

CIVIC COMMITTEE
of The Commercial Club of Chicago



JUST THE FACTS:

A PRIMER ON ILLINOIS PENSIONS



EXECUTIVE SUMMARY

- A reasonable and sustainable state pension system is critical to all Illinois residents. State pensions help recruit and retain qualified public employees to work in our schools, universities and state agencies, and provide a secure income for those individuals when they retire. A sustainable system must provide reasonable and well-funded pensions to participants in the state's five pension plans at an annual cost that does not require unaffordable tax increases or significant cuts in other essential state services.
- Today, the five state pension plans are not sustainable. They have an aggregate unfunded pension liability of \$83 Billion and are only 43% funded.
- To address this serious underfunding, state contributions to the pension plans have increased dramatically over the last 5 years. In FY2008, pension contributions used 6% of General Funds Revenue; in FY2013 they will consume 15% – even after the recent tax increase.
- The growth in General Funds pension contributions from 2008 to 2013 represents \$3.5 Billion that could have gone to other critical state programs.

That \$3.5 Billion is greater than the entire General Funds appropriation to the Department of Human Services in the Governor's proposed FY2013 budget, and more than half of the General Funds appropriation to the State Board of Education. Those extra resources could have ameliorated the deep Medicaid cuts currently under consideration, or funded increases in General State Aid to Illinois' public schools, or paid the bills owed to financially-strapped social service agencies.

Given the state's fiscal challenges, it will be more and more difficult to fully fund these pension contributions going forward.

- If Illinois fails to address its pension system through a set of comprehensive and lasting reforms, all of its citizens will ultimately suffer. Participants in the underfunded pension plans will be put at risk. The state's ability to provide vital public services will be severely hampered. And a growing financial burden will be imposed on Illinois residents, prompting many to choose to leave the state.

- The current pension crisis is not the fault of state workers and teachers, who have made their employee contributions each paycheck.

However, despite these regular employee contributions, the unfunded pension liability of the five state plans grew from about \$20 Billion in FY1996 to \$83 Billion by the end of FY2011. Part of this growth is the result of the “Great Recession,” which negatively impacted the pension plans’ investment returns, but other factors also played a significant role:

1. Inadequate state funding caused 44% of the growth in the unfunded liability from 1996 to 2011. This is the result of a statutory pension schedule that did not fully fund annual pension costs, as well as the state’s history of taking pension “holidays” (when it did not fund even the statutory amount).
 2. Lower-than-expected returns on pension fund assets caused 22% of the growth in the unfunded liability over this period. Average 10-year asset returns have not met expectations (particularly as a result of the “Great Recession”), and new market realities suggest this trend may continue.
 3. Variances or changes in actuarial assumptions and other elements that increased the cost of the plans contributed 34% of the growth in the unfunded liability. Such factors included improvements in life expectancies, salary increases beyond those that were assumed, benefit enhancements, etc.
- Insufficient annual state pension contributions caused almost half of the growth in the unfunded liability from 1996-2011. Yet the state has had great difficulty making even these inadequate contributions. For example:
 - The state used part of the proceeds of its \$10 Billion pension bond issuance in 2003 to make annual contributions, and used only \$7.3 Billion to immediately reduce the unfunded liability;
 - In 2006 and 2007, the state’s required pension contributions were lowered after some modest reforms were enacted; and
 - In 2010 and 2011, the state issued pension bonds to cover its annual contributions.

The state’s history of shorting its required pension contributions calls into question whether it will make the much higher future contributions required under current law, especially given its own fiscal challenges.

- As the state’s fiscal challenges grow, the plans themselves have started to consider the impact if the state reduces its pension contributions below the current statutory schedule. In the spring of 2012, Dick Ingram, Executive Director of the Teachers’ Retirement System (TRS), began a series of town hall meetings with his membership to

educate them about the realities of public pensions in Illinois and provide facts “designed to help teachers understand a debate that is vital to their futures.”

During those meetings across the state, Director Ingram has been presenting the results of three scenarios that assume the state is not able to make its full statutory contributions going forward. “These scenarios are based on assumptions that funding from the General Assembly will not meet current statutory requirements and show insolvency dates that range from the year 2030 to 2049....[and] the dates projected would be prudently viewed as optimistic since they assume that we will be able to continue to earn a rate of return of 8.5%, which is less likely under these scenarios.”

- A comprehensive and lasting solution for the state’s pension system will require input from all stakeholders – public employees and retirees, agencies providing other critical public services, taxpayers, and elected officials. A number of proposals have already been put forth. These include Governor Quinn’s reform proposal, which calls for increasing employee contributions by 3%, reducing cost of living adjustments, phasing in an increase in the retirement age and shifting some costs to local school districts, community colleges and public universities.
- It is essential that all pension reform proposals be evaluated in their entirety, with an understanding of the trade-offs that are being made and the sacrifices that are being asked from different groups of stakeholders. Proposals that focus on narrowly-defined groups – such as new employees only – may require crushingly heavy sacrifices from that small group and may negatively impact the ability to hire qualified staff.
- To ensure that proposals are reasonable and fair, they should be evaluated against the following set of guiding principles:
 - The recognition that the current system is unsustainable, and the creation of a sustainable pension system going forward that is on a clear path to at least 90% funding;
 - A schedule of state (and local) contributions that does not crowd out other critical public programs, or require unreasonable tax increases or additional borrowing;
 - Shared sacrifice across constituencies and generations by asking all stakeholders – including new employees, current employees and taxpayers – to participate in the solution. Not singling out one group to bear a disproportionate share of the sacrifice;
 - Improved pension security through a plan design that includes both a revised defined benefit component and a defined contribution component;
 - Shared risks going forward so that neither the state/employers nor employees bear the entire risk for investment returns or actuarial assumptions;

- Protecting benefits earned to-date by retirees and current employees, within the context of shared sacrifice;
 - Funding stability so that all stakeholders are assured that the solution will “stick” and the unfunded liability will be addressed through a realistic payment schedule that does not crowd out resources for other public programs;
 - Realistic actuarial assumptions that evolve to meet demographic and other changes and are based on nationally-recognized standards.
- Ensuring the sustainability and affordability of the state’s pension system going forward is going to be a difficult task. But it is one that must be undertaken now. Putting off this task only makes the problem worse, and the necessary fixes more onerous. It is essential that all stakeholders come together in good faith to develop and pass a solution that is reasonable and fair to all.

