Pennies on the Dollar: How Illinois Shortchanges Its Teachers' Retirement

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About TeacherPensions.org

Teacherpensions.org provides high-quality information and analysis to help stakeholders—especially teachers and policymakers—understand the teacher pension issue and the trade-offs among various options for reform. We believe there is a need for additional analysis of and communication about teacher pensions—an issue that has not yet gained sufficient traction nationally, despite its seriousness and immediacy. We aim to make the issues around teacher pensions more accessible and relevant to the general public, more compelling to policymakers, and more understandable for current teachers.

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Teacherpensions.org is a project of Bellwether Education Partners, a nonprofit dedicated to helping education organizations in the public, private, and nonprofit sectors become more effective in their work and achieve dramatic results, especially for high-need students. To do so, we provide a unique combination of exceptional thinking, talent, and hands-on strategic support.
Introduction

Illinois’ pension plans have sent the state on a downward spiral. One out of every four dollars that state taxpayers send to Springfield goes toward pensions, and the vast majority of these contributions go toward paying down large pension debt, not the actual retirement benefits given to state and local workers like teachers.¹ As a consequence, the state’s credit is rated last in the country, and the state’s largest city, Chicago, was recently downgraded to junk status because of the city’s failure to deal with its own pension debt.² Illinois already has one of the highest tax burdens in the country, closing off any easy fixes for the state.³ Complicating matters, in May 2015, the state Supreme Court declared unconstitutional a pension reform law that attempted to cut costs by reducing benefits for existing workers.

The recent decision heightens the urgency for legislators to deal with the state’s massive unfunded liability, now over $100 billion across its five retirement systems. The teacher pension system alone makes up over half of the debt, with a total unfunded liability of $57.9 billion.⁴ Policymakers have already passed cuts to teacher pension plans and will need to continue funneling revenue to pay off the debt.

But what policymakers and others have failed to ask is how well the current pension system is actually serving its workers, particularly teachers. While many assume that the current problems lie solely in the state’s failure to properly manage its finances, few consider the design of the current plan and the impact it has on workers.
The existing pension structure backloads benefits and disproportionately favors teachers who stay for 30 or 35 years, at the expense of everyone else. The state plan assumes, and depends upon, the fact that the majority of teachers will not stay long enough to collect full benefits. Under the current plan, more than half of new teachers will not qualify for any pension benefits at all. Moreover, recent pension reforms severely cut benefits for new workers. In many cases, new and future teachers pay more in contributions than their pension benefits are worth; they are essentially subsidizing the state’s debt.

This brief will examine how and why Illinois teachers are negatively affected by the current system, and it concludes with recommendations for what policymakers can do to ensure all teachers—not just some of them—are given a path to a secure retirement. By adopting a different retirement plan for teachers, the state could better maintain its own finances and provide better benefits for teachers. In the face of growing pension debt that eats away at state resources, Illinois direly needs reform. Rather than fight to preserve a system that leaves the majority of its members without adequate retirement benefits, Illinois should use this time of financial unrest to carefully consider its options for sustainable and equitable pension reform.
How Illinois Shortchanges the Majority of Its Teachers

All Illinois public school teachers participate in a defined benefit pension plan. (Chicago teachers participate in a pension plan separate from the state Teachers’ Retirement System, but generally follow the same parameters as the state plan. See sidebar, “Chicago Teacher Pension Fund.”) In this type of retirement plan, the employer promises a predetermined benefit level based on a formula calculated by multiplying a worker’s total years of service, a worker’s final average salary, and a multiplier factor. Plans determine the number of years of service required to receive a minimum pension (the vesting requirement), as well as the age at which workers can retire and begin receiving benefits (the normal retirement age). Upon a worker’s retirement, a pension is a promise that the state will deliver monthly benefits for the rest of that person’s life.

