



Report on the 90% Funding Target of Public Act 88-0593

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Forecasting and Accountability
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Executive Summary

This report looks at the financial status of the State retirement systems in Illinois. The following is a summary of the findings:

- P.A. 88-593 requires the State to make contributions to the State retirement systems so that total assets of the systems will equal 90% of their total actuarial liabilities by fiscal year 2045. The contributions are required to be a level percent of payroll in fiscal years 2011 through 2045, following a phase-in period that began in FY 1996.
- P.A. 88-593 also requires the Commission on Government Forecasting and Accountability to make a periodic evaluation of whether the 90% target funded ratio continues to represent an appropriate funding goal for State-funded retirement systems in Illinois.
- The funded ratio places the unfunded liabilities in the context of the retirement system's assets. Expressed as a percentage of a system's liabilities, the funded ratio is calculated by dividing net assets by the accrued actuarial liabilities. The result is the percentage of the accrued liabilities that are covered by assets.
- At the end of FY 1995 (the year before the implementation of P.A. 88-593), the systems' total unfunded liabilities were almost \$19.5 billion. By the end of FY 2005, the liabilities totaled \$38.6 billion, an increase of 97% from the FY 1995 level.
- Investment returns performed above expectations in the early years of the current funding plan, however Fiscal Years 2001 and 2002 saw significant investment losses when compared to actuarial assumptions. Investment losses were also recorded in Fiscal Year 2003. The five State-funded retirement systems have benefited significantly from the upturn in the financial markets over the last two fiscal years.

- P.A. 93-0002 authorized the State to issue \$10 billion in general obligation bonds for the purpose of making required contributions to the five state-funded retirement systems.
- P.A. 94-0004 (SB 27) contained several important reforms that are expected to reduce the rate of growth of the accrued liabilities of the five State-funded retirement systems.

Commission staff analyzed projected contributions based on the 1994 actuarial valuations of the five State-funded retirement systems and compared them with the most recent actuarial forecasts. This analysis, shown on pages 16 and 17, shows that the total cost of the current funding plan has not grown appreciably from what the 1994 forecasts had predicted (this despite counteractive factors such as formula increases, investment gains and losses, the infusion of pension obligation bond proceeds, and the funding reductions and reforms contained in P.A. 94-0004). While the current pension funding plan will continue to present significant challenges from a budgetary perspective, the Commission believes that the goal of reaching a 90% funded ratio by 2045 as called for in P.A. 88-593 should be maintained.

I. PUBLIC ACT 88-593

Public Act 88-593

Public Act 88-593 amended the State-funded retirement systems' Articles of the Pension Code to require annual appropriations to the systems as a level percent of payroll, beginning in FY 2010, following a 15 year phase-in period which began in FY 1996. The goal of P.A. 88-593 is to attain a 90% funding ratio by FY 2045. After FY 2045, the State must contribute the annual amount needed to maintain a 90% funding ratio.

P.A. 88-593 requires the Board of Trustees of each retirement system to certify the required State contributions for each fiscal year by the preceding November 15th. The Act contains language authorizing a continuing appropriation of the required State contributions, which has removed the contributions from the budgeting process and ensures the certified contributions will be made.

The General Provisions Article of the Pension Code was amended by Public Act 88-593 to state that the General Assembly finds that a funding ratio of 90% is an appropriate goal for the State-funded retirement systems in Illinois. The Act further states "that a funding ratio of 90% is now the generally-recognized norm throughout the nation for public employee retirement systems that are considered to be financially secure and funded in an appropriate and responsible manner."

P.A. 88-593 requires the Commission on Government Forecasting and Accountability (CGFA), in consultation with the retirement systems and the Governor's Office of Management and Budget, to make a determination every five years as to whether the 90% funding ratio continues to represent an appropriate funding goal.

Rationale for 90% Funding Target

According to the June 1994 Survey of State and Local Government Employee Retirement Systems, prepared by the Public Pension Coordinating Council (PPCC), the value of assets as a percentage of the Pension Benefit Obligation averaged 90.2% for the retirement systems surveyed by the PCCC in the summer of 1993. It can be assumed that P.A. 88-593 was referring to this survey when it stated "that a funding ratio of 90% is now the generally recognized norm throughout the nation for public employee retirement systems." A snapshot of national trends in the funding status of public pension funds is shown at the end of Section II. While the volatility in the financial markets in recent years has clearly had a negative impact on the funding status of public pension systems nationwide, the Commission reaffirms the endorsement of a 90% funding target contained in P.A. 88-593.

II. NATIONAL OVERVIEW

National Overview

The chart below reflects data contained in the 2005 Wilshire Report on State Retirement Systems. The chart provides an overview of the financial condition of 64 State Retirement Systems which provided actuarial values for fiscal years 2000 through 2004. The chart also shows that at the end of FY 2004, 84% of these 64 state pension systems, or 54 systems, have liabilities that exceed assets. Also, the average funded ratio for all 64 state systems was 83% at the end of FY 04.

Financial Overview of 64 State Retirement Systems					
(\$ in Billions)					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
<u>Total Pension Assets:</u>					
Market Value	\$795.0	\$730.1	\$669.1	\$681.7	\$778.9
<u>Total Pension Liabilities</u>	\$727.4	\$792.7	\$850.1	\$889.4	\$942.3
<u>Average Funded Ratio</u>	109%	92%	79%	77%	83%
<u>Underfunded Plans</u>	39%	69%	92%	97%	84%

III. CALCULATING THE FUNDED RATIO

The Funded Ratio

The funded ratio places the unfunded liabilities in the context of the retirement system's assets. Expressed as a percentage of a system's liabilities, the funded ratio is calculated by dividing net assets by the accrued liabilities. The result is the percentage of the accrued liabilities that are covered by assets. At 100%, a fully funded system has sufficient assets to pay all benefits earned to date by all its members. Of course, in order to calculate the funded ratio, the accrued actuarial liabilities must be calculated and the actuarial value of plan assets must be determined.

Determining the Actuarial Accrued Liability

Various actuarial cost methods have been devised to allocate systematically to employers and employees the expenses incurred under a pension plan as employees earn benefits. In other words, an actuarial cost method determines how much money should be set aside each year so that, when the employee retires, the system will be able to pay the earned benefits. An actuarial funding method is also used to determine the contributions needed in order to meet the costs of currently accruing benefits and improve or stabilize the system's financial condition. The state-funded retirement systems calculate accrued liability based on the *projected unit credit method*, as explained below.

Projected Unit Credit Method

The pension benefit obligation (PBO) is the actuarial accrued liability calculated using the projected unit credit actuarial method. The PBO is the sum of the present value of:

- benefits payable to current retirees;
- benefits that will become payable to inactive vested members;
- accrued benefits of active vested members;
- accrued benefits of active employees who are likely to become vested; and
- benefits due to future salary increases.

Calculation of Actuarial Assets

There are four different methods that can be used to determine the actuarial value of plan assets. Assets may be valued at the original purchase price or at the market value on the date of the actuarial valuation. Two methods of valuing assets which smooth short-term market fluctuations are the smoothed market method and the blended method. The smoothed market method uses a moving average to smooth market fluctuations, while the blended method uses the average of the cost and market value of assets. The State-funded retirement systems currently determine the actuarial value of their plans' assets using the market value of the assets on the date of the actuarial valuation.

The Significance of Actuarial Funding Ratios

The ratio of assets to liabilities in a defined benefit pension plan, commonly known as the “funding ratio,” is a widely utilized method for gauging the health of a retirement system. If a pension plan’s assets are equal to its liabilities, the plan is considered to be *fully funded* (or funded at 100%). If a plan has a shortfall of assets to liabilities (or a funded ratio of less than 100%) then the plan carries an *unfunded liability*. Hence, such a plan would be considered *underfunded*. If a pension plan is underfunded, that does not mean that the plan cannot pay the benefits that its current employees and retirees have earned. Indeed, virtually all underfunded defined benefit public employee pension plans, including the five State-funded plans, continue to meet their current obligations.

