

Illinois Pension Primer

A VISUAL GUIDE TO PUBLIC EMPLOYEE PENSIONS
IN THE STATE OF ILLINOIS



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What is a public pension?

A public pension is a type of retirement plan for public employees. The public employee and the government entity make contributions toward a pool of funds set aside for the employee's future benefit. The pool of funds is then invested on the employee's behalf, allowing the employee to receive benefits upon retirement. In Illinois nearly all public pension plans are **defined benefit plans**.* **Defined contribution plans** are more common in the private sector.

Defined Benefit Plan *

- Benefit is guaranteed to last throughout retirement.
- Based on a formula that considers years of service + average pay.
- Funded through employer and employee contributions and investment earnings.
- **Risk falls on employer** who must make up any shortfalls in funding.
- Much less portable than Defined Contribution.

Defined Contribution Plan

- Does not guarantee a specific benefit. Benefit is based on the amount of money in the plan at retirement.
- Combines fixed employer contribution with employee contributions.
- Common examples are 401(k), 403(b) and 457 plans.
- **Risk falls on employee**; employer obligation ends upon employee's retirement.
- Almost completely portable.

*** Most public employees in Illinois are not covered by Social Security for their employment with the State of Illinois.***

How many public pension plans are in Illinois?

There are
675

public pension plans in Illinois, operated by the State of Illinois and local governments including...

State of Illinois funds

- Teachers' Retirement System (TRS)
- State Employees' Retirement System (SERS)
- State Universities Retirement System (SURS)
- Judges' Retirement System
- General Assembly Retirement System

Chicago-area pension funds

- Chicago Municipal Employees
- Chicago Laborers
- Chicago Police
- Chicago Fire
- Cook County Employees
- Cook County Forest Preserve District Employees
- Metropolitan Water Reclamation District Employees
- Chicago Transit Authority Employees
- Chicago Public School Teachers
- Chicago Park District Employees

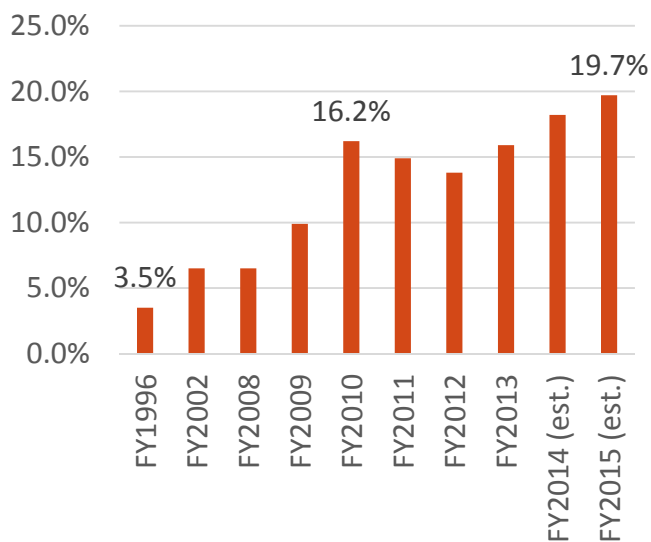
Illinois Municipal Retirement Fund (IMRF)