Illinois has periodically adjusted its pension formula to change the cost—and value—of the retirement benefits it offers teachers. Those benefits depend on when the teacher was hired. Benefits got progressively more generous throughout the 1990s, and before the recent recession, teachers received a flat 2.2 percent multiplier. Upon retirement, a teacher’s annual benefit grew 3 percent a year to keep up with inflation (called cost-of-living adjustments). Teachers could retire with full benefits as early as age 55.
In 2011, in response to worsening financial conditions, the state legislature created a less generous plan for new teachers called “Tier II.” Teachers hired before 2011 remain in their original plan, “Tier I,” and maintain the same benefits as before. Teachers hired after 2011, however, are placed in a new tier, “Tier II,” and receive substantially worse benefits. Tier II imposes a higher minimum service requirement (up from five to 10 years, making it more difficult for new teachers to qualify for a minimum benefit), a higher normal retirement age (meaning teachers have fewer years to collect pension payments over a lifetime), a less generous pension formula (calculating the final average salary from the last eight years of service instead of just four), and a lower, uncompounded cost-of-living adjustment (COLA).  

### Table 1  Illinois Teacher Benefits Depend on a Teacher’s Hire Date

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Vesting</strong></td>
<td>5 years</td>
<td>5 years</td>
<td>10 years</td>
</tr>
<tr>
<td><strong>Final Average Salary</strong></td>
<td>Based upon the highest 4 years of service</td>
<td>Based upon the highest 4 years of service</td>
<td>Based upon the highest 8 years of service</td>
</tr>
<tr>
<td><strong>Multiplier</strong></td>
<td>1.67, 1.9, 2.1, multipliers for every 10 years of service, and 2.3 each year over 30 (with a cap at 75 percent of salary at year 38)</td>
<td>2.2 percent for all teachers and/or service credited after July 1, 1998</td>
<td>2.2</td>
</tr>
<tr>
<td><strong>Normal Retirement Age</strong></td>
<td>Age 62 with 5 years of service Age 60 with 10 years Age 55 with 35 years</td>
<td>Age 62 with 5 years of service Age 60 with 10 years Age 55 with 35 years</td>
<td>Age 67 with 10 years of service</td>
</tr>
<tr>
<td><strong>COLA (cost-of-living adjustment)</strong></td>
<td>3 percent, compounded annually</td>
<td>3 percent, compounded annually</td>
<td>Annual adjustment equal to 3 percent or half of the annual increase in the Consumer Price Index, whichever is lower; the adjustment applies only to the original benefit and does not compound annually.</td>
</tr>
</tbody>
</table>
Both Tier I and Tier II backload benefits, meaning a teacher must work many years before qualifying for a benefit that would allow them to live comfortably in retirement. But the recent changes have severely cut retirement benefits for new teachers. Figure 1 compares pension benefits, adjusted for inflation in 2014 dollars, for Illinois teachers hired in 2010 (Tier I) versus 2012 (Tier II). There’s a significant gap between the pre- and post-recession plans. Not only is it harder for new teachers hired after 2011 to qualify for a pension, but the value of Tier II benefits remain minimal for many years into a teacher’s career.

Sources: Calculations for benefits use the benefit parameters for new hires found in Table 1, as well as the model found in Robert Costrell and Michael Podgursky, “Peaks, Cliffs, and Valleys: The Peculiar Incentives in Teacher Retirement Systems and Their Consequences for School Staffing,” *Education Finance and Policy* 4, no. 2 (2009): 175–211, and in Robert Costrell and Josh McGee, “Teacher Pension Incentives, Retirement Behavior, and Potential for Reform in Arkansas,” *Education Finance and Policy* 5, no. 4 (2010): 492–518. Benefits are based on the Society of Actuaries RP 2014 Mortality Table, a discount rate of 5 percent, a 0 percent COLA, and a starting salary of $40,000 with a 2.75 percent annual increase for a female teacher who enters the profession at age 25. Calculations do not include benefit caps.
Table 2  Illinois Teachers May Pay More into the Pension System than They’ll Get Back

<table>
<thead>
<tr>
<th>Illinois Tier II Teachers Hired in 2012 or Later</th>
<th>A Teacher Who Teaches for 10 Years</th>
<th>A Teacher Who Teaches for 20 Years</th>
<th>A Teacher Who Teaches for 30 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Lifetime Retirement Benefits</td>
<td>$34,857</td>
<td>$76,150</td>
<td>$233,187</td>
</tr>
<tr>
<td>Total Employee Contributions</td>
<td>$42,940</td>
<td>$103,142</td>
<td>$185,826</td>
</tr>
<tr>
<td>Difference (Employee Benefits Minus Their Own Contributions)</td>
<td>-$8,083</td>
<td>-$26,992</td>
<td>$47,361</td>
</tr>
</tbody>
</table>

