TRS Issues and Answers: Pension Reform Proposals

(http://trs.illinois.gov/subsections/press/PensionReformProposals.htm#HB3411)

Pension Reform Proposal – House Bill 3411

Issue: A comprehensive overhaul of the Illinois pension code, House Bill 3411, was proposed on February 27, 2013 in the General Assembly by House Republican Leader Tom Cross of Oswego and State Rep. Elaine Nekrtiz, D-Northbrook.

TRS will not take a position on House Bill 3411. It is the legislature's job to dictate the laws and rules that govern TRS and other public pension systems. The job of TRS is to administer those laws and work to secure the System's finances so that the promises made to generations of teachers by the General Assembly can be kept.

Answer: The bill seeks to stabilize TRS finances and eliminate the System's unfunded liability in 30 years by raising active member contributions, raising the retirement age for younger member, reducing the cost of living adjustment for all retired members, delaying all COLA payments until age 67 and requiring all new members after the bill becomes law to join a new "Tier III" that is composed of both a traditional pension and a 401(k) style retirement fund.

*For all active and retired **Tier I** members (service before January 1, 2011)*

- The Tier I COLA is capped at 3 percent and each year the percentage increase would be equal to one-half of the consumer price index, calculated from the member's original pension amount, not from the current pension amount.
  - All Cost of Living Adjustments apply only to the first $25,000 of a pension. The COLA for annual benefits of $25,000 or more is capped at $750.
  - Currently, the average TRS pension is $48,216. Under current law, for example, with the COLA that pension grows to $49,662 in the second year and $51,152 in the third year. In this proposal, with a capped COLA, the same pension would grow to $48,966 in the second year and $49,716 in the third year.
- Members would not receive a COLA until age 67 or five years after they retire, whichever comes first. This would apply to all retired members already receiving a COLA under the old rules. These members could see their COLA suspended for a period of time, but would not lose any COLAs previously received.
- The salary used to determine an active member's final average salary would be capped at the maximum Social Security wage base, which is $113,700 in 2013. However for a TRS member employed under an individual or union contract, the cap would be set at the member's maximum salary under the contract at the time the law takes effect, if the salary exceeds the Social Security wage base. Contractual salaries that are below the Social Security wage base when the bill takes effect would be allowed to rise to the Social Security wage base.
- Active member contributions would increase from 9.4 percent to 10.4 percent during the 2013-2014 school year and increase to 11.4 percent beginning in the 2014-2015 school year.
- The retirement age would be set on a sliding scale based on the member's age and the time the law takes effect:
  - 45 and older: Current rules apply. Retire between the ages of 55 and 59 with at least 20 years of service and receive a reduced benefit, or at 60 or more and receive a full benefit
  - 40 to 44 years old: Retire at 56 to 60 with at least 20 years of service for a reduced benefit and at 61 for full benefits.
  - 35 to 39 years old: Retire at 58 to 62 with at least 20 years of service for a reduced benefit and at 63 for full benefits.
  - 34 and younger: Retire at 60 to 64 with at least 20 years of service for a reduced benefit and at 65 for full benefits.

*For all **Tier II** members (beginning TRS service between January 1, 2011 and the effective date of HB 3411)*

- Tier II members can irrevocably elect to join the new Tier III benefit plan or remain in Tier II.

Creates a new Tier III benefit structure (beginning service after the effective date of HB 3411)

- The Tier III benefit structure is a "hybrid" combination of:
  - A TRS-style defined benefit annuity – a guaranteed lifetime pension.
  - A 401(k)-style defined contribution plan – an amount of money contributed over the member's career that is distributed evenly in retirement until the account is exhausted.
- For the defined contribution "DC" plan:
  - Each Tier III member will contribute at least 5 percent of salary to the DC plan and would be allowed to contribute more.
  - School districts would contribute between 3 percent and 10 percent of salary to the DC plan. The actual amount will be negotiated by employers and employees in each district.
  - Each Tier III member will have an individual account with TRS, and the System is directed invest the account's funds according to each member's age: An "aggressive strategy" for younger members and a "conservative strategy" for older members.
  - The member could "roll over" all funds in the DC plan into another retirement vehicle, like a private 401(k) plan.
- For the defined benefit "DB" plan:
  - Each Tier III member will contribute 4 percent of salary to the DB plan.
  - The Tier III COLA is capped at 3 percent and each year the percentage increase would be equal to one-half of the consumer price index, calculated from the member's original pension amount, not from the current pension amount.
  - A member can retire with a full pension at age 67.
  - A member can retire between the ages of 62 and 66, but the member's pension will be reduced by 0.5 percent for each month the member is under age 67. For example, a member retiring at age 62 would receive a pension reduced by 30 percent from a "full" pension earned by the member.
- The formula for calculating a Tier III DB pension is different from a Tier I pension:
  - Instead of a multiplier of 2.2 percent, the multiplier will be 1.1 percent.
  - The member's "final average salary" in the calculation would be the average of the eight highest consecutive salaries out of the last 10 years of service.
  - The salary used to determine an active member's final average salary would be capped at the maximum Social Security wage base, which is $113,700 in 2013. However for a TRS member employed under an individual or union contract, the cap would be set at the member's maximum salary under the contract at the time the law takes effect, if the salary exceeds the Social Security wage base. Contractual salaries that are below the Social Security wage base when the bill takes effect would be allowed to rise to the Social Security wage base.

