



THE GOVERNOR'S PENSION COMMISSION

Pension Reform Report and Recommendations

(including Summary of May 2004 Interim Report)

February 11, 2005

THE GOVERNOR’S PENSION COMMISSION:
PENSION REFORM REPORT AND RECOMMENDATIONS
FOR GOVERNOR ROD BLAGOJEVICH

February 11, 2005

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EXECUTIVE SUMMARY

The Governor's Pension Commission was mandated by Governor Rod Blagojevich to review the financial condition of the State of Illinois' Retirement Systems and make recommendations focused on improving the Systems' financial condition and affordability. The Commission's recommendations do not affect earned pension benefits of current State employees or pension benefits being received by current retirees.

The Commission has studied the causes of the Retirement Systems' current underfunded position, the pension plan provisions, the use of Pension Obligation Bonds, other types of pension plans, alternative funding formulas, and related issues. The Commission established a set of guiding principles for State pension funding. Based on those principles, it developed specific recommendations for changes to State pension plan provisions and pension funding in order to ameliorate the Retirement Systems' poor financial status.

Initial estimates from the Retirement Systems' actuaries and consultants from Deloitte Consulting LLP indicate that implementing some of the Commission's recommendations could reduce the Retirement Systems' actuarial accrued liability in 2045 by \$145.5 billion, or 28%, from \$521.5 billion to \$376.0 billion. Additionally, the total expected State contribution for 2006-2045 could be reduced by \$54.2 billion, or 20%, from \$275.1 billion to \$220.9 billion.

I. INTRODUCTION

The Illinois Retirement Systems currently provide pension benefits to approximately 647,000 members in five retirement systems. Over the past thirty years, the State has funded pensions significantly below necessary contribution levels each year, and has added pension benefits without sufficient dollars set aside to pay for these benefits. The combination of these factors has caused the retirement systems to be in a severely underfunded position. As a result, the State's underfunded pension liabilities are significantly greater than those of any other state, as reflected in the following chart:

State	2003 Unfunded Liabilities (\$ millions)	Rank
Texas	\$22,613	46 th
California	25,545	47 th
New York	28,302	48 th
Ohio	29,650	49 th
ILLINOIS	\$43,104	50th

Source: Wilshire Associates 2004

The State of Illinois issued \$10 billion of Pension Obligation Bonds in June of 2003 to reduce its funds' increasing liabilities. Proceeds from the bond sales provided the balance of fiscal year 2003 and 2004 State pension contributions in the amount of \$2.16 billion, as well as an additional immediate contribution of over \$7.3 billion toward reducing the five public employee retirement systems' unfunded liabilities. The infusion of \$7.3 billion on July 3, 2003 reduced the retirement systems' unfunded liability from \$43 billion to approximately \$34 billion, and increased the funded ratio from 48.6 percent on June 30, 2003 to over 57 percent just three days later.

Despite the positive effects of the \$10 billion pension obligation bond revenues on the funding status of the retirement systems, the State pension funds still face grave financial challenges. In fact, Illinois State government's unfunded pension debt is significantly greater than all of the State's bonded debt combined. Governor Rod Blagojevich convened the Governor's Pension Commission in the spring of 2004 in order to address continuing concerns over the long-term liabilities of the State's five pension systems.

II. THE PENSION COMMISSION MANDATE AND HISTORY

Governor Blagojevich's mandate to the Pension Commission is:

To review the financial condition of the Illinois State Pension Systems and provide recommendations for improving their financial condition. Areas for consideration include:

- The amount and growth of the retirement systems' unfunded liabilities;
- Current and future employee pension plans and contribution structures;
- and
- The effect of the pension funds' financial condition on the State's overall current and future financial condition.

Recommendations should focus on improving the affordability of the State's retirement systems.

The Governor's Pension Commission met six times between April 16 and May 24, 2004, to focus on near-term State funding of pension liabilities. The members of that iteration of the Pension Commission unanimously agreed that an adequate analysis of the

important public policy issue of unfunded State pension obligations must consider benefit and contribution changes as well as funding strategies. However, in the interest of producing timely recommendations on immediate funding issue, and given the Commission's desire not to interfere with on-going collective bargaining negotiations, it was decided to issue an interim report on near-term funding strategy in May 2004.¹

III. CURRENT COMMISSION MEMBERSHIP

Membership in the Governor's Pension Commission (the "Commission") consists of the following individuals:

- The Honorable Roland Burris, Interim Chair, is a partner in Burris, Wright, Slaughter & Tom, LLC has held numerous offices in Illinois including Comptroller and Attorney General;
- *Representative Mark Beaubien represents Illinois' 52nd District and is the Budget Negotiator for the House Republicans;
- Representative Rich Bradley represents Illinois' 40th District and is the Chairman of the House Personnel and Pensions Committee;
- Senator Bill Brady represents Illinois' 44th District and is the Minority Spokesperson of the Senate Insurance and Pensions & Investments Committees;
- Andy Davis is Chairman and CEO of Rock Island Company of Chicago, and the Vice-Chairman of the Chicago Stock Exchange;

¹ A summary of the Interim Report is attached in Appendix A.

- Ronald Denard is Vice President of Finance and Administration at SoftSheen-Carson, a L'OREAL USA Company;
- Eric Langshur is President and Chief Executive Office of TLContact Inc. and the former President of Bombardier Aerospace CAS;
- *Representative Bob Molaro represents Illinois' 21st District and was Chairman of the former Pension Laws Commission;
- Laurence Msall is President of The Civic Federation;
- Ronald Powell is President of United Food and Commercial Workers #881 and Vice President of United Food and Commercial Workers International;
- Gerald Roper is President and Chief Executive Officer of the Chicagoland Chamber of Commerce;
- *Senator Jeff Schoenberg represents Illinois' 9th District and is Chairman of the Senate Appropriations II Committee, Vice Chairman of the Senate Appropriations III Committee and is Co-Chair of the Commission on Government Forecasting and Accountability (former IEFC); and
- Paula Wolff is a Senior Executive at Chicago Metropolis 2020.

* Denotes current members of the Commission on Government Forecasting and Accountability (formerly Illinois Economic and Fiscal Commission).

IV. STRUCTURE OF THIS REPORT

The next five sections of this report outline the Commission's analysis and recommendations. Section V provides an overview of the pension systems and the causes of the current underfunding situation. Section VI details the principles that guided

this Commission's work. Section VII discusses the Commission's recommended changes to pension plan provisions and Section VIII discusses the Commission's recommended changes to pension funding. The Commission also reviewed the use of Pension Obligation Bonds, other types of pension plans and alternative funding formulas, which are discussed in Sections IX and X.

V. OVERVIEW OF THE PENSION SYSTEMS AND FUNDING PROBLEMS

The Retirement Systems of Illinois consist of five distinct plans, which have accrued liabilities of approximately \$90 billion as of June 30, 2004. Three of these plans represent over 98% of the State's pension liabilities: the Teachers' Retirement System ("TRS"), State Universities Retirement System ("SURS") and the State Employees' Retirement System ("SERS"). As of June 30, 2004, TRS accounted for \$50.9 billion in estimated liabilities (\$19.4 billion of which was unfunded); SURS \$19.1 billion (\$6.5 billion of which was unfunded); and SERS, \$18.4 billion (\$8.4 billion of which was unfunded). The other two plans, the General Assembly Retirement System ("GARS"), \$0.2 billion (\$0.1 billion of which was unfunded) and the Judges Retirement System ("JRS") \$1.2 billion (\$0.6 billion of which was unfunded), have generated relatively small obligations. State funding payments are currently determined by the 1995 funding law described below and the 2002 Early Retirement Incentive ("ERI") program.

The 1995 Funding Law

By 1995, the retirement systems' unfunded liability had grown to approximately \$20 billion. Public Act 88-593 (the "1995 law") made a number of changes to public

employee pensions, the most significant of which was the adoption of a funding schedule. The General Assembly established a funding ratio objective of 90% of liabilities for the State funded retirement systems, to be achieved by 2045. From FY2011 through FY2045, the required contribution would be a level percent of payroll required to reach 90% funding by FY2045. For FY1996 through FY2010, the contribution percent would increase in equal increments to the rate required in FY2011.

The Causes of the Current Underfunding Situation

The Commission has identified and analyzed several factors and their relationship to the current underfunding of the State pension systems, noting the following:

- For each of the past thirty years, annual State contributions have been less than the necessary amount (the interest and current costs) determined by the retirement systems' actuaries. Since 1995, and through June 2003, the contribution shortfall totaled \$10.6 billion. This increased the amount of underfunding;
- The State increased pension benefits by \$5.8 billion since 1995, and through June 2003, without introducing sufficient funding to pay the related costs. This also increased the amount of underfunding;
- The employees within the various State pension systems have met their obligations by paying the contributions as determined in accordance with the Illinois Pension Code;
- Since 1995, and through June 2003, the State pension funds experienced investment losses of \$6.4 billion;

- After implementation of the 1995 law, annual funding decisions adhered to a fixed, ramped-up payment schedule, but did not adjust for the cyclical opportunity provided by the long 1990s economic expansion to contribute in excess of the fixed payment amounts provided for in the 1995 funding law; and
- State pensions were under-funded in an exceptionally strong economic environment, while benefits – most notably, costly increased benefits included in the 2002 Early Retirement Incentive program and, also, enhanced benefits formulas – were added. A downturn in the economy followed the expansion, and pension systems’ earnings declined while costs of new benefits increased.

