Current Topics in Public Pensions

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PREPARE PROTECT EDUCATE INFORM

Today's Topics - Primarily Member Issues

- Tier 2 Impact
- Police and Fire Life Expectancy
- Who Pays for Public Pensions?
- Divorce and the Illinois Public Pension
- Disability Awards in Illinois Pension Systems

Tier 2 Impact

Impact of Tier 2 on Funding and Taxes

Tier 2 Effective for New Hires – 1/1/11

Changes	Salary used for pension calculation, the annual pension increase (often called COLAs), the benefit paid to a survivor and the age at which an unreduced pension may begin. **Importantly, the percentage (%) of salary contribution paid by the Tier 2 member is the same as Tier 1.**

Retirement Age	Downstate and Chicago PD and FD maintained reasonable retirement ages (55). Much higher ages were instituted for Illinois State Police (60) and for Cook County, police/fire in IMRF and Illinois university police (67).

Tier 1 and Tier 2 Cost Comparison

The Jackson Twins. In a Downstate Police fund, two employees are hired at age 25, one just before 1/1/11 and one just after. Assuming non-compounding COLA of 2% (Tier 2 COLAs fluctuate), and Social Security based life-expectancy, the Tier 2 payout will be 31% lower during the retiree and survivor's lifetimes, excluding consideration of disability.

Who pays? Since the Tier 2 police make the same 9.91% of pay contribution, all cost reduction accrues to the taxpayer. So the municipal savings on the normal cost portion of retirement is more than 31%. A prominent Article 3-4 actuary says that the Tier 2 normal cost may be as low as 5% of salary.

Tier Cost Comparison (cont)

<u>Impact Overall</u>. The impact of Tier 2 on funding and taxes will be considerable, given time. However, the percentage of taxation that goes towards the amortization of unfunded liabilities is not changed by Tier 2. Thus, well-funded plans will see a Tier 2 impact sooner; poorly funded plans not as quickly.

<u>Skokie Penetration</u>. Skokie Police and Fire active personnel have surpassed 25% of members at Tier 2. Fire is approaching 30%.

<u>Tier 1/Tier 2 membership numbers</u> are shown for *all funds* in the 2017 Illinois Department of Insurance Biennial Report.

Tier 1 and Tier 2 Cost Comparison

Tier 2 Cost Reduction –

What's the Takeaway?

Tier 2 Normal Costs are considerably lower than Tier 1, especially considering the payroll contribution from the police officer/firefighter. This will soon be felt by the taxpayer as more and more members are in Tier 2. The pension plans level of funding will influence how quickly Tier 2 changes are felt.

A Second, Political, Takeaway

Some public plans nationwide have switched to defined-contribution or hybrid plans for new employees. This type of change is hailed as reform by certain media (*WSJ*) and think-tank groups.

But, Illinois' Tier 2 system is substantially lower in cost than most DC systems. We have already "reformed," big time.

How is Tier 2 Cheaper than DC?

If Tier 2 costs 5% of salary, any DC match at or above that level is not a cost-saving approach.

And then, the whole issue of the downside of Defined Contribution comes in to play:

- inadequate overall savings,
- high comparative costs,
- low benefits for early career disability,
- “leakage.”

Police and Fire Life Expectancy

Police and Fire Life Expectancy

RUMOR: Police and Fire personnel don't live very long.

FACT: Publicly available proof is scarce.

- Oregon and California statewide pension system studies showed no difference but omitted the largest cities and some urban counties.
- It is intuitive that public safety workers may live longer than the entire population due to education, income, medical insurance and entry-level good health.
- It is equally intuitive that the physical and mental demands of the profession lead to specific or general health issues that shorten life when compared to a town's general service employees.

Next Action: a look at the Skokie data

Reviewing Skokie’s Information

- Pension administrator (CPA firm) had good data on fire/police current retirees and survivors on pension.
- IMRF was willing and able to provide data on current retirees and limited information on survivors.
- Gaps in IMRF survivor data were filled-in with the help of a knowledgeable long-term employee and internet available obituaries.

Reviewing Skokie's Information (cont)

- Limitations:

  (a) the database is small (there were only 19 police survivors on the date examined).

  (b) the number of female police/fire retirees is small.

  (c) "there is a "survivor bias" in favor of IMRF employees. They can start the job at any age, even at age 60. They are simply going to be older while working, on pension and at death when compared to FD/PD.

