

# The Status of SURS: Pension Funding & State Debt



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# The Starting Point: Minimum FY 2013 Deficit

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<b>(i)</b>	<b>Total FY2013 Projected General Fund Revenue (all sources)</b>	<b>\$33.719 B</b>
<b>(ii)</b>	<b>Hard Costs Entering FY2013</b>	<b>\$ 9.450 B</b>
<b>(iii)</b>	<b>Revenue Available after Paying Hard Costs in FY2013</b>	<b>\$24.269 B</b>
<b>(iv)</b>	<b>Minimum carry forward of unpaid bills from FY2012</b>	<b>\$8.50 B</b>
<b>(v)</b>	<b>Net Revenue Available for GF Services in FY2013</b>	<b>\$15.769 B</b>
<b>(vi)</b>	<b>Dollar Amount of FY2013 GF Appropriations for Services</b>	<b>\$24.328 B</b>
<b>(vii)</b>	<b>Minimum FY2013 Revenue Shortfall</b>	<b>(-\$8.559) B</b>

\*All data from the Governor's FY2013-FY2015 General Fund projections issued on 1/20/2011 or FY2013 Budget proposal, except Projected Revenue which is from HR 707 and SR 586

# How General Revenue Funds are Spent

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**Over \$9 out of \$10 of G.R.F. are spent on:**

- Education  
(PreK-12, plus Higher Ed) 35%
  - Healthcare 30%
  - Human Services 21%
  - Public Safety 5%
- 91%**

# FY 2012 Enacted vs. FY 2000 Actual

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Every Major Category Of Funding For Current Public Services Has Been Cut In Real Terms Since FY 2000

Category (Millions)	FY 2012 Enacted	FY 2000 Adjusted	\$ Change	% Change
<b>General Fund Including</b>				
Pensions	\$28,721	NA	NA	NA
Pension	\$4,230	NA	NA	NA
<b>General Fund Excluding</b>				
Pensions	\$24,491	\$30,829	(\$6,338)	-20.6%
K-12 Education	\$6,824	\$7,443	(\$619)	-8.3%
Higher Education	\$2,092	\$3,306	(\$1,214)	-36.7%
Health Care <sup>1</sup>	\$8,058	\$8,952	(\$894)	-10.0%
Human Services <sup>2</sup>	\$4,754	\$7,066	(\$2,312)	-32.7%
Public Safety <sup>3</sup>	\$1,558	\$2,075	(\$517)	-24.9%

Sources: Figure 5 above, FY 2000 data from CGFA FY 2002 Budget Summary.

Notes: 1) DPH and HFS (Public Aid in 2000 and 2001)

2) Aging, DCFS and DHS

3) Corrections, Juvenile Justice, and State Police. No Juvenile Justice in FY 2000.

4) Index value for FY 2000 has been approximated by using 2001 and 2001 ECI.

For Health Care Medical Care Midwest CPI (MCMWCPI) has been used.

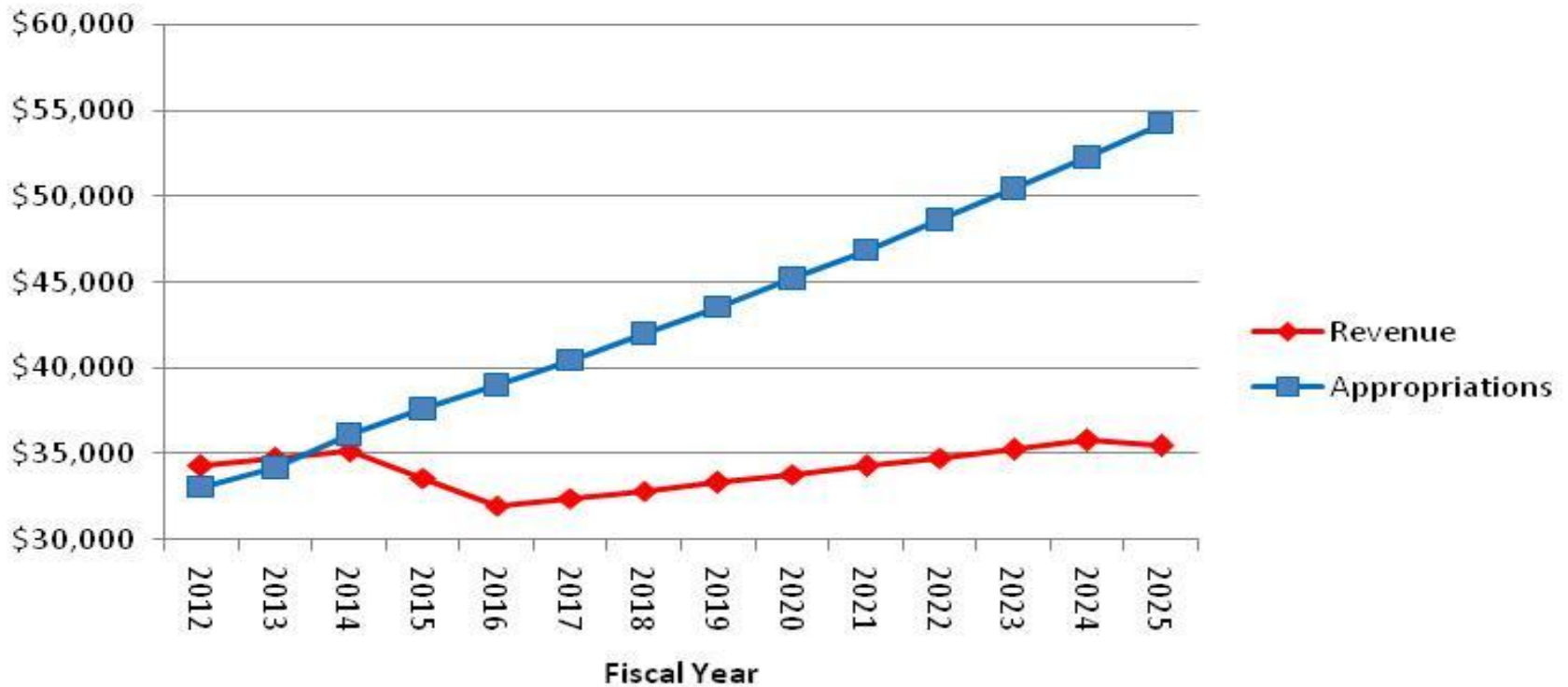
Sources: Figure 5 and CGFA Illinois State Budget FY 2001. FY 2000 Teacher and State worker retirement contributions excluded from agency appropriations.