For School Districts

Each school district will pay the entire annual cost of the Tier III DB plan, as well as the cost of any unfunded liability that may develop in the plan.

For State Government

- If the state does not pay its annual contribution to TRS within a set period of time, TRS could go to court to force the state to pay the contribution in the same way that the Illinois Municipal Retirement Fund can force local governments to pay their contributions.
- The law is designed to make TRS 100 percent funded in 30 years.

- Once the state's outstanding pension obligation bonds are paid off, the money being used to retire that debt will be dedicated to paying off the TRS unfunded liability until that liability is retired, instead of funding the annual cost of pensions.

Pension Reform Proposal - Senate Bill 1

Issue: A new comprehensive pension reform proposal, Senate Bill 1, was introduced in the General Assembly on January 9, 2013 by Senate President John Cullerton that seeks to stabilize TRS finances and eliminate the System's unfunded liability in 30 years.

Answer: Senate Bill 1 is actually the combination of two previous pension overhaul proposals sponsored by President Cullerton and State Rep. Elaine Nekritz, D-Northbrook. The bill creates an "either-or" situation between the Cullerton proposal and the Nekritz proposal. Both proposals affect the same parts of the pension code.

If SB 1 is enacted, the pension reform provisions that originated with Rep. Nekritz – "Part A" of the bill – will become law and the provisions that originated with President Cullerton – "Part B" of the bill – will not become law.

But it is a certainty that SB 1 "Part A," if enacted, will be challenged in court as unconstitutional. If any part of "Part A" is found unconstitutional by the courts, the unconstitutional language of "Part A" automatically would be replaced with the corresponding language in "Part B." If all of "Part A" is found unconstitutional, then it is replaced by all of "Part B."

In a nutshell, "Part A" imposes benefit reductions and higher contributions on all active and retired TRS members in order to stabilize the System's long-term finances. "Part B" requires all active and retired members to make a choice: Either accept a reduced cost of living adjustment and maintain access to the state's health insurance program for retired teachers, or keep the current TRS COLA and lose access to state supported health insurance in retirement.

President Cullerton says he believes that the "choice" provisions of "Part B" do not violate the pension protection clause of the Illinois Constitution because members are part of the decision-making process. He believes "Part A" violates the constitution because it unilaterally lowers pension benefits in violation of the Constitution.

Rep. Nekritz says she believes that "Part A" is constitutional because long-term pension benefits already are "impaired" and therefore unconstitutional. TRS and the other four state pensions systems have shown that because of decades of inadequate state funding and rising costs, in about 20 years the System will not have enough money to pay all pension benefits. She believes the provisions of "Part A" will secure the finances of the Systems in the future and eliminate the current unconstitutional impairment.

The main argument in any court challenge to SB 1 is expected to be that the bill changes the pension benefits of retired and active TRS members and therefore violates the pension protection clause of the state constitution. That clause prevents existing pension benefits from being "diminished or impaired."

TRS will not take a position on Senate Bill 1. It is the legislature's job to dictate the laws and rules that govern TRS and other public pension systems. The job of TRS is to administer those laws and work to secure the System's finances so that the promises made to generations of teachers by the General Assembly can be kept.

TRS suggests patience and cannot advise members what they should do about retirement decisions to be made in the foreseeable future and how this proposed legislation may affect those decisions.

"Part A"
For all members, in general "Part A" would reduce the annual cost of living adjustment; raise the retirement age for all members under age 46; increase active member contributions by 2 percentage points over time; cap the amount of salary that can be used to determine a final average salary; create a new law that prevents the state from skipping its annual pension contribution; and shifts the annual cost of TRS pensions from the state to local school districts.

The goal of "Part A" is to reduce the entire $93 billion unfunded liability of TRS and the state's other pension systems by fiscal year 2045, as well as reduce the annual payment state government must make to support the systems. The legislation would increase the total contributions paid by members and school districts.

