

# Illinois Public Pensions

A pension management and investment newsletter for Illinois pension funds  
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## Illinois Public Pensions

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## **Legislative update: Why IGFOA frowns on DROP legislation as proposed**

### **Deferred Retirement Option Plan Amendment to House Bill 1816**

#### ***compiled from reports of the IGFOA Legislative Committee***

As the Spring 2006 IPP newsletter went to press, the Illinois 94th General Assembly was considering legislative proposals to provide Deferred Retirement Option Plans, aka DROP to local government employees participating in Downstate Police and Firefighter pension funds. DROP allows an employee to begin drawing his or her pension five years before actually retiring. This results in a “double dipping,” with the employee receiving up to 175% of their salary during those five years.

The IGFOA opposes the DROP program as proposed in early March because:

- 1) It is **not elective by the municipality**. The Pension Boards, not the Village Boards and City Councils, could make the decision as to whether or not a DROP plan will be offered. The Pension Boards are not elected by or accountable to the residents of their community and therefore should not be making that decision. The Pension Boards should not be given the authority to create a new benefit, which, if it is determined not to be “cost neutral,” would be paid for by the municipalities. The Pension Boards should not be given the power to effect how long the employee base may work for the municipality.

Proponents will also argue that the DROP program is “optional” because it would have to be selected by each local police and fire pension board. Again, this is simply incorrect—there is no local option. Due to recent legislation these pension boards are controlled 3-2 by union representatives, who will of course elect to provide this new benefit to their members. Further, this legislation is in direct violation of the agreement between municipalities and the firefight-

er unions to not advance legislation affecting pension costs between 2004 and 2008 in exchange for the significant pension enhancements that were given to unions in 2004.

- 2) IGFOA continues to recommend to the State Legislature that a second, independent actuary re-run the numbers to confirm that the DROP would be “cost neutral.” **IGFOA is not confident that the proposed structure of the DROP will result in cost neutrality.** The fact is, the numbers were run using five year old data (2001) and historically such approach has resulted in much higher than anticipated costs.

The Legislative Committee reviewed actuarial calculations from twelve different communities around the State, including 23 different Downstate pension funds. The actuarial reports revealed that the proposed DROP would result in:

- ◆ average cost of 2.35% of payroll
- ◆ average increase in pension tax levy of 9.87%
- ◆ 2.35% drop in funding levels. And
- ◆ average increase in municipality’s unfunded pension liability \$1.75 Million.

The total increase in unfunded pension liability for the twelve municipalities reviewed exceeded \$40 Million.

- 3) IGFOA believes that the addition of a DROP program **will add significant administrative and accounting responsibilities to the pension funds** (municipalities). There has been an indication that a DROP program will result in an increase to the scope and cost of the audit. The Teachers’ Retirement System of Louisiana has a DROP program and it has estimated that the annual cost to administer the DROP is approximately \$1 million per year. There is no reason to believe that the cost to administer a DROP program for over 600 funds would be any less. In fact, it could be more because of the loss in the economy of scale.
- 4) If the DROP is not “cost neutral,” it will impact all municipalities, but it will especially **negatively impact “tax capped” municipalities.**

- 5) IGFOA believes that the **addition of a DROP program will create a huge reporting problem to the Division of Insurance.** For actuarial purposes (both for the DOI and your private actuary, if you use one), the DROP deposits and the interest earned on them must be deducted from the Fund's assets and earnings prior to making the calculation. This will probably result in delays by the DOI in performing and delivering each Fund's actuarial calculation.

*IGFOA continues to monitor legislative activity and work with General Assembly Legislative staff and interested Councils of Government to address these concerns. Find Legislative Updates at [http://www.igfoa.org/legislativecomm\\_update.html](http://www.igfoa.org/legislativecomm_update.html)*

## **GASB: The next big bang**

### **GASB statement nos. 43 and 45 prescribe accounting and financial reporting for Other Postemployment Benefits (OPEB)**

**by By Frederick G. Lantz, Partner/Director of Government Services, Sikich LLP  
and Brian W. Caputo, Director of Finance/City Treasurer, City of Aurora**

The Governmental Accounting Standards Board (GASB) issued two pronouncements in April 2004 and June 2004 that will dramatically change how governments account and report transactions related to other post employment benefits. In summary, cash basis accounting for measuring and reporting the cost of OPEB will no longer be allowed. Instead, accrual basis accounting for the cost of OPEB will be required.

**GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pensions***, issued in April 2004, provides guidance on accounting and financial reporting and disclosures requirements for reporting by administrators or trustees of OPEB plan assets or by employer's or sponsors that include OPEB

plan assets as trust or agency funds in their financial reports.

1. GASB S-43 supersedes the guidance contained in GASB Statement No. 26, *Accounting and Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*.
2. GASB S-43 is consistent with the guidance contained in GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, with certain modifications to reflect differences between pension plans and OPEB plans.

**GASB Statement No. 45**, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pension*, issued in June 2004, provides guidance on employers' accounting and financial reporting for OPEB costs, whether or not those costs are advance funded.

1. GASB S-45 supersedes the guidance contained in GASB Statement No. 12, *Disclosure of Information on Postemployment Benefits Other Than Pension Benefits by State and Local Governmental Employers*.
2. GASB S-45 is generally consistent with GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, with certain modifications to reflect the differences between pension benefits and OPEB.

