



Status of Local Pension Funding Fiscal Year 2004

**An Evaluation of Ten Local Government Employee
Pension Funds in Cook County**

Prepared by
The Civic Federation
February 27, 2006

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In 1894, a group led by several of Chicago's most prominent citizens—including Jane Addams, Bertha Palmer and Lyman J. Gage—coalesced around a serious issue: the need to address deep concerns about the city's economic, political and moral climate at the end of the 19th century. The resulting organization, called The Civic Federation, evolved during the 20th century to become a leading advocate for governmental fiscal responsibility and an effective champion of rational tax policy. The work of the Federation continues to evolve in the 21st century as a greater emphasis is placed on working with government officials to improve the efficiency, effectiveness and accountability of Chicago-area governments.

Today, The Civic Federation remains true to the non-partisan mission established by its founding members. That mission is to work with Chicago area governmental bodies to help them reduce their costs and improve the quality of government services by:

- Promoting opportunities to reform local tax structures;
- Guarding against wasteful expenditure of public funds; and
- Serving as a technical resource to public officials and opinion leaders through non-partisan tax and fiscal research.

Since 1996, the Federation has produced an annual survey of the nine major local government employee pension funds in Cook County. This year, we have added a tenth fund, the Retirement Plan for Chicago Transit Authority Employees.

This report is intended to provide the lawmakers, pension trustees, and the public with the information they need to make informed decisions regarding these important matters of local government finance.

Laurence Msall
President

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TABLE OF CONTENTS

EXECUTIVE SUMMARY	4
PUBLIC EMPLOYEE PENSION FUND OVERVIEW	5
FUNDS INCLUDED IN ANALYSIS	5
ACTIVE EMPLOYEES AND BENEFICIARIES	5
EVALUATING PENSION FUND STATUS	8
PENSION FUND STATUS INDICATORS	8
CAUSES OF PENSION FUNDING STATUS CHANGE	10
SCOPE OF REPORT	14
FUNDED RATIOS: POLICY CONSIDERATIONS	14
ASSETS AND LIABILITIES OF LOCAL PENSION FUNDS	15
INVESTMENT RATE OF RETURN	18
HISTORICAL TRENDS	19
REVENUES AND EXPENDITURES.....	21
FUNDED RATIOS.....	24
ACTUARIAL VALUE OF ASSETS.....	24
MARKET VALUE OF ASSETS.....	25
UNFUNDED ACTUARIAL LIABILITIES	26
CIVIC FEDERATION RECOMMENDATIONS	28
LINK BENEFIT ENHANCEMENTS TO FULL FUNDING	29
REDUCE BENEFITS FOR NEW EMPLOYEES: ESTABLISH A TWO-TIERED SYSTEM.....	29
LIMIT ANNUITY INCREASES FOR NEW HIRES AT THE LESSER OF 3% OR CPI	29
REQUIRE EMPLOYER CONTRIBUTIONS TO RELATE TO FUNDING LEVELS	30
REFORM PENSION BOARDS OF TRUSTEES TO BALANCE STAKEHOLDER INTERESTS, SAFEGUARD ASSETS	30
GLOSSARY.....	32
APPENDIX A: REVENUE AND EXPENDITURE CALCULATIONS	34
SOURCES FOR FY2004.....	36

EXECUTIVE SUMMARY

The Civic Federation recently concluded an analysis of the fiscal year 2004 actuarial valuation reports for ten major local government employee pension funds. The funds analyzed in our report include the plans for the City of Chicago, Chicago Park District, Chicago Public Schools, Cook County, Cook County Forest Preserve District, Metropolitan Water Reclamation District, and the Chicago Transit Authority, included this year for the first time.

Ratio of Active Employees to Beneficiaries

Since FY1997, the ratio of total active employees to beneficiaries for the ten funds combined has gradually dropped from 1.79 actives for every one beneficiary, to 1.46 in FY2004.

Assets and Liabilities

Combined, the ten pension funds had approximately \$47.9 billion in accrued liabilities, and assets with an actuarial value of \$33.5 billion and a market value of \$33.1 billion.

Unfunded Liabilities

Unfunded liabilities continue to grow by large increments each fiscal year: \$3.6 billion in FY2002, \$3.1 billion in FY2003, and \$3.0 billion in FY2004. The aggregate unfunded liabilities now stand at **\$14.4 billion**.

