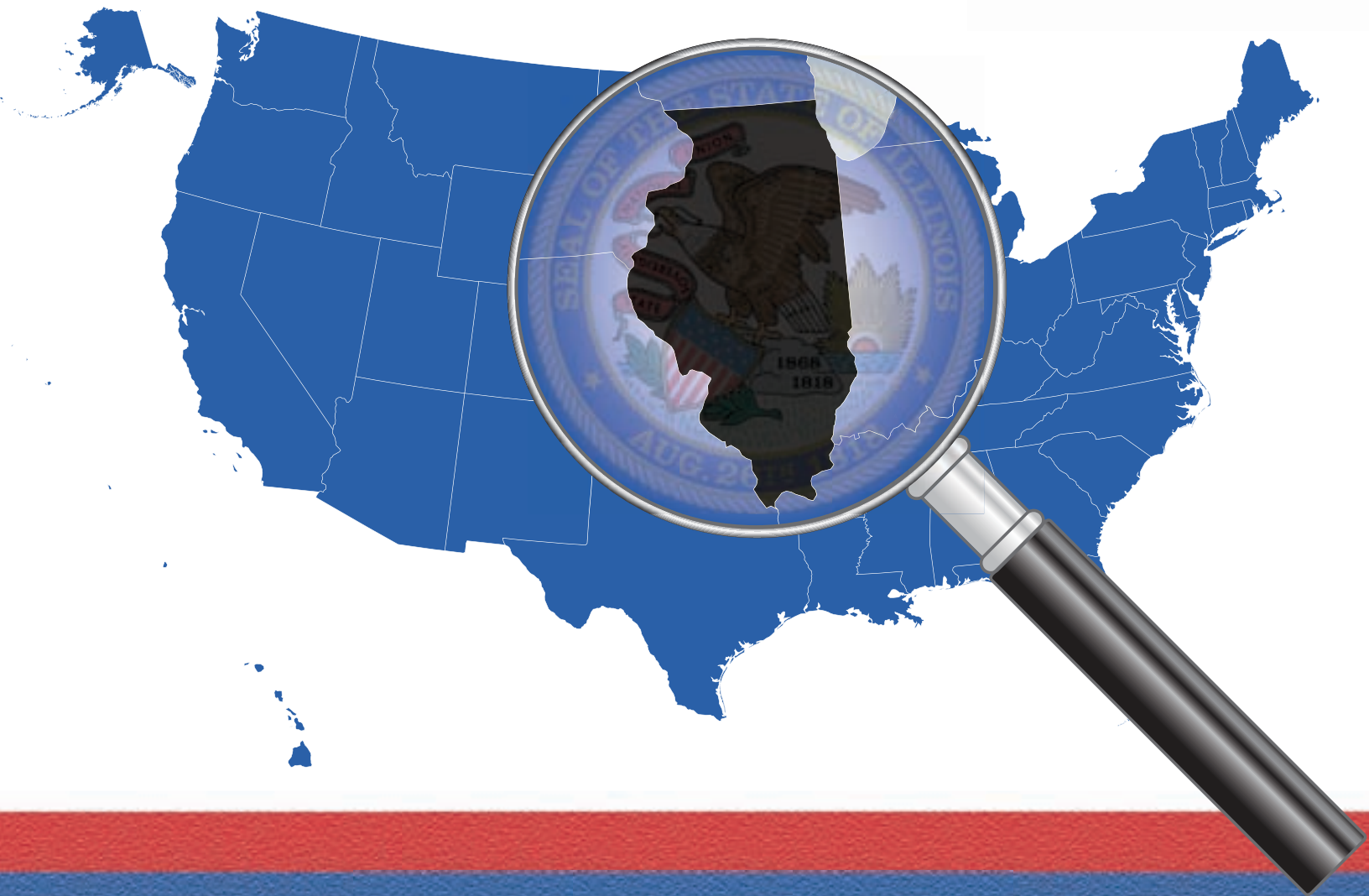


State of Illinois

Report of the Pension Modernization Task Force



House Joint Resolution 65

Report of the Pension Modernization Task Force
House Joint Resolution 65

November, 2009

Honorable Pat Quinn, Governor, and Members of the 96th General Assembly,

Pursuant to House Joint Resolution 65, the Pension Modernization Task Force and its subcommittees met from June 18, 2009, to November 9, 2009. The discussion of the Task Force and the subcommittees focused on the five tasks detailed in HJR 65. The Task Force brought in experts regarding many areas affecting the state pension systems, and a great deal of information was made available to all members of the Task Force to review and analyze. The meetings were open to the public, many interested parties attended, and often times participated in the discussions.

The attached report is the product of the Task Force. The Findings of the three main subcommittees were voted on individually to be included in the report; however, the report in its entirety was not approved by a majority of the members. A decision was made by the Task Force to publish the report as is, and allow the readers of this report to review all of the information, including input and opinions put forth by individual members and interest groups listed in the Appendices. We urge legislators and others interested in resolving the state pension system financial crisis to be sure to read the appendices as there is information located there that many members believe is vital to understanding and addressing our continuing challenges related to the State Pension funding issues we face.

The lack of a majority-approved report underscores the seriousness and complexity of the issues facing the Task Force. While the final report did not result in the consensus many had hoped for, it does contain valuable factual data which, if acted upon, could result in substantial long term savings. In addition, the report clearly underscores the fact that full actuarial calculated payments to the systems based on both actual cost and unfunded liability must be made. The eventual success of this effort will, in large part, be determined by what action is taken by the General Assembly and Governor in the near future. We hope that the information in this report assists all of its readers in determining the appropriate next steps for our state to address this issue.

Sincerely,

Members, Pension Modernization Task Force

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I. Factual Background



The Pension Modernization Task Force – HJR 65

The Pension Modernization Task Force was created pursuant to House Joint Resolution 65. The Resolution called for the creation of a 19-member task force to be charged with the following tasks:

- Analyze the public policy implications of changing pension benefits on the State of Illinois' ability to attract and retain public employees, teachers, and University professionals;
- Analyze the level of the current pension benefit structure in Illinois as it compares to other states in the geographical region and to other states that have systems that are not coordinated with Social security;
- Analyze the level of benefit programs currently being offered in the private sector;
- Analyze the long-term costs of our current systems, including the expected increase in benefit payments, the effects of continued underperformance in the funds' investment portfolio, and the effects of increasing life expectancies on our State-funded systems; and
- Analyze which pension benefits in Illinois should be modernized.

In light of the complexity of the issues to be studied, the task force formed four subcommittees in order to provide for an in-depth examination of the Illinois pension crisis. The four subcommittees were: benefits, collective bargaining, funding, and investments. The subcommittees met on a bi-monthly basis between June and October. Pursuant to the resolution, the staff of the Commission on Government Forecasting and Accountability was charged with providing staff support to the task force, in conjunction with the State-funded retirement systems actuaries and staff. House Joint Resolution 65 requires the task force to report its findings to the General Assembly and Governor on or before November 1, 2009. This report reflects the work and findings of three subcommittees of the task force: investments, benefits, and funding. No substantive findings were produced by the Collective Bargaining subcommittee.

Pension Modernization Task Force Members

- Donald McNeil, Chair, appointed by the Governor
- Representative Kevin McCarthy (D – 37), Vice-Chair, appointed by the Speaker of the House
- Senator Jeff Schoenberg (D - 9), appointed by the Senate President
- Senator Kwame Raoul (D - 13), appointed by the Senate President
- Senator Chris Lauzen (R – 25), appointed by the Senate Minority Leader
- Senator John Jones (R – 54), appointed by the Senate Minority Leader
- Representative Elaine Nekritz (D - 57), appointed by the Speaker of the House
- Representative Roger Eddy (R – 109), appointed by the House Minority Leader
- Representative Raymond Poe (R – 99), appointed by the House Minority Leader
- William H. Franklin, SERS annuitant, appointed by the Governor
- Rob Karr, Vice President, Government & Member Relations, Illinois Retail Merchants Association, appointed by the Governor
- Will Lovett, Government Relations Consultant, Illinois Education Association, appointed by the Governor
- Doris Lowry, appointed by the Governor
- Eden Martin, President, Commercial Club of Chicago, appointed by the Governor
- Bill Perkins, Legislative Director, Service Employees International Union, Illinois Council, appointed by the Governor
- Ed Rosenthal, TRS annuitant representative, appointed by the Governor
- Hank Scheff, Director of Research and Employee Benefits, AFSCME Council 31, appointed by the Governor

- Tom Weisner, Mayor of Aurora, appointed by the Governor
- Nick Yelverton, Legislative Director, Illinois Federation of Teachers, appointed by the Governor

Alternate Members

- Laurence Msall, President, The Civic Federation, appointed by the Governor
- Representative Kathleen Ryg, appointed by the Governor

Recap of the Governor's 2004 Pension Commission

In early 2004, Governor Blagojevich mandated the creation of a pension commission to study the financial condition of the State of Illinois' Retirement Systems and make recommendations on improving the systems' financial condition and affordability. The commission met six times between April 16 and May 24, 2004, and issued 9 points for consideration by the General Assembly, some of which were acted upon in the 94th General Assembly. The commission's recommendations and subsequent legislative actions are summarized below:

- 1) The General Assembly must not adopt any new pension benefits without a new funding source identified at the point of adoption. In addition, an explicit sunset provision must be attached to any new pension benefit.

Action Taken: Public Act 94-0004 requires every new benefit increase to identify and provide for additional funding at least sufficient to fund the resulting annual increase in cost as it accrues to the system. Unless the funding inadequacy is corrected by the General Assembly, the benefit increase would expire at the end of the fiscal year. In addition, Public Act 94-0004 provides that all benefit increases will expire 5 years after the effective date of the increase, unless an earlier date is specified in the legislation that provides the benefit increase.

- 2) For purposes of State pension liability, pay increases in the final average period of employment should be limited as determined by the Governor and the General Assembly, unless fully funded by the local employer or employee.

Action Taken: Public Act 94-0004 provided a mechanism by which the liability associated with salary increases above a certain level may be shifted to the employer (school districts and universities) providing those salary increases. The Act provides that during the years used to determine final average salary, the employer must pay to TRS or SURS an amount equal to the present value of the increase in benefits resulting from salary increases above 6%. The employer contribution required by Public Act 94-0004 must be paid in a lump sum within 30 days of the receipt of the bill from the retirement system. The Act specifies that the retirement system must calculate the contribution amount using the same actuarial assumptions and tables used for the most recent actuarial valuation.

The salary increase payment provision for TRS and SURS contained in Public Act 94-0004 does not apply to salaries paid under contracts or collective bargaining agreements entered into, amended, or renewed before the effective date of the Act (June 1, 2005).

- 3) Eliminate the money purchase option under SURS for new hires only.

Action Taken: P.A. 94-0004 eliminated the Money Purchase Option for new hires in SURS.

- 4) Define more precisely the rate of interest applied to the current money purchase option under SURS.

Action Taken: P.A. 94-0004 gave the responsibility for setting the Money Purchase rate of interest to the Comptroller, rather than the SURS Board of Trustees.

- 5) Increase the eligibility requirements for new employees to receive unreduced benefits.

Action Taken: None.

- 6) Limit automatic annual pension increases for new hires only.

Action Taken: None

- 7) Limit employee groups eligible for the Alternative Retirement Formula benefits for new hires only.

Action Taken: Prior to the enactment of P.A. 94-0004, all employees of the Department of Corrections were covered by the SERS alternative formula. Public Act 94-0004 provides that for employees entering service after July 1, 2005, only Department of Corrections employees who are headquartered at a correctional facility, parole officers, members of an apprehension unit, members of an intelligence unit, and DOC investigators will be covered by the alternative formula. New employees included in other groups currently covered by the alternative formula will continue to be eligible for the SERS alternative formula.

- 8) Increase the employee contribution rate for those employees receiving alternative retirement formula benefits.

Action Taken: None

- 9) Increase employee contributions to SERS, SURS, TRS, JRS, and GARS by 1%.

Action Taken: None

The 1995 Funding Law

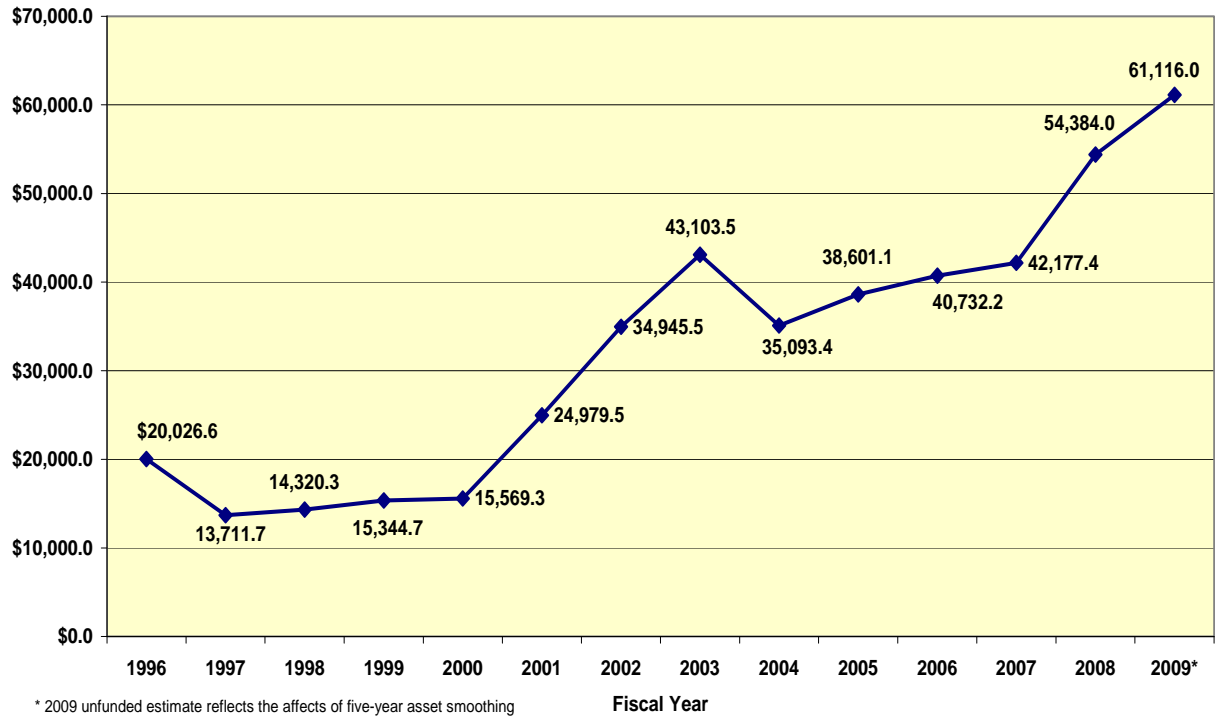
P.A. 86-273, which became effective on August 23, 1989, implemented a pension funding plan that provided for increasing the State's contribution incrementally over a 7-year period, beginning in FY 1990, so that by FY 1996, the minimum State contribution would be an amount that, when added to other sources of employer contributions, is sufficient to meet the normal cost and amortize the unfunded liability over 40 years as a level percentage of payroll.

The Legislature and the Governor did not adhere to the provisions of P.A. 86-273. A class action suit, *People ex rel. Sklodowski*, was brought against the State for its failure to abide by the Act. The case was heard by the Illinois Supreme Court, and in 1994 the court ruled that active participants and retirement systems had neither a constitutional nor a vested contractual right to enforce statutory funding obligations.

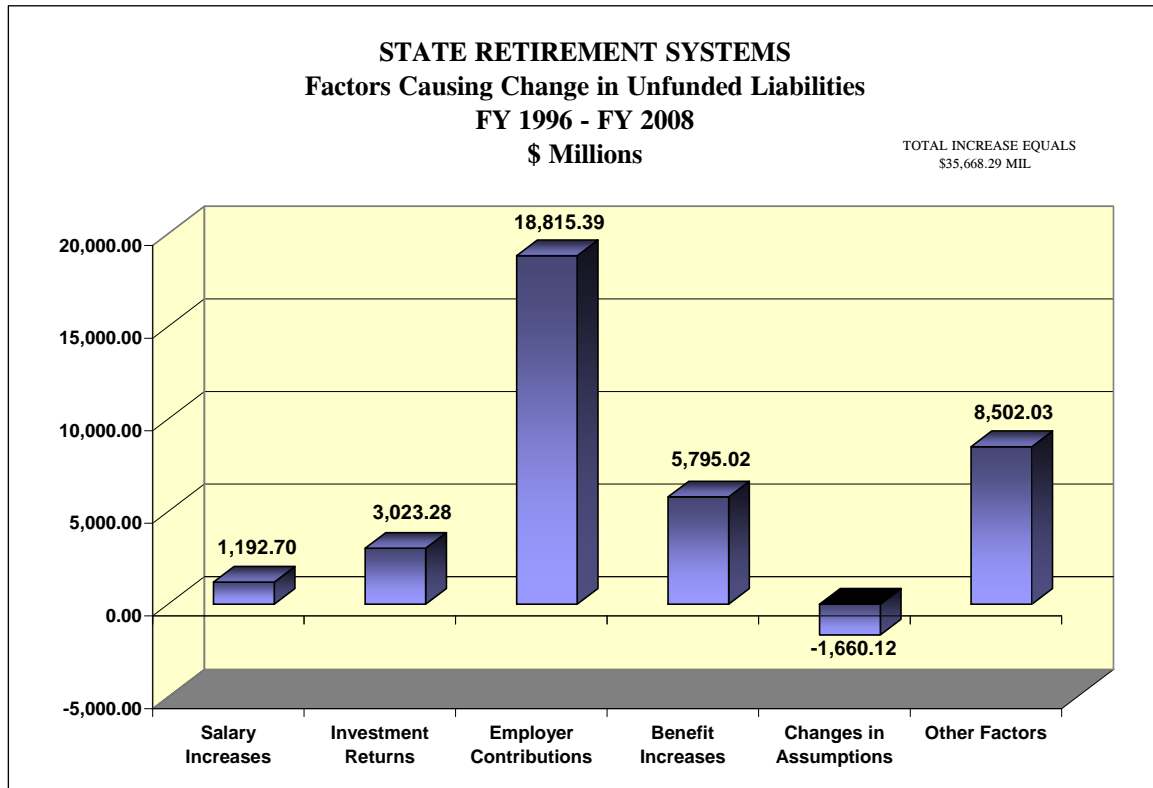
While the Sklodowski case was pending before the high court, Governor Jim Edgar signed Public Act 88-0593 into law. The Act implemented a funding plan for the five State retirement systems that requires the State to make contributions as a level percent of payroll in fiscal years 2011 through 2045, following a phase in which began in fiscal year 1996. The contributions are required to be sufficient, when added to employee contributions, investment income, and other income, to bring the total assets of the systems to 90% of the actuarial liabilities by fiscal year 2045. Each system is required to certify the amount necessary for the next fiscal year by November 15 of the current fiscal year, for inclusion in the Governor's budget. Unlike P.A. 86-273, P.A. 88-0593 contained a continuing appropriation provision to make up for any deficiency in the annual appropriations to the State systems.

The chart below outlines the growth in the unfunded liability from FY 1996 – FY 2009. It should be noted that the FY 2009 unfunded liability is an estimate and may change once the retirement systems issue their final 2009 actuarial reports.

**Growth of the Unfunded Liability
FY 1996 - FY 2009
Estimate from Retirement Systems
All Five Systems Combined
\$ in Millions**



The table below shows the factors that contributed to the growth in the unfunded liability for all five State systems for the period FY 1996 – FY 2008. During this period, the total unfunded liability has grown by \$35.7 billion. As shown in the chart, the largest driver of the growth in the unfunded liability has been insufficient employer contributions, which has added \$18.8 billion to the total unfunded liability. The unfunded liability has increased by \$8.5 billion due to “other factors” such as more retirements than expected, rates of mortality that did not meet actuarial projections, and terminations that did not meet actuarial projections.



Because “other factors” is a somewhat nebulous category, some further explanation is required. An example of “other factors” can be found in the 2007 experience study of the Teachers’ Retirement System. Pursuant to the Illinois Pension Code, retirement system actuaries conduct an experience study every five years. The objective of the study is to investigate the demographic and economic experience of the active members, annuitants, and survivors covered by the system, after which the actuaries make adjustments to their assumptions based on the results of the investigation. In TRS’ 2007 experience study, the system’s actuary recommended revisions in actuarial assumptions that increased the system’s accrued liability by \$2.4 billion (this cost was recognized in TRS’ 2007 actuarial valuation). The leading drivers of this increase were rates of regular service retirement (\$1.3 billion), rates of mortality among active members, annuitants, and survivors (\$830.3 million), and the granting of optional service

and sick leave service credit by school districts (\$421.5 million). Appendix E, on page 156, shows a detailed breakout of the growth of the unfunded liability for all five systems for the period FY 1996 – FY 2008.

Historical Pension Legislation

90th General Assembly (1997 – 1999)

SERS Formula Increase (P.A. 90-0582)

P.A. 90-0065 implemented a flat rate formula for SERS Regular Formula members covered by Social Security of 1.67% for all years of service. Regular Formula members not covered by Social Security moved to a flat rate formula of 2.2% for all years of service. The Act applied to all members retiring on or after January 1, 1998.

TRS Formula Increase (P.A. 90-0582)

P.A. 90-0582 implemented a retirement formula increase for members of the Teachers' Retirement System. The Act provided that active teachers would earn creditable service on or after July 1, 1998 at a rate of 2.2% of final average salary for each year of service. The Act also allowed teachers to make contributions to TRS in order to upgrade past service earned prior to the implementation of the flat-rate formula.

Creation of Self-Managed Plan in SURS (P.A. 90-0448)

P.A. 90-0448 gave members of the State Universities Retirement System the option to enroll in a Self-Managed Plan in which participants are able to choose from a variety of investment options ranging from mutual funds to annuity contracts. Members who choose the SMP become vested after earning 5 years of service credit.

91st General Assembly (1999-2001)

"Rule of 85" for SERS (P.A. 91-0927)

P.A. 91-0927 created a "Rule of 85" for the State Employees' Retirement System, wherein an employee is eligible to retire when the employee's age plus service credit equals 85 years.

92nd General Assembly (2001-2003)

SERS Alternative Formula Increase (P.A. 92-0014)

P.A. 92-0014 changed the retirement formula for alternative formula employees to 2.5% for each year of service for members coordinated with Social Security and 3.0% for each year of service for non-coordinated members. The Act increased the maximum retirement annuity for alternative formula employees to 80% of final average salary.

SERS Early Retirement Incentive (Public Act 92-0566)

Public Act 92-0566 created the 2002 Early Retirement Incentive for certain SERS and TRS members. The ERI allowed members to purchase up to five years of service credit and age enhancement. Eligible members were then required to leave employment between July 1, 2002 and December 31, 2002. Over 11,000 members took advantage of the ERI, and a majority of the participants were eligible to receive benefits immediately following termination.

93rd General Assembly (2003 – 2005)

Pension Obligation Bond (P.A. 93-0002)

Public Act 93-0002 amended the General Obligation Bond Act to increase bond authorization by \$10 billion. These general obligation bonds were designated as a pension funding series. The State used a portion of the bond proceeds to pay part of the FY 2003 State contribution and all of the FY 2004 State contributions to the retirement systems. Of the \$10 billion, \$7.3 billion was used to reduce the unfunded liabilities of the State-funded retirement systems.

Along with the \$10 billion increase in bond authorization, Public Act 93-0002 included a provision requiring State contributions to the retirement systems to be reduced by the amount of the debt service (the amount of principal and interest payments) on the bonds. The legislation set the maximum annual employer contribution to each system at the amount that would have been contributed without the bond issuance, minus the total debt service payments for the fiscal year. Effectively, the reduction in retirement contributions is used to pay the debt service on the bonds.

State of Illinois									
\$10,000,000,000 Taxable GO Bonds (Series June 2003 Pension)									
Allocation of Bond Proceeds to Pension Systems									
Retirement System			Prorated Bond Proceeds			Unfunded Liability			
System		Projected 2004 Contributions as of March 31, 2003	Unfunded Liability at June 30, 2002	Participation	Allocated Bond Proceeds	Assets at June 30, 2002	Liabilities at June 30, 2002	Ratio Before	Ratio After(1)
TRS	Teachers Retirement	1,027,258,000	20,681,389,000	59.180%	4,330,373,948	22,366,000,000	43,048,000,000	52%	62%
SURS	State Universities	349,989,000	6,839,364,160	19.570%	1,431,994,224	9,815,000,000	16,654,000,000	59%	68%
SERS	State Employees	440,962,000	6,617,151,766	18.940%	1,385,895,278	7,673,800,000	14,291,000,000	54%	63%
SERS	Judges	36,526,000	677,187,479	1.940%	141,955,483	343,700,000	1,021,000,000	34%	48%
SERS	General Assembly	5,790,000	130,531,977	0.370%	27,073,983	54,000,000	184,000,000	29%	44%
TOTAL		1,860,525,000	34,945,624,382	100.000%	7,317,292,916	40,252,500,000	75,198,000,000	54%	63%
From Bond Proceeds		1,860,000,000							
From GRF		525,000							
Source: Governor's Office of Management and Budget									

94th General Assembly (2005 – 2007)

Change in Funding Provisions for State Systems (P.A. 94-0004)

Public Act 94-0004 changed the funding plan created in 1994 by Public Act 88-0593. The Act set the State contribution levels for FY 2006 and FY 2007, rather than requiring the State to make contributions based on actuarial calculations contained in the pension funding plan under P.A. 88-0593. In addition, the separate funding of the liability created by the 2002 SERS Early Retirement Incentive was eliminated. The following table provides a comparison of the FY 2006 certified contributions and FY 2007 contributions with the State contributions that were required by Public Act 94-0004. The actual appropriations to the Systems were contained in SB 1548 (P.A. 94-0015).

Public Act 88-0593 Contributions vs. Public Act 94-0004 Contributions (in Millions \$)						
	FY 2006			FY 2007		
System	PA 88-0593	PA 94-0004	Difference	PA 88-0593	PA 94-0004	Difference
TRS	\$1,058.5	\$534.6	\$523.9	\$1,233.1	\$735.5	\$497.6
SERS	690.3	203.8	486.5	832.0	344.2	487.8
SURS	324.9	166.6	158.3	391.9	252.1	139.8
JRS	38.0	29.2	8.8	44.5	35.2	9.3
GARS	5.5	4.2	1.3	6.3	5.2	1.1
Total	\$2,117.2	\$938.4	\$1,178.8	\$2,507.8	\$1,372.3	\$1,135.6

SERS Alternative Formula Changes (P.A. 94-0004)

Prior to the enactment of P.A. 94-0004, all employees of the Department of Corrections were covered by the SERS alternative formula. Public Act 94-0004 provides that for employees entering service after July 1, 2005, only Department of Corrections employees who are headquartered at a correctional facility, parole officers, members of an apprehension unit, members of an intelligence unit, and DOC investigators will be covered by the alternative formula. New employees included in other groups currently covered by the alternative formula will continue to be eligible for the SERS alternative formula.

SURS Money Purchase Retirement Option Changes (P.A. 94-0004)

Public Act 94-0004 eliminated the Money Purchase Formula for employees who became members of SURS after July 1, 2005. The Money Purchase Formula was an actuarial based formula using the member's accumulation of retirement contributions and interest, multiplied by 2.4, and divided by an age-based actuarial factor. Beginning in FY 2006, the Act requires the Comptroller (rather

than the SURS Board of Trustees) to determine the interest rate to be used when crediting interest to the accounts of current employees.

Salary Increase Payments For Teachers and State University Personnel (P.A. 94-0004)

Public Act 94-0004 provided a mechanism by which the liability associated with salary increases above a certain level may be shifted to the employer (school districts and universities) providing those salary increases. The Act provides that during the years used to determine final average salary, the employer must pay to TRS or SURS an amount equal to the present value of the increase in benefits resulting from salary increases above 6%. The employer contribution required by Public Act 94-0004 must be paid in a lump sum within 30 days of the receipt of the bill from the retirement system. The Act specifies that the retirement system must calculate the contribution amount using the same actuarial assumptions and tables used for the most recent actuarial valuation.

The salary increase payment provision for TRS and SURS contained in Public Act 94-0004 does not apply to salaries paid under contracts or collective bargaining agreements entered into, amended, or renewed before the effective date of the Act (June 1, 2005).

Teacher Sick Leave Service Credit (P.A. 94-0004)

Prior to the enactment of P.A. 94-0004, members of TRS could establish up to 2 years of service credit for unused and uncompensated sick leave without making contributions. Public Act 94-0004 provides that if days granted by an employer are in excess of the normal annual sick leave allotment, the employer is required to contribute to TRS the normal cost of the benefits associated with this excess sick leave.

Retention of "Pipeline" Early Retirement Option in TRS (P.A. 94-0004)

An Early Retirement Option for members of TRS was created in 1980 and, prior to 2005, had been extended every 5 years since its inception. (Public Act 91-0017 extended the TRS ERO option until June 30, 2005). If an employee exercised the ERO option (i.e. retires before age 60 with less than 34 years of service) employee and employer contributions were required to avoid discount. The employee contribution was 7% of salary for each year less than age 60 or 35 years of service (whichever is less) and the employer contribution was 20% of salary for each year less than age 60. Public Act 92-0582 removed the employee contribution for members with 34 years of service and Public Act 91-0017 removed the employer contribution requirement for employees who retire with 34 years of service.

Public Act 94-0004 allowed TRS members to participate in the "pipeline" ERO if the member retired between June 30, 2005 and July 1, 2007.

New Early Retirement Option in TRS (P.A. 94-0004)

Public Act 94-0004 creates a new ERO effective July 1, 2005. If an employee exercises the new ERO option (retires before age 60) employee and employer contributions are required to avoid discount. The employee contribution is 11.5% of salary for each year less than age 60 or 35 years of service (whichever is less) and the employer contribution is 23.5% of salary for each year less than age 60. In addition, all active TRS members are required to contribute 0.4% of salary

towards the cost of ERO. This contribution would be refunded, without interest, if the member does not utilize the ERO, if the member takes a refund from TRS, if the member dies, or if the ERO is terminated.

By June 30, 2012 (and every 5 years thereafter), TRS is required to review the System's ERO experience to determine if the required contributions adequately fund the ERO. The TRS Board of Trustees must submit the results to the Commission on Government Forecasting and Accountability, who must then recommend to the General Assembly (by February 1, 2013) if the required ERO contributions should be adjusted. If the General Assembly does not adjust the required contributions as recommended, the ERO would be terminated at the end of that fiscal year.

Application of New Benefits (P.A. 94-0004)

Public Act 94-0004 requires every new benefit increase to identify and provide for additional funding at least sufficient to fund the resulting annual increase in cost as it accrues to the System. Unless the funding inadequacy is corrected by the General Assembly, the benefit increase would expire at the end of the fiscal year. In addition, Public Act 94-0004 provides that all benefit increases will expire 5 years after the effective date of the increase, unless an earlier date is specified in the legislation that provides the benefit increase.

Exemptions to 6% End-of-Career Salary Increase Cap (P.A. 94-1057)

P.A. 94-1057 amended both the Downstate Teachers' and State Universities' Articles of the Pension Code to exempt the employer (the university or the school district) from paying the increased contribution associated with certain salary increases above 6% granted during the employee's final average salary period. The Act applies to specifically enumerated salary increases granted between June 1, 2005 and July 1, 2011 as follows:

- Salary increases paid to teachers or university employees who are ten or more years away from retirement.
- Salary increases that result when a teacher is transferred from one employer to another as a result of school consolidation.
- Salary increases paid to teachers or university employees that are earned as a result of summer school or overload work. (Overload work must be for the sole purpose of academic instruction in excess of the standard number of instruction hours, and the overload pay must be necessary for the educational mission).
- Salary increases due to promotion for which a teacher is required to hold a certificate or supervisory endorsement issued by the State Teacher Certification Board. The certification must be different than what was required for the teacher's previous position, and the position must have existed and been filled by a member for no less than one complete academic year.
- Salary increase due to promotion for which a university employee moves to a higher classification under the State Universities Civil Service System,

promotion to a tenure-track faculty position, or promotion to a position recommended on a promotional list created by the Illinois Community College Board.

- Payments to a teacher from the State Board of Education or the State of Illinois over which the school district does not have discretion.
- Salary increases granted to teachers or university employees under the aforementioned conditions after July 1, 2011, but before July 1, 2014, pursuant to a contract or collective bargaining agreement entered into on or after June 1, 2005, but before July 1, 2011.

P.A. 94-1057 also requires both SURS and TRS to file a report with the Governor and General Assembly by January 1, 2007 outlining the number of recalculations performed by school districts or universities, the dollar amount by which each school district or university's contribution was changed due to the recalculation, and the total amount received from each school district or university as a result of P.A. 94-0004. The Act also requires both SURS and TRS to provide an estimate of the increase in state contributions resulting from the aforementioned end-of-career salary increase exemptions.

96th General Assembly (2009 – 2011)

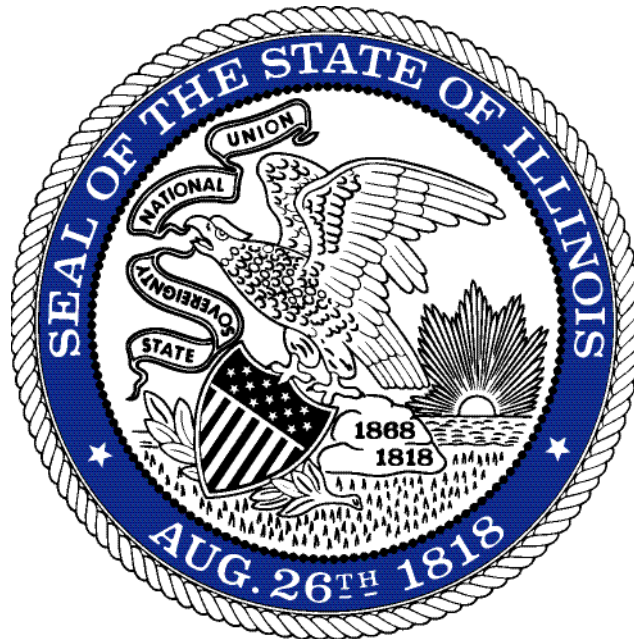
Pension Obligation Bonds (P.A. 96-0043)

P.A. 96-0043 mandates the issuance of new pension bonds totaling \$3.466 billion. The bond sale proceeds, net of sales expenses, will be used as a portion of the FY 2010 State contributions to the various State pension systems. Specifically, the Act establishes the FY2010 State pension contributions as follows: (1) TRS - \$2,089,268,000, (2) SERS - \$723,703,100, (3) SURS - \$702,514,000, (4) JRS - \$78,832,000, (5) GARS - \$10,454,000. The FY 2010 total inflows into each of the 5 systems from all sources will be equal to the GRF portion of the certified amounts for each system. In the event a portion of the bonds cannot be sold, the State contributions will be increased by an amount necessary to offset the unsold bond amount.

P.A. 96-0043 also establishes that as of June 30, 2008, the actuarial value of each system's assets will be equal to their market value. In determining the actuarial value of the systems' assets for fiscal years after June 30, 2008, any unexpected gains or losses from investment returns incurred in a fiscal year will be recognized in equal annual amounts over the 5 year period following that fiscal year. An unexpected gain or loss will be defined as any deviation from the forecasted 8.5% return on invested assets.

P.A. 96-0043 specifies the legislative intent that all of the operating funds freed up by the bond sale should be used to fund programs and services provided by community-based human services providers to ensure the State continues assisting the most vulnerable citizens.

II. Investments



Findings of the Investment Subcommittee

Investment Consolidation

At the present time, three boards oversee the investments of the five State-funded pension systems. The Illinois State Board of Investment (ISBI) oversees the investments of the General Assembly Retirement System, Judges Retirement System, and the State Employees Retirement System. The Teachers Retirement System and the State Universities Retirement System each invest their own assets independently.

In December of 2008, State Treasurer Alexi Giannoulis put forth a proposal to consolidate the investment activities of all five of the State-funded pension systems into a single investment entity, to be called the Illinois Public Employees Retirement System (ILPERS). The ILPERS proposal was introduced as SB 1734 in the spring legislative session, and the Commission on Government Forecasting and Accountability contracted with AON Investment Consulting to study the fiscal impact of the proposal.

On August 12th, 2009, the Investment Subcommittee of the Pension Modernization Task Force heard testimony from AON representatives William “Flick” Forna and Jack Dyer (the AON findings are set forth on pages 21-24 of this report). At the August 26th, 2009 meeting of the Investment Subcommittee, Task Force member Ed Rosenthal made a motion that the subcommittee recommend that the General Assembly not pursue investment consolidation. The subcommittee unanimously approved Mr. Rosenthal’s motion.

The Investment Subcommittee also heard testimony from the investment officers at TRS, SURS, and ISBI on a wide range of issues including each system’s respective asset allocation, utilization of female and minority investment managers, and the cost of statutorily-mandated Sudan and Iran divestiture requirements, among other matters. The written testimony of the retirement systems can be found in appendices K-M of this report.

Actuarially Assumed Rates of Return on Investment

Public and private sector retirement plans adopt an actuarial assumed rate of return on investments to determine the amount of contributions necessary to fund the plan, and to determine current and future payments on unfunded liabilities. The actuarial assumed rate of return on investment is the rate a plan is expected to earn over the long term.

Private sector retirement plans, regulated under the Employee Retirement Income Security Act (ERISA), are limited to a 6.1% actuarial assumed rate of return on investment for plan years beginning in 2009. An ERISA regulated

retirement plan jeopardizes losing its tax exempt status for implementing an assumed rate of return in excess of 6.1%.

The 5 State retirement systems' assumed rates of return range from 8% to 8.5%, exceeding ERISA limitations on tax qualified private sector retirement plans by 1.9% to 2.4%. The boards of the five State retirement systems are empowered by law to adjust their respective rates of return to better fit economic and actuarial changes.

This task force recognizes that the 5 state retirement systems have historically experienced investment returns comparable to their actuarial assumed rates of return on investments. However, the task force also notes that market volatility can jeopardize the accuracy of current actuarial assumed rates of return on investments and that volatility can have a significant impact on the amount of annual state contributions as well as the level of unfunded liability.

CGFA staff asked Mr. Fornia of AON Consulting to share his thoughts on the appropriateness of the systems' current investment return assumptions. His letter can be found on Page 25.

AON Consulting Analysis of Investment Consolidation Proposal

Executive Summary

- Savings:
 - Merging the systems would likely achieve investment manager fee savings
 - Ultimately savings are heavily dependent on how ILPERS structures its investments, and there are multiple possible scenarios
 - Based on the current manager configuration of the systems, our likely case, traditional asset manager fee savings is ≈\$21M in the first year of full implementation
- Costs:
 - Depending on the markets' volatility, the transition will cost between ≈\$31M and ≈\$48M
 - This suggests a pay back period of about 1½ to 2½ years



2

AON INVESTMENT CONSULTING

Sources of Potential Savings

- Investment management fees represent the **overwhelming** source of potential savings
 - In the year ended June 2008, the systems reported paying \$243M in fees with \$179M going to traditional managers
 - The vast majority of the savings will result from a reduction of traditional manager fees, although modest savings may ultimately be realized for alternative manager fees also
- Other potential savings, eliminating redundancies across the systems, provides only a modest savings, ≈\$2-3M per year
 - Actual savings achieved would be highly dependent on how ILPERS invested its assets and structured its operations



3

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Sources of Cost

- Transitioning the systems' assets into ILPERS is the **overwhelming** cost of merging the systems
- Other costs are minor and include such things as asset liability modeling, investment manager review and searches, custodian costs, etc.
 - Aon's estimate of these start-up costs is \$1.5M



4

Aon INVESTMENT CONSULTING

Estimating Traditional Fee Savings

- Aon contacted current managers from ISBI, TRS and SURS
- Used the survey information from the current managers to develop a template to model the savings of various manager consolidation scenarios
- Scenarios maintained the asset allocation and passive versus active strategies of the systems
- Reduced managers to take advantage of fee scaling but consider issues of concentration
- Our likely or base case estimate was for a savings of \$21M in the first full year of implementation.
- In a more optimistic case we estimated savings of \$35M
- In a pessimistic/worst case we consolidated only the overlapping managers with resultant savings of only \$1.5M



5

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Estimating Transition Costs

- Aon contacted leading transition managers
- Used implementation shortfall data from transition managers to estimate transition costs
- Used both volatile and less volatile market data
- Applied data to the actual value of assets moved in each scenario
- Aon contacted other large pension systems as “reality check”



6

AON INVESTMENT CONSULTING

Illinois Public Employees Retirement System Potential Investment Fee Impact of Proposed Merger

All figures in million dollars

- Estimated Aggregate Dollar Fee Savings on Traditional Assets When Fully Implemented	<u>Estimated Savings</u>	
- Estimated Cost of Transitioning Traditional Assets	\$20,225	
- Estimated ILPERS Start Up Cost	(\$34,378)	
	(\$1,500)	
	Current	Estimated Savings
	Cost / Fees	Percentage Nominal
- Estimated Savings Due to Consolidating Investment Oversight Staff	\$5,250	60%
- Estimated Long-term Alternative Asset Fee Savings	\$51,200	10%
- Estimated Custody Savings	\$1,600	60%
- Estimated Investment Consulting Savings	\$1,200	68%
	Total Estimated First Year (Cost) / Savings	(\$5,481)
Assumed Assets Net Growth Rate (including contributions and ben pmts)	6.00%	
Assumed Inflation Growth	2.25%	
Assumed Staff Cost Growth Rate	2.50%	
Assumed Custodial Fees Growth Rate	2.25%	
Discount Rate	6.00%	

	Year	Traditional Assets	Traditional Investment Fees Savings	Other Costs / Savings	Net Present Value
Update Present Value Calculation	1	\$32,389	\$20,225	-\$31,807	-\$10,926
	2	\$34,332	\$21,511	\$4,848	\$23,459
	3	\$36,392	\$22,852	\$5,708	\$23,979
	4	\$38,576	\$24,292	\$6,659	\$24,517
	5	\$40,890	\$25,834	\$7,710	\$25,066
	6	\$43,344	\$27,456	\$8,898	\$25,607
	7	\$45,944	\$29,143	\$10,144	\$26,128
	8	\$48,701	\$30,952	\$11,546	\$26,664
	9	\$51,623	\$32,884	\$24,367	\$33,887
	10	\$54,721	\$34,943	\$25,722	\$33,875

Discounted value of estimated 10 years savings \$232
Break-even Year 2



7

AON INVESTMENT CONSULTING

Bottom Line

Initial traditional manager fee savings	\$20-30M
Other initial savings	≈\$5M
As assets grow savings grow, year 10 =	≈\$50M - \$60M
Depending on market volatility consolidation costs are:	\$30M - \$50M
Implied payback period	1½ yrs - 2½ yrs





October 16, 2009

Daniel A. Hankiewicz
Pension Manager
Commission on Government Forecasting & Accountability
703 Stratton Office Building
Springfield, IL 62706

Re: Investment Return Assumptions

Dear Dan:

You asked that I give you my thoughts on appropriate investment return assumptions for public pension funds. This is because the Pension System Modernization Task Force may be considering taking a position that the 8.5% investment return assumption used by most Illinois Statewide Retirement systems is too optimistic and should be lowered.

An actuarial assumed rate of return is typically based on the asset allocations used by the underlying pension systems. Based on our review of the Illinois systems, an assumption of 8.5% does not seem unreasonable. I have not conducted an analysis of all issues relating to selection of investment return assumption, but if I had, I might recommend that the systems use an assumption of 8.25% or 8.00%, however.

In order to select an investment return rate, actuaries follow the Actuarial Standard of Practice (ASOP) no. 27, which governs selection of economic assumptions for measuring pension obligations. This ASOP has many aspects, including analyzing cash flows, asset allocations and inflation expectations. Actuaries also often look to system investment consultants for their estimates of returns and variance in the returns. Actuaries may run a Monte Carlo simulation, which projects the return on assets numerous times, and then examines the annual returns determined in each projection in aggregate. Under actuarial standards of practice known as "best estimate range", a return assumption is generally assumed to be reasonable if it falls within this 25th to 75th percentile range.

The 2007 Public Fund Survey, which surveyed 125 public pension plans with estimated combined assets of 2.6 trillion dollars, found a median investment return assumption is 8.0%. Of these 125 plans, the highest investment return assumption is 8.50%, which was used by 20 of the plans.

A second study of public plans finds similar results. In their 2009 Wilshire Report on State Retirement Systems: Funding Levels and Asset Allocation, Wilshire Consulting examined the asset allocation for 125 state retirement systems. This study took the asset allocations of the 125 plans, as well its own assumptions on asset returns for each asset class, and found a median expected return of 7.5%, which is again lower than the 8.5% selected for the Illinois plans. When focused on real returns, the Wilshire study probably does not show as much of a



Aon Consulting

Employee Benefits Consulting

disparity, because they use an inflation assumption which is likely also lower than that used by the Illinois plans.

While I do not find the 8.50% assumption unreasonable, at first blush, an assumption of 8.25% or 8.00% might be considered more reasonable.

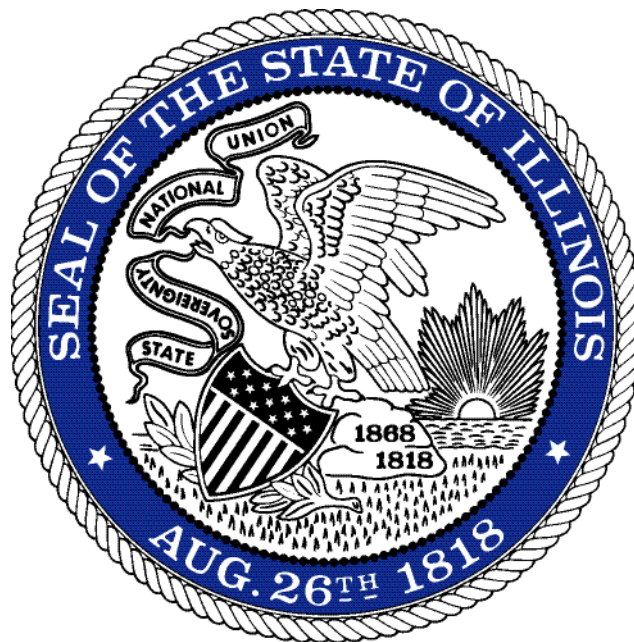
Please call me if you would like to discuss this further.

Sincerely,

A handwritten signature in black ink, appearing to read "W B Forna".

William B. Forna, F.S.A., E.A.
Senior Vice President
(303) 782-3394
(303) 782-3307 (fax)

III. Benefits



Findings of the Benefits Subcommittee

The work of the Benefits Subcommittee centered around two key questions:

- 1) Is the current level of benefits in line with other states?
- 2) How much savings could be derived from Gov. Quinn's two-tier proposal?

Is the current level of benefits in line with other states?

In order to find an answer to the first question, the Benefits Subcommittee examined the findings contained in the Wisconsin Legislative Council's 2006 Comparative Study of Major Public Employee Retirement Systems. In order to determine how Illinois compares to the 85 public employee retirement systems surveyed in the Wisconsin study, the subcommittee examined four categories: age and years of service, employee contribution rates, retirement formulas, and post-retirement annuity cost-of-living adjustments. The results of this examination are set forth on pages 36-37. In the four categories that the subcommittee studied, Illinois's state-funded retirement systems were generally found to be in the statistical median.

The Benefits Subcommittee also invited the Oregon Public Employees Retirement System to discuss their state's experience with a multi-level pension system. The discussion revealed that Oregon's third-tier benefits cost their state 4-5% of salary more than TRS costs the State of Illinois. Oregon's total retirement costs equaled 12.1% of payroll, while Illinois' cost for TRS will drop to 6.63% in the coming years. Oregon public employees receive Social Security benefits in addition to their pension while Illinois teachers do not.

The Subcommittee studied the total retirement costs of neighboring states: Indiana (12.85%), Iowa (14.24%), Kentucky (7.25%), Michigan (11.8%), Missouri (8.71%), and Wisconsin (10.6%). Thus, the Benefits Subcommittee concluded that the future cost of TRS (6.63%) to Illinois is clearly not out of line with other states.

Regarding the Public vs. Private Sector Retirement Comparison: The Task Force found that the state's normal retirement costs are comparable and at times less than the cost of the private sector model. To that point, it must be clearly understood that 78% of those in the state retirement systems do not receive Social Security coverage. Every single employer in the private sector must provide Social Security coverage for their employees. This is a cost to private employers amounting to 6.2% of their payroll.