Skokie Data – Male Retirees Age 60+

	Police	Fire	IMRF
Number of Retirees	80	77	103
Average Age	71.5	72.7	73.4
Median Age	71.5	72.1	72.4
Oldest Retiree	93	91	95

Age at Death of Male Skokie Employee/ Retirees*

	Police	Fire	IMRF
Number of Survivors	19	37	41
Average Age at Death	63.6	67.9	73.9
Median Age at Death	62.9	67.3	74.2
Age Range at Death	35 to 89	33 to 88	47 to 89

*whose survivor received a pension in September 2014

What Does the Skokie Data Show?

Age of Retirees:

- Male retires aged 60 and over are oldest at IMRF (73.4) then fire (72.7) and police (71.5).
- This may be simply a reflection of the "survivor bias" mentioned: IMRF employees/retirees *will be* older than police and fire personnel.

Age at Death:

- Sworn personnel age-at-death was younger than general service employees - six years younger for fire and a surprising *ten years younger at police*.
- This is a larger gap that I expected, even considering the older age of the IMRF group.

What Does the Skokie Data Mean?

From a pension funding standpoint: not much. If Skokie does have shorter life expectancy than the actuary's table, that will be picked up as actuarial gains as people die young.

From a public policy standpoint: all stakeholders should be concerned about a life-expectancy gap. Public safety labor and leadership groups have been diligent in identifying methods to reduce health risks, especially the well-documented cancer exposure for firefighters. Their recommendations should be carefully considered by public officials.

From an employee standpoint: redouble efforts to maintain good health: a physician relationship, age/gender appropriate screening, smoking cessation, physical activity and stress reduction.

Who Pays for Public Pensions?

Who Pays for Public Pensions?

Secret Hint: it is the member AND the taxpayer

Members pay a substantial contribution to Illinois public pensions. Considering the normal cost only, the member contribution each year is north of 30%, and some member contributions are estimated to be as high as 40% of the normal cost.

Then what's this about?

> *…. these pension millionaires contributed so little to the system that they "broke-even" on their "cost-basis" within the first 20 months of retirement." (Forbes,* April 22, 2016).

What's going on?

This writer, and many others, gives the member *no* credit for the investment earnings on their contributions. The troublemaker simply divides the member's contributions into the expected lifetime pension. This is a meaningless calculation, but especially irrelevant if it ignores investment returns on the member's contributed capital.

Who Pays for Public Pensions?

So what is *this* about:

From "Pension Benefits of Chicago Workers," Illinois Policy Institute Website

> *Ms. (Teacher) … will receive $2.4 million in pension benefits during her retirement… Yet she contributed just $147,032 to the pension system over her 30-plus year career. Her direct contributions…will cover just 6.2 percent of her expected lifetime benefits.* ***Including the interest earned on those contributions, the total would cover approximately 12 percent.***

→ This writer is saying that the member contributed just 6.2% of the lifetime pension but when investment earnings ARE considered, the amount she contributed still only grows to 12%, less than twice the contributed amount.

→ Really? The amount contributed over more than 30 years does not even double when investment returns are computed?

Who Pays for Public Pensions?

Why is the estimate of this career teacher's contributions to her own pension so low? Because it mistakenly assumes that her money disappears the day she retires. Take a look…..

I can recreate the 12% figure by crediting 5% annual earnings over her career.

- But the Chicago Teachers Fund certainly earned more than that over the past 30+ years. If the rate is increased to 7% annually, her contribution and earnings on the day she retires will cover 19% of her lifetime pension.

BUT, there's more:

- Employee's accumulated payroll contributions and earnings don't disappear on retirement day.
- They continue to earn interest and gains during retirement. Using Social Security life-expectancy tables and the 7% interest rate, I estimate she contributed 32% of her own pension, approximately the expected amount.

Don't let the substantial contribution of public employees to their own pensions be denigrated or dismissed, ever.

Who Pays for Public Pensions?

And what about the taxpayer. Anyone taking shots at them?

***Yes*, take a look:**

- Announcing a study by a national pension system association, the press release declared that investment returns were the “most significant” source of plan funding and that employer contributions comprised “only” 24% of plan revenue.

