Framework for Public Pension Reform: *Navigating the Hurdles*

League of Women Voters
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How Serious is this Problem?
Who is Responsible for the Problem?

- Bad to Worse
  - In 2003 Illinois State pension systems had unfunded liability of $43 billion ranking dead last in the U.S. – no other state even close
  - In 2011 Illinois State pension systems had unfunded liability of $85 billion, remaining the worst funded pension system in U.S.
    - TRS represents $43.8 billion of that amount
- State of Illinois caused this problem
  - For 40 years, failed to fund properly; spent pension $
  - State added benefits w/o increasing contributions
  - Bad investment planning and decisions
  - Employees have always made their required contributions
- Largest financial problem Illinois faces is unfunded pension debt

Who is Responsible for Fixing the Problem?

Possible solutions to address TRS system funding

- ❑ State of Illinois
- ❑ Teachers
- ❑ School districts

We Saw This Coming …

- Illinois Constitution Pension Clause (1970)
  - Enacted in reaction to profound underfunding of pension systems for public employees
    - At that time, State Pension systems approximately 39% funded
    - In 2011 (40 years later), funded at approximately 43%
  - Addressed need to "vest" benefits so public employers could not abandon or reduce benefits
    - Economic crisis
    - Home rule
  - <u>Intended</u> to limit State options

Pension Clause of Illinois Constitution of 1970 (Article XII, Section 5)

Membership in any pension system 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**.

What Does It Mean?

- Generally believed to mean:
  - once person is member of TRS, benefit and contribution rates vest, until and during retirement
  - rules that apply to benefits or contributions cannot be changed to adversely affect member

- Multiple court decisions in last 40 years
  - All found unconstitutional any effort to:
    - reduce pension benefits for active or retired public pension recipients
    - raise active member contributions without a corresponding increase in benefits

What Doesn't It Mean?

- Over past 40 years, unions sued to compel proper funding of pension systems at least 3 times
  - No requirement that system be funded at any particular percentage or level
- Only "funding" requirement is that State is required to pay benefits when they are due

How Can We Fix This?

Who Can Fix This?

Lining Up the Lawyers

- **Illinois Legislative Counsel**
  - Madiar opinion(s)(2011)
- **TRS**
  - Jenner & Block (2005)
- **Jenner & Block**
  - Illinois Pension Law Handbook (2012)
- **Office of the Governor**
  - DeVito opinion(s)(2010)
- **Illinois Education Association**
  - DLA Piper (2010)
- **Commercial Club of Chicago**
  - Sidley & Austin opinion(s)(2010)
    - Teacher eligibility, contributions and benefits can all be changed at any time
    - Alternatively can change if not yet "accrued"
    - Become insolvent
- **Pension Modernization Task Force (2009)**
  - Cannot affect "earned or accrued" benefits, but can change system going forward for existing teachers

Evolution of a Solution

- State of Illinois
  - Cannot compel any level of funding
  - Cannot become "insolvent"
  - Has not taken responsibility for over 40 years
- Teachers
  - Issue is whether teachers can be part of solution for existing members in the System
    - Cannot impair or diminish benefits of members
- School districts
  - Path of least resistance
  - <u>Note however</u>: any district solution will involve teachers

Step 1
New System Members

- P.A. 96-889 was sponsored by Senate President John Cullerton and House Speaker Michael Madigan and signed by the Governor. The legislation caps qualified "pension" salary at $106,800.
- Retirement age is raised to 67 for full benefits, with a minimum of 10 years of service.
- Teachers are eligible for reduced benefits at age 62.
- The changes <u>only apply to new employees.</u>
- The Act took effect on <u>January 1, 2011.</u>
- The new law is estimated to save over $200 billion implemented during a 35-year span.
- The new law eliminates the 3 percent annually-compounded COLA
- New law has simple interest raises of half the CPI or 3 percent, whichever is lower.
- Law prohibits pension "double-dipping," where someone gets a public pension while also receiving a salary from a different public system.

Step 1
Public Act 096-0889

Features	Old System	New System
Minimum Retirement Age	60 (at least 8 yrs. service)	67 (at least 10 yrs. service)
Yearly COLA	3% compounded	.5% of Consumer Price Index (no > than 3%)
Salary/Benefit Ceiling	$240,000	$106,800
"Double Dipping"	Allowed	Prohibited
Calculation of final average salary	Average of highest 4 yrs. salary of last 10	Average of highest 8 yrs. of last 10

Step 2 - Two Directions

SB 1673 & HB 6204

Shift normal pension costs to local school districts

- House Speaker Madigan has said the costs of teacher and university pensions need to be transferred from the state because teachers and university employees are not state employees.

