Illinois Economic
and
Fiscal Commission

Report on the Cost and Savings of The State Employees' Early Retirement Incentive Program

(P.A. 92-0566)

May 2004
703 Stratton Office Building
Springfield, IL 62706

Illinois Economic and Fiscal Commission

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INTRODUCTION

The Illinois Economic and Fiscal Commission is required by 40 ILCS 5/14-108.3(h) to provide the General Assembly with a report of the annual cost or savings associated with the Early Retirement Incentive Program (ERI) offered to eligible members of the State Employees' Retirement System (SERS) and to eligible state employees covered by the Teachers' Retirement System (TRS). Specifically, the Commission is required to report the annual amount of payroll savings realized by the State due to the ERI, as well as the net annual savings or cost to the State due to the ERI.

As required, this report outlines the estimated payroll savings in FY 2003 due to the ERI, and the net annual savings to the State for FY 2003. For FY 2004, an estimate of payroll savings is included, and the expected total savings to the State for FY 2004.

EXECUTIVE SUMMARY

Public Act 92-0566 (HB 2671) created an Early Retirement Incentive (ERI) Program for certain members of SERS and State employees covered by TRS. To be eligible for the ERI, members must have been, during June 2002; in active payroll status; on layoff status with a right of recall; or receiving a disability benefit for less than 2 years. Members were required to file the ERI application with the Board of Trustees prior to December 31, 2002 and leave employment between July 1, 2002, and December 31, 2002. The Directors and other heads of departments were allowed to extend the deadline for participation in the ERI for key personnel to April 30, 2003, by notifying the System in writing prior to December 31, 2002. SERS members who participated in the ERI are prohibited from returning to work under contract with any State agency. It should be noted that ERI participants, like all SERS retirees, may return to State employment as temporary employees for up to 75 days in a calendar year.

According to SERS, there were 86,406 State employees in July of 2002. By March of 2003, the number of State employees had dipped below 74,000 and has remained at about that level since, as shown in Table 1. 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.

State Employees' Retirement System
Active Member Headcount

	FY 2003		**FY 2004**	
Month	State Employees*	Change from July 2002	State Employees*	Change from July 2002
July	86,406		74,073	-12,333
August	86,187	-219	74,719	-11,687
September	86,492	86	74,557	-11,849
October	85,056	-1,350	74,316	-12,090
November	81,644	-4,762	73,215	-13,191
December	81,126	-5,280	73,977	-12,429
January	81,221	-5,185	74,343	-12,063
February	80,351	-6,055	74,165	-12,241
March	73,986	-12,420	74,160	-12,246
April	73,729	-12,677	73,228	-13,178
May	73,892	-12,514	N/A	N/A
June	74,062	-12,344	N/A	N/A

* Represents the number of employees on a State payroll at any time during the three-month period ending during the month noted.

Based on the cost and savings components identified in the report, Commission staff estimates the ERI has resulted in a savings to the State in FY 2003 and FY 2004 as follows:

FY 2003 (millions $)		**FY 2004** (millions $)	
Lump Sum Payouts	$129.0	Retirement Contributions	$71.0
Retirement Contributions	0.0	Group Insurance	5.0
Group Insurance	2.6	FY 2004 Cost	$76.0
FY 2003 Cost	$131.6		
		Reduction in Lump Sum Payouts	$25.8
Reduction in Payroll	$330.0	Reduction in Payroll	580.0
Reduction in Payroll Cost	36.3	Reduction in Payroll Cost	56.0
FY 2003 Savings	$366.3	FY 2004 Savings	$661.8
Net FY 2003 Savings	**$234.7**	**Net FY 2004 Savings**	**$585.8**

As the State will be required to contribute substantially more for the ERI ($382.0 million) beginning in FY 2005, the annual savings associated with the ERI will be smaller in the next several fiscal years. But, unless employee headcount and payroll increase significantly from current levels, the State will continue to realize annual savings from the 2002 SERS ERI. Future reports will outline the cumulative savings associated with the 2002 ERI, as well as the annual cost or savings.