Additionally, many private employers provide a contribution to a 401k plan. According to a press release from the "51st Annual Survey of Profit Sharing and 401k Plans" report, "Private company retirement contributions averaged 4.4 percent of payroll. They are highest in profit sharing plans (8.6 percent of pay) and lowest in 401(k) plans (3.2 percent of pay)". Adding the average employer contribution of 4.4% of pay to the mandatory 6.2% of payroll

payable towards Social Security amounts to a total private employer contribution of 10.6% of pay. When you compare this to the state's normal cost of TRS at 6.63%, the private sector retirement costs are more expensive.

How much savings could be derived from Gov. Quinn's two-tier proposal?

The Benefits Subcommittee asked the Commission on Government Forecasting and Accountability to study the two-tier pension proposal that Gov. Quinn announced during his FY 2010 budget address on March 18, 2009. The results of the cost study are shown on pages 38-39. The Commission's actuary, Sandor Goldstein, studied the cost savings associated with each individual component of the proposal against the backdrop of the current funding plan. As shown on page 38, increasing the retirement age to 67 would have the greatest impact, saving \$88.3 billion in state contributions over the life of the funding plan. It should be noted that when the actuary studied the individual components of Gov. Quinn's plan, all other aspects of the plan were held constant. For example, in the scenario where only the retirement age is increased, the current benefit formula is held in place. In the scenario where only the benefit formula is reduced, the current retirement age is held in place. When all of the components of the plan are combined, as shown on page 38, the total savings is less than the savings associated with increasing the retirement age only. CGFA staff asked Mr. Goldstein to explain this result, and his letter can be found on page 40.

In sum, the subcommittee finds that the current benefit structure is not the primary contributor to the current pension crisis; the main culprit is the State's inability to fund its pension systems according to actuarial principals. Gov. Quinn's reform proposal could reduce future pension liability over an extended period of time if pension funding were to remain constant. Significant savings would not be realized for approximately 25 – 30 years. However, it is ultimately up to policy makers to determine if the current retirement costs are reasonable. The Subcommittee outlined previously that Illinois' retirement costs are lower than our neighboring states. Notably, the changing of benefits will not reduce the state's current unfunded pension liability, nor will it make any changes to the required pension payments in the near-term.

State Employees' Retirement System

Regular Formula - Plan Summary

Retirement Age

- ❑ “Rule of 85” – retirement when member’s age plus years of service equals 85.
- ❑ Age 60 with 8 years of service credit.
- ❑ Age 55 with at least 25 years of service (reduced one-half of one percent for each month the member is under age 60).

Retirement Formula

- ❑ 1.67% of final average salary for each year of service for members covered by Social Security.
- ❑ 2.2% of final average salary for each year of service credit for members not covered by Social Security.

Maximum Annuity

- ❑ 75% of final average salary.

Salary Used to Calculate Pension

- ❑ Highest 48 consecutive months of service within the last 120 months of service.

Annual COLA

- ❑ 3% compounded.

Employee Contributions

- ❑ 4.0% of salary for members covered by Social Security.
- ❑ 8.0% of salary for members not covered by Social Security.

State Employees' Retirement System Alternative Formula - Plan Summary

Retirement Age

- ☐ Age 55 with at least 20 years of service.
- ☐ Age 50 with at least 25 years of service.

Retirement Formula

- ☐ 2.5% of final average salary for each year of service for members covered by Social Security.
- ☐ 3.0% of final average salary for each year of service credit for members not covered by Social Security.

Maximum Annuity

- ☐ 80% of final average salary.

Salary Used to Calculate Pension

- ☐ Rate of pay on the last day of employment, or the average of the last 48 months of compensation, whichever is greater.

Annual COLA

- ☐ 3% compounded.

Employee Contributions

- ☐ 8.5% of salary for members covered by Social Security.
- ☐ 12.5% of salary for members not covered by Social Security.

State Universities Retirement System

Traditional Defined Benefit Formula Plan Summary

Retirement Age

- ☐ Age 62 with at least 5 years of service.
- ☐ Age 60 with at least 8 years of service.
- ☐ Any age with 30 years of service.

Retirement Formula

- ☐ 2.2% of final average salary for each year of service.

Maximum Annuity

- ☐ 80% of final average salary.

Salary Used to Calculate Pension

- ☐ For hourly employees and those who receive an annual salary in installments during 12 months of each academic year, the 48 consecutive calendar-month period ending with the last day of final termination of employment or the 4 consecutive academic years of service in which the employee's earnings were the highest, whichever is greater.
- ☐ For all other employees, the average annual earnings during the 4 consecutive academic years of service which his or her earnings were the highest.

Annual COLA

- ☐ 3% compounded.

Employee Contributions

- ☐ 8.0% of salary.

Teachers Retirement System Defined Benefit Plan Summary

Retirement Age

- ☐ Age 62 with 5 years of service credit.
- ☐ Age 60 with 10 years of service credit.
- ☐ Age 55 with 20 years of service credit (discounted annuity or Early Retirement Option)
- ☐ Age 55 with 35 years of service credit.
- ☐ “Rule of 85” for TRS members who are employees of the State of Illinois.

Retirement Formula

- ☐ 2.2% of final average salary for each year of service credit earned after June 30, 1998 (prior years under graduated formula can be upgraded).

Maximum Annuity

- ☐ 75% of final average salary.

Salary Used to Calculate Pension

- ☐ Average of the four highest consecutive annual salary rates within the last 10 years of service.

Annual COLA

- ☐ 3% compounded.

Employee Contributions

- ☐ 9.4% of salary.

Judges' Retirement System Plan Summary

Retirement Age

- ❑ Age 60 with 10 years of service.
- ❑ Age 62 with 6 years of service.
- ❑ Age 55 with 10 years of service (reduced $\frac{1}{2}$ of 1% for each month under 60).

Retirement Formula

- ❑ 3.5% of final salary for each of the first 10 years of service, plus
- ❑ 5% of final salary for each year of service in excess of 10 years.

Maximum Annuity

- ❑ 85% of final salary.

Salary Used to Calculate Pension

- ❑ Salary on last day of service.

Annual COLA

- ❑ 3% compounded.

Employee Contributions

- ❑ 11.0% of salary.

General Assembly Retirement System Plan Summary

Retirement Age

- ❑ Age 55 with 8 years of service.
- ❑ Age 62 with at least 4 years of service.

Retirement Formula

- ❑ 3.0% of final salary for each of the first 4 years of service, plus
- ❑ 3.5% of final salary for each of the next 2 years of service, plus
- ❑ 4.0% of final salary for each of the next 2 years of service, plus
- ❑ 4.5% of final salary for each of the next 4 years of service, plus
- ❑ 5.0% of final salary for each year of service in excess of 12 years

Maximum Annuity

- ❑ 85% of final salary.

Salary Used to Calculate Pension

- ❑ Salary on last day of service.

Annual COLA

- ❑ 3% compounded.

Employee Contributions

- ❑ 11.5% of salary.

Comparison of IL Systems to Other Major Public Employee Retirement Systems

Normal Retirement			
<u>Years of Service / Age</u>	<u>2000</u>	<u>2006</u>	<u>IL State Retirement Systems</u>
35 years of service/age 55 or older	8 plans	7 plans	TRS
30 years of service/age 55 or older	28 plans	28 plans	SURS
28 years of service/age 55 or older	3 plans	4 plans	-
27 years of service/age 55 or older	2 plans	2 plans	-
25 years of service/age 55 or older	12 plans	11 plans	SERS (Reg. Formula)
20 years of service/age 55 or older	4 plans	4 plans	SERS (Alt. Formula)
TOTAL	57 plans	56 plans	

Source: Wisconsin Legislative Council, 2006 Comparative Study of Major Public Employee Retirement Systems, p. 10 (available at: http://www.legis.state.wi.us/lc/publications/crs/2006_retirement.pdf)

"Rule of Y"			
<u>Rule of Y</u>	<u>1996</u>	<u>2006</u>	<u>IL State Retirement Systems</u>
Rule of 90	4 plans	3 plans	-
Rule of 88	1 plan	1 plan	-
Rule of 85	3 plans	5 plans	SERS (Reg. Formula)
Rule of 80	4 plans	5 plans	-
TOTAL	12 plans	14 plans	

Source: Wisconsin Legislative Council, 2006 Comparative Study of Major Public Employee Retirement Systems, p. 10 (available at: http://www.legis.state.wi.us/lc/publications/crs/2006_retirement.pdf)

Employee Contribution Rates as a Percentage of Pay			
<u>Contribution Rates</u>	<u>2000</u>	<u>2006</u>	<u>IL Retirement Systems</u>
5% or less	34 plans	28 plans	SERS (Reg. Formula)
More than 5%	35 plans	45 plans	SERS (Alt. Formula), SURS, TRS, JRS, GARS
Rate varies (usually by age or employee classification)	6 plans	6 plans	-
Plan is noncontributory	10 plans	6 plans	-
TOTAL	85 plans	85 plans	

Source: Wisconsin Legislative Council, 2006 Comparative Study of Major Public Employee Retirement Systems, p. 15 (available at: http://www.legis.state.wi.us/lc/publications/crs/2006_retirement.pdf)

Formula Multiplier			
Formula Multiplier	2000	2006	IL State Retirement Systems
1.1% to 1.3%	3 plans	-	-
Over 1.3% to 1.5%	3 plans	2 plans	-
Over 1.5% to 1.7%	18 plans	12 plans	SERS (Reg. Formula)
Over 1.7% to 1.9%	12 plans	14 plans	-
Over 1.9% to 2.1%	19 plans	24 plans	-
Over 2.1%	7 plans	8 plans	SERS (Alt. Formula), SURS, TRS, JRS, GARS
Employer determines formula multiplier	2 plans	2 plans	-
Formula benefit plus money purchase	2 plans	4 plans	-
Money purchase plan	2 plans	2 plans	-
TOTAL	68 plans	68 plans	

Source: Wisconsin Legislative Council, 2006 Comparative Study of Major Public Employee Retirement Systems, p. 22 (available at: http://www.legis.state.wi.us/lc/publications/crs/2006_retirement.pdf)

Post-Retirement Annuity Cost-of-Living Adjustments			
	2002	2006	IL State Retirement Systems
Adjustments indexed to CPI	39 plans	38 plans	-
Automatic percentage increase	22 plans	23 plans	SERS (Reg. Formula), SERS (Alt. Formula), SURS, TRS, JRS, GARS
Investment surplus	3 plans	4 plans	-
Ad hoc (any increase must be authorized by Legislature or a decision-making board) or money purchase	21 plans	20 plans	-
TOTAL	85 plans	85 plans	

Source: Wisconsin Legislative Council, 2006 Comparative Study of Major Public Employee Retirement Systems, p. 28 (available at: http://www.legis.state.wi.us/lc/publications/crs/2006_retirement.pdf)

CGFA Actuarial Analysis of Two-Tier Proposal

CGFA Analysis of Governor's Two-Tier Pension Proposal Reduction in State Contributions as Compared to Current Law, Fiscal Years 2010 - 2045 FY 2010 Contribution Assumed to be Equal to Amount Certified (\$ in millions)						
Benefit Change	TRS	SERS	SURS	JRS	GARS	Total Reduction
Increase Retirement Age						
- Age 67 or Age 62 with 35 Years of Service*	29,636.8	7,666.7	6,339.2	1,066.8	83.1	44,792.5
- Age 67 (Age 65 for TRS) or Age 62 with 35 Years of Service	22,472.7	7,666.7	6,339.2	1,066.8	83.1	37,628.4
- Age 65 or Age 62 with 35 Years of Service	22,472.7	7,117.4	5,177.3	1,004.5	75.0	35,846.9
Elimination of Subsidized Survivor Benefits	1,690.2	666.0	1,092.3	405.5	23.8	3,877.8
Reduced Retirement Benefit Formula	4,639.4	1,963.1	1,916.2	1,387.8	91.8	9,998.3
- Benefit Formula Equal to 2.0% of FAS						
- 1.5% Coordinated with Social Security						
- Maximum 70% of FAS						
Change to 8-Year FAS Period	4,509.7	1,747.1	1,874.1	398.0	26.3	8,555.2
Change in Automatic Annual Increases	6,855.8	2,457.7	2,636.3	337.0	22.3	12,309.1
- Lesser of 3% or 1/2 of CPI						
Salary over \$150,000 Not Pensionable	23,964.4	4,905.9	3,043.1	1,176.4	10.2	33,100.0
Salary Limited to \$150,000 Indexed for Inflation	3,185.1	14.0	807.9	246.3	2.8	4,256.1
All Changes Combined*	34,644.1	8,615.1	8,637.0	1,889.1	96.0	53,881.4

*All Changes Combined only assumes an Increased Retirement Age of Age 67 or Age 62 with 35 Years of Service

CGFA Actuarial Analysis of Two-Tier Proposal

CGFA Analysis of Governor's Two-Tier Pension Proposal Reduction in Accrued Liability as Compared to Current Law, Fiscal Years 2010 - 2045 FY 2010 Contribution Assumed to be Equal to Amount Certified Baseline: -25% Investment Return Assumption (\$ in millions)						
Benefit Change	TRS	SERS	SURS	JRS	GARS	Total Reduction
Increase Retirement Age						
- Age 67 or Age 62 with 35 Years of Service*	83,749.3	18,166.5	15,871.8	1,075.4	123.1	118,986.1
- Age 67 (Age 65 for TRS) or Age 62 with 35 Years of Service	61,393.6	18,166.5	15,871.8	1,075.4	123.1	96,630.5
- Age 65 or Age 62 with 35 Years of Service	61,393.6	16,413.7	12,248.5	910.6	100.6	91,067.0
Elimination of Subsidized Survivor Benefits	15,380.3	2,780.1	3,926.5	999.1	60.2	23,146.2
Reduced Retirement Benefit Formula	25,417.8	6,192.6	4,555.0	3,027.2	219.6	39,412.1
- Benefit Formula Equal to 2.0% of FAS						
- 1.5% Coordinated with Social Security						
- Maximum 70% of FAS						
Change to 8-Year FAS Period	24,978.2	5,511.4	4,454.9	868.2	63.0	35,875.6
Change in Automatic Annual Increases	32,935.4	7,753.1	6,266.9	735.1	53.3	47,743.8
- Lesser of 3% or 1/2 of CPI						
Salary over \$150,000 Not Pensionable	138,123.7	26,512.7	15,825.3	4,420.2	36.5	184,918.3
Salary Limited to \$150,000 Indexed for Inflation	27,691.6	67.0	3,006.1	2,400.7	(16.2)	33,149.2
All Changes Combined*	190,733.8	47,265.7	33,739.6	5,375.4	350.6	277,465.1

*All Changes Combined only assumes an increased retirement age of 67 or age 62 with 35 years of service

October 20, 2009

Mr. Dan Hankiewicz
Commission on Government
Forecasting and Accountability
Room 703
Stratton Office Building
Springfield, Illinois 62706

Re: Funding Projections for Governor's Budget Proposal

Dear Dan:

At the request of the Pension Modernization Task Force, we have provided you with separate funding projections for each of the proposed benefit changes for new employees in the Governor's budget proposal. We have also provided a combined funding projection that includes all of the proposed benefit changes for new employees in the Governor's budget proposal.

For the five systems combined, our projections for the proposed change in the retirement age eligibility showed a total reduction in State contributions through 2045 of approximately \$88.3 billion. Our projections for all of the proposed changes combined showed a total reduction in State contributions of approximately \$53.9 billion.

You have asked me to explain why the total reduction in State contributions for all of the proposed changes combined is less than the total reduction in State contributions for the change in the retirement age eligibility alone. One reason for this is that one of the proposed changes is a reduction in contributions for new employees. This proposed change is estimated to result in an increase in State contributions of approximately \$28.2 billion. This increase in State contributions is included in the projections for all of the proposed changes combined but not in the projections for only the change in retirement age eligibility. Also the \$28.2 billion increase in State contributions is based on all other benefit provisions remaining unchanged. With the proposed increase in retirement age eligibility, the increase in State contributions will actually be considerably higher than this amount.

In addition, the \$88.3 billion reduction in State contributions for the proposed change in retirement age eligibility is based on all other benefit provisions being unchanged. With the other proposed reductions in benefits for new employees, the reduction in State contributions for the proposed change in retirement age eligibility will be considerably less than this amount.

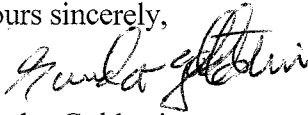
GOLDSTEIN & ASSOCIATES
Actuaries and Consultants

Mr. Dan Hankiewicz
October 20, 2009
Page 2

Therefore, it is important to keep in mind that all of the proposed changes interact with each other and it is not possible to assess the impact of all of the proposed changes combined by looking at the impact of the individual proposed changes.

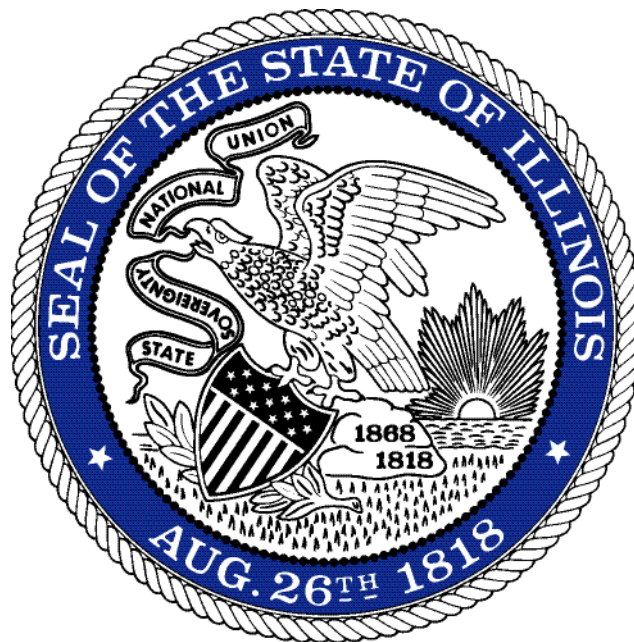
If you have any questions regarding the above, please let me know.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Sandor Goldstein", written over the typed name.

Sandor Goldstein
Consulting Actuary

IV. Funding



Findings of the Funding Subcommittee

Without a doubt, funding the accrued liability of the five State pension systems will continue to be the single greatest financial challenge facing the State of Illinois. The Funding Subcommittee heard testimony from various outside groups on subjects such as asset transfers, further pension bonding, and the creation of municipal IPO's as solutions to reducing the unfunded liability. While these subjects provided for a wide-ranging discussion, no consensus was reached regarding asset transfers or alternatives to the current funding plan.

The table below outlines CGFA's initial estimate of the FY 2011 budget hole. As shown in the table, approximately half of the \$11.4 billion budget deficit is due to pension-related spending pressures: an additional \$3.5 billion from General Funds will be required to replace the GRF portion of the FY 2010 contribution that came from the pension obligation notes authorized by P.A. 96-0043; \$800 million in first-year debt service payments on the pension notes; and an additional \$1.2 billion to meet the statutorily-required pension funding obligation under P.A. 88-593.

FY 2011 Budget Hole [Base]	
*Excludes non-pension related spending pressures	
Gap from one-time FY 2010 Revenues	\$5,784
Pension Note Proceeds	\$3,466
Federal Stimulus	\$1,966
Fund Sweeps	\$352
1st Year Repay of Pension Notes	\$800
Estimated Pension Increase	\$1,200
Carry forward of FY 2010 Deficit	\$3,673
FY 2011 Budget Hole [Base]	\$11,457

Note - CGFA staff will present an updated revenue forecast in the spring legislative session, and the projected FY 2011 budget hole will likely be revised upwards at that time.

The funding requirements under current law are outlined beginning on page 47.

How did we get here?

The reality is that the primary cause of the State's unfunded pension liability is Illinois's decades-long failure to make its full, actuarially required employer contribution to the five pension systems. This poor fiscal practice was codified in the 1995 pension funding bill "P.A. 88-0593," known commonly as the "**Pension Ramp**" bill. During the first 15 years of the Pension Ramp, the State's employer contribution was set at levels that continued the practice of not making the full actuarially required employer contribution, thereby increasing the unfunded liability amount. This poor fiscal practice was followed by a \$10 billion pension obligation bond issue in 2003 (P.A. 93-0002), which diverted \$2.7 billion of the bond proceeds to cover expenses in the state's operating budget, thereby allowing the state to skip part of the FY 03 and all of the FY 04 payment required under the 1995 funding law. In addition, P.A. 94-0004 reduced the FY 06 and FY 07 payments by \$2.3 billion. The deadly combination of nearly 30 years of systematic State underfunding of its employer contributions to the pension systems, followed by the cataclysmic decline in asset values caused by the national meltdown in financial markets over the last year, combined to create an all-time high in the State's unfunded pension liability.

The State's failure to make its required employer contributions to the five pension systems can in turn be traced to one, simple cause: a State fiscal system that is so poorly designed that it failed for decades to generate enough revenue growth to both maintain service levels from one year to the next, and cover the State's actuarially required employer contribution to its five pension systems. This ongoing "structural deficit" imposed a tough fiscal/political choice on State elected officials – fully fund pensions and dramatically cut services, or skip a portion of the pension payment and maintain as many services as possible. Not wanting to implement dramatic cuts in spending on essential services, the legislature and various governors elected to instead divert revenue from making the required employer pension contribution to maintaining services like education, healthcare, public safety and caring for disadvantaged populations. Effectively, the State used the pension systems as a credit card to fund ongoing service operations.

What should the State do?

Given that the State's poorly designed revenue system created the structural deficit that in turn incentivized elected officials to shortchange the State's employer contributions to its pension systems, pension funding reform is not possible without enhancing State revenue. (In theory, the State budget also could be balanced by an enormous reduction in expenditures, but there is little likelihood that the General Assembly could make such cuts without reducing social services and programs to politically unacceptable levels). If State revenue is to be enhanced, it should be done in a manner that: (i) reforms major aspects of Illinois's flawed revenue system; and (ii) modernizes the fiscal system to both comport with the State's economy and support long-term economic growth. As a final note, the unfunded liability has grown to such a significant size that a new, rational payment schedule, one that front-loads costs, should also be considered.

By adhering to the 1995 funding schedule, the State is essentially borrowing money from future generations to pay for current operating expenses. Deferring current pension payments will only exacerbate the State's pension funding problem and diminish the positive effects of a restructured benefit system for new hires if one is created. Under current pension laws the State's FY2011 required pension contribution is estimated at \$4.5 billion with a \$700 million debt service payment on the FY 2010 pension notes authorized by P.A. 96-0043, so if it fails to make the \$4.0 billion certified contribution for FY2010 it will be enormously difficult for the State to find the political will to make the full payment in FY 2011 and beyond.

The Funding Subcommittee recommends the State stay the course, and, at a minimum, adhere to the 1995 pension funding plan. Though not perfect, the current funding plan allows forward progress to be made in the funding ratios of the pension plans. We support many of the pension payment plans that surfaced during the subcommittee's discussions and believe paying down debt is good public policy. However, with no new revenue sources to support these ideas, they are not feasible at this time. The Funding subcommittee also was presented with numerous asset-transfer ideas, including the sale of the lottery and the toll way and other state assets. We recommend COGFA analyze data and thoroughly study these ideas to present recommendations to the General Assembly to ensure they have the necessary information to make a sound decision on any asset transfers.

Pension Obligation Bonds

Several members of the subcommittee favor the continued limited use of Pension Obligation Bonds ("POBs"), such as those suggested in the 95th General Assembly by Senator Don Harmon (SB 788), but only when market conditions are favorable and only as a debt swap to refinance a portion of the existing unfunded liability. POBs issued so far have been used in large measure as a substitute for regular pension contributions, in effect borrowing to pay the ongoing cost of pension benefits. Proponents contend that in the future, the State should use POBs primarily as a pure debt swap and in tandem with the actuarial required contributions for normal cost and the unfunded liability on the books of the pension funds. Repayments to bondholders should be done on a level-dollar basis (and never back-loaded). David Vaught of Governor Quinn's Office testified that bonding a portion of the unfunded liability, if financed at less than the actuarial rate, would provide the following benefits: a down payment to supplement regular annual payments; long-term savings; needed cash for reinvestment by the pension systems; and a more secure guarantee of payment by the State.

Critics of POBs fear that the State will use these bonds as an excuse not to fund the pensions out of current revenues in future years. Opponents of new POBs expressed these additional concerns: Pension bonds would create an additional "full faith and credit" obligation on the part of the State. The State already has to pay off the \$10 billion in bonds issued under Governor Blagojevich. It also will have to pay off the \$3.5 billion in pension notes that

were approved earlier this year. The State has recognized the dangers of too much debt by setting a limit on the amount of general obligation bonds it may issue (based on the amount of debt service on all outstanding bonds as a percentage of general fund appropriations – currently set at 7%). With the additional borrowing necessary to fund the new capital plan, the addition of more pension obligation bonds might put the State's debt over this limit.

FUNDING PROJECTIONS FOR THE STATE RETIREMENT SYSTEMS

All Five Systems Combined

Retirement System Projections with Asset Smoothing

Estimated Contribution Based on Laws in Effect on June 30, 2008*

(\$ in millions)

Fiscal Year	Annual Payroll	Total State Contribution	State Contribution as a % of Payroll	Total Employee Contribution	Accrued Liabilities	Assets	Unfunded Liabilities	Funded Ratio
2009					124,970.6	63,854.5	61,116.1	51.1%
2010	17,541.4	4,046.6	23.1%	1,420.6	131,322.5	63,181.0	68,141.5	48.1%
2011	18,149.2	4,503.1	24.8%	1,469.3	137,862.7	62,494.9	75,367.8	45.3%
2012	18,867.8	4,903.1	26.0%	1,525.1	144,546.2	61,767.7	82,778.5	42.7%
2013	19,616.9	5,356.1	27.3%	1,583.2	151,365.7	61,065.7	90,300.0	40.3%
2014	20,405.8	5,829.7	28.6%	1,645.6	158,321.1	64,343.5	93,977.6	40.6%
2015	21,243.4	6,323.3	29.8%	1,712.9	165,419.5	68,082.7	97,336.8	41.2%
2016	22,134.0	6,637.6	30.0%	1,784.9	172,672.0	72,105.2	100,566.8	41.8%
2017	23,072.9	6,940.5	30.1%	1,861.7	180,085.5	76,386.1	103,699.5	42.4%
2018	24,063.4	7,254.7	30.1%	1,943.0	187,678.7	80,923.4	106,755.3	43.1%
2019	25,104.1	7,580.3	30.2%	2,028.3	195,459.5	85,694.9	109,764.6	43.8%
2020	26,198.9	7,902.2	30.2%	2,118.0	203,442.7	90,694.9	112,747.8	44.6%
2021	27,350.6	8,242.9	30.1%	2,213.2	211,647.8	95,957.4	115,690.3	45.3%
2022	28,562.6	8,604.2	30.1%	2,313.6	220,093.2	101,520.6	118,572.7	46.1%
2023	29,837.8	8,986.5	30.1%	2,419.4	228,798.1	107,431.5	121,366.7	47.0%
2024	31,163.4	9,367.5	30.1%	2,530.5	237,783.8	113,713.3	127,070.5	47.8%
2025	32,540.1	9,767.0	30.0%	2,645.5	247,065.0	120,398.9	126,666.1	48.7%
2026	33,975.9	10,209.4	30.0%	2,766.4	256,670.3	127,575.0	129,095.3	49.7%
2027	35,471.3	10,672.7	30.1%	2,891.8	266,613.0	135,295.7	131,317.3	50.7%
2028	37,026.5	11,136.0	30.1%	3,020.5	276,906.0	143,580.7	133,325.2	51.9%
2029	38,659.4	11,627.3	30.1%	3,153.6	287,577.8	152,467.6	135,110.2	53.0%
2030	40,372.6	12,126.3	30.0%	3,294.9	298,586.9	161,973.2	136,613.7	54.2%
2031	42,128.2	12,642.0	30.0%	3,438.3	310,020.5	172,201.5	137,819.0	55.5%
2032	43,988.6	13,217.5	30.0%	3,591.7	321,902.4	183,280.8	138,621.6	56.9%
2033	45,929.3	13,836.8	30.1%	3,752.4	334,248.0	195,309.6	138,938.4	58.4%
2034	47,962.3	15,324.9	32.0%	3,917.8	347,085.5	209,438.9	137,646.6	60.3%
2035	50,097.4	16,001.6	31.9%	4,090.1	360,458.5	224,788.6	135,669.8	62.4%
2036	52,338.8	16,711.7	31.9%	4,270.1	374,416.5	241,494.8	132,921.7	64.5%
2037	54,699.8	17,459.6	31.9%	4,464.4	389,012.8	259,711.9	129,301.0	66.8%
2038	57,174.9	18,243.3	31.9%	4,671.8	404,270.8	279,612.2	124,658.6	69.2%
2039	59,769.1	19,064.6	31.9%	4,883.7	420,241.5	301,326.3	118,915.3	71.7%
2040	62,513.1	19,933.6	31.9%	5,108.1	436,995.9	325,003.1	111,992.8	74.4%
2041	65,424.3	20,855.8	31.9%	5,350.6	454,641.2	350,864.2	103,777.0	77.2%
2042	68,483.6	21,824.8	31.9%	5,608.5	473,255.5	379,302.8	93,952.7	80.1%
2043	71,677.7	22,836.0	31.9%	5,871.9	492,879.2	410,451.8	82,427.4	83.3%
2044	75,007.8	23,889.7	31.8%	6,146.2	513,562.9	444,541.7	69,021.2	86.6%
2045	78,485.1	24,989.6	31.8%	6,433.8	535,368.3	481,834.3	53,534.0	90.0%

* Note - All Projections shown herein are based on estimated FY 2009 asset and liability figures generated by the retirement systems' actuaries at the request of CGFA staff, with the exception of SERS. The SERS projections are based on a draft of the system's 2009 actuarial report. All numbers shown in this section of the report are subject to change upon the release of each system's FY 2009 actuarial report.

FUNDING PROJECTIONS FOR THE TEACHERS' RETIREMENT SYSTEM
With (25%) Return in FY 2009 and Five-Year Prospective Smoothing
(\$ in millions)

Fiscal Year	Annual Payroll	Total State Contribution	State Contribution as a % of Payroll	Total Employee Contribution	Accrued Liabilities	Assets	Unfunded Liabilities	Funded Ratio
2009					72,307.5	37,900.5	34,406.9	52.4%
2010	9,252.8	2,087.7	23.4%	909.0	76,100.2	37,603.8	38,496.4	49.4%
2011	9,642.3	2,307.1	24.8%	944.1	79,987.7	37,144.6	42,843.1	46.4%
2012	10,047.7	2,517.2	26.0%	981.1	83,966.5	36,543.4	47,423.1	43.5%
2013	10,476.7	2,777.0	27.5%	1,020.0	88,038.8	35,860.4	52,178.4	40.7%
2014	10,934.7	3,057.4	29.0%	1,062.5	92,213.6	37,598.1	54,615.4	40.8%
2015	11,426.3	3,359.3	30.5%	1,109.1	96,512.6	39,699.9	56,812.8	41.1%
2016	11,954.5	3,556.9	30.8%	1,159.5	100,958.0	42,065.9	58,892.1	41.7%
2017	12,516.6	3,745.0	31.0%	1,213.8	105,571.2	44,687.8	60,883.4	42.3%
2018	13,108.3	3,937.4	31.1%	1,271.2	110,369.3	47,558.1	62,811.2	43.1%
2019	13,730.0	4,135.6	31.2%	1,331.2	115,365.9	50,652.4	64,713.5	43.9%
2020	14,385.5	4,328.7	31.2%	1,394.4	120,580.8	53,972.0	66,608.8	44.8%
2021	15,075.3	4,533.7	31.2%	1,461.6	126,035.0	57,545.8	68,489.1	45.7%
2022	15,800.9	4,751.3	31.2%	1,532.5	131,753.7	61,406.6	70,347.1	46.6%
2023	16,561.1	4,981.3	31.2%	1,607.1	137,754.6	65,590.3	72,164.2	47.6%
2024	17,351.9	5,208.4	31.1%	1,685.2	144,055.2	70,117.1	73,938.0	48.7%
2025	18,175.5	5,448.7	31.1%	1,766.2	150,672.2	75,012.2	75,660.0	49.8%
2026	19,031.5	5,716.0	31.1%	1,851.4	157,620.7	80,328.2	77,292.5	51.0%
2027	19,915.7	5,994.0	31.2%	1,938.8	164,909.3	86,098.8	78,810.5	52.2%
2028	20,827.7	6,268.4	31.2%	2,027.5	172,539.2	92,327.9	80,211.3	53.5%
2029	21,783.9	6,559.4	31.2%	2,118.3	180,528.8	99,024.5	81,504.2	54.9%
2030	22,782.6	6,852.2	31.2%	2,214.8	188,895.9	106,238.0	82,657.9	56.2%
2031	23,818.5	7,160.2	31.2%	2,313.7	197,653.2	114,007.3	83,645.9	57.7%
2032	24,889.6	7,496.9	31.2%	2,417.6	206,802.0	122,391.6	84,410.4	59.2%
2033	25,995.3	7,861.4	31.3%	2,525.9	216,332.8	131,431.2	84,901.6	60.8%
2034	27,145.5	8,968.1	34.2%	2,635.7	226,245.8	141,937.6	84,308.2	62.7%
2035	28,349.1	9,365.7	34.2%	2,749.3	236,560.8	153,241.4	83,319.4	64.8%
2036	29,610.5	9,782.5	34.2%	2,867.3	247,302.0	165,417.1	81,884.9	66.9%
2037	30,939.3	10,221.5	34.2%	2,996.3	258,495.2	178,553.0	79,942.2	69.1%
2038	32,330.0	10,680.9	34.2%	3,135.1	270,135.1	192,749.6	77,385.4	71.4%
2039	33,790.8	11,163.5	34.2%	3,275.5	282,250.7	208,068.7	74,182.0	73.7%
2040	35,349.4	11,678.5	34.2%	3,425.2	294,890.6	224,586.7	70,303.9	76.2%
2041	37,022.2	12,231.1	34.2%	3,589.6	308,144.3	242,449.8	65,694.5	78.7%
2042	38,786.7	12,814.0	34.2%	3,765.8	322,069.3	261,970.6	60,098.7	81.3%
2043	40,629.3	13,422.8	34.2%	3,944.2	336,689.7	283,196.6	53,493.1	84.1%
2044	42,546.7	14,056.2	34.2%	4,129.6	352,038.1	306,266.8	45,771.3	87.0%
2045	44,549.3	14,717.8	34.2%	4,324.4	368,163.4	331,347.0	36,816.3	90.0%
2046	46,645.0	4,279.6	9.5%	4,528.9	385,131.9	346,618.7	38,513.2	90.0%

FUNDING PROJECTIONS FOR THE STATE EMPLOYEES' RETIREMENT SYSTEM
With (19.7%) Return in FY 2009 and Five-Year Prospective Smoothing
(\$ in millions)

Fiscal Year	Annual Payroll	Total State Contribution	State Contribution as a % of Payroll	Total Employee Contribution	Accrued Liabilities	Assets	Unfunded Liabilities	Funded Ratio
2009					25,298.3	11,000.0	14,298.4	43.5%
2010	4,113.0	1,167.1	28.4%	234.6	26,642.2	11,090.9	15,551.3	41.6%
2011	4,194.2	1,268.9	30.3%	239.7	28,074.0	11,268.8	16,805.2	40.1%
2012	4,359.8	1,361.7	31.2%	249.4	29,559.4	11,518.4	18,041.0	39.0%
2013	4,525.4	1,456.5	32.2%	259.1	31,091.8	11,845.2	19,246.6	38.1%
2014	4,692.5	1,551.1	33.1%	268.8	32,666.5	12,855.8	19,810.8	39.4%
2015	4,863.7	1,646.1	33.8%	278.8	34,278.7	13,940.1	20,338.5	40.7%
2016	5,039.3	1,706.8	33.9%	288.9	35,921.8	15,060.0	20,861.8	41.9%
2017	5,219.7	1,767.9	33.9%	299.3	37,591.7	16,208.4	21,383.3	43.1%
2018	5,406.3	1,831.2	33.9%	310.0	39,287.1	17,386.6	21,900.6	44.3%
2019	5,600.2	1,897.0	33.9%	321.2	41,002.5	18,591.8	22,410.6	45.3%
2020	5,801.9	1,964.4	33.9%	332.8	42,733.0	19,818.2	22,914.8	46.4%
2021	6,011.5	2,034.6	33.8%	344.8	44,475.1	21,065.7	23,409.4	47.4%
2022	6,230.2	2,108.1	33.8%	357.3	46,222.5	22,333.4	23,889.2	48.3%
2023	6,459.9	2,184.6	33.8%	370.2	47,974.2	23,623.3	24,350.9	49.2%
2024	6,693.5	2,263.1	33.8%	383.5	49,728.0	24,934.0	27,794.0	50.1%
2025	6,927.6	2,341.2	33.8%	396.7	51,477.5	26,261.5	25,216.0	51.0%
2026	7,170.1	2,423.5	33.8%	410.3	53,227.4	27,618.5	25,608.9	51.9%
2027	7,425.2	2,510.4	33.8%	424.6	54,976.9	29,011.2	25,965.7	52.8%
2028	7,691.6	2,599.9	33.8%	439.5	56,731.4	30,445.3	26,286.1	53.7%
2029	7,971.8	2,694.5	33.8%	455.2	58,497.2	31,933.4	26,563.8	54.6%
2030	8,267.5	2,793.3	33.8%	471.9	60,207.5	33,430.8	26,776.7	55.5%
2031	8,545.7	2,886.3	33.8%	486.7	61,932.6	34,983.8	26,948.8	56.5%
2032	8,868.4	2,996.3	33.8%	505.0	63,685.3	36,631.9	27,053.4	57.5%
2033	9,211.7	3,114.6	33.8%	524.5	65,482.6	38,407.6	27,075.0	58.7%
2034	9,575.1	3,353.6	35.0%	545.4	67,339.3	40,623.0	26,716.3	60.3%
2035	9,958.5	3,487.9	35.0%	567.4	69,267.8	43,043.9	26,223.9	62.1%
2036	10,361.8	3,629.1	35.0%	590.8	71,283.2	45,701.1	25,582.0	64.1%
2037	10,785.0	3,777.3	35.0%	615.3	73,398.3	48,625.5	24,772.8	66.2%
2038	11,227.3	3,932.3	35.0%	640.9	75,625.0	51,848.5	23,776.5	68.6%
2039	11,687.5	4,093.4	35.0%	667.6	77,971.6	55,399.9	22,571.7	71.1%
2040	12,165.7	4,260.9	35.0%	695.2	80,448.2	59,312.9	21,135.3	73.7%
2041	12,662.5	4,434.9	35.0%	723.9	83,062.3	63,620.8	19,441.5	76.6%
2042	13,177.8	4,615.4	35.0%	753.6	85,820.1	68,357.7	17,462.4	79.7%
2043	13,711.0	4,802.2	35.0%	784.3	88,729.4	73,561.2	15,168.2	82.9%
2044	14,264.0	4,995.8	35.0%	816.0	91,796.8	79,270.8	12,526.0	86.4%
2045	14,836.7	5,196.4	35.0%	848.8	95,027.5	85,527.6	9,499.9	90.0%

FUNDING PROJECTIONS FOR THE STATE UNIVERSITIES RETIREMENT SYSTEMS
With (20%) Return in FY 2009 and Five-Year Prospective Smoothing
(\$ in millions)

Fiscal Year	Annual Payroll	Total State Contribution	State Contribution as a % of Payroll	Total Employee Contribution	Accrued Liabilities	Assets	Unfunded Liabilities	Funded Ratio
2009					25,600.1	14,267.6	11,332.5	55.7%
2010	3,999.6	702.5	17.6%	275.1	26,741.0	13,786.6	12,954.4	51.6%
2011	4,129.3	826.2	20.0%	283.5	27,884.0	13,361.7	14,522.3	47.9%
2012	4,269.5	919.9	21.5%	292.6	29,022.9	12,967.8	16,055.0	44.7%
2013	4,416.9	1,013.6	22.9%	302.0	30,153.8	12,604.1	17,549.6	41.8%
2014	4,574.0	1,108.1	24.2%	312.1	31,273.1	13,079.0	18,194.0	41.8%
2015	4,740.6	1,199.5	25.3%	322.8	32,369.8	13,575.4	18,794.4	41.9%
2016	4,918.9	1,250.4	25.4%	334.2	33,440.5	14,051.4	19,389.1	42.0%
2017	5,106.4	1,299.0	25.4%	346.2	34,474.0	14,497.2	19,976.8	42.1%
2018	5,309.3	1,352.1	25.5%	359.3	35,473.4	14,917.2	20,556.3	42.1%
2019	5,524.9	1,408.2	25.5%	373.2	36,437.9	15,315.3	21,122.6	42.0%
2020	5,752.5	1,464.4	25.5%	388.1	37,367.4	15,691.0	21,676.3	42.0%
2021	5,994.5	1,524.4	25.4%	403.9	38,263.6	16,049.0	22,214.6	41.9%
2022	6,251.4	1,588.9	25.4%	420.9	39,126.1	16,395.4	22,730.7	41.9%
2023	6,525.8	1,658.7	25.4%	439.1	39,957.9	16,739.0	23,218.9	41.9%
2024	6,815.3	1,728.1	25.4%	458.5	40,764.6	17,084.4	23,680.1	41.9%
2025	7,122.3	1,803.1	25.3%	479.3	41,550.7	17,443.2	24,107.5	42.0%
2026	7,446.9	1,888.5	25.4%	501.3	42,324.6	17,835.0	24,489.6	42.1%
2027	7,790.1	1,979.4	25.4%	524.8	43,091.5	18,273.4	24,818.1	42.4%
2028	8,153.0	2,071.2	25.4%	549.7	43,858.4	18,768.9	25,089.5	42.8%
2029	8,535.5	2,169.1	25.4%	576.2	44,628.2	19,336.3	25,291.9	43.3%
2030	8,939.5	2,268.6	25.4%	604.2	45,408.1	19,987.5	25,420.6	44.0%
2031	9,365.8	2,375.4	25.4%	633.7	46,201.7	20,740.3	25,461.4	44.9%
2032	9,816.3	2,494.8	25.4%	664.7	47,018.8	21,622.4	25,396.4	46.0%
2033	10,291.7	2,621.1	25.5%	697.5	47,866.9	22,658.1	25,208.7	47.3%
2034	10,793.7	2,748.4	25.5%	732.0	48,758.3	23,868.5	24,889.8	49.0%
2035	11,323.8	2,882.9	25.5%	768.5	49,704.2	25,281.4	24,422.9	50.9%
2036	11,881.9	3,024.5	25.5%	807.0	50,714.6	26,925.7	23,788.9	53.1%
2037	12,471.5	3,174.1	25.5%	847.5	51,803.2	28,835.7	22,967.6	55.7%
2038	13,093.4	3,332.0	25.4%	890.2	52,986.8	31,049.9	21,936.9	58.6%
2039	13,745.8	3,497.7	25.4%	934.9	54,278.4	33,605.7	20,672.7	61.9%
2040	14,431.1	3,671.8	25.4%	981.7	55,689.7	36,540.7	19,149.1	65.6%
2041	15,150.1	3,854.5	25.4%	1,030.9	57,230.3	39,894.6	17,335.7	69.7%
2042	15,905.9	4,046.6	25.4%	1,082.5	58,914.3	43,712.2	15,202.1	74.2%
2043	16,699.8	4,248.4	25.4%	1,136.7	60,749.4	48,039.0	12,710.4	79.1%
2044	17,534.0	4,460.6	25.4%	1,193.6	62,746.9	52,925.0	9,821.9	84.3%
2045	18,409.5	4,683.2	25.4%	1,253.3	64,913.1	58,421.8	6,491.3	90.0%

FUNDING PROJECTIONS FOR THE JUDGES' RETIREMENT SYSTEM
With (19.7%) Return in FY 2009 and Five-Year Prospective Smoothing
(\$ in millions)

Fiscal Year	Annual Payroll	Total State Contribution	State Contribution as a % of Payroll	Total Employee Contribution	Accrued Liabilities	Assets	Unfunded Liabilities	Funded Ratio
2009					1,525.2	615.2	910.0	40.3%
2010	161.2	78.8	48.9%	17.7%	1,595.9	632.2	963.7	39.6%
2011	168.1	89.4	53.2%	18.5%	1,670.0	656.1	1,013.9	39.3%
2012	174.7	92.4	52.9%	19.2%	1,746.6	679.0	1,067.5	38.9%
2013	181.3	96.4	53.1%	19.9%	1,826.6	701.9	1,124.7	38.4%
2014	187.5	100.1	53.4%	20.6%	1,909.2	757.4	1,151.7	39.7%
2015	195.0	104.7	53.7%	21.5%	1,995.5	814.9	1,180.5	40.8%
2016	202.8	109.2	53.8%	22.3%	2,084.5	876.0	1,208.5	42.0%
2017	211.0	113.8	54.0%	23.2%	2,177.0	941.0	1,236.0	43.2%
2018	219.4	118.4	54.0%	24.1%	2,272.7	1,009.9	1,262.8	44.4%
2019	228.2	123.3	54.0%	25.1%	2,372.4	1,083.2	1,289.2	45.7%
2020	237.3	127.9	53.9%	26.1%	2,475.7	1,160.6	1,315.1	46.9%
2021	246.8	132.8	53.8%	27.1%	2,583.2	1,242.7	1,340.6	48.1%
2022	256.7	138.0	53.8%	28.2%	2,694.8	1,329.5	1,365.3	49.3%
2023	266.9	143.4	53.7%	29.4%	2,810.2	1,421.4	1,388.8	50.6%
2024	277.6	148.7	53.6%	30.5%	2,929.4	1,518.1	1,411.3	51.8%
2025	288.7	154.3	53.4%	31.8%	3,052.5	1,619.9	1,432.6	53.1%
2026	300.3	160.7	53.5%	33.0%	3,179.7	1,727.9	1,451.8	54.3%
2027	312.3	167.4	53.6%	34.3%	3,311.3	1,842.7	1,468.6	55.6%
2028	324.8	174.0	53.6%	35.7%	3,446.6	1,963.9	1,482.6	57.0%
2029	337.7	180.9	53.6%	37.2%	3,586.4	2,092.5	1,493.8	58.3%
2030	351.3	187.8	53.5%	38.6%	3,730.7	2,228.6	1,502.1	59.7%
2031	365.3	195.1	53.4%	40.2%	3,880.3	2,373.3	1,506.9	61.2%
2032	379.9	203.3	53.5%	41.8%	4,035.1	2,527.9	1,507.2	62.6%
2033	395.1	212.4	53.7%	43.5%	4,195.5	2,693.8	1,501.7	64.2%
2034	410.9	225.3	54.8%	45.2%	4,362.0	2,875.8	1,486.2	65.9%
2035	427.4	234.3	54.8%	47.0%	4,535.0	3,070.9	1,464.1	67.7%
2036	444.5	243.6	54.8%	48.9%	4,714.9	3,280.3	1,434.7	69.6%
2037	462.2	253.4	54.8%	50.8%	4,902.1	3,505.2	1,397.0	71.5%
2038	480.7	263.5	54.8%	52.9%	5,097.0	3,746.9	1,350.1	73.5%
2039	499.9	274.1	54.8%	55.0%	5,300.2	4,007.0	1,293.2	75.6%
2040	519.9	285.0	54.8%	57.2%	5,512.0	4,286.9	1,225.0	77.8%
2041	540.7	296.4	54.8%	59.5%	5,733.1	4,588.5	1,144.6	80.0%
2042	562.4	308.3	54.8%	61.9%	5,964.0	4,913.5	1,050.5	82.4%
2043	584.9	320.6	54.8%	64.3%	6,205.0	5,263.6	941.4	84.8%
2044	608.3	333.4	54.8%	66.9%	6,456.9	5,641.1	815.8	87.4%
2045	632.6	346.8	54.8%	69.6%	6,720.2	6,048.2	672.0	90.0%

FUNDING PROJECTIONS FOR THE GENERAL ASSEMBLY RETIREMENT SYSTEM
With (19.7%) Return in FY 2009 and Five-Year Prospective Smoothing
(\$ in millions)

Fiscal Year	Annual Payroll	Total State Contribution	State Contribution as a % of Payroll	Total Employee Contribution	Accrued Liabilities	Assets	Unfunded Liabilities	Funded Ratio
2009					239.5	71.2	168.2	29.7%
2010	14.8	10.5	70.8%	1.7	243.3	67.5	175.8	27.8%
2011	15.3	11.6	75.8%	1.8	247.1	63.7	183.3	25.8%
2012	15.9	12.0	75.1%	1.8	250.8	59.0	191.8	23.5%
2013	16.6	12.6	75.8%	1.9	254.7	54.1	200.6	21.2%
2014	17.2	13.1	76.3%	2.0	258.8	53.1	205.7	20.5%
2015	17.8	13.7	76.8%	2.0	263.0	52.4	210.6	19.9%
2016	18.5	14.3	77.4%	2.1	267.2	51.9	215.3	19.4%
2017	19.2	14.9	77.4%	2.2	271.6	51.6	220.0	19.0%
2018	20.1	15.6	77.5%	2.3	276.2	51.7	224.4	18.7%
2019	20.9	16.2	77.6%	2.4	280.9	52.2	228.7	18.6%
2020	21.7	16.8	77.3%	2.5	285.8	53.1	232.7	18.6%
2021	22.5	17.3	77.1%	2.6	290.9	54.2	236.7	18.6%
2022	23.4	18.0	77.0%	2.7	296.0	55.6	240.4	18.8%
2023	24.2	18.6	76.8%	2.8	301.3	57.4	243.9	19.1%
2024	25.2	19.2	76.5%	2.9	306.6	59.6	247.1	19.4%
2025	26.0	19.8	76.1%	3.0	312.1	62.1	250.0	19.9%
2026	27.1	20.7	76.4%	3.1	317.9	65.4	252.5	20.6%
2027	28.1	21.5	76.5%	3.2	324.0	69.6	254.4	21.5%
2028	29.4	22.5	76.5%	3.4	330.4	74.7	255.7	22.6%
2029	30.5	23.3	76.5%	3.5	337.3	80.8	256.4	24.0%
2030	31.8	24.2	76.3%	3.7	344.7	88.2	256.5	25.6%
2031	32.9	25.1	76.1%	3.8	352.7	96.8	255.9	27.4%
2032	34.4	26.2	76.3%	4.0	361.3	107.0	254.2	29.6%
2033	35.6	27.3	76.8%	4.1	370.3	119.0	251.3	32.1%
2034	37.1	29.5	79.7%	4.3	380.1	134.0	246.1	35.2%
2035	38.6	30.7	79.7%	4.4	390.6	151.1	239.5	38.7%
2036	40.1	32.0	79.7%	4.6	401.9	170.6	231.3	42.4%
2037	41.7	33.2	79.7%	4.8	413.9	192.5	221.4	46.5%
2038	43.4	34.6	79.7%	5.0	426.9	217.3	209.6	50.9%
2039	45.1	35.9	79.7%	5.2	440.7	244.9	195.7	55.6%
2040	46.9	37.4	79.7%	5.4	455.4	275.9	179.5	60.6%
2041	48.8	38.9	79.7%	5.6	471.1	310.5	160.6	65.9%
2042	50.8	40.5	79.7%	5.8	487.9	348.9	139.0	71.5%
2043	52.7	42.0	79.7%	6.1	505.6	391.3	114.3	77.4%
2044	54.9	43.7	79.7%	6.3	524.3	438.1	86.2	83.6%
2045	57.0	45.4	79.7%	6.6	544.1	489.7	54.4	90.0%

V. Letters & Minority Reports



V. Letters & Minority Reports

Minority Report of the Civic Committee of
The Commercial Club of Chicago

Pension Modernization Task Force

Minority Report of the Civic Committee of The Commercial Club of Chicago

I. Factual Background

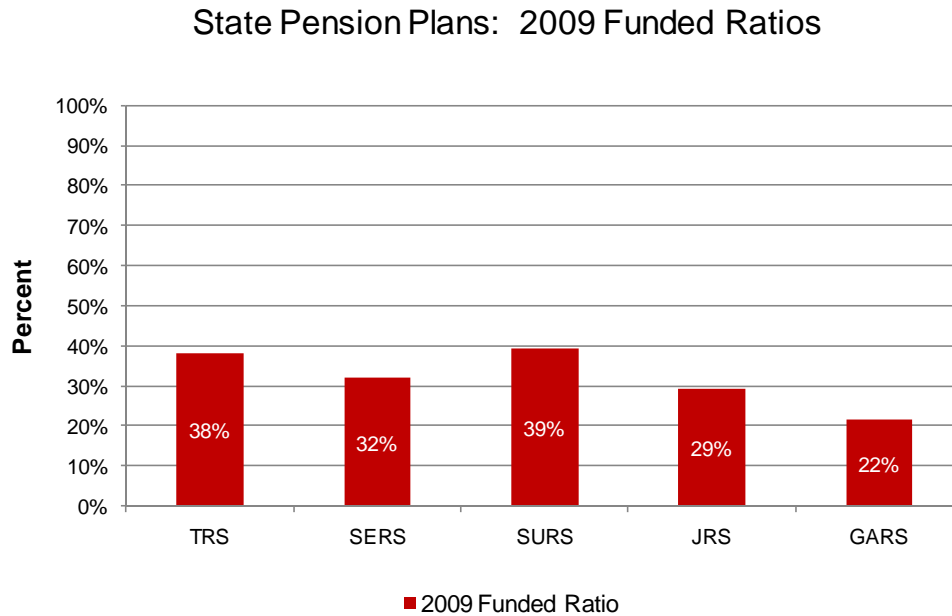
The State of Illinois is nearly bankrupt. The operating budget for the current fiscal year, FY2010, is not balanced. The Commission on Government Forecasting and Accountability material submitted to this Task Force suggests (at p. 42) that the State's current real budget deficit for FY2010 – after eliminating borrowed money from revenues, and eliminating one-time, non-recurring revenue sources, and taking into account the real economic costs of the pensions and retiree health care – may be in the range of \$15 billion. One of the main reasons we are in this fiscal mess is that Illinois does not adequately fund its pension costs. It has not done so for at least a decade. (The State likewise does not adequately fund its retiree health care costs.) The State's "normal" pension costs amount to about \$1.6 Billion per year. But the State's \$79 billion of piled-up unfunded pension obligations is increasing – due to reversal of the 8.5% discount rate – to the extent of about \$6.7 billion per year. Just to keep the unfunded obligation from growing, the State should be funding pensions to the extent of about \$8.3 billion out of operating revenues.

