



**IPPFA ANNUAL TRAINING CONFERENCE
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**RENAISSANCE HOTEL
ST. LOUIS, MISSOURI**

**LEGAL ISSUES DEALING WITH UNDER- FUNDING;
STRATEGIES AND OPTIONS WHEN YOUR MUNICIPALITY UNDER- FUNDS YOUR
PENSION FUND**

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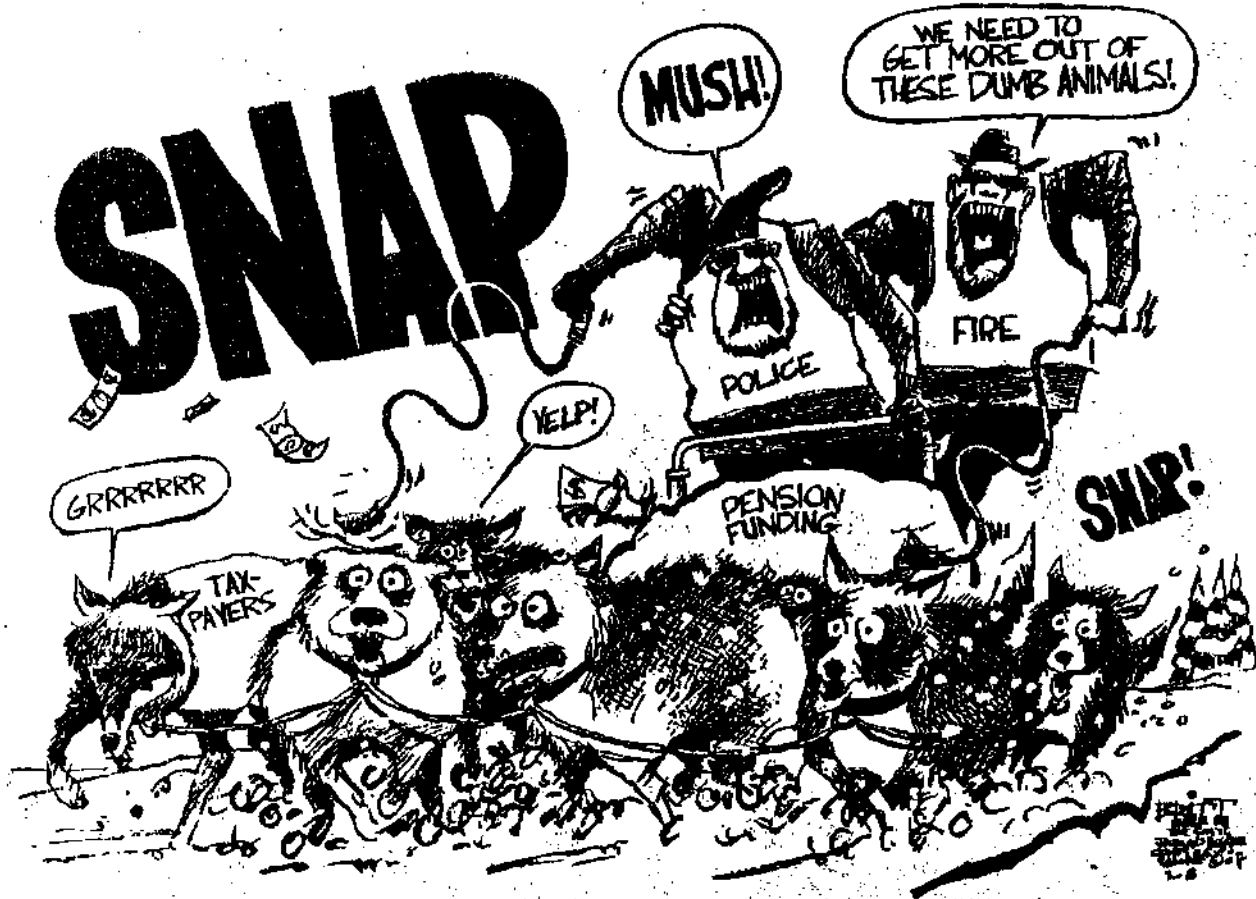
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OPINION

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THE STATE JOURNAL-REGISTER

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Visit sj-r.com and click on "Opinion" to see an archive of Britt cartoons.