### **Implementation schedule**

The implementation of both pronouncements will be phased in over a three year period, similar to GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* and is based on the calculation of total revenues from S-34 to determine which phase of implementation your government or plan is effective for.

Therefore, if you were a phase 1 government for GASB S-34, you are a phase I government for GASB S-43 and S-45, and so forth. Early implementation of GASB S-34 will

not require early implementation of GASB S-43 and S-45, instead the required implementation date would apply. Early implementation is encouraged, but not required. If comparative financial statements (not MD&A) are presented, the prior year figures should be restated.

The **implementation dates for GASB S-45** by phase are as follows:

- a. Phase I—periods beginning after December 15, 2006 (fiscal years ending December 31, 2007 and thereafter).
- b. Phase II—periods beginning after December 15, 2007 (fiscal years ending December 31, 2008 and thereafter).
- c. Phase III—periods beginning after December 15, 2008 (fiscal years ending December 31, 2009 and thereafter).
- d. Blended and/or discretely presented component units are required to use the same implementation date as the primary government, regardless of the phases noted above.

The **implementation dates for GASB S-43** are effective one year prior to the effective dates of GASB S-45 for the employer (if a single employer plan) or for the largest participating employer (for a multiple employer plan).

The first step to implementing GASB S-43 and GASB S-45 is determining whether or not your government has an other post employment benefit. OPEB arises from an exchange of salaries and benefits for employee services, and it is part of the compensation that employers offer for services received. OPEB is defined as post employment benefits other than pension benefits. Post-employment is defined as the period between termination of employment and retirement as well as the period after retirement.

### **Other Post-employment Benefits Defined**

1. Healthcare benefits, regardless of the type of plan that provides them;

- a. Medical insurance is often the most significant benefit included in this category.
  - b. This also includes dental, vision, hearing and other health related benefits.
  - c. If these benefits are provided through a defined benefit pension plan, then they must be accounted for separately from the pension benefit provided by the plan.
2. Other forms of postemployment benefits such as life insurance, disability, long-term care and other benefits.
    - a. These are only included in the OPEB definition to the extent that they are provided separately from a defined benefit pension plan.
    - b. If these benefits are provided through a defined benefit pension plan (e.g., disability benefits provided by a police or fire pension plan in Illinois), then the benefits are considered to be pension benefits, not OPEB, and the requirements of GASB S-25 and S-27 apply.

If you the employer pay any portion of these benefits for a retiree, other than through an early retirement incentive, you have an OPEB. In addition, if even if the employer does not ultimately pay any OPEB benefits (e.g., retirees pays full amount of premium or a cobra rate), an OPEB may be created by an “implicit subsidy.” The implicit subsidy results from the retiree paying the same premium as an active employee, even though the retiree may pay 100% of the premium and the employer pays nothing. Since GASB believes that retiree’s health care costs are greater than active employee’s health care costs, the fact that the same premium is charged to both groups will result in the “implicit” subsidy.

However, when an employer participates in a community-rated health insurance plan, in which premium rates reflect the projected health claims experience of all participating employers rather than that of any single participating employer, and the insurer or provider organization charges the same unadjusted premiums for both

active employees and retirees, it is appropriate to use the unadjusted premiums as the basis for projection of retiree benefits, to the extent permitted by actuarial standards. Therefore, no OPEB to the employer exists in a community rated plan, assuming the retiree pays 100% of the community rated premium. If the employer pays a portion of the community rated premium, then the portion paid by the employer is the basis for the OPEB calculation.

Other post-employment benefits do not include special termination benefits and/or early termination offers and benefits.

1. Special termination benefits are inducements offered by employers to employees to hasten the termination of services, or payments made in consequence of the early termination of services (collectively referred to as termination offers and benefits), and, therefore, are different in nature from compensation for services.
2. Accordingly, termination offers and benefits-including special termination benefits as defined in GASB Statement No. 47, *Accounting for Termination Benefits* are distinguished from OPEB and are excluded from the scope of GASB S-45, regardless of who provides or administers them.
3. However, the effects, if any, of an employee's acceptance of a special termination offer on OPEB obligations incurred through an existing defined benefit plan (for example, an increase in the employer's obligation to provide postemployment healthcare benefits) should be accounted for in accordance with GASB S-43 and S-45.

## **Types of OPEB**

Once you have determined if you have an OPEB, the next step is to apply GASB S-45 to determine the type of OPEB benefit provided to employees and the type of OPEB plan used to provide the benefits to determine the appropriate methodology to apply to the employer's accounting and financial reporting for the costs of

OPEB. GASB S-45, like GASB S-27, identifies 2 types of OPEB benefits and three types of OPEB plans.

In a **defined contribution OPEB**, the employer contributes a specified amount (usually a specified percentage of the employee's current salary, or a percentage of the amount of sick leave accrued at retirement or termination).

- a. In a defined contribution OPEB, an employee is entitled to benefits only to the extent of total accumulated employee and employer contributions and related investment earnings.
- b. Defined contribution OPEB do not involve actuarial measurements.

In a **defined benefit OPEB**, the employee is promised a specific benefit at retirement or termination (usually a specific % of health insurance premiums).

