

FY10 Illinois Pension Reform Proposals
SURS Implications
Fact Sheet
5/22/09

Pension reform measures covering all of the State employee retirement systems were initially proposed in the Governor’s Fiscal Year 2010 (FY10) Budget. To create “uniformity” between the five state pension systems, the Governor recommended implementing changes in retirement age, benefit formulas, cost of living adjustments (COLA), and employee contributions for new employees employed after a future date¹. Senate Bill (SB) 1292 contains amendments to the Pension Code consistent with the proposals outlined in the Governor’s budget effective for **new employees** hired August 1, 2009 and thereafter. **SB1292 contains no amendments to benefits or contribution rates for current employees.** A summary of the recommended changes as outlined in the FY2010 Illinois State Budget and SB1292 and their specific impact on employees participating in the State Universities Retirement System (SURS) are outlined below:

Change Factors	Current - SURS	Proposed Governor’s Budget/SB1292 All Systems (SURS, SERS, TRS, JRS, GARS)
Retirement Age	<p>SURS retirement annuities are paid for life. Retirement annuity can begin when any of the following conditions are met:</p> <ul style="list-style-type: none"> • At least age 55 and have 8 or more years of service • At least age 62 and have 5 or more years of service • Any age when 30 years of service is achieved, provided covered employment terminated on or after August 2, 2002. 	<p>Governor’s Budget: Age 67 (for those born after 1960) for unreduced benefits. No combination of age and service will qualify an employee for full retirement benefits.</p> <p>SB1292: Age 67 with at least 10 years of service or age 62 with 35 years of service</p>
Retirement		
Early Retirement	<p>At least age 55 and have 8 or more years of service (benefits reduced for early retirement if retire between ages 55 and 60)</p>	<p>Governor’s Budget: Age 62 for early retirement.</p> <p>SB1292: Age 62 with at least 10 years of service</p>
Benefit Formula	<p>The average annual earnings during the 4 consecutive academic years of service in which the earnings were the highest.</p> <ul style="list-style-type: none"> • General Formula • Money Purchase Formula (available for employees hired prior to July 1, 2005) • Minimum Annuity Formula • Police Officer & Firefighter Formula <p>All eligible formulas will be used to calculate the retirement annuity. An employee will receive the larger of the eligible amounts. Regardless of the formula used, the applicable maximum will not be exceeded.</p>	<p>Governor’s Budget: 2.0% of final pay per year of service. Final pay is eight year average on base compensation. Credit limited to 35 years of service. Payable as life annuity.</p> <p>SB1292: 2.0% of the final average rate of earnings payable as a life annuity. The average annual rate of earnings is calculated across eight consecutive years during the ten year period during which earnings were the highest. Earnings are base earnings only and do not include overtime or bonuses. <i>The monthly rate of earnings used to determine the final average rate of earnings cannot exceed the (annualized) Social Security Covered Wage Base (currently \$106,800) or \$150,000, whichever is less.</i></p>

COLA	Each January 1st annuity will be increased automatically by 3% of the annuity. The automatic increase is a compounded percentage, with the 3% increase figured into the annuity amount each year. The first increase will begin on the January 1st following the month in which retirement occurs. It will be prorated for the number of months between the retirement date and the following December 31st.	<p>Governor's Budget: 50% of the change in consumer price index or 3%, whichever is less, applied to the annual benefit awarded upon retirement.</p> <p>SB1292: On the first anniversary of retirement and annually thereafter, the retired employee or survivor, who has attained age 67, will have their originally granted annuity increased by (1) 3% or (2) one-half of the percentage increase, if any, in the Consumer Price Index for All Urban Consumers measured from the preceding January 1 to January 1 of current year, whichever is less.</p>
Employee Contribution	8% Traditional	<p>Governor's Budget: Current Employees 10% New Employees 7%</p> <p>SB1292: Current Employees – no change New Employees 7%</p>

Additionally, proposed changes in SB1292 will not allow new employees to convert unused sick time into service credit. The bill is silent with respect to alternative Police/Fire employee formulas. The bill also introduces several new alternative forms of optional annuities for survivor benefits including: Joint and 50% survivor annuity, Joint and 75% survivor annuity, Joint and 100% survivor annuity, and Single life annuity with 60, 120, or 180 months of guaranteed payments.