\*Inflation adjustments made using ECI index and population change

# Illinois' Structural Deficit

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## General Fund Revenue and Appropriations (\$ millions)



# The Five State Pension Systems

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1. Judges' Retirement System of Illinois (JRS)
2. Teachers' Retirement System of the State of Illinois (TRS)
3. State University Retirement System of Illinois (SURS)
4. State Employees' Retirement System of Illinois (SERS)
5. General Assembly Retirement System of Illinois (GARS)

# The Five State Pension Systems

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## Retiree Statistics as of Fiscal Year 2010

Plan	# of Active Employees	# of Retirees	Ave. Yearly Pension	Ave. Length of Service	Ave. Age of Retirement
JRS	966	665	\$112,548	17	62.4
SERS	64,143	45,659	\$31,981	25	-
TRS	170,275	87,654	\$44,844	28	69
<b>SURS</b>	<b>72,996</b>	<b>40,364</b>	<b>\$33,960</b>	<b>20</b>	<b>61.9*</b>
GARS	182	278	\$49,788	13	59.6

Source: FY 2010 Comprehensive Annual Financial Reports. \* From FY 2011 CAFR

# What is An Underfunded Pension System?

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- An underfunded pension system is one in which the retirement system's liabilities exceed its assets.
- The difference between liabilities and assets is the **unfunded liability**.
  - Also known as the unfunded accrued liability and the unfunded actuarial accrued liability.

# Calculating Liabilities

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For all five systems, it is calculated using the **projected unit credit method (PUC)**:

- PUC calculates liabilities by first asking, “what is the benefit worth?”
  - Entry Age Normal calculates by first asking “How much will I need to live on?”
  
- Total liability (PUC) is the sum of:
  1. benefits payable to current retirees;
  2. benefits that will become payable to inactive vested members;
  3. accrued benefits of active vested members;
  4. accrued benefits of active employees who are likely to become vested;
  5. benefits due to future salary increases.

# Calculating Assets

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- In Illinois the retirement systems calculate the **actuarial value of assets (AVA)** by smoothing investment gains/losses over a 5 year period
  - 20% of year's excess/shortfall is recognized each year beginning with the current year
  - Example:
    - ✦ SURS actual investment FY 2011 performance was 23.8%
    - ✦ SURS smoothed investment FY 2011 performance was 4.5%
- Can also be calculated by simply looking at assets' market value (MVA).

# The State Systems' Unfunded Liabilities Using Different Asset Valuation Methods

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<b>Year</b>	<b>Unfunded Liability (AVA)</b>	<b>Unfunded Liability (MVA)</b>
<b>2010</b>	<b>\$75.74</b>	<b>\$85.57</b>
<b>2011</b>	<b>\$82.91</b>	<b>\$83.08</b>

Source: The Commission on Government Forecasting & Accountability

Numbers in Billions

# The Five State Systems' Unfunded Liabilities

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## Funding Status as of Fiscal Year 2011

Plan	Actuarial Liabilities	Actuarial Value of Assets	Unfunded Liability
JRS	1,952,539.4	614,596.2	1,337,943.2
SERS	31,395,007.8	11,159,836.6	20,235,171.2
TRS	81,299,745.0	37,769,753.0	43,529,992.0
SURS	31,514,300.0	13,945,700.0	17,568,600.0
GARS	298,408.4	63,161.0	235,247.3

Source: FY 2011 Comprehensive Annual Financial Reports  
Numbers in thousands

# Funded vs. Underfunded

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- There are 2 other ways to examine a retirement system's financial status:
  - Funded ratio
    - ✦ Is calculated by dividing assets by liabilities.
    - ✦ In 2010 the aggregate funded ratio for state and local pension systems was 77% (Center for Retirement Research at Boston College).
  - Ratio of the unfunded liabilities to active employee payroll.

# The Five State Systems' Funded Status

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## Funding Status as of Fiscal Year 2011

Plan	Unfunded Liability (using AVA)	Funded Ratio	Unfunded Liability/Payroll
JRS	1,337,943.2	31.5%	791.0%
SERS	20,235,171.2	35.6%	480.5%
TRS	43,529,992.0	46.5%	472.9%
SURS	17,568,600.0	44.3%	507.6%
GARS	235,247.3	21.2%	1548.9%

Source: FY 2011 Comprehensive Annual Financial Reports  
Numbers in thousands

# System Funding

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- **Three mechanisms: employer contributions, employee contributions, and investment returns**
- **Normal Cost (for PUC): the cost of new benefit accruals**
  - Is based on the present value of a projected lifetime benefit
  - Cost of benefit for **current** employees
  - Increases over the duration of employment
  - Paid by combination of employer and employee contributions
    - ✦ Employee contribution rate is fixed, employer rate fluctuates

# Employer Contributions

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- **Annual Employer Contributions:** at its most basic, it is the sum of the employer normal cost, interest on the unfunded liability, and an amount to pay down an unfunded liability.
- **Amortizing an unfunded liability:**
  - Governmental Accounting Standards Board guidelines specify it should be amortized over 30 years (can be closed or open).
    - ✦ GASB guidelines for the employer contribution known as the Annual Required Contribution (ARC)
    - ✦ Target is for full-funding (100% funded ratio)
  - Legislation passed in Illinois in 1994 instituted a 50-year, closed funding plan.
    - ✦ Target is for 90% funded ratio by the end of FY 2045