Sources: Calculations for benefits use the benefit parameters for new hires found in Table 1, as well as the model found in Robert Costrell and Michael Podgursky, “Peaks, Cliffs, and Valleys: The Peculiar Incentives in Teacher Retirement Systems and Their Consequences for School Staffing,” Education Finance and Policy 4, no. 2 (2009): 175–211, and in Robert Costrell and Josh McGee, “Teacher Pension Incentives, Retirement Behavior, and Potential for Reform in Arkansas,” Education Finance and Policy 5, no. 4 (2010): 492–518. Benefits are based on the Society of Actuaries RP 2014 Mortality Table, a discount rate of 5 percent, and a starting salary of $40,000 with a 2 percent annual increase for a female teacher who enters the profession at age 25. Calculations do not include benefit caps.

In fact, new teachers will actually experience negative net pension wealth during their first two decades of service under the Tier II plan. This is because the value of a teacher’s contributions plus interest exceeds what she would receive in future benefits. Put another way, she would get less in return than what she paid into the system.

That’s because Illinois has one of the most punitive withdrawal policies of any public retirement plan in the United States. All states allow teachers to withdraw their own contributions, sometimes with interest, but Illinois teachers can’t even withdraw their own contributions in full. Although Illinois teachers contribute 9.4 percent of their salary for each year they work, the state imposes a 1 percentage point withdrawal tax and allows them to pull out only 8.4 percent when they leave. The remaining 1 percent stays with the system to fund the state's debt. These teachers do not receive any interest on their own contributions, and they are ineligible to withdraw any portion of the sizable contributions the state made on their behalf. On top of this, public school teachers in Illinois lack Social Security’s retirement benefits, a decades-old policy decision that persists despite Social Security’s potential value for teachers. (See sidebar, “Lack of Social Security Places Illinois Teachers on a Precarious Path”).
Pennies on the Dollar: How Illinois Shortchanges Its Teachers’ Retirement

Today, public school teachers in Illinois do not participate in Social Security. The exclusion of teachers from Social Security comes from decisions made decades ago. State workers were left out of the original Social Security Act in 1935, but states were later given the option to participate or remain uncovered. Illinois and a handful of other states are allowed to remain outside the federal program as long as they provide their public sector workers with an adequate retirement plan that meets a “safe harbor” threshold of benefits. If the state or municipality does not meet the safe harbor provision, they must enroll their members in Social Security and pay the associated payroll taxes. Actuarial projections indicate that TRS benefits will drop below the safe harbor at some point in the near future because Tier II benefits grow at a slower rate than the growth of Social Security benefits.

Illinois teachers would have much to gain from participating in Social Security. Social Security would provide guaranteed, inflation-protected benefits that, for most workers, would exceed what the state provides. Even under various proposals to reform Social Security, teachers would still gain a positive accrual of benefits. While extending Social Security coverage to teachers will mean employer and employees will need to contribute to the federal program, the benefits of participation outweigh the costs.

Illinois teachers already face insufficient pension benefits; their exclusion from Social Security only further heightens their retirement risk. Rather than continue a worsening situation where teachers are penalized for choosing to work in Illinois’ public schools, the state needs to ensure that reforms actually promote adequate retirement security of its teaching workforce.

Lack of Social Security Places Illinois Teachers on a Precarious Path

Bearing the brunt of reform cuts, new Illinois teachers are subsidizing the state’s pension obligations for their first two decades of service—essentially paying a penalty just for the privilege of participating in the system. A Tier I teacher with 10 years of service under the 2010 plan would receive a positive accrual in net retirement savings, whereas that same teacher hired in 2012 would have a pension worth less than her contributions. In Tier II, a teacher with 10 years of service will receive overall lifetime pension benefits totaling $35,000. But she will have made contributions from her paycheck that should be worth $43,000. Even though she would receive a pension upon retirement, on average she’ll lose more than $8,000 on her investment.

