ILLINOIS POLICY INSTITUTE | SPECIAL REPORT

Saving Chicago: Pension reform without tax hikes

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Illinois Policy Institute

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Saving Chicago

Chicago politicians have exploited city-worker pensions for nearly two decades.

They've used the city's pension systems as slush funds and pension benefits as bargaining chips to further their own agenda, with seemingly no regard for Chicago's fiscal health.[1]

Now those pension systems are nearly insolvent and the city is heading toward bankruptcy. Chicago is facing an onslaught of credit downgrades, billion-dollar budget deficits and grim comparisons to Detroit.[2]

Politicians control Chicago's pension systems, and they've run them into the ground.

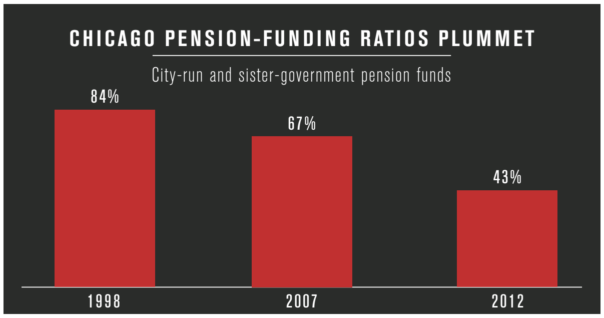
It's time to take that control away and put it where it belongs – with city workers.

Just look at the mess politicians have made.

The police officers' fund has just $0.31 for every dollar required to pay out future benefits. The firefighter fund, just $0.25.[3]

They are among the worst-funded pensions in the nation, and with no real plan to fix them, it's only a matter of time before they run dry.[4]

The city's laborers and teachers, as well as transit, park and municipal workers, all find themselves in the same predicament. Collectively, the city's pension funds have less than half the money required to meet their future obligations.



Source: Commission on Government Forecasting and Accountability
Note: The four city-run funds cover police, fire, laborers and municipal workers. The sister government funds cover teachers, and transit and park employees.

Chicago's official pension shortfall is now $29 billion.[5] Detroit, by comparison, had just a $3.5 billion shortfall when it filed for bankruptcy last year.[6]

Not surprisingly, the rating agencies have caught on. Moody's Investors Service slashed Chicago's credit rating in March, leaving it just three notches above junk status. Of the nation's largest cities, only Detroit has a worse rating.[7]

Chicago's embarrassing fall can be traced to a host of reckless acts by the political elite. Here are some examples:

SKIPPED PAYMENTS: IN 2010, POLITICIANS PASSED A THREE-YEAR PENSION "HOLIDAY" THAT ALLOWED THE CHICAGO PUBLIC SCHOOLS, OR CPS, TO SKIP $1.2 BILLION IN PENSION CONTRIBUTIONS TO THE TEACHER PENSION SYSTEM.[8]

POLITICIZED PENSIONS: POLITICIANS ALSO BARTER SALARY AND PENSION BENEFITS IN EXCHANGE FOR UNION POLITICAL SUPPORT, WITH NO REGARD TO WHETHER TAXPAYERS CAN AFFORD THE INCREASED COSTS. THAT'S DRIVEN UP CITY AND SISTER GOVERNMENT PAYROLL COSTS BY 20 PERCENT SINCE 2004, DESPITE AN OVERALL 12 PERCENT CUT IN TOTAL EMPLOYMENT. AND THE AVERAGE 30-YEAR CAREER CITY WORKER WHO RETIRES TODAY EXPECTS NEARLY $2 MILLION IN BENEFITS OVER HIS OR HER LIFETIME.[9]

Chicagoans will be paying for this recklessness through higher taxes. In 2015, taxpayer contributions to city-run and sister-government pensions will double to $3 for every $1 city employees put in. And most pension reform plans on the table call for even higher property taxes.[11]

But there's also a social cost to this recklessness, seen prominently in the indiscriminate cuts already being made to core government services.

Chicago students have 50 fewer schools to attend and nearly 3,000 fewer teachers and staff to learn from as a result of massive budget cuts driven largely by pension costs.[12]

Residents in neighborhoods with crumbling streets and growing potholes have to wait longer for repairs. The city has 2,000 fewer municipal worker positions today than it did in 2004.[13]

And Chicago's effort to battle crime faces even more challenges, with 1,500 fewer police officers and staff protecting neighborhoods and families compared to eight years ago.[14]

Chicago's deepening crisis will soon force politicians to decide between two paths.

The first is to use tax hikes to prop up a failed system run by the same politicians who bankrupted it in the first place.

The second is to give workers control over their own retirements, and to make the tough choices necessary to bring about real retirement security for Chicago's city workers.

The Illinois Policy Institute's proposal follows the second path. It aims to end the city's crisis and to preserve Chicago's status as a world-class city.

CHICAGO PENSION QUICK FACTS

City-run and sister-government pension systems
(See Appendix 5 for full details)

PENSION FUND FACTS FISCAL YEAR 2012	CITY-RUN PENSION FUNDS				SISTER GOVERNMENT-RUN PENSION FUNDS		
	POLICE	FIRE	MUNICIPAL	LABOR	TEACHERS	CTA	PARKS
PENSION FUND MEMBERS	Chicago Police Department employees and administrative staff	Chicago Fire Department employees and administrative staff	Elected officials, Chicago Housing Authority, Public Buildings Commission, Law Dept. & Board of Elections Employees, employees not covered by other systems	Roadworkers, sewer workers, plumbers, construction workers, groundskeepers, etc.	Chicago Public Schools teachers and administrative staff	Chicago Transit Authority employees	Chicago park district employees
ACTIVE EMPLOYEES	12,026	4,740	31,326	2,865	30,366	8,317	2,977
REGULAR RETIREES	9,035	2,821	19,614	2,737	22,636	7,794	2,104
PENSION SHORTFALL IN MILLIONS	$6,903	$3,073	$8,564	$1,059	$8,012	$1,165	$426
TOTAL LIABILITY IN MILLIONS	$10,052	$4,066	$13,637	$2,375	$17,376	$2,867	$866
TOTAL ASSETS IN MILLIONS	$3,149	$993	$5,073	$1,316	$9,364	$1,703	$441
PERCENT FUNDED	31%	24%	37%	55%	54%	59%	51%
EMPLOYEE CONTRIBUTIONS IN THOUSANDS	$95,892	$53,273	$130,266	$16,559	$187,141	$48,400	$10,404
EMPLOYER CONTRIBUTIONS IN THOUSANDS	$207,228	$84,144	$158,380	$14,415	$138,800	$62,800	$10,868
BENEFIT DETAILS	**POLICE**	**FIRE**	**MUNICIPAL**	**LABOR**	**TEACHERS**	**CTA**	**PARKS**
EMPLOYEE CONTRIBUTION	9% OF SALARY	9.125% OF SALARY	8.5% OF SALARY	8.5% OF SALARY	9% OF SALARY	10.125% OF SALARY	10% OF SALARY
MINIMUM REGULAR RETIREMENT AGE	50 WITH 20 YEARS SERVICE	50 WITH 20 YEARS SERVICE	50 WITH 30 YEARS SERVICE	50 WITH 30 YEARS SERVICE	55 WITH 20 YEARS SERVICE	55 WITH 25 YEARS SERVICE	55 WITH 10 YEARS SERVICE
STARTING PENSION FORMULA % OF FINAL AVG. SALARY FOR EACH YEAR OF SERVICE	2.5%	2.5%	2.4%	2.4%	2.2%	2.15%	2.4%
COST-OF-LIVING ADJUSTMENT (COLA)	3% OR 1.5% SIMPLE	3% OR 1.5% SIMPLE	3% COMPOUNDED	3% COMPOUNDED	3% COMPOUNDED	AD-HOC	SIMPLE, LESSER OF 3% OR ½ CPI
AVERAGE SALARY	$84,415	$88,389	$50,782	$69,386	$69,757	$66,142	$36,882
PENSION FACTS FOR RECENTLY RETIRED CAREER* WORKERS	**POLICE**	**FIRE**	**MUNICIPAL**	**LABOR**	**TEACHERS**	**CTA**	**PARKS**
AVERAGE CURRENT PENSION	$72,880	$80,696	$50,194	$58,974	$65,281	$47,783	$36,673
AVERAGE RETIREMENT AGE	57	60	60	57	61	58	56
AVERAGE ANNUAL COLA	$2,186	$2,421	$1,506	$1,769	$1,958	AD-HOC	$293

*RECENTLY RETIRED CAREER WORKERS ARE EMPLOYEES WHO HAVE SPENT 30 YEARS OR MORE WORKING FOR THE CITY OR ITS SISTER GOVERNMENTS AND HAVE RETIRED WITHIN THE LAST THREE YEARS.

SOURCE: COMMISSION ON GOVERNMENT FORECASTING AND ACCOUNTABILITY, INSTITUTE CALCULATIONS BASED ON FREEDOM OF INFORMATION ACT (FOIA) DATA OBTAINED FROM INDIVIDUAL PENSION FUNDS.

The solution: Executive summary

The Illinois Policy Institute's holistic plan puts Chicago back on a path to financial security. The plan achieves this by ending the political mismanagement of pensions that has left the city with more than $29 billion in pension debt, dangerously underfunded pensions, retirement benefits that are no longer affordable and fewer resources for core government services.[15]

The plan's first step is to take control of retirements away from politicians and put it in the hands of city workers. Going forward, workers will own and control a hybrid retirement plan that contains two key elements: a self-managed plan and a Social Security-like benefit. The plan is careful to protect benefits that have already been earned by current workers and retirees under the existing pension plan.

By moving to a hybrid pension plan, retirement costs will become a more stable and predictable portion of city budgets, helping prevent indiscriminate cuts to core government services. And taxpayers would no longer be subject to paying higher taxes to fund ever-growing pension shortfalls.

1. Hybrid retirement benefits: Going forward, workers are given ownership and control over individualized, portable retirement accounts. The plan gives workers a hybrid retirement plan that allows them to benefit from market returns, but also provides them with the stability offered by fixed monthly, Social Security-like benefits.

- **Self-managed plan:** Workers contribute 8 percent of their salary toward a portable retirement investment account. The employee contribution will be deposited into the employee's retirement account each pay period. Investments will be made at the employee's discretion.
- **Social Security-like benefit:** Employers will contribute a matching 7 percent of salary to their employees' retirements each pay period. The employer contribution will be used to purchase a Retirement FIRST (Fixed Income Retirement Security you Trust) contract each year from an insurance company. These contracts will provide the employee with a fixed monthly, Social Security-like benefit during retirement.

2. Current benefits: The plan ensures already-earned pension benefits are protected.

- **Current workers:** Pension benefits already earned will be preserved and paid to workers upon retirement. All future benefits will accrue under the new hybrid retirement plan.
- **Current retirees:** Retirees will continue to receive their pension benefits and already accrued cost-of-living adjustment, or COLA, increases.

3. Cost-of-living adjustments, or COLAs: Reforming COLAs is the single-largest lever for reducing the city's massive pension debt, but any reform must protect career workers with limited annual pensions. Means-testing is the most effective and equitable way to reform COLAs.

The Illinois Policy Institute's reform plan protects COLA benefits of career workers who dedicated more than 30 years to the city and earn annual pensions of less than the maximum annual Social Security payment for a private-sector worker who has reached the full retirement age. Retirees earning pensions exceeding the maximum Social Security benefit – currently at approximately $32,000 – will not receive additional COLA increases until the pension systems are fully funded. Any already-accrued COLA increases, however, will be preserved.[16]

4. Retirement age: This plan aligns the retirement age for city workers with the private sector. The age at which workers can begin collecting a pension is based on how close workers are to retirement under current law and how many years they've dedicated to the city. The plan protects the retirement ages of longtime employees who are already nearing retirement. The closer employees are to their current legal retirement age, the fewer additional years are added to that retirement age, provided the new age will be no lower than 59 (due to the nature of their work, Chicago's police and fire employees will retire at an earlier age). Younger workers will be given more time to plan and budget for changes in the retirement age.

ILLINOIS POLICY INSTITUTE'S REFORM PLAN FOR CHICAGO'S FOUR CITY-RUN PENSION PLANS

Fiscal year 2014

REFORM CATEGORY	IMPACT OF REFORM			
IN BILLIONS	CURRENT LAW	REFORM PLAN	CHANGE	% CHANGE
UNFUNDED LIABILITY	$22.00	$11.20	-$10.80	-49%
FUNDING RATIOS	32.6%	48.6%	16%	49%
TOTAL LIABILITY	$32.60	$21.70	-$10.90	-33%
CURRENT YEAR CONTRIBUTION*	$1.01	$1.19	$0.18	17%

*Current year contribution for fiscal year 2015 does not include CPD, CTFP or CTA
Source: see appendix 1 for methodology used in all projections

The results: Executive summary

The city of Chicago contributes to four city-run pension funds: police, fire, laborers and municipal workers. Chicago taxpayers are also responsible for funding the pensions of the city of Chicago's sister governments: Chicago Public Schools, the Chicago Park District and the Chicago Transit Authority.

For simplicity, this analysis focuses exclusively on the four city-run funds. Separate results for the Chicago Teachers' Pension Fund are included in Appendix 4.

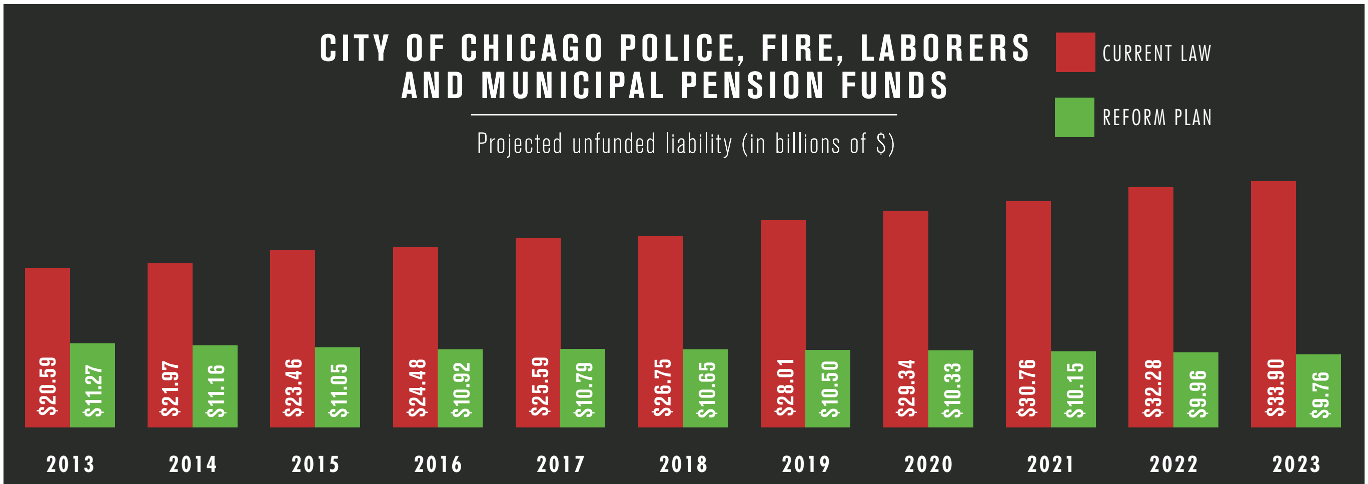
The Illinois Policy Institute's plan:

- Dramatically improves the funding ratio of the four city-run plans. The funding ratio immediately increases by nearly 50 percent – to 48.6 percent from 32.6 percent – quickly enhancing the overall health of the pension systems.
- Immediately reduces the unfunded liability by nearly half, to $11.2 billion, and stops future growth in the accrual of defined-benefit liabilities.
- Pays down the remaining unfunded liability in flat annual installments based on an Annual Required Contribution. The ARC contributions fully fund the systems in 30 years. These contributions make retirement costs a more stable and predictable portion of city budgets and help prevent indiscriminate cuts to core government services.

