Commission on Government Forecasting and Accountability

PENSION IMPACT NOTE
104th General Assembly

BILL NO: **HB 2540** February 25, 2025

SPONSOR (S): Kifowit

SYSTEM: All systems

FISCAL IMPACT

HB 2540 makes significant changes to the Illinois Pension Code, including modifications to the pension funding plan for the 5 systems and various changes to Tier 2 provisions. A comprehensive actuarial study will be conducted on the major provisions of this legislation, and an updated note will be published once a study becomes available.

SUBJECT MATTER: HB 2540 revises the Illinois Pension Code by implementing a new State funding plan targeting 100% funding by FY 2049 and introducing a 20-year layered amortization for the five State systems. The bill reallocates 50% of bond debt service from prior pension bond laws to the Pension Stabilization Fund for extra pension payments from FY 2031 to FY 2041. The bill also modifies Tier 2 benefits, adjusting Final Average Salary calculations, normal retirement age, and early retirement penalties. Additionally, it removes the requirement for CGFA to review the 90% funding target. More detail is provided below.

COMMENT:

State Funding Plan for the Five State Retirement Systems (TRS, SURS, SERS, JRS, and GARS) – Effective upon Becoming Law

Current Law

- The State shall contribute to the five State retirement systems a minimum required amount such that the required contribution is sufficient to bring the funded ratio of each system up to **90% by the end of FY 2045**.
- The annual required State contribution shall be calculated as a level percentage of payroll over the years remaining to and including FY 2045 and shall be determined under **the projected unit credit** actuarial cost method.
- **The 5-year asset and assumption "smoothing" methods** shall be used in order to mitigate the impact of any unexpected events or changes that may increase or decrease the State contribution.
  - With asset smoothing, implemented by P.A. 96-0043, which became effective on July 15, 2009, any gains or losses from investment fluctuations would be recognized in an equal annual amount over a period of 5 years.
  - Similarly, assumption smoothing, implemented by P.A. 100-0023, which became effective on July 6, 2017, serves to spread out the impact of any change in actuarial assumptions over the 5 year-period.
- Beginning in FY 2046, the minimum State contribution shall be the amount required to maintain the funded ratio of each system at 90%.

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- HB 2540 would modify the current State funding plan for the five State retirement systems starting in FY 2027.
  - The FY 2026 State contribution would still be determined under the current funding plan.
- Major changes in the State funding plan would include:
  - Changing the funding goal to achieve 100% funding by FY 2049;
  - Starting in FY 2036, implementing a 20-year layered-amortization approach when determining the minimum State contribution; and
  - Using the entry age normal cost method beginning in FY 2050.

- Details on the modified State funding plan, categorized by three separate time periods, are discussed as follows:
  - For FY 2027 through FY 2035:
    - The minimum annual State contribution shall be determined by each system to be sufficient to achieve a **100%** funded ratio by the end of **FY 2049**. This contribution shall be calculated as a level percentage of payroll over the remaining years up to and including FY 2049, using the **projected unit credit** actuarial cost method.
    - **The 5-year Asset smoothing and assumption smoothing methods** shall continue to be used when determining the required State contribution, consistent with current law.

  - For FY 2036 through FY 2049:

- Beginning in FY 2036, a layered-amortization approach for a period of 20 years would be used when determining the minimum annual State contribution.
    - The minimum annual State contribution shall be the amount estimated for the upcoming fiscal year **plus an actuarial "layering" component**, such that the funded ratio of each system equals 100% **20 years** after the fiscal year during which the contribution is made.
    - This adjustment shall be implemented in equal annual amounts over a 20-year period beginning in the fiscal year in which the current actuarial valuation is used to determine the required State contribution.
    - Thus, the 5-year asset smoothing and assumption smoothing methods shall sunset after FY 2035 and would be replaced with the 20-year layered-amortization approach, beginning in FY 2036.

Table 1 below provides a graphic illustration of how a "layered amortization" program functions. **The chart is for illustration purposes only, and is not an actuarial projection**. The chart assumes an unfunded liability is generated in each valuation year shown at left. If the unfunded liability does not increase in the valuation year shown, there would be no 20-year "amortization layer" attributable to that fiscal year.

