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Illinois' other debt disaster: $73 billion in unfunded state retiree health insurance benefits

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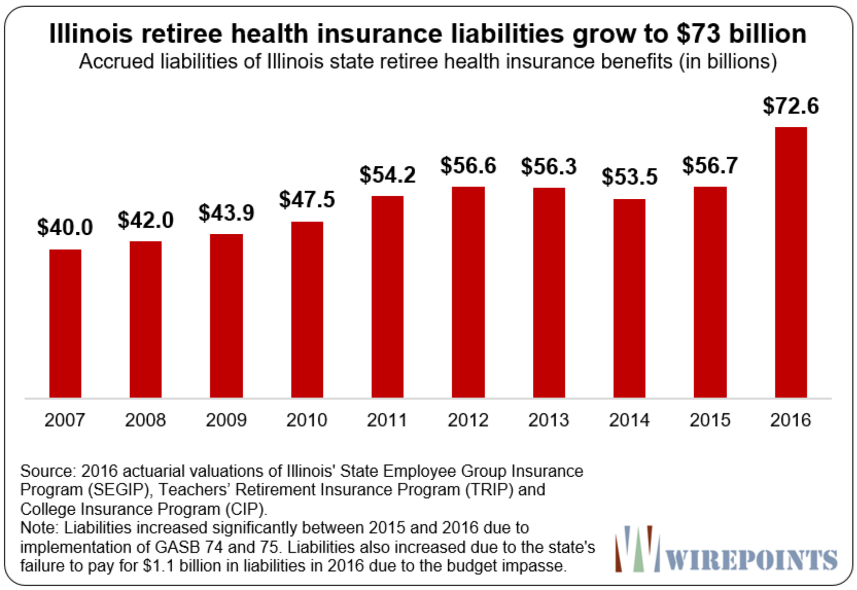
Introduction

Pensions get all the attention when it comes to Illinois' collapsing finances. But there's another government-worker benefit also wreaking fiscal havoc – free and heavily-subsidized retiree health insurance for state workers.

Illinois has promised $166 billion in retiree health insurance benefits to public-sector workers over the next 38 years. Actuaries say the state should have $73 billion invested today so it can safely make those payments in the future. The problem is, the state hasn't set aside anything at all.

That $73 billion hole is yet another financial time-bomb – one that's been totally ignored thus far by Illinois' lawmakers, civic leaders and the media. Unfunded healthcare promises have grown 80 percent in the past decade and are now compounding Illinois' state and local pension crises.

Illinois courts have ruled that public employee health obligations, like pension benefits, [cannot be impaired](). Unlike pensions, however, nothing is set aside and invested to cover that future expense. The liability is entirely unfunded, which is called a "pay-go" system. Instead of setting aside money for future costs, the state simply pays retiree healthcare costs as they are incurred. Growing future costs are left to future budgets.



Expect those annual payments for retiree health benefits to further squeeze Illinois' budgets as the bills come due. Payments by the state – meaning taxpayers – will rise from $1 billion today to nearly $6 billion in the future to meet the state's yearly retiree health insurance obligations.

Officially, retiree health and pension costs are already set to consume more than a quarter of the state budget over the next 30 years. But the state's official numbers grossly underestimate Illinois' true retirement costs. If the real cost of pensions and retiree health insurance were properly measured and paid for, they would consume an [untenable 50 percent]() of the state's annual budget.

That fact shows that without massive reforms, retirement costs are going to damage Illinois beyond repair. The state has no choice but to dramatically reduce its unfunded obligations.

Illinois' "other" retirement debt

Illinois provides 567,000 public sector workers and retirees with subsidized retiree health insurance benefits.

Beneficiaries include state employees and retirees (including state workers, public university employees, judges, and lawmakers), who participate in the State Employee Group Insurance Program (SEGIP); teachers in the Teachers' Retirement Insurance Program (TRIP); and community college employees in the College Insurance Program (CIP).