- a. The employer and/or employee then must contribute an amount large enough to assure that sufficient monies will be on hand to pay the promised benefits upon the employee's retirement.
- b. This amount is determined through an actuarial computation that involves a variety of estimates about employees and future rates of inflation in order to charge the cost of the benefit to the period of service provided by the employee.

### **Distinguishing between single and multiple employer plans**

GASB S-45 classifies defined benefit OPEB as single-employer and multiple-employer. A single employer OPEB is one to which only one employer contributes. Generally, the single employer OPEB also covers only one employer's employees. A special funding situation may exist, for example, where a state government makes the employer contributions for school districts. The state would treat this as a single employer plan since only one employer (the state on behalf of local governments) contributes.

A multiple-employer OPEB is one that more than one employer contributes (e.g., IMRF, TRS, WPERS). Some multiple-employer OPEB plans are aggregations of single-employer OPEB plans and have separate complete actuarial valuations for each participating government. These OPEB plans are classified as agent OPEB plans (e.g., IMRF). Other multiple-employer OPEB plans are essentially one large OPEB plan with cost-sharing arrangements and one actuarial valuation is performed for the OPEB plan as a whole. These OPEB plans are classified as cost sharing OPEB plans (e.g., TRS, WPERS).

### **Benefits included in OPEB**

The benefits to include in the OPEB are based on the amount of the benefit provided by the employer (i.e., **ultimately to be paid by the employer**). However, this should include all benefits to be provided to plan members or beneficiaries in accordance with the current substantive plan (the plan terms as understood by the employer and plan members), including any changes to plan terms that have been made and communicated to employees. Usually, the written plan is the best evidence of the terms of the exchange; however, in some cases the substantive plan may differ from the written plan. Accordingly, other information also should be taken into consideration in determining the benefits to be provided, including other communications between the employer and plan members and an established pattern of practice with regard to the sharing of benefit costs between the employer and plan members.

When an employer provides benefits to both active employees and retirees through the same plan (e.g., all participate in the same health care plan which is common throughout the United States), the benefits to retirees should be segregated for actuarial measurement purposes. The calculation of future retiree benefits should be based on claims costs, or age-adjusted premiums approximating claims costs, for retirees, in accordance with actuarial standards issued by the Actuarial Standards Board. This is often referred to as an **implicit subsidy** in practice. Therefore, the single premium would need to be converted to an age-adjusted premium with the difference between the two being the basis for

## **Example: The City of Aurora**

The City of Aurora chose to implement early to demonstrate sound financial management and show the City's true financial picture to the new Mayor, Aldermen, and labor unions. Key components of the first actuarial report for the City's OPEB revealed:

- Unfunded Actuarial Accrued Liability (UAAL) as of 12/31/03: \$154.7 million.
- 2004 Annual Required Contribution (ARC): \$14.4 million.
- UAAL as of 12/31/04: \$164.1 million.
- 2005 ARC: \$15.5 million.
- 2006 ARC: \$16.9 million.

Refer to the excerpts from the City's Comprehensive Annual Financial Report for the fiscal year ending December 31, 2004 at [www.igfoa.org](http://www.igfoa.org).

### **Budgetary implications for the City included:**

#### **1. Establishing a separate internal service fund**

Previously, employee and retiree health insurance costs were accounted for in the "Health Insurance Fund." The City separated employee and retiree health insurance accounting into different funds ("Employee Health Insurance Fund" and "Retiree Health Insurance Fund") in 2005 to prepare for separate trust fund.

#### **2. Charging back OPEB costs to each budget program**

#### **3. Phased-in funding**

The City is developing a plan for achieving 100% funding of its ARC. It is likely that the plan will include gradually increasing its contribution toward the ARC gradually over a number of years until 100% funding is achieved

#### **4. Impact upon operations**

While still to be realized, the impact on operations is expected to be dramatic. The City must cut expenses or increase revenues to phase-in funding of the OPEB liabilities. Other possible considerations are whether retiree health insurance benefits can be discontinued and the impact of employees delaying retirement until age 65?

determining the cost to include in the OPEB calculation. If the retirees participate in an employers self-insured health plan, segregating claims costs for retirees in a self-insured plan will provide the best measure of the cost of the OPEB for the calculation (less retiree contributions).

### **Developing the Annual Required Contribution (ARC)**

For single employer defined benefit OPEB plans and multiple-employer agent defined benefit OPEB plans, the development of the cost of OPEB benefits for the period and the determination of the employer funding requirement, the annual required contribution (ARC) is based upon:

1. Projecting future cash flow requirements of the benefits to be provided;
2. Discounting those future cash flows to their present value, and
3. Allocating the present value of the cash flows to specific years of employees' service based on an actuarial cost method.
  - a. Actuarial valuations are required to be performed at least biennially for plans with a total membership of 200 or more.
  - b. Plans with a total membership of fewer than 200 are required to have actuarial valuations performed at least triennially.
  - c. Single employer plans (and certain agent multiple employer plans) with fewer than 100 total plan members can perform their own actuarial valuations (at least triennially) using tables and other information contained in GASB S-45.
  - d. Total members is the sum of:
    - 1) Employees in active service,
    - 2) Terminated employees who have accumulated benefits but are not yet receiving them, and

- 3) Retired employees and beneficiaries currently receiving benefits.
- e. A valuation would need to be performed in the off years for significant changes in plan members, benefits or other factors that could have a material impact on the funded status or funding requirements of the plan.
- f. The actuarial valuation does not need to be as of the employer's fiscal year end (but for practical reasons it should), but should be the same date each year (or biennially or triennially).
  - 1) The valuation for disclosing the funded status of the OPEB plan should be performed within one year of the plan's 0 of the plan for the current fiscal year.
  - 2) The valuation to determine the employer's funding requirement should be performed no more than twenty four months prior to the start of the fiscal year to which the funding relates.