All pension plans, whether fully funded or not, depend on employee/employer contributions and investment income in order to remain financially solvent. The primary difference between a fully funded plan and an underfunded plan is that the underfunded plan requires contributions to pay for benefits that are currently being accrued as well as to eliminate the shortfall between assets and accrued liabilities. A fully funded pension plan has no such shortfall and therefore only requires contributions to pay for benefits that are currently being accrued. This does not mean that no future contributions will be required for a fully funded plan, but rather that the actuarial value of the plan’s assets equal its accrued liabilities at that moment in time.

It should be stressed that the funded ratio is merely a snapshot based on an assortment of long-term financial and demographic assumptions. It is merely a way of attempting to ascertain what the fund’s obligations would be if the plan ended as of the actuarial valuation date and all of the plan’s future obligations became payable at once. However, all of the plan’s future obligations are not payable at once, but rather they are payable over many years into the future. This period of years allows the plan the necessary time to accrue the assets needed to pay future obligations.

Achieving full funding of a pension plan is not unlike a mortgage, in which a homeowner has a long period of time – usually 30 years – to amortize the mortgage. If the homeowner makes all of his or her scheduled payments, the mortgage would be considered fully funded at the end of the 30-year period. At any point during the 30-year amortization period, the outstanding amount of the mortgage is akin to a pension fund’s unfunded liability.

IV. THE FINANCIAL HEALTH OF THE STATE RETIREMENT SYSTEMS UNDER P.A. 88-593

The following table provides a summary of the financial condition of each of the five State retirement systems, showing their respective liabilities and assets as well as their combined unfunded liabilities and funded ratios, as of June 30, 2005.

Summary of Financial Condition State-Funded Retirement Systems June 30, 2005 (\$ in Millions)				
System	Net Assets	Accrued Liabilities	Unfunded Liability	Funded Ratio
TRS	\$34,085.2	\$56,075.0	\$21,989.8	60.8%
SERS	10,494.1	19,304.6	8,810.5	54.4%
SURS	13,350.2	20,349.9	6,999.7	65.6%
JRS	565.0	1,236.5	671.5	45.7%
GARS	83.3	212.9	129.6	39.1%
TOTAL	\$58,577.80	\$97,178.90	\$38,601.10	60.3%

Changes in Funded Ratios and Unfunded Liability since Passage of Public Act 88-593

Several factors influence the unfunded liabilities of a retirement system. For the purpose of determining the reasons for the changes in the unfunded liabilities (and the funded ratios) these factors have been grouped in six categories, as follows:

- 1) **Salary Increases.** The actuary assumes an average rate of growth of employees' salaries, based on historical figures. Because pension benefits are calculated as a percentage of employees' wages, salary levels are an important factor in determining an employee's future level of benefits. If actual salaries increase more than assumed, the unfunded liabilities also increase. Conversely, if actual salary increases are less than assumed, the unfunded liabilities decrease.

- 2) **Investment Returns.** Based on historical averages, the actuary assumes an annual rate of return on assets. If actual returns are greater than the assumed rate, the unfunded liabilities decrease. If actual returns are less than assumed, the unfunded liabilities will increase.

- 3) **Employer Contributions.** A widely applied measure of the adequacy of funding compares an employer's actual contributions to the actuarially

recognized standard of “normal cost plus interest.” Under this funding method, an employer makes contributions sufficient to cover the cost of all benefits earned by employees during the year (the normal cost) plus makes an interest payment on the unfunded liabilities of the retirement system. This funding method attempts to freeze the unfunded liabilities without reducing them in total. If employer contributions are insufficient based on this measure, a system’s unfunded liabilities grow. If contributions are equal to or greater than required by this method, the system’s unfunded liabilities either remain constant or diminish.

- 4) **Benefit Increases.** Under the State Constitution, pension benefits cannot be lowered for current employees, but are often increased for a variety of reasons. Any improvement in benefits causes an immediate rise in the unfunded liabilities of the system.
- 5) **Changes in Actuarial Assumptions.** Actuaries periodically revise previous assumptions based on recent experience which they feel more accurately reflects what may occur in the future. These changes could relate to investment returns, salary increases, mortality rates, staff turnover, and many other factors. Some changes, such as a decrease in the assumption on investment returns, cause an immediate increase in the unfunded liabilities. Other changes, such as a reduction in the assumed rate of salary growth, cause a decrease in the unfunded liabilities.
- 6) **Other factors.** This factor encompasses all other events that do not fall into one of the previous categories. These factors include a change in the actuarial assumptions, or elements that had previously been overlooked but now must be considered.

This section of the study focuses on how these six factors have affected the unfunded liabilities, and therefore the funded ratios, of the State funded retirement systems since the implementation of P.A. 88-593.

State-Funded Retirement Systems, Combined

At the end of FY 1995 (the year before the implementation of P.A. 88-593), the systems' total unfunded liabilities were almost \$19.5 billion. By the end of FY 2005, unfunded liabilities totaled \$38.6 billion, an increase of 97% from the FY 1995 level. The following table shows how six factors affected the combined unfunded liabilities of the State-funded retirement systems between FY 1995 and FY 2005.

	Salary Increases	Investment Returns	Employer Contributions	Benefit Increases	Actuarial Assumptions	Other Factors	Total
1996	\$278.1	(\$950.4)	\$1,648.4	\$17.8	(\$781.7)	\$316.7	\$528.9
1997	(174.6)	(1,718.0)	1,571.6	179.1	(6,629.2)	456.3	(6,314.9)
1998	(113.2)	(2,788.1)	984.2	2,250.2	0.0	275.7	608.7
1999	77.1	(988.6)	883.4	33.9	125.2	893.5	1,024.5
2000	154.5	(1,307.1)	902.6	3.0	0.0	471.6	224.6
2001	64.2	6,610.6	887.5	652.1	2.5	1,261.0	9,478.0
2002	134.4	5,575.4	1,624.1	234.1	1,377.7	1,020.2	9,966.0
2003	125.6	2,071.5	2,426.0	2,425.0	0.0	1,110.1	8,158.2
2004	135.8	(3,841.7)	(4,713.1)	0.0	0.0	408.5	(8,010.5)
2005	35.0	(1,033.6)	2,393.9	0.0	26.4	2,085.6	3,507.3
Total	\$716.9	\$1,630.0	\$8,608.7	\$5,795.2	(\$5,879.1)	\$8,299.1	\$19,170.8

As Table 1 shows, the failure to make employer contributions at a normal-cost-plus-interest level over the ten-year reporting period was the most significant catalyst in the increase in unfunded liabilities of all five State-funded systems. A change to a market valuation of assets in FY 1997 served to mitigate the total actuarial loss over this period. Despite strong investment returns during the first half of the reporting period, two years of very poor returns in FY 2001 and FY 2002 contributed to an overall actuarial loss in that category. Pension Obligation Bond (POB) proceeds in FY 2004 had a positive actuarial impact on both investment returns and employer contributions. Because of the POB proceeds, FY 2004 was one of only two years in which the systems' overall actuarial liabilities decreased to a significant degree. Benefit increases and other miscellaneous factors also contributed to the increase in liabilities.

Teachers' Retirement System

The unfunded liabilities of the Teachers' Retirement System have increased by over \$10 billion since the end of FY 1995. Table 2 details the factors that caused the increase in unfunded liabilities.