Over 560,000 Illinois state workers get free or subsidized retiree health insurance

Membership counts of Illinois' state retiree health insurance programs

	SEGIP	TRIP	CIP	Total
Active workers	108,291	154,176	20,319	282,786
Inactives and retirees	157,808	114,276	12,538	284,622
Total	**266,099**	**268,452**	**32,857**	**567,408**

Source: Source: 2016 actuarial valuations of Illinois' State Employee Group Insurance Program (SEGIP), Teachers' Retirement Insurance Program (TRIP) and College Insurance Program (CIP).

SEGIP provides the most lucrative health insurance benefits of the three systems. SEGIP members with 20-plus years of service receive free health insurance during retirement. (The system current provides state workers with a 5 percent discount on their retiree health insurance for every year of work, maxing out at 100 percent for 20 years of work. Retirees who retired before 1998 earned free health insurance after just 8 years of service – the minimum vesting requirement.)

According to a 2011 study by Mercer on behalf of the Commission on Government Forecasting and Accountability (COGFA), most SEGIP members end up receiving free insurance: "Roughly three fourths of current retirees have at least twenty years of service and, therefore, do not have to pay contributions."

Free retiree health insurance for state workers costs Illinois taxpayers $200,000 to $500,000 per retiree

SEGIP Actuarial Valuation Sample Life Costs, June 30, 2013

Value of retiree healthcare benefit depending on member age and pension benefit tier					
Regular pension formula			Alternate pension formula		
Pension Tier	Current age	**Cash value of benefit**	Pension Tier	Current age	**Cash value of benefit**
1	35	$339,624	1	35	$492,113
1	40	$333,356	1	40	$482,102
1	45	$315,686	1	45	$462,029
1	50	$283,267	1	50	$412,488
1	55	$269,963	1	55	$313,993
2	28	$248,372	2	28	$251,524
2	40	$223,096	2	40	$212,628

Source: Data obtained from a 2016 FOIA request to the Governor's Office.
Note: A worker in the private sector would need the "present value" amounts available at retirement to purchase the equivalent amount of health insurance provided to retired Illinois state workers.

Wirepoints also analyzed the 2018 state employee pension database and found that 73 percent of State Employee Retirement System (SERS) members have worked the requisite years to get free retiree health insurance.

The present value of that benefit for career workers is worth $200,000 to $500,000 per retiree, depending on the pension tier and age of the employee, according to a 2016 FOIA obtained from the Governor's office.

(Retiree health insurance benefits contribute to the $110,000 average annual compensation packages received by state AFSCME workers. For details, see: Six facts Pritzker can't ignore when negotiating AFSCME's contract.)

Free retiree health insurance provided entirely at the employer's expense is a benefit that's rare in the public sector and almost unheard of in the private sector.

The Mercer study found that, on average, state county and city governments across the nation who offer retiree insurance benefits only pay about half of their employee's premiums during retirement.

Mercer also found that most small- and medium-sized employers in the private sector do not offer retiree health benefits. And the 25 percent of large employers (500-plus employees) who do offer retiree health insurance benefits only pay half the cost of insurance, on average.

On average, employers in both public and private sectors who offer retiree health benefits only subsidize half of employee insurance premiums during retirement

2010 Mercer Survey – Average participant contributions* for retiree healthcare

Retiree status	States	Counties	Cities	Private sector (500+ employees)
Pre-Medicare	54%	49%	53%	54%
Medicare eligible	54%	49%	59%	52%

Source: COGFA, Mercer Report – Retiree Healthcare Contributions May 2011
*As a percentage of premiums (does not include out-of-pocket costs; e.g., deductibles and copays).