*The IGFOA Technical Accounting Review Committee (TARC) continues to monitor and discuss the impacts of GASB 43 and 45 for Illinois local governments. TARC will be presenting a panel discussion of OPEB reporting at the April 27th Illinois Public Pension Institute and plans to hold an OPEB implementation workshop this summer. For additional resources visit [http://www.igfoa.org/TARC\\_update.html](http://www.igfoa.org/TARC_update.html).*

# Comparisons of Illinois Public Pensions

compiled by Chris Staron, NIU Graduate Intern, IGFOA

Employee Group	Illinois Municipal Retirement Fund (IMRF)	Teacher Retirement System (TRS)	State University Retirement System (SURS)	Downstate Police Pension	Downstate Firefighter Pension
<b>Full Retirement</b>	Age 60 with 8 years of service or Age 55 with 35 years of service	<ul style="list-style-type: none"> <li>Age 62 with 5 years of service,</li> <li>Age 60 with 10 years of service, or</li> <li>Age 55 with 35 years of service</li> </ul>	<ul style="list-style-type: none"> <li>Age 55 with 8 years of service,</li> <li>Age 62 with 5 years of service or</li> <li>Any age with 30 years of service</li> </ul>	<ul style="list-style-type: none"> <li>Age 50 with 20 years of service or</li> <li>8 years of service with exceptions</li> </ul>	Age 50 with 20 years of service
<b>Refund</b>	<ul style="list-style-type: none"> <li>less than 8 years: employee contributions,</li> <li>more than 8 years but less than age 55: get member and employee contribution,</li> <li>more than 8 years and older than age 55: must take pension</li> </ul>	Only retirement contributions (no interest or survivor benefits)	<ul style="list-style-type: none"> <li>Traditional: receive contributions plus 4.5% interest</li> <li>Portable: 5 or more years-contributions plus 4.5% interest employer contribution</li> </ul>	Employee contributions	Employee contributions
<b>How is Pension Calculated</b>	Average of 48 consecutive months within last 120 (limits on raise in last 3 months)	Highest 4 consecutive years of last 10 years (limits on raise for state contributions)	Highest 4 consecutive years	Final day's salary	Final month's salary
<b>Pension Formula FRE = Final Rate of Earning</b>	For First 15 Years: •1.67% x FRE x years After 15 Years: •2% x FRE x years	2.2% x FRE x years (post 1998 service)	1: 2.2% x FRE x years 2: Money Purchase calculation 3: \$25 x years of benefit service	2.5% x FRE x years	Under 20 years: •table Over 20 years: •2.5% x FRE x years of service
<b>Pension Amount at full age w/20 years of service</b>	Age 60: 35% of FRE	Age 60: 44% of FRE	Age 60: 44% of FRE	Age 50: 50% of FRE	Age 50: 50% of FRE
<b>Maximum Pension</b>	75% of FRE after 40 years	75% of FRE after 35 years	80% of FRE after 37 years	75% of FRE after 30 years	75% of FRE after 30 years
<b>Annual Increases</b>	3% non-compounded but receive supplemental benefit payment (13th check)	3% compounded	3% compounded	3% compounded	3% compounded
<b>Employee Contribution</b>	4.5% •Pension: 3.75% •Survivor: .75%	9.4% •Retirement: 7.5% •Annual Increase: .5% •Survivor: 1% •ERO: .4%	8% Retirement: 6.5% Annual Increase: .5% Survivor: 1%	9.91%	9.455%
<b>Employer Contributions</b>	Most of pension costs, most of survivor costs, all of disability benefits, and all of death benefits	State makes most of contributions	Average 9.1% by state	Depends on Fund	Depends on Fund
<b>FICA Benefits</b>	Yes Employee- •6.2% for Social Security on 1st \$94,200 •1.45% for Medicare on all income Employer: •Pays matching 7.65%	Medicare Contribution of 1.45% by employee and matched by employer	Medicare Contribution of 1.45% by employee and matched by employer	Generally, No	Generally, No
<b>Early Retirement Option</b>	<ul style="list-style-type: none"> <li>Age 55-60 with less than 30 years: 25% less for each month under age 60.</li> <li>Age 55-60 and 30-35 years: lesser of .25% for each month under age 60 or .25% for each month less than 35 years.</li> <li>Early Retirement Incentive (ERI)- may be able to purchase credit at age 50 with 20 years of service.</li> </ul>	<ul style="list-style-type: none"> <li>Age 55-60 with 20-35 years: reduced 6% each for each year under 60.</li> <li>Early Retirement Option: Employer contributes 23.5% and employee contributes 11.5% of FRE multiplied by lesser of years of service under 35 or years under age 60.</li> </ul>	Under 2.2% formula, benefits that begin before 60 will be reduced by 1/2% for each month under age 60.	Pension received at age 60 or mandatory retirement = 2.5% x FRE x years of service	See formula