Approximately 660 Downstate & Suburban Police and Fire Funds

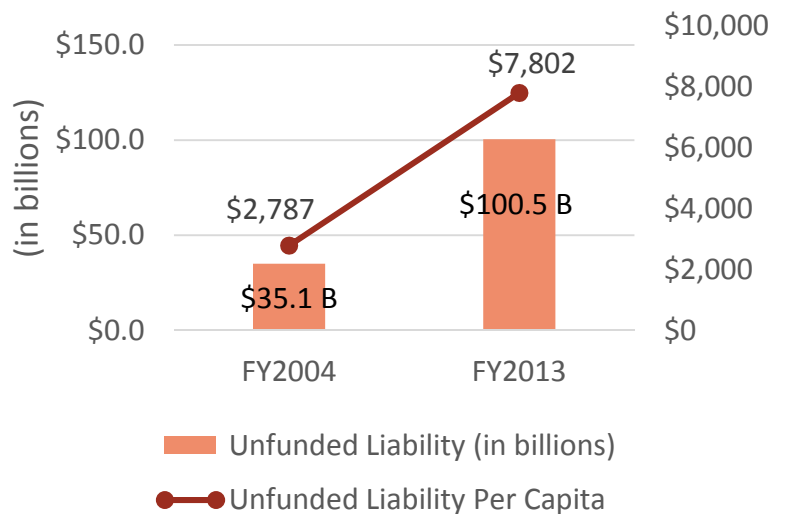
What do public pensions mean to Illinois taxpayers?

Pensions are designed to provide secure retirement benefits for public employees who provide government services. However, Illinois' unaffordable pension systems are crowding out these same essential services such as criminal justice, public health and education. The chart on the left shows the increasing percentage of Illinois' budget devoted to pension costs. But even this percentage has not been enough to keep the **unfunded liability** from growing. As the chart on the right shows, unfunded liabilities for all state funds equaled \$7,802 per resident of Illinois as of FY2013.

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



How are pension benefits calculated?

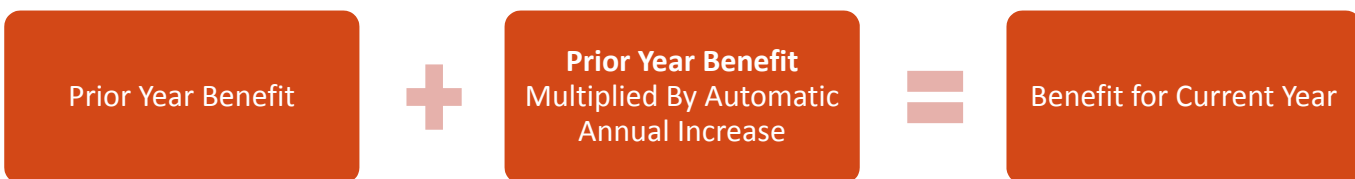
Sample Benefit Calculation for First Year of Retirement



Sample Benefit Calculation for Subsequent Years of Retirement (Simple Interest)



Sample Benefit Calculation for Subsequent Years of Retirement (Compound Interest*)



*The 3% **compound interest annuity increase** provided by many funds in Illinois is an expensive benefit, as an employee can effectively double their annual benefit within 25 years.*

Who pays for pension benefits?

Defined benefit pensions in Illinois are funded through **employee contributions**, taxpayer-funded **employer contributions** and **investment returns**. If contributions and investment earnings fall below expectations, the employer must make higher contributions to make up the difference.

This relationship can also be expressed as the fundamental equation of pension plan financing:

