Understanding Illinois Pension Problem

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June 17, 2010

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Agenda

- Retirement Environment Today
- Framing the Issue
- How and Why Did the Pension Problem Develop in Illinois?
- What Can Illinois Do About the Pension Problem?

Retirement Environment Today

- The pension funding crisis continues to put stress on government budgets and will likely continue to worsen without action
- Compliance with GASB Statement No. 45 Requirement for Postemployment Benefits Other Than Pensions (OPEB) creates even more budgetary stress
- The U.S. Economy is slowly struggling to improve
- Investment market fluctuations and volatility create uncertainty
- A shift in benefit philosophy has occurred: empowerment is in and paternalism is out
- The ability of Baby Boomers to afford to retire creates even more uncertainty
- There is a greater emphasis/understanding of defined contribution plans
- Awareness by members, rating agencies, press, tax payers, etc. of worsening public pension problem is increasing

Retirement Environment Today

The world in which public retirement programs operate has changed dramatically in recent years, and the programs must be proactively managed in order to maintain benefit/cost balance.

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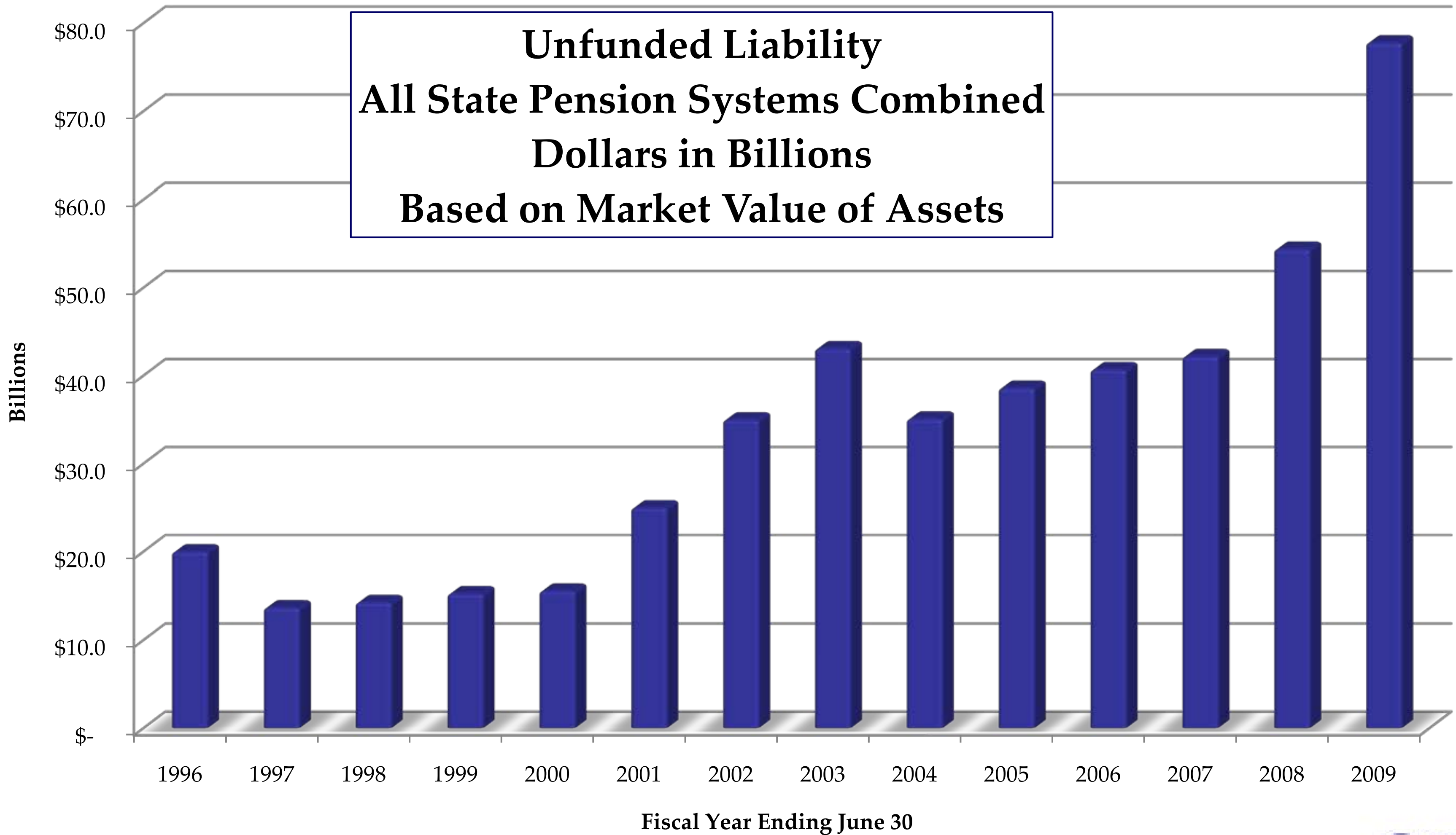
Framing the Issue
Unfunded Actuarial Accrued Liability