Introduction

A sustainable state pension system is critical to every Illinois resident. Reasonable and properly-funded state pensions help recruit and retain qualified public employees to work in our schools, universities and state agencies. Upon retirement, state pensions should provide a secure level of income for these workers – many of whom do not participate in Social Security. The pension system must also be affordable – both for employees and for the taxpayers who support it. Annual state pension contributions must be attainable without requiring unaffordable tax increases or significant cuts in other essential state services.

Illinois' state pension system is made up of five pension plans that provide pension benefits for downstate and suburban teachers, public university and community college workers, employees of state agencies, members of the General Assembly and judges.

Chart 1 illustrates the benefits available to current employees ("Tier 1") who are members of the state's three largest pension plans: the Teachers' Retirement System (TRS), State Universities Retirement System (SURS) and State Employees' Retirement System (SERS).

Chart 1 also describes the benefits available to new employees (those hired after January 1, 2011 or "Tier 2") in those plans.

Chart 1

KEY RETIREMENT PLAN PROVISIONS TIER 1 VS. TIER 2

Tier 1				Tier 2			
Plan	TRS	SURS	SERS (Regular)	Plan	TRS	SURS	SERS (Regular)
Normal Retirement Age	•60/10 years •62/5 years •55/35 years	•60/8 years •62/5 years •Any age/30 years	•60/8 years •Rule of 85	Normal Retirement Age	•67/10 years		
Final Average Pay Used to Calculate Pension	Highest 4 years out of last 10 years	Highest 4 years	Highest 4 years out of last 10 years	Final Average Pay Used to Calculate Pension	Highest 8 years out of last 10 years of pensionable earnings Pensionable earnings may not exceed \$106,800 as automatically increased by the lesser of 3% or ½ of CPI		
COLA	3% compounded	3% compounded	3% compounded	COLA	Lesser of 3% or ½ CPI simple		

Source: "A Report on the Financial Condition of the IL State Retirement Systems," March 2012, Commission on Government Forecasting and Accountability

Today, these plans are neither sustainable nor affordable. Illinois has one of the most vulnerable state pension systems in the nation. In 2008, the Pew Center on the States found that Illinois had the lowest-funded state pensions, with an aggregate funded level of only 54%. By the end of Fiscal Year 2011 (FY2011)¹, this funded level had dropped to 43%.²

The State of Illinois also faces a significant budget crisis. Despite last year's 67% personal income tax hike and 45% corporate income tax increase, the state continues to run large annual operating deficits. The state has amassed billions of dollars in unpaid bills as a result of these ongoing deficits and, absent significant reforms, Illinois' fiscal condition is expected to deteriorate even further. The state's total unpaid bills are projected to increase from \$9 billion at the end of FY2012 to more than \$34 billion at the end of FY2017 – about the size of the state's *total operating budget* in FY2013.

Given these budgetary challenges, it is unlikely that the state will be able to make the growing annual contributions necessary to restore its current pension system to fiscal health.

The condition of Illinois' severely underfunded pension system, combined with the state's continuing financial instability and budget deficits, threatens the pensions of retirees as well as current and future public employees. It also hampers the state's ability to provide its citizens with vital public services and places an unsustainable financial burden on all Illinois residents.

Each year that the state delays action to address its fundamental structural pension issues, the more risk the system faces and the harder it becomes to fix. Past pension reform efforts, while steps in the right direction, have not been comprehensive enough to address the root causes of the problem and have imposed stringent reforms on a narrow group of stakeholders. In addition, previous reform efforts have often been used as a rationale for reducing state contributions to the pension plans rather than as a means for improving the fiscal condition of the plans themselves.

A comprehensive and lasting solution will require input from all stakeholders – public employees and retirees, agencies providing other critical public services, taxpayers, and elected officials – based on a common understanding of the current situation. This report attempts to provide that common understanding. It focuses on the condition of the three largest state pension plans: TRS, SURS and SERS. While the two smaller plans for the General Assembly (GARS) and Judges (JRS) are not addressed in as much detail, the same concepts can be applied to those plans as well.

The report is organized around four key objectives:

- Estimating the unfunded pension liability

¹ The state's fiscal year runs from July 1 – June 30; therefore, FY2011 ran from July 1, 2010 – June 30, 2011.

² In addition to its underfunded pension system, the state also must address its retiree health care programs, which are essentially 0% funded. The most recent published estimate of the unfunded retiree health care liability is for FY2009, when it was \$44 Billion. More recent estimates suggest that the FY2011 unfunded retiree health care liability was \$54 Billion.

- Identifying the key drivers of the structural pension deficit and the growing unfunded pension liability
- Understanding the implications of further inaction
- Providing a framework for solutions

Estimating the unfunded pension liability

An unfunded pension liability is the additional amount of money that must be put into a pension plan today to fully support the benefits that have already been earned by retirees and current employees. It does not include amounts required to fund benefits for future service.

The unfunded liability is calculated by subtracting the value of the assets in a pension plan from the value of the liabilities of that plan.

- The assets are the accumulated market value of all the stocks, bonds, and other investments that have been purchased with employee and employer contributions, plus any investment returns. (The state currently provides the vast majority of employer contributions to the five state pension plans.)
- The liabilities are the cost of the pension benefits – to be paid in the future – that have already been earned by current workers and retirees.

Valuing the assets of a pension plan is fairly straightforward; valuing the liabilities is more complicated.