Investment Rate of Return

The average rate of return for those funds that follow a calendar year fiscal year was 10.6%, down from 20.1% in FY2003. The average rate of return for funds using a July 1 to June 30 fiscal year was 15.3%, up from 4.0% in FY2003.

Revenues and Expenditures

Investment income represented 72.8%, or \$3.7 billion, of the \$5.1 billion in total pension fund income for all funds combined. Employee and employer contributions represented 12.9% and 13.7% of total income, respectively. Benefit payments represented 85.3%, or \$2.4 billion, of the \$2.8 billion in total expenditures.

Funded Ratios

Actuarial funding ratios continue to fall. The actuarial funded ratio for the aggregate of all ten funds' assets and liabilities was 70.0%, down from 74.5% in FY2003. The CTA's funded ratio has dropped most dramatically in recent years, from 80.0% in FY1999 down to 39.4% in FY2004, due in large part to a change in actuarial assumptions. The next lowest FY2004 funded ratios are the Firemen at 42.3%, and the Policemen at 55.9%.

Civic Federation Recommendations

Local governments must take immediate action to slow the downward spiral of pension underfunding by controlling factors which lead to increases in liabilities, as well as shortfalls in assets. The Civic Federation recommends the following actions:

- Stop granting benefit enhancements unless contributions are also increased to fully fund the enhancements;
- Reduce benefits for new employees to scale back excessive benefits granted in the past;
- Limit annual annuity increases to the lesser of 3% or inflation for new hires;
- Require employer contributions to relate to funding levels; and
- Reform pension boards of trustees to better balance stakeholder interests and safeguard assets.

PUBLIC EMPLOYEE PENSION FUND OVERVIEW

All public pension plans surveyed in this report are defined benefit plans.¹ In defined benefit plans, employers and employees annually contribute fixed amounts to investments intended to cover future benefit payments. Upon retirement, the employee receives an annuity based upon his or her highest salary (usually based on an average of several years) and length of service. If the amounts contributed to the plan over the term of the employee's employment (plus accrued earnings) are insufficient to support the benefits (including health and survivor's benefits), the former employer is required to pay the difference.

Funds Included in Analysis

The City of Chicago enrolls its employees in four different pension systems:

- Municipal Employees' Annuity and Benefit Fund of Chicago
- Laborers' and Retirement Board Employees' Annuity and Benefit Fund of Chicago
- Firemen's Annuity and Benefit Fund of Chicago
- Policemen's Annuity and Benefit Fund of Chicago

In addition, six other local government pension funds are analyzed in this report:²

- County Employees' and Officers' Annuity and Benefit Fund of Cook County
- Forest Preserve District Employees' Annuity and Benefit Fund of Cook County³
- The Metropolitan Water Reclamation District Retirement Fund
- Public School Teachers' Pension and Retirement Fund of Chicago⁴
- Park Employees' & Retirement Board Employees' Annuity and Benefit Fund⁵
- Retirement Plan for Chicago Transit Authority Employees

Active Employees and Beneficiaries

The ten pension funds reviewed in this report collectively covered 134,027 active public employees and 91,845 beneficiaries in FY2004.

The three largest funds -- Municipal Employees' Annuity and Benefit Fund of Chicago, Public School Teachers' Pension and Retirement Fund of Chicago, and County Employees' and Officers' Annuity and Benefit Fund of Cook County -- accounted for 72.0% of the active employees covered by these plans and 61.4% of annuitants.

¹ By contrast, in a defined contribution plan, the employee and employer contribute fixed amounts. The retiree's annuity is based upon the total amount contributed to the plan over the employee's tenure. In general, the employer's liability ends upon the employee's retirement, apart from ancillary health benefits. Two common examples of defined contribution plans are 401(k) or 403(b) plans, referring to the governing sections of the tax code. Some public employee funds in the United States are now "hybrid" plans, offering a combined defined benefit and defined contribution to employees.

