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**TO THE PENSION SUBCOMMITTEE
OF THE SENATE AND HOUSE STATE GOVERNMENT COMMITTEES:
AN UPDATE ON CURRENT PLAN DESIGN OF,
INCLUDING CURRENT RESEARCH EFFORTS FOR,
THE IOWA PUBLIC EMPLOYEES' RETIREMENT SYSTEM**

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OVERVIEW

Since I began at IPERS in the late autumn of 1987, it has been my privilege to work closely with the State Government Committees of the Senate and House, and especially this subcommittee on pension policy. I believe our *mutual* concern has been - and continues to be - to provide a financially sound, benefit-competitive, dependable, worry free and cost efficient plan for our 300,000 members. (This number includes over 150,000 active members and almost 68,000 retirees.)

As we can jointly testify, our plan's has been anything but static. Rather, by working together (IPERS and our Constituent Group proposing, and you enacting), we have overseen incredible changes to our plan in the last dozen years as IPERS has steadily evolved to become one of the most competitive plans in the country for public employees. And all this while maintaining low, predictable costs to our members and employers and becoming one of the best funded plans in the nation (with a fully funded ratio of 97.7% as of June 30, 2000).

Throughout our efforts over the years, we have consistently sought to:

- a) Preserve the financially sound status of the IPERS' Trust Fund;
- b) Achieve the greatest good for the greatest number of our members;
- c) Maintain a stable and predictable contribution rate¹; and
- d) Achieve a defensibly competitive level of benefits compared to other statewide public systems.

We do not believe in "resting on our laurels"; rather, together with our Constituent Group, we are always investigating ways to best improve the plan for the greatest good of our members. This is evidenced by our employing outside consultants several times over the years in order to learn from their expert advice.² In keeping with the legislative mandate from the 2000 session of the Iowa General Assembly, IPERS is close to announcing a successful finalist in our search for a consultant to aid us in examining the widest possible range of expanding portability both into and out of IPERS. We are to report the results of this study to the General Assembly on or before September 1, 2001.

Please be assured of our ongoing willingness to work closely with you in jointly exploring ways in which IPERS can continue to improve in a manner that is best for all of our members.

¹ For *regular* service members it has remained at 5.75% for employers and 3.7% for members for more than 20 years. Members of IPERS' special public safety groups and their employers pay rates which are annually set by IPERS' actuary to cover the value of their benefits which exceed those available to regular service members.

² Buck Consultants in 1995 and 1997 on over-all plan design, with a special emphasis on needed enhancements to our benefit structure to make us nationally competitive with our peer statewide public employee plans; Buck Consultants in 1997 on the issue of expanded disability and the question of defined benefit versus defined contribution plans; and, together with the PORS and MFPRSI, Mercer, Inc. regarding benefit parity for members of public safety groups. Note that the 1995 Buck report also included, as per the requirements of the contract, recommendations regarding changes in IPERS' structure and governance.

Summary of Major Plan Changes: 1988-2000

For Active Members

1. Providing greater flexibility for service credit portability into IPERS by allowing *buy-in* of service earned elsewhere as a public employee³ and *buy-back* for previously refunded IPERS' service;
2. Allowing greater flexibility for service credit portability out of IPERS by granting terminating vested members a portion of the employer contributions;
3. Enhancing the active member death benefit so that surviving beneficiaries will have a choice between selecting a payout equivalent to the members' actuarial present value of their benefit at time of death, or choosing to receive this benefit as an annuity; and
4. Establishing the Supplemental Account for Active Members (SAAM) which is designed to give active members a *dividend type* credit into a separate account which will be theirs to access either upon termination from public employment or at time of retirement.