Getting Chicago's pension shortfall under control

Reducing the city's unfunded liability to a sustainable and affordable level is an essential component of real pension reform. The Illinois Policy Institute's reform plan immediately reduces the unfunded liabilities by 45 percent, to $11 billion. The plan further reduces the unfunded liability by another 13 percent, to $9.76 billion over the next decade.

In contrast, despite massive increases in contributions, the city's $20 billion in unfunded liabilities jumps by 65 percent over the next decade under current law.



*Does not include CPS, CPD or CTA.
Source: see appendix 1 for methodology used in all projections

Details of the plan:

The Illinois Policy Institute's reform plan contains three key elements:

- A hybrid retirement plan
- A means-testing of cost-of-living adjustments
- An alignment of the retirement age with the private sector

1. New hybrid plan:

The Illinois Policy Institute's reform plan is careful to protect already-earned pension benefits under the existing pension plan. Workers will receive these benefits upon retirement.

Going forward, all active workers will participate in a hybrid retirement plan that contains two key elements: a self-managed plan and a Social Security-like benefit.

This plan allows members to benefit from market returns, but also provides them with the stability offered by fixed monthly, Social Security-like benefits.

Under the hybrid plan, each pay period the worker will contribute 8 percent of his or her salary toward retirement savings, while the employer provides a matching 7 percent contribution.

The employee contribution – Self-managed plan:

The 8 percent employee contribution will be deposited into the employee's individual self-managed retirement savings account each pay period. The employee will own and control his or her retirement account. The money in this account will be portable, allowing workers to transition careers and take their retirement savings with them.

(The self-managed plan, or SMP, portion of the hybrid is directly modeled after the SMP retirement plan created for the Illinois State Universities Retirement System in 1995. The SURS plan, under which employees contribute 8 percent and the employer contributes 7 percent to the SMP, has over 18,000 participating members.)

The employer contribution – Retirement FIRST:

The 7 percent employer contribution would be used to purchase a Retirement FIRST (Fixed Income Retirement Security you Trust) contract from an insurance company. Each year, a Retirement FIRST contract is purchased. These contracts will provide a Social Security-like benefit during retirement.

Employees will own their Retirement FIRST contracts, allowing them to transition careers and take their benefits with them.

Example: Self-managed plan

The employee will deposit 8 percent of his or her paycheck every pay period into a self-managed retirement account. The employee owns and controls the money in this account. Self-managed retirement accounts are portable and transferable from job to job. This will allow a worker to transition careers and take their retirement savings with them.

The self-managed retirement account gives employees the opportunity to participate in long-term market returns by investing in a broad range of options at their discretion.

The money in this account will grow over time through accruing employee contributions and investment returns each pay period during the employee's working career.

When an employee reaches retirement age, he or she can begin to draw from the self-managed account for retirement needs. The remaining assets in the account can continue to grow in the account during retirement.

Consider the following example for an employee starting today:

- Starting age: 25
- Starting salary: $35,000
- Annual raises: 4 percent
- Investment returns: 7.5 percent*[17]
- Retirement age: 67
- Final salary: $174,757
- Self-managed plan balance: $1,252,767
- Annual benefit: $123,077
- Replacement rate: 70 percent

***Note: Under current law, the municipal and laborers' pension funds use a 7.5 percent rate of return, the police fund uses a 7.75 percent rate of return and the fire fund uses an 8 percent rate of return on investment. The Institute's calculations assume the more conservative rate of the four funds: a 7.5 percent rate of return on investment.**

Based on the above assumptions, this employee would retire with $1.25 million in his or her SMP account.

If this amount were converted to annual payments during the remainder of their retirement life, the employee would draw $123,077 annually during retirement – equal to approximately 70 percent of his or her final salary.

That income will be in addition to the amount of an employee will receive from their Retirement FIRST contract, the other portion of their hybrid retirement plan.

SELF-MANAGED PLAN RETIREMENT BENEFITS

AGE	SALARY	SMP ACCOUNT BEGINNGING BALANCE	INVESTMENT INCOME	YEARLY CONTRIBUTION TO SMP (ASSUMES END OF YEAR)	DC ACCOUNT ENDING BALANCE
25	$35,000	$0	$0	$2,800	$2,800
26	$36,400	$2,800	$210	$2,912	$5,922
27	$37,856	$5,922	$444	$3,028	$9,395
28	$39,370	$9,395	$705	$3,150	$13,249
29	$40,945	$13,249	$994	$3,276	$17,518
30	$42,583	$17,518	$1,314	$3,407	$22,239
31	$44,286	$22,239	$1,668	$3,543	$27,449
32	$46,058	$27,449	$2,059	$3,685	$33,193
33	$47,900	$33,193	$2,489	$3,832	$39,514
34	$49,816	$39,514	$2,964	$3,985	$46,463
35	$51,809	$46,463	$3,485	$4,145	$54,092
36	$53,881	$54,092	$4,057	$4,310	$62,460
37	$56,036	$62,460	$4,684	$4,483	$71,627
38	$58,278	$71,627	$5,372	$4,662	$81,661
39	$60,609	$81,661	$6,125	$4,849	$92,635
40	$63,033	$92,635	$6,948	$5,043	$104,625
41	$65,554	$104,625	$7,847	$5,244	$117,716
42	$68,117	$117,716	$8,829	$5,454	$131,999
43	$70,904	$131,999	$9,900	$5,672	$147,571
44	$73,740	$147,571	$11,068	$5,899	$164,538
45	$76,689	$164,538	$12,340	$6,135	$183,014
46	$79,757	$183,014	$13,726	$6,381	$203,120
47	$82,947	$203,120	$15,234	$6,636	$224,990
48	$86,265	$224,990	$16,874	$6,901	$248,766
49	$89,716	$248,766	$18,657	$7,177	$274,600
50	$93,304	$274,600	$20,595	$7,464	$302,660
51	$97,036	$302,660	$22,699	$7,763	$333,122
52	$100,918	$333,122	$24,984	$8,073	$366,180
53	$104,955	$366,180	$27,463	$8,396	$402,039
54	$109,153	$402,039	$30,153	$8,732	$440,925
55	$113,519	$440,925	$33,069	$9,082	$483,075
56	$118,060	$483,075	$36,231	$9,445	$528,751
57	$122,782	$528,751	$39,656	$9,823	$578,230
58	$127,693	$578,230	$43,367	$10,215	$631,812
59	$132,801	$631,812	$47,386	$10,624	$689,823
60	$138,113	$689,823	$51,737	$11,049	$752,608
61	$143,638	$752,608	$56,446	$11,491	$820,545
62	$149,383	$820,545	$61,541	$11,951	$894,036
63	$155,358	$894,036	$67,053	$12,429	$973,518
64	$161,573	$973,518	$73,014	$12,926	$1,059,457
65	$168,036	$1,059,457	$79,459	$13,443	$1,152,360
66	$174,757	$1,152,360	$86,427	$13,981	$1,252,767
				TOTAL ANNUAL BENEFIT :	$123,077
				PERCENTAGE OF FINAL SALARY :	70.4%

NOTE: ASSUMES NEW EMPLOYEE STARTING TODAY
SOURCE: ILLINOIS POLICY INSTITUTE CALCULATIONS

Example: Fixed Income Retirement Security you Trust (FIRST)

In addition to the benefits accrued under the self-managed plan, workers will also benefit from a Retirement FIRST contract.

Retirement FIRST contracts provide fixed monthly benefits for workers during their retirement.

Employees will use the employer's 7 percent contribution to purchase a Retirement FIRST contract.

Employees will purchase a new contract every year. Each additional contract adds to the total fixed monthly benefit an employee will receive during retirement.

Consider the following example:

- Starting age: 25
- Starting salary: $35,000
- Annual raises: 4 percent
- Retirement age: 67
- Final salary: $174,757
- Actuarial assumptions:*[18]
- Beginning Retirements FIRST contract: $70,901
- Replacement rate: 41 percent

***Note: These assumptions are for informational purposes only and subject to change according to actual market conditions.**

Under this example, a 25-year-old employee who purchases Retirement FIRST contracts annually until his or her retirement at age 67 would receive benefits during retirement that total $70,901 per year – or about 41 percent of the employee's final year of salary.

RETIREMENT FIRST CONTRACT BENEFITS

AGE	SALARY	COST OF CONTRACT	ANNUAL BENEFIT TO BE RECEIVED AT RETIREMENT
25	$35,000	$2,450	$2,136
26	$36,400	$2,548	$2,112
27	$37,856	$2,650	$2,100
28	$39,370	$2,756	$2,076
29	$40,945	$2,866	$2,064
30	$42,583	$2,981	$2,040
31	$44,286	$3,100	$2,028
32	$46,058	$3,224	$2,004
33	$47,900	$3,353	$1,980
34	$49,816	$3,487	$1,968
35	$51,809	$3,627	$1,944
36	$53,881	$3,772	$1,920
37	$56,036	$3,923	$1,908
38	$58,278	$4,079	$1,884
39	$60,609	$4,243	$1,860
40	$63,033	$4,412	$1,836
41	$65,554	$4,589	$1,812
42	$68,117	$4,772	$1,788
43	$70,904	$4,963	$1,764
44	$73,740	$5,162	$1,752
45	$76,689	$5,368	$1,728
46	$79,757	$5,583	$1,704
47	$82,947	$5,806	$1,680
48	$86,265	$6,039	$1,656
49	$89,716	$6,280	$1,632
50	$93,304	$6,531	$1,596
51	$97,036	$6,793	$1,572
52	$100,918	$7,064	$1,548
53	$104,955	$7,347	$1,524
54	$109,153	$7,641	$1,500
55	$113,519	$7,946	$1,476
56	$118,060	$8,264	$1,440
57	$122,782	$8,595	$1,416
58	$127,693	$8,939	$1,392
59	$132,801	$9,296	$1,356
60	$138,113	$9,668	$1,332
61	$143,638	$10,055	$1,308
62	$149,383	$10,457	$1,272
63	$155,358	$10,875	$1,248
64	$161,573	$11,310	$1,212
65	$168,036	$11,763	$1,188
66	$174,757	$12,233	$1,152

NOTE: ASSUMES NEW EMPLOYEE STARTING TODAY

SOURCE: ILLINOIS POLICY INSITUTE CALCULATIONS

TOTAL ANNUAL BENEFIT: $70,901

PERCENTAGE OF FINAL SALARY: 40.6%

Combined SMP and Retirement FIRST benefits

Under the Illinois Policy Institute's plan, all active workers will participate in a hybrid retirement plan that contains two key elements: a self-managed plan and a Social Security-like benefit.

Based on the assumptions used in the previous examples, the employee will receive $123,077 annually from his or her self-managed account and an additional $70,901 annually from the Retirement FIRST contracts. The total annual benefit from the Institute's hybrid plan will equal $193,978, or 111 percent of the employee's final salary.

EXAMPLE BENEFITS AN EMPLOYEE CAN EXPECT TO RECEIVE DURING RETIREMENT

ASSUMED RATE OF RETURN	**7.50%**
SMP ANNUAL BENEFIT	$123,077
RETIREMENT FIRST ANNUAL BENEFIT	$70,901
TOTAL ANNUAL BENEFIT	**$193,978**
FINAL SALARY	$174,757
PERCENTAGE OF FINAL SALARY	111%

SOURCE: ILLINOIS POLICY INSTITUTE CALCULATIONS

Total retirement benefits under different rates of return

The SMP portion of the Institute's plan depends on market returns to provide benefits for an employee's retirement. Historically, the average rate of return over the long term exceeds 8 percent.

The Institute also provides examples of the impact lower-market returns can have on an employee's retirement benefits.

If the assumed rate of return for the SMP averaged only 6.5 percent during the investment period, the employee's total annual retirement benefit would equal $168,719, or 97 percent of final salary.

If the assumed rate of return for the SMP averaged only 5.5 percent during the investment period, the employee's total annual retirement benefit would equal $149,442, or 86 percent of final salary.

TOTAL RETIREMENT BENEFITS UNDER DIFFERENT RATES OF RETURN

ASSUMED RATE OF RETURN	**6.50%**
SMP ANNUAL BENEFIT	$97,818
RETIREMENT FIRST ANNUAL BENEFIT	$70,901
TOTAL ANNUAL BENEFIT	**$168,719**
FINAL SALARY	$174,757
PERCENTAGE OF FINAL SALARY	97%
ASSUMED RATE OF RETURN	**5.50%**
SMP ANNUAL BENEFIT	$78,541
RETIREMENT FIRST ANNUAL BENEFIT	$70,901
TOTAL ANNUAL BENEFIT	**$149,442**
FINAL SALARY	$174,757
PERCENTAGE OF FINAL SALARY	86%

SOURCE: ILLINOIS POLICY INSTITUTE CALCULATIONS

2. Means-test COLAs:

Reforming cost-of-living adjustments, or COLAs, is the single-largest lever for reducing the city's pension debt and ensuring there is sufficient funding to pay for already-earned retirement benefits.

A full suspension of COLA increases could potentially reduce the city's $22 billion pension shortfall by approximately one-third.[19]

But any reform must protect retirees who dedicated their full careers to the city and receive limited annual pensions. Means-testing is the most effective and equitable way to reform COLAs.

Today, the average city-level retiree with a 30-year career has a pension of $58,430 and receives an average COLA of $1,753.[20]

In contrast, the average private-sector retiree in the U.S. will receive $15,300 in annual Social Security benefits. The Social Security COLA will be 1.5 percent for 2014, meaning the average Social Security COLA will be $228.[21]

That means the average city government retiree will receive in 2014 a COLA that's nearly eight times what the average Social Security beneficiary receives.

The Illinois Policy Institute's reform plan protects COLA benefits for those who dedicated 30 or more years to the city and earn annual pensions of less than the maximum annual Social Security payment ($31,704) for a private-sector worker.

Retirees earning pensions exceeding the maximum annual Social Security payment will not receive additional COLAs until the pension system is fully funded. However, retirees will continue to receive already-accrued COLA increases.

3. Align retirement age:

Unlike their private-sector counterparts, Chicago government workers are able to retire in their 50s while collecting most of their final average salary. This puts a tremendous strain on the city's taxpayers, as well as the pension systems.

Chicago's pension systems cover more than 34,000 retirees. Approximately 50 percent of city government pensioners began collecting a pension before the age of 60. The average pension for workers who retired before the age of 60 with at least 30 years of service credit is $59,455.[22]

The government workers who retired early in life did nothing wrong. They made an economic decision that's fair game under current law. But Chicago can no longer afford to pay city workers to retire a decade earlier than their private-sector counterparts.

According to a recent Associated Press-NORC Center for Public Affairs Research poll, 82 percent of working Americans age 50 or older say it is at least somewhat likely they will work for pay in retirement. The survey also found that 47 percent of working survey respondents now expect to retire later than they previously thought and, on average, plan to retire at about age 66.[23]

Government workers should be free to retire when they wish, but should only begin collecting a pension when they reach the Social Security retirement age.

The Illinois Policy Institute's reform plan follows the lead of Rhode Island's 2011 pension reform (see retirement age table on following page) and aligns the retirement age with the Social Security retirement age while protecting workers who are nearing retirement under current law (due to the nature of their work, Chicago's police and fire employees will retire at an earlier age).[24]

The new age at which workers can begin collecting a pension will be based on how close workers are to retirement under current law and how many years they've dedicated to working for the city.

The plan protects the retirement ages of longtime employees who are already nearing retirement. The closer employees are to their current legal retirement age, the fewer additional years are added to that retirement age, provided the new age will be no lower than 59. Younger workers will be given more time to plan and budget for changes in the retirement age.

Following Rhode Island's reform ensures the retirement age is equitably increased to protect Illinois' pension system from insolvency.

Retirement age examples:

The Institute used the Rhode Island Retirement Security Act of 2011 as a guideline for its retirement age reforms.

The scenario below uses Rhode Island's new retirement ages as a proxy and should be considered informational only.

