Office of Management and Budget
Executive Office of the Governor

Chairman Johnson, Ranking Member Andrews, Vice Chairman Kline, Representative Biggert, Representative Davis, and Members of the Subcommittee, I am John Filan, Director of the State of Illinois Governor's Office of Management and Budget. I appreciate the opportunity to appear before you today

Background

The State of Illinois sponsors five retirement plans covering state employees, university employees, teachers outside of Chicago, judges, and members of the state General Assembly. As of the date of the most recent actuarial valuation (June 30, 2005), the plans on an aggregate basis were 60.3% funded, up from 48% in 2003.

During the 1970's, 1980's and the first half of the 1990's, state contributions were grossly inadequate during both good and bad economic times. As a result, in 1994, the state adopted a payment schedule (Public Act 88-593) that first became effective in fiscal 1996. However, the payment schedule continued to grossly underfund each of the pension funds. At that point in time (June 30, 1995), the plans on a total basis were 52.4% funded, with an unfunded liability of $19.5 billion.

Unfunded Growth Since 1995

The total unfunded liability of the state pension system more than doubled from $19.5 billion as of June 30, 1995 (the year before implementation of the 50-year payment plan) to $43.1 billion as of June 30, 2003, the beginning of the current gubernatorial term in office.

The $43.1 billion unfunded liability as of June 30, 2003 equates to a funded ratio of 48.6%. The primary drivers of the increase in unfunded liability and consequent reduction in funded ratio include:

- State contributions determined in accordance with the 1995 Payment Plan were designed not to be sufficient to fund the normal cost and interest on the unfunded liability – this amounted to $10.9 billion. In other words, the 1995 plan was flawed from the beginning.

- Significant investment losses incurred during the three fiscal years ended June 30, 2003 - $6.5 billion

- Benefit improvements passed by the legislature from 1995 through 2003 with out any source of funding – 5.8 billion.

A combination of consistently underfunding the pensions and continuing to provide more and more benefits without a way to pay for them resulted in more than doubling the unfunded liability.

The following chart shows the components of the increase in the unfunded liability from 1996 to 2003 (numbers in billions):

Unfunded Liability at 6/30/1995	$19.5
Change due to:	
State Contributions	$10.9
Actuarial Investment Losses (Gains)	6.5
Unfunded Benefit Improvements	5.8
All Other Factors	.4
Total Increase	$23.6
Unfunded Liability at 6/30/2003	$43.1

Failings of 1995 Payment Schedule

The 1995 payment schedule was structurally flawed when it was enacted. We agree that adopting a payment policy for the state pension contributions was definitely needed. Unfortunately, the 1995 payment schedule Governor Edgar's administration proposed would not decrease the pension debt for 40 years. First of all, it incorporated a 15 year ramp-up period, which increased contributions over a period of 15 years from a starting level that was totally arbitrary and grossly less than the amount needed to keep the unfunded liability from increasing. Thus the state was guaranteed to experience a growing unfunded liability from 1996 through at least 2010. This had the impact of deferring and increasing the entire liability into the future. To make matters even worse, contributions for years after 2010, although determined as a level percent of pay, are also not sufficient to pay normal cost and interest on the unfunded liability until around 2034. As a result, the unfunded liability was originally projected to grow from the June 30, 1995 level of $19.5 billion to more than $70 billion by 2034 before it finally reduces to $45 billion in 2045 (based on projections from the June 30, 2005 actuarial valuation). Ultimately, the 1995 payment schedule did nothing more than push the entire unfunded liability out 40 years to 2034.

2003/2004 Pension Obligation Bonds

In response to the enormous challenges facing the state in funding the state pension systems, Governor Blagojevich developed, and is currently in the process of implementing, a long-term, multi-step plan to reform the state's pension system. The ultimate goal of this reform plan is to develop a retirement program that is affordable for the state, and at the same time, meets the retirement security needs of the state's pension system participants.

The **first step** taken by the Governor to address these tough issues was to provide the state pension systems with a cash infusion and reduce the state's pension debt. During June of 2003, the state issued $10 billion of Pension Obligation Bonds, all of which, except for $500 million which was used to cover issuance costs and initial debt service payments, was paid into the pension systems. Of this $10 billion total, $7.3 billion was disbursed to the pension systems as an **additional state contribution over and above any annual contribution requirements. Note this was the first time in the history of Illinois that payments were made above the annual contribution requirements.**

This additional cash infusion on July 3, 2003 immediately reduced the pension system's unfunded liability, and increased the system's funded ratio from 49% as of June 30, 2003 to over 57% literally overnight. (With investment earnings, the funded ratio subsequently improved to over 60% by June 30, 2005.) With this single action, the security of the members and retirees' pensions improved significantly. This reduction in liability exceeds the goals set out in the 1995 payment plan.