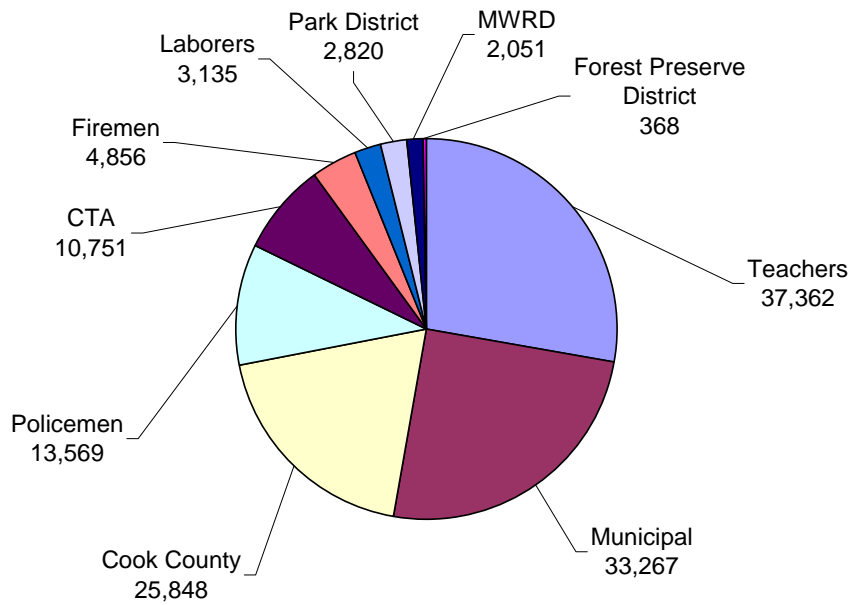
² The term "local government" is used here broadly and includes the Chicago Transit Authority, an Illinois municipal corporation. The seven governments and ten funds analyzed in this report were created by Acts of the Illinois General Assembly.

³ The funds of Cook County and the Cook County Forest Preserve District are governed by the same pension board.

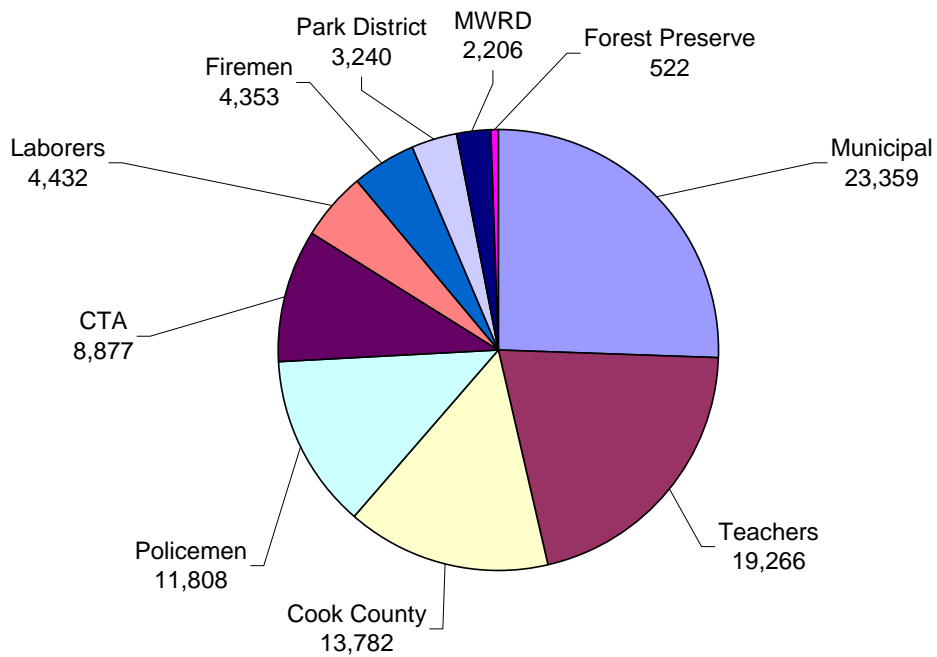
⁴ The Chicago Board of Education enrolls teachers in the Public School Teachers' Pension and Retirement Fund of Chicago. All other employees of the Board of Education are enrolled in the City of Chicago's Municipal Employees' Annuity and Benefit Fund.

⁵ The fiscal year of the Park Employees' and the Public School Teachers' pension funds is July 1-June 30. The other eight funds use a January 1 – December 31 fiscal year.