Example: Consider a 44-year-old worker, born in 1970, who started working at the age of 20 and currently has 24 years of service. Under the current system, he or she can retire at age 50 after working for 30 years total.

That worker has currently completed 80 percent of the service years needed to retire at age 50 under current law. Using the Rhode Island data as a proxy, that worker's new retirement age would be 59 under the Institute's reform.

ESTIMATED NEW RETIREMENT AGE FOR ILLINOIS

Rhode Island Retirement Security Act of 2011 matrix used as proxy

For those born in 1960 or later: new retirement age is based on a Social Security Normal Retirement Age of 67																		
Percentage of years completed toward current retirement age as of June 30, 2012	Your retirement age under current law																	
	50	51	52	53	54	55	56	57	58	59	60	61	62	63	64	65	66	67
10%	65.3	65.4	65.5	65.6	65.7	65.8	65.9	66.0	66.1	66.2	66.3	66.4	66.5	66.6	66.7	66.8	66.9	67.0
20%	63.6	63.8	64.0	64.2	64.4	64.6	64.8	65.0	65.2	65.4	65.6	65.8	66.0	66.2	66.4	66.6	66.8	67.0
30%	61.9	62.2	62.5	62.8	63.1	63.4	63.7	64.0	64.3	64.6	64.9	65.2	65.5	65.8	66.1	66.4	66.7	67.0
40%	60.2	60.6	61.0	61.4	61.8	62.2	62.6	63.0	63.4	63.8	64.2	64.6	65.0	65.4	65.8	66.2	66.6	67.0
50%	59.0	59.0	59.5	60.0	60.5	61.0	61.5	62.0	62.5	63.0	63.5	64.0	64.5	65.0	65.5	66.0	66.5	67.0
60%	59.0	59.0	59.0	59.0	59.2	59.8	60.4	61.0	61.6	62.2	62.8	63.4	64.0	64.6	65.2	65.8	66.4	67.0
70%	59.0	59.0	59.0	59.0	59.0	59.0	59.3	60.0	60.7	61.4	62.1	62.8	63.5	64.2	64.9	65.6	66.3	67.0
80%	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.8	60.6	61.4	62.2	63.0	63.8	64.6	65.4	66.2	67.0
90%	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.8	60.7	61.6	62.5	63.4	64.3	65.2	66.1	67.0
100%	50.0	51.0	52.0	53.0	54.0	55.0	56.0	57.0	58.0	59.0	60.0	61.0	62.0	63.0	64.0	65.0	66.0	67.0
Those born between 1943 and 1954 have a Social Security Normal Retirement Age of 66: new age for this group is shown in example below																		
10%	64.4	64.5	64.6	64.7	64.8	64.9	65.0	65.1	65.2	65.3	65.4	65.5	65.6	65.7	65.8	65.9	66.0	67.0
20%	62.8	63.0	63.2	63.4	63.6	63.8	64.0	64.2	64.4	64.6	64.8	65.0	65.2	65.4	65.6	65.8	66.0	67.0
30%	61.2	61.5	61.8	62.1	62.4	62.7	63.0	63.3	63.6	63.9	64.2	64.5	64.8	65.1	65.4	65.7	66.0	67.0
40%	59.6	60.0	60.4	60.8	61.2	61.6	62.0	62.4	62.8	63.2	63.6	64.0	64.4	64.8	65.2	65.6	66.0	67.0
50%	59.0	59.0	59.0	59.5	60.0	60.5	61.0	61.5	62.0	62.5	63.0	63.5	64.0	64.5	65.0	65.5	66.0	67.0
60%	59.0	59.0	59.0	59.0	59.0	59.4	60.0	60.6	61.2	61.8	62.4	63.0	63.6	64.2	64.8	65.4	66.0	67.0
70%	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.7	60.4	61.1	61.8	62.5	63.2	63.9	64.6	65.3	66.0	67.0
80%	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.6	60.4	61.2	62.0	62.8	63.6	64.4	65.2	66.0	67.0
90%	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.7	60.6	61.5	62.4	63.3	64.2	65.1	66.0	67.0
100%	50.0	51.0	52.0	53.0	54.0	55.0	56.0	57.0	58.0	59.0	60.0	61.0	62.0	63.0	64.0	65.0	66.0	67.0
Those born between 1955 and 1959 have a Social Security Normal Retirement Age between 66.2 and 66.8: example below is 66.5 (1957)																		
10%	64.9	65.0	65.1	65.2	65.3	65.4	65.5	65.6	65.7	65.8	65.9	66.0	66.1	66.2	66.3	66.4	66.5	67.0
20%	63.2	63.4	63.6	63.8	64.0	64.2	64.4	64.6	64.8	65.0	65.2	65.4	65.6	65.8	66.0	66.2	66.4	67.0
30%	61.6	61.9	62.2	62.5	62.8	63.1	63.4	63.7	64.0	64.3	64.6	64.9	65.2	65.5	65.8	66.1	66.4	67.0
40%	59.9	60.3	60.7	61.1	61.5	61.9	62.3	62.7	63.1	63.5	63.9	64.3	64.7	65.1	65.5	65.9	66.3	67.0
50%	59.0	59.0	59.3	59.8	60.3	60.8	61.3	61.8	62.3	62.8	63.3	63.8	64.3	64.8	65.3	65.8	66.3	67.0
60%	59.0	59.0	59.0	59.0	59.0	59.6	60.2	60.8	61.4	62.0	62.6	63.2	63.8	64.4	65.0	65.6	66.2	67.0
70%	59.0	59.0	59.0	59.0	59.0	59.0	59.2	59.9	60.6	61.3	62.0	62.7	63.4	64.1	64.8	65.5	66.2	67.0
80%	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.7	60.5	61.3	62.1	62.9	63.7	64.5	65.3	66.1	67.0
90%	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.0	59.8	60.7	61.6	62.5	63.4	64.3	65.2	66.1	67.0
100%	50.0	51.0	52.0	53.0	54.0	55.0	56.0	57.0	58.0	59.0	60.0	61.0	62.0	63.0	64.0	65.0	66.0	67.0

SOURCE: EXECUTIVE SUMMARY - RHODE ISLAND GENERAL ASSEMBLY RETIREMENT SECURITY LEGISLATION

Summary of results

The Illinois Policy Institute's reform plan was analyzed by Nichols Actuarial Consulting LLC. The goal of the analysis was to estimate the effect of the Illinois Policy Institute's proposed reforms.

The analysis focused on Chicago's four city-run pension funds – police, fire, laborers, and municipal workers. Chicago taxpayers are also responsible for unfunded pension liabilities for the Chicago Public Schools, the Chicago Park District and the Chicago Transit Authority. However, for purposes of this report, the analysis focuses exclusively on the four city funds (separate results for the Chicago Teachers' Pension Fund in Appendix 4).

The analysis compared the Illinois Policy Institute's reform plan to current law using five key metrics:

- Actuarial Accrued Liabilities, or AAL, under current law.
- Funding levels under current law.
- Annual contributions under current law.
- The Unfunded Actuarial Accrued Liability, or UAAL, under current law.
- The Annual Required Contribution, or ARC, necessary to fully fund the four systems under the existing benefit structure.

This section first summarizes the findings and then reviews the projected results for each of the five metrics.

SECTION 4

Projected results for Chicago's four city-run funds

Summary of results in 2014

According to the analysis (see Appendix 1), the reforms included in the Illinois Policy Institute's plan:

- Dramatically improve the funding ratio of the four city-run plans. The funding ratio immediately increases by nearly 50 percent – to 48.6 percent from 32.6 percent – quickly enhancing the overall health of the pension systems.
- Immediately reduces the unfunded liability by nearly half, to $11.2 billion from $22 billion, and stops future growth in the accrual of defined-benefit liabilities.
- Pays down the remaining unfunded liability in flat, annual installments based on an Annual Required Contribution, or ARC. The ARC payments fully fund the systems in 30 years. These contributions make retirement costs a more stable and predictable portion of city budgets, and help prevent indiscriminate cuts to core government services.

ILLINOIS POLICY INSITUTE'S REFORM PLAN FOR CHICAGO'S FOUR CITY-RUN PENSION PLANS

Fiscal year 2014

REFORM CATEGORY	IMPACT OF REFORM			
IN BILLIONS	CURRENT LAW	REFORM PLAN	CHANGE	% CHANGE
UNFUNDED LIABILITY	$22.00	$11.20	-$10.80	-49%
FUNDING RATIOS	32.6%	48.6%	16.0%	49%
TOTAL LIABILITY	$32.60	$21.70	-$10.90	-33%
CURRENT YEAR CONTRIBUTION*	$1.01	$1.19	$0.18	17%

*CURRENT YEAR CONTRIBUTION FOR FISCAL YEAR 2015 DOES NOT INCLUDE CPD, CTFP OR CTA
SOURCE: SEE APPENDIX 1 FOR METHODOLOGY USED IN ALL PROJECTIONS

Summary of results in 2023

The analysis of the Illinois Policy Institute's reform plan also included projected results through 2023. Based on the assumptions (see Appendix 1), by 2023 the Illinois Policy Institute's plan decreases the unfunded liability by more than 70 percent compared with current law.

ILLINOIS POLICY INSITUTE'S REFORM PLAN FOR CHICAGO'S FOUR CITY-RUN PENSION PLANS

Fiscal year 2023

REFORM CATEGORY	IMPACT OF REFORM			
IN BILLIONS	CURRENT LAW	REFORM PLAN	CHANGE	% CHANGE
UNFUNDED LIABILITY	$33.90	$9.80	-$24.10	-71%
FUNDING RATIOS	18%	43%	25%	143%
TOTAL LIABILITY	$41.30	$17.20	-$24.10	-56%
CURRENT YEAR CONTRIBUTION*	$1.11	$1.28	$0.17	15%
PAYMENTS OVER PAST 10 YEARS	$10.40	$13.50	$3.10	30%

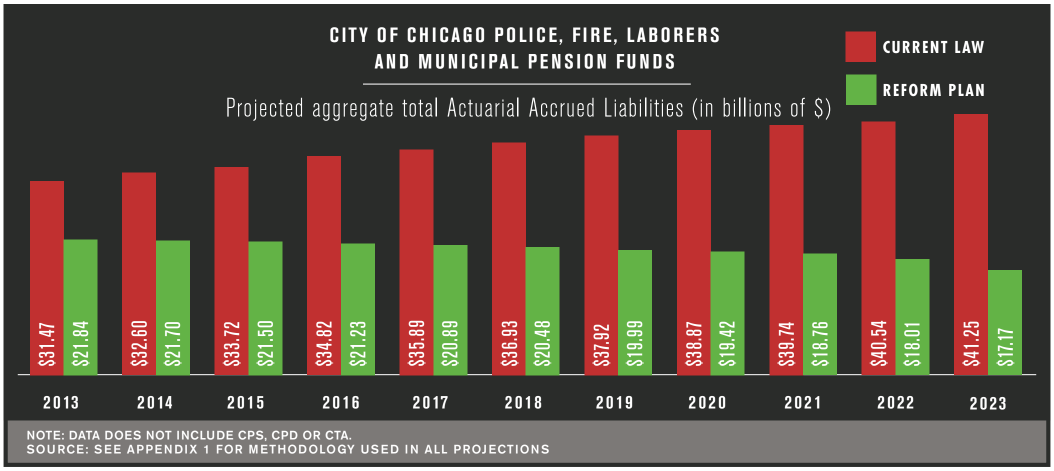
*CURRENT YEAR CONTRIBUTION FOR FISCAL YEAR 2015 DOES NOT INCLUDE CPD, CTFP OR CTA
SOURCE: SEE APPENDIX 1 FOR METHODOLOGY USED IN ALL PROJECTIONS

1. Stops future growth in uncontrollable liabilities

The only way to end Chicago's pension crisis and preserve the benefits workers have already earned is to stop accruing additional liabilities under the current system.

The Illinois Policy Institute's reform plan ends the pension crisis and stops future defined benefit liabilities from accruing. According to the analysis, the Illinois Policy Institute's plan decreases the actuarial accrued liability by 21 percent, to $17.2 billion in 2023 from $21.8 billion in 2013.

In contrast, without reform the four city pension funds will see their total actuarial accrued liabilities increase by approximately 31 percent during the next decade, to $41.2 billion in 2023 from $31.5 billion in 2013. This massive increase in liabilities happens despite the large spike in funding in 2015 under current law.

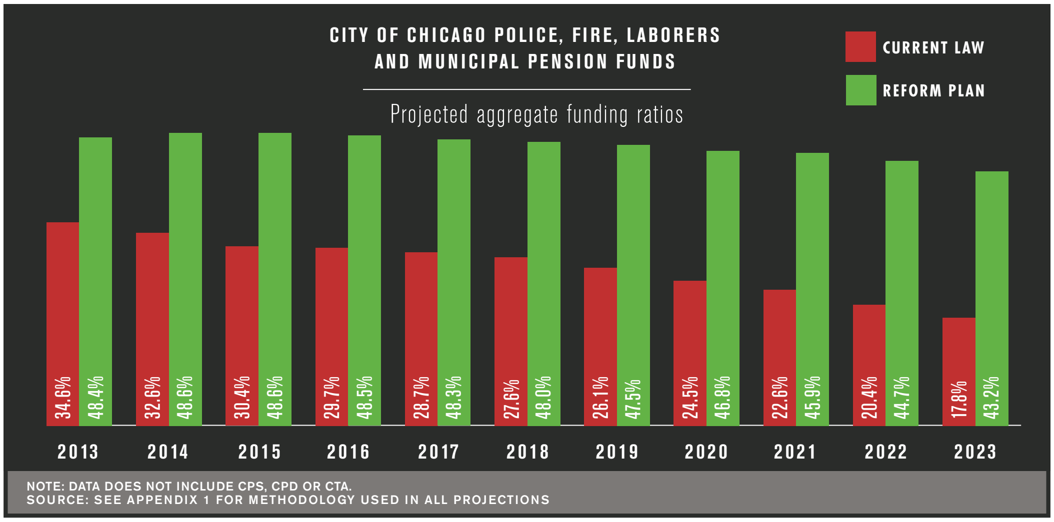


2. Improves the security of retirees by improving funding levels

City-worker retirements will never be secure without a real and sustainable plan to fully fund Chicago's pension systems.

The four city pension funds will be nearly bankrupt in 10 years under current law – with an aggregate funding ratio of just 17.8 percent in 2023. That drop in the funding ratio occurs despite dumping billions more into the pension system starting in 2015. And without real reforms to the current system, the city will continue to experience unpredictable growth in its unfunded liabilities.

In contrast, the Illinois Policy Institute's reform plan brings the aggregate funding ratios to more than 43 percent funded – a significant increase compared with current law. Going forward, by eliminating the accrual of additional defined-benefit liabilities, the pension funds can reliably reach 100 percent funding in 30 years.

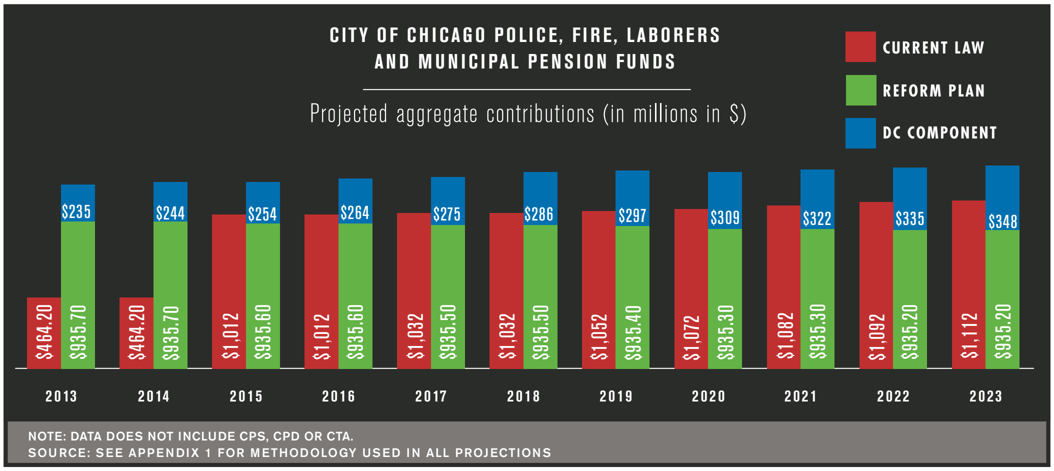


3. Pays down the existing debt in disciplined, level-dollar payments

A key element in eliminating Chicago's massive pension debt is paying it down in responsible and stable installments.

