



**STATE OF ILLINOIS PENSION SYSTEMS:
ANALYSIS AND RECOMMENDATIONS**

*(Excerpted from The Civic Federation's
State of Illinois FY2006 Recommended Operating Budget:
Analysis and Recommendations)*

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OVERVIEW: THE GOVERNOR'S PENSION FUNDING REFORM PROPOSALS

Illinois is in a pension funding crisis. This crisis was created over the last 30 years, in which the General Assembly and Governors past and present jointly failed to meet the State's pension fund obligations.

As a result, the State of Illinois faces future financial obligations of staggering proportions. Even after issuance of \$10 billion in Pension Obligation Bonds in 2003, the State still must make contributions totaling *\$275.1 billion* to the five retirement systems to attain the statutory requirement of a 90% funded ratio by 2045. This sum – some six times greater than the entire proposed FY2006 State operating budget -- will increase even further if the State continues to ignore the financial reality of its flawed pension policies.

Therefore, the Civic Federation **unequivocally supports comprehensive pension reform for the State of Illinois**. It is imperative that the General Assembly take decisive action to control the spiraling costs of state employee pensions and fund the state's pension systems at the levels required by law.

As a first step toward the total reform necessary, we support the Governor's proposed changes in Illinois' state pension systems. Significantly, these proposed reforms address the State's need to reduce the costs of the pension systems over time. The Governor's proposed solutions are not perfect; we would have preferred even greater reforms. However, these proposals, based on the recommendations of the Governor's Pension Commission, represent a targeted, realistic effort at containing mounting expenditures that threaten to crowd out state spending for education, public safety, and healthcare.

The current slate of proposed reforms are not in themselves sufficient to give the state's employee retirement systems the strong financial footing required by both state law and fiscal responsibility. Nevertheless, these modest and equitable solutions will have a profound fiscal impact over time. To maintain the State of Illinois' financial integrity, the General Assembly must embrace and enact these proposed reforms, and must be prepared to take more aggressive steps in the future including a moratorium on any new benefits until a mechanism for adequately funding existing benefits is implemented.

Pension Funds Undermined by Decades of Fiscal Irresponsibility

For decades, the State of Illinois has failed to adequately fund its employee retirement systems. At the same time, it has added an extraordinary array of new benefits without providing funds to pay for these increases. Even after passage of the historic 1995 pension funding reform law, designed to bring the State's pension funds to a 90% funded ratio by 2045, the General Assembly failed to make the actuarially recommended payments into the system, while adding more than \$5.8 billion in new unfunded pension enhancements. This lack of fiscal accountability is the principal engine behind the State's current financial situation.

The Civic Federation believes Governor Blagojevich's proposed FY2006 budget includes two important initiatives to control pension costs: It curbs increases in benefits for current employees, and it provides reduced benefits for new hires.

The current retirement system allows for many serious -- and costly -- abuses. For example, school districts and universities may give virtually unlimited end-of-career raises to retiring administrators, resulting in drastically increased pension costs for those retirees that, under current law, the State of Illinois must assume. Alternative-formula pension benefits, originally intended only for sworn police officers and other state employees working in high-risk, physically strenuous jobs, are now offered to one-third of all state employees. The State Universities Retirement System's use of a money purchase option offers employees an unjustified and unrealistically high rate of interest. The Pension Commission's report offered commonsense solutions to these and other abuses, and many of those solutions are adopted under the Governor's proposed reforms.

To Contain Escalating Costs, Benefits for New Employees Must be Reduced

Any solution to the State's pension funding crisis requires limits on benefits for new hires. If state employee pension costs are not contained, the General Assembly will be forced to support a massive tax increase or significantly slash spending for decades to come. Although this move is likely to face opposition from state workers, the private sector -- and many governments -- are moving in this direction. It must be noted that, even with the recommended reduction in benefits for new hires, the Illinois state pension systems will still offer generous retirement benefits unavailable to most private-sector employees. Therefore, the Civic Federation strongly supports creating a modestly changed but more reasonable and affordable retirement benefit for future employees.

