Teachers' Retirement System - http://trs.illinois.gov/subsections/press/TRSIssuesUpdate.htm

TRS Issues Update

In recent months, while reporting on the financial problems faced by Illinois and other states, several news organizations, including the *New York Times* and Fox News, have focused attention on public pension systems throughout the country as one reason why states are facing multi-million-dollar revenue shortages.

The common thread in these stories is that public pensions are too generous, are mismanaged, make too many risky investments and force states like Illinois to spend billions of dollars every year on retirees instead of states services, and that increases the potential for budget deficits and higher taxes.

TRS has not been immune to these complaints, but in most cases the criticisms have been outright falsehoods. TRS can refute the inaccuracies that have been leveled in the media against the System in the following explanations.

Sale of TRS Assets

Claim: The *Chicago Tribune*, the *Daily Herald* in suburban Chicago and *Pensions & Investments* magazine are reporting that TRS could sell as much as $3 billion in assets in order to fulfill pension obligations. The story also has aired on WBBM-AM in Chicago, a main news-talk radio station.

Truth: TRS is selling assets in order to meet its obligations to retired teachers and benefit recipients. But the sale of assets is not an immediate concern for retired teachers and is not an indication that the System is going bankrupt. Retired teachers will continue to get their checks and the checks will be good.

TRS has $33 billion in assets, so selling $3 billion is about 10 percent of all TRS assets. And during fiscal year 2010 which ended in June, preliminary reports indicate that the TRS portfolio generated more than $4 billion in investment income. TRS expects to pay out $4.1 billion in pensions and benefits during fiscal year 2011, so there is enough money on hand to cover all obligations.

TRS is selling assets only because the state does not have the money on hand to make its annual, required contribution to TRS and five other state pension systems. The Comptroller's Office is authorized to contribute $2.35 billion to TRS during fiscal year 2011, but because of the state's budget problems, the Comptroller doesn't have the money to make its normal monthly payment to the System.

For every month that we do not receive the state payment, TRS plans to sell approximately $250 million per month, for a potential total of $3 billion for the entire fiscal year. If the state borrows money to make the contribution, TRS will have no need to sell any more assets.

A bill authorizing the sale of bonds to make this year's pension contribution is pending in the General Assembly. It was approved by the House this spring but is stalled in the Senate. The earliest action could be taken on the bill is in November after the general election.

In selling assets, TRS is repeating steps that were taken last year when the state initially did not have the money to pay TRS and the other retirement systems. Last year TRS sold $1.3 billion in assets until the state sold bonds to pay the pension systems.

TRS is not alone in selling assets. The State Universities Retirement System could sell $1.2 billion and the State Board of Investment could sell $960 million because the state has yet to make its contribution.

"Risky" Investments

Claim: A Northwestern University study from March, 2010 concludes TRS has the "fourth riskiest" pension system in the country, with 81.5 percent of investments classified as "risky."

Truth: The "study" is misleading. It merely totals the assets that TRS and 24 other pension systems have that are not held in cash or invested in fixed income securities, and labels these investments as "risky." No valuation is assigned to any of the thousands of individual investments held by TRS, so the study does not rank how risky the TRS portfolio is compared to any other system. TRS is required to maximize the resources available for retired teachers. All investments carry some element of risk. Without its investment portfolio, TRS could not keep pace with the resources needed for pension and benefit checks. Forty-nine percent of a TRS pension check comes from investment income. Check out the "study" at www.npr.org/templates/story/story.php?storyId=125059110.

"Mismanagement"

Claim: TRS is endangering teacher pensions by seeking to make a fast buck through "risky" trades in derivatives – attempting to recoup $4.4 billion in investments that were lost during fiscal year 2009.

Truth: TRS did lose $4.4 billion during 2008-2009, but almost every investor lost money. The losses stemmed from a worldwide economic downturn in stocks, bonds and real estate, not because of mismanagement or trading in derivatives. This year TRS has not made any substantial changes in its investment philosophy, and the overall $33.7 billion portfolio is on track for a positive rate of return that exceeds 19 percent. The target rate of return for TRS is 8.5 percent.

Derivatives

Claim: TRS is needlessly risking members' assets in the last year on derivative investments in order to make a lot of money quickly. The media point a negative finger at TRS for trading in derivatives because many financial commentators blame derivative trading for sparking the 2008-2009 economic downturn.