# System Funding Example: State Contributions to SURS

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- According to the Commission on Government Forecasting & Accountability, **“The single largest driver of the growth in the unfunded liabilities has been insufficient employer contributions.”**

FY	ARC	Actual State Contribution	Shortfall	State Contribution as % of ARC
2002	\$436.9	\$256.1	-\$180.8	58.6%
2003	\$597.5	\$285.3	-\$312.2	47.7%
2004*	\$691.0	\$1,757.5	N/A	254.3%
2005	\$607.8	\$285.4	-\$322.4	47.0%
2006	\$662.0	\$180.0	-\$482.0	27.2%
2007	\$705.9	\$261.1	-\$444.8	37.0%
2008	\$707.5	\$344.9	-\$362.6	48.8%
2009	\$874.0	\$451.6	-\$422.4	51.7%
2010	\$1,003.3	\$696.6	-\$306.7	69.4%
2011	\$1,259.0	\$773.6	-\$485.4	61.4%

Source: SURS FY 2011 CAFR

# SURS Financial Big Picture

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- As of Fiscal Year 2011:
  - Funded Ratio (using AVA) is 44.3%
  - Unfunded Liabilities are \$17.57 billion (using AVA)
    - ✦ UL/payroll is 507.6%
- Insufficient state contributions are the primary reason for the large unfunded liabilities.

# Public Act 88-0593: The Pension Ramp

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- Went into effect on August 26, 1994 (FY 1995)
  - Funding schedule did not start until FY 1996
- At the end of FY 1994 the UL for all five systems was \$17.0 billion
  - From 1989-1994 UL grew by \$8.34 billion
    - ✦ 55.7% of this growth was from insufficient employer contributions
- At the end of FY 1994 the UL for SURS was \$4.14 billion
  - From 1989-1994 UL grew by \$1.53 billion
    - ✦ 64.4% of this growth was from insufficient employer contributions

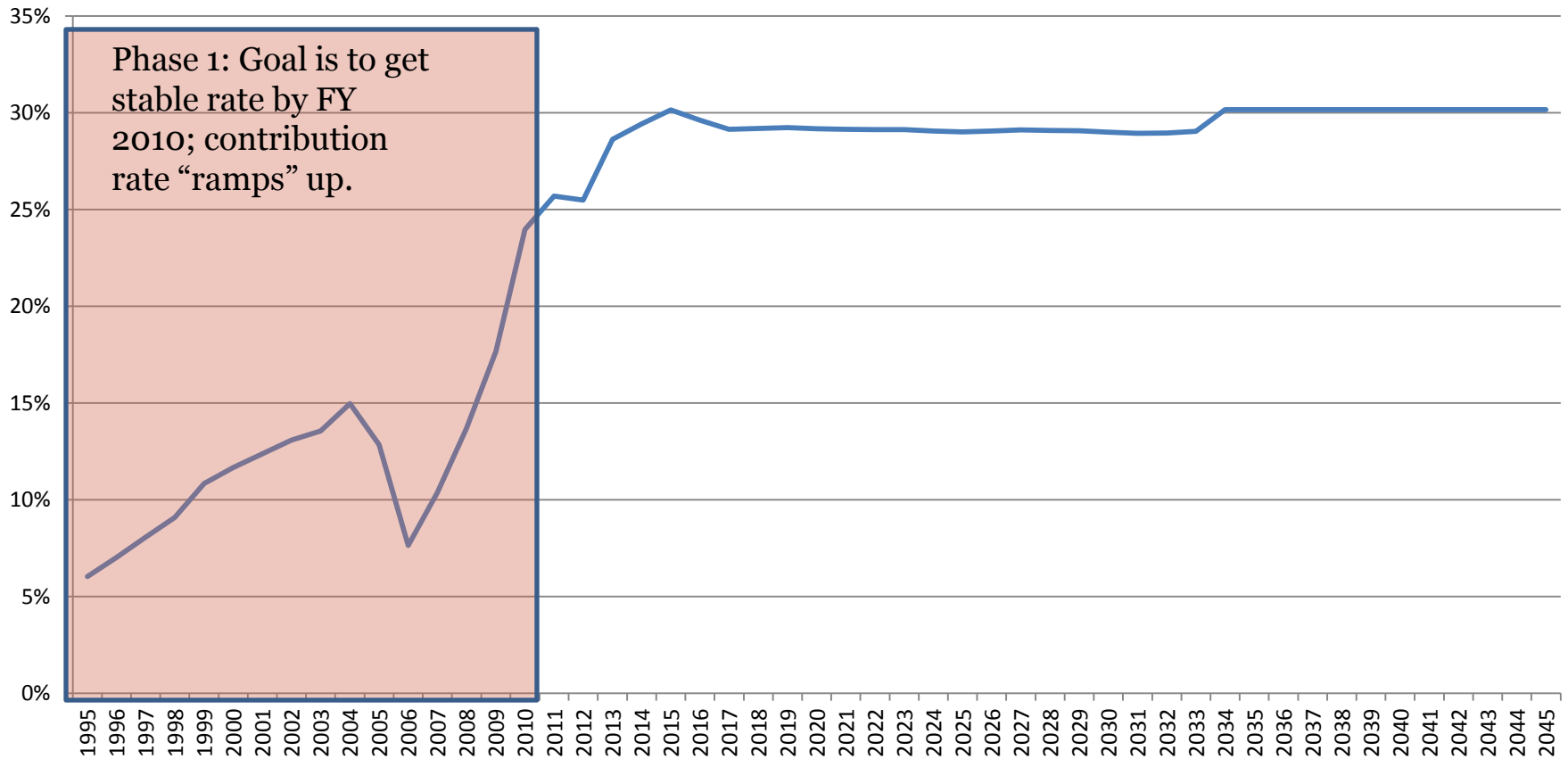
# Public Act 88-0593: The Pension Ramp

- Mandated that state's annual pension contribution be a continuing appropriation
- Funding Structure:
  - Fiscal Years 1996-2010: a 15-year phase-in period in which the state's annual contributions were calculated as a percentage of payroll.
    - ✦ Contribution rate increases steadily from year-to-year in order to reach stable rate.
  - Fiscal Years 2011-2045: the state is to contribute a percentage of payroll that is sufficient to bring the systems to a 90% funded ratio by 2045.
    - ✦ Contribution rate is to stay stable (31% - 33%).