The Illinois Policy Institute's reform plan levels out future retirement payments. These level-dollar payments of approximately $935 million become a smaller percentage of the budget going forward. The level-dollar amounts also introduce stability and predictability into the city's budgeting process.

In addition to the $935 million pension payment, the Institute's plan includes a Retirements FIRST contribution equal to 7 percent of payroll. This payment totals $234 million in 2013, and rises with payroll to $348 million in 2023.

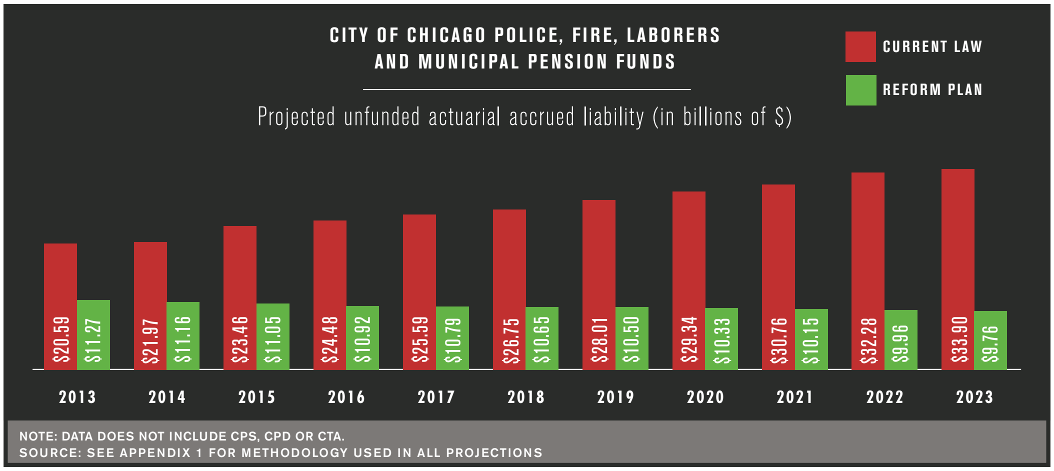


4. Dramatically reduces unfunded liability

Chicago cannot return to good fiscal standing unless it dramatically reduces its unfunded liability.

Under current law, unfunded liabilities increase by 65 percent over the next decade despite significant increases in city pension contributions.

In contrast, the Illinois Policy Institute's reform reduces the unfunded liabilities by 45 percent immediately, and a further 13 percent over the next decade.

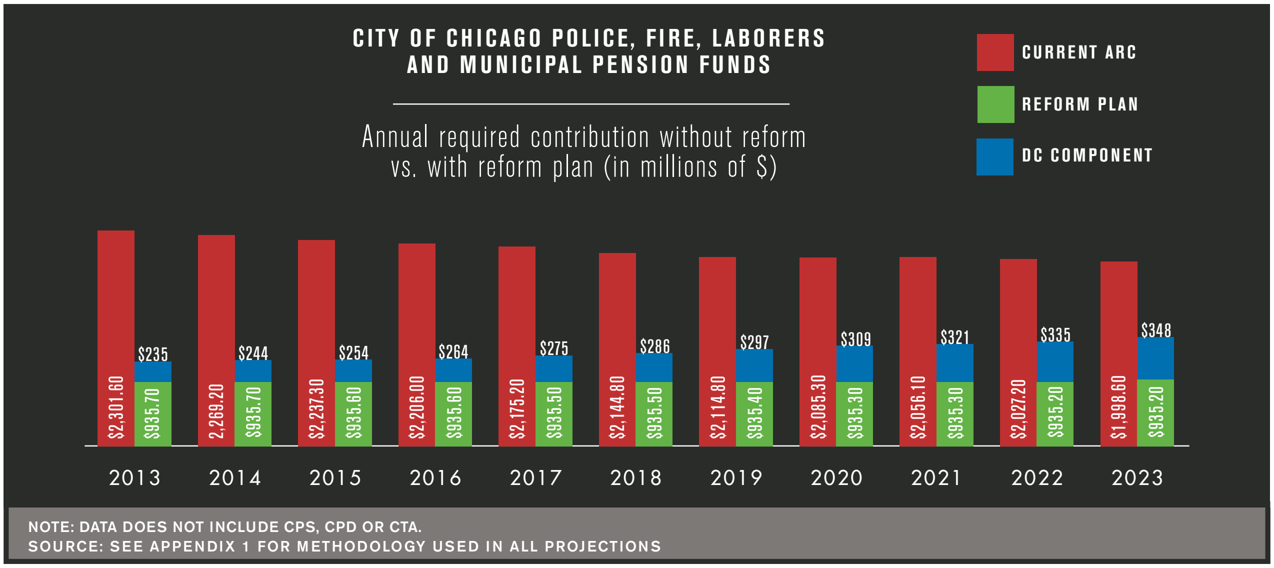


5. Making the Annual Required Contribution

A common narrative surrounding the city of Chicago's pension crisis is that politicians simply need to put more money into the system. But what's not understood is how much would be necessary to fully fund the pension systems under the existing benefit structure.

If Chicago were to pay what's called the Annual Required Contribution – what the actuaries require – the payments would overwhelm the city's budget. The pension payment would increase to approximately $2.3 billion for the four city-run pension funds, more than two-thirds of the city's entire operating budget.

However, paying the ARC alone does nothing to fundamentally change the problems with the existing defined-benefit structure.



The Illinois Policy Institute's comprehensive reform combines real pension reform with an ARC, reducing pension payments to a predictable level. The defined benefit pension payments, in addition to the self-managed employer contribution, would total approximately $1.2 billion. That's $1 billion less than what the ARC payment would be without pension reform.

Under the Illinois Policy Institute's reform plan, the ARC allows the city of Chicago to fully fund the four city-run pension systems during the next 30 years.

Why it works

The Illinois Policy Institute's holistic plan puts Chicago back on a path to financial security. The plan achieves this by ending the political mismanagement of pensions that has left the city with more than $29 billion in pension debt, dangerously underfunded pensions, retirement benefits that are no longer affordable and fewer resources for core government services.[25]

Here's how the Illinois Policy Institute's plan outperforms current pension law:

1. Chicago's financial future

Current law: There's no dispute that Chicago is on an unsustainable path toward insolvency. Increasing taxes and slashing core services to make room in the budget for the current politically controlled pension funds will only worsen the trend of out-migration and credit downgrades.

Illinois Policy Institute's plan: Chicago will be back on a path toward economic growth and sustainability. The reform would set the stage for an economic turnaround and end the cycle of credit downgrades and out-migration.

2. City budgets

Current law: Politicians have used the pension systems as slush funds and workers as bargaining chips to further their own agendas, with seemingly no regard for Chicago's fiscal health. The current structure makes it difficult for Chicago to accurately budget for pension costs as they continue to consume a greater portion of city funds.

Illinois Policy Institute's plan: Budgets will be more stable and predictable for four main reasons:

- Additional defined-benefit liabilities will stop accruing.
- The unfunded liability is significantly reduced.
- Employer pension contributions will total a level 7 percent of payroll.
- The remaining liability is paid down in responsible and level installments.

3. Taxpayers

Current law: Taxpayers will be forced to pay millions more in contributions and new taxes to prop up the same politically controlled pension system.

Illinois Policy Institute's plan: Taxpayers would no longer be subject to paying higher taxes and fees to fund ever-growing pension shortfalls. The new hybrid retirement plan would allow the city to control retirement costs and focus resources on core government services.

4. Workers

Current law: Workers are trapped in pension systems under which they have no voice and no control. Their retirements are threatened by pension systems approaching insolvency due to decades of mismanagement by politicians.

Illinois Policy Institute's plan: Going forward, workers will own and control a hybrid retirement plan that contains two key elements: a self-managed plan and a Social Security-like benefit. The plan protects benefits that have already been earned by both current workers and retirees under the existing pension plan.

5. City services

Current law: Pensions are consuming funding for core government services. Residents are being hurt by Chicago's indiscriminate cuts to services – schools, police and public works – to pay for pensions.

Illinois Policy Institute's plan: Residents will be protected from cuts to core government services due to increasing pension payments. The reform plan would allow local officials to better preserve funding for the classroom and public safety.

6. Chicago's obligation

Current law: Despite dumping billions more into the pension system through increased payments starting in 2015, Chicago's unfunded liabilities will grow uncontrollably. Unfunded liabilities will increase by 65 percent over the next decade.

Illinois Policy Institute's plan: These reforms reduce unfunded liabilities by 45 percent immediately, and a further 13 percent over the next decade. The city of Chicago will pay down its pension debt in fixed annual payments and city workers will be given control and ownership over their own retirement accounts going forward.

Appendix 1: Methodology

The purpose of this report is to demonstrate that drastic measures must be implemented by the city of Chicago to keep its pension funds sustainable, without significant increases to taxes. To illustrate these points, a simple projection of liabilities and assets was prepared to show trends, not to predict future asset and liability levels. The analysis relied upon the actuarial accrued liability information provided in the Gabriel Roeder and Smith and Segal actuarial valuations, and asset and cash flow information from each system's Comprehensive Annual Financial Report, or CAFR. Additional information was also taken from the city of Chicago's CAFR.

Benefit payments were assumed to increase 6 percent per year over the 10-year period from 2013-2023 under current law. Contributions were assumed to remain at the 2012 level, except for the Police, Fire and Teachers funds. Contributions for Police and Fire increase under current law starting in 2015, and Teachers in 2014. The assumptions used to project assets and liabilities are the same as those used in the most recent actuarial valuations.

Without actual participant data, specific savings were not calculated for each proposed change. However, we estimate that with a combination of freezing accruals, increasing the normal retirement age, and means-testing the cost-of-living allowance, a 40 percent reduction in actuarial accrued liability can be achieved for active participants and a 20 percent reduction can be achieved for those participants in pay status. We also estimate that the proposed changes would decrease payouts by 30 percent over the next 10 years (payouts in 2023 would be 70 percent of what they would have been with the changes) on a pro-rated basis. The ultimate reductions in liabilities and payouts will depend on the level of changes implemented, and will be determined by the systems' actuaries.

Nichols Actuarial Consulting LLC has provided actuarial services to large state retirement systems and social security systems for small countries. Their actuary, Joe Nichols, has been an actuary in the public pension area for over 20 years.

Methodology sources

The actuarial analysis used membership and actuarial assumptions data provided by each pension system's Comprehensive Annual Financial Report and Actuarial Valuation Report for 2012.

Actuarial accrued liability and general participant data were collected using each pension system's 2012 Actuarial Valuation Report:

- Firemen's Annuity and Benefit Fund of Chicago – Actuarial Valuation Report for the year ending Dec. 31, 2012
- Policemen's Annuity and Benefit Fund of Chicago – Actuarial Valuation Report for the year ending Dec. 31, 2012
- Municipal Employees' Annuity and Benefit Fund of Chicago – Actuarial Valuation Report for the year ending Dec. 31, 2012
- Laborers' and Retirement Board Employees' Annuity and Benefit Fund – Actuarial Valuation Report for the year ending Dec. 31, 2012
- Public School Teachers' Pension and Retirement Fund of Chicago – Statutorily Required Funding Valuation as of June 30, 2012

Asset and cash flow information, as well as additional information, was provided by each system's 2012 Comprehensive Annual Financial Report:

- Firemen's Annuity and Benefit Fund of Chicago Comprehensive Annual Financial Report - Dec. 31, 2012
- Policemen's Annuity and Benefit Fund of Chicago - Comprehensive Annual Financial Report for the year ended Dec. 31, 2012
- Municipal Employees' Annuity and Benefit Fund of Chicago - Comprehensive Annual Financial Report for the fiscal year ended Dec. 31, 2012
- Laborers' and Retirement Board Employees' Annuity and Benefit Fund - Comprehensive Annual Financial Report for the fiscal year ended Dec. 31, 2012
- Chicago Teachers' Pension Fund 117th Comprehensive Annual Financial Report for the year ended June 30, 2012

Appendix 2: How the plan impacts current workers – retirement example

For current employees, pension benefits already earned in the defined-benefit plan will be preserved and paid upon retirement. All future benefits will accrue under the new hybrid retirement plan.

Current employees will have three streams of revenue during retirement: Their benefits earned under the defined-benefit plan, the benefits earned from their self-managed plan and the benefits earned from their Retirement FIRST contracts.

Already-earned benefits

Consider a municipal employee who started working in 1994 at age 25 with a $25,000 annual salary. Today, that employee would be 40 years old and earning a salary of $45,024 (assuming a 4 percent annual salary growth).

The employee's defined-benefit plan stops accruing when the Illinois Policy Institute's reform plan is enacted, but all benefits earned up to that point would be preserved and paid out upon retirement.

Under the current defined benefit retirement formula, the employee would receive 36 percent of his current salary of $45,024 (2.4 percent of annual salary multiplied by the 15 years he or she has worked so far).

The annual defined benefit the employee would receive during retirement would equal $16,209 – or about 13 percent of the employee's final year of salary: $124,827 at age 66.
(The retirement age of 67 is used to make the results comparable to the example from Section 3: Details of the plan.)

Total benefits

In total, the employee would receive the following annual benefits upon reaching the standard retirement age:

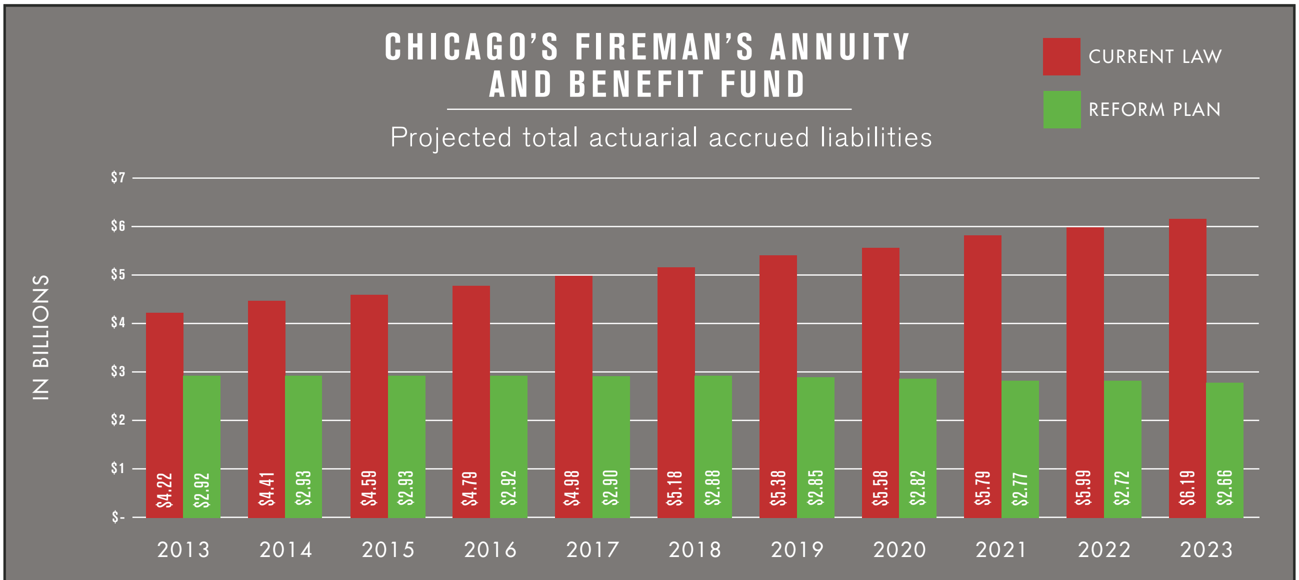
- $16,209 annually from their already-earned defined benefits (13 percent of final salary)
- $45,518 annually from their self-managed account (36 percent of final salary)
- $30,073 annually from their Retirement FIRST contract (24 percent of final salary)

The current employee's benefits would equal $91,800 – or about 74 percent of the employee's final year of salary.