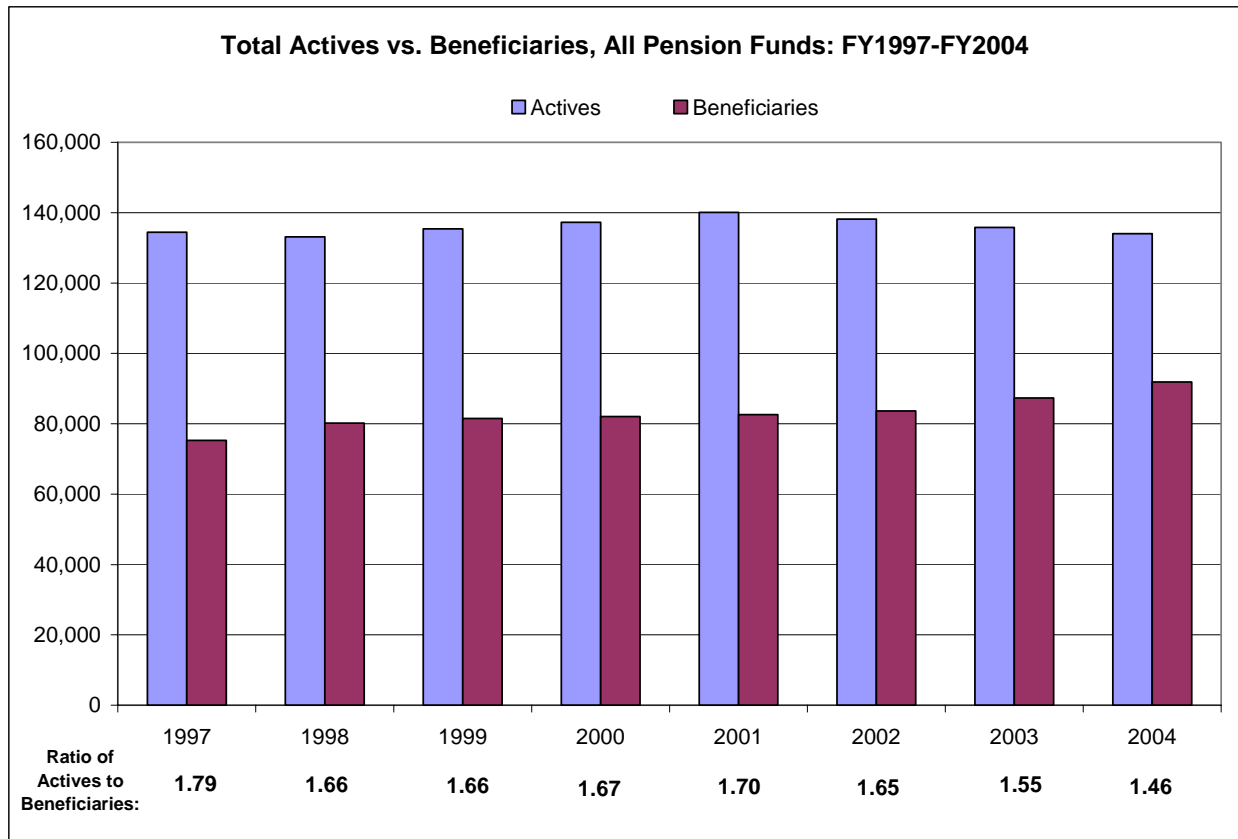
Distribution of Active Employees FY2004



Distribution of Beneficiaries FY2004



Since FY1997, the ratio of total active employees to beneficiaries has gradually dropped from 1.79 actives for every one beneficiary, to 1.46 in FY2004.



In FY2004, the Teachers' fund had the highest active-to-beneficiary ratio, at 1.94. The Laborers', Park District, MWRD, and Forest Preserve funds all had *more* beneficiaries than actives in FY2004. For most funds, decline in the ratio resulted from personnel cuts or early retirement initiatives, which reduce the number of active employees while increasing beneficiaries.

Ratio of Active Employees to Beneficiaries, by Fund: FY1997-FY2004								
	1997	1998	1999	2000	2001	2002	2003	2004
Fire	1.13	1.10	1.07	1.06	1.13	1.13	1.14	1.12
Police	1.36	1.34	1.31	1.28	1.24	1.21	1.20	1.15
Municipal	1.87	1.58	1.72	1.74	1.78	1.72	1.68	1.42
Laborers	0.95	0.85	0.90	0.97	0.99	0.92	0.90	0.71
Teachers	2.12	2.19	2.13	2.12	2.18	2.09	1.97	1.94
Park District	1.25	1.34	1.09	1.12	1.06	1.09	1.03	0.87
MWRD	0.98	1.00	0.99	0.97	0.99	0.95	0.94	0.93
Cook County	2.82	2.41	2.40	2.41	2.35	2.33	1.87	1.88
Forest Preserve	2.44	2.16	2.19	2.31	1.80	1.52	0.78	0.70
CTA	1.41	1.23	1.15	1.19	1.25	1.25	1.24	1.21

EVALUATING PENSION FUND STATUS

The following section describes the primary indicators of pension fund health, or status, used in this report.