When valuing pension liabilities, actuaries have to make numerous predictions about when current employees will retire, what level of salary they will be earning before retirement, how long they will live after retirement, etc. Because pension benefits will be paid out in the future, actuaries also need to discount the value of those benefits back to today – using a “discount rate”³ – so that they can compare them to the current value of pension assets. If the current value of the assets in the pension plan equals the value of the liabilities – discounted back to today – then the plan is said to be 100% funded. In theory, a plan that is 100% funded has put aside adequate amounts to fund future benefit payments for benefits that have already been earned.

One of the most important assumptions in valuing pension liabilities is the discount rate applied to those future payouts of benefits. The higher the discount rate, the lower the calculated liabilities. Pension plans using higher discount rates have to accumulate fewer assets to achieve 100% funding. This provides a powerful incentive for pension plans to use higher, rather than lower, discount rates. *Private sector* pension plans operate under strict requirements for the discount rates used in valuing their liabilities – today they are generally no higher than 6%. However, governmental accounting standards allow *public* pension plans to

³ A discount rate is used to calculate the amount of cash today that is equivalent in value to a payment, or to a stream of payments, to be made in the future – in this case, the stream of pension benefits to be paid in the future. The basic idea is that receiving \$1,000 now is worth more than receiving \$1,000 five years from now, because a person who has money today can invest it and receive an additional return over the five years.

set their own discount rates based on the long-term expected return on the assets in their plans.

Most public pension plans use discount rates in the range of 7-8%, which significantly reduce the value of their pension liabilities and associated unfunded liabilities. However, one of the dangers of using such high discount rates is that public pension plans must achieve *equally high* rates of return on their assets each year – otherwise the value of the assets in their plans slips below the value of the liabilities, and the unfunded liabilities grow rapidly. The recent market downturn hit public pensions particularly hard because of their high expected returns and discount rates, and their unfunded liabilities ballooned.

Another danger is that pension plans will invest in riskier assets to achieve their high expected rates of return. Concerns have been raised that pension plans may be investing in overly risky asset classes as they “chase” such high rates of return.

At the end of FY2011, Illinois’ five state plans had total assets valued at \$63 Billion on a current market basis. Aggregate liabilities were valued at \$146 Billion, leaving an unfunded liability of about \$83 Billion (\$146 Billion - \$63 Billion).

The average discount rate used to value Illinois pension liabilities – based on expected returns on pension assets across the five plans – is 8.2%. Given new market realities, that assumption for the long-term return on assets may be aggressive. A few of the plans have already acknowledged that their expected returns have been ambitious, and recently reduced their return assumptions. However, many believe that the plans’ return assumptions, and associated discount rates, continue to be too high in this new economic environment. If the more conservative discount rates used by private sector plans are applied to the calculation of the state’s aggregate unfunded pension liability, it increases from \$83 Billion to an estimated \$120 Billion or more.

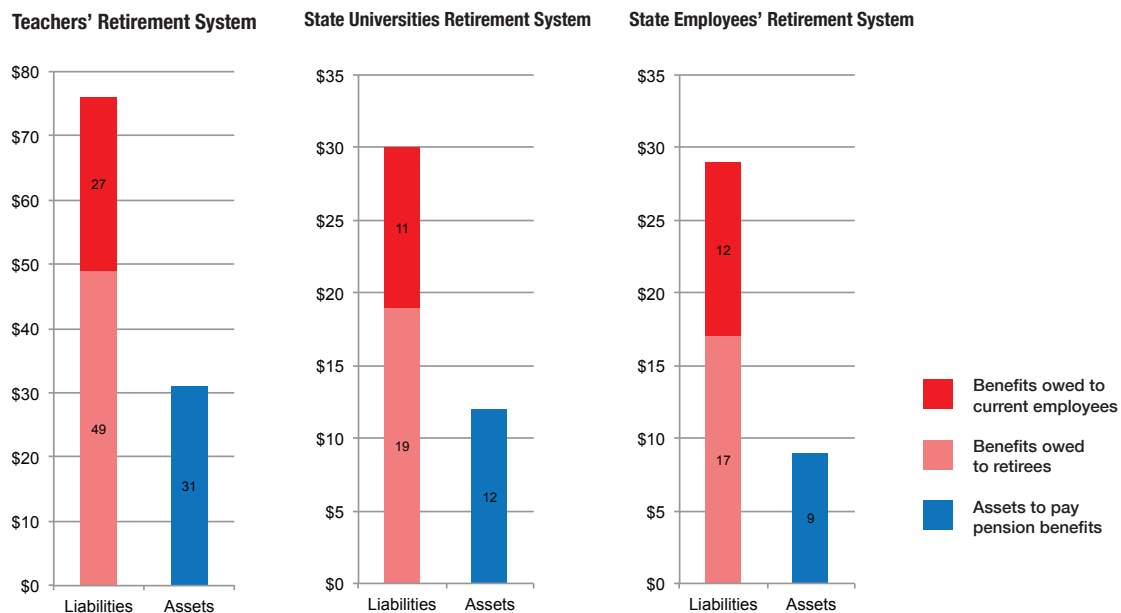
Even under the assumption that pension plan assets will earn the assumed average 8.2% return, the state’s pension plans are still in a precarious financial position. The plans’ aggregate funded level is only 43% (\$63 Billion divided by \$146 Billion). Pension plans with funded levels that are closer to 100% are typically considered healthy; a funding level of only 43% is a very serious problem.

Some have said that it is not necessary for the assets in a plan to equal the liabilities of the plan at any given time, because those liabilities will be paid out over many years in the future. They believe that there will be plenty of time to accumulate more assets in the plan before those liabilities come due. The problem with such an argument is that the additional assets that a plan accumulates each year from employee and employer contributions are earmarked for the additional liabilities (earned benefits) that also accumulate each year. Additions to plan assets are not intended to cover liabilities from previous years – if they are being used for that purpose, the fund begins to resemble a Ponzi scheme.

