

Illinois Public Pension Fund Association Regional Seminar February 16, 2017



**ELAINE KELLER / ELBA ACEVEDO
MANAGERS
PUBLIC PENSION DIVISION
ILLINOIS DEPARTMENT OF INSURANCE**

Agenda



The Examination Process

Elaine Keller
Audit Manager

Preparing for the DOI Examination



- **Overview of DOI Exam Group and Process**
- **Updated Exam Procedure**
- **Pre-Examination**
- **During Exam**
- **Post-Exam**
- **Hearing**
- **Director's Order**
- **Common Exam Findings**
- **Questions?**



Division Examinations



- **Division is instilled with authority to enforce provisions of the Illinois Pension Code**
 - **Article 1 – General Provisions**
 - **Article 1A – Division’s duties and responsibilities**
 - **Articles 3 – Police Pension Code**
 - **Article 4 – Firefighters Pension Code**
 - **Title 50 – Administrative Code**
 - **26 Articles govern current total of 672 public pension funds. the contain laws specific to other types of pension funds**

Division Exam Process - Updates



- **Division is tasked with performing examinations every 3 years**
- **Exam process begins with a robust review of Annual Statements**
- **More Desk Exams / Less Field Exams**
- **Shifting focus to high risk-profile items**
- **Focus on governance, financing, awards**





What to Prepare For



- **Document Requests**
- **Subpoenas to municipalities for documents**
- **Interrogatories**

Updated Exam Process - Steps



- **Perform Exam (Desk or Field)**
- **Issue DRAFT Exam Report**
- **Fund *may* file written response within 2 weeks**
 - ✦ **No automatic extensions!**
 - ✦ **We may agree to additional time...+/- 30 days**
- **Division issues Final Report (“Report of Examination”)**
- **Fund has 30 days to request hearing**
 - ✦ **On facts contained in the Final Report (not Compliance matters)**
- **Hearing requested**  **Fund will receive Notice of Hearing**
- **No hearing**  **Director’s Order issued**
- **Fund has 15 days to comply with Director’s Order**
 - ✦ ***Even if no longer an issue, a Finding stays in if found during Exam period.**

Updated Procedure – Step One



- **Pre-Examination Letter**
 - Sent to the Fund Secretary (US Mail or E-Mail)
 - Copy to Treasurer;
 - Identifies if Desk or Field Exam
 - Copy of Warrant
 - Document Requests
 - Second letter sent to Municipality copying the Board

- **Two Weeks to Respond**



Updated Procedure – Step One



- **Document Requests**
 - **Over 30 Types of Documents**
 - **All should already be in the files of the Fund or Municipality**

What to Prepare For



- **Salary and Benefits History**
 - ✦ **Salary Ordinances / Collective Bargaining Agreements/ Employment Contracts**
 - ✦ **Any and all records for Benefit Awards or Payments**
 - ✦ **Records of creditable service gaps and purchases**
 - ✦ **Accumulated Contributions**
 - ✦ **Payroll records**

- **Membership Applications**

- **Board records**
 - ✦ **Meeting Minutes**
 - ✦ **Treasurer's Bond**
 - ✦ **Bank Confirmation Forms (for Signatures)**
 - ✦ **Board Policies, Rules, and Regulations**
 - ✦ **Investment Policy/Contract Agreement**
 - ✦ **Record Retention Policy**
 - ✦ **Vendor Agreements**

Updated Procedure – Step One



Interrogatories

- **Any benefit awards since last exam**
 - **Refunds Granted**
 - **Benefits Granted**

- **List of New Hires**

- **Management information**

- **Membership Records**

- **Salary Review:**
 - **What is the payroll frequency?**
 - **Does “salary” include items not in the base pay?**
 - **Were retroactive payments made?**
 - **What contribution rate is used?**

Updated Procedure – Step Two



- **Examination Performed – Team Exams**
 - **Review of all benefits granted since last exam;**
 - ✦ **Benefit Discrepancy Report (available in PASS)**
 - ✦ **Perform benefit calculations**
 - **Schedule P, CBAs, Employment Agreements, Ordinances, etc.**
 - **Review Bank Forms/Signature Cards**
 - **Review Payroll Records**
 - ✦ **Salary and contributions**
 - **Review of all Membership Records**
 - ✦ **Confirming correct documents are retained**
 - **Review of all Meeting Minutes**
 - ✦ **Expenses, Training, Elections, Quorum, etc.**