Illinois cannot afford to continue to fund adequately – or pay – these pensions. Nor should it. The level of pension benefits provided by the State's plans generally exceeds those available in the private sector – i.e. available to taxpayers who pay the State's bills.

The State's pension plans must be reformed and made less costly. And adequate funding – consistent with actuarial principles – must be provided. Illinois cannot and should not continue to deal with its pension costs by borrowing – by transferring the current cost of pensions to future budgets and generations of taxpayers. If Illinois does not seriously address these problems now, there may soon come a time when no combination of service cuts or tax increases will be sufficient to cover these mounting costs. Taxpayers will be unwilling to pay both current costs and those left over from the past. They will take their businesses, their investments, and their jobs to another state – one unburdened by a huge costly legacy from the past. The longer we wait to fix our pension problems, the more we jeopardize our future.

The basic facts are not in dispute. Illinois' pension funds are radically underfunded (Figure 1).

Figure 1



Source: Commission on Government Forecasting and Accountability Pension Briefing, April 2009

The underfunding of these pension plans is so serious that it threatens the fiscal stability of the State and its subdivisions – municipalities, schools and other local government agencies throughout Illinois that rely on State funding or revenue-sharing¹. In the coming years, the annual contributions necessary to pay off the mountain of pension debt will rise and consume a larger and larger share of the State's annual revenues. The State then will be faced with two difficult choices: massive cutting of State expenditures and grants, or raising taxes to such a high level that some businesses and residents will flee Illinois. Or both.

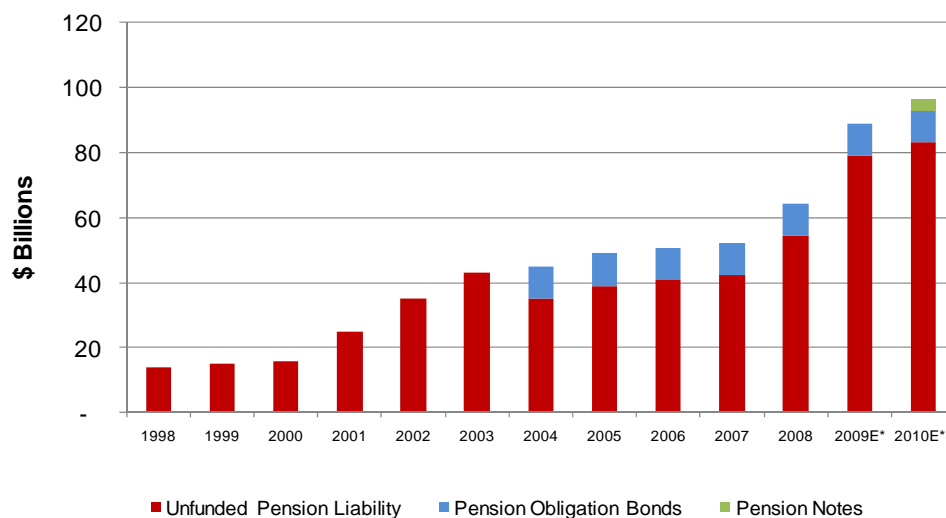
The pension debt crisis has been in the making for years. The main reason we have such an enormous unfunded liability today is because in the past, instead of balancing budgets and making hard choices, the State has borrowed to cover current costs. In particular, the State has failed to cover the costs of public pensions on a current basis, instead shifting them from the present to the future through underfunding and also through borrowing in the form of pension bonds or pension notes.

¹ For example, local governments currently receive a 10% share of the State's personal income tax revenue; they also receive 1.25% of the total State and local sales tax rate of 6.25%. In addition, most school districts are dependent on the State for "foundation level" school funding.

The State's total pension obligation – both the unfunded obligation and the remaining pension debt – has jumped in the last 10 years from \$15 billion at the end of FY1999 to \$89 billion at the end of FY2009 (Figure 2). That obligation is expected to rise to more than \$95 billion by the end of FY2010, as the unfunded liability continues to grow and the State takes on even more pension debt with the issuance of \$3.5 billion in pension notes to pay its statutory FY2010 pension contribution (Figure 2).

Figure 2

State Unfunded Pension Liability and Other Pension Debt



*Estimate is based on COGFA April 2009 Pension Briefing projection of \$78.9 B unfunded liability at the end of FY2009.

**Estimate is based on COGFA April 2009 Pension Briefing projection of \$83 B unfunded liability at the end of FY2010 and \$3.5 B in pension notes issued in FY2010. The Governor's proposed \$16 B in new pension bonds would not change the total amount of pension debt, but would convert approximately \$16 B (minus transaction costs) of unfunded liability into pension obligation bonds.

Source: "2008 Bonded Indebtedness Report of the State of Illinois," January 2009, Commission on Government Forecasting and Accountability; Commission on Government Forecasting and Accountability Monthly Briefing, April 2009; "Report on the Financial Condition of the State Retirement Systems," February 2009, Commission on Government Forecasting and Accountability; Commission on Government Forecasting and Accountability Monthly Briefing, February 2009; "Report on the Financial Condition of the State Retirement Systems," February 2008, Commission on Government Forecasting and Accountability; "Report on the Financial Condition of the State Retirement Systems," July 2007, Commission on Government Forecasting and Accountability; Historical unfunded liability data from Senate GOP staff.

Figure 2 shows that as of the end of the most recent fiscal year – FY2009 – which was June 30, 2009, the State's unfunded liabilities in its pension plans added up to about \$79 billion (Pension Briefing April 2009, Commission on Government Forecasting and Accountability).

The Commission on Government Forecasting and Accountability (COGFA) recently submitted to this Task Force a statement showing that the unfunded liabilities are much less – only \$61 billion. COGFA's statement is simply false. The amount of the unfunded liabilities does vary over time because both the amount of the liabilities and the values of the assets in the funds vary. However, the most recent information with respect to these liabilities and asset values – as of the end of FY2009 – shows that the unfunded liabilities amount to approximately \$79 billion. The lower number was calculated by

COGFA using a methodology that does not accurately reflect the financial condition of the State's pension plans.

COGFA's calculation is purportedly based on a law passed by the Legislature permitting "asset smoothing" (Senate Bill 1292). Senate Bill 1292 allows "*for purposes of determining the required State contribution...* for fiscal years after June 30, 2008, any actuarial gains or losses from investment return incurred in a fiscal year shall be recognized in equal annual amounts over the 5-year period following that fiscal year." But in determining and reporting the *financial reality* – including the unfunded status – of the pension funds, "asset smoothing" cannot possibly justify false reporting. The economic reality is that (1) the present value of the liabilities in the pension funds as of 6/30/09 was about \$125 billion, and (2) the present value of the assets in the pension funds as of 6/30/09 was about \$46 billion. The unfunded liability as of 6/30/09 was *in fact* \$79 billion -- not \$61 billion.

II. Why Illinois' Pensions are so Massively Underfunded.

The pension funding crisis is the result of a number of factors.

A. Benefits more generous and more costly than those generally available in the private sector.

State retirees currently receive more generous pension benefits than those available to most Illinois taxpayers. Generally speaking, the State's five pension plans permit employees to receive "normal" (unreduced) retirement at or before the age of 60 with 8-10 years of service (depending on the plan). Pensions are based on average total salary in the highest consecutive 4 years within the last 10 years of employment. Retirees receive annual increases to their pensions intended to offset increases in the cost of living (COLA). These increases are 3% per year, compounded.

Some State retirement system provisions are even more generous than those described above. Members of the General Assembly may retire at the age of 55 if they have 8 years of service or more, and the formula used to determine their retirement benefit is quite generous – once they have achieved 20 years of service, members of the General Assembly will receive 85% of their salary on the last day of their service. In essence, a legislator who wins his/her seat at the age of 35, and retains it for the next 20 years, may retire at the age of 55 and receive 85% of final salary each year thereafter – with a 3% annual cost-of-living adjustment, compounded.

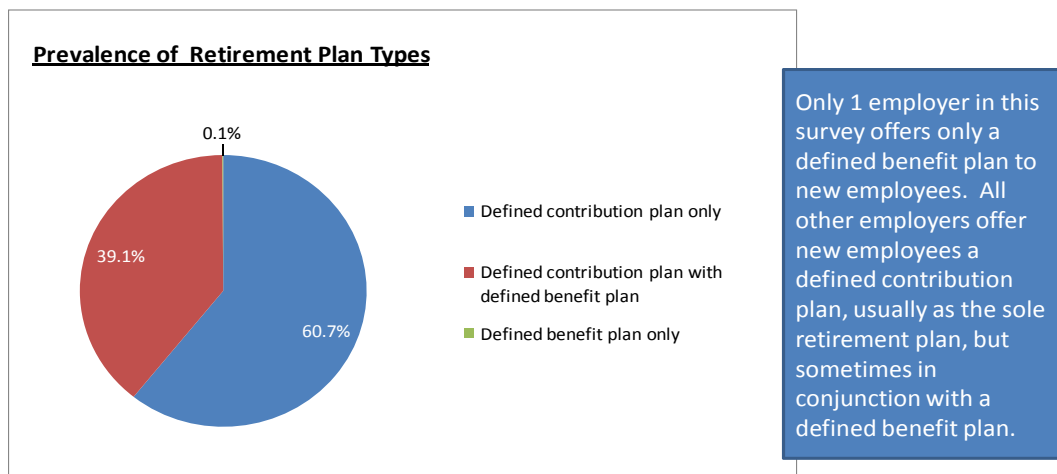
Some participants in the State Employees Retirement System receive more generous benefits under the "alternative formula," which applies not only to higher-risk jobs such as fire fighters, State police and State highway maintenance workers, but also to revenue investigators and commerce commission police officers. Alternative formula employees may retire at age 55 with at least 20 years of service and age 50 with at least 25 years of service, and they accrue benefits at a higher rate than other State employees. Their pension benefit is calculated based on their rate of pay on the last day of employment, or the average of the last 48 months of compensation, whichever is *greater* (and then receive the 3% compounded COLA after retirement).

In the private sector, employee pensions have in recent years become less generous – and less costly – as a result of competitive and other economic pressures on employers. Many companies have shifted away from defined benefit plans to defined contribution plans, and others have retained defined benefit plans but trimmed benefits.² Still others have adopted two-tier plans – one for existing employees whose rights have vested, and new ones for new employees.³

For new employees, defined contribution plans are overwhelmingly prevalent in the private sector; only one employer in a recent Hewitt Associates survey offered only a defined benefit plan to new employees (Figure 3). More than half of surveyed employers offered only a defined contribution plan to new employees, and the rest offered a defined benefit plan in conjunction with a defined contribution plan.

Figure 3

**Prevalence of Defined Benefit and Defined Contribution Plans:
New Employees in the Private Sector**



Source: Hewitt Associates survey of 940 private sector employers

² Private sector employees also participate in Social Security, which requires additional contributions by both the employee and employer each year and provides additional benefits upon retirement. Almost 80% of State employees do not participate in Social Security. State employees as a group have had opportunities to join Social Security in the past, but have declined participation, which has allowed both the employees and the State to avoid making annual Social Security contributions.

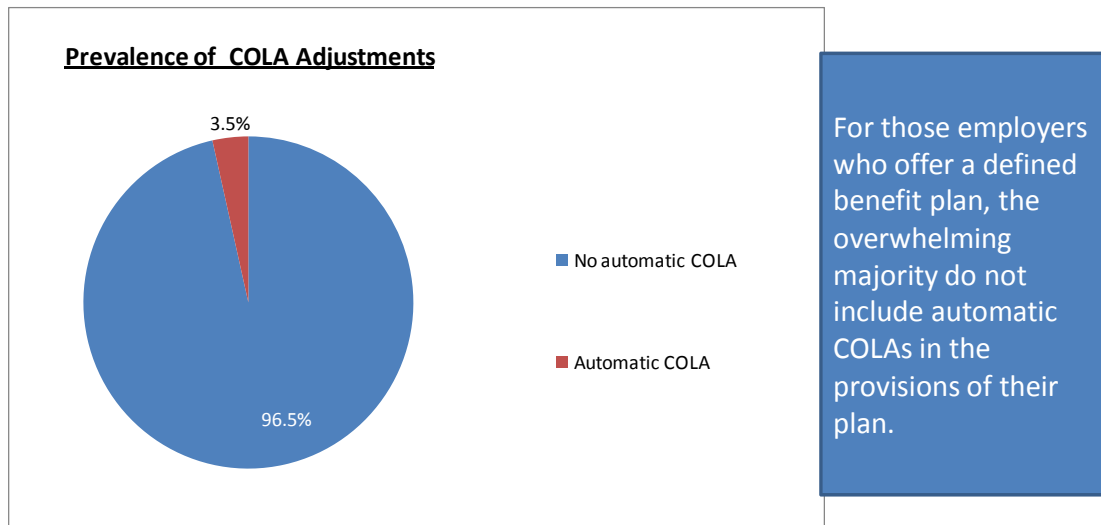
³ Aon Consulting presentation to the Pension System Modernization Task Force, August 12, 2009, p. 10.

For those companies that offer a defined benefit plan (in conjunction with a defined contribution plan), the provisions of those plans are significantly less generous than those of the State's pension plans, particularly in terms of cost of living adjustments and age requirements for full retirement benefits.

Provisions for automatic cost of living adjustments (COLAs) – such as the 3% COLA provided to State retirees – are extremely rare in private sector defined benefit plans (Figure 4).

Figure 4

**Prevalence of Automatic Cost-of-Living Adjustments:
Private Sector Defined Benefit Plans**

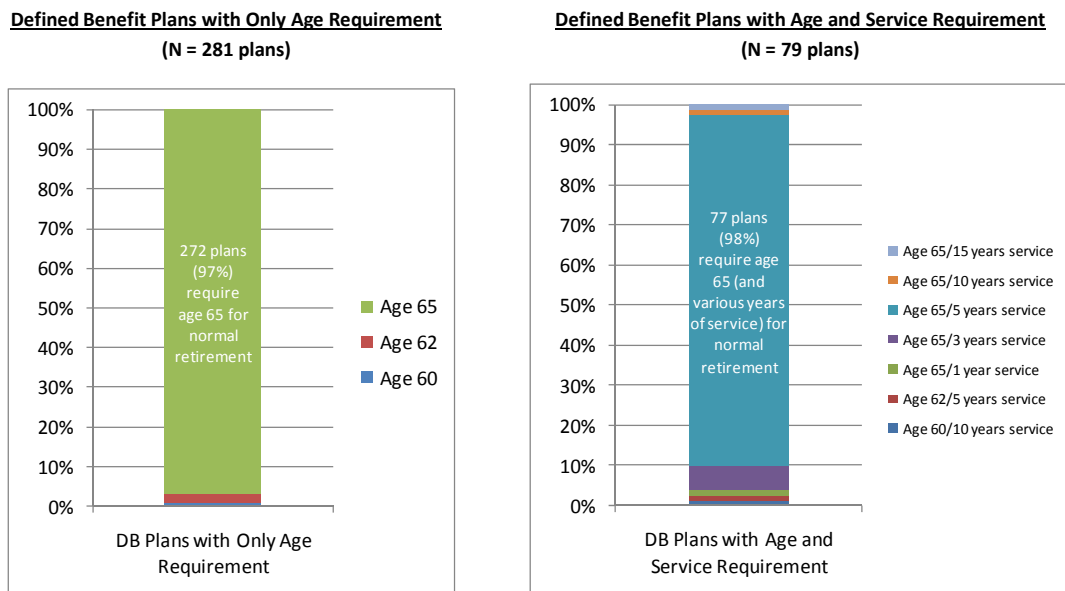


Source: Hewitt Associates survey of 371 private sector defined benefit plans (almost all are offered in conjunction with defined contribution plan).

Age requirements for normal retirement are also significantly different between the private sector and the State. The State's pension plans allow for normal retirement at or before the age of 60. The vast majority of private sector defined benefit plans require age 65 for normal retirement, either alone or in conjunction with a service requirement (Figure 5).

Figure 5

**Prevalence of Different Age Requirements:
Private Sector Defined Benefit Plans with Age Requirement for Normal Retirement**



Source: Hewitt Associates survey of 360 private sector defined benefit plans that have some age requirement for normal retirement.

A substantial disparity thus exists between pension benefits generally available in the private sector and the State’s pension plans. This disparity should not continue, for two reasons. First, the State cannot afford it. Second, maintaining such a disparity is unfair to taxpayers – who largely work in the private sector – who must pay higher taxes to support the more generous and more costly benefits provided to the State’s employees.

B. Pension abuses.

Illinois’ public sector pensions have been subjected to abuse. The *Chicago Sun-Times* recently reported that nearly 4,000 retired government workers now have pensions that pay them at least \$100,000 per year; and more than half have collected more than \$1 million each since they retired. A few have topped \$2 million, and five have received more than \$3 million each. (*Sun-Times*, September 11, 2009.)

One way to abuse the system is to “double up” – arrange to get more than one pension from the funds. The *Sun-Times* reported that the former chair of anesthesiology at Cook County Hospital and the University of Illinois has two pensions totaling \$447,233 per year.

Another way is to retire from one job and take another – thus earning both a pension and a salary. This can happen because the State’s pension plans permit

retirement long before normal retirement age. The *Sun-Times* reported the case of a Chicago city worker who retired from one job at age 49 and took a new job with the City – and now receives a pension and salary totaling \$246,721 per year. (*Sun-Times*, September 13, 2009.) Another 62-year old worker was reportedly drawing three pensions – totaling over \$280,000 – and drawing a salary of over \$246,000.

Another way is to manipulate the career-end compensation number. The amount which public pension beneficiaries receive is dependent on the amount of their salary at career end. A sharp escalation of salary at career end – either in the final year, or some number of years used as the base for pension calculations – can dramatically increase pension benefits. It has been particularly tempting for local school districts to play this game at career end since the State – rather than the local school district – bears the increased pension costs generated by such manipulation.

Still another form of abuse, as recently described by the *Chicago Sun-Times*, is to permit career-end salary hikes to increase pension rights, even when the employee is no longer working for State government or the schools. The *Sun-Times* found “more than five dozen” retired government workers whose pensions are based not on their public salaries, but rather on the higher salaries that they were paid by labor unions, lobbying groups and other non-governmental organizations after they left the State’s payroll.

These abuses have added to the build-up of the State’s pension liabilities.

C. Pension underfunding has shifted the burden of current costs onto future budgets and taxpayers.

The principal cause of the build-up in unfunded liabilities has been the *failure of the State to fund* the pension costs on a current basis. Under pressure from the groups which benefit from the pensions, the State – both the Executive Branch and the Legislature – has allowed the benefits to become very costly; and it has been unwilling to trim them back. For similar reasons, the State has been unable to make substantial cuts in its general State budget. But over time the State’s revenues have become inadequate to cover the State’s increasing expenditures and grants. And raising taxes would be unpopular. So – unable to cut and unwilling to take the risk of raising taxes – the State has ignored rising pension and retiree health care costs. It has in effect shifted them off to the future – to future budgets and future taxpayers. It has accomplished this through formulas which back-end-load costs and through borrowing.

In 1995 the State legislature enacted Public Act 88-593 to deal with pension underfunding. This law created a 50-year payment plan to bring funding ratios to 90% by 2045 (an estimated unfunded liability of \$54 billion on a total accrued pension liability of around \$540 billion). The 1995 law required the State to make contributions at a level percent of payroll, but with an initial “ramp-up” phase-in from 1996-2010.

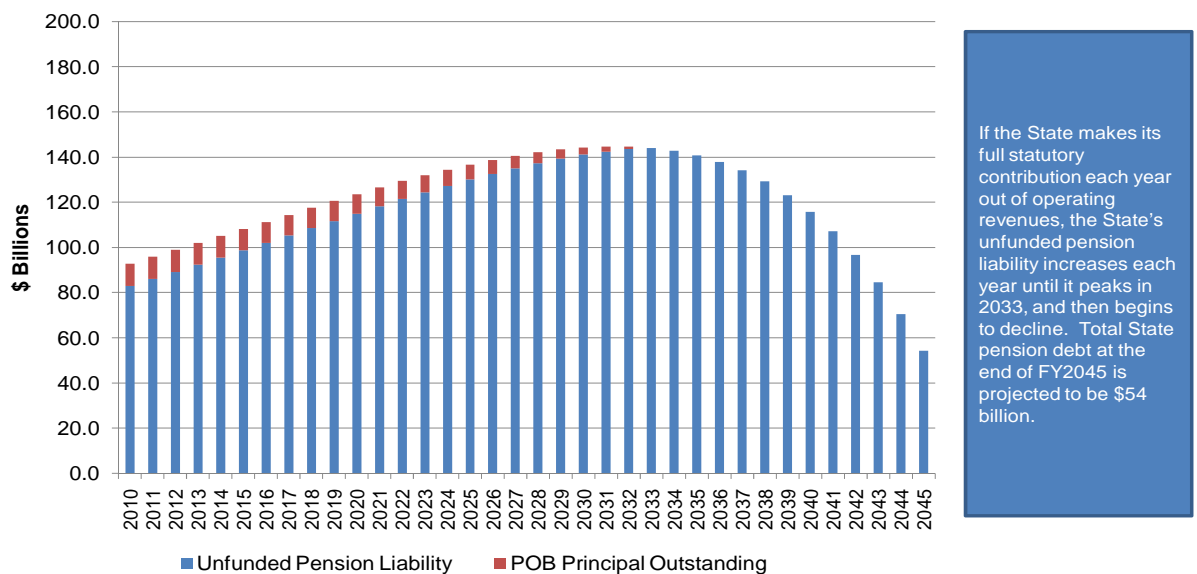
The 1995 plan was structurally flawed from the beginning because it did not require State contributions to cover “Normal Cost Plus Interest” (reversal of the 8.5% discount each year) until after 2030 – thereby substantially “back-end loading” the State’s pension funding and guaranteeing that the unfunded liability would continue to grow for many years. In addition, the State has failed to make its required statutory contributions in recent years, leading to even further growth in the unfunded liability. The net result of this underfunding has been a quadrupling of the unfunded liability from \$16 billion in FY2000 to \$79 billion at the end of FY2009 (Figure 2).

The stock market decline of 2007-2008 contributed to the substantial increase in the unfunded liability over the last few years, but the pension funds were in trouble long before the current economic downturn. The Civic Committee issued its report warning of the impending implosion of the State's finances in December 2006 – well before the stock market collapse of 2008. Figure 2 shows that in FY2007 the unfunded liability was about equal to its level in FY2003 – the year that the State issued \$10 billion in pension obligation bonds and dumped part of the proceeds into the pension funds. The growth in the unfunded liability back to this level by the end of FY2007 was largely the result of ongoing underfunding of annual pension contributions.

Because of the structural flaws in the 1995 plan, the unfunded liability is projected to grow even more over the next 25 years. As shown in Figure 6, even if the State makes its required statutory contribution going forward, the unfunded liability is projected to grow to more than \$144 billion by 2033 – when it is projected to peak and then begin to decline (as the statutory contribution in those later years surpasses “Normal Cost Plus Interest”).⁴

Figure 6

Total Pension Debt: Statutory Contribution From Operating Revenue



Source: "2008 Bonded Indebtedness Report of the State of Illinois," January 2009, Commission on Government Forecasting and Accountability; Commission on Government Forecasting and Accountability Monthly Briefing, April 2009.

⁴ The graphs in this document use the most recent projections published by COGFA – a pension briefing published in April 2009 and a report on the pension funds published in February 2009 – and therefore do not include the impact of pension asset smoothing (SB1292). Pension "asset smoothing" reportedly would reduce the FY2011 statutory contribution from \$5.4 billion to \$4.5 billion – further back end loading the State's pension funding.

The problem with this massive and growing unfunded liability, reflecting the significant underfunding in the early years of the statutory schedule, is that huge and unsustainable contributions from the State would be required in later years to reduce the unfunded liability to \$54 billion by 2045. According to the statutory schedule, by FY2026 the State's required pension contribution is projected to exceed \$10 billion, and by FY2040 it is projected to exceed \$20 billion. From 2034-2045, pension contributions would be *more than 33% of the State's payroll* each year. Given the State's inability to make its pension contributions in recent years – when those payments were less than 20% of payroll – the required contributions from 2034-2045 are impossibly high. And with each year that the State fails to make its statutory contribution now, the required payments in those later years would be even higher.

If the State continues its historical practice of balancing its annual budget through borrowing, Illinois may soon reach a “tipping point” beyond which it will be impossible to reverse the fiscal slide into bankruptcy. This is because the radical cost cutting and huge tax increases necessary to pay all the deferred costs from the past would become so large that many businesses and individuals would be driven out of Illinois, thereby magnifying the vicious cycle of contracting State services, increasing taxes, and loss of the State's tax base.

III. The State's Pension Plans Must be Reformed.

The State's pension programs must be reformed to reduce costs and mirror more closely the standards and yardsticks that have been adopted in the private sector. The State cannot afford the current programs any longer. Moreover, it is unfair to require taxpayers to bear the costs of the current pension programs for the State's employees.

A. Creation of a second, less-costly tier of pension benefits for new employees

The State should create a second and less-costly tier of retirement benefits for new employees – preferably a defined contribution plan, but at a minimum a defined-benefit plan with less-costly benefits – with adjusted employee contributions.

The detailed recommendations below parallel the recommendations of earlier amendments to Representative McCarthy's bill (SB1292) and draw on many of the recommended approaches described in Aon's recent presentation to the Commission⁵ and implemented in other states.⁶

- Increase the normal retirement age to 67 (with 10 years of service) and the early retirement age to 62 (with 10 years of service).
- Reduce the benefit accrual rate to 2.0% of pay for employees not covered by Social Security and 1.5% of pay for employees covered by Social Security.
- Limit COLA to the lesser of 3% or ½ of the Consumer Price Index.

⁵ Aon Consulting presentation to the Pension System Modernization Task Force, August 12, 2009, p. 12.

⁶ Aon Consulting presentation to the Pension System Modernization Task Force, August 12, 2009, p. 15.

- Change current provisions for the calculation of pension benefits to be calculated solely on base salary up to the Social Security Covered Wage Base. Calculate final average salary on the average of the highest consecutive eight years out of the last ten years, with the provision that the final 12 months average cannot exceed final average pay by more than 25%.
- As proposed in earlier amendments to SB1292, the above prospective changes in pension benefits should be accompanied by adjustments to employee contribution levels.

When second-tier plans are adopted for new workers, if the plans are reasonably well funded, there appears to be no problem with pooling the assets of the old and new (second-tier) plans. Such pooling does not put at risk the contributions made by the new employees who will participate in the new or second-tier plans.

But when the pension plans are as badly-underfunded and at risk as the Illinois pension plans, it could well be unfair to pool the contributions of the new employees in the second-tier plans with those in the old plans. In effect, this would permit the plan administrators to use the contributions of the new employees to pay out benefits to the employees in the old plans, rather than to build values that would be available when the time comes for the new employees to start to receive pensions. To allow such pooling in these circumstances would be to create a sort of Ponzi scheme – in which initial investors are paid out of the monies contributed by subsequent investors. Injecting such features into a second pension plan for new employees – when existing pension plans are radically underfunded – would not only be unfair to the new employees, but would create or impose on the plan administrators potential conflicts of duty – arising from the impossibility of paying pensions to the earlier group of employees (under the existing plans) without using revenues contributed by the new employees to make the payments, instead of building up values for the pension needs of the new employees in the second tier.

This problem would be avoided by structuring the second-tier plans as defined contribution plans, since the contributions of each new employee would be cordoned off and used entirely to build retirement programs for the new employees. Accordingly, we recommend the use of defined contribution plans. But if the State decides to continue with the defined benefit plan approach, that choice will underscore the need to separate the asset pools, and not to use contributions of the new group of employees to pay out benefits to the employees participating in the current plans.⁷

B. Reforming the current pension programs prospectively for current active employees

⁷ One might ask: isn't the problem identified here one that already exists *within* the structure of the existing pension plans? Aren't contributions of employees hired later, and younger, being used to pay benefits to the older group of employees as they retire? The answer is that with plans as underfunded as the State's, there is clearly potential unfairness here as well. Where assets are already commingled, there may be no good way to avoid the problem. But it clearly should be disclosed. The administrators of the current plans should make disclosure to all their members – particularly the new employees and those farther from the point of retirement – that contributions from these younger members are being or may be used (or assets acquired with those contributions are being or may be used) to fund pensions for retirees or older employees, rather than to build up asset values that will be available for their own retirement when the time comes.

The Pension Protection Clause of the Illinois Constitution provides:
“Membership in any pension retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.” Ill. Const., art XIII, #5.

Representatives of employees have suggested that this clause does more than protect an employee’s contractually vested rights. They have argued – or assumed – that provisions in pension plans could not be altered prospectively if the effect were to reduce benefits which might be accrued in future years. Accordingly, they have argued that the State’s current pension benefits could not be reformed prospectively to make them less costly to the State.

The 1970 amendments to the State’s Constitution were intended to grant contractual status to participation in public pension plans. Such status means that accrued rights have contractual protection. Such status does not mean that provisions in pension plans might not be changed prospectively to make them less costly – so long as rights accrued prior to the change are fully protected. The “benefits” which “shall not be diminished or impaired” are the contract rights vested under the “enforceable contractual relationships” protected by the Constitution. (See Appendix A.)

Under pressure of economic circumstances, many plans available to employees working in the private sector have been adjusted prospectively, without interfering with vested rights. Such incidents of prospective adjustment have not been deemed to violate employees’ contractual rights.

Similarly, the changes proposed above for a second-tier of pension benefits for *new* employees can and should be considered as amendments to the pension plans for prospective application to *current active* employees. If current active employees moved prospectively into the second-tier plan, it is estimated that the current \$79 billion in unfunded liabilities would be reduced by perhaps \$18-19 billion – to around \$60 billion.⁸ The annual “normal” pension cost would also immediately decrease to something below \$1.6 billion, as current and new employees would accrue future benefits under the less-costly, second-tier plan.

Alternatively, if the Illinois courts should ultimately determine that the current pension plans cannot be amended prospectively for current employees, such employees should be required by law to increase their pension contributions to an average of 11% for employees not covered by Social Security and 7% for employees covered by Social Security.

IV. Proposals Submitted to the Task Force for More “Ramping” and More Massive Borrowing Simply Invite the Governor and Legislative Branch Leaders to Avoid the Problem By Continuing to Shift it Off to Future Leaders, Future Budgets, and Future Taxpayers.

At the heart of our State’s current fiscal crisis is a continued pattern of avoided responsibility – of avoiding hard choices needed to balance our State’s budget, of putting off problems to the future ... to some other Governor, or some other Legislature. The

⁸Under this approach, accrued contract rights are protected, but no participant accrues any further benefit under the old plan based on either additional years of service or compensation growth. Replacing the “final average salary” assumption in the current benefit formula with each participant’s current salary is estimated to reduce the unfunded liability by \$18-19 billion.

politics of avoiding blame – or placing it on others – has trumped responsible government. When our elected officials refuse to make hard choices, Democracy fails. Proposals for further “ramps” – i.e., supposedly-temporary underfunding – or more massive borrowing are nothing more than invitations to further avoidance of responsibility and further failure.

A. Creation of a new pension ramp.

Ramp or stair-step increases that take many years to move the State to full actuarial funding are one way to shift today’s costs to the future and postpone making hard decisions. We have seen such ramps before. As one ramp leads upward to an appropriate but uncomfortable level of funding, we adopt another ramp – another postponement of bearing today’s costs today.

Annual pension funding should be based on actuarial requirements, not what the State thinks it can comfortably afford. The State’s unwillingness in the past to make the difficult budget choices that would allow for full actuarial funding of the pensions is what got us to our current crisis. It cannot be allowed to continue.

B. Issuance of more pension obligation bonds.

Some observers have suggested that pension obligation bonds (POBs) are like a person facing bankruptcy using a VISA card to pay his MasterCard debt. Actually, POBs are far worse than that. Reliance on massive borrowing to get out of a fiscal mess would be like ignoring one’s mortgage, one’s MasterCard debt, and one’s American Express Card debt – and ignoring all the other elements of budget deficit and fiscal difficulty – and then using a VISA card to buy stocks in the hope that increases in stock values would solve the problem.

Pension obligation bonds (POBs) are an avoidance – not a solution. POBs would shift a huge burden to the future. They would allow State leaders to continue to put off making hard decisions. The State’s leaders should do their fiduciary duty, which includes – in the circumstances we now face – cutting the costs of State government, making needed reforms in the State’s programs and grants, and meeting the State’s obligations.

Pension bonds are a terrible idea for a number of reasons:

1. Pension bonds would create an additional “full faith and credit” obligation on the part of the State. The State already has to pay off the \$10 billion in bonds issued under Governor Blagojevich. It will also have to pay off the \$3.5 billion in pension notes which were approved earlier this year. It must pay not only the principal of these obligations, but interest as well.
2. The State has recognized the dangers of too much debt by setting a limit on the amount of general obligation bonds it may issue (based on the amount of debt service on all outstanding bonds as a percentage of general fund appropriations – currently set at 7%). With the additional borrowing necessary to fund the new capital plan, the addition of more pension obligation bonds would likely put the State’s debt over this limit.

3. Such borrowing would almost certainly be used (as Governor Blagojevich used it) as an excuse for continuing not to fund pension costs at an actuarially-correct level out of current revenues. And the mountain of debt would just keep getting bigger.
4. Such borrowing would be enormously risky. In the private sector it is called “arbitrage.” One borrows at a lower rate of interest in order to invest the borrowed money in an investment that may draw a higher return. Private-sector arbitrageurs pursue such strategies with their own money only subject to careful controls and limitations. Moreover, such arbitrage investment strategies involve taking on greater risk – as shown by the history of New Jersey’s experiment with pension bonds. (After New Jersey issued \$2.7 billion in pension obligation bonds in 1997, the equity markets into which these monies had been invested plummeted between 2000 and 2002 – leading to “negative arbitrage.”)⁹
5. Such borrowing is also costly. Lawyers and investment bankers charge for their services incurred in issuing the bonds. The risk of “pay to play” is increased.
6. What happens when the borrowed money runs out? Would we issue still more bonds? And pile up even more costs to be paid by future taxpayers?

The advocates of ramping and borrowing – and cost shifting generally – say that times are hard and that the State cannot afford to bear these costs. Times will be better in the future, they say, and these costs will be more affordable then.

Times are indeed hard. Budget cuts would be painful. Taxes would be burdensome. These have always been the arguments – the very same arguments – for avoiding hard choices and shifting costs to the future. These arguments are why – over the past decade – Illinois has accumulated \$79 billion of unfunded pension liabilities, and another \$24 billion-plus of unfunded retiree health obligations – as well as additional billions of pension-related debt. Such shifting of burdens to the future cannot go on indefinitely.

The State officials who allowed this to happen over the past decade will go down in the history of the State as people who created a terrible problem by avoiding hard choices. Our recommendation to Governor Quinn is that he should not be one of those officials.

⁹ For a few years after the issuance of the POBs, New Jersey’s pension funds generated returns in the double-digits. But with the market decline of 2000, returns fell dramatically. Overall, from 1997-2005, the pension funds averaged an annual return well below the 7.6% that New Jersey promised in interest on the bonds, thus leading to “negative arbitrage” (over and apart from the transaction costs associated with issuing the bonds). (*Business Week*, June 13, 2005)

V. The State Should Fund its Pensions Out of Current Operating Revenues Consistent with Actuarial Principles.

Once needed pension reforms – including a second-tier of benefits prospectively for both current and future employees – have been put in place¹⁰, the State must increase its annual pension contributions to levels required by actuarial principles. The annual pension contribution should be sufficient to cover the “normal cost” each year, plus an appropriate amortization of the unfunded liability. An actuarial formula that reflects projected inflation by tying the State’s contribution to a “percentage of payroll” makes no sense when the assumed future “percentage of payroll” far exceeds any sustainable level. Back-end-loading of costs must cease.

Union representatives have made it clear – understandably, given their responsibility to those they represent – that they oppose a second tier of benefits prospectively, either for new employees or current ones. Their duty is to their members. But the Governor and members of the Legislature have a different set of duties – to the citizens of Illinois for whom State Government exists and who pay its bills. The unions and the business community may join in supporting the adequate pension funding consistent with actuarial principles. But an essential part of the package of reforms must be pension reform and cost reduction – a second-tier plan prospectively. These must be conditions of any enhanced funding. Organized labor cannot have it both ways – no reforms and enhanced funding. Without the needed reforms, and without enhanced funding, the pension funds will run out of money at some point soon. Retirees will have sound legal claims against the funds, but – as the old legal saying goes – “you can’t get blood out of a turnip.” Any attempt at that point to solve the problem through massive tax increases would simply drive businesses and individual taxpayers out of the State.

Assuming that labor and business and other interested groups can come together on a package that includes both pension reform and support for actuarially-correct funding, difficult budget choices will be necessary on both the cost side and the revenue side. Cost savings from the pension reforms will not be nearly enough. The State’s retiree health care program offers the potential for substantial reform and additional cost savings. In addition, significant cost-cutting will be necessary in other State programs and grants. And if taxes are increased, then the increased revenues must be used to pay down the liabilities we already have – not to pay for new programs or new liabilities. Given that the assignment of this Task Force is pension reform and modernization, it would be inappropriate to go beyond our mandate and address the additional cost-cutting and/or particular revenue measures that may become necessary. However, all reform and cost-cutting options should be exhausted before any such measures are considered.

¹⁰ In addition, the State should address the related subject of retiree health care. The current program, which provides a 100% premium subsidy to retirees with 20 years of service or more, is expensive and unsustainable long-term. Just as the State’s pension program, the State’s retiree health care program needs to be brought into line with the programs available to Illinois taxpayers. Unlike pensions however, retiree health care benefits are not even arguably protected under the State’s Constitution – making this a critical area for reform and cost-cutting.

APPENDIX A

Pension Reform Analysis

The Pension Protection Clause of the Illinois Constitution provides: “Membership in any pension retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.” Ill. Const., art. XIII, § 5. As the Supreme Court recognized, the “primary purpose” of the clause was “to eliminate any uncertainty as to whether state and local governments were obligated to pay pension benefits to their employees.” *People ex rel. Sklodowski v. State*, 182 Ill. 2d 220, 228 (1998). Prior to the 1970 Constitution, when a pension plan was mandatory, “the rights created in the relationship were considered in the nature of a gratuity that could be revoked at will.” *Id.* The Pension Protection Clause changed that, “mak[ing] participation in a public pension plan an enforceable contractual relationship [that] demands that the ‘benefits’ of that relationship ‘shall not be diminished or impaired.’” *Id.* at 228-29.

An increasingly important question is whether a *prospective* diminishment in pension benefits — meaning a diminishment that applies only to an employee’s future service, not to benefits already accrued from the employee’s prior service — causes a pension benefit to be “diminished or repaired.” The answer is No. Four years after the 1970 Constitution, the Supreme Court held that “the purpose and intent of the constitutional provision was to insure that pension rights or public employees *which had been earned* should not be ‘diminished or impaired’” *Peters v. City of Springfield*, 57 Ill. 2d 142, 152 (1974) (emphasis added); see also *People ex rel. Ill. Fed’n of Teachers v. Lindberg*, 60 Ill. 2d 266, 271 (1975) (reiterating standard from *Peters*). Thus, the only pension benefits protected from diminishment are those “which had been earned” at the time the pension scheme is altered. Pension benefits earned in the past cannot be reduced, while benefits that the employee hopes to earn in the future can be reduced.

The Attorney General considered this very issue in Atty. Gen. Op. No. S-1407, 1979 Ill. Atty. Gen. 9 (Jan. 10, 1979) (attached hereto). In Public Act 80-841, the General Assembly amended the manner in which the Pension Code calculated an employee’s pension. Prior to the amendment, the pension was based on “final average compensation,” meaning the actual monthly pay during any four of the employee’s last ten years of service, which usually was the last four years, when the employee’s wages generally were the highest. The amendment provided that, for purposes of calculating “final average compensation,” the employee’s salary for the last 12 months of the four-year period could not exceed the “final average compensation” by more than 25%.

The Attorney General recognized that the amendment, “by changing the way in which State employees’ compensation is considered for pension calculation purposes, may result in lower pensions for some employees than they would have received otherwise.” *Id.* at 10. For example, if “a State employee happened to receive \$9,000 each of the first three years and then was appointed to a \$13,000 position the fourth year,” the employee’s “final average compensation” would have been \$10,000 under the former system, but about \$200 less under the amendment. *Id.* at 11. The question was

whether the amendment diminished pension benefits under the Pension Protection Clause.

In answering that question, the Attorney General focused on the above-quoted passage from *Peters*, which makes clear that the Clause was designed to protect only those pension rights “which had been earned.” *Id.* at 13. Applying that principle, the Attorney General concluded that “applying the [amendment] to pay received before January 1, 1978,” the amendment’s effective date, would violate the Clause. *Id.* By contrast, the Attorney General stated that the amendment “may be applied only to earnings received after” the effective date.

The lesson of *Peters*, then, is that the Pension Protection Clause prohibits state and local governments from reducing pension benefits earned in prior years, but permits state and local governments to reduce pension benefits an employee may earn in the future, benefits that have not yet accrued. This conclusion is in accord with the underlying premise of the Clause, which was to “create a contractual right to benefits.” *Skłodowski*, 182 Ill. 2d at 233. “Statutory pension rights cannot be altered, modified, or released except in accordance with usual contract principles,” meaning that “the constitutional protection afforded public pensions extends as far as the pension rights conferred by statute and contract.” *Smithberg v. Illinois Mun. Retirement Fund*, 306 Ill. App. 3d 1139, 1143 (1999). Contract law does not permit one party to deprive its counterparty of fruits of the contract that have already been earned. But contracts, and statutes, are not frozen in place for all eternity, and can be amended to alter the parties’ relationship on a prospective basis. See *Peter*, 57 Ill. 2d at 151-52 (municipality may lower retirement age from 63 to 60 even if effect is to reduce pension benefits of retirees); *Higgins v. Sweitzer*, 291 Ill. 551, 554 (1920) (“the right to prospective salary of an office or position is not a property right”). By adding the Pension Protection Clause to the 1970 Constitution, the Framers intended to adopt those very principles to govern the rights and obligations inherent in public pensions.



The Civic Federation

177 North State Street, Suite 400, Chicago, IL 60601 • 312.201.9066 fax 312.201.9041 • www.civicfed.org

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October 28, 2009

Donald McNeil
Chairman, State of Illinois Pension Modernization Task Force
c/o Barnes & Thornburg LLP
One North Wacker Drive
Suite 4400
Chicago, IL 60606

Dear Chairman McNeil:

The Civic Federation seconds and supports the proposed report submitted by Eden Martin to the State of Illinois Pension Modernization Task Force. We believe that his report best reflects the financial condition of the State pension systems and more completely fulfills the mandate of House Joint Resolution 65.

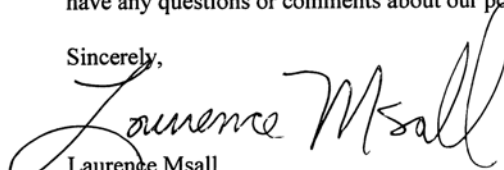
While Mr. Martin's report describes the State of Illinois as "nearly bankrupt," we believe there is mounting evidence that a judge could find the State is already insolvent. For several years, the State of Illinois has routinely acted to push current obligations into future years by borrowing, skipping pension payments, failing to pay vendors on time, and simply passing unbalanced budgets. It is difficult to see how the State could claim that it is currently solvent when it is demonstrably unable to pay its bills.