As shown in **Chart 2**, the funding level of the state pension plans was so low at the end of FY2010 that plan assets were not even sufficient to cover the full benefits that had already been earned by current *retirees*, let alone the full benefits that had been earned by current *employees*.

Chart 2

PLAN ASSETS AND LIABILITIES AS OF JUNE 30, 2010 (\$ Billions)



Note: In FY2011, the funded ratios of each of the state pension plans were as follows: **TRS**: 46% funded; **SERS**: 35% funded; **SURS**: 45% funded; **JRS**: 31% funded; **GARS**: 20% funded.

Source: Commission on Government Forecasting and Accountability; actuarial data provided by the retirement systems

Identifying the key drivers of the structural pension deficit and the growing unfunded pension liability

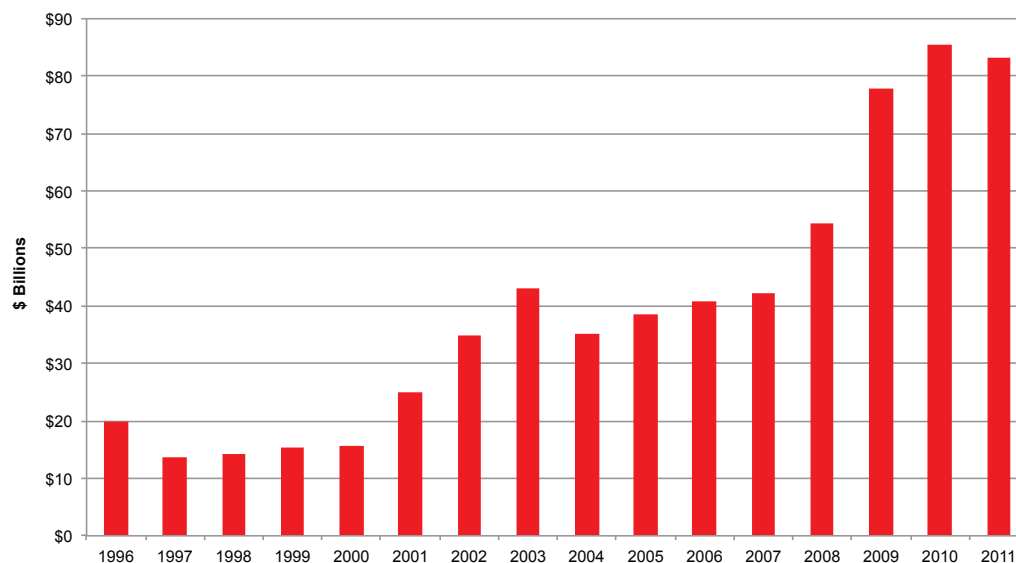
The aggregate unfunded liability of the state's five pension plans has grown from about \$20 Billion in FY1996 to \$83 Billion at the end of FY2011, despite the enactment of a statutory funding schedule for the five state pension plans in 1995.

The "1995 law" was intended to create a schedule of required annual state contributions that would be sufficient, when added to employee contributions, investment income and other income, to bring the total assets of the plans to 90% of the actuarial liabilities by FY2045. However, even at the time of enactment the 1995 law did not fully address the state's pension issues, although it was an improvement over prior funding plans. In an effort to reduce the budgetary burden imposed by pension contributions, the law put in place a schedule of required state contributions that underfunded the pensions for decades (including a 15-year "ramp" from 1996-2010 that phased-in the state's increased pension contributions) and

allowed the unfunded liability to grow. Over time, other factors have also negatively affected the value of pension plan assets and liabilities, and the unfunded pension liability has increased dramatically. **Chart 3** shows the increase in the aggregate unfunded pension liability from 1996 to 2011.

Chart 3

AGGREGATE UNFUNDED LIABILITY OF THE FIVE STATE PENSION PLANS (FY1996-2011)



Source: "A Report on the Financial Condition of the IL State Retirement Systems," March 2012, Commission on Government Forecasting and Accountability

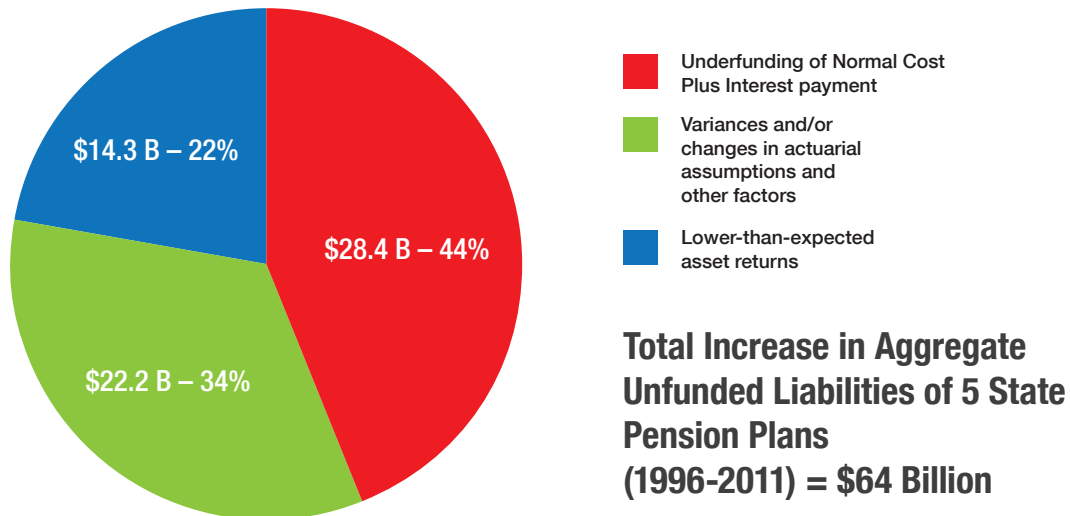
The causes of the increase in the aggregate unfunded pension liability since the enactment of the 1995 law fall into three main buckets:

1. The inadequacy of annual state contributions to the pension plans, which led to significant underfunding of annual pension costs;
2. Pension plan asset returns that were lower than expected (particularly as a result of the "Great Recession");
3. Variances or changes in actuarial assumptions and other factors that increased the cost of the pension plan benefits but were not matched by increased contributions. These include improvements in life expectancy, benefit enhancements, etc. during the intervening years.