Pension Fund Status Indicators

Pension fund status indicators show how well a pension fund is meeting its goal of accruing sufficient assets to cover its liabilities. Ideally, a pension fund should hold exactly enough assets to cover all of its current and prospective liabilities. Current liabilities are benefits owed to retirees in the current year, and include pension payments as well as any other retirement benefits, such as retiree health insurance. Prospective liabilities are all of the future retirement benefits promised to past and current employees and their beneficiaries. A pension fund is considered 100% funded when its asset level equals the actuarially determined amount required to meet all accrued current and prospective liabilities. A funding level under 100% is cause for concern, because it means that a fund's current and reasonably expected future assets are insufficient to meet the promises that have been made to date.

Assets and liabilities are calculated using a number of actuarial assumptions. Liabilities are calculated using assumptions about such factors as salary levels, retirement age, and life expectancy. Assets can be reported by their **market value**, which recognizes unrealized gains and losses immediately in the current year, but this measure is subject to significant market volatility and can be misleading, as year-to-year variations typically average out over the life of the pension plan. Under Government Accounting Standards Board (GASB) Statement No. 25, assets of public pension plans must also be reported based on their **actuarial, or smoothed, market value**. The actuarial value uses an average of the assets market values from previous years, thus smoothing out fluctuations in the market value.⁶ Because the significant changes in reporting required by GASB 25 took effect in FY1997, the majority of trend data in this report begins with that year.

It is important to consider two critical factors when evaluating pension fund status. First, the status of a pension fund is in large part a function of the actuarial methods and assumptions made. Changes to assumptions based on demographic trends, plan experiences, or even a change in actuary can produce substantially different pictures of a fund's status.

Second, pension fund status is best evaluated in multi-year trends, rather than a single year in isolation, because pension financing is inherently long-term. Negative multi-year trends are cause for concern, and indicate a need for a change in funding strategy. If a given indicator is low, but has been stable for several years, that gives somewhat less cause for alarm than a fund that was previously healthy but has experienced precipitous decline in recent years.

⁶ In November 1994, the Government Accounting Standards Board (GASB) issued Statement No. 25 that established new standards for the reporting of a pension fund's assets. The requirement became effective June 15, 1996. Up until that statement, most pension funds used two measurements for determining the net worth of assets, book value (recognizing investments at initial cost or amortized cost) and market value (recognizing investments at current value). In Statement No. 25, GASB recommends a "smoothed" market value, also referred to as the actuarial value of assets, in calculations for reporting pension costs and actuarial liabilities. The smoothed market value or actuarial value of assets accounts for assets at market values by averaging unexpected gains or losses over a period of 3 to 5 years.

The following three common indicators are used in this report:

Funded Ratio

The most basic indicator of pension fund status is its ratio of assets to liabilities, or funded ratio. Usually this ratio is expressed in terms of actuarial values, as required by GASB 25. When a pension fund has enough assets to cover all its accrued liabilities, it is considered 100% funded. This does not mean no further contributions are needed, but rather that the plan is funded at the appropriate level on the date of valuation. A funding level under 100% is cause for concern, since it means that a fund does not have sufficient assets to cover the promises that have been made to date.

Although the ultimate goal of any pension fund is to be fully funded, with 100% of accrued liabilities covered by assets, there is no official industry standard or best practice for an acceptable funded ratio other than 100%. The Illinois General Assembly has set 90% as a target funded ratio for state pension funds, stating “90% is now the generally-recognized norm throughout the nation for public employee retirement systems that are considered to be financially secure and funded in an appropriate and responsible manner” (40 ILCS 5/1-103.3). Similarly, the Chicago Teachers’ fund requires additional employer contributions when the ratio falls below 90% (40 ILCS 5/17-127ff.). The CTA pension plan had provisions to permit benefit increases if the 2001 funded ratio exceeded 86.47%, and the 2003 ratio exceeded 84.99% (Section 8.1(6-7)).