Appendix 3.1: Projected results by fund – Chicago Fireman's Annuity and Benefit Fund

Total actuarial accrued liabilities

Under current law, total actuarial accrued liabilities increase by 46 percent over the next decade. Under the Illinois Policy Institute's reform plan, accrued liabilities are reduced going forward by ending the accrual of any new defined-benefit liabilities and by introducing a hybrid retirement plan.



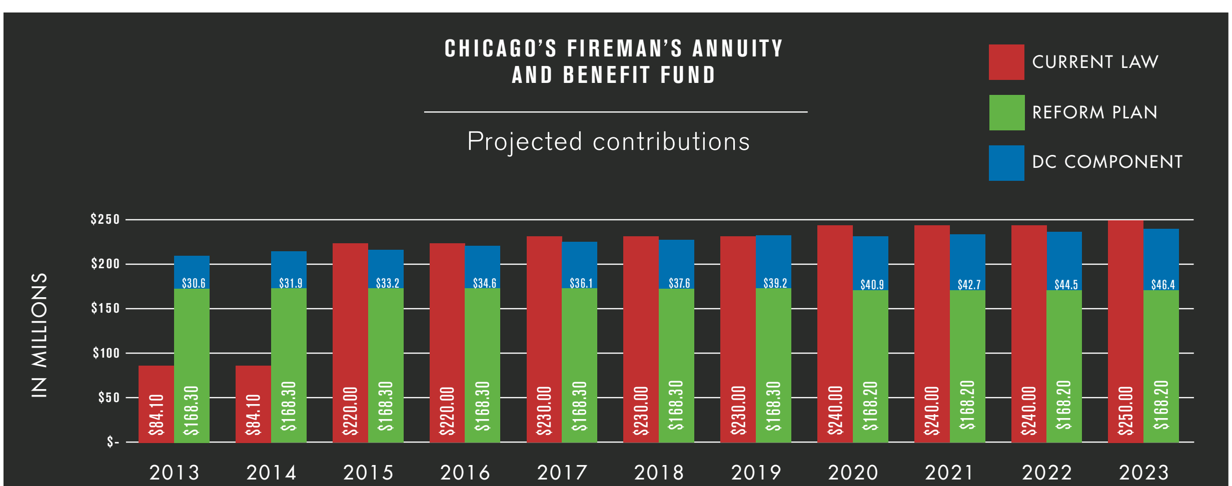
SOURCE: SEE APPENDIX 1 FOR METHODOLOGY USED IN ALL PROJECTIONS

Contributions

Pension contributions will increase by 160 percent in 2015 to more than $220 million annually under current law.

However, higher payments alone do nothing to fundamentally change the problems with the existing defined-benefit structure.

The Institute's hybrid plan levels out future retirement contributions by ending the accrual of new defined-benefit liabilities and by significantly reducing the unfunded liability.

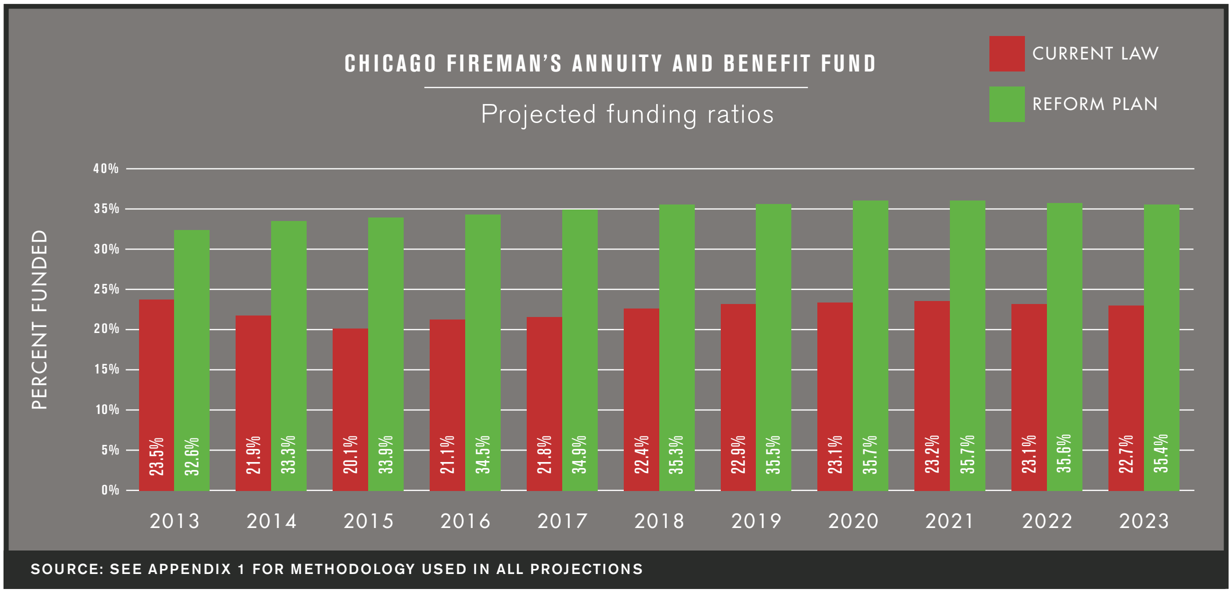


SOURCE: SEE APPENDIX 1 FOR METHODOLOGY USED IN ALL PROJECTIONS

Funded percentages

Despite significant contribution increases under current law, funding ratios remain at unsustainable levels going forward. And without real reforms to the current system, the city will continue to experience unpredictable growth in its unfunded liabilities.

In contrast, the Illinois Policy Institute's plan ends the accrual of new defined-benefit liabilities and significantly reduces the unfunded liability. This improves funding ratios, reaching 100 percent in 30 years – with stable and predictable pension contributions.

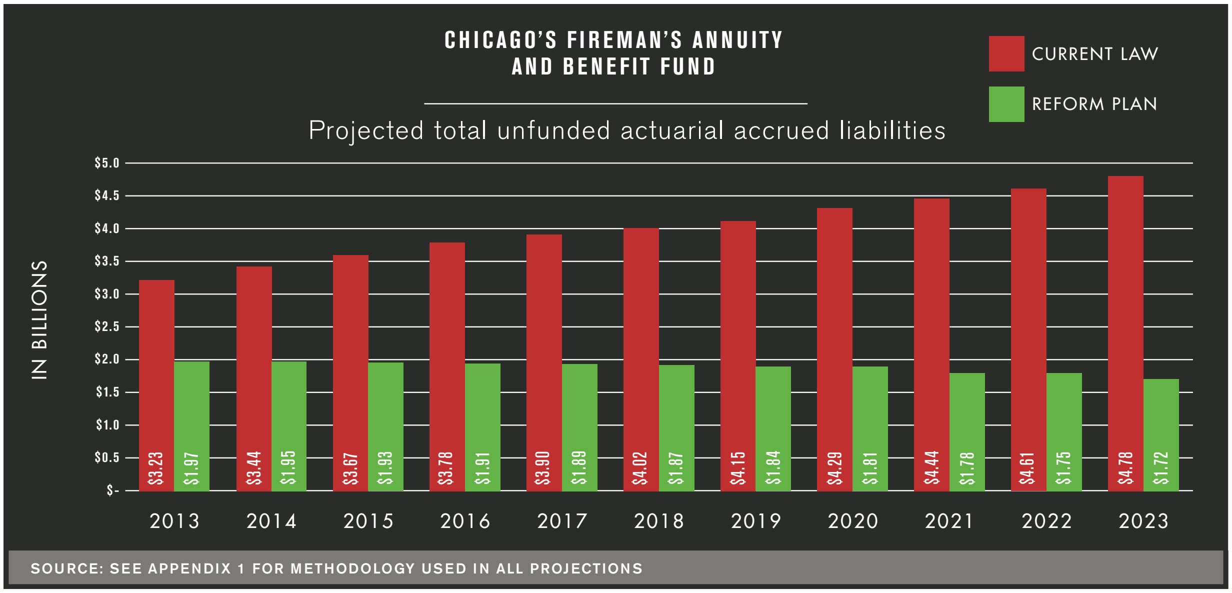


Unfunded actuarial accrued liabilities

Chicago cannot return to good fiscal standing unless it dramatically reduces its unfunded liability.

Under current law, unfunded liabilities increase by 48 percent over the next decade despite significant increases in city pension contributions.

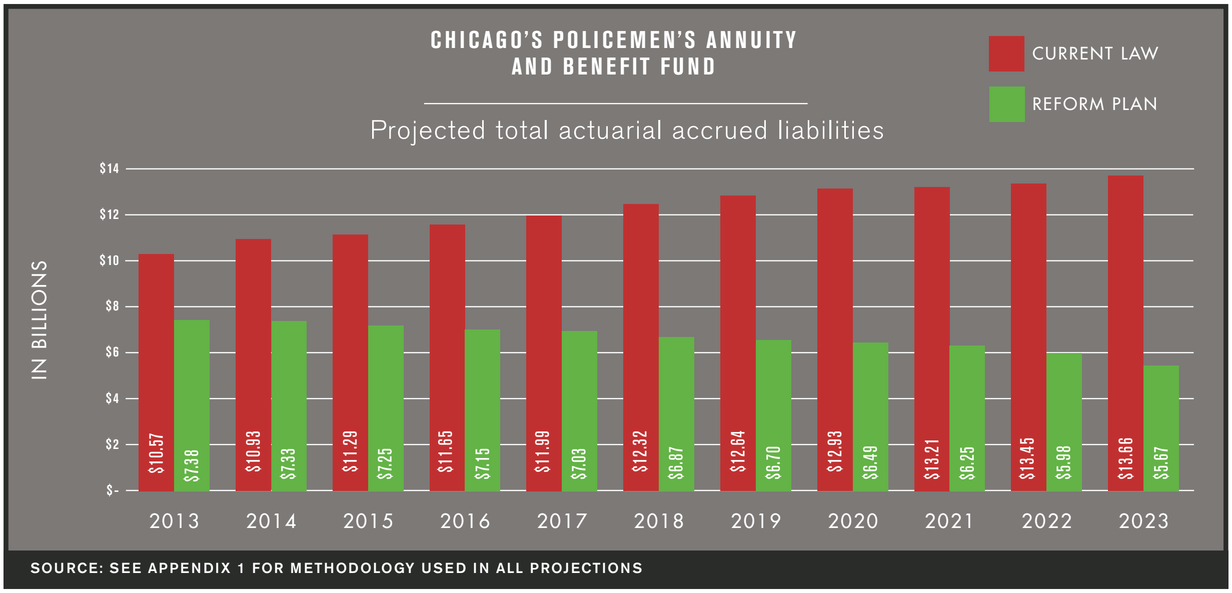
In contrast, the Illinois Policy Institute's reform reduces the unfunded liabilities by 39 percent immediately, and a further 13 percent over the next decade.



Appendix 3.2: Projected results by fund – Chicago Policemen's Annuity and Benefit Fund

Total actuarial accrued liabilities

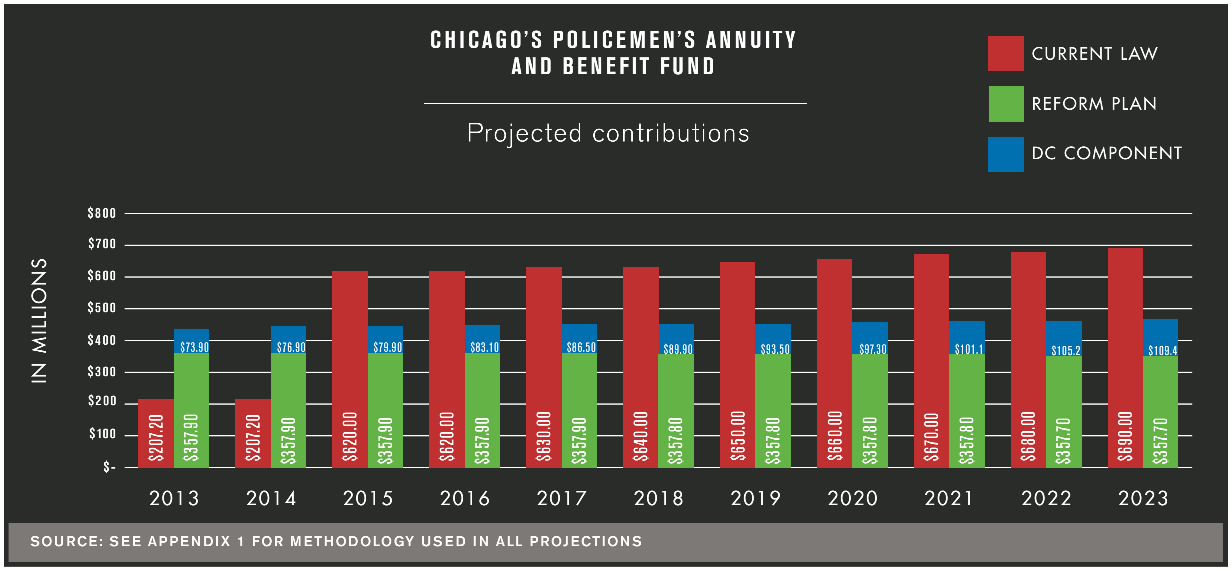
Under current law, total actuarial accrued liabilities increase by 30 percent over the next decade. Under the Illinois Policy Institute's reform plan, accrued liabilities are reduced going forward by ending the accrual of any new defined-benefit liabilities and by introducing a hybrid retirement plan.



Contributions

Pension contributions will increase by 200 percent in 2015 under current law. However, higher payments alone do nothing to fundamentally change the problems with the existing defined-benefit structure.

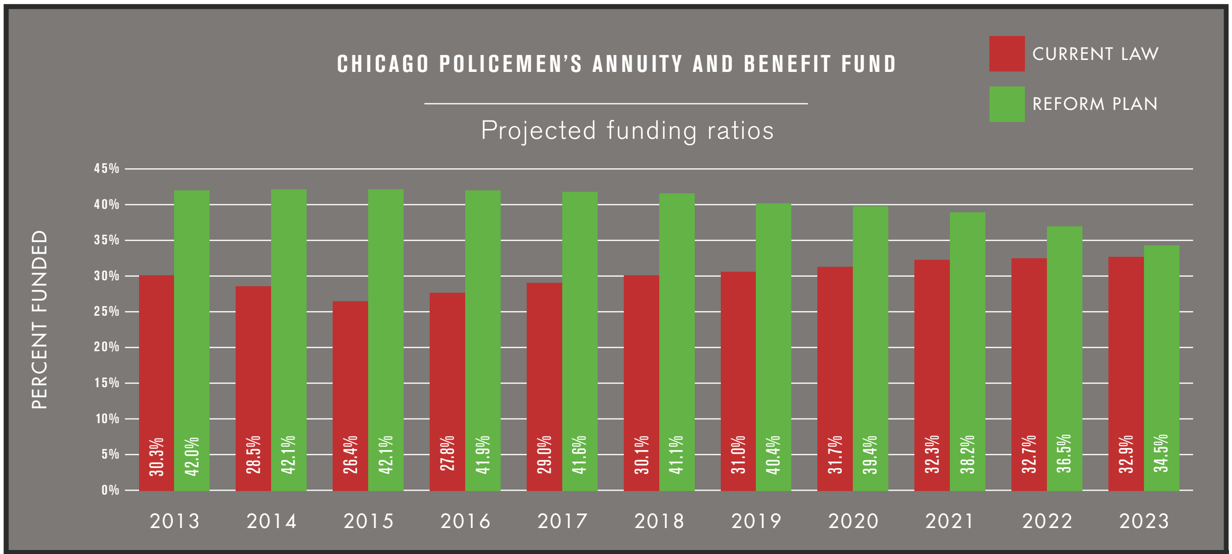
The Illinois Policy Institute's hybrid plan levels out future retirement contributions by ending the accrual of new defined-benefit liabilities and by significantly reducing the unfunded liability.