Governor's Pension Commission

The **second step** was the Governor's appointment of a Pension Commission to review the pension system's funding issues, and make recommendations focused on improving the system's financial condition and affordability. The Commission met numerous times and issued their report and recommendations on February 11, 2005.

The Governor then examined and considered the recommendations contained in the Commission's report. Based on the recommendations of the Commission, the Governor next proposed changes to the plan provisions and funding mechanisms for the state retirement systems.

Public Act 94-4

The **third step** taken by the Governor to reform the pension system was to submit the set of proposed changes to the Legislature. After review and negotiation, several reforms to the state pension system, known as Public Act 94-4, were adopted.

The net results of the pension reforms included in PA 94-4 is a projected reduction in the 2045 actuarial accrued liability of approximately $83 billion according to the independent determination of the pension systems' actuaries, as well as a reduction in state contribution requirements of approximately $3 billion over the next 40 years according to the independent determination of CGFA (in their January 2006 report).

The Governor's commitment to streamline and revitalize state government has resulted in the elimination of 13,000 non-essential positions, reducing the state payroll to under 57,000 employees (after decades where the payroll hovered near 70,000 employees, resulting in a bloated and inefficient state government). In addition to the annual payroll savings this effort has generated, the most current actuarial valuation of the State Employees Retirement System (SERS) as of June 30, 2005 projected a savings of approximately $5 billion in state contribution requirements to SERS between fiscal year 2006 and 2045 as a result of this effort. This $5 billion contribution savings represents an additional $2 billion savings over the $3 billion discussed above.

Governor’s Pension Reforms

The reforms included in Public Act 94-4 represent the first time future liabilities and costs of the Illinois pension system have ever been reduced.

Recent statements have referred to "raiding" Illinois state pension funds. Those statements are nothing more than political rhetoric from elected officials who, for years, voted for budgets and benefits that drove the unfunded liability to $43 billion. If there’s something the Blagojevich administration has been deficient on when it comes to pension funding, it’s failing to aggressively halt the attempts of those who created the problem to then re-write history and try to pass the blame onto others.

In 2003 when Governor Blagojevich took office the combined assets of the five state retirement funds were $40.7 billion. By the end of the Gov's first two budget years (June 30, 2005) those assets had grown to $58.8 billion -- $18.1 billion more than when the Governor took office. This is, by far, the single largest increase in pension assets in any 2 year period in history.

Further, according to the retirement systems, as of June 30, 2006 those same cash and investments are in excess of $61.9 billion -- a full $21 billion more (50% more) than when Governor Blagojevich took office in 2003.

The $21 billion increase in assets came from $12.2 billion of deposits into the retirement funds by the Blagojevich administration through June 30, 2006 as well as investment earnings on those deposits.

There have been record deposits and increases in assets, and substantial earnings on those assets since Governor Blagojevich took office -- despite the rhetoric and attacks leveled by politicians seeking to hide their own shameful record when it comes to pension funding and benefits.

Governor Blagojevich’s administration has contributed the most funds to the state pension system of the last four administrations. The following table illustrates state contributions to the pension system under the last four administrations:

Fiscal Year Period	Contributions (Millions)	Average Annual Contribution	Percent of Resources
2004 – 2007 Blagojevich	$13,300.0	$3,325.0	12.9%
2000 – 2003 Ryan	$5,818.4	$1,454.6	6.08%
1996 – 1999 Edgar	$3,433.7	$ 858.4	4.30%
1992 – 1995 Edgar	$2,067.6	$ 516.9	3.28%

Another way to look at the impact of the Governor's actions is to compare the unfunded liability and funded ratio of the pension systems with and without the additional contribution of the pension obligation bonds. With the additional contribution of the pension obligation bonds, the unfunded liability and funded ratio are $38.6 billion and 60.3% respectively as of June 30, 2005. Without the proceeds of the pension obligation bonds, the unfunded liability and funded ratio would have been $47.6 billion and 50.4% respectively as of the same date. Again the results are demonstrably better than if the Governor's actions had not been implemented.