Public Act 92-0566
The SERS Early Retirement Incentive Program

Public Act 92-0566 (HB 2671) created an Early Retirement Incentive (ERI) Program for certain members of SERS and State employees covered by TRS. To be eligible for the ERI, members must have been, during June 2002: in active payroll status; on layoff status with a right of recall, or receiving a disability benefit for less than 2 years. Members were required to file the ERI application with the Board of Trustees prior to December 31, 2002 and leave employment between July 1, 2002, and December 31, 2002. The Directors and other heads of departments were allowed to extend the deadline for participation in the ERI for key personnel to April 30, 2003, by notifying the System in writing prior to December 31, 2002. SERS members who participated in the ERI are prohibited from returning to work under contract with any State agency. It should be noted that ERI participants, like all SERS retirees, may return to State employment as temporary employees for up to 75 days in a calendar year.

Members who were eligible to purchase the 5 years of service credit (and age enhancement) were not required to retire, but rather to terminate State employment. Participants who weren't immediately eligible for a retirement annuity may retire upon reaching eligibility. In addition, ERI participants were eligible for an unreduced annuity beginning at age 50 with at least 20 years of service, rather than at age 55 with 25 years of service.

In order to participate in the ERI, the member was required to have accumulated at least 8 years of creditable service (at least 5 as active service), excluding service established by this ERI. The 5 years of active service could include military service that interrupts employment and the qualifying period, but could not include any other type of optional service credit. Employees participating in the ERI received up to 5 years of additional service credit by paying the full retirement contribution rate, for each year of service, based on the salary in effect on June 1, 2002. If the employee's lump sum payment for accumulated vacation, sick, and personal leave was larger than the amount of the required contribution; the contribution must have been made from the lump sum (pre-tax) prior to retirement. If the lump sum payment was not large enough, the remaining amount due is deducted from the retirement annuity in 24 equal monthly installments.

Public Act 92-0566 required SERS and TRS to determine the net increase in the unfunded liability resulting from the ERI and report the amount to the Governor and the Illinois Economic and Fiscal Commission by November 15, 2003. In FY 2004, the State contributed $70 million to SERS and $1 million to TRS towards this liability. In FY 2005 through FY 2013, the State must amortize at 8.5% interest the remaining ERI liability in equal annual installments as certified by SERS and TRS.

According to SERS, 11,039 members elected to participate in the ERI. Of these, 10,301 were eligible to retire immediately (Option 1), while 738 members elected to terminate employment and receive benefits at a later date (Option 2). The average number of ERI months purchased was 58 and the average age at termination was 57 for Option 1 participants and 48 for Option 2 participants. According to the System, the average cost of purchasing the ERI service credit was $11,624 per participant and the average total monthly benefit of all ERI participants was almost $2,505.

According to SERS, the ERI created additional SERS liability totaling slightly more than $2.4 billion. After taking into account the FY 2004 contributions of $70 million, the annual amortization payments needed over the next 9 years, beginning in FY 2005, equal $380.3 million. This ERI contribution is in addition to the regular State contribution to SERS. For State employees covered by TRS, the System estimates the ERI added $10.85 million in additional liability. Given the FY 2004 employer contribution of $1 million, TRS estimates the State will have to contribute almost $1.7 million per year for the next 9 years (beginning in FY 2005) in order to amortize this additional liability.

ERI Impact on Employee Headcount

According to SERS, there were 86,406 State employees in July of 2002. By March of 2003, the number of State employees had dipped below 74,000 and has remained at about that level since, as shown in Table 1. 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.

TABLE 1

State Employees' Retirement System
Active Member Headcount

	FY 2003		FY 2004	
Month	State Employees*	Change from July 2002	State Employees*	Change from July 2002
July	86,406		74,073	-12,333
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May	73,892	-12,514	N/A	N/A
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* Represents the number of employees on a State payroll at any time during the three-month period ending during the month noted.

As Table 1 illustrates, the number of State employees is still significantly below the pre-ERI level. Further, at the end of March 2004, headcount was still lower by more than 12,000 employees, which is more than the 11,039 SERS members who took advantage of the 2003 SERS ERI.

Temporary and Contractual Employees

Commission staff is compiling a historical analysis of the use of temporary and contractual employees utilized by the State. The attempt is to see if the reduction in headcount has increased the use of contractual and temporary employees.

FY 2003 ERI Cost/Savings

Public Act 92-0566 (HB 2671) requires the Illinois Economic and Fiscal Commission to report on the annual amount of payroll savings due to the ERI and the net annual savings or cost of the ERI. To that end, Commission staff has identified the cost and savings components associated with the ERI, and estimated the FY 2003 cost or savings associated with the ERI.