As a result of the above, the unfunded liability grew to \$43 billion by June of 2003.

Additional factors that contributed to the growth in unfunded liabilities include:

- The gradual extension by the State of the Alternative (enhanced) Formula to approximately 5,380 employees brought the total number of employees covered by the Alternative Formula to 24,845, thus increasing liabilities;
- Significant market upturns since 1995 followed by downturns resulted in reduced investment returns, thus increasing unfunded liabilities; and
- The 2002 Early Retirement Initiative increased liabilities and certified contributions.

VI. GUIDING COMMISSION PRINCIPLES

The Commission emphasized that pension funding decisions should be consistent with fundamental values of the people of Illinois and the capacity of the State economy to prosper, adopting the following principles:

- The State must fully honor its pension obligations;
- Under no circumstance should pension payments be deferred;
- The availability of State revenues is impacted by the stages of the business cycle, and pension funding decisions should be adjusted accordingly;
- Pension funding decisions must take into account the feedback between those decisions and Illinois' economic growth;
- Pension-funding choices should not damage State creditworthiness and its capacity to raise funds in capital markets. Unfunded Illinois pension benefits are real state liabilities that directly impact the State's creditworthiness and are greater than the State's bonded debt for all other purposes;
- The State pension systems are currently significantly underfunded. State government must address this issue;
- Any new benefits must have new funding sources to support them when enacted;
- Changes should be designed to simplify the systems and be applied equally to all systems where applicable that are the responsibility of the State of Illinois;
- Changes must be in compliance with Illinois' Constitutional provisions regarding pension benefits;
- The use of Pension Obligation Bonds must be limited to alleviating past underfunding;
- Local employer pension enhancement decisions that impact state resources must adhere to principles incorporated in State law and be paid for by the employing entities; and

- An on-going Pension Commission should be created, staffed by the Governor's Office of Management and Budget, to serve as a review mechanism for all suggested changes to pension laws.

VII. CHANGES IN PENSION PLAN PROVISIONS

When reviewing potential changes to employee pension plans, the Commission felt it important to again note that the current underfunding is not the fault of the State employees -- the employees within the various State pension systems have always paid their contributions in accordance with the Illinois Pension Code. To that end, the Commission's recommendations do not affect earned pension benefits of current State employees or pension benefits being received by current retirees.

Although the Commissioners agree with the conclusions of various actuaries that many of the basic benefits to State employees under the pension systems are comparable with national public retirement systems norms, there are certain provisions that are not consistent with general public retirement system practices. Therefore, the Commission recommends consideration of the following changes to pension plan provisions.

Estimated savings attributable to pension plan changes below are included in Appendix B. These changes could reduce the Retirement Systems' actuarially accrued liability in 2045 by up to \$145 billion and reduce the total expected State contributions between FY2006 through FY2045 by up to \$54 billion:

- 1) The General Assembly must not adopt any new pension benefit without a new funding source identified at the point of adoption. In addition, an explicit sunset provision must be attached to any new pension benefit;
- 2) For purposes of State pension liability, pay increases in the final average period of employment should be limited as determined by the Governor and the General Assembly, unless fully funded by the local employer or employee. A possible limitation on pay increases in the final average period of employment for purposes of pension liability would be limited to 5%;
- 3) Eliminate the money purchase pension plan option under SURS, for new hires only;
- 4) Define more precisely the rate of interest applied to the current money purchase option under SURS. Using the long-term rate of return, but not to exceed the most recent five-and ten-year rates of return, reduce the interest rate on money purchase for current participants to 6%;
- 5) Increase the eligibility requirements for new employees to receive unreduced benefits by changing the minimum age to 65 with 8 years of service;
- 6) Limit automatic annual pension increases for new hires only to 2%, limited to the first \$12,000 of annual pension for members covered by Social Security and \$24,000 for members not covered by Social Security;
- 7) Limit employee groups eligible for Alternative (enhanced) Retirement Formula benefits, for new hires only to Sworn Police Officers only;
- 8) Increase the employee contribution rate for those employees receiving alternative retirement formula benefits; and
- 9) Increase employee contributions to the SERS, SURS, TRS, JRS and GARS by 1%.

Additional options can be found in Appendix C. Estimates of these options have not been provided as of the date of this report. Upon receiving estimates, the Commission may issue a supplemental report regarding these options.

VIII. CHANGES IN PENSION FUNDING

The Commission recommends that the 1995 law be revisited and analyzed for potential revisions, and that any changes to the 1995 law should be reviewed annually. When crafting the 1995 legislation, the members of the General Assembly along with the actuaries were making assumptions 50 years into the future. Additionally, the 1995 law stated that that law would be reviewed and adjusted every five years.

As a result, the Commission urges that if the General Assembly were to implement the \$52 billion in savings identified in Section VII, or some significant portion thereof, the Commission would support the following changes to the 1995 law. It is critical to note, however, that under no circumstances does the Commission support disregarding any payments into the State pension systems.

Specific options, recommendations and observations for changes in funding include:

1. The 1995 funding plan should be amended to reflect the \$146 billion reduction in accrued liabilities \$54 billion in reduced State contributions resulting from the recommended pension plan changes outlined in the previous section.

2. Consistent with the 1995 funding plan, the revised funding plan should incorporate the following principles:
 - a. Reflect the 1995 funding plan's goal of a 90% funded ratio by 2045;
 - b. Provide for a ramping of contributions to a constant percent of payroll by 2011 (and including the 2002 ERI amendment to the 1995 funding plan);
and
 - c. Provide for continuing appropriation authority for pension contributions.
3. Any savings produced by the proposed pension plan changes, or any significant portion thereof, should be proportionately allocated for the required contributions from 2006 through 2045, and should parallel to the existing funding structure.

Reflecting the pension plan changes and savings recommended in this report, and applying the guidelines in paragraphs 1 and 2 above, the Commission hereby recommends the attached representative example of the revised funding plan presented as Appendix D.

IX. PENSION OBLIGATION BONDS

In 2003, Pension Obligation Bonds (“POBs”) were issued to help fund the State pension systems. Notwithstanding anything else in this report, the Commission recommends that the issuance of additional POBs be explored as a viable option contingent upon the following:

- POBs should not be issued until and unless there are structural changes made to the pension plans similar to those recommended in Section VII of this report ; and
- All POB proceeds should be used to reduce the unfunded liability.

The Commission presents two possible uses of POBs:

- To correspond with the amount and duration of the liability created by the Early Retirement Initiative of 2002; and
- To reduce unfunded pension obligations if market conditions are favorable and would sustain such an issuance.

X. ADDITIONAL TOPICS FOR ANALYSIS

The Governor's Pension Commission continues to study the concepts of defined contribution plans and dynamic scoring, described below. It is also gathering data to estimate the financial impact of those options listed in Section XII for which savings estimates were not yet available. The Commission will forward its findings to Governor Blagojevich when they become available.

Defined Contribution Plans

The Commission considered an option recommending that the State replace all or part of its current Defined Benefit plans with Defined Contribution plans. However, the Commission strongly believes that this concept will require additional study. Defined contribution plans can significantly reduce unfunded liabilities. Once the State gets the current pension debt levels under control, a Defined Contribution Plan should be strongly considered in the near term for newly hired employees and current employees who voluntarily opt out of defined benefit programs.

Alternative Funding Formulas

Capital and population are mobile, seeking their most advantageous location, especially within an area with a common currency. Illinois, as a result, is in constant competition

with other States for jobs and economic growth. State fiscal policy choices must take into account the feedback between its tax and spending decisions and economic growth.

In the 1990's, when the Illinois economy was strong and revenues were robust, the State failed to direct additional revenues towards the underfunding of the State pension systems to remedy the problem and close the underfunding gap. The Commission heard testimony and discussed principles relating to structuring a mechanism to ensure that there is an overfunding of the State pension systems when the Illinois business cycle is more prosperous. Diane Swonk, Chief Economist of Mesirow Financial and former Chief Economist of Bank One twice appeared before the Pension Commission to discuss the Principle of Dynamic Scoring.

Ms. Swonk explained that overfunding of the pension systems should occur during robust economic times to counter less funding during periods of an economic downturn.

However, Ms. Swonk withheld endorsing specific triggers that should precipitate the State's overfunding of the systems. The Commission agrees that the Governor and the General Assembly should make pension funding decisions which are adjusted if and when revenues are impacted by the stages of the business cycle. However, specific economic triggers that would result in the funding adjustments should be explored further. When State revenues exceed the previous year's revenues, the State should utilize a prescribed percentage to pay more into funding the pension systems.

Conversely, it is critical to establish a funding floor so that a minimum amount is always contributed towards the systems, even during down economic periods.

Finally, Mr. James Hacking, Executor Director of the State Universities Employment System, introduced a reserve concept similar to the State's Rainy Day Fund. Mr. Hacking's reserve concept basically stated that if, just prior to the start of any state fiscal year the estimated general funds revenues for the next succeeding state fiscal year exceed the current fiscal year's estimated general funds revenues by more than 4%, then a portion of that amount of the general funds revenues, reduced by any amount that is required by law to be transferred to the Budget Stabilization Fund, shall be distributed to the five state contributory retirement systems.