Table 1

<table>
<tr><th rowspan="2">Valuation Date June 30 (Fiscal Year)</th><th rowspan="2">Fiscal Year State Contribution Determined</th><th colspan="11">The Effect of the 20-Year Layered Amortization for Fiscal Year</th></tr>
<tr><th>2035</th><th>2036</th><th>2037</th><th>2038</th><th>2039</th><th>...</th><th>2055</th><th>2056</th><th>2057</th><th>2058</th><th>2059</th></tr>
<tr><td>2034</td><td>2036</td><td></td><td colspan="6">Amortization Layer Based on the FY 2034 Valuation</td><td></td><td></td><td></td><td></td></tr>
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<tr><td>2037</td><td>2039</td><td></td><td></td><td></td><td></td><td colspan="6">Amortization Layer Based on the FY 2037 Valuation</td><td></td></tr>
<tr><td colspan="13">The layering process would continue each year in a similar fashion, extending beyond the determination of FY 2049 State contribution.</td></tr>
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- When making these determinations, the annual required State contribution shall be calculated as a level percentage of payroll for the remaining years up to and including FY 2049, using **the projected unit credit** actuarial cost method.

- Beginning in FY 2050:
    - **The entry age normal** actuarial cost method shall be used instead of the projected unit credit actuarial cost method.
        - PUC and EAN are two methods of calculating a pension fund's normal cost. PUC backloads costs, causing normal costs to rise over time, while EAN spreads costs evenly for stable

contributions. Public pensions favor EAN for long-term stability, while PUC can lead to escalating costs. Though total costs are the same under both, the timing of contributions impacts funding patterns and budget stability.

- Any additional State contributions made under the Budget Stabilization Act shall not be considered when determining the minimum State contribution under the modified State funding plan in HB 2540.

Change to the Tier 2 Final Average Salary (FAS) Calculation

Current Law

Under current law, the Tier 2 Final Average Salary (FAS) is the average of the highest 8 consecutive annual salaries (or 96 consecutive monthly salaries) within the last 10 years (or 120 consecutive months). For Downstate police and firefighters as well as Chicago firefighters (excluding Chicago police), the Tier 2 FAS may instead be the average of the highest 48 consecutive monthly salaries within the last 60 months if this amount is greater than the 8-year average FAS.

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- FAS equal to average of the highest 6 years (or 72 consecutive months) within the last 10 years (120 months);
- Maximum pensionable earnings shall not be less than the Social Security Wage Base; and
- No retroactive adjustment to contributions or benefits between January 1, 2011 and January 1, 2028

Lower Tier 2 Retirement Age

Under current law, Tier 2 members can retire at age 67 with 10 years of service for normal retirement, except for public safety officials, who have an earlier normal retirement age. These include:

- SERS Tier 2 Alternative formula: age 60 or age 55 with 20 years
- SURS Fire/Police: age 60
- Downstate Police and Fire: age 55
- Chicago Police and Fire: age 55 or mandatory retirement at age 63
- IMRF Sheriff's plan: age 55

HB 2540 would lower the non-public safety Tier 2 normal retirement age to age 65 from age 67 with 10 years of service for applicable pension funds.

No Early Retirement Reduction Penalty for Certain Tier 2 Members

Current Law

Under current law, Tier 2 members are penalized for early retirement. If a Tier 2 member retires earlier than the normal retirement age, his or her benefit is reduced by 6% for each year under the normal retirement age, up to a maximum reduction of 30% (for retiring 5 years early). For example, the earliest retirement age for a SERS Tier 2 member under the regular formula is 62, instead of the normal retirement age of 67, and the member's benefit is permanently reduced by 30% (6% x 5 years).

Currently, the Tier 2 pensionable salary is capped, and members do not make contributions on salary above the cap. The Tier 2 salary cap started at $106,800 in Calendar Year (CY) 2011.

- For most pension funds:
  - The salary cap increases annually by the lesser of 3% or **one-half** of the annual unadjusted percentage increase in the Consumer Price Index-U (CPI-U).
  - As a result, the Tier 2 pensionable salary is capped at $127,283 in CY 2025.
- For GARS, JRS, and downstate police and firefighter pension funds:
  - The salary cap increases annually by the lesser of 3% or **100%** of the annual unadjusted CPI-U.
  - As a result, the Tier 2 pensionable salary cap is equal to $141,408 in CY 2025.
- For the Cook County Pension Fund:
  - The Tier 2 salary cap has been set at the SSWB beginning January 1, 2024, pursuant to P.A. 103-0529. The Social Security Wage Base (SSWB) is $176,100 in CY 2025.