As shown in **Chart 4**, annual underfunding has been the largest contributor to the growth of the unfunded liability, but it has accounted for less than half of the total.

Chart 4

CAUSES OF THE INCREASE IN UNFUNDED LIABILITIES (FY1996-2011)



Source: "A Report on the Financial Condition of the IL State Retirement Systems," March 2012, Commission on Government Forecasting and Accountability

Inadequate annual state contributions to the pension plans

In order to keep the unfunded pension liability from growing each year, the state would have to make an annual contribution that equals "Normal Cost Plus Interest." The Normal Cost Plus Interest payment is the sum of the employer normal cost (the cost of benefits earned that year minus employee contributions) plus interest on any unfunded liability.

The required state contributions established by the 1995 law were less than this Normal Cost Plus Interest amount for the first 30+ years of the statutory schedule, which guaranteed that the unfunded liability would grow each year even if all other actuarial and asset return assumptions were met.

For example, the FY2012 employer normal cost is estimated at approximately \$1.7 Billion. The interest on the unfunded liability – which is calculated by multiplying the unfunded liability from the previous year (\$83 Billion at the end of FY2011) by the discount rate (an average 8.2% across the five state pension plans) – equals about \$6.7 Billion. This means the Normal Cost Plus Interest payment to keep the unfunded liability from growing during FY2012 is an estimated \$8.3 Billion.⁴ The state's actual FY2012 contribution to the five state pension funds

⁴ Individual estimates may not sum to the total due to rounding.

is only \$4.9 Billion, an underfunding of approximately \$3.4 Billion that will cause the unfunded liability to continue to grow.

In addition, the state has, on occasion, taken "pension holidays" and failed to contribute even the inadequate payments required by the 1995 law. These pension holidays have only worsened the condition of the five state pension plans.

As shown in **Chart 4**, annual underfunding of the pension plans caused about 44% of the growth in the unfunded pension liability since 1996.

Pension asset returns that were lower than expected

Expected rates of return on pension assets are a key assumption that drives the calculation of how much money needs to be contributed into pension funds today to pay for pension benefits in the future. If those rate of return assumptions are not met, contributions will be insufficient and the unfunded pension liability will grow.

Charts 5, 6 and 7 compare the assumed rate of return for pension assets in TRS, SURS and SERS to their actual 10-year returns. None of these systems have achieved their expected long-term rate of return over the last 10 years. **Chart 4** illustrates that lower-than-expected asset returns contributed to more than 20% of the growth in the unfunded pension liability since 1996.

Chart 5

TEACHERS' RETIREMENT SYSTEM: RATE OF RETURN ON INVESTMENT (FY2002-2011)

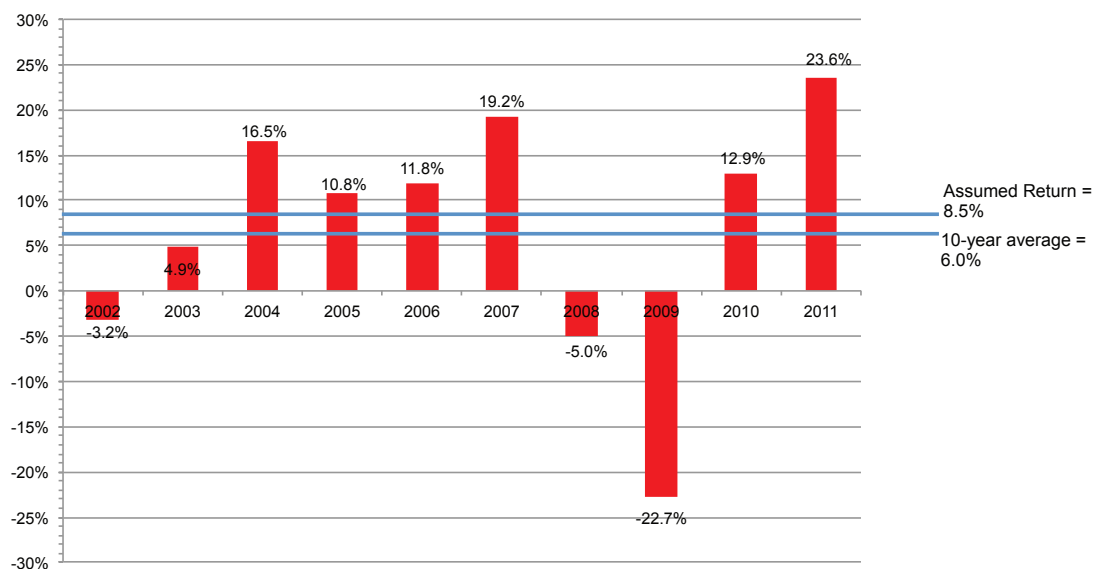
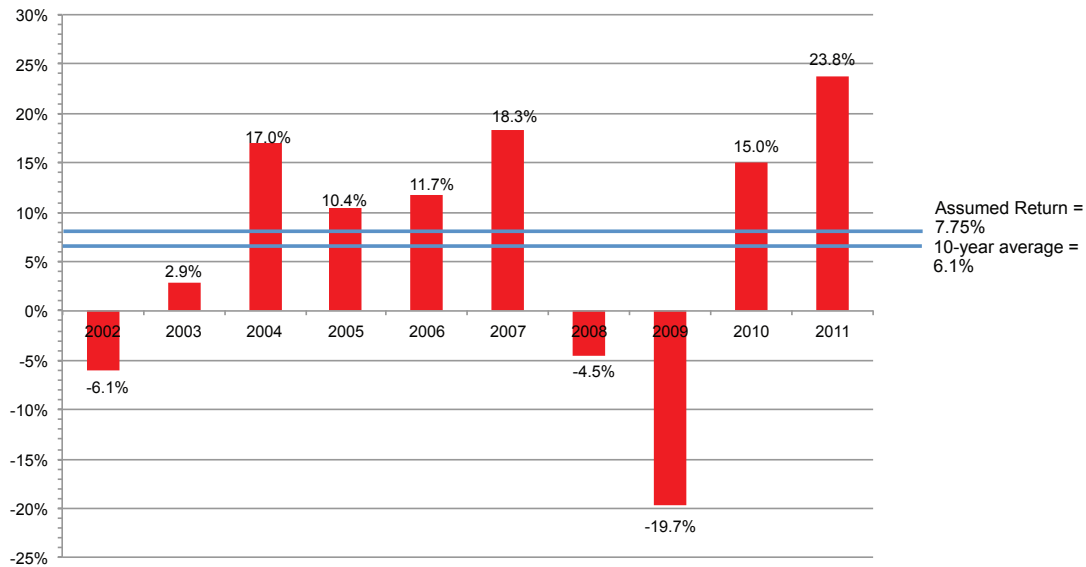