Pension Reforms May Generate Savings, but Fiscal Restraint Must Continue

Actuaries and consultants for the Governor's Office of Management and Budget estimate these reforms will reduce pension fund liabilities by \$100 billion over 40 years, thereby reducing the required State contributions by a total of \$55 billion over that time period.

In anticipation of those projected savings, the proposed FY2006 budget would reduce by \$819 million the State's required, certified contribution to the five retirement systems. This is a troubling aspect of the Governor's proposal; the Civic Federation calls on the Governor's financial team to provide significantly more detail on the figures and actuarial methodology underlying that savings estimate and the long-term financial impact of the reduced FY2006 pension payment.

The use of the proposed "proportional savings" in this budget marks the second year in a row that the Blagojevich administration has proposed a State operating budget that fails to make the entire certified payment to the pension systems. The Civic Federation is very concerned by any move to alter the funding contribution formula adopted in the 1995 reform law. It is precisely because the State has repeatedly failed to fulfill its constitutional obligations to adequately fund employee retirement systems that the Civic Federation is pessimistic about the State's ability without extraordinary changes to fully control the mounting pension deficit. As a result, the State must both adhere to an inviolable funding schedule as required by the 1995 pension funding reform law and impose a long-term moratorium on any new benefits.

Last year, the State of Illinois' budget similarly failed to meet the entire certified payment amount. The Administration claimed that payment shortfall in part reflected millions of dollars in "savings" to the retirement systems that accrued from the favorable interest rate on the issuance of pension obligation bonds and the actuarially determined 8.5% rate of return on major fund assets. The State also failed to make the full payment required by the unexpectedly high cost to the pension system of the FY2002 Early Retirement Initiative. The Civic Federation opposed both reductions from the State's compliance with the 1995 pension funding law.

Although the Civic Federation continues to support the 1995 funding law, we believe it is essential that the General Assembly enact the Governor's proposed pension reforms. Quite simply, these changes must be made now if the State is to ever break the cycle of deferring, expanding and ignoring its long-term financial obligations. Therefore, we reluctantly accept the State's proposal to reduce its certified pension contributions in FY2006, but only if the Governor's proposed pension reforms, including the establishment of a two tier system, are implemented.

The Civic Federation very reluctantly accepts the State's proposal to reduce its certified pension contributions in the FY2006 budget. This reduced pension payment may be the one-time incentive needed for the General Assembly to adopt these necessary pension funding reforms this year. However, we will adamantly oppose any future State budget proposal that fails to make the full certified pension payment. The irresponsible practice of failing to meet this constitutional obligation created the current crisis, and it must end. We support the Governor's pension proposal only because it includes crucial structural reforms; absent those changes, we would not countenance yet another failure to make the entire certified payment to the State pension systems.

While we can support a one-time reduction in funding for this year only, we caution that it is impossible for the Civic Federation to verify the dollar amount that has been proposed by the State for savings. Many have questioned whether these amounts represent actual "proportional savings" to the State. However, until and unless the administration fully discloses their actuarial methodology for calculating these savings, this issue will continue to be the subject of debate. Therefore, we urge the administration to fully disclose and explain the details of how the \$819 million reduction represents proportional savings to the pension system and reveal its method for calculating savings as soon as possible.

If members of the General Assembly oppose using these anticipated future savings to balance the current budget, we strongly urge them to adopt the proposed pension reforms on their own merits and to present alternative spending cuts to close the resulting \$819 million gap. Disagreement over the amount of proportional savings or continued adherence to the 1995 law should not be used as an excuse to not adopt comprehensive pension reforms this year.

ANALYSIS: STATE OF ILLINOIS RETIREMENT SYSTEMS

The State of Illinois funds five retirement systems for employees and retirees: the State Employees Retirement System (SERS), the Teachers' Retirement Employment Retirement System (TRS), the State Universities Retirement System (SURS), the Judges' Retirement System (JRS) and the General Assembly Retirement System (GRS). A total of 647,038 individuals are currently enrolled in these five systems.

