# "THE ROLE OF THE DEPARTMENT OF INSURANCE IN PENSION REFORM"

Illinois Department of Insurance
Division of Public Pension

# Illinois Public Pension Fund Association
# Naperville Regional Seminar – January 27, 2011

Presented by

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# Pension Reform Overview

- ***Public Act 96- 1495*** *was signed by Governor Quinn on December 30, 2010. It became effective January 1, 2011.*
- **Summary of Changes:**
  - Creates a **Second Tier of benefits** for Police Officers and Firefighters as of 1/1/11.
  - Provides **expanded investment options** for Article 3 and 4 pension funds.
  - Requires the **Commission on Government Forecasting and Accountability** to conduct three studies impacting Article 3 and 4 funds.
  - Creates an **IMRF style enforcement mechanism** to require municipalities to make required contributions to Police and Fire funds beginning in 2016.
  - Requires **actuarial changes**, including a 90% funding ramp by 2040, usage of the projected unit credit actuarial cost method, and recognition of investment gains and losses over a five year period.

# “Tier I” Pension Benefits

**40 ILCS 5/3-111(d). Pension.**

“Notwithstanding any other provision of this Article, the provisions of this subsection (d) apply to a person who is not a participant in the self managed plan and who first becomes a police officer under this Article on or after January 1, 2011.”

**40 ILCS 5/4-109(c). Pension.**

“Notwithstanding any other provision of this Article, the provisions of this subsection (c) apply to a person who first becomes a firefighter under this Article on or after January 1, 2011.”

**Benefits for existing Article 3 and Article 4 participants are not impacted by PA 96-1495.**

# "Tier I" – DOI Impacts

- **Annual Statement** format will need to incorporate a status indicator to flag participants as Tier 1 or Tier 2. This flag will be necessary to assist with appropriate benefit calculations.
- **Legal Interpretations** – "Meaning of First Entry Under Article"
  - New Fund Creation due to 2010 Census.
  - Previous participants who withdrew contributions.
  - Creditable Service Time Transfer windows (e.g. Article 5 or 6).
  - May ultimately need to be addressed in a trailer bill.
- **No additional funding** for implementation of Pension Reform.

# "Tier II" Pension Benefits

**Police/Firefighters first entering the Article after 12/31/10:**

- **Retirement at age 55** with 10 or more years of service.
- **Early Retirement at age 50** with 10 or more years of service, but with a penalty of ½ of 1% for each month that the retiree is under 55 years of age (6% per year, up to 30% maximum penalty).
- **Final Average Salary** based on the highest consecutive 96 months of the final 120 months of service.
- **Maximum pension** is 75% of final average salary, earned at 2.5% annually up to 30 years of service.

# "Tier II" Pension Benefits

**Police/Firefighters first entering the Article after 12/31/10:**

- **Pensionable salary capped at $106,800** increased yearly by the lesser of ½ of the Consumer Price Index – U (CPI-U) or 3% of the originally granted pension.

- **COLA increases begin at age 60 or on the first anniversary of the pension start date, whichever is later.** COLA increases are based on the lesser of ½ of the CPI-U or 3% of the originally granted pension.

- **Surviving Spouse, children or parent(s) pensions** are set at 66 2/3% of the pension at the date of death. COLA increases are based on the lesser of ½ of the CPI-U or 3% of the originally granted pension.

# "Tier II" – DOI Impacts

- **"Siren"** to be finalized on Pension Reform for distribution in the near future.
- The Department of Insurance is required to **annually certify the COLA increase and Pensionable Salary Cap increase.** The calculation utilizes the October to September Consumer Price Index-U increase. The certified increase will be ½ of the annual CPI-U increase or 3%, whichever is less.
- Changes required to the **annual reporting system**
  - **New Status Code** to identify Tier 1 and Tier 2 participants.
  - **Validation** for Salary Cap ($106,800 for FY 11).
  - **Benefits Calculator** to be updated.

# "Tier II" – DOI Impacts

- Changes to the **Audit Process:**
  - **Pension Auditors** receiving training on new Pension Reform requirements.
  - **Audit Impact will be delayed** as fund examinations that include FY 2011 cannot begin until final annual reports have been filed by the individual fund. These audits will likely not begin until the last quarter of calendar year 2011.
  - Due to two tier system, audits will increase in complexity as time goes on.
  - The agency will include **Pension Reform reference materials** in the reportable items of audits now being completed (e.g. placement of calculation of final average salary in membership file).

# Expanded Investment Options

- ***40 ILCS 5/1-113.2(8) Permitted Investments***

  Interest bearing funds or pooled accounts of the **Illinois Metropolitan Investment Funds.**

- ***40 ILCS 5/1-113.2(14) Permitted Investments***

  **Corporate bonds** managed through an investment advisor:

  - **Must be rated as investment grade** by one of the 2 largest rating services at the time of purchase.
  - **If subsequently downgraded** below investment grade, the bonds must be liquidated from the portfolio within 90 days after being downgraded by the manager.

# Expanded Investment Options

- ***40 ILCS 5/1-113.4a Additional permitted investments for funds with net assets of $10,000,000 or more.***
  - **Common and preferred stocks**
    - Must be invested through an **investment adviser.**
    - Must be listed on a **national securities exchange or board of trade.**
    - Securities must be of a corporation **in existence for at least 5 years.**
    - Market value of stock in any one corporation **may not exceed 5%** of the total outstanding stock of that corporation.
    - Straight convertible or preferred stock **must be issued or guaranteed by the corporation** whose common stock qualifies for investment by the pension fund board.