Unfunded Liabilities

Unfunded actuarial liabilities are those liabilities, both current and prospective, not covered by actuarial assets. It is calculated by subtracting the actuarial value of assets from the accrued actuarial liability of a fund.

One of the functions of this indicator is to measure a fund’s ability to bring assets in line with liabilities. Healthy funds are ones that are able to reduce their liabilities over time; substantial and sustained increases in unfunded liabilities are cause for concern.

It can be useful to express unfunded liability as a percentage of payroll covered by the plan. This measurement expresses the unfunded liability in terms of the current personnel expenditures and demonstrates the relative size of the unfunded liability. One of the functions of this indicator is to measure a fund’s ability to manage or make progress on reducing its unfunded liability. A sign of a reasonable funding strategy would be a gradual decrease in unfunded liability as a percent of covered payroll over time. If unfunded liability continues to increase as a percentage of covered payrolls, then a new funding strategy and the level of benefits granted by the fund may need to be reconsidered.

Investment Rate of Return

A pension fund invests the contributions of employers and employees in order to generate additional revenue over an extended period of time. Investment policies should be aligned with the fund’s actuarial assumptions in order to design an appropriate risk and yield levels for the plan’s portfolio. The annual rate of return on investments is an important indicator of the strength of a fund’s investment strategy.

Most local funds assume an 8% average annual rate of return, so a given year's rate can be compared to that benchmark, or to the fund's assumed rate of return if different from 8%. Rates of return for various funds can also be compared to each other, or to specific market indices.

Low or negative investment income usually causes a significant drop in pension fund assets, although this effect is smoothed over time under the actuarial method of calculating assets.

Causes of Pension Funding Status Change

The following are four major factors that influence a pension plan's funding status.

Sustained Investment Losses or Gains

Investment income is the primary driver of income for pension funds, and represented 72% of the total income for the ten funds combined in FY2004 (see p. 22). Multi-year investment gains or losses that deviate substantially from the assumed rate of return (often 8%) have a major impact on fund assets. Investment income is the primary driver of total income. While employee and employer contribution amounts are relatively stable from year to year, investment income can fluctuate widely, usually representing the majority of income when rates of return are positive.

The strong investment market of the late 1990s produced several years of significant gains for pension funds. Likewise, the market decline of 2000-2002 created major losses for the funds. The effects of these gains and losses are felt for several years beyond their market occurrence due to the actuarial smoothing of assets.

For example, the Chicago Park District fund experienced an overall investment return of roughly 13.4% in FY2004, well above its actuarially assumed rate of 8%. However, when this return is calculated based on the actuarially smoothed value of assets over 5 years, it drops to 3.6%, increasing the unfunded liability by \$27.0 million for FY2004.⁷

Benefit Enhancements

Enhancements to retirement benefits can take various forms, such as an increase in the annuity formula, reduction in total years of service required for maximum annuity, or a reduction in retirement age for maximum annuity. Specific early retirement initiatives, designed to encourage older employees to retire early, can also be considered benefit enhancements, although they are typically available only for a limited time and are sometimes funded through additional employer or employee contributions.

Benefit enhancements increase a pension fund's liabilities, because they increase the promised payments that will be made to beneficiaries either in the form of pensions or other post-retirement benefits. In the case of collective bargaining, these enhancements are part of the overall economic package negotiated by employers and employees, and are often granted in exchange for short-term employee concessions on salaries or health insurance. Benefit

⁷ Park Employees' & Retirement Board Employees' Annuity and Benefit Fund, *Comprehensive Annual Financial Report for Fiscal Year Ended June 30, 2004*, pp. 37 and 56. The Park Fund's fiscal year is July 1 to June 30.

enhancements are an attractive option for employers, since they create long-term liabilities that can be traded for short-term savings on other employee costs. For the CTA, plan changes are made exclusively through the collective bargaining process. For the other nine funds analyzed in this report, plan changes that have been collectively bargained must also be passed by the Illinois General Assembly and are codified in state statute.

Once granted, benefit enhancements cannot be diminished, according to the Constitution of the State of Illinois.⁸ The only way for an employer to reduce liabilities by reducing retirement benefits is to reduce those benefits for new employees. This is commonly called a “two-tiered” system, where new and existing employees are promised different retirement benefits.