Source: 6/30/09 CGFA Report

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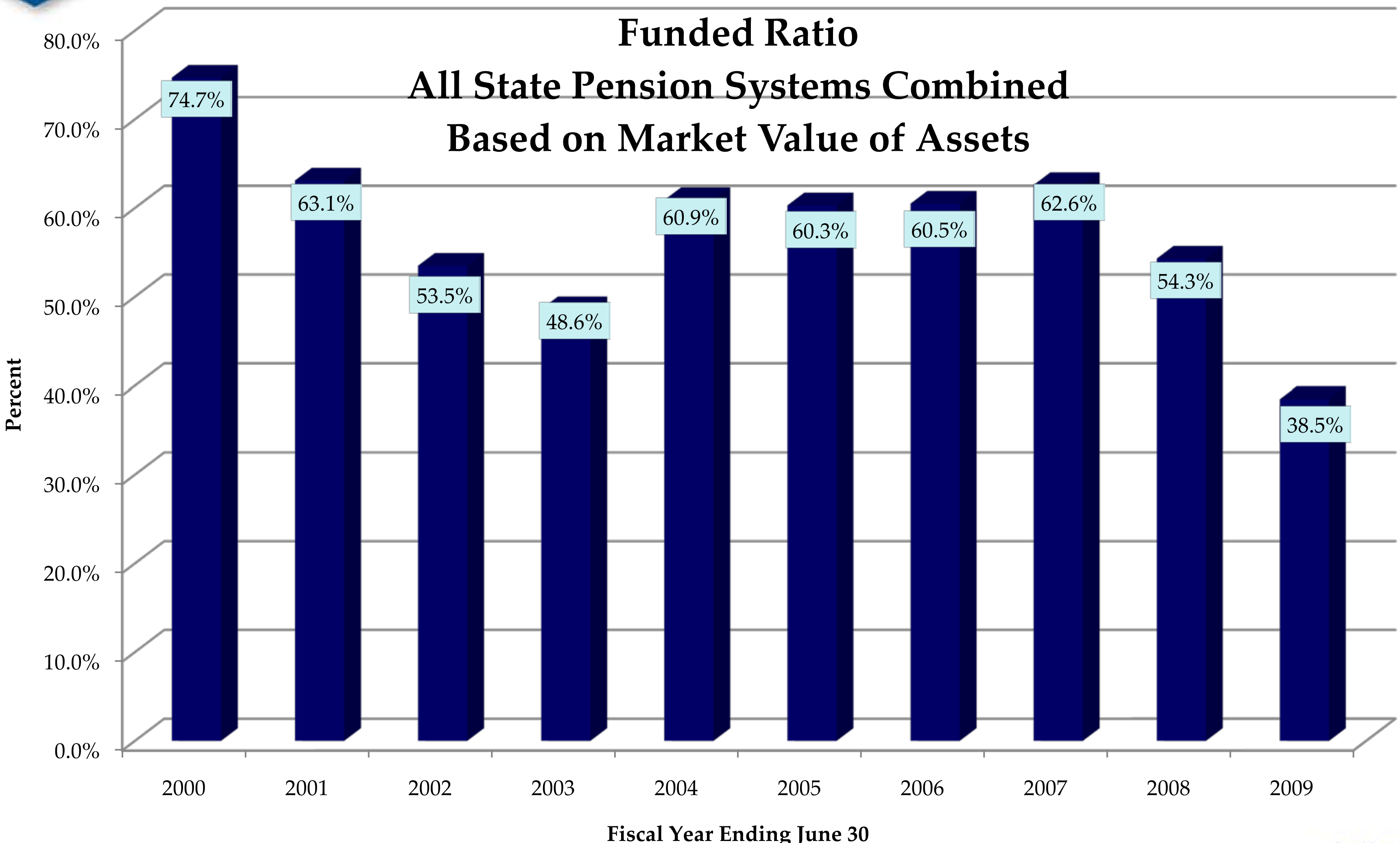
Framing the Issue
Funded Ratio