The information contained in this handout is designed to highlight basic information for individuals who have been elected or appointed as trustee board members to Police and Firefighter Pension Funds in downstate Illinois. Due to time and space constraints, the subject matter in this handout is greatly condensed. Trustees seeking more detailed information on any of the areas highlighted in this material should consult with the IPPFA or an attorney who is experienced in dealing with Public Pension Fund issues.

Before one can address how to deal with underfunding issues, one must fully understand how a downstate police and fire pension fund receives it's monies.

1. **FUNDING SOURCES FOR YOUR PENSION FUND:**

Downstate Police and Firefighter Pension Funds receive their monies from four (4) sources:

- A. Contributions by participants which are based upon statutory percentages of their salary. Currently, firefighter's contribute 9.455% of their pay while police officers are required to contribute 9.91% of their pay. These employee contribution rates are significantly less than the employer contribution rates and can only be altered by the Illinois General Assembly. (40 ILCS 5/3 - 125.1 Police) (40 ILCS 5/4 - 118.1 Fire)
- B. Return on fund investments. (40 ILCS 5/4 -128)
- C. Employer contributions primarily come from a tax on real property, but can also come from other local revenue sources (40 ILCS 5/3 -125 Police) (40 ILCS 5/4 - 118/(a) Fire) (This contribution amount is usually determined by the State Actuarial Report or an independent Actuarial Report obtained by the board or municipality.)
- D. Gifts and donations in the form of money, real estate, or personal property. (40 ILCS 5/3 - 140.1 Police) (40 ILCS 5/4 - 129.1 Fire)

Downstate Police (40 ILCS 5/3 - 125) and Downstate Fire (40 ILCS 5/4 -118) contain statutory language regarding financing pension funds as follows:

"The city council or the board of trustees of the municipality shall annually levy a tax upon all the taxable property of the municipality at the rate on the dollar which will produce an amount which, when added to the deductions from the salaries or wages of police officers (firefighters), and revenues available from other sources, will equal a sum sufficient to meet the annual requirements of the (police/fire) pension funds."

Municipal funding of Police and Fire Pension Funds consists of two (2) elements, which differ slightly for Police and Fire.

A. Police

1. The normal cost of the Police Pension Fund for the fiscal year involved;
2. The amount necessary to amortize the Pension Fund's unfunded accrued liability by the year 2033.

B. Fire

1. The normal cost of the Fire Pension Fund for the year involved or 17.5% of the salaries of the firefighters for the year involved, whichever is greater;
2. The amount necessary to amortize the Pension Fund's unfunded accrued liability by the year 2033.

Trustees should be aware of and monitor these four (4) funding sources to make certain the integrity of the fund is preserved. Failure to receive sufficient funds from all four (4) of these sources will result in an under funding of the fund. Current Illinois law requires all pension funds to be fully funded by the year 2033.

After fully understanding the process of funding, Trustees must examine the State requirements to address proper funding.

2. STATE ACTUARIAL REPORT:

One of the most important responsibilities as a trustee of a police or firefighter pension fund is for you to be familiar with and review the State actuarial report which is produced on an annual basis by the Illinois Department of Insurance. This actuarial report is produced based upon information which is provided by the pension board in its' annual statement and other information which is available to the Department. Part of the information which is generated in this report includes information on the amount your fund is under funded as well as the recommended funding level from the municipality. State law requires all pension funds to be fully funded by the year 2033. Trustees are required to review this information and submit a written request to the municipality for funding (typically through a tax levy) on an annual basis. A pension fund trustee has a fiduciary duty to see that contributions are properly made by the municipality. Trustees are under a statutory duty to investigate any possibility of under funding as it relates to the fund.

3. **STRATEGIES AND OPTIONS WHEN YOUR MUNICIPALITY UNDERFUNDS YOUR PENSION FUND**

A. **Hiring an independent actuary.**

Pension boards have the authority to hire professionals to assist them in carrying out their fiduciary responsibilities. One of these professionals could be an independent actuary who can meet with the Board to provide a direct analysis of their pension fund with specific assumptions which are unique to the individual pension fund. For example, issues which an independent actuary will address include, interest rate assumption on investments, mortality rate assumptions, decrement assumption other than mortality, salary progression assumptions, along with other issues.

An independent actuarial report will present the fund with a more precise estimate of the minimum contribution by the Municipality than the one provided by the State.

The statute requires a Municipality to base its contributions to the pension fund on an Actuarial Report. The Municipality may rely on the Actuarial Report produced by the Illinois Department of Insurance, an independent Actuarial Report produced by the Pension Fund, or an independent Actuarial Report produced by the Municipality.