MEMBERS OF ILLINOIS RETIREMENT SYSTEMS			
Pension Fund	Members	Annuitants	Total
Teachers	239,210	71,165	310,375
University	147,969	38,487	186,456
State Employees	93,418	54,298	147,716
Judges	941	873	1,814
General Assembly	280	397	677
Total	481,818	165,220	647,038

Illinois has historically underfunded its pension funds. In 2004, Wilshire Associates reported that the state ranked 49th in the nation for the amount of unfunded liabilities in its pension funds. At that time, unfunded liabilities totaled \$43.1 billion.¹

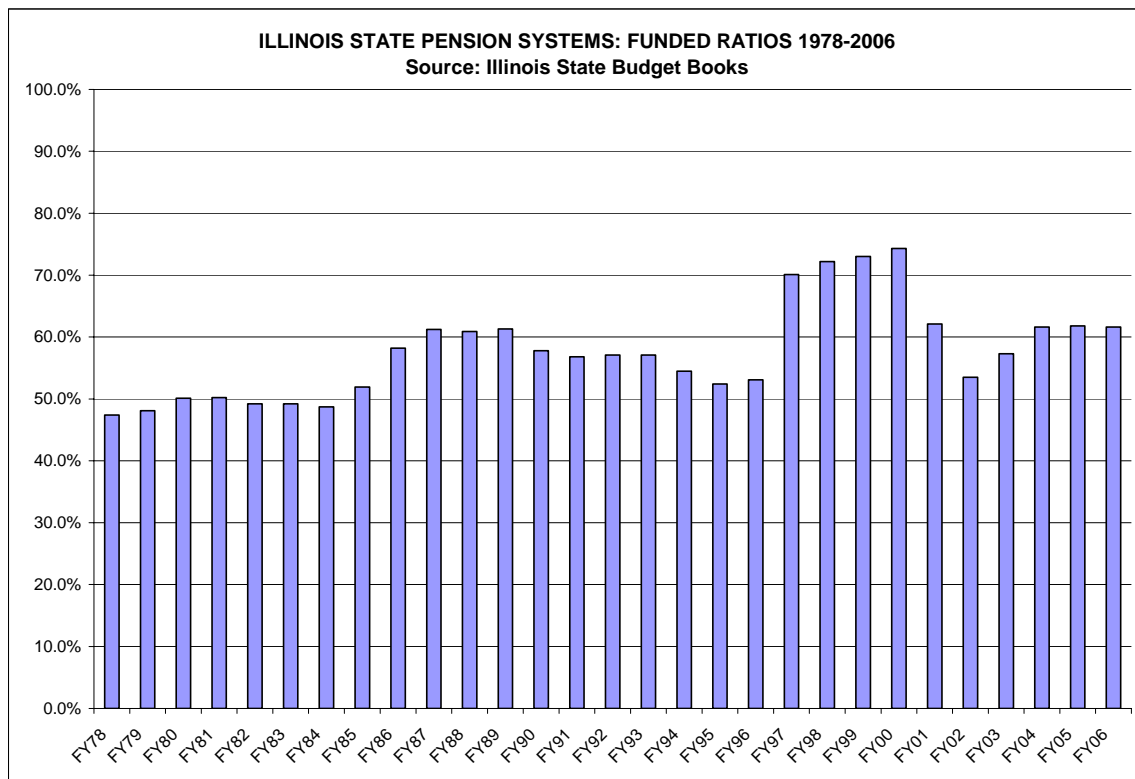
In 1995, Public Act 88-593 established a 50-year schedule of funding requirements to compensate for the State's previous years of underfunding the pension plans. It requires that the state's contribution "equal a percentage of payroll necessary to amortize 90% of unfunded liabilities" by the year 2045. However, since 1995, succeeding Governors and General Assemblies have added \$5.8 billion in new pension benefit enhancements, further increasing the State's pension liabilities.

