Report on the 2006 SERS Alternative Retirement Cancellation Payment Option

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Commission on Government Forecasting and Accountability

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Report on the 2006 Alternative Retirement Cancellation Payment

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 August and September of 2006. 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 2007 due to the ARCP and the net annual savings to the State for FY 2007.

Public Act 94-0839
The 2006 Alternative Retirement Cancellation Payment Option

Public Act 94-0839 (SB 1977), which became effective on June 6, 2006, provided an enhanced refund option for certain State employees terminating State service before September 30, 2006 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 June 2006 and in an eligible position continuously since January 1, 2006. 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 August 31, 2006. Employees not under the Governor's purview were required to apply by August 1, 2006. Participants then had to terminate service within one month of their application being approved and in no event later than September 30, 2006.

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 Employees' Retirement System termination 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.

P.A. 94-0839 stipulated that 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.

2006 ARCP Impact on State Headcount

The State Employees' Retirement System reports that 257 employees participated in the ARCP and were paid refunds. Table #1 below shows all 257 ARCP participants by state agency. In addition, the table shows the average salary of ARCP participants by state agency.

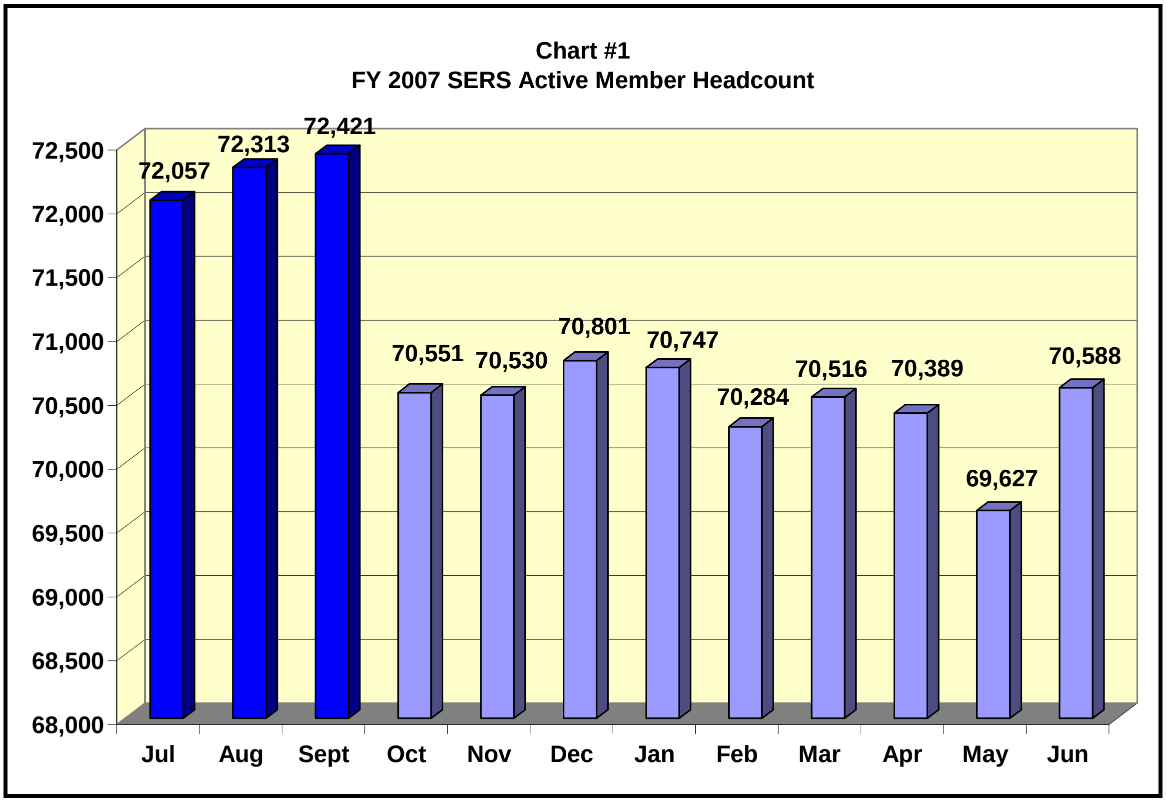
Table #1 - ARCP by Agency

Agency	ARCP Participants	Average Salary
Transportation	37	$39,037
Human Services	23	$48,464
CMS	18	$56,647
State Police	17	$48,709
Corrections	16	$51,656
General Assembly	15	$36,291
Revenue	13	$57,727
DCEO	11	$62,644
Public Aid	11	$46,672
Courts	9	$44,010
Comptroller	9	$58,698
DCFS	9	$48,524
Natural Resources	8	$41,366
Veterans Affairs	8	$44,714
Public Health	7	$54,038
Juvenile Justice	5	$48,444
Employment Security	5	$54,713
Historic Preservation	5	$39,391
Governor	3	$49,576
Financial & Professional Regulation.	3	$42,656
Commerce Commission	3	$64,300
Military Affairs	3	$37,780
Board of Education	2	$34,620
Other	17	$43,521
Total	257	

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, CMS, State Police, Corrections, and the General Assembly. These seven agencies accounted for half of all state employees who elected to take the ARCP buyout.