For Members Nearing Retirement

1. Giving greater value for each year of service by increasing the formula multiplier in annual increments from 50% in 1990 to 60% in 1994 (which increased the value of each year of service from 1.67% to 2.0%);
2. Allowing credit for more years of service by granting an additional 1% of value for each year from 31 through 35⁴;
3. Lifting the covered wage ceiling in 1996⁵; and
4. Eliminating or reducing the early retirement adjustment for qualifying individuals beginning with the Rule of "92" to today's Rules of "88" and "62 and 20"⁶.

³ Expanded by the 2000 session of the General Assembly to include service as a public school teacher in Canada as well as service in the United States Peace Corps.

⁴ Providing for a maximum formula multiplier of 65% for members with 35 or more years of regular (non public safety) service.

⁵ The law as changed by the 2000 session of the General Assembly will allow the full value of a more highly compensated employee's wages to be used in calculating his or her retirement benefits beginning calendar year 2002.

⁶ The 2000 session of the General Assembly "sweetened" the "Rule of 88" further by allowing graded adjustments depending upon when a retiring member *would* have attained the "Rule of 88". For all practical purposes, this change can be of significant advantage for a person who has 26 or more years of service at age 55.

For Members in Retirement

1. Assisting retirees maintain purchasing power by authorizing IPERS to pay 100% of the previous year's Consumer Price Index (not to exceed 3%) as a dividend to retirees:
 - First, by regularly giving *ad hoc dividends*, plus occasional *permanent* adjustments to base pensions⁷, to pre July 1990 retirees⁸;
 - Second, providing that same group with *annual* Cost of Living Adjustments beginning in 1996⁹; and,
 - Third, awarding all post-June 1990 retirees¹⁰ with a *Favorable Experience Dividend* beginning in 1999¹¹. (The payout in January 2001 is expected to exceed \$30 million.)

We are proud of the progress we have made, and equally proud of the open and cooperative process whereby proposals were reached and recommendations made for your consideration.

Guiding Principles for A Balanced And Fiscally Sound System¹²

The *design* of any pension plan inherently reflects the values of both its original creators, and those who follow working to sustain and improve it. A *defined benefit* plan such as IPERS is intended to benefit primarily career employees who eventually retire under the System. This reflects the perceived value that the public owes its career employees a higher retirement benefit than members with fewer years of service, or those who sever membership in the system through taking a refund of their contributions upon termination of public employment. Even with all of the many changes made over the several decades of its existence, this orienting purpose of the Fund remains constant. However, changes to our plan design made in the 1990s have provided greater value to all of our members, even to those who never retire under the System.

Guiding Principles from Iowa Code Chapter 97D

In 1990, the Iowa General Assembly established long-term goals by which each public retirement system in the State was to guide itself and by which proposals for benefit enhancements should be measured.

⁷ In both 1996 and 1998.

⁸ The dividend paid in November 2000 totaled over \$19 million.

⁹ Prior to that time the Legislature had to act before a dividend could be paid. The net result was an annual dividend adjusted upwards every other year.

¹⁰ To include all future retirees, as well.

¹¹ Contingent upon the solvency of the FED Reserve Fund. We are happy to report that with the additional transfer to the FED reserve fund within the IPERS Trust Fund following the June 30, 2000 valuation by our actuary (as is authorized by law), this FED reserve fund now slightly exceeds nine years' worth of projected maximum FED payouts.

¹² This section is also from my 1999 report to the Governor and General Assembly.

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

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

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

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

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

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

Additional Guiding Principles Developed by IPERS in Past Years

In our 1995 response to the Buck Study we also added some additional guiding principles for use in assessing proposed enhancements to the Fund. That articulation reflected years of our efforts to portray the impact of benefit enhancements with respect to both the demographic segments of our membership whom they were designed to benefit, as well as their financial cost to the Fund. We believe that these additional principles, coupled with those found in Chapter 97D, are of fundamental importance in helping us attain – and sustain - a balanced and soundly funded retirement plan.

