



WORLD BANK GROUP
Social Protection & Labor

The Illinois Pension System Case Study

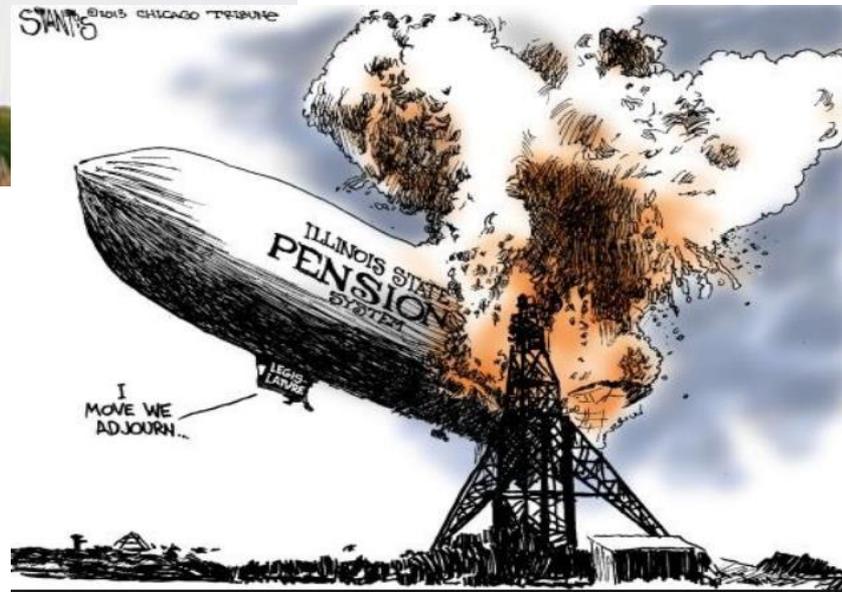
Pensions Core Course

April 26, 2016

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Organization

1. Historical background and causes
2. Questions for discussion
3. The Exercise
4. Epilogues

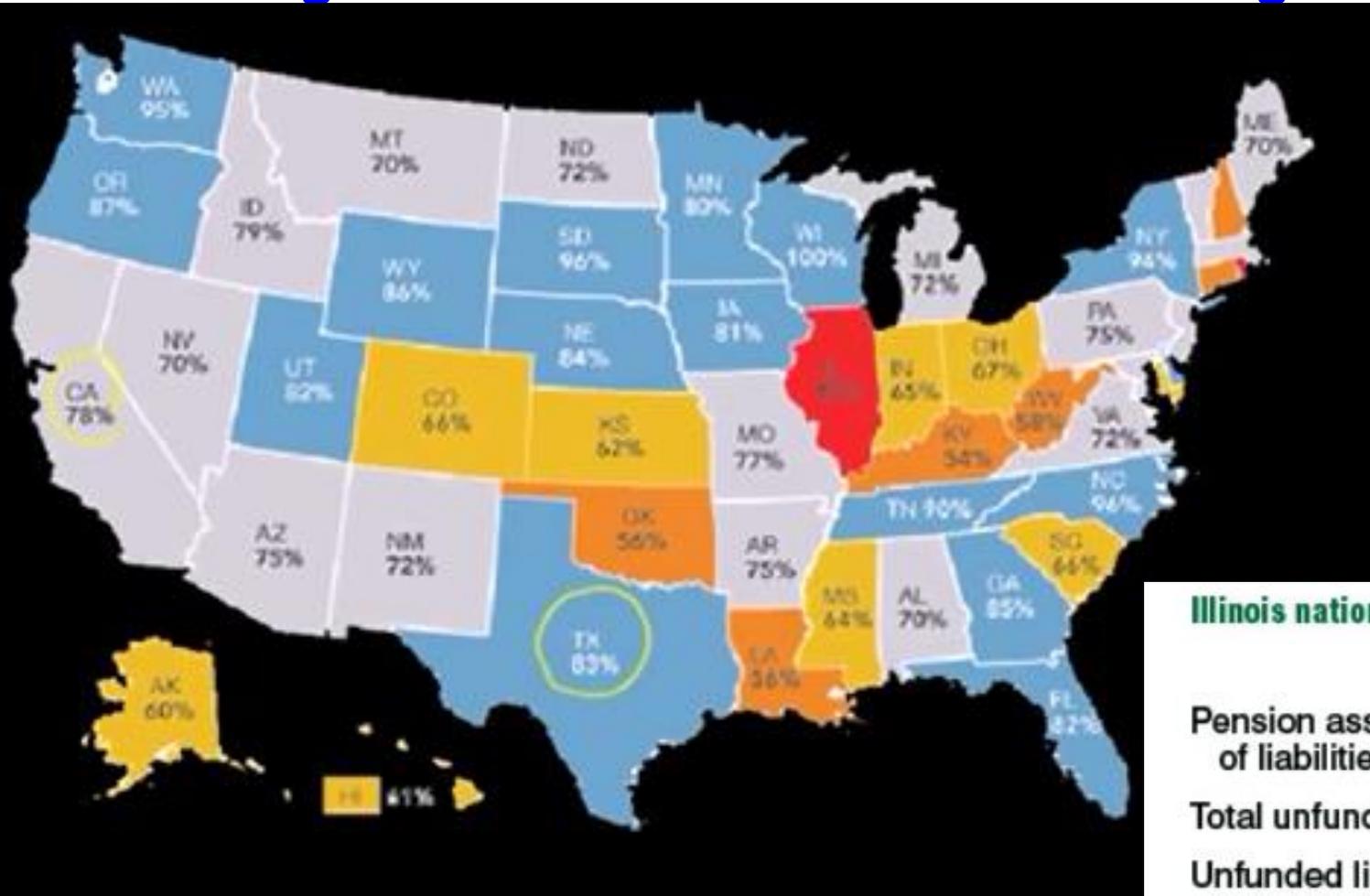


Background - US State Pension Funding Status

In 1917, the Illinois Pension Laws Commission warned State leaders in a report that the retirement systems were nearing “insolvency” and “moving toward crisis” because of the State’s failure to properly fund the systems. This nearly century old report also recommended action so that the pension obligations of that generation would not be passed on to future generations.



