WSJ: Illinois Pension Fix Faces Political Test.

CHICAGO—Top lawmakers in Illinois reached a long-sought agreement to fix the nation's most broken state public-employee retirement system, but the deal faces likely resistance from some legislators and unions who fear it will mean deep cuts to pension benefits.

Democratic and Republican leaders in the Illinois legislature announced the agreement on Wednesday and are expected to release details Friday. They said the plan would save an estimated $160 billion by reducing cost-of-living increases for retirees, raising the retirement age for younger workers and capping the salary amount used to calculate pension payments. That would close the large gap between promised benefits and current assets to pay for them over the next 30 years, they said.

In coming days, legislative leaders and Gov. Pat Quinn, a Democrat, will try to sell the plan to rank-and-file members of the House and Senate, many of whom have rejected proposed changes to the retirement system over the past two years. Votes are expected Tuesday.

The governor has staked much of his tenure on righting the troubled retirement system, making passage of an overhaul plan particularly important as he prepares to run for re-election next year. He is seen as vulnerable in his bid for a second term, with a crowded field of Republicans vying to challenge him. A poll conducted by Public Policy Polling earlier this month showed 34% of those surveyed approved of Mr. Quinn's job performance.

The agreement also is expected to provide a template for Chicago Mayor Rahm Emanuel to follow for his city, which for years has paid far less into its retirement system than needed to keep it solvent. City payments to local pension funds are set to more than double to nearly $1.1 billion starting in 2015. Mr. Emanuel has warned that if changes aren't made, the city will face a combination of property-tax increases and cuts in services, equating the scheduled increase to the cost of having 4,300 police officers on the street.

"Illinois's pension crisis will not truly be solved until relief is brought to Chicago and all of the other local governments across our state that now stand on the brink of a fiscal cliff," said Mr. Emanuel, who would face re-election in 2015.

While other states from Wyoming to Rhode Island have been paring back retirement benefits in recent years, Illinois lawmakers have remained deadlocked over how to address a pension-system shortfall that has ballooned to nearly $100 billion. The result: Illinois has the lowest credit rating among U.S. states, and the rating for Chicago is among the lowest for major U.S. cities.

To date, unions have successfully argued that government workers shouldn't be punished for decades of mismanagement by the state, which underfunded the retirement system. But union leaders have seen support erode as concern over the state's finances grows and their sway in a statehouse dominated by Democrats ebbs. "This has been an epic pension battle," said Michael Carrigan, president of the Illinois AFL-CIO. "We are marshaling our resources."

Dire fiscal problems in such places as Detroit and Puerto Rico have left lenders increasingly leery of Illinois and its largest city. While Illinois and Chicago remain in a considerably stronger financial position than those places, analysts say both Illinois and Chicago are considered distressed. Appetite for such debt has become weaker and interest costs have risen.

Howard Cure, director of municipal research at Evercore Wealth Management LLC, said Illinois finance officials have become more aggressive in marketing their bonds and have been reminding investors the state constitution puts debtholders first in line for payments. Illinois's 10-year bonds trade at a premium that is more than triple California's, but well below Puerto Rico's, according to Thomson Reuters Municipal Market Data.

Mr. Cure said if Illinois can pass an overhaul that delivers significant retirement-system savings, it could begin to win back investors. "It's a pretty diverse state. It's not as if Illinois went through what Michigan went through," he said, referring to the near-collapse of the auto industry during the recessionand Detroit's recent efforts to refinance its debt through bankruptcy.

But failure to pass an overhaul plan could have an equally damaging effect, with the higher premiums attached to Illinois debt becoming commonplace rather than a temporary exception, said Duane McAllister, a portfolio manager at BMO Global Asset Management.

"It's not Detroit, and it's not Puerto Rico. Unfortunately, it gets thrown into the same trading basket," said Mr. McAllister, referring to Detroit's bankruptcy filing and a selloff in the island's bonds amid concerns about a wide budget deficit there. He added that as an owner of Illinois debt, he is guardedly optimistic about the latest agreement.

The agreement is the first time top leaders in the state's House and Senate have backed the same plan. Senate President John Cullerton, a Democrat, pushed for a proposal earlier this year, backed by unions, that would have given employees choices over benefit cuts and found savings through retirement health care. But House Speaker Michael Madigan, also a Democrat, opposed it, saying it didn't deliver enough savings.

Now, union leaders are gearing up to fight—first at the capitol and then in court if necessary. They are encouraging members to call their legislators and visit their offices in the coming days in what they have dubbed a pension emergency. If the bill passes, labor leaders expect to sue the state, arguing benefits promised to employees and retirees are protected under the state constitution. The challenge has long been discussed by unions, with the state likely to argue that certain benefits aren't protected, particularly in light of the state's fiscal problems.

"You would have a line at the courthouse door," said Anders Lindall, a spokesman for American Federation of State, County and Municipal Employees in Illinois. "Every teacher, every nurse, every caregiver, every public employee and retiree would have standing to sue."

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Updated Nov. 28, 2013 6:29 p.m. ET