APPENDIX A

The May 2004 Interim Report of the Pension Commission made the following recommendations:

The proposed FY2005 budget funds \$2 billion of the \$2.5 billion mandated State payment to the pension funds out of general revenue. To fund the remaining \$0.5 billion FY2005 obligation, ten out of the eleven total members of the Commission identified four options that can be used singly or in combination:

- Use part of the better-than-expected present-value savings that resulted from the extraordinarily beneficial market interest rates when the 2003 Pension Obligation Bonds were sold;
- Execute another Pension Obligation Bond program to take advantage of market interest rates that are still significantly below expected longer-term asset yields;
- Reschedule the funding mandated in the Early Retirement Incentive program to make it more in line with other State pension funding; and/or
- Fund the remaining contribution out of general revenues.

Note: Commissioner Laurence Msall filed a dissenting report relating to the May 2004 Interim Report, however, he fully supports the Commission's overall findings as reflected in this consolidated February 11, 2005 Pension Reform Report and Recommendations.

APPENDIX B

CHANGES IN PENSION PLAN PROVISIONS

Options Selected for Consideration

Draft estimates have been provided by the Retirement Systems' actuaries and consultants from Deloitte Consulting LLP. Both the total accrued pension liability reductions (\$145 billion) and total expected State contribution reductions (\$54 billion) are as stated in Section VII of the Report for the below combination of options. However, the actuaries and consultants caution that the individual draft projections for each of the below recommendations are interdependent upon one another and will vary depending on which combination of recommendations are adopted. Therefore, the individual draft projections for each of the below recommendations are presented for illustrative purposes only, while the total liability reductions and contribution reductions remain as stated in Section VII of the Report. In addition, variations of those changes will not necessarily produce similar results.

- 1) The General Assembly must not adopt any new pension benefit without a new funding source identified at the point of adoption. In addition, an explicit sunset provision must be attached to any new pension benefit;

- 2) For purposes of State pension liability, pay increases in the final average period of employment should be limited as determined by the Governor and the General Assembly, unless fully funded by the local employer or employee. Possible limitations on pay increases in the final period of employment include:

Limit increases to 5%. This is estimated to reduce accrued liabilities in the year 2045 by \$19.47 billion, and to save \$16.20 billion in State contributions.

- 3) Eliminate the money purchase pension plan option under SURS, for new hires only. This is estimated to reduce accrued liabilities in the year 2045 by \$4.73 billion, and to save \$1.18 billion in State contributions;

- 4) Define more precisely the rate of interest applied to the current money purchase option under SURS. Options include:

Use the long-term rate of return, but not to exceed the most recent five-and ten-year rates of return. For example, reducing the interest rate on money purchase for current participants to 6% is estimated to reduce accrued liabilities in the year 2045 by \$2.25 billion, and to save \$5.47 billion in State contributions.

- 5) Increase the eligibility requirements for new employees to receive unreduced benefits. Options include:

Change the minimum age to 65 with 8 years of service. This is estimated to reduce accrued liabilities in the year 2045 by \$30.90 billion, and to save \$11.51 billion in State contributions.

- 6) Limit automatic annual pension increases for new hires only. Options include:

Automatic annual pension increase of 2%, limited to the first \$12,000 of annual pension for members covered by Social Security and \$24,000 for members not covered by Social Security. Reducing the automatic annual increase to 2% for new hires only is estimated to reduce accrued liabilities in the year 2045 by \$74.20 billion, and to save \$4.76 billion in State contributions.

- 7) Limit employee groups eligible for Alternative (enhanced) Retirement Formula benefits, for new hires only. Options include:

Sworn Police Officers only. This is estimated to reduce accrued liabilities in the year 2045 by \$13.96 billion, and to save \$1.36 billion in State contributions.

- 8) Increase the employee contribution rate for those employees receiving alternative retirement formula benefits; and

- 9) Increase employee contributions to the SERS, SURS, TRS, JRS and GARS by:

1%. This is estimated to save \$13.72 billion in State contributions between 2006 and 2045.

APPENDIX C

CHANGES IN PENSION PLAN PROVISIONS

Additional Options for Consideration

- 1) For purposes of State pension liability, pay increases in the final average period of employment should be limited as determined by the Governor and the General Assembly, unless fully funded by the local employer or employee. Additional possible limitations on pay increases in the final period of employment include:
 - Limit increases to 3%.
 - Limit increases for employees with 25-30 years of service to the actual average salary increase for all employees over that time period.
 - Limit increases to the lesser of Consumer Price Index or 5%.

- 2) Define more precisely the rate of interest applied to the current money purchase option under SURS. Additional option includes:

Use the long-term rate of return, but not to exceed either of the two most recent five-year rates of return.

- 3) Increase the eligibility requirements for new employees to receive unreduced benefits. Additional options include:
 - Change the minimum age to 62 with 30 years of service.
 - Change the minimum age to 60 with 35 years of service.
 - Change the minimum age to that age at which the member qualifies for an unreduced Social Security benefit.

- 4) Limit automatic annual pension increases for new hires only. Additional options include:
 - Automatic annual pension increase matches the Consumer Price Index or some comparable index, but is no higher than 4% and no lower than 1%, limited to the first \$12,000 of annual pension for members covered by Social Security and \$24,000 for members not covered by Social Security.
 - Automatic annual pension increase of 60% of CPI or some comparable index but no greater than 3%, limited to the first \$12,000 of annual pension for members covered by Social Security and \$24,000 for members not covered by Social Security.

- 5) Limit employee groups eligible for Alternative (enhanced) Retirement Formula benefits, for new hires only. Additional option includes:

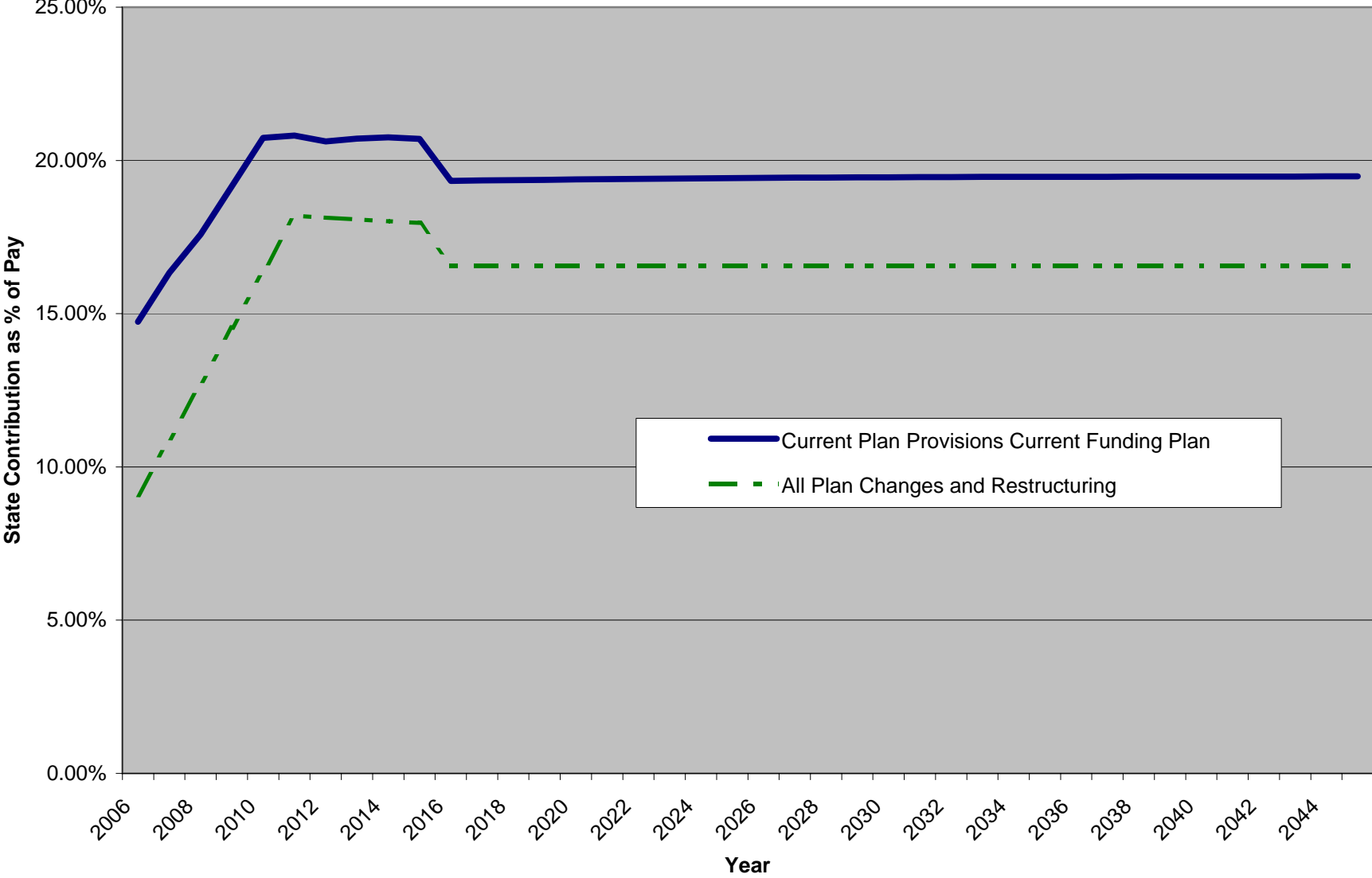
Sworn Police Officers and others only if the recipient pays the full additional costs;