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Under HB 2540, if a Tier 2 member has reached the Tier 2 salary cap and is within 5 years of the normal retirement age, the early retirement reduction penalty would be 0%, provided that the member still meets the service credit requirements for normal retirement.

Change to the Tier 2 Automatic Annual Increase

Current Law

- All funds and systems except JRS & GARS have Tier 2 automatic annual increases that are non-compounded, and are calculated at the lesser of:
  - 3%; or
  - ½ the annual unadjusted percentage increase (not less than zero) in the CPI-U.
  - If the increase in CPI-U is 0, no increase is payable.
- JRS & GARS Tier 2 automatic annual increases are compounded, and are calculated at the lesser of:
  - 3%; or
  - The annual unadjusted percentage increase in the CPI-U.
- Tier 2 COLAs are payable at the later of January 1 occurring either on or after the attainment of age 67 or the first anniversary of retirement, except for public safety officials, who start receiving increases at age 60.

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After the effective date of this bill, each Tier 2 annual increase (COLA) in a retirement annuity or supplemental annuity shall be a non-compounded 3% increase. (This legislation does not change the current Tier 2 COLA for GARS and JRS.) Along with the new formula, the starting date of Tier 2 COLAs would be the later of the following dates:

- For most pension funds:
  1) January 1 occurring on or after age 67, age 65 with at least 20 years or service, or January 1 occurring on or after the attainment of the full and unreduced retirement age; or
  2) The first anniversary of retirement
- For Downstate police and fire, Chicago police and fire, and IMRF sheriffs:
  1) January 1 occurring on or after age 60 or the attainment of the full and unreduced retirement age; or
  2) The first anniversary of retirement

  Please note that for the Chicago Fire Article, the language amending the Tier 2 COLA timing is identically added; however, the language for the non-compounded 3% COLA is not included. It is unclear whether this omission is a drafting error or the intent of this bill.
- For IMRF regular plan:
  1) January 1 occurring on or after age 65, or the attainment of the full and unreduced retirement age; or
  2) The first anniversary of retirement

Placing Downstate Police & Fire and Chicago Police & Fire Articles Under the Ambit of the Retirement Systems Reciprocal Act

Current Law

Under current law, neither the Chicago Police and Chicago Fire, nor the Downstate Police and Downstate Firefighters' Articles of the Illinois Pension code are included under the Retirement Systems Reciprocal Act, although reciprocity exists between the funds within each respective article (e.g., members of Downstate police funds can utilize reciprocity with other Downstate Police Funds, although this involves the transfer of service credits, whereas the Downstate Fire article has true reciprocity amongst fire pension funds).

The Retirement Systems Reciprocal Act allows for active employees to combine service credit earned from various participating systems to apply towards the minimum vesting requirements of the fund that they participate in currently or the fund that they last participated in before terminating active service. For example, a Tier 2 member in IMRF could utilize reciprocity and combine 4 years of prior service in SERS and 6 years in IMRF to meet the 10-year Tier 2 vesting requirement in IMRF.

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HB 2540 would place the Downstate Police, Downstate Fire, Chicago Police, and Chicago Fire Articles of the Illinois Pension Code under the ambit of the Reciprocal Act. The bill states that participation under the Reciprocal Act would only apply to members who have not yet begun receiving retirement annuities as of the effective date. In other words, retired members would not be entitled to a recalculation of their pensions based upon reciprocal service.

Retirement Eligibility for Tier 2 Cook County Sheriff's Police Officers

HB 2540 provides that a Tier 2 Cook County Pension Fund member who is a deputy sheriff and a member of the Cook County Police Department would be eligible to retire at age 55 with at least 20 years of service credit for service as a deputy sheriff. Also, under this bill, such Tier 2 members would receive automatic annual increases that are non-compounded and calculated at the lesser of 3% or one-half of the annual unadjusted percentage increase (not less than zero) in the CPI-U. This differs from the new 3% simple COLA applied to Tier 2 members under other funds under this bill. Furthermore, COLAs for these members would be payable on January 1 following the first anniversary of the annuity start date. Currently, the normal retirement eligibility for a Tier 2 Cook County Sheriff's police officer is age 67 with at least 20 years of service.

