Report on the 2005 SERS Alternative Retirement Cancellation Payment Option (P.A. 94-0109)

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Commission on Government Forecasting and Accountability

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INTRODUCTION

The Commission on Government Forecasting and Accountability is required by 40 ILCS 5/14-108.6 to provide the General Assembly and the Governor with a report of the annual savings or cost of the alternative retirement cancellation payment (ARCP) offered to eligible members of the State Employees' Retirement System (SERS) in July 2005. Specifically, the Commission is required to report the annual amount of payroll savings realized by the State due to the ARCP, as well as the net annual savings or cost to the State due to the program.

As required, this report outlines the estimated payroll savings in FY 2006 due to the ARCP and the net annual savings to the State for FY 2006.

Public Act 94-0109
The 2005 Alternative Retirement Cancellation Payment Option

Public Act 94-0109 (SB 1442) provided an enhanced refund option for certain State employees terminating State service before October 31, 2005 with the agreement that those participants forfeit all SERS benefits. The Alternative Retirement Cancellation Payment (ARCP) option was limited to 500 employees in specific job titles under the Governor's purview and an unlimited number of employees in all job titles not under the Governor's purview with the authorization of the director or department head. In order to participate in the ARCP, eligible employees must have been employed during July 2005 and in an eligible position continuously since January 1, 2005. Employees could not participate if they had previously received any SERS retirement annuity.

Employees under the Governor's purview were required to file an application with the SERS Board of Trustees by September 30, 2005. All other employees were required to apply by September 1, 2005. Participants then had to terminate service within one month of their application being approved and in no event later than October 31, 2005.

The enhanced refund included all of the employee's contributions to the retirement system, with interest at 6.5% annually, multiplied by two. The regular State Employee's Retirement System refund provision only allows for a refund of employee contributions, without interest. Eligible participants could receive either the enhanced refund in a lump sum, or roll it into another qualified plan, or a combination of the two. Members who accepted the refund waived all rights to any type of SERS benefit, including survivor's benefits and death benefits.

A person who participated in ARCP and later returns to State employment is required to repay to SERS the amount of the enhanced refund, less the amount of employee contributions (or regular refund amount), within 60 days of the return to service, unless returning as a temporary employee. If the member wishes to re-establish the service credit that was forfeited by the acceptance of the refund, he or she must also pay the regular refund amount with interest from the date of the refund to the date of repayment.

2005 ARCP Participants by State Agency

The State Employees' Retirement System reports that 285 employees participated in the ARCP and were paid refunds. Table 1 below shows all 285 ARCP participants by state agency. In addition, the table shows the average salary, age, and years of service of ARCP participants.

Table #1 - ARCP by Agency

Agency	ARCP Participants	Average Salary	Average Age	Average Service (Yrs.)
Transportation	59	$50,306	34	8
Human Services	36	$54,941	44	10
Corrections	27	$45,974	43	10
Central Management Services	27	$54,289	37	9
Public Aid	22	$42,978	40	11
Children & Family Services	21	$47,254	45	12
Revenue	15	$47,214	40	10
Boards and Commissions	12	$43,145	37	6
State Officers & General Assembly	11	$36,505	34	5
Commerce & Econ. Opportunity	9	$59,069	34	5
Financial & Professional Regulation	7	$57,744	42	13
State Police	7	$60,533	42	15
Natural Resources	5	$45,271	37	8
Commerce Commision	5	$49,896	44	6
Treasurer	4	$50,613	39	6
Public Health	4	$57,135	48	6
EPA	4	$36,615	34	5
Military Affairs	3	$35,604	32	6
Employment Security	2	$86,796	37	2
Governor's Office	1	$39,996	31	2
Board of Education	1	$43,800	43	20
Veterans Affairs	1	$58,536	36	5
Aging	1	$73,464	39	10
Human Rights Commission	1	$29,880	33	6
Total	285			

As shown in Table 1 above, the largest group of ARCP participants came from the Department of Transportation, followed by the Departments of Human Services, Corrections, CMS, Public Aid, and DCFS. These six agencies accounted for two-thirds of all state employees who elected to take the ARCP buyout.