# Expanded Investment Options

- ***40 ILCS 5/1-113.4a Additional permitted investments for funds with net assets of $10,000,000 or more (continued).***
  - **Mutual Funds**
    - Must be invested through an **investment advisor.**
    - Must be **managed by an investment company** registered under the Federal Investment Company Act of 1940 and registered under the Illinois Securities Law of 1953.
    - Must have been **in operation for at least 5 years.**
    - Must have **total net assets of $250,000,000** or more.
    - Comprised of a **diversified portfolio** of common or preferred stocks, bonds, or money market instruments.

# Expanded Investment Options

- ***40 ILCS 5/1-113.4a Additional permitted investments for funds with net assets of $10,000,000 or more (continued).***
  - **Total investment in the items** authorized under this new Section 1-113.4a and Section 1-113.3 cannot exceed:
    - **50**% of fund's net present assets effective July 1, 2011.
    - **55** % of fund's net present assets effective July 1, 2012.
  - **Requires the pension fund to electronically file** any reports of investment activities required by the Department of Insurance.

# Expanded Investment Options – DOI Impacts

- **"Siren"** to be finalized on Pension Reform for distribution in the near future.
- **Pension Auditors** receiving training on new investment options and direction on reviewing those options during audits.
- **Changes required** to the annual reporting system:
  - **Modify annual statements** for acceptance of newly required reports of investment activities.
  - **Validation change** to accept corporate bonds as authorized.
  - **Validation change** to allow additional stock and mutual fund investments for the funds above $10,000,000.
- **Legal interpretations** to formalize DOI positions.

# Financing – Actuarial Changes

- ***40 ILCS 5/3-125(a) and 4-118(a) Financing***
  - **Municipalities required** to fund pension fund to 90 % of the total actuarial liabilities by 2040.
    - Must be determined by an **Enrolled Actuary.**
    - Actuarial liabilities determined using **Projected Unit Credit Actuarial Cost Method.**
    - **Amortization payment** determined using level percent of payroll method through 2040.

# Financing – Actuarial Changes

- ***40 ILCS 5/3-125(b) and 4-118(a-5) Financing***
  - **Valuation of Pension Fund Assets**
    - **On March 31, 2011,** the actuarial value of a pension fund's assets shall be equal to the market value of the assets as of that date.
    - In determining the actuarial value of assets after March 31, 2011, any **actuarial gains or losses from investment returns** incurred in a fiscal year shall be recognized in **equal amounts over the 5-year period** following that fiscal year.

# Financing – Actuarial Changes DOI Impacts

- **“Siren”** to be finalized on Pension Reform for distribution in the near future.
- Department of Insurance to employ an **Enrolled Actuary**.
- **Modify actuarial valuation programs** to incorporate:
  - New amortization period.
  - New actuarial cost method.
  - New 90% funding requirement.
  - New asset valuation method.
  - New investment gain and loss requirement.
  - New Tier-2 benefit structure.
- The Department is **temporarily unable to provide** tax levies, portability or new fund calculations until programs are modified.

# Enforcement of Municipal Contributions

- **Effective in FY 2016,** Municipalities will be required to make full annual employer contributions to Article 3 and Article 4 funds.
- **If a muncipal contribution payment is more than 90 days late,** an Article 3 or Article 4 pension fund can certify to the Illinois State Comptroller the amounts of the delinquent payments. The pension fund must give notice to the municipality of this action.
- **The Comptroller must deduct and deposit into the pension fund** the certified amounts or portion of those amounts from the following proportions of grants of state funds to the municipality:
  - In FY 2016, one-third of the total amount of any grants of State funds;
  - In FY 2017, two-thirds of the total amount of any grants of State funds;
  - In FY 2018 and thereafter, the total amount of any grants of State Funds;
- **The deduction cannot exceed** the amount of delinquent payments.

# Enforcement of Municipal Contributions DOI Impacts

- **The Department does not have a formalized role** in the enforcement mechanism for municipal contributions as contained in PA 96-1495.

- It is expected that the **Department will serve in an advisory capacity** to assist pension funds and municipalities with questions regarding the certification process.

# Commission on Governmental Forecasting and Accountability (COGFA) Studies

- **Feasibility of creating an investment pool for Article 3 and Article 4 Pension Funds.** The study will include an analysis of any costs or savings associated with establishing the system and transferring assets to the pool. Study results are due 12/31/2011 to the General Assembly.
- **Feasibility of creating a cost-share component** where municipalities and fund members each contribute 50% of normal cost to a defined benefit plan. Study results are due 12/31/2011 to the General Assembly.
- **A study of Article 3 and Article 4** fund balances, historical employer contribution rates, and actuarial formulas utilized as the basis for employer contributions. Additional items to be reviewed include assumed rates of return, available contribution fund sources, impact of revenue limiting factors such as non-home rule status, and existing statutory funding compliance procedures and mechanisms. Study results are due 12/31/2012 to the General Assembly.

# Commission on Governmental Forecasting and Accountability (COGFA) Studies – DOI Impact

- **Provision of fund contact information to COGFA.** COGFA will be developing an on-line survey to assist with the required studies. Fund trustees will be contacted and asked to access the survey on the COGFA website.

- **Sharing of applicable historical data** as contained in the Annual Statement reporting system. DOI will signed and dated by the treasurer and the authorized representative of the bank(s) utilized by the pension fund.

- **Assistance with gathering data or contacting funds** on an as-needed basis.

# Questions or Comments?

# Contacting the Public Pension Division

**Internet:**

https://insurance.illinois.gov/Applications/Pension

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|---|---|
| **Mailing Address:** | Illinois Department of Insurance<br>Public Pension Division<br>320 West Washington Street, Room 606<br>Springfield, IL 62767 |
| **Phone:** | (217) 782-7542 or (800) 207-6958 |
| **Fax:** | (217) 524-5978 |
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# Speaker contact information

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