Funded percentages

Despite significant contribution increases under current law, funding ratios remain at unsustainable levels going forward. And without real reforms to the current system, the city will continue to experience unpredictable growth in its unfunded liabilities.

In contrast, the Illinois Policy Institute's plan ends the accrual of new defined-benefit liabilities and significantly reduces the unfunded liability. This improves funding ratios, reaching 100 percent in 30 years – with stable and predictable pension contributions.



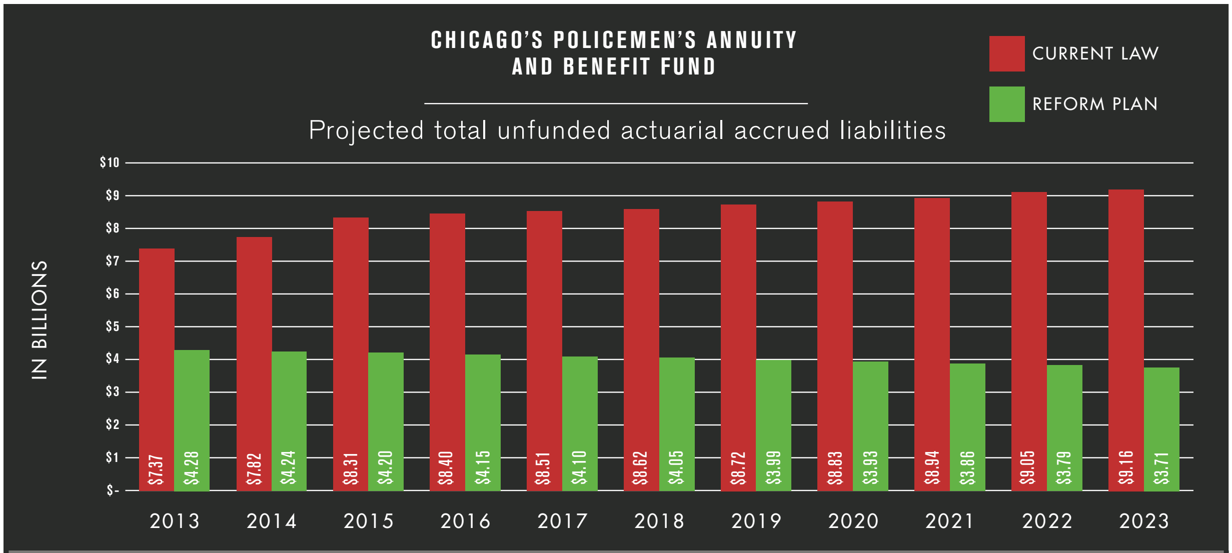
SOURCE: SEE APPENDIX 1 FOR METHODOLOGY USED IN ALL PROJECTIONS

Unfunded actuarial accrued liabilities

Chicago cannot return to good fiscal standing unless it dramatically reduces its unfunded liability.

Under current law, unfunded liabilities increase by 24 percent over the next decade despite significant increases in city pension contributions.

In contrast, the Illinois Policy Institute's reform reduces the unfunded liabilities by 42 percent immediately, and a further 13 percent over the next decade.

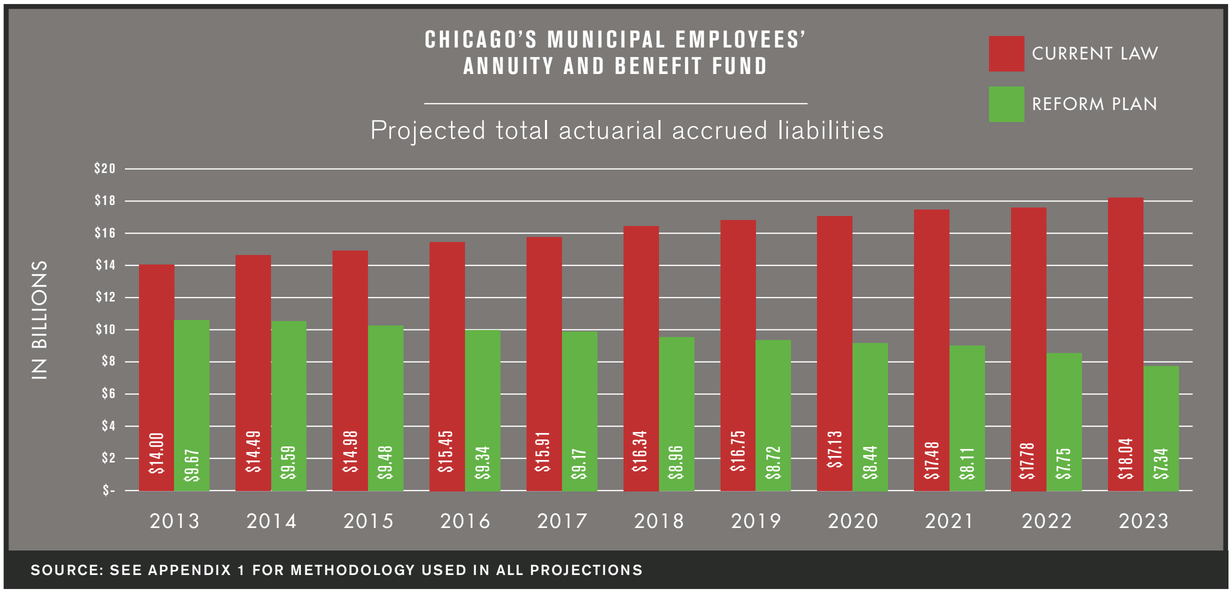


SOURCE: SEE APPENDIX 1 FOR METHODOLOGY USED IN ALL PROJECTIONS

Appendix 3.3: Projected results by fund – Chicago Municipal Employees' Annuity and Benefit Fund

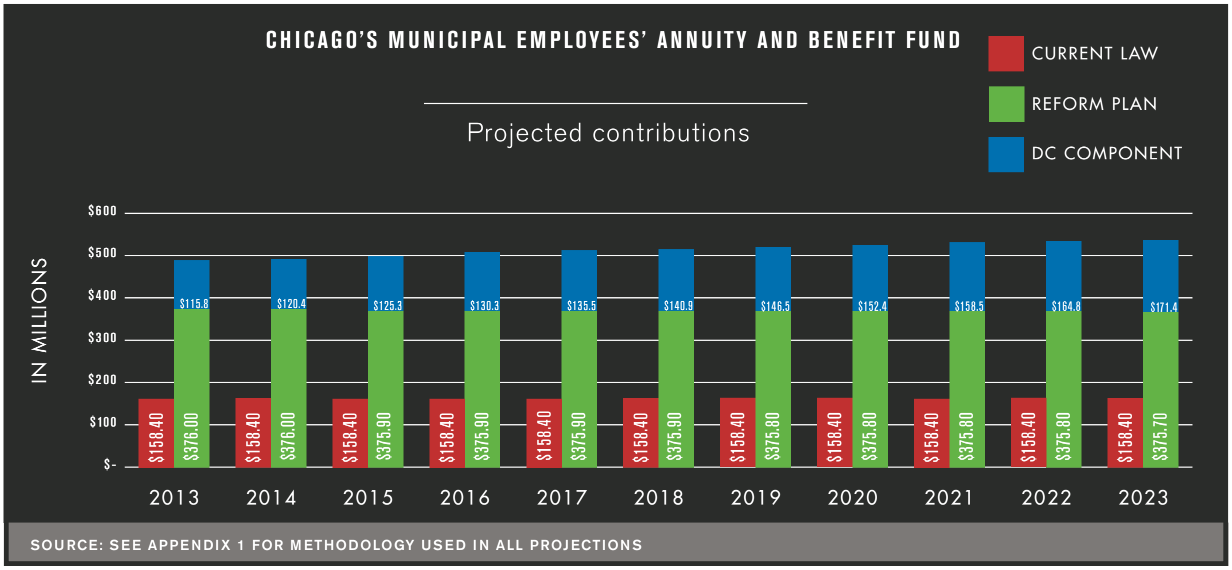
Total actuarial accrued liabilities

Under current law, total actuarial accrued liabilities increase by 30 percent over the next decade. Under the Illinois Policy Institute's reform plan, accrued liabilities are reduced going forward by ending the accrual of any new defined-benefit liabilities and by introducing a hybrid retirement plan.



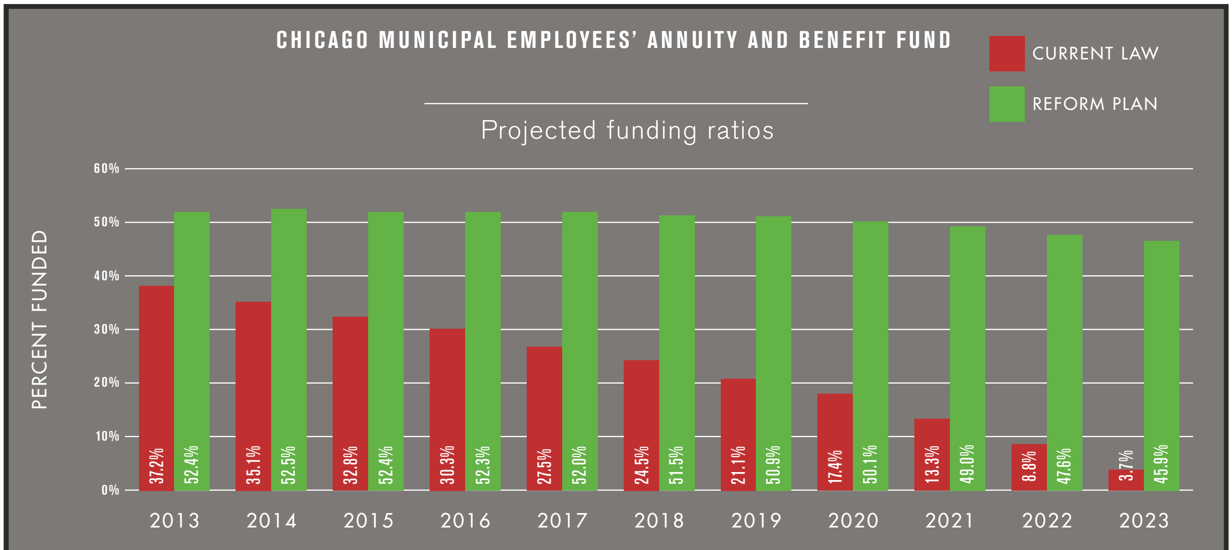
Contributions

Contributions under current law are not nearly enough to fund municipal pensions. At the current contribution rate, the fund will be entirely bankrupt by 2023. The Institute's reform plan levels out future retirement payments, reduces accrued liabilities and fully funds municipal pensions by 2045.



Funded percentages

Chicago's municipal pension fund will run out of assets in 10 years. In contrast, the Illinois Policy Institute ends the accrual of new defined-benefit liabilities and significantly reduces the unfunded liability. This improves funding ratios, reaching 100 percent in 30 years – with stable and predictable pension contributions.



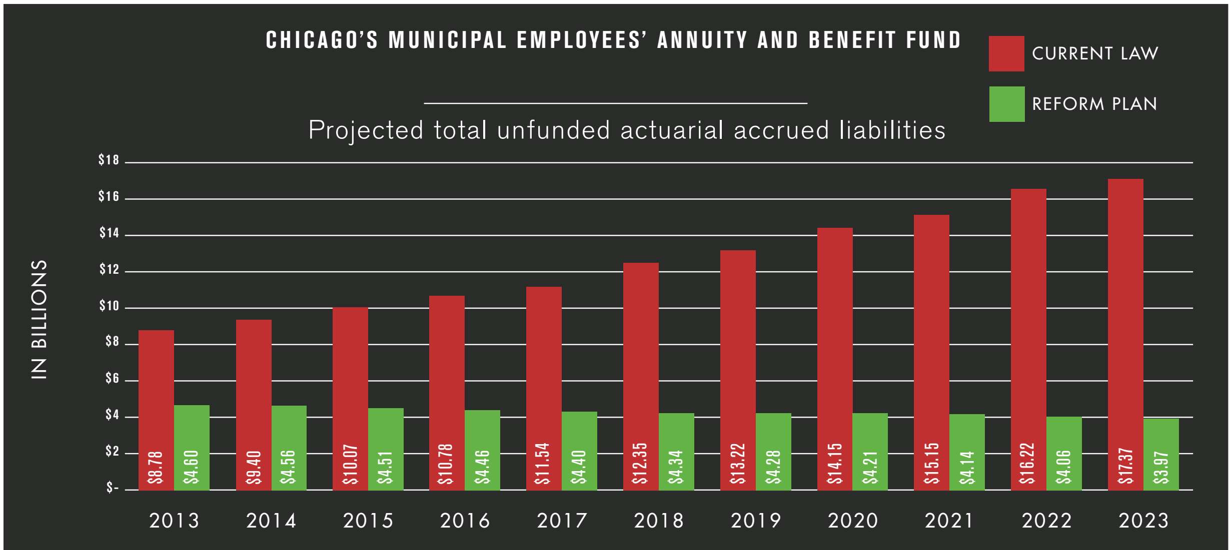
SOURCE: SEE APPENDIX 1 FOR METHODOLOGY USED IN ALL PROJECTIONS

Unfunded actuarial accrued liabilities

Chicago cannot return to good fiscal standing unless it dramatically reduces its unfunded liability.

Under current law, unfunded liabilities increase by 100 percent over the next decade despite significant increases in city pension contributions.

In contrast, the Illinois Policy Institute's reform reduces the unfunded liabilities by 48 percent immediately and a further 14 percent over the next decade.