$$\text{Contributions} + \text{Income} = \text{Benefits} + \text{Expenses}$$

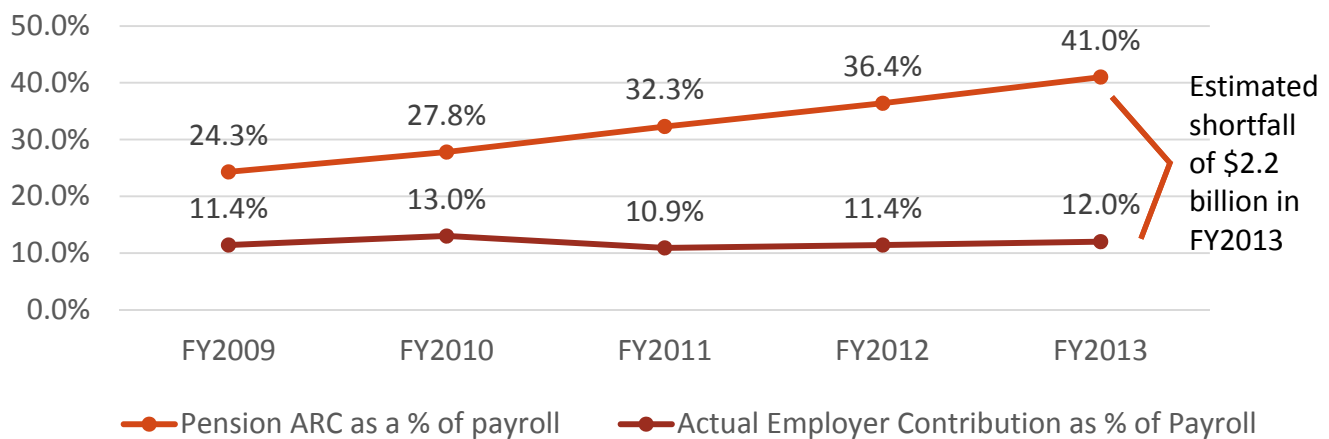
This equation shows how important **risk** is when designing a pension funding plan or deciding how to invest assets. It is the decisions made on the left side of the equation with regard to contributions and investments that largely determine how risky a defined benefit pension plan is to taxpayers. Ultimately, if too much risk is taken on by the plan, the benefits on the right side of the equation may be jeopardized.

The equation also impacts **intergenerational equity**, the principle that paying for the costs of current employees—including pensions—should not be pushed off onto future generations of taxpayers.

How much should governments contribute to their pension fund?

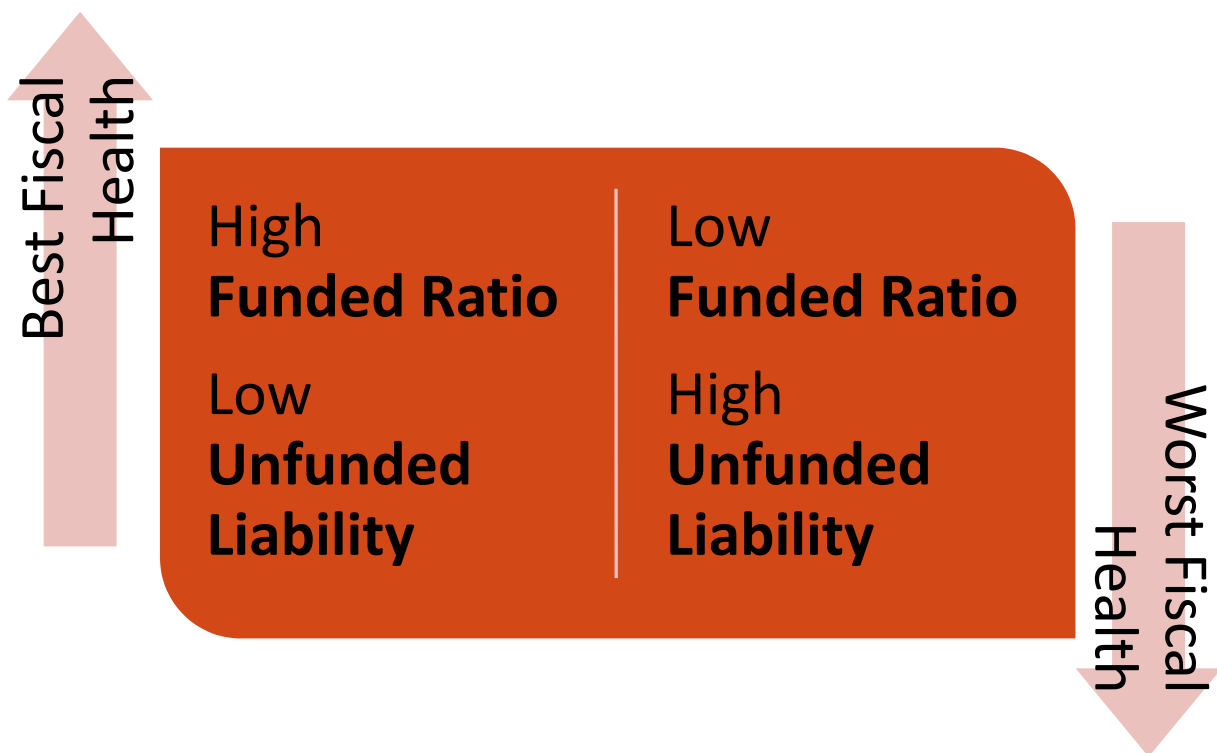
There is no required funding standard for public plans. However, a reasonable funding strategy is to pay the annual cost of the pension plan (“normal cost”) plus an amount to pay down any unfunded liability. An approximation of this standard was developed for reporting purposes by the **Governmental Accounting Standards Board** and can still be used as a benchmark. The “**annual required contribution**” or ARC represents a reasonable approximation of the amount of money the employer might contribute each year to cover current year costs and to reduce unfunded liabilities. The chart below shows how ten pension funds in the Chicago area are falling increasingly short of this commonly used benchmark.