- An official of an Illinois statewide fund told the *Rockford Register Star* that members contributed 14% of the cost of their pensions, investment income funded 60% and tax dollars “contributed only 26%.”

Who Pays for Public Pensions?

- Here, the role of the taxpayer is being diminished by emphasizing and mischaracterizing the impact of investment earnings in the pension revenue stream.

- Of course investment revenue is important; it's mostly why you spend 16 or more hours per year in training. **But investment revenue is *not* a source of capital for pension funding.**

- CONSIDER a self-employed neighbor who has saved and invested for retirement. Who funded most or all of his retirement income?

  (a) Vanguard
  (b) Charles Schwab
  (c) Tom Sawyer and John Falduto
  (d) your neighbor

Reasonable people disagree on this. **But go back to the secret hint**. Who pays for public pensions? The member and the taxpayer, both substantially.

Who Pays for Public Pensions?

With this proper attitude, let's redo the math behind the two news pronouncements in Slide #21:

In the national association study, if 10% of annual revenue comes from employees; 24% from taxpayers and 66% from investment earnings, the source of funding is 30% employee group and 70% taxpayer.

In the Illinois statewide fund, if 14% is paid in by members, 60% from investments and 26% from taxpayers, then the source of funding is 35% membership and 65% from the public. Note: this fund is in Social Security.

Who pays for public pensions?

Divorce and the Illinois Public Pension

Divorce and the Illinois Public Pension

History of requiring pension plans to split pensions between payees began in the United States Military

1970-1980s	Two unrelated happenstances: 1) a rise in the number and power of female legislators, and 2) several well-publicized stories about military wives ending up with nothing following a divorce.
1981	Supreme Court rules that military pensions cannot be treated as property in a state divorce case.
1982	*Uniformed Services Former Spouses Protection Act (USFSPA).* Negated the Supreme Court decision; it was the first involvement of US Congress in state divorce proceedings.
1984	*Retirement Equity Act of 1984.* Creates the *Qualified Domestic Relations Order (QDRO)* requiring private sector pension plan to directly pay a portion of a pension awarded in a divorce to an alternate payee; the *REA* law does not apply to state and local public pensions. Why not?
1998-2005	Creation and Amendment of *Illinois QILDRO*.

Divorce and the Illinois Public Pension

- Let's compare Illinois QILDRO to the private-sector QDRO.
- Under federal QDRO laws and regulations, the pension plan may not be forced to pay a benefit that is not provided for under the plan (just like Illinois) and the plan must be kept whole on an *actuarial basis.*
- The court order may be a "shared interest" QDRO, similar to Illinois QILDRO and used when the member is already retired. **OR** it may be a "**separate interest**" QDRO usually set up when divorce occurs before retirement. Illinois QILDROs are *not* separate interest orders. In an Illinois QILDRO, the benefit paid to the alternate payee is a "derivative" benefit, it is derived from the payment to the retiree.
- The private-sector QDRO's "separate interest" is a real separate interest. The member doesn't have to retire in order for alternate payee to begin receiving money. Also, the separate interest survives the retiree's death. Yet the pension plan is kept whole on an *actuarial basis.*
- Consider Timmy and the former Mrs. Timmy in the private sector.

Private Sector Timmy and the "Ex"

Married in their 30's, divorced in their 40's. Ex obtains a "separate interest" QDRO for ½ of Timmy's pension earned during the marriage. Estimated value of her benefit: $1,000.

At the pension plan's normal retirement age (NRA) of 62, Timmy keeps working. Ex wants her money. She *can* collect it. She is younger than Timmy but meets plan's "early" age. Pension plan commences payment of $750, the actuarial value of her $1,000 at the plan's NRA.

Timmy retires at 67. His pension is reduced by $1,400, not $1,000. The Plan must be paid back for the Ex's payments during the shorter period left in Timmy's lifetime. Timmy and the new Mrs. are not happy.

Timmy dies in one year. *The Ex's payments keep being made*, new Mrs. survivor benefit is reduced. OR, if the Ex dies in one year; Timmy's payments still go down $1,400 a month for his life.

The Ex-Mrs. Timmy truly had a "separate interest" of $1,000 per month at the Plan's Normal Retirement Age (NRA).

Illinois Public Sector: Mr. Charlie and the "Ex"

<u>Married in their 30's, divorced in their 40's</u>. Ex obtains an Illinois QILDRO for ½ of Charlie's pension earned during the marriage.