If the State is found to be insolvent under the classical cash flow definition of insolvency, which is the "inability to pay debts as they come due," it is not only the pension rights of non-vested employees that will be in jeopardy. All the **obligations** of the State, whether vested or not, will be competing for funding with the other essential **responsibilities** of State government. Even vested pension rights are jeopardized when a government is insolvent.

For these reasons, we strongly urge the Task Force to adopt Eden Martin's proposed report including the recommended changes to reduce benefits and increase funding for the State pension systems. Additional revenues will be necessary once pension reforms have been made for the State to meet its pension funding obligations; we recommend an income tax increase to achieve this purpose, but only if the outlined pension benefit reforms are made. We reject any further pension borrowing by the State and urge this Task Force to recognize the damage that borrowing has already done to both the pension systems and the State's finances.

The Civic Federation appreciates the opportunity the Illinois Pension Modernization Task Force has afforded us to analyze and propose reforms to the State's crisis-ridden pension systems. If you have any questions or comments about our position, please call me at 312-201-9044.

Sincerely,



Laurence Msall
President

cc: Governor Pat Quinn
David Vaughn

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V. Letters & Minority Reports

Letter from Taxpayers' Federation of Illinois
to Chairman McNeil and the Illinois
Pension Modernization Task Force



Taxpayers' Federation of Illinois

430 East Vine Street • Suite A • Springfield, Illinois 62703

Voice: 217.522.6818 • Fax: 217.522.6823

website: www.taxpayfedil.org • e-mail: tfi@iltaxwatch.org

October 30, 2009

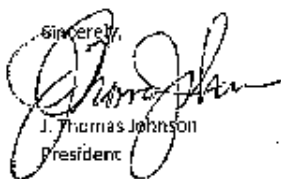
Mr. Donald McNell
Chairman, State of Illinois Pension Modernization Task Force
c/o Barnes & Thornburg LLP
One North Wacker Dr., Suite 4400
Chicago, IL 60606

Dear Chairman McNell:

We have reviewed the Proposed Pension Modernization Task Force Report submitted by Eden Martin of the Civic Committee of Chicago and a member of the Task Force. We find the draft report appropriately presents the dire financial position of the state pension funds specifically and the overall financial condition of state government. It is clear that the funding of pensions has been a low priority of our state's policy makers and we cannot continue the ways of the past. Funding priority is important but pension reform must be incorporated in the plan.

The current benefit and cost sharing structure is unaffordable given current and future expected demographics. The benefit structure far exceeds what is available in the private sector. If the taxpayer's of our state are expected to support a "solution" to the financial challenges facing our state, they demand reform of our public benefit plans as part of that solution. Historically, the justification given for the generous government employee benefit structure was the lack of comparable wage compensation programs for government employees. That is no longer the case. Current reports of the U.S. Bureau of Labor Statistics show public employees are compensated considerably higher than the employees in the private sector.

We strongly support the proposed for the reforms set forth in Mr. Martin's draft report and urge the Task Force to adopt them as its recommendations.

Sincerely,

J. Thomas Johnson
President

cc: Rep. Kevin McCarthy, Vice-Chairman

V. Letters & Minority Reports

Letter from Illinois Manufacturers' Association
to Chairman McNeil and the Illinois
Pension Modernization Task Force

From: Mark Denzler [mailto:mdenzler@ima-net.org]
Sent: Wednesday, October 28, 2009 5:54 PM
To: dmcneil@btlaw.com
Cc: Mark Denzler
Subject: Pension Reform Task Force Response

Chairman McNeil:

On behalf of the Illinois Manufacturers' Association, I would like to express our very strong support of the report submitted by Eden Martin to the Pension Task Force. There is absolutely no doubt that this report best reflects the current status and accuracy of Illinois' pension systems and offers the best course for resolving this issue that threatens Illinois' economic future. Without action, the problem will only worsen dramatically causing the further exodus of jobs and people.

The IMA, and our Board of Directors, strongly encourages the Pension Task Force to adopt Eden's proposed report. Thank you for the opportunity to analyze and respond.

Regards,
Mark

Mark Denzler
Chief Operating Officer, VP Government Affairs
Illinois Manufacturers' Association
220 E. Adams Street
Springfield IL 62701
(217) 522-1240 ext. 3008
(217) 525-2526 (fax)

V. Letters & Minority Reports

Letter from Illinois Retail Merchants
Association to Chairman McNeil and the
Illinois Pension Modernization Task Force

From: Rob Karr [mailto:rkarr@irma.org]
Sent: Wednesday, October 28, 2009 5:37 PM
To: 'McCurdy, Steve'
Cc: 'Carol Gadbois'; Laurence Msall; 'Mark Denzler'
Subject: Pension Task Force

Steve, thank you for re-sending me the call-in information last Monday morning. Unfortunately, for whatever reason, I was unable to connect through to the Pension Task Force meeting Monday despite repeated attempts. Nevertheless, I have sat through the various meetings, read handouts, reviewed COGFA's draft and, most recently, Eden Martin's proposed amendment to the COGFA draft. As a business representative of the Task Force, I wholeheartedly support Mr. Eden's report as an accurate reflection of what has occurred to date and urge its adoption. – Rob Karr, IRMA

*Rob Karr
Illinois Retail Merchants Association
216 Broadway
Springfield, IL 62701
(phone) 217-544-1003
(fax) 217-528-0616*

V. Letters & Minority Reports

Minority Report of The Institute for Illinois'
Fiscal Sustainability at The Civic Federation

State of Illinois Pension Systems
Analysis and Recommendations



STATE OF ILLINOIS PENSION SYSTEMS

Analysis and Recommendations

EXCERPTED FROM

STATE OF ILLINOIS FY2010 RECOMMENDED OPERATING & CAPITAL BUDGETS

Analysis and Recommendations

**Prepared by:
The Institute for Illinois' Fiscal Sustainability
at
The Civic Federation
May 11, 2009**

*The Civic Federation
would like to express its sincerest gratitude
to the John D. and Catherine T. MacArthur Foundation,
whose generous grant to fund
the Institute for Illinois' Fiscal Sustainability at The Civic Federation
made the research and writing of this report possible.*

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CIVIC FEDERATION POSITION ON STATE OF ILLINOIS FY2010 BUDGET PROPOSAL REGARDING PENSIONS

Partial Pension Payments in FY2009 and FY2010

The Civic Federation **opposes** the state's proposed partial pension payment holiday for both FY2009 and FY2010. The state's five retirement systems are significantly underfunded as it currently stands. Further delay in paying down the already accrued debt only continues to push responsibility for today's bills onto future generations.

In light of the projected \$162 billion in reduced liabilities over 35 years from the proposed pension benefit reforms for new hires, Governor Quinn is proposing to fund only the normal cost of the state's five pension funds for FY2010. The total pension contribution proposed by the state is nearly \$2.1 billion, including debt service on the 2003 pension obligation bonds. This is \$2.5 billion less than the pension contribution required under the 1995 pension funding law, which is \$4.5 billion, including debt service.

Additionally, Governor Quinn has proposed to reduce the state's FY2009 pension payment by \$550 million. When combined with the FY2010 reduction, the state is proposing to reduce its pension contributions by \$3.0 billion over this two-year period. Under current pension laws the state's FY2011 required pension contribution is estimated at \$5.4 billion, so if it fails to make the \$4.0 billion certified contribution for FY2010 it will be enormously difficult for the state to find the political will to make the full payment in FY2011 and beyond.¹

The positive gains accrued from the state's proposal to create a second tier of pension benefits does not give the state license to shirk its current pension funding responsibilities on already accrued liabilities. Reforming the pension benefit structure for new hires is necessary if the state is to have any hope of fixing its currently unaffordable pension system.

Governor Quinn's Pension Reform Proposal

The Civic Federation **supports** Governor Quinn's proposed reforms of the state pension systems.

Creation of a Second Tier of Pension Benefits for New Hires

The Civic Federation supports the proposed changes to the current pension benefit structure for new hires. By creating a second tier of pension benefits for new employees the state is taking an important step towards resolving its mounting pension benefit funding problem.

The FY2010 budget proposed by Governor Quinn creates a separate retirement benefit plan for new hires. Some of the proposed pension benefit reforms for new hires include raising the retirement age for receiving both unreduced and reduced benefits, reforming the benefit formulas and revising the Cost of Living Adjustment to the lesser of 3% or 50% of the Consumer Price

¹ Commission on Government Forecasting and Accountability, "Pension Briefing" April 2009, p. 11.

Index. Over the next 35 years the proposed reforms are projected to reduce the state's pension liabilities by \$162 billion.

For many years the Federation has recommended that the state create a separate tier of benefits for new employees as a means of controlling its out-of-control retiree benefit costs. The Federation commends Governor Quinn for taking this historic step towards resolving the state's unfunded pension crisis and urges the General Assembly to pass these long overdue reforms. The state is facing future financial pension obligations of staggering proportions. Modifying the benefit structure for new employees is a vital part of any plan that will successfully reverse this disastrous course.

Increasing Current Employee Pension Contributions

The Civic Federation endorses the state's proposal to increase pension contributions for current state employees. Recognizing that current employees will receive generous pension benefits upon retirement, the state is taking action to ensure the burden of paying for these benefits is equitably distributed amongst the beneficiaries and taxpayers. Governor Quinn has recently made statements indicating he is no longer considering increasing employee pension contributions. The Federation strongly disagrees with that sentiment. We believe the burden of funding the state's pension systems should be shared by both the employees receiving the benefits and the state's taxpayers.²

Employees covered by the State retirement systems contribute a percentage of their compensation for their own pensions and to fund survivors' benefits. Governor Quinn is proposing to increase current employee's pension contribution by two percentage points, while decreasing the employee contribution rate for new hires by one percentage point. We believe a better alternative would be to keep employee contributions the same for both new and existing employees. The rationale put forth by the Governor's office is that the current employees who will be receiving more extensive, and therefore expensive, pension benefits should bear more of the burden associated with funding the plan.

In past analyses the Civic Federation has recommended increasing the amount current employees contribute towards their retiree benefits as a means of offsetting the escalating cost of providing these benefits. The Federation is pleased that this year Governor Quinn has heeded our calls and hopes he continues down the path toward shared responsibility for funding the state's pension systems, injecting much needed funds into the five pension funds while equitably distributing the burden of funding the promises made to state employees.

Civic Federation Additional Pension Reform Recommendations

The Civic Federation applauds the Governor for proposing a new two-tiered system for pension benefits. However, we believe additional reforms are necessary to make the system's liabilities more manageable in the long-term.

² Doug Finke. "Quinn abandons proposed pension cost hike." The State Journal-Register (May 7, 2009).

Fund State Pension Systems at Certified Contribution Amount for FY2009 and FY2010

The state of Illinois must make the full mandated FY2009 and FY2010 pension contribution payments under the 1995 pension funding reform law. By not adhering to this funding schedule the state is essentially borrowing money from future generations to pay for current operating expenses. Any amount of savings recognized from restricting benefits for new hires should be used to offset the state's existing enormous pension liability. Deferring current pension payments will only exacerbate the state's pension funding problem and diminish the positive effects of a restructured benefit system for new hires. Under current pension laws the state's FY2011 required pension contribution is estimated at \$5.4 billion, so if it fails to make the \$4.0 billion certified contribution for FY2010 it will be enormously difficult for the state to find the political will to make the full payment in FY2011 and beyond.³

Impose a Moratorium on New Pension Benefits

The General Assembly approved the Pay-As-You-Go Act, which requires that any state pension enhancements also provide for their own funding, after it was proposed by Governor Blagojevich as part of his FY2006 budget. While this plan is a more fiscally responsible approach to pensions than the State has had in the past, the General Assembly can still add to the state's already unaffordable pension plans if it identifies new revenues, thus potentially leaving taxpayers on the hook for continuously expanding benefits and costs. The state should impose a moratorium on any new employee benefits until the pension system has achieved a 90.0% funded ratio. We call on the legislature to reject, and the Governor to veto, any new pension enhancements regardless of whether they are tied to additional funding sources.

Require Balance on Pension Boards Between Employees, Management and Taxpayer Interests

The state should require a balance of employee, management, and taxpayer interests in the governance of its retirement system Boards. Board seats should be set aside for members with professional expertise or certification in financial asset investment, and all members who do not already possess such expertise should be required to receive some relevant financial training on an annual basis.

Require Pension Benefit Reforms Before Authorizing Pension Obligation Bonds

The State of Illinois should not issue more pension obligation bonds unless it follows the precedent of the Chicago Transit Authority and negotiates reforms to employee pension benefits with unions that will curb future pension liabilities first.

Study the Costs and Benefits of Conversion to a Defined Contribution Plan

The State should undertake a study to determine both the costs and benefits of moving to a defined contribution pension plan. Such a move would require a very large infusion of assets into the system, such as from a multi-billion dollar asset sale or pension obligation bond issue. This would be necessary because the State would still be required to provide benefits to employees in the existing defined benefit plans for decades. This obligation would persist even

³ Commission on Government Forecasting and Accountability, "Pension Briefing" April 2009, p. 11.

as the funding stream for those plans diminishes with the shift of new employees into the new defined contribution plan. There would also be a need for start up funds for the new defined contribution plan.

Institute Additional Retiree Health Insurance Reforms

In addition to pension benefits, the state also provides Other Post-Employment Benefits (OPEB) to its retirees. The following are recommendations made by the Civic Federation on how the state can reduce the costs associated with escalating OPEB expenses.

Eliminate the Indemnity Plan for Retirees For Both In-Network and Out-of-Network Visits

Eliminating the costly indemnity plan for retirees and placing enrollees in HMO or OAP plans that cost significantly less could save the State between \$176.6 and \$253.4 million per year (estimated savings in 2007).

Study the Possibility of Establishing an Independent Healthcare Trust Fund

The Civic Federation recommends that the state study the feasibility of establishing an independent healthcare trust fund for its retirees. In a report released in February of 2009, the Civic Committee of the Commercial Club recommended creating an independent healthcare trust fund as a means of funding the health care needs of the state's retired employees. The Civic Committee noted that in 2007 the Illinois General Assembly approved legislation that created a health care trust fund for the retirees of the Chicago Transit Authority.

An initial lump sum payment was necessary to create the CTA's trust fund, and the same would be true for the state if they attempt to create a similar funding structure for their retiree healthcare costs. The Civic Committee estimated that the state could save \$1.1 billion if it implemented a retiree healthcare trust fund, along with increased retiree premium contributions and plan modifications.⁴

Consider Taxation of Retirement Income

The Civic Federation recommends that the state study the possibility of taxing retirement income. Currently, Illinois imposes no income tax on public or most private retirement income. This is in contrast to a majority of states, 39, that impose some type of personal income tax on either public or private retirement income.⁵ It is important to note that seven states do not impose a personal income tax.⁶

The FY2007 Tax Expenditure Report issued by the Illinois Comptroller in 2008 compared other states' tax treatment of retiree income, concluding that "Illinois provides one of the most

⁴ See "Facing Facts 2009: An Updated Report on the State of Illinois' Fiscal Crisis" Civic Committee of the Commercial Club of Chicago (February 2009).

⁵ Ronald Snell and Bert Waisanen, "State Personal Income Taxes on Pensions and Retirement Income: Tax Year 2007." National Conference of State Legislatures (July 2007).

⁶ *Ibid.*

favorable treatments of retirement income for its retirees.”⁷ For example, Illinois is one of five states that provides some variation of a full exemption of private retirement income derived from certain private plans.⁸ Additionally, Illinois is one of only ten states that excludes all federal, state and local pension income from taxation.⁹ According to the Comptroller’s report, “public pension income is fully exempt in ten states, including Illinois, with 26 states providing partial exemptions and five fully taxing this income.”¹⁰

The state could receive approximately \$1.3 billion in additional revenue each year if it imposed a 4% personal income tax on retiree income.¹¹ This number is based on the most recent data available, FY2007, for all federally taxed retirement and social security income earned by Illinois residents.

Taxing retirement income will raise equity concerns that flow from the flat rate structure of the Illinois income tax. Flat rate income tax systems provide for the same rate for all taxpayers regardless of ability to pay. Thus, they proportionately have a greater financial impact on lower income earners. This issue could be addressed through adoption of a graduated income tax structure that affects higher income earners at proportionally greater rates than lower income earners. This will require the approval of a state constitutional amendment to authorize a progressive personal income tax.

STATE OF ILLINOIS RETIREMENT SYSTEMS

This section of the analysis describes the funding and reform proposals for the state’s five retirement systems. The first section provides membership and funding information for the plans in FY2010, along with a discussion regarding the Governor’s proposed pension benefit reforms. The next section depicts the pension reform and funding proposals since 2003.

The Governor’s FY2010 Pension Funding Proposal

The State of Illinois funds five retirement systems: the General Assembly Retirement System (GARS), the Judges’ Retirement System (JRS), the State Employees Retirement System (SERS), the State Universities Retirement System (SURS), and the Teachers’ Retirement Employment Retirement System (TRS). Currently there a total of 708,990 individuals are currently enrolled in these five systems.

⁷ Illinois Comptroller’s FY2007 Tax Expenditure Report, p. 3 (August 2008) at <http://www.apps.ioc.state.il.us/ioc-pdf/TaxExpRptFY2007Web.pdf> (last visited on April 24, 2009).

⁸ Illinois and Mississippi do not tax retirement income from “qualified” private retirement plans; Hawaii does not tax retirement income from “contributory” private plans; Alabama does not tax retirement income from “defined benefit” private plans; Pennsylvania does not take retirement income from any private plan. Ibid p. 5.

⁹ Ronald Snell and Bert Waisanen, “State Personal Income Taxes on Pensions and Retirement Income: Tax Year 2007.” National Conference of State Legislatures (July 2007).

¹⁰ *Ibid.*

¹¹ This calculation is based upon the FY2007 Tax Expenditure Report released by the Illinois Comptroller’s Office at <http://www.apps.ioc.state.il.us/ioc-pdf/TaxExpRptFY2007Web.pdf> (last visited on April 24, 2009).

Members of Illinois Retirement Systems: Current Enrollment			
Pension Fund	Members as of 06.30.08	Annuityants	Total
Teachers	265,735	91,497	357,232
University	159,795	45,346	205,141
State Employees	87,916	56,111	144,027
Judges	982	956	1,938
General Assembly	257	395	652
Total	514,685	194,305	708,990

Source: Illinois State Budget FY2010, p. 4-1.

In FY2010 the state will fund the normal cost of their five pension plans for a total pension payment of \$1,517.0 million.¹² Normal cost represents the amount needed to cover the present value of the benefits earned by system members in each fiscal year. The state will also pay \$543.6 million in required debt service payments on pension obligation bonds issued in 2003.¹³ As a result, **the total FY2010 payment for pensions will be \$2,060.6 million.**

In order to fulfill the statutory requirement that the state's pension systems attain a 90.0% funded ratio by June 30, 2045, **the required contribution to the systems for FY2010 should be \$4,046.7 million.**¹⁴ Including the \$543.6 million in debt service, the pension payments that the state should make in FY2010 total **\$4,514.5 million, or roughly 8.5% of the state's proposed operating budget.**¹⁵

The Governor is also proposing to reduce the state's FY2009 pension payment by \$550 million. Combined with the \$2,453.9 million reduction in the state's FY2010 proposed pension payment, the state will be decreasing its required contribution to the five pension funds by over **\$3.0 billion** over the two-year period. Under current pension laws the state's FY2011 required pension contribution is estimated at \$5.4 billion, and rises to \$5.6 billion in FY2012 in order to reach a target of 90% funded in the year 2045.¹⁶

As of March 18, 2009 the five state pension funds had accrued an actuarial loss of approximately \$20.0 billion for the first part of FY2009.¹⁷ This is combined with an actuarial loss of \$9.0 billion in FY2008.¹⁸

According to the most recent audited financial statements, the five state pension funds had a combined funded ratio of 54.3% and unfunded liabilities of \$54.4 billion on June 30, 2008.¹⁹ An

¹² Illinois State Budget FY2010, p. 4-3.

¹³ Commission on Government Forecasting and Accountability, "Pensions – A Report on the Financial Condition of the State of Illinois Retirement Systems as of June 30, 2008", (February 2009), p. 82.

¹⁴ Commission on Government Forecasting and Accountability, "Pensions – A Report on the Financial Condition of the State of Illinois Retirement Systems as of June 30, 2008", (February 2009), p. 69.

¹⁵ The \$4,514.5 million total is reached by adding the debt service and required pension contributions to the systems, minus \$75.8 million in debt service for SERS that is already included in the required contribution figure. Information provided by the Commission on Government Forecasting and Accountability, April 28, 2009.

¹⁶ Commission on Government Forecasting and Accountability, "Pension Briefing" April 2009, p. 11.

¹⁷ Illinois State Budget FY2010, p. 2-2.

¹⁸ Illinois State Budget FY2010, p. 2-2.

unaudited estimate of the funds' financial condition as of **December 31, 2008** shows a **combined funded ratio of 40.0% and unfunded liabilities of \$73.4 billion.**²⁰

The Governor's FY2010 Pension Reform Proposal

The FY2010 budget proposes several changes to the current pension structure for *new* state hires, maintaining the current pension structure for existing state employees. These changes include adjustments to the retirement age, benefit formula, cost of living payment increases and employee contributions. The following chart depicts current plan benefits as compared to the Governor's proposed changes for new hires.

State of Illinois FY2010 Budget: Comparison of Current Pension Benefits and Proposed Pension Benefit Reforms		
	Current Plan for Current Employees and New Hires	Proposed Changes for New Hires
Basic Benefit Formula	2.2% if not covered by Social Security 1.67% if covered by Social Security Alternate formula for special risk employees	2.0% if not covered by Social Security 1.5% if covered by Social Security No alternate formula
Final Average Salary	Total salary & averaged over 4 highest consecutive years during final 10 years	Base salary & averaged over 8 highest consecutive years during final 10 years Social Security Covered Wage Base indexed going forward
Credited Service	No service limit and may purchase/convert credited service	Service limited to 35 years and may not purchase credited service or convert sick/vacation time
Maximum Benefit	75% for SERS and TRS 80% for SURS	70% if not covered by Social Security 52.5% if covered by Social Security
Retirement Age - Unreduced Benefits	SERS: age 60 & 8 years; 35 years; Rule of 85 SURS: age 60 & 8; age 62 & 5; 30 years TRS: age 60 & 10; age 62 & 5; 35 years	Later of 1) Social Security Retirement age, and 2) 10 years
Retirement Age - Reduced Benefits	SERS: age 55 & 25 years SURS: age 55 & 8 years TRS: age 55 & 20 years Reduction = 6% per early year	62 years & 10 years Reduction = 6% per early year
Form of Benefit	50% joint and survivor + optional forms w/ reduction	Life annuity + optional forms w/ reduction
COLA	3% & Compound Interest	Lesser of 3% or 50% of CPI & Simple Interest
Employee Contributions - Current Employees	SERS covered by SS: 4% SERS not covered by SS and SURS: 8% TRS: 9%	SERS covered by SS: 6% SERS not covered by SS and SURS: 10% TRS: 11%
Employee Contributions - New Hires	SERS covered by SS: 4% SERS not covered by SS and SURS: 8% TRS: 9%	SERS covered by SS: 3% SERS not covered by SS and SURS: 7% TRS: 8%
Death Benefits	SERS & TRS: 30% to 80% of average pay SURS: 50% of accrued benefit	Survivor portion of 50% joint and survivor benefit payable to spouse
Disability Benefits	SERS: 50% of FAP non-occupational; 75% occupational SURS: 50% of FAP TRS: 35% of FAP non-occupational; 60% occupational	Unreduced accrued benefit to begin following receipt of all sick leave, STD and LTD benefits

Source: Governor's Office of Management and Budget, State of Illinois.

¹⁹ Commission on Government Forecasting and Accountability, "Financial Condition of the State of Illinois Retirement Systems as of June 30, 2008" (February 2009), p. 83.

²⁰ Commission on Government Forecasting and Accountability, "Monthly Briefing" (February 2009), p. 8.

The Governor is proposing to increase the age at which new hires would be eligible for retirement benefits to mirror the age requirement for receiving federal Social Security benefits, 67 years of age for those born after 1960. Furthermore, new hires would not be eligible for early reduced benefits prior to obtaining 62 years of age.

Changes are also being proposed to the formulas used to calculate retirement benefits. For example, retirees covered by Social Security would earn 1.5% of final pay per service year, whereas retirees not covered by Social Security would earn 2.0%. The definition of “final pay” for new hires will be calculated by using the average base pay over the final eight years of service, and going forward will base salary calculations on indexed Social Security Covered Wage Base. Additionally, years eligible for credited service will be limited to 35.

The cost of living adjustment calculation would also be modified for new hires under Governor Quinn’s plan. The new COLA calculation would be based on either 50% of the change in the consumer price index (CPI) or 3%, whichever is lower, and would accrue as simple rather than compounded interest.

The aforementioned changes are all designed to bring uniformity to pension plans for new hires. Existing pension plans would not experience these changes. In light of this fact, Governor Quinn is proposing to increase the employee contributions for *current* employees by 2 percentage points, while reducing the employee contribution rate for new hires by 1 percentage point. The intent behind this change is to place more of the burden for funding the current, and more generous, pension plans on the employees who will be receiving the benefits. However, it should be noted that Governor Quinn has recently made statements indicating he is no longer considering increasing employee pension contributions.²¹

Overall, it is estimated that the changes in the new hires’ plans would reduce pension liabilities by \$162 billion over the next 35 years.²² The state will release its revised pension funding schedule via upcoming draft legislation.²³

Changes in State Pension Funding: 2003 to 2008

Since 2003, several changes have been made regarding how the State’s retirement systems are funded.

Issuance of \$10.0 Billion in Pension Obligation Bonds in 2003

In his first year in office, Governor Blagojevich championed Public Act 93-0002, which authorized the issuance of \$10.0 billion in pension obligation bonds. The proceeds of these bonds were to be used to boost the pension funds’ assets and reduce unfunded liabilities.

Initially, the funds’ managers and the Governor’s financial team estimated that the pension funds would earn investment income at the traditional long-term actuarial rate of 8.5% and that the

²¹ Doug Finke. “Quinn abandons proposed pension cost hike.” The State Journal-Register (May 7, 2009).

²² Illinois State Budget FY2010, p. 4-3.

²³ Communication between the Civic Federation and the Governor’s Office of Management and Budget, April 27, 2009.

pension bond proceeds would earn at least that rate over the 30-year life of the bonds. The financial team forecasted that economic savings would result from issuing the \$10.0 billion in bonds at the then-current market interest rate of approximately 5.8%, as long as the funds earned a long-term actuarial rate of 8.0%.

In fact, the bonds were ultimately issued at an interest rate of 5.05% while the pension funds' actuaries ultimately projected an 8.5% expected rate of return for the entire asset portfolio. The State estimated that it would realize \$860.0 million in additional "savings" from these favorable rates. In its FY2005 budget, the State proposed to capture \$215.0 million, or 25.0% of the increase, reserving the remainder for capture in future years. The \$215.0 million "savings" was used as the basis for reducing the State's pension contribution by a similar amount in FY2005.

Governor's FY2006 Pension Funding Reform Proposals and Partial Pension Holiday

Governor Blagojevich proposed a number of pension funding reform proposals in the FY2006 State of Illinois Budget. These proposals were all originally recommended by the Governor's Blue Ribbon Pension Commission, which was composed of representatives from the General Assembly, business, labor, and civic groups. The Governor accepted all but two of the Commission's recommendations:

- Requiring employees to increase the percentage of salary they pay into the retirement systems by 1 percentage point; and
- Considering shifting to a defined contribution (DC) plan at some point in the future.

The General Assembly approved a few of the Governor's proposed reforms with some modifications. The most significant proposals enacted into law were capping end-of-career salary increases, eliminating the State Universities Retirement Systems money purchase option for new hires, limiting eligibility for alternative formulas, and requiring funding for enhanced benefits. The legislators rejected proposals to:

- Change the eligibility for full benefits to age 65, with between 8 and 30 years of service; age 62 with 30 to 35 years of service; or age 60 with 35 years or more of service; and
- Limit automatic benefit increases for new hires to the lesser of the change in the rate of inflation or 3% and apply increases only to the first \$12,000 in annual pension for retirees covered by Social Security and \$24,000 for retirees not covered by Social Security.

New proposals approved by the legislature and signed into law by the Governor enacted a two-year deferral of \$2.3 billion in pension contributions, created a second Blue Ribbon Task Force to further study pension reform, created a cost neutral early retirement program, and eliminated lump sum awards for earned and untaken sick pay.

The exhibit below presents a comparison of the Governor's FY2006 original pension funding proposals, as well as new proposals that were advanced during the legislative session and the final action taken by the General Assembly.

Pension Funding Reforms Original v. New Proposals for FY2006	
Governor's Original Proposals	Final Budget Approved by GA
Cap end-of-career salary increases to 3%	6% annual cap adopted
Eliminate SURS money purchase option for new hires	Approved
Recalculate money purchase interest rate to reflect long-term rate of return, not 9%	Authorized comptroller to set rate
No new benefits without funding	Approved
Limit automatic increases to CPI	Approved
Change retirement age for new hires	Not approved
New Proposals	Final Budget Approved by GA
Defer pension contributions by \$2.3 billion over two years	Approved
Create task force to study pension reform	Approved
Create cost neutral early retirement program paid for by local employers/beneficiaries	Approved
Eliminate lump sum awards for unearned sick pay to boost pensions	Approved

In addition to the pension funding reforms, the General Assembly approved legislation (P.A. 94-0004) in FY2006 which authorized reductions in State contributions to its five retirement systems from the originally certified amounts in both FY2006 and FY2007 (for a total reduction of \$2.3 billion). In accordance with P.A. 94-0004, the State contributed nearly \$1.4 billion to its retirement funds in FY2007—that figure was \$1.1 billion less than the certified contribution amount. The exhibit below shows the difference between the certified amount for each State pension fund and the amount that was appropriated in FY2006 and FY2007.

FY2006 & FY2007 Certified Contributions v. Final General Assembly Appropriations (in \$ millions)								
FY2006				FY2007			Total 2-Year Contributions	Total Reduction
System	Certified Contributions	P.A. 94-0004	Difference	Certified Contributions	P.A. 94-0004	Difference		
TRS	\$ 1,058.5	\$ 531.8	\$ 526.7	\$ 1,233.1	\$ 735.5	\$ 497.6	\$ 2,291.6	\$ 1,024.3
SERS	\$ 690.3	\$ 203.8	\$ 486.5	\$ 832.0	\$ 344.2	\$ 487.8	\$ 1,522.3	\$ 974.3
SURS	\$ 324.9	\$ 166.6	\$ 158.3	\$ 391.9	\$ 252.1	\$ 139.8	\$ 716.8	\$ 298.1
JRS	\$ 38.0	\$ 29.2	\$ 8.8	\$ 44.5	\$ 35.2	\$ 9.3	\$ 82.5	\$ 18.1
GARS	\$ 5.5	\$ 4.2	\$ 1.3	\$ 6.3	\$ 5.2	\$ 1.1	\$ 11.8	\$ 2.4
Total	\$ 2,117.2	\$ 935.6	\$ 1,181.6	\$ 2,507.8	\$ 1,372.2	\$ 1,135.6	\$ 4,625.0	\$ 2,317.2

Source: Commission on Government Forecasting and Accountability. Report on the 90% Funding Target of Public Act 88-0593.

The Commission on Governmental Forecasting and Accountability estimated that the final pension program approved for FY2006 would cost the State an additional \$4.7 billion and reduce actuarial liabilities by \$38.6 billion over 40 years. The retirement systems' actuaries estimated that \$6.8 billion more would be incurred in costs and the liabilities would be reduced by \$44.6 billion.

Estimated Impact of P.A. 94-0004 Total Projected State Contributions for FY2006-FY2045 Prepared by CFGA (in \$ millions)						
State Contributions	TRS	SERS	SURS	JRS	GARS	TOTAL
Pre P.A. 94-0004	\$ 160,302	\$ 68,065	\$ 61,184	\$ 6,538	\$ 862	\$ 296,951
P.A. 94-0004	\$ 155,507	\$ 78,068	\$ 60,531	\$ 6,654	\$ 877	\$ 301,637
Difference	\$ (4,795)	\$ 10,003	\$ (653)	\$ 116	\$ 15	\$ 4,686
FY2045 Liability Reduction	\$ 26,265	\$ 667	\$ 11,690	\$ -	\$ -	\$ 38,622

Source: Commission on Government Forecasting and Accountability, August 2005.

Estimated Impact of P.A. 94-0004 Total Projected State Contributions for FY2006-FY2045 Prepared by Retirement Systems (in \$ millions)						
State Contributions	TRS	SERS	SURS	JRS	GARS	TOTAL
Pre P.A. 94-0004	\$ 156,715	\$ 65,340	\$ 60,688	\$ 6,538	\$ 862	\$ 290,143
P.A. 94-0004	\$ 152,550	\$ 75,928	\$ 60,914	\$ 6,654	\$ 877	\$ 296,923
Difference	\$ (4,165)	\$ 10,588	\$ 226	\$ 116	\$ 15	\$ 6,780
FY2045 Liability Reduction	\$ 34,322	\$ 675	\$ 9,655	\$ -	\$ -	\$ 44,652

Source: Commission on Government Forecasting and Accountability, August 2005.

Governor Blagojevich's FY2008 Pension Funding Proposal

The Governor's FY2008 budget proposed providing the State's five pension plans with \$25.9 billion in new assets. This infusion would have provided for an 83.0% funded ratio in FY2008, 34 years ahead of the current 50-year funding schedule, had this proposal been adopted.²⁴ Under the Governor's proposal, the increase in the funded ratio would have been achieved through two financing mechanisms:

1. *The long-term lease of the Illinois Lottery:* The State proposed entering into a long-term concession of the Illinois Lottery. The State expected that the lease of the Illinois Lottery would generate \$10.0 billion in cash; and
2. *The issuance of \$15.9 billion in pension obligation bonds:* All proceeds from the bond issue would be paid into the State retirement systems. The structure of the pension obligation bond issue would have resembled the previous POB transaction in 2003. Debt service payments would have been supported by deductions from the unfunded liability payments that would have been necessary if the bonds were not issued.

The General Assembly rejected the Governor's FY2008 pension funding proposal.

Governor Blagojevich's FY2009 Pension Funding Proposal

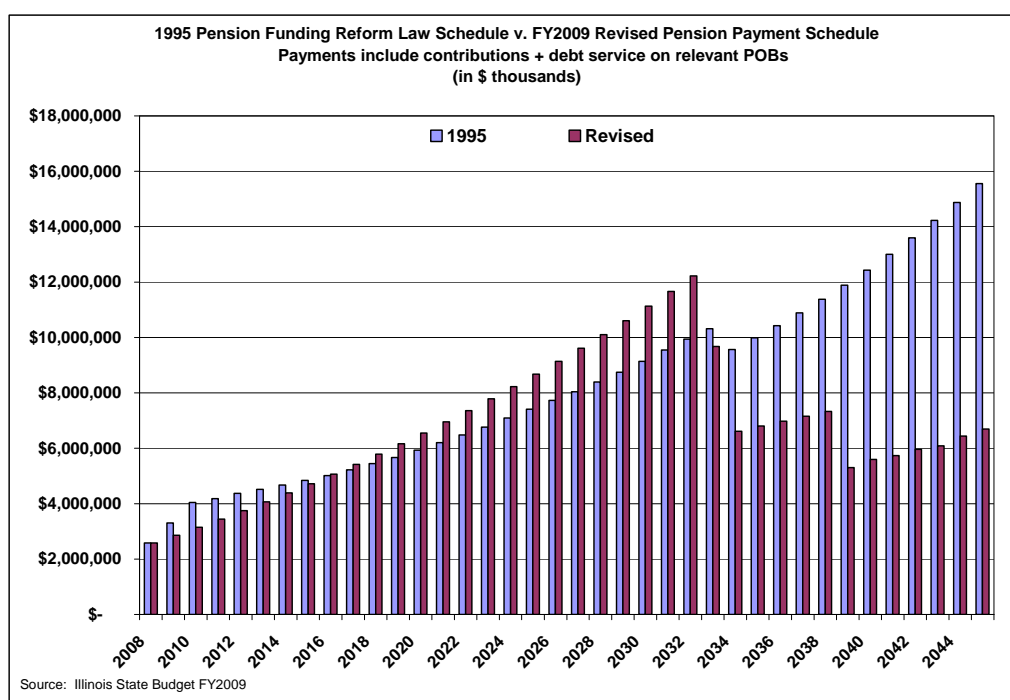
The FY2009 budget proposed issuing between \$12.0 and \$20.0 billion in pension obligation bonds to increase the assets of the state's pension funds. The bonds would have been paid for through General Fund revenues.

If the state had issued \$16.0 billion in pension obligation bonds, it could have immediately placed \$15.9 billion of that amount into the pension funds, thereby increasing the funded ratio from 62.6% to approximately 75.2%. One hundred million dollars would have been used for administrative costs associated with bond issuance. Also, pension payments would have been rescheduled and the FY2009 payment would have been \$280.0 million greater than the payment made in the previous year. In succeeding years, payments would have been equal to \$280.0 million plus a 3% annual increase until the funds achieved a 90.0% funded ratio in 2033, twelve years ahead of the current schedule. The current system required \$19.9 billion in debt service

²⁴ Presentation by John Filan, Chief Operating Officer, State of Illinois, to the Civic Federation, March 14, 2007, p. 25.

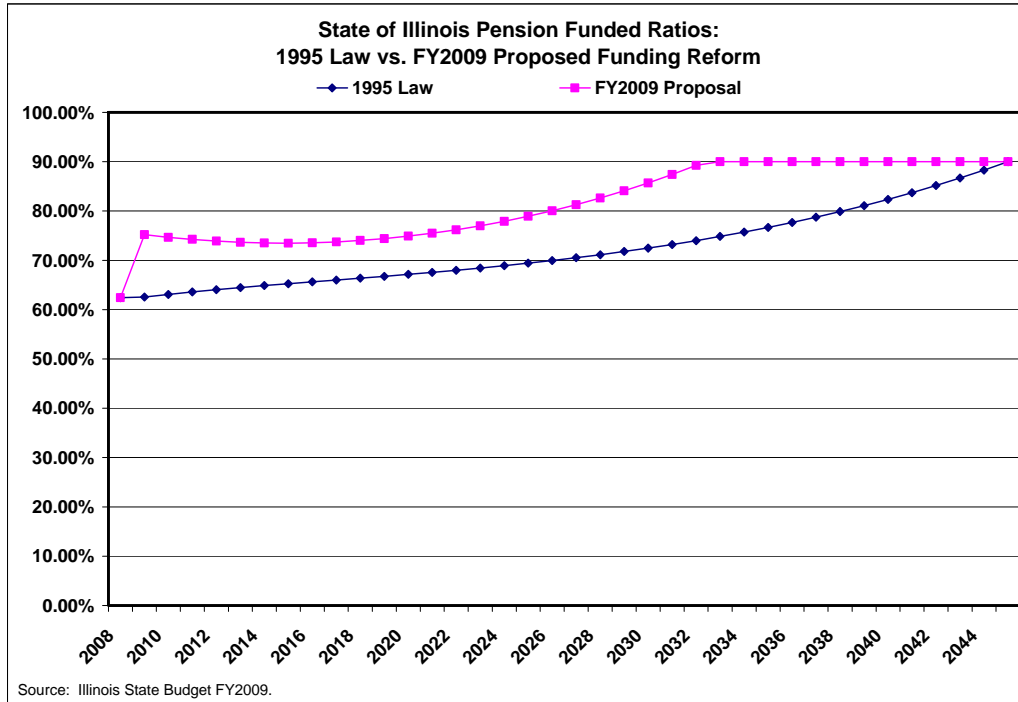
through FY2033 to pay for the \$10.0 billion 2003 pension obligation issue. This contrasted with the \$57.6 billion in debt service costs for two pension obligation bond issues (2003 and 2008) under the FY2009 reform proposal.

Overall, it was estimated that the plan would have saved the state \$55.0 billion in future contributions.²⁵ The savings would have accrued because the interest rate on the pension obligation bonds would have been approximately 5.5% while the borrowed funds would have earned 8.5% through investment returns. The “savings” represented the spread between interest paid on the bonds and interest earned on the invested funds. The state proposed to use the savings to reduce its pension obligation payments to the amount required under the 1995 pension funding reform law. The following exhibit illustrates the differences in required payments for contributions plus debt service under the current 1995 pension funding law versus under the FY2009 budget proposal.



The differences between the funded ratios of the five State of Illinois pension systems under the 1995 pension funding reform law versus under the Governor’s FY2009 proposal is illustrated below. Putting \$15.9 billion into the pension funds would have immediately increased the funded ratio from 62.5% to 75.2% in FY2009. In FY2033, the funded ratio would have reached 90%, as compared to 74.8% under the current system.

²⁵ Illinois State Budget FY2009, pp. 4-1 and 4-2.



The General Assembly rejected the Governor’s FY2009 pension funding proposal.

OTHER POST-EMPLOYMENT BENEFITS

Retired State of Illinois employees and their dependents are entitled to other post-employment benefits (OPEB), including health care, dental, vision and life insurance.²⁶ The State of Illinois pays for the retirement systems’ portion of the employer cost for these benefits for all five retirement systems.²⁷

It is projected that there will be 78,000 retirees and survivors enrolled in the state’s OPEB program in FY2010, along with an additional 157,000 dependents.²⁸ As of April 21, 2008 the actuarial liability for the state’s other post-employment obligations totaled \$24.2 billion.²⁹ OPEB costs are paid for by the state using a pay-as-you-go method, which means monies have not been set aside in a separate fund or trust to pay down this existing liability.³⁰ In FY2007, the last year for which audited financial data is available, the state’s OPEB expenses for retirees and their dependents totaled \$599.3 million.³¹

²⁶ According to the State’s audited financial statements: “Substantially all State employees become eligible for postemployment benefits if they eventually become annuitants under one of the State sponsored pension plans.” State of Illinois Comprehensive Annual Financial Report for FY2007, p. 117.

²⁷ State of Illinois Comprehensive Annual Financial Report for FY2007, p. 117; State Employees’ Retirement System of Illinois Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2008, p. 27.

²⁸ Communication between the Civic Federation and the Governor’s Office of Management and Budget, April 30, 2009.

²⁹ Communication between the Civic Federation and the Governor’s Office of Management and Budget, April 30, 2009.

³⁰ State of Illinois Comprehensive Annual Financial Report for FY2007, p. 117.

³¹ State of Illinois Comprehensive Annual Financial Report for FY2007, p. 117.

EMPLOYEE AND RETIREE CONTRIBUTIONS FOR HEALTH INSURANCE

The Governor's FY2010 budget proposal includes a \$200 million increase in employee and retiree contributions to their health insurance premiums. This increase is expected to require negotiated changes to collective bargaining agreements with employees, as well as a change to the State Employee Group Insurance Act (5 ILCS 375/10).³²

The State of Illinois Group Insurance Program serves employees, retirees, and dependents of the State government, State universities, the General Assembly, and the judiciary. Participants can choose from three major health care plan types: an indemnity plan (Quality Care Health Plan), a modified preferred provider plan (Open Access Plan), and a health maintenance organization (various HMOs). The Quality Care Health Plan (QCHP) is a self-insured indemnity plan, also commonly called a "traditional plan" or a "fee-for-service plan." Indemnity plans were the standard health insurance program before the rise of managed care plans (e.g., HMOs and PPOs) in the 1980s. A major service feature distinguishing indemnity plans from managed care plans (e.g., HMOs and PPOs) is the degree of freedom that enrollees have in choosing medical service providers. Participants are permitted to choose any physician or hospital, although QCHP provides discounted rates for use of physicians that are members of a network, a feature modeled on PPO plans. Indemnity plans also typically have higher participant out-of-pocket costs than managed care plans.

The Open Access Plan (OAP) is a modified Preferred Provider Organization (PPO), which is a plan that uses significant monetary incentives to encourage the use of network providers. The OAP has different tiers offering different levels of freedom of choice and participant cost-sharing.

Health Maintenance Organizations (HMO) are typically the most restrictive, but the lowest cost health insurance programs. HMO plan coverage is restricted to network providers only and referrals for specialized services or hospitalization must be directed by the patient's primary care physician. Participant plan costs are low, with no deductibles and limited co-payments.

The State Employees' Group Health Insurance Program had an estimated 346,451 participants in FY2009, of which 35.7% were in the QCHP indemnity plan and 64.3% were in managed care plans (OAP or HMO).³³ In FY2009 the average cost per participant was \$6,108 for the QCHP plan, compared to \$4,517 for the HMO plans and \$4,415 for the OAP plans.³⁴

The Governor's proposal would increase premiums for employees who choose to participate in the QCHP indemnity plan. According to the Commission on Government Forecasting and Accountability, QCHP participants paid an average monthly premium of \$79.15, or 12.0% of the total premium in FY2009. This would rise to \$309.56 a month, or 44.4% of the total premium in FY2010 under the Governor's proposal. The monthly premium for non-Medicare eligible

³² Commission on Government Forecasting and Accountability, "Liabilities of the State Employees' Group Health Insurance Program: Fiscal Year 2010," March 2009, p. 5.

³³ Commission on Government Forecasting and Accountability, "Liabilities of the State Employees' Group Health Insurance Program: Fiscal Year 2010," March 2009, p. 5.

³⁴ Commission on Government Forecasting and Accountability, "Liabilities of the State Employees' Group Health Insurance Program: Fiscal Year 2010," March 2009, p. 11.

retirees in QCHP would rise from \$12.98 currently to \$582.71, which would be 62.7% of the total premium in FY2010.³⁵

³⁵ Commission on Government Forecasting and Accountability, "Liabilities of the State Employees' Group Health Insurance Program: Fiscal Year 2010," March 2009, p. 14.

V. Letters & Minority Reports

Minority Report of The Civic Federation

The State of Illinois Retirement Systems:
Funding History and Reform Proposals



THE STATE OF ILLINOIS RETIREMENT SYSTEMS: Funding History and Reform Proposals

A Civic Federation Issue Brief

**Prepared by:
The Civic Federation
September 30, 2008**

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This article reviews the five retirement systems of the State of Illinois and discusses their current condition, the history of funding shortfalls and benefit enhancements, and attempts to improve the financial health of the systems.

It focuses exclusively on pension benefits and does not address other post-employment benefits such as retiree health care. The State recently projected that its liabilities for retiree health care total approximately \$24.0 billion.¹ More details on this liability will be known when the State publishes its fiscal year 2008 audited financial statements next year.²

CURRENT CONDITION OF THE STATE PENSION FUNDS

The State of Illinois funds five retirement systems for public employees and retirees: the State Employees Retirement System (SERS), the Judges' Retirement System (JRS), the General Assembly Retirement System (GRS), the State Universities Retirement System (SURS), and the Teachers' Retirement System (TRS). The Teachers' Retirement System includes all public school teachers in the state except those employed by the Chicago Board of Education, which has a separate pension fund.³ All of these systems are defined benefit plans, which guarantee retirees a specific annuity based on years of service and final salary.⁴

Members

There are a total of 506,338 active members and 189,274 annuitants receiving benefits from the five pension funds. The ratio of active employees to annuitants ranges from a high of 3.6 actives per annuitant in the University fund to a low of 0.7 actives per annuitant in the General Assembly fund. A low active to annuitant ratio can create fiscal stress because it means there are less employee contributions and more annuity payments.

Members of Illinois Retirement Systems: Current Enrollment				
Pension Fund	Active Employees	Annuitants	Total	Ratio of Actives to Annuitants
Teachers	258,531	89,269	347,800	2.9
University	156,952	43,395	200,347	3.6
State Employees	89,598	55,265	144,863	1.6
Judges	990	946	1,936	1.0
General Assembly	267	399	666	0.7
Total	506,338	189,274	695,612	2.7

Source: Illinois State Budget FY2009, p. 4-1.

¹ Yvette Shields. "Illinois OPEB Smaller but still Daunting," *The Bond Buyer*. April 22, 2008.

² Starting with its financial statements for the year ended June 30, 2008, the State will adopt the Governmental Accounting Standards Board Statement No. 45: *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

³ The State makes limited contributions to the Chicago Teachers' Retirement Fund. For more information see Civic Federation "Status of Local Pension Funding Fiscal Year 2006," pp. 15, 18 at http://www.civicfed.org/articles/civicfed_266.pdf.

⁴ A small percentage of state university employees are voluntarily enrolled in a defined contribution option called the Self-Managed Plan, which more like a 401(k). The vast majority of employees are in the defined benefit plan.