Source: 6/30/09 CGFA Report

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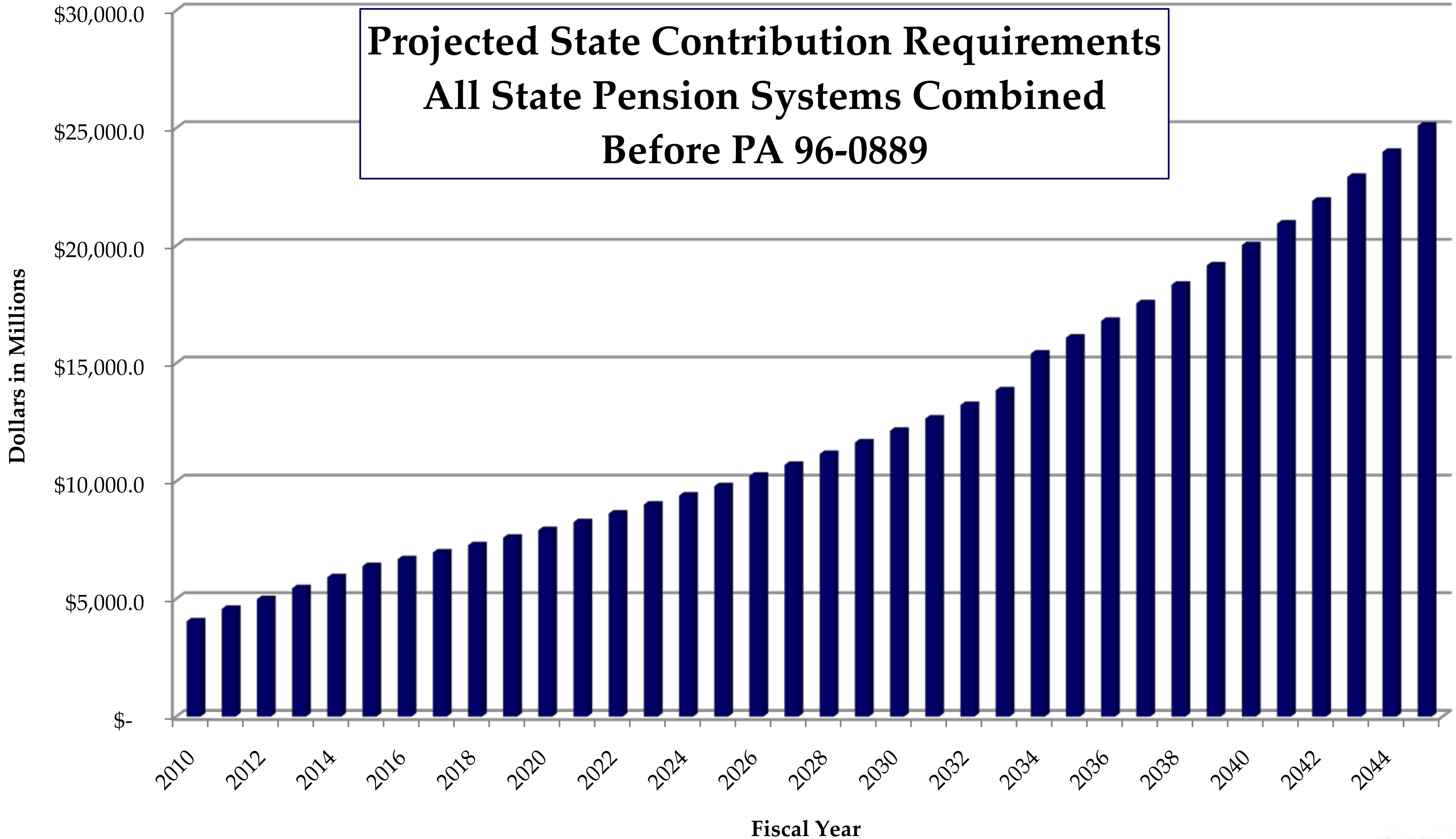
Framing the Issue