  “Those spending the money are responsible for paying the bill,” Madigan said, alluding to the fact that school districts determine teacher salaries and therefore have some control over how much teacher pensions will be in retirement. “In Illinois, we have a very unusual situation.”

Continue State role and funding in teacher pensions

- The GOP opposition to the Madigan proposal stems from a legislative provision that would gradually shift the state’s pension costs for teachers and university employees to local school districts and universities.

Step 2
Through the "back door"

- House Speaker Madigan dismissed Republican concerns that shifting financial responsibility for pensions to local districts will result in local property tax increases.

  "Their responsibility is to live within their costs, live within their budgets." Madigan said of school districts. "Will there be some difficult (collective) bargaining? Yes … but that's why people seek to serve on school boards."

Step 2
Current System Members

- TRIP
  - TRIP was created in the State Employees Group Insurance Act of 1971 (5 ILCS 375). Section 6.5(h) of the Act provides:
    - "The program of health benefits provided under this Section may be amended by the State and is not intended to be a pension or retirement benefit subject to protection under Article XIII, Section 5 of the Illinois Constitution."

- COLA
  - Class – action litigation has been initiated in at least 3 states over efforts to decrease or cap COLA increases retirees receive.
  - Issue here is changing COLA adjustments prior to retirement.

Current Legislative Initiatives

Bills/Sponsor	SB 1673 A#5/Madigan	SB 1673 A#6/Cross	HB 6204/Fortner
Status	Passed out of committee in May 2012; was not considered by full House	Passed out of committee in May 2012; was not considered by full House	Introduced in August 2012; has not been assigned to committee
Primary Features	Choice of retirement benefits for Tier 1 employees and retirees, new employees will be automatically enrolled in the Cash Balance Plan, requires districts to pay the "normal cost" of pension benefits*	Choice of retirement benefits for Tier 1 employees and retirees, requires districts to pay a "penalty" on salary increases that count toward the final average salary calculation**	Caps pensionable salary and requires excess salary to be counted toward Defined Contribution Plan, creates a new 32 year pension funding plan, increases employee contribution***
Effective Date	July 1, 2013	July 1, 2013	No effective date included; if passed, Rep. Fortner intends for benefit changes to go into effect July 1, 2013

Current Legislative Initiatives

Bills/Sponsor	SB 1673 A#5/Madigan	SB 1673 A#6/Cross	HB 6204/Fortner
Funding Structure	100% funded by 2043; assumes savings from employee benefit changes; shift of normal cost to districts is estimated to save the state $700-800 million annually once the normal cost is the full responsibility of districts.	100% funded by 2043; assumes savings from employee benefit changes and assumes additional revenue for TRS through the district penalty on salary increases.	100% funded by 2045; increases state contribution by an equal percentage each year, transfers revenue from existing bond payments to pension fund after bonds reach maturity (2015, 2019, 2033).
Tier 1 Benefit Changes (Tier 1 employees = hired before January 1, 2011)	Choose between two retirement packages: 1. Continue 3% compounded COLA, future salary increases cannot count toward pension after the expiration of the current contract/CBA, forfeit access to state subsidized retiree healthcare, cannot participate in ERO. 2. Reduce COLA to ½ CPI, future salary increases count toward pension, maintain access to state subsidized retiree healthcare, can participate in ERO. Option to contribute up to 2% toward Cash Balance Plan.	Choose between two retirement packages: 1. Continue 3% compounded COLA, future salary increases cannot count toward pension after the expiration of the current contract/CBA, forfeit access to state subsidized retiree healthcare, cannot participate in ERO. 2. Reduce COLA to ½ CPI, future salary increases count toward pension, maintain access to state subsidized retiree healthcare, can participate in ERO.	Choose between two retirement packages: 1. Continue in Defined Benefit Plan, pensionable salary is capped at the salary level at the end of the current CBA/contract or $110,100, whichever is greater (the cap increases by ½ CPI each year). Salary above cap is automatically counted toward Defined Contribution Plan. 2. Move accumulated TRS funds to Defined Contribution Plan.