Chart 6

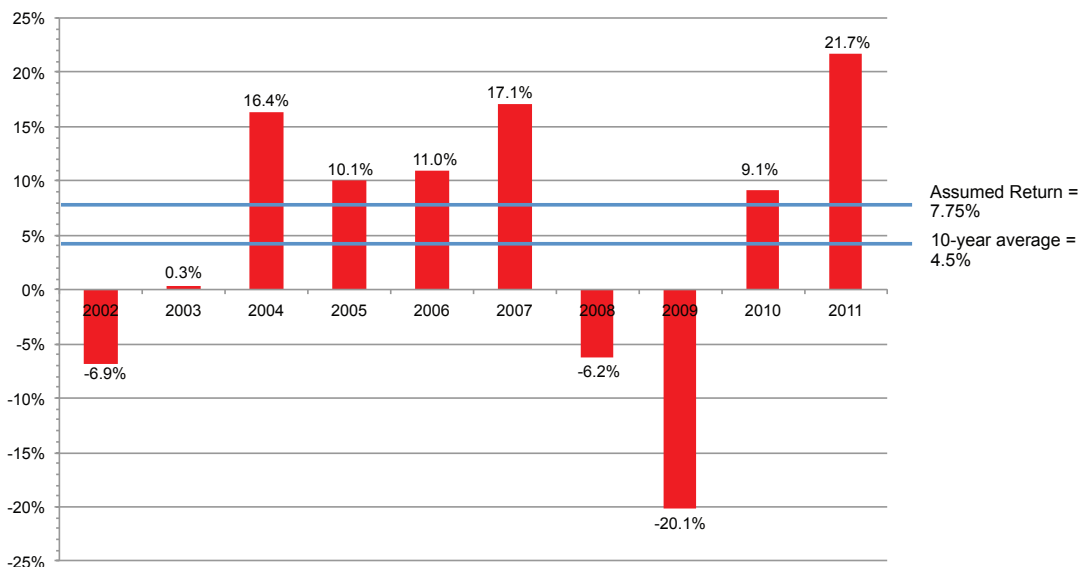
STATE UNIVERSITIES RETIREMENT SYSTEM: RATE OF RETURN ON INVESTMENT (FY2002-2011)



Source: "A Report on the Financial Condition of the IL State Retirement Systems," March 2012, Commission on Government Forecasting and Accountability; Official Statement \$575 Million State of Illinois General Obligation Bonds Series of March 2012, [http://www.state.il.us/budget/26.%20March%202012%20GO%20\\$575%20million.pdf](http://www.state.il.us/budget/26.%20March%202012%20GO%20$575%20million.pdf)

Chart 7

STATE EMPLOYEES' RETIREMENT SYSTEM: RATE OF RETURN ON INVESTMENT (FY2002-2011)



Source: "A Report on the Financial Condition of the IL State Retirement Systems," March 2012, Commission on Government Forecasting and Accountability; Official Statement \$575 Million State of Illinois General Obligation Bonds Series of March 2012, [http://www.state.il.us/budget/26.%20March%202012%20GO%20\\$575%20million.pdf](http://www.state.il.us/budget/26.%20March%202012%20GO%20$575%20million.pdf)

Variances or changes in actuarial assumptions and other factors that increased the cost of the pension plans

Actuaries have to make a multitude of assumptions when valuing the cost of defined benefit plans and determining necessary contributions. These include assumptions about final salaries, years of service, years in retirement (which require assumptions about when employees will retire as well as mortality assumptions), etc. Since these assumptions attempt to predict realities that are far in the future, many of them will be inaccurate. Over time, as true retirement rates, mortality rates, salaries, etc. become known, and if any variances are not matched by changes in contributions, they will have an impact on the unfunded liability. If these variances mean that the pension plans are more expensive than originally assumed, then the unfunded liability will grow.

For example, mortality assumptions are a key component when evaluating the cost of a pension plan. Fortunately, people are living longer and longer. But longer lives mean that retirees are collecting pension benefits for a longer period of time. According to the National Center for Health Statistics, a 60 year-old person was expected to live for an additional 18.3 years in 1970. By 1990 that had improved to an additional 20.9 years; and by 2007, a 60 year-old person was expected to live 22.5 more years. Such variances, multiplied across the hundreds of thousands of participants in the state pension plans and without corresponding increases in employee contributions, can have a significant impact on the plans' unfunded liabilities.

In the case of the state's five pension plans, variances and changes in actuarial assumptions and other factors caused about 1/3 of the growth in the unfunded liability since 1996.