1. As stewards of a public fund¹³, we must balance our obligation to provide a generous retirement system - one which is competitive with other statewide retirement plans – with the need to be sensitive to public perceptions of the cost/benefit ratio of benefits received by IPERS' members. In this context, IPERS' formula is designed so that *a member's total retirement payout from IPERS and Social Security should not exceed 100% of the member's pre-retirement income at time of retirement.* As IPERS now allows a member to retire with a maximum of 65% of the member's highest average three years of covered wages, this – together with Social Security – will bring a member with 35 years of service into the 90% plus range.¹⁴

¹³ The employer contributions to which is derived through taxation.

¹⁴ As the average IPERS' member still retires with between 20 and 25 years of service, however, the vast majority of our membership can expect an IPERS' return of between 40% and 50% of his/her highest three average years of covered wages.

2. *Insofar as is possible, those members who receive the value of benefit enhancements should pay their proportionate share.*¹⁵
3. *Inter-generational equity must be preserved and protected: our benefit program must be designed with all of our members in mind - the already retired, those nearing retirement, and those many years from retirement.*¹⁶ We believe that a well-designed pension system must not only fairly credit members' accrued values based upon such factors as years of service and earned wages, but also heed the special needs which the few sometimes have of the many: the disabled, those who have taken time from the work force to raise children (truly an *accrued value* to the larger society), or retirees struggling near the poverty line. A balanced perspective founded on inter-generational equity allows us to factor in the interests of all of our members.
4. *Individual equity, while not the sole indicator of plan design balance, is also important.* Insofar as is possible, neither retirees nor actives should receive disproportionate value relative to the other, and an active member's account value for service time should fairly reflect accrued value of their years of service and not their age.
5. *Weigh proposed enhancements as to their value for sound plan design many years from now.* Many proposals for benefit enhancement result from the latest "great idea" enacted by several states or proposed by an influential constituent group. Demographic pressures which may be relatively time specific also fuel others. We must weigh benefit proposals according to not only how they would affect our total membership today, but also as to how well they will serve us tomorrow.

¹⁵ Even where members are able and willing to pick up the additional cost themselves - in conjunction, of course, with the support of their public employer - we must be sensitive to how easily improvements for *some* quickly become goals for *others*. If not carefully monitored, this quickly becomes Plan design of the worst kind by incrementally adding uncoordinated elements.

¹⁶ As it is difficult to fix a precise standard by which inter-generational equity can be achieved, we will attempt - in assessing the various proposed recommendations we will be making in this paper - to give each an "*inter-generational equity*" ranking.

“Where from Here” - IPERS Looks Forward

We are not willing to “rest on our laurels”, either, for a retirement plan - despite its extremely long-term perspective (30-40 years) - is a living organism and must remain responsive to the needs of our entire membership.

Balancing these needs, including appropriate accounting for the wishes of the “silent majority”, can often be a challenge. This is especially true when vocal - and well-funded - proponents of particular plan designs are active in advocating fundamental changes in plan design the implementation of which could substantially, and negatively, impact a majority of our members who are less heard and less able to influence.

We have not been bashful, either, about seeking expert assistance in working with us on plan design issues. Since 1995, and again with the support of the General Assembly, we have asked consultants to twice review our over-all plan design (in the context of other statewide public retirement systems), as well as to focus in specifically on the question of *defined contribution* versus *defined benefit* styled plans.

In keeping with a mandate from the 2000 session of the Iowa General Assembly, IPERS is close to announcing a successful candidate to assist us in examining the full spectrum of options by which we can enhance **portability** for our membership, both into and out of IPERS’ covered service. Knowing that you continue to have an interest in examining as well ways in which defined contribution like vehicles can be used to improve IPERS’ over-all design, a scrutiny of these plans, plus a review of hybrid vehicles incorporating features of defined contribution plans, is also part of our charge to this consultant.

Repeated below is the “work plan” statement of our *Request for a Proposal* on enhancing portability.