Projected State Contribution Requirements



Source: 6/30/09 CGFA Report

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Framing the Issue
Illinois Challenges

- Ability to Pay
  - Is the projected growth in pension funding requirements affordable in the near term as well as in future years?
  - Will the projected growth in pension funding requirements crowd out opportunities for the State to invest in education, economic development, and health care.
  - Is the current level of pension benefit sustainable in the future?
- Financial Rating
  - Could unfunded pension liabilities create an issue with rating agencies?
- Competitiveness and Retirement Security
  - How do benefits levels and features compare to other public and private plans?
  - Do current benefit levels allow members to retire at, above or below their pre-retirement standard of living?
  - How do the lower benefit levels provided under SB1946 for new hires compare?

How and Why Did the Pension Problem Develop in Illinois?

- Lack of any (ERISA equivalent) funding requirements allows for potential underfunding of pension liabilities
  - Public pension plans are currently under no Federal (IRS) requirement to annually contribute the amount needed to keep the unfunded from increasing

    (In fact, Public pension plans are not required to prefund their liabilities at all)
  - Public pension plans are currently under no Federal (IRS) requirement to maintain a fully (100%) funded plan
  - Public pension plans do not suffer any specific penalty for not maintaining a 100% funded plan
- Investment market downturn
- Benefit improvements, primarily during "good" times
- Little incentive or urgency to fix problem – or the "It won't be my problem after I am out of office" mentality
- Aging workforce
- Attraction/necessity of freed resources to spend elsewhere as result of reduced pension contributions

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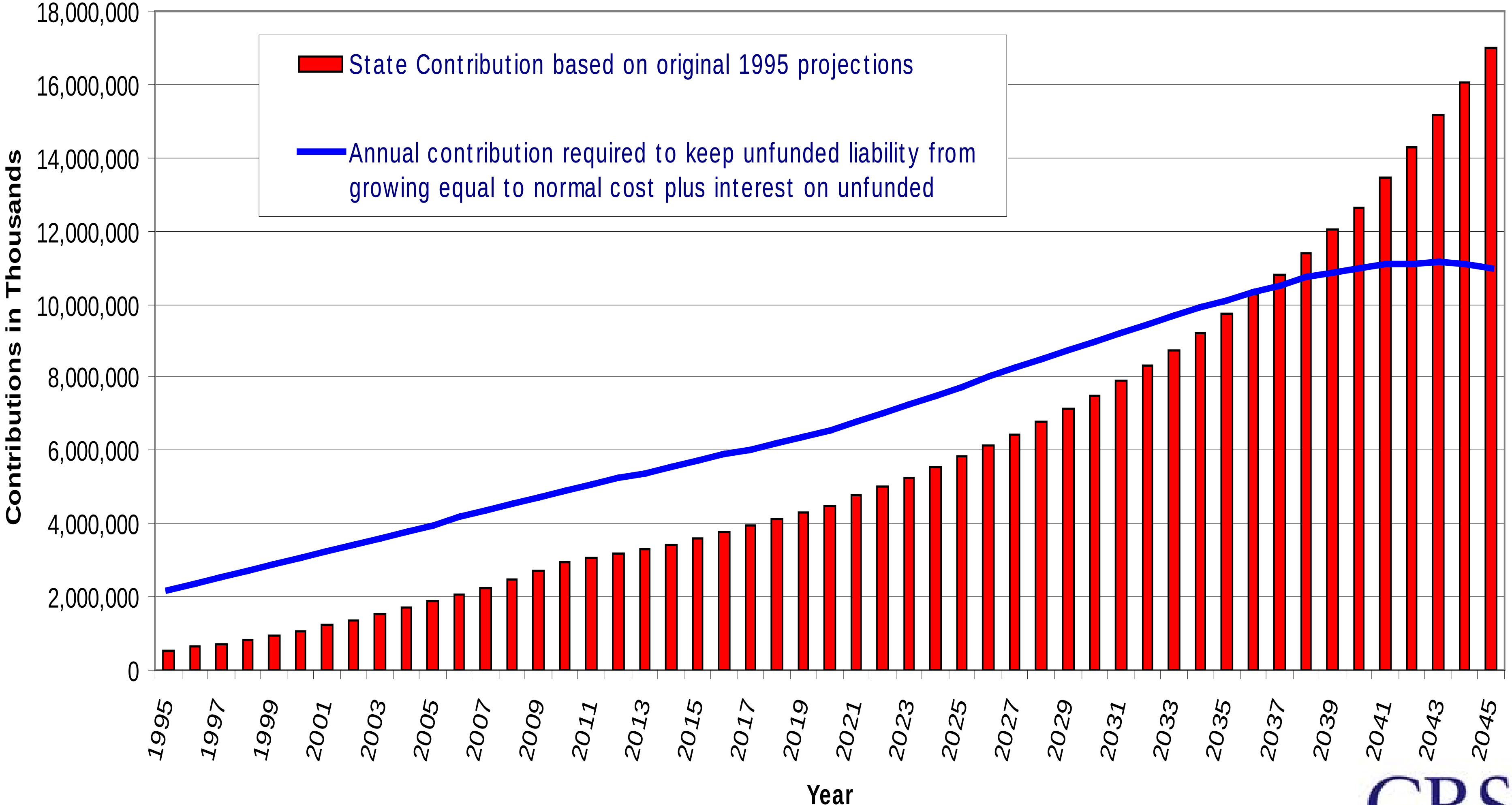
Projected State Contribution Schedule
In Accordance with Original 1995 Funding Policy