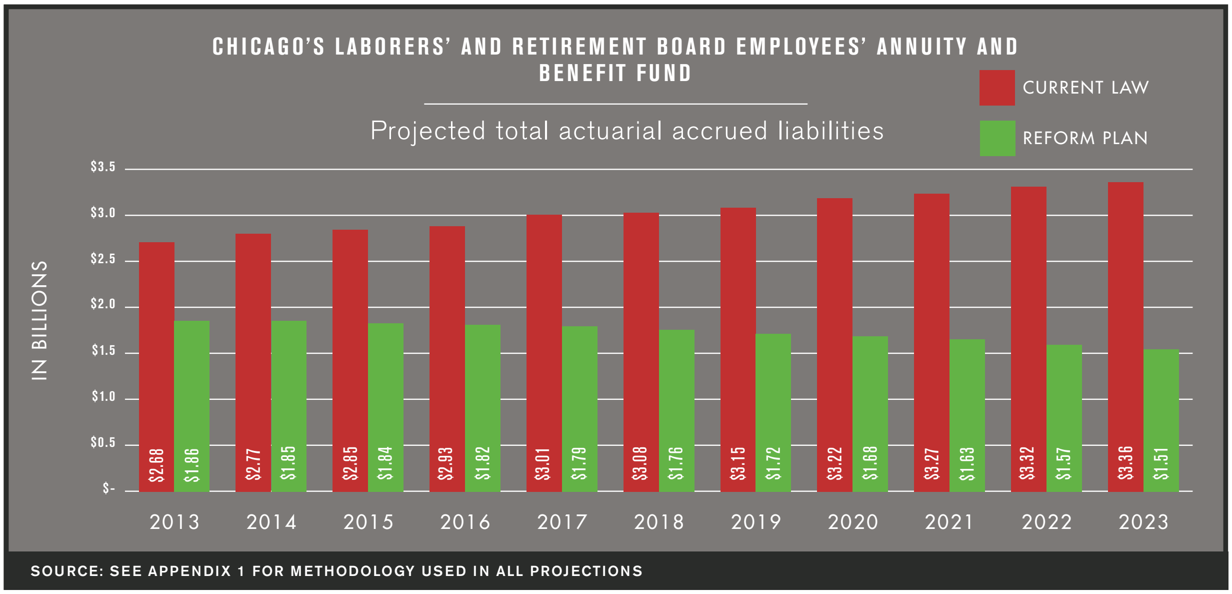


SOURCE: SEE APPENDIX 1 FOR METHODOLOGY USED IN ALL PROJECTIONS

Appendix 3.4: Projected results by fund – Chicago Laborers' and Retirement Board Employees' Annuity and Benefit Fund

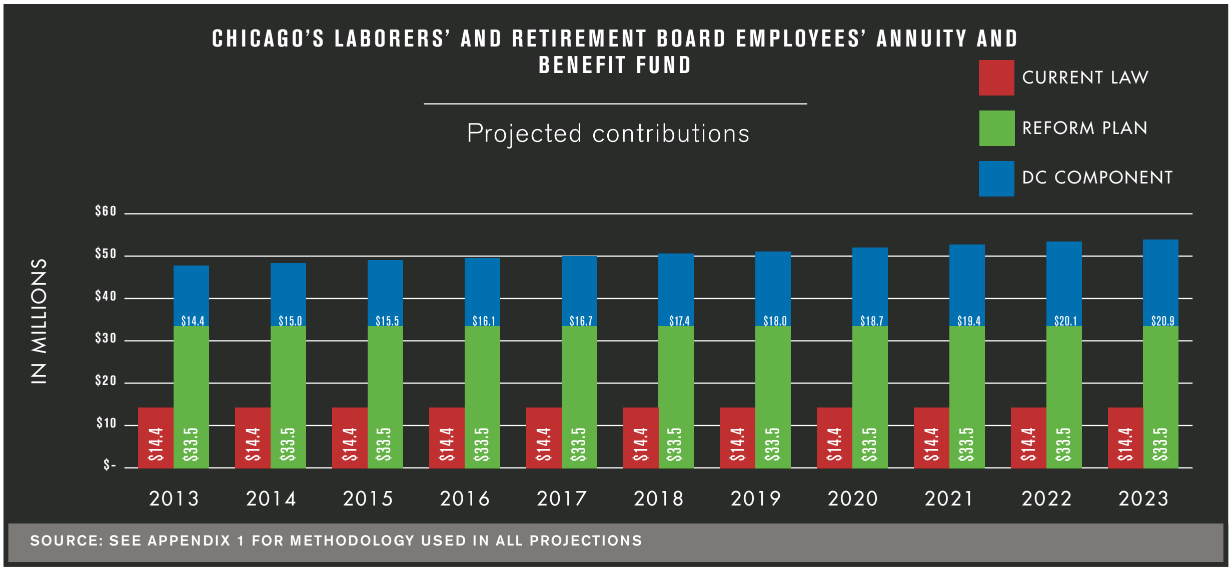
Total actuarial accrued liabilities

Under current law, total actuarial accrued liabilities increase by 25 percent over the next decade. Under the Illinois Policy Institute's reform plan, accrued liabilities are reduced going forward by ending the accrual of any new defined-benefit liabilities and by introducing a hybrid retirement plan.



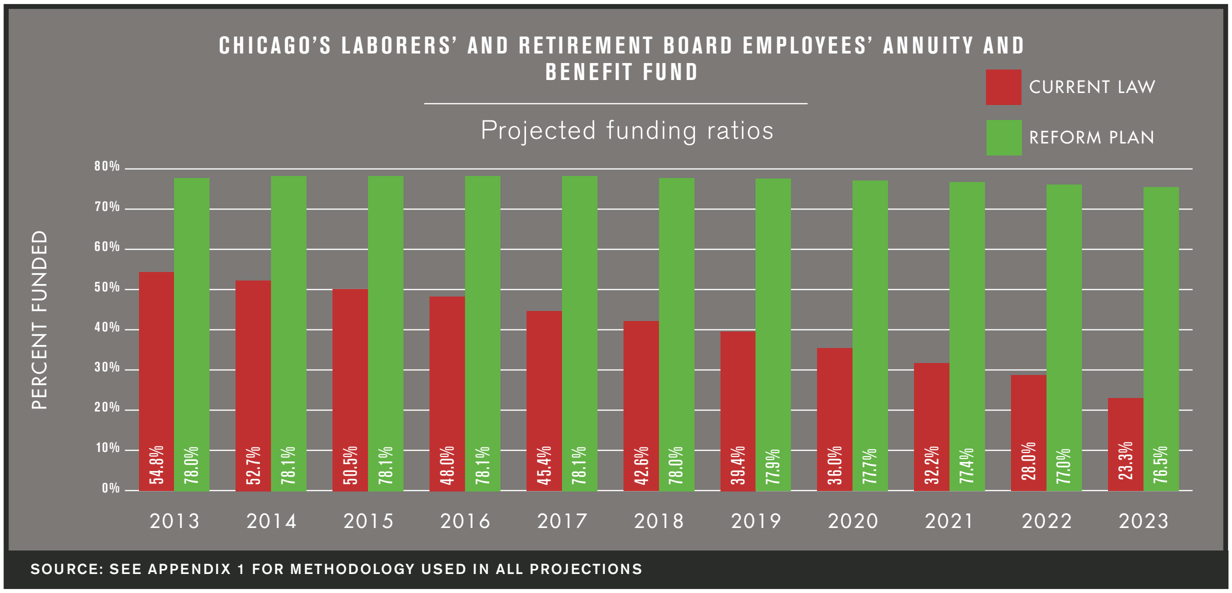
Contributions

Contributions under current law are not nearly enough to fund laborer pensions. At the current contribution rate, the fund will be nearly bankrupt by 2023. The Institute's reform plan levels out future retirement payments, reduces accrued liabilities and fully funds laborers' pensions by 2045.



Funded percentages

Chicago's laborer pension fund will drop to nearly bankrupt levels during the coming years. In contrast, the Illinois Policy Institute plan ends the accrual of new defined-benefit liabilities and significantly reduces the unfunded liability. This improves funding ratios, reaching 100 percent in 30 years – with stable and predictable pension contributions.

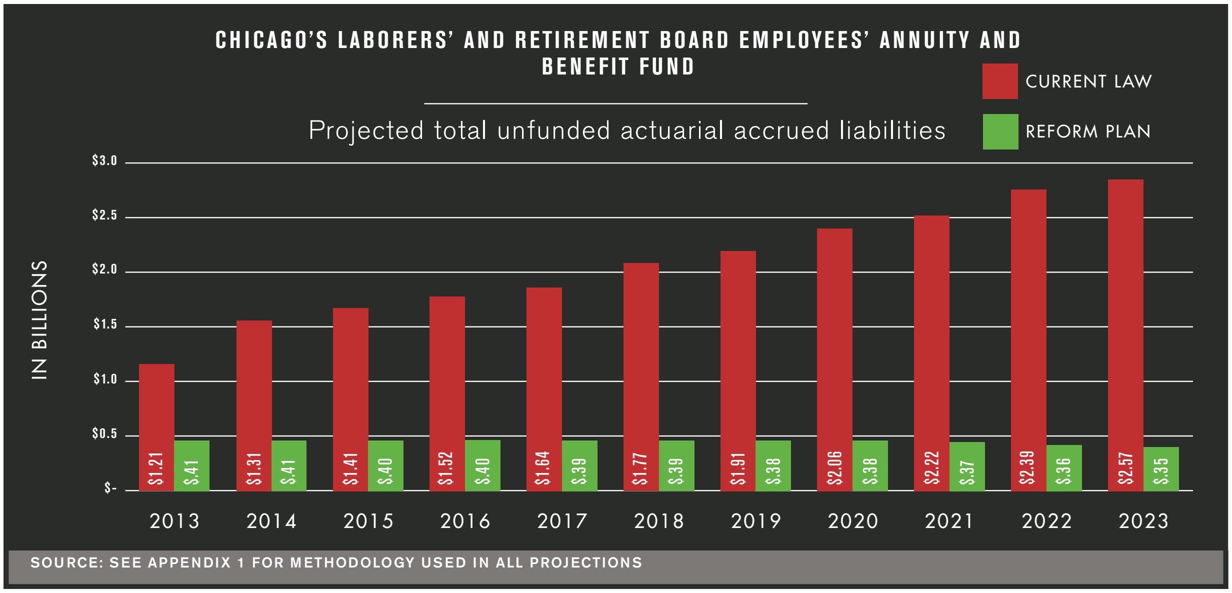


Unfunded actuarial accrued liabilities

Chicago cannot return to good fiscal standing unless it dramatically reduces its unfunded liability.

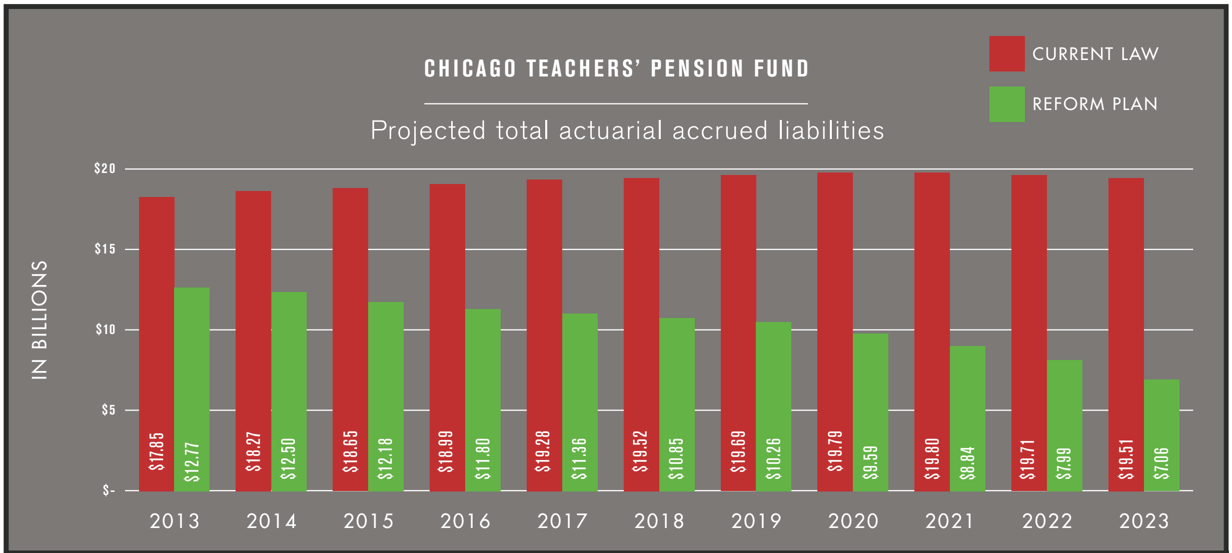
Under current law, unfunded liabilities increase by 113 percent over the next decade despite significant increases in city pension contributions.

In contrast, the Illinois Policy Institute's reform reduces the unfunded liabilities by 39 percent immediately, and a further 14 percent over the next decade.



Appendix 4: Projected results by fund – Chicago Teachers' Pension Fund
Total Actuarial accrued liabilities

Under current law, total actuarial accrued liabilities will increase by 9 percent over the next decade. Under the Illinois Policy Institute's reform plan, accrued liabilities are reduced going forward by ending the accrual of any new defined-benefit liabilities and by introducing a hybrid retirement plan.

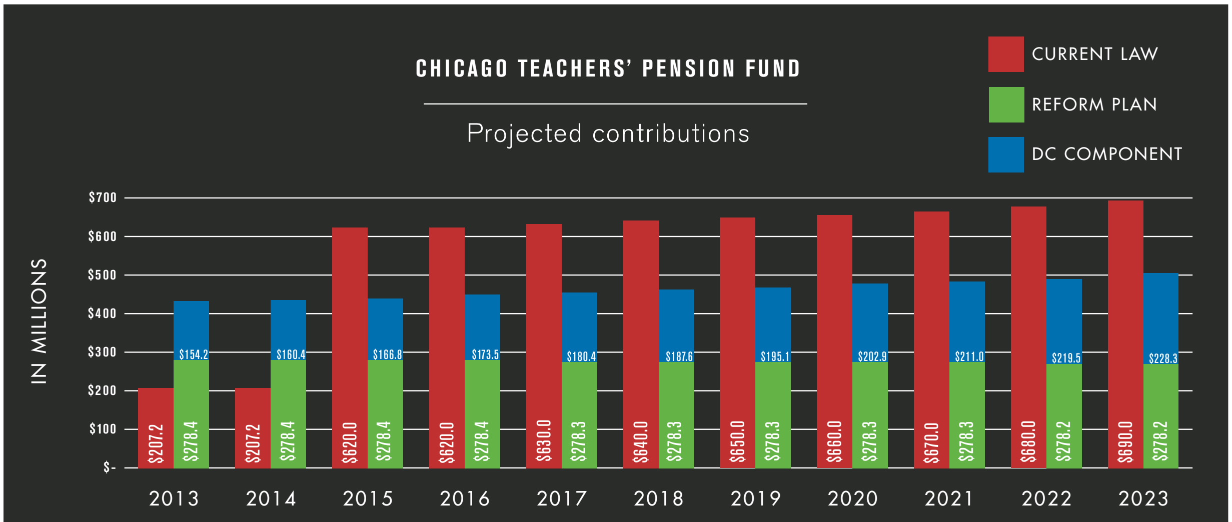


SOURCE: SEE APPENDIX 1 FOR METHODOLOGY USED IN ALL PROJECTIONS

Contributions

Pension contributions will increase by 200 percent in 2015. However, higher payments alone do nothing to fundamentally change the problems with the existing defined benefit structure.

The Institute's hybrid plan levels out future retirement contributions by ending the accrual of new defined-benefit liabilities and by significantly reducing the unfunded liability.

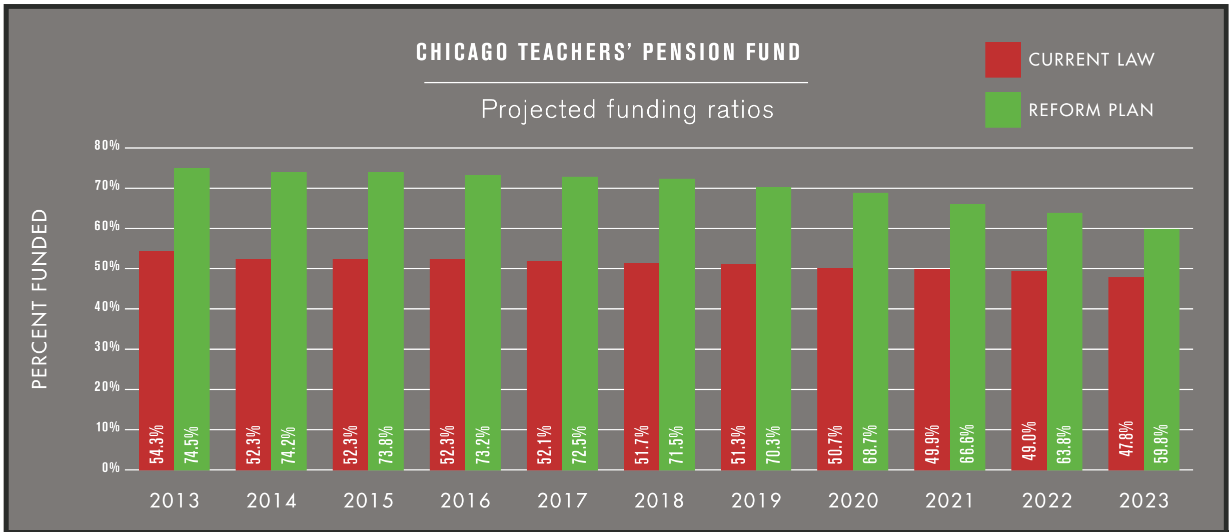


SOURCE: SEE APPENDIX 1 FOR METHODOLOGY USED IN ALL PROJECTIONS

Funded percentages

Despite significant contribution increases under current law, funding ratios remain at unsustainable levels going forward. And without real reforms to the current system, the city will continue to experience unpredictable growth in its unfunded liabilities.

