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Opinion: The simplest fix for Illinois' Tier 2 pensions is the best one

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When it comes to stabilizing state finances, Illinois has made tremendous progress recently. Coming out of the COVID-19 pandemic recession, the state made smart choices like paying down debt early, making supplemental pension contributions and contributing to the reserve fund. As a result, Illinois is in the best fiscal position it has been in decades, as demonstrated by its recent credit rating upgrades.

However, pensions remain a substantial risk to our state's financial health: At the end of FY 2022, the state's five pension funds were roughly 44% funded and unfunded liabilities totaled about $139 billion. In addition, unfunded liabilities for local pension funds total $71 billion, based on analysis of the most recent actuarial valuations of each of the pension funds. A significant portion of the state's operating budget — over 20% — goes to making annual pension contributions, as does a similar percentage of the city of Chicago's budget. These large contributions crowd out spending in other priority areas, from education to public safety.

Now the General Assembly is weighing how to address another risk: Tier 2 pension benefits falling out of compliance with federal regulations. IRS rules require that public employees receive a pension benefit at least as good as they would under Social Security — known as safe harbor. However, pension benefits provided through the less generous tier of benefits for government employees hired since Jan. 1, 2011, known as Tier 2, are at risk of violating safe harbor due to the way benefits are calculated. This is because the maximum amount of salary considered in Social Security benefits has grown faster than the maximum pensionable salary for Tier 2 pensions.

We agree this issue needs to be addressed. But in doing so, we urge the General Assembly to stick with the simplest, most cost-effective fix for the safe harbor compliance issue: changing the Tier 2 pensionable salary cap to match the pay cap used to determine Social Security benefits, known as the Social Security Wage Base (SSWB). Making this one change would ensure Tier 2 is permanently compliant with federal regulations without substantially adding to pension costs because not all employees will retire with a pensionable salary at or above the SSWB. The model of this approach was taken by Cook County in HB 2352, which was recently signed into law.

We are pleased that the Illinois House Personnel and Pensions Committee is holding a series of hearings on the Tier 2 safe harbor issue this summer in search of a proactive solution. The hearings have made clear that adjusting the pensionable salary cap is the best fix. As the General Assembly works on legislation to address safe harbor, studies are still needed to estimate what the safe harbor changes would cost each local government. We heard projections at the Tier 2 hearings this summer for several of the state's pension funds and the Chicago Teachers' Pension Fund, but estimates are still needed for the rest of the government employers across Illinois whose budgets could be impacted by increasing Tier 2 pensionable salary.

Other Tier 2 pension enhancements have been proposed as part of the safe harbor "fix," but these proposals far overshoot what is necessary to prevent compliance issues and would be more costly in the long run. Two such bills introduced during the spring legislative session, SB 1629 and SB 1630, would enhance benefits for Chicago firefighters beyond the benefit increases necessary to ensure compliance with federal regulations. They would also add substantially to Chicago's pension liabilities, thereby exacerbating the city's pension challenge given that Chicago's pension funds are collectively only about 24% funded. Any benefit changes that go above and beyond what is required for federal compliance should be considered separately from the federal compliance issue, with full actuarial analysis of costs, and identification of funding to pay for it.

Tier 2 has been an important contributor to curbing Illinois' unsustainable pension liabilities. At the time it was created, the Commission on Government Forecasting and Accountability projected Tier 2 benefits would save the state $71 billion in pension contributions through 2045. Had Tier 2 never been enacted, the state's pension systems would be in far worse shape than they are today. It would be a step backward for the state to increase benefits beyond what is necessary to ensure continued compliance with federal safe harbor regulations.

In recent years, Illinois has started climbing out of the financial hole it has been in for decades by making fiscally responsible decisions. Let's focus on continuing that climb rather than digging ourselves deeper. We welcome the opportunity to engage more deeply with the state and city to help identify ways to continue our fiscal progress.

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