With respect to pension system funding, the Budget Proposal limits the State's contribution to the five retirement systems to the "normal cost" for FY10 (\$1.52 billion), plus \$544 million debt service on Pension Obligation Bonds, resulting in a total FY10 contribution of \$2.06 billion. Normal costs represent the present value of benefits earned by system members during each fiscal year. The proposal makes no payment toward the accumulated State pension debt created by 30 years of underfunding the retirement systems. The Budget Proposal instead relies on plan design changes to support an assumption that no additional State contributions will be required to achieve the goal of reaching the 90% funding ratio by 2045.⁶ Plan design changes are assumed to reduce the accrued actuarial liability through 2045 by \$162 billion.¹

Implications for the SURS Sector

The combined effect of the Budget Proposal and SB1292 would cause SURS participants to subsidize necessary reductions in unfunded liabilities created in the other public retirement systems through benefit enhancements and early retirement incentives for which SURS participants were ineligible and from which they received no benefit. Further, the proposed changes, if implemented for the SURS, would result in the highest proportional impact among the five public retirement systems. For example, the SURS already has the lowest average monthly retiree benefit. Additionally, based on existing trends, the change in retirement age will especially affect the SURS. The average retirement age of SURS participants is 62 which would mean that most retirees would fit into the early retirement category, given the average service of 20 years, and receive a reduced benefit.

Comparison of Key Indicators Between Systems²

Key Indicators	SURS	TRS	SERS	GARS	JRS
Average Annual Salary of a Participant	\$43,460.00	\$60,254.00	\$56,008.00	\$78,064.00	\$161,070.00
Average Service of a Retiree	20	29	25 to 30	14	17
Typical Age of Retiree	62	69	69	60	63
Monthly Benefit Typical Retiree	\$ 2,609.83	\$3,461.08	\$2,251.03*	\$3,921.75	\$ 8,684.50

* Represents the amount received by retirees who are not receiving social security. A typical retiree receiving social security receive approximately \$1,798.12²

Senate Bill 1292 would limit the monthly rate of earnings used to determine the final average rate of earnings (FRE) to the annualized Social Security Covered Wage Base (currently \$106,800)³ or \$150,000, whichever is less. The current annual compensation limit for SURS is \$245,000 (for participants certified on or after July 1, 1996) based on the IRS 401(a)(17) limits.⁴ The higher education labor market encompasses many job groups with average compensation rates exceeding the Social Security Covered Wage Base. Accordingly, this new limitation would affect a relative large number of higher education employees in the future.

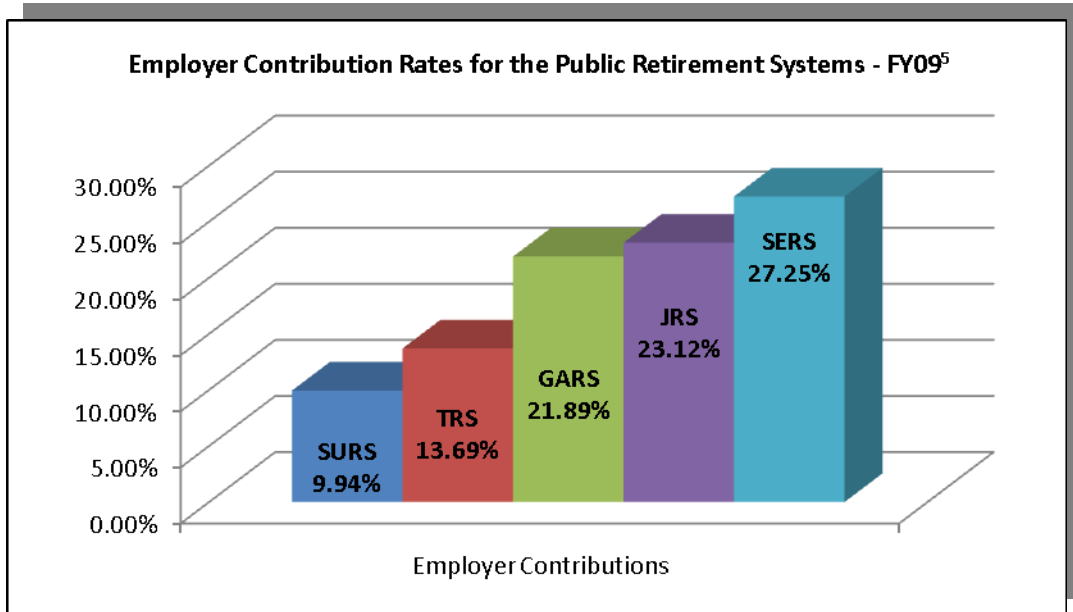
SERS, SURS, TRS, GARS, and JRS - Comparative Statistics⁵