2005 ARCP Impact on State Headcount

According to SERS, there were 71,357 State employees in June 2005 before the ARCP option was offered. Headcount increased slightly from July through September, but at the completion of the ARCP period, headcount had declined to 70,613. At the end of the fiscal year, headcount had increased to 71,314.

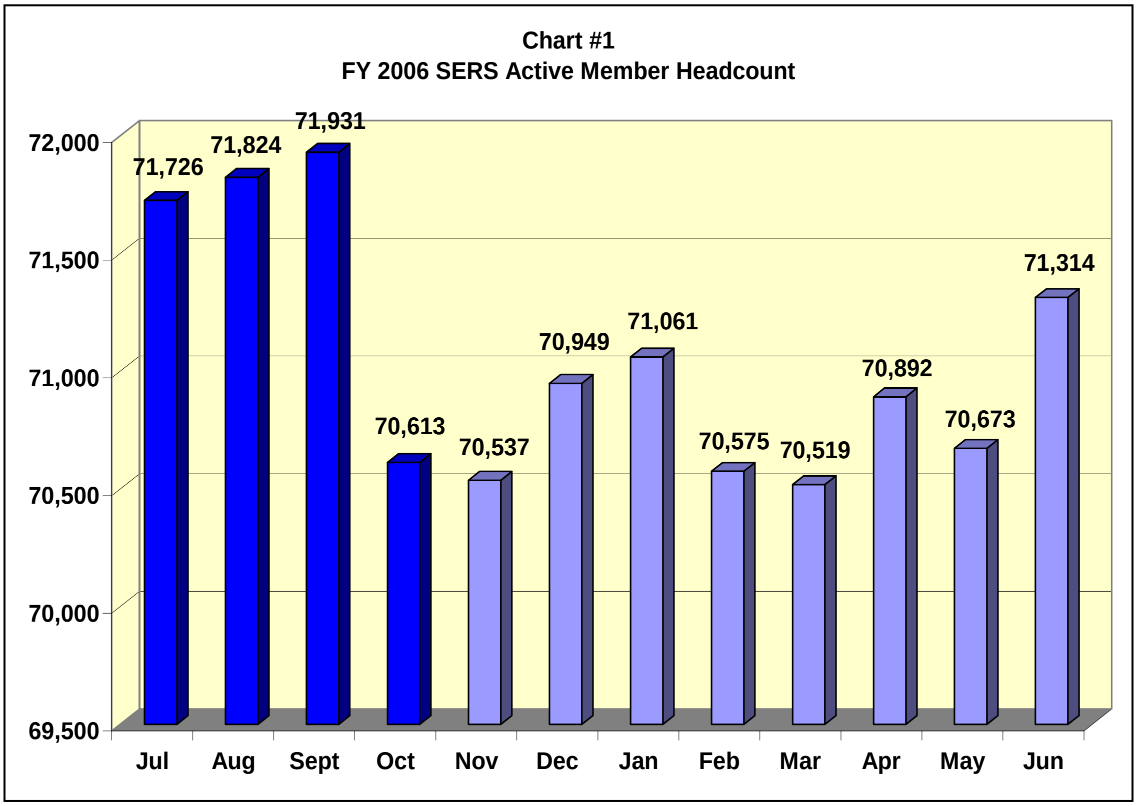


Chart 1 above illustrates the change in headcount throughout FY 2006 (the first four months of the fiscal year are shaded dark to reflect state headcount during the ARCP period). It should be noted that the employee totals include employees who are still in the first 6 months of employment, during which time they are not members of SERS.

The ARCP participants ranged in age from 18 to 69. Chart 2 below shows ARCP participants by age group. The majority of state employees who opted to take the ARCP buyout were under 40 years of age. The 2005 ARCP attracted very few employees over age 50, most of whom are vested in SERS and have more years of service credit than younger employees.