According to actuarial assumptions from the Illinois Teachers’ Retirement System (TRS), the majority of newly hired teachers will pay this tax. Seventy-eight percent of newly hired teachers in 2014 are expected to leave the Illinois teaching workforce before teaching 26 years, the point at which a teacher “breaks even” on her contributions. This means that over three-quarters of the state’s newly hired teachers will not receive any positive accrual of retirement benefits.
Figure 2 compares net pension wealth accrual and teacher retention rates. The chart shows two data curves: the net benefits a teacher would earn and the percentage of teachers who remain in the workforce to receive these benefits.

Illinois is not alone in this trend: Nearly every state cut teacher retirement benefits after the recession. From 2010 to 2011, over 90 percent of pension legislation passed some sort of benefit reduction. But Illinois was one of the worst offenders. Compared to teacher pension plans in other states, Illinois once offered full-career teachers slightly above-average retirement benefits. Benefits for new Illinois teachers are now far below the median state. All across the country, post-recession pension cuts have fallen hardest on new hires, but Illinois' new and future teachers face particularly steep cuts. Not only have the state's attempts to curb growing pension costs failed, the reforms will also make it more difficult to attract and retain new and future teachers.
While teachers employed in Chicago participate in the Chicago Teachers’ Pension Fund (CTPF) rather than the Illinois Teachers’ Retirement System, they still follow the same state Tier I and Tier II vesting requirements, but use slightly different retirement ages and service years. According to CTPF’s plan assumptions, over half of teachers will leave before the 10-year vesting requirement. This means that less than half of new Tier II Chicago teachers will qualify for a minimum pension benefit. Like all other teachers in Illinois, Chicago teachers do not participate in Social Security.

Today, the Chicago Teachers Pension Fund is just 51.5 percent funded, and unlike the state TRS, the Chicago Public Schools (CPS) district rather than the state is responsible for paying the majority of the fund’s employer contributions. While CTPF was fully funded during the stock market boom in the late 1990s and into the early 2000s, CPS was given legislative approval to skip contributions to the system because of a district budget crisis. After a decade-long pension “holiday” and partial payments, CTPF’s funding levels began to decline in 2004.

Like the state system, Chicago also attempted to pass a pension reform law that would have reduced benefits for certain city workers, and like the state law, a city court overturned the legislation because of constitutional concerns. While the legislation would not have directly impacted Chicago’s teachers, the lower court’s decision, if upheld, diminishes the likelihood that the state will attempt to pass similar reforms for city teachers. Instead, cuts will continue to be passed on to new hires and/or alternative revenue will be needed to shore up funding through tax hikes, budget cuts, or increased employee contributions.

The burden of pension debt falls squarely on Chicago’s taxpayers, schools, and teachers. Chicago residents are double taxed for pensions, once for the state’s general fund that pays into TRS, and again for the city’s own pension costs. Pension payments place undue fiscal pressure on the district, and CPS even struggled to pay full contributions alongside teacher payroll at the end of the 2014-2015 school year. For the city’s schools, last year’s statutorily required pension contributions ate up 11 percent of CPS’ total operating budget, or nearly $1,600 per student. Employer contributions will continue to rise until 2059. On top of employer contributions, CPS “picks up” 7 percent of the 9 percent employee contribution that teachers are supposed to pay. That cost the district another $127 million last year. All of this money could be spent on education resources for students, teacher development, upfront compensation, or a more equitable supplemental retirement plan like Social Security.
Illinois’ Pension Underfunding Negatively Impacts Teachers and School Districts

Illinois’ new and future teachers are paying the price for the state’s failure to responsibly manage its pension finances over the past several decades. The state created Tier II as a way to mitigate growing pension debt after the recession, but the attempt was crude and has not solved the state’s pension problems. Instead, Illinois’ history of underfunding has led to reform cuts that have magnified the structural inequities and issues with the system.

