DOBROVOLNY LAW OFFICES
James L. Dobrovolny
Attorney At Law
306 W. Green Street
Urbana, Il. 61801
Telephone: (217) 344-2376 Telecopier: (217) 344-2382

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Letters to the Editor
Peoria Journal Star
1 News Plaza
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Re: State Pensions Commentary of February 28, 2010

Dear Editor,

This letter probably exceeds your Letter to the Editor requirements. I would ask that you publish it a Guest Opinion or other such means. I have background and experience with the public pensions and their issues referred to in the Commentary of February 28, 2010. I have represented police and firefighter pension boards in Illinois for over 25 years in a variety of matters, and I am Deputy Counsel to the Illinois Public Pension Fund Association (IPPFA) comprised of about 400 of the 600 plus Police and Firefighter Pension Fund Boards in Illinois. This letter is solely my opinion though and not that of IPPFA.

The article in Sunday's paper about State Pensions and "Sweeteners" displayed a lack of insight into or understanding of the Public Pension System in Illinois and its funding issues. Given the shallow depth of coverage or insight that it provided by focusing on one proposed benefit, the Commentary was not appropriate. The article's tenor does a great disservice to your readers and Illinois taxpayers by failing to educate as to what the real issue is, what its cause is, and what the solution is.

We have been hearing a lot from radicalized municipal groups that our local and state public pension system is unsustainable and there needs to be drastic change. The article parrots those groups and infers that new retirement benefits are the main cause of these increasing amounts the tax payer must pay the retirement system and the increasing unfunded liability. **So what is the truth? Is it the benefit changes that caused the unfunded liability to increase, or are they scapegoating public employees for a failure of the State to properly fund the pensions?** First, a look at the recent Illinois Pension Modernization Task Force Report illuminates what the real problem is. After six months of deliberations, the Illinois Pension Modernization Task Force produced a substantive final report that examined the fundamental problems with funding the state's five public employee pension systems. Unfortunately, the legislature may never have the opportunity to use the Task Force's findings to guide it to crafting solutions that would actually address the unfunded liability problems. The proposed final report failed (10-9) to gain enough votes to be endorsed by the Task Force. Instead of accepting the report and the findings therein, some members' cherry picked information that fit their political interests and ideological views, rather than facts that would dispel myths and alleviate fear among taxpayers.

Among the findings that certain members of the Task Force did not want voters and taxpayers to know include:

1. The cost to taxpayers of state-funded pension benefits is less than the private sector, and less than public pensions in neighboring states;
2. The level of benefits when compared to 85 public employee retirement systems nationwide are average;
3. Seventy-eight (78%) of funds' beneficiaries do not receive Social Security, meaning their pension is their sole source of retirement

income; This is unlike workers in the private sector, who receive both Social Security and private retirement benefits. This non-participation in Social Security saves our local communities and the State hundreds of millions of dollars every year in employer contributions. Why did we not read about that in the article?

4. Changes or cuts to future benefits will not reduce [by one penny] the state's debt for past benefits already earned (the "unfunded liability"), nor lower required pension payments in the near term;
5. **The primary cause of the state's unfunded liability is the state's "decades-long failure to make its full employer contribution to the systems,**" even as participants continue to pay their own significant share;
6. The state should consider a new payment schedule to replace the 1995 funding "ramp," and new revenues are required.

The Center for Tax and Budget Accountability (CTBA) testified during the Funding Subcommittee on Wednesday August 26, 2009, that despite oft-repeated claims to the contrary, the primary cause of the state's pension funding woes have very little, if anything, to do with over generous benefits, high employee head counts or inflated costs.

"The state's failure to make its required employer contributions to the five pension systems stems from a state fiscal system that is so poorly designed it, for decades, failed to generate enough revenue growth to both maintain service levels from one year to the next, and cover the state's actuarially required employer contribution," CTBA Executive Director Ralph Martire said.

Where does Journal Star Commentary comes up with the conclusion that public pensions far outpace private sector pensions? The facts do not support that conclusion.

Given that the State's poorly designed revenue system created the structural deficit that in turn incentivized elected officials to shortchange the state's employer contributions to its pension systems, pension funding reform is not possible without enhancing state revenue. In the Spring, members of the General Assembly will have to make a decision between maintaining the status quo or implementing an unpopular but desperately needed revenue enhancement.

**How did we get here?** P.A. 86-273, which became effective on August 23, 1989, implemented a pension funding plan that provided for increasing the State's contribution incrementally over a 7-year period, beginning in FY 1990, so that by FY 1996, the minimum State contribution would be an amount that, when added to other sources of employer contributions, is sufficient to meet the normal cost and amortize the unfunded liability over 40 years as a level percentage of payroll.

The Legislature and the Governor did not adhere to the provisions of P.A. 86-273. A class action suit, *People ex rel. Sklodowski*, was brought against the State for its failure to abide by the Act. The case was heard by the Illinois Supreme Court, and in 1994 the court ruled that active participants and retirement systems had neither a constitutional nor a vested contractual right to enforce statutory funding obligations.

While the *Sklodowski* case was pending before the high court, Governor Jim Edgar signed Public Act 88-0593 into law. The Act implemented a funding plan for the five State retirement systems that requires the State to make contributions as a level percent of payroll in fiscal years 2011 through 2045, following a phase in which began in fiscal year 1996. The contributions are required to be sufficient, when added to employee contributions, investment income, and other income, to bring the total assets of the systems to 90% of the actuarial liabilities by fiscal year 2045. Each system is required to certify the amount necessary for the next fiscal year by November 15 of the current fiscal year, for inclusion in the Governor's budget. Unlike P.A. 86-273, P.A. 88-0593 contained a continuing appropriation provision to make up for any deficiency in the annual appropriations to the State systems. Guess what – 2011 is nearly here, and the State has not made the necessary contributions all along, preferring to call the non-payments "Pension Holidays" as an example, and now they and others such as the *Journal Star* who have bought into the pension envy pap want to blame benefits!