6) Increase employee contributions to the SERS, SURS, TRS, JRS and GARS by:

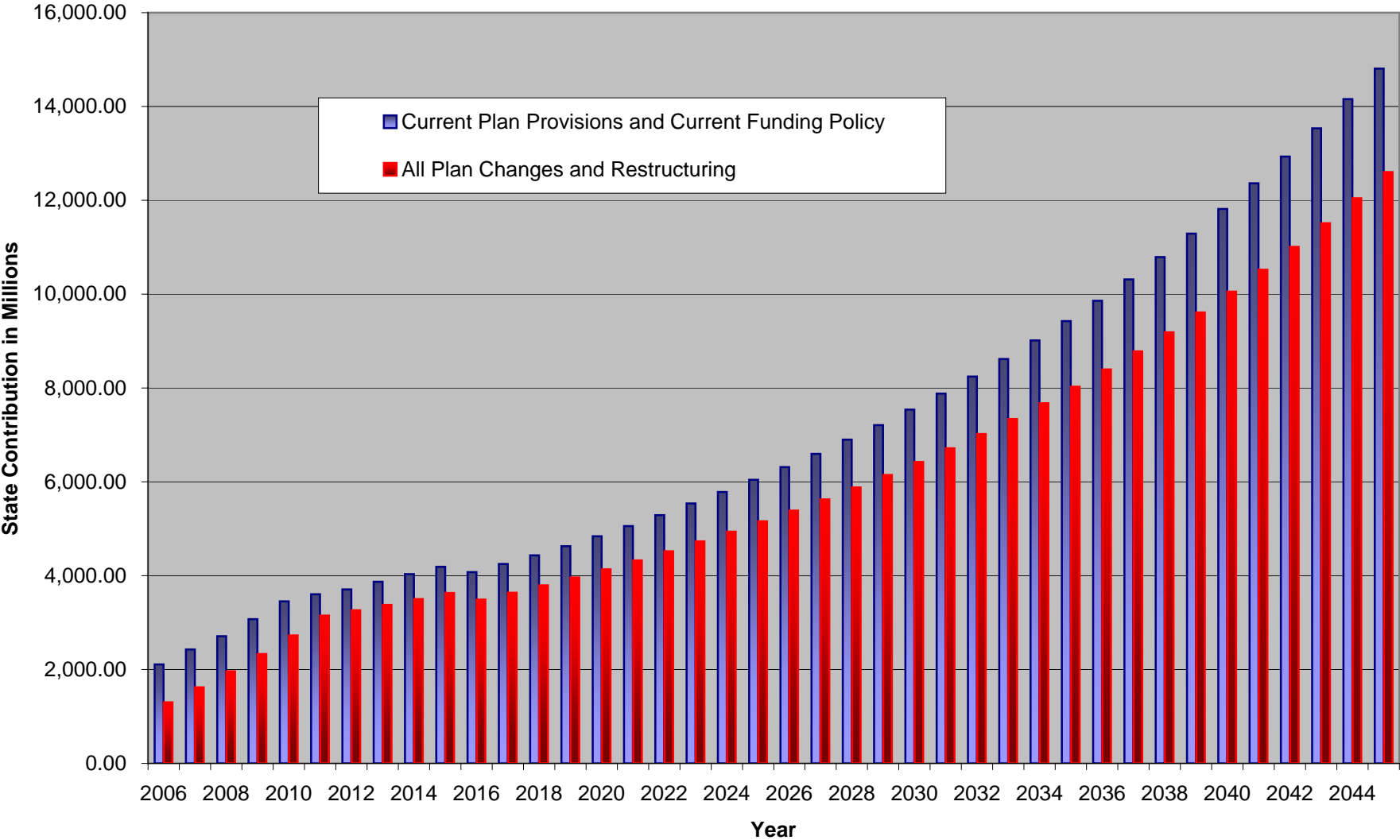
- $\frac{1}{2}\%$ per year for the next four years.
- $\frac{1}{4}\%$ per year for the next two years.
- 5% of applicable rate (e.g., 8% becomes 8.4%)
- Adjust increased employee contributions to reflect the actual increased cost of underlying benefits.

Estimates of these options have not been provided as of the date of this report. Upon receiving estimates, the Commission may issue a supplemental report regarding these options.

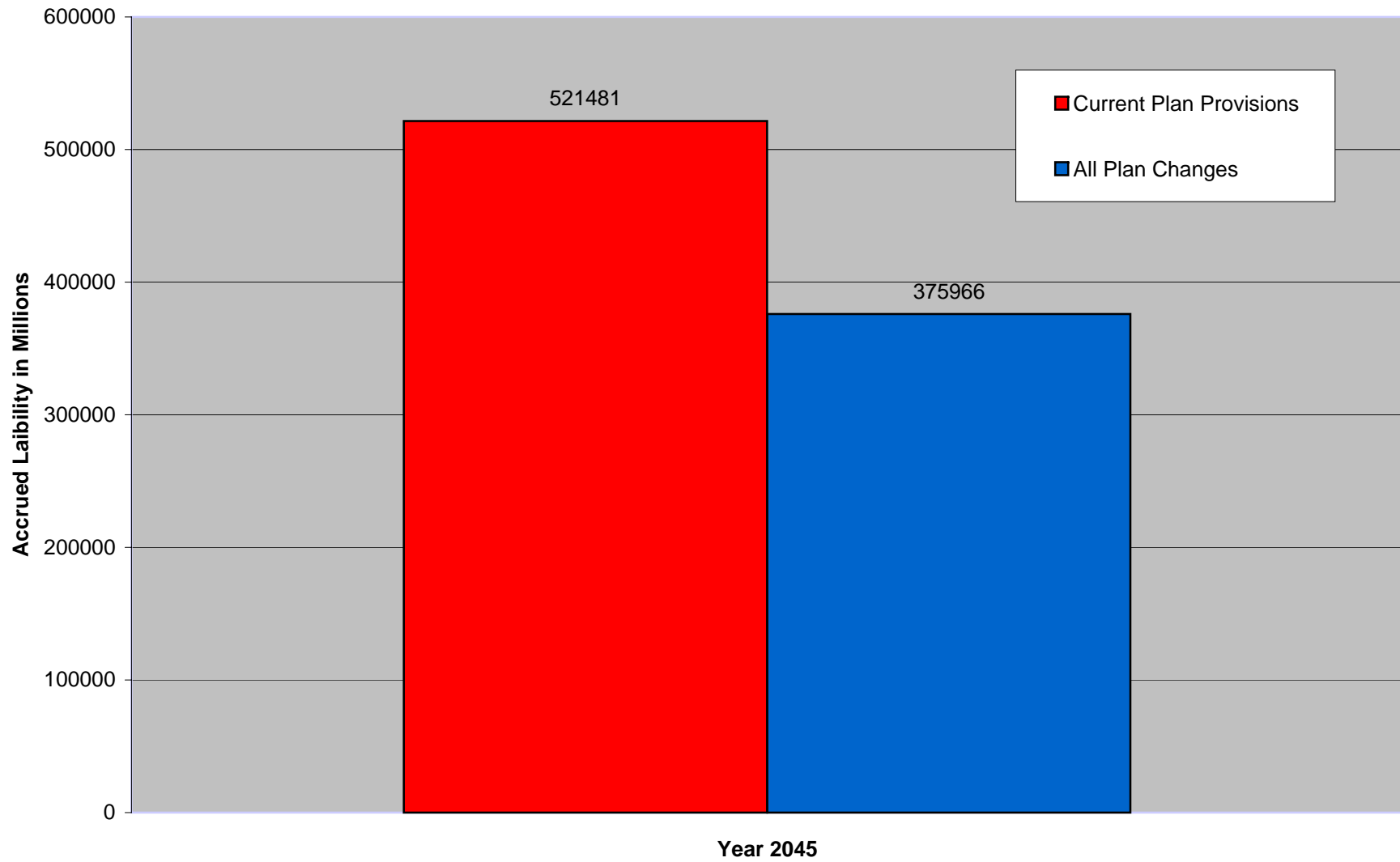
**Appendix D-1
State Contribution**



**Appendix D-2
State Contribution**



Appendix D-3 Gross State Pension Liability in 2045





BILL BRADY
STATE SENATOR
44TH LEGISLATIVE DISTRICT

□ 2203 EASTLAND DRIVE, STE. 3
BLOOMINGTON, IL 61704
309/664-4440
FAX: 309/664-8597

□ 105-A CAPITOL BUILDING
SPRINGFIELD, IL, 62706
217/782-6216
FAX: 217/782-0116

□ 332 W. MARION AVE., STE. N-1
FORSYTH, IL 62535
217/876-9407

February 9, 2005

Commission Members:

First, let me reiterate my view that I believe the full commission should have voted on the main body of the commission's report. If we had been given the opportunity to vote, I would have voted against the report. These comments detail my opposition to the report.

