ALTERNATIVE RETIREMENT CANCELLATION PAYMENT

P.A. 93-0839

Commission on Government
Forecasting and Accountability
703 Stratton Office Building
Springfield, Illinois 62706

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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 5/14-108.5(g) 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 June 2004. 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 2005 due to the ARCP and the net annual savings to the State for FY 2005.

Public Act 93-0839
The Alternate Retirement Cancellation Payment Option

Provisions of the 2004 ARCP

Public Act 93-0839 (SB 2206) provided an enhanced refund option for certain State employees terminating State service before October 31, 2004 with the agreement that those participants forfeit all SERS benefits. The Alternate Retirement Cancellation Payment (ARCP) option was limited to 3,000 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 June 2004 and in an eligible position continuously since January 1, 2004. Employees could not participate if they had previously received any SERS retirement annuity or Contingent Lump Sum Incentive Program (CLSIP) payment.

Employees under the Governor's purview were required to file an application with the Board of Trustees by September 30, 2004. All other employees were required to apply by September 1, 2004. Participants then had to terminate service within 2 weeks of their application being approved and in no event later than October 31, 2004.

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 accepting 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.

ARCP Impact on State Headcount

The State Employees' Retirement System reports that 542 employees participated in the ARCP and were paid refunds. The ARCP participants ranged in age from 18 to 86 with less than a year of service to 48 years of service. Overall, the average age of the participants was just over 41 years, and the majority of participants had less than 8 years of service.

According to SERS, there were 73,465 State employees in June 2004 before the ARCP option was offered. Headcount increased in July through September, but at the completion of the ARCP, headcount had declined to 72,484. At the end of the fiscal year, headcount had further declined to 71,330. The chart below illustrates the change in headcount throughout FY 2005 and into FY 2006. 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 Members Headcount
FY 2005

Month	State Employees	Change from 06/2004
June (2004)	73,465	
July	74,127	662
August	74,051	586
September	73,980	515
October	72,484	-981
November	72,233	-1,232
December	72,796	-669
January	72,556	-909
February	71,846	-1,619
March	71,604	-1,861
April	71,273	-2,192
May	70,933	-2,532
June (2005)	71,330	-2,135
July (2005)	71,726	-1,739
August (2005)	71,824	-1,641
September (2005)	71,931	-1,534
October (2005)	70,613	-2,852
November (2005)	70,537	-2,928

The lightly shaded areas represent the months (July-October) in which the ARCP took place.

FY 2005 ARCP Impact on SERS

As of June 30, 2004, SERS paid out $23.4 million in enhanced refunds to ARCP participants, and the liability released as a result equaled $28.2 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 $4.8 million as follows:

ARCP Effects on SERS – FY 2005

Release of participants' liability	$28,220,739
Refunds paid to ARCP participants	$23,387,217
Reduction in Unfunded Liability	**$4,833,522**

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 $23.4 million to the 542 ARCP participants. Without the ARCP option these employees would have been eligible for refunds substantially less than paid under the ARCP. Based on agency payout information, regular termination refunds for the ARCP participants would have amounted to $7.6 million. Therefore, the amount by which enhanced refunds exceeded this amount, or $15.8 million, represents the main cost component to SERS associated with the ARCP program.

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. The combined liability for these participants equaled over $28.2 million based on agency information. Employees with more years of service generate greater liability, and therefore, ARCP participants with longer service generated larger savings. However, just over half of the participants had less than 8 years of service and were not vested in the system or eligible for benefits.

FY 2005 ARCP Impact of State Costs/Savings

Public Act 93-0839 (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 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 542 ARCP participants in FY 2005 is estimated to be $1.35 million. Commission staff assumes that all but 100 of the 542 participants would have left State employment without the ARCP. Based on the foregoing assumption, $250 thousand in lump sum payments to 100 ARCP recipients constitutes the lump-sum payout cost component of the enhanced refund. It should be noted that lump-sum payouts of unused sick and vacation leave was a one-time cost factor in FY 05 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 a SERS report, the total final monthly pay for all ARCP participants amounted to $1.9 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 05 payroll reduction associated with the 542 ARCP recipients totaled $17.8 million. Because Commission staff estimated that all but 100 of the ARCP participants would have terminated state employment in the absence of the enhanced refund, a payroll savings of $3.3 million in FY 05 can be attributed to the ARCP.

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 reduction in State headcount through FY 2005, 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 $3.3 million associated with 100 ARCP recipients who would have remained on the state

payroll in the absence of the enhanced refund offering, the State saved approximately $252 thousand in employer contributions for Social Security and Medicare in FY 05.

Similarly, the State was no longer responsible for making employer contributions to SERS on behalf of the ARCP participants. In FY 2005, the State made state employer retirement contributions at a rate of 16.1% of payroll. Hence, the reduction in employer retirement contributions attributable to the 100 ARCP recipients who would have remained on the state payroll in the absence of this incentive amounted to $531.3 thousand. Therefore, the state realized a total savings of $783.3 thousand in payroll related costs in FY 05 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 05 group health insurance reduction associated with the 100 ARCP participants who would not have otherwise terminated employment totaled $744 thousand.

Estimate of FY 2005 State Cost/Savings

Based on the preceding cost and savings components, staff estimates the ARCP has resulted in a savings to the State in FY 2005 as follows:

($ in Millions)	
Reduction in Payroll	$3.3
Reduction in Payroll Costs	$0.8
Reduction in Group Health Ins Costs	$0.7
FY 2005 Savings	$4.8
Lump-sum Payouts	$0.3
FY 2005 Cost	$0.3
Net FY 2005 Savings	**$4.5**

It should be noted that ARCP-related savings will continue to accrue beyond FY 2005 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 2005 only. Greater savings will be realized in FY 2006 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:

Commission on Government Forecasting and Accountability
703 Stratton Office Building
Springfield, Illinois 62706
(217) 782-5320
(217) 782-3513 (FAX)

http://www.ilga.gov/commission/cgfa/cgfa_home.html