# Why it's Called the Pension Ramp: TRS Example

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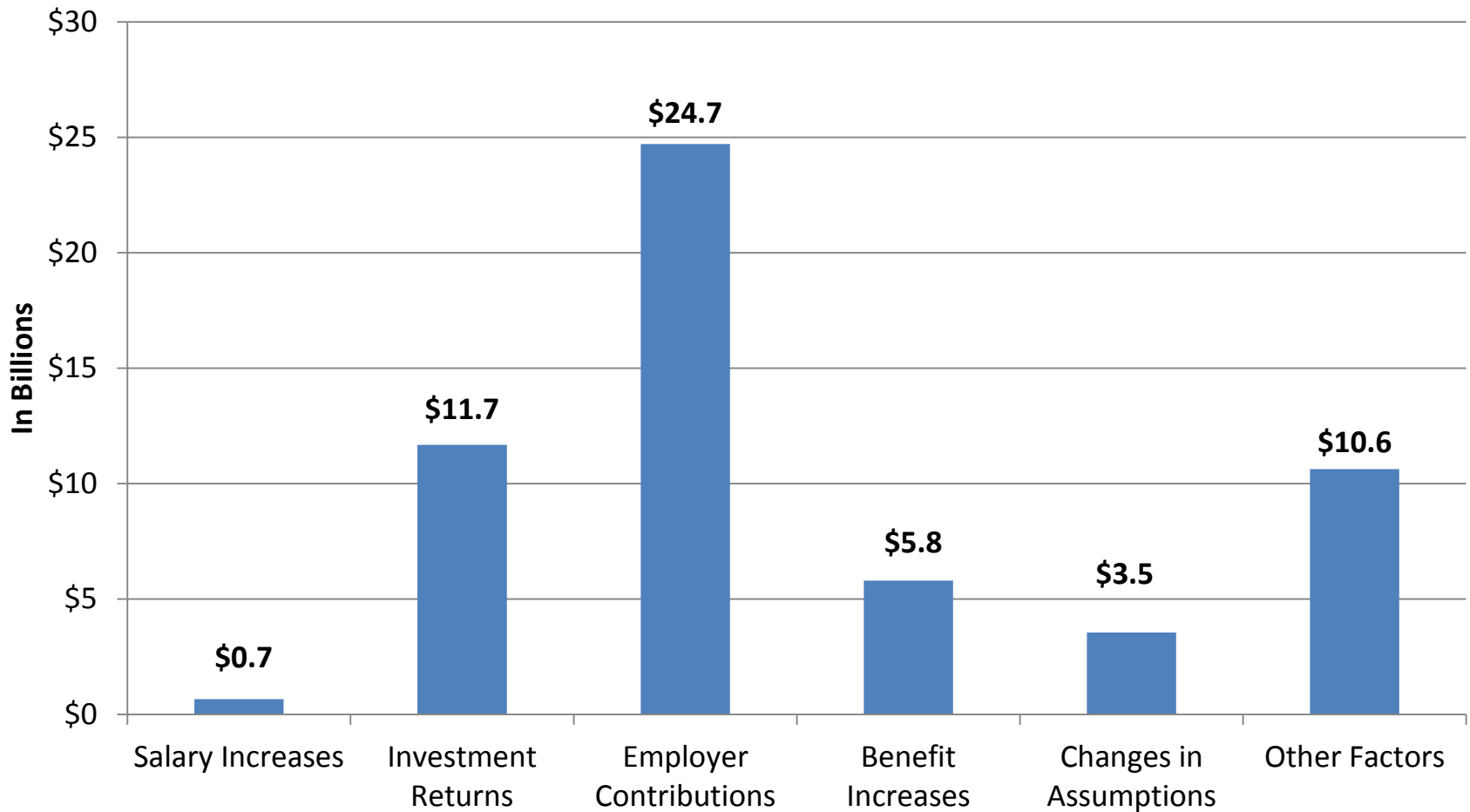
## Actual and Projected Employer Contribution Rates