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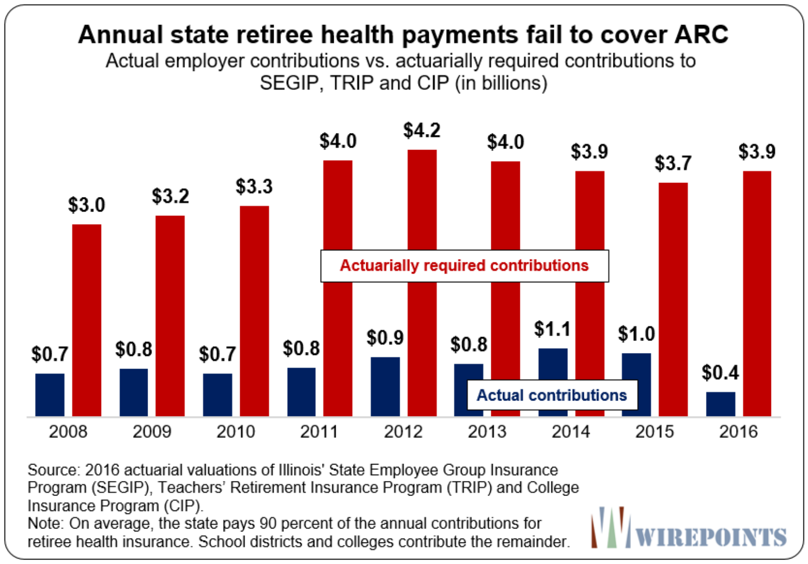
Members of TRIP and CIP get different, less generous benefit packages, but still receive insurance subsidies worth 50 to 75 percent of their premium costs – subsidies paid for by taxpayers.

A growing budget problem

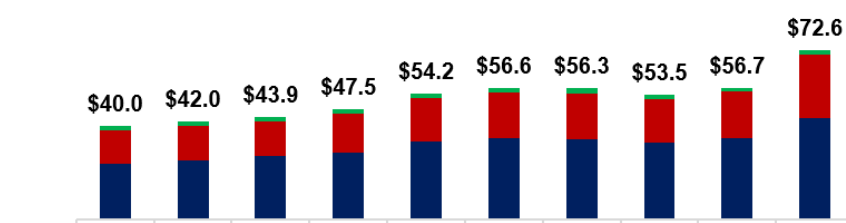
Illinois operates on a pay-go basis for retiree health insurance, meaning it falls far short of paying the actuarially required contribution, or ARC, for health benefits. The ARC is the amount actuaries say the state should pay to cover both current year costs and some of the unfunded liability.

For example, in 2008 the state funding shortfall already totaled $42 billion. But instead of paying the ARC of $3 billion, Illinois contributed just $700 million – the amount needed to pay only that year's benefits.

That same underpayment has continued since then. The state has consistently underfunded its ARCs, leading to an average payment shortfall of about $3 billion a year.



Those yearly shortfalls, along with recent changes in accounting, have pushed up Illinois' retiree health insurance debt to $73 billion.

