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ISSUE BRIEF

Who Would Benefit and By How Much from Proposed Changes to Illinois Tier 2?

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KEY FINDINGS

- Increasing the pensionable pay cap to the Social Security Wage Base would increase the average annual Tier 2 pension for full career public workers in Illinois by 7% to 17%; the largest increases would go to the select few public sector workers who make large, six figure salaries.
- Average public workers in Illinois are not expected to earn salaries above the pensionable pay cap until they have at least 20 to 25 years of service; only between 22% and 47% of new hires are expected work more than two decades, and a majority are expected leave within 10 years.
- Reducing the final average salary period from 8 years to 4 years would improve benefit values for virtually all public sector workers in Tier 2, increasing the average annuity by around 4.4%. The cost of making this improvement is projected to be 82% less than raising the pensionable pay cap.
- Lowering the retirement eligibility age would mean workers could collect checks earlier, but at substantially lower amounts because they would be working fewer total years.

OVERVIEW

In November 2024, a group of Illinois legislators introduced House Bill 5909 (HB5909) to make several substantive changes to the Tier 2 benefits provided by various Illinois state and municipal retirement systems: (1) increase the pensionable pay cap to the Social Security Wage Base (SSWB); (2) reduce the final average salary period from eight years to four; (3) improve the cost-of-living adjustment; and (4) reduce retirement eligibility criteria, such as lowering the normal age from 67 to 60.

While the bill wasn't adopted, the proposed concepts in the bill are not going away as general concerns about the value of Tier 2 benefits is on-going. Anticipating this, the Illinois legislature commissioned a cost estimate on HB5909, which found the combined changes would cost at least $30 billion.

Cost is an important consideration of any change in public retirement benefits. It is also crucial to consider how benefit provision changes would influence outcomes. Specifically, how would the proposed changes under HB5909 affect the size of the benefit that Tier 2 retirees might otherwise earn?

Equable analyzed the proposed changes using benefit forecasting models built into the Retirement Security Report (RSR).[1] We considered how each provision would change expected annuity values and the net present value of benefits. This analysis provides some insight on which of the proposed changes has the highest value leverage (e.g., the best "bang for the buck") and shows the relative scale of any improvement in benefits.

EFFECTS OF PROPOSED TIER 2 CHANGES ON EXPECTED PENSION BENEFITS FOR FULL CAREER WORKERS

Defined benefit pension plans generally are designed to have the majority of benefits earned toward the end of a workers' career. Most public employees don't work a full career, but those who do often experience the largest effects of benefit design changes.

The table below shows the estimated annuity (e.g., annual pension payment) that an average member of Tier 2 would be expected to earn from various Illinois pension plans.[2] The table also shows how that annuity would change if various proposed changes in HB5909 were adopted.

Members of some retirement systems are more likely to earn salaries above the pensionable pay cap than others, depending on their profession or location. As a result, increasing that cap to the Social Security Wage Base increases the average annuity by a larger percentage for some retirement systems than others.

The expected Tier 2 annuity declines for most systems based on lowering the normal retirement age because the average worker would now leave at age 60 instead of age 67—meaning they could draw checks earlier, but wouldn't accumulate the larger annual benefit from those seven additional years of service.

CHANGE IN EXPECTED AVERAGE ANNUITY FOR FULL CAREER WORKERS WHO ARE MEMBERS OF TIER 2 IF THE POLICY PROPOSALS IN HB5909 ARE ADOPTED

		ILLINOIS TEACHERS (TRS)	ILLINOIS STATE (SERS) GENERAL	SERS PUBLIC SAFETY (W/ OUT SS)	SERS PUBLIC SAFETY (WITH SS)	CHICAGO TEACHERS (TPF)	CHICAGO MUNICIPAL (MEABF)*
Tier 2 Baseline	Expected Average Annuity	$73,056	$69,390	$64,518	$54,539	$76,401	$70,044
#1 Increase Salary Cap to SSWB	Est. Annuity % Change	$78,336 7.2%	$80,995 16.7%	$69,248 7.3%	$58,537 7.3%	$84,887 11.1%	$70,044 0.0%
#2 Revised Final Average Salary	Est. Annuity % Change	$76,305 4.4%	$72,476 4.4%	$67,387 4.4%	$56,964 4.4%	$79,799 4.4%	$74,856 6.9%
#3 COLA Enhancement	Est. Annuity % Change	$74,575 2.1%	$70,810 2.0%	$66,008 2.3%	$55,799 2.3%	$78,026 2.1%	$71,565 2.2%
#4 Lower Normal Retirement Age	Est. Annuity % Change	$61,328 -16.1%	$50,541 -27.2%	$64,518 0.0%	$54,539 0.0%	$66,970 -12.3%	$60,545 -13.6%
Four Combined Policy Changes	Est. Annuity % Change	$67,558 -7.5%	$59,457 -14.3%	$64,518 17.6%	$64,149 17.6%	$77,638 1.6%	$66,236 -5.4%

*The MEABF tier of benefits measured here is formally their "Tier 3" which provided slight modifications to Tier 2 based on a 2017 law.
Source: Calculations based on benefit model using provisions as published by each plan in their most recent actuarial valuation; policy change provisions as described by Segal in their January 8, 2025 memo. The figures above are based on a prospective member of Tier 2 under the status quo benefit provisions (a baseline) and under proposed changes (various scenarios). Like other Retirement Security Report benefit models, we assume a 25-year-old entrant earning average starting pay for members of each given retirement plan, whose salary will grow using the assumptions adopted by that retirement plans' trustees. For more methodological details on our approach, see RSR materials here.

