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Senate Committee on Deficit Reduction

Pensions Hearing

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One of the most significant contributors to our state's fiscal challenges is our failure to properly set aside assets to meet our responsibilities to fund future employee retirement benefits. The lack of proper employer contributions and the recent significant adjustment in the value of investment assets now puts the state in a position where we only have 40% of the resources required to meet our future liabilities. This development has not occurred overnight but it has been a result of decisions made over the last 30 years. Our greatest concern is what will be required to service this $70+ Billion dollar debt. Future projections suggest that it will take as much as 25% of own source revenue to do so. That will take resources away from other things such as investments in education and the capital infrastructure of the state. Healthcare availability for our most needy citizens will be impacted by this enormous debt.

In order to understand our predicament, we should first look at the original design of the retirement benefit structure and evaluate whether times have changed to the point that they need to be changed to meet the modern day. Originally the benefit was structured to provide a decent retirement for our long term government employees. After a long and dedicated career one would retire (really) and be with us long enough to draw maybe ten years worth of benefits. Over the years age access to these benefits have been reduced, benefits have been enhanced, and the life expectancy demographics have developed to the point that some full benefit annuitants will now receive benefits for a period longer than they actually were employed. As these occurred the state did not keep up with the plan modifications and funding levels to produce a properly funded plan. The benefits available in the existing plans are much more generous than what exists today in the private sector. Initially, plan benefits were created in part to "compensate" for the compensation levels of the government versus private sector. There has been dramatic change in this arena since original plan design. (See attached chart.)

The other action or inaction, is once the underfunding level was acknowledged, the state designed a back loaded funding catch-up program that pushes the problems down the road. This funding plan creates even larger fiscal challenges for future state leaders as they will be balancing the pressures of demand for government services and a responsible tax structure. The state's long term fiscal health is dependent upon a balanced tax burden that can keep Illinois competitive for both job creation and investment.

The answers then are pension program redesign and an adherence to a fiscally responsible funding plan for current normal costs and debt amortization. I will address the components of the first and ready to discuss the funding plan at the appropriate time.

Pension program redesign should start with what is the level of benefit we want to provide and at what time should those benefits be able to be accessed. We are concerned that at this time quite often employees that complete their career today in our various programs start drawing pensions at a relatively "young" age compared to those of a couple generations ago and in many cases start a new career at competitive compensation levels in the private sector where they start accruing new benefits usually under a defined contribution system. That generally was not the career path of the retiree when these plans were originally established. When you retired you retired.

So what are some of the options that should be considered?

1. Increase the retirement age to the levels incorporated in the Social Security program.
2. Determine the level of benefit that should be established at the end of the retiree's career. (% of replacement earnings.) This should vary dependent upon whether the employee is coordinated with Social Security.
3. Change the annual accrual rate to correspond to the later retirement age and level of benefit.
4. Change the COLA adjustment to a more reasonable level.
5. Rationalize and increase the employee contribution responsibility.
6. Determine whether we should convert to a defined contribution program rather than a defined benefit system or some form of hybrid. Under SERS today employees are covered under social security, other programs are not. All private sector employees are covered under Social Security. One option would possibly be to establish a defined benefit program to produce the same level of benefits that could be achieved under Social Security (at a lower cost) coupled with a defined contribution or cash balance system.

One of the issues that should be reviewed is which of these proposed changes to our retirement plan structure could be adopted for current employees for prospective benefit accruals.

Inexorably, tied to these modifications is the impact they would have on the cost of retiree healthcare programs. Today the greatest retiree healthcare cost burden is associated with the early retiree. Full costs associated with these participants are impacted largely because of lack of the ability to coordinate with the Medicare program. The cost of employee healthcare coverage is greatest during the ten year period prior to Medicare coordination. A later retirement age would greatly reduce retiree healthcare costs.