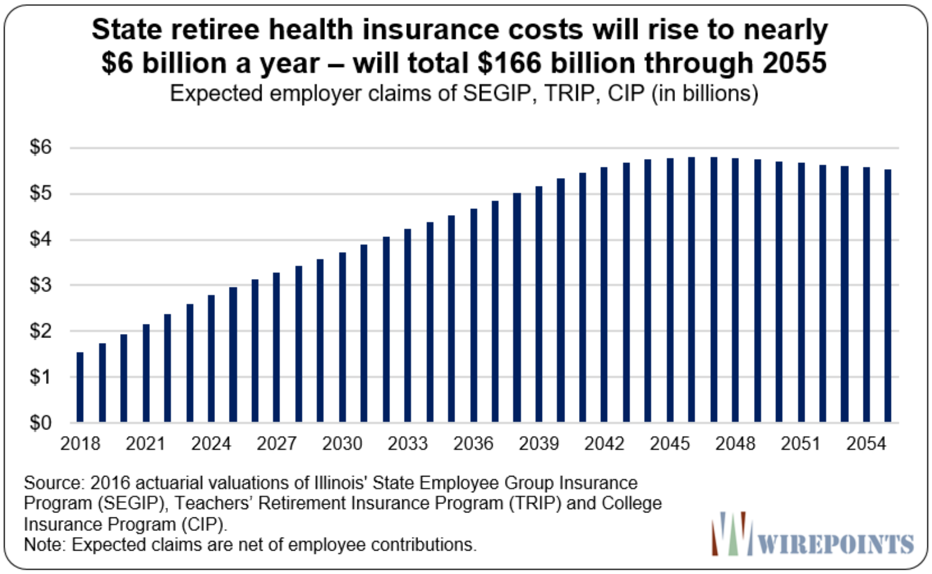


	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
CIP	$2	$2	$2	$2	$2	$2	$2	$2	$2	$2
TRIP	$14	$15	$15	$17	$19	$19	$19	$19	$20	$27
SEGIP	$24	$26	$27	$29	$33	$35	$34	$33	$35	$43
Total	$40	$42	$44	$47	$54	$57	$56	$53	$57	$73

Source: 2016 actuarial valuations of Illinois' State Employee Group Insurance Program (SEGIP), Teachers' Retirement Insurance Program (TRIP) and College Insurance Program (CIP).
Note: Liabilities increased significantly between 2015 and 2016 due to state implementation of GASB 74 and 75. Liabilities also increased due to the state's failure to pay for $1.1 billion in liabilities in 2016 due to the budget impasse.

The rising shortfall matters since the annual pay-go cost of retiree healthcare is growing rapidly. By 2025, the pay-go amount will total $3 billion a year. By 2032 it will exceed $4 billion.

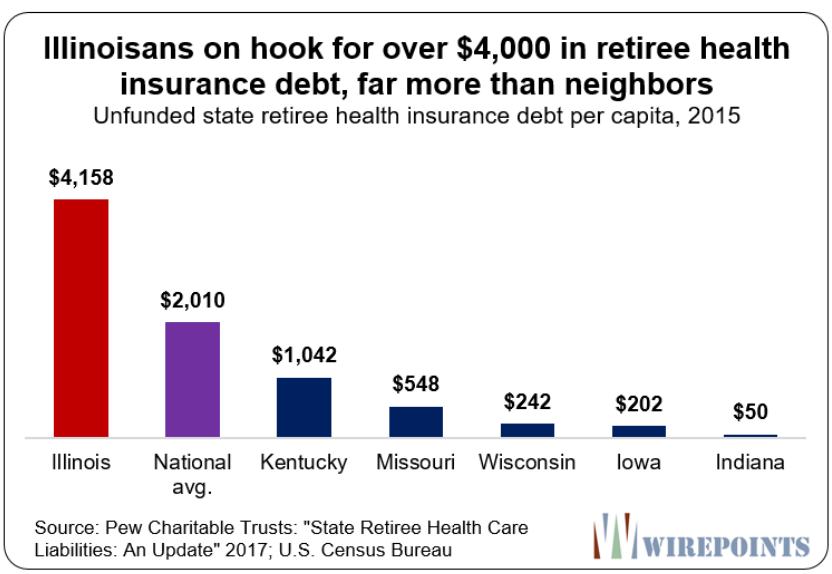
In total, the pay-go amounts will grow by 5 percent annually through 2045. The state has nothing set aside to take any of that additional pressure off of the budget.



Illinois is not alone in treating retiree healthcare as a pay-as-you-go cost. Fifteen states have absolutely nothing set aside to pay retiree healthcare. And over two dozen more have less than a quarter percent of the money they need set aside, according to data collected by the Pew Charitable Trusts.

But the extent of underfunding is extreme in Illinois. That's particularly true when comparing the unfunded retiree health care debt per capita in Illinois versus our neighboring states.

As of 2015, each Illinoisan was on the hook for more than $4,100 in total unfunded retiree health benefits, the 6th-most in the nation. That amount is double the national average and quadruple what Kentuckians owe. And it's many, many times more than what residents in states like Wisconsin and Indiana are burdened with. It's another debt that makes Illinois noncompetitive vis-a-vis its neighbors.