Source: Buck Consultants, FY 2011 Actuarial Report

# Growth in Unfunded Liabilities for the Five State Systems FY 1996-2010

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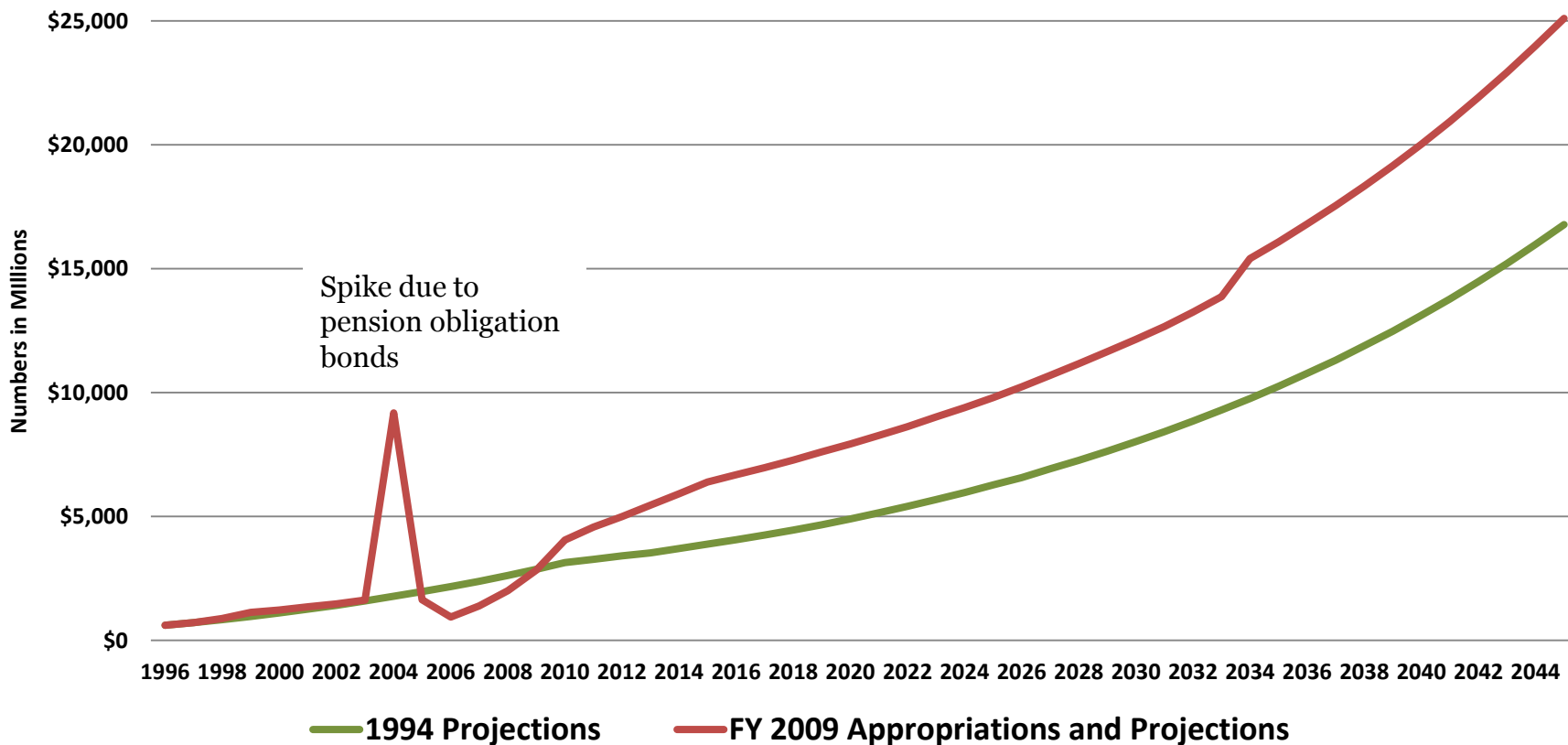


Source: The Commission on Government Forecasting and Accountability. 2011. *A Report on the Appropriateness of the 90% Funding Target of Public Act 88-593*. p. 9

# Funding Schedule: State Contributions 1996-2045

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## Changes in Funding Schedule: 1994 Projections vs. 2009 Projections



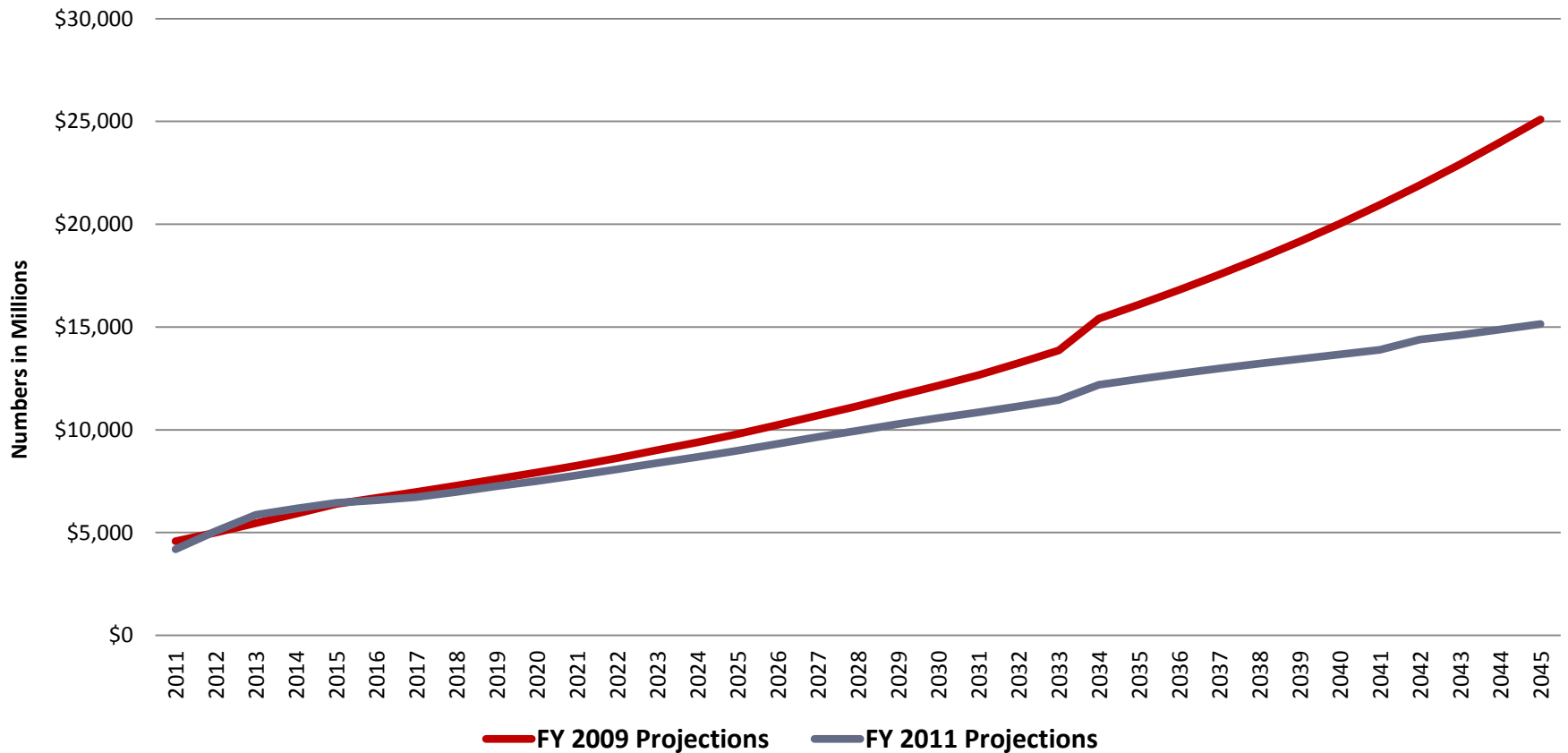
# Public Act 96-0889 of 2010: Two Tier Pension Systems