Specifics for TRS Members:
For all active and retired Tier I members (service before January 1, 2011)

- All COLAs would be suspended for four years following the enactment of the bill.
- After the COLA is reinstated, the annual TRS 3 percent COLA would apply only to the first $25,000 of a pension.
  - Currently, the average TRS pension is $48,216. Under current law, for example, with the COLA that pension grows to $49,662 in the second year and $51,152 in the third year. In this proposal, with a capped COLA, the same pension would grow to $48,966 in the second year and $49,716 in the third year.
- Members would not receive a COLA until age 67 or five years after they retire, whichever comes first. This would apply to all retired members already receiving a COLA under the old rules. These members could see their COLA suspended for a period of time, but would not lose any COLAs previously received.
- The salary used to determine an active member's final average salary would be capped at the maximum Social Security wage base, which is $113,700 in 2013. However for a TRS member employed under an individual or union contract, the cap would be set at the member's maximum salary under the contract at the time the law takes effect, if the salary exceeds the Social Security wage base. Contractual salaries that are below the Social Security wage base when the bill takes effect would be allowed to rise to the Social Security wage base.
- Active member contributions would increase from 9.4 percent to 10.4 percent in 2014 and increase to 11.4 percent in 2015.

For School Districts:
"Part A" does not mandate a shift, over time, of responsibility for the entire annual employer's cost of TRS pensions from state government to local school districts.

For State Government:

- If the state does not pay its annual contribution to TRS within a set period of time, TRS could go to court to force the state to pay the contribution in the same way that the Illinois Municipal Retirement Fund can force local governments to pay their contributions.
- The law is designed to make TRS 100 percent funded in 30 years.
- Once the outstanding pension obligation bonds are paid off, the money being used to retire that debt will be dedicated to paying off the TRS unfunded liability until that liability is retired, instead of funding the annual cost of pensions. In fiscal year 2013, the amount of TRS funds dedicated to paying off the bond debt is $347 million.

"Part B"
The goal of "Part B" is to reduce the entire $93 billion unfunded liability of TRS and the state's other pension systems by fiscal year 2045, as well as reduce the annual payment state

government must make to support the systems. The legislation would increase the total contributions paid by members and school districts.

Specifics for TRS members:
For all *active and retired* Tier I members (service before January 1, 2011)

- "Part B" requires all active, inactive and retired TRS members to choose between two options in the make-up of their retirement benefits after the bill takes effect. This irrevocable, one-time election would have to be made during a five-month period after the bill becomes law.
  - **Option 1:** Accept a change in the annual Cost Of Living Adjustment for a TRS pension – from 3 percent compounded to a COLA that is capped at 3 percent or one-half of the consumer price index, whichever is less. The COLA would not be compounded. The TRS member retains "access" to state-supported health insurance through the Teachers' Retirement Insurance Program. For active members, all future salary increases will be used to calculate the member's future pension.
  - **Option 2:** Reject the change in the COLA and it remains at 3 percent compounded annually. The TRS member losses "access" to state-supported health insurance through the Teachers' Retirement Insurance Program. For active members, all future salary increases will not count when the member's future pension is calculated.
- Regardless of which COLA is elected, TRS members would be eligible for a COLA on the January 1 in the year after turning age 67 or in the year after the fifth anniversary of the member's retirement, whichever is earlier. If a retired Tier I member now eligible for the current COLA accepts the reduced COLA, the current COLA would suspended until the member is eligible for the new COLA. Any COLAs received prior to this "suspension" would be kept by the member.
- "Part B" allows all active TRS members that elect the reduced COLA to participate in a "cash balance plan" that would supplement their Tier I benefits.
  - Under the plan, TRS members would pay an annual salary contribution of 2 percent in addition to their regular contribution for Tier I benefits. School districts would pay an annual contribution. TRS would annually credit interest of up to 10 percent, depending on investment earnings.
  - While the contributions of all cash balance plan members would be commingled for investment purposes, each member in the program would have an individual "notional" account on file with TRS that would be comprised of their individual contributions, school district contributions and investment income.
  - Upon retirement, TRS would calculate a guaranteed life-time annuity based solely on the money credited to each member's account and adjusted for estimated future investment earnings and the member's anticipated lifespan in retirement. The annuity continues even after money in the member's account is exhausted.
- "Part B" allows Tier I members between age 55 and age 59 that elect the reduced COLA to make a one-time member contribution to TRS so they can avoid the required reduction in their annuities they would face by taking their benefits before age 60. The member contribution and the school district contribution would equally be 50 percent of the projected cost of the eliminating the reduction in the benefit.
  - School districts may limit the number of members that may take advantage of this early retirement option in any year to at least 10 percent of eligible members that have the right to participate. Participation would be allocated according to seniority in that district.

Under "Part B," only certified educators working for school districts or state agencies will be allowed to be TRS members – no future private organization employees are allowed.

For School Districts:
"Part B" does not mandate a shift, over time, of responsibility for the entire annual employer's cost of TRS pensions from state government to local school districts.

For State Government:
Under "Part B," if the state fails to pay any monthly share of its legally-required contribution to TRS within 90 days, the TRS Board would have the right to go to the Illinois Supreme Court for an order commanding the comptroller to pay TRS out of the state budget's General Revenue Fund.