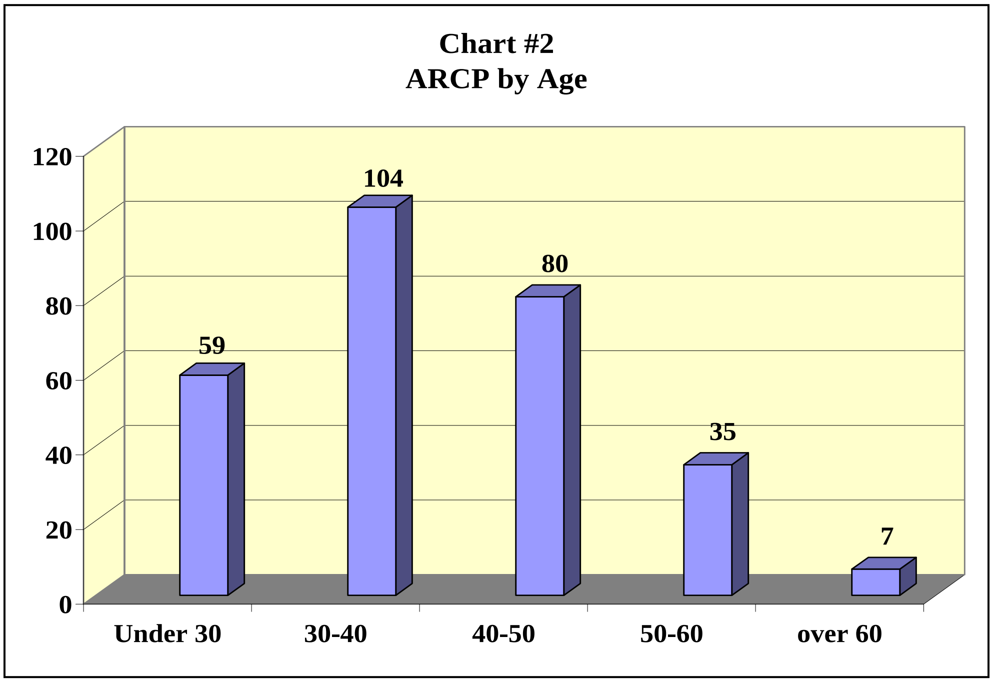
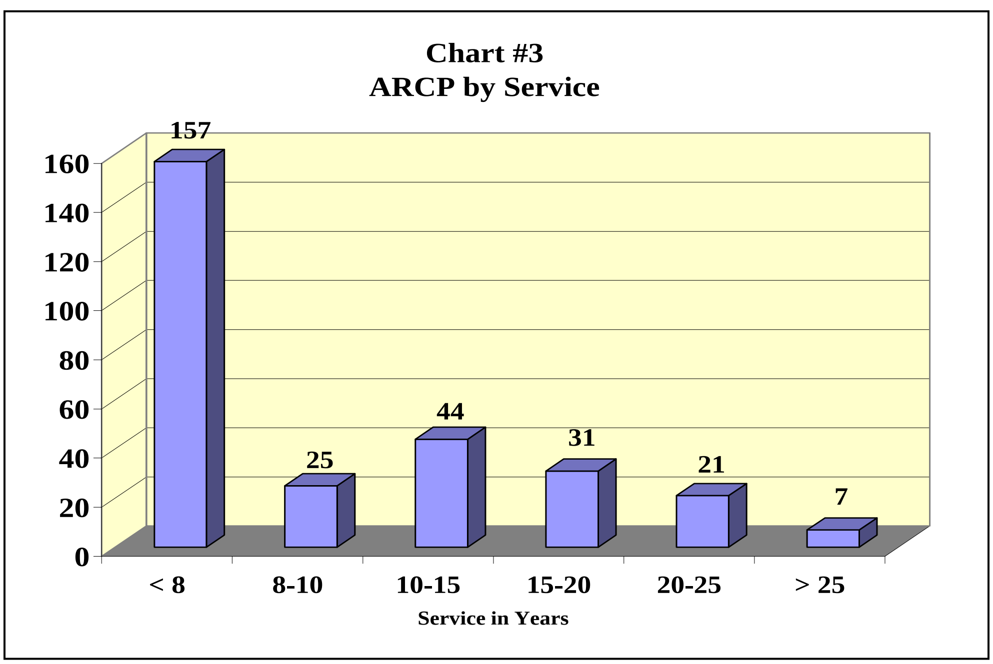


Chart #3 below shows ARCP participants by years of service. As shown in the chart, the overwhelming majority of employees who opted for the buyout had less than 8 years of service credit in SERS, and had not yet vested in the retirement system.



