

A Tale of Two Retirement Systems. (How Illinois taxpayers got stuck with an unnecessary \$7 Billion bill.)

Back in 2005, the Illinois Legislature and Governor decided on another “pension holiday” (not the first) during which they drastically reduced the State’s required payment to their employees’ pension funds. (Employees received no holiday and, like all past years, were required to pay their full share into their retirement fund.) When the State takes a “holiday,” it really means defer the bill, with interest, to future taxpayers. The Illinois State Universities Retirement System (SURS) was one of the systems affected by this “holiday.”

It’s ironic that about that time, another state pension plan similar to SURS, was anticipating that it would soon end the “pension holiday” it had been on for 16 years. From November of 1990 to 2009, the University of California Retirement Plan (UCRP) **operated entirely on investment earnings** with no payments from either employers or employees. In 2005, after 16 years of no payments into the system, the UCRP balance still had about 110% of the funds needed to meet future retirement costs of all former and current employees. It is remarkable that this “holiday” lasted almost half the length of most workers’ careers! In fact, over half the employees (in 2009) in UCRP were fully covered but had never been required to pay into their retirement system!

The so called “Illinois pension crisis” - a belief not supported by evidence - is a classic example of an urban legend, widely repeated in television and newspaper stories throughout Illinois.

For several years politicians and government officials struggling with Illinois’ fiscal budget challenges have complained of the “high cost of public employee pensions.” These complaints have resulted in many news stories and editorials on this topic. Many editorial writers have uncritically accepted these statements about “high cost” as fact. Some have advocated that the “pension monkey” be removed from the taxpayer’s back. Others suggest it is time to bring “lucrative” public pensions more in line with “what is offered in the private sector.”

This urban legend offers no evidence to substantiate a connection between the actual cost of pensions and the state’s budget woes. However, these views have tended to make the state’s employees and their retirement systems the scapegoat for the state’s budget problems.

These opinions also completely ignore ample evidence of the real cause of today’s pension fund debt - the bad decisions of past Legislatures and Governors who failed to meet their fiscal responsibilities to both state employees and Illinois taxpayers. For over 30 years Illinois politicians have failed to pay the full employer share of pension costs, choosing instead to pass the bill on to future taxpayers.

As evidence of Illinois’ urban legend about pension costs, one need only look at the University of California Retirement Plan (UCRP) which is similar in size and structure to Illinois’ SURS. In 2006, UCRP had about 33,600 retirees compared with about 32,000 SURS retirees. Both plans are defined benefit retirement plans with similar employee/employer contribution requirements and similar retirement benefit scales. Both plans are sponsored by state government and the employer guarantees employee retirement benefits. However, there is one very significant difference in the way the two plans have been funded by their state sponsors.

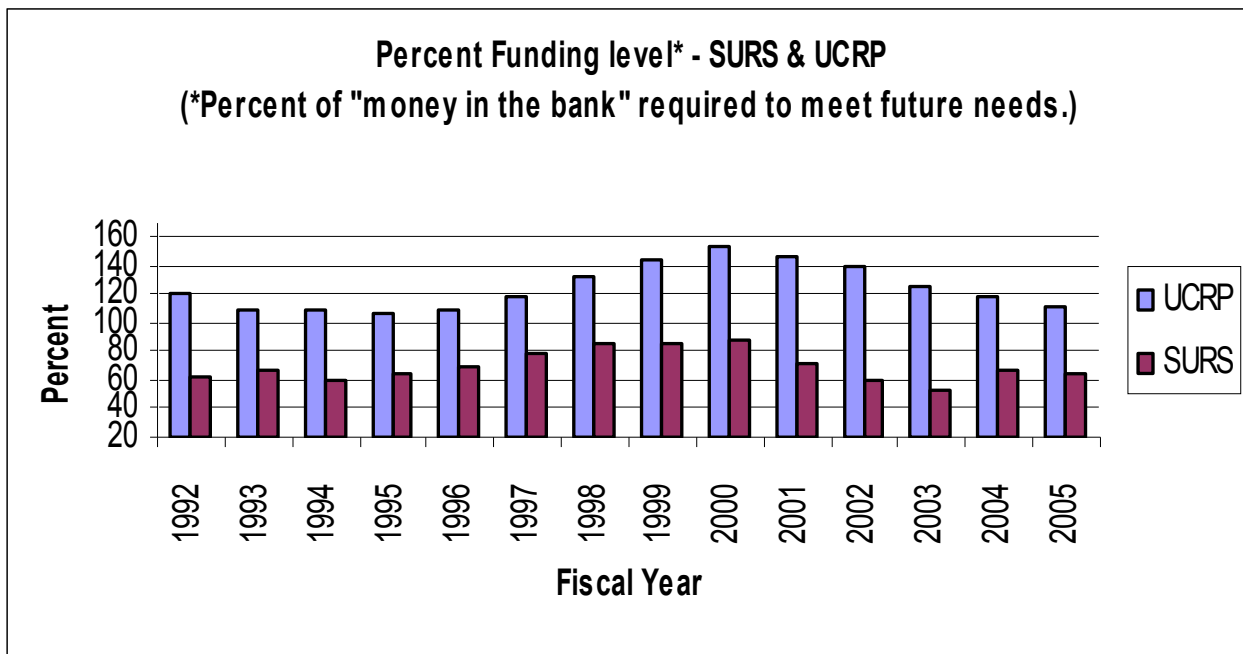
The UCRP has always had a policy of “full funding” for its plan. In contrast, Illinois has never funded SURS according to an actuarial method that would achieve full funding. (From FY-1996 through FY-2005, Illinois did increase funding, although not at a level high enough to meet full-funding requirements. The FY-2006 and FY-2007 state payments reverted to

political actions and were not based on actuarial requirements. This is in spite of the fact that Illinois is constitutionally obligated to pay all retiree annuities when they become due. This action has been a costly mistake for Illinois taxpayers. **This one difference in funding policy has resulted in a huge savings to taxpayers in California and a huge debt to taxpayers in Illinois.** How big is this difference?