Back to top

Pension Reform - House Bill 98 and Senate Bill 35

Issue: This comprehensive pension reform proposal is sponsored by Rep. Elaine Nekritz, D-Northbrook in the House and by State Sen. Daniel Biss, D-Evanston, in the Senate. It seeks to stabilize TRS finances and eliminate the System's unfunded liability in 30 years.

Answer: For all members, in general the proposal would reduce the annual cost of living adjustment; raise the retirement age for all members under age 46; increase active member contributions by 2 percentage points over time; cap the amount of salary that can be used to determine a final average salary; create a new law that prevents the state from skipping its annual pension contribution; and shifts the annual cost of TRS pensions from the state to local school districts.

If this new proposal is approved by legislators and signed into law by the governor, it will face a court challenge. The main argument will be that the bill changes the pension benefits of retired TRS members and therefore violates the pension protection clause of the state constitution. That clause prevents existing pension benefits from being "diminished or impaired."

TRS will not take a position on House Bill 98 or Senate Bill 35. It is the legislature's job to dictate the laws and rules that govern TRS and other public pension systems. The job of TRS is to administer those laws and work to secure the System's finances so that the promises made to generations of teachers by the General Assembly can be kept.

The legislation, if enacted, would reduce the unfunded liabilities of TRS and the state's other pension systems, as well as the annual payment state government must make to support the systems. The legislation would increase the total contributions paid by members and school districts.

- The total unfunded liability of TRS in fiscal year 2014 would be reduced by 46 percent, from $53.5 billion to $36.5 billion. The unfunded liability of all state pension systems next year would be cut from $95 billion to $67 billion, a 41.8 percent reduction.
- The state's required contribution to TRS in FY 2014 would be reduced by 54.5 percent, from $3.4 billion to $2.2 billion. The state's total contribution in FY 2014 to all state pension systems would decline by 39.6 percent, from $6.7 billion to $4.8 billion.
- Over the next 30 years, the state's total contributions to TRS would be cut in half, from $226.9 billion to $112.7 billion.
- Total contributions from TRS members in FY 2014 would increase by 9 percent, from $1 billion to $1.9 billion. Over the next 30 years, total TRS member contributions would increase by 12.8 percent, from $52.1 billion to 58.8 billion.
- Total contributions from school districts in FY 2014 would more than double, from $120 million to $250 million, mostly because of the proposed phased-in shift in the annual cost of pensions from the state to local districts. Over the next 30 years, total school district contributions would increase by 359 percent, from $7.8 billion to $35.9 billion.

Specifics for TRS members:
For all *active and retired* Tier I members (service before January 1, 2011)

- The annual 3 percent COLA would apply only to the first $25,000 of a pension.
  - Currently, the average TRS pension is $48,216. Under current law, with the COLA that pension grows to $49,662 in the second year and $51,152 in the third year. In this proposal, with a capped COLA, the same pension would grow to $48,966 in the second year and $49,716 in the third year.
- Members would not receive a COLA until age 67 or five years after they retire, whichever comes first. This would apply to all retired members already receiving a COLA under the old rules. These members could see their COLA suspended for a period of time.
- The retirement age would be set on a sliding scale based on the member's age and the time the law takes effect:
  - 46 and older: Retire between the ages of 55 and 59 with at least 20 years of service and receive a reduced benefit, or at 60 and receive a full benefit
  - 40 to 45 years old: Retire at 56 to 60 with at least 20 years of service for a reduced benefit and at 61 for full benefits.
  - 35 to 39 years old: Retire at 58 to 62 with at least 20 years of service for a reduced benefit and at 63 for full benefits.
  - 34 and younger: Retire at 60 to 64 with at least 20 years of service for a reduced benefit and at 65 for full benefits.
- The salary used to determine an active member's final average salary would be capped at the maximum Social Security wage base, which is $113,700 in 2013. However for a TRS member employed under an individual or union contract, the cap would be set at the member's salary at the time the law takes effect if the salary exceeds the Social Security wage base. Contractual salaries that are below the Social Security wage base when the bill takes effect would be allowed to rise to the Social Security wage base.
- Active member contributions would increase from 9.4 percent to 10.4 percent in 2014 and increase to 11.4 percent in 2015.

For all Tier II members (service after January 1, 2011)

- Members would have the option of staying with the existing Tier II benefit structure or switching to a "cash balance" plan, which is a hybrid between a defined benefit plan and a defined contribution plan.
  - Here's how a cash balance plan works: TRS members and school districts would continue to pay an annual contribution and TRS would annually credit investment earnings of between 4 percent and 10 percent to each member.
  - While the contributions and investment earnings of all "cash balance members" would be commingled for investment purposes, each "cash balance" member would have an individual notional account on file with TRS that would be comprised of their individual contributions, school district contributions and investment income.
  - Upon retirement, TRS would calculate a guaranteed life-time annuity based solely on the money credited to each member's account and adjusted for estimated future investment earnings and the member's anticipated lifespan in retirement. The annuity continues even after money in the member's account is exhausted.
  - All new TRS members that begin service after the law takes effect will automatically be enrolled in the cash balance plan.