Updated Procedure – Step Three



- **Draft Report of Examination Written by the Lead Examiner**
 - Peer review
 - Supervisor review
- **Draft Report sent to Fund for a Response**
 - Fund has two weeks to respond
 - Fund may request an extension (+/- 30 days)
 - Respond to Findings
 - Describe steps to compliance



Updated Procedure – Step Four



- **Examiner Reviews the Response from Fund**
- **Makes any appropriate edits to draft the Final Report of Examination**
- **Final Report is Reviewed by Management**
- **Final Report is issued to the Fund**
 - **The Fund has 30 Days to request a hearing on the FACTS contained in the report (NOT on Compliance matters)**

Updated Procedure – Step Five



- **If the Fund requests a hearing on the Report of Examination, a Notice of Hearing will be issued to the Fund President and Secretary.**
- **The Notice of Hearing will outline the date, time and location of the Hearing.**
- **The Hearing will be on the facts contained in the Report of Examination .**
- **The Hearing Officer will make a recommendation to the Director.**
- **The Director will issue an Order:**
 - **Order the Division to edit the Final Report pursuant to the Findings of the Hearing, OR**
 - **Order the Pension Fund to come into Compliance with the Findings in the Final Report.**

Updated Procedure – Step Five



- **If the Fund does not request a hearing on the Report of Examination, the Director will issue an Order.**
- **The Director's Order will order the Pension Fund to come into compliance with the provisions of the Illinois Pension Code (the Findings).**
- **The Fund has 15 business days to comply with the findings in the Report of Examination.**

Updated Procedure – Miscellaneous



- **After the close of the Examination (i.e., when the Director's Order is issued), the Report of Examination, Board Response, and Director's Order are considered public documents.**
- **At any time during the Examination Process, the Division may refer investigatory information to the Illinois Attorney General's Office.**
- **Upon receipt of the Warrant, the fund may submit an Independent CPA Audit for our review, which may be accepted in lieu of performing a DOI Examination.**

Common Findings – Process



- **Failure to Comply with the Examination – Sections 1A-104 and 1A-105**
 - **Our examiners will work with you to make the process painless**
 - **Communication is key**



Common Findings - Management



- **Rules and Regulations**
 - If you lack rules and regulations, we recommend you adopt them.
 - Cannot be in contravention to the Illinois Pension Code.
- **Board of Trustees Composition**
 - Elections
 - Appointments
- **Board of Trustees Training**
- **Board Expenses**
 - Reasonable
 - Necessary
 - Fiduciary duty to defray expenses

Common Findings - Management



- **Treasurer's Bond**
 - **Treasurer's bond, not an insurance policy or other bond**
- **Bank Signatories and Bank Confirmation Cards**
 - **Should match reality.**
 - **Treasurer must be a required signer**
 - **Treasurer may delegate authority but must do so in writing.**
 - **Don't forget about Online Bank Account authorities**

Common Findings – Salary / Contributions



- **Failure to deduct employee contributions at the rate prescribed in the Pension Code**
 - **9.91%/9.455% of “salary for pension purposes” for regular contributions, 1% additional for combined creditable service (reciprocity) – 40 ILCS 5/3-125.1 and 3-110; 40 ILCS 5/4-118.1 and 4-109.3**
- **Failure to withhold employee contributions from all “salary for pension purposes” - Administrative Code 4402.35**
- **Failure withhold contributions on retroactive pay including retroactive pay to beneficiaries**

Common Findings – Salary / Contributions



- **Improper withholding of employee contributions from income not considered “salary for pension purposes” - Administrative Code 4402.40**
 - **Accumulated unused time, awards, automobile/meals/housing/uniform allowance, merit pay, overtime pay, shift differential, and temporary pay received for less than one year**

Common Findings - Salary



- **Inclusion of non-pensionable wages in salary for pension purposes. (50 Ill. Adm. Code 4402)**
 - **Longevity pay vs. Retirement incentive pay**
 - **Salary attached to rank vs. Temporary pay**
 - **Holiday pay vs. Overtime pay**
 - **Education pay vs. Merit pay**
 - **Salary vs. Reimbursements and Allowances**