ILLINOIS STATE PENSION ENHANCEMENTS ADDED SINCE 1995 LAW		
YEAR	BENEFIT	COST
1995	TRS Early Retirement Incentive	\$ 150,000,000
1997	SURS Conversion from Step Rate to Flat Formula	\$ 180,000,000
1998	TRS Conversion from Step Rate to Flat Formula	\$ 1,000,000,000
1998	SERS Conversion from Step Rate to Flat Formula; Alternative formula final rate of pay conversion from average of final 4 years to pay on final day	\$ 1,250,000,000
2001	SERS Rule of 85 added; alternative formula conversion from Step Rate to Flat Formula	\$ 650,000,000
2002	SURS added 30 years of service and out provision	\$ 60,000,000
2002	SERS added highway maintainers and DHS security to alternative formula	\$ 170,000,000
2003	SERS Early Retirement Incentive	\$ 2,370,000,000
TOTAL		\$ 5,830,000,000

Source: FY2006 Illinois State Budget, p. 2-2.

The exhibit that follows shows historic funding ratios for the State of Illinois' five retirement systems between FY1978 to FY2006 as projected. Until FY1984, ratios rarely rose higher than 50%. After passage of the 1995 funding reform law, funded ratios rose to a high of 74.3% in FY2001 before falling once again. Clearly, the State has fallen short in its efforts to adequately fund its pension systems.

¹ State of Illinois. FY2006 State Budget, p. 2-1.



\$10 Billion in Pension Obligation Bonds Issued in 2003

In 2003, Governor Blagojevich signed Public Act 093-0002 authorizing the issuance of \$10 billion of Pension Obligation Bonds. The proceeds of these bonds were to be used to fund current and future unfunded liabilities of the State’s five pension funds.

The Civic Federation has traditionally cautioned governments against using long-term debt to address budget shortfalls. However, the Federation recognized the extraordinarily difficult financial position of Illinois and most other state governments. As a result of the dire budget conditions of the State, past funding inadequacies, and historically low interest rates, The Civic Federation supported this proposal.

While supportive of the Governor’s proposal, The Civic Federation strongly warned against the practice of debt financing to correct ordinary budget shortfalls or to fund normal operations, which would traditionally include current pension obligations. The Federation also offered the following concerns and suggestions:

- The General Assembly and the public at large should be aware that this financial strategy would not eliminate all the problems associated with the funding of State pensions.
- We strongly encouraged the General Assembly to be mindful of the benefit levels granted to employees.
- In the future, the State should also consider authorizing cost effective, contemporary borrowing techniques such as variable rate obligations.

Pension Fund Indicators

The Civic Federation uses two measures to present a multi-year evaluation of the fiscal health of the State of Illinois pension funds: funded ratios and the value of unfunded liabilities.

Funded Ratios: Slight Projected Decrease for All Funds

Five years of information on actual and projected funded ratios for the State's pension funds are illustrated in the following exhibit. In FY2004, funded ratios increased for all funds because of the distribution of funds from the \$10 billion Pension Obligation Bond issue. Between FY2005 and FY2006:

- The projected funded ratio for the State Employees' Retirement System will increase from 53.4% to 54.3%;
- The projected funded ratio for the Teachers' Retirement System will remain at the 61.7%, ratio reported the previous year;
- The State Universities Retirement System projected ratio will decline slightly from 65.0% to 64.4%;
- The Judges' Retirement System will decline from a funded ratio of 45.6% to 45.2%;
- The General Assembly Retirement System will decrease from a funded ratio of 38.6% to 37.2%.

ILLINOIS STATE RETIREMENT SYSTEMS FUNDED RATIOS					
	FY2002	FY2003*	FY2004	FY2005 Estimate	FY2006 Estimate
State Employees' Retirement System	53.7%	50.5%	54.2%	53.4%	54.3%
Teachers' Retirement System-Downstate	52.0%	58.5%	61.9%	61.7%	61.7%
State Universities Retirement System	58.9%	61.8%	66.0%	65.0%	64.4%
Judges' Retirement System	33.7%	43.9%	46.2%	45.6%	45.2%
General Assembly Retirement System	29.3%	39.0%	40.0%	38.6%	37.2%
ALL STATE RETIREMENT SYSTEMS	53.5%	57.3%	61.6%	61.8%	61.6%

* Includes proceeds of Pension Obligation Bonds on a pro forma basis.