	Salary Increases	Investment Returns	Employer Contributions	Benefit Increases	Actuarial Assumptions	Other Factors	Total
1996	\$400.4	(\$577.3)	\$966.0	\$17.8	\$0.0	\$166.5	\$973.4
1997	(59.1)	(830.9)	992.4	0.0	(2,944.7)	88.8	(2,753.5)
1998	(46.0)	(1,417.7)	776.2	1,000.3	0.0	71.2	384.0
1999	44.0	(389.0)	677.4	33.9	125.2	533.9	1,025.4
2000	(33.4)	(450.4)	723.6	0.0	0.0	197.3	437.1
2001	(10.3)	3,089.8	733.9	0.0	0.0	632.7	4,446.1
2002	4.9	2,696.2	1,074.4	0.0	694.7	360.0	4,830.2
2003	171.8	827.4	1,415.6	53.8	0.0	658.5	3,127.1
2004	217.3	(2,168.9)	(2,811.5)	0.0	0.0	357.2	(4,405.9)
2005	236.7	(682.3)	1,299.8	0.0	26.4	1,706.2	2,587.1
Total	\$926.3	\$96.9	\$5,847.8	\$1,105.8	(\$2,098.4)	\$4,772.3	\$10,651.0

The leading causes of the increase in unfunded liabilities of TRS were insufficient employer contributions and other miscellaneous factors (such as waiving ERO payments for teachers with 34 years of service). Over the ten-year period, years of strong investment returns in the first half of the reporting period were offset by two particularly poor years in 2001 and 2002. The POB proceeds in FY 2004 served to offset the overall actuarial losses in both investment returns and employer contributions.

State Universities' Retirement System

Table 3 shows the factors that caused the unfunded liabilities of SURS to increase approximately \$2.3 billion from the end of FY 1995 to the end of FY 2005.

	Salary Increases	Investment Returns	Employer Contributions	Benefit Increases	Actuarial Assumptions	Other Factors	Total
1996	(\$70.5)	(\$105.4)	\$456.0	\$0.0	\$0.0	\$86.8	\$366.9
1997	(44.0)	(312.3)	424.8	179.1	(3,342.4)	198.5	(2,896.3)
1998	5.2	(765.7)	158.8	0.0	0.0	48.1	(553.6)
1999	44.3	(273.3)	147.2	0.0	0.0	314.9	233.1
2000	171.5	(587.5)	162.0	0.0	0.0	13.7	(240.3)
2001	70.3	2,068.5	141.4	0.0	0.0	266.7	2,546.9
2002	90.8	1,568.7	313.9	63.0	485.3	155.6	2,677.3
2003	10.3	583.0	549.4	0.0	0.0	328.4	1,471.1
2004	(62.9)	(950.5)	(846.0)	0.0	0.0	41.2	(1,818.2)
2005	(19.4)	(218.0)	536.8	0.0	0.0	208.0	507.4
Total	\$195.6	\$1,007.5	\$2,044.3	\$242.1	(\$2,857.1)	\$1,661.9	\$2,294.3

The leading causes of the increase in unfunded liabilities of SURS were investment losses, driven mainly by two years of particularly poor returns in FY 2001 and FY 2002, and also insufficient employer contributions over the ten-year time period (with the exception of the Pension Obligation Bond proceeds in FY 2004). Offsetting the increase in unfunded liabilities somewhat was the changeover to valuation of assets at market value in FY 1997, which caused a decline in the unfunded liabilities of SURS of over \$3.3 billion.

State Employees' Retirement System

Table 4 shows the elements that caused the unfunded liabilities of SERS to increase by more than \$5.7 billion from the end of FY 95 to the end of FY 05.

	Salary Increases	Investment Returns	Employer Contributions	Benefit Increases	Actuarial Assumptions	Other Factors	Total
1996	(\$63.8)	(\$251.4)	\$196.6	\$0.0	(\$781.7)	\$47.1	(\$853.2)
1997	(65.1)	(541.6)	121.7	0.0	(379.9)	152.9	(712.0)
1998	(62.0)	(568.8)	9.4	1,249.9	0.0	148.7	777.2
1999	(12.5)	(307.0)	21.0	0.0	0.0	32.9	(265.6)
2000	14.6	(252.7)	(21.8)	0.0	0.0	250.2	(9.7)
2001	(8.0)	1,368.8	(29.4)	652.1	0.0	310.0	2,293.5
2002	52.0	1,247.3	186.9	171.1	168.1	496.2	2,321.6
2003	(28.3)	629.5	404.5	2,371.2	0.0	97.8	3,474.7
2004	(22.3)	(679.7)	(944.1)	0.0	0.0	6.8	(1,639.3)
2005	(166.5)	(123.1)	503.5	0.0	0.0	144.1	358.0
Total	(\$361.9)	\$521.3	\$448.3	\$4,444.3	(\$993.5)	\$1,686.7	\$5,745.2

The unfunded liabilities of SERS increased by over \$5.7 billion from FY 96 through FY 05, driven primarily by benefit increases in FY 98 (retirement formula increase) and FY 2003 (the 2002 Early Retirement Incentive). The actuarial loss in investment returns over the ten-year period was due in large part to two years of poor returns in FY 2001 and FY 2002. Also adding to the overall increase in unfunded liabilities were insufficient employer contributions in each year over the ten-year period (with the exception of the POB proceeds in FY 2004) and other miscellaneous factors.

Judges' Retirement System

The unfunded liabilities of the Judges' Retirement System increased by \$362.0 million between FY 1995 and FY 2005. Table 5 details the factors that caused this increase in unfunded liabilities.

	Salary Increases	Investment Returns	Employer Contributions	Benefit Increases	Actuarial Assumptions	Other Factors	Total
1996	\$10.0	(\$13.7)	\$24.5	\$0.0	\$0.0	\$14.9	\$35.7
1997	(7.7)	(28.1)	27.2	0.0	37.9	15.3	44.6
1998	(10.2)	(30.5)	34.1	0.0	0.0	7.2	0.6
1999	0.5	(16.5)	32.5	0.0	0.0	8.8	25.3
2000	2.2	(14.1)	33.2	3.0	0.0	8.3	32.6
2001	(7.5)	61.8	35.8	0.0	0.0	17.0	107.1
2002	(11.8)	54.5	42.2	0.0	28.4	8.6	121.9
2003	(26.4)	27.2	49.3	0.0	0.0	18.9	69.0
2004	6.3	(36.7)	(92.3)	0.0	0.0	(2.0)	(124.7)
2005	(15.1)	(8.9)	46.4	0.0	0.0	27.5	49.9
Total	(\$59.7)	(\$5.0)	\$232.9	\$3.0	\$66.3	\$124.5	\$362.0

Insufficient employer contributions, along with changes in actuarial assumptions and miscellaneous other factors caused the unfunded liabilities to increase over the FY 1995 levels. Investment income and slower-than-anticipated salary growth both served to offset a portion of the increase.

General Assembly Retirement System

As shown in Table 6, the unfunded liabilities of the General Assembly Retirement System increased by more than \$50 million from the end of FY 95 to the end of FY 05.