Illinois’ prolonged underfunding becomes more and more problematic for the state. TRS has been underfunded throughout its history. While funding levels shift intermittently, today, the Illinois Teachers’ Retirement System is just 40.6 percent funded and has $57.9 billion in unfunded liabilities. This means for every dollar the state has promised in future payments, it has saved only 40 cents. The unpaid debt means growing interest costs, worse credit scores, and lower returns. Although the stock market has risen threefold since the depths of the latest recession, Illinois can’t grow what it doesn’t save. Carrying large debts limits Illinois’ ability to respond to its fiscal needs, burdening teachers, districts, and taxpayers.
These costs are somewhat buried within the pension contributions, but they’re real. Within pension systems, there are two types of costs: the actual cost of benefits and the debt cost. The benefits cost is the amount of cash a pension plan projects it needs to contribute in the current year in order to pay benefits in future years for existing members and retirees. The debt cost is the amount required to pay down any accrued debt.

Illinois’ debt cost has skyrocketed and employer contributions are projected to quadruple over the next three decades (see Figure 3). TRS makes up over half (55 percent) of the total unpaid debt of the state’s five retirement systems.¹³

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**Figure 3  Illinois Pension Debt Is Driving Up Teacher Pension Costs**

![Graph showing the annual cost of benefits and debt cost from 1995 to 2039.](http://trs.illinois.gov/pubs/actuarial/2013valuationrept.pdf)


*Notes: The annual cost of benefits represents the normal cost. The debt cost represent the amortization costs. Also, the state legislature passed a pension holiday from 2006 to 2007, allowing the state to skip its required annual pension contributions in those years.*
Although almost two-thirds of Illinois school districts pay a portion of the teachers’ employee contributions (nicknamed a “pension pick-up”), local school districts are only required to pay a small portion of the system’s employer contribution (districts pay only 0.58 percent of teacher salaries). The state is responsible for the remainder. This distribution means that school districts share an unequal portion of paying for pension obligations. Districts can give late-career salary raises—negotiated with local unions and wholly separate from the state as a way to “spike” pension benefits. These salary raises trigger pension debt, but districts don’t feel the immediate fiscal strain because they only need to pay a fraction of the cost.

Moreover, funding for Illinois’ school districts is highly inequitable and higher-income districts are able to afford much larger per pupil expenditures and higher teacher salaries. Pensions exacerbate these inequities, because districts contribute only a small fraction of the total pension costs and the rest is born by the state. So even though higher-income districts tend to offer higher teacher salaries, the state, and not the district, picks up the majority of their retirement costs.

By 2040, all of Illinois’ pension contributions will go toward paying off debt; none of it will pay for the annual costs of benefits. That’s because Illinois teachers are paying more into the pension plan than the pension plan estimates those benefits are worth. Over time, teachers will be expected to foot the entire cost of their own benefits, plus the state’s debt. Even as some individual members benefit from the system—realistically only those who stay for 25 or 30 years—as a group Illinois teachers hired after 2012 will be net contributors to the state retirement plan. They will be subsidizing the plan while accruing benefits worth less than their own contributions.

Illinois’ failure to manage its pension obligations is having a negative impact on its teachers, school districts, and taxpayers. Almost $3.6 billion was spent paying off pension obligations—equivalent to over a third of the state’s budget for K-12 schools, or nearly 50 percent more than what Illinois spends on its public universities.
A Path Forward for Illinois

Improving the retirement benefit offered to new hires and making it optional for existing workers would provide a fiscally responsible framework that is more responsive to workforce needs. Unlike the current traditional defined-benefit plans, there are alternative retirement plans that would offer fully portable benefits, ensuring greater retirement security for all workers. There are a range of options that meet those goals—such as well-designed defined contribution, 401(k)-type plan; hybrid plans that combine smaller pensions with more flexible accounts, or alternative defined benefit structures called cash balance plans—and Illinois should weigh the trade-offs to decide what works best for its unique needs.

One option would be to allow teachers to opt into the same defined contribution plan offered to full-time staff at Illinois’ state universities. They can opt into a 401(k)-type plan through the State Universities Retirement System (SURS). SURS employees who opt in contribute 8 percent of their salary, and employers contribute an additional 7.6 percent, which workers receive in full after five years of service. The plan offers low-cost mutual funds that automatically allocate investments based on the employee’s age, allowing members to access low-maintenance, diversified investments. SURS employees, like Illinois teachers, also do not participate in Social Security, so the total contributions for the SURS plan is much lower than what Illinois is paying for the teacher plan. Yet it provides a fully portable, well-designed benefit for all workers.
Alternatively, the state could implement a smooth-accrual, defined-benefit plan, called a cash balance plan, for new and future teachers. In a cash balance plan, the employer and employees contribute to the plan and employees are guaranteed a fixed return (e.g., 5 percent). At retirement, teachers can take their total balance as a lump sum or as a guaranteed lifetime annuity. Benefits are directly tied to annual contributions, meaning workers would accumulate proportional benefits for every year they worked, rather than being forced to wait for many years for sufficient benefits.