For all school districts:

- School districts would be responsible, beginning in 2014, for paying an increased share of the annual costs of TRS pensions and the state would pay less toward these costs. Eventually, school districts would be responsible for paying the entire annual cost of benefits being earned every year. In FY 2013, the annual cost of TRS pensions is approximately $900 million.

- Starting in 2014, the share of the annual cost paid by local school districts would increase by 0.5 percent each year until the total annual pension cost is paid by the districts.

For state government:

- If the state does not pay its annual contribution to TRS within a set period of time, TRS could go to court to force the state to pay the contribution in the same way that the Illinois Municipal Retirement Fund can force local governments to pay their contributions.
- The law is designed to make TRS 100 percent funded in 30 years.
- Once the outstanding pension obligation bonds are paid off, the money being used to retire that debt will be dedicated to paying off the TRS unfunded liability until that liability is retired, instead of funding the annual cost of pensions. In fiscal year 2013, the amount of TRS funds dedicated to paying off the bond debt is $347 million.

Ralph Martire Plan to Re-Amortize Illinois' Pension Debt Over 44 Years

Issue: In January, 2013, Ralph Martire, executive director of the Center for Tax and Budget Accountability, proposed a multi-year solution to the state's pension financing problem that would replace the current 30-year full-funding plan with a 44-year payment plan. Essentially, he wants to re-finance the pension "mortgage" to lower the annual payment.

Martire points out correctly that the biggest part of the pension problem is the $93 billion unfunded liability facing Teachers' Retirement System and the four other state pension funds. The TRS share of this unfunded liability alone is $53 billion. Two-thirds of the state's annual pension contribution is devoted to paying down the unfunded liability. The remainder is the actual cost of a year's pensions.

Answer: Martire's plan would "restructure" 90 percent of the $93 billion unfunded liability, or roughly $85 billion. All but 10 percent of the unfunded liability would be paid off by 2057, through equal annual contributions from state government. Martire estimates the payment would be approximately $6.9 billion every year for 44 years.

Currently, state law requires the government to pay off the pension systems' unfunded liability by 2044 in annual contributions. These contributions, however, increase in size annually between 2013 and 2044. For TRS, the annual state contribution in 2014 is scheduled to be $3.4 billion. It will increase by 170 percent over the next 31 years to $9.31 billion.

Legislators of both parties say that this continually rising "ramp" payment is too expensive and will be unaffordable in the future because it will re-direct money from other state budget priorities.

In 2011 legislative leaders investigated Martire's concept of lengthening the number of years the state could take to pay off the unfunded liability but rejected the idea as too expensive right now with current state tax resources.

In two ways, Martire's plan runs counter to the TRS Board of Trustees' resolution of 2012 that calls for an actuarially-sound plan to pay off the unfunded liability:

- Normal actuarial practice calls for a 30-year payment plan; and extending the payment period is just kicking the can further down the road – something the legislature already has done for years.
- Normal actuarial practice calls for pension system to be 100 percent funded – to carry no unfunded liability. By only paying off 90 percent of this debt, the Martire plan leaves an unfunded liability of 10 percent into the future.

The annual $6.9 billion pension payment envisioned under the Martire plan to pay off the unfunded liability would not cover all of the state's pension costs in any given year.

- Along with the annual payment toward the unfunded liability, the state also must pay the annual cost of pensions earned in that year. For TRS alone, that cost is roughly $1.1 billion in 2014 and it will grow to $3.1 billion by 2045.
- The state also would have to pay an annual amortized contribution to help pay off the 10 percent unfunded liability that is left over under the Martire plan, further increasing the state's total pension contribution.

One variation of the Martire plan to extend the payment period for the unfunded liability would be for the state to sell $85 billion in bonds and immediately pay off 90 percent of the system's unfunded liability. The state would then be left with an annual "hard debt," of $6.9 billion owed to bondholders.
This variation of the Martire plan would be a tough sell for two reasons:

- An $85 billion bond issue would dwarf the $26.6 billion in outstanding general obligation bonds that the state already has to pay off. The state's credit rating already is the lowest of any of the 50 states because of outstanding debts. The largest recent bond sale by the State of Illinois was $3.7 billion.
- The pool of potential bond buyers would be small – if there are any potential buyers at all – because of the high risk involved with loaning money to the State of Illinois.

Pension Reform - Senate Bill 2404 - "We Are One Illinois" Coalition Proposal

Issue: On December 19 the We Are One Illinois Coalition unveiled a proposal designed to help solve the state's public pension financial problems over the long term. Major aspects of this proposal have been introduced in the General Assembly as Senate Bill 2404, sponsored by State Sen. Linda Holmes, D-Aurora.

Answer: The We Are One Illinois Coalition's complete proposal included various state revenue increases of $2.348 billion to boost funding for TRS and the other public pension systems. The proposal focused on "shared sacrifice" from TRS members, Illinois taxpayers and state government.