	Salary Increases	Investment Returns	Employer Contributions	Benefit Increases	Actuarial Assumptions	Other Factors	Total
1996	\$2.0	(\$2.6)	\$5.3	\$0.0	\$0.0	\$1.4	\$6.1
1997	1.3	(5.1)	5.5	0.0	(0.1)	0.8	2.3
1998	(0.2)	(5.4)	5.7	0.0	0.0	0.5	0.5
1999	0.8	(2.8)	5.3	0.0	0.0	3.0	6.4
2000	(0.4)	(2.4)	5.6	0.0	0.0	2.1	4.9
2001	(0.6)	10.1	5.8	0.0	0.0	1.3	16.7
2002	(1.5)	8.7	6.7	0.0	1.2	(0.2)	15.0
2003	(1.8)	4.4	7.2	0.0	0.0	6.5	16.3
2004	(2.6)	(5.9)	(19.2)	0.0	0.0	5.3	(22.4)
2005	(0.7)	(1.3)	7.4	0.0	0.0	(0.2)	5.2
Total	(\$3.7)	(\$2.3)	\$35.4	\$0.0	\$1.1	\$20.4	\$50.9

The increase in the unfunded liabilities of the General Assembly Retirement System from FY 96 through FY 05 was caused primarily by insufficient employer contributions (with the exception of the FY 04 POB proceeds) and other miscellaneous factors. Some of the factors that mitigated the overall increase were actuarial gains realized from lower-than-expected salary increases and higher-than-assumed investment returns.

V. ORIGINAL AND CURRENT PROJECTIONS OF STATE CONTRIBUTIONS AND FUNDED RATIOS

This section of the study compares the original 1994 estimates of annual required contributions (and the resulting funded ratios) with the current projections of annual required contributions, which are based on the June 30, 2005 actuarial valuations for each system.

Original Projections (1994 Projections)

The original projections of required annual contributions for the funding plan created by Public Act 88-593 were based on the June 30, 1994 actuarial valuation. The first year of the funding plan was FY 1996 and the contributions for FY 1996 were certified in November 1994. At that time, the assets of the retirement systems were valued at cost, the actuarial assumptions of the systems were more conservative, and the benefit formulas of the 3 large retirement systems had not yet been increased.

Current Projections (2005 Projections)

The current projections of required annual contributions are based on the June 30, 2005 actuarial valuation. These projections take into account changes in actuarial assumptions, the valuation of assets at market value, Pension Obligation Bond proceeds and changes contained in P.A. 94-0004 such as the elimination of the Money Purchase program in SURS for new hires and the modification of the Early Retirement Option in TRS, as well as the funding reductions in FY 2006 and FY 2007.

State-Funded Retirement Systems, Combined

Table 7 compares the original estimate of the required annual contributions to all of the State retirement systems with the current estimate, as prepared by the retirement systems. Also shown are the original and current projections of the funded ratios. The original contribution column includes the FY 1996 certified appropriations and the estimated contributions for selected fiscal years for the remainder of the funding plan. The current contribution column includes the actual State contributions for FY 1996 through FY 2005, the actual appropriation amounts for FY 2006, the certified contributions for FY 2007 (per P.A. 94-0004), and estimated contributions for selected fiscal years for the remainder of the funding plan.

Except for federal and trust funds paid to SERS, the contributions include only State appropriations from the General Revenue Fund, Common School Fund, and State Pensions Fund. Employer contributions from school districts and all other sources are excluded.

FY	1994 Projection P.A. 88-593		2005 Projection P.A. 88-593		Difference (2005 - 1994)	
	Contribution	Funded Ratio	Contribution	Funded Ratio	Contribution	Funded Ratio
1996	\$607.2	52.3%	\$609.1	54.9%	\$1.9	2.6%
1997	\$718.7	52.6%	\$712.2	70.1%	-\$6.5	17.6%
1998	\$839.6	52.0%	\$881.5	72.2%	\$41.9	20.3%
1999	\$970.4	51.6%	\$1,122.6	73.0%	\$152.2	21.3%
2000	\$1,109.4	51.4%	\$1,224.7	74.7%	\$115.3	23.3%
2001	\$1,256.8	51.0%	\$1,346.6	63.1%	\$89.8	12.1%
2002	\$1,419.3	51.5%	\$1,469.3	53.5%	\$50.0	2.1%
2003	\$1,591.7	51.7%	\$1,628.3	48.6%	\$36.6	-3.1%
2004	\$1,776.5	52.1%	\$9,178.5	60.9%	\$7,402.0	8.9%
2005	\$1,967.6	52.5%	\$1,638.0	60.3%	-\$329.6	7.8%
2006	\$2,172.3	52.9%	\$935.6	58.8%	-\$1,236.7	6.0%
2007	\$2,390.3	53.4%	\$1,372.2	57.7%	-\$1,018.1	4.3%
2008	\$2,623.8	54.0%	\$1,981.3	57.2%	-\$642.5	3.2%
2009	\$2,871.4	54.7%	\$2,662.0	57.2%	-\$209.4	2.5%
2010	\$3,140.4	55.4%	\$3,401.2	57.7%	\$260.8	2.2%
2011	\$3,271.7	56.2%	\$3,641.3	58.2%	\$369.6	2.0%
2012	\$3,411.1	56.9%	\$3,774.3	58.7%	\$363.2	1.8%

	1994 Projection P.A. 88-593		2005 Projection P.A. 88-593		Difference (2005 - 1994)	
		Funded		Funded		Funded
	Contribution	Ratio	Contribution	Ratio	Contribution	Ratio
2013	\$3,536.7	57.6%	\$3,938.6	59.1%	\$401.9	1.5%
2014	\$3,709.1	58.3%	\$4,097.5	59.5%	\$388.4	1.2%
2015	\$3,881.6	59.0%	\$4,262.0	59.9%	\$380.4	0.9%
2016	\$4,062.9	59.7%	\$4,435.4	60.3%	\$372.5	0.6%
2017	\$4,253.1	60.4%	\$4,617.1	60.6%	\$364.0	0.2%
2018	\$4,452.8	61.1%	\$4,808.7	61.0%	\$355.9	-0.1%
2019	\$4,662.7	61.9%	\$5,010.6	61.3%	\$347.9	-0.6%
2020	\$4,898.2	62.5%	\$5,223.7	61.7%	\$325.6	-0.8%
2021	\$5,146.2	63.0%	\$5,448.1	62.1%	\$301.9	-0.9%
2022	\$5,407.2	63.5%	\$5,683.9	62.5%	\$276.8	-1.0%
2023	\$5,681.8	64.0%	\$5,932.2	62.9%	\$250.4	-1.1%
2024	\$5,969.2	64.6%	\$6,193.9	63.4%	\$224.8	-1.2%
2025	\$6,271.3	65.2%	\$6,464.7	63.9%	\$193.4	-1.3%
2026	\$6,568.1	65.8%	\$6,747.8	64.5%	\$179.7	-1.3%
2027	\$6,920.2	66.5%	\$7,040.5	65.1%	\$120.4	-1.4%
2028	\$7,269.1	67.2%	\$7,351.4	65.7%	\$82.3	-1.5%
2029	\$7,635.7	68.0%	\$7,676.9	66.5%	\$41.1	-1.5%
2030	\$8,020.8	68.8%	\$8,018.8	67.3%	-\$2.0	-1.5%
2031	\$8,425.1	69.7%	\$8,377.0	68.1%	-\$48.2	-1.5%
2032	\$8,849.2	70.7%	\$8,752.2	69.1%	-\$97.1	-1.6%
2033	\$9,294.9	71.5%	\$9,145.3	70.1%	-\$149.7	-1.4%
2034	\$9,763.6	72.6%	\$9,558.3	71.2%	-\$205.4	-1.3%
2035	\$10,255.5	73.7%	\$9,989.9	72.4%	-\$265.7	-1.2%
2036	\$10,772.0	74.8%	\$10,442.1	73.7%	-\$329.9	-1.1%
2037	\$11,314.2	76.0%	\$10,916.1	75.1%	-\$398.1	-0.9%
2038	\$11,884.7	77.3%	\$11,414.9	76.6%	-\$469.8	-0.7%
2039	\$12,485.1	78.6%	\$11,937.4	78.2%	-\$547.7	-0.4%
2040	\$13,115.8	80.0%	\$12,485.7	79.9%	-\$630.1	-0.1%
2041	\$13,778.9	81.5%	\$13,058.9	81.7%	-\$719.9	0.2%
2042	\$14,475.3	83.1%	\$13,659.9	83.6%	-\$815.4	0.5%
2043	\$15,208.2	84.8%	\$14,289.7	85.6%	-\$918.5	0.8%
2044	\$15,978.3	86.6%	\$14,947.9	87.7%	-\$1,030.4	1.2%
2045	\$16,786.6	90.0%	\$15,636.4	90.0%	-\$1,150.2	0.0%
Total	\$312,872.4		\$315,142.3		\$2,269.9	

The factors that have contributed to the changes in overall projected contributions are detailed system-by-system on the following pages.