Common Findings – Pension Benefits



- **Pension benefit calculation errors:**
 - **Incorrect salary used as the basis for the calculation.**
 - **Tier I: Salary attached to rank**
 - **Tier II: Average salary with a cap**
 - **Incorrect percentage used based upon pensioner's years of creditable service.**
 - **Incorrect entry, birth, or retirement dates used to determine creditable service time.**
 - **Errors in the calculation of cost of living increases.**
 - **Surviving spouses incorrectly receive cost of living increases (Tier 1).**
 - **Initial increase amounts are incorrectly compounded.**

Common Findings - Investments



- **Investment Policy and Investment Advisor Agreement not submitted to the Division within 30 days of their adoption (policy) or execution (agreement). - 40 ILCS 5/1-113.6 and 1-113.5(c)**
- **Investments in certain categories exceed allowable limits – 40 ILCS 5/1-113.2 through 113.4a**



Common Findings – Fiduciary Duty



- **Trustees have a fiduciary duty to the Fund.**

Common Findings – Membership Records



- **Record Retention Policy Missing (New)**
- **Application to participate in the Fund (← This is commonly missing!)**
- **Documents indicating medical records are on file**
- **Membership Records should contain:**
 - **Birth Certificate (copy)**
 - **Death Certificate (copy – if applicable)**
 - **Marriage License, Divorce Decree, QILDRO (copies - if applicable)**
 - **Application for Benefits**
 - **Record of Creditable Service (Leaves, Disciplinary Reports, etc.)**
 - **Rank: Promotions, Demotions, etc.**
 - **Payroll and record of contributions made by participants**

Common Findings – Corporate Records



- **Filing Errors in Annual Statement Filings**
- **Incomplete meeting minutes**
 - **Annual board officer elections**
 - **Trustee election results**
 - **Trustee Appointments**
 - **Voting records on board motions**
 - **Approval of annual pension benefit increases**
 - **Detailed benefit and refund information**
 - **Financial information presented at meetings not attached**
 - **Expenses not approved / amounts or payee not recorded**
 - **Annual actuarial requirement not discussed or approved**
 - **Minutes not signed by president and/or secretary of board**

What Can You Do To Address Common Findings?



- **Adopt or Update Board Rules and Regulations**
- **Review Reporting errors -- the Benefit Discrepancy Report**
- **Review Benefit Calculations -- Benefit Calculator tool**
- **Review requirements -- FAQs and Sirens**
- **Ask Investment Advisors/Consultants to attend Meeting(s)**
- **Director's Order following an exam generally orders the Fund to come into compliance with the Code.**

You can do these things before or apart from an examination.

Agenda



- **Overview on Compliance
Definition and Examples**

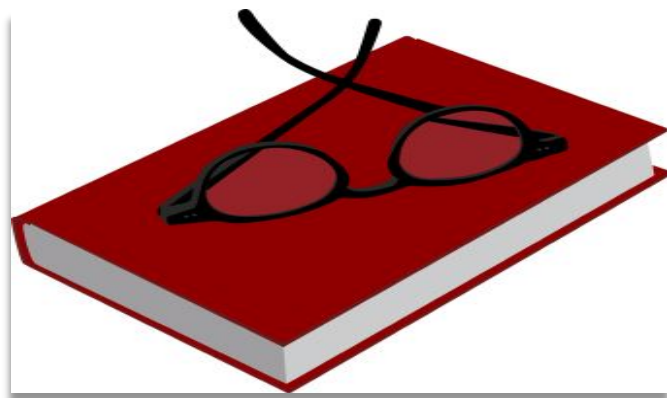
BY ELBA ACEVEDO

MANAGER, COMPLIANCE



Objective and Goal

Know the Regulations and Administrative Rules that Guide the Pension Funds



- **Gain an Understanding of , What it means to be in Compliance**
- **Gain an Understanding of the Board of Trustees**
- **Gain an Understanding of , What it means to be a Fiduciary**

What Does it Mean to be in Compliance



- Compliance is Actions, Policies, Procedures being in agreement with established guidelines or specifications, or the process of becoming so.
- Compliance encompasses the efforts to ensure that an Pension Fund is abiding by the governmental Regulations and Legislation.
- Compliance is a concern partly because of ever-increasing number of regulations that require care about maintaining an understanding of the regulatory compliance requirements.
- Compliance is an Understanding of the details of the Pension Fund.
- Knowing the regulations, rules, opinions, standards in which a Pension Fund needs to be in compliance.

