November 19, 2007

Issue: Illinois Police Officers And Fire Fighters: How Good Are Their Pensions?

<u>A response presented by the Illinois Public Pension Fund Association</u>

James M. Banovetz recently co-authored a policy statement for the *NIU Center for Governmental Studies.* We are dismayed that a man of Dr. Banovetz's credentials, without citing any independent research, has presented a paper which is a complete restatement of the biased report published in February, 2007 entitled, "*Fiscal Analysis of the Downstate Police, Fire, and IMRF Pension Systems"* prepared by the Illinois Municipal League (IML). The Illinois Public Pension Fund Association (IPPFA) has already responded to this report in its April, 2007 study entitled "*Fiscal Analysis of the Downstate Police, Fire, and IMRF Pension Systems- A Critical Commentary"* . [1]

In the interest of clarity, the pertinent conclusions reached in the IPPFA response are once again presented in rebuttal to the stated IML position.

1. The Illinois Public Pension Fund Association (IPPFA) finds this report to be incomplete and misleading as to the information presented for the Downstate Police and Fire systems.

2. Funding of public retirement programs is required by statute for <u>all systems</u> in the State; and, all of the State systems, including the IMRF, use an independent actuary to determine the funding requirements based upon statutory guidelines. The IMRF is free to choose its own independent actuary as are the State administered systems. Furthermore, the Police statute provides that it is the independent Pension Board's responsibility—not the municipality's— to determine the amount of the reserves needed to meet the actuarial requirements.

3. Since Unfunded Actuarial Liabilities are essentially actuarial calculations based upon assumptions regarding future events and a chosen actuarial cost method, a comparison among pension funds is a useless exercise unless all pension funds in the comparison use the same set of actuarial assumptions and actuarial cost methods. This is clearly not the case in the State. **Thus, the table comparison on Page 10 of the IML report is a misleading attempt to compare "per capita funding comparisons" where no comparison should be made.**

4. The IML report states that "the unfunded liabilities…ultimately represent the total deficit of the fund for which no money has been set aside… [and that]…the unfunded liability has more than doubled between 2000 and 2004." "During this period of growing unfunded liability, the funded ratio of the aggregate downstate police funds declined 10.3% from 72.7% funded

in 1987 to 62.4% funded in 2004…" **Again we find the statement misleading.**

The "funding ratio" is **<u>never used</u>** to determine the solvency of a pension fund. The solvency of the pension fund is measured more by the solvency of the sponsor than by a ratio of pension assets to liabilities

5. The Illinois Department of Professional and Financial Regulation (IDPFR) annually calculates the required contribution to fund the public safety plans. These calculations are often not used to determine the tax levies by the municipalities who choose to retain independent actuaries for these calculations. These independent actuarial calculations almost exclusively produce lower municipal contribution requirements than the calculations provided by the IDPFR.

6. Despite the ability to select an independent actuary, many municipalities choose not to follow the recommendations of the actuaries that they select. **<u>It is quite self-serving now to present a comparison of "actuarial liabilities", determined under a stated basis which is rejected by many municipalities, and compare that to an asset base which is completely biased as contributions are exclusively controlled by these municipalities.</u>**

7. In 1993, the funding statute was modified to change the method of amortization of unfunded actuarial liabilities. Studies by IDPFR staff at that time calculated that this change in methodology would result in the following outcome: **<u>If every actuarial assumption used in funding were exactly realized (a virtually impossible scenario), then the unfunded actuarial liability would increase 300% in 12-years (simply because of the lower payments) and then would begin its decline to 0% by 2033.</u>**

8. The IML report notes that "after several years of high investment returns in the late 1990's, there was a significant decline between 2000 and 2002. However investment returns were more than adequate between the years 1987 and 2004....The funds should have therefore experienced a net investment gain over this seventeen-year period, positively impacting the funding level."

   Given the warnings of expected large increases in unfunded liabilities which were provided in 1993 to the municipalities by the IDPFR, the foregoing statement is completely misleading and borders on deception.

9. We are not unsympathetic to the burden passed on to taxpayers for properly funding the municipal pension programs. Strong management requires a recognition that pension funding should occur while the

pensions are being earned and not passed off to future generations of taxpayers.

It is unseemly for these same municipalities to raise issues which were anticipated and to attempt to blame the system for performing exactly as anticipated and rather hypocritical to be presenting statistics using the IDPFR results for comparative purposes when the municipalities appear to be primarily responsible for these results.

10. We disagree that the fiscal problems being experienced by the problematic state-funded plans are also in existence within the Downstate Police and Fire Pension Systems. On average the State funded plans are approximately 60% funded, while the Downstate Police and Fire plans are close to 70% funded.

“Facts” without support

Dr. Banovetz, however, is not satisfied with simply reiterating the positions espoused by the IML. He then proceeds to present unsupported and undocumented conclusions on other issues.