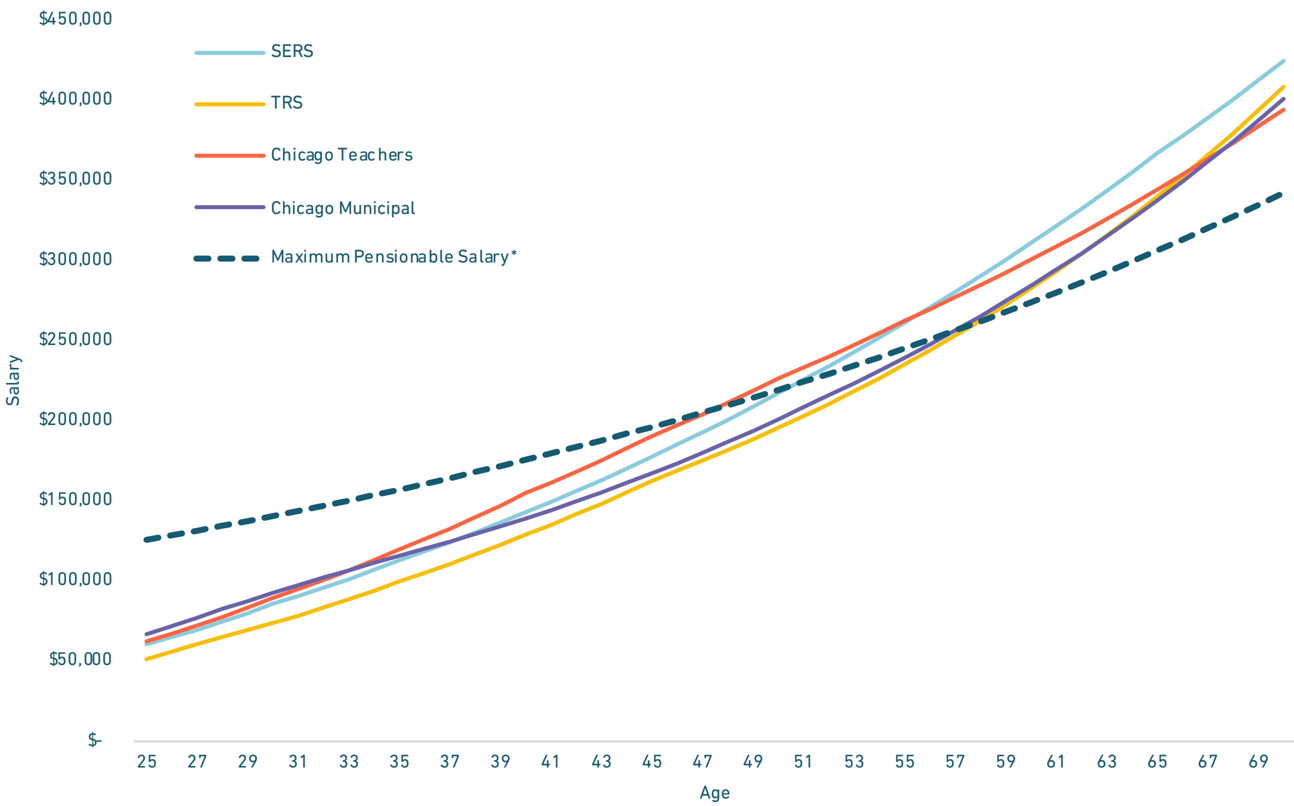
FULL CAREER WORKERS WOULD BENEFIT MORE THAN OTHER PUBLIC EMPLOYEES FROM THE PROPOSED TIER 2 CHANGES

The majority of the proposed changes to Tier 2 in HB5909 would affect workers who serve a full career, as opposed to short-term and medium-term public employees. Consider the following:

- None of the proposed changes affect the 10 year vesting requirement for Tier 2 benefits. Anyone who works less than 10 years wouldn't see an improvement in their benefits.
- The change in final average salary rules would benefit everyone who vests, but the scope of using four years instead of eight years would build over time and primarily affect those with 20 or more years of service compared to those with 10 to 20 years.
- The cost-of-living adjustment improvement becomes more valuable the larger a benefit someone has earned.
- The normal retirement age is more likely to benefit those who work a full career or who are hired later in their careers.

