# Report on the Cost and Savings of the State Employees' Early Retirement Incentive Program
## (P.A. 92-0566)

June 2006
703 Stratton Office Building
Springfield, Illinois 62706

# *Commission on Government Forecasting and Accountability*

***COMMISSION CO-CHAIRMEN***

Senator Jeffrey M. Schoenberg
Representative Terry R. Parke

| ***SENATE*** | ***HOUSE*** |
|---|---|
| Don Harmon | Mark H. Beaubien, Jr. |
| Christine Radogno | Frank Mautino |
| Steven Rauschenberger | Robert Molaro |
| David Syverson | Richard Myers |
| Donne Trotter | Elaine Nekritz |

EXECUTIVE DIRECTOR
Dan R. Long

DEPUTY DIRECTOR
Trevor J. Clatfelter

AUTHOR OF REPORT
Dan Hankiewicz

OFFICE ASSISTANT
Briana Stafford

# *TABLE OF CONTENTS*

## *2006 Report on the Cost Savings of the State Employees' Early Retirement Incentive Program (P.A. 92-0566)*

## The Financial Condition of the Illinois State Retirement Systems

## June 2006

## INTRODUCTION

The Commission on Government Forecasting and Accountability 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 total estimated payroll-related savings due to the ERI, and the estimated increase in State contributions to SERS resulting from funding changes contained in P.A. 94-0004. In addition, the report provides an estimate of increased healthcare costs attributable to shifting 11,039 employees to the retiree category.

# Public Act 92-0566
# The SERS Early Retirement Incentive Program

*The Provisions of the 2002 SERS ERI*

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 were allowed to 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.

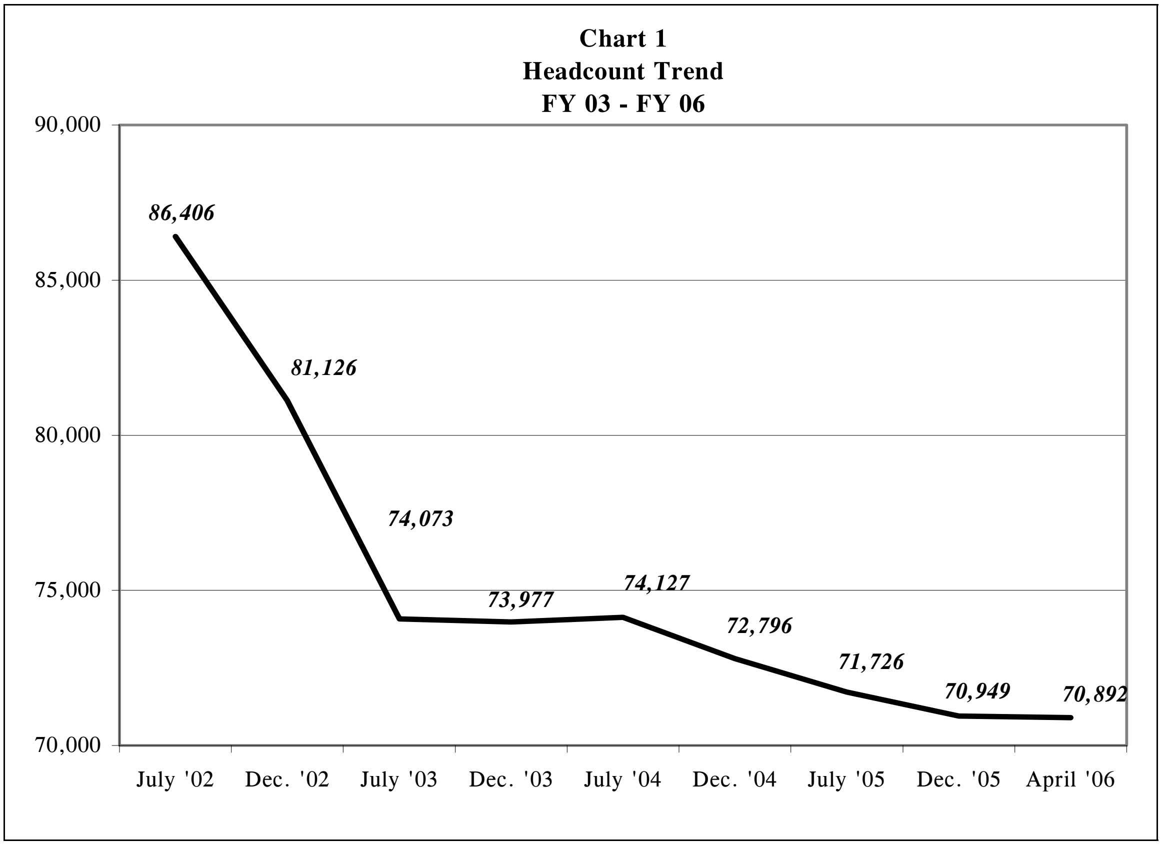
In order to participate in the ERI, the member was required to have accumulated at least 8 years of creditable service (at least 5 as active service), excluding service established by this ERI. The 5 years of active service could include military service that interrupted employment and the qualifying 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 was deducted from the retirement annuity in 24 equal monthly installments.

