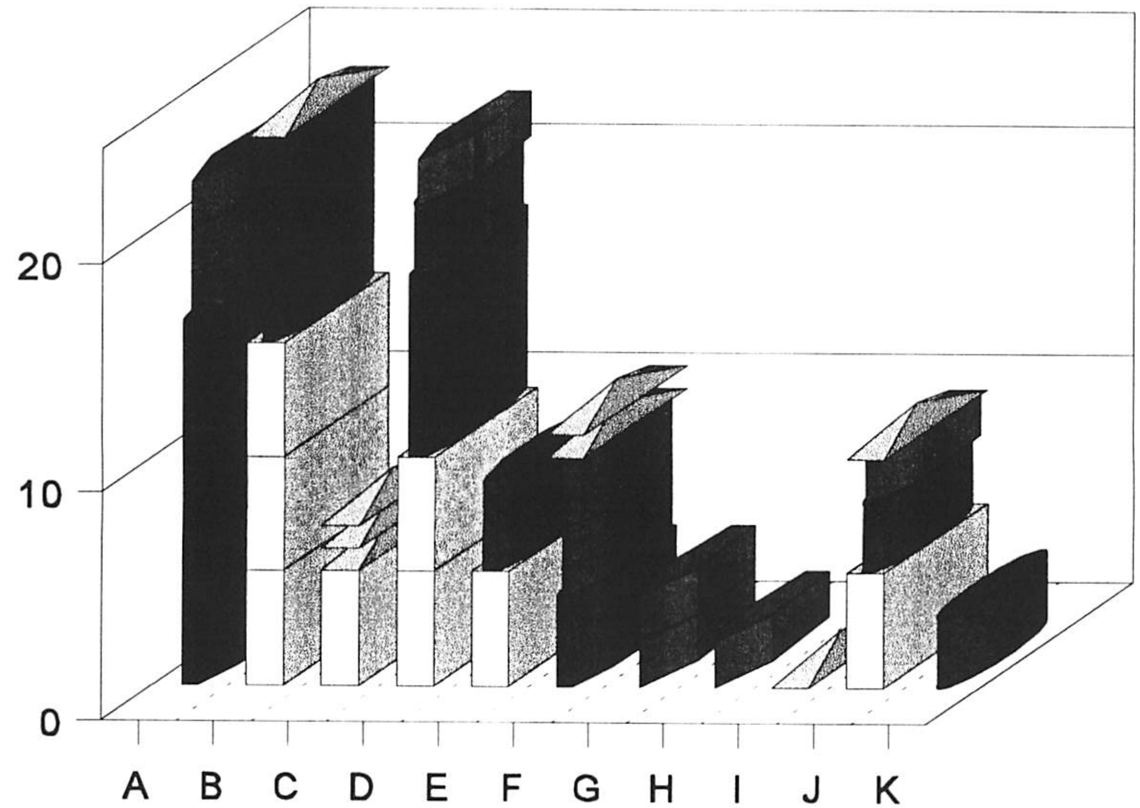
LEGEND: Each geometric shape and color shading represents one persons vote.

BUCK CONSULTANTS

RANKING:
Yellow = 5
Red = 4
Green = 3
Blue = 2
Gray = 1

Results of Poll, August 27, 1996

Ranking of Major Issues: First Poll of Day -- IPERS' STAFF



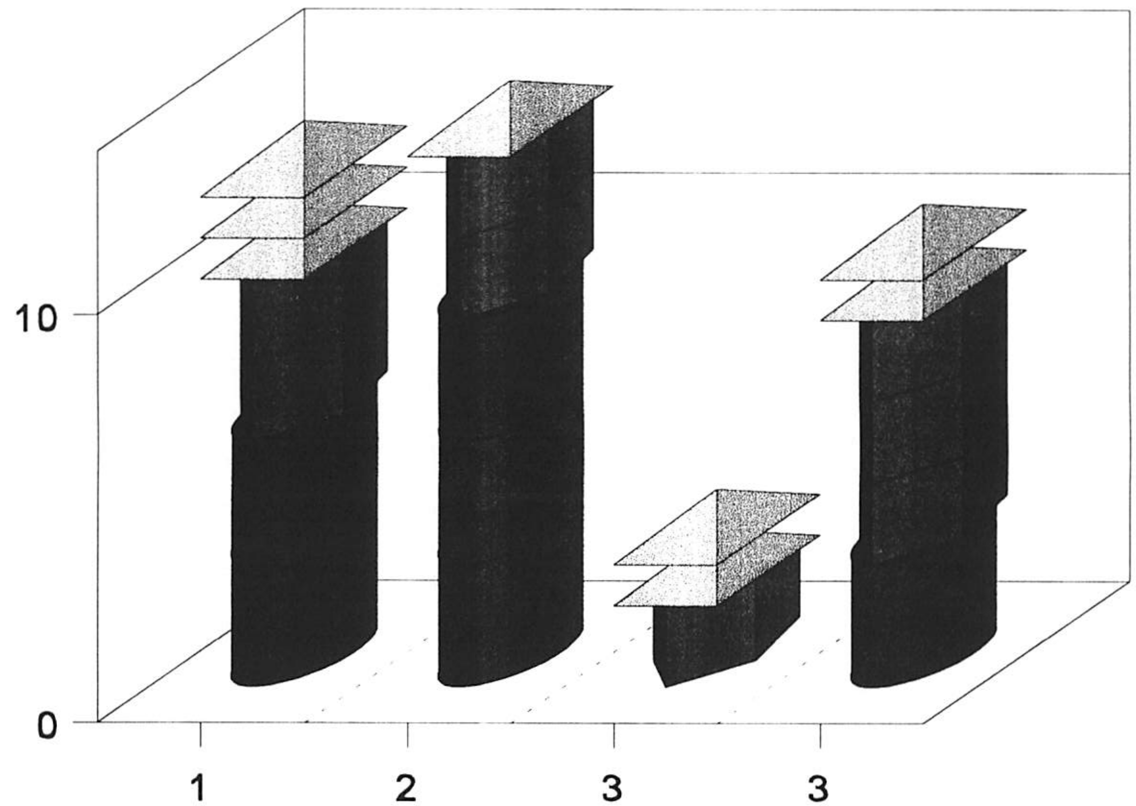
A = Extending the Colas	E = Earlier Retirement Options	I = Adjusting Contribution Rates
B = Portability/Refunds/ Frozen Benefits	F = Increased "Active Death" Benefits	J = Extending Minimum Benefits
C = Health Care Assistance	G = Removing Cap on Years of Service	K = Reinstating 3 Year Final Average
D = Additional Savings Options	H = Disability	

LEGEND: Each geometric shape and color shading represents one persons vote.

RANKING:
Green = 3
Blue = 2
Gray = 1

Results of Second Poll, August 27, 1996

Ranking of Major Issues: Top Three -- IPERS' STAFF



1 = Extending the Colas 2 = Portability/Refunds/Frozen Benefits	3 = Health Care Assistance 3 = Additional Savings Options

LEGEND: Each geometric shape and color shading represents one persons vote.