Source: FY2006 Illinois State Budget, p. 2-9.

Unfunded Liabilities: Increase of \$2.1 Billion Projected in FY2006

The unfunded liabilities of the State's five pension funds are projected to be \$37.7 billion in FY2006. This is approximately a 6.2%, \$2.1 billion increase over FY2005. Since FY2002, unfunded liabilities have increased by 7.9%, or from \$34.9 billion to \$37.7 billion. The use of proceeds from the FY2003 issue of \$10 billion in Pension Obligation Bonds did reduce unfunded liabilities between FY2003 and FY2004 by \$1.6 billion. However, unfunded liabilities are projected to increase again in FY2006 in part because of the need to pay for unanticipated costs of the FY2002 Early Retirement Initiative.

STATE PUBLIC EMPLOYEE RETIREMENT SYSTEMS UNFUNDED LIABILITIES (FY02-FY06) - \$ Millions							
RETIREMENT SYSTEM	FY2002	FY2003	FY2004 Estimate	FY2005 Estimate	FY2006 Estimate	\$ CHG FY02-FY06	% CHG FY02-FY06
State Employees'	\$ (6,617.1)	\$ (8,706.0)	\$ (8,452.5)	\$ (8,965.0)	\$ (9,284.0)	\$ (2,666.9)	40.3%
Teachers' Retirement	\$ (20,681.4)	\$ (19,478.2)	\$ (19,402.8)	\$ (20,672.7)	\$ (21,911.2)	\$ (1,229.8)	5.9%
State Universities	\$ (6,839.3)	\$ (6,878.4)	\$ (6,495.3)	\$ (6,991.4)	\$ (7,449.7)	\$ (610.4)	8.9%
Judges'	\$ (677.1)	\$ (604.2)	\$ (621.5)	\$ (661.6)	\$ (701.8)	\$ (24.7)	3.6%
General Assembly	\$ (130.5)	\$ (119.8)	\$ (124.4)	\$ (129.3)	\$ (134.2)	\$ (3.7)	2.8%
TOTAL	\$ (34,945.4)	\$ (35,786.6)	\$ (34,145.0)	\$ (35,501.0)	\$ (37,691.9)	\$ (2,746.5)	7.9%

Source: FY2006 Illinois State Budget, p. 2-9.

The Governor's FY2006 Pension Funding Reform Proposals

Governor Blagojevich proposed a number of pension funding reform proposals in the FY2006 State of Illinois Budget. These proposals were all originally recommended by the Governor's Blue Ribbon Pension Commission, which is composed of representatives from the General Assembly, business, labor and civic groups. The Commission issued an interim report prior to release of the budget.

Several of the Commission's recommendations have been slightly modified and the difference between the Commission's proposal and the Governor's recommendation is identified below.

Actuaries and consultants for the Governor's Office of Management and Budget estimate that the reform proposals in the FY2006 budget will generate approximately \$55 billion in cost savings over 40 years. The cost savings are expected to accrue because of reductions in State contributions to the five retirement systems required to meet the 90% funded ratio goal by 2045. Over 40 years, the reforms are expected to reduce pension fund liabilities by \$100 billion.

1. Link Automatic Annual Increase to CPI (New Hires Only)

The current rate of automatic increase for retirement annuities is 3% per year. Other retirement systems index the rate of increase to the CPI, limit the dollar amount of increase, or approve new increases annually.

Proposal: For new hires only, automatic increases would be limited to the lesser of the change in CPI or 3% and apply only to the first \$12,000 in annual pension for retirees covered by Social Security and \$24,000 for retirees not covered by Social Security.

Projected Savings: \$19 billion over 40 years

Difference from Commission Recommendation: The Commission had recommended that the annual rate of automatic increase be limited to 2% or CPI.