Advisory Commission on Pension Benefits

The **fourth step** in the Governor's long-term plan to reform the state's pension system consisted of establishing an Advisory Commission on Pension Benefits. The mandate of this Advisory Commission on Pension Benefits (the "Commission") was to consider and make recommendations concerning revenue sources, changing the age and service requirements, automatic annual increase benefits, and employee contribution rates of the State-funded retirement systems and other pension-related issues.

The Commission met five times between September 23 and October 27, 2005. After extensive and productive discussions of the State Retirement Systems, the Commission crafted several recommendations. The next step in the Governor's plans to reform the state's pension system will be for the legislation to consider the Commission's recommendations. Some of these recommendations were included and adopted in the Fiscal Year 2007 budget.

Commission on Government Forecasting and Accountability ("CGFA")

Earlier this year, the Commission on Government Forecasting and Accountability ("CGFA") (a bi-partisan commission whose statutory role encompasses monitoring of the state's pension systems including their progress toward the funding levels set forth in the 1995 pension legislation) issued a ten year report (on the 1995 payment plan). The report compares the actual progress toward the 90% funded goal (in 2045) on a year by year basis. CGFA engaged its own independent actuary to track the impact of all cash contributions by the state, changes in pension benefits such as the early retirement incentive program (ERI), the impact of the pension obligation bond issued in 2003 and actual investment results. The same actuary developed a year-by-year set of projections back in 1995 when the pension funding plan was adopted. This year's report compared those 1995 projections of where the pension plans were projected to be (relative to the funded ratio level) in 2005 versus what the funding levels actually were at that same date.

In fact, following is a quote directly from CGFA's report in January of 2006 "Despite counteractive factors such as formula increases, investment gains and losses due to market volatility, the infusion of Pension Obligation Bond proceeds and funding reductions as contained in PA94-4, the total cost of the current funding plan has not grown appreciably from what was originally projected in 1994."

The bottom line is simple and stark: the 1995 pension payment schedule estimated the funded ratio would be 52.5% in 2005 while the actual funded ratio achieved was 60.3%. So, as a result of the policies put in place since Governor Blagojevich took office in 2003, the state of Illinois is well ahead of the funding level expected and designed in the 1995 payment schedule.

This significant and material increase in the funded ratio was due primarily to the record additional contribution in Fiscal 2004 associated with the $10 billion pension obligation bond and earnings on that additional contribution.

Those that accuse this governor of "raiding" the pension systems conveniently forget the additional funding that went to the systems. In fact, the 1995 projections of the CGFA actuary estimated that the state would make $12.3 billion of contributions from 1996 through 2005. In fact, the actual contributions for the same period totaled $19.8 billion, thereby exceeding the statutory requirements by $7.5 billion. Once again, we are well ahead of the original 1995 payment schedule.

Conclusion

I know there's a lot of numbers being stated today but let me repeat those findings of the independent actuary of CGFA -- $7.5 billion of contributions more than called for in the 1995 plan, and a funded ratio of 60.3% versus only 52.5% (called for in the 1995 payment plan).

I challenge anyone to refute those numbers and that result. Specifically, answer this simple question: if the funds were raided, how can they have $7.5 billion more than statutorily required and the funded ratio is 7.8% more than the independent actuary estimated?

Illinois has had the worst funded pension system by far for many years – solely caused by 30 years of underfunding, including many years of planned underfunding. Illinois also had a practice of adding billions of dollars of costly benefits without providing any new funding, which only made the longstanding underfunding worse. We have put a stop to this in Illinois—the Governor proposed and signed into law in 2005 a key pension reform: no new benefits without a full funding source.

Our submission to the Committee outlines many of the steps we have taken and the recommendations we have made. Illinois has made demonstrable progress on pension funding for the first time in decades. I believe that we have taken the first steps towards the pension reform necessary to strengthen the retirement system's balance sheet, protect taxpayers and preserve retirement security for our employees. We still have a long way to go and are committed to continue down that path.

By any measure Illinois state pension systems for retirees and current employees are better funded and more secure that they were when Governor Blagojevich came into office. Any statement to the contrary -- particularly statements or inferences about "raiding" or "stealing" -- is not only patently false, they scream for the records of those making those statements to be examined and the truth revealed.

Thank you for allowing me to speak to you today.