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The Civic Federation

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August 8, 2023

Dear Chairperson Kifowit and Members of the House Personnel & Pensions Committee:

As the House Personnel and Pensions Committee considers a path forward for Tier 2 pensions in Illinois this year, the Civic Federation urges this Committee and the Illinois General Assembly to consider the following recommendations:

- Any changes to Tier 2 pension benefits should be the most effective, least costly and most directly tied to addressing compliance with IRS Safe Harbor rules. Increasing the pensionable salary cap to more closely align with the Social Security Wage Base would be the most direct Tier 2 “fix.”
- Before passing any legislation to change Tier 2 benefit calculations, the Illinois General Assembly should call for an actuarial study of both state and local pension plans to estimate when pension plans will fail to meet Safe Harbor compliance, and what the cost of any enhanced benefits would be to government employers (e.g., municipalities, police and fire departments) in terms of annually required pension contributions and long-term unfunded liabilities. This study should be as comprehensive as possible and look at a variety of pension plans statewide.

The Civic Federation understands that the Illinois legislature will need to pass legislative changes to the statutes that govern each of the pension funds in Illinois (except for those whose employees are already covered by Social Security) in order to meet IRS standards ensuring that public employees receive a retirement benefit that is deemed equivalent to Social Security benefits, known as Safe Harbor. If a pension plan’s benefits fall out of compliance with IRS rules and fail to meet the Safe Harbor tests, employees would be subject to a Social Security withholding of 6.2% of their salary, matched by an employer contribution of 6.2%, in addition to pension contributions.

In order to avoid having to make Social Security contributions, the most simple and direct course of action is to adjust the pensionable salary cap, or the maximum amount of salary on which a pension benefit can be based. The Safe Harbor test looks at the following key plan features to determine whether a plan is an adequate Social Security replacement plan: the compensation multiplier (the percentage of final pay per year of service); number of years used to determine final average compensation; and the definition of compensation used by the plan (which under Social Security is the Social Security Wage Base, and under pension plans is the final pay cap).

Specifically, the issue is the growing difference between the Social Security Wage Base (SSWB) and the Tier 2 pay cap, both of which are the upper salary limit upon

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which retirement benefits can be based. The two have diverged since 2011 because the Tier 2 pay cap increases at a slower rate than the SSWB. Both of these figures were \$106,800 in 2011, but as of 2023 the SSWB is \$160,200, while the Tier 2 pay cap is only \$123,489.

If the State were to simply change the Tier 2 pay cap to match the Social Security Wage Base, pension plans across the State would no longer be at risk of falling out of compliance with Safe Harbor. This was the approach taken by legislation you co-sponsored during the spring 2023 legislative session impacting Cook County pensions, House Bill 2352.

However, legislation introduced earlier this year in Senate Bills 1629 and 1630 that you also co-sponsored, were also billed as a Safe Harbor "fix," but would far overshoot what is required for Safe Harbor compliance. These bills would have substantially increased benefits for all Tier 2 Chicago firefighters by changing final average pay calculations and increasing the Tier 2 cost of living adjustment. As you know, the City of Chicago estimated that these enhancements would have increased pension obligations by \$3.3 billion through 2055.

The Civic Federation opposed these bills. Increasing benefits for all Tier 2 employees in this manner is far more expensive than the simple compliance fix of setting the Tier 2 pay cap equal to the Social Security Wage Base. Additionally, one-off changes implemented to individual pension plans, rather than through a statewide, comprehensive solution, is inefficient and likely to be more expensive than taking the time to find and implement a comprehensive change, as the Civic Federation recommends.

As you know, once pension benefits are provided, they become protected under the Illinois Constitution and cannot be reduced later. **Reinstating pension benefits without analysis showing they are sufficient to address potential issues with Tier 2 could substantially reverse much of the work the State has done to reduce massive pension liability costs.** The State cannot afford to take a step backward by unnecessarily increasing Tier 2 pension benefits. **The Civic Federation calls on the Illinois General Assembly to conduct a comprehensive, statewide evaluation to determine when Tier 2 benefits will violate Safe Harbor rules, then institute only the changes necessary to ensure that pension plans in Illinois meet Safe Harbor rules.**

Thank you for your attention to our concerns. Please do not hesitate to contact me with any questions at (312) 201-9066 or at swetmore@civicrofed.org.

Sincerely,



Sarah J. Wetmore
Acting President
Civic Federation