Ensuring the Tier 1 Status across All Pension Funds – Effective upon Becoming Law

HB 2540 would add a new provision to clarify a "once in Tier 1, always in Tier 1" standard for all Tier 1 members across all pension funds. This provision overrules any conflicting provisions in the Pension Code.

Under HB 2540, a member of a pension fund would be allowed to establish or regain service if the following conditions are met:

- Being active in any pension fund, regardless of which pension fund the service credit is re-established for;
- Paying the employee and employer contributions that would have been required, or in the case of refund, making refund payments, plus interest;
- Completing any required forms; and
- Meeting all the requirements within one year of the effective date of this bill, unless installment payments are allowed for paying the required contributions or refund payments.

A pension fund shall not be required to recalculate a final determined benefit unless a member has a pending action against a pension fund regarding a final determined benefit as of the effective date of this bill.

Accelerated Pension Benefits Payment Programs for GARS, CTPF, and JRS

Current Law

- PA 100-0587 implemented an accelerated pension benefit payment in lieu of any pension benefit for SERS, SURS, & TRS ('Total Buyout"), as follows:
  - Inactive vested Tier 1 & Tier 2 members may elect to receive an accelerated pension payment equal to 60% of the present value of the member's pension benefits in lieu of receiving a traditional retirement annuity.
- PA 100-0587 also established an accelerated pension benefit for a reduction in annual Tier 1 retirement annuity and survivor's annuity increases in SERS, SURS, and TRS ("COLA Buyout"), as follows:
  - A member may elect to receive a lump sum payment equal to 70% of the difference of the present value of the Tier One 3% compounded COLA and the present value of a reduced COLA (simple 1.5%); and
  - Annual increases begin on the January 1 occurring on or after the attainment of age 67 or the first anniversary of retirement, whichever is later.
- If an eligible member returns to service, all benefits earned are based solely on service after returning; the accelerated payment may not be repaid and credit cannot be reinstated.
- PA 102-0718 extended the sunset date of the two buyout programs to June 30, 2026.

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- HB 2540 establishes both a "Total Buyout" and "COLA Buyout" plan within GARS, JRS, and CTPF;
- The buyout plans mirror the existing plans in SERS, SURS, & TRS, **except** that:
  - Funding for the buyout programs will come from the General Revenue Fund and not from proceeds from the State Pension Obligation Acceleration Bonds, as is the case with the existing buyout programs.
- HB 2540 establishes January 1, 2031 as the sunset date for the GARS, JRS, and CTPF buyout programs.

Estimated payment for SERS members under the Alternative Formula

HB 2540 adds language to the SERS Alternative Formula provision that creates an "estimated payment" of a retirement annuity to commence no later than 30 days after:

- the member's last day of employment, or;
- the date the member files for benefits, whichever is later.

The estimated payment shall be:

- the best estimate of SERS; and
- based on information that the System possesses at the time of the estimate.

In the event that a discrepancy exists between the "estimated payment" and the annuity a member is eligible to receive under statute, the System shall either pay or recover the difference within 6 months of the start of the affected annuity.

According to SERS, the Tier 1 Alternative Formula final average salary (FAS) calculation is a very complex exercise, without factoring in the various types of non-pensionable payments issued to employees during their final years of service. SERS asserts that there are often instances in which members have received non-pensionable compensation with the retirement contributions erroneously deducted by their payroll offices. The system maintains that substantial effort is required to sift through and rectify these errors before the proper annuity calculation can be made.