Teachers' Retirement System

Table 8 provides a summary of the original projected annual employer contributions and funded ratios, per P.A. 88-593.

TABLE 8							
TEACHERS' RETIREMENT SYSTEM							
Original and Current Projected Contributions and Funded Ratios							
(\$ in Millions)							
	1994 Projection P.A. 88-593		2005 Projection P.A. 88-593		Difference (2005-1994)		
FY	Contribution	Funded Ratio	Contribution	Funded Ratio	Contribution	Funded Ratio	
1996	\$324.3	54.3%	\$324.3	57.8%	\$0.0	3.5%	
1997	390.8	53.4%	378.0	64.5%	(12.8)	11.1%	
1998	463.1	52.7%	460.4	66.8%	(2.7)	14.1%	
1999	541.6	52.3%	567.1	67.0%	25.5	14.7%	
2000	623.8	52.0%	634.0	68.2%	10.2	16.2%	
2001	712.1	51.9%	719.4	59.5%	7.3	7.6%	
2002	807.0	52.0%	810.6	52.0%	3.6	0.0%	
2003	909.1	52.2%	926.0	49.3%	16.9	-2.9%	
2004	1,018.5	52.6%	5,358.7	61.9%	4,340.2	9.3%	
2005	1,128.9	53.0%	903.9	60.8%	(225.0)	7.8%	
2006	1,247.0	53.4%	531.8	59.5%	(715.2)	6.1%	
2007	1,372.4	53.9%	735.5	58.6%	(636.9)	4.7%	
2008	1,505.9	54.5%	1,049.8	58.2%	(456.1)	3.7%	
2009	1,647.1	55.1%	1,418.6	58.4%	(228.5)	3.3%	
2010	1,801.9	55.7%	1,814.4	59.1%	12.5	3.4%	
2020	2,757.6	58.8%	2,739.5	63.9%	(18.1)	5.1%	
2030	4,477.4	62.1%	4,261.8	70.2%	(215.6)	8.1%	
2040	7,268.6	75.0%	6,658.6	81.7%	(610.0)	6.7%	
2045	9,261.1	90.0%	8,371.6	90.0%	(889.5)	0.0%	

Contributions to TRS are generally expected to be lower than originally projected for the remainder of the funding plan. This is due primarily to the infusion of over \$4.0 billion in Pension Obligation Bond proceeds in FY 2004 and the reforms contained in SB 27 such as the Modified Early Retirement Option (ERO), the elimination of the Money Purchase Option for new employees, the shifting of costs to school districts for end-of-career salary increases, and requiring school districts to pay the normal cost for granting sick leave in excess of two years.

State Universities' Retirement System

Table 9 compares the original and current projections of estimated annual contributions and the resulting funded ratios for SURS. The current contributions column includes the annual employer contributions to the accounts of participants in the Self-Managed Plan (detailed below Chart 9).

FY	1994 Projection P.A. 88-593		2005 Projection P.A. 88-593		Difference (2005-1994)	
	Contribution	Funded Ratio	Contribution	Funded Ratio	Contribution	Funded Ratio
1996	123.9	50.1%	123.9	50.1%	\$0.00	0.0%
1997	154.1	49.6%	159.5	79.4%	\$5.40	29.8%
1998	186.9	49.3%	201.6	85.8%	\$14.70	36.5%
1999	222.5	49.3%	217.6	85.3%	(\$4.9)	36.0%
2000	261.3	49.4%	224.5	88.2%	(\$36.8)	38.8%
2001	303.3	49.7%	232.6	72.1%	(\$70.7)	22.5%
2002	348.6	50.0%	240.4	58.9%	(\$108.2)	8.9%
2003	397.5	50.5%	269.6	53.9%	(\$127.9)	3.4%
2004	450	51.1%	1,743.7	66.0%	\$1,293.7	14.9%
2005	506.5	51.8%	270.0	65.6%	(\$236.5)	13.8%
2006	567.3	52.5%	166.6	63.9%	(\$400.7)	11.4%
2007	632.5	53.3%	252.1	62.5%	(\$380.4)	9.3%
2008	702.5	54.1%	357.9	61.5%	(\$344.6)	7.4%
2009	777.3	55.1%	456.5	60.7%	(\$320.8)	5.6%
2010	857.8	56.2%	572.4	60.3%	(\$285.4)	4.1%
2020	1,393.40	70.0%	1,021.9	58.1%	(\$371.5)	-11.9%
2030	2,336.40	77.6%	1,636.7	58.0%	(\$699.7)	-19.6%
2040	3,909.40	85.2%	2,667.7	72.6%	(\$1,241.7)	-12.6%
2045	5,054.40	90.0%	3,407.9	90.0%	(\$1,646.5)	0.0%

Due to the Pension Obligation Bond proceeds, FY 2004 was the only year in which contributions to SURS significantly exceeded projections. Contributions are expected to be significantly lower than projected when P.A. 88-593 was enacted due to the changeover to a valuation of assets at market value in FY 1997 and, to a lesser extent, the elimination of the Money Purchase option for new members after July 1, 2005 as contained in P.A. 94-0004 (SB 0027).

State Employees' Retirement System

Table 10 provides a summary of the current projected State contributions to SERS, as well as the original projected contributions and corresponding funded ratios, per Public Act 88-593, based on the June 30, 1994 actuarial valuation.

FY	1994 Projection P.A. 88-593		2005 Projection P.A. 88-593		Difference (2005-1994)	
	Contribution	Funded Ratio	Contribution	Funded Ratio	Contribution	Funded Ratio
1996	\$144.5	56.1%	\$146.4	70.1%	\$1.9	14.0%
1997	157.5	55.4%	158.2	80.1%	0.7	24.7%
1998	171.3	54.8%	200.7	75.6%	29.4	20.8%
1999	185.9	54.4%	315.5	79.9%	129.6	25.5%
2000	201.5	54.0%	340.8	81.7%	139.3	27.7%
2001	216.1	53.7%	366.0	65.8%	149.9	12.1%
2002	235.7	53.5%	386.1	53.7%	150.4	0.2%
2003	254.2	53.4%	396.1	42.6%	141.9	-10.8%
2004	273.9	53.3%	1,864.7	54.2%	1,590.8	0.9%
2005	294.7	53.3%	427.4	54.4%	132.7	1.1%
2006	316.9	53.4%	203.8	52.6%	-113.1	-0.8%
2007	340.5	53.5%	344.2	51.4%	3.7	-2.1%
2008	366.4	53.6%	520.0	50.8%	153.6	-2.8%
2009	393.5	53.9%	718.0	51.0%	324.5	-2.9%
2010	422.4	54.2%	929.0	51.9%	506.6	-2.3%
2020	659.8	60.4%	1,328.0	59.1%	668.2	-1.4%
2030	1,065.6	68.2%	1,912.0	65.1%	846.4	-3.1%
2040	1,707.5	80.7%	2,836.0	78.4%	1,128.5	-2.3%
2045	2,177.4	90.0%	3,454.0	90.0%	1,276.6	0.0%

Contributions to the State Employees' Retirement System are projected to be appreciably greater than the original assumptions under P.A. 88-593. The increased funding requirements in future years are due in large part to reductions in contributions of \$974.0 million in both FY 06 and FY 07 as contained in P.A. 94-0004. The

additional funding obligations created by the 2002 Early Retirement Incentive and the steep market downturn in Fiscal Years 2001 and 2002 have also driven up future contributions pursuant to the current funding plan.