Plan	Total Members	Active Members	Coordinated with Social Security	Employee Contribution	Employer Contribution FY09*
State Employees' Retirement System (SERS)	127,050	66,237	Yes (96% of active members)	8% Noncoordinated 4% Coordinated	21.049% - SERS 6.2% - OASDI 27.249% Total
Judges Retirement System (JRS)	1949	957	No	11% 8.5% (if not contributing to survivor's annuity)	23.12% Total
General Assembly Retirement System (GARS)	652	182	No	11.5% 9.5% (if not contributing to survivor's annuity)	21.89% GARS
Teachers' Retirement System (TRS)	355,584	165,572	No	9.4%	.58% School .50% School (Federal Sources) 12.61% State 13.69% Total
State University Retirement System (SURS)	189,089	73,086	No	8% for traditional plan	9.94% SURS

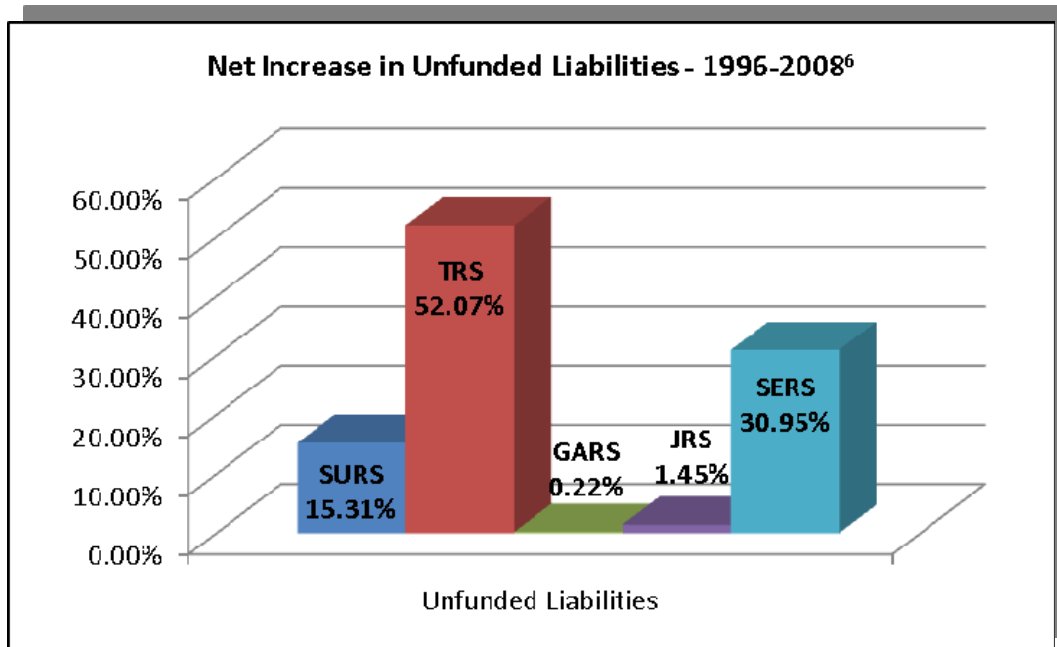
*Additionally, all employers contribute 1.45% to Medicare for employees

The level of State contributions to the SURS system as a percent payroll are the lowest in the state at 9.94% (see below) compared, for example, with a net 27.25% State contribution rate for most SERS participants. This difference is largely attributable to the fact that SURS participants have not participated in early retirement benefit enhancements that were legislated

for participants of the SERS and TRS. As a result, SERS benefits account for only 15.3% of the increase in unfunded liabilities since 1995.