FY 2007 SERS Headcount

Chart #1 below illustrates the change in headcount throughout FY 2007 (the first three 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.



NOTE: According to SERS, the drop-off in headcount from September to October is most likely attributable to seasonal employees leaving the payroll.

The ARCP participants ranged in age from 18 to 93. Chart #2 below shows ARCP participants by age group. The 2006 ARCP attracted very few employees over age 50, many of whom are vested in SERS and have more years of service credit than younger employees.

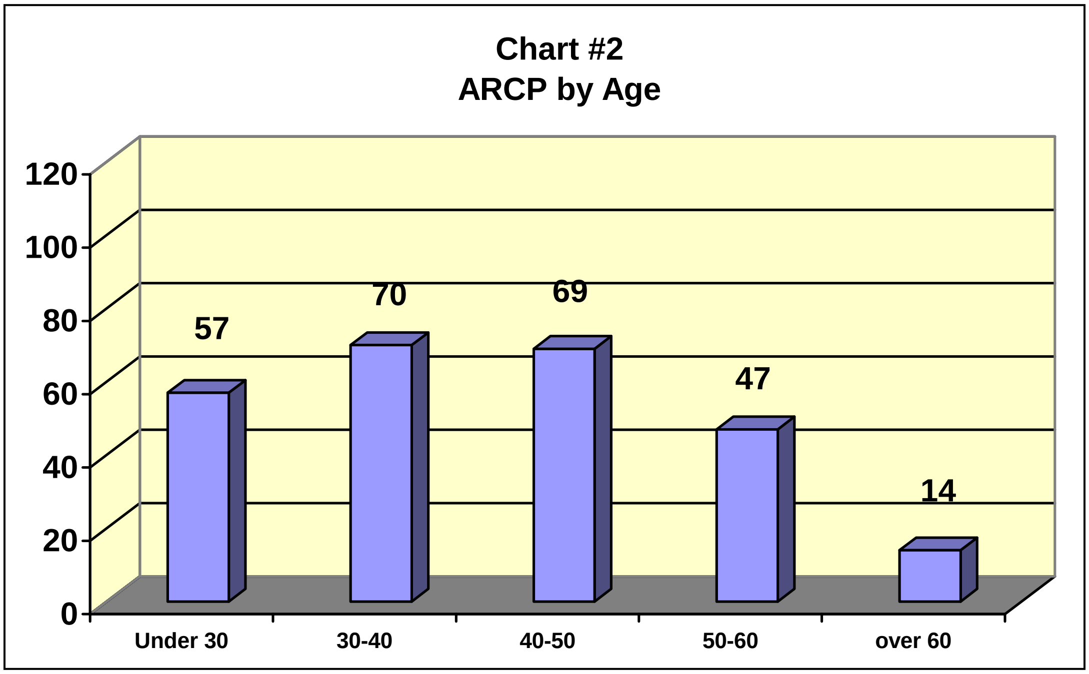
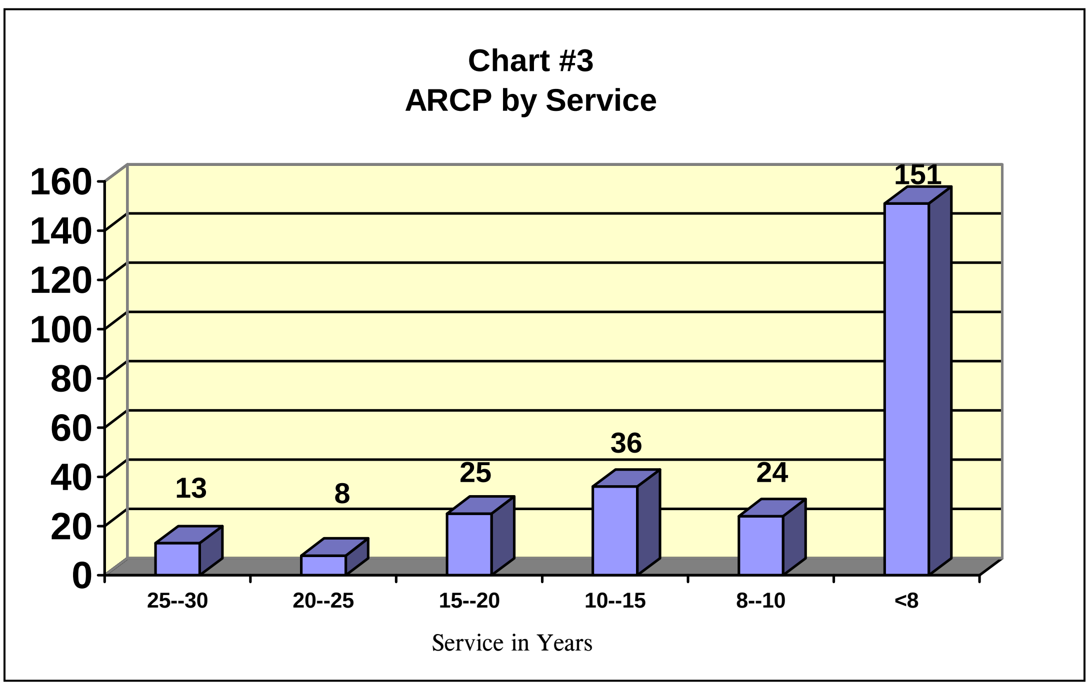