Ten Chicago-Area Pension Funds Combined:
Annual Required Contribution vs.
Actual Employer Contribution
FY2009-FY2013



How do we measure public pension fund financial health?

A pension fund should hold exactly enough assets to cover all of its liabilities. The ability of a pension fund to meet this goal can be measured by two common indicators: **funded ratio** and **unfunded liability**. The chart below shows the relationship of these status indicators to the fiscal health of the fund.



How can the financial health of a public pension plan improve or deteriorate?

Four major factors influence a pension plan's funding status: sustained **investment losses or gains**, the adequacy of **employer** and **employee contributions**, **benefit enhancements** and changes to **actuarial assumptions** or methods.



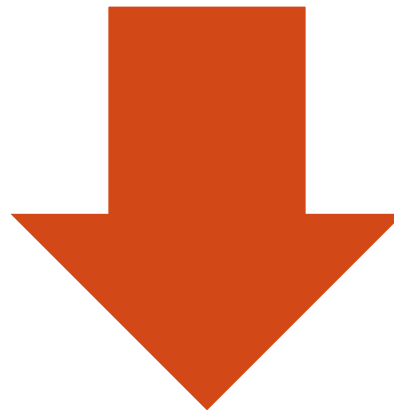
Improving Fiscal Health

- Sustained **investment gains**
- Adequate **employer contributions**
- Reasonable **actuarial assumptions** that are regularly reviewed and reassessed



Deteriorating Fiscal Health

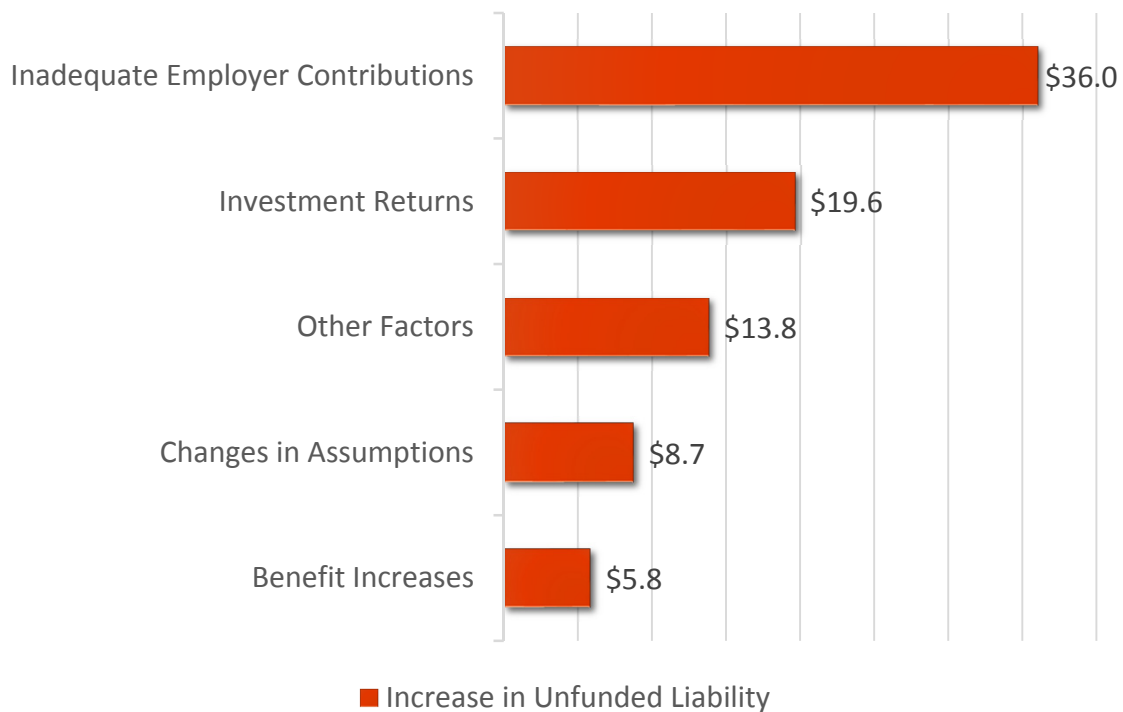
- Sustained **investment losses**
- Inadequate **employer contributions**
- Underfunded **benefit increases**
- Overly optimistic **actuarial assumptions** including rate of return