During the 16 year “holiday”, California taxpayers paid nothing towards UCRP retiree pensions, but during this time about \$9 billion in benefits have been paid out from plan investment earnings. Since UCRP had enough funds to meet all future retirement costs of past and current employees, California taxpayers saved the \$9 billion paid out plus 16 years of costs for future retiree benefits. Illinois, on the other hand, chose each year to “charge” much of the cost of current and future retiree benefits -- much like an enormous credit card debt. While California taxpayers saved over \$9 billion, Illinois legislators ran up a taxpayer bill of about \$7 billion to SURS.

It should be noted that our legislators’ current plan for solving the pension funding shortfall is to replace only 90% of the amount owed over the next 35 years. (This is like saying “we choose to pay interest (currently 8%) on the total debt for 35 years and then continue to pay interest on at least 10% of the debt forever!”)

The chart below shows the historical difference in the actuarial funding level of the UCRP and SURS.



A defined benefit retirement plan is designed so that 100% funding is a “break even” point. A 100% funding level is needed for the plan to provide adequate investment earnings to meet all future obligations. Plan balances above 100% provide a bonus in investment returns but plan balances below 100% result in an investment penalty to taxpayers. By looking at the 100% line in the above chart, one can see that California taxpayers have earned a bonus interest every year. One can also see that Illinois taxpayers have suffered a lost interest penalty every year. Of course, this lost interest penalty (“under funding”) must eventually be made up by taxpayer payments. The arithmetic is not complicated. If your goal is to have a \$1,000,000 fund balance to support your retirement, would you prefer to earn 8% interest on 60% of your goal (\$600,000) or on 120% of your goal (\$1,200,000)? That’s really all there is to the “Illinois pension crisis.”

Another myth about defined benefit retirement systems is that they are risky for taxpayers

because of uncertainties in the stock market performance. Some persons point to the negative investment returns pension plans suffered during years 2001 and 2002 and complain that taxpayers must bear the extra burden of these poor negative earnings. During those two years SURS investment returns were a -8.8% in 2001 and -6.1% in 2002. UCRP was also subject to those same negative market forces and had investment returns of -5.5% in 2001 and -9.2% in 2002. However, because of their full funding policy, UCRP was able to pay all required retirement benefits from their accumulated earnings, weather the market downturn and still maintain a surplus of funds. Poor investment returns are not the Illinois problem.

The table below shows a historical comparison of UCRP and SURS plan funding levels and rates of investment returns.

Comparison of University of California Retirement Plan (UCRP) and SURS percent of plan funding ratio and percent of earnings on investment.

Year	Actuarial Percent Funded		Total Fund Investment Earnings	
	UCRP	SURS	UCRP	SURS
1988	128.1%	60.9%	-7.4%	2.2%
1989	143.2%	64.0%	16.8%	17.0%
1990	161.4%	63.5%	13.7%	9.6%
(UCRP suspends employee and employer contributions.)				
1991	150.3%	63.3%	9.3%	5.4%
1992	121.1%	63.0%	15.3%	10.2%
1993	109.4%	65.8%	17.1%	11.2%
1994	108.1%	60.3%	-2.8%	0.7%
1995	106.6%	63.4%	26.2%	16.5%
1996	110.1%	68.5%	21.2%	18.5%
1997	118.7%	79.4%	25.8%	21.4%
1998	131.6%	85.8%	21.8%	17.8%
1999	144.8%	85.3%	12.2%	11.5%
2000	153.8%	88.2%	12.8%	14.0%
2001	147.7%	72.1%	-5.5%	-8.8%
2002	138.4%	58.9%	-9.2%	-6.1%
2003	125.7%	53.9%	5.6%	2.9%
2004	117.9%	66.0%	14.3%	17.0%
2005	110.3%	65.6%	10.3%	10.4%
Avg	129.29%	68.22%	10.97%	9.52%

Data from systems' Annual Financial Reports.
 Compiled by John Terwilliger, May, 2006
 UCRP_SURS

An examination of the properly funded UCRP makes it obvious that the so called Illinois pension crisis is nothing more than an urban legend. The crisis in Illinois is past legislative failures to pay the State's obligations. We must insist that current legislators muster the willpower to step forward to solve the problems they have inherited and not just push the bill off to future generations of taxpayers. While raising the funds to pay off this debt will be painful, ignoring it only adds additional costs to future Illinois taxpayers. The problem is not too generous pensions; it is the mounting debt for employee benefits already earned. It is time for Illinois legislators to meet their obligations to their employees and also save taxpayers a lot of money. They need to do this for our children and grandchildren!

More

Update: Because of the recent financial turmoil affecting all of us, beginning in 2009, participants in UCRP resumed payments into the system. Still, this is a remarkable 18-year period of time that neither taxpayers, workers or employers had paid into the system!

In retrospect, UCRP probably should not have suspended the employee portion of payments to the system. Employees should have the expectation of contributing towards their future retirement. The taxpayers are there as a backup and should be given the advantage of the plan's gains.

John Terwilliger

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