*ERI Utilization*

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 approximately $2,505.

## ERI Impact on Employee Headcount

According to SERS, there were 86,406 State employees in July of 2002. By July of 2003 (the beginning of FY 04), the number of State employees had dipped to approximately 74,000, as shown in Chart 1 below. Headcount remained at about that level until October 2004, when it dropped further due to two incentive programs aimed at reducing headcount. 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.



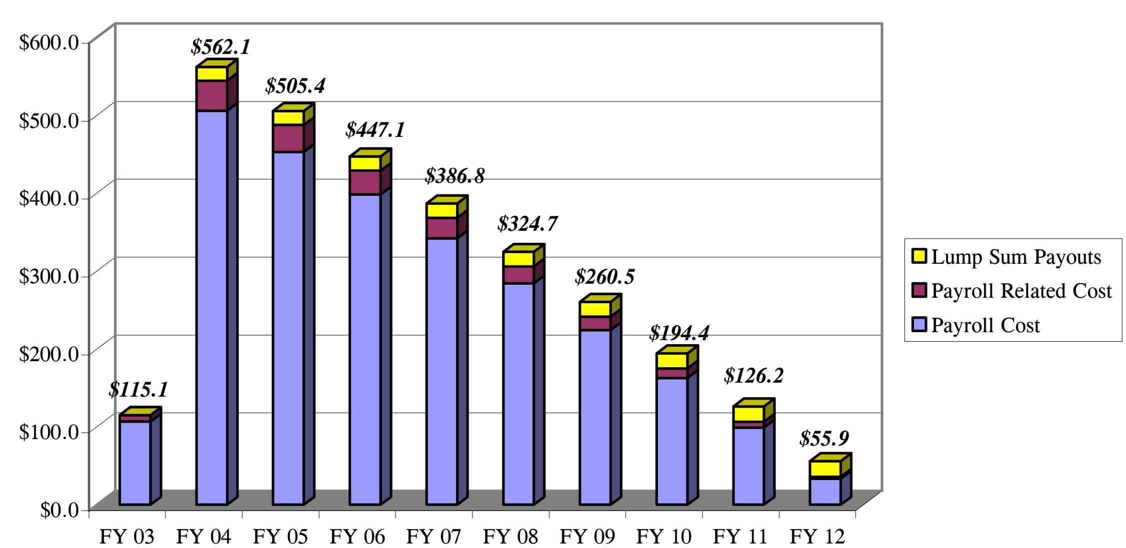

As Chart 1 illustrates, the number of State employees is still significantly below the pre-ERI level. At the end of April 2006, State employee headcount was more than 15,000 below the pre-ERI level. In fact, the reduction in payroll and headcount has been more dramatic in FY 2005, as the State has adopted two other programs with the goal of reducing headcount. This first program was the Alternative Retirement Cancellation Payment (ARCP) program and the second was the Contingent Lump Sum Incentive Payment (CLSIP) program. The ARCP program provided an enhanced refund from SERS for people leaving State employment before September 30, 2004 and the CLSIP program provided a severance payment to people leaving State employment between November 1, 2004 and December 31, 2004. The ARCP option was offered again in FY 06

## Payroll Related Savings Due to ERI

The most significant savings component attributable to the ERI is the reduction in State headcount and payroll. As was previously noted, all 11,039 ERI participants left the state payroll in FY 2003. In order to calculate the total projected payroll savings associated with the ERI, Commission staff assumed that all 11,039 participants would have retired in equal annual increments of 1,104 over the ten-year period FY 2003 – FY 2012 had the ERI not been offered. Commission staff further assumes that the positions vacated by the ERI will remain unfilled and that headcount will remain at current levels through FY 2012. Chart 2 below shows the amount of payroll savings attributable to the ERI. The increase in payroll savings from FY 03 to FY 04 reflects the fact that all ERI participants were off the payroll for the entire fiscal year in FY 04. Payroll savings decline in each fiscal year thereafter as more and more ERI participants would have left state employment absent the ERI.

Because of the reduction in payroll, the costs associated with payroll will also be reduced by the ERI. Specifically, the state will realize a reduction in the employer contributions for Social Security and Medicare (7.65% of payroll) that will continue to accrue until FY 2012, as shown in Chart 2 below. Chart 2 also depicts the reduction in lump sum payouts for unused sick and vacation leave, as estimated by Commission staff. Total lump sum payouts to early retirees in FY 2003 amounted to almost $174 million, which partially offset payroll savings in that year. However, the amount of lump sum payouts that would have been made to SERS members leaving the payroll in subsequent years had the ERI not occurred will serve to augment savings realized from reduced payroll and payroll related costs.