In either of these options, workers would be able to monitor their accounts and take their account balances wherever they go—a flexibility that’s nonexistent in the current pension plan. This would allow for greater transparency and portability.

**Figure 4** shows a cost-neutral cash balance plan for Illinois’ new teachers. The plan essentially redistributes the backloaded funds so that all teachers accrue benefits earlier in their career. (To be clear, the redistribution is for future teachers only; it would not reduce benefits for existing teachers.) Because this cash balance plan is cost-neutral, the state could switch to this alternative plan, provide more equitable, portable benefits to teachers, and enhance the state’s fiscal position without incurring any additional costs beyond what it already allocates toward Tier II benefits.

Over three-quarters of new teachers are expected to leave with negative net benefits in the current plan. These teachers would all benefit from a cash balance plan. As discussed previously, in the current system, a Tier II 25-year-old teacher who leaves after 10 years of service accrues a retirement benefit worth less than she contributed. Under a cash balance plan, that same teacher would earn positive benefits for every year she works. By the time she has worked 10 years, she would have a benefit worth $33,000. Over three-quarters of new teachers are expected to leave with negative net benefits in the current plan. These teachers would all benefit from a cash balance plan. While teachers with over 35 years of experience would receive lower benefits than they would have under the old system (because benefits are no longer backloaded), under the cash balance plan, no one would see their total retirement wealth fall just because they continued working after reaching the normal retirement age.
Pennies on the Dollar: How Illinois Shortchanges Its Teachers’ Retirement

Figure 4 Illinois’ Early and Mid-Career Teachers Would Receive Better Benefits under a Cost-Neutral Cash Balance Plan

Source: Calculations for benefits use the benefit parameters for new hires found in Table 1, as well as the model found in Robert Costrell and Michael Podgursky, “Peaks, Cliffs, and Valleys: The Peculiar Incentives in Teacher Retirement Systems and Their Consequences for School Staffing,” Education Finance and Policy 4, no. 2 (2009): 175–211, and in Robert Costrell and Josh McGee, “Teacher Pension Incentives, Retirement Behavior, and Potential for Reform in Arkansas,” Education Finance and Policy 5, no. 4 (2010): 492–518. Benefits are based on the Society of Actuaries RP 2014 Mortality Table, a discount rate of 5 percent, and a starting salary of $40,000 with a 2 percent annual increase for a female teacher who enters the profession at age 25. Calculations do not include benefit caps.

Note: While no salary cap is included in this calculation, it should be noted that teachers can only receive up to 75 percent of their salary. Therefore, teachers who teach beyond the normal retirement age would experience a drop in benefits after teaching more than 30 years.
Unlike the current system, which discourages work at older ages by reducing benefits after normal retirement, teachers who choose to teach beyond the normal retirement age would continue to earn additional retirement benefits.

Switching to either a cash balance plan or a defined contribution plan would also help the state alleviate its financial burden moving forward. Cash balance and defined contribution plans by definition cannot be underfunded, mitigating the state’s long-standing tendency to allow its politicians to overpromise retirement benefits while it under-saved for them.

Additionally, Illinois could use upfront cash incentives to encourage existing teachers to opt into a new plan. A recent economic study found that teachers largely undervalue their existing pension benefits. In 1998, Illinois allowed late-career public school teachers to buy upgraded, more generous retirement benefits. However, on average, teachers were willing to pay just 20 cents of their current compensation for a dollar of future retirement benefits. In other words, these teachers preferred current wages over pension wealth by a factor of five-to-one. Studies from Washington State also indicate that, when given the option, teachers prefer the state’s alternative retirement plan over the existing defined benefit plan. Given that many existing teachers will accrue negative benefits under the current plan for many years into their career, as well as how much teachers undervalue pension benefits, the state should clearly articulate, through a well-orchestrated communications plan, the advantages of switching to a new alternative plan where the majority of teachers gain a positive accrual of benefits. At the same time, the state will improve its own fiscal housekeeping, lower its debt, and stop accruing additional pension debt moving forward.
Recommendations