PART III [of *Request for Proposals to Evaluate and Recommend Enhancements to the Portability of the Benefits of the Iowa Public Employees’ Retirement System (IPERS)*]

SCOPE OF WORK AND DELIVERABLES

3.1 SCOPE OF WORK. The Contractor will be retained to assist IPERS in evaluating issues regarding the portability of benefits and to recommend enhancements to the portability of IPERS’ benefits. The Contractor will analyze the various options available to increase the portability of benefits given IPERS’ current benefit structure and demographic profile of its membership, as well as any significant demographic trends which the Contractor perceives need to be addressed. The Contractor will recommend enhancements that will add flexibility and increased portability to IPERS’ benefits in order to make IPERS more effective and responsive to its members and stakeholders. A final report outlining the Contractor’s analysis, conclusions and recommendations will be submitted to IPERS. The Contractor’s scope of work will not encompass a detailed actuarial analysis of its recommendations. However, the Contractor will consider and include in its report the generalized cost implications of the various options and recommendations. Mr. Greg Cusack, Chief Benefits Officer, will serve as the project manager and will be the Contractor’s contact at IPERS.

3.2 PHASES. Contractor's services are to be divided into three (3) phases:

- A. RESEARCH SCOPE AND METHODOLOGY.** Research and compile comprehensive information comparing IPERS' current benefits and restrictions as they relate to the issue of portability with those of other state public pension systems, with an emphasis on those systems which serve multiple employers, e.g., state, county, city and school employees. The extent and exact composition of the proposed peer group used to evaluate IPERS' benefits and restrictions is dependent upon the initial determination of the Contractor. At a minimum, the Contractor is expected to:

Include in its research system descriptions; a comparison of specific system benefits and restrictions as they relate to the issue of portability; covered members; costs; and, unfunded liabilities.

Seek to identify "best practices" or recent pending or proposed innovations regarding the portability of pension benefits.

Utilize both primary and secondary research techniques.

Submit a work plan in response to this RFP that clearly details the Contractor's proposed research methodologies.

- B. ANALYSIS.** The successful Contractor will provide expert advice to IPERS, including communicating with IPERS and its constituent group at meetings to be scheduled in Des Moines, Iowa, from the contract award date through presentation of the final report. At a minimum, the Contractor will present preliminary findings, in person, in Des Moines, Iowa. Additional onsite visits will be made as necessary, including potential presentations in 2000 and 2001 before committees of the General Assembly of the State of Iowa.

- C. CONCLUSIONS.** Prepare and submit a written initial project report, including the project's scope, approaches utilized, and any preliminary findings, to IPERS, by April 30, 2001, summarizing the research and analysis of key issues to date, with preliminary recommendations for action or further study. Detailed analysis, recommendations and conclusions will be submitted to IPERS in a written final report by June 15, 2001. Any possible additional contracted services must be completed no later than August 15, 2001.

3.3 DELIVERABLES. The above contracted services are to be communicated to IPERS in the following manner:

- A. RESEARCH OUTLINE.** The Contractor will submit a research outline at the beginning of the project that clearly defines the scope of the intended research and the research methodologies that will be employed.
- B. MONTHLY STATUS REPORTS.** The Contractor will submit monthly status reports regarding its progress. As they arise, the Contractor will clearly identify any potential impediments to the successful completion of the project.
- C. INITIAL PROJECT REPORT.** The Contractor will submit a written report as outlined and required in Section 3.2.C, by April 30, 2001.
- D. FINAL REPORT.** The Contractor will submit a written final report by June 15, 2001 that will include its research findings, a detailed analysis of the issues, and its conclusions and recommendations.
- E. PRESENTATIONS.** The Contractor will be available at mutually agreed upon times to present its findings, conclusions and recommendations to IPERS and possibly to the General Assembly of the State of Iowa.
- F. POST REPORT.** The Contractor will update IPERS regarding any relevant changes in federal law that are enacted, or are likely to be enacted, during the course of its contract with IPERS.