- Created a 2<sup>nd</sup> tier for all Five State Systems
  - Affects employees hired after December 31, 2010.
  - Major changes:
    - ✦ Reduced benefits.
    - ✦ Increased retirement age to 67.
    - ✦ Reduced survivors' benefits to 66.67% of retiree's benefit.
    - ✦ Prevents individuals from collecting both a public pension and a salary from a public employer.
- Lowers state contributions because:
  - 1. Lower total normal cost associated with Tier-II.
  - 2. Tier-II member contributions cover a greater portion of the total normal cost associated with their benefits.

# Tier II & Reduction in State Contributions

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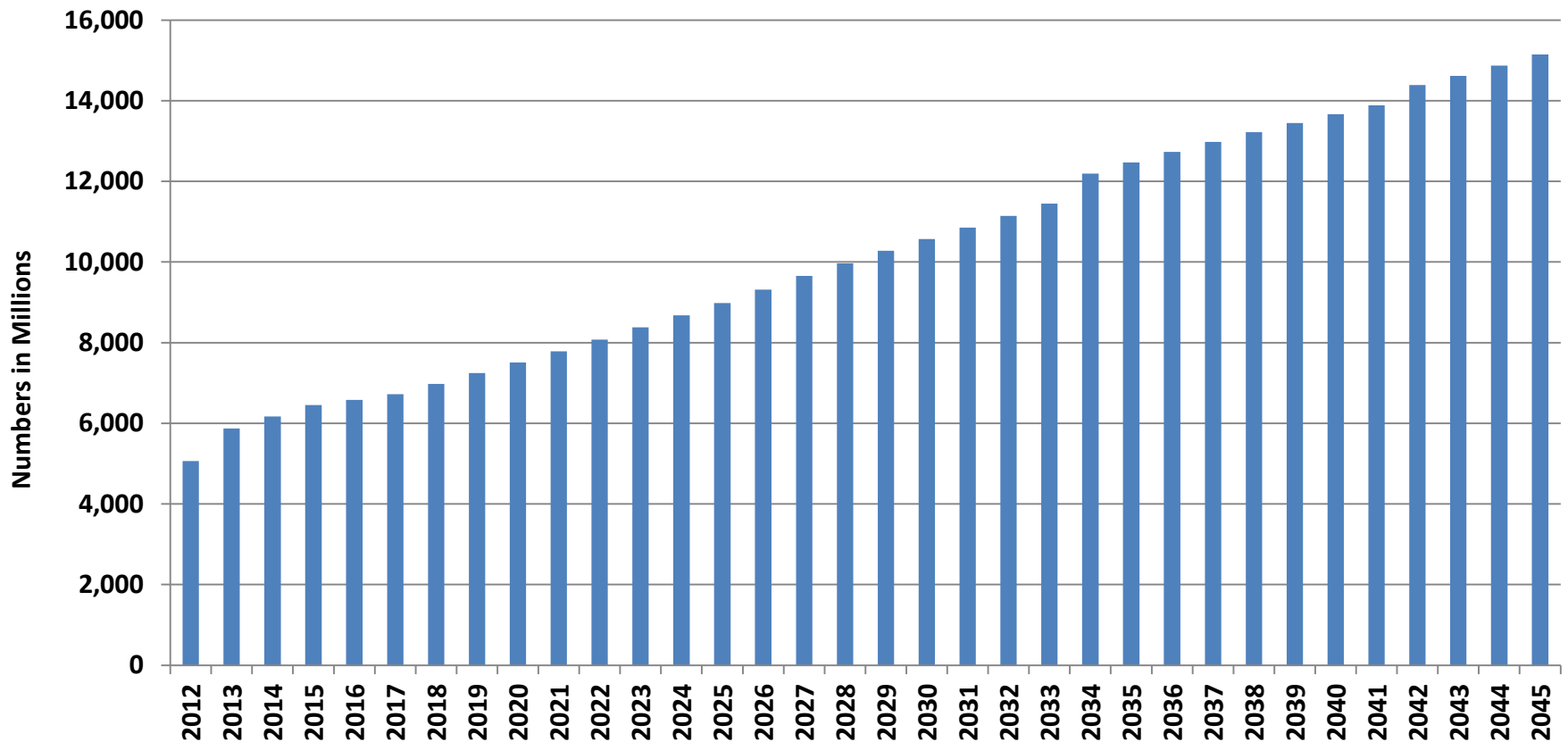
## Change in State Contributions with Creation of Tier-II