2005 ARCP Impact on the State Employees' Retirement System

At the conclusion of the 2005 ARCP period, SERS paid out \$12.2 million in enhanced refunds to ARCP participants, and the liability released as a result totaled \$14.6 million. Based on information provided by the retirement system, the Commission determines that the ARCP has resulted in a reduction in the unfunded liability of SERS of \$2.4 million, as shown in the chart below:

FY 2006 ARCP Effects on SERS	
Members participating in ARCP	285
Release of Participants' Liability	\$14,567,008
Refunds Paid to SERS Members	\$12,184,232
Reduction in Unfunded Liability	\$2,382,775
Funded Ratio - Pre-ARCP	54.36%
Funded Ratio - Post-ARCP	54.34%

Cost Component - SERS Payout to ARCP Participants

Refunds
The major cost in the ARCP program was the enhanced refund paid by SERS. The refund included all of the employee's contributions to the retirement system, with interest at 6.5% annually, multiplied by two. SERS paid out enhanced refunds totaling \$12.2 million to the 285 ARCP participants. Without the ARCP option these employees would have been eligible for refunds substantially less than what they received under the ARCP. According to the retirement system, regular termination refunds for the ARCP participants would have amounted to \$4.3 million. Therefore, the amount by which enhanced refunds exceeded this amount, or \$7.9 million, represents the main cost component to SERS associated with the ARCP program.

Savings Component - SERS Reduction in Liability

Release of Liability
In exchange for the enhanced refund, ARCP participants forfeited all rights to any SERS benefit – thus releasing millions of dollars in liability from SERS. According to SERS' actuary, the combined liability for these participants totaled \$14.6 million. Employees with more years of service generate greater liability, and therefore, ARCP participants with longer service generated larger savings. Conversely, employees with fewer years of service generate a smaller release of accrued liability to the retirement system. According to SERS, 157 ARCP participants had less than 8 years of service credit, and were therefore not vested in the retirement system.

Savings Attributable to 2005 ARCP

Public Act 94-0109 (SB 2206) requires the Commission on Government Forecasting and Accountability to report on the annual amount of payroll savings due to the ARCP and the net annual savings or cost to the State from the program. To that end, Commission staff has identified cost and savings components associated with the 2005 ARCP and estimated the State's costs and savings as a result of the program.

Cost Components

Lump-sum Payouts

In addition to the enhanced refunds, ARCP participants were paid lump-sums for unused sick and vacation leave. Based on agency payout information, total lump-sum payouts to all 285 ARCP participants in 2005 is estimated to be $865.2 thousand. It should be noted that lump-sum payouts of unused sick and vacation leave was a one-time cost factor in FY 06 only.

Savings Components

Payroll Reduction

In addition to the cancellation of pension liability, the State benefits from a reduction in headcount and payroll. Based on information provided by the retirement system, the total final monthly pay for all ARCP participants amounted to $1.2 million. Because the participants did not leave at the beginning of the fiscal year, the Commission staff determined payroll savings for the remainder of the fiscal year by analyzing the participants' month of departure and final monthly pay. Based on these calculations, the Commission determined that the total FY 06 payroll reduction associated with the 285 ARCP recipients totaled $10.8 million.

This report does not calculate for positions replaced and the additional pay generated by new hires. Typically, new hires would start at a lower pay scale than employees with even a few years of service. Based on the slight reduction in State headcount through FY 2006, Commission staff assumes that the vacated positions have most likely not been filled.