2. Cap the State's Obligation to Assume Pension Costs for End-of-Career Salary Increases

Currently, school district and universities can grant teachers, faculty and administrators large salary increases in the final years of their career. Pension benefits for these employees are based on the salary received in the final four years of employment. Because the State assumes the cost of these pension increases through the Teachers Retirement System and State Universities Retirement System, these costs have risen substantially over time.

Proposal: *For purposes of determining the State's share of pension benefits only, end-of-career employee raises would be capped at 3% per year. School districts and universities would assume the burden of paying for pension increases above the 3% cap.*

Projected Savings: \$17 billion over 40 years

Difference from Commission Recommendation: *The Commission had recommended that end-of-career employee raises would be capped at no more than 5% per year*

3. Recalculate the Money Purchase Option Interest

The SURS Board determines the interest rate applied to employee contributions for money purchase option calculations based on its interpretation of relevant statutes. During the 5-year period ending June 30, 2004, the SURS Board determined the applicable interest rate was 9% even though the actual rate of return for SURS investments was less than 3.3%.

Proposal: *Defining the interest credit under the Money Purchase Option as the long-term rate of return, but not to exceed either the most recent 5 or 10 year rates of return.*

Projected Savings: \$10 billion over 40 years

4. Change Retirement Ages (New Hires Only)

Members of the state's retirement systems are currently eligible for full retirement benefits when they attain age 60, unlike most private sector retirement systems that require retirement at age 65.

Proposal: *The eligibility for full benefits would be increased to age 65, with 8 years or more of service; age 62 with 30 years or more of service; or age 60 with 35 years or more of service.*

Projected Savings: \$5.5 billion over 40 years

5. Eliminate Money Purchase Option for SURS Annuitants (New Hires Only)

Members of the State Universities Retirement System (SURS) may have their benefits calculated under basic plan provisions or the Money Purchase Option and opt for that calculation which brings the higher benefit.

The Money Purchase Option aggregates employee contributions and provides an annual interest credit, which is determined by the SURS Board. When the employee retires, the accumulated contributions plus interest are then marched by the State at 140%.

Proposal: *For new hires only, the Money Purchase Option would be eliminated.*

Projected Savings: \$2.5 billion over 40 years

6. Limit Eligibility for Alternative Formula Pension Benefits (New Hires Only)

State Employees Retirement System (SERS) provides a higher benefit formula and earlier retirement eligibility for certain employees in “high risk” jobs. However, the high risk category has been expanded over time from sworn police officers to 1/3rd of all state workers.

Proposal: *Limit alternative formula to police officers and employees who meet defined risk criteria.*

Projected Savings: \$1.5 billion over 40 years

7. No New Pension Benefits without Funding

One of the reasons for the steady increases in unfunded liabilities over time is the practice by succeeding Governors and General Assemblies of approving increases in retirement benefits without also providing for additional funding to pay for those new benefits.

The Pension Commission had recommended that no new benefits for state employees without a new funding source identified at the time of adoption. An explicit sunset provision should be attached to any new pension benefit.

The Governor has reintroduced his Balanced Budget Act this year. The Act would require that any appropriation bill that includes new spending would require identification of new revenues or reduced spending in order to pay for the initiative. This proposal would address the Commission’s concern that no new pension benefits be added without corresponding revenues. However, the Governor has not embraced the sunseting of new pension enhancements.

Funding Reform Concepts Rejected

Governor Blagojevich has explicitly rejected two concepts considered by the Pension Commission:

- Requiring employees to increase the percentage of salary they pay into the retirement systems or
- Any consideration of shifting to a Defined Contribution (DC) Plan.

1. Increase Employee Contributions by 1%

Employees covered by the state retirement systems contribute a percentage of their compensation for their own pensions and to fund survivor’s benefits. For example, members of the State Employees Retirement System (SERS), employees covered by the regular retirement formula are required to make the following contributions:

- Members with Social Security: 3.5% of compensation (pension) + .5% (survivors') = 4.0% total
- Members without Social Security: 7.0% of compensation (pension) + 1.0% (survivors') = 8.0% total

The Commission recommended that employee contributions to each of the five retirement systems be increased by 1%.