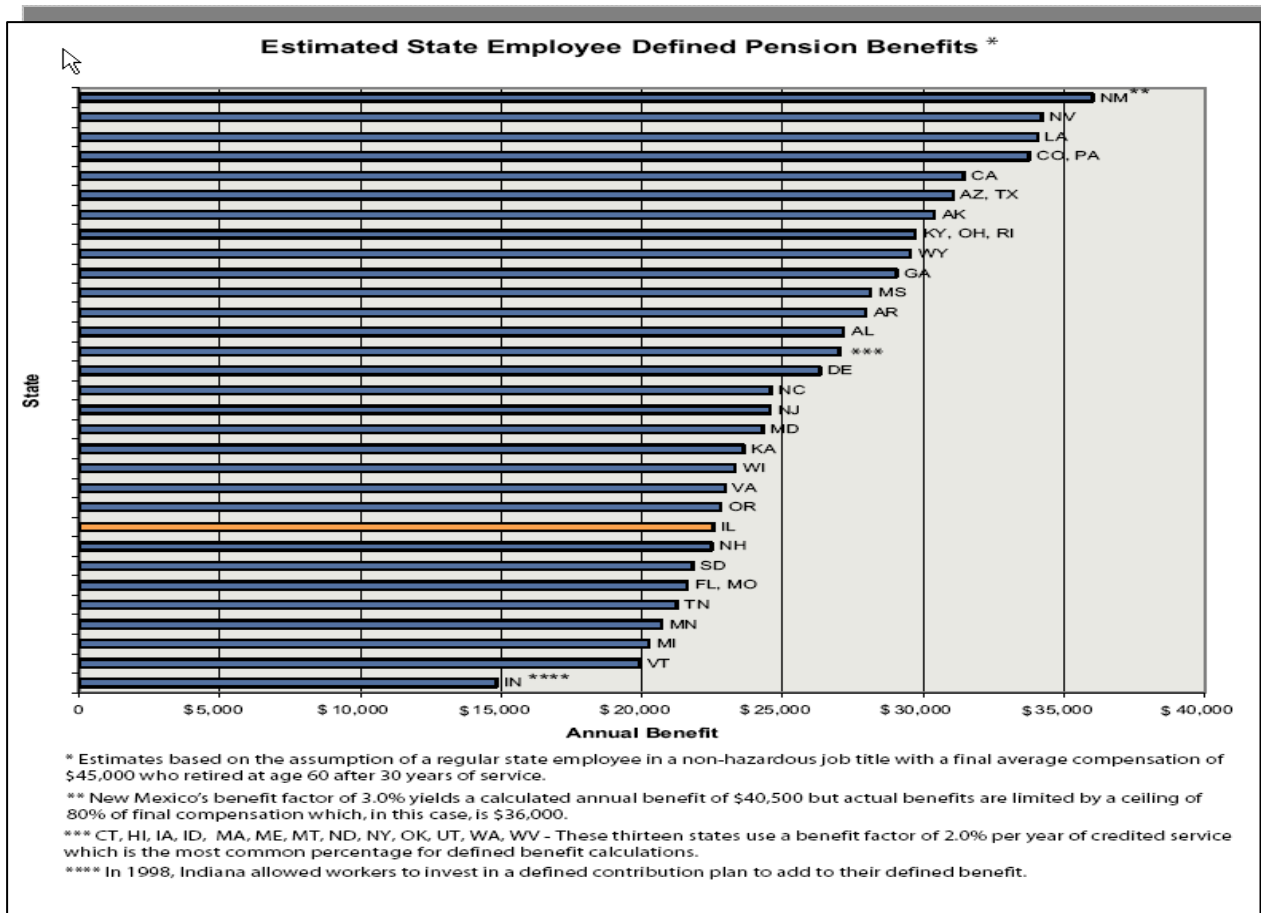
The SURS, university employers, employees, and annuitants have historically taken a very responsible approach toward inclusion of the system in various early retirement incentives and other specialized benefit proposals that would increase unfunded liabilities attributable to the SURS. Consequently, among the state public retirement systems, SURS maintains the lowest growth rate in unfunded liabilities and the lowest state contribution rates. Unfortunately, given the premise that the pension plan reforms are based upon budgetary implications of unfunded State liabilities, an inverse relationship exists between the benefit “reforms” proposed for SURS and the state funding/unfunded liability obligations attributable to SURS participants.