Chart #3 below shows ARCP participants by years of service. As shown in the chart, the overwhelming majority of employees who opted for the enhanced buyout had less than 8 years of service credit in SERS, and had not yet vested in the retirement system.



2006 ARCP Impact on SERS

At the conclusion of the 2006 ARCP period, SERS paid out $10.5 million in enhanced refunds to ARCP participants, and the liability released as a result totaled $12.4 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 $1.8 million, as shown in the chart below:

FY 2006 ARCP Effects on SERS	
Members participating in ARCP	257
Release of Participants' Liability	$12,355,483
Refunds Paid to SERS Members	$10,496,965
Reduction in Unfunded Liability	$1,858,518
Actuarial Liability – Pre-ACRP	$20,874,541,910
Actuarial Liability – Post- ARCP	$20,862,186,427
Assets – Pre-ARCP	$10,899,853,065
Assets-Post ARCP	$10,899,356,100
Funded Ratio - Pre-ARCP	52.2%
Funded Ratio - Post-ARCP	52.2%

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 $10.5 million to the 257 ARCP participants. Without the ARCP option these employees would have been eligible for refunds substantially less than what they received under the ARCP. The Commission estimates that regular termination refunds for the ARCP participants would have amounted to $3.7 million. Therefore, the amount by which enhanced refunds exceeded this amount, or $6.8 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 $12.4 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, 151 ARCP participants had less than 8 years of service credit, and were therefore not vested in the retirement system.

2006 ARCP Impact of State Costs/Savings

Public Act 94-0839 (SB 1977) 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, certain ARCP participants were paid lump-sums for unused sick leave, while all ARCP participants were paid lump-sums for unused vacation leave. Total lump-sum payouts to all 257 ARCP participants in 2006 is estimated to be $822.4 thousand. It should be noted that lump-sum payouts of unused sick and vacation leave was a one-time cost factor in FY 07 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 an SERS report, the total final monthly pay for all ARCP participants amounted to slightly over $1.0 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 07 payroll reduction associated with the 257 ARCP recipients totaled $9.2 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. Because State headcount remained relatively stable throughout FY 2007, 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 $9.2 million associated with 257 ARCP recipients who would have remained on the state payroll in the absence of the enhanced refund offering, the State saved approximately $706.3 thousand in employer contributions for Social Security and Medicare in FY 2007.

Similarly, the State was no longer responsible for making employer contributions to SERS on behalf of the ARCP participants. In FY 2007, the State made state employer retirement contributions at a rate of 11.5% of payroll. Hence, the reduction in employer retirement contributions attributable to the 257 ARCP recipients who would have remained on the state payroll in the absence of this incentive amounted to $1.0 million. Therefore, the state realized a total savings of $1.7 million in payroll related costs in FY 07 as a result of the enhanced refund program.

Reduction in Group Health Insurance Costs

Over time the State will also realize some 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 net FY 07 group health insurance reduction associated with the 257 ARCP participants totaled $1.3 million.

Estimate of FY 2007 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 2007 as follows:

($ in Millions)	
Reduction in Payroll	$9.2
Reduction in Payroll Costs	$1.7
Reduction in Group Health Ins Costs	$1.3
FY 2007 Savings	$12.2
Lump-sum Payouts	$0.8
FY 2007 Cost	$0.8
Net FY 2007 Savings	**$11.4**

It should be noted that ARCP-related savings will continue to accrue beyond FY 2007 if the vacant positions remain unfilled. As noted earlier, the only non-pension cost component associated with ARCP – the lump-sum payouts for unused sick and vacation leave – was a one-time cost factor in FY 07 only. Greater savings will be realized in FY 08 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