Constitutional Protection

Public employee pension benefits cannot be diminished for current employees. Article XIII, Section 5 of the Illinois State Constitution states that:

“Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.”

No such guarantee is provided for other post employment benefits, such as health insurance.

The constitutional protection of pension benefits means that once granted, benefit enhancements cannot be taken away. Benefit levels can only be reduced for new employees.

Basic Measures of Pension Fund Status

The systems have a combined accrued liability of \$112.9 billion and \$70.7 billion in assets, for a net unfunded liability of \$42.2 billion in fiscal year 2007. Accrued liabilities are actuarially calculated estimates of the total pension benefits, both current and prospective, earned by employees on the date of the estimate. Current liabilities are benefits owed to retirees in the current year, while prospective liabilities are all of the future retirement benefits promised to past and current employees and their dependents. The estimate of accrued liabilities expresses in the present value of dollars the amount of money that will be needed to pay for these earned benefits when current employees retire, so it includes assumptions about the investment rate of return, expected salary increases, mortality, turnover, and other factors.

Unfunded liabilities are those liabilities, both current and prospective, not covered by assets. Unfunded liability is calculated by subtracting the actuarial value of assets from the accrued actuarial liability of a fund.

The funded ratios of the five retirement plans range from a low of 37.6% for the General Assembly to a high of 68.4% for the University fund, with a combined funded ratio of 62.6% in FY2007. The funded ratio is the ratio of assets to liabilities and is a common indicator of the financial health of a pension system.⁵ The following table shows the five pension systems' unfunded liabilities and funded ratios for FY2007.

⁵ For more on funded ratios and unfunded liabilities, see the Civic Federation, “Status of Local Pension Funds Fiscal Year 2006”, pp. 9-10 at http://www.civicfed.org/articles/civicfed_266.pdf.

FY2007 Illinois Retirement Systems Funded Ratios and Unfunded Liabilities (\$ millions)				
Pension Fund	Accrued Liability	Net Assets	Unfunded Liability	Funded Ratio
Teachers	\$ 65,648	\$ 41,909	\$ 23,739	63.8%
University	\$ 23,362	\$ 15,986	\$ 7,376	68.4%
State Employees	\$ 22,281	\$ 12,079	\$ 10,202	54.2%
Judges	\$ 1,385	\$ 670	\$ 715	48.4%
General Assembly	\$ 232	\$ 87	\$ 145	37.6%
Total	\$ 112,909	\$ 70,731	\$ 42,177	62.6%

Source: Commission on Government Forecasting and Accountability, "Pensions: Report on the Financial Condition of the State Retirement Systems," February 2008, p. 14.

Some people believe that there is no real need to achieve 100% funding. They argue that governments, unlike private corporations, are not at risk of dissolving and, therefore, can meet their obligations in perpetuity. However, public pensions should be funded sufficiently to prevent the *growth* of the unfunded liability. If the unfunded liability is growing and the plan has no practical strategy for reducing it, this is cause for serious concern. As stated by Keith Brainard, the Research Director for the National Association of State Retirement Administrators: "More pertinent considerations with regard to funding a public pension plan may be whether: a) the amount needed to fund the benefit and amortize the unfunded liability is causing fiscal stress, and b) the plan's unfunded liability is diminishing, or there is a plan in place to reduce the unfunded liability."⁶ An employer's inability to or decision not to meet its actuarially required contribution due to fiscal stress indicates a potentially serious problem. In its recommendations to the Governor and General Assembly of Vermont, the Commission on Funding the Vermont State Teachers' Retirement System put it more bluntly: "While [insolvency] may seem somewhat far in the future, actuaries point out that the critical tipping point is not when assets run out or even decline, but when Governors and Legislatures no longer believe the required contributions are realistic and give up trying to fund the actuarially required contributions."⁷ Insolvency is closer for some funds than for others. Prior to the passage of Public Act 94-0839, the Chicago Transit Authority pension fund was projected to run out of money to pay retiree healthcare benefits in 2008⁸ and become totally insolvent in 2013 if nothing was done to reduce benefits or increase contributions.⁹ Public Act 94-0839 required increased contributions beginning in 2009 that would bring the funded ratio to 90% by the year 2058. The passage of Public Act 95-0708 established the funding sources and benefit changes required to allow the CTA pension fund to reach 90% funded by the year 2060.

⁶ Keith Brainard, *Public Fund Survey Summary of Finding for FY2004*, (National Association of State Retirement Administrators, September 2005), p. 1.

⁷ *Report of the Commission on Funding the Vermont State Teachers' Retirement System: Recommendations to the Governor and the General Assembly*, November 2005, p.12.

⁸ Retirement Plan for Chicago Transit Authority Employees, *Actuarial Valuation as of January 1, 2007*, p. 3.

⁹ Retirement Plan for Chicago Transit Authority Employees, *Actuarial Valuation as of January 1, 2006*, Presentation by Gabriel Roeder Smith on September 28, 2006, p. 6.

Nationwide Comparison

According to a Standard & Poor's analysis of state pension funds, Illinois has consistently ranked or tied for 47th lowest funded ratio in the nation over the last three years. The ranking examined the two principal state-sponsored pension systems for most states, which included only the State Employees' and Teachers' systems for Illinois. These two systems represent 71% of the total enrollment of the five state retirement systems and 80% of the total unfunded liability.

States Ranked by Pension Systems' Funded Ratio						
Rank	FY2004		FY2005		FY2006	
1	Florida	112.1%	Florida	107.3%	Oregon	110.5%
25	Arkansas	85.4%	Missouri	83.2%	Arkansas	81.3%
45	Louisiana	61.9%	Louisiana	63.5%	Alaska	61.0%
46	Connecticut	59.9%	Rhode Island	59.4%	Oklahoma	59.5%
47	Illinois (SERS+TRS)	59.9%	Illinois (SERS+TRS)	58.4%	Illinois (SERS+TRS)	59.5%
48	Rhode Island	59.4%	Connecticut	58.3%	Connecticut	56.4%
49	Oklahoma	57.0%	Oklahoma	56.9%	Rhode Island	53.4%
50	West Virginia	43.9%	West Virginia	47.1%	West Virginia	52.7%
	Mean (of 50 states)	83.5%	Mean (of 50 states)	81.8%	Mean (of 50 states)	83.5%
	Median (of 50 states)	85.4%	Median (of 50 states)	82.3%	Median (of 50 states)	85.4%

Note: The pension fund data for most states include the two principal state-sponsored retirement systems (e.g., state employees and teachers) or, in a few cases, a third large system. For 19 states, the data represent a single, all-inclusive system.

Source: Standard & Poor's: *Rising U.S. State Unfunded Pension Liabilities Are Causing Budgetary Stress*, February 22, 2006; *Improved U.S. State Pension Funding Levels Could be on the Horizon*, February 27, 2007; *Market Volatility Could Shake Up State Pension Funding Stability*, February 20, 2008

The Standard & Poor's analysis also computed the unfunded liability per capita for each state based on its principal statewide pension systems. By comparing total unfunded liability to the state population, unfunded liability per capita provides a measure of the pension obligation per resident as well as a basis for comparison across states. Illinois had the 40th or 42nd highest unfunded pension liability per capita in the last three years, with a FY2006 per capita debt of roughly \$2,524 for just the Teachers' and State Employees' retirement systems.

States Ranked by Unfunded Pension Liability Per Capita						
Rank	FY2004		FY2005		FY2006	
1	Florida	\$ (662)	Oregon	\$ (574)	Oregon	\$ (1,449)
25	Michigan	\$ 928	Missouri	\$ 1,100	Maryland	\$ 1,259
38	Nevada	\$ 1,951	Maine	\$ 2,120	Ohio	\$ 2,380
39	Mississippi	\$ 1,979	Mississippi	\$ 2,241	Louisiana	\$ 2,430
40	Illinois (SERS+TRS)	\$ 2,191	Nevada	\$ 2,370	Illinois (SERS+TRS)	\$ 2,524
41	Maine	\$ 2,268	Louisiana	\$ 2,385	Kentucky	\$ 2,537
42	Louisiana	\$ 2,391	Illinois (SERS+TRS)	\$ 2,455	Nevada	\$ 2,627
43	Ohio	\$ 2,463	Ohio	\$ 2,599	Colorado	\$ 2,686
	Mean (of 50 states)	\$ 1,183	Mean (of 50 states)	\$ 1,378	Mean (of 50 states)	\$ 1,664
	Median (of 50 states)	\$ 964	Median (of 50 states)	\$ 1,124	Median (of 50 states)	\$ 1,289

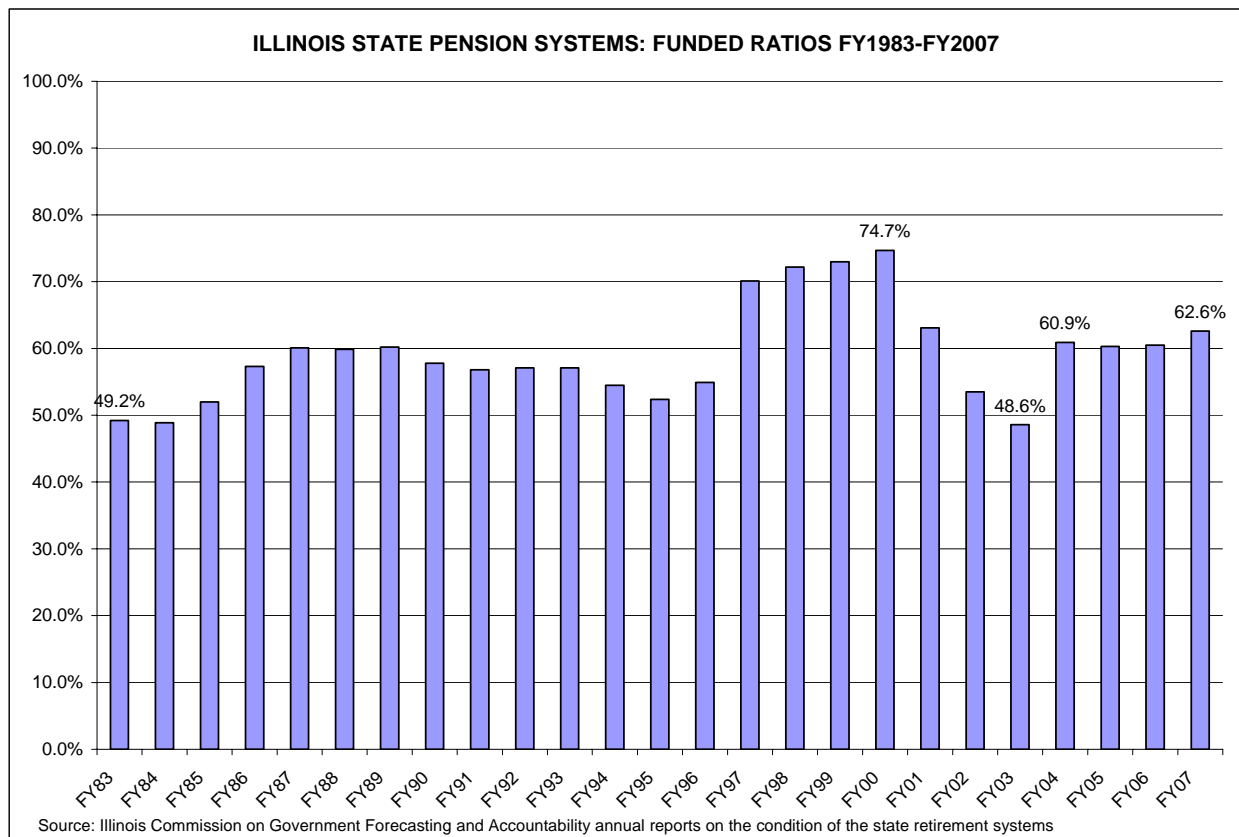
Note: The pension fund data for most states include the two principal state-sponsored retirement systems (e.g., state employees and teachers) or, in a few cases, a third large system. For 19 states, the data represent a single, all-inclusive system.

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Multi-Year Trends

Because pension systems are long-term in nature, pension fund status is best evaluated using multi-year trends, rather than a single year in isolation. Negative multi-year trends are cause for

concern because they show a lack of mechanisms to stabilize and improve the health of the pension fund. The following graph shows the composite funded ratio of the five state pension systems in the twenty-five years between FY1983 and FY2007. The ratio reached a high of 74.7% in FY2000 and a low of 48.6% in FY2003. It is important to note that changes to assumptions based on demographic trends, plan experiences or even a change in actuary can produce substantially different pictures of a fund's status, however. For example, the funded ratio jumped from 54.9% in FY1996 to 70.1% in FY1997 due primarily to a change in asset valuation methodology (changed from book value to market value of assets). Thus even multi-year trends do not necessarily provide strict “apples-to-apples” comparisons but are useful for rough illustrations of trends.



The following table provides more detail on the factors affecting changes in the total unfunded liability of the five state retirement systems. Over the last twenty years, the total unfunded liability has grown by \$34.8 billion, a five-fold increase from \$8.0 billion in FY1987 to \$42.2 billion in FY2007. By far the largest factor in this increase has been a persistent shortfall in employer (State) contributions, accounting for \$23.4 billion in additional unfunded liabilities. The shortfall is the difference between the pension contributions made by the State and the “normal cost”, which is that portion of the present value of pension plan benefits and administrative expenses which is allocated to a given valuation year, plus interest on the existing unfunded liability. In other words, normal cost plus interest is the minimum amount the employer should contribute in order to simply prevent growth of the unfunded liability, not even to pay it down. In every year except FY2004, the State failed to contribute normal cost plus

interest, so it was not even able to keep the unfunded liability from growing (FY2004 was exceptional due to the infusion of \$7.3 billion in pension obligation bond proceeds). As will be discussed later in this article, a State law that took effect in 1995 set a schedule of employer contribution amounts that is actually designed to allow the unfunded liabilities to continue to grow until the year 2034 because if the contributions will be less than normal cost plus interest until then. The fact that the normal cost plus interest contribution is so large that the State determined it would take decades before it could make that level of contribution is an indication of how unaffordable the State's pension promises have become.

In the following table, all negative amounts lower the unfunded liability while positive amounts raise the unfunded liability.

State of Illinois Retirement Systems Causes of Changes in Unfunded Liability FY1988-FY2007 (How the Unfunded Liability Grew From \$8.0 Billion in FY1987 to \$42.2 Billion in FY2007)							
	Salary Increases Higher/(Lower) Than Assumed	Investment Returns (Higher)/(Lower) Than Assumed	Employer Contribution Shortfall	Benefit Increases	Changes in Actuarial Assumptions	Other Misc. Factors	Total Change in Unfunded Liability from Previous Year
FY1988	\$ (34,052,059)	\$ 6,306,090	\$ 519,786,624	\$ 49,222,714	\$ 118,000,000	\$ 1,949,221	\$ 661,212,590
FY1989	\$ 111,550,715	\$ (52,042,288)	\$ 565,568,554	\$ -	\$ (20,887,988)	\$ 10,630,631	\$ 614,819,624
FY1990	\$ 94,547,676	\$ (243,972,980)	\$ 660,944,428	\$ 1,306,464,892	\$ 185,673,427	\$ (111,177,746)	\$ 1,892,479,697
FY1991	\$ (54,468,211)	\$ 104,663,823	\$ 812,237,689	\$ 26,065,805	\$ 214,173,000	\$ 130,791,725	\$ 1,233,463,831
FY1992	\$ 79,890,460	\$ (602,130,431)	\$ 1,030,677,439	\$ 269,361,507	\$ (78,780,129)	\$ 474,713,955	\$ 1,173,732,801
FY1993	\$ 188,489,643	\$ (362,058,701)	\$ 1,083,975,777	\$ 94,564,386	\$ 12,544,000	\$ 192,352,026	\$ 1,209,867,131
FY1994	\$ 180,359,391	\$ (230,115,526)	\$ 1,210,860,533	\$ 193,098,000	\$ 772,125,000	\$ 763,322,396	\$ 2,889,649,794
FY1995	\$ 66,868,468	\$ 237,630,645	\$ 1,506,297,408	\$ 152,891,000	\$ -	\$ 519,277,917	\$ 2,482,965,438
FY1996	\$ 277,985,995	\$ (950,269,913)	\$ 1,648,415,257	\$ 17,772,000	\$ (781,711,306)	\$ 316,831,110	\$ 529,023,143
FY1997	\$ (174,569,177)	\$ (1,718,043,900)	\$ 1,571,561,355	\$ 179,117,000	\$ (6,629,275,167)	\$ 456,217,865	\$ (6,314,992,024)
FY1998	\$ (113,186,439)	\$ (2,788,182,020)	\$ 984,293,345	\$ 2,250,183,128	\$ -	\$ 275,635,915	\$ 608,743,929
FY1999	\$ 77,096,356	\$ (988,726,350)	\$ 1,007,531,385	\$ 33,870,000	\$ 125,223,000	\$ 769,534,480	\$ 1,024,528,871
FY2000	\$ 154,524,395	\$ (1,307,066,975)	\$ 1,047,267,505	\$ 2,848,501	\$ -	\$ 326,927,419	\$ 224,500,845
FY2001	\$ 43,970,419	\$ 6,599,006,799	\$ 1,047,049,618	\$ 652,110,224	\$ -	\$ 1,068,141,533	\$ 9,410,278,593
FY2002	\$ 134,391,291	\$ 5,575,370,512	\$ 1,740,995,055	\$ 234,100,000	\$ 1,377,773,875	\$ 903,437,467	\$ 9,966,068,200
FY2003	\$ 125,633,545	\$ 2,071,493,135	\$ 2,435,147,683	\$ 2,425,023,094	\$ -	\$ 1,101,032,114	\$ 8,158,329,571
FY2004	\$ 135,696,594	\$ (3,841,756,713)	\$ (4,689,820,728)	\$ -	\$ -	\$ 385,281,832	\$ (8,010,599,015)
FY2005	\$ 35,073,822	\$ (1,033,615,146)	\$ 2,431,545,009	\$ -	\$ 26,425,000	\$ 2,048,339,759	\$ 3,507,768,444
FY2006	\$ 108,341,567	\$ (1,843,091,310)	\$ 3,484,514,960	\$ -	\$ 704,573,166	\$ (323,161,524)	\$ 2,131,176,859
FY2007	\$ 314,931,325	\$ (6,064,132,235)	\$ 3,321,010,982	\$ -	\$ 2,735,156,000	\$ 1,138,267,050	\$ 1,445,533,122
20 YEAR							
TOTAL	\$ 1,753,075,776	\$ (7,430,733,484)	\$ 23,419,859,878	\$ 7,886,692,251	\$ (1,238,988,122)	\$ 10,448,345,145	\$ 34,838,551,444

Source: Illinois Commission on Government Forecasting and Accountability annual reports on the condition of the state retirement systems

Note: "Employer Contribution Shortfall" means the difference between the employer contribution and normal cost + interest on the unfunded liability

As shown in the table above, benefit increases also added over \$7.8 billion to the unfunded liability since FY1987. In FY1998 the benefit formulas for the Teachers' and State Employees' systems were increased, adding over \$2.2 billion to the unfunded liability in that year. An Early Retirement Initiative for state employees added \$2.4 billion to the unfunded liability in FY2003.¹⁰

The effect of investment returns varies significantly from year to year depending on whether returns are higher or lower than the assumed annual rate of return. Actuaries assume a certain annual rate of return on investments based on historical averages, and when actual returns are higher than the assumed rate, they reduce the unfunded liability. The assumed rates of return are currently 8.0% for Judges, General Assembly, and State Employees, and 8.5% for Teachers and University funds. Overall, investment returns helped to reduce the unfunded liability by \$7.4

¹⁰ Commission on Government Forecasting and Accountability, "Report on the Financial Condition of the Illinois Public Employee Retirement Systems." August 2006, p.15.

billion over twenty years, but could not overcome the effects of the employer contribution shortfalls, benefit increases, and other factors.

Other “miscellaneous factors” that influence unfunded liabilities include the extent to which actual retirement rates, disability, death, and withdrawals differ from expectations.

THE PROBLEMS: INADEQUATE CONTRIBUTIONS AND UNAFFORDABLE BENEFITS

As noted above, the State of Illinois retirement systems have suffered from low funding levels for decades. The single biggest long-term contributor to State’s growing unfunded liability is the persistent shortfall in State contributions. Investment losses such as those experienced in recent years have also had a significant negative effect, but investment gains in bull markets have done much over the years to offset the State’s failure to make adequate pension contributions.

Because of Illinois’ history of underfunding its pension systems, recent Illinois governors have championed pension funding reform. Governor Edgar successfully won legislative approval of a funding reform law in 1994 that required the State to fund its pensions according to a schedule that would bring them up to a 90% funded ratio by 2045. Governor Blagojevich won legislative approval for and issued \$10 billion in pension obligation bonds. He also secured approval for the implementation of several structural reforms initially proposed by a Blue Ribbon Pension Commission. However, benefit enhancements granted between 1995 and 2003 undid much of the progress that was made in reducing the systems’ unfunded liabilities.

Contribution Shortfalls and Attempted Remedies

As noted above, shortfalls in employer contributions¹¹ are the single biggest contributor to the State’s growing unfunded liabilities. The chronic underfunding of Illinois state pension funds created the impetus for enacting a funding reform law in 1994. Public Act 88-593 went into effect in 1995 and established a fifty-year schedule of funding requirements to compensate for the State’s previous years of underfunding its pension plans. Following a 15-year phase-in period, the law requires State contributions at a level percent of payroll beginning in FY2010 sufficient to achieve a 90% funded ratio by 2045. The retirement systems calculate and certify the amount needed each year to meet the requirements of this funding schedule.

After implementation of the 1995 law annual pension contributions adhered to a fixed payment schedule. Unfortunately, they did not adjust upwards during the late 1990s economic expansion to contribute in excess of the fixed payment amounts provided for in the 1995 funding law. This was a lost opportunity to improve the funding situation during a time of strong state revenues.¹²

¹¹ Employees also contribute to the pension systems, at rates ranging from 4.0% to 11.5% of salary depending on the system and whether or not the employee is also in Social Security. See Illinois Department of Financial and Professional Regulation Division of Insurance, “2007 Public Pension Report”.

¹² See The Governor’s Pension Commission: Pension Reform Report and Recommendations for Governor Rod Blagojevich, February 11, 2005, pp. 8-9.

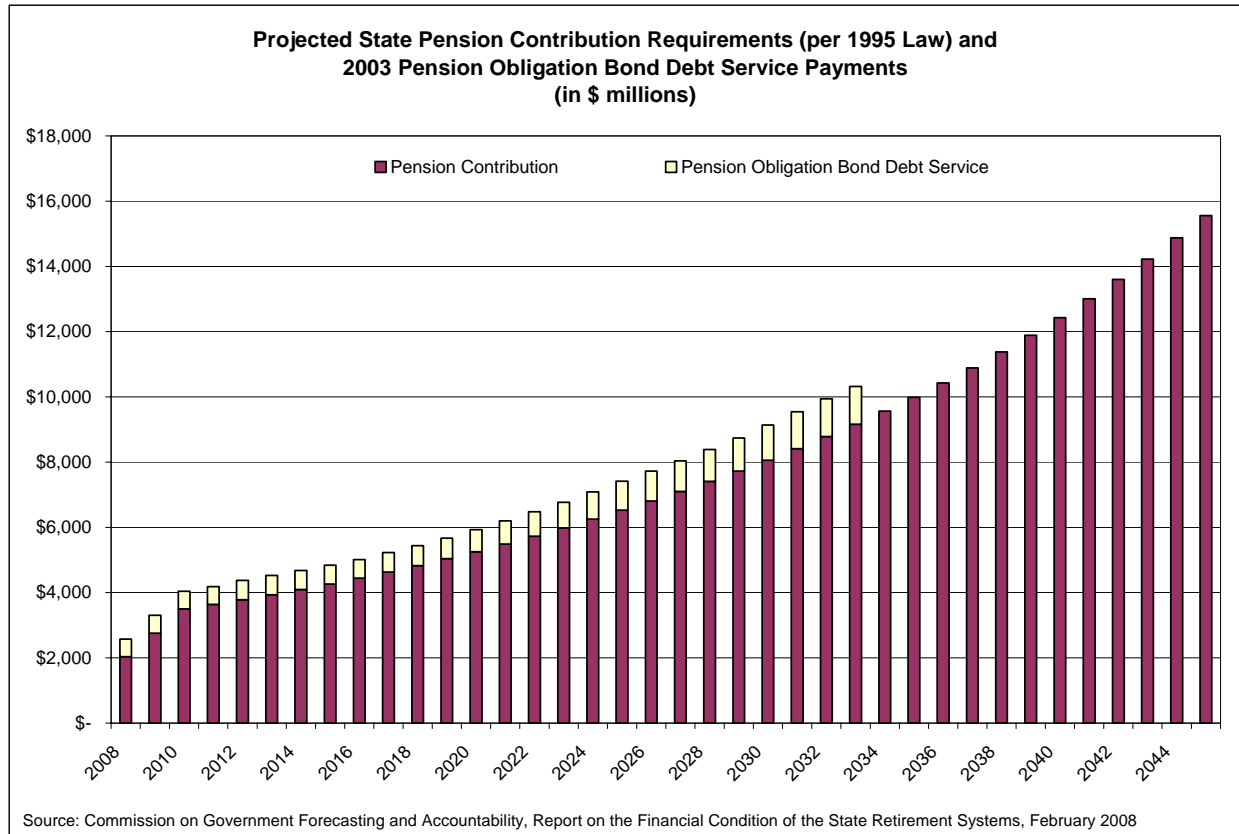
The 1995 funding schedule was subsequently modified in 2005 by Public Act 94-0004, which introduced some structural pension reforms but reduced the FY2006 and FY2007 required State contributions, thus reverting back to old habits of underfunding (see below).

Issuance of \$10 Billion in Pension Obligation Bonds in 2003

In his first year in office, Governor Blagojevich championed Public Act 93-0002, which authorized the issuance of \$10 billion in pension obligation bonds. The proceeds of these bonds were to be used to boost the pension funds' assets to compensate for past underfunding and reduce future unfunded liabilities. Unfortunately, the State ultimately used a portion of the bond proceeds to pay part of the FY2003 pension contributions and all of the FY2004 contributions, thus creating a hole in future operating budgets and putting a net amount of only \$7.3 billion toward the massive unfunded liability.

Initially, the funds' managers and the Governor's financial team estimated that the pension funds would earn investment income at the traditional long-term actuarial rate of 8.0% and that the pension bond proceeds would earn at least that rate over the 30-year life of the bonds. The financial team forecasted that savings would result from issuing the bonds at the then-current market rate of approximately 5.8%, as long as the funds earned a long-term actuarial rate of 8.0%. In fact, the bonds were actually issued at an interest rate of 5.05% while the pension funds' actuaries ultimately projected an 8.5% expected rate of return for the entire asset portfolio. The State estimated that it would realize \$860.0 million in additional "savings" from this favorable rate spread. In its FY2005 budget, the State proposed to capture \$215.0 million, or 25.0% of the additional "savings", reserving the remainder for capture in future years. The \$215.0 million "savings" was used as the justification for reducing the State's pension contribution by a similar amount in FY2005.

The State still owes over \$19.4 billion in principal and interest on the 2003 pension obligation bonds. A full accounting of the annual pension payments made by the State should include the pension bond debt service. The following chart illustrates the projected State contributions to the pension funds per the 1995 law as well as the pension bond debt service.



The FY2006-FY2007 Partial Pension Holiday

The General Assembly approved legislation (P.A. 94-0004) in 2005 authorizing reductions in State contributions to its five retirement systems from the amounts originally certified by the systems in both FY2006 and FY2007 (for a total reduction of \$2.3 billion). The exhibit below shows the difference between the certified amount for each State pension fund per the 1995 funding law and the amount that was appropriated in FY2006 and FY2007. These figures do not include debt service payments on the 2003 pension obligation bonds.

FY2006 & FY2007 Certified Contributions vs. Final General Assembly Appropriations (In \$ millions)								
System	FY2006			FY2007			Total 2-Year Contributions	Total Reduction
	Certified Contributions	P.A. 94-0004	Difference	Certified Contributions	P.A. 94-0004	Difference		
TRS	\$ 1,058.5	\$ 531.8	\$ 526.7	\$ 1,233.1	\$ 735.5	\$ 497.6	\$ 2,291.6	\$ 1,024.3
SERS	\$ 690.3	\$ 203.8	\$ 486.5	\$ 832.0	\$ 344.2	\$ 487.8	\$ 1,522.3	\$ 974.3
SURS	\$ 324.9	\$ 166.6	\$ 158.3	\$ 391.9	\$ 252.1	\$ 139.8	\$ 716.8	\$ 298.1
JRS	\$ 38.0	\$ 29.2	\$ 8.8	\$ 44.5	\$ 35.2	\$ 9.3	\$ 82.5	\$ 18.1
GARS	\$ 5.5	\$ 4.2	\$ 1.3	\$ 6.3	\$ 5.2	\$ 1.1	\$ 11.8	\$ 2.4
Total	\$ 2,117.2	\$ 935.6	\$ 1,181.6	\$ 2,507.8	\$ 1,372.2	\$ 1,135.6	\$ 4,625.0	\$ 2,317.2

Source: Commission on Government Forecasting and Accountability. Report on the 90% Funding Target of Public Act 88-0593, January 2006.

The Commission on Governmental Forecasting and Accountability, a legislative commission that provides the General Assembly with economic and financial research, estimated that the final pension contribution and reform package approved in P.A. 94-0004 would reduce the systems' total liabilities by \$38.6 billion over 40 years due to benefit reforms (see page 15). But

because P.A. 94-0004 also allowed a partial contribution holiday in FY2006 and FY2007, the State would ultimately have to contribute \$4.7 billion more to the systems over 40 years.

Estimated Impact of P.A. 94-0004 Total Projected State Contributions for FY2006-FY2045 Prepared by CGFA (in \$millions)						
State Contributions	TRS	SERS	SURS	JRS	GARS	TOTAL
Pre P.A. 94-0004	\$ 160,302	\$ 68,065	\$ 61,184	\$ 6,538	\$ 862	\$ 296,951
P.A. 94-0004	\$ 155,507	\$ 78,068	\$ 60,531	\$ 6,654	\$ 877	\$ 301,637
Difference	\$ (4,795)	\$ 10,003	\$ (653)	\$ 116	\$ 15	\$ 4,686
FY2045 Liability Reduction	\$ 26,265	\$ 667	\$ 11,690	\$ -	\$ -	\$ 38,622

Source: Commission on Government Forecasting and Accountability, August 2005 Monthly Briefing.

Governor Blagojevich's FY2008 Pension Funding Proposal

In FY2008, the State faced projected pension contribution requirements of \$2.0 billion for FY2008, climbing to \$2.7 billion in FY2009 and \$3.5 billion in FY2010. When debt service on the 2003 pension obligation bonds was included, the total payment projections rose to \$2.6 billion in FY2008, \$3.3 billion in FY2009, and \$4.0 billion in FY2010.¹³ The total \$2.6 billion payment for FY2008 represented 5.3% of the proposed \$49.0 billion FY2008 operating budget.

The Governor's FY2008 budget proposed providing the State's five pension plans with \$25.9 billion in new assets. This infusion would have created an 83.0% funded ratio in FY2008, 34 years ahead of the current 50-year funding schedule.¹⁴ It also would have reduced the total required pension contributions and debt service to \$1.9 billion in FY2008, \$2.1 billion in FY2009, and \$2.4 billion in FY2010.

The Governor's proposal utilized two financing mechanisms:

1. *The long-term lease of the Illinois Lottery:* The State proposed entering into a long-term concession of the Illinois Lottery. The State expected that the lease of the Illinois Lottery would generate \$10.0 billion in cash; and
2. *The issuance of \$15.9 billion in pension obligation bonds:* All proceeds from the bond issue would be paid into the State retirement systems. The structure of the pension obligation bond issue would have resembled the previous transaction in 2003. Debt service payments would have been supported by deductions from the unfunded liability payments that would have been necessary if the bonds were not issued.

The General Assembly rejected the Governor's FY2008 pension funding proposal.

¹³ Commission on Government Forecasting and Accountability, Report on the Financial Condition of the State Retirement Systems, July 2007.

¹⁴ Presentation by John Filan, Chief Operating Officer, State of Illinois, to the Civic Federation, March 14, 2007, p. 25.

Governor Blagojevich's FY2009 Pension Funding Proposal

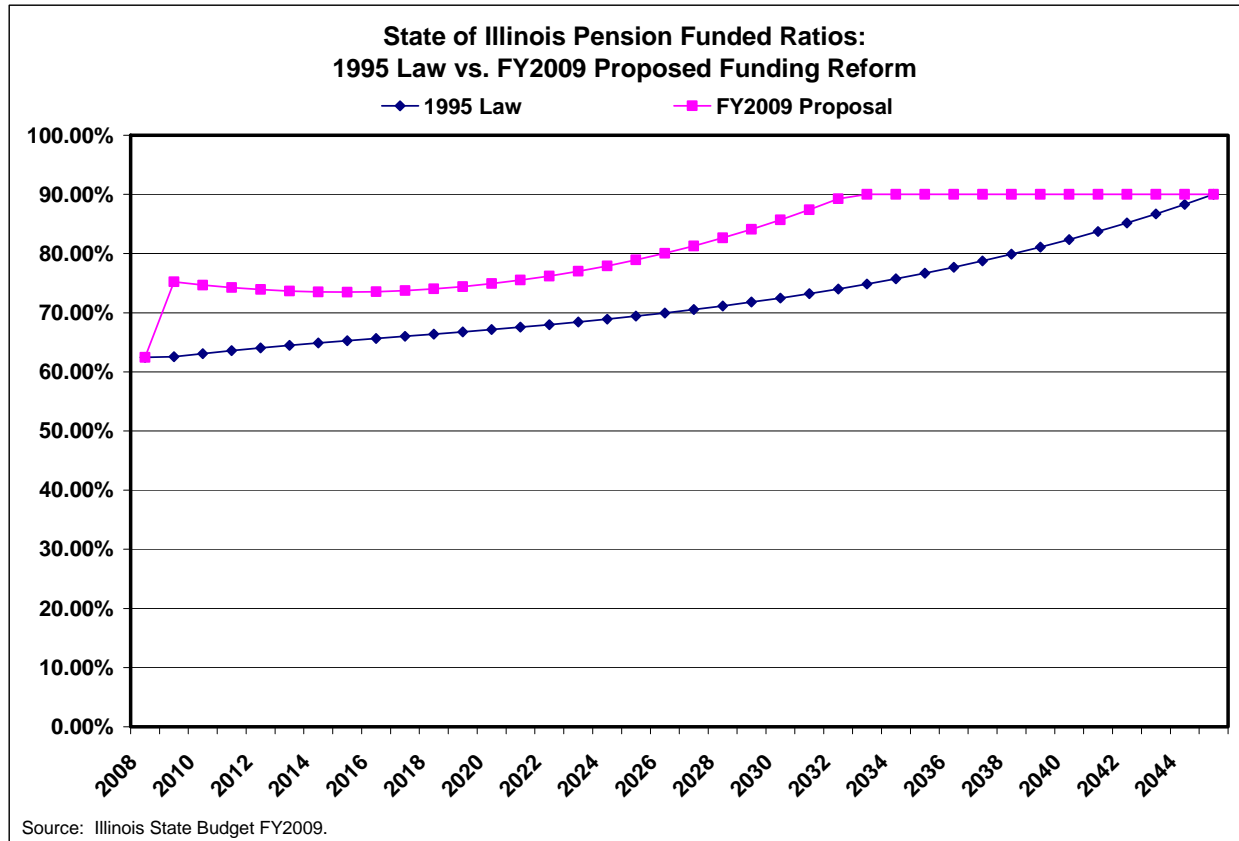
In his FY2009 budget proposal, Governor Blagojevich recommended issuing between \$12 and \$20 billion in pension obligation bonds to increase the assets of the State's pension funds. The bonds would be paid for through General Fund revenues.

If the State issued \$16 billion in pension obligation bonds (the midpoint of the Governor's proposal range), it could immediately place \$15.9 billion of that amount into the pension funds, thereby increasing the combined funded ratio from 62.6% to approximately 75.2%. One hundred million dollars would be used for administrative costs associated with bond issuance, pension payments would be rescheduled, and FY2009 payments would be set at \$280.0 million greater than the payment made in the previous year. In succeeding years, payments would be equal to \$280.0 million plus a 3% annual increase until the funds achieved a 90.0% funded ratio in 2033, twelve years ahead of the current schedule.

The Governor's office estimated that the plan would save the State \$55.0 billion in future contributions.¹⁵ The "savings" would accrue because the interest rate on the pension obligation bonds would be approximately 5.5% while the borrowed funds would earn 8.5% through investment returns. As with the 2003 pension obligation bonds, the "savings" represent the spread between interest paid on the bonds and interest earned on the invested funds. Also as in 2003, the State proposed to use the savings to reduce its required pension contributions from the 1995 pension funding law schedule.

The differences between the funded ratios of the five State of Illinois pension systems under the 1995 pension funding reform law versus under the Governor's FY2009 proposals is illustrated below. Putting \$15.9 billion into the pension funds would immediately increase the funded ratio from 62.5% to 75.2% in FY2009. In FY2033, the funded ratio would reach 90%, as compared to 74.8% under the current system.

¹⁵ Illinois State Budget FY2009, pp. 4-1 and 4-2.



A bill permitting the issuance of \$16 billion in pension obligation bonds was passed by the Illinois Senate in May but failed to pass the House of Representatives.

Benefit Enhancements and Proposed Reforms

Between 1987 and 2003, benefit enhancements added \$7.8 billion in unfunded liabilities to the pension systems. Between 1995 and 2003, Governors Edgar and Ryan, with support from succeeding General Assemblies, weakened the impact of the 1995 pension funding law by approving benefit enhancements that added \$5.8 billion in unfunded liabilities.

Illinois State Pension System Benefit Enhancements: 1995-2003		
Year	Benefit Enhancement	Cost
1995	TRS Early Retirement Incentive	\$ 150,000,000
1997	SURS Conversion from Step Rate to Flat Formula	\$ 180,000,000
1998	TRS Conversion from Step Rate to Flat Formula	\$ 1,000,000,000
1998	SERS Conversion from Step Rate to Flat Formula; Alternative formula final rate of pay conversion from average of final 4 years to pay on final day	\$ 1,250,000,000
2001	SERS Rule of 85 added; alternative formula conversion from Step Rate to Flat Formula	\$ 650,000,000
2002	SURS added 30 years of service and out provision	\$ 60,000,000
2002	SERS added highway maintainers and DHS security to alternative formula	\$ 170,000,000
2003	SERS Early Retirement Incentive	\$ 2,370,000,000
TOTAL		\$ 5,830,000,000

Source: FY2006 Illinois State Budget, p. 2-2.

One of the biggest contributors to increased retirement costs was the Early Retirement Incentive (ERI) offered to state workers in 2002. The full cost of the ERI was originally estimated to be \$622 million in additional unfunded pension liabilities, or approximately \$80,000 per employee. The liability was to be amortized over 10 years at an annual cost of \$70 million. However, there were a number of errors in the original estimate and assumptions that soon proved false. First, instead of accruing a retirement benefit equal to 1.67% of their final paycheck for the first ten years of service, as is usually the case, retirees in “high stress” jobs such as public safety positions were credited with a 2.5% accrual rate. Approximately one third of state employees were classified as working in “high stress” positions. For all other employees, the ERI package waived the penalty that normally would have reduced annual pension payments by 6% for each year an employee was less than 60 years of age at the time of retirement. Therefore, a 50-year-old employee would reap the same benefits as a 60-year-old employee. These two changes added costs of approximately \$62,000 per employee, boosting the average ERI cost of \$80,000 to \$142,000.¹⁶

The two changes described above also encouraged younger workers to retire. Roughly half of retirees were 55 or younger. Consequently, the State will pay this group’s retirement costs for a longer period of time than is usually the case because they live longer in retirement, thereby further boosting costs. The ERI also had provisions allowing retirees to purchase additional years of service. These two additional factors added an average of \$58,000 in costs per retiree for a total average cost of \$200,000, far in excess of the original estimate of \$80,000 per person.¹⁷

When the estimates were revised in 2003, the total additional unfunded liabilities were calculated at \$2.4 billion, or four times the original estimate of \$622 million. This was a \$1.8 billion error. The recalculated annual cost to amortize the ERI jumped from \$70 million to \$382 million.

¹⁶ Information on the cost of the early retirement initiative is from Greg Burns, “Pension Debacle Grows,” in *Chicago Tribune*, March 28, 2004.

¹⁷ Greg Burns, “Pension Debacle Grows,” in *Chicago Tribune*, March 28, 2004.

Adhering to the 10-year amortization plan would have required such a sharp increase in pension contributions that Governor Blagojevich and General Assembly subsequently chose to eliminate the 10-year amortization period and fold the ERI liability into the general liability of the pension systems, amortized through the year 2045 (P.A. 94-0004).

FY2006 Pension Benefit Reform Proposals

Governor Blagojevich made a number of pension reform proposals in the FY2006 State of Illinois Budget. These proposals were all originally recommended by the Governor's Blue Ribbon Pension Commission, which was composed of representatives from the General Assembly, business, labor, and civic groups. The Governor accepted all but the following two Commission recommendations:

- Require employees to increase the percentage of salary they pay into the retirement systems by 1%; and
- Consider shifting from a defined benefit to a defined contribution plan at some point in the future.

The General Assembly approved a few of the Governor's proposed reforms with some modifications. The most significant proposals enacted into law as Public Act 94-0004 were capping end-of-career salary increases, eliminating the State Universities Retirement System money purchase option for new hires, limiting eligibility for alternative formulas, and requiring funding for enhanced benefits. The legislators rejected the Governor's proposals to:

- Change the eligibility for full benefits to age 65 with between 8 and 30 years of service; age 62 with 30 to 35 years of service; or age 60 with 35 years or more of service; and
- Limit automatic benefit increases for new hires to the lesser of the change in the rate of inflation or 3% and apply increases only to the first \$12,000 in annual pension for retirees covered by Social Security and \$24,000 for retirees not covered by Social Security.

New proposals approved by the legislature and signed into law by the Governor enacted a two-year deferral of \$2.3 billion in pension contributions, created a second Blue Ribbon Task Force to further study pension reform, created a cost neutral early retirement program, and eliminated lump sum awards for earned and untaken sick pay.

The exhibit below presents a comparison of the Governor's FY2006 original reform proposals, as well as new proposals that were advanced during the legislative session and the final action taken by the General Assembly.

FY2006 Pension Reform Proposals: Governor's Original Proposals vs. Final Approved Proposals	
Governor's Original Proposals	FINAL BUDGET APPROVED
Cap End of Career Salary Increases to 3%	6% annual Cap Adopted
Eliminate SURS Money Purchase Option (New Hires)	Approved
Recalculate Money Purchase Interest Rate to Reflect Long-Term Rate of Return, not 9%	Authorized Comptroller to set rate
No New Benefits w/o Funding	Approved
Limit Alternative Formula Benefits (New Hires)	Approved
Limit Automatic Annuity Increases to Rate of Inflation	Not Approved
Change Retirement Age (New Hires)	Not Approved
New Proposals	
Defer Pension Contributions by \$2.3 Billion over 2 Years	Approved
Create a second Task Force to Study Pension Reform	Approved
Create Cost Neutral Early Retirement Program Paid for by Local Employers/Beneficiaries	Approved
Eliminate Lump Sum Awards for Unearned Sick Pay to Boost Pensions	Approved

CIVIC FEDERATION STATE PENSION REFORM RECOMMENDATIONS

Over the course of different Governors and different General Assemblies, the State of Illinois has underfunded its retirement systems while approving expensive benefit enhancements. The modest benefit reforms enacted in Public Act 94-0004 represent a small step toward recognition that the retirement benefits granted to public employees have become unaffordable for the State. The contributions required to bring the systems to 90% funded by 2045 are rapidly crowding out spending on other State programs. The projected \$4.0 billion required payment for pension bond debt service and system contributions in 2010 will likely represent 7% of the State's total operating budget. The more the unfunded liability is allowed to grow, the more the costs of current government services are shifted onto future generations.

The State of Illinois must implement comprehensive pension benefit reforms if it is ever going to seriously address the long-term costs and liabilities of its five retirement systems. A model for sound pension benefit restructuring was provided last year upon the approval of landmark pension and healthcare reforms for the Chicago Transit Authority through HB 656. The General Assembly, as part of omnibus mass transit funding and structural reform legislation, implemented the following CTA pension reforms:¹⁸

- Increasing employee contributions to the pension fund from 3% of payroll to 6%;
- Reducing the amount of pension benefits available at age 55 with 10 years of service (pension benefits were formerly available at age 55 with 3 years of service) for new hires; and
- Making full pension benefits available at age 64 with 25 years of service (full benefits were formerly available at age 55) for new hires.

The General Assembly should consider the same types of reforms for the State's five retirement systems. Because the Illinois Constitution protects employees' pension benefits once granted, benefit levels can only be scaled back for new hires. In addition to scaling back unaffordable benefits, the State must also end the practice of taking pension contribution holidays.

¹⁸ See Illinois P.A. 95-708.

Fund State Pension Systems at Certified Contribution Amount

The State of Illinois has a responsibility to follow the mandate of the 1995 pension funding reform law. Fixing the pension funding problem requires discipline and sacrifice. We urge the State to fund its pension obligations at the full amount required by the 1995 law each year. The State should not add new programs and recurring operating expenditures until it pays down its existing, constitutionally-guaranteed pension obligations. Each time the State reduces contributions to the retirement systems, it is deferring expense to future years.

Impose a Moratorium on New Pension Benefits

The General Assembly approved the Pay-As-You-Go Act as part of P.A. 94-0004, which requires that any State pension enhancements also provide for their own funding. While this plan is a more fiscally responsible approach to pensions than the State has had in the past, the General Assembly can still add to the State's already unaffordable pension plans if it identifies new revenues, thus potentially leaving taxpayers on the hook for continuously expanding benefits and costs. The State should impose a moratorium on **any** new employee benefits until the pension system has achieved a 90% funded ratio. We call on the legislature to reject, and the Governor to veto, any new pension enhancements regardless of whether they are tied to additional funding sources.

Raise the Retirement Age for New Hires

Members of the State's retirement systems are currently eligible for full retirement benefits when they reach age 60, unlike most private sector retirement systems, which make 65 the minimum age of retirement with full benefits. The Civic Federation believes that the age at which employees become eligible for full benefits should be increased to age 65 for employees with between 8 and 30 years of service, age 62 for employees with between 30 and 35 years of service, and age 60 for employees with 35 or more years of service.

Fix Automatic Increases for New Hires at the Lesser of 2% or the Rate of Inflation

The current rate of automatic increase for retirement annuities is 3% per year. Other retirement systems index the rate of increase to the rate of inflation, limit the dollar amount of increase, or approve new increases on an ad hoc basis. For new hires only, automatic increases should be limited to the lesser of the rate of inflation or 2% and should apply only to the first \$12,000 in annual pension payments for retirees covered by Social Security and \$24,000 for retirees not covered by Social Security.

Require Balance on Pension Boards between Employees, Management, and Taxpayers

The State should require a balance of employee, management, and taxpayer interests in the governance of its retirement system Boards. Board seats should be set aside for members with professional expertise or certification in financial asset investment, and all members who do not already possess such expertise should be required to receive some relevant financial training on an annual basis.

Require a 1% Increase in Employee Contributions

Employees covered by the State retirement systems contribute a percentage of their compensation for their own pensions and to fund survivors' benefits. For example, for members of the State Employees Retirement System (SERS), employees covered by the regular retirement formula are required to make the following contributions:

- Members with Social Security: 3.5% of compensation (pension) + 0.5% (survivors) = 4% total
- Members without Social Security: 7% of compensation (pension) + 1% (survivors) = 8% total

The Civic Federation believes that all public employees covered by the State's five retirement systems should contribute an additional 1% of their salaries to the cost of their pensions.

Study the Costs and Benefits of Conversion to a Defined Contribution Plan

The State should undertake a study to determine both the costs and benefits of moving to a defined contribution pension plan such as is now the private sector standard. Such a move would require a very large infusion of assets into the system, such as from a multi-billion dollar asset sale or pension obligation bond issue. This would be necessary because the State would still be required to provide benefits to employees in the existing defined benefit plans for decades. This obligation would persist even as the funding stream for those plans diminishes with the shift of new employees into the new defined contribution plan. There would also be a need for start up funds for the new defined contribution plan.