What Does it Mean to be in Compliance



- The main reason for Compliance is to ensure that a Pension Fund is able to both manage compliance risk and meet its regulatory guidelines. The exact nature of compliance varies depending upon factors such as the fund size, the number of Active Members, Beneficiaries, the size of Pension Fund dictates the nature of the data it maintains, collects, and stores.
- A regular review of internal compliance is beneficial to the fund a whole.
- Prominent regulations, standards and legislation with which organizations may need to be in compliance include: Article 1 and Article 4 of Illinois Pension Act 40ILCS 5/4, Administrative Rules, and Guidelines Developed by the Department of Insurance.

Board Of Trustees



- The board of trustees of an Article 3 Police Pension Fund should consist of **2** trustees elected by and from the active members of the fund, **1** trustee elected by and from the beneficiaries members of the fund, and **2** trustees appointed. (40 ILCS 5/3-105).
- The board of trustees of an Article 4 Firefighters Pension Fund should consist of **2** trustees elected by and from the active members of the fund, **1** trustee elected by and from the retired/disabled members of the fund, and **2** trustees appointed. (40 ILCS 5/4-121).

Common Board Questions?



Answers



- Article 3/4 Pension Fund should consists 5
- 3 constitute a quorum and the affirmative vote of 3 members is necessary to adopt any motion, resolution, or ordinance
- Newly appointed or newly elected board trustees must participate in a 32 hour trustee there after annually complete 16 hours
- **Differs, for Police Fund a third elected active member can not serve on the board for beneficiary . Until such time as the fund has a beneficiary, the board would consist of 4 members only.** For Fire Fund if there are no retired or disabled members, or none willing, a third active member may be elected (40 ILCS 5/4-121)
- **Differs: Terms are two year for Police Fund three years Fire Fund**
- **Differs for Police Fund** annually elect, in July, a President, Vice-president, Secretary and Assistant Secretary. (40 ILCS 5/3-130) For Fire Fund required to annually elect a President and Secretary. (40 ILCS 5/4-121)
- Numerous – Including : Fiduciary Duty

Example of Compliance



- Board Member Training after the first year – assumption completes the 32 hours
- What is required in the second year 16 hours but...

Compliance



Training Requirements:

After the first year and meeting the 32 hrs : 16 hrs annually of continuous education : Paid by pension fund of which 8 should be in Ethics Training (or the ethics training will be an additional training amount); Section 1-113.18

Section 1-109.3 (a) & (b) : Educational expense is paid by Pension Fund (c) ; Ethics Training 40 ILCS 5/1-113.15

Trustees must complete the electronic training curriculum on the Open Meeting Act. This is a one time requirement (see initial requirement) however, if trustee is the Open Meetings Act Officer then this is an annual requirement .

Section 1-109.3 (a) & (b) : Educational expense is paid by Pension Fund (c) ; Ethics Training 40 ILCS 5/1-120.105b

What Happens if Training is not completed:

Member is not eligible to serve on the board of trustees of an Article 3 or 4 pension fund, unless the board member completes the missed training within 6 months after the date the member failed to complete the required training. In the event of a board member's failure to complete the required training, a successor shall be appointed or elected, as applicable, for the unexpired term. A successor who is elected under such circumstances must be elected at a special election

109.3(d)

Yearly Ethics Training Requirement



- *Sec. 1-113.18. Ethics training.*
- *All board members of a retirement system, pension fund, or investment board ...must attend ethics training of at least 8 hours per year. The training required under this **Section shall include training on ethics, fiduciary duty, and investment issues and any other curriculum that the board of the retirement system, pension fund, or investment board establishes as being important for the administration of the retirement system, pension fund, or investment board.** Each board shall annually certify its members' compliance with this Section and submit an annual certification to the Division of Insurance of the Department of Financial and Professional Regulation.*

Fiduciary Definitions




- Fiduciary: A person invested **with the rights** and powers to be exercised for the benefit of another person.
- Fiduciary Duty: One party **acting for** another party
- Fiduciary Relationship: **Trust between the parties**. Care and responsibility must be taken for the best interest of the principal.

Who is a Fiduciary?