Cost Components

Lump-Sum Payouts

One of the largest FY 2003 ERI costs was the increase in agency payouts for unused sick and vacation leave. Based on agency payout information provided by the Comptroller's office, total lump sum payouts in FY 2003 totaled almost $174 million. As some of the ERI participants would have retired in FY 2003 even without an ERI, Commission staff estimates that $45 million in lump sum payments would have been made in FY 2003 even in the absence of an ERI. Therefore, Commission staff estimates total FY 2003 lump sum payments attributable to the ERI to be $129 million.

The argument could be made that these lump-sum payouts should **not** be considered a cost associated with the ERI, as they would have to be made at some point in the future for each employee, regardless of when the employee retires. But, lump-sum payouts that would have not otherwise been payable in FY 2003 became payable as members who would not have retired (or been eligible to retire) chose to participate in the ERI. Therefore, staff decided that lump-sum payouts, adjusted to ERI participants, be considered a cost in FY 2003. But, the reduction in lump-sum payouts over the following five fiscal years should be considered a savings in those fiscal years.

Employer Retirement Contributions to SERS and TRS

The ERI legislation contained provisions which required the liability created by the program to be amortized over 10 years, in order to attempt to match the period of reduced payroll. The legislation did not require employer retirement contributions to be made in FY 2003, but requires a $70 million retirement contribution to be made to SERS and a $1 million contribution to TRS in FY 2004. The remainder of the liability, as certified by the systems, must be amortized over the nine years beginning in FY 2005.

Change in the Number of Employees Covered by CMS Group Health Insurance

The SERS ERI could have increased CMS group health insurance costs for two reasons. First, active employees pay a portion of the health insurance premium while retirees with at least 20 years of service are not required to pay any portion of the health insurance premium. Second, for every ERI participant that is replaced, there will be an increase in health insurance costs for the State, as there will then be a retiree and an employee (rather than just an employee) covered by CMS group health insurance.

Based on membership data provided by CMS, the number of people covered by CMS group health insurance has remained steady from FY 2002 through FY 2004. So, rather than increasing total membership of the CMS group health insurance program, the ERI simply shifted many employees to the retiree category. Based on the timing of the early retirements and an average increase in monthly costs of $35.29 (as most recent retirees make no health insurance contribution), it is estimated the ERI increased group health insurance costs by $2.6 million in FY 2003.

Savings Components

Payroll Reduction

Of course, the main savings from the ERI is the reduction in State headcount and payroll. Primarily, payroll reduction is a result of fewer people on the State payroll. As noted previously, State headcount is still lower than pre-ERI levels.

In order to come up with an annual payroll savings amount, Commission staff compared the actual State payroll for FY 2003 to what the payroll would have been without the ERI. Based on the timing and number of ERI retirements, Commission staff estimates the FY 2003 payroll savings due to the ERI totaled approximately $330 million.

Reduction in Payroll-Related Costs

Because of the reduction in payroll, the costs associated with payroll were also reduced by the 2002 ERI. Specifically, the reduced payroll resulted in a reduction in the employee retirement contributions made by the State on behalf of the member (4% to 5.5% of payroll) and a reduction in employer contributions for Social Security and Medicare (7.65% of payroll). For FY 2003, staff assumed the State would have contributed 4% of payroll, representing the employee contribution that would have been made in FY 2003 on behalf of early retirees. In addition, the State would be been responsible for making the employer portion of the Social Security contribution for at least 90% of ERI participants, as the overwhelming majority of participants were covered by Social Security. All members were assumed to be Medicare participants.

Estimate of FY 2003 ERI Cost/Savings

Based on the preceding cost and savings components, staff estimates the ERI has resulted in a savings to the State in FY 2003 (in millions $) as follows:

Lump Sum Payouts	$129.0
Retirement Contributions	0.0
Group Insurance	2.6
FY 2003 Cost	$131.6
Reduction in Payroll	$330.0
Reduction in Payroll Cost	36.3
FY 2003 Savings	$366.3
Net FY 2003 Savings	**$234.7**

The FY 2003 savings is mainly attributable to the realization of payroll savings in FY 2003, even though no additional ERI contributions were required to be made to SERS or TRS until FY 2004. This reduction in payroll more than offset the increase in lump sums that were paid to ERI participants in FY 2003.

FY 2004 ERI Cost/Savings

Generally, the cost and savings components used to determine the estimated fiscal impact in FY 2004 are the same as those used to calculate the FY 2003 impact. But, one key difference is the absence of lump sum payouts in FY 2004, as the ERI window for terminating employment ended in FY 2003. Therefore, no lump sum payments were made to ERI participants in FY 2004. In fact, as the ERI caused many lump sum payments to be "shifted" to FY 2003 from later years, the reduction in lump sum payouts in FY 2004 is considered a savings in FY 2004.