Senate Bill 2404 only includes portions of the Coalition's proposal that create a funding guarantee in state law; make the state's funding of public pensions a contractual obligation of state government toward public employees; and increased salary contribution rates to TRS and the other public pensions systems. The bill requires the state to fund the pension systems in a manner that results in a 100 percent funding level by fiscal year 2045. The bill does not alter the current benefit structure for current retirees or active members.

TRS will not take a position either in support or in opposition to Senate Bill 2404 or the We Are One Illinois proposal.

$350 million annually in new revenue from active teachers and state employees

In Senate Bill 2404, new revenue would be generated by increasing payroll contributions for active TRS members and state employees in the State Employees Retirement System, the State Universities Retirement System, Judges' Retirement System and General Assembly Retirement System. TRS members alone would contribute $200 million each year, or 57 percent of the annual total.

The TRS contribution rate for active teachers would climb from the current 9.4 percent to 10.4 percent in the first year after enactment and to 11.4 percent in the second year. Active TRS

members contributed $917.6 million to the System in fiscal year 2012.

Active members in SERS, SURS, JRS and GARS also would pay an extra 2 percent in member contributions. Active SERS members currently contribute 8 percent of their pay; active SURS members currently contribute 8 percent; active JRS members currently contribute 11 percent; and active GARS members currently contribute 11.5 percent.

A funding guarantee in state law
The main reason the TRS funding level is only 42 percent is because state government has never funded the System at levels that an actuary would say required to cover all long-term obligations. Since 1970, this funding shortfall to TRS totals $30 billion.

The We Are One proposal calls for a new state law that guarantees the state will make an actuarially required contribution to TRS every year.

In Illinois, only pension benefits for members are protected as a contractual right by the state constitution. In other states, both pension benefits and state contributions to help fund the benefits are guaranteed as contractual rights for members. We Are One wants a similar contractual protection for contributions to TRS and the other state systems.

The Illinois Municipal Retirement Fund is the only statewide pension system that currently has a legal guarantee of funding (from local governments) and the IMRF funded ratio is 83 percent.

Under Senate Bill 2404, if the state does not pay its annual contribution to TRS within a set period of time, TRS could go to court to force the state to pay the contribution in the same way that the IMRF can force local governments to pay their contributions.

Facing Old Problems of Pension Funding and the Foundation of Pension Reform

Issue: The TRS Board of Trustees on March 30, 2012 approved a resolution which acknowledges that due to changing circumstances that call into question the General Assembly's ability to meet the existing plan to fund TRS, drastic changes are needed to maintain the long-term viability of TRS and the other state pension systems.

Answer: The Trustees directed TRS Executive Director Dick Ingram to inform TRS members, organized labor, legislators and other government officials that growing state budget deficits over the next five years could lead to insolvency for TRS in as little as 18 years, unless meaningful changes are made in the pension funding mechanism. There are five key elements to "meaningful" pension reform.

According to projections from TRS and other sources, the state's backlog of unpaid bills is expected to grow from $9.2 billion this year to $34.8 billion by fiscal year 2017. Pension costs are expected to grow by 35 percent during the period of time to $7.8 billion.

This bad budget news is putting real pressure on legislators to make substantial cuts in the state's $53 billion budget; now and in the future. One target many legislators have mentioned is a reduction in the statutorily-required contribution to the state's pension systems. (The TRS share of that contribution is $2.7 billion.)

Up until 2012, TRS always operated under the assumption that state government will follow the law and make its entire payment. We no longer can count on this assumption and it is more likely that the General Assembly will change the law to lower the statutorily-required contribution.

If the state cuts its contribution to TRS in the future, sample "stress test" scenarios show that

under the worst option TRS would become insolvent in 2030 when benefit obligations would exceed assets. Under the best option TRS is solvent until 2049. Here are the three sample stress tests:

- The TRS FY 2012 contribution grows by 3% each year for 37 years
  - TRS is insolvent in 2049 ($2.9 billion deficit)
- The TRS FY 2012 contribution of $2.4 billion is frozen at that level for 37 years
  - TRS is insolvent in 2038 ($8.4 billion deficit)
- The FY 2012 contribution is cut to 60% of the original level and stays frozen at $1.4 billion for 37 years
  - TRS is insolvent in 2030 ($434 million deficit)

In order to keep TRS solvent over the long-term, meaningful pension reform must be enacted to better balance expected revenues and anticipated benefit costs. The three key elements to pension reform are:

1) **Use only actuarially-based math to determine contributions and liabilities.** The Illinois pension math dictated in the pension code artificially lowers the state's cost of funding pensions. These laws supersede the true calculation of the state's annual pension contribution. We need to calculate the cost in the way the rest of the world does it. Here is a breakdown of the differences:

Illinois Political Math

- The state's goal would be to have only 90 percent of the assets on hand to pay all future obligations and maintain a 10 percent unfunded liability
- The state's annual contribution is reduced each year by the amount of debt service needed to pay off the bonds sold over the course of the last decade to finance the state's annual contribution
- The state's goal is to reach 90 percent funding in 50 years
- Future savings over several decades from reform measures are counted now before they are actually realized
- Total price tag for fiscal year 2013: $2.7 billion

Standard Actuarial Math

- The state's goal would be to retire the unfunded liability and have 100 percent of the assets on hand to pay all future obligations
- The state's annual contribution is not reduced each year by the amount of debt service needed to pay off the bonds sold over the course of the last decade to finance the state's annual contribution
- Obligations are amortized over a 30 year period
- The annual cost of pensions to the state is based on what is needed to fund pensions now
- Total price tag for fiscal year 2013: $3.8 billion

2) **Illinois must enact funding guarantees for the pension systems into law.** A statutory funding guarantee would ensure that all future state government contributions are made in full when they are due. Most other states operate with these guarantees and in Illinois the Illinois Municipal Retirement Fund benefits from this type of mandated payments.

3) **The financial inequities of the Tier II funding and benefit structure must be fixed.** Current law requires Tier II members to pay 9.4 percent of salary and that subsidizes both Tier I and Tier II benefits. The Tier II contribution is 50 percent higher than the benefit's value, which

is 6 percent of their pay. In 20 years, when Tier II members are a majority in TRS, the subsidy they pay cause a reduction in the state's annual contribution. Eventually, the state will not owe any annual contribution to TRS because the members will be paying the entire cost. This is fundamentally unfair to Tier II members.

4) **Any solution enacted by the General Assembly must be uncomplicated and easy to understand and administer.**

5) **Any solution must adhere to the Illinois Constitution's Pension Protection Clause.** Article XIII, Section 5 of the Illinois Constitution reads: "Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired."

Extending the Illinois Income Tax to Pensions and Retirement Income

Issue: Currently, Illinois citizens do not have to pay Illinois income tax on pensions and other retirement income. Legislative leaders have discussed changing the law to extend the income tax to pensions and all retirement income.

Answer: No legislation has been drafted yet, but initial suggestions called for taxing pensions at 5 percent – which is the current state individual tax rate. He estimated that extending the income tax to retirement income would raise $1.6 billion annually for the state. Any extension of the income tax would exempt "modest pensions," but that has yet to be defined.

TRS has not seen any specific language so it is difficult to analyze the concept. However, it is likely that extending the income tax to retirement income would be challenged in court. Taxing pensions and retirement income also will be very difficult to pass in the legislature because seniors are a large, active group of voters and they do go to the polls.

TRS cannot predict what the courts may do, but it is likely that extending the income tax to pensions is constitutional and would not violate the pension protection clause of the Illinois Constitution. Taxing pensions does not diminish or impair the benefit teachers and public employees receive, it is a tax on that benefit. In a practical sense, taxing pensions does diminish the retirement benefit. Legally, however, it would not be a diminishment.

Placing Illinois Teachers in Social Security

Issue: Requiring newly-hired Illinois teachers to become part of Social Security would help ease the burden on TRS, lower the state's contribution to public pension systems, help ease the long-term financial problems facing Social Security, and create more income stability for retired teachers.

Answer: Making newly-hired teachers pay into Social Security and allowing them to be eligible for benefits would affect all current and retired teachers.

Illinois teachers have never been part of the Social Security system. Most teachers rely almost solely on a TRS pension during retirement. Active teachers contribute 9.4 percent of their paycheck to help fund TRS and school districts contribute 0.58 percent of every teacher's salary to the System. Last year, all told, teachers contributed $917 million to TRS and school districts contributed $155 million.

For new teachers to become part of Social Security this scenario would mean a mandatory 12.4 percent payroll deduction split evenly between the member and the employer, which in the case

of Illinois teachers is school districts and state government. Teachers would still be required to contribute 9.4 percent of salary to TRS.

For school districts, the cost of teacher pensions would immediately rise by a considerable amount. Instead of contributing 0.58 percent per new teacher, every district would have to contribute 6.2 percent per teacher. It is estimated that this increased cost would equal $41 million for Illinois school districts in the first year and more than $2.4 billion over 10 years. Plus, districts would still have to contribute 0.58 percent for each participant in the current system.

Finally, a 1999 study by the General Accounting Office found that adding teachers and other public employers from around the country who are not currently in Social Security would create, at best, a temporary surge in revenue for Social Security. Over the long term, adding teachers to Social Security would only increase the System's total obligations and deepen the long-term funding problem.

Public Schools Paying More of the "Normal Cost" of Teacher Pensions

Issue: This proposal would require all school districts outside of the City of Chicago to pay a greater share of the cost of pensions for TRS members.