Reduction in Payroll Related Costs

The reduced headcount also resulted in a reduction in employer contributions for Social Security and Medicare (7.65% of payroll). Based on the reduced payroll of $10.8 million associated with 285 ARCP recipients who would have remained on the state payroll in the absence of the enhanced refund offering, the State saved approximately $827 thousand in employer contributions for Social Security and Medicare in FY 06.

Similarly, the State was no longer responsible for making employer contributions to SERS on behalf of the ARCP participants. In FY 2006, the State made state employer retirement contributions at a rate of 7.79% of payroll. Hence, the reduction in employer retirement contributions attributable to the 285 ARCP recipients who would have remained on the state payroll in the absence of this incentive amounted to $841.4 thousand. Therefore, the state realized a total savings of $1.7 million in payroll related costs in FY 06 as a result of the enhanced refund program.

Reduction in Group Health Insurance Costs
Over time the State will also realize savings in group health insurance costs. ARCP participants with less than eight years service will no longer be covered by the State's group insurance for retirees. Because the participants did not leave at the beginning of the fiscal year, the Commission staff determined group insurance savings for the remainder of the fiscal year by analyzing the participants' month of departure. Commission staff also assumed an average of 1.5 dependents per departing employee. Based on this information, the Commission estimates that the total FY 06 group health insurance reduction associated with the 285 ARCP participants totaled $2.1 million.

Estimate of FY 2006 State Savings

Based on the preceding cost and savings components, Commission staff estimates the ARCP has resulted in a savings to the State in FY 2006 as follows:

($ in Millions)	
Reduction in Payroll	$10.8
Reduction in Payroll Costs	$1.7
Reduction in Group Health Ins Costs	$2.1
FY 2006 Savings	$14.6
Lump-sum Payouts	$0.9
FY 2006 Cost	$0.9
Net FY 2006 Savings	**$13.7**

It should be noted that ARCP-related savings will continue to accrue beyond FY 2006 if the vacant positions remain unfilled. As noted earlier, the major cost component associated with ARCP – the lump-sum payouts for unused sick and vacation leave – was a one-time cost factor in FY 06 only. Greater savings will be realized in FY 07 and beyond in the absence of this cost.

BACKGROUND

The Commission on Government Forecasting and Accountability (CGFA), a bipartisan, joint legislative commission, provides the General Assembly with information relevant to the Illinois economy, taxes and other sources of revenue and debt obligations of the State. The Commission's specific responsibilities include:

1) Preparation of annual revenue estimates with periodic updates;
2) Analysis of the fiscal impact of revenue bills;
3) Preparation of "State Debt Impact Notes" on legislation which would appropriate bond funds or increase bond authorization;
4) Periodic assessment of capital facility plans;
5) Annual estimates of public pension funding requirements and preparation of pension impact notes;
6) Annual estimates of the liabilities of the State's group health insurance program and approval of contract renewals promulgated by the Department of Central Management Services;
7) Administration of the State Facility Closure Act.

The Commission also has a mandate to report to the General Assembly ". . . on economic trends in relation to long-range planning and budgeting; and to study and make such recommendations as it deems appropriate on local and regional economic and fiscal policies and on federal fiscal policy as it may affect Illinois. . . ." This results in several reports on various economic issues throughout the year.

The Commission publishes several reports each year. In addition to a Monthly Briefing, the Commission publishes the "Revenue Estimate and Economic Outlook" which describes and projects economic conditions and their impact on State revenues. The "Bonded Indebtedness Report" examines the State's debt position as well as other issues directly related to conditions in the financial markets. The "Financial Conditions of the Illinois Public Retirement Systems" provides an overview of the funding condition of the State's retirement systems. Also published are an Annual Fiscal Year Budget Summary; Report on the Liabilities of the State Employees' Group Insurance Program; and Report of the Cost and Savings of the State Employees' Early Retirement Incentive Program. The Commission also publishes each year special topic reports that have or could have an impact on the economic well being of Illinois. All reports are available on the Commission's website.

These reports are available from:

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http://www.ilga.gov/commission/cgfa2006/home.aspx