Joint NWSSBO and ED-RED Finance-Legislation Meeting

Special Guests:
Dr. Michael Jacoby, Illinois ASBO
Andrew Malahowski, Franczek Radelet

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Constitutional Background

• Illinois Constitution, Article XIII, Section 5: “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.”

• In Peters v. City of Springfield, 57 Ill. 2d 142, 152 (1974), the Illinois Supreme Court noted that the “purpose and intent of the constitutional provision was to insure that pension rights of public employees which had been earned should not be ‘diminished or impaired.’”
Constitutional Background

There is a significant amount of lower court and historical authority for the proposition that benefits cannot be changed from the moment the employee first enters the applicable pension system.

- *Kraus v. Board of Trustees*, 72 Ill. App. 3d 833, 849 (1st Dist. 1979) (applying constitutional protections as of the moment the individual “became an employee”).

- 4 Proceedings 2931 (Mrs. Kinney: “…All we are seeking to do is to guarantee that people will have the rights that were in force at the time they entered into the agreement to become an employee....”).
Constitutional Background

Illinois precedent supports the idea that pension benefits are guaranteed under principles of contract law.

• Felt v. Board of Trustees, 107 Ill. 2d 158, 162 (1985) (“the general intendment of section 5 was to protect the pension benefits of public employees by first creating ‘a contractual relationship between the employer and the employee....’”).

• 4 Proceedings 2925 (Mr. Green: “Now this amendment does two things: It first mandates a contractual relationship between the employer and the employee; and secondly, it mandates the General Assembly not to impair or diminish these rights.”).
Common Questions

• “Is there a real problem?”
• “Why don’t we just terminate/freeze the plan and provide a defined contribution plan like private companies?”
• “Why don’t we just raise taxes/start taxing retirement income/raise revenue from other sources?”
• “Can this be fixed without benefit reductions?”
• “Who do we blame?”
• “What should we try?”
Pension Reform Options: The Levers

• Employee Contributions
• Automatic Annual Increase (“COLA”)
• Retirement Age
• Definition of “Salary” and Limitations on Pensionable Earnings
• Rate of Accrual
• Cash Balance or Defined Contribution Plans
• Shift Funding Responsibility to School Districts
• Retiree Health Care
• State Funding “Guarantees”
• Early Retirement Option
Pensionable Salary Limitation

• Potential constitutional arguments for/against

• Administrator compensation options to meet hiring and retention goals:
  – Additional non-pensionable compensation
  – 403(b)/457(b) employer contributions (up to IRS limits)
  – Additional fringe benefits
    • Travel reimbursements and allowances
    • FSA employer contributions
    • Additional paid time off/buy-backs
    • Life insurance
Early Retirement Option ("ERO")

• Set for legislative review in 2013

• If not renewed by 6/30/2013, automatically repealed

• If not renewed, only available for members who are age 55 on or before 6/30/2013, and whose last day of work is 6/29/2013 (no more six-month window)
Early Retirement Option ("ERO")

If renewed, member and employer contributions would increase:

• COGFA recommended that the member contribution increase from 11.5% per year to 14.4% per year

• COGFA recommended that the employer contribution increase from 23.5% per year to 29.3% per year
A quick review of prior legislation

“Choice” plan

Tier 1 and retirees must choose between:

Option 1. Maintain 3% compounded COLA, lose access to state retiree health insurance, future salary increases do not count toward pension calculation, cannot participate in ERO

Option 2. Base COLA on the lesser of ½ CPI or 3%, maintain access to state retiree health insurance, count future salary increases as part of pension calculation, may participate in ERO

Includes shift of normal cost to districts
Includes Cash Balance Plan for new hires

Nekritz/Biss plan

New benefit plan for Tier 1 and retirees:

• Incremental increase in retirement age for employees under 46
• COLA starts 5 years after retirement or age 67, whichever is earlier
• COLA applies to first $25,000 of pension (annual adjustment is capped at $750)
• Employee contribution increase from 9.4% to 11.4%
• Pensionable salary capped at the rate in the final year of the current contract or the SS Wage Index, whichever is higher

Includes shift of normal cost to districts
Includes Cash Balance Plan for new hires
New Fiscal Pressure in FY 14

• Pension payment will increase by $1 billion
• Revenue expected to grow by $600 million
• 2/3 of the pension payment pays for debt; 1/3 pays the normal cost of benefits
• ISBE funding has been reduced by $900 million in the last four years
Major points of contention

• Constitutionality of benefit changes
• Shift of normal cost to districts/higher ed and impact on property taxes
• Balance of pension payment, budget reductions, and new revenue
• Effective date of changes
• Moving employees from a defined benefit plan to a defined contribution plan
Management Discussions with Legislative Leaders

Issues included in initial discussions:

- Cost Shift
- Employee contribution increase
- COLA changes
- Fix to Tier 2 to ensure pension falls above the social security threshold
- Employer “pick-up” of the employee TRS contribution
- ERO
- TRIP
Management Discussions with Legislative Leaders

Primary Recommendations from Management:
• Guarantee to pay unfunded liability annually
• Fix Tier 2
• Allow for grandfathering current CBAs
• Cannot support benefit diminishments that would violate the Constitution
• If a cost shift, phase in over multiple years, tie with mandate relief, and change TRS governance structure