<u>At the pension plan's normal retirement age (NRA) of 50</u>, Charlie keeps working. Ex wants her money. She *cannot* collect it. She needs to wait until Charlie retires.

<u>Charlie retires at age 60</u>. His pension is reduced by the court awarded amount to the ex-Mrs. Charlie and the Ex commences receiving the same amount as the reduction. No actuarial factors are used nor are needed.

<u>Charlie dies in one year</u>. The Ex's payments stop and all of the earned survivor pension goes to the new Mrs. Charlie. OR, if the Ex dies first, Charlie's full pension is restored.

The Ex-Mrs. Charlie did NOT have a "separate interest" in the pension benefit that she would have had as a private-sector divorcee eligible for a QDRO. The private-sector Ex-Mrs.Timmy did *a lot* better.

How well does the Illinois system protect the alternate payee? Should it do better?

Disability Awards in Illinois Public Safety

Disability Pension Awards in Illinois

East Coast and other scandals put public disability pensions in the spotlight. But Illinois police & fire trustees (and support personnel) responsibly manage the disability process. I took a look…

Dan's Approach	IDOI report review for Illinois fire and police data.
	Internet search for outside-Illinois police, fire or combined public safety funds audits or actuarial reports.
	Excluded: Plans that combine public safety with general service employees. Also excluded NYC because of probable effect of September 11th tragedy on disability rates.
	Math: divided disability pension dollars paid by total disability/service pension dollars paid.

This computes a percentage of payments that are for disability. (Calculation excludes survivor pensions).

Disability Awards – Illinois

System	Disability Rate
Chicago Police	4.0%
Chicago Fire	13.0%
Article 3 Police	9.8%
Article 4 Fire	17.3%
Chicago Fire/Police	6.4%
Article 3 and 4 Fire/Police	13.1%
All Illinois Municipal Police	6.4%
All Illinois Municipal Fire	15.6%
All Illinois Municipal Police/Fire	9.6%

Chicago Fire and Police convert to service pensions at age 63

Disability Rates – Comparisons:
Big Cities – Separate Funds

System	Disability Rate
St. Louis Police	9.3%
Houston Police	4.1%
Chicago Police	*4.0%*
St. Louis Fire	49.1%
Chicago Fire	*13.0%*

Disability Rates – Comparison:
Big Cities – Combined Funds

System	Disability Rate
Wichita Police/Fire	9.3%
Dallas Fire/Police	4.2%
Fresno Police/Fire	47.8%
San Jose Police/Fire	43.9%
Washington DC Police/Fire	24.4%
Los Angeles Fire and Police	17.4%
Miami Fire/Police	2.8%
Chicago Fire/Police Combined	*6.4%*

Disability Rates – Comparison:
Statewide Public Safety Systems

System	Disability Rate
Ohio Police and Fire	28.8%
Muni Police/Fire of Iowa	35.9%
Arizona Public Safety	*13.2%*
New York Police Fire (ex. NYC)	19.8%
Arkansas Local Fire/Police	16.7%
New Jersey Fire/Police	14.9%
Colorado Fire/Police	9.1%
All Illinois Municipal Police/Fire *Illinois Downstate Police/Fire*	*9.6%* *13.1%*

Disability Awards - Thoughts

Illinois rates are quite low

- Why? Consider that there is both responsible management and a favorable “disability culture.”
- Regardless of any problems with data comparisons, it is a fact that Illinois disability rates for *all police/fire systems* are lower than they were 10 years ago. Public safety disability pensions in Illinois have gone down relative to service pensions over the last decade.
- Comparing police to fire, universally fire disability rates are higher.
- Comparing Chicago to Downstate/Suburban**:**

  (a) Chicago converts to service pensions at Age 63, but also

  (b) Chicago trustees have broad latitude and authority to review disability applications, in a manner similar to union Taft-Hartley plans.

Disability System Improvements?

Illinois Downstate police/fire system disability adjudication is complex and expensive.

Chicago systems much less so. Private union Taft-Hartley plans similarly simple as Chicago FD/PD.

Florida police/fire: Initial or preliminary review by trustees. If a favorable decision cannot be made, case proceeds to full hearing and independent exams.

Should changes be considered for Illinois Article 3/4 disability processes?

Questions and Comments ?