PENSION REFORM: SB 42

OVERVIEW:

Since the creation of Illinois' retirement systems, government leaders have consistently failed to annually invest the manageable amount that an employer should to maintain a healthy, growing and stable retirement system. Because of decades of irresponsible fiscal management, Illinois has the highest unfunded liabilities in the nation.

Because the Illinois Constitution sets a high standard to protect workers and retirees, changes in benefits to pensions cannot be established in an easy fashion. Multiple court decisions have reinforced the pension protections. And while benefit structures of the past cannot be changed, new and modern retirement benefits can be established.

That's why creating new and flexible retirement options are critical. The new reforms aim to seek fairness for the worker, establish savings for the taxpayer and ensure funding manageability for the State of Illinois.

A Modern Hybrid Plan (aka "Tier III")

The "Tier III / Hybrid Plan" more closely reflects the private sector retirement plans where *newly hired* workers entitled to retirement benefits under the State Employee Retirement System [(SERS) (only employees *not* covered by social security)], State University Retirement System (SURS) and Teachers' Retirement System (TRS) will participate in a mixed defined contribution/defined benefit plan.

The concept and practice of a state-level hybrid plan isn't new. A popular hybrid system is available to a number of SURS employees already.

The hybrid plan seeks to reduce costs to retirement systems and taxpayers through a variety of means, including rebalancing the full burden of financial market fluctuations away from taxpayers. This natural investment return changes under the plan will be shared by (new) workers and the employer. The benefit to the worker and (future) retiree is the potential likelihood for growth in the DC portion of their account. So, should the market experience strong growth, the individual will reap that benefit.

A New & Meaningful Choice for Some Workers

The new plan also provides existing workers with the option to move into the Tier III hybrid system. This choice is provided to most workers under the existing Tier II plan, should they choose to make that adjustment.

A $500 Million Savings to State Taxpayers by Putting Costs on the <u>Actual</u> Employer

The new Tier III plan moves the "normal cost" (the standard employer portion of retirement investment costs) away from the state taxpayers to the local employer. The local employer is, for example, the local school district, instead of the state of Illinois. Under other set plans (Tier I & II), the local employer cost is covered by the State of Illinois.

Under the new reforms, savings are projected to be $500 million.

> ***SURS and TRS Cost shift***
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> Under the new reforms, SURS & TRS employers will now be responsible for making a pension contribution for employees whose salary exceeds that of the Governor's. The employers impacted are universities, community colleges and local school districts. This means that state taxes will not be directed to paying for pensions for employees well above average / high salaries.

Over $892 Million in Savings Through Investment Return "Smoothing."

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The pension reform plan also phases in, over a 5-year period, any changes in actuarial or investment return assumptions made by the pension systems. This creates a more manageable approach to making the state's payments to the pension system if assumptions change. For example, if a pension system originally assumes a 5% rate of return, but then changes that rate to 3%, state tax dollars are obligated to make up the outstanding 2% - to the tune of hundreds of millions of dollars.

The new smoothing provisions allow a reasoned approach to the state taxpayers if a pension system lowers its assumed rate of return, requiring an increase in the State's pension contribution. This new reform ensures that that change will be phased in over 5 years, allowing for manageability. Retroactive smoothing is also allowed back to FY 2014. This creates an estimated savings of $892.1 million.

ADDITIONAL REFORMS

Recertification / Recalculations to Establish Manageability
The reform package requires a recertification of the state contribution to reflect the changes made to GARS, JRS, SERS, SURS, and TRS by November 1, 2017. Because of smoothing provisions and other changes, the retirement systems will recalculate the payment owed by state government to reflect the savings and provisions for payment manageability.

Streamlining General Revenue Fund Contributions for SERS
For FY2018, the reform package continues the practice of consolidating all state revenue fund contributions to SERS into one collective line item. Past practice divided the contributions through a bureaucratic web of agency-by-agency appropriations. This reform is a simpler, more transparent way to account for payments.

SURS Direct Appropriation
Extends through FY 18 the existing requirement that contributions from the State Pensions Fund to SURS be a portion of the certified contributions, rather than being in addition to the certified contribution. This establishes a $155 million spending reduction.