# Comparison of Illinois public pension fund death and disability benefits

compiled by Chris Staron, NIU Graduate Intern, IGFOA

Employee Group	Illinois Municipal Retirement Fund (IMRF)	Teacher Retirement System (TRS)	State University Retirement System (SURS)	Downstate Police Pension	Downstate Firefighter Pension
<b>Duty Disability</b>	<ul style="list-style-type: none"> <li>•50% of salary</li> <li>•only paid if 66.67% worker's compensation is not paid (IMRF pays minimum of \$10 a month)</li> <li>•12 consecutive months of IMRF service required</li> <li>•Benefits are also reduced by Social Security Benefits</li> </ul>	<ul style="list-style-type: none"> <li>•60% of contract rate (salary)</li> <li>•No minimum service requirement</li> <li>•Reduced by any amounts received from workers compensation</li> </ul>	<ul style="list-style-type: none"> <li>•50% of your average earnings</li> <li>•2 year service requirement may be waived</li> <li>•Disability Retirement Allowance of 35% of your base compensation if unable to return to work</li> </ul>	<ul style="list-style-type: none"> <li>•For first 365 days: 100% of salary under Public Employee Disability Act</li> <li>•Then 66.67% from worker's compensation greatest of: 1) 65% of salary 2) retirement pension, excluding annual increases 3) retirement pension and annual increases if certain criteria are met</li> </ul>	<ul style="list-style-type: none"> <li>•For first 365 days: 100% of salary under Public Employee Disability Act</li> <li>•Then 66.67% from worker's compensation</li> <li>•Then greater of: 1) 65% of the monthly salary 2) retirement pension, excluding annual increases. plus \$20 per month for each child under 18 (can't exceed 75%)</li> </ul>
<b>Non-duty Disability</b>	<ul style="list-style-type: none"> <li>•50% of salary</li> <li>•12 consecutive months of IMRF service required</li> </ul>	<ul style="list-style-type: none"> <li>•40% of contract rate (salary)</li> <li>•3 years of service credit required</li> <li>•Cost of living increase of 7% after 4 years and 3% thereafter</li> </ul>	<ul style="list-style-type: none"> <li>•50% of your average earnings</li> <li>•2 years of service credit required</li> <li>•Disability Retirement Allowance of 35% of your base compensation if unable to return to work</li> </ul>	<ul style="list-style-type: none"> <li>•50% of salary</li> <li>•No service requirement</li> </ul>	<ul style="list-style-type: none"> <li>•50% of the monthly salary</li> <li>•7 years of creditable service required</li> </ul>
<b>Occupational Disease</b>	<ul style="list-style-type: none"> <li>•50% of salary</li> <li>•only paid if 66.67% worker's compensation is not paid (IMRF pays minimum of \$10 a month)</li> <li>•12 consecutive months of IMRF</li> <li>•Benefits are also reduced by Social Security Benefits</li> </ul>	N/A	N/A	Only police officers who are employed in a combined police and fire department and conducting regular fire duties.	greater of: 1) 65% of salary 2) retirement pension, without annual increases, but with \$20 per month for each child under 18 (can't exceed 75%)
<b>Duty Death</b>	Lump sum death benefit = 1 year's earnings plus any balance in your member account	N/A	N/A	Pension = 100% of salary%	Pension = 100% of salary
<b>Non-duty Death</b>	<ul style="list-style-type: none"> <li>•Less than one year: member contributions</li> <li>•Between one and eight years: lump sum = 1 year's earnings plus any balance in your member account</li> <li>•More than eight years: \$3,000 plus surviving spouse pension or lump sum = 1 year's earnings plus any balance in your member account</li> </ul>	<ul style="list-style-type: none"> <li>•Lump sum up to last salary or</li> <li>•survivor benefit if dependent beneficiary</li> </ul>	<ul style="list-style-type: none"> <li>Less than 1.5 years of service</li> <li>•total contributions and interest plus an additional death benefit of up to \$5,000</li> <li>At least 1.5 years of service</li> <li>•7/8ths of member's total contributions and interest with survivor benefits or</li> <li>•If survivor benefits are waived, total contributions and interest plus additional death benefit of up to \$5,000</li> </ul>	<ul style="list-style-type: none"> <li>•at least 20 years of service: earned pension</li> <li>•10-20 years: 50% of salary</li> </ul>	<ul style="list-style-type: none"> <li>•54% of monthly salary plus 12% of monthly salary for each minor child or</li> <li>•with 20 years of service: 100% of earned pension</li> </ul>
<b>Death When Retired</b>	<ul style="list-style-type: none"> <li>\$3,000 plus</li> <li>•surviving spouse pension (survivor benefit) or</li> <li>•member contributions and interest</li> </ul>	<ul style="list-style-type: none"> <li>•Lump sum of \$3,000</li> <li>•1/6 of last salary or</li> <li>•survivor benefit if dependent beneficiary</li> </ul>	<ul style="list-style-type: none"> <li>•Survivor Benefit or</li> <li>•Without survivor benefit, remainder of employee contributions and interest, or \$1,000, whichever is greater.</li> </ul>	earned pension	Greater of: •54% of monthly salary plus 12% of monthly salary for each minor child or •100% of earned pension
<b>Survivor Benefit</b>	50% of pension	<ul style="list-style-type: none"> <li>Dependent beneficiary</li> <li>•Death while employed: \$1,000 and monthly benefit generally not less than \$400 or \$600 with minor children</li> <li>•Death when retired: \$1,000 and generally 50% of member's earned pension</li> </ul>	Lump sum of \$1,000 plus a monthly survivor benefit of at least 50% of the earned retirement benefit.	see death benefits	see death benefits