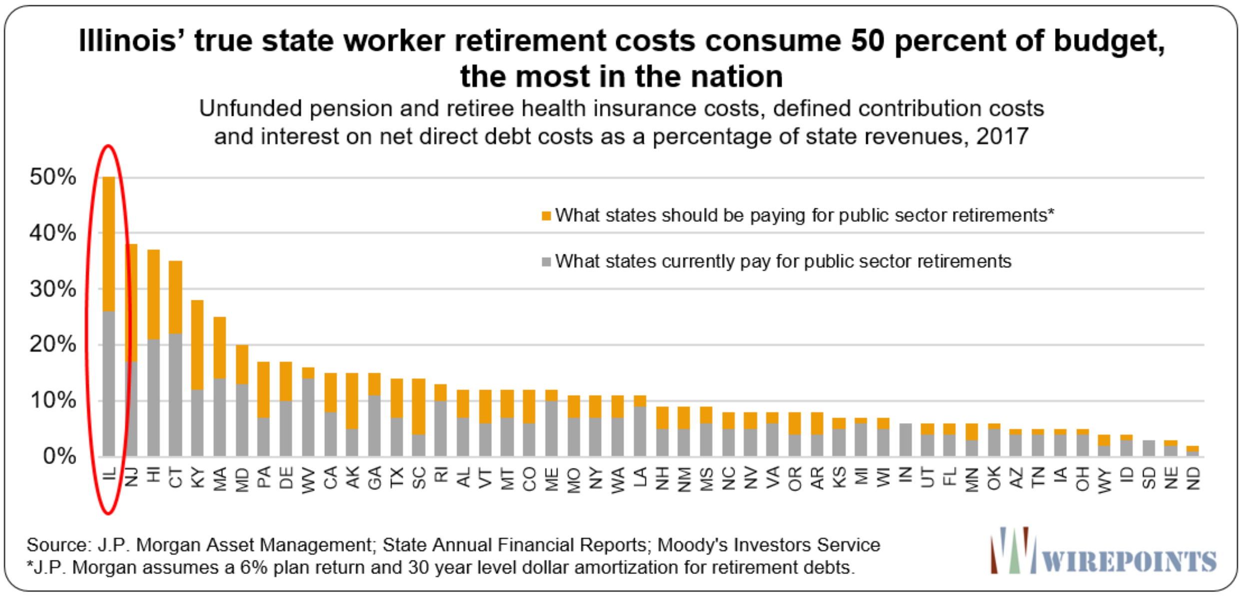
But that's based on older numbers. As of 2016, Illinoisans are burdened with $5,700 each in state retiree health insurance debts. (Liabilities increased significantly between 2015 and 2016 due to state implementation of GASB 74 and 75. Liabilities also increased due to the state's failure to pay for $1.1 billion in liabilities in 2016 due to the budget impasse.)

The total cost of state retirements

When you add up what Illinois owes in pension and retiree health debt – valued under more realistic assumptions – it becomes crystal clear that Illinois' situation is far more dire than currently reported by the state, the media or rating agencies.

J.P. Morgan recently looked at the amount states should be paying toward pensions and retiree health care to be actuarially sound – as opposed to what states currently pay. They found Illinois to be the outlier nationally, with more than 50 percent of its budget needed to reach an actuarially sound position.

By comparison, 37 states need only 15 percent or less of their budgets to be considered sound.



J.P. Morgan's assessment is another profound indicator of just how bankrupt Illinois has become. It's untenable.

And that analysis doesn't even include Chicago's $71 billion in pension shortfalls (Moody's estimates), as well as tens of billions more in other local government retirement debts.

This mess is the result of handing out unaffordable benefits at all levels of government for decades. The state alone has allowed total pension benefits to grow over 1,000 percent over the last 30 years – a pace far faster than taxpayers could ever afford.

Layer on top of that free and heavily subsidized health insurance benefits and it's no wonder Illinois faces one of the most extreme crises of any state in the nation.

Barring massive reforms that reduce those liabilities, expect everyone in Illinois to lose.