Truth: TRS has been successfully trading in derivatives since 1986 without harming pensions. In the last year, TRS saw those derivative investments return $173 million. That is not a lot in a $33 billion portfolio and certainly not enough to cover the $4.4 billion losses of the previous year. In reality, for institutional investors like TRS, derivatives serve another purpose. They are never used to make quick profits, but to reduce risk in a large portfolio and to make some investments available at a lower cost. Despite the negative image, all large pension funds and institutional investors trade in derivatives. Derivatives comprise the largest investment market in the world, valued at $650 trillion. Derivatives are investment contracts whose value is based on the performance of a bundled group of financial assets, almost like a mutual fund. At TRS, a derivative investment is only made in conjunction with an investment in an asset that is included in the derivative package. The value of a particular investment, on its own, may vary over a period of time. But coupled with other investments, the average value of the package does not vary as wildly because the combined investments buffer each other – as one falls, another rises.

Underfunding

Claim: TRS, like many other pension systems throughout the United States, is "underfunded" over the long term and does not have sufficient resources to meet all its obligations to retired teachers in the future.

Truth: Unfortunately, TRS is underfunded in the long term. During the last fiscal year, the System's unfunded liability, as measured under state law, stood at $35 billion, leaving a funded ratio of 52 percent. In other words, if all obligations were called due today, the System could not meet 48 percent of the outstanding pensions and benefits. That won't happen because not all teachers will retire at once. This underfunding problem is several decades old, and has been caused primarily by state elected officials not contributing enough money to the System to meet its projected long-term needs. Evidence exists that an unfunded liability problem existed as far back as the 1950s.

Teacher Pensions are too "Generous"

Claim: The guaranteed benefits of retired teachers and other government workers are too high and are out of synch with retirement benefits found in the private sector. The rising costs of maintaining these pensions should be scaled back in order to avoid tax increases and cuts in other public services.

Truth: The average annual retirement benefit for an Illinois teacher is a little more than $43,000. When you consider that Illinois educators do not qualify for Social Security during their teaching years, this benefit cannot qualify as "too generous." Not only are these benefits the sole monetary lifeline for retired teachers, but they stimulate the economy: The pensions and benefits paid annually to retired teachers living in Illinois create more than $4 billion in economic activity, including more than 30,000 full-time jobs that mean $2.3 billion in wages for non-teachers.

Reduce Pension Benefits for Current TRS Members

Claim: Because of Illinois' financial trouble, benefits to existing teachers and government employees should not be guaranteed, but lowered to save the state billions of dollars every year. One argument is that pension credits for existing teachers should be left intact for service they have performed but reduced for future service they have not yet performed.

Truth: Pension benefits for existing teachers and government employees are guaranteed by Article XIII, Paragraph 5 of the Illinois Constitution and cannot be "diminished" in any way. Since 1972, at least seven court cases have affirmed the meaning of this clause. It is highly unlikely that the General Assembly will challenge this well-established legal precedent. There is no language in the Constitution that remotely comes close to allowing pension benefits to be changed prospectively for service that has not yet been performed.

Pension Guarantee

Claim: The Civic Committee of the Commercial Club of Chicago has said that pensions due to

Illinois teachers and public employees are not guaranteed by the state; implying that if a state pension system goes broke, retirees have no recourse to collect the money owed them. It cites the Illinois Pension Code - 40 Illinois Compiled Statutes 5/22-403 - as saying that "any pension payable under any law herein before referred to shall not be construed to be a legal obligation or debt of the State..."

Truth: For TRS members, their pensions are guaranteed by the State of Illinois. The Civic Committee does not quote the entire law when referencing the Illinois Pension Code and leaves out an important phrase - "...unless otherwise specifically provided in the law creating such fund." In other words, language in another state law creating a pension fund can override this section of the Illinois Pension Code.

For Illinois teachers, the section of the Pension Code cited by the Commercial Club is overridden by 40 ILCS 5/16-158(c), a part of the law that created TRS. This section specifically states, "Payment of the required State contributions and of all pensions, retirement annuities, death benefits, refunds, and other benefits granted under or assumed by this System, and all expenses in connection with the administration and operation thereof, are obligations of the State."

In addition, Article XIII Section 5 of the Illinois Constitution says protects "membership" in any state pension system as an "enforceable contractual relationship."