In contrast, the Illinois Policy Institute's plan ends the accrual of new defined-benefit liabilities and significantly reduces the unfunded liability. This improves funding ratios, reaching 100 percent in 30 years – with stable and predictable pension contributions.



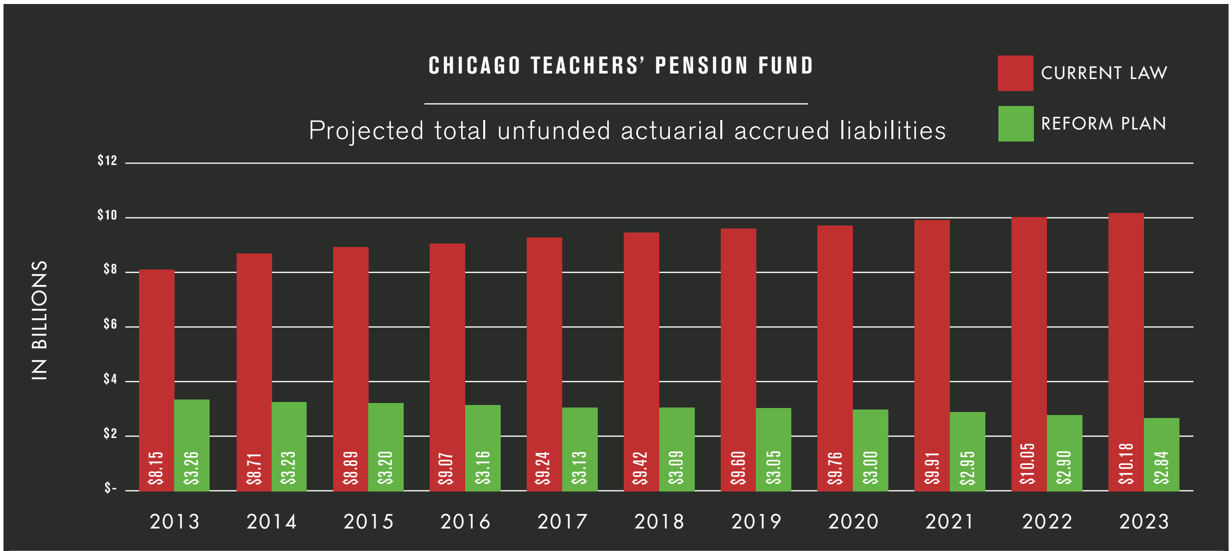
SOURCE: SEE APPENDIX 1 FOR METHODOLOGY USED IN ALL PROJECTIONS

Unfunded actuarial accrued liabilities

Chicago cannot return to good fiscal standing unless it dramatically reduces its unfunded liability.

Under current law, unfunded liabilities increase by 25 percent over the next decade despite significant increases in city pension contributions.

In contrast, the Illinois Policy Institute's reform reduces the unfunded liabilities by 60 percent immediately, and a further 13 percent over the next decade.



SOURCE: SEE APPENDIX 1 FOR METHODOLOGY USED IN ALL PROJECTIONS

Appendix 5: Chicago pension facts

CHICAGO PENSION FACTS							
SOURCE: COGFA & INDIVIDUAL ACTUARIAL REPORTS, FY 2012							
ENTITY	RETIREMENT AGE	RETIREMENT FORMULA	MAXIMUM ANNUITY	FINAL SALARY	EMPLOYEE CONTRIBUTION	EMPLOYER CONTRIBUTION	COST OF LIVING ADJUSTMENT (COLA)
POLICE	50 WITH 20 YEARS SERVICE 50 WITH 10 YEARS SERVICE: (ACCUMULATED ANNUITY) MANDATORY RETIREMENT AT 63	For employees with 20 or more years of service: 50% of final avg salary, plus 2.5% of final avg salary for each year in excess of 20	75% OF FINAL AVERAGE SALARY	Avg of 4 highest consecutive years within final 10 years of service	9% OF SALARY	Actuarially determined contributions with a funding goal of 90% by the end of FY 2040	3% simple with no limit if born before 1/1/1955 1.5% simple if born after 1/1/1955, 30% maximum
FIRE	50 WITH 20 YEARS SERVICE 50 WITH 10 YEARS SERVICE: (ACCUMULATED ANNUITY)	For employees with 20 or more years of service: 50% of final avg salary, plus 2.5% of final avg salary for each year in excess of 20	75% OF FINAL AVERAGE SALARY	Avg of 4 highest consecutive years within final 10 years of service	9.125% OF SALARY	Actuarially determined contributions with a funding goal of 90% by the end of FY 2040	3% simple with no limit at age 60, or age 55 if born before 1/1/55 1.5% simple if born after 1/1/55, 30% maximum
LABORERS	60 WITH 10 YEARS SERVICE 55 WITH 20 YEARS SERVICE 50 WITH 30 YEARS SERVICE 55 WITH 10 YEARS SERVICE: (MONEY PURCHASE)	2.4% of final average salary for each year of service	80% OF FINAL AVERAGE SALARY	Avg of 4 highest consecutive years within final 10 years of service	8.5% OF SALARY	Required to contribute an amount equal to the employee contributions to the fund two years prior to the year in which the tax is levied, multiplied by 1.00	3% compounded starting three years after age 53 or at age 60
MUNICIPAL	60 WITH 10 YEARS SERVICE 55 WITH 20 YEARS SERVICE 50 WITH 30 YEARS SERVICE 55 WITH 10 YEARS SERVICE: (MONEY PURCHASE)	2.4% of final average salary for each year of service	80% OF FINAL AVERAGE SALARY	Avg of 4 highest consecutive years within final 10 years of service	8.5% OF SALARY	Required to contribute an amount equal to the employee contributions to the fund two years prior to the year in which the tax is levied, multiplied by 1.25	3% compounded starting three years after age 53 or at age 60
TEACHERS	62 WITH 5 YEARS SERVICE 55 WITH 20 YEARS SERVICE	2.2% of final average salary for each year of service	75% OF FINAL AVERAGE SALARY	Avg of 4 highest consecutive years within final 10 years of service	9% OF SALARY	Required to make contributions calculated as a level percentage of payroll sufficient to bring the fund's total assets up to 90% by 2059	3% compounded starts at age 61
PARKS	50 WITH 10 YEARS SERVICE (if 45 or older as of 1/1/15) 58 WITH 10 YEARS SERVICE (if under 45 as of 1/1/15)	2.4% of final average salary for each year of service	80% OF FINAL AVERAGE SALARY	Avg of 4 highest consecutive years within final 10 years of service	2015: 10% OF SALARY 2017: 11% OF SALARY 2019: 12% OF SALARY UNTIL 90% FUNDED	Required to contribute an amount equal to the employee contributions during the fiscal year two years prior to the year the tax is levied 2014: MULTIPLIED BY 1.10 2015: MULTIPLIED BY 1.70 2017: MULTIPLIED BY 2.30 2019: MULTIPLIED BY 2.90 SUPPLEMENTAL CONTRIBUTIONS: $12.5 MILLION IN 2015 & 2016, AND $50 MILLION IN 2019	Starts at age 60 Simple COLA, lesser of 3% or ½ CPI SUSPENDED IN 2015, 2017, 2019
CTA	Normal retirement age of 65 EMPLOYEES HIRED BEFORE 1/18/08: 55 WITH 25 YEARS SERVICE 55 WITH 3 YEARS SERVICE* EMPLOYEES HIRED AFTER 1/18/08: 64 WITH 25 YEARS SERVICE 55 WITH 10 YEARS SERVICE* *ANNUITIES REDUCED 5% EVERY YEAR YOUNGER THAN 65	2.15% of final avg salary for each year of service for employees retiring on or after 1/1/01	70% OF FINAL AVERAGE SALARY	Highest avg compensation over any four calendar years out of the final 10 years of service prior to normal retirement	10.125% OF SALARY	14.25% OF SALARY	Made on an ad-hoc basis; most recent increase of $40 per month for members who retired after 1991 but before 2000

Source: Commission on Government Forecasting and Accountability, 2012 Actuarial reports from individual funds, Institute calculations based on Freedom of Information Act (FOIA) data obtained from individual pension funds

APPENDIX

Appendix 5: Chicago Pension Facts

CHICAGO PENSION FACTS

	SOURCE: INDIVIDUAL CAFRS, FY 2012						SOURCE: COGFA, FY 2012 (MILLIONS OF $)								SOURCE: COGFA, FOIA DATA	
ENTITY	ACTIVE MEMBERS	REGULAR RETIREES	SURVIVORS	DISABLED	INACTIVE MEMBERS	TOTAL BENEFICIARIES	PAYROLL	NET ASSETS	ACCRUED LIABILITES	UNFUNDED LIABILITES	FUNDED RATIO	EXPECTED RoR	EMPLOYEE CONTRIB.	EMPLOYER CONTRIB.	AVG. SALARY	AVG. CURRENT PENSION FOR A CAREER WORKER
POLICE	12,026	9,035	3,405	526	664	12,966	$1,012	$3,149	$10,052	$6,903	31.30%	7.75%	$95.80	$207.20	$84,415	$72,880
FIRE	4,740	2,821	1,442	350	60	4,613	$419	$993	$4,066	$3,073	24.40%	8.00%	$53.20	$84.10	$88,389	$80,696
LABORERS	2,865	2,737	1,239	255	1,408	4,231	$199	$1,316	$2,375	$1,059	55.40%	7.50%	$16.60	$14.40	$69,386	$59,974
MUNICIPAL	31,326	19,614	4,506	530	13,465	24,650	$1,591	$5,073	$13,638	$8,564	37.20%	7.50%	$130.20	$158.4	$50,782	$50,194
TEACHERS	30,366	22,636	2,822	468	4,245	25,926	$2,225	$9,364	$17,376	$8,012	53.90%	8.00%	$187.10	$138.80	$69,757	$65,281
PARKS	2,977	2,104	817	0	153	2,921	$114	$441	$866	$426	50.90%	8.00%	$10.40	$10.90	$36,882	$36,673
CTA	8,751	8,638	780	944	84	10,092	$549	$1,703	$2,867	$1,165	59.40%	8.50%	$48.40	$62.8	$66,142	$47,783

*Recently retired career workers are employees who have spent 30 years or more working for the city or its sister governments and have retired within the last three years

Source: Commission on Government Forecasting and Accountability, 2012 Actuarial reports from individual funds, Institute calculations based on Freedom of Information Act (FOIA) data obtained from individual pension funds

[1] Ted Dabrowski, "Moody's downgrade: Chicago's path toward junk," Illinois Policy Institute (March 5, 2014): http://illinoispolicy.org/moodys-downgrade-chicagos-path-toward-junk/.
Illinois Policy Institute, "Pensions vs schools," http://illinoispolicy.org/simplereport/pensions-vs-schools-chicago-public-schools/, Chicago Teachers' Pension Fund. http://ctpf.org/general_info/advocacy/fundinghistory.pdf.

[2] Ted Dabrowski, "Moody's downgrade: Chicago's path toward junk," Illinois Policy Institute (March 5, 2014): http://illinoispolicy.org/moodys-downgrade-chicagos-path-toward-junk/.

[3] Commission on Government Forecasting and Accountability, "Illinois Public Retirement Systems: A Report on the Financial Condition of the Illinois Municipal, Chicago and Cook County Pension Funds in Illinois, January 2014." http://cgfa.ilga.gov/Upload/Small%20Systems%202013%20FINAL.pdf

[4] Morningstar Inc. "The State of City Pension Plans 2013: A Deep Dive into Shortfalls and Surpluses," (Nov. 12, 2013): http://www.nasra.org/Files/Topical%20Reports/Credit%20Effects/Morningstarcities1311.pdf.

[5] Ted Dabrowski and Ben VanMetre, "The hidden bill: Chicago taxpayers and the looming crisis." Illinois Policy Institute (Sept. 17, 2013): http://illinoispolicy.org/simplereport/the-hidden-bill-chicago-taxpayers-and-the-looming-crisis/.

[6] Micheline Maynard, "Detroit Is Eligible For Bankruptcy, And City Pensions Are At Risk" Forbes (Dec. 3, 2013): http://www.forbes.com/sites/michelinemaynard/2013/12/03/detroit-is-eligible-for-bankruptcy-and-city-pensions-are-at-risk/.

[7] Ted Dabrowski, "Moody's downgrade: Chicago's path toward junk," Illinois Policy Institute (March 5, 2014): http://illinoispolicy.org/moodys-downgrade-chicagos-path-toward-junk/.

[8] Illinois Policy Institute, "Pensions vs schools," http://illinoispolicy.org/simplereport/pensions-vs-schools-chicago-public-schools/, Chicago Teachers' Pension Fund. http://ctpf.org/general_info/advocacy/fundinghistory.pdf.

[9] Institute calculations based on Freedom of Information Act data obtained from individual pension funds.

[10] Josh Dwyer, "CPS layoffs should not surprise CTU," Illinois Policy Institute (July 19, 2013): http://illinoispolicy.org/cps-layoffs-should-not-surprise-ctu/.

[11] City of Chicago, 2013 Annual Financial Analysis, http://www.cityofchicago.org/content/dam/city/depts/obm/supp_info/Budget%20Documents/2013AFA.pdf.

[12] Josh Dwyer, "CPS layoffs should not surprise CTU," Illinois Policy Institute (July 19, 2013): http://illinoispolicy.org/cps-layoffs-should-not-surprise-ctu/.

[13] Municipal Employees' Annuity and Benefit Fund of Chicago, "Comprehensive Annual Financial Report for the fiscal year ended Dec. 31, 2012," http://www.meabf.org/publications/2012_CAFR.pdf.

[14] Policemen's Annuity and Benefit Fund of Chicago, "Comprehensive Annual Financial Report for the year ended Dec. 31, 2012," http://www.chipabf.org/ChicagoPolicePension/PDF/Financials/CAFER/CAFR_2012_Final.pdf.

[15] Ted Dabrowski and Ben VanMetre, "The hidden bill: Chicago taxpayers and the looming crisis." Illinois Policy Institute (Sept. 17, 2013): http://illinoispolicy.org/simplereport/the-hidden-bill-chicago-taxpayers-and-the-looming-crisis/.

[16] Social Security Administration, "Fact Sheet: 2014 Social Security Changes," http://www.ssa.gov/pressoffice/factsheets/colafacts2014.pdf.

[17] Under current law, the municipal and laborers' pension funds use a 7.5 percent rate of return, the police fund uses a 7.75 percent rate of return and fire uses an 8 percent rate of return on investment. The Institute's calculations assume the more conservative rate of the four funds: a 7.5 percent rate of return on investment.

[18] Retirement FIRST benefits based on actuarial assumptions of: 4 percent wage inflation, 6 percent earned rate and 0.5 percent mortality improvement. These assumptions are for informational purposes only and subject to change according to actual market conditions.

[19] Nichols Actuarial Consulting LLC

[20] Institute calculations based on Freedom of Information Act data obtained from individual pension funds.

[21] Social Security Administration, "Fact Sheet: 2014 Social Security Changes," http://www.ssa.gov/pressoffice/factsheets/colafacts2014.pdf.

[22] Institute calculations based on Freedom of Information Act (FOIA) data obtained from individual pension funds.

[23] Jill Schlesinger, "Retirement now requires those living longer to work longer," Chicago Tribune (Oct. 16, 2013): http://www.chicagotribune.com/business/sns-201310161730--tms--retiresmctnrs-a20131016-20131016,0,7752242.story.

[24] "Executive Summary - Rhode Island General Assembly Retirement Security Legislation," http://www.pensionreformri.com/.

[25] Ted Dabrowski and Ben VanMetre, "The hidden bill: Chicago taxpayers and the looming crisis," Illinois Policy Institute (Sept. 17, 2013): http://illinoispolicy.org/simplereport/the-hidden-bill-chicago-taxpayers-and-the-looming-crisis/.