On January 28, 2005, I voted to forward to the Governor and General Assembly for their consideration and examination various pension benefit changes that had been discussed but not fully agreed upon by the commissioners. I agree information should be forwarded to the Governor and General Assembly. I personally do not support the benefit changes as explained below. Detailed below is my opposition to the savings plan which I voted against at our meeting February 4, 2005. I believe this plan amounts to borrowing now from questionable savings at the expense of our children and grandchildren. Also detailed below are my thoughts on bonding and other issues.

Benefit Changes

It is my belief that the recommendations generally diminish benefits for new hires and violates numerous existing agreements between the State and its employees. Our State has negotiated with its employees, over the course of numerous years, a compensation package that encompasses everything from health insurance coverage, pension benefits, salary and salary increases, to life insurance coverage. It is my view that the State has a certain amount of money that it can utilize to fund this compensation package and by entering into an agreement with the employees, the State obligates itself to fund each element by the agreed upon terms.

Teachers, represented by their unions, have worked to create a retirement formula and a mechanism to fund that formula through years of negotiating. The retirement benefits negotiated for the teachers of our State were agreed upon by the members of the General Assembly, the Governor, and the members of that critical profession.

If this Administration wishes to avoid its responsibilities to fund our pension obligations, the Administration should have negotiated ways to alter those pension benefits by

agreeing upon different terms than contained in the accepted union contracts and should have communicated with all parties involved in the negotiating of benefits for teachers. Now that I have explained my philosophy, it should be clear why I cannot support recommending enacting the following changes or any related suggested options:

- Reducing cost-of-living raises on pension benefits for new hires from the current 3% to 2%.
- Raising the full retirement age for new hires from 60 up to 65.
- Limiting the alternative formula eligibility for new hires.
- Increasing employee contributions for pensions.
- Eliminating the “money purchase” formula for new hires and fixing the interest rate on the formula for existing employees.

Needed Reform

The end-of-career salary increases for superintendents do need to be addressed.

The 1995 Formula

I do not agree that we should change the formula adopted in 1995 if we are not improving it. It's shortsighted for us to reduce our contributions in the short run, and push the costs onto our children and grandchildren. There is no compelling, fiscally sound reason to lower our current goal of reaching 90% funding, or to stretch that out another 20 years into the future – going from 2045 to 2065.

I oppose changing the 1995 formula to create any plan to “recognize” future savings that may (or may not) occur under long-term reforms. That's just another attempt to allow the Governor to avoid systemic budget changes and address Illinois' lagging job creation. No matter how you spin it, we would simply be spending money now that we don't (and may never) have. The responsible course is to recognize savings **only** in the years in which those savings actually occur. To build a proposed budget – or to enact a budget – that under funds our pensions today, in hopes of receiving savings sometime in the future, is the height of irresponsibility. It's especially irresponsible to under fund pensions using “savings” that rely on reforms that have not passed and are probably not going to pass the General Assembly.

But, let's suppose that some of these reforms would happen to pass. Even then, the savings depend on the unlikely assumption that future legislators will not restore these benefit cuts at some point over the next 30-40 years. There are simply too many variables in these assumptions to serve as a sound foundation for today's state budgets. We have no accurate idea now how many future employees we will have in future years, what their salaries may be or how our investments will perform over the next 30-40 years. In fact, the loss of investment earnings from short-term underfunding could erase any savings from reforms that could occur. What is being proposed is not unlike the neglect of our predecessors whose underfunding of the pension systems led to our pension pressures

today. I believe it is poor public policy to “cash in” today on the long-term bet that these savings will indeed occur.

What we can guarantee, though, is that if we rush to spend these paper “savings” on expanded government spending, we will take on new costs and **never** see the savings materialize. We will only be digging ourselves a deeper hole. The **only** responsible course is to use any savings that do occur to whittle down our \$35 billion in unfunded pension liabilities (the largest among any of the 50 states). Spending future savings today does nothing to cure this \$35 billion albatross.

Bonding

I oppose bonding to fund the 2002 early-retirement liabilities unless the bonding is done strictly under the conservative conditions recommended by the Commission on Government Forecasting and Accountability (formerly the Illinois Economic and Fiscal Commission). Those conditions include a maximum bond repayment schedule of 10 years and compliance with our “debt responsibility” law. That will require level-principal payments. We must also require that 100% of any bonds should be competitively bid to eliminate the perception or reality of the possibilities of undue influence and corruption. Additionally, as recommended by the forecasting commission and discussed by this commission, all proceeds of any bonding should be directed to the pensions system and not used for the general state budget. (We already have had considerable budget relief from the almost \$600 million in annual payroll costs that were eliminated with the early retirements.) Short of this type of responsible bonding plan, I believe we should cash fund this early retirement liability over the next 10 years or less.

I object to any plan to bond current-year contributions to allow increased government spending, as the State did with the \$10 billion 2003 bonding program. I have not been persuaded that any bonding can be structured responsibly to bond any sizable portion of our \$35 billion unfunded liability. In any event, reforms should not be used as a carte blanche to do more bonding that locks in undue burdens on future taxpayers and our children and grandchildren.

Dynamic-scoring principle or alternative funding

I concur with the recommendation to consider the dynamic-scoring principle (now called alternate funding formulas), though I believe we should only use this principle to drive increased contributions to our pension systems, and not as yet another excuse to under fund pensions below our current formula.

Defined-contribution plan

I have long advocated creating a defined-contribution plan. A defined-contribution plan offers the opportunity to lower and stabilize both the State’s and employees’ contributions, while offering employees a plan that allows personal responsibility, flexibility and portability. We should explore both a required defined-contribution plan

for new employees and an optional plan for existing and new employees. I understand that there would be some short-term added costs to the State with a new defined-contribution plan if newly hired employees were required to join the defined-contribution plan, or if substantial numbers of existing or new employees joined an optional defined-contribution plan. But I believe the long-term rewards to both the State and the employees may be worth the immediate costs to the State and merit detailed consideration.

Conclusion of Employee Represented Organizations

As a member of the labor community in Illinois, I applaud the Governor for convening the Pension Commission to focus on near-term State funding of pension liabilities. I believe we have identified key problems in addressing the future of each of the five State-funded pension plans and debated a number of scenarios that will assist the State in meeting its promises and obligations to its workforce. However, in solidarity with the working families employed by the State of Illinois, I cannot support the recommendations set forth by this Commission.

First and foremost, State employees in the five State employee pension funds have upheld their responsibility under the Pension Code by making their required contributions. Unfortunately, for the past thirty years, the State has not. In addition, through the collective bargaining process, State employees have agreed to higher pension contributions, wage freezes and an end to cashable sick leave to gain and maintain adequate pension benefits upon retirement. In addition, educators have previously agreed to higher contributions in the cost of upgrading their past service to gain pension improvements.

I appreciate that the report adopted by the Commissioners stressed numerous times that the current under-funding of the State pension plans is not the fault of State employees. Unfortunately, the solutions adopted by this Commission will in fact impact the very people who have already fulfilled their obligations.

In Exhibit A of the report, there is a recommendation that pay increases in the final average period of employment should be limited as determined by the Governor and the General Assembly unless fully funded by the local employer or employee.

Scenario A & B limits the pay increase to 3% and 5% respectively. This is unworkable for state employees represented by the Building Trade Unions and receiving the Prevailing Rate. These employees have no control over annual pay increases. Likewise, non-Prevailing Rate employees through the collective bargaining process could also receive pay increases in excess of 3%. While these employees vote to accept or reject the collective bargaining agreement, wages, like benefits, are negotiated rather than set arbitrarily. The problem of certain recipients receiving huge pay increases near retirement is isolated and most often managerial employees. There is no reason why all State employees should be penalized for the actions of a select few.

In a similar instance, wage increases and cost of living increases for members of the General Assembly and the Judiciary branch are set by the Compensation Review Board and cannot be lowered by either the General Assembly or Judiciary. Often times, one Chamber of the General Assembly has rejected the recommendations of the Compensation Review Board, only to have the other Chamber vote to accept the Report thereby granting pay increases to all participants in the plan. The pension benefits these participants receive should be based on their final period of employment. It is what they have legally earned.

The State should not implement a two-tier pension system for new hires. As a proponent of an equal days pay for an equal days work, it is unconscionable for labor to accept two workers doing the same job while one receives less compensation. A two-tier pension system for new hires is patently unfair. This would include a lower cost of living adjustment (COLA) than current plan participants receive. This scenario also includes the prohibitions of new hires from participating in the money purchase option under the State Universities Retirement System.

While labor agrees that sworn police officers should benefit from being enrolled in the Alternative Formula, we also believe that a number of State employees work under equally hazardous conditions. The danger is not any greater for an employee working as a barber, an electrician or an instructor in a State correctional facility than it is for

correctional officers. All employees working in a State correctional or developmental center face the same inherent dangers day in and day out. This danger does not distinguish employees by date of hire. . In addition, if the General Assembly and the Governor recognizes that other positions in the State are inherently more dangerous; future Governors and members of the General Assembly should have the latitude to recognize these dangers and place these workers in the Alternative Formula.

Increasing the employee contributions is the most unfair recommendation of all. The burden of adequately funding the pension plans should not fall on the very people who have been identified in this report as meeting their obligations.