What has contributed to the financial deterioration of Illinois' pension system?

The chart below shows how each of these factors (sustained **investment losses**, inadequate **employer contributions**, unfunded **benefit enhancements** and changes to **actuarial assumptions**) has contributed to the dramatic increase in the State of Illinois' **unfunded pension liability** since 1996.

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



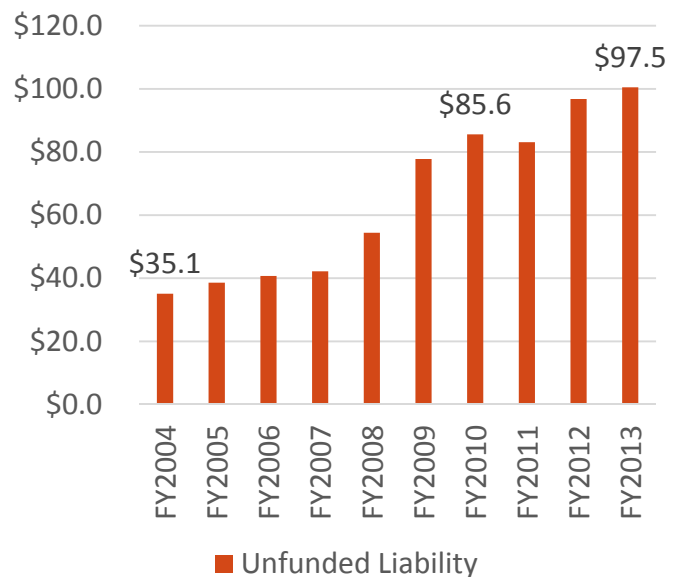
What is the status of Illinois' public pension funds?

The five state-funded pension funds have experienced a significant and ongoing decline in **funded ratio**, from a combined 60.9% in FY2004 to a combined 41.1% in FY2013. Combined **unfunded liabilities** for the five funds have increased by \$62.4 billion or 177.8% to nearly \$100 billion in FY2013.