V. Letters & Minority Reports

Letter from Office of the Governor to
Chairman McNeil and the Illinois Pension
Modernization Task Force



OFFICE OF THE GOVERNOR

207 STATE HOUSE
SPRINGFIELD, ILLINOIS 62706

PAT QUINN
GOVERNOR

OCTOBER 13, 2009

PENSION MODERNIZATION TASK FORCE

Key Recommendations

The goal

To stabilize the Illinois pension system in order to meet the State's constitutional and legal obligation to fund existing and future liabilities. Pension reform needs to happen now, as the longer the State waits, the larger the problem—now over \$70 billion—becomes.

How we got here

The pension funding crisis is the result of a number of factors, including:

- Inadequate funding, that is, funding below accepted standards of normal cost plus amortization of the unfunded liability;
- Low requirements for employee contributions in the pension code, as compared to what is required to fund a long pension benefit with cost of living adjustments;
- Adoption of new benefits without additional funding; and
- Investment returns below actuarial assumptions.

Key Principles for Consensus and Compromise

A multi-faceted approach is necessary to address the crisis. We propose:

- Securing appropriate funding from numerous sources;
- Creating sufficient new revenue streams;
- Solving the problem sooner as a much less costly solution because the longer Illinois waits to address this problem, the larger it will get; and
- Modernizing and reforming the current system.

October 2009

Key Elements

Funding

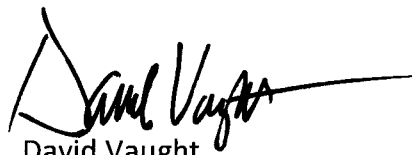
- Consistent and increased funding is required to meet existing and future pension obligations.
- The 1995 ramp was too long and gradual to secure a strong funding system. A new, shorter phase-in, whether by a ramp or stair-step increases, is necessary to move from the funding currently required in FY 09 to full actuarial funding, with a target of 90% funding in 2045. This phase-up of funding needs to occur over a multi-year period, with annual increases as permitted by State revenue growth in order to be sustainable.
- Increases in employee contribution rates will help provide a secure, reliable, and steady source of funding, but should be implemented only through the collective bargaining process.
- Pension obligation bonds, such as those suggested in the prior legislative session by Senator Don Harmon, should be utilized, when market conditions permit, as a debt swap to refinance a portion of the existing unfunded liability. Bonding about 20% of the unfunded liability, if financed at less than the actuarial rate, would provide:
 - a down payment to supplement regular annual payments;
 - long-term savings;
 - needed cash for reinvestment by the pension systems; and
 - a more secure guarantee of payment by the State.
- Pension obligation bonds issued so far have been used in large measure as a substitute for regular pension contributions, in effect borrowing to pay the ongoing cost of pension benefits. In the future, such pension obligation bonds should be used primarily as a pure debt swap and in tandem with required contributions for normal cost.
- Reduction of the actuarial target from its current 8½% rate to the 8% rate most states use would make pension funding actuarial calculations more conservative and more realistic. It would recognize that a portion of pension portfolios are invested in safer, lower yielding fixed income instruments. The proper discount rate for valuing the unfunded liabilities of the pension system is the long-term actuarial assumption for rate of return. The Task Force should recommend that each of the systems examine the current assumption to modify the assumption based on long-term realistic market assessments and make recommendations for a consistent assumption.
- A broader investment policy, including the implementation of Public Act 96-0753 (HB 2557), should be utilized to maximize diversification and return.
- Asset smoothing, adopted into law in 2009, should continue to prevent disruption of State budgets as markets change.
- Asset infusions should continue to be pursued as possible funding sources to minimize the unfunded liability.

Revenue Enhancements

- The existing State structural deficits, where expenses grow faster than revenues, must be brought into balance to enable adequate pension funding.
- Increases in taxes based on ability to pay must be utilized as part of a funding solution.
- Consideration should be given to studying the taxation of some early retirement income, not including any Social Security payments. Illinois is one of only two states with an income tax that do not tax some retirement income.

Modernization and Reform

- Modernization, including the current provisions of SB 1292, sponsored by Representative Kevin McCarthy, is a necessary element in a package to comprehensively address funding and revenue concerns.
- While the existing benefit structure for current employees and retirees must remain intact, reformed pension benefits for new hires will provide long-term savings. A second tier of benefits for new hires does not solve the immediate problem of paying for the existing unfunded liability.
- Some moderation of retirement age provisions could be made, provided the remaining provisions of SB 1292 are intact, to provide a substantial—not just token—reform.
- Modifications to the pension code to encourage employees to continue working beyond the years required to accrue maximum pension benefits should be made to reduce the burden on the state's pension cost and help retain valuable employees.
- Benefits for most public employees are comparable to other states but compounding fixed COLA's, early retirement ages, short benefit calculation periods, and excessive wage bases are among the provisions that require adjustment in a pension modernization.
- Outlier provisions, such as double-dipping, union perks, and other similar perks—all of which favor only a small proportion of annuitants—must be addressed to insure that the larger number of moderate pensions do not appear tainted as well.
- A task force should convene every 3-5 years to provide ongoing review of the State pensions.



David Vaught

Senior Advisor to the Governor

V. Letters & Minority Reports

Letter from Representative Kevin McCarthy
to Chairman McNeil and the Illinois
Pension Modernization Task Force



DISTRICT OFFICE:
8951 WEST 151ST STREET
ORLAND PARK, ILLINOIS 60462
(708) 226-1999
FAX (708) 226-9068

ILLINOIS HOUSE OF REPRESENTATIVES
KEVIN A. MCCARTHY
STATE REPRESENTATIVE - 37TH DISTRICT

SPRINGFIELD OFFICE:
271 - S STRATTON BUILDING
SPRINGFIELD, ILLINOIS
62706
(217) 782-3316
FAX (217) 789-6250

November 6, 2009

Chairman McNeil and Task Force Members,

It has been a privilege to serve on the Pension Modernization Task Force with you, and I believe the hearings were informative and allowed for generous input by all interested parties.

After listening to the many different views, I am more convinced than ever that significant changes are needed to sustain our pension systems. Much of the presented information has made it crystal clear that the financial condition of our five systems is deplorable, and threatens their very existence. Any reasonable individual would have to admit that the funding projections for the current systems would be impossible for any future General Assembly to meet. Tough choices need to be made, and they need to be made now.

With this in mind, I believe a two tier system for new employees is absolutely necessary. This new program should include older retirement ages; an annual increase for retirees tied to the Consumer Price Index, or another index; a limit on pensionable salary; reductions in the benefit accrual rates; and, a new formula for determining final average salary. The contribution for these new employees should be recalculated, using a more reasonable expected rate of return. There should also be a prohibition from receiving any government pension while working in another position where a government pension can be earned.

Further study should be recommended to determine what future benefits, those not previously earned by current employees, can be altered without violating current constitutional provisions.

Thank you for including these remarks in the final report.

Sincerely,

A handwritten signature in cursive script, reading "Kevin A. McCarthy", is written in dark ink.

Kevin McCarthy

State Representative

V. Letters & Minority Reports

Letter from Representative Roger Eddy to
Chairman McNeil and the Illinois
Pension Modernization Task Force



ILLINOIS HOUSE OF REPRESENTATIVES
STATE OF ILLINOIS

ROGER EDDY

State Representative • 109th District

108 South Main, P.O. Box 125
Hutsonville, Illinois 62433
(618) 563-4128
(618) 563-4129 Fax
redyunit1@aol.com

234-N Stratton Office Building
Springfield, Illinois 62706
(217) 558-1040

November 4, 2009

Over the last four months, the Pension Modernization Task Force and its subcommittees have convened numerous times and were presented with factual information to analyze and discuss at each meeting. Overall, the information presented demonstrated that current state pension system benefits were not overly generous when compared to other state public benefit systems. Certain benefit elements in Illinois' pension system, however, could be modernized to provide a cost savings to the State in the long term. Examples of potential benefit modernizations include raising the retirement age, reducing cost of living increases, and capping the maximum amount of pensionable income. That being said, the benefits for current employees should remain unchanged pursuant to Article XIII, Section 5 of the Illinois Constitution.

It should be noted that the one consistent fact revealed during every meeting of the task force was that changing the state pension system employee benefits will not reverse the nearly \$80 billion in pension fund liabilities. The only way we can reduce the liabilities is to change our budgeting behavior by prioritizing pension funding. Payments must be reflective of true actuarial-based calculations, not calculations reflective of General Revenue Fund balances after other spending priorities in the budget have been established. Once a realistic pension payment schedule is in place, pension benefit modernization can take place.

There is no doubt that our pension debt cannot be mitigated solely by borrowing or changing employee benefits. Illinois must adhere to an actuarial-based pension payment schedule that will advance the pension systems to a 90% funded ratio going forward.

Employee benefit modernization is a logical partnership to prioritizing the State's contributions to the pension system. Opportunity lies in the way we handle future pension funding and state pension system benefit modernization. Care should be taken, however, to not overly standardize pension system benefits. The Teachers Retirement System and the State Universities Retirement System employees do not contribute to Social Security; thereby wholly relying on their state pensions upon retirement. This fact needs to be taken into consideration when recommending benefit changes.

The issues of adequate pension funding and employee benefit modernization are here to stay and must be addressed simultaneously to maximize our pension reform efforts.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Roger L. Eddy", written over a light-colored, possibly embossed, signature line.

Roger L. Eddy

V. Letters & Minority Reports

Letter from Representative Raymond Poe to
Chairman McNeil and the Illinois
Pension Modernization Task Force

SPRINGFIELD OFFICE:

E-1 Stratton Building
Springfield, Illinois 62706
217/782-0044
FAX: 217/782-0897



RAYMOND POE
STATE REPRESENTATIVE - 99TH DISTRICT

COMMITTEES:

- Appropriations - Higher Education
- Personnel & Pensions
Minority Spokesperson
- Environment & Energy
- Prison Reform
- State Government Administration
- Transportation, Regulation,
Roads, & Bridges
- Commission on Government
Forecasting & Accountability

October 16, 2009

Mr. Donald McNeil, Chairman
Illinois Pension Modernization Task Force
One North Wacker Drive, Suite 4400
Chicago, Illinois 60606-2833

Dear Chairman McNeil:

As a member of the Pension Modernization Task Force and Representative to the largest contingency of state employees in Illinois, I would like to thank you for the opportunity to serve on the Benefits Subcommittee. I believe the testimony provided by officials of both the public and private sectors will prove beneficial to the process of seeking out real solutions to our State's pension problems.

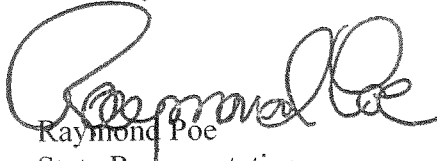
After reviewing the submitted testimony and comparing Illinois' public pension system to other states, I find it telling that Illinois' \$17,568 average annual retirement benefit for all public employees ranks below the amount paid by comparable states. This reality, combined with the fact that Illinois' annual retirement benefits are in line with the overall national average, it is hard to argue that state pension system benefits are the source of the fiscal challenges facing the state pension systems.

So how do we effectively address our embattled pension system? Some have suggested a shift to a state employee 401(k)-style plan as a way out of this financial mess. While this approach has been popular with private sector employers, we need to remain mindful that there are distinguishable differences between public and private sector employment. While private sector employers are often motivated by financial gains, public sector employers like the State of Illinois are bound by the constitution to serve the public and eliminate poverty. We only need to look at past failures of other states, such as Alaska, Michigan, and West Virginia, to understand that shifting state employees from a defined benefit system to a defined contribution system is not the financial panacea we are hoping for the State pension systems.

The truth is that Illinois' pension systems are victim to decades of financial neglect. Until we prioritize state pension funding in the budget and pay the combined \$80 billion in pension liabilities to our five retirement systems, we will not make headway against our mounting debt.

I believe the answer to resolving our financial problems with the state pension systems lies in establishing a 50-year binding pension funding schedule that legislative leaders and the governor cannot shortchange. The General Assembly and the governor should also consider establishing a funding source to financially stabilize the pension systems.

Sincerely,

A handwritten signature in black ink, appearing to read 'Raymond Poe', written in a cursive style.

Raymond Poe
State Representative
99th District

V. Letters & Minority Reports

Minority Report of the
Illinois Education Association

Pension Modernization Task Force

- Submitted by Will Lovett, Illinois Education Association

Opening Statement:

The IEA appreciates the opportunity to serve on the Pension Modernization Task Force. The chance to discuss the issues, data and competing ideas was a useful exercise.

We would like to state here three facts that we believe are extremely significant to this discussion:

- These members DO NOT receive Social Security benefits.
- Average Statewide TRS Annuity = \$41,532
- Average Statewide SURS Annuity = \$27,936

In recognizing these facts and considering the discussions of the task force, we offer the following recommendations for your review:

Recommendations for the Benefits Subcommittee:

- Reconstitute the Pension Laws Commission.
- Review benefits, funding and investments on a 3 – 5 year basis.
- Statement acknowledging Illinois teachers' pension benefits are average and cost less when compared to other states.
- Statement acknowledging that the state's normal retirement costs are comparable and at times less than the cost of the private sector model.

Recommendations for the Funding Subcommittee:

- Encourage the General Assembly to seek new revenue.
- State should at a minimum adhere to current funding plan.
- COGFA should continue to study asset-transfers.

Recommendations for the Investment Subcommittee:

- Recommendation: None.

We provide further detailed information about our recommendations in the following pages.

We look forward to discussing these recommendations as we move forward.

Recommendations for the Benefits Subcommittee:

Recommendation: Reconstitute the Pension Laws Commission.

The Task Force should consider reconstituting the Pension Laws Commission to provide a forum to analyze benefits, funding and investments. The Commission's sole responsibility would be focused on pension issues and could properly and thoroughly discuss proposed benefit changes and enhancements, their costs, and the impact on the state's budget. This would serve as a mechanism to ensure Illinois pension benefits continue to remain within the mainstream when compared to neighboring states.

Background

The Pension Laws Commission was a forum established in the 1990s that was utilized to critique pension benefits legislation. The Commission was comprised of General Assembly members along with individuals from labor and the public. The Commission was eliminated in 2003 and its remnants were consolidated into the Commission on Government Forecasting and Accountability.

It was the accepted practice that pension provisions must pass the Commission before making their way through the legislature. This practice helped to ensure that when legislation was passed, there was a clear understanding how the provisions were to work and most importantly, how they would be funded.

Understanding how the Commission functioned while in existence is crucial to understanding why it should be reconstituted. The Commission was solely dedicated to pension issues. It gave all involved parties the ability to dutifully discuss and negotiate legislation in a forum with staff assistance to ensure everyone knew what was actually in the bill and how it would impact each respective party. The Commission utilized the assistance of an actuary and was better able to flush out the meaning and intent of pension legislation. Some may argue that current legislative committees working with pension issues could do this work. However, the discussion about two-tier benefits exhibits that there is much misinformation about where Illinois ranks in the way of pension benefits and how a two-tier pension system impacts the current retirement systems. A forum such as the Pension Laws Commission could assist with the processing of information.

Recommendation: Review benefits, funding and investments on a 3 – 5 year basis.

The Task Force should consider the review and study of benefits, funding, and investments every three – five years by a legislatively created task force such as the one currently in place. This would serve as a mechanism to ensure Illinois pension benefits continue to remain within the mainstream when compared to neighboring states. Perhaps this task force could serve under the recommended Pension Laws Commission.

Recommendation: Statement acknowledging Illinois teachers' pension benefits are average and cost less when compared to other states.

The Task Force should issue a statement acknowledging Illinois teachers' pension benefits are average and cost less when compared to other states. During the subcommittee task force meetings, findings from outside organizations and states found that on average Illinois teachers pay more for benefits and receive less in benefits when compared to other comparable states.

Below is data collected by the Benefits sub-committee to support this recommendation:

Oregon Public Employees Retirement System: The Benefits subcommittee invited the Oregon Public Employees Retirement System to discuss their state's experience with a multi-level pension system. The discussion revealed that Oregon's third-tier benefits cost their state 4-5% of salary more than TRS costs the State of Illinois. Oregon's total retirement costs equaled 12.1% of payroll, while Illinois' cost for TRS will drop to 6.63% in the coming years. Oregon public employees receive Social Security benefits and Illinois teachers do not.

Retirement costs in neighboring states are: Indiana (12.85%), Iowa (14.24%), Kentucky (7.25%), Michigan (11.8%), Missouri (8.71%), and Wisconsin (10.6%).¹

AON Consulting: The Benefits subcommittee asked AON Consulting to prepare a report comparing the public and private retirement programs. The AON report showed that when comparing Illinois to comparable states, Illinois teachers pay 15% more for their retirement benefits; Illinois teachers contribute 9.4% of their salary, while teachers in the other states contribute 8.14%. Additionally, AON's research found that "***Illinois teachers receive***

¹ Social Security costs are included when applicable.

a lesser benefit” than their colleagues in other states ***“even though they pay more for their benefit.”*** AON’s report showed a “hypothetical” benefit for teachers in the other states to be \$27,117, while Illinois teachers would only receive a benefit of \$25,850.

Recommendation: Statement acknowledging that the state’s normal retirement costs are comparable and at times less than the cost of the private sector model.

The Task Force should issue an affirmation that the retirement costs for the state are actually lower than the costs for private employers. It must be clearly understood that 78% of those in the state retirement systems do not receive Social Security coverage. Every single employer in the private sector must provide Social Security coverage for their employees. This is a cost to private employers amounting to 6.2% of their payroll.

Additionally, many private employers provide a contribution to a 401k plan. According to a press release from the “51st Annual Survey of Profit Sharing and 401k Plans” report, *“Private company retirement contributions averaged 4.4 percent of payroll. They are highest in profit sharing plans (8.6 percent of pay) and lowest in 401(k) plans (3.2 percent of pay)”*. Adding the average employer contribution of 4.4% of pay to the mandatory 6.2% of payroll payable towards Social Security amounts to a total private employer contribution of 10.6% of pay. When you compare this to the state’s normal cost of TRS at 6.63%, the private sector costs are more expensive. The graph exhibited by Appendix A illustrates this data.

Conclusion

Data collected from state pension systems shows that the current level of TRS benefits is average and affordable. Appendix B shows that the State’s share of the normal cost of benefits is affordable and becomes more affordable throughout the life of the plan. The current normal cost to the state to fund TRS is 7.75% and drops to 6.63% by 2038, putting TRS within 0.4% of the cost of Social Security.¹

Appendix C compares the normal cost of benefits between Illinois teachers and teachers in neighboring states and in the city of Chicago. The attachment shows that Illinois is well within the average (if not lower) at 6.63% compared to our neighboring states at 7.25%, 8.71%, 10.6%, 11.8%, 12.85%, and 14.24%.

¹ Social Security costs are included when applicable.

Finally, Appendix D compares the benefits between Illinois and neighboring states. The data shows that on average, Illinois TRS members contribute more for their benefit, while often receiving a lesser benefit.

It is important to note while reviewing Appendices C and D the states that receive Social Security benefits and those that do not. Participants in TRS and SURS **do not** receive Social Security benefits for their years as an educator. The state saves billions by not having to pay into Social Security which private employers must do. This is a key point to understanding the true cost of retirement benefits as shown by Appendix C, and the total benefits shown in Appendix D.

Recommendations for the Funding Subcommittee:

Recommendation: Encourage the General Assembly to seek new revenue.

We recommend the General Assembly seek new revenue sources. The current revenue structure cannot support the demands on state government and substantial new revenue is needed to meet the states past obligations and to continue to provide resources for education and other areas of state government.

There was general consensus from the Funding subcommittee that the task force would never have been created if the annual pension payment was the normal cost of \$1.6 billion, and that the FY10 pension payment of \$4 billion was so high only because of the unfunded pension liability. We would further argue that this situation was not caused by the moderate pension benefits earned, but rather because the state has not met their pension funding obligation and this situation cannot be erased by the enactment of a two-tier pension system.

AON Consulting: AON determined in its report to the task force that the problem was contributions and not benefits. Their report states, "*full actuarially required contributions have rarely been made...pension obligation bonds have masked the problem.*" Furthermore, AON stated if the plan is facing insolvency in a short time frame, "*new tiers won't help.*"

The Center for Tax and Budget Accountability (CTBA): The CTBA prepared a report entitled "The Illinois Funding Crisis" for the Pension Modernization Task Force and presented their findings to a subcommittee. Their study illustrates that the true problem "*...is a Revenue not a Spending problem.*"

The General Assembly pension payment is a bill that the state has for decades decided not to pay, which has resulted in debt growing to an amount estimated to be \$70 billion. Teachers and those participating in the retirement systems have always and will always pay their required pension contribution. It has been the standard practice of the state not to pay its required contribution and instead fund other areas of government.

Recommendation: State should adhere to current funding plan.

We recommend the state stay the course and at a minimum adhere to the 1995 pension funding plan. Though not perfect, the current funding plan allows forward progress to be made in the funding ratios of the pension plans. The plan currently provides enough resources to almost entirely curtail the retirement systems from having to sell assets to pay benefits.

We support many of the pension payment plans that surfaced during the subcommittee's discussions and believe paying down debt is good public policy. However, with no new revenue sources to support these ideas, they are not feasible.

Background

Illinois is moving into the 16th year of a 50-year funding plan that was created in 1995. The goal of the current law is to have all State Retirement Systems at a 90% funded status by 2045. The funding plan called for a "ramp up" of state contributions to the five state funded pension funds for the first 15 years of the plan. Each year of the "ramp up" required a much larger payment than the previous year. This was crafted so that a sufficient pension contribution could be eased into the state budget. Sufficient state contributions would pay for benefits earned in the past (unfunded) and for those that are earned each day going forward.

The crafters of the bipartisan 1995 funding plan knew that the state could not immediately make a sufficient pension contribution so they structured the plan to make the transition to that point easier, which made the funding plan "back loaded." Theoretically, after reaching the 15th year of the payment plan the pension payments were supposed to be built into the state budget as a level percentage of pay, making pension funding more manageable and less of a budgetary issue.

However, since the implementation of the 1995 funding plan the state has taken two "pension holidays" and relied on pension obligation bonds and pension notes to alleviate the strain on the state budget caused by the unfunded pension liability. This coupled with the recent volatility of the

investment markets has forced the state to contribute an additional billion dollars from the previous fiscal year.

Recommendation: COGFA should continue to study asset-transfers.

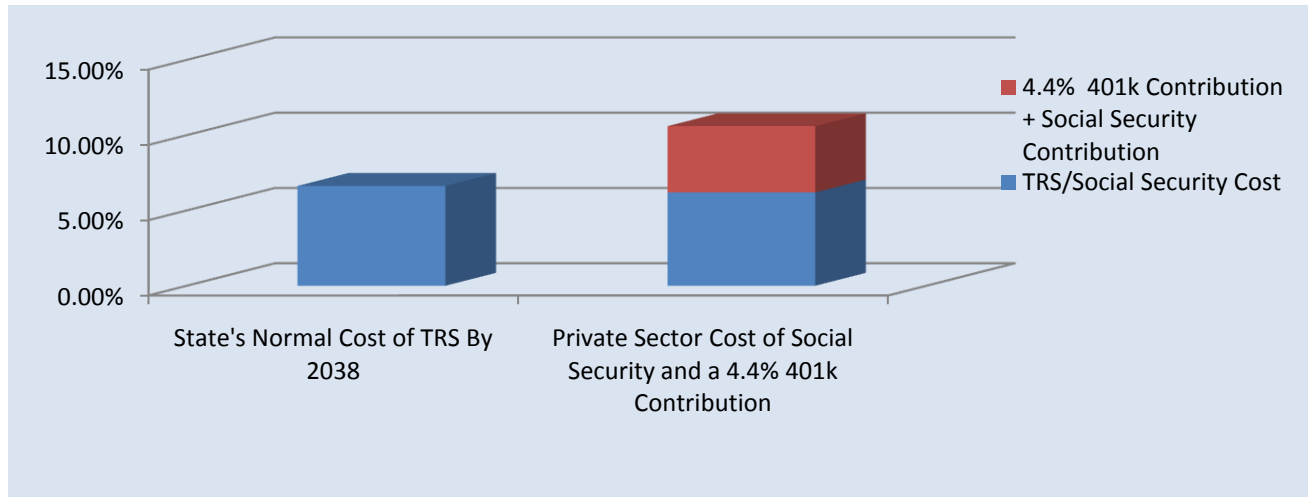
The Funding subcommittee was presented with numerous asset-transfer ideas including the sale of the lottery and the toll way and other state assets. We recommend COGFA analyze data and thoroughly study these ideas to present recommendations to the General Assembly to ensure they have the necessary information to make a sound decision on any asset-transfers.

Recommendations for the Investment Subcommittee:

Recommendation: None.

Members that serve on the five state retirement system boards are fiduciaries of that board which requires them to act in the best interests of those that participate in the retirement plans. We feel confident in the constant reassessments done by each state retirement system and strongly feel it is sufficient enough to determine each funds target investment returns plus the portfolio in which they choose to invest in.

COMPARISON OF PRIVATE SECTOR COST TO STATE'S NORMAL COST



Social Security alone costs private employers almost as much as our pension plans cost the state. Add a modest employer-paid contribution of 4.4 percent plus an employer sponsored savings plan, and the private sector model becomes significantly more expensive. To get a true comparison, add the cost of Social Security (6.2 percent of salary) to the average private sector contribution of 4.4 percent * of salary and now you are at an employer contribution that exceeds the state's actual annual retirement costs. * "51st Annual Survey of Profit Sharing and 401k Plans." Published by: Profit Sharing/401k Council of America.

TRS Employer Normal Cost, FY 2009 - FY 2045

From Schedule XIII of 2008 valuation report				From Schedule XIA of valuation report		Remainder = State Portion of Employer Normal Cost *	
Fiscal	Payroll	Total Employer Normal Cost		Subtract other employer contributions*			
Year	Total Amount	Amount	Rate	Employer 0.58%	Projected Federal	Amount	Rate
		\$		\$		\$	
1	9,252,805,323	846,936,893	9.15%	(53,666,271)	(75,718,545)	717,552,077	7.75%
2	9,642,327,622	866,199,075	8.98%	(55,925,500)	(79,414,262)	730,859,313	7.58%
3	10,047,747,552	885,537,987	8.81%	(58,276,936)	(82,226,357)	745,034,694	7.41%
4	10,476,699,653	908,675,437	8.67%	(60,764,858)	(86,336,214)	761,574,365	7.27%
5	10,934,659,907	934,180,639	8.54%	(63,421,027)	(90,465,883)	780,293,728	7.14%
6	11,426,309,486	965,900,052	8.45%	(66,272,595)	(94,533,455)	805,094,002	7.05%
7	11,954,450,534	1,003,372,721	8.39%	(69,335,813)	(98,902,932)	835,133,976	6.99%
8	12,516,639,814	1,045,552,289	8.35%	(72,596,511)	(103,554,101)	869,401,678	6.95%
9	13,108,263,978	1,091,039,943	8.32%	(76,027,931)	(108,448,794)	906,563,218	6.92%
10	13,729,996,549	1,140,042,601	8.30%	(79,633,980)	(113,592,583)	946,816,039	6.90%
11	14,385,487,827	1,194,469,999	8.30%	(83,435,829)	(119,015,669)	992,018,501	6.90%
12	15,075,322,885	1,251,749,063	8.30%	(87,436,873)	(124,722,891)	1,039,589,299	6.90%
13	15,800,876,958	1,315,154,159	8.32%	(91,645,086)	(130,725,628)	1,092,783,444	6.92%
14	16,561,071,388	1,380,083,518	8.33%	(96,054,214)	(137,014,956)	1,147,014,348	6.93%
15	17,351,864,395	1,449,453,033	8.35%	(100,640,813)	(143,557,436)	1,205,254,784	6.95%
16	18,175,518,206	1,521,890,398	8.37%	(105,418,006)	(150,371,783)	1,266,100,610	6.97%
17	19,031,527,183	1,595,469,738	8.38%	(110,382,858)	(157,453,814)	1,327,633,066	6.98%
18	19,915,674,471	1,669,590,445	8.38%	(115,510,912)	(164,768,643)	1,389,310,890	6.98%
19	20,827,683,269	1,743,964,097	8.37%	(120,800,563)	(172,313,979)	1,450,849,555	6.97%
20	21,783,870,485	1,824,028,507	8.37%	(126,346,449)	(180,224,817)	1,517,457,241	6.97%
21	22,782,601,368	1,905,376,965	8.36%	(132,139,088)	(188,487,632)	1,584,750,245	6.96%
22	23,818,517,278	1,989,631,853	8.35%	(138,147,400)	(197,058,090)	1,654,426,363	6.95%
23	24,889,639,616	2,074,127,972	8.33%	(144,359,910)	(205,919,823)	1,723,848,239	6.93%
24	25,995,267,983	2,155,865,177	8.29%	(150,772,554)	(215,067,034)	1,790,025,589	6.89%
25	27,145,460,548	2,237,681,350	8.24%	(157,443,671)	(224,582,939)	1,855,654,740	6.84%
26	28,349,125,337	2,325,563,381	8.20%	(164,424,927)	(234,541,237)	1,926,597,218	6.80%
27	29,610,539,243	2,417,196,714	8.16%	(171,741,128)	(244,977,311)	2,000,478,276	6.76%
28	30,939,344,313	2,516,389,236	8.13%	(179,448,197)	(255,970,934)	2,080,970,105	6.73%
29	32,329,998,191	2,610,097,268	8.07%	(187,513,990)	(267,476,251)	2,155,107,028	6.67%
30	33,790,831,447	2,714,518,365	8.03%	(195,986,822)	(279,562,184)	2,238,969,359	6.63%
31	35,349,432,845	2,839,725,468	8.03%	(205,026,711)	(292,456,984)	2,342,241,774	6.63%
32	37,022,168,466	2,974,101,314	8.03%	(214,728,577)	(306,296,052)	2,453,076,685	6.63%
33	38,786,714,381	3,115,852,555	8.03%	(224,962,943)	(320,894,696)	2,569,994,916	6.63%
34	40,629,287,633	3,263,871,965	8.03%	(235,649,868)	(336,138,884)	2,692,083,213	6.63%
35	42,546,698,395	3,417,903,296	8.03%	(246,770,851)	(352,002,227)	2,819,130,218	6.63%
36	44,549,274,274	3,578,776,194	8.03%	(258,385,791)	(368,570,168)	2,951,820,236	6.63%

* Additional employer contributions (for ERO and salary increases exceeding 6% used in final average salary) are assumed to be paid at retirement for some members, not as percentages of pay for all members. These lump sums are anticipated when determining state funding requirements. If they could be expressed as percentages of pay, the state share of employer normal cost identified in the exhibit would be lower.

Apples to Apples

Neighboring State's Total Retirement Costs

Excluding Cost of Unfunded Liabilities

Illinois' Annual Normal Cost for the Teachers' Retirement System: **6.63%** of Salary by 2038.

Chicago Teachers' Pension Fund Annual Normal Cost Including the State's Contribution: **7.254%**

Indiana's Cost for Retirement Benefits Including **Social Security**:
 $6.2\% + 6.65\% = \mathbf{12.85\%}$

Iowa's Cost for Retirement Benefits Including **Social Security**:
 $6.2\% + 8.04\% = \mathbf{14.24\%}$

Kentucky's Annual Normal Cost for their Teachers: **7.25%**

Michigan's Annual Cost for Retirement Benefits Including **Social Security**:
 $6.2\% + 5.6\% = \mathbf{11.8\%}$

Missouri's Annual Normal Cost for their Teachers: **8.71%**

Wisconsin's Annual Cost for Retirement Benefits Including **Social Security**:
 $6.2\% + 4.5\% = \mathbf{10.6\%}$

Illinois Teachers Compared to our Neighbors

State	Social Security (Y/N)	Member Contribution	Multiplier	Age Requirement	Final Average Salary (FAS)	Max. Allow. Pension	COLA
Illinois TRS	NO	9.40%	2.2% x years x FAS	Age 62 w/ 5 years, Age 60 w/ 10 years, or Age 55 w/ 35 years	4 highest consecutive years out of last 10 years	75%	3% Compounded
Chicago TRS	NO	9%	2.2% x years x FAS	Age 60 w/ 20 years, Age 62 w/ 5 years or Age 55 w/ 34 years	4 highest consecutive years out of last 10 years	75%	3% Compounded
Indiana TRF	YES	None	1.1% X years x FAS + Money purchase plan	Age 65 w/ 10 years or Age 60 w/ 15 years. Rule of 85 for those between 56-59.	5 highest years	Unlimited	Ad Hoc
Iowa	YES	3.9%	2% x years (up to 30) + 1% for each year 31-35 x FAS	Age 65 w/ any years, Age 62 w/ 20 years, or Rule of 88	3 highest years	65%	13th Check
Kentucky	NO	9.86%	2.5% x years x FAS (after 7/1/83)	Age 60 w/ 5 years or any age/27 years	5 highest years	100%	1.5%+Ad Hoc
Michigan	YES	6.4%	1.5% x years x FAS	Any age w/ 30 years, age 60 w/ 10 years	3 highest consecutive years	Unlimited	3% Simple
Missouri	NO	13%	2.5% x years x FAS	Age 60 w/ 5 years or any age/30 years. Rule of 80	3 highest consecutive years	100%	CPI up to 5%, Compounded
Wisconsin	YES	5%	1.6% X years x FAS. Prior to 2000, 1.765% x years x FAS.	Age 65 w/ any years or Age 57 w/ 30 years.	3 highest years	70%	Depends on investment results/other indicators

Prepared by the Illinois Education Association. Data compiled from "Characteristics of Large Public Education Pension Plans" and verified on each retirement system's website. Note: SURS benefits are comparable to TRS benefits.

PSCA RELEASES 51st ANNUAL SURVEY OF PROFIT SHARING AND 401(k) PLANS
NEW SURVEY SHOWS GREATER USE OF AUTOMATIC ENROLLMENT AND HIGHER PARTICIPATION RATES
9/25/2008

PRESS CONTACT:

P: (312) 419-1863

Profit Sharing/401k Council of America

F: (312) 419-1864

David Wray

davidw@psca.org

20 North Wacker Drive Suite 3700

<http://www.pzca.org>

Chicago, IL 60606

CHICAGO -- (BUSINESS WIRE – September 25, 2008) – The Profit Sharing/401k Council of America (PSCA), a national nonprofit association committed to retirement savings through employee-sponsored defined contribution programs, has released its *51st Annual Survey of Profit Sharing and 401(k) Plans*, which provides the most up-to-date information available on current practices and trends in profit sharing and 401(k) plans.

"The trend toward greater sponsor involvement in plans continues," said David Wray, president of [PSCA](http://www.pzca.org). "The increase in the number of companies utilizing automatic enrollment continues to be strong. It is encouraging that participation continues to climb, due in part to the increase in automatic enrollment."

[PSCA's Annual Survey](#) reports on the 2007 plan year experience of 1,011 plans with 7.4 million participants and more than \$730 billion in plan assets. Plans represented in the survey are diverse, representing companies of all sizes and regions across the United States.

The survey covers a wide variety of topics relevant to plan sponsors and the industry at large, including data on participation rates, catch-up contributions, company contributions, asset allocation, investment options, company stock, professional management, investment advice, automatic enrollment, and more. PSCA's annual surveys are frequently used by companies to provide benchmarks for their plans and by the government as a resource for public policy decisions.

Below are some highlights from the survey:

Automatic Enrollment

Following a big increase in 2006, more plans of all sizes added automatic enrollment in 2007. More than half of large plans utilize this feature and usage by small plans doubled.

Asset Allocation

The typical plan has approximately 65 percent of assets invested in equities. Assets are most frequently invested in actively managed domestic equity funds (29.1 percent of assets), indexed domestic equity funds (10.0 percent), stable value funds (8.6 percent), and balanced stock/bond funds (8.0 percent).

Catch-up Contribution

Catch-up contributions for participants aged 50 and older are permitted in 99.1 percent of plans. 33.5 percent of these plans offer a match on the catch-up contributions. The percentage of eligible employees who make catch-up contributions ranged from 43.1 percent at the smallest companies to 12.0 percent at the largest.

Company Contributions

Company contributions average 4.4 percent of payroll. They are highest in profit sharing plans (8.6 percent of pay) and lowest in 401(k) plans (3.2 percent of pay). Numerous formulas are used to determine company contributions. In plans permitting participant contributions, the most common formula is a fixed match only, present in 24.8 percent of plans (including plans with safe harbor matches). For plans with fixed matches, the most common matches are \$.50 per \$1.00 up to the first 6 percent of pay (26.2 percent of plans), \$1.00 per \$1.00 up to the first 4 percent of pay (10.4 percent of plans) and \$1.00 per \$1.00 up to the first 3 percent of pay (8.1 percent of plans).

Employee Participation

81.9 percent of eligible employees have balances in their 401(k) plans. Pre-tax participant deferrals average 5.6 percent of pay for non-highly compensated workers (the first increase since 2004) and 7.0 percent of pay for highly compensated workers.

Investment Fund Structure - NEW

Overwhelmingly, money is managed in mutual funds, although larger companies also use collective trusts and separately managed accounts.

Investment Options

The number of funds offered to plan participants have plateaued. Plans offer an average of 18 funds for participant contributions. The funds most commonly offered for participant contributions are actively managed domestic equity funds (76.8 percent of plans), actively managed international equity funds (73.4 percent of plans), indexed domestic equity funds (70.4 percent of plans), and actively managed domestic bond funds (63.8 percent of plans).

Roth 401(k)

30.3 percent of plans permit Roth 401(k) contributions. 12.6 percent of those eligible are doing so.

Self-Directed Accounts

Self-directed brokerage windows are offered in 15.6 percent of plans, while open mutual fund windows are offered in 5.3 percent of plans. 2.0 percent of plan assets are invested through brokerage windows, and .9 percent of plan assets are invested through mutual fund windows.

Vesting

Immediate vesting is present for matching contributions in 43.6 percent of plans and for non-matching contributions in 20.0 percent of plans. Among plans that do not have immediate vesting, graduated vesting tends to be the most common arrangement for all plan types.

PSCA's *51st Annual Survey of Profit Sharing and 401(k) Plans* is available for purchase for \$375 for non-PSCA members and \$145 for members. [Order online](#) or call (312) 419-1863.

About the Profit Sharing/401k Council of America

The Profit Sharing/401k Council of America (PSCA), a national non-profit association of 1,200 companies and their 6 million employees, advocates increased retirement security through profit sharing, 401(k) and related defined contribution programs to federal policymakers and makes practical assistance with profit sharing and 401(k) plan design, administration, investment, compliance and communication available to its members. PSCA, established in 1947, is based on the principle that "defined contribution partnership in the workplace fits today's reality." PSCA's services are tailored to meet the needs of both large and small companies with members ranging in size from Fortune 100 firms to small, entrepreneurial businesses.

V. Letters & Minority Reports

Letter from Edward Rosenthal, Annuitant
Member, to Chairman McNeil and the Illinois
Pension Modernization Task Force

To: Pension Modernization Task Force

From: Edward Rosenthal, Annuitant Member

Re: An Annuitant's Perspective

Date: November 6, 2009

First, I want to thank the Governor for the opportunity to serve on this task force. I have enjoyed the opportunity to participate and to represent my fellow annuitants.

I found the task force meetings extremely valuable because for the first time we were able to see data quantifying some of the questions before us. We have been told that the state cannot afford the current pension system. We have seen articles in the Sun-Times and Tribune outlining the abuses of the system. But in this task force we have received data that gives a more complete and accurate picture.

The Sun-Times series on "The Pension Bonanza" starts out with the headline "The Millionaire Pension Club (and you're paying for it). Upon reading the article you find out that their definition of a pension millionaire is someone who has received \$1,000,000 in pension benefits. Using this definition, a pensioner receiving a \$33,000 yearly pension becomes a "millionaire" in 30 years. The average TRS retiree receives a pension of \$41,500 yearly. In 24+ years, they become "pension millionaires". In fact, using this argument, a household that made \$50,000 a year in salary over 20 years would be a millionaire household! Clearly, none of these people are saving enough money to be millionaires, but the image is falsely put into people's minds.

"And you're paying for it" is also incorrect. I questioned a TRS Trustee and was told that in my pension check, about 50% comes from investments, over 27.5% comes from member contributions, and less than 22.5% comes from tax dollars. It is erroneous to believe (or to

publish) that the pensions only are paid by tax dollars. Tax dollars are the smallest part of my pension check!

The reports of the Civic Committee and Civic Federation point out that the benefits of the current pension plan are excessive and not available in the private sector. What they don't point out is that the current pensions are less expensive than the private sector. We were presented data that the normal cost of the TRS pension is about 7.75% in 2009 and will drop to 6.63% in 2038. In the private sector, employers are required to pay 6.2% of salary for social security (TRS annuitants do not receive social security) and according to data received by the task force, **"Private company retirement contributions averaged 4.4 percent of payroll. They are highest in profit sharing plans (8.6 percent of pay) and lowest in 401(k) plans (3.2 percent of pay)". Added to the social security contribution, the average private sector cost is 10.6% of salary. If the issue is the cost of the benefits, clearly our pensions are a bargain!**

Are the benefits too great? The AON report indicated that compared to 9 other non-social security states, in TRS the average employee contribution is greater than the average of the other 9 states and the benefit is lower. In fact all the reports we received (University of Wisconsin, Oregon Public Employees Retirement System) indicated that Illinois benefits were in the middle of the pack or below compared to other non-social security states.

Clearly there are some abuses within the pension systems. The Sun-Times took those outliers and made them seem like the norm. TRS figures indicate that as of August, 2009 over 62% of TRS pensions are below \$50,000 and less than 2% are over \$100,000. That's not what most people believe by reading the papers.

Up till now, the pension debate has been based on beliefs or hearsay. With this report, we have some hard data that indicates:

- 1) Our pension benefits are at or below the middle of the pack.**
- 2) The cost of our pensions is below the cost that the private sector pays for social security plus 401K's and profit sharing.**

Over the years, members of the pension systems have made every payment required of them as required by contract and law. It has been the state legislature that has failed in its duty to make their required payments. It seems unfair to expect that the solution to this problem (the unfunded pension obligation) would come from the group that has ALWAYS met its obligation.

V. Letters & Minority Reports

Letter from The Civic Federation to
Chairman McNeil and the Illinois
Pension Modernization Task Force



The Civic Federation

177 North State Street, Suite 400, Chicago, IL 60601 • 312.201.9066 fax 312.201.9041 • www.civiced.org

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October 28, 2009

Donald McNeil

Chairman, State of Illinois Pension Modernization Task Force
c/o Barnes & Thornburg LLP
One North Wacker Drive
Suite 4400
Chicago, IL 60606

Dear Chairman McNeil:

The Civic Federation seconds and supports the proposed report submitted by Eden Martin to the State of Illinois Pension Modernization Task Force. We believe that his report best reflects the financial condition of the State pension systems and more completely fulfills the mandate of House Joint Resolution 65.

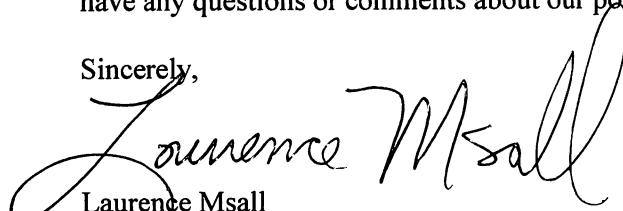
While Mr. Martin's report describes the State of Illinois as "nearly bankrupt," we believe there is mounting evidence that a judge could find the State is already insolvent. For several years, the State of Illinois has routinely acted to push current obligations into future years by borrowing, skipping pension payments, failing to pay vendors on time, and simply passing unbalanced budgets. It is difficult to see how the State could claim that it is currently solvent when it is demonstrably unable to pay its bills.

If the State is found to be insolvent under the classical cash flow definition of insolvency, which is the "inability to pay debts as they come due," it is not only the pension rights of non-vested employees that will be in jeopardy. All the **obligations** of the State, whether vested or not, will be competing for funding with the other essential **responsibilities** of State government. Even vested pension rights are jeopardized when a government is insolvent.

For these reasons, we strongly urge the Task Force to adopt Eden Martin's proposed report including the recommended changes to reduce benefits and increase funding for the State pension systems. Additional revenues will be necessary once pension reforms have been made for the State to meet its pension funding obligations; we recommend an income tax increase to achieve this purpose, but only if the outlined pension benefit reforms are made. We reject any further pension borrowing by the State and urge this Task Force to recognize the damage that borrowing has already done to both the pension systems and the State's finances.

The Civic Federation appreciates the opportunity the Illinois Pension Modernization Task Force has afforded us to analyze and propose reforms to the State's crisis-ridden pension systems. If you have any questions or comments about our position, please call me at 312-201-9044.

Sincerely,



Laurence Msall
President

cc: Governor Pat Quinn
David Vaught

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V. Letters & Minority Reports

Minority Report of the Labor Coalition

Task Force Proposals

LABOR COALITION **TASK FORCE PROPOSALS**

The labor coalition of this Pension Task Force, consisting of members from the Service Employees International Union, Illinois Federation of Teachers, American Federation of State County & Municipal Employees, and the Illinois Education Association, would like to propose the following statements for the task force to endorse:

- The Illinois pension funding crisis is massive, and the need for a solution is urgent. The current \$70 plus billion unfunded liability for the five Illinois state pension funds, and the nearly \$10 billion owed to the holders of the Pension Obligation Bonds, were primarily caused by inadequate funding, that is, funding by the state well below the GASB standard of Actuarial Required Contributions (the ARC as defined as the normal cost plus amortization of the unfunded liability over 30 years). Covered employees have always made their full contribution as required by the Pension Code.
- The proper discount rate for valuing the unfunded liabilities of the five state pension systems is their long-term actuarial assumption for the rate of return on plan assets. The Task Force recommends that each of the systems examine the current assumption to see if modification is warranted by current market conditions. Using a low risk discount rate, as is required for U.S. private pension funds, is NOT appropriate for public pension funds, and would end up costing taxpayers more to address the pension funding crisis.
- The longer Illinois waits to address this problem, the larger it will get. Solving the problem sooner will be much less costly.
- The retirement benefits for Illinois public school teachers, university employees, and state employees are, as a whole, comparable to similar plans sponsored by other states. In addition, the employee contribution rates for these Illinois public sector workers are comparable to similar public pension plans.
- The state's normal cost is very affordable, in light of the fact that there is no FICA tax for over 75 percent of the workers. These benefits are more affordable than the average cost in the private sector. This is because Illinois teachers, university employees, and state employees contribute significantly more to their retirement plan than is typical in the private sector.
- A second tier of pension benefits for new hires does not solve the problem of how to pay for the current unfunded liability. The only answer to this problem is for the Illinois General Assembly and the Governor to enact new revenues that can both support state-funded services and pay down the pension debt.
- The General Assembly should create a funding a plan based upon the actuarial required contribution, targeted to 100 percent of actuarial liabilities, with no unsustainable funding "ramps."
- Currently, the five state pension funds are on year 15, the final year of the ramp period defined in the current pension funding law, which went into effect for FY 1996. At a minimum, the General Assembly must follow current law and fund the pensions at the required level for FY 2011 and beyond. Anything less than

this would repeat the problems of the past, deferring our pension obligations to future taxpayers.

- The General Assembly should consider modifications to the Pension Code to encourage employees to continue working beyond the years required to accrue the maximum pension percentage. Properly structured, these modifications could reduce the burden on the state's pension costs and help retain valuable employees.
- The pension obligation bonds issued so far by the state have been used in large measure as a substitute for regular pension contributions from the General Revenue Fund, in effect borrowing to pay the ongoing cost of pension benefits. This is a band-aid approach and is not sound public policy. In the future, such pension obligation bonds should be used ONLY as a pure debt swap, and the repayment to the bond holders should be done on a level-dollar basis (and never back-loaded), and only in tandem with the required ARC for the normal cost and the remaining unfunded liability on the books of the pension funds. Pension Obligation Bonds should only be considered when market conditions look favorable.
- The state should convene a pension policy task force every 3-5 years to evaluate the pension systems' performance.

V. Letters & Minority Reports

Minority Report of Center for Tax and Budget Accountability

Summary of Testimony Provided to the Pension
Modernization Task Force – Funding Subcommittee

SUMMARY OF TESTIMONY PROVIDED TO THE PENSION MODERNIZATION TASK FORCE – FUNDING SUBCOMMITTEE

FROM: The Center for Tax and Budget Accountability

I. Executive Summary:

Illinois' Decades Long Practice of Not Making Its Full Employer Contribution is the Primary Cause of the State's Unfunded Pension Liability.

The Center for Tax and Budget Accountability appreciates this opportunity to assist the Pension Modernization Task Force and its Fund Subcommittee (collectively, the "**Task Force**") in the Task Force's mission of developing potential solutions to the state's aggregate \$73.4 billion unfunded pension liability, that exists across all five public employee retirement systems the state has the responsibility to fund. Given the dire condition of Illinois' state budget, resolving the state's outsized unfunded liability will go a long way to putting Illinois' fiscal house in order.

