LWVIL Pension Study

Background

Article XIII, Section 5 (the “Pension Clause”) of the 1970 Illinois Constitution

Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.

This section is interpreted to mean that participation in a public pension system creates an enforceable contractual relationship. Therefore, the State of Illinois has a legal obligation to pay employees those benefits that have accrued to them under the applicable pension system.

With this Section 5 as background, there are two sets of opposing legal arguments about changing current Illinois public employees’ pensions:

1. The rules/regulations for current public employees’ pensions are based on the date of hire and cannot be changed without violating Section 5.
2. A current public employee’s pension benefits already accrued cannot be changed, but future pension benefits can be changed without violating Section 5.

The first position is articulated in a legal brief by Eric Madiar, Chief Legal Counsel to Illinois Senate President John Cullerton. The second position is articulated in a legal brief/article by Sidley Austin law firm representing the Civic Committee of the Commercial Club of Chicago.

The State of Illinois has fiscal responsibility for the funding of five primary retirement systems: the General Assembly Retirement System (GARS); the Judges’ Retirement System (JRS); the State Employees’ Retirement System (SERS); the State Universities Retirement System (SURS); and the Teachers’ Retirement System (TRS). These systems are considered ‘defined benefit’ plans, meaning at retirement employees will receive monthly annuities for life. The annuities are based on several factors, including years of service, retirement age, salary(ies) on which amount of pension is based, and other provisions. Employees contribute a percentage of salary to their pension system. Contributions from the state should be in an amount referred to as ‘normal cost plus interest.’ The ‘normal cost’ is the value of pension benefits earned during a particular year. ‘Interest’ is the amount needed to cover what is referred to as the interest on the unfunded liability, which liability is generally defined as the present value of the annuity payments earned to date and that will be paid in the future minus the value of the current assets of a plan. Illinois uses an 8.5% rate for this interest calculation.

For a variety of reasons, Illinois has not contributed all the funds needed to keep the five pension systems at the levels usually recommended by the financial community. In addition, the State has not earned expected rates of return on investments and actuarial assumptions were not accurate. As a result the five pension systems are severely underfunded (calculated to be less than 50% funded) and the State currently does not have the financial means to resolve this problem.

The current Illinois pension systems seem to be unsustainable and create an overwhelming burden for the State. The issues to be addressed are what changes can be made to the pension systems under the Pension Clause; what type of system would be sustainable and appropriate for Illinois going forward; and what safeguards may be put in place to prevent problems of the current magnitude occurring again.

There are many suggestions out there as to how to remedy the situation. Changes to the pension systems were made which will impact employees hired after January 1, 2011. At issue are the
systems for employees employed prior to January 1, 2011 and, in particular, interpretation of the portion of the Illinois Constitution Pension Clause that states “...the benefits of which shall not be diminished or impaired.” (Article XIII, Section 5).

There is legislation being considered which would change the pension systems and, thus possibly ‘diminish’ or ‘impair’ employee benefits. Legal and political opinions are being made in favor of and against any changes. The constitutionality of these changes is a major factor in these opinions.

Summary of Legal Opinions on Issue of Changes to Pension Systems

The main issue is whether Illinois can make any changes in the pension systems that may be interpreted as having ‘diminished or impaired’ the benefits without violating the Pension Clause. Would any change in formula ‘impair’ or ‘diminish’ the benefits? There are two memoranda which address this issues: One is Eric Madiar’s opinion entitled “Is Welching on Public Pension Promises an Option for Illinois?,” dated March 4, 2011, which makes the case that no changes would be allowed for employees in the system prior to January 1, 2011, without the consent of each individual member, since the Pension Clause specifically assigns the pension rights as “an enforceable contractual relationship.” The other is Sidley Austin’s response to Madiar, entitled “The General Assembly’s Authority to Enact Comprehensive Pension Reform Legislation,” dated April 11, 2011, which contends that making changes that protect the future of the system as a whole are needed to keep the systems from totally collapsing and, therefore, do not constitute ‘impairment’ or ‘diminishing’ the system. Sidley Austin has an earlier memorandum on the subject dated December 7, 2010, entitled “The State of Illinois, and the City of Chicago and Smaller Municipalities, Are Not the Guarantors of The Payment of Pension Benefits.”