**Chart 2**
**Payroll Related Savings**
**($ in Millions)**



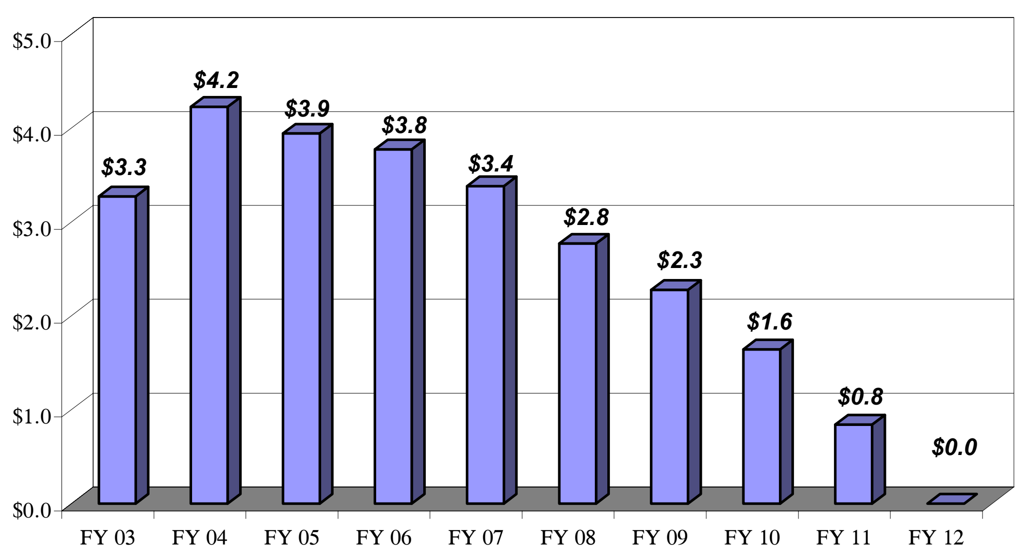
Based on the foregoing analysis, Commission staff concludes that the 2002 ERI will result in total payroll related savings of $2.9 billion over the period FY 2003 – FY 2012.

## Increase in Retiree Healthcare Costs

The 2002 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 health insurance premium (although retirees do continue to pay for dependent coverage). 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. However, as noted earlier, Commission staff assumes that headcount will remain at current levels through FY 2012. Therefore, the net cost to the state results from shifting all 11,039 ERI participants to the retiree category. Commission staff assumes that all ERI participants had at least 20 years of state service and therefore make no contribution toward their health insurance in retirement.

As shown in Chart 3 below, shifting all 11,039 ERI participants to the retiree category will cost the state approximately $26.1 million in lost group insurance contributions over the period FY 2003 – FY 2012.

**Chart 3**
**Increase in State Healthcare Costs Attributable to ERI**
**($ in Millions)**



## Funding the Liabilities Associated with the 2002 ERI

Public Act 92-0566 required SERS to determine the net increase in the unfunded liability resulting from the ERI and report the amount to the Governor and the Commission on Government Forecasting and Accountability. SERS calculated and certified the unfunded ERI liability amount to be $2.3 billion. The legislation required the State to contribute $70 million to SERS in FY 2004 towards this liability. The Act also specified that for Fiscal Years 2005 through FY 2013, the State must amortize at 8.5% interest the remaining ERI liability in equal annual installments as certified by SERS.

Public Act 93-0839 required the impact of the ERI to be recalculated, based on the increase in the present value of future benefits resulting from the ERI, rather than the impact on the accrued liability. According to SERS, the increase in the present value of future benefits that resulted from the ERI is $1.75 billion, while the increase in accrued liability resulting from the ERI totaled $2.3 billion.

Public Act 94-0004 (SB 27) eliminated the 10-year, level dollar ERI amortization. Hence, the liabilities associated with the ERI will not be funded separately, but rather as part of the regular funding plan for the five State-funded retirement systems as set forth in P.A. 88-593. The Act requires that state contributions be paid to the systems so that by the end of Fiscal Year 2045, the ratio of accumulated assets to accrued actuarial liabilities will be 90%. P.A. 94-0004 also stipulated that newly-hired employees of the Department of Corrections starting after July 1, 2005 who are not headquartered at a correctional facility no longer qualify for the alternative formula in SERS.

The chart below details the change in accrued liabilities and the increase in total contributions resulting from P.A. 94-0004, as provided by SERS' actuary. While the benefit changes affecting correctional employees served to reduce SERS' accrued liabilities slightly, funding reductions in FY 2006 and FY 2007 and the elimination of the original ten-year ERI amortization will result in increased state contributions to SERS of approximately $10.3 billion between FY 2005 and FY 2045.

| ***SERS - Change in Accrued Liability at FY 2045 ($ in Millions)*** | |
|---|---|
| Before P.A. 94-0004 | $90,748.0 |
| After P.A. 94-0004 | $90,072.0 |
| Decrease Due to Benefit Changes | ($676.0) |
| | |
| ***SERS - Change in Total Contributions, 2005 - 2045 ($ in Millions)*** | |
| Before P.A. 94-0004 | $65,760.2 |
| Decrease Due to Benefit Changes | ($98.9) |
| Increase Due to Funding Reductions and ERI Amortization | $10,279.8 |
| Estimated Total Contributions After P.A. 940004 | $75,941.1 |

# 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**