Answer: Currently active teachers, school districts and state government split the cost of what is owed this year to retired TRS members, as well as the cost of benefits for future retirees. These contributions are supplemented by TRS investment income. The proposal would not affect teacher contributions, but would require school districts to pay a greater share of the pension cost due each year – what is called the the "normal cost" – alleviating the state from paying current costs. The state would be responsible only for the future cost of TRS pensions. Estimates indicate that in fiscal year 2012, annual school district contributions would have risen from a total of $155 million per year to more that $800 million per year, while the state's annual contribution would drop from $2.4 billion to $1.6 billion.

House Speaker Michael Madigan, D-Chicago and Senate President John Cullerton, D-Chicago, have said they do not believe it is fair that suburban and downstate school districts do not pay more of what is owed in a given year to retired teachers. They note that in the City of Chicago, a larger share of the annual cost of teacher pensions each year is funded by a property tax levy in the city – about 18.6 percent, compared to 2.3 percent in the rest of the state. Under legislation proposed in the spring of 2012, suburban and downstate school districts would be responsible, beginning in 2014, for paying an increased share of the annual costs of TRS pensions and the state would pay less toward these costs. Eventually, school districts would be responsible for paying the entire annual cost of benefits being earned every year.

Shifting the annual cost of pensions to local governments does nothing to lower costs for taxpayers. The proposal is just a transfer of responsibility for pensions costs from a larger group of taxpayers to a smaller group of taxpayers. The cost of the pensions remains the same. The shift means that the annual cost of pensions for a particular school district's teachers would not be spread out statewide among millions of taxpayers, but only spread among thousands of people who live in that school district, much like the way municipalities pay for the pension costs for police and firefighters.

Under the latest proposal, between 2014 and 2019, the share of the annual cost paid by local school districts would increase by 1 percent each year and then by 0.5 percent in each year after 2019 until the total annual pension cost is paid by the districts.

Pension Reform Proposals – Amendments to House Bills 1154, 1165 and 1166

Issue: Four proposals designed to improve the finances of TRS and the state's pension systems were introduced on February 28, 2013 in the Illinois House for debate. The measures, sponsored by House Speaker Michael Madigan, would reduce retirement benefits or increase active member contributions in order to cut the state's future pension liabilities.

TRS will not take a position on any of these proposals. It is the legislature's job to dictate the laws and rules that govern TRS and other public pension systems. The job of TRS is to administer those laws and work to secure the System's finances so that the promises made to generations of teachers by the General Assembly can be kept.

Answer: These proposals were overwhelmingly rejected on the floor of the House of Representatives.

House Bill 1154

Amendment 1 – Eliminate all future cost of living increases for all TRS member in Tier 1; either active or retired. TRS would continue to pay any COLA that members already have received.

- For TRS, a rough estimate indicates that eliminating future COLAs trims about $19 billion off of the System's total projected liability of $91.5 billion, as well as the unfunded liability of $53 billion. The System's funded status improves from the current 42.1 percent to 53.1 percent.
- The loss of the COLA would negatively affect the future of all TRS members because their pensions would not increase at all to counter any future increases in the cost of living.

Amendment 2 – No future COLA for all Tier 1 members in retirement until the TRS funded ratio reaches 80 percent. The current TRS funded ratio is 42.1 percent. TRS would continue to pay any COLA that members already have received.

- For TRS, suspending the COLA would likely increase the funded ratio to just over 50 percent. It would likely take about 20-25 years before the TRS funded ratio reached 80 percent. This means most current TRS retirees would not get another COLA. Future retirees would in theory start getting a COLA in 20 to 25 years.
- The suspension of the COLA would negatively affect the future of all TRS members because their pensions would not increase at all for two decades to counter any future increases in the cost of living.

House Bill 1165

Amendment 1 – Increase the Tier 1 retirement age to 67 from 60. Tier 1 members could retire at age 62 with a reduction in their pension of 0.5 percent for each month that the member is under age 67. For example, a member retiring at age 62 would receive a pension reduced by 30 percent from a "full" pension earned by the member.

- For TRS, this change would reduce the System's unfunded liability by anywhere between $7 billion and $11 billion based on the number of members that "run for the door." (members that are eligible to retire under the old law who do retire under the old law before the new retirement age is effective) If all eligible members retire before the change, the unfunded liability drops by $7 billion. If no eligible members retire, the unfunded liability drops by $11 billion.
- The proposal would save state government's contributions to TRS by $61.5 billion over the next 30 years and reduce the state's total commitment to all five public pension systems by $81.6 billion.

House Bill 1166

Amendment 1 – Increase the salary contribution of TRS active members in Tier 1 by 5 percentage points, from 9.4 percent to 14.4 percent.

- Tier 1 member contributions would increase by about $10 billion over 30 years.
- The increase in active member contributions would result in a proportionately larger reduction in the state's contribution over the next 30 years. The state's total payments through 2045 would be lowered by approximately $16 billion to $17 billion.
- This proposal would not greatly affect the TRS unfunded liability because the proposal just shifts the source of some TRS funds from state government to TRS members.