Below is an attempt at condensing both Sidley Austin (“SA”) and Madiar (“M”) arguments into a point/counterpoint summary:

SA: The Pension Clause protects only benefits earned earned to date, not future benefits. Pensions are based on ‘earned benefits’ to that point. Future benefits are ‘expectations’ and rely on any number of factors, including continuation in service and salary.

M: Public employees are already obligated to contribute and work in order to receive pension benefits. Continued employment does not constitute acceptance of a revised pension system because the only way to preserve rights under the existing contract is to be forced to quit. Employees’ rights are secured under the contract at the time of membership in the pension system.

SA: Pension Clause is not meant to protect pensions (a right) at the cost of state services (a duty of the state). The framers of the 1970 Constitution rejected proposals for requiring full funding.

M: SA mischaracterizes the convention debates. Sponsors meant for Pension Clause to protect the employees’ pension rights as a contract and enforceable in court. While the framers rejected proposals for any required funding, contractual rights of employees to pensions would make funding those pensions an expectation.

SA: Legislation does not ‘diminish’ or ‘impair’ pension benefits since it would ultimately save the systems from the underfunding issue. If Illinois were a corporation and could consider bankruptcy, pension funds would be considered a contract right, not a property right, and holders of contract rights are unsecured creditors.

M: Pension Clause constitutes a guarantee that the State will pay 100% of all pension benefits, regardless of circumstances.

SA: Pension benefits should be treated the same as salaries and health benefits, which can be changed or modified. Of all state employees, only judges’ salaries are protected from reduction during their service.

M: Each of the state’s five pension codes has similar provision of “Obligations of the State.
The payment of the required department contributions, all allowances, annuities, benefits granted under this Article, and all expenses of administration of the system are obligations of the State of Illinois to the extent specified in this Article.” The Pension Clause in itself puts pensions in a different category than salaries and health benefits.

Illinois Court Cases That Have Rendered Decisions Impacting Pension Issues

1. Peters v. City of Springfield., 57 Ill. 2d 142, 311 N.E.2d 107 (1974) (IL Supreme Court) addresses City of Springfield ordinances that lowered the firemen’s retirement age from 63 to 60. Firemen argued that this change was beyond the City’s home rule powers and that it impaired their ability to maximize their pensions by working to age 63, in violation of the Pension Clause. The trial court agreed with the firemen, but the Supreme Court disagreed. The Supreme Court said that the City was within its home rule powers and that the Pension Clause was not violated. The Peters court determined that the Pension Clause was intended to “insure the rights of public employees which had been earned should not be diminished…” This language in the Clause did not prevent the City from changing the retirement age.

2. Kraus v. Bd of Trustees, 72 Ill. App. 3d 833, 390 N.E.2d 1281 (1st Dist. 1979) (IL Appellate Court) A police officer went on disability due to an on-duty injury after 11 years of active service. When he entered the force, in 1956, an officer could retire after 20 combined years of active service and disability, and could base retirement on the salary for his rank when he elected to retire. In 1973, before the officer met the 20-year requirement to retire, the legislature changed the Pension Code to give an officer a pension based on his salary at the time he went on disability. The police pension board thus based the officer’s retirement on his salary in 1967 rather than the salary for his rank in 1976 when he retired. The trial court reversed the police pension board.

The Appellate Court agreed with the trial court and held that the amendment to the Pension Code (in 1973) could not apply to the officer because the Pension Clause “entitled [him] to receive the benefits under the relevant sections of the Pension Code as in effect at the time the constitutional provision became effective in 1971.” The court said pension rights became fixed when an employee entered the pension system or when the constitution became operative, whichever was later, but not at retirement.