“Illinois’ outstate police and firefighters’ pensions are generous when compared to the pension systems offered by other states”—

> Not according to the well publicized 2004 study of “State Police” plans by *Workplace Economics, Inc*. which listed at least 18 other state police pension plans with better retirement formulas than the outstate plans. [2]

“Illinois also has the only public pension system in the nation which calculates individual police and fire pensions based either on an annualization of the amount of the last paycheck or the individual’s highest annual pay, whichever is greater”—

> Misleading at best, as at least two states (New Jersey and Indiana) use salary paid during the final year of service prior to retirement. [3]

Dr. Banovetz makes a suggestion which is particularly disturbing and shows a complete lack of understanding of the actuarial process and the profession. In commenting on the tax cap dilemma facing many municipalities, Dr. Banovetz suggests that to solve this problem municipalities have to *“use actuarial assumptions that would enable them to meet their statutory obligations to finance pensions and still keep their rates of property tax increases within statutory tax cap limitations, but not enough to keep their funds properly financed.”*

> This is not an available option which would be presented by any competent professional actuary to any municipality. The Code of Professional Conduct adopted by every major actuarial organization specifically prohibits an actuary to engage in any manner in this type of subterfuge. [4]

Police and fire unions *"acknowledge their fund's fiscal plight,…'but are not unsympathetic to the burden passed on to taxpayers for properly funding the municipal pension programs', but assert that 'managing a municipality is a difficult task requiring tradeoffs with the budget'."*

The full quotation is as follows:

> "We are not unsympathetic to the burden passed on to taxpayers for properly funding the municipal pension programs. Managing a municipality is a difficult task requiring trade-offs within the budget. <u>However, strong management requires a recognition that pension funding should occur while the pensions are being earned and not passed off to future generations of taxpayers.</u> <u>The system for proper funding of municipal pension plans was altered in 1993 when the contribution methodology was changed at the behest of the municipalities to lower their current costs. It is now unseemly for these same municipalities to raise issues which were anticipated and to attempt to blame the system for performing exactly as anticipated.</u>" (emphasis added) [5]

<u>Opinions without substance</u>

Despite offering no citations for the above conclusions, Dr. Banovetz then proceeds to offer his opinions as to a proper solution to this "pension crisis".

> *What should be done to improve the funds' financial health?*
>
> *Ultimately Illinois Governor Rod Blagojevich put the matter most succinctly in his 2003 annual budget address to the General Assembly when he argued. "Unless we reform the way we fund our pensions…we will never eliminate the structural deficit that takes money away from education, from healthcare, from law enforcement, from parks and from everything we care about."*

Dr. Banovetz's "solution" to Governor Blagojevich's challenge is that "No further benefit enhancements should be considered for municipal police and fire pension funds until the legislature has taken meaningful action to make the funds more fiscally sound ."

Governor Blagojevich and the legislature however appear to disagree with Dr. Banovetz, for on August 28, 2007, Public Act 95-0530 was signed into law. This statute amended 40 ILCS 5-3/125 to provide “that the annual property tax levied for pension purposes shall be forwarded directly to the treasurer of the board within 30 business days after receipt by the county. Effective immediately.” [6]

Nonetheless, this statutory change, although quite welcome, simply begs the question. **Why was this legislation necessary?** The answer is, obviously, that many municipalities feel it is their absolute right to withhold amounts collected from taxpayers for the specific purpose of funding police and firefighter pension funds for prolonged periods of time rather than releasing these funds to the Trustees for investment and disbursement to pensioners and beneficiaries.

We suggest that rather than proffering a limitation on benefit enhancements, Dr. Banovetz should instead focus on urging the municipalities and the courts to comply with the current statutes which would enhance the solvency of the outstate funds.

Dr. Banovetz continues—

> *Unions would be well advised to avoid the kinds of “double speak” which has characterized their support of the DROP proposal.*

In what is clearly an incorrect citation [7], Dr. Banovetz indicates that the unions would not advance and fight for the [DROP] proposal unless it was attractive to their membership (meaning that they expected many of their members would take advantage of the added benefits). We challenge Dr. Banovetz to present any substantiated study or independent research paper which supports his uninformed statement. To our knowledge there are none.

Unfortunately, in our opinion, Dr. Banovetz has succumbed to fallacious, unsupported arguments presented by the Illinois Municipal League as facts, in an attempt to shift blame to the Illinois Legislature for causing the underfunded status of the outstate retirement plans; when the true culprits appear to be the municipalities themselves.

We are disappointed in Dr. Banovetz.

ENDNOTES

[1] Dr. Banovetz cites this treatise in his footnote 12 plainly as an "undated paper prepared by the Illinois Public Pension Fund Association commenting on the IML report and titled, simply, 'Introduction'." The full report is available on the Illinois Public Pension Fund Association website www.ippfa.org under Legislative Summary: Alert.

[2] http://www.leoff.wa.gov/boardStudies/documents/AgendaItem6-FinalAverageSalaryAppendixA-InitialConsideration.pdf

[3] *Ibid*

[4] http://www.actuary.org/pdf/prof/code_of_conduct.pdf. See particularly Precept 1 with annotations: "An Actuary shall act honestly, with integrity and competence, and in a manner to fulfill the profession's responsibility to the public and to uphold the reputation of the actuarial profession."

[5] "*Fiscal Analysis of the Downstate Police, Fire, and IMRF Pension Systems-A Critical Commentary",* IPPFA, (April, 2007) p.9

[6] P.A. 95-0530: http://www.ilga.gov/legislation/billstatus.asp?DocNum=65&GAID=9&GA=95&DocTypeID=SB&LegID=27276&SessionID=51 Synopsis As Introduced.

[7] The IPPFA response in Endnote No. 5 above makes no mention of the DROP program. Perhaps Dr. Banovetz is referring to the article "Deferred Retirement Option Plans (DROP Plans)", by Arthur H. Tepfer and Carol V. Calhoun, Esq., *Pension & Benefits Week*, (10/13/1998), ©1998 Research Institute of America