Alternative Formula Eligibility and Applicable Service Credit Upgrade Provisions for Investigators/Security Employees of the Departments of Lottery and Human Services

The current SERS retirement benefits for both Tier 1 & 2 Investigators for the Department of the Lottery are detailed in the chart found below:

Current Law						
Employee	**Tier**	**SS-Coordinated?**	**Contribution Rate**	**Multiplier**	**Full Retirement**	**Reduced Retirement**
Investigator for the Dept. of Lottery	1	No	8%	2.20%	Age 60 with 8 years of service credit OR Rule of 85	Ages 55-60 with 25-30 years (Reduced 1/2 of 1% every year under age 60)
Investigator for the Dept. of Lottery	2	No	8%	2.20%	Age 67 with 10 years service credit	Ages 62-67 with 10 years (Reduced 1/2 of 1% every year under age 67)
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Investigator for the Dept. of Lottery	1	No	12.5%	3.00%	Age 55 with 20 years of service OR Age 50 with 25 years of service	N/A
Investigator for the Dept. of Lottery	2	No	12.5%	3.00%	Age 55 with 20 years of service	N/A

HB 2540 amends the Illinois Pension Code to allow participation in the SERS Alternative Formula for investigators for the Department of the Lottery.

HB 2540 also allows a security employee of the Department of Human Services in the Alternative Formula to elect to convert up to 13 years of prior service credit as a security employee in the Department of Human Services into service credit under the Alternative Formula. HB 2540 also allows a State highway maintenance worker in the Alternative Formula to elect to convert up to 8 years of prior service credit. In both cases, the employee is required to pay an amount equal to the difference between the employee contributions already made and those that would have been paid had their prior service been rendered under the Alternative Formula, plus interest thereon at the statutory service credit purchase rate (the “effective rate”) of 6%, compounded annually, from the date of service to the date of payment.

Alternative Formula Participation for Certain Security Employees of the Department of Juvenile Justice

Currently, in order for a security employee of the Department of Juvenile Justice to participate in the SERS alternative formula, the employee must be employed in a position at a DJJ facility and have involvement in areas such as training of delinquent youths, providing rehabilitative and vocational training, and assisting other personnel who perform these duties. Additionally, the employee must:

- Be over the age of 21; and
- Possess a high school diploma or equivalent and either:
    - A bachelor's or advanced degree from an accredited college or university; or
    - 2 or more years of experience providing direct care to youth in the form of residential care, coaching, case management, or mentoring.

HB 2540 stipulates that the bachelor's or advanced degree requirement shall no longer determine eligibility for the alternative formula for the above-mentioned positions at DJJ. Affected employees may convert their prior regular formula service to alternative formula service by paying the difference between the employee contributions for that period of service and the amounts that would have been contributed had the member been participating in the alternative formula from the date of service to the date of payment. The member is not required to pay the employer's normal cost nor interest for the period of service they wish to upgrade.

Additional Pension Stabilization Fund Payments – Effective upon Becoming Law

HB 2540 would create additional payments to the Pension Stabilization Fund, made under the auspices of the Office of the Comptroller, as follows:

- **FY 2031: an additional $175 million would be paid into the Pension Stabilization Fund.**
- **FY 2032 through 2034: $250 million would be paid into the Pension Stabilization Fund.** This payment is equivalent to one half of the principal payments concluding in FY 2030 made by the state to pay off the $6 billion Income Tax Proceed Bonds issued under PA 100-0023.
- **FY 2035 through 2041: $750 million would be paid to the Pension Stabilization Fund in addition to any payments made towards achieving the goal of funding every pension system at 100% by 2049.** These payments are approximately equivalent to one half of the principal payments made under the Income Tax Proceed Bonds ending in FY 2030 and one half of the last principal payment made under the Pension Obligation Bonds issued under PA 93-0002 ending in FY 2033.

HB 2540 states that none of the aforementioned payments made to the Pension Stabilization Fund shall be used in actuarial calculations of required contributions to achieve the 100% funding goal at the end of FY 2049, as mentioned previously.

CMS' Expenses Regarding the State Employees Deferred Compensation Plan

HB 2540 provides that beginning July 1, 2028, the expenses of the State Employees Deferred Compensation Plan shall be borne by CMS.

Commission on Government Forecasting and Accountability Analysis of 90% Funding Ratio – Effective upon Becoming Law

Under current law, the Commission on Government Forecasting and Accountability (CGFA) is required to review and analyze the state's goal of 90% funding of actuarial liabilities by FY 2045, and make recommendations every five years as to the efficacy of this funding goal. CGFA's most recent analysis was published in November 2021. HB 2540 would eliminate this requirement.

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