Of course, the necessary first step to resolving any significant structural problem is accurately identifying its primary cause. In this regard, the data are clear. Despite oft-repeated claims to the contrary, the primary cause of the state's pension funding woes have very little, if anything, to do with the over-generous benefits, high employee head counts or inflated costs. Consider, for instance, the popular belief that Illinois has an overly large public workforce. Nothing could be further from the truth. Despite having the fifth largest population of any state, Illinois ranks 49th among the states, next to last, in number of state employees per capita.¹ This is nothing new, as historically, Illinois has not been a high public employee head count state. In fact, the number of workers employed by state government declined by 4532 from 1997-2007.²

Illinois also does not have overly generous benefits. The pension benefits provided to Illinois teachers, firefighters, police officers and all other public employees are average when compared to other states.³ According to the Illinois State Comptroller, pension benefits paid to regular state employees in Illinois are low relative to benefits provided by other states. Illinois ranks in the bottom one fifth of all states for retirement benefits paid to an average state worker.⁴ New York State, which has a five tier pension system, provides a greater benefit in its lowest fifth tier, than Illinois does in its one tier system. Moreover, 76 percent of Illinois' state retirement plan participants are not coordinated with Social Security, and hence do not get that benefit on retirement. This is unlike workers in the private sector, who receive both Social Security and private retirement benefits. Illinois similarly has a low-cost pension

¹ United States Census Bureau, Statistical Abstract of the United States, 1993-2006.

² U.S. Department of Commerce, Bureau of Economic Analysis.

³ United States Census Bureau, Employee Retirement Systems of State and Local Governments. 2001-2002

⁴ State of Illinois FY08 Budget Book

system. The weighted average normal cost across all five systems is 9.3% of payroll, which is 26% less than the national average.⁵

The reality is that the primary cause of the state's unfunded pension liability is Illinois' decades-long failure to make its full, actuarially required employer contribution to the five pension systems. This poor fiscal practice was even codified in the 1995 pension funding bill "P.A. 88-0593", known commonly as the "**Pension Ramp**" bill. During the first 15 years of the Pension Ramp, the state's employer contribution was set at levels which continued the practice of not making the full actuarially required employer contribution, thereby increasing the unfunded liability amount. The deadly combination of nearly 30 years of systematic state underfunding of its employer contributions to the pension systems, followed by the cataclysmic decline in asset values caused by the national meltdown in financial markets over the last year, combined to create an all-time high in the state's unfunded pension liability.

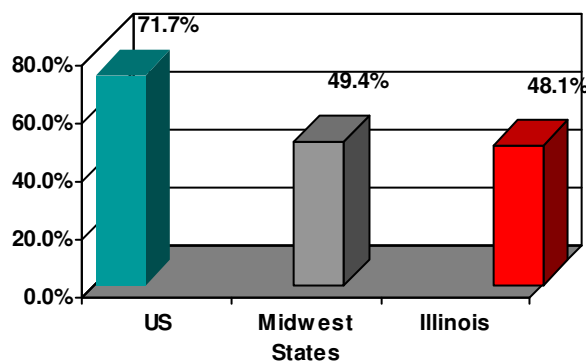
The state's failure to make its required employer contributions to the five pension systems can in turn be traced to one, simple cause: a state fiscal system that is so poorly designed it, for decades, failed to generate enough revenue growth to both maintain service levels from one year to the next, and cover the state's actuarially required employer contribution to its five pension systems. This ongoing "structural deficit" imposed a tough fiscal/political choice on state elected officials—fully fund pensions and dramatically cut services, or skip a portion of the pension payment and maintain as many services as possible. Not wanting to implement dramatic cuts in spending on essential services, the legislature and various governors elected to instead divert revenue from making the required employer pension contribution to maintaining services like education, healthcare, public safety and caring for disadvantaged populations. Effectively, the state used the pension systems as a credit card to fund ongoing service operations.

Given that the state's poorly designed revenue system created the structural deficit that in turn incentivized elected officials to shortchange the state's employer contributions to its pension systems, pension funding reform is not possible without enhancing state revenue. If state revenue is to be enhanced, it should be done in a manner that: (i) reforms major aspects of Illinois flawed revenue system; and (ii) modernizes the fiscal system to both comport with the state's economy and support long-term economic growth. As a final note, the unfunded liability has grown to such a significant size—\$73.4 billion—that a new, rational payment schedule, one that front loads costs, should also be considered.

II. Illinois Economy as it Relates to Budget:

- Illinois has the fifth largest population (12,831,970) of any state in the nation.⁶ According to the Bureau of Economic Analysis (BEA), in 2008, Illinois also had the fifth largest state economy with a Gross Domestic Product in excess of \$633 billion. With that said, since 1990, economic growth in Illinois has lagged both the Midwest region and the nation as a whole.

But, IL Gross State Product Grew Less than U.S. or Midwest States, 1990-2007



⁵ Weighted average based on data provided by each of the five retirement systems.

⁶ Bureau of Economic Analysis, News Release, June 5, 2008.

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- Moreover, the state of Michigan is included in the Midwest – and its economy has been on the downturn over this entire period. If Michigan is taken out, the other Midwestern states significantly outpace Illinois in long-term growth.
- High tax burden cannot be blamed for this long-term, poor economic track record. **Overall, total state and local tax burden as a percentage of income in Illinois ranks 41st in the country.**⁷ This tax burden figure isolates and includes every tax and fee charged by any unit of state or local government in Illinois, versus those charged by every unit of state or local government in every other state. Illinois also has the second lowest tax burden in the Midwest to Missouri (Missouri is only one-tenth of one percent lower). **When state taxes as a percentage of income are considered in isolation, Illinois drops to 43rd in tax burden.**

III. Out of Control Spending is not the Problem:

- In fact, after adjusting for inflation, Illinois' General Fund spending is anywhere from \$1.344 billion to \$4.451 billion less in the current fiscal year 2010, than it was a decade ago in FY 2000.

Category	FY 2000 Actual	FY 2000 Adj to FY 2010 (MW CPI) *	FY 2010 Enacted	Diff FY 2000 - FY 2010 (MW CPI)	FY 2000 Adj to FY 2010 (ECI) **	Diff FY 2000 - FY 2010 (ECI)
General Fund	\$21,294	\$27,429	\$26,085	(\$1,344)	\$30,536	(\$4,451)
Education	\$7,957	\$10,250	\$9,309	(\$941)	\$11,411	(\$2,102)
Health Care	\$5,022	\$6,469	\$7,896	\$1,427	\$7,202	\$694
Pension	\$1,230	\$1,584	\$121	(\$1,463)	\$1,764	(\$1,643)
Human						
Services	\$3,456	\$4,452	\$3,934	(\$518)	\$4,956	(\$1,022)
All Other	\$3,629	\$4,675	\$4,825	\$150	\$5,204	(\$379)

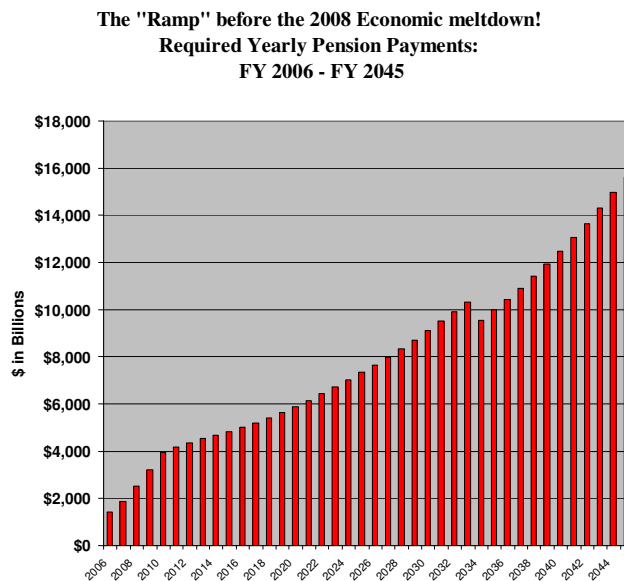
*MWCPI – Midwest Consumer Price Index, Published by the Bureau of Labor Statistics (“BLS”)

**ECI – Employment Cost Index, Published by BLS.

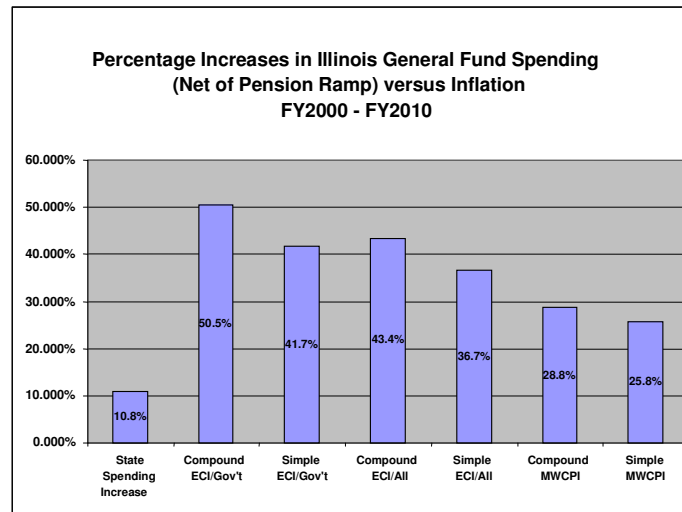
- Focusing on state spending during the 10 years before the recession hit still indicates Illinois is very low spending overall. According to the BEA, in 2007, Illinois had a Gross Domestic Product of \$609.9 billion. The General Fund of the State of Illinois in 2007 was \$28.4 billion (rounding up, based on the Comptroller's annual report). That means General Fund spending accounted for just 4.6 percent of the Illinois state GDP.
- According to the same BEA data, the Illinois GDP was \$403.9 billion ten years earlier, in 1997. In 1997, the Illinois General Fund was \$17.3 billion (rounding up, using the Comptroller's final annual report). That means General Fund spending accounted for 4.3 percent of the Illinois GDP in 1997. Hence, General Fund spending as a percentage of GDP increased by just three-tenths of one percent during that 10 year period. This, despite the shift of responsibility to cover healthcare costs from the private sector to the public sector (today, over 40% of Illinois workers do not have employer-provided health insurance and over 30% of the state's population is uninsured or on Medicaid), plus the phase-in of the pension ramp, which imposed annual cost increases on state government to cover decades of underfunding. According to the BEA, Illinois ranks 45th in state spending as a percentage of state GDP, despite having the fifth largest population.

⁷ Federation of Tax Administrators, www.taxadmin.org.

- Funding the five state retirement systems for public employees has challenged Illinois state government for decades. As state decision makers continually found themselves short of the revenue needed to cover both maintaining essential services from one year to the next, and making the full, actuarially determined employer contribution required to fund the pension systems, they consistently opted to skip full funding of the retirement systems to maintain spending on services.
- The state's historic underfunding of the pension systems led to the 1995 Pension Ramp legislation. The following chart shows the ramp schedule from FY 2006 forward – before the impact of the 2008-2009 market crash.



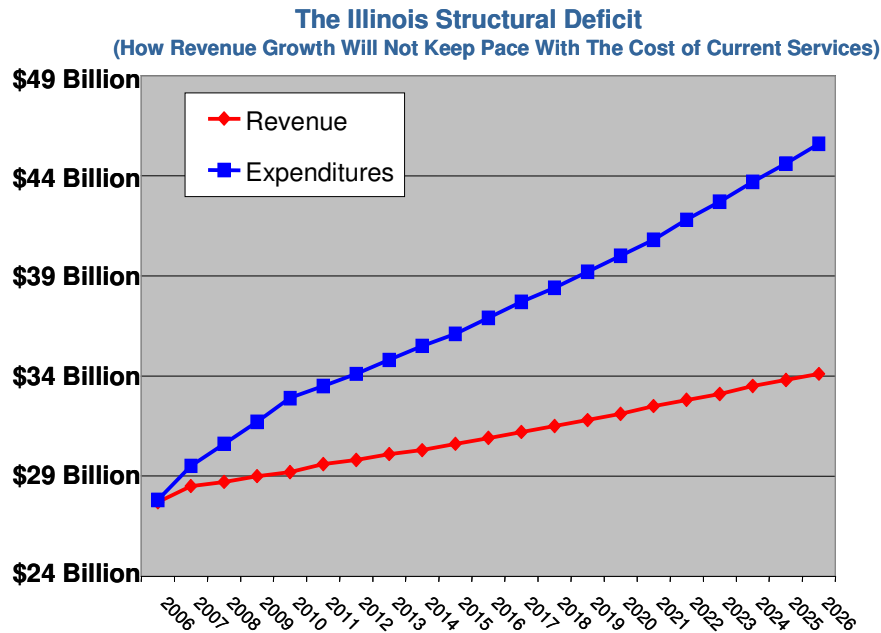
- In fact, increased funding the state contributed to the pension systems over the last 10 years should not be counted when considering whether state spending over time has increased or decreased in real terms. This is because enhanced funding of the pensions is not an increase in spending on services, but rather payment of over due debt.
- The following chart shows the percentage increase in state spending on services, expressed in nominal dollars, from FY 2000 – FY 2010, compared to changes in inflation over that period.



- When state spending over the last decade is analyzed honestly, it is quite clear that under any data-based analysis, Illinois is cutting spending to levels that clearly cannot meet needs.

Item	Amount
FY 2010 Appropriations	\$ 26.085 B
FY 2000 Appropriations	\$ 21.294 B
Nominal Dollar Increase	\$ 4.791 B
Scheduled FY 2010 Pension Ramp increase over 2000 levels	-(\$ 3.422 B)
Nominal difference in Appropriations for Services in FY 2010 over FY 2000, Net of Pension Increase	\$ 1.369 B

- The main reason Illinois has run up a large unfunded liability is simple – the state's revenue system has historically underperformed over time, creating a structural deficit.



*Note, this structural deficit model was designed for CTBA by Fred Giertz, PhD., economist at the University of Illinois. It follows the Congressional Budget Office's methodology of: (i) assuming continuation solely of existing law, no new or expanded services of any type; and (ii) adjusting growth in service cost and revenue solely for estimated population changes and historic rates of inflation.

IV. The Deficit

- Today, Illinois state government is facing a significant, multibillion dollar deficit, caused in large part by the structural deficit outlined above, but certainly exacerbated by the deep and long lasting national recession that started over 18 months ago, in December 2007.
- The size of the state's deficit can be identified by reviewing the one-time revenue used to support the FY 2010 budget.

Illinois' State FY2010 Budget Breakdown	
APPROPRIATIONS	\$26.08 B*
ONE-TIME, NONRECURRING REVENUES	
Debt Proceeds from issuance of five-year Pension Notes	\$3.466 B
Federal Stimulus	\$1.843 B
Fund Sweeps	\$.356 B
Debt Restructuring	\$.600 B
TOTAL NONRECURRING REVENUE	\$6.265 B**
<p>* Note: The FY2010 budget figure does NOT include at least \$3.2 B in past due, unpaid bills carried forward from FY2009—and there is NO revenue source to pay this amount.</p> <p>**Note: That means over 21% of the FY2010 budget is covered with one-time, nonrecurring revenues not available in FY2011.</p>	

- The preceding chart does not include the \$4 billion in unpaid bills the state currently owes providers that was carried forward into FY 2010.
- The Governor's Office of Management and Budget just announced that it is reducing its revenue estimates for FY 2010 by \$900 million—\$850 million of which is projected lower income tax receipts, and \$50 million of which is projected lower gaming revenue.
- This creates a huge problem in FY 2011, when the state will have to replace one-time revenue and cover the \$4 billion in unpaid bills, if it wants to maintain the General Fund at the \$26.085 billion level of FY 2010.

Illinois' FY2011 Starting Budget Shortfall —Minimum	
Replacement of one-time FY2010 revenues and debt	\$6.265 B
First installment of five-year Debt Service on Pension Notes	\$.800 B
Carry Forward of Operating Deficits from FY2009/2010	\$4.0 B
Increase in required pension contribution under the Pension Ramp*	\$1.2 B
TOTAL MINIMUM FY2011 STARTING DEFICIT	\$12.265 B
<p>* In 1995, Illinois passed a pension ramp bill requiring significant, annual increases in the state's contribution to its public employee retirement systems, to make up for a decades long practice of failing to make the full, employer contribution into the system. That is why the pension contribution escalates by \$1.2 billion next year.</p> <p>*Note, this chart does not include the \$900 M revenue shortfall the Governor's Office of Management and Budget now estimates for FY 2010.</p>	

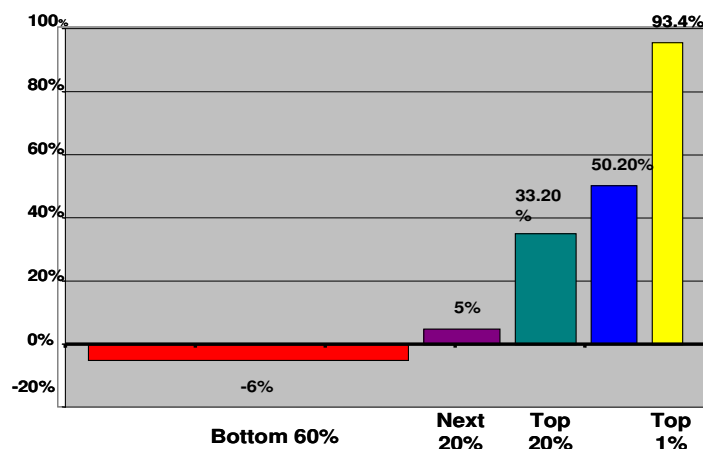
V. Attacking the Problem with a Responsible Solution: Raise Revenue + Re-think the Ramp:

- Illinois cannot fund its pension obligations without raising revenue. However, a poorly designed tax increase is not the answer, since the state's fiscal system is so flawed to begin with.
- Instead, Illinois should take this opportunity to reform its fiscal system comprehensively, to make it work in a modern economy and comport with the four, fundamental principles of sound tax policy, which are that the system be:

FAIR	➔	PROGRESSIVE
RESPONSIVE	➔	TO MODERN ECONOMY
STABLE	➔	DURING POOR ECONOMIES
EFFICIENT	➔	DOESN'T DISTORT PRIVATE MARKETS

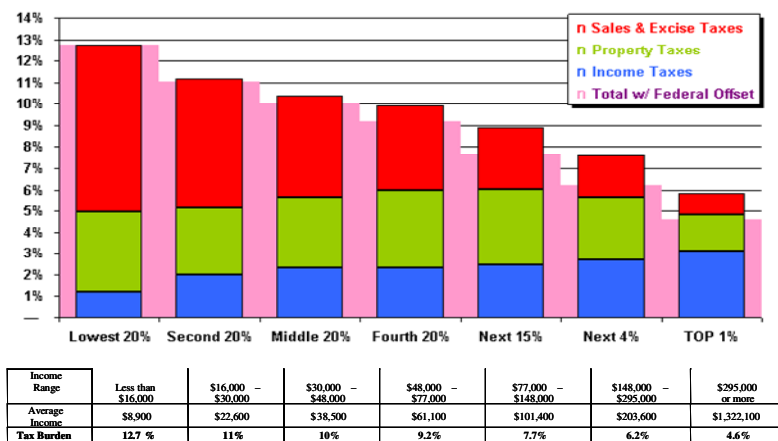
- A “fair” tax system in a capitalist economy is a “progressive” tax system, that is, one that imposes a greater tax burden on affluent, than low and middle income earners, when tax burden is measured as a percentage of income.
- The reason a “progressive” tax is fair in a capitalist economy is that upper income families receive a disproportionate share of income growth over time in capitalist economy, as shown by the chart below. Also, because of this unequal share in income growth over time, a progressive tax system is also “responsive” that is, it responds to how the economy actually grows over time, helping revenue growth keep pace with economic growth.

Income Growth in the United States 1979-1999
(Real 1999 Dollars)
***Source U.S. Census Data**



- The easiest way to create a fair, responsive, progressive tax system is through a progressive income tax rate structure, like the federal government's. Illinois is constitutionally prohibited from having a progressive income tax rate structure.⁸
- Illinois is one of only 6 states with an income tax that has a flat tax rate that applies to all taxpayers. The other five states are: Colorado (4.63%), Indiana (3.4%), Massachusetts (5.3%), Michigan (4.35%), and Pennsylvania (3.07%). Every other state has some progressivity built into the rate structure.
- This flat rate has helped make Illinois a regressive, unresponsive, unfair taxing state.

State & Local Tax Burden as a Percentage of Income

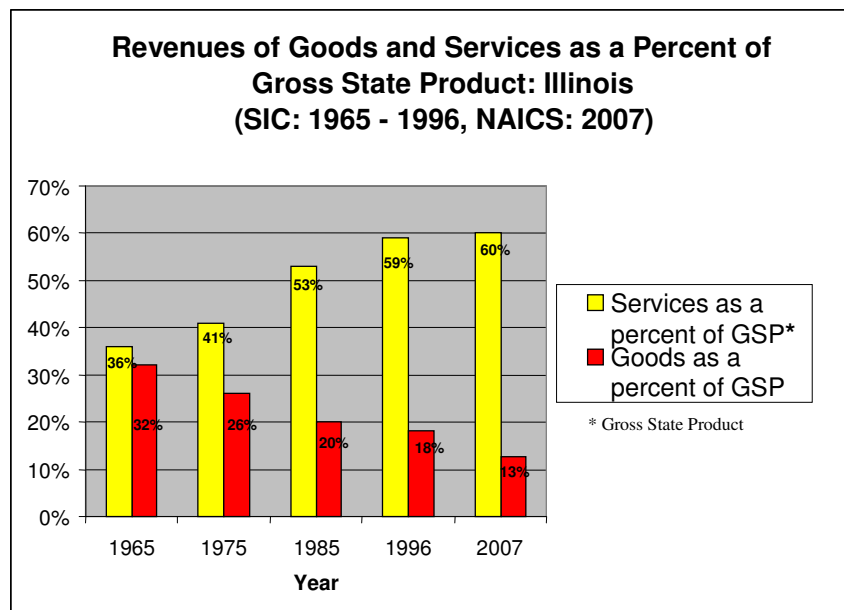


- Illinois, with its 3% rate, has the lowest flat rate of all states with a flat income tax, and the lowest overall effective rate of all states with an income tax—(note, some states with progressive rate structures have a lower initial rate for very low income folks, but have a much greater overall rate after taking the progressivity into account.)
- Following are the top income tax rates in certain states:
 - (A) The Midwest
 - Ohio - 6.24%
 - Missouri - 6.0%
 - Kentucky - 6.0%
 - Indiana - 3.4%
 - Wisconsin - 6.75%
 - Iowa - 8.98%
 - Michigan - 4.35%
 - Minnesota - 7.85%
 - (B) Other Big States
 - New York - 6.85%

⁸ Illinois Constitution, Article 9, subsections, 3 (a), 3(b) (1970).

New Jersey - 8.97%
California - 9.3%

- As the preceding demonstrates, Illinois has plenty of room to increase its income tax rate and remain low tax overall. For instance, a personal income tax rate of 5% would tie Illinois with Mississippi for the seventh lowest personal income tax rate of the 41 states with an income tax.
- To be fair, any tax increases in Illinois, whether based on the income or sales tax, should be accompanied by tax relief targeted to low and middle income families, preferably in the form of refundable tax credits. The Earned Income Tax Credit is a good example.
- To further modernize its tax system and generate some stable revenue, Illinois also must expand its sales tax base to include services.
- This is because a broad based sales tax is very stable – even during economic downturns. Unfortunately, of the 46 state with a sales tax, Illinois’ sales tax base is the third most narrow, because it excludes most services. As the following Figure demonstrates, this is a prescription for fiscal failure. Illinois cannot afford to leave the largest and fastest growing segment of its economy out of its tax base and expect to balance its budget or pay its pension debt.

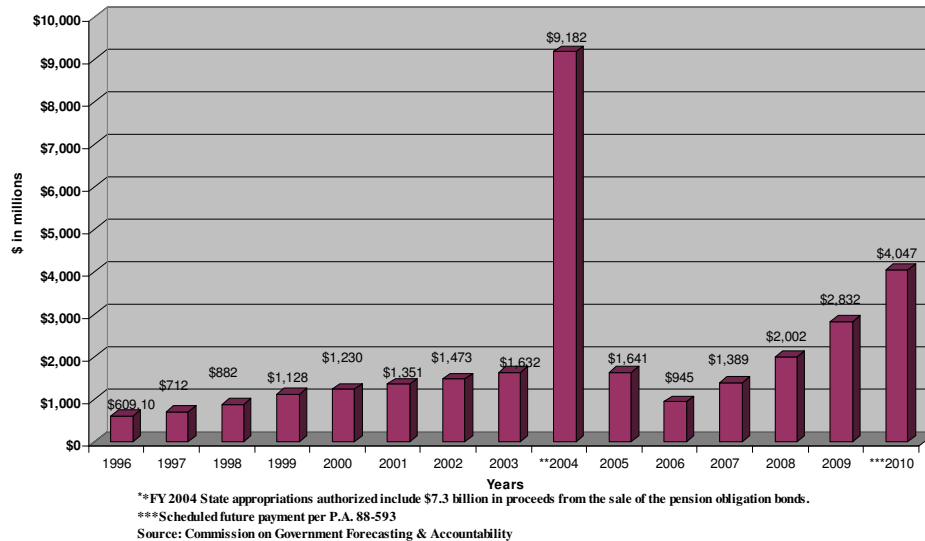


- The current mix of state revenues simply cannot meet the cost of existing human services, education, and pension obligations. Illinois must modernize the state tax system in order to raise enough money to pay its bills – this requires a comprehensive package of fiscal solutions. HB 174 raises approximately \$5-\$6 billion in new, recurring revenue while modernizing the state’s tax system and making it fairer; doubles the state income tax credit Illinois homeowners receive for property taxes paid on their principal residence; increases the corporate income tax rate from 4.8% to 5%; and makes meaningful new investments in education.

VI. “Amortization” the Responsible Funding Solution:

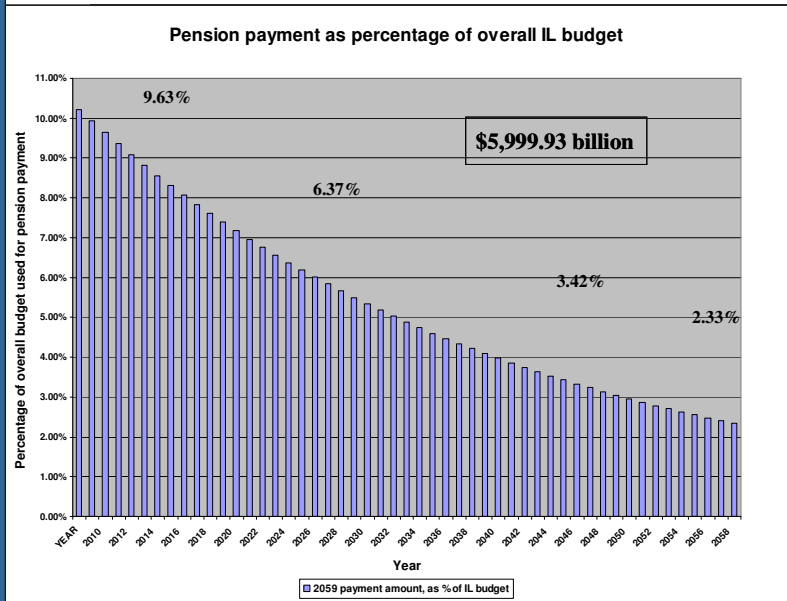
- The creation of the “Pension Ramp” under P.A. 88-0593 (1994) was an attempt to address the unfunded pension liability. Intended to force increased payments to the retirement systems over time, the Pension Ramp established a time-frame during which Illinois was required to fund both: (i) the actuarially determined employer contribution the state owed for retirement benefits accruing to existing employees (the “**Normal Cost**”); plus (ii) make up a portion of previously unpaid employer contributions and the associated return thereon. The Pension Ramp amortized this payment schedule over 50 years, with a target of funding 90% of total actuarial liabilities by 2045. The Pension Ramp created a framework that established a 15 year ramp period, during which the newly mandated contributions Illinois had to make for current and past employees increased in annual increments. Unfortunately, there was a deficiency within the ramp – a lack of revenue to fully fund the employer contributions.

State Contributions Annually since the 1995 Pension Ramp Passed



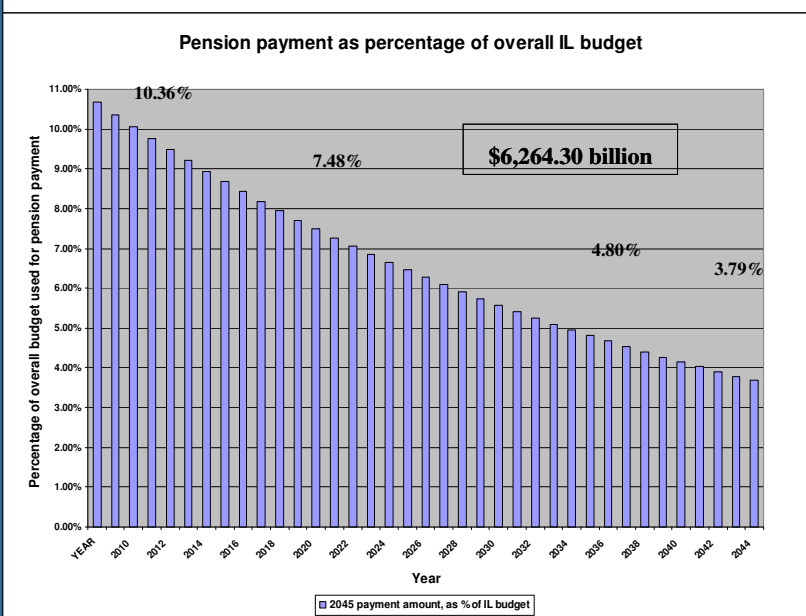
- In order to solve the long-term unfunded pension liability the ramp could be re-amortized with a new payoff date of 2059. Payment amounts assume an unfunded liability of \$73.4 billion and a flat interest rate of 8.0% over a 36 and 50 year period, respectively. In moving forward, we must assume that the Illinois budget will keep pace with inflation, increasing at an average rate of 3% per year.

2059 Payment as Percentage of Illinois Budget

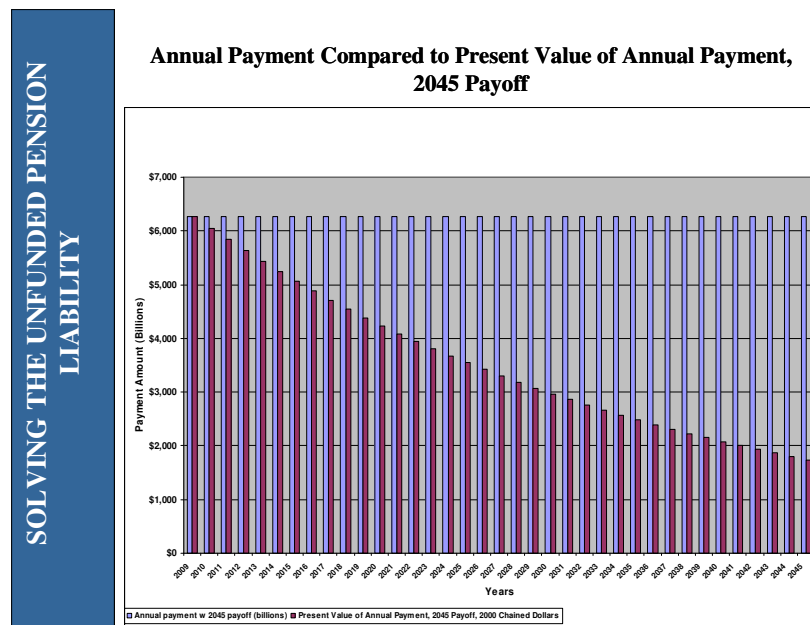
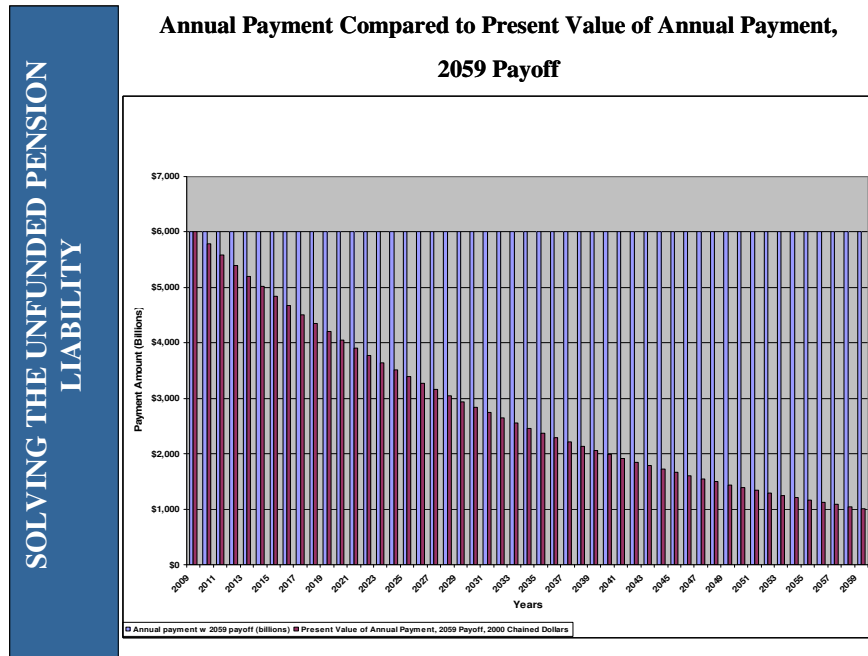


- These budget projections are based upon the average annual historic CPI (consumer price index) of 3.0% for a 15 year period of 1983-2008.

2045 Payment as Percentage of Illinois Budget



- The annual proposed payment schedules in comparison with the present value payment schedule front loads the amount that is needed to pay down the unfunded liability.



- Instead of unattainable, increasing payments that “ramp-up” over time, the proposed payoff schedule requires level and realistic payments.

VII. One Size Does Not Fit All – When it Come s to Pension Reform!

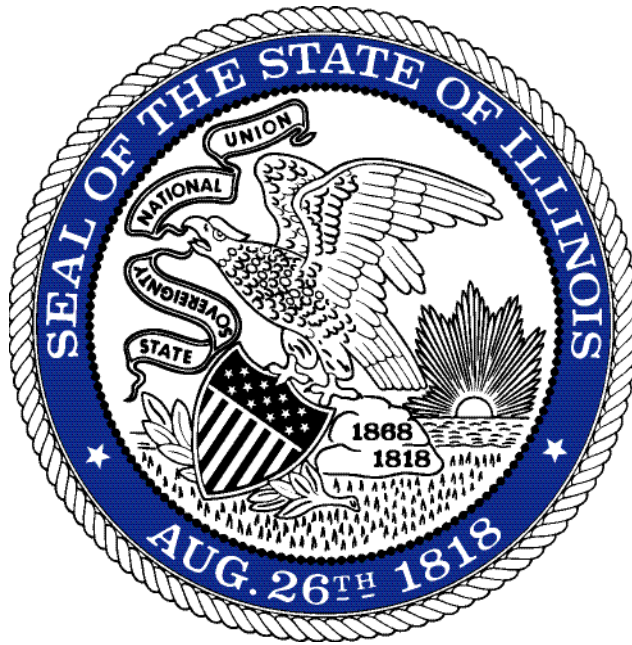
- Based upon the presentation, “Comparison of Public and Private Retirement Benefits”, assessments were submitted to the Funding Committee of the Pension Modernization Task Force:
 - “Must Change Cash Flows in Short Time”
 - “New Tiers Won’t Help”
 - “Time is of the Essence”
 - “Cash infusion from other revenue sources”
 - “Due to lack of revenue the 5-state funded retirement systems are in danger of becoming insolvent.”
- CTBA agrees with those assessments and stresses that unless the unfunded liability is dealt with in a fiscally responsible manner the problem will only get worse.
- On the flipside, we disagree with AON Consulting when it recommends that Illinois cut benefits for current workers and current recipients as a means to solving the pension crisis, for the simple reason that the state cannot constitutionally implement those changes. Under Section 5 of Article XIII of the Illinois Constitution, “membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.” This clause is commonly referred to as the “Pension Protection Clause.
- AON Consulting also recommended that Illinois may be able to attain a cash infusion through borrowing. Borrowing simply prolongs the inevitable tanking of the retirement systems and takes an already debilitating debt from bad to worse. Far better to create a recurring revenue source, such as under HB 174, to permit the state to pay its pension obligations.

VIII. Illinois Cannot Afford to Make the Same Mistake Twice:


- Under current law, P.A. 88-0593 (Funding Plan for State-Funded Retirement Systems), Illinois would have to contribute \$437.6 billion through 2045. This averages \$12.2 billion a year – an already unattainable amount proven by the growing unfunded liability. The Pension Ramp failed, in large part, due to the absence of a revenue stream to support it, and its irresponsible back loading of costs.
- Under the Governor’s proposed Stair Step Funding Plan and Two-Tier proposal, Illinois would have to pay substantially more, \$532.3 billion through 2045 than under current law. This would ultimately cost the state an additional \$94.7 billion between now and 2045.⁹ The Commission on Government Forecasting and Accountability’s actuary concluded that the Governor’s proposal to reduce benefits for new employees is not appropriate for reducing costs. CTBA agrees. The state of Illinois needs responsible comprehensive revenue enhancements and a revised re-amortized pension ramp.

⁹ Stair Step Funding Proposal, Governor’s Office, 5/8/2009.


Appendices



Appendix A


<div style="display: flex; justify-content: space-between; align-items: center;"> <div style="text-align: left;">  <p>TRS Retirement Security for Illinois Educators</p> </div> <div style="text-align: center;"> <h3>Cost of Mandatory Social Security</h3> <h4>Assuming Coverage for All Current & Future TRS Members</h4> </div> </div>					
Fiscal Year	Total Payroll for Active Teachers	6.2% Employer Contribution	6.2% Member Contribution	Total Contributions for Employers & Members	
2011	\$ 9,642,327,622	\$ 597,824,313	\$ 597,824,313	\$	1,195,648,625
2012	10,047,747,552	622,960,348	622,960,348		1,245,920,696
2013	10,476,699,653	649,555,378	649,555,378		1,299,110,757
2014	10,934,659,907	677,948,914	677,948,914		1,355,897,829
2015	11,426,309,486	708,431,188	708,431,188		1,416,862,376
2016	11,954,450,534	741,175,933	741,175,933		1,482,351,866
2017	12,516,639,814	776,031,668	776,031,668		1,552,063,337
2018	13,108,263,978	812,712,367	812,712,367		1,625,424,733
2019	13,729,996,549	851,259,786	851,259,786		1,702,519,572
2020	14,385,487,827	891,900,245	891,900,245		1,783,800,491
2021	15,075,322,885	934,670,019	934,670,019		1,869,340,038
2022	15,800,876,958	979,654,371	979,654,371		1,959,308,743
2023	16,561,071,388	1,026,786,426	1,026,786,426		2,053,572,852
2024	17,351,864,395	1,075,815,592	1,075,815,592		2,151,631,185
2025	18,175,518,206	1,126,882,129	1,126,882,129		2,253,764,258
2026	19,031,527,183	1,179,954,685	1,179,954,685		2,359,909,371
2027	19,915,674,471	1,234,771,817	1,234,771,817		2,469,543,634
2028	20,827,683,269	1,291,316,363	1,291,316,363		2,582,632,725
2029	21,783,870,485	1,350,599,970	1,350,599,970		2,701,199,940
2030	22,782,601,368	1,412,521,285	1,412,521,285		2,825,042,570
2031	23,818,517,278	1,476,748,071	1,476,748,071		2,953,496,142
2032	24,889,639,616	1,543,157,656	1,543,157,656		3,086,315,312
2033	25,995,267,983	1,611,706,615	1,611,706,615		3,223,413,230
2034	27,145,460,548	1,683,018,554	1,683,018,554		3,366,037,108
2035	28,349,125,337	1,757,645,771	1,757,645,771		3,515,291,542
2036	29,610,539,243	1,835,853,433	1,835,853,433		3,671,706,866
2037	30,939,344,313	1,918,239,347	1,918,239,347		3,836,478,695
2038	32,329,998,191	2,004,459,888	2,004,459,888		4,008,919,776
2039	33,790,831,447	2,095,031,550	2,095,031,550		4,190,063,099
2040	35,349,432,845	2,191,664,836	2,191,664,836		4,383,329,673
Cumulative cost over 30 years:	\$	37,060,298,521	\$	37,060,298,521	\$ 74,120,597,041
		\$37 billion		\$37 billion	\$74 billion

Appendix B

<div><div><div><div>Illinois Teachers' Retirement System</div><div>Comparison of Total Normal Cost for Members Hired After 6/30/2009</div><div>Under Current Plan Provisions and Under the Proposed Plan (SB 1292, HAMS 1 & 2))</div></div></div></div>										
Total Normal Cost Includes:				Current Plan			Proposed Plan		Change	
The state normal cost for benefits				See Chart			See Chart		See Chart	
The federal funds normal cost for benefits				*			*		*	
The school district contribution toward the 2.2 formula				0.58%			0.58%		0.00%	
The employer normal cost for administrative expenses; plus				0.20%			0.20%		0.00%	
The member statutory contribution rate; plus				9.40%			7.00%		-2.40%	
Member payments to purchase optional service within two years of retirement				0.25%			0.00%		-0.25%	
Total New Hire Projected Normal Cost Dollars for FY 2010 through FY 2045 (in million \$				100,646			\$ 46,714		\$ (53,932)	
Present Value at 6/30/2009 of Total New Hire Projected Normal Cost (in millions)				\$ 14,522			\$ 6,941		\$ (7,581)	
State New Hire Projected Normal Cost Dollars for FY 2010 through FY 2045 (in million \$				\$ 36,895			\$ 736		\$ (36,158)	
Present Value at 6/30/2009 of State New Hire Projected Normal Cost (in millions)				\$ 4,859			\$ (41)		\$ (4,900)	
Year Ended June 30	Current Plan			Proposed Plan			Change in			
	State Benefit NC Rate	Total Normal Cost Dollars	State Normal Cost Dollars	State Benefit NC Rate	Total Normal Cost Dollars	State Normal Cost Dollars	State Benefit NC Rate	Total Normal Cost Dollars	State Normal Cost Dollars	
2010	5.40%	72,031,075	24,275,286	1.19%	40,494,441	5,332,662	-4.22%	(31,536,634)	(18,942,624)	
2011	5.23%	145,669,073	48,082,717	1.19%	82,793,217	10,902,935	-4.05%	(62,875,856)	(37,179,782)	
2012	4.01%	205,443,712	56,460,109	0.39%	115,233,435	5,435,474	-3.62%	(90,210,277)	(51,024,635)	
2013	3.42%	267,550,689	65,447,077	0.12%	151,262,990	2,216,322	-3.30%	(116,287,699)	(63,230,755)	
2014	3.20%	334,405,799	77,740,375	-0.06%	187,847,454	(1,408,254)	-3.25%	(146,558,345)	(79,148,629)	
2015	3.12%	406,377,409	92,763,035	-0.17%	225,835,020	(5,159,280)	-3.29%	(180,542,389)	(97,922,315)	
2016	3.13%	483,658,477	110,553,916	-0.27%	264,783,876	(9,535,087)	-3.40%	(218,874,601)	(120,089,003)	
2017	3.22%	568,522,591	132,912,808	-0.34%	305,626,863	(13,886,900)	-3.56%	(262,895,728)	(146,799,708)	
2018	3.34%	660,652,648	158,718,650	-0.39%	348,925,651	(18,241,888)	-3.72%	(311,726,997)	(176,960,537)	
2019	3.51%	762,398,472	190,027,032	-0.42%	394,579,858	(22,815,170)	-3.93%	(367,818,613)	(212,842,203)	
2020	3.68%	872,491,580	225,586,654	-0.43%	444,202,780	(26,303,996)	-4.12%	(428,288,800)	(251,890,650)	
2021	3.88%	992,294,048	266,325,166	-0.43%	497,330,566	(29,450,021)	-4.31%	(494,963,482)	(295,775,188)	
2022	4.06%	1,120,545,968	310,751,403	-0.42%	554,374,852	(32,054,745)	-4.48%	(566,171,116)	(342,806,148)	
2023	4.27%	1,261,649,218	362,508,701	-0.41%	616,004,308	(33,906,889)	-4.67%	(645,644,910)	(396,415,590)	
2024	4.46%	1,413,132,802	418,586,126	-0.39%	682,014,325	(35,655,815)	-4.85%	(731,118,477)	(454,241,941)	
2025	4.66%	1,578,893,183	482,325,918	-0.36%	753,750,942	(36,303,242)	-5.02%	(825,142,241)	(518,629,161)	
2026	4.88%	1,760,233,524	554,286,857	-0.33%	830,928,618	(36,627,267)	-5.20%	(929,304,906)	(590,914,124)	
2027	5.08%	1,955,970,626	632,680,690	-0.29%	915,301,898	(35,409,505)	-5.37%	(1,040,668,728)	(668,090,196)	
2028	5.28%	2,168,859,957	719,631,926	-0.25%	1,006,325,508	(33,560,687)	-5.53%	(1,162,534,449)	(753,192,613)	
2029	5.45%	2,393,095,510	811,426,512	-0.21%	1,102,926,445	(30,958,884)	-5.67%	(1,290,169,065)	(842,385,396)	
2030	5.62%	2,631,670,110	910,254,423	-0.17%	1,205,710,586	(27,544,878)	-5.80%	(1,425,959,524)	(937,799,301)	
2031	5.77%	2,883,963,557	1,014,382,121	-0.13%	1,317,369,751	(21,593,831)	-5.90%	(1,566,593,806)	(1,035,975,952)	
2032	5.94%	3,157,092,976	1,130,114,838	-0.09%	1,435,120,834	(16,201,145)	-6.02%	(1,721,972,142)	(1,146,315,983)	
2033	6.09%	3,447,680,483	1,253,678,398	-0.04%	1,563,067,826	(7,791,824)	-6.13%	(1,884,612,657)	(1,261,470,222)	
2034	6.23%	3,755,107,171	1,384,611,720	0.01%	1,699,520,696	2,104,420	-6.22%	(2,055,586,475)	(1,382,507,300)	
2035	6.35%	4,077,846,497	1,521,569,260	0.06%	1,844,505,047	13,616,317	-6.29%	(2,233,341,450)	(1,507,952,942)	
2036	6.47%	4,420,799,542	1,669,376,674	0.11%	1,998,222,696	26,872,332	-6.37%	(2,422,576,845)	(1,642,504,342)	
2037	6.59%	4,779,834,124	1,824,678,065	0.15%	2,160,399,877	41,993,353	-6.44%	(2,619,434,247)	(1,782,684,711)	
2038	6.70%	5,157,543,191	1,989,342,906	0.21%	2,334,616,066	61,929,339	-6.49%	(2,822,927,125)	(1,927,413,567)	
2039	6.78%	5,541,654,732	2,152,239,920	0.26%	2,514,866,583	81,363,988	-6.52%	(3,026,788,149)	(2,070,875,931)	
2040	6.86%	5,940,703,947	2,323,654,832	0.31%	2,702,448,023	102,984,722	-6.55%	(3,238,255,923)	(2,220,670,110)	
2041	6.92%	6,335,766,449	2,490,629,695	0.35%	2,891,054,215	123,334,817	-6.57%	(3,444,712,234)	(2,367,294,878)	
2042	6.95%	6,714,333,915	2,646,771,417	0.39%	3,082,245,158	145,387,172	-6.57%	(3,632,088,756)	(2,501,384,245)	
2043	6.97%	7,085,663,256	2,797,445,715	0.42%	3,277,787,672	169,244,573	-6.55%	(3,807,875,584)	(2,628,201,143)	
2044	6.98%	7,458,224,202	2,947,216,610	0.46%	3,479,400,061	195,038,108	-6.52%	(3,978,824,140)	(2,752,178,503)	
2045	6.99%	7,834,391,048	3,097,514,191	0.50%	3,687,330,748	222,839,461	-6.49%	(4,147,060,301)	(2,874,674,729)	

*All normal cost rates shown are a percentage of total payroll. The federal funds normal cost is approximately 3.6% of the state's normal cost.