3. Felt v. Bd of Trustees of Judges Retirement Sys., 107 Ill. 2d 158, 481 N.E.2d 698 (1985) (IL supreme Court) involved a Pension Code provision which allowed judges to retire with a pension based on their salary on their last day of service. This was changed by the General Assembly effective in 1982 to a pension based on the average salary during the last year of service. Judges who entered service under the former provision and retired after 1982 said application of the Code change to them violated the Pension Clause and the Contracts Clause. The trial court agreed and so did the Supreme Court. The Illinois Attorney General (arguing for the validity of the legislature’s change) argued that the legislature could modify pension benefits under its police power (that is, the power to act for the general health safety and welfare of the public). However, the Supreme Court said that the change caused substantial impairment for the judges’ benefits. Madiar emphasizes that the Supreme Court relied on Kraus (even though it is an Appellate Court decision) in its analysis of this case.

Pension Code was amended to require current employees to make that purchase of military service time by September of 1974. The employee attempted to purchase his military service years in 1983 and the retirement system denied his request. The trial court reversed. On appeal, the Supreme Court upheld the trial court and held that the employee was entitled to enforce his right to purchase the service credit according to the Pension Code as it was written when the Pension Clause became effective. The Supreme Court said “rights to exercise this option and make these additional payments are contractual rights by virtue of [the Pension Clause] and the legislature cannot divest plaintiff of these rights.” The Supreme Court found that Kraus was in accord with its holding here.

5. People ex rel. Illinois Federation of Teachers v. Lindberg, 60 Ill. 2d 266, 268-70, 326 N.E.2d 749, 750-51 (1975) (IL Supreme Court) Members of the teachers’ pension systems and members of other systems filed a mandamus action as a class to require the State to pay amounts originally appropriated by the General Assembly to their retirement systems after the Governor exercised his item reduction veto power to reduce the appropriated amounts. They contended that the Pension Clause represented an enforceable, contractual right to have their respective pension systems funded in an actuarially sound manner and that the provisions of the Code were a binding obligation on the legislature that could not be ‘impaired.’ The plaintiffs asked the court to restore the original appropriation. The trial court dismissed the class action. The IL Supreme Court concluded that the drafters of the Constitution did “not establish the intent to constitutionally require a specific level of pension appropriations during a fiscal year.”

6. People ex rel. Sklodowski v. State of Illinois, 182 Ill. 2d 220, 695 N.E.2d 374 (1998) (IL Supreme Court) Filed by participants of the State’s five pension systems because of the State’s failure to make the pension contributions prescribed by Public Act 86-274, which committed the State to make additional pension contributions and pay the existing unfunded liabilities of each system over a 40-year period. Plaintiffs claimed in enacting Public Act 86-274 as part of the Pension Code, the legislature made its funding schedule an enforceable contractual right under the Clause and that failure to follow that schedule impaired their contractual rights. They sought a writ of mandamus to force the IL comptroller and others to comply with the Act’s funding schedule. The Court dismissed the complaint because the requested relief would violate the separation of powers clause under the IL constitution. During plaintiffs’ appeal, the legislature passed Public Act 88-593, repealing the earlier Act and establishing a less rigorous funding schedule. A motion to dismiss was denied and the Appellate Court revised the trial court’s decision. In its decision, the IL Supreme Court determined that (1) the Clause was included to eliminate the distinction in legal protections afforded to mandatory and optional pension plans prior to the 1970 Constitution; (2) the Clause “makes participation in a public pension plan an enforceable contractual relationship and also demands that the ‘benefits’ of that relationship” not be “diminished or impaired;” and (3) the contractual relationship is governed by the actual terms of the Pension Code at the time the employee becomes a member of the pension system. However, the Court reversed the appellate court and reaffirmed that the Clause does not create a contractual basis to expect a particular level of funding, but rather a right that they would receive the money due them at retirement.