Background - US State Pension Funding Status



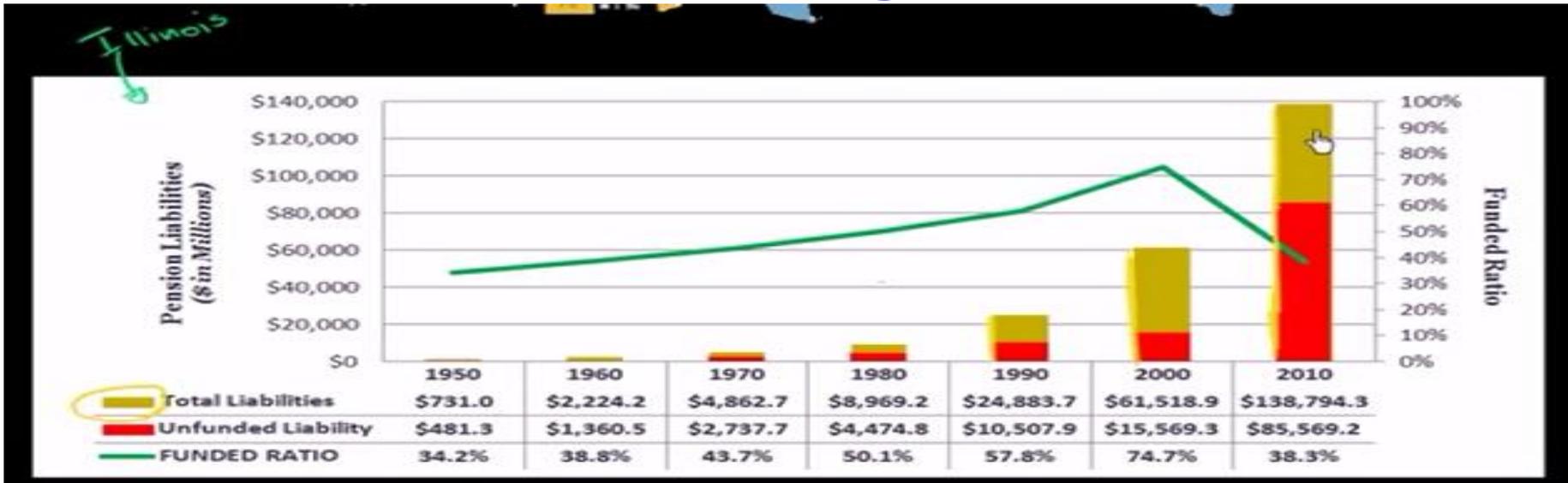
Illinois national pension ranking

State ranking

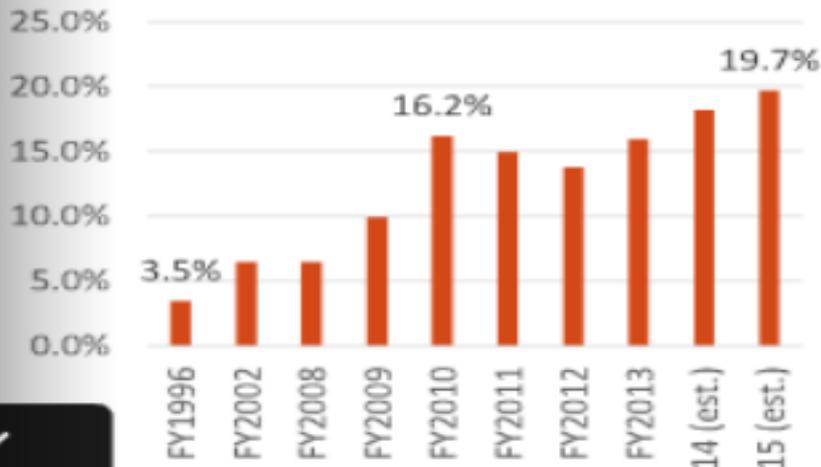
Pension assets as percent of liabilities	50
Total unfunded liability	49
Unfunded liability as percent of tax revenue	48
Unfunded liability as percent of state GDP	44

Source: The Pension Bomb, Joshua Rauh, The Milken Institute Review, First Quarter 2011

Historical Background



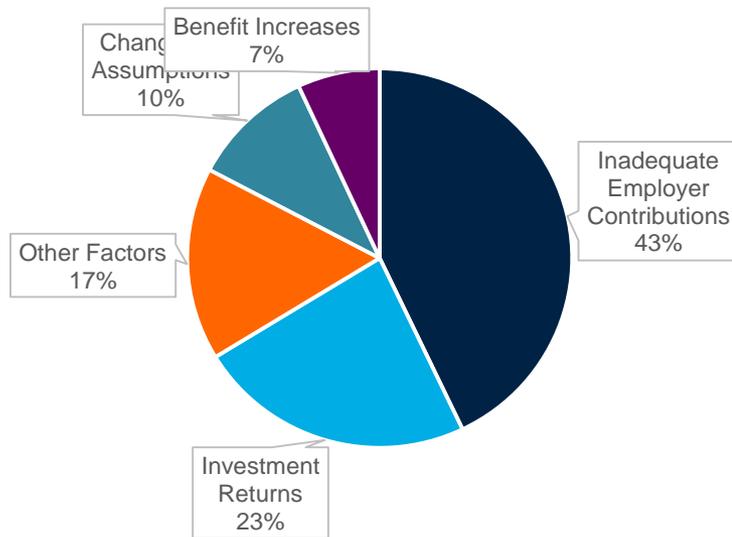
State of Illinois **General Funds** Pension Contributions as % of State-Source General Funds Revenues



Unfunded Liability Per Capita of State Pension Funds for Illinois Residents FY2004 vs. FY2013