Two significant benefit increases have contributed to the increased cost as well: P.A. 90-065 provided a new flat-rate regular SERS formula of 1.67% of final average salary per year of service for members contributing to Social Security (coordinated), and 2.2% of final average salary per year of service for employees not contributing to Social Security (non-coordinated).

P.A. 92-0014 increased the alternative retirement formula to 3.0% of final average salary per year of service for employees not contributing to Social Security and 2.5% for employees contributing to Social Security.

Judges' Retirement System

Table 11 compares the original and current projections of estimated annual contributions and the resulting funding ratios for the Judges' Retirement System.

	1994 Projection P.A. 88-593		2005 Projection P.A. 88-593		Difference (2005-1994)	
FY	Contribution	Funded Ratio	Contribution	Funded Ratio	Contribution	Funded Ratio
1996	\$12.1	40.7%	\$12.1	48.0%	\$0.0	7.3%
1997	13.6	39.5%	13.7	44.7%	\$0.1	5.2%
1998	15.3	38.4%	15.7	47.7%	\$0.4	9.3%
1999	17.1	37.5%	18.7	48.4%	\$1.6	10.9%
2000	19.1	36.7%	21.4	48.5%	\$2.3	11.8%
2001	21.3	36.2%	24.3	40.7%	\$3.0	4.5%
2002	23.5	35.9%	27.5	33.7%	\$4.0	-2.2%
2003	26.0	35.9%	31.4	30.7%	\$5.4	-5.2%
2004	28.7	36.2%	178.6	46.2%	\$149.9	10.0%
2005	31.6	36.6%	32.0	45.7%	\$0.4	9.1%
2006	34.6	37.3%	29.2	44.7%	-\$5.4	7.4%
2007	37.9	38.1%	35.2	43.4%	-\$2.7	5.3%
2008	41.4	39.1%	47.1	42.8%	\$5.7	3.7%
2009	45.2	40.3%	60.9	42.9%	\$15.7	2.6%
2010	49.3	41.6%	75.6	43.9%	\$26.3	2.3%
2020	80.7	53.6%	118.3	54.3%	\$37.6	0.7%
2030	130.9	65.0%	183.8	65.7%	\$52.9	0.7%
2040	213.6	80.1%	284.4	80.4%	\$70.8	0.3%
2045	272.6	90.0%	355.6	90.0%	\$83.0	0.0%

The estimated annual contributions based on the current actuarial valuation are larger than those estimated in the original projections for the remainder of the funding period. This is due in large part to insufficient employer contributions, funding reductions contained in P.A. 94-0004, and two years of negative investment returns in FY 2001 and FY 2002.

General Assembly Retirement System

Table 12 compares the original and current projections of estimated annual contributions and the resulting funded ratios for GARS.

	1994 Projection P.A. 88-593		2005 Projection P.A. 88-593		Difference (2005-1994)	
FY	Contribution	Funded Ratio	Contribution	Funded Ratio	Contribution	Funded Ratio
1996	\$2.4	33.2%	\$2.4	40.4%	\$0.0	7.2%
1997	2.7	31.3%	2.8	39.4%	\$0.1	8.1%
1998	3.0	29.3%	3.1	41.7%	\$0.1	12.4%
1999	3.3	27.4%	3.7	41.5%	\$0.4	14.1%
2000	3.7	25.6%	4.0	41.6%	\$0.3	16.0%
2001	4.0	23.7%	4.3	34.9%	\$0.3	11.2%
2002	4.5	22.2%	4.7	29.3%	\$0.2	7.1%
2003	4.9	20.8%	5.2	25.3%	\$0.3	4.5%
2004	5.4	19.6%	32.9	40.1%	\$27.5	20.5%
2005	5.9	18.7%	4.7	39.1%	-\$1.2	20.4%
2006	6.5	18.1%	4.2	37.2%	-\$2.3	19.1%
2007	7.0	17.6%	5.2	34.4%	-\$1.8	16.8%
2008	7.6	17.3%	6.5	31.9%	-\$1.1	14.6%
2009	8.3	17.3%	8.0	30.1%	-\$0.3	12.8%
2010	9.0	17.6%	9.8	28.8%	\$0.8	11.2%
2020	14.5	26.8%	16.0	25.7%	\$1.5	-1.1%
2030	23.5	44.9%	24.5	37.0%	\$1.0	-7.9%
2040	38.3	72.2%	38.0	67.5%	-\$0.3	-4.7%
2045	48.9	90.0%	47.3	90.0%	-\$1.6	0.0%

The estimated annual contributions to GARS based on the June 30, 2005 actuarial valuation track closely with the original projections under P.A. 88-593.

VI. COMMISSION FUNDING RECOMMENDATION

Commission Recommendation

P.A. 88-593 requires a periodic evaluation of whether the 90% target funded ratio represents an appropriate goal for the five State-funded retirement systems. As evidenced by the national overview on page 2, the average funded ratio of 64 state retirement systems at the end of FY 2004 was 83%. While the average funded ratio for all the systems in the survey fell considerably from FY 2001 through FY 2003 due to the downturn in the financial markets, it can be assumed that the average funded ratio for these 64 systems will approach or exceed 90% by the end of FY 2006. Therefore, the Commission believes that a 90% funding target is appropriate in light of national trends. In addition, despite multiple benefit increases and the aforementioned bear market years, the current projections of future contributions are generally on course with the original projections based on the June 30, 1994 actuarial valuations of each of the five State-funded systems. Furthermore, the Commission believes that adhering to an explicit and well-defined funding schedule will produce stable, predictable results for both the state and retirement system members and annuitants.

Office of Management and Budget Letter Concerning 90% Funding Ratio





STATE OF ILLINOIS
EXECUTIVE OFFICE OF THE GOVERNOR
GOVERNOR'S OFFICE OF MANAGEMENT & BUDGET
SPRINGFIELD 62706

ROD R. BLAGOJEVICH
GOVERNOR

December 22, 2005

Senator Jeffrey Schoenberg
State House, Room 218-B
Springfield, Illinois

Representative Terry Parke
State House, Room 220
Springfield, Illinois

Re: Review of Public Act 88-593

Dear Senator Schoenberg and Representative Parke:

Public Act 88-593 established a 50-year payment plan for the five state pension systems. This payment plan was adopted to address the State's inability to pay normal cost and interest on the unfunded liability each year since 1978. The basic principal of this 50-year payment plan is to attain a 90% funded ratio by the end of fiscal 2045 and maintenance of that 90% funded ratio thereafter. The Act also requires the Office of Management and Budget, every five years, to consider and determine whether the 90% funding ratio continues to represent an appropriate goal for state sponsored retirement plans in Illinois.

Following are the findings and recommendations of the Office of Management and Budget with regard to continued appropriateness of the 90% funding ratio.

Illinois Pension System Challenge

Funding of the State's past pension debts, accumulated over three decades, represents the greatest financial challenge for the State of Illinois.

The unfunded liability of the State pension systems more than doubled from \$19.5 billion as of June 30, 1995 (the year before implementation of the 50-year payment plan) to \$43.1 billion as of June 30, 2003 (with a funded ratio of 48.6%). Due primarily to infusion of proceeds of the 2003 Pension Obligation Bonds (POB), and associated earnings, the unfunded liability is currently at \$38.6 billion as of June 30, 2005 (with a funded ratio of 60.3%).