This report makes numerous recommendations to the Governor and General Assembly that include different options to consider. Yet, one option that is not considered is the option of increased revenue to adequately fund the pension systems. For decades, in both good and bad economic times, the State did not fulfill its pension funding obligations. And now, the State is seeking reduced benefits, a two-tier system for new employees, and increased pension contributions by the very people who have loyally fulfilled their responsibilities.

Although this report recommends further study for Defined Contribution Plans, employee represented organizations will oppose any departure from the Defined Benefit Plan currently in use. It is true that many private industry employers have moved away from offering employees defined benefit pensions and instead offer Defined Contributions Plans as a means of retirement savings. However these plans are more risky and less secure due to volatility in the stock market and retirement benefits not being guaranteed.

In the past, some public employers have attempted to negotiate lower retirement contribution rates. But if this is allowed to occur, even for new hires, it will completely alter the stability of any of the programs. If the employer contribution level is lower, eventually the benefit levels will be too.

The various entities of labor organizations who represent State employees, teachers and university professionals know and understand that Illinois has a crisis in funding its pension obligations. We are also aware that this unfunded liability has a direct bearing on the State's creditworthiness. However, we believe that the State has made a promise through collective bargaining and legislation to its employees and educators and these promises should be kept. We believe that the only way to fully achieve the goal of 90% funding by 2045 is to fund a level percentage of payroll.

Simply, we believe that a promise made should be a promise kept.

Respectfully submitted.

Ronald E. Powell
President, Local 881 and
UFCW International Vice President

1110 Honeysuckle
Wheeling, IL 60090
1/14/05

The Honorable Roland Burris
Burris, Wright, Slaughter & Tom, LLC
35 East Wacker, Suite 500
Chicago, IL 60601

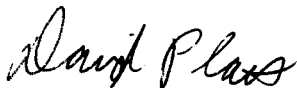
Dear Mr. Mathias:

I am writing to ask you to support extending the early retirement option for educators. It is well known that a teaching career involves extreme dedication to the profession. The monetary reward is not equivalent to the amount of hard work that is put into a job which affects the future of our society. Teachers have the responsibility for preparing students to be productive members of society. Yet their rewards are few. Social security benefits are limited or not available. There is no justification for denying teachers a comfortable retirement after a long, arduous career.

Local school districts have been able to benefit from the early retirement option by replacing higher paid employees with those who are hired at a lower salary. This has helped to balance their finances which are not supported enough by the state which has not met the Constitutional obligation of funding 51 percent of the cost of education.

The ERO is needed. It is a fair way of saving local districts millions of dollars. It is one of the few incentives that draws good teachers into the field. It is good public policy. Teachers should not be punished because the state has failed to meet its obligations. To deny this benefit would be a moral injustice. It is necessary to extend the early retirement option.

Respectfully submitted,



David Platt

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American Federation
of State, County and
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AFL-CIO



January 25, 2005

The Honorable Roland Burris, Chairman
Burris, Wright, Slaughter & Tom, LLC
35 E. Wacker, #500
Chicago IL 60601

Dear Chairman Burris:

We are writing to urge you to oppose the proposed benefit changes in the five state-funded pension plans being considered by the Governor's Pension Commission.

The Governor's Office of Management & Budget (OMB) would have you believe that a significant portion of the state's unfunded pension liabilities stems from recent benefit increases that were enacted by the General Assembly and signed by the Governor "with no funding source." This is simply not the case.

In fact, these pension increases were enacted as part of an agreed bill process where all parties--the State, the retirement system, and the unions representing employees participated in the give and take of negotiations to provide fair pension benefits to Illinois public employees and to fund those improvements.

Each of the benefit increases that applied broadly to public employees (SERS standard and alternative formula and TRS formula increases) were overwhelmingly approved by the General Assembly because they achieved a fair and reasonable level of future retirement benefits and also contained significant contributions from employees to help pay for those enhanced benefits.

State employees, through negotiations with their union (AFSCME), agreed to higher employee pension contributions, a wage freeze, an end to cashable sick leave, and significant changes in eligibility for fully subsidized retiree health benefits in order to win decent pension benefits. Similarly, teachers agreed to make higher paycheck contributions and to share in the cost of upgrading their past service to gain their pension benefit improvements.

The large pension payments coming due over the next several years to the state-funded pension systems result solely from the state's failure to make the

actuarially-required pension payments prior to FY 1996, and from the pension plan under-funding that was built into the beginning of the 50 year funding plan that began in FY 1996--the fifteen year "ramp" up to the required level percentage of payroll contribution rate. These payments owed to the state's pension funds are not driven by recent benefit changes (which brought pension benefits only up to a median level compared to other states), whose costs were substantially offset by enhanced employee contributions.

In this context we ask you to vote "no" on the following Governor's Pension Commission Recommendations:

1. No on a reduced COLA for new hires
2. No on eliminating the money purchase option for new hires
3. No on limiting the rate of interest applied to the current money purchase option
4. No on "local funding" for benefit increases in final year(s) due to salary increases over certain percentages
5. No on higher normal retirement ages for new hires
6. No on limiting SERS alternative formula application to new hires to peace officers only
7. No on increasing employee contributions for those on Alternative Formula
8. No on an across- the-board contribution increase for all current participants in all systems
9. No on a requirement that pension benefits have "a defined new funding source" or an "express sunset provision."

To the extent that pension benefits and contributions are now part of the collective bargaining process, we think that is the appropriate forum for the Governor to discuss these issues. Indeed, OMB Director John Filan himself publicly stated that he favored this approach in the early days of this Administration. The truth is that pension benefits in Illinois are not out of line with other states. Prior to 1998, for example, SERS benefits ranked 49th out of the fifty states. Now, although Illinois is 6th in per capita income among all states, SERS pension benefits are somewhat below the average for all states. And Illinois is dead last in the ratio of state employees to citizens.

We agree that the 1995 funding plan could be restructured. But the only fiscally sustainable answer is to eliminate the ramp and fund to the 90% target at a level percentage of payroll. This won't be easy to accomplish, but it is the only solution that can actually work. We must, however, stress that **funding for such a level percent of pay funding plan must come from revenue increases and not budget cuts.**

Defined Contribution plans, by their nature, cost more to administer and, on average, earn less than our current Defined Benefit pension plans. They do not save the state anything, except to the extent that they are structured to provide lower retirement benefits--something that is not warranted given current benefit levels. While the SURS may have had some unique reasons to need such an alternative to recruit senior, experienced university faculty, we are not persuaded that such an alternative for the other state pension systems makes sense.

We are open to discussing support for additional Pension Obligation Bonds, with the proceeds going to reduce the unfunded liabilities of the systems. Clearly economic conditions must be right, as they were two years ago when \$10 billion of such bonds were snapped up in a matter of hours. POBs should be explored as a viable option to fund pension obligations at a lower interest rate than the systems currently charge on their unfunded liabilities, as part of a revised funding plan.

Please call us at 312-641-6060 if you wish to discuss these matters further.

Sincerely,



Henry Bayer
Executive Director



Hank Scheff
Director of Employee Benefits



January 26, 2005

Roland Burris, Chairman
Burris, Wright, Slaughter & Tom, LLC
35 East Wacker, Suite 500
Chicago, IL 60601

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Re: Recommendations & Concerns to Governor's Pension Commission

Dear Chairman Roland Burris:

I am writing to discuss the plans of the Governor's Pension Commission and the options for moving forward. First, please accept my sincere thanks for the many months of work and deliberation that has gone into the Commission. To be sure, there are few responsibilities more important than securing the deferred pay and retirement benefits of our members.

Second, allow me to share with you some of my concerns about the various options under consideration. On behalf of our members, we oppose the proposals that would involve a so-called "two-tier" system, which would penalize new hires with a reduced COLA, and/or no money purchase formula, and/or a higher retirement age, and so on. Besides, not solving the state's budgetary problems, these policies would likely violate the collective bargaining process and end up causing more harm than good.

Similarly, the proposals to increase employee contributions and to create new requirements, such as sunset provisions, are dead-ends. The appropriate forum to discuss ideas such as these is the collective bargaining process. Those involved know that our members (as well as the members of other unions) have been very flexible and given up benefits that our members receive in other states in order to arrive at a fair solution to the state fiscal difficulties. We do not see it as the role of this Commission to put forward recommendations that interfere with the collective bargaining efforts in which we have partnered with the state to arrive at a fair budgeting plan.

Finally, I would like to identify some common ground for moving forward:

1. **Restructuring the 1995 funding plan:** While we do not favor ending the fundamental goals of the funding plan, we believe there are ways to improve it. For example, the plan must have a new revenue source and not force budget cuts elsewhere. We would appreciate further discussion about ways to enhance the revenue options so that we do not continue to under-fund the systems.

2. **Expanding Defined Benefit options:** Contrary to some of the propaganda emanating from the Governor of California and elsewhere, defined benefit plans provide the most cost effective way to deliver retirement security. These plans earn more, have lower administrative costs and lower fees than other options. The DB model is so sensible, that we propose expanding it, possibly in the form of legislation requiring all qualified Illinois employers to provide their employees with a DB plan or to contribute at least 9% of an employees' salary to an equivalent. Illinois could be a pioneer in allowing private sector employers to buy into the public system, thus diversifying the system's assets, making genuine retirement security available to all Illinois workers, and giving private sector employees a stake in the future of the state DB plans. While there may be technical difficulties involved in managing new, private sector employers and participants, they would not be unmanageable. The economies of scale that we achieve in the public sector would make DB plans more readily available and cheaper for employers through an innovative public-private partnership.

