Actuarial Funding Problem

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Actuarial Funding Problem

- On July 1,1993 public pension funds unfunded liability was amortized over a new 40-year period as a level percentage of payroll rather than in equal annual payments.

Actuarial Funding Problem

- In mortgage terms, we have refinanced the liabilities over a NEW 40-Year period and have set up payments under a NEGATIVE AMORTIZATION SCHEDULE! Under negative amortization, payments are initially determined at an artificially low amount which are scheduled to increase dramatically in future years BUT WHICH CURRENTLY ARE INSUFFICIENT TO FUND THE INTEREST PORTION OF MORTGAGE!

Actuarial Funding Problem

- It should be noted that the amortization payments to the pension under this 1993 law were about 60% lower then they would have been under the old law in the beginning years. But by 2020 the 1993 amortization schedule will be 66% higher than the old law. By the end of the 40-year period in 2033, the amortization schedule will be over 31/2 times the original prior law payment.

Actuarial Funding Problem

- What can be done? The first step is understanding and educating. In practical terms municipal authorities should fund the pension if possible over the actuarial amount. Those dollars are cheaper today and will help reduce the unfunded liability. Assumptions should be conservative in nature.

Actuarial Funding Problem

- What can be done: A new law should be passed that allows the amortization clock to be restarted with the old actuarial method of equal annual payments. This should stabilize the funding and stop the increasing amount needed to fund the pensions.

Examining the municipal payment in two pieces is appropriate. The payment on the normal cost, by definition, is always a level percentage of payroll. This normal cost is offset by the 9% contributions made by the police officers. In our example, this net municipal cost is a constant 18% of payroll – an initially affordable amount. The payment on the unfunded liability under new law also is a constant percentage of payroll – in our example, slightly under 3% of payroll. But as payroll increases, this amortization payment also increases. Figure 2 illustrates this concept.

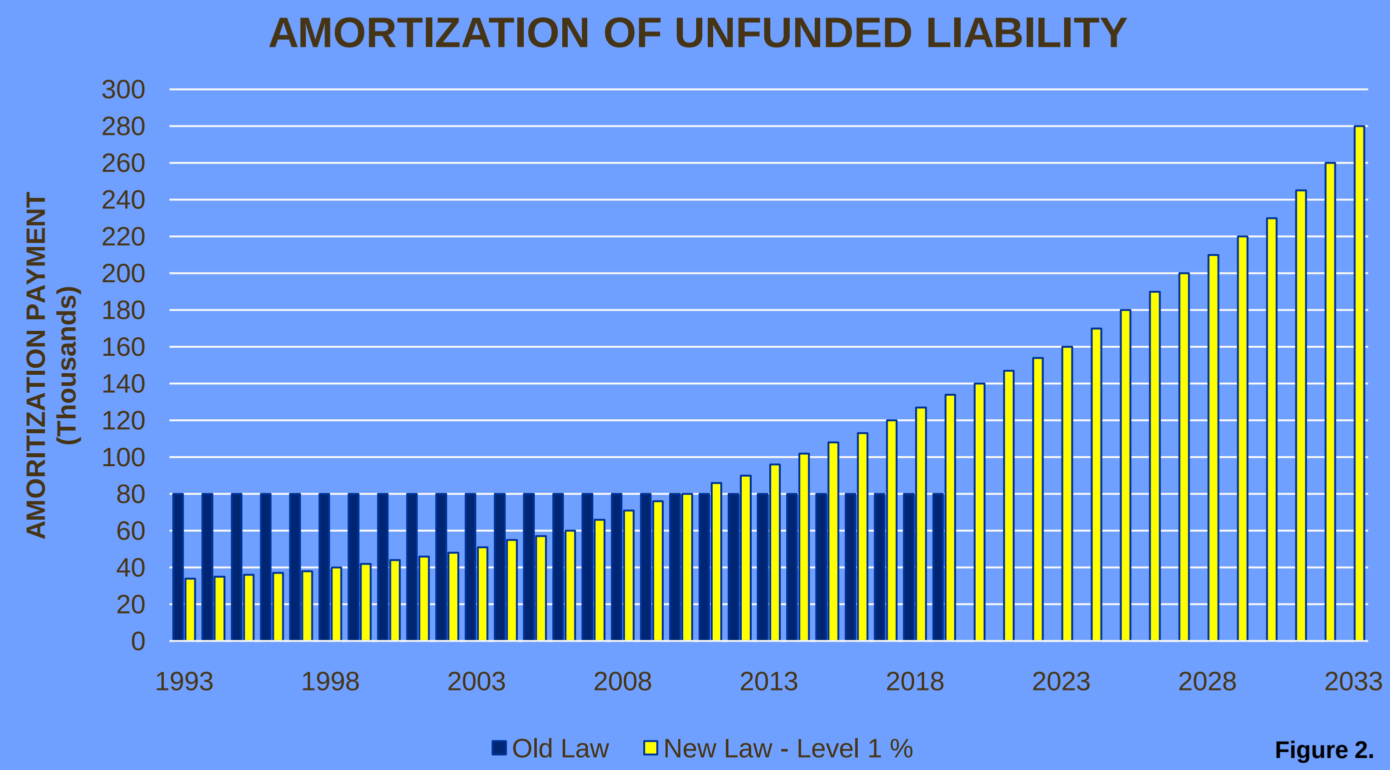

Figure 2.

Note that the amortization payment in the early years is approximately 60% lower under the new law than the prior law. By the year 2010, when the unfunded liability was originally scheduled to be fully amortized, the amortization payment will be over 66% higher than under prior old law. By the end of the 40-year period, 2033, the amortization payment will be almost 3 ½ times the original prior law payment.

Payroll Tax Savings

- For most Municipalities having a police and fire pension fund has resulted in a payroll tax savings to the municipality. How can that be? By having a police and fire pension fund most municipalities are exempted from paying FICA for those police and fire personnel who are participants in the system.

Payroll tax savings

- It works this way. The employer (your municipality) has to pay 6.2% towards social security. That is their contribution, and payroll cost. So if your police officer payroll is, “lets say two million a year”. The municipality is saving $124,000 in contributions that they do not have to make to FICA.

Payroll Tax Saving

- Why don’t they have to pay FICA for police and firefighters? When social security was set up, municipalities lobbied to be exempt under the understanding that they would provide a good retirement pension so there was no need to have social security coverage

Payroll Tax Savings

- Do the municipalities pay FICA for the other public employees? The answer is yes they do, although you will not see it added into the retirement costs for those employees.

Retirement Realities

- Police Officers and Firefighters rely on their pension as the main source of retirement security. They do not have paid health insurance in retirement, most do not have social security or suffer the government pension offset when they earn enough credits.

Retirement Realties

- Police Officers and Firefighters pay the highest contribution levels toward their pensions in the state. In the Midwest the municipal police and firefighters pay more towards their pensions then what is paid in the surroundings states.

Retirement Realities

- Most of the surrounding states have paid retiree health insurance for their police and fire retirees. Illinois municipalities have a basic retirement pension for Municipal Police and Fire.