Source: The Commission on Government Forecasting and Accountability

# Projected State Pension Contributions: FY 2012-2045

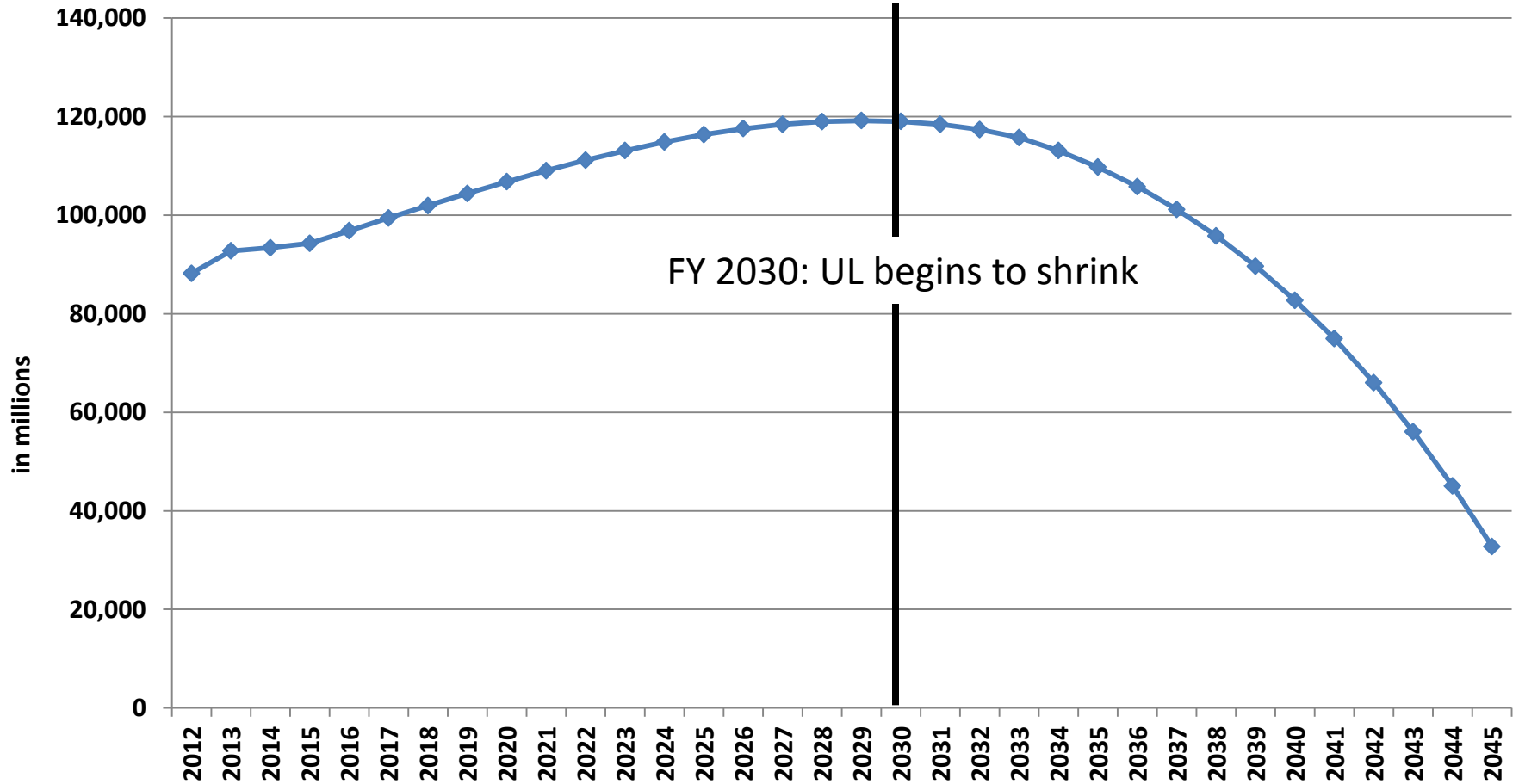
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Source: CGFA. "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2011," p. 95.

# Growth in Unfunded Liabilities FY 2012 – FY 2045

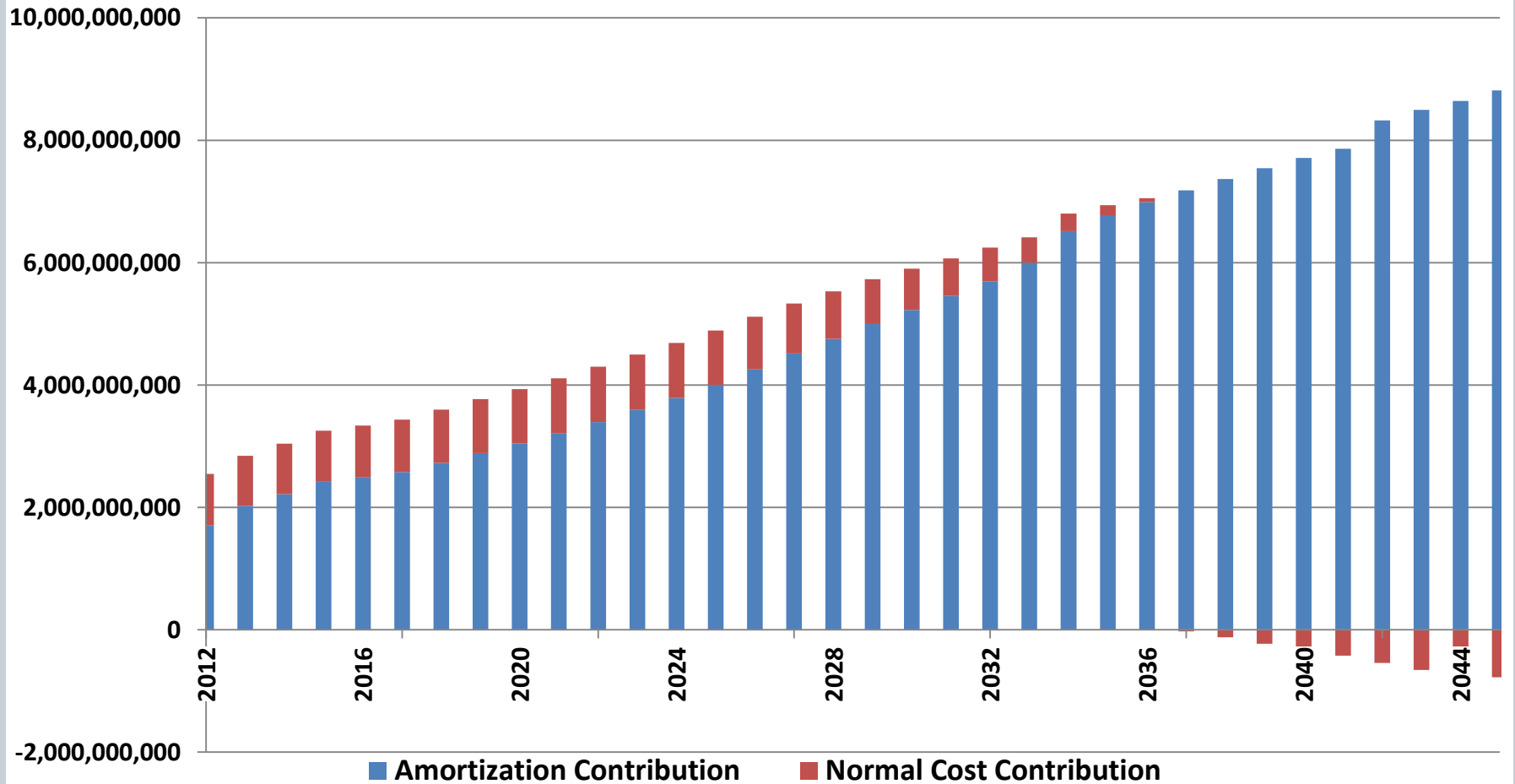
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Source: CGFA. "A Report on the Financial Condition of the IL State Retirement Systems: Financial Conditions as of June 30, 2011," p. 95.