- **Anyone you assign responsibilities:**
 - Investment Manager(s)
 - Allocation between/among the trustees for specific fiduciary activities other than the management of assets
 - ✦ FOIA/OMA
 - ✦ Secretary
 - ✦ Treasurer of the Fund
 - ✦ Trustee

Fiduciary Duty – Section 1-109



- Fiduciary shall discharge his or her duty solely in the interest of the participants and beneficiaries;
- For the exclusive purpose of:
 - Providing benefits to participants and beneficiaries; and
 - Defraying reasonable expenses
- With care, skill, prudence and diligence of a **prudent man** acting under the same circumstances;
- By diversifying investments to minimize risk of large losses; and
- In accordance with the Pension Code!

Standard of Care = Prudent Man Rule



- Prudent Man Rule
- Based off ERISA (federal law for private pensions)
- Primary purpose is to “protect beneficiaries of employee benefit plans.”

Who is owed the duty?



- The entire Pension Fund is owed the duty: not necessarily one specific person.
- Duty is owed to the participants and beneficiaries
 - A noted Case Marconi v. Chicago Heights Police Pension Bd, 870 N.E.2d 273 (2006) The Pension Fund
 - All - Former, Current and Future Members

Examples of a Breach



- **Commingling Assets**
 - The Fund assets are separate from the municipality's assets
 - Do not borrow between the two!
- **Conflict of Interest**
 - Just being aware of the conflict of interest and agreeing it is not a conflict is not an example of prudence
- **Failing to Oversee Others**
 - Attorneys, accountants, board clerks, municipal payroll officials, chiefs, anyone acting on behalf of the Fund

Prohibited Transactions



- Section 1-110
- Shall not cause the fund to enter into transaction:
 - Sale or exchange to party-in-interest without adequate consideration
 - Lending/extension of credit to party-in-interest without receipt of adequate security and reasonable rate of interest
 - Furnishing of goods, services or facilities to party-in-interest without adequate consideration
 - Transfer of assets to party-in-interest without adequate consideration
- Shall not: engage in self-dealing!
- A Fiduciary Duty regarding Investments : Section 1-110 prohibits a trustee from knowingly cause or advise the pension fund to engage in an investment transaction when the trustee has a direct interest in the transaction or has a business relationship with the adviser who would benefit from the transaction.
 - ✦ **Violation is a class 4 felony.**

Breach of Fiduciary Duty



- Failure to exercise the standard of care required by you as a Fiduciary
 - Not acting prudently, reasonably in the executing of your trustee duties
- Attorney General: Possible that you may breach if you fail to act in accordance with the standard of care
 - Prudent Man Rule
- You shall use reasonable care to prevent any other trustee from committing a breach of duty
- Shall jointly manage and control the assets of the fund

What do you do if you suspect a Breach?



- Document
- Report
- Talk with your Board
- Talk to DOI

Protect Yourself



- **Training!**
 - Duties & Responsibilities
 - Ethics Training – at the very **least 8** hours
 - Paid by the Pension Fund (considered a necessary expense)
- **Section 1-107**
 - Pension Fund may indemnify trustees against all damage claims and suits, including defense of the trustee.
 - NOT willful misconduct or gross negligence
 - ✦ **Gross Negligence = intentional disregard of known risk and entire absence of care for (property of) others, constructive or legal willfulness**
 - Authorized to insure against loss or liability of the trustees, must obtain that insurance through a company licensed to write such coverage in Illinois.

Compliance of Filing the Annual Statement



- **The Importance of the data**
 - Allows Review and Comparisons for the understanding of the Pension Funds, the financial data, the participants data, the investment data
 - Allows for the Department's Actuarial to perform a review of the relevant data for valuations.
 - Basis for the Department's Reports

Items Includes in the Annual Statement



- *40 ILCS 5/1A-109*
- *Sec. 1A-109. Annual statements by pension funds.*
- *Each pension fund shall furnish to the Division an annual statement in a format prepared by the Division. The Division shall design the form and prescribe the content of the annual statement and, at least 60 days prior to the filing date, shall furnish the form to each pension fund for completion. The annual statement shall be prepared by each fund, properly certified by its officers, and submitted to the Division within 6 months following the close of the fiscal year of the pension fund.*
- *The annual statement shall include, but need not be limited to, the following:*
 - *(1) a financial balance sheet as of the close of the fiscal year;*
 - *(2) a statement of income and expenditures;*
 - *(3) an actuarial balance sheet;*
 - *(4) statistical data reflecting age, service, and salary characteristics concerning all participants;*
 - *(5) special facts concerning disability or other claims;*
 - *(6) details on investment transactions that occurred during the fiscal year covered by the report;*
 - *(7) details on administrative expenses; and*
 - *(8) such other supporting data and schedules as in the judgement of the Division may be necessary for a proper appraisal of the financial condition of the pension fund and the results of its operations. The annual statement shall also specify the actuarial and interest tables used in the operation of the pension fund.*
- *A pension fund that fails to file its annual statement within the time prescribed under this Section is subject to the penalty provisions of Section 1A-113.*
- *(Source: P.A. 90-507, eff. 8-22-97.*