Moving forward, Illinois should:

1. **Place new teachers in a new alternative retirement plan, ideally one that includes Social Security.** Switching to an alternative retirement plan such as a cash balance or a defined contribution plan would provide a fiscally responsible framework that is more responsive to workforce needs. Unlike the current traditional defined-benefit plans, these alternative retirement plans do not allow the state to create new debt going forward and are fully portable for workers. Moreover, all teachers would leave their service with a net gain in retirement benefits. Although Social Security coverage would come with additional costs, the state simply can’t match the nationally portable, secure benefit that Social Security provides.

2. **Use cash buyouts to encourage existing workers to opt into the new alternative plan.** Given that many existing teachers lose out under the current plan for many years into their career and that many teachers undervalue pension benefits, the state should clearly articulate the advantages of switching to a new alternative plan. By offering teachers optional cash buyouts from their right to accrue future benefits, the state would improve its own finances and reduce its pension debt going forward. The state would also avoid any legal challenges by making it purely voluntary. Meanwhile, teachers could decide whether they’d prefer to receive upfront cash today or to wait many years for their promised benefits to be paid out over time. Empirical evidence from a prior buyout episode in Illinois suggests many teachers would take that deal.
3. **Responsibly deal with existing debt.** The state needs to pay its full required contributions on time and should follow the recommendations of the National Society of Actuaries Blue Ribbon Panel (an independent panel of actuary and budget professionals and economists) to prompt the state to better assess and responsibly handle its existing debt. Additionally, holding school districts accountable for a larger share of employer contribution pension costs could better redistribute the burden and deter districts from taking actions that impact pension debt (such as late-career salary raises, or “pension spiking,” which trigger the state’s pension obligations without any immediate consequences for districts).

Incentivizing current workers to opt into the alternative retirement plan will additionally alleviate the normal cost of benefits in future years. Moving all new workers to a retirement plan where contributions are directly tied to benefits will ensure full funding moving forward.

**Conclusion**

Illinois’ current pension practices are unsustainable. Rather than dealing with its inadequate benefit structure, it has responded to escalating pension debt by significantly cutting benefits for new workers and attempting to cut benefits for current workers and retirees. Neither policy, however, has successfully addressed the state’s debt or the backloaded benefits the state offers its teaching workforce. The existence of a two-tier system inherently creates greater inequity among workers, putting the state’s new and future workers at a disadvantage. Moreover, asking new teachers to pay off debts built up prior to their service is not fair or equitable, let alone a good way to attract talented teachers into the profession.

Instead, Illinois must move in a different direction. State policymakers could place the state on a more fiscally sound path while ensuring the retirement security of the state’s teachers. Doing so will require shifting from the current pension structure. Maintaining the existing system only perpetuates the current inequities and gaps in coverage. Illinois policymakers should instead seek solutions that address the needs of both the state and its teachers.
Endnotes


However, Illinois provides a more generous COLA than neighboring Midwestern states. Indiana, Wisconsin, Iowa, and Michigan provide COLAs only on an ad hoc basis and/or based upon investment returns. These states, however, also provide Social Security for their members, whereas Illinois does not. Missouri and Kentucky, which do not offer Social Security to their members, provide a COLA equal to the change in the Consumer Price Index, or a 2 percent and 1.5 percent cap, respectively.


15. For every dollar awarded in final salary, an additional $15.51 is added to the state’s pension obligations. Marguerite Roza and Jessica Jonovski, “How Late-Career Raises Drive Teacher-Pension Debt,” Edunomics Lab, December 2014, http://www.teacherpensions.org/resource/how-late-career-raises-drive-teacher-pension-debt. Legislation passed in 2005 imposed a 6 percent cap on end-of-career raises, so districts can spike salary up to this cap without being penalized.
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16 “Education Funding: Chicago and the State,” Advance Illinois (Powerpoint presentation), September 2015.