Appendix C

<div style="display: flex; align-items: center;">  <div> Illustration of Increase in TRS Employer (School District) Contribution to Cover Employer Normal Cost Based on Current Benefit Plan and June 30, 2008 Actuarial Valuation Results Target Employer Normal Cost: Approximately 8.30%* </div> </div>							
Fiscal Year	Total Active Member Payroll	% of Pay			\$ Amounts		
		Current law	Proposed	Total	Current law	Proposed	Total
		2.2 formula	Phase-in: add 0.5% per year	Reach target in FY 26	2.2 formula	Phase-in: add 0.5% per year	Reach target in FY 26
2009	\$ 8,817,486,572	0.58%	-	0.58%	\$ 51,141,422	\$ -	\$ 51,141,422
2010	9,252,805,323	0.58%	-	0.58%	53,666,271	-	53,666,271
2011	9,642,327,622	0.58%	0.50%	1.08%	55,925,500	48,211,638	104,137,138
2012	10,047,747,552	0.58%	1.00%	1.58%	58,276,936	100,477,476	158,754,411
2013	10,476,699,653	0.58%	1.50%	2.08%	60,764,858	157,150,495	217,915,353
2014	10,934,659,907	0.58%	2.00%	2.58%	63,421,027	218,693,198	282,114,226
2015	11,426,309,486	0.58%	2.50%	3.08%	66,272,595	285,657,737	351,930,332
2016	11,954,450,534	0.58%	3.00%	3.58%	69,335,813	358,633,516	427,969,329
2017	12,516,639,814	0.58%	3.50%	4.08%	72,596,511	438,082,393	510,678,904
2018	13,108,263,978	0.58%	4.00%	4.58%	76,027,931	524,330,559	600,358,490
2019	13,729,996,549	0.58%	4.50%	5.08%	79,633,980	617,849,845	697,483,825
2020	14,385,487,827	0.58%	5.00%	5.58%	83,435,829	719,274,391	802,710,221
2021	15,075,322,885	0.58%	5.50%	6.08%	87,436,873	829,142,759	916,579,631
2022	15,800,876,958	0.58%	6.00%	6.58%	91,645,086	948,052,617	1,039,697,704
2023	16,561,071,388	0.58%	6.50%	7.08%	96,054,214	1,076,469,640	1,172,523,854
2024	17,351,864,395	0.58%	7.00%	7.58%	100,640,813	1,214,630,508	1,315,271,321
2025	18,175,518,206	0.58%	7.50%	8.08%	105,418,006	1,363,163,865	1,468,581,871
2026	19,031,527,183	0.58%	8.00%	8.58%	110,382,858	1,522,522,175	1,632,905,032
2027	19,915,674,471	0.58%	8.00%	8.58%	115,510,912	1,593,253,958	1,708,764,870
2028	20,827,683,269	0.58%	8.00%	8.58%	120,800,563	1,666,214,662	1,787,015,224
2029	21,783,870,485	0.58%	8.00%	8.58%	126,346,449	1,742,709,639	1,869,056,088
2030	22,782,601,368	0.58%	8.00%	8.58%	132,139,088	1,822,608,109	1,954,747,197
2031	23,818,517,278	0.58%	8.00%	8.58%	138,147,400	1,905,481,382	2,043,628,782
2032	24,889,639,616	0.58%	8.00%	8.58%	144,359,910	1,991,171,169	2,135,531,079
2033	25,995,267,983	0.58%	8.00%	8.58%	150,772,554	2,079,621,439	2,230,393,993
2034	27,145,460,548	0.58%	8.00%	8.58%	157,443,671	2,171,636,844	2,329,080,515
2035	28,349,125,337	0.58%	8.00%	8.58%	164,424,927	2,267,930,027	2,432,354,954
2036	29,610,539,243	0.58%	8.00%	8.58%	171,741,128	2,368,843,139	2,540,584,267
2037	30,939,344,313	0.58%	8.00%	8.58%	179,448,197	2,475,147,545	2,654,595,742
2038	32,329,998,191	0.58%	8.00%	8.58%	187,513,990	2,586,399,855	2,773,913,845
2039	33,790,831,447	0.58%	8.00%	8.58%	195,986,822	2,703,266,516	2,899,253,338
2040	35,349,432,845	0.58%	8.00%	8.58%	205,026,711	2,827,954,628	3,032,981,338
2041	37,022,168,466	0.58%	8.00%	8.58%	214,728,577	2,961,773,477	3,176,502,054
2042	38,786,714,381	0.58%	8.00%	8.58%	224,962,943	3,102,937,150	3,327,900,094
2043	40,629,287,633	0.58%	8.00%	8.58%	235,649,868	3,250,343,011	3,485,992,879
2044	42,546,698,395	0.58%	8.00%	8.58%	246,770,851	3,403,735,872	3,650,506,722
2045	44,549,274,274	0.58%	8.00%	8.58%	258,385,791	3,563,941,942	3,822,327,733
Total Contributions FY 11-FY 45					\$ 4,647,429,182	\$ 56,907,313,176	\$ 61,554,742,358
* Notes:							
1. Current 0.58% employer contributions are already applied towards employer normal cost.							
2. Assumes federal funds will be applied towards employer normal cost (included with employer contrib. in this illustration).							
3. Target employer normal cost rate would need to be adjusted periodically because it fluctuates with covered population.							
4. Assumes that school district hiring behavior is not affected by increase in required contributions.							

Appendix D

State Contributions That Would Have Been Required For Each Year From FY 96 Through FY 08 Based on the Annual Required Contribution Under GASB Statement No. 25						
<u>Fiscal Year</u>	<u>TRS</u>	<u>SERS</u>	<u>SURS</u>	<u>JRS</u>	<u>GARS</u>	<u>Total</u>
1996	\$ 1,350,997,000	\$ 335,219,027	\$ 590,100,000	\$ 37,711,076	\$ 7,942,130	\$ 2,321,969,233
1997	927,842,000	211,125,012	432,600,000	26,021,939	4,939,052	1,602,528,003
1998	983,312,000	206,725,718	290,400,000	28,867,624	5,318,505	1,514,623,847
1999	932,909,000	319,746,993	296,200,000	38,631,275	6,092,002	1,593,579,270
2000	1,003,612,000	299,081,856	325,300,000	40,205,224	6,311,995	1,674,511,075
2001	1,102,441,000	294,351,538	326,500,000	42,546,928	6,530,519	1,772,369,985
2002	1,163,262,000	306,509,801	435,300,000	47,277,311	6,961,911	1,959,311,023
2003	1,427,519,000	449,348,585	597,500,000	53,470,841	7,752,005	2,535,590,431
2004	1,716,977,000	576,219,951	691,000,000	63,261,895	8,894,016	3,056,352,862
2005	1,683,212,000	727,428,010	607,800,000	57,749,460	8,302,564	3,084,492,034
2006	1,679,524,000	672,555,569	662,000,000	62,927,993	8,593,196	3,085,600,758
2007	2,052,396,000	823,802,760	705,900,000	73,371,653	10,125,503	3,665,595,916
2008	1,949,463,000	986,410,891	707,500,000	75,134,070	10,672,535	3,729,180,496

Appendix E

STATE RETIREMENT SYSTEMS CHANGES IN UNFUNDED LIABILITY FY 1996 - FY 2008							
	SALARY INCREASES	INVESTMENT RETURNS (HIGHER)/LOWER THAN ASSUMED	EMPLOYER CONTRIBUTIONS N. C. + INTEREST (HIGHER)/LOWER	BENEFIT INCREASES	CHANGES IN ACTUARIAL ASSUMPTIONS	OTHER FACTORS	TOTAL CHANGE IN UNFUNDED LIABILITY FROM PREVIOUS YR
TRS							
6/30/1996	400,399,000	(577,281,000)	965,961,000	17,772,000	0	166,531,000	973,382,000
6/30/1997	(59,062,000)	(830,936,000)	992,390,000	0	(2,944,771,000)	88,773,000	(2,753,606,000)
6/30/1998	(46,017,000)	(1,417,747,000)	776,189,000	1,000,300,000	0	71,152,000	383,877,000
6/30/1999	44,030,000	(389,014,000)	677,408,000	33,870,000	125,223,000	533,933,000	1,025,450,000
6/30/2000	(33,403,000)	(450,361,000)	723,606,000	0	0	197,345,000	437,187,000
6/30/2001	(10,310,000)	3,089,765,000	733,877,000	0	0	632,729,000	4,446,061,000
6/30/2002	4,934,000	2,696,199,000	1,074,422,000	0	694,736,000	360,047,000	4,830,338,000
6/30/2003	171,802,000	827,434,000	1,415,610,000	53,850,000	0	658,524,000	3,127,220,000
6/30/2004	217,255,000	(2,168,876,000)	(2,811,516,000)	0	0	357,250,000	(4,405,887,000)
6/30/2005	236,687,000	(682,294,000)	1,299,840,000	0	26,425,000	1,706,431,000	2,587,089,000
6/30/2006	68,398,000	(1,159,525,000)	1,913,368,000	0	0	(400,028,000)	422,213,000
6/30/2007	149,682,000	(3,785,653,000)	1,739,187,000	0	2,410,756,000	813,081,000	1,327,053,000
6/30/2008	(153,987,000)	5,514,988,000	1,529,701,000	0	0	(428,135,000)	6,462,567,000
TOTALS	990,408,000	666,699,000	11,030,043,000	1,105,792,000	312,369,000	4,757,633,000	18,862,944,000
SURS							
6/30/1996	(70,535,000)	(105,383,000)	456,044,000	0	0	86,823,000	366,949,000
6/30/1997	(44,026,000)	(312,322,000)	424,816,000	179,117,000	(3,342,395,000)	198,529,000	(2,896,281,000)
6/30/1998	5,238,000	(765,736,000)	158,840,000	0	0	48,075,000	(553,583,000)
6/30/1999	44,300,000	(273,300,000)	271,300,000	0	0	190,800,000	233,100,000
6/30/2000	171,500,000	(587,500,000)	306,700,000	0	0	(130,949,000)	(240,249,000)
6/30/2001	70,300,000	2,068,500,000	301,000,000	0	0	107,131,000	2,546,931,000
6/30/2002	90,800,000	1,568,700,000	430,800,000	63,000,000	485,300,000	38,744,000	2,677,344,000
6/30/2003	10,300,000	583,000,000	558,500,000	0	0	319,300,000	1,471,100,000
6/30/2004	(62,900,000)	(950,500,000)	(822,700,000)	0	0	17,893,000	(1,818,207,000)
6/30/2005	(19,400,000)	(218,000,000)	574,300,000	0	0	170,520,000	507,420,000
6/30/2006	28,600,000	(414,100,000)	734,900,000	0	0	164,900,000	514,300,000
6/30/2007	67,000,000	(1,342,000,000)	707,200,000	0	324,400,000	105,900,000	(137,500,000)
6/30/2008	30,600,000	2,004,400,000	590,900,000	0	0	329,100,000	2,955,000,000
TOTALS	321,777,000	1,255,759,000	4,692,600,000	242,117,000	(2,532,695,000)	1,646,766,000	5,626,324,000
SERS							
6/30/1996	(63,804,332)	(251,369,719)	196,620,212	0	0	47,104,123	(71,449,716)
6/30/1997	(65,121,542)	(541,583,072)	121,668,957	0	(379,894,379)	152,898,511	(712,031,525)
6/30/1998	(62,013,427)	(568,807,725)	9,431,057	1,249,883,128	0	148,729,225	777,222,258
6/30/1999	(12,536,220)	(307,064,512)	21,020,544	0	0	32,949,396	(265,630,792)
6/30/2000	14,642,937	(252,699,421)	(21,811,201)	0	0	250,182,926	(9,684,759)
6/30/2001	(8,000,000)	1,368,815,911	(29,398,605)	652,110,224	0	309,964,003	2,293,491,533
6/30/2002	52,000,000	1,247,268,792	186,860,538	171,100,000	168,144,000	496,199,643	2,321,572,973
6/30/2003	(28,282,435)	629,483,966	404,526,925	2,371,173,094	0	97,815,307	3,474,716,857
6/30/2004	(22,316,647)	(679,743,495)	(944,135,304)	0	0	6,804,783	(1,639,390,663)
6/30/2005	(166,479,933)	(123,132,472)	503,532,346	0	0	144,142,000	358,061,941
6/30/2006	33,070,000	(250,686,000)	772,374,000	0	710,976,000	(101,544,000)	1,164,190,000
6/30/2007	98,239,312	(878,435,107)	816,648,269	0	0	190,866,392	227,318,866
6/30/2008	207,247,739	1,690,697,791	615,695,516	0	0	130,264,860	2,643,905,906
TOTALS	(23,354,548)	1,082,744,937	2,653,033,254	4,444,266,446	499,225,621	1,906,377,169	10,562,292,879
JRS							
6/30/1996	9,999,484	(13,671,404)	24,518,236	0	0	14,931,343	35,777,659
6/30/1997	(7,658,092)	(28,145,182)	27,156,529	0	37,922,093	15,264,216	44,539,564
6/30/1998	(10,160,914)	(30,497,137)	34,123,085	0	0	7,218,733	683,767
6/30/1999	456,439	(16,539,663)	32,504,330	0	0	8,821,168	25,242,274
6/30/2000	2,215,672	(14,134,561)	33,196,266	2,848,501	0	8,268,502	32,394,380
6/30/2001	(7,464,258)	61,790,163	35,767,996	0	0	17,044,333	107,138,234
6/30/2002	(11,821,953)	54,489,350	42,170,792	0	28,381,924	8,609,434	121,829,547
6/30/2003	(26,392,926)	27,183,676	49,293,246	0	0	18,906,930	68,990,926
6/30/2004	6,291,883	(36,709,772)	(92,295,242)	0	0	(1,952,146)	(124,665,277)
6/30/2005	(15,087,614)	(8,899,756)	46,427,305	0	0	27,509,646	49,949,581
6/30/2006	(18,612,759)	(17,213,516)	55,344,402	0	(11,189,825)	12,319,701	20,648,003
6/30/2007	(3,952,822)	(51,310,984)	50,305,409	0	0	28,046,308	23,087,911
6/30/2008	(8,834,671)	90,806,378	42,511,153	0	0	4,924,005	129,406,865
TOTALS	(91,022,531)	17,147,592	381,023,507	2,848,501	55,114,192	169,912,173	535,023,434
GARS							
6/30/1996	1,926,843	(2,564,790)	5,271,809	0	0	1,441,644	6,075,506
6/30/1997	1,298,457	(5,057,646)	5,529,869	0	(136,881)	753,138	2,386,937
6/30/1998	(233,098)	(5,394,158)	5,710,203	0	0	460,957	543,904
6/30/1999	846,137	(2,808,175)	5,298,511	0	0	3,030,916	6,367,389
6/30/2000	(431,214)	(2,371,993)	5,576,440	0	0	2,079,991	4,853,224
6/30/2001	(555,323)	10,135,725	5,803,227	0	0	1,273,197	16,656,826
6/30/2002	(1,520,756)	8,713,370	6,741,725	0	1,211,951	(162,610)	14,983,680
6/30/2003	(1,793,094)	4,391,493	7,217,512	0	0	6,485,877	16,301,788
6/30/2004	(2,633,642)	(5,927,446)	(19,174,182)	0	0	5,286,195	(22,449,075)
6/30/2005	(645,631)	(1,288,918)	7,445,358	0	0	(262,887)	5,247,922
6/30/2006	(3,113,674)	(1,566,794)	8,528,558	0	4,786,991	1,190,775	9,825,856
6/30/2007	3,962,835	(6,733,144)	7,670,304	0	0	373,350	5,273,345
6/30/2008	(2,217,940)	11,400,154	7,073,235	0	0	(613,134)	15,642,315
TOTALS	(5,110,100)	927,678	58,692,569	0	5,862,061	21,337,409	81,709,617
ALL							
6/30/1996	277,985,995	(950,269,913)	1,648,415,257	17,772,000	0	316,831,110	1,310,734,449
6/30/1997	(174,569,177)	(1,718,043,900)	1,571,561,355	179,117,000	(6,629,275,167)	456,217,865	(6,314,992,024)
6/30/1998	(113,186,439)	(2,788,182,020)	984,293,345	2,250,183,128	0	275,635,915	608,743,929
6/30/1999	77,096,356	(988,726,350)	1,007,531,385	33,870,000	125,223,000	769,534,480	1,024,528,871
6/30/2000	154,524,395	(1,307,066,975)	1,047,267,505	0	0	326,927,419	224,500,845
6/30/2001	43,970,419	6,599,006,799	1,047,049,618	652,110,224	0	1,068,141,533	9,410,278,593
6/30/2002	134,391,291	5,575,370,512	1,740,995,055	234,100,000	1,377,773,875	903,437,467	9,966,068,200
6/30/2003	125,633,545	2,071,493,135	2,435,147,683	2,425,023,094	0	1,101,032,114	8,158,329,571
6/30/2004	135,696,594	(3,841,756,713)	(4,689,820,728)	0	0	385,281,832	(8,010,599,015)
6/30/2005	35,073,822	(1,033,615,146)	2,431,545,009	0	26,425,000	(4,048,339,759)	3,507,768,444
6/30/2006	108,341,567	(1,843,091,310)	3,484,514,960	0	704,573,166	2,323,161,524	2,131,176,859
6/30/2007	314,931,325	(6,064,132,235)	3,321,010,982	0	2,735,156,000	1,138,267,050	1,445,233,122
6/30/2008	72,808,128	9,312,292,323	2,785,880,904	0	0	35,540,731	12,206,522,086
TOTALS	1,192,697,821	3,023,278,207	18,815,392,330	5,795,023,947	(1,660,124,126)	8,502,025,751	35,668,293,930

Appendix F

TEACHERS' RETIREMENT SYSTEM Changes in Net Assets (\$ in millions)													
Fiscal Years	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
Additions to Assets													
State of Illinois	1,041.1	737.7	534.3	906.8	1,031.5	929.7	814.7	724.0	639.3	573.0	467.0	385.1	355.1
Pension Obligation Bonds	0.0	0.0	0.0	0.0	4,330.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Employees	865.4	826.2	799.0	761.8	768.6	732.0	681.2	643.6	619.6	866.4	441.0	416.7	399.1
School Districts	88.3	83.4	99.3	109.0	93.9	58.2	66.3	74.4	69.9	43.7	18.8	18.7	17.3
Federal	42.4	32.5	24.3	39.8	33.7	33.3	26.3	23.2	21.4	19.8	17.2	17.4	17.0
Net Investment Income	-2,015.0	6,831.3	3,993.3	3,330.0	4,485.7	1,060.9	-724.0	-1,015.3	2,336.2	2,089.7	2,873.1	2,644.6	2,095.9
Total Asset Additions (A)	22.2	8,511.1	5,450.2	5,147.4	10,743.8	2,814.1	864.5	449.9	3,686.4	3,592.6	3,817.1	3,482.5	2,884.4
Deductions from Assets													
Benefits	3,424.0	3,111.8	2,877.2	2,533.1	2,262.3	1,998.6	1,759.7	1,566.8	1,402.2	1,284.1	1,210.0	1,161.0	1,121.6
Refunds	60.2	59.7	58.0	59.4	48.0	43.1	38.8	35.8	28.8	25.9	24.4	22.1	23.1
Administrative Expenses	16.6	15.2	15.3	14.4	13.6	13.9	15.4	13.1	11.7	10.8	9.9	10.3	10.0
Total Asset Deductions (B)	3,500.8	3,186.7	2,950.5	2,606.9	2,323.9	2,055.6	1,813.9	1,615.7	1,442.7	1,320.8	1,244.3	1,193.4	1,154.7
Change in Net Assets (A-B=C)	-3,478.6	5,324.4	2,499.7	2,540.5	8,419.9	758.5	-949.4	-1,165.8	2,243.7	2,271.8	2,572.8	2,289.1	1,729.7

Appendix G

STATE EMPLOYEES' RETIREMENT SYSTEM													
Changes in Net Assets (\$ in millions)													
Fiscal Years	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
Additions to Assets													
State of Illinois	587.7	358.8	210.5	427.5	478.7	396.1	386.1	366.0	340.9	315.5	200.8	158.2	146.4
Pension Obligation Bonds	0.0	0.0	0.0	0.0	1,386.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Employees	250.0	224.7	214.1	209.3	199.8	285.2	196.9	173.8	164.8	159.6	155.9	145.7	137.2
Net Investment Income	-680.8	1,779.9	1,104.4	949.1	1,419.8	12.1	-549.9	-619.4	926.0	903.8	1,076.0	952.6	736.2
Total Asset Additions (A)	156.9	2,363.4	1,529.0	1,585.9	3,484.3	693.4	33.1	-79.6	1,431.7	1,378.9	1,432.7	1,256.5	1,019.8
Deductions from Assets													
Benefits	1,214.1	1,161.5	1,110.6	1,064.0	978.2	831.5	617.9	537.6	489.9	440.8	399.4	368.7	351.8
Refunds	16.8	14.1	13.4	14.1	12.4	28.4	14.2	17.0	15.9	14.0	14.8	13.1	13.8
Administrative Expenses	9.5	8.8	8.1	8.3	7.7	8.2	7.6	7.1	6.6	6.4	6.2	5.7	5.3
Total Asset Deductions (B)	1,240.4	1,184.4	1,132.1	1,086.4	998.3	868.1	639.7	561.7	512.4	461.2	420.4	387.5	370.9
Change in Net Assets (A-B=C)	-1,083.5	1,179.0	396.9	499.5	2,486.0	-174.7	-606.6	-641.3	919.3	917.7	1,012.3	869.0	648.9

Appendix H

STATE UNIVERSITIES' RETIREMENT SYSTEM													
Changes in Net Assets (\$ in millions)													
Fiscal Years	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
Additions to Assets													
State of Illinois	340.3	252.1	166.7	269.9	311.7	269.6	240.4	232.6	224.6	217.6	201.6	182.1	147.4
Pension Obligation Bonds	0.0	0.0	0.0	0.0	1,432.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Employees	310.1	304.0	292.4	285.6	275.1	275.9	277.5	241.8	238.0	219.7	221.8	202.2	197.0
Federal	43.6	42.4	43.0	42.9	39.6	40.4	38.7	34.0	31.3	26.7	26.2	0.0	0.0
Net Investment Income	-714.8	2,597.8	1,566.8	1,302.0	1,865.3	255.4	-666.5	-1,064.7	1,501.3	1,104.5	1,474.6	1,490.0	1,077.8
Total Asset Additions (A)	-20.8	3,196.3	2,068.9	1,900.4	3,923.7	841.3	-109.9	-556.3	1,995.2	1,568.5	1,924.2	1,874.3	1,422.2
Deductions from Assets													
Benefits	1,279.2	1,180.6	1,086.6	1,005.4	915.9	837.3	743.3	664.8	590.2	525.9	466.5	419.2	379.5
Refunds	54.9	53.4	51.4	43.1	39.1	35.2	39.5	48.3	48.4	31.9	29.7	29.8	25.8
Administrative Expenses	12.1	11.7	12.0	12.8	12.3	13.2	13.1	12.7	12.3	11.3	10.7	8.7	8.0
Total Asset Deductions (B)	1,346.2	1,245.7	1,150.2	1,061.3	967.3	885.7	795.9	725.8	650.9	569.1	506.9	457.7	413.3
Change in Net Assets (A-B=C)	-1,367.0	1,950.6	918.7	839.1	2,956.4	-44.4	-905.8	-1,282.1	1,344.3	999.4	1,417.3	1,416.6	1,008.9

Appendix I

JUDGES' RETIREMENT SYSTEM Changes in Net Assets (\$ in millions)													
Fiscal Years	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
Additions to Assets													
State of Illinois	47.0	35.2	29.2	32.0	36.5	31.4	27.5	24.2	21.4	18.7	15.7	13.8	12.1
Pension Obligation Bonds	0.0	0.0	0.0	0.0	142.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Employees	15.4	14.2	13.6	13.3	13.7	12.9	12.5	12.3	12.0	11.3	10.8	10.5	9.8
Net Investment Income	-38.0	98.2	60.4	50.9	45.2	0.5	-24.2	-28.3	43.7	43.9	54.0	49.8	39.8
Total Asset Additions (A)	24.4	147.6	103.2	96.2	237.4	44.8	15.8	8.2	77.1	73.9	80.5	74.1	61.7
Deductions from Assets													
Benefits	80.5	75.6	69.0	64.5	60.9	56.7	52.8	48.3	44.2	40.8	38.6	36.1	33.1
Refunds	0.8	0.6	0.8	0.7	0.4	0.6	0.8	1.0	0.9	0.7	0.9	0.3	0.5
Administrative Expenses	0.5	0.5	0.4	0.5	0.5	0.4	0.0	0.0	0.0	0.0	0.0	0.5	0.4
Total Asset Deductions (B)	81.8	76.7	70.2	65.7	61.8	57.7	53.6	49.3	45.1	41.5	39.5	36.9	34.0
Change in Net Assets (A-B=C)	-57.4	70.9	33.0	30.5	175.6	-12.9	-37.8	-41.1	32.0	32.4	41.0	37.2	27.7

Appendix J

GENERAL ASSEMBLY RETIREMENT SYSTEM													
Changes in Net Assets (\$ in millions)													
Fiscal Years	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996
Additions to Assets													
State of Illinois	6.8	5.4	4.2	4.7	5.9	5.1	4.7	4.3	3.9	3.6	3.1	2.8	2.4
Pension Obligation Bonds	0.0	0.0	0.0	0.0	27.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Employees	1.8	1.7	1.4	1.5	1.6	1.9	1.6	1.4	1.3	1.4	1.2	1.3	1.1
Net Investment Income	-4.7	13.0	8.2	7.5	11.7	0.1	-3.8	-4.6	7.3	7.6	9.5	9.0	7.5
Total Asset Additions (A)	3.9	20.1	13.8	13.7	46.2	7.1	2.5	1.1	12.5	12.6	13.8	13.1	11.0
Deductions from Assets													
Benefits	15.3	14.7	14.1	13.4	12.5	11.1	9.9	9.2	8.8	8.4	7.9	7.4	7.0
Refunds	0.1	0.3	0.2	0.0	0.1	0.1	0.1	0.0	0.1	0.1	0.0	0.2	0.1
Administrative Expenses	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Total Asset Deductions (B)	15.7	15.2	14.6	13.7	12.9	11.5	10.3	9.5	9.2	8.7	8.1	7.8	7.3
Change in Net Assets (A-B=C)	-11.8	4.9	-0.8	0.0	33.3	-4.4	-7.8	-8.4	3.3	3.9	5.7	5.3	3.7

ILLINOIS STATE BOARD OF INVESTMENT

1. Summarize the COGFA report on the cost/benefits of consolidating the five pension funds investment authority. (Question to be answered by COGFA)
2. How do Illinois pension systems compare with other systems in their peer group?

Illinois Public Pension Funds Total Fund Performance (for periods ending March 31, 2009)

	1 YEAR	3 YEAR	5 YEAR	10 YEAR
Illinois State Board of Investment	-25.5%	-6.2%	0.4%	2.1%
Municipal Employees' Annuity and Benefit Fund	-29.4%	-8.3%	-1.5%	1.2%
State Universities Retirement System of Illinois	-29.2%	-6.9%	0.0%	2.2%
Teachers' Retirement System of Illinois	-26.5%	-5.6%	1.1%	3.4%
Metropolitan Water Reclamation District Fund	-25.7%	-7.6%	-1.9%	1.0%
Illinois Municipal Retirement Fund	-24.3%	-5.7%	0.8%	3.1%
Public School Teachers' Pension & Retirement Fund	-24.2%	-5.9%	0.6%	3.0%

3. What is the schedule for each system's asset allocation analysis?

ISBI conducts an asset allocation study every five years and makes changes intermittently as needed. The current asset allocation was last updated in March of 2008.

4. What is the current asset allocation of each pension system?

Illinois State Board of Investment Asset Allocation as of March 31, 2009

Asset Class	Target Allocation
Fixed Income	20.0%
U.S. Equity	30.0%
International Equity	20.0%
Hedge Funds	10.0%
Real Estate	10.0%
Alternative Investments	5.0%
Infrastructure	5.0%
Total Portfolio	100%

5. How do Illinois pension systems utilize hedge funds?

ISBI currently investments in five hedged equity fund of funds with low leverage and constrained investments. ISBI has had a positive experience with the Board's allocation to hedge funds. As mentioned above, ISBI has a target allocation of 10% to hedge funds with an actual allocation of 9.9% as of May 31, 2009.

6. To what extent do Illinois pension systems utilize minority investment managers and brokerage firms?

Illinois State Board of Investment Minority Manager Utilization as of March 31, 2009

Asset Class	% of Total Fund
Intermediate Fixed Income	3.53%
Domestic Equity	16.15%
International Equity	0.63%
Hedge Funds	2.29%
Private Equity	0.17%
Real Estate	0.39%
Total % of ISBI Portfolio	23.2%

Illinois State Board of Investment Minority Brokerage Utilization (FYTD through June 30, 2009)

Asset Class	% of Total Commissions
Intermediate Fixed Income	30.0%
Domestic Equity	57.0%
International Equity	7.0%

7. What is the cost impact of the Sudan and Iran divestiture?

ISBI realized a gain of \$7M from the sale of prohibited investments in Sudan and a loss of \$9M for the divestiture of prohibited securities in Iran. As a note, the Sudan Law prohibits the Board from transferring or disbursing funds to, depositing into, acquiring any bonds or commercial paper from, or otherwise loaning to or investing in any entity unless a certifying company certifies to the Board that with respect to investments in a publicly traded company, the certifying company has relied on information provided by an

independent researching firm that specializes in global security risk (Risk Metrics Group) and (ii) 100% of the Board's assets for which the certifying company provides services or advice are not and have not been invested or reinvested in any forbidden entity at any time after December 27, 2007 (4 months after the effective date of this Act). Any entity that the Board has disbursed funds to, deposited into, acquired any bonds or commercial paper from, loaned to or invested in has provided the required documentation; thus, the Board has not had to divest itself of any forbidden entities. In addition, the Board pays a fee to Risk Metrics Group to receive a certified list of prohibited securities for both Sudan and Iran for \$27,500 and \$12,000, respectively.

8. How does the new ethics legislation affect the investment policy?

The following points provided by ISBI's General Counsel summarize ways in which Public Act 96-0006 (the "Act") affects the Board's investment policy.

A. The Act convenes a working group consisting of: (i) representatives from the retirement systems, pension funds, and the Board ("pension entities"), (ii) persons that provide investment services and (iii) members of the financial industry. This working group will review the performance of investment managers and consultants that provide investment services to the pension entities, develop uniform standards for comparing the costs of investment services and make relevant recommendations to the pension entities. The Working Group will work in coordination with the Commission on Government Forecasting and Accountability, and must draft a report, which the Treasurer will submit to the Governor and General Assembly by January 1, 2011. Given that this working group will discuss the Board's investment performance and investment managers, as well as other investment related matters, it may result in changes to the Board's investment policy.

B. The Illinois Pension Code is amended to redefine "emerging manager." Emerging manager is now defined as "a qualified investment adviser that manages an investment portfolio of at least \$10,000,000 but less than \$10,000,000,000 and is a "minority-owned business", "female-owned business" or "business owned by a person with a disability" as those terms are defined in the Business Enterprise for Minorities, Females, and Persons with Disabilities Act. Prior to the Act, the cap for assets under management was set at \$2,000,000,000. This change in definition will change the nature of the Board's emerging manager program, given that a larger universe of investment managers will be considered "emerging" under the Act.

C. The State's public policy encouraging the pension entities' usage of emerging managers is clarified to include the utilization of emerging managers for all investment mandates. The Act also amends the public policy statement to encourage pension entities to increase the racial, ethnic, and gender diversity of their fiduciaries. By January 1, 2010, the Act requires the pension entities to adopt a policy setting forth quantifiable goals for the utilization of emerging managers. The pension entities must establish three separate goals: (i) a goal for emerging managers who are minority-owned businesses, (ii) a goal for emerging managers who are female-owned businesses and (iii) a goal for emerging managers whose businesses are owned by persons with disabilities. These goals must be based on the percentage of the total dollar amount of investment service contracts let to minority-owned businesses, female-owned businesses and businesses owned by persons with disabilities. The revised policy must be reviewed on an annual basis. This change in

policy and the specific goal requirements will require amendment to the Board's emerging manager program. Given that the Board is already committed to investing with emerging managers, the real effect to the Board's investment policy will be fulfilling the specific goals established for each type of emerging manager.

D. On or before January 1, 2010, the Act requires the pension entities to adopt a policy setting forth goals for increasing the utilization of minority broker-dealers, who are qualified broker-dealers that meet the definition of a minority-owned business, female-owned business or business owned by a person with a disability, under the Business Enterprise for Minorities, Females, and Persons with Disabilities Act. The policy must be reviewed on an annual basis. ISBI has already established this policy, but must extend it to businesses owned by people with disabilities.

E. The procurement of investment advisers and consultants for investment services must be awarded through a competitive bidding process that is substantially similar to Article 35 of the Illinois Procurement Code. By June 2, 2009, the Act requires the pension entities to adopt a procurement policy to be posted on the pension entities' websites and filed with the Illinois Procurement Policy Board. The Act provides limited exceptions where competitive bidding is not required. These exceptions must be addressed in the procurement policy. Any exceptions to the competitive bidding requirement must be published on the pension entities' websites, including the name of the person authorizing the procurement and a brief explanation of the reason for the exception. Though the procurement policy may not necessarily change who the Board, as fiduciaries, selects for investment services, it will change how the Board governs the selection process.

F. The Act requires that all consultants and investment advisers be registered under the Federal Investment Advisers Act of 1940. ISBI's current providers are in compliance with this requirement.

G. The Act requires a number of specific terms to be present in the Board's contracts for investment services; however, it is unlikely that the contract terms will impact how the Board implements its investment policy. Further, substantively, the Board's contracts already contain provisions addressing the specific terms.

H. The Act limits the term of consultant contracts to five years. At five years, these contracts must be re-bid, but the pension entities may allow their current consultants to participate in the bidding process.

I. The Act expands the Pension Code's prohibited transactions section to prohibit the pension entities' board members, employees, and consultants from engaging in an investment transaction with an investment adviser when the board member, employee, consultant or their spouse has (i) any direct interest in the income, gains or profits of the investment adviser through which the investment transaction is made; or (ii) has a relationship with that investment advisor that would result in a pecuniary benefit for the board member, employee, consultant or any of their spouses. For this provision, "consultant" includes an employee or agent of a consulting firm who has greater than 7.5% ownership interest in the consulting firm. Violation of this provision is a Class 4 felony. This provision

clarifies, as well as broadens, other existing prohibited transactions. The Board does not engage in prohibited transactions, but this provision will serve as an additional guide for investment and fiduciary compliance.

J. The Act prohibits any pension entity board member, employee or spouse of a board member or employee from knowingly having any direct interest in the income, gains or profits of any investments made on behalf of a pension entity for which such person is a board member or employee, nor receiving any pay or emolument for services in connection with the investment. No board member or employee may become an endorser or surety, or in any manner an obligor for money loaned or borrowed from any pension entity. Annuities provided in accordance with the Illinois Pension Code or any income, gains or profits related to any non-controlling interest in any public securities, mutual fund, or other passive investment are not considered monetary gain on investments. Violation of this provision is a Class 3 felony. Further to my comment above, this new provision will serve as an additional guide for investment and fiduciary compliance.

K. The Act prohibits any person or entity from retaining a person or entity to attempt to influence the outcome of an investment decision of or the procurement of investment advice or services of the pension entity for compensation, contingent in whole or in part upon the decision or procurement. A violation of this provision is a Class 4 felony. This provision will prevent any investment by the Board in a private investment fund utilizing a placement agent.

9. Provide ISBI's performance for the following time periods: 10 year, 20 year and Since Inception.

Illinois State Board of Investment Performance (ending May 31, 2009)

Time Period	Annualized Return
10 Year	2.6%
20 Year	7.2%
Since Inception (1983)	8.5%

10. How much will need to be funded so investments are not sold off to make benefit payments? (Question to be answered by SERS)

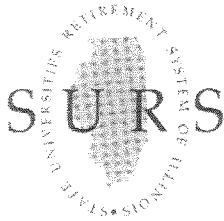
Please feel free to contact Johara El-Harazin at johara.elharazin@illinois.gov for further detail or additional questions.
Thank you.

Response to Questions from Pension System Modernization Task Force Sub-Committee



August 12, 2009

**Daniel L. Allen
Chief Investment Officer**



**State Universities Retirement System Response to
Questions for COGFA/Retirement System Research
Pension Modernization Task Force**

- 1. Summarize the COGFA report on the cost/benefits of consolidating the five pension funds investment authority.***

This question was addressed in a previous meeting of the Task Force.

- 2. How do Illinois pension systems compare with other systems in their peer group?***

SURS generally ranks slightly above median in a universe of other large public pension plans over the three-to-five year period. Given SURS' large size, broad diversification, and significant reliance on passive management, SURS is most likely to rank near the middle of the universe over time.

Please see Exhibit 1 for a summary of SURS' long-term investment returns.

- 3. What is the schedule for each system's asset allocation analysis.***

The SURS Board establishes the asset allocation targets and ranges and reviews them periodically. The target allocation will be reviewed annually for reasonableness relative to significant economic and market changes or to changes in the System's long-term goals and objectives. Typically, every three to five years the Board will undertake a comprehensive review of the asset allocation policy designed to assess the continuing appropriateness of Investment Policy. This ordinarily involves an asset-liability study that places the development of Investment Policy into the context of future benefit payments, liabilities, required funding and the prospective funded status of liabilities.

The most recent asset/liability study was completed in September 2007.

- 4. What is the current asset allocation of each pension system?***

The SURS asset allocation can be found on the first page of the SURS Investment Update, which is attached as Exhibit 2 for your information.

- 5. How do Illinois pension systems utilize hedge funds?***

Although SURS has examined the prospect of investing in hedge funds, the Board has not chosen to utilize hedge fund investments at this time.

- 6. To what extent do Illinois pension systems utilize minority managers and brokerage firms?***

Investment Management

SURS has historically utilized minority managers and brokerage firms to a significant extent and continues to do so today. It is the goal of the Board that, subject to its

fiduciary responsibility, 15% of investment assets be managed by emerging, minority- and women-owned investment managers. As of June 30, 2009, nearly \$1.6 billion, or 14.4% of SURS assets, were managed by emerging, minority and women-owned firms.

It is also the goal of the Board that, subject to its fiduciary responsibility, the use of emerging, minority- and women-owned investment managers be significant in each of the broad asset classes in which SURS is invested and not concentrated in any particular asset class. The table below identifies utilization goals and actual utilization rates for each of the four major asset classes. While these objectives may not be immediately achieved, the desire is to show meaningful progress toward these goals over time.

SURS Goals for Utilization of Minority- and Women-Owned Investment Management Firms

Asset Class	Goal (%)	Actual Utilization (%) as of June 30, 2009
Total Fund	15%	14.4%
U.S. Equity	25%	26.7%
Non-U.S. Equity	10%	7.6%
Fixed Income	10%	9.7%
Alternative Investments*	10% of new allocations	42.9%

*42.9% of new commitments to alternative investments in FY2009 were made to emerging, minority- or women-owned firms.

Brokerage

SURS' Investment Policy establishes specific minimum expectation levels for trading with minority-owned and women-owned brokerage firms. Section XV of the SURS Investment Policy, entitled "Emerging Investment Managers and Broker/Dealers" is attached as Exhibit 3 for your reference. Investment managers are expected to meet or exceed these minimum expectations, which are asset class-specific. The following table illustrates the minimum expectations levels for each asset class. SURS' investment managers, in the aggregate, are exceeding the minimum levels in each asset class.

SURS Minimum Expectations for the Usage of Minority- and Women-Owned Brokerage Firms

Asset Class	Minimum Expectation	Actual Usage (%) as of March 31, 2009
U.S. Equities		41.6%
Active U.S. Equities	25.0%	
Enhanced U.S. Equities	10.0%	
Non-U.S. Equities	10.0%	27.9%
Global Equities	17.5%	23.0%
Fixed Income*	16.25%	19.0%

*Minimum expectation for fixed income is gradually being phased in to a 20% level. As of March 31, 2009, the weighted goal was 16.25%.

7. *What is the cost impact of the Sudan and Iran divestitures?*

The cost impact of the Sudan divestiture is difficult to quantify. SURS experienced “start up” costs associated with the Sudan legislation resulting from the need to move to Sudan-free commingled funds. In addition, investment managers are required to purchase a list of Sudan-restricted securities from an independent research firm specializing in global security risk. Opportunity cost is probably the most significant potential cost associated with the Sudan legislation, though. Opportunity cost, which can be positive or negative, represents the potential loss (or gain) from not investing in the Sudan-restricted securities. If the companies on the Sudan list increase in price more than the securities selected to replace them, SURS experiences an opportunity cost that is detrimental to the portfolio. In general, restricting the investment universe is likely to reduce the investment return of a portfolio over time.

Like the Sudan divestiture, the cost impact of the Iran divestiture is also difficult to quantify. SURS purchases an Iran list from a third party vendor in order to provide the investment managers a list of prohibited securities. Again, the most significant cost impact is likely the potential opportunity cost from not being able to purchase the restricted securities. Through May 29, 2009, more than \$17 million in Iran-restricted securities had been divested from the SURS portfolio. Please see the attached memo to the SURS Investment Committee (Exhibit 4) for more information.

8. *What efforts have been made by the Illinois pension systems to comply with Public Act 96-0006?*

SURS is in the process of complying with the requirements of Public Act 96-0006. Please see the attached memo from staff to the SURS Investment Committee (Exhibit 5) detailing our efforts to date in this area, including the adoption of an investment procurement policy and collection of third party fee disclosure data from investment managers. SURS has recently added a Compliance Officer to its staff to assist in this and other compliance-related assignments. As an example, please see Exhibit 6, which contains an annual letter sent to investment managers seeking compliance certifications on several topics, including the Sudan and Iran legislation.

9. *Provide SURS’ performance for the following time periods: 10 year, 20 year and since inception.*

**Investment Performance for State Universities Retirement System
Periods Ending June 30, 2009**

Time Period	Annualized Return*
10 Year	2.8%
20 Year	7.2%
Since Inception (October 1981)	9.8%

*Returns are net of investment management fees.

10. *Discuss the most recent actuarial valuation of the fund.*

Attached as Exhibit 7 is a summary of the most recent SURS actuarial valuation, as of June 30, 2008.

Appendix M



Retirement Security for Illinois Educators

Teachers' Retirement System of the State of Illinois
2815 West Washington Street, P.O. Box 19253
Springfield, Illinois 62794-9253
TDD (217) 753-0329
(800) 877-7896
trs.illinois.gov

Investment Questions From Pension Modernization Task Force TRS Responses

1. Summarize the CGFA/Aon report (CGFA will provide response)
2. How do Illinois pension systems compare with other systems in their peer group?

TRS agrees with the comparison below supplied by the Illinois State Board of Investment as of **March 31, 2009**. In a broader peer group of funds over \$1 billion surveyed by our investment consultant R V Kuhns, TRS ranked in the 21st percentile over the 10-year period.

	1-Year	3- Year	5-Year	10-Year
TRS	-26.5%	-5.6%	1.1%	3.4%
ISBI	-25.5	-6.2	0.4	2.1
SURS	-29.2	-6.9	0.0	2.2

3. What is the schedule for each system's asset allocation analysis?

An asset allocation study is required every three years under the TRS investment policy. Additionally, studies are conducted as needed. For example, an updated study was performed in early 2009 after the significant dislocation in the capital markets that occurred in 2008.

4. What is the current asset allocation of each pension system?

The long term asset allocation for TRS is as follows:

ASSET ALLOCATION POLICY MIX	PERCENT OF TOTAL FUND
Domestic Equity Investments	26%
International Equity Investments	20%
Fixed Income Investments	15%
Real Estate Investments	14%
Private Equity Investments	10%
Real Return Investments	10%
Absolute Return Investments	5%
Short-term Investments	0%

Currently TRS employs an interim asset allocation target as it takes time to prudently grow into the long term targets for the more illiquid asset classes. The following is the System's interim asset allocation policy mix:

INTERIM ASSET ALLOCATION POLICY MIX	PERCENT OF TOTAL FUND
Domestic Equity Investments	30.50%
International Equity Investments	20.00%
Fixed Income Investments	16.00%
Real Estate Investments	14.00%
Private Equity Investments	7.00%
Real Return Investments	8.75%
Absolute Return Investments	2.50%
Short-term Investments	1.25%

5. How do the Illinois systems utilize hedge funds?

TRS classifies hedge fund strategies within its absolute return asset class. Absolute return strategies are primarily used for risk mitigation purposes. The main purpose of the absolute return asset class is to have low correlation

to both domestic and international equities; in addition these strategies as a whole are expected to exhibit volatilities (as measured by standard deviation) of less than 10%. The long term target allocation for absolute return strategies is 5%.

6. To what extent do Illinois pension systems utilize minority investment managers and brokerage firms?

The following preliminary June 30, 2009 information is supplied for TRS.

WMBE Brokerage	
<u>Equity: U.S. and International</u>	
U.S. Equity – percent MBE commissions	14.5%
Stated Goal U.S. Equity	<u>15.0%</u>
Over/Under U.S. Equity Goal	-0.5%
Intl. Equity – percent MBE commissions	9.2%
Stated Goal Intl. Equity	<u>8.5%</u>
Over/Under Intl. Equity Goal	+0.7%
Total U.S. and Int'l Equity commissions	\$22.9 million
Total U.S. and Int'l Equity MBE commissions	\$3.0 million
Total MBE as Percent of Total Commissions	13.0%
Total Number of MBE Broker/Dealers Utilized	44
<u>Fixed Income</u>	
Market value traded – percent MBE	16.4%
Stated Goal – Fixed income	<u>12.5%</u>
Over/Under Fixed Income Goal	+3.9%
Total Number of MBE Broker/Dealers Utilized	11

MBE Managers	
Total WMBE relationships employed by TRS	19
Total WMBE assets under management	\$ 3.17 billion
Percent of Total Fund (WMBE managers)	11.15%
FY 2009 Goal	<u>12.50%</u>
Over/Under (Percentage)	-1.35%
Over/Under (Assets)	-\$385.3 million

7. What is the cost impact of the Sudan divestiture?

Public Act 95-0521 relating to Sudan became effective August 28, 2007. The legislation defines a “forbidden entity” as the government and any subdivisions of the Republic of the Sudan and any company doing business in the Sudan. The statute excludes all companies licensed by the U.S. Department of Treasury’s Office of Foreign Asset Control (“OFAC”), companies operating legally within existing restrictions put into place by the U.S. government, holdings in mutual funds, companies who are certified as Non-Government Organizations by the United Nations, and companies providing humanitarian relief in Sudan.

Each investment firm managing assets for TRS must certify that 100% of the fund’s assets are not invested in a forbidden entity on an annual basis as of June 30. TRS Staff monitors potential violations via a bi-monthly internal process to detect Sudan purchases.

The following is a report updating costs/benefits for domestic equity and international equity for the fiscal year July 1, 2008 through June 30, 2009.

Domestic Equity

TRS benefited slightly from the Sudan impact for FY09 by \$3.01 million, or 3.3 basis points. The impact came entirely from large cap managers as there was no impact within the small cap or small/mid cap styles. At the security level, most of the impact came from the energy sector. Managers were prohibited from holding several energy companies including Schlumberger and Total. During the fiscal year, the substitute companies/portfolio baskets

utilized by investment managers actually outperformed the prohibited companies.

International Equity

While the international equity portfolio had a small positive impact during the June 2009 quarter, the Sudan restriction cost the System \$22 million for the full fiscal year. The December 2008 and the March 2009 quarters were particularly hard hit. Conversely to domestic equity, the Sudan exclusions in the energy sector were a large part of the negative impact. The majority of the costs resulted from these energy exclusions (including Total, Royal Dutch and PetroChina), as well as restrictions in the consumer discretionary sector (particularly within the auto industry).

8. How does the new ethics legislation (PA 96-0006) affect investment policy?

Many of the requirements and recommendations from this new ethics legislation will be incorporated into other documentation not associated with the TRS investment policy. The aim of answering this question is to quantify those provisions in PA 96-0006 that have or will be formally added to the TRS Investment Policy.

- TRS has altered the way it denotes W/MBE utilization goals by capturing the following denominations: Minority, Women, and Disabled/Other. In addition TRS will break W/MBE asset management goals into the following asset class aggregations: Equity, Fixed Income and Alternatives. Goals for W/MBE brokerage and asset management utilization for FY 2010 will be finalized by end of calendar year 2009.
- TRS has altered its Board initiated search process documentation by incorporating language that requires staff to invite the “highest rated” W/MBE manager that fits all search criteria to a finals presentation at a TRS Board meeting.
- Consultant contracts must be re-bid at least every five years. A formal RFP process must precede the hiring of the new consultant.
- Although the law stated that additional disclosures were needed from TRS advisors regarding fees paid to third parties, TRS had already incorporated this process so no additional language was necessary.
- TRS is updating its procurement policy

9. Provide investment performance for the following periods: 10-year, 20 – year, and since inception.

TRS Investment Performance for Periods Ending March 31, 2009	
Time Period	Annualized Return (net of fees)
10-year	3.05%
20-year	7.36%
Since inception (1982)	9.19%