

SECTOR COMMENT

Illinois Governor Proposes Sweeping Public Pension Reforms, a Credit Positive

From [Weekly Credit Outlook](#)

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On 20 April, Illinois Governor Pat Quinn proposed a plan that would overhaul public pension funding and increase minimum retirement ages and required pension contributions by workers and participating local governments and public universities. The administration's recognition of the need to substantively reform the pension system is credit positive for the [State of Illinois](#) (A2 stable), which has struggled to address its pension challenges for decades.

A state senate bill that would have required pension participants to pay more to remain in their existing plan failed to win approval from the governor or the state's house last year. Pension reforms must be approved by the state's General Assembly, a process that could result in substantial revisions to the governor's proposals. The governor's plan allows for negotiation on contentious points: for example, it proposes that local governments and public universities be required to start covering the normal costs associated with their employees' pensions over a period of "several years," removing that responsibility from the state. Normal costs are the value of future retirement benefits that covered employees accrue in a given year.

Savings from specific elements in the proposal are also unspecified, although the state projects that measures affecting individual plan participants would cut statutorily required contributions by \$65 billion to \$85 billion in total through 2045. This would reduce the state's pension contributions by 19%-24%, based on current projections from the state legislature's Commission on Government Forecasting and Accountability. Other changes affecting employees include limits on cost of living adjustments (COLAs). If the state also manages to shift responsibility for paying the normal costs of the employees of school districts and public universities to the schools and universities themselves, then its annual pension funding burden would fall even more.

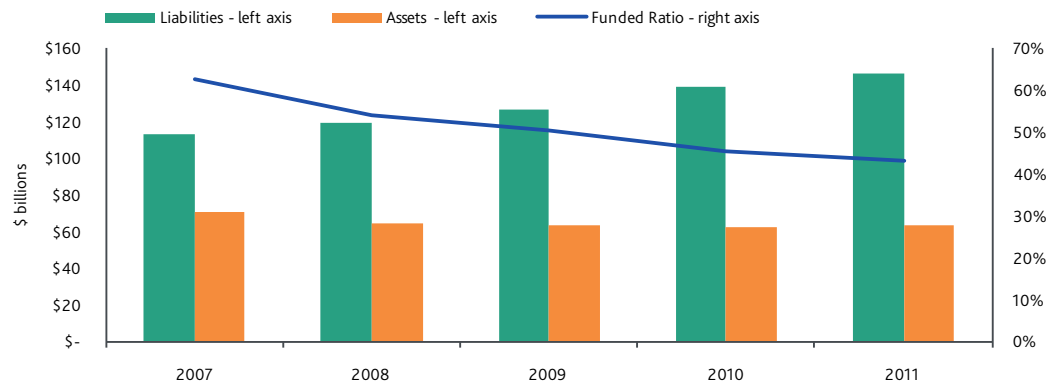
If enacted, the changes also may spur litigation from public employee unions, which will invoke Illinois' constitutional protections of pension benefits. The governor's plan aims to avoid litigation by asking individual employees to accept new terms (such as a minimum retirement age of 67) in exchange for continued retirement health insurance and for having future pay increases factored into pension benefit calculations. This approach underscores the political and legal difficulty of decreasing current employees' benefits. Litigation in a handful of states challenges changes to current-employee benefits. However, a significant number of states recently enacted legislation to reduce current employees' benefits after earlier legislation changed benefits for new or incoming employees.

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Downgraded to A2 from A1 in January, Illinois became the lowest-rated US state largely because of its weak pension funding.¹ How much any enacted pension reform bolsters the state's credit standing depends largely on the degree to which the reform reduces the actuarial accrued liability (AAL) of its five major plans. As of 30 June 2011, the plans' reported AAL had risen to \$146.5 billion from \$113 billion in 2007. Plan assets declined 10% in the same period to \$63.6 billion, resulting in a 43% reported funded ratio (see exhibit). Illinois in 2010 enacted a package of reforms affecting new employees (as of January 2011), but which had no impact on the AAL.

Illinois Pensions' Aggregate Funded Status



Source: State of Illinois General Obligation Refunding Bonds Series of May 2012, preliminary official statement.

¹ See [Key Drivers of Illinois' Downgrade to A2 From A1](#), 20 January 2012.

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