Illinois Retirement Systems
Combined **Funded Ratio**:
FY2004-FY2013



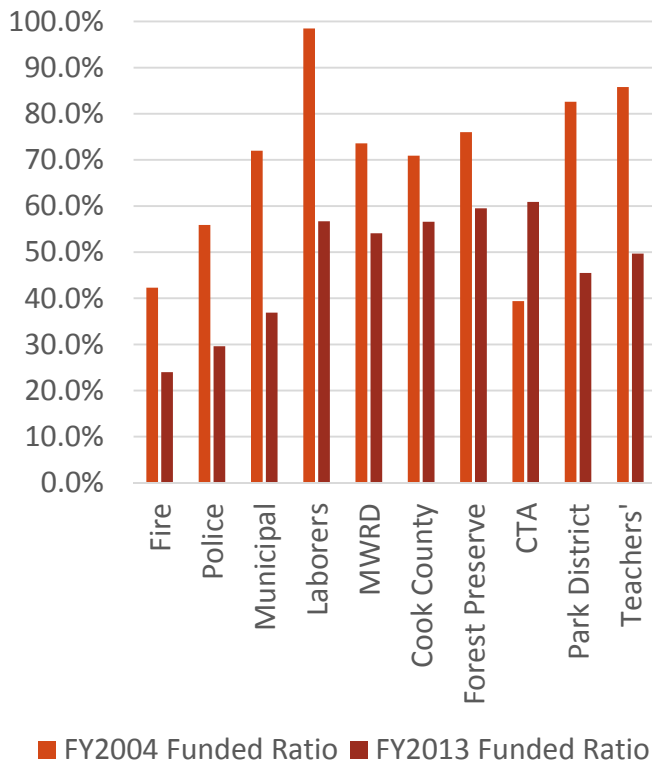
Illinois Retirement Systems Combined
Unfunded Liability
FY2004-FY2013
(in \$ billions)



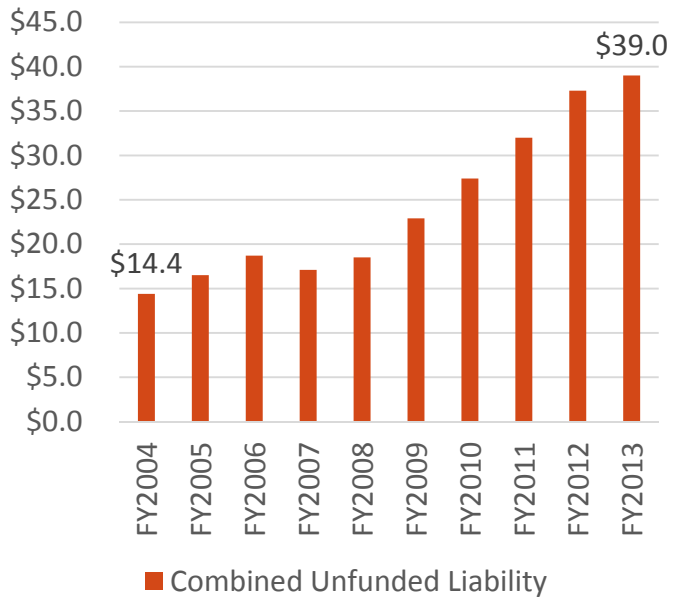
What is the status of public pension funds in the Chicago area?

The combined actuarial value **funded ratio** of the ten Chicago-area pension funds has fallen from 69.7% in FY2004 to 47.3% in FY2013. Combined **unfunded liabilities** for the same ten funds grew from \$14.4 billion in FY2004 to \$39.0 billion in FY2013.