Current Legislative Initiatives

Bills/Sponsor	SB 1673 A#5/Madigan	SB 1673 A#6/Cross	HB 6204/Fortner
Tier 2 Benefit Changes (Tier 2 employees = hired after January 1, 2011)	Choose between two retirement packages: 1. Continue in current Defined Benefit Plan. 2. Move accumulated TRS funds into Cash Balance Plan.	No change.	Choose between two retirement packages: 1. Salary above $110,100 is counted toward DCP. The salary cap increases annually by ½ CPI. *Pensionable salary is already capped for Tier 2;* this plan allows employees to receive retirement earnings on their salary above the cap through the DCP. 2. Move accumulated TRS funds into DCP.
Retiree Benefit Changes	Choose between two retirement packages: 1. Continue 3% compounded COLA, forfeit access to state subsidized retiree healthcare. 2. Reduce COLA to ½ CPI, maintain access to state subsidized retiree healthcare.	Choose between two retirement packages: 1. Continue 3% compounded COLA, forfeit access to state subsidized retiree healthcare. 2. Reduce COLA to ½ CPI, maintain access to state subsidized retiree healthcare.	No change.

Current Legislative Initiatives

Bills/Sponsor	SB 1673 A#5/Madigan	SB 1673 A#6/Cross	HB 6204/Fortner
New Hire Benefits	New hires after July 1, 2013 would be automatically enrolled in the Cash Balance Plan. Employee contribution is 9% and district contribution is 3.4%. These employees cannot count unused sick leave toward service credit.	No new program; new hires would be in Tier 2 employees.	No new program; new hires would be Tier 2 employees.
Employee Contribution	Tier 1/retires – 9.4% Tier 2 – 9.4 CBP – 9%	9.4%	1. DBP – approx. 10% for current salary in contract or salary under the cap, 6% for salary over the cap. 2. DCP – 8% for salary under the cap, 6% for salary over the cap, members may contribute above required rates.
District Contribution	Phase in 1% of normal cost in FY 14 and add additional 1% each year until FY 19, then add additional 0.5% each year until entire normal cost is district responsibility.	Penalty on salary increase over prior year in determining final average salary; begins after expiration of CBA/contract; similar penalty formula as is currently in place for salary increases above the 6% cap.	1. DBP - .58% for salary included in current contract/salary under the cap; 3% for salary over the cap. 2. DCP – 3% of salary.

Current Legislative Initiatives

Bills/Sponsor	SB 1673 A#5/Madigan	SB 1673 A#6/Cross	HB 6204/Fortner
ERO	Available for Tier 1 employees choosing the lower COLA option; penalty is split equally between district and employee.	Available for Tier 1 employees choosing the lower COLA option; penalty is split equally between district and employee.	Silent on extension; would be up to G.A. to extend in Spring 2013.

* The "normal cost" of pension benefits is the amount required to cover pension benefits after subtracting the employee contribution and contribution for federally-funded employees. This number fluctuates based on actual investment returns, revenue from TRS employees and school districts, and state legislation changing the cost of pension benefits. TRS estimates that the normal cost of benefits will be 19.86% of payroll in Fiscal Year 2014. After subtracting the 9.4% employee contribution and 1% liability for federally-funded employees, the remaining portion of the normal cost is 9.46% of payroll. Under the Speaker's plan, this would be the district contribution, phased in over several years. These numbers reflect action taken by the TRS Board on September 21, 2012 to change their actuarial assumptions.

**Currently, districts pay a "penalty" on salary increases over 6% of the prior year's salary for TRS employees in their final four years of employment. The penalty is calculated through a formula including years of service, employee age, and a multiplier determined by TRS. Should this legislation pass, TRS will develop a new multiplier formula which will establish the district penalty. Some helpful background on the current formula and multiplier is available here: http://trs.illinois.gov/subsections/employers/pubs/INS40.pdf

***TRS estimates that the normal cost of benefits will be 19.86% of payroll for Fiscal Year 2014. Under Rep. Fortner's plan, the employee contribution would be the greater of 6% or ½ of the normal cost of benefits. Based on the current normal cost calculation, a TRS employee would be required to pay 9.93% of their salary, a slight increase from the current 9.4% employee contribution.

Challenges to Solutions

- Solutions
  - May be shaped by possibility of legal challenges
  - May be directly challenged
- Greater the direct or indirect impairment of benefits, greater the likelihood of legal challenges

Possible litigants

- IEA/IFT/AFSCME (any public union)
- Individual teacher/school official
- IASB/IASA
- Five Illinois pension systems (687,000 members)