B. **Compare State Actuarial Report to independent Actuarial Report.**

One advantage to obtaining an independent Actuarial Report is to allow fund members and the Municipality to have a comparison to the State Actuarial Report. While the Municipality may choose to base its contribution on the lower of the two suggested minimum contributions, it will lend credibility to the pension board's request for funding.

C. **Verify funding from all four (4) sources to make certain of all receipts of monies which are due the Pension Fund.**

Part of a Trustee's fiduciary duty is to make certain that the fund is receiving monies from all sources which are due to the pension fund. Boards should anticipate that when addressing issues of funding through the Municipality, that they can assure the Municipality that they have met their fiduciary responsibility in making sure that the fund has received all monies from any other sources (i.e. member contributions, return on investment, gifts (if any)). Once the board has established that it has met this fiduciary responsibility the remaining funding must come from the Municipality. Since the Municipality is asked to levy a tax or generate funding from another source, it must be able to assure the taxpayers of the Municipality that the request

is credible. The issue of credibility cuts both ways, in that it is in the best interest of pension fund members to demonstrate to the taxpayers that the fund is generating funding through sources other than Municipality contributions.

D. **Meet with Municipality representatives to determine why municipal underfunding exists and whether the Municipality will fully fund pursuant to Statute.**

Should a Municipality fail to issue a proper tax levy or provide the minimum funding requirement pursuant to the Actuarial Report, the pension board must act timely to meet with representatives of the Municipality to determine why the Municipality has failed to meet its statutory obligation. Municipalities may have different forms of government which may require board members to meet with a Mayor, City Manager, Finance Commissioner, Treasurer, Committee Chairman, or a combination of these individuals, to schedule a meeting with representatives of the Police or Fire Pension Boards to begin face to face negotiations. Boards would be well advised to involve their board attorney in these discussions. While Municipalities may offer an explanation for underfunding due to a short term financial crisis (i.e. Plant closure or other one time event which severely impacts the tax base), a plan should be established in which the Municipality fulfills its contribution requirements on a timely basis. Failure to address this issue timely will only cause the underfunding issue to worsen.

E. **Determine if the Municipality is willing to conduct a public hearing pursuant to the Truth in Taxation Law to increase tax revenues to fund the Pension Fund.**

The Truth in Taxation Law¹ requires a taxing district to compare the amount of its proposed aggregate property tax levy, to the amount of taxes extended for the district in the prior year. Notice must be published in a newspaper and a public hearing must be held, if the proposed aggregate tax levy is more than 5% greater than the previous year's tax extension. No elected official enjoys facing the voters to request a tax increase and therefore, elected officials tend to use this as a last resort. Most Municipalities plan their annual budgets on a 4.99% increase of the prior fiscal year's budget in order to avoid the need for a public hearing. However, out of that 4.99% increase, there must be sufficient revenues to properly fund the police and fire pension funds, along with all other Municipality services. If a public hearing is to take place, a joint effort should be made by pension fund members and the Municipality to properly educate the taxpayers as to the need for the additional funding.

¹ 35 ILCS 200/18-55 through 35 ILCS 200/18-100

F. **Create a strategy to educate and inform the taxpayers of the situation and the statutory requirements which must be met.**

The editorial cartoon from The State Journal-Register, dated February 13, 2008, which is included with these materials, depicts one point of view regarding the perception people may have regarding funding of police and fire pension funds. The current legislative session in Springfield, Illinois contains a number of proposals from the Illinois Municipal League which impact on police and fire pension funding. It is important for pension fund members to make certain that taxpayers fully understand the pension funding process and that they are provided accurate information in order that they make an informed decision.

G. **If all else fails, hire competent legal counsel to take legal action against the Municipality to collect proper tax revenues for pension funding.**

Litigation by the pension fund against the Municipality should always be viewed as a last resort. Pension boards faced with this situation should hire experienced legal counsel to represent their interest. At the end of the day, members of the police and fire pension funds are employed by the Municipality and typically reside in the community in which they work. Litigation typically creates heightened tension and animosity between the litigants. The Municipality typically reacts to litigation by initiating layoffs of police or fire employees in an effort to fulfill it's obligations to the pension fund. The pension fund members typically react with lowered morale when faced with additional work loads and the concerns related to their personal job security. Occasionally, these issues tie in with labor contracts which may have been negotiated with the Municipality and labor unions which represent police officers and/or firefighters.