Article 3/4 Statistics - 2015

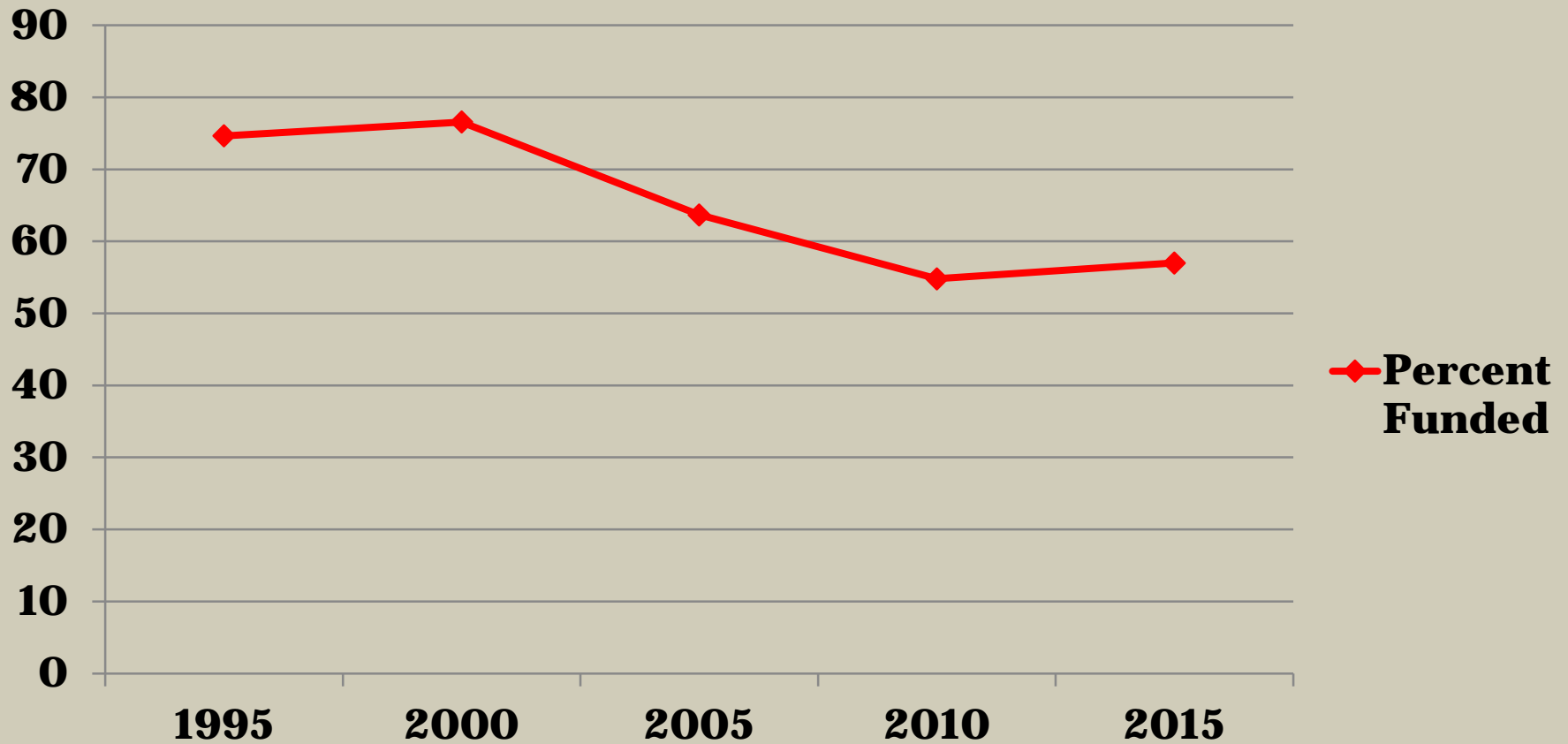


- Total Funds Regulated: 357 / 296*
- Total Article 4 Participants: 23,550 / 17,383
(Actives/Annuitants/Disabled/Survivors)
- Aggregate Article 4 Assets: \$7.29 / 5.27 B
- Total Actuarial Liabilities: \$12.9 / \$9.5 B
- Average Funding Condition: 57% / 57%