3. **Pension Obligation Bonds:** We support returning to the capital markets at the appropriate time to refinance the pension debt and lower costs for the State.

I am available for additional discussion on these ideas. Please feel free to call me at (312) 787-5868 or our Capital Stewardship Director, Bill Dempsey at (312)-233-8783 to discuss these options further.

Sincerely,



Christine Boardman
President, Local 73
Treasurer, SEIU State Council



Tom Balanoff
President, Local 1
President, SEIU State Council



A Union of Professionals

January 27, 2005

Roland Burris, Chairman
Governor's Pension Task Force
35 E. Wacker, Ste. 500
Chicago, IL 60601

Dear Mr. Burris:

The IFT appreciates the gravity of the Governor's Pension Commission's charge to seek solutions to the pension funding crisis in Illinois. A number of options have been researched and reviewed. Several have been discarded. We agree with the Commission and its intent to not diminish pension benefits currently guaranteed under the Illinois Constitution.

More importantly, the Commission has recognized that the most important factor in this crisis is that the state failed to meet its funding obligations to the systems for many years prior to the 1995 pension funding reform act. Active members of each of these systems have been acknowledged for fulfilling their obligations to the systems during that period and since, and that is appreciated.

The state must meet the requirements of the ramp-up period provided in the 1995 pension funding law. In the current economic downturn, this has been difficult. The pension obligation bonds authorized in 2004 provided a very successful vehicle for the state to meet its funding requirements during the current year.

The IFT believes that the current law must be strictly enforced, and we will seek to ensure that its continuing appropriation requirements are met. Many ways to do this have been discussed, including issuing additional pension obligation bonds, reductions in pension benefits for new hires and additional contributions from members of the system.

The one solution that makes the most sense to us is increasing revenue, and unfortunately that has not been part of the Commission's discussions. I do not believe the governor's reluctance to support revenue enhancements at this time should deter the members of the Commission from recommending what they believe is the most effective way to deal with the serious problem facing the state today with respect to its long term pension debt.

A second Pension Obligation Bonding program is a potential short term solution that will ease the burden for those crafting the FY 06 budget. Based on the highly successful program in FY 05, this option may be the best solution short of a permanent new revenue stream. We believe the window is still open for another successful POB program and hope that avenue is pursued.

**Illinois Federation
of Teachers**

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James E Dougherty
PRESIDENT

Raymond Mackey
CHIEF OF STAFF



An affiliate of
the AFT, AFL-CIO

Some consideration has been given to changing the ramp schedule. This is only a partial solution since it merely puts off the state's responsibility to make up past shortfalls. In the end it will cost Illinois taxpayers more due to interest incurred in a longer pay-off period. It would also substantially reduce the current funding ratios of the systems from their already low levels. For these reasons, we do not believe this is a practical solution to the problem.

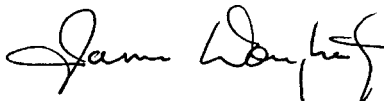
The Illinois Federation of Teachers is also adamantly opposed to requiring employees of its public pension systems to pay a second time for average benefits that are under-funded as a result of the state's own historical financial negligence to the systems. The problems confronting the administration today regarding its pension obligations are fundamentally revenue problems, not benefit problems. Solutions must be crafted which reflect that reality.

Therefore, the IFT asks each member of the Commission to vote NO on the following proposals:

1. Increases in contribution rates for current members in all systems and the SERS alternative formula without commensurate benefit increases
2. Reductions in benefits for new hires, including:
 - a raise in the normal retirement age
 - a reduction in the COLA
 - limitations in the SERS alternative formula to peace officers only
3. Elimination of or changes to the rate of interest for the money purchase formula (SURS)
4. "Sunset provisions" for new pension legislation that are simply intended to avoid pension protections specified in the Illinois Constitution
5. Limitations, including cost shifting, on end of career salary enhancements in which there are no safeguards against inequitable treatment of educational employees
6. Changing the current defined benefit plans to defined contribution plans. For basic economic security in retirement, members of TRS and SURS need the defined benefit since they are not coordinated with Social Security.

If I can be of further assistance, please feel free to contact me at your convenience.

Sincerely,



James Dougherty
President

JD/adw
iou34071afl/cio

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February 1, 2005

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Roland Burris, Chairman
Burris, Wright, Slaughter & Tom, LLC
35 East Wacker, Suite 500
Chicago, IL 60601

Dear Roland Burris, Chairman:

Thank you for your service on the Governor's Pension Commission. Finally, we have a Governor that is willing to shine light on the condition of our five pension systems. Unfortunately, it is for the wrong reasons. The only fundamental problem with the retirement systems relates to funding, not over generous benefits.

As you may know, SUAA represents future annuitants (current faculty and staff) and current annuitants of the State Universities Retirement System. Increasingly, our growth is due to current faculty and staff who are concerned about what will happen with their retirement plan.

I urge you to oppose proposed changes as outlined in the draft presented to the commission at the last meeting on Friday, January 28, 2005.

In the interest of time we will outline a few reasons why we oppose changes in benefits while supporting new funding alternatives.

Benefits

Many, including our organization, have worked hard over the years to improve retirement benefits. Even with this hard work our systems are described as only average when compared nationally. Does that mean that now we want to set up future retirees with something less than average, or "below average?" This could have several long term impacts: inability to attract skilled professionals and become less competitive in the world job market, lower morale, and reduced loyalty. Our colleges and universities

make huge contributions to the growth and economy of the State because they have been able to attract talented and committed faculty-staff. Illinois cannot afford a "below average" retirement system.

Funding

It is refreshing to read in the draft document that the State of Illinois' admits its failure to properly fund the systems. This should be the real focal point for the commission. The systems did their job by regularly providing actuarial tables for the unfunded liability that needed to be funded. It is past Governors and General Assemblies that determined other priorities that meant adequate pension system funding was never given priority.

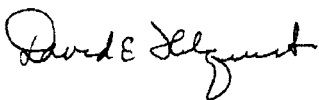
We applaud the determination in the mid 90's that led to legislation that finally developed a payment system to get to 90% of funding. Again, it was a half step plan that stretched out payments over 50 years, transferring significantly higher unfunded liabilities to future taxpayers, Governors and General Assemblies. These funding challenges were not caused by the hundreds of thousands of employees throughout Illinois. Employees have consistently paid their share of the contributions to the system. It is the State not providing its share of the funding that caused the problem; so it should be the responsibility of the State to solve the problem but not at participant/employee expense.

We do support legislation that allows using bonds to move the systems toward full funding. The central question is why should system participants be penalized for the failure of the State of Illinois to fund its share of retirement benefits? In our private lives we periodically have to look at our priorities and hold off on new purchases. Perhaps at this time, the State needs to take care of old obligations before it can take on all of its new initiatives. It is the right thing to do.

We wish to continue a dialog toward resolution of the funding problem. Every dollar not invested in the retirement system today will cost the State \$3.13 in fifteen years. We are open to creative suggestions such as the bonding program last year that has paid dividends. Can we put our collective heads together to find a resolution to funding while maintaining the integrity of the current systems?

We challenge you to find solutions to the pension systems funding requirements and maintain or even improve future benefits. The State of Illinois and its employees will be better for it.

Sincerely,



David Hilquist
President



Illinois Education Association-NEA

February 2, 2005

Dear Pension Task Force Members:

The IEA appreciates the gravity of the Commission's charge to seek solutions to the pension funding problem in Illinois and looks forward to working with you on this issue.

However, the problem is not benefits -- Retirement benefits paid to teachers and other state employees are in the middle of their counterparts in other states.

As you know, the IEA has consistently voiced strong opposition to any reduction in benefits for current participants or new hires and to any increase in pension contributions by active members.

Increasing active members' pension contributions is "simply a tax increase" on teachers to pay for inaction by previous General Assemblies.

After all, teachers and other state employees did not create this pension funding crisis. We paid our required contributions while during the '90s, the state did not. It's time for the state to meet its pension obligations and make the payments.

Therefore, we are also opposed to any reduction in the current pension funding plan. We supported the last Pension Obligation Bond program and would be receptive to another program which would turn the "soft" debt of the pension systems into a "hard" debt.

If we can be of further assistance, please feel free to contact us at your convenience.

Sincerely,

A handwritten signature in cursive script that reads 'Anne Davis'.

Anne Davis
President

**PATRICIA BURKE
2619 POPLAR VIEW BEND
ELGIN, IL. 60120**

February 5, 2005

Dear Mr. Burris,

I am writing to you regarding the Early Retirement Option for teachers. I am a teacher with over 30 years of experience. I have been planning my retirement for the past 3 years. I will turn 55 shortly after the ERO is due to expire. Therefore, this situation seriously impacts myself and my family.