# Required Contributions Example (TRS): Normal Cost vs. Amortization

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Source: Buck Consultants, FY 2011 Actuarial Report

# Proposed Pension Reform: Senate Bill 512, Amendment 2

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- **Proposed Changes:**
  - Creates a 3<sup>rd</sup> tier to all state systems, except for JRS.
  - The 3<sup>rd</sup> tier would be a defined contribution (DC) system. A DC system is similar to a 401(k).
  - Employee contribution rates for Tier 1 members in all systems, except for JRS, would dramatically increase.
    - ✦ A SURS, Tier 1 member's contribution would increase to 15.31% initially, and then to 17.31% in 2017
  - State contributions would be calculated as a percentage of personal income, corporate income, and sales tax.

# Proposed Pension Reform: Institute of Government & Public Affairs Proposal for SURS

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- **Create Tier III hybrid**
  - Provide all new employees with hybrid DB/DC Plan
- **Peg SURS Effective Rate of Interest to Market Rates**
- **Redistribute SURS Funding Burden**
  - Shift part of employer normal cost requirement from state to universities, colleges, and community colleges
  - Increase employee contributions
- **Align Pension Vesting Rules with Private Sector**
  - “2-to-6” year step
  - All members be vested after 6 years of service

# How do the Plans Compare?

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## IGPA

- Only reduces the state's normal cost contributions
  - Does not address amortizing the unfunded liabilities
- Employers would pay part of normal cost
- Increases Tier-1 contributions
- Provides Tier-2 members with an improved benefit
- Provides new hires with hybrid-DB/DC plan

## SB 512

- Only reduces the state's normal cost contributions
  - Does not address amortizing the unfunded liabilities
- Employers would not pay part of normal cost
- Increases Tier-1 contributions
- Does not provide Tier-2 members with an improved benefit
- Provides new hires with DC plan

# Defined Contribution Retirement

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- **Advantage of DC:**
  - In terms of ensuring state contributions, it creates fiscal discipline
  - Benefits would be portable from job to job
  - Employees' can access the account for emergencies before their retirement
- **Disadvantages of DC:**
  - Compared to DB plans, administrative costs are higher
  - Retirement benefits are not guaranteed
  - Lesser investment returns
  - Communication and educational challenges

# Criticism of Defined Contribution Plans

- “If you read the legislative history ... of the 401(k), it's clear this was a little tax break for the folks who made lots and lots of money” — Elizabeth Warren, Harvard Law professor
- “No one thought this out. The 401(k) plans were originally introduced as supplemental plans.” —Alicia Munnell, Director of Boston College’s Center for Retirement Research
- “The most important explanation [in why states have introduced DC plans] turns out to be political rather than economic” — Center for Retirement Research

# Governor Quinn's Proposed Pension Reforms

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- **Current employees choose between reduced benefits and keeping current benefit**
  - Reduced Benefit Option:
    - Increase current employee contribution rates by 3%
      - ✦ SURS rate would increase to 11%
    - Reduce Tier-I COLA to lesser of 3% or 1/2 CPI, would not be compounded
      - ✦ Also would delay COLA to earlier of 67 or five years after retirement
    - Increase retirement age to 67
  - Current Benefit Option:
    - Current employees give up retiree healthcare subsidies (does not affect TRS)
    - Current employees future raises would not count in their pension benefit calculation
- **Funding changes:**
  - Establish 30-year, closed ARC
    - ✦ Retirement systems would have 100% funded ratio by 2042
  - Employers begin paying employer normal cost for employee pensions (impacts SURS and TRS only)

# Concluding Remarks

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- The state faces a debt problem, not a pension benefit problem
- The five retirement systems' unfunded liabilities of \$83 billion cannot and should not be mitigated through benefit changes
- Truly addressing the state's pension debt problem must involve
  - 1. Redesigning the funding schedule (aka the pension ramp)
  - 2. Generating increased revenue through a graduated income tax and expansion of the sales tax

# The Status of SURS: Pension Funding & State Debt

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**QUESTIONS?**