History of Actuarial Liabilities



Percent Funded



Pension Funding

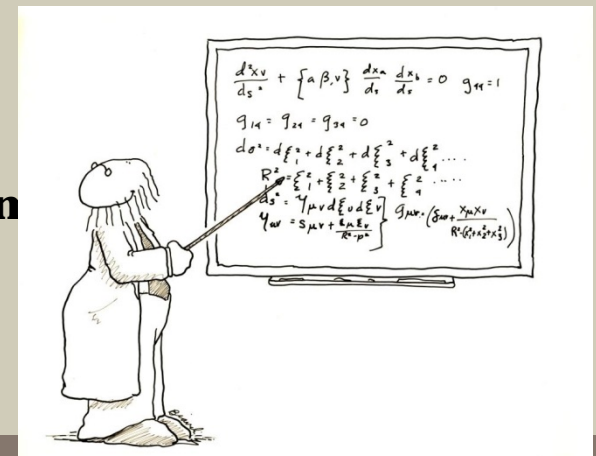


Income: (Coming into the Funds):

- Pension Funds are Funded by Municipal / Employee Contributions and Investment Income

Expenses (Going out of the Funds):

- Pension Funds spend money by paying pension benefits and expenses
- Therefore...
 - Municipal / Employee Contributions + Investment Income = Pension Benefits + Expenses



Example:

Article 4 Financials – What Does it Mean?



- **Remember the Calculation...**

- **For the Year 2015:**

- **Municipal / Employee Contributions + Investment Income = Pension Benefits + Expenses**

- ✦ **\$553 Million > \$433 Million**

- ✦ **So why only 57% funded??**

- ✦ **→ LIABILITIES (Future)**

Causes of Pension Fund Underfunding



Four Common Causes of Underfunding

- **Enhanced Benefits / Common Pension Errors**
 - **Unreasonable Expenses**
 - **Low Return on Investments**
 - **Municipal Underfunding**

Enhanced Benefits and Common Pension Errors



- **Board awards benefits based on pensionable salary that includes non-pensionable salary items**
 - Retirement Incentives
 - Longevity not pro-rated
 - Holiday pay
 - Re-Entry into Active Service
 - Wrong COLA, Creditable Service breaks not paid
- **Board Duty:**
 - Fiduciary Duty to the FUND (past, present, future)
 - Correction of Payments – Mistake Provisions
- **Public Pension Division Limitations:**
 - Audit Findings
 - Advisory Opinions

Unreasonable Expenses



- **Board members have a fiduciary duty to defray reasonable expenses of administering the pension fund**
- **Board Duty:**
 - **Fiduciary Duty to the FUND (past, present, future)**
 - **Be reasonable and prudent when approving expenses!**
- **Public Pension Division Limitations:**
 - **Audit Findings**
 - **Advisory Opinions**

Low Return on Investments



- **Investment Income is (more than) one half of the Fund's funding source**
- **Historical Rate of Return for Article 3 and 4 Funds is 4.95% for 10 years, 6.95% for 5 years**
- **2015 was 4.4% for Article 4**
- **Total \$5 Billion Investment Assets for Article 4 Funds**
- **Consolidation of Investment Assets?**
- **Assumptions in Actuarial Valuations – 5% - 7.25%**

What Can We Do For You?



- **The Division's mission is: compliance, education, transparency.**
- **We aim to be a resource for Public Pension Funds' Boards, Participants and Beneficiaries.**
 - **Advisory Opinions**
 - **800 Hotline**
 - **DOI.Pension@Illinois.gov E-mail inbox**
 - **Sirens**
 - **FOIA Portal on the Division's Website**

Contacting the Public Pension Division



Internet:

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

Mailing Address: Illinois Department of Insurance
Public Pension Division
122 South Michigan Avenue – 19th Floor
Chicago, IL 60603

Phone: (800) 207-6958

Email: **doi.pension@illinois.gov**

Questions?