The Early Retirement Option is a key benefit, not only for teachers, but to the school districts around the state of Illinois. Because the state has not fully funded education, the ERO allows districts to deal with the funding crisis. Many of the education associations have negotiated agreements that have adjusted some concerns so that only the teachers who truly deserve this benefit are entitled to it. Personally, I am not taking any bonus. I would just like to have the ability to buy one year of service with my unused sick days and retire within the six month period of my 55th birthday.

I was alarmed to read the study from the Government Performance Project that states that Illinois has the largest unfunded pension liability in the nation. It also says that the state has poor long-term budget planning. I am concerned that the state legislature has failed to fully fund the pension. I have dutifully been paying my share and upgrade for many years. I expected that the state had been matching its portion of the benefit. Now the teachers are being penalized for things that are not in their control.

I urge you to come to some resolution of this issue sooner rather than later, as it affects many teachers in the state. There are many good reasons to extend ERO. This benefit is not only good for teachers, but school communities as well.

Thank you for your kind consideration.

Respectfully,

Patricia L. Burke

Patricia L. Burke

IEA Member

Community Unit School District #300



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February 9, 2004

TO: Governor's Pension Commission

FR: David Hilquist, SUAA President

RE: Statement for Appendix

This memo is in response to an invitation by the commission to provide comments as it relates to retirement system "recommendations, items for examination and consideration." I want to thank you for giving us the opportunity to voice our concerns one more time and the promise to include our remarks in the report appendix.

We do not support the recommendation for the new funding mechanisms as described; the arbitrary withholding any future pension legislation if there is not a funding stream; nor the benefit cuts proposed. Below is an explanation.

First, the funding "considerations" in the proposed pension plan changes are just so much smoke and mirrors. It appears the commission is looking for ways to divert tax dollars for other purposes. It is wrong to take future projected "savings" and spend them now in other program areas. This is no different than past Governors actions that got us where we are today- with serious under funding. We hope that this debate will result in determining what the right thing is.

Second, the benefit "considerations" are a direct affront to all retirement system participants. All systems have clearly established benefits negotiated, deliberated and agreed to by all parties. This process has provided assurance of a certain quality of life once retirement is reached. Why would you want to do less (employees pay half) for employees that are being asked to take over heavier work loads for those that have left and not been replaced?

Third, the recommendation to withhold any pension legislation, if there is not a funding stream, is unfair. To purposefully inhibit the deliberative process of State Government as it relates to retirement systems is dangerous. The democratic and due processes are at stake here and infringement of these rights may be unconstitutional.

If these "considerations" come to pass, we predict that in 10, 15 or 25 years, future legislators will be facing the same problems of today but again, on a much larger scale.

We recommend that at the very least the State continue the 1995 funding plan and not at employees/retirees expense as proposed. State employees and retirees have always paid their full obligations to the retirement system and should not be penalized.

We call for the State of Illinois to clearly state that full payment to the retirement systems is a priority and stop the games. The security of over a half a million voting employees and retirees should be important to those that govern our great State.

Again, thank you for the opportunity to make a statement.

January 21, 2005

To the Members of the Governor's Pension Commission:

Thank you for this chance to share our views on funding public pension systems properly. We applaud the commission's efforts in understanding issues that confront Illinois pension systems. We are appreciative of the substantial efforts made to continue the state's unblemished record of complying with the 50-year funding law. In particular, we note the issuance of pension obligation bonds that will have a continuing impact on state contribution requirements for many years to come.

Together we have learned much. From our perspective, the principal problem has been neglect of responsibilities. The neglect spanned five decades, beginning during World War II and continuing into the mid-90s.

You have asked us to share recommendations for meeting the state's current pension funding requirements. For reasons outlined in this letter, the only solution we recommend is continued compliance with the existing funding law.

Benefits

We are dismayed with the focus on benefit reductions because the approach falls far short of meeting existing responsibilities. It is, in fact, the unfunded liability that drives increased funding requirements. If all of the proposed new employee benefit reductions were implemented for new members, state contributions would still be high because the state is responsible for the existing unfunded liability and the constant compounding of interest on the unpaid principal.

Current benefit levels are not out of line. All parties and the analysis by the commission's actuaries agree TRS benefits are essentially middle-of-the road. In fact, TRS members pay more than teachers in other non-Social Security states. Under the proposals before you now, current members will pay more for the same benefits. New participants will pay the increased rate but receive lower benefits.

Other problems would arise from the individual benefit reduction proposals. Capping benefit increases for new hires at two percent on the first \$24,000 means members will lose purchasing power rapidly upon retirement. The TRS money purchase feature is a standard element of good plan design and is fair to members and the state. It is based on a statutory six percent interest rate that is set well below our actuarial assumption and the experience of the past 20 years.

Remember, too, that TRS members are not covered by Social Security. The state has consistently opposed coverage for the very sound reason that mandatory coverage

increases the total pension/retirement cost. As a result, the TRS plan is far more efficient. The efficiency comes at the cost of the loss of the Social Security safety net. As a result, one should be extremely skeptical of any defined contribution proposal that overlooks the member's essential economic security.

Funding

In addition to benefit reductions, you are being asked to consider extending the current 50-year funding period. New funding scenarios were prepared for today's meeting that extend the funding period to 70 years. In other words, the funding program would not be complete until a teacher entering the system this year is 82 years old.

It does not take an actuary to conclude that extending the funding period will not save the state money in the long run. The interest clock will continue to run. You cannot fund the pension systems at whatever level is convenient and expect pension funding obligations to go away.

Efficiency and effectiveness

TRS continues ongoing efforts to minimize state funding requirements through careful administration and wise investment of available assets.

- The FY2006 funding request reflects a \$12 million reduction by matching the contribution rate from federal funds with the rate paid through the state contribution.
- TRS has exceeded actuarial earnings assumptions when measured over both 10- and 20-year periods. Last year's 16.5 percent investment return resulted in an \$18 million reduction in the FY2006 contribution request.
- Our careful control of administrative expenses is demonstrated by overall costs that rank below our sister systems in Illinois and nationwide.

Our recommendation is based on our understanding of the history of state funding. That history shows the state has consistently changed the rules whenever the cost of past irresponsibility grew too great. In an attached perspective, we review some of these past choices. I am hopeful that it will help explain why we urge you to stay the course and comply with the funding law.

Sincerely,

Jon Bauman
Executive Director

Attachment: Perspective on State Retirement System Funding

cc: John Frigo, Office of Management and Budget
Lance Weiss, Deloitte Consulting LLP
Howard Freidin, Deloitte Consulting LLP

Perspectives on State Retirement System Funding

Years ago, the state had to pick between saving for pensions to be paid another day and paying for programs that many thought were of immediate importance.

So, money owed the pension systems for benefits being earned went to fund other programs.

Years went by. State funding needs increased faster than state revenue. Pension funding needs grew because state contributions were too low to cover actual costs, much less the interest on previously unpaid contributions. This caused unfunded liabilities to grow, slowly at first, and then much more rapidly. This is very similar to the amount due on a credit card growing when only minimum payments are made.

At one time, state law called on the state to contribute 120 percent of member contributions. This standard was never met.

A seven-year phase-in was enacted in 1989 (Public Act 86-0273) as part of a pension funding reform law. The purpose of the phase-in, or ramp, was to build increased contributions into the state budget over time and avoid the fiscal shock of doing it all at once. Additional funding under PA 86-0273 began in FY1990, in the amount of \$30 million, or half the amount specified by the new law.

The 1989 law had no teeth. State contributions were based on whatever had been appropriated the previous year, not the amounts certified by the retirement systems as the amounts required by the funding law. This was the era of “level funding.”

In 1994, another funding law was enacted, but it had teeth. Public Act 88-0593 contained a continuing appropriation requirement. Funding was not an option and the General Assembly has faithfully followed this mandate every year since enactment. (This act is often called the 1995 law because the funding requirements first became effective on July 1, 1995.)

By the time the 1995 law was enacted, the systems' unfunded liabilities had grown dramatically. The ramp was 15 years instead of seven because the difference between what the systems were getting and what they needed had grown so much higher. While the ramp spared short-term budget pain, it legalized continued under funding for the next 50 years.

Now we are discussing funding for FY2006, the 11th step on the 15-year ramp. The required contributions are high, and they will continue to increase as anticipated in the 1995 funding law. The ultimate funding levels would have been lower if the unfunded liabilities had not grown so large by 1995 and if the ramp had been shorter. The ramp allows the unfunded liabilities to grow since the required contributions are lower than required under a more standard actuarial funding method.

What has changed since the 1995 funding law? Three things:

1. Asset valuation method: FY1999 and subsequent funding requirements were reduced because assets were valued at market rather than book value.
2. Benefit increases: Illinois pensions were brought closer to national averages. State employees and teachers paid significant portions of the costs. The state pays for about 25 percent of the cost of increasing teacher benefits to the 2.2 formula.
3. Revenue decline / Pension obligation bonds (POBs): State revenues suffered in the wake of the economic downturn that began the new century. While state retirement system assets also declined, they did not cause the increased funding requirements. These were largely due to the ramp. In 2003, the state issued pension obligation bonds to help fund the retirement systems. Appropriations to the retirement systems were reduced by the amount the state owed as debt service. The state contribution for TRS for FY2006 is actually \$290 million less than would have been required absent the POBs.

What has not changed?

The state's responsibility to fund pensions as promised did not change.