The primary drivers of the increase in unfunded liability between 1995 and 2003 include:

- State contributions determined in accordance with the 50-year payment plan that were designed to underfund the normal cost and interest on the unfunded liability, thus increasing the liability.
- Significant investment losses incurred during the three fiscal years ended June 30, 2003.
- Unfunded benefit improvements adopted between 1995 through 2002.

Total required State contributions to the pension system, determined in accordance with the 50-year payment plan, are projected to increase from \$609 million for fiscal 1996 to \$15.6 billion in 2045. (Reduced from a projected 2045 contribution of \$16.8 billion determined when the 50-year payment plan was first implemented.)

Appropriateness of 90% Funded Ratio

Public Act 88-593 requires the Office of Management and Budget to consider and determine whether the 90% funding ratio continues to represent an appropriate goal for state sponsored retirement plans in Illinois.

For comparison purposes, please note that the private sector has no equivalent percentage funding target, but is subject to additional minimum contribution requirements if the funded level falls below 90%.

Adopting a statutory payment plan for the state pension systems was needed. The 50-year payment plan, however, was structurally unaffordable when it was enacted though. First of all, it incorporated a 15 year ramp-up period, which increased contributions over a period of 15 years from a starting level that was arbitrary and significantly less than the amount needed to keep the unfunded liability from increasing, thereby further increasing the unfunded liability. Thus the state was guaranteed to experience a growing unfunded liability from 1996 through at least 2010. This had the result of deferring the entire 1995 unfunded liability into the future.

Contributions for years after 2010, although determined as a level percent of pay, are also not sufficient to pay normal cost and interest on the unfunded liability until around 2034. Therefore, as a result of the 50-year payment plan, the unfunded liability was actually projected to grow from the 6/30/95 level of \$19.5 billion to as much as \$78 billion by 2034 before it finally begins to reduce to \$53 billion in 2045.

The fact that the 50-year payment plan called for continued underfunding for 40 years until 2035, with the underfunding being paid back at an 8.5% interest rate, caused the annual contribution schedule to quickly become unaffordable. Both the payment plan structure and high interest cost of the liability required a full examination of how to resolve this decades long structural issue.

The 90% funded target for a state pension plan represents a reasonable and appropriate funding target. The Office of Management and Budget concurs with the majority report of the Advisory Commission on Pension Benefits (established by Public Act. 94-4) which

recommends a series of changes needed to attain a 90% funded ratio for the state pension systems. (See recommendations of Advisory Commission Report below.)

Governor's Pension Reform Plan

The first step taken by the Governor to address these structural issues was to provide the state pension systems with a cash infusion and reduce the state's pension debt. During June of 2003, the state issued \$10 Billion of Pension Obligation Bonds, all of which, except for \$500 million which was used to cover issuance costs and initial debt service payments, was paid into the pension systems. Of this \$10 billion total, \$7.3 Billion was disbursed to the pension systems as an additional state contribution over and above any annual contribution requirements. This additional cash infusion on July 3, 2003 immediately reduced the pension system's unfunded liability from \$43 Billion to approximately \$36 Billion, and increased the system's funded ratio from 49% as of June 30, 2003 to over 57% literally overnight. (With investment earnings, the funded ratio actually improved to over 60% by June 30, 2005.)

With this single action, the security of the members and retirees' pensions improved significantly. This reduction in liability was never anticipated or included in the 50-year payment plan.

Public Act 94-4

Deloitte Consulting LLP, (the consulting actuary to the Governor's Pension Commission and the Governor's Office of Management & Budget) reports that, of several estimates prepared by different actuaries, the most appropriate, reasonable and complete estimate of the net savings associated with Public Act 94-4 is a projected reduction in the 2045 actuarial accrued liability of approximately \$44 billion (or 8%) , as well as a reduction in state contribution requirements of **approximately** \$3 billion over the next 40 years.

The Governor's management and budgetary actions have resulted in the reduction of headcount to its lowest level in more than 30 years. In addition to the annual payroll savings this headcount reduction effort has generated, SERS, in their 6/30/05 actuarial valuation, recognized savings of approximately \$5 billion in state contribution requirements between fiscal year 2006 and 2045 as a result of this effort. This \$5 billion contribution savings is in addition to the \$3 billion discussed above.

Governor's Pension Reforms

The reforms included in Public Act 94-4 represent the first time future liabilities and benefits of the Illinois pension system have ever been reduced.

In addition to the changes included in Public Act 94-4, payments to the state's pension systems have substantially increased in each of the last four year periods since fiscal 1992.

The following table illustrates payments for the state's pension systems in four year periods between fiscal year 1992 and 2007:

Fiscal Year Period	Payments (Billions)	Average Annual Payment	Percent of General Revenue Fund Resources
2004 - 2007	\$7,497	\$1,874	7.29%
2000 - 2003	\$5,818	\$1,455	6.08%
1996 - 1999	\$3,433	\$ 858	4.30%
1992 - 1995	\$2,067	\$ 517	3.28%

Note: Payment numbers above DO NOT include the additional infusion of \$7.317 billion from the June 2003 Pension Obligation Bonds. If included, the \$7.497 billion payment for the period 2004 through 2007 would be increased by an additional \$5.829 billion (\$7.317 billion net of debt service of \$1.488 billion).

Advisory Commission on Pension Benefits

As required under Public Act 94-4, the Governor's established an Advisory Commission on Pension Benefits. The mandate of this Advisory Commission on Pension Benefits (the "Commission") was to consider and make recommendations concerning changing the age and service requirements, automatic annual increase benefits, and employee contribution rates of the State-funded retirement systems and other pension-related issues.

The Commission met five times between September 23 and October 27, 2005 and recommended the following be considered by an agreed bill process:

- The Commission recommends that the State adopt means by which to dedicate revenues in excess of a specific target percentage of growth towards the additional funding of the pension systems when those targets are met, and establish a minimum when those targets are not met.
- The Commission recommends that if the State sells certain assets, then 100% of the resulting revenues should be dedicated towards reducing liabilities, including the Pension Systems' unfunded liabilities, as a component part of a broader plan to reduce those unfunded liabilities.
- The Commission recommends that the General Assembly consider creating incentives for employees to continue working beyond the year when they achieve the maximum pension percentage as a means to reduce the State's pension costs.
- The Commission recommends that the General Assembly consider the issuance of Pension Obligation Bonds as quickly as practicable as a financing instrument to reduce the State's pension costs, as long as (1) there are favorable market conditions and (2) the issuance of such POBs is a component part of a broader plan to reduce the Pension Systems' unfunded liabilities.

- The Commission recommends that the General Assembly should explore new revenue sources dedicated to reducing the Pension Systems' debt, as a component part of a broader plan to reduce the Pension Systems' unfunded liabilities.
- The Commission affirms the significance of the benefit reforms achieved in the 2005 Spring legislative session, and also affirms that, at the present time, most SERS, TRS and SURS benefits and employee contributions are comparable to other public pension systems in the United States. The Commission further recommends that the General Assembly should regularly review, as part of the agreed bill process as well as their normal budgetary review process, the affordability of the Pension Systems' plan provisions regarding benefits and make an affirmative determination thereon.

In conclusion, the 90% funded target for a state pension plan represents a reasonable and appropriate funding target. The Office of Management and Budget concurs with the majority report of the Advisory Commission on Pension Benefits (established by Public Act. 94-4) which recommends a series of changes needed to attain a 90% funded ratio for the state pension systems.