Source -- 6/30/94 Actuarial Valuation Reports

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Components of Change in Unfunded Liability 6/30/96 to 6/30/09

Factor	Total $	Percentage*
Salary Increases	$ 808,961,821	1.40%
Investment Returns (Based on MVA)	$ 23,132,399,120	40.06%
Employer Contributions	$ 20,398,326,908	35.33%
Benefit Increases	$ 5,777,251,947	10.01%
Changes in Actuarial Assumptions and Methods	$ -1,660,124,126	-2.88%
Other Factors Including Actuarial Experience Gains/Losses	$ 9,283,229,085	16.08%
Total	$ 57,740,044,755	100%

*** Percentage impact of each factor is highly dependent on the time period selected**

Source 6/30/09 CGFA Report

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What Can Illinois Do About the Pension Problem?

- Illinois Actions Taken to Date
  - Prior to 1995, according to a State Legislator, Illinois annually underfunded the five state sponsored retirement plans, pushing the costs onto future generations of tax payers.
  - In 1995, Illinois lawmakers approved reforms including a specific payment schedule to bring retirement system to 90% funding level by 2045. Payments were to gradually increase over a 15-yr phase-in period set to expire in 2010.
  - In July of 2003, the State issued $10 Billion of Pension Obligation Bonds ("POB")
  - Public Act 94-4
  - Public Act 96-0889 (SB1946)

