Governor Pritzker Goes on Record: Tier 2 and Statutory Minimum Contribution Changes Inbound?

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In 2010, Illinois passed the Tier 2 changes to Illinois pension plans which eliminated 3% annual compounded living adjustments for retirees, raised the age for full benefits from 62 to 67, and increased the vesting timeline to 10 years. The change followed concern about the health of Illinois pension plans after a history of questions about Illinois' underfunded pension liabilities. But now there are concerns that the Tier 2 benefits do not at least match Social Security benefits, meaning they violate federal "Safe Harbor" provisions.

As the pressure mounts to change and maybe even eliminate Tier 2, Illinois Governor J.B. Pritzker went on record signaling the desire to make potential changes to Tier 2. In April 2024, Governor Pritzker noted that there was an "obvious" need to make changes to Tier 2 to make sure the state was meeting the Social Security Safe Harbor rules. The Governor did not offer what precise changes would be made or the financial logistics involved, but he asserted that state leaders need to avoid "pension sweeteners" in any fix to Tier 2. Therefore, Tier 2 modifications may be on the horizon.

The Social Security "Safe Harbor"

In Illinois, public employees do not pay into Social Security because the benefits they receive from their publicly funded pension provide certain minimum benefits that meet or exceed Social Security benefits. The "Safe Harbor" test looks at three key plan features: (1) the compensation multiplier; (2) the number of years used to determine final average compensation; and (3) the definition of compensation. If the plan design itself does not meet the "Safe Harbor" provisions, the benefit for each employee is reviewed to determine compliance.

There is a split of opinions on whether Illinois' Tier 2 benefits meet the Safe Harbor. Some contend that Tier 2 meets that standard. Others assert that Tier 2 might become problematic because of the definition of compensation for Tier 2 which includes a pay cap. The Tier 2 pay cap for statewide pensions grows at a rate of one-half of the CPI or 3%, whichever is less while the Social Security wage base grows at CPI – meaning the Social Security wage base grows at a faster rate than Tier 2 benefits. Eventually the wage base for Social Security will surpass the pay cap in effect for Tier 2 beneficiaries if left unchanged. Once the pension plan no longer qualifies under the Safe Harbor analysis, it means that a public employee's wages are mandatorily covered by Social Security and subject to withholding – a situation that could prove to be costly.

Article 3 and 4 pension funds, however, may not need the same changes to Tier 2 as other statewide pension funds because the pay cap language was changed to be the lesser of 3% or the CPI in the legislation that created the consolidated investment funds. However, the pushes to eliminate Tier 2 or make more substantial changes would impact Article 3 and 4 pension funds. Without any specific proposals from the Illinois legislature or an indication from Governor Pritzker about what the "obvious" changes will be, many questions about the fate of Tier 2 remain.

It is unclear what side the General Assembly may take in this debate. If it accepts that Tier 2 runs afoul of the Safe Harbor test, then it may well seek to enhance Tier 2 benefits.

Statutory Minimum Contribution Amendments?

In addition, the Pension Code's statutory minimum actuarial valuation calculation may be amended. In addition to addressing Tier 2, Governor Pritzker supported a plan to extend the pension funding target date that was originally set by legislation passed in 1995. While the Illinois Municipal League ("IML") introduced legislation aimed at requiring funds to be 90% funded by the end of the municipal fiscal year in 2050 this year (a change from 2040 for Article 3 and 4 pension funds), Governor Pritzker proposed a plan to fully fund Illinois state pension plans by 2048 (state plans have

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a 90% funding target by 2045 currently). Governor Pritzker's proposal put a damper on the IML plan because it proposed a much more aggressive target and indicated a move to full funding by a date certain versus the original 90% funding target – a substantial change that would likely impact the calculation of minimum contributions. The IML bill, which had some traction, was eventually re-referred to the Rules Committee and did not pass by the end of the 2024 regular legislative session.

Looking ahead, there will certainly be proposals to adjust Tier 2 and the funding target dates soon, but the specifics are still lacking. These changes may be addressed during the legislative veto session in November. Accordingly, we recommend pension fund trustees and stakeholders watch the General Assembly's movements closely when it reconvenes. ■

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