Sincerely,



John Filan
Director

State Retirement Systems Letter Concerning 90% Funding Ratio





STATE
RETIREMENT
SYSTEMS

- State Employees' Retirement System of Illinois
- General Assembly Retirement System
- Judges' Retirement System of Illinois

Internet: <http://www.state.il.us/srs>

E-Mail: ser@mail.state.il.us

2101 South Veterans Parkway, P.O. Box 19255, Springfield, IL 62794-9255

December 30, 2005

Senator Jeffrey Schoenberg
Co-Chairman, CGFA
830 Davis Street, Suite 102
Evanston, IL 60201

Representative Terry Parke
Co-Chairman, CGFA
837 West Higgins Road
Schaumburg, IL 60195

Dear Senator Schoenberg and Representative Parke:

Public Act 88-0593 established a funding goal for the five state pension systems with a 90% funding ratio by the year 2045, and to maintain the funding ratio thereafter. This Act also called for the 90% funding goal to be reviewed every five years by the Systems and the Governor's Office of Management and Budget.

It is not certain why the 90% target was initially included in the legislation, but in view of the length of the funding plan and the consensus of the public funds, we would recommend this goal be raised to 100%. We believe the long term funding target should equal the total obligations, and over 40 years, the increased contributions should be relatively small.

Very truly yours,

Robert V. Knox, Executive Secretary
State Retirement Systems

Jon Bauman, Executive Director
Teachers' Retirement System

Dan Slack, Executive Director
State Universities Retirement System

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RVK/mn
cc: Dan Long, CGFA

APPENDIX I. LEGISLATIVE OVERVIEW

This section of the report summarizes the major legislative actions that have significantly impacted the State-funded retirement systems since the Commission last reported on the appropriateness of the 90% funding target.

2002 Early Retirement Incentive (ERI)

Public Act 92-0566 (HB 2671) created an Early Retirement Incentive (ERI) Program for certain members of the State Employees Retirement System (SERS) and State employees covered by the Teachers' Retirement System (TRS). To be eligible for the ERI, members must have been, during June 2002: in active payroll status; on layoff status with a right of recall, or receiving a disability benefit for less than 2 years. Members were required to file the ERI application with the Board of Trustees prior to December 31, 2002 and leave employment between July 1, 2002, and December 31, 2002.

According to SERS, 11,039 members elected to participate in the ERI. Of these, 10,301 were eligible to retire immediately (Option 1), while 738 members elected to terminate employment and receive benefits at a later date (Option 2). The average number of ERI months purchased was 58 and the average age at termination was 57 for Option 1 participants and 48 for Option 2 participants. According to the System, the average cost of purchasing the ERI service credit was \$11,624 per participant and the average total monthly benefit of all ERI participants was almost \$2,505.

Pension Obligation Bonds

On April 7, 2003, Governor Blagojevich signed House Bill 2660 into law as Public Act 93-0002. The legislation authorized the State to issue \$10 billion in general obligation bonds for the purpose of making required contributions to the five state-funded retirement systems. After payment of fees, commissions, and interest, a total of \$9,477.3 million was deposited into the newly-created Pension Contribution Fund (PCF). The act specified that the first \$300 million was to be used to reimburse the General Revenue Fund for a portion of the FY 2003 State contributions to the retirement systems. In addition, the next \$1,860.0 million was reserved to reimburse GRF for all of the FY 2004 employer contributions to the State-funded retirement systems. The remainder of the POB proceeds, \$7,317.3 million, was distributed to the retirement systems in proportion to their unfunded liabilities, as outlined in the chart below.

System	Pre-POB Unfunded Liability	POB Proceeds	Post-POB Unfunded Liability	Funded Ratio Before POB Proceeds	Funded Ratio After POB Proceeds
TRS	\$23,809.0	\$4,330.0	\$19,478.0	49.3%	58.5%
SERS	10,092.0	1,386.0	8,706.0	42.6%	50.5%
SURS	8,311.0	1,432.0	6,879.0	53.9%	61.8%
JRS	746.0	142.0	604.0	30.7%	43.9%
GARS	147.0	27.0	120.0	25.3%	39.1%
Combined	\$43,105.0	\$7,317.0	\$35,787.0	48.6%	57.3%

P.A. 94-0004 (SB 0027)

On June 1, 2005, Governor Blagojevich signed SB 0027 into law as Public Act 94-0004. The Act makes several changes to the Illinois Pension Code, including a reduction in the required FY 2006 and FY 2007 State contributions to the State-funded retirement systems, as shown in the chart below:

<i>Certified and Projected Contributions vs. Public Act 94-0004 Contributions</i> (in millions \$)						
<i>System</i>	FY 2006			FY 2007		
	Certified Contributions	<i>P.A. 94-0004</i>	Reduction	Projected Contributions	<i>P.A. 94-0004</i>	Reduction
TRS	\$ 1,058.5	\$ 534.6	\$ 523.9	\$ 1,233.1	\$ 738.0	\$ 495.1
SERS	690.3	203.8	486.6	832.0	344.2	487.8
SURS	324.9	166.6	158.2	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	\$ 2,117.1	\$ 938.4	\$ 1,178.7	\$2,507.9	\$1,374.7	\$1,133.2

P.A. 94-0004 changes the funding plan created in 1994 by Public Act 88-0593 by setting the State contribution levels for FY 2006 and FY 2007, rather than requiring the State to make contributions based on actuarial calculations. In addition, the separate funding of the liability created by the 2002 SERS Early Retirement Incentive was eliminated.

The legislation also contained several reforms that the Commission has discussed in previous meetings. These changes are expected to curtail the rate of growth in liabilities which may result in lower required annual State contributions over the life of the funding plan.

BACKGROUND

The Commission on Government Forecasting and Accountability (CGFA), a bipartisan, joint legislative commission, provides the General Assembly with information relevant to the Illinois economy, taxes and other sources of revenue and debt obligations of the State. The Commission's specific responsibilities include:

- 1) Preparation of annual revenue estimates with periodic updates;
- 2) Analysis of the fiscal impact of revenue bills;
- 3) Preparation of "State Debt Impact Notes" on legislation which would appropriate bond funds or increase bond authorization;
- 4) Periodic assessment of capital facility plans;
- 5) Annual estimates of public pension funding requirements and preparation of pension impact notes;
- 6) Annual estimates of the liabilities of the State's group health insurance program and approval of contract renewals promulgated by the Department of Central Management Services;
- 7) Administration of the State Facility Closure Act.

The Commission also has a mandate to report to the General Assembly ". . . on economic trends in relation to long-range planning and budgeting; and to study and make such recommendations as it deems appropriate on local and regional economic and fiscal policies and on federal fiscal policy as it may affect Illinois. . . ." This results in several reports on various economic issues throughout the year.

The Commission publishes several reports each year. In addition to a Monthly Briefing, the Commission publishes the "Revenue Estimate and Economic Outlook" which describes and projects economic conditions and their impact on State revenues. The "Bonded Indebtedness Report" examines the State's debt position as well as other issues directly related to conditions in the financial markets. The "Financial Conditions of the Illinois Public Retirement Systems" provides an overview of the funding condition of the State's retirement systems. Also published are an Annual Fiscal Year Budget Summary; Report on the Liabilities of the State Employees' Group Insurance Program; and Report of the Cost and Savings of the State Employees' Early Retirement Incentive Program. The Commission also publishes each year special topic reports that have or could have an impact on the economic well being of Illinois. All reports are available on the Commission's website.

These reports are available from:

Commission on Government Forecasting and Accountability
703 Stratton Office Building
Springfield, Illinois 62706
(217) 782-5320
(217) 782-3513 (FAX)

http://www.ilga.gov/commission/cgfa/cgfa_home.html