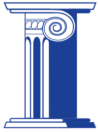

INSTITUTE BRIEF

Volume 21, Number 4 February 2014

IPERS – Is "OK" Good Enough?

By Deborah D. Thornton

In late December, the Fiscal Year 2013 Iowa Public Employee Retirement System (IPERS) annual report was issued. It was greeted with good cheer by many in the Legislature and state government.

IPERS is an important but often misunderstood part of long-term state government finances, representing billions of taxpayer dollars and liability. The impact of these legislatively approved retirement benefits on the state government budget, especially long-term fiscal liabilities, and therefore taxpayers is significant.

The problems with government-employee pensions, especially in states such as Illinois and California, are well-known. On a nationwide basis the government-employee pension plans are funded at only 72.6 percent of the amount promised to retirees.[1] On the positive side, five states are 90 percent or more funded – Wisconsin, New York, North Carolina, South Dakota, and Washington. In general, a pension plan is considered to be adequately funded if 80 percent of the money owed is available. The question is, "Is this good enough?"

This directly affects all taxpayers, because at some point in time the money must be found to pay the promised pensions. Government pensions, as most are set up today, are another long-term entitlement program with insufficient funding, similar to Social Security, Medicare, and Medicaid.

Admittedly, IPERS is doing better than it was a few years ago. The current funded ratio, based on the FY 2013 Comprehensive Annual Financial Report (CAFR), released in December, is 81 percent, up from 79.5 percent in 2012. This is still well down from its 97.9 percent high in 2000, before the financial crisis and large increase in retirees, but has stabilized in the "approved" 80 percent range.[2] However, the IPERS unfunded actuarial liability (UAL) is still almost $6 billion, or a full year of the state budget.

IPERS is a traditional, defined-benefit (DB) system, meaning that the amount an employee receives in retirement is based on "years of service, a multi-year average covered wage, and a multiplier."[3] The money comes from that originally put in by employers and employees and the growth through investments in stocks and bonds. This money must be equal to the money promised to be paid out. Changes in any of the three factors – money in, money growth, and money out – are critical to long-term solvency.

There have been changes to all three factors over the last few years. The contribution rate for regular employees has increased from 9.95 percent to 14.45 percent. It is expected to remain at this rate until the funding ratio reaches 95 percent.[4] According to the FY 2013 CAFR, "Over the years, failure to pay the actuarial contribution rate has contributed significantly to the growth in the UAL."[5] The Legislature made this rate easier to change by allowing it to fluctuate up or down by as much as 1 percent each year, without specific legislative action. While the recent increases make the plan more stable, state government – via the taxpayers – is also paying more.

The money growth factor has fluctuated wildly over the last few years. The greatest loss was in FY 2009, at just over 16 percent. The greatest growth was FY 2011, at almost 20 percent. Then in FY 2012 the growth was only 3 percent. However, for FY 2013 the "results (10.1 percent) were slightly below the investment policy benchmark of 10.64 percent and well behind the 12.61 percent median return of…large public funds."[6] Neither taxpayers nor retirees should count on investment returns of 10 percent or more every year.

A Publication of: **Public Interest Institute *at* Iowa Wesleyan College**
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IPERS covers a wide range of government workers. The majority are school employees, including the Regent universities. As of FY 2013, there were 165,095 working employees, down almost 2,800 from FY 2008, and almost 105,000 retirees drawing benefits, up over 17,400 in the same time period.[7] Benefits paid out in FY 2013 were $1.71 billion, up 7.4 percent from last year.[8] The continuing increase in retirees and benefits paid out, along with the decrease in workers adding money, is a critical part of the risk of the IPERS system just as with Social Security and Medicare.

The increase in retirees and reduction in employees reflects that a DB plan is basically a Ponzi scheme – if the previously allocated money does not earn enough to pay the current beneficiaries, the new money will be used to pay those beneficiaries.

Other major changes made in 2012 which will help ensure solvency include increasing the employment time required for full vesting to seven years, using the "high-five" compared to a control year in figuring retirement payments, and decreasing benefits for early retirement. These changes, which only apply to new hires – not previous hires – will not, however, address the long-term concerns. As long as the pension plans are DB plans, with a promise to pay X amount no matter what, state government and future taxpayers retain significant risk.

Changes being made by other states include ending the practice of double-dipping, where an employee is allowed to retire and start drawing a pension, then is able to be re-hired and receive both a paycheck and a pension. Other options include increasing the retirement age and extending the "high-five" salary used to determine the pension to "high-seven," or even eight, years. Another option is converting to a 401k type defined contribution (DC) or hybrid DB/DC system.

IPERS remains at risk of under-funding in the future. The amounts owed to both current and future beneficiaries must be paid by future taxpayers – the younger workers of today and tomorrow. Unfortunately, many of these workers are already finding their financial future constrained.

Yes, IPERS is now at the "approved" funding level, though that is only 80 percent of the money actually needed. The question remains, "Is that good enough?" The long-term risk to future taxpayers makes the answer, "No."

A summary chart of relevant data is available at www.limitedgovernment.org/table21-4.html.

(Endnotes)

[1] "The State of State Pension Plans 2013: A Deep Dive into Shortfalls and Surpluses," Morningstar, September 16, 2013, p. 2, <http://corporate.morningstar.com/US/documents/Retirement/StateofPensions2013.pdf> accessed on October 3, 2013.

[2] "Iowa Public Employees Retirement System Comprehensive Annual Financial Report FY 2013," p. 7, <http://www.ipers.org/publications/misc/pdf/financial/cafr/cafr.pdf> accessed on January 14, 2014.

[3] "Iowa Public Employees' Retirement System," Center for State and Local Government Excellence, November 21, 2011.

[4] "Iowa Public Employees Retirement System Comprehensive Annual Financial Report FY 2013," p. 6.

[5] Ibid.

[6] Ibid., p. 5.

[7] "Iowa Public Employees Retirement System Comprehensive Annual Financial Report," FY 2008 through FY 2013, <http://www.ipers.org/publications/archives.html> accessed on January 14, 2014.

[8] "Iowa Public Employee Retirement System Comprehensive Annual Financial Report FY 2013," p. 19.

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