2. Consider Defined Contribution Plans for New Hires

The State's five retirement systems provide defined benefit (DB) plans. Certain SURS members can, however, opt to join a defined contribution (DC) plan.

The Commission recommended that once the State stabilizes the funding of its pension system, it should consider replacing all or part of its Defined Benefit pension plans for new hires with Defined Contribution Plans. DC plans can significantly reduce unfunded liabilities over time.

Impact of the Proposed Pension Funding Reforms on the FY2006 Budget

The Pension Commission recommended that the State's 1995 pension funding plan be amended to reflect reductions in accrued liabilities and reduced state contributions resulting from adoption and implementation of any pension reforms. *This recommendation was contingent upon adoption of all or most of the Commission's proposals.*

Implementing the reforms outlined above will reduce required State of Illinois contributions to the five retirement systems by approximately \$55 billion over 40 years. The FY2006 budget reflects these reductions in the total amount of \$819 million.

Adopting the Governor's funding reform proposals without changing the current funding plan would result in a reduction of \$80.9 million. The remaining \$738.5 million in reductions result from the Governor's plan to change the current funding plan by allocating proportional savings from adoption of the reforms to the budget this year.²

The FY2006 budget includes the following pension funding principles:

- The State will maintain the 1995 plan's goal of a 90% funded ratio in 2045
- The pension funding plan will provide for a ramping of contributions to a constant percent of payroll by 2011 (including the 2002 Early Retirement Initiative amendment to the 1995 funding plan)
- Continuing appropriation authority for pension contributions will be provided.
- Any savings produced by the proposed pension reforms will be "proportionately" allocated for required contributions for each retirement fund from 2006 through 2045.

The exhibit below shows the difference between the original amount certified by the individual retirement systems and the amount proposed by the Blagojevich administration in the FY2006 budget.

² Commission on Government Forecasting and Accountability, Monthly Briefing, February 2005, p. 16

FY2006 CERTIFIED CONTRIBUTIONS VS. BUDGET BOOK RECOMMENDATIONS (In Millions of Dollars)							
System	Certified Contributions			Budget Book Recommendations			Budgeted Reduction from Certified Amount
	Retirement System	Debt Service	Total State Cost	Retirement System	Debt Service	Total State Cost	
TRS	\$ 1,058.5	\$ 293.7	\$ 1,352.2	\$ 591.6	\$ 293.7	\$ 885.3	\$ (466.9)
SERS	\$ 759.3	\$ 24.8	\$ 784.1	\$ 553.7	\$ 24.8	\$ 578.5	\$ (205.6)
SURS	\$ 324.7	\$ 97.2	\$ 421.9	\$ 184.4	\$ 97.2	\$ 281.6	\$ (140.3)
JRS	\$ 38.0	\$ 9.6	\$ 47.6	\$ 32.3	\$ 9.6	\$ 41.9	\$ (5.7)
GARS	\$ 5.5	\$ 1.8	\$ 7.3	\$ 4.6	\$ 1.8	\$ 6.4	\$ (0.9)
Total	\$ 2,186.0	\$ 427.1	\$ 2,613.1	\$ 1,366.6	\$ 427.1	\$ 1,793.7	\$ (819.4)

Sources: FY2006 Illinois State Budget Book, Commission on Government Forecasting and Accountability

CIVIC FEDERATION RECOMMENDATIONS

Impose a Moratorium on New State Employee Pension Enhancements

The Governor's Blue Ribbon Pension Commission recommended that not only should any new pension enhancements be accompanied with an identified source of funding, but they should also sunset after a period of time. We concur with both of these sound proposals. It is certainly proper to discuss, review and reconsider benefits for new employees at any time. However, the Civic Federation believes that even more rigorous cost control efforts are essential.