Understanding the implications of further inaction

The statutory pension contribution schedule established by the 1995 law has underfunded the true cost of the state pension system in each year since 1996, causing the unfunded liability to grow and grow. But even this inadequate schedule of contributions has proven too burdensome for the state's operating budget – in many years, the state has either reduced its required pension contribution or turned to various forms of borrowing to cover the payment.

In 2003, the state issued \$10 Billion in pension obligation bonds to put toward its unfunded pension liability. However, of the \$10 Billion in bond proceeds, only \$7.3 Billion was actually used to reduce the unfunded liability. The remainder went toward the state's required annual contributions in FY2003 and FY2004, as well as debt service and fees.

In FY2006, the General Assembly passed some modest pension reforms. These reforms were used as the rationale for arbitrarily reducing the state's required pension contributions by \$1.2 Billion in FY2006 and \$1.1 Billion in FY2007.

The state issued pension bonds to cover its FY2010 pension contribution, and then additional bonds a year later to make its FY2011 pension payment.

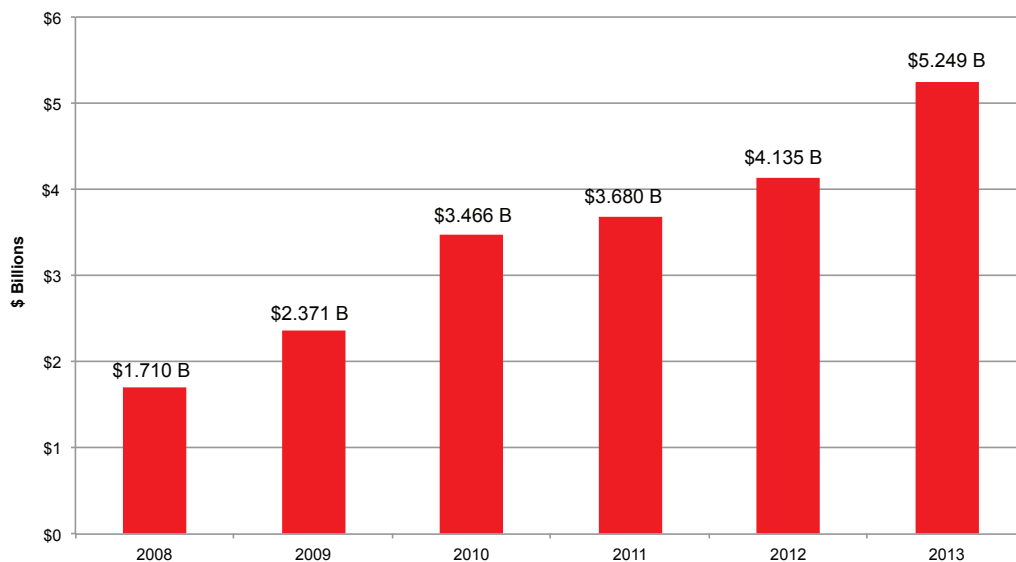
In FY2011, the state also put in place a “Tier 2” pension plan for new hires with reduced benefits. While these reforms were an important first step in moving the state pension plans toward fiscal health, not all of the savings from these reforms were used for the benefit of the plans. Instead, some of the *future* savings from these reforms were used to reduce *current* state pension contributions.

The pressures on the state’s operating budget will only worsen in the future as required pension payments increase under the statutory schedule. The state’s history of shorting its pension contributions calls into question reliance on those future pension contributions.

In his FY2013 Budget Address, Governor Pat Quinn highlighted the budgetary challenges posed by escalating statutory pension contributions. **Chart 8** shows the increase in the required General Funds revenue payment for state pensions from 2008 to 2013. The required FY2013 payment is \$5.2 Billion – triple what it was in FY2008. **Chart 9** shows the change in the percentage of General Funds revenue that must now go to pensions – from 6% in FY2008 to 15% in FY2013.

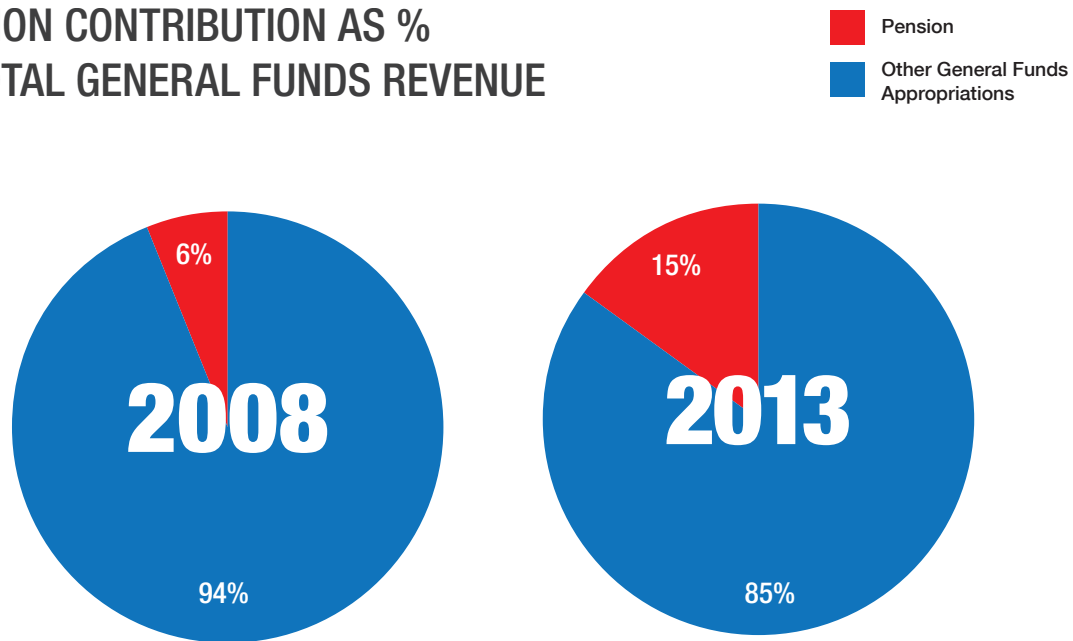
Chart 8

GENERAL FUNDS STATUTORY PENSION CONTRIBUTIONS (FY2008-2013)



Source: "Moving Forward. Stabilizing Our Budget. Building & Growing Our Economy," Illinois State Budget Fiscal Year 2013 Presentation
Note: Pension bond payments are not included in this analysis.