Chris Staron, Graduate Intern with IGFOA is working on his Masters in Public Administration at Northern Illinois University. Chris earned an undergraduate degree in History and Political Science from the University of Notre Dame. Chris can be reached at [cstaron@igfoa.org](mailto:cstaron@igfoa.org) or 630-663-0019.

## **Civic Federation recommends public pension board reform**

### **Report prepared by The Civic Federation**

Many state and local public pension funds in Illinois face negative outlooks driven by recent declines in investment returns coupled with years of increasing pension benefits, while payments into the pension systems have been skipped or reduced.

In the face of mounting shortfalls in these public pension funds, the Civic Federation and others have worked to draw the attention of public officials and voters to the need to reform these pension systems and return them to sound financial condition. Far less consideration has been given to the related, and equally significant, issue of the composition of the governing boards that oversee these pension funds.

Clearly, the task of public pension fund oversight carries significant responsibilities, and the individual backgrounds and viewpoints of pension board members will affect the decisions made by those boards—decisions that ultimately have a serious impact on taxpayers. For these reasons, The Civic Federation has undertaken the task of examining the composition of public pension boards in Illinois, reviewing the required background qualifications for members and the balance between management representatives, employee representatives, and private citizens. Our research finds that the composition of most public pension fund boards in Illinois favors employees; only one board includes citizen trustees, and only one board includes financial experts.

In reviewing public pension board composition in other states, The Civic Federation finds that many other jurisdictions require their pension governing boards to reflect a balance between employees, management and citizens. Many others also require financial training or expertise for at least some of their trustees.

The Civic Federation believes that balance in pension board composition is of critical importance if Illinois is to confront and more equitably debate the escalating

costs of public pensions. In the view of the Civic Federation, the best pension board structure is tripartite, representing the three stakeholder groups of employees (active and retired), management, and independent citizen taxpayers. Pension boards should also require demonstrated financial expertise in some members, and should further require relevant training for the non-expert trustees. Therefore, the Civic Federation makes the following recommendations for reforms to the composition of the boards of trustees of public pension systems in Illinois, and urges the General Assembly to take legislative action to:

### **1. Balance employee and management representation on pension boards**

The mission of a public pension fund's board of trustees should be to safeguard the fund's assets through prudent investments and effective management. The board should not function as an advocate for the interests of one stakeholder, especially when such advocacy may result in policy changes that increase fund liabilities. Rather, the trustees should focus on safeguarding the fund's assets to ensure that sufficient amounts are available to pay for promised benefits when they come due.

The composition of a board, and the backgrounds and affiliations of the individual members, serve as an indicator of the interests that are likely to be represented and promoted by that board's actions. Unfortunately, most of Illinois' public pension system boards do not reflect a balance of interests because a majority of members on those boards are active employees or retirees.

The Illinois General Assembly should pass legislation revising the composition of public pension boards in Illinois to ensure that board composition does not favor employee and retirees' interests over those of other stakeholders.

### **2. Develop a tripartite structure that includes citizen representation on pension boards**

Pension Board trustees act as stewards for all pension system contributions, both those made by individual employees and those made by employers, using taxpayer

funds. If those funds are unable to meet their obligations to annuitants, taxpayers will act as the funds' effective insurers, because the State of Illinois is constitutionally required to make benefit payments regardless of any shortfall in those funds. Therefore, board composition should represent the interests of the employees (both active and retired), the employers, and the taxpayers. However, only one Illinois public pension fund, the Teachers' Retirement System, is statutorily required to include any private citizen representation on its Board of Trustees.

The Illinois General Assembly should pass legislation to include citizen members on pension board of trustees, thus creating a tripartite structure that would balance the distinct interests of the three stakeholder groups: taxpayers, management, and current and retired employees.

### **3. Include financial experts on pension boards, and require training for non-experts**

Effective stewardship of millions of dollars of assets is a major task that requires significant financial expertise. While trustees can seek financial advice from the systems' staff and consultants, the board should have a firm, independent command of investment-related issues to fulfill its fiduciary function as the systems' ultimate investment decision-making body. For that reason, each pension system board should include several financial experts with experience in investing and managing large asset portfolios.

Although some Illinois funds require the system's controller or financial officer to sit on the pension board, only one Illinois public pension fund, the Teachers Retirement System, explicitly requires its board to include some members with experience and competency in financial and business management.<sup>23</sup>

The Illinois General Assembly should pass legislation to require the membership of public pension boards to include financial experts with experience in investing or managing large asset portfolios. Furthermore, all pension trustees should receive some relevant financial training on an annual basis.