3.4 SUBJECT AREA CONTENT. The research, ensuing communication, initial report, and final report to be provided by the successful Contractor must provide IPERS with a thorough analysis of the issue of portability. For example, the research, ensuing communication, initial report, and final report to be provided by the successful Contractor are expected to address these representative issues related to the portability of IPERS benefits:

- A. An analysis of potential IPERS enhancements to allow for greater portability of retirement savings into IPERS for covered members. The Contractor's final report should address the advantages, disadvantages and generalized costs of the following:
 - 1. Expansion of the current scope of covered employment for purposes of the purchase of service credit by members to include private sector employment and/or any other employment or time periods not currently eligible.
 - 2. Reduction of the cost of the purchase of service credit, or addition of more flexibility to the method of purchase of service credit.
 - 3. Expansion of the various methods of reciprocity or portability between IPERS and the other Iowa public employment defined benefit retirement systems, including the Peace Officers' Retirement System, the Judicial Retirement System, the Municipal Fire and Police Retirement System and the defined contribution system administered by the Iowa Board of Regents.
 - 4. Expansion of the use of pre-tax payroll deductions or other pre-tax funds to purchase service credit.
 - 5. Assessment of the potential impact of pending federal legislation to allow for the purchase of service credit with retirement savings from Internal Revenue Code (IRC) Section 457 and 403(b) plans.
 - 6. Assessment of the potential impact of federal legislation to allow for the "rollover" or direct transfer of service credit between defined benefit plans.
 - 7. Establishment of defined contribution accounts under IRC Section 401(a), 457 or 403(b) for the "rollover" of accrued retirement savings from prior employment.
 - 8. Development of any additional options or recommendations to enhance the ability of members to transfer to IPERS their retirement savings from prior employment.

- B. An analysis of potential IPERS enhancements to allow for greater portability of retirement savings for members who separate from covered service. The Contractor's final report should address the advantages, disadvantages and generalized costs of the following:
 - 1. Addition of partial and/or full lump sum distribution options for the actuarially equivalent value of members' accrued benefits.
 - 2. Indexing of terminated vested members' accrued benefits.
 - 3. Reduction of the current vesting schedule.
 - 4. An increase of the percentage of employer contributions that can be refunded to both vested and non-vested members.
 - 5. An increase in the interest rate used to calculate refunds to members.
 - 6. Expansion of the various methods of reciprocity or portability between IPERS and the other Iowa public employment defined benefit retirement systems, including the Peace Officers'

Retirement System, the Judicial Retirement System, the Municipal Fire and Police Retirement System and the defined contribution system administered by the Iowa Board of Regents.

7. Assessment of the potential impact of federal legislation to allow for the “rollover” or direct transfer of service credit between defined benefit plans.
 8. Implementation of a “hybrid” plan through any of the following options:
 - I. Modifications to the current defined benefit plan to allow for the addition of defined contribution features, such as cash balance, pension equity, life cycle, or DROP features.
 - II. The addition of an IRC Section 401(a) defined contribution plan as part of a gain sharing, floor offset, target benefit, age weighted or new comparability profit sharing, or other arrangement.
 - III. Establishment of a defined contribution IRC Section 401(a) plan for employee contributions.
 - IV. Use of a defined contribution IRC Section 401(a) plan for employer gain sharing, matching, or other contributions based upon voluntary employee contributions to supplemental IRC Section 457 and 403(b) plans.
 - V. Addition of IPERS-sponsored supplemental IRC Section 457 and 403(b) plans funded through voluntary employee contributions.
 9. Development of any additional options or recommendations to enhance the ability of members to transfer their accrued retirement benefits from IPERS upon separation from employment.
- C. The Contractor’s final report must discuss the funding of the various proposed plan features through current contributions; additional employer and/or employee contributions; favorable investment experience; any other suitable methods.
 - D. The Contractor’s final report must discuss the potential effects of the implementation of any proposed changes to IPERS’ current plan features on members’ income replacement ratio.