Funded Ratios for Ten Chicago Pension Funds
FY2004 vs. FY2013

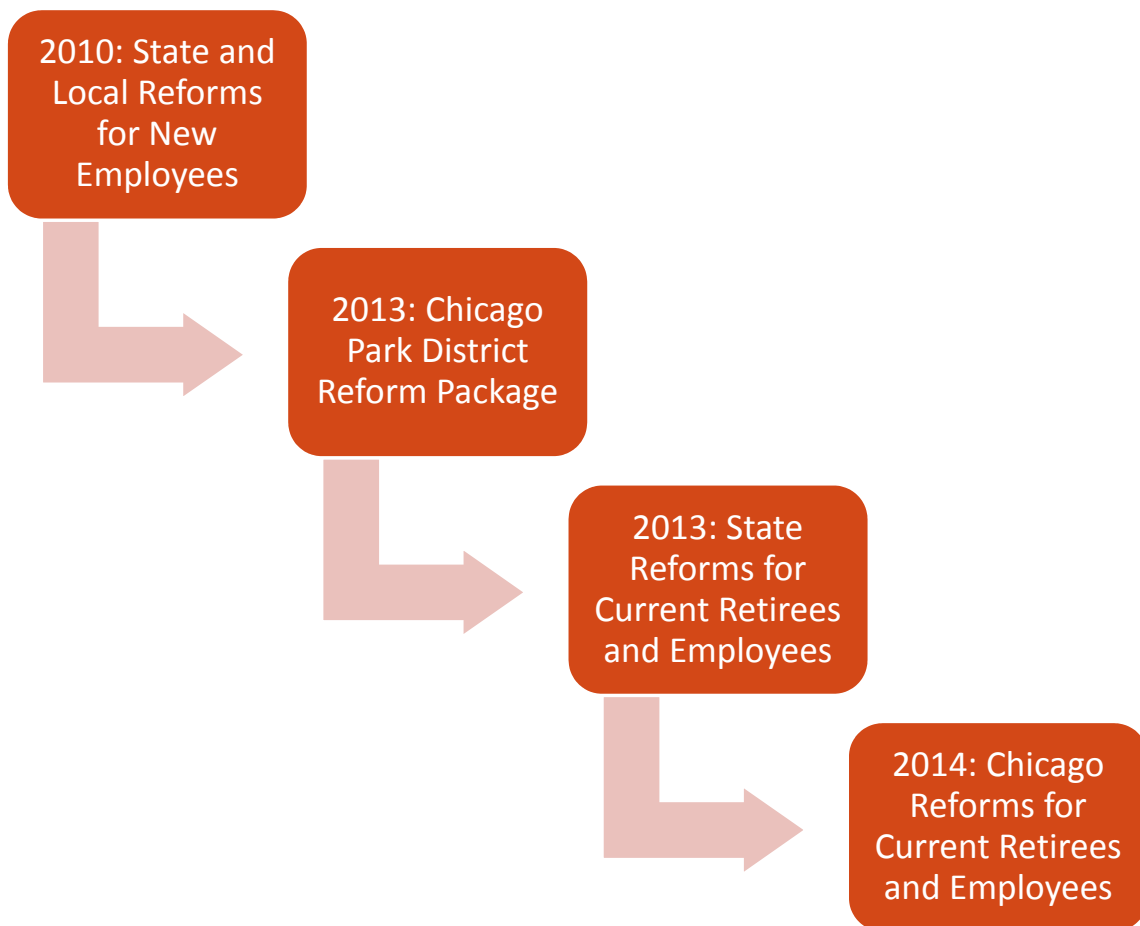


Ten Chicago Pension Funds Combined **Unfunded Liability**
FY2004-FY2013
(in \$ billions)



Source: Financial Statements for the ten funds analyzed, FY2004-FY2013
Funded ratio and unfunded liability based on actuarial value of assets.

What is being done to address Illinois' pension funding crisis?



**** Hover over each button for more detail on these selected reform efforts.****

As of publication of this report, the 2013 State pension reforms for current retirees and employees are being considered by the Illinois Supreme Court. The 2014 Chicago reforms are being considered in Cook County Circuit Court.

Want to learn more?

Read the companion piece to this visual guide for more detail on the concepts discussed here:

A Plain-English Guide to Public Employee Pensions in the State of Illinois

The Civic Federation annually publishes more complex and comprehensive reports on the status of local pensions in the Chicago area and State of Illinois.

Status of Local Pension Funding Fiscal Year 2012

State of Illinois Enacted FY2015 Budget: A Review of the Operating and Capital Budgets for the Current Fiscal Year

And follow the Civic Federation's blog or **@CivicFederation** on Twitter for ongoing analysis of fiscal developments across Illinois.
Civic Federation Blog & RSS Feed

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