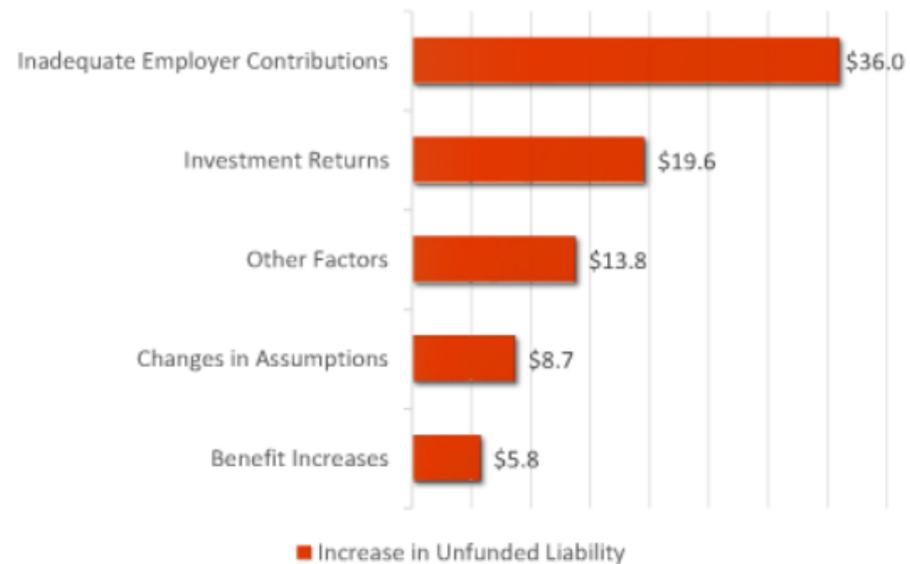


Causes



- Inadequate Employer Contributions
- Investment Returns
- Other Factors
- Changes in Assumptions
- Benefit Increases

Increases to the **Unfunded Liability** of Illinois' Retirement Systems FY1996-FY2013 (in \$ billions)

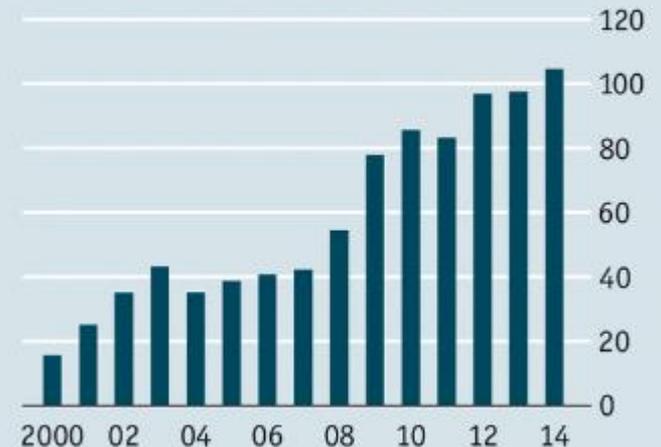


Questions for Consideration

1. Why has the Funded Ratio fallen so precipitously?
2. Is the Funded Ratio of concern to workers, taxpayers and the State Treasury?
3. What are the options to remedy it?

