Pension Modernization Task Force

- **Submitted by Will Lovett, Illinois Education Association**

Opening Statement:

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

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

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

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

Recommendations for the Benefits Subcommittee:

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

Recommendations for the Funding Subcommittee:

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

Recommendations for the Investment Subcommittee:

- Recommendation: None.

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

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

Recommendations for the Benefits Subcommittee:

Recommendation: Reconstitute the Pension Laws Commission.

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

Background

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

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

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

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

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

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

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

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

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

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

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

[1] Social Security costs are included when applicable.

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

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

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

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

Conclusion

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

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

[1] Social Security costs are included when applicable.

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

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

Recommendations for the Funding Subcommittee:

Recommendation: Encourage the General Assembly to seek new revenue.

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

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

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

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

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

Recommendation: State should adhere to current funding plan.

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

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

Background

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

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

However, since the implementation of the 1995 funding plan the state has taken two "pension holidays" and relied on pension obligation bonds and pension notes to alleviate the strain on the state budget caused by the unfunded pension liability. This coupled with the recent volatility of the investment markets has forced the state to contribute an additional billion dollars from the previous fiscal year.

<u>Recommendation: COGFA should continue to study asset-transfers.</u>

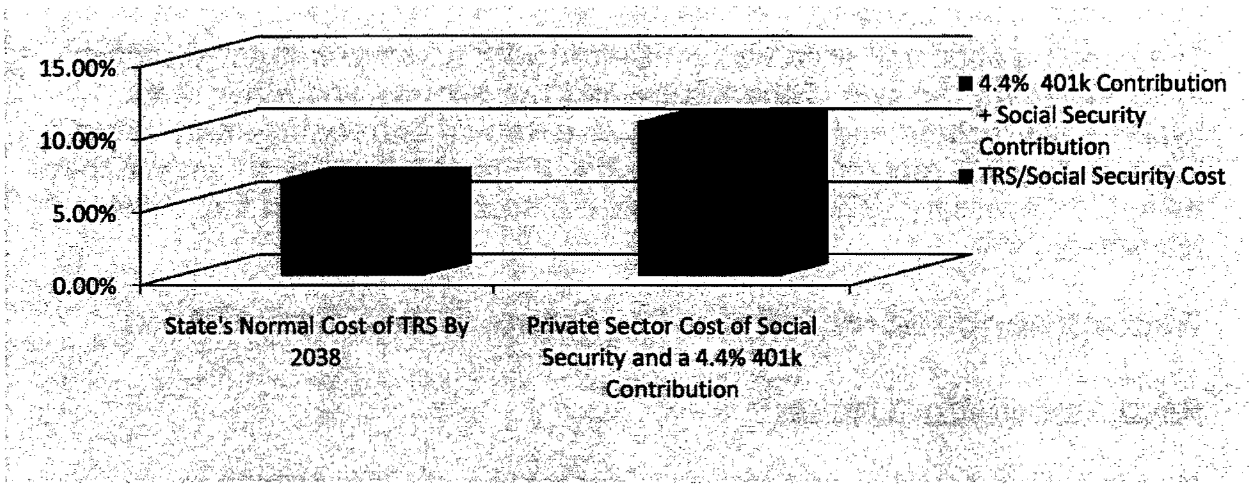
The Funding subcommittee was presented with numerous asset-transfer ideas including the sale of the lottery and the toll way and other state assets. We recommend COGFA analyze data and thoroughly study these ideas to present recommendations to the General Assembly to ensure they have the necessary information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

Recommendations for the Investment Subcommittee:

<u>Recommendation: None.</u>

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

COMPARISON OF PRIVATE SECTOR COST TO STATE'S NORMAL COST



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

TRS Employer Normal Cost, FY 2009 - FY 2045

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

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

Apples to Apples
Neighboring State's Total Retirement Costs

Excluding Cost of Unfunded Liabilities

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

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

Indiana's Cost for Retirement Benefits Including **Social Security**: 6.2%+6.65%=**12.85%**

Iowa's Cost for Retirement Benefits Including **Social Security**: 6.2%+8.04%=**14.24%**

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

Michigan's Annual Cost for Retirement Benefits Including **Social Security**: 6.2%+5.6%=**11.8%**

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

Wisconsin's Annual Cost for Retirement Benefits Including **Social Security**: 6.2%+4.5%=**10.6%**

Illinois Teachers Compared to our Neighbors

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

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

FOR IMMEDIATE RELEASE APPENDIX E

PSCA RELEASES 51st ANNUAL SURVEY OF PROFIT SHARING AND 401(k) PLANS

NEW SURVEY SHOWS GREATER USE OF AUTOMATIC ENROLLMENT AND HIGHER PARTICIPATION RATES

9/25/2008

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

"The trend toward greater sponsor involvement in plans continues," said David Wray, president of PSCA. "The increase in the number of companies utilizing automatic enrollment continues to be strong. It is encouraging that participation continues to climb, due in part to the increase in automatic enrollment."

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

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

Below are some highlights from the survey:

Automatic Enrollment

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

Asset Allocation

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

Catch-up Contribution

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

Company Contributions

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

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

Investment Fund Structure - NEW

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

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

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

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

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

PSCA's *51st Annual Survey of Profit Sharing and 401(k) Plans* is available for purchase for $375 for non-PSCA members and $145 for members. Order online or call (312) 419-1863.
****About the Profit Sharing/401k Council of America****

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