96% of SERS 66,237 active members are also coordinated with Social Security, meaning that these employees receive *both* unreduced Social Security benefits and a SERS pension benefit upon retirement.⁵ **The State of Illinois pays an additional 6.2% (OASDI) Social Security contribution on behalf of these employees.** Therefore (for FY09), the State of Illinois will pay a total of **27.249% in employer contributions on behalf of SERS participants** (21.049 SERS + 6.2% OASDI). In comparison the State of Illinois pays **12.61% on behalf of TRS participants and 9.94% on behalf of SURS participants.** In FY2010, the SURS state contribution rate would decrease by .22%, bringing the State contribution rate to 9.92%.

National Market Comparisons

The Illinois public higher education sector must compete in the national market for the recruitment and retention of qualified faculty and professional staff. In national IBHE peer group comparisons (2008) across the Illinois public universities, all-rank faculty salaries average **93.9%** of median peer group salaries.¹⁰ However, when salaries are combined with fringe benefits (including comparative pension plans), Illinois’ standing drops precipitously *at the current level of benefits.* **The pension reform proposals would considerably erode the competitive status of compensation levels offered by the Illinois public universities.** This trend is also reflected in the table below⁷:



SURS benefits are less-than “middle of the road” compared to national state employee defined benefit policies. “Illinois ranks in the bottom one-fifth of all states for retirement benefits for an average state worker.”⁸

Social Security Participation

SURS replaces Social Security (OASDI) and represents the only funded retirement plan for Illinois higher education employees. Whenever a SURS annuitant has eligibility for Social Security pension benefits, by virtue of independent private sector employment, those benefits are substantially reduced in accordance with the windfall elimination and government pension offset provisions, which apply to non-coordinated public retirement system benefits, contained in the Federal Internal Revenue Code. The average normal cost of providing the *current* SURS benefit package (9.94%) is equivalent to the federal Social Security OASDI annual cost rate (11.2%).⁹

Unlike Illinois, many public and private universities in other states provide opportunities for employees to participate in an internal retirement plan in addition to Social Security (similar to current standards for SERS participants). Essentially all private sector employers (including private universities) contribute to Social Security in addition to an internally funded retirement program, and/or a 401(k) alternative. In such cases, concurrent Social Security contributions are made and there is no subsequent offset to participant benefits in retirement. The public universities provide no matching contributions for supplemental employee 403(b) or 457(b) programs.

SURS Funding Status⁸

Fiscal Year	Total Actual Required Contribution (ARC)*	Member Contributions	Net State ARC	Actual State Contributions	State Cont as a Percent of Net ARC	Actual State Contributions - Net State ARC
1995	\$ 739.5	\$ 185.9	\$ 553.6	\$ 128.1	23.14%	\$ (425.50)
1996	\$ 787.1	\$ 197.0	\$ 590.1	\$ 147.4	24.97%	\$ (442.70)
1997	\$ 634.8	\$ 202.2	\$ 432.6	\$ 182.0	42.08%	\$ (250.60)
1998	\$ 512.1	\$ 221.7	\$ 290.4	\$ 227.8	78.44%	\$ (62.60)
1999	\$ 509.2	\$ 213.0	\$ 296.2	\$ 237.9	80.32%	\$ (58.30)
2000	\$ 547.8	\$ 222.5	\$ 325.3	\$ 241.1	74.11%	\$ (84.20)
2001	\$ 548.1	\$ 221.6	\$ 326.5	\$ 247.1	75.69%	\$ (79.40)
2002	\$ 686.9	\$ 251.6	\$ 435.3	\$ 256.1	58.84%	\$ (179.20)
2003	\$ 843.8	\$ 246.3	\$ 597.5	\$ 285.3	47.74%	\$ (312.20)
2004	\$ 934.8	\$ 243.8	\$ 691.0	\$ 1,757.5	254.34%	\$ 1,066.50
2005	\$ 859.7	\$ 251.9	\$ 607.8	\$ 285.4	46.96%	\$ (322.40)
2006	\$ 914.9	\$ 252.9	\$ 662.0	\$ 180.0	27.19%	\$ (482.00)
2007	\$ 968.3	\$ 262.4	\$ 705.9	\$ 261.1	36.99%	\$ (444.80)
2008	\$ 971.6	\$ 264.1	\$ 707.5	\$ 344.9	48.75%	\$ (362.60)
2009	\$ 1,147.3					
Total	\$ 11,605.9	\$ 3,236.9	\$8,369.0	\$ 4,781.7	57.14%	\$ (3,587.3)