For example, Public Act 93-0654, passed in 2004, made several changes to the plan provisions of the Chicago Policemen’s fund. It increased the minimum annuity formula accrual rate for service over 20 years to 2.5%, from 2.0%, and limited total benefits to 75% of final average salary. It also increased the minimum monthly benefit for age-service requirements to \$950 for 2004 and \$1,050 thereafter, and it raised the minimum widow annuity to \$900 per month in 2004 and \$1,000 per month thereafter. Fund actuaries estimate that these changes increased the plan’s actuarial liability by \$99.0 million.⁹

Changes to Actuarial Assumptions

Actuarial assumptions and methods can change for various reasons, including demographic trends, analysis of recent plan experiences, or new industry standards such as GASB requirements. There are a number of acceptable methods for computing a plan’s assets, liabilities, and funding requirements. A change from one method to another can produce a significant change in the assets, liabilities, or funding requirements of a fund.

For example, in FY2004 the Cook County plan changed its actuarial assumptions on annual investment rate of return (reduced to 7.5% from 8.0%) and salary increases (reduced to 5.0% from 5.5%). These changes were made based on a plan experience analysis for the FY2000-FY2003. As a result of the changes, the actuaries estimated that the total actuarial liability of the plan increased by \$142.9 million.¹⁰

Another illustrative example is that of the CTA, whose actuarial accrued liability increased by \$456.8 million in FY2001 when the valuation of retiree health insurance premiums was changed to better recognize the full value of that benefit. This change also dropped the funded ratio from 80.0% to 66.3% in market-based asset value.¹¹ Although such large increases in unfunded liabilities are discouraging, the Civic Federation urges governments and pension funds to fully

⁸ In Illinois, as in many states, pension benefits granted to public employees are guaranteed by the State Constitution. *Constitution of the State of Illinois, Article XIII Section 5.*

⁹ Policemen’s Annuity and Benefit Fund of Chicago, *Actuarial Valuation Report for the Year Ending December 31, 2004*, pp. 7 and 9.

¹⁰ County Employees’ and Officers’ Annuity and Benefit Fund of Cook County, *Actuarial Valuation as of December 31, 2004*, pp. 10 and 12.

¹¹ Retirement Plan for Chicago Transit Authority Employees, *Actuarial Valuation Report for the Year Beginning January 1, 2002*, pp. 2 and 7.

recognize all liabilities for post-employment benefits as soon as possible, since GASB Statement No. 45 will require their recognition by FY2007.¹²

Employer and Employee Contributions

Employee contributions are typically established as a certain percentage of pay. Employer contributions for the CTA are also a percentage of pay; the employer contributes 6.0% of employee compensation and employees contribute 3%, for a total of 9%. Employer contributions to the Chicago Teachers' fund usually consist of a lump sum from the State of Illinois (roughly \$65 million), as well as additional amounts from the State and the Chicago Board of Education when the funded ratio falls below 90%.

For the other eight plans analyzed in this report, the basic employer contribution is set in state statute as a multiple of the total employee contribution made two years prior. The statute requires that the employer levy a property tax not to exceed the multiple amount. Employers levy an amount that, when added to the revenue from Personal Property Replacement Taxes, equals the multiple amount.¹³ The following table lists the basic fund multiples, not including special additions or subtractions specified in statute:

¹² For information on GASB 45, see <http://www.gasb.org/st/summary/gstsm45.html>.

¹³ The Personal Property Replacement Tax (PPRT) is a corporate income tax, established when the Illinois General Assembly abolished all ad valorem personal property taxes on corporations in 1979. The State distributes PPRT revenues to local taxing districts according to a formula based partly on each district's share of personal property tax collection in 1976 or 1977.