## Public pension board composition

There are three serious flaws in the current composition of the boards of trustees of public pension systems in Illinois: They favor employees' interests, they lack citizen representation, and they do not require financial expertise.<sup>5</sup>

**Illinois Public Pension Boards Favor Employees' Interests** The primary mission of a public pension fund board of trustees should be to safeguard the fund's assets through prudent investments and effective management. The board should not function as an advocate for the interests of one stakeholder, especially when advocating those interests creates increased liabilities for the fund. Rather, the trustees should focus on conserving and increasing the fund's assets to ensure that sufficient amounts are available to pay promised benefits when they come due. Although not all pension boards produce results favoring one stakeholder over another, board composition serves as an indicator of the interests most likely to be represented in the board's actions.

Unfortunately, the membership of most Illinois public pension boards does not reflect a balance of interests; instead, the majority of board members are active employees or retirees.<sup>6</sup> As seen in the table below, which lists state statutory requirements for the composition of all Illinois' public pension fund boards, only two of the 16 boards evenly match employee/retiree representation with management and independent citizen representation.<sup>7</sup> The Illinois Municipal Retirement Fund's membership is evenly matched numerically, but the annuitant member cannot vote. Employees and annuitants are currently in the minority on the State Universities Retirement System Board; however, while state statute requires four of the nine members to be annuitants or actives, the governor is empowered to shift that balance by appointing other board members who "may, but need not, be participants or annuitants of the System." These five discretionary appointees currently include the president of the Service Employees International Union Local 73, so it can be argued that the majority of the SURS Board represents the interests of the employees.

## Illinois Public Pension Boards of Trustees Composition

<b>Fund</b>	<b>Employees and Retirees less than 50% of Board?</b>
General Assembly	No, 7 out of 7
Downstate & Suburban Police Funds	No, 3 out of 5
Downstate & Suburban Fire Funds	No, 3 out of 5
Chicago Police	Even, 4 out of 8
Chicago Fire	Even, 4 out of 8
IMRF	Even, 4 out of 8 (Yes, 3 out of 7 voting)
Chicago Municipal	No, 3 out of 5
Cook County and Cook County Forest Preserve*	No, 5 out of 7
Chicago Laborers'	No, 4 out of 6
Chicago Park District	No, 4 out of 7
MWRD	No, 3 out of 5
SERS	No, 4 out of 7
SURS	Yes, 4 out of 9, but variable**
TRS	No, 6 out of 11
CPS	No, 10 out of 12
Judges	No, 4 out of 5

*\*Cook County and the Cook County Forest Preserve are separate funds governed by the same board of trustees Source: Illinois Pension Code, 40 ILCS 5*

*\*\*State statute allows the Governor discretion to shift the balance of representation by appointing additional active employees or annuitants to the Board*

Imbalances in board composition can lead to board actions that favor employees' and retirees' interests over the interests of the government and the taxpayers. For example, 10 of the 12 Trustees of the Chicago Public School Teachers' Pension and Retirement Fund are employees or annuitants. Not surprisingly, the Fund's 2004 Comprehensive Annual Financial Report states the Board's commitment to advocating benefit increases for employees: "The Trustees and Fund administrators will continue to work diligently to represent the interests of the members through further accomplishment of the Trustees' legislative agenda. The Board, in conjunction

with Fund consultants, continues to work in Springfield toward improving benefits for the members.”<sup>9</sup> In our view, a pension board’s goal should not be to advocate or lobby for the interests of one stakeholder, especially when advocating those interests creates greater liabilities for the fund. Rather, the first and foremost responsibility of a board of trustees should be to safeguard the fund’s assets to ensure that sufficient amounts are available to pay promised benefits when they come due.

*For more information, contact Lise Valentine, Ph.D. – Civic Federation Vice President and Research Director, at 312-201-9066.*

## **Illinois pension news**

### **Commission urges continuation of 90% Funded Ratio Goal**

Illinois Commission on Government Forecasting and Accountability’s January 2006 Report on the 90% Funding Target of Public Act 88-0593 concludes that, “While the current pension funding plan will continue to present significant challenges from a budgetary perspective, the Commission believes that the goal of reaching a 90% funded ratio by 2045 as called for in P.A. 88-593 should be maintained.”

For more information on this subject, visit [http://www.ilga.gov/commission/cgfa/cgfa\\_home.html](http://www.ilga.gov/commission/cgfa/cgfa_home.html)

### **RFP Checklist for OPEB Actuarial Valuation available through GFOA**

With the first GASB 43 and 45 OPEB liability implementation deadline of December 2006 approaching, many entities are in the process of procuring actuarial professional services to determine their OPEB liability. The GFOA Committee on Retirement and Benefits Administration prepared a RFP Checklist for OPEB Actuarial Valuation. It is a checklist for the development of a request for proposals for the procurement of these services. It provides guidance on definition of terms and specific requirements, and items for consideration based

on sample RFP's and the collective knowledge of GFOA members. It should be utilized in conjunction with GASB Statements 43 and 45 and the related implementation guide.

For more information, visit [http://www.gfoa.org/services/documents/OPEB\\_Checklist\\_final\\_000.doc](http://www.gfoa.org/services/documents/OPEB_Checklist_final_000.doc)

The screenshot shows the IGFOA website's 'HOT TOPICS' section. It features three articles: 'Predatory Lending', 'Sudan Divestment', and 'Deferred Retirement Option Plans (DROP)'. Each article has a brief summary and a link to read more.