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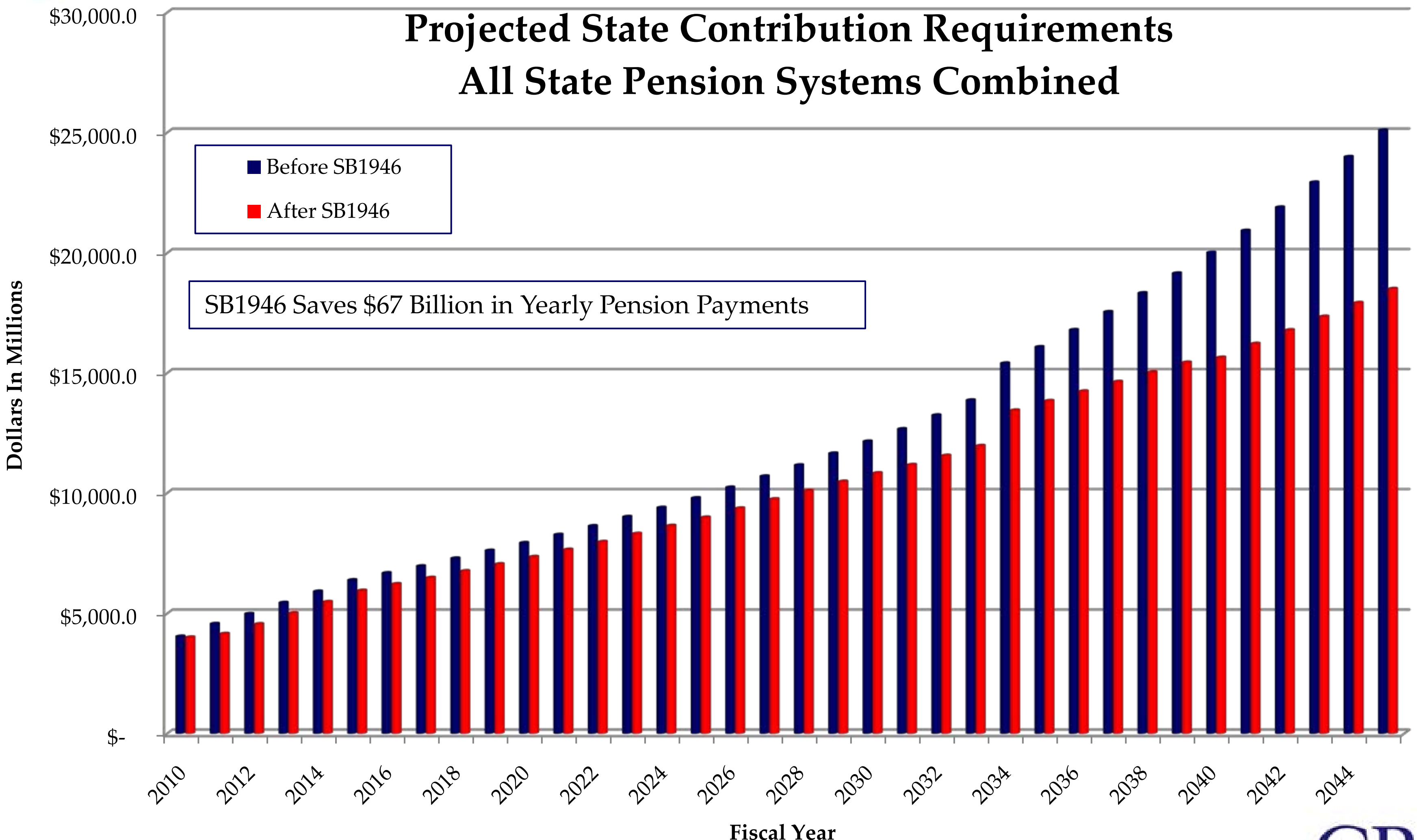
Projected State Contribution Requirements
Before and After SB1946



Source: Illinois Government News Network Website

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Challenges and Obstacles to Fixing the Pension Problem in Illinois

- Continued lack of any (ERISA equivalent) funding requirements allows for future underfunding of pension liabilities
- Uncertain investment market
- Little incentive or urgency to fix problem – or the "It won't be my problem after I am out of office" mentality
- Attraction/necessity of freed resources to spend elsewhere as result of reduced pension contributions.
- In Illinois, any pension benefit reductions are subject to interpretation of Article XIII, Section 5 of 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.
- Collective bargaining and employee relations issues
- Illinois borrowed money so the state could cover the legally required pension contribution on behalf of FY10, instead of making the payments out of operating revenue. It is now considering doing the same for FY11.

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Fixing the Pension Problem in Illinois
Pension Funding 101

	Benefits Paid
+	Administrative Expenses
-	Investment Return on Plan Assets
=	Ultimate Pension Plan Cost

- Benefits paid determined by negotiated and/or legislated plan provisions
- Administrative expenses determined by investment, funding and System policies
- Investment return determined by investment and funding policies

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Fixing the Pension Problem in Illinois
Pension Funding 101

	Benefits Paid
+	Administrative Expenses
-	Investment Return on Plan Assets
=	Ultimate Pension Plan Cost

- Ultimate plan cost generally shared by employees and employer
- Annual employee and employer contributions represent a systematic means of pre-funding the ultimate system costs
- Annual contributions for employees and employer generally set by statute

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Two Basic Approaches to Dealing with Illinois' Pension Funding Problem

- **Approach 1--Reduce Costs by:**
  - reducing basic and/or ancillary plan benefits (for current and/or new hires)
  - increasing investment return
  - reducing administrative expenses
  - finding alternate funding sources*
- **Approach 2--Defer Costs by:**
  - changing funding policy
  - changing actuarial assumptions
  - changing actuarial funding method
  - changing actuarial asset valuation method

* *Ultimate plan cost doesn't change, but plan sponsor and/or members share may be reduced*

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Questions?

For More Information…

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Acknowledgement

Thank you to Alex Rivera and Judy Kermans who checked and peer reviewed this presentation.

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