(\$ in millions)

Member contributions have always been paid 100% by employees through automatic payroll deduction. The “Employer normal cost” is the cost to provide the benefits that are earned by active participants in the System for that year’s service, net of member contributions. Any time that the state contribution is not paying the employer normal cost, the liabilities of the System are increased. Historic State funding lapses resulted in the accrual of extreme future unfunded liabilities. In 1995, a funding plan was designed to resolve the unfunded liability and reach a 90% statutory funding ratio by 2045 (PA: 88-593).

Payment of the normal cost does not pay any portion of the unfunded accrued actuarial liability (UAAL).⁸ Standard pension funding as established by the Governmental Accounting Standards Board, called the “annual required contribution” or “ARC,” requires payment by the employer of the total normal cost for the fiscal year, plus an amount sufficient to amortize the UAAL over a prescribed period of time (currently through 2045).⁸ The net State/SURS ARC for FY 2008 was \$707.5 million.⁸ The chart above provides a comparison of the State contributions since 1995 as a percent of the net State ARC for the SURS. The total ARC went down for FY 1998 as a result of the change from book to market.⁸ The State issuance of Pension Obligation Bonds is reflected in the 2004 statistics. However, the net funding lapses still exceed \$3.5 billion in base dollars alone. This amount continues to negatively compound as past and future investment earnings are forfeited because of the original and continuing loss of scheduled State contributions.

Conclusion

The higher education sector is pragmatic about the reality of State unfunded liabilities and the continuing implications for the State budget process. Stabilizing the unfunded liability situation must take precedence regardless of the source of this problem. Otherwise, the stability of the pension systems will continue to decline, leading to even greater crises in the future. However, implementation of the proposed reforms should not be based upon an assumption that SURS benefits are excessive or inconsistent with the public higher education market. In reality, Illinois offers a relatively conservative pension program for higher education employees, that is not coordinated with Social Security, and which did not participate in popular State early retirement programs of past years. The funding crisis is solely related to the lapses of required State funding year after year. Should the reform proposals be implemented for future employees, Illinois’ public universities and community colleges will ultimately be forced to make other compensation adjustments necessary to attract and retain a workforce that must be competitive in regional and national markets.

¹ Illinois State Budget, Governor Patrick Quinn, Fiscal Year 2010

² Illinois Public Employee Retirement Systems - Center for Tax and Budget Accountability - April 2009

³ SSA/IRS Reporter, Winter 2008

⁴ Internal Revenue Service - <http://www.irs.gov/newsroom/article/0,,id=187833,00.html>

⁵ TRS, SERS, SURS, GARS, JRS - 2008 Comprehensive Annual Reports

⁶ Pensions: A report from the Commission on Government Forecasting & Accountability on the Financial Condition of the State of Illinois Retirement Systems as of June 30, 2008

⁷ Fiscal Focus, Illinois Comptroller’s Office - January/February 2007 Issue

⁸ SURS Information Booklet - March 2009

⁹ Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance (OASDI) Trust Funds - 2008

¹⁰ American Association of University Professors (AAUP) - 2008