New at [www.igfoa.org](http://www.igfoa.org)

Hot Topics at <http://www.igfoa.org/HotTopics.htm>

The screenshot shows the IGFOA website's 'Use the IGFOA Training Plan to Develop a Department-wide Training Plan' section. It includes an overview, instructions, and two worksheets: 'Calendar Fiscal Year' and 'May 1st Fiscal Year'. There is also a section for 'IGFOA Training Plan - Budget Worksheet Directions'.

Build your own career development plan at <http://www.igfoa.org/TrainingPlan.htm>

The screenshot shows the IGFOA website's 'IGFOA GUIDE TO FINANCIAL SERVICES FOR GOVERNMENT' section. It provides information about the guide, how to use it, and includes a search box for finding firms and a browse button for accounting services.

Financial Services Guide at <http://www.igfoa.org/FinSvcGuide.html>

...And there's always something new at the [IGFOA Members Exchange](http://www.igfoa.org) on-line bulletin board

# The Illinois Public Pension Institute

*Legislative and regulatory mandates dominate the concerns facing Illinois Downstate Police and Firefighter Pension Funds this year. Join your colleagues to learn more and explore how others are handling the constant stream of public pension financial management challenges.*

*This is an advanced level seminar geared to participants with at least three years experience in local government finance or equivalent education. Basic familiarity with the Illinois Downstate Police and Firefighters pension system desired. No advanced preparation is required. Earn 5 CPE.*

**Date:** Thursday, April 27, 2006

**Time:** 8:30 am–4:00 pm

**Location:** Hickory Ridge Confercenc Center, Lisle

**IGFOA member fee:** \$185.00

**Register at** [www.igfoa.org](http://www.igfoa.org)

## INSTITUTE HIGHLIGHTS

- ▶ Economic Update with Diane Swonk, Chief Economist, Mesirow Financial starts the morning off with an overview of how the economy is faring and what's in store for pension funds.
- ▶ Pension Legislative Update
- ▶ Sudan Divestiture Act
- ▶ Update on pending DROP legislation and the DROP concept
- ▶ Public Safety Employee Benefits Act
- ▶ Expanding Investment Options for Downstate pension funds
- ▶ Accounting requirements and their impact on Downstate Pension Fund
- ▶ GASB Statements 43 and 45 on accounting for retiree health care and other non-pension post-retirement benefits is right around the corner!

*IGFOA is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be addressed to the National Registry of CPE Sponsors. 150 Fourth Avenue North, Suite 700, Nashville, TN, 37219-2417. Web site: [www.nasba.org](http://www.nasba.org)*

# Tentative Illinois Public Pension Institute Agenda

*subject to change*

8:00-9:00 am	<b>Registration</b>
8:15-8:45 am	<b>GASB 40 Roundtable</b> A working session on GASB 40 implementation issues.
9:00-9:45 am	<b>Economic Update</b> with Diane Swonk, Chief Economist, Mesirow Financial A retrospective view of how investment trends, benefit levels, and actuarial assumptions have led to the current funding status of Illinois public pension funds.
9:45-10:15 am	<b>Underfunded Pension Funds:</b> How Did We Get Here?
10:15-10:30 am	<b>Break</b>
10:30-11:15 am	<b>Pension Legislation Update:</b> Public Safety Employee Benefits Act, Update on pending DROP legislation and the DROP concept and Expanding Investment Options for Downstate pension funds: HB 4685.
11:15-12:15 pm	<b>Accounting Requirements and Their Impact on Downstate Pension Fund Financial Statements</b> GASB Statements 43 and 45 on accounting nonpension postretirement benefits.
12:15-1:15 pm	<b>Lunch</b> Microfinance to Alleviate Poverty in Developing Nations—How finance can help the rest of the world's ills.
1:15-2:15 pm	<b>Strategies for the Current Investment Environment</b>
2:15-2:30 pm	Break
2:30-3:30 pm	<b>Sudan Divestiture Act</b> , what it means and what is required to be in compliance, what impact this could have on a Fund's total return and funding level, options for compliance: New "clean," SudanFree investments.
3:30-4:00 pm	<b>Police and Fire Pension Portability</b>

## **Reserve these dates!**

Watch for registration announcements at  
[www.igfoa.org](http://www.igfoa.org)

**South Metro Chapter Meeting**  
**Friday, April 7**

**Accounts Receivable and Cash Handling**  
**Thursday, April 20**

**Illinois Public Pension Institute**  
**Thursday, April 27**

**GFOA 100th Conference**  
**Montreal Canada • Sunday-Wednesday, May 7-10**

**Illinois Reception at GFOA Conference**  
**Sunday, May 7**

**TARC Meeting**  
**Monday, May 15**

**South Metro Chapter Meeting & Golf Outing**  
**Friday, June 16**

**Joint IGFOA and WGFOA Conference**  
**Ho Chunk Hotel, Wisconsin • Thursday and**  
**Friday, June 8 and 9.**  
**Featured topics: Debt Management**

**Public Finance Law Institute,**  
**Friday, August 25**

**IGFOA Annual Conference**  
**Peoria • Sunday-Tuesday, September 24-26**