*The FY2013 introduced budget assumes \$160 million contribution through unclaimed property fund, which would reduce contribution from General Funds to \$5.090 Billion.

Chart 9**PENSION CONTRIBUTION AS %
OF TOTAL GENERAL FUNDS REVENUE**

Source: "Moving Forward. Stabilizing Our Budget. Building & Growing Our Economy," Illinois State Budget Fiscal Year 2013 Presentation

Concerns are growing as statutory pension contributions swallow up resources that could be used for critical public programs such as education, health care and public safety. Given the state's historical inability to make much lower pension contributions, the likelihood of the state making its growing statutory contributions going forward seems low. Key stakeholders are beginning to realize that the state pension system, in its current form, is not sustainable.

In the spring of 2012, Dick Ingram, Executive Director of TRS, began a series of town hall meetings with his membership to educate them about the realities of public pensions in Illinois and provide facts "designed to help teachers understand a debate that is vital to their futures."

During these meetings, Director Ingram has been presenting the results of three scenarios that assume the state is not able to make its full statutory contributions going forward. Under each scenario, TRS becomes insolvent. The scenarios assume:

- The TRS FY2012 contribution of \$2.4 Billion grows by 3% each year for 37 years
 - TRS is insolvent in 2049;
- The TRS FY2012 contribution of \$2.4 Billion is frozen at that level for 37 years
 - TRS is insolvent in 2038;

- The TRS FY2012 contribution is cut 60% to \$1.4 Billion and frozen at that level for 37 years
 - TRS is insolvent in 2030.

Providing a framework for solutions

A comprehensive and lasting solution for the state's pension system will require input from all stakeholders – public employees and retirees, agencies providing other critical public services, taxpayers, and elected officials. A number of proposals have already been put forth to address the crisis.

During last year's legislative session, House Speaker Michael Madigan and Leader Tom Cross co-sponsored Senate Bill 512, which would change the pension plans for current and new employees going forward (previously-earned benefits were unaffected). Current employees would be given a choice of 3 pension plans going forward: the current defined benefit plan (with a higher employee contribution); the reformed defined benefit plan offered to new employees (with a lower employee contribution); or a self-managed plan (with a lower employee contribution). New employees would be given a choice of 2 pension plans going forward: the reformed defined benefit plan they are currently offered (with a lower employee contribution) or a self-managed plan (with a lower employee contribution). The state would contribute the same amount regardless of the plan chosen by the employee. In addition, the state would amortize the current \$83 Billion unfunded liability under a more conservative schedule than current law.

The Institute of Government and Public Affairs (IGPA) recently published their version of a reform proposal for one of the five state plans – the State Universities Retirement System. This proposal calls for the creation of a hybrid plan that would include a scaled-down defined benefit (DB) plan with an additional defined contribution (DC) component. This plan would be the sole option for new employees and would be a voluntary choice for current employees. (The hybrid would be designed to cost the state no more than it is now spending on the reformed DB plan for new employees.) SURS employers – public universities and colleges – would be required to contribute toward both the DB and DC portion of the hybrid pension system, as well as to help fund the benefits for current employees who remain in the current DB plan. SURS members (employees) would also be expected to pay more; IGPA recommends a modest increase of no more than 3% of pay. The state would be solely responsible for amortizing the current unfunded pension liability. In addition, the state would contribute, at a minimum, 6.2% of payroll toward future pension accruals.

On April 20th, Governor Quinn released his own pension reform proposal. The proposal includes a 3% increase in employee contributions, reducing cost of living adjustments, phasing in an increase in the retirement age and shifting some costs to local school districts, community colleges and public universities.

In addition to these comprehensive plans, a variety of individual reforms have also been proposed. It is essential that all proposals be evaluated in their entirety, with an understanding of the trade-offs that are being made and the sacrifices that are being asked from different groups of stakeholders. Proposals that focus on narrowly-defined groups – such as new employees only – may require crushingly heavy sacrifices from that small group and negatively impact the ability to hire qualified staff, where a comprehensive set of reforms would require more reasonable sacrifices from a broader base.

In order to understand trade-offs and ensure that proposals are reasonable and fair, they should be evaluated against the following set of guiding principles:

Guiding Principles

- The recognition that the current system is unsustainable, and the **creation of a sustainable pension system** going forward that is on a clear path to at least 90% funding;
- **A schedule of state (and local) contributions that does not crowd out** other critical public programs, or require unreasonable tax increases or additional borrowing;
- **Shared sacrifice across constituencies and generations** by asking all stakeholders – including new employees, current employees and taxpayers – to participate in the solution. Not singling out one group to bear a disproportionate share of the sacrifice;
- **Improved pension security** through a plan design that includes both a revised defined benefit component and a defined contribution component;
- **Shared risks going forward** so that neither the state/employers nor employees bear the entire risk for investment returns or actuarial assumptions;
- **Protecting benefits earned to-date** by retirees and current employees, within the context of shared sacrifice;
- **Funding stability** so that all stakeholders are assured that the solution will “stick” and the unfunded liability will be addressed through a realistic payment schedule that does not crowd out resources for other public programs;
- **Realistic actuarial assumptions** that evolve to meet demographic and other changes and are based on nationally-recognized standards.

Ensuring the sustainability and affordability of the state’s pension system going forward is going to be a difficult task. But it is one that must be undertaken now. Putting off this task only makes the problem worse, and the necessary fixes more onerous. It is essential that all stakeholders come together in good faith to develop and pass a solution that is reasonable and fair to all.