Cost Components

Employer Retirement Contributions to SERS and TRS

According to SERS, the ERI created additional SERS liability totaling slightly more than $2.4 billion. TRS estimates the ERI added $10.85 million in additional liability to TRS. But, the ERI legislation only required FY 2004 contributions of $70 million to SERS and $1 million to TRS. This ERI contribution is in addition to the regular employer contributions to SERS. The Systems have certified that beginning in FY 2005, the required annual ERI contributions to SERS and TRS total $380.3 million and $1.7 million, respectively, per year for the next 9 years.

Increase in the Number of Employees Covered by CMS Group Health Insurance

Based on membership data provided by CMS, the number of people covered by CMS group health insurance has remained steady from FY 2002 through FY 2004. So, rather than increasing total membership of the CMS group health insurance program, the ERI simply shifted many employees to the retiree category. Based on an average increase in monthly costs of $37.68, it is estimated the ERI increased group health insurance costs by $5.0 million in FY 2004.

Savings Components

Payroll Reduction

Based on data provided to the Commission by SERS regarding the salaries of ERI participants, staff estimates the FY 2004 payroll savings due to the ERI to be $580.0 million. The actual savings may differ slightly depending on the pace of hiring State employees for the remainder of FY 2004, but it appears the pace of replacing early retirees will remain slow while the State continues to struggle with fiscal difficulties.

Reduction in Payroll-Related Costs

As in FY 2003, the reduction in FY 2004 payroll has reduced the costs associated with payroll. The State no longer has to make the employee retirement contributions (4% to 5.5% of payroll) on behalf of SERS members who participated in the ERI or the employer contributions for Social Security and Medicare (7.65% of payroll). To calculate these savings, staff made the same assumptions as used in FY 2003 regarding the Social Security and Medicare eligibility of ERI participants. But, as all employees not covered by a bargaining unit were required to make the required employee retirement contribution of 4% of salary beginning July 1, 2004, it was assumed that the State would have only been required to make the employee contribution of 66% of those that participated in the 2002 ERI.

Lump-Sum Payouts (Years 2-6)
As discussed previously, there will be a reduction in lump-sum payouts to employees in FY 2004 through FY 2008, as payouts that would have been made in these fiscal years were instead paid in FY 2003. This reduction in lump-sum payouts, as estimated by Commission staff, is considered an ERI savings in FY 2004, as absent the ERI, total lump sum payouts in FY 2004 would have been larger. Assuming 20% of the lump sum payouts to early retirees would have actually been paid out in FY 2004, the actual FY 2004 reduction in lump sum payouts is estimated to be $25.8 million.

Estimate of FY 2004 Cost/Savings

Based on the estimates of the preceding cost and savings components, staff estimates the FY 2004 SERS ERI impact to be (in millions $) as follows:

Retirement Contributions	$71.0
Group Insurance	5.0
FY 2004 Cost	$76.0
Reduction in Lump Sum Payouts	$ 25.8
Reduction in Payroll	580.0
Reduction in Payroll Cost	56.0
FY 2004 Savings	$661.8
Net FY 2004 Savings	**$585.8**

As was the case in FY 2003, the substantial savings realized in FY 2004 was mainly a result of the large reduction in payroll and a relatively small increase in the required ERI contributions to the retirement systems. **As the State will be required to contribute substantially more for the ERI ($382.0 million) beginning in FY 2005, the annual savings associated with the ERI will be smaller in the next several fiscal years. But, unless employee headcount and payroll increase significantly from current levels, the State will continue to realize annual savings from the 2002 SERS ERI. Future reports will outline the cumulative savings associated with the 2002 ERI, as well as the annual cost or savings.**

BACKGROUND

The Illinois Economic and Fiscal Commission, 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; and

5) Annual estimates of public pension funding requirements and preparation of pension impact notes; and

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.

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 three primary reports. The "Revenue Estimate and Economic Outlook" describes and projects economic conditions and their impact on State revenues. "The Illinois Bond Watcher" 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. The Commission also periodically publishes special topic reports that have or could have an impact on the economic well being of Illinois.

These reports are available from:

Illinois Economic and Fiscal Commission
703 Stratton Office Building
Springfield, Illinois 62706
(217) 782-5320
(217) 782-3513 (FAX)

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