The optimistic view

Illinois unfunded pension liabilities*, \$bn



Source: Commission on Government Forecasting and Accountability

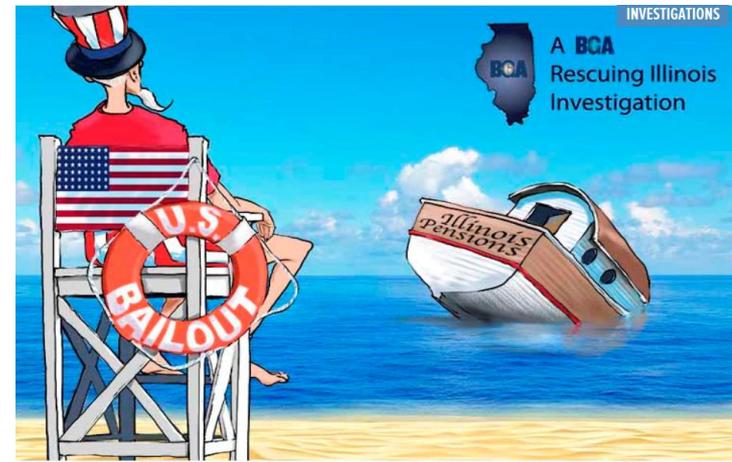
*Based on asset market values

Questions for Group Exercise

- Divide into 3 groups:
 - (i) **Public service employees' confederation;**
 - (ii) **Illinois State Treasurer;** and
 - (iii) **Association of Illinois taxpayers.**
- Evaluate the choices and formulate a reform program.
- Key questions to address in reform program:
 1. What are the changes in parameters and qualifying conditions that you propose for your constituency?
 2. How will the proposed changes improve contribution affordability, benefit adequacy and/or Illinois fiscal sustainability (including quantifying the results)?
 3. What are the tradeoffs you see in achieving these goals?
 4. How do the proposed changes meet the needs of your constituents?

Reform Options

1. Pension Bonds
 - a. Soft (implicit) debt becomes hard & payable
 - b. State highly indebted
 - c. Effect on price of existing bonds -> total debt service costs
2. Change in Asset Allocation
 - a. Increase allocation (already 30%) to private equity and hedge funds?
 - b. Invest in other assets to exceed the hurdle rate of 8.5%
3. Raise Corporate & Personal Income Taxes
4. Increase Employee Contributions
5. Decrease Plan Liabilities
 - a. Increase normal retirement age for new employees to 67.
 - b. Reduce the accrual rate
 - c. Increase the years in the wage base from 5 to 8.
 - d. Limit COLA to 3% or $\frac{1}{2}$ of CPI whichever is less.
6. Put in place DC plan for new employees
7. US government bailout?



State Constitutional Constraint

According to the Illinois Constitution:

Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, *the benefits of which shall not be diminished or impaired.*

2013 Legislative Reform

Report: Pension Crisis Risks Crippling Illinois

100 retired teachers in Illinois earning more than \$15,000 per month



BY: Bill Morris [Follow @FBillMorris](#)

October 29, 2013 12:41 pm

Illinois pays six-figure salaries to nearly 5,000 teachers who will not set foot in a classroom this year via the state's beleaguered pension system, according to a new study.

Lawrence Wyllie, former superintendent of the Lincoln-Way school system, draws nearly \$300,000 each year in retirement and



"Teachers, caregivers, police, and others stand to lose huge portions of their life savings," We Are One Illinois, a coalition of labor unions, said in a statement.

On the flip side, some argued that the reform doesn't go far enough. Illinois, which has the worst credit rating of any state in the country, has set aside only 40% of the funds it needs to pay the pensions it promised current workers and retirees. Today, 20 cents of every tax dollar goes toward pension obligations -- up 400% from two decades ago, according to a recent report.

Epilogue 1. - 2013 Legislative Content

- **Limiting COLAs.** 3% COLA remains in place, but amount of pension to which the COLA applies capped, typically at \$1,000 per year of service.
 - Effect: Protects COLA's value for lower-paid workers, but those who received bigger pensions lose some ground to inflation.
- **Raising the retirement age:** Workers age 45 or under: retirement age rise by up to five years. (The younger they are today, the higher the age will rise.) In many cases, that'll mean an increase in the full retirement age to 60, from 55.
- **Giving funding requirements more teeth.** The legislature commits to contributing a set amount to the pension plans each year, and public-sector unions would have the right to sue if the state fell short of those commitments.
- **Reducing mandatory contributions.** Required worker contributions decrease by 1 percentage point (employees' average around 5%).
- **Creating a 401(k) option.** Some employees could choose to invest their retirement savings in a self-managed 401(k) type plan, rather than pooling it with the state retirement funds.
- **Fiscal savings.** Est. savings of \$160 billion over three decades -- desperately needed to help fill the state's \$100 billion pension shortfall.

Epilogue 2. – 2015 Court Ruling and Legislative Impasse

Illinois Supreme Court Rejects Lawmakers' Pension Overhaul

By MONICA DAVEY MAY 8, 2015



- May 2015 State Supreme Court over-ruled reform program.
- 2016 Budget not enacted
- 2017 Budget proposal submitted (without pension reforms)
- Efforts to get Federal support