Most public workers are not expected to earn salaries above the pensionable pay cap until they have at least 20 to 25 years of service. This is shown in Figure 1 below, which uses each retirement systems' salary growth assumptions and inflation assumptions to compare how an average new employee's salary would grow over time compared to the pensionable pay cap.[3] Put another way, a 25-year-old hired tomorrow making an average starting salary that grows at the rates assumed by each retirement system wouldn't hit the projected pensionable pay cap until age 48 or later.

FIGURE 1 | PROJECTED SALARY FOR A NEW HIRE EARNING AN AVERAGE STARTING SALARY, COMPARED TO PROJECTED GROWTH IN THE PENSIONABLE PAY CAP, BY RETIREMENT SYSTEM



* Note: Municipal Employees' Annuity and Benefit Fund (Chicago Municipal) uses a higher inflation assumption (2.5%) relative to the other plans (2.25%). As a result, the maximum pensionable salary for MEABF is not hit until age 66, but normal retirement age is at 65.

COMPARING THE ESTIMATED COSTS OF TIER 2 CHANGES TO THE SCOPE OF IMPROVEMENT IN BENEFITS FOR PARTICIPANTS

The benefit provisions of Illinois Tier 2 generally provide a reasonable benefit for full career workers (e.g., an up to 75% income replacement), but also provide among the poorest benefits for short- and medium-term workers compared to peer retirement plans.[4] The costs of making changes to Tier 2 could be significant, which means any improvements should be studied carefully for how they would affect state and local budgets. But irrespective of any consideration about Social Security's safe harbor provisions or contentions about recruiting, there are retirement security reasons to consider improving Tier 2 benefit provisions — at least for those working less than 20 years.

If there is political will to improve Tier 2 benefits in some way it is worth considering the scope of individuals who may benefit from the dollars that the legislature makes available.

- Tier 2 works best for Full-Career Workers — individuals who work the multiple decades necessary to reach the normal retirement age would be able to earn a partially-inflation adjusted pension that replaces 75% of their pre-retirement income. There are better benefits nationally, but on its own this is at least at the minimum level of income necessary to provide a secure retirement.

- By contrast, the majority of workers with 20 years or less experience accumulate very little value from their participation in Tier 2. This is principally because of the 10 year vesting period and the restriction on drawing an unreduced pension check until age 67.[5]

Reducing the final average salary period would help more people than the pensionable pay cap (see analysis on the previous page and the table below on the right), but would cost 82% less (see table below on the left).

SEGAL COST ESTIMATES FOR LEGISLATURE

PROPOSED CHANGES	COSTS TO ADOPT CHANGE FOR TRS, SERS AND SURS
#1 Increase Salary Cap to SSWB	$6.18 Billion
#2 Revised Final Average Salary	$1.12 Billion
#3 COLA Enhancement	$4.4 Billion
#4 Lower Normal Retirement Age	$11.3 Billion
Four Combined Policy Changes	$29.8 Billion

HOW LONG EACH RETIREMENT SYSTEM EXPECTS NEW HIRES TO REMAIN WORKING

	10 YEARS OR LESS	20 YEARS OR LESS	WORK FULL CAREER TO NORMAL RETIREMENT
Illinois Teachers (TRS)	42.5%	9.9%	47.6%
Illinois State (SERS) General	60.5%	8.5%	31.0%
SERS Public Safety	43.6%	8.6%	47.8%
Chicago Teachers (TPF)	70.9%	7.3%	22.1%
Chicago Municipal (MEABF)	62%	12.5%	25.5%

DISCLAIMER

It is not our intent to advocate for or against any of these proposed changes. There are trade-offs associated with the costs of these changes and the way they might improve benefits for workers. Given a perspective from the labor point of view or the state budget point of view, each of these changes may be more or less compelling.

NOTES & CITATIONS

[1] The Retirement Security Report is an interactive tool created by Equable Institute that determines whether public sector retirement plans are providing a path to retirement income security.

[2] Technical Note: The “expected annuity” reflects the nominal dollar value of benefits that would be earned if a worker stayed until normal retirement eligibility and then lived their full life expectancy. Because the initial payment earned will be lower than the last payment made based on cost-of-living adjustments, the figure we report is the average annuity payment during an average worker’s retirement period (generally expected to be age 67 to 86).

[3] It is challenging to estimate the exact number of people who would reach the pensionable pay cap over time because Illinois retirement systems do not report complete salary data. This is primarily because some employers only report to the retirement system(s) they participate in the salary of their staff up to the pensionable pay cap. However, using data on salaries reported separately from the retirement systems we estimate that the share of members who will hit the cap are 1.7% of TRS, 9.3% of Chicago Teachers, and 2.74% of Chicago Municipal.

[4] See Retirement Benefit Scores in various analyses from the Retirement Security Report

[5] An individual hired in their 50s could work a 10-20 year career and retire at or around age 67 without inflation affecting the value of their benefit. However, someone hired in their 20s that works 10 to 20 years will earn a benefit in nominal dollars that is heavily eroded by inflation by the time they are able to start drawing benefits at age 67, even factoring in inflation adjustments from that point forward.