**So why blame benefits?** Well it's an easy way to take the heat off public officials. Some of them didn't know or understand this current dysfunctional funding mechanism. Many did know and chose to gut public pensions by not funding them.

The Journal's Commentary blames benefits that public employees receive when in reality, Illinois state-funded retirement systems are generally found to be in the statistical median nationally.

The Subcommittee also studied the total retirement costs of neighboring states: Indiana (12.85%), Iowa (14.24%), Kentucky (7.25%), Michigan (11.8%), Missouri (8.71%), and Wisconsin (10.6%). Thus, the Benefits Subcommittee concluded that the future cost of the Illinois Teachers Retirement System (TRS), as an example, (6.63%) to Illinois is clearly not out of line with other states.

Regarding the Public vs. Private Sector Retirement Comparison, The Task Force found that the state's normal retirement costs are comparable and at times less than the cost of the private sector model. To that point, it must be clearly understood and as noted earlier that 78% of those in the state retirement systems do not receive Social Security coverage. Every single employer in the private sector must provide Social Security coverage for their employees. This is a cost to private employers amounting to 6.2% of their payroll. Even if a public employee holds down a second job (as many must) and contributes to Social Security, when it comes time to retire and draw on that, they do so at a drastically reduced rate. For most Illinois public employees, their pension is all they receive upon retirement – fully 78% are not covered by and do not receive Social Security. This is unlike workers in the private sector, who receive both Social Security and private retirement benefits. This non-participation in Social Security saves the State hundreds of millions of dollars every year in employer contributions. Why did we not read about that in the Commentary?

Additionally, many private employers provide a contribution to a 401k plan. According to a press release from the “51st Annual Survey of Profit Sharing and 401k Plans” report, “Private company retirement contributions averaged 4.4 percent of payroll. They are highest in profit sharing plans (8.6 percent of pay) and lowest in 401(k) plans (3.2 percent of pay)”. Adding the average employer contribution of 4.4% of pay to the mandatory 6.2% of payroll payable towards Social Security amounts to a total private employer contribution of 10.6% of pay. When you compare this to the state’s normal cost of TRS at 6.63%, the private sector retirement costs are more expensive.

Frequently, fully funded defined benefit plans attain high enough investment returns that public sector employers are able to reduce the amount of normal cost paid from tax collections, freeing taxpayer revenue to cover services. This cost savings can be significant, as the experience of the Illinois Municipal Retirement Fund (“IMRF”) demonstrates. The IMRF, the second largest pension fund in Illinois covering public employees such as bus drivers, sewer workers, office staff, and municipal administrators, has enjoyed a funding advantage for years, in large part because it demands full and on time payments from member government employers and employees. As a result, the IMRF has consistently maintained high levels of funding. Why are police and firefighters, teachers, judges, university employees, state employees, and the other public pension fund employees second class employees in the eyes of so many state and city leaders compared to the IMRF covered employees? Those pension envy agitators who blame the benefits of the pension plan as the cause, should look first to see if they actually paid what they should have all along, and then look at the current methodology of funding as the reason for their concern.

I am not unsympathetic to the burden passed on to taxpayers for properly funding the State and municipal pension programs. Managing a State or municipality is a difficult task requiring trade-offs within the budget. However, strong management requires a recognition that **pension funding should occur while the pensions are being earned and not passed off to future generations of taxpayers.** As noted earlier, the system for proper funding of State pension plans was altered in 1989 when the contribution methodology was changed to lower their then current costs. It is now unseemly for the State, politicians running for office, or newspapers such as the Journal Star to raise an alarm about issues which were anticipated and attempt to blame the beneficiaries of the system as the system performs exactly as anticipated!

Part of the Moral Contract we have with Public Employees is that in exchange for them going out and risking their life and limb every day for us in the case of public safety officers, or putting up with a rude and unsympathetic public with a smile in the case of other State-wide public pension employees, we will guarantee them a good pension. Not a great pension, a good pension. When we enter into that Moral Contract we owe it to our public employees to be responsible and live up to our end of the bargain and make certain that their pension is there when they need it, no quibbling about it – no whining about it, "I promised it. I didn't save for it. I guess I thought my kids and grandkids would pay it."

**<u>So what needs to be done here?</u>** I believe that we need to refinance the pension system using the actuarial method of equal annual payments over a new funding schedule, just like you would for a mortgage on your house. It would be a level annual payment schedule with rolling amortization. This would place a stable funding system in place.

An additional effective idea is the continued limited use of Pension Obligation Bonds ("POBs"), such as those suggested in the 95th General Assembly by Senator Don Harmon (SB 788), **but only when market conditions are favorable and only as a debt swap to refinance a portion of the existing unfunded liability**. POBs issued so far have inappropriately been used in large measure as a substitute for regular pension contributions, in effect borrowing to pay the ongoing cost of pension benefits. Not wise.

We need to educate our elected leaders about how the pensions are funded and what really caused this issue of underfunding. Allowing individuals or groups who are ideologically driven against defined benefits for Public Employees to misrepresent or outright deceive the public and elected officials is a recipe for disaster for our Community and for Illinois.

Please call me if you have any questions.

Sincerely,

James L. Dobrovolny
Attorney at Law

JLD