Framework for Public Pension Reform:
Navigating the Constitutional Hurdles

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How Serious is this Problem?  
Who is Responsible for the Problem?

Bad to Worse
- In 2003 Illinois State pension systems had unfunded liability of $43 billion ranking dead last in the U.S. – no other state even close
- In 2011 Illinois State pension systems had unfunded liability of $85 billion, remaining the worst funded pension system in U.S.
  - TRS represents $43.8 billion of that amount

State of Illinois caused this problem
- For 40 years, failed to fund properly; spent pension $
- State added benefits w/o increasing contributions
- Bad investment planning and decisions
- Employees have always made their required contributions

Largest financial problem Illinois faces is unfunded pension debt
Who is Responsible for Fixing the Problem?

Possible solutions to address TRS system funding

- State of Illinois
- Teachers
- School districts
We Saw This Coming ...

  - Enacted in reaction to profound underfunding of pension systems for public employees
    - At that time, State Pension systems approximately 39% funded
    - In 2011 (40 years later), funded at approximately 43%
  - Addressed need to “vest” benefits so public employers could not abandon or reduce benefits
    - Economic crisis
    - Home rule
  - Intended to limit State options
Membership in any pension system 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.
What Does It Mean?

- Generally believed to mean:
  - once person is member of TRS, benefit and contribution rates vest, until and during retirement
  - rules that apply to benefits or contributions cannot be changed to adversely affect member

- Multiple court decisions in last 40 years
  - All found unconstitutional any effort to:
    - reduce pension benefits for active or retired public pension recipients
    - raise active member contributions without a corresponding increase in benefits
What Doesn’t It Mean?

- Over past 40 years, Unions sued to compel proper funding of pension systems at least 3 times
  - No requirement that system be funded at any particular percentage or level
- Only “funding” requirement is that State is required to pay benefits when they are due
How Can We Fix This?

Who Can Fix This?
Lining Up the Lawyers

- **Illinois Legislative Counsel**
  - Madiar opinion(s)(2011)
- **TRS**
  - Jenner & Block (2005)
- **Jenner & Block**
- **Office of the Governor**
  - DeVito opinion(s)(2010)
- **Illinois Education Association**
  - DLA Piper (2010)

- **Commercial Club of Chicago**
  - Sidley & Austin opinion(s)(2010)
    - Teacher eligibility, contributions and benefits can all be changed at any time
    - Alternatively can change if not yet “accrued”
    - Become insolvent

- **Pension Modernization Task Force (2009)**
  - Cannot affect “earned or accrued” benefits, but can change system going forward for existing teachers
Evolution of a Solution

- State of Illinois
  - Cannot compel any level of funding
  - Cannot become “insolvent”
  - Has not taken responsibility for over 40 years

- Teachers
  - Issue is whether teachers can be part of solution for existing members in the System
    - Cannot impair or diminish benefits of members

- School districts
  - Path of least resistance
  - **Note however:** any district solution will involve teachers
Features of “Plan”

- A 3 percentage point increase in the member contribution, from 9.4 percent to 12.4 percent
- The retirement age will be gradually increased over several years to age 67.
- Upon retirement, the cost of living adjustment will be changed from 3 percent compounded to a COLA that is capped at 3 percent or one-half of the CPI, whichever is less. The new COLA is not compounded.
- Upon retirement, a member’s COLA will not begin until 5 years of retirement, or age 67, whichever comes first.
- Reducing the state “subsidy” for health insurance premiums that retired employees receive.

Does not affect current retirees

Other key parts of the pension stabilization plan are:

- A strong guarantee requiring the state to pay its full annual contribution to TRS and the other pension systems.
- School districts will have to begin paying the total annual cost of TRS pensions.

Estimated costs to local school districts

- Early estimates indicate that annual school district contributions would rise from a total of $171 million per year to more that $700 million per year, while the state’s annual contribution would drop from $2 billion to $1.3 billion.
Key “Plan” Elements

- **TRIP**
  - TRIP was created in the State Employees Group Insurance Act of 1971 (5 ILCS 375). Section 6.5(h) of the Act provides:
    - “The program of health benefits provided under this Section may be amended by the State and is not intended to be a pension or retirement benefit subject to protection under Article XIII, Section 5 of the Illinois Constitution.”

- **COLA**
  - Class – action litigation has been initiated in at least 3 states over efforts to decrease or cap COLA increases retirees receive.
  - Issue here is changing COLA adjustments prior to retirement.
Challenges to Solutions

- Solutions
  - May be shaped by possibility of legal challenges
  - May be directly challenged
- Greater the direct or indirect impairment of benefits, greater the likelihood of legal challenges

Possible litigants
- IEA/IFT/AFSCME (any public union)
- Individual teacher/school official
- IASB/IASA
- Five Illinois pension systems (687,000 members)