The Governor has proposed a "Pay as You Go" Act that would require any appropriation bill that includes new spending to identify new revenues or reduced spending in order to pay for the initiative. We urge the General Assembly to approve this Act as a means of capping runaway long-term obligation costs. We were dismayed that the legislature failed to take up a similar proposal by Governor Blagojevich last year.

If the General Assembly fails to adopt the Pay as You Go Act, new pension enhancements may be approved by the legislature without identified funding. Adding more benefits without funding would, of course, negate the financial benefits that accrue from adopting any or all of the Governor's pension reforms.

However, even if the Pay as You Go Act is approved, spending could still rise. The legislature could simply increase benefits and find new ways to pay for them. While this is a more fiscally responsible approach, it still keeps the State on a never-ending treadmill of continuously expanding benefits and costs.

The Civic Federation believes that the time has come to stop expanding employee pension benefits. Therefore, we call on the legislature to reject and the Governor to veto any new pension enhancements whether they are funded or not. In addition, the State must adopt a moratorium on any new benefit enhancements until such time as substantial progress has been made on reducing the State's billions of dollars in pension liabilities and will likely require waiting at least 10 years until the FY2002 Early Retirement Initiative fiasco is full paid for.

Require Employees to Increase Pension Contributions by 1%

The Federation believes all public employees covered by the State's five retirement systems should contribute an additional 1% of their salaries to the cost of their pensions. This increase should be required immediately for new hires and non-union employees. Although current contracts prevent this increase from being implemented immediately for employees covered by collective bargaining agreements, the State should, as a matter of policy, require increased contributions in future contracts. Stratospheric pension costs pose a serious threat to the financial future of the State of Illinois and its residents, and containing those costs must be a shared, ongoing, focused effort. We do not believe a single percentage point increase is onerous or unreasonable, especially when balanced against the generous retirement benefits state employees receive.

Study the Costs and Benefits of a Defined Contribution Pension Plan

The Commission recommended that once the State stabilizes the funding of its pension system, it should consider replacing all or part of its Defined Benefit pension plans for new hires with Defined Contribution (DC) Plans. DC plans, which are the predominant form of retirement benefit provided to the average American worker, can significantly reduce unfunded liabilities over time and offer employees greater flexibility as they change jobs.

In reviewing the past thirty years, we have seen no evidence that the General Assembly has the requisite fiscal discipline to transparently execute a well funded Defined Benefit retirement system. For that reason, we think that a shift to a Defined Contribution system must be seriously considered for new hires when it is financially feasible. We understand that the transition costs for the shift could be expensive because of the current dramatic underfunding of the retirement systems. However, the Civic Federation urges the Governor, the Pension Commission and the legislature to undertake a study of this option to determine both costs and benefits. This study should include consideration of transition funding mechanisms because the cost savings and benefits of a shift to a DC plan in the long term may outweigh short-term expenses. While the Civic Federation opposes the issuance of any new Pension Obligation bonds to fund current or future State of Illinois pension obligations, there may be the potential for issuing such bonds for the sole purpose of funding the transition costs to a defined contribution plan. This would, of course, be contingent upon financial feasibility and the identification of real, substantial cost savings over time.

The State Should Not Mandate Local Pension Enhancements without Providing Funding

The General Assembly frequently approves legislation increasing the level and scope of local government employee pension benefits. However, no funding is provided for what amounts to yet another costly unfunded mandate for cash strapped local governments. We believe that the concept of "pay as you go" funding should be extended to include State of Illinois actions that financially impact the pension costs of local governments. If the General Assembly sees fit to enhance benefits, it should identify and provide the requisite funding for those enhancements.

Fully Disclose all Pension Information in Budget Book

The FY2006 Budget Book does not include full information about the amount requested for appropriations for the State Employee' Retirement System, nor does it include information about the proposed allocation of \$819 million savings per system if the Governor's pension funding reform, proposals are adopted. The public needs full and accurate financial information in order to understand and evaluate the Governor's budget proposals, particularly on an important issue such as pension funding. The Civic Federation recommends that the State full disclose all relevant financial information about contribution levels for all retirement systems in the Pension section of future Budget Books.