STATUTORILY REQUIRED EMPLOYER CONTRIBUTION MULTIPLES		
FUND	STATUTE	Required employer contribution: <u>multiple of the employee contribution 2 years prior</u>
Fire	40 ILCS 5/6-107	2.26
Police	40 ILCS 5/5-168	2.00
Municipal	40 ILCS 5/8-173	1.25
Laborers	40 ILCS 5/11-169	1.00
Teachers	40 ILCS 5/17-127	State pays amount equal to 20-30% of the contribution made to TRS. State pays an additional amount equal to 0.544% of total teacher payroll, unless Fund was 90% or more funded (actuarial) in the previous fiscal year. Beginning 1999, the employer contributes an amount equal to 0.58% of each teacher's salary, to offset a portion of costs associated with P.A. 90-582, unless Fund was 90% or more funded (actuarial) in the previous fiscal year.
Parks	40 ILCS 5/12-149	1.10
MWRD	40 ILCS 5/13-503	2.19 , except for employee contributions to optional additional benefits made after January 1, 2003, which are multiplied by 1.00 .
Cook County	40 ILCS 5/9-169	1.54
Forest Preserve	40 ILCS 5/10-107	1.30
CTA	N/A	employer contribution collectively bargained, not governed by statute ¹⁴

These multiples are fixed, and except for the Teachers' fund, the employer is not permitted to reduce its contribution unless the funded ratio reaches 100%. There are sometimes exceptions to this rule. For example, Public Act 93-0654 allowed the Chicago Park District to reduce its employer contribution by \$5 million in each of calendar years 2004 and 2005, although the District was not required to reduce its property tax levy equivalently. This will represent roughly a 50% reduction in the employer contributions for the Park's fund in FY2005 and FY2006.

Occasionally there are legislated requirements for additional employer contributions. For example, Public Act 90-766 required the City of Chicago to make additional contributions to the Firemen's fund for FY1999-FY2013 in order to reduce the unfunded liability. However, Public Act 93-0654 rescinded that requirement for FY2004-FY2013.

GASB requires that actuaries calculate an actuarially required annual employer contribution. This is the employer's share of that year's normal cost (the portion of benefits value attributable

¹⁴ Provisions of the CTA Retirement Plan are subject to collective bargaining between the CTA and Locals 241 and 208 of the Amalgamated Transit Union. Plan text is available at <http://www.ctapension.com/about/PlanDocument.asp>.

to the current year) as well as an amount needed to amortize the unfunded liability over 30 or 40 years. Sometimes the actuary will express this figure as a multiple and compare it to the statutory multiple. For example, for FY2004 the MWRD plan's actuaries calculated that the actuarially required employer multiple would have been 3.64, instead of the statutory 2.19; this shortfall resulted in a \$16.4 million increase in the plan's unfunded liability for FY2004.

Scope of Report

This report presents broad trends for the ten pension funds, often aggregating the results for all ten funds. It is designed to provide an overview of trends for these funds, not to examine the specific causes for changes in the status of individual funds. For such an analysis, readers should consult the *Actuarial Valuation Reports* and *Financial Statements* of the individual funds.

FUNDED RATIOS: POLICY CONSIDERATIONS

One policy question inherent in an examination of pension funding is, "How shall the burden of payment be apportioned between current and future taxpayers?" If funding levels are too low, future taxpayers will experience a disparity between the level of taxes and the level of services: higher taxes will be paid to provide benefits to persons who are retired (pension benefits are constitutionally protected under Illinois law and therefore take precedence over all other obligations of government). On the other hand, if funding levels are too high, current taxpayers are being asked to endure a greater disparity between the level of taxes and services received from government than future generations.

Many experts concur that there is no real need to achieve 100% funding. They argue that governments, unlike private corporations, are not at risk of dissolving and, therefore, can meet their obligations in perpetuity. However, public pensions should be funded sufficiently to prevent the *growth* of the unfunded liability. If the unfunded liability is growing and the plan has no practical strategy for reducing it, this is cause for serious concern. As stated by Keith Brainard, the Research Director for the National Association of State Retirement Administrators: "More pertinent considerations with regard to funding a public pension plan may be whether: a) the amount needed to fund the benefit and amortize the unfunded liability is causing fiscal stress, and b) the plan's unfunded liability is diminishing, or there is a plan in place to reduce the unfunded liability."¹⁵ If the employer cannot, or chooses not to meet its actuarially required contribution due to fiscal stress, this is cause for concern. In its recommendations to the Governor and General Assembly of Vermont, the Commission on Funding the Vermont State Teachers' Retirement System puts it more bluntly: "While [insolvency] may seem somewhat far in the future, actuaries point out that the critical tipping point is not when assets run out or even decline, but when Governors and Legislatures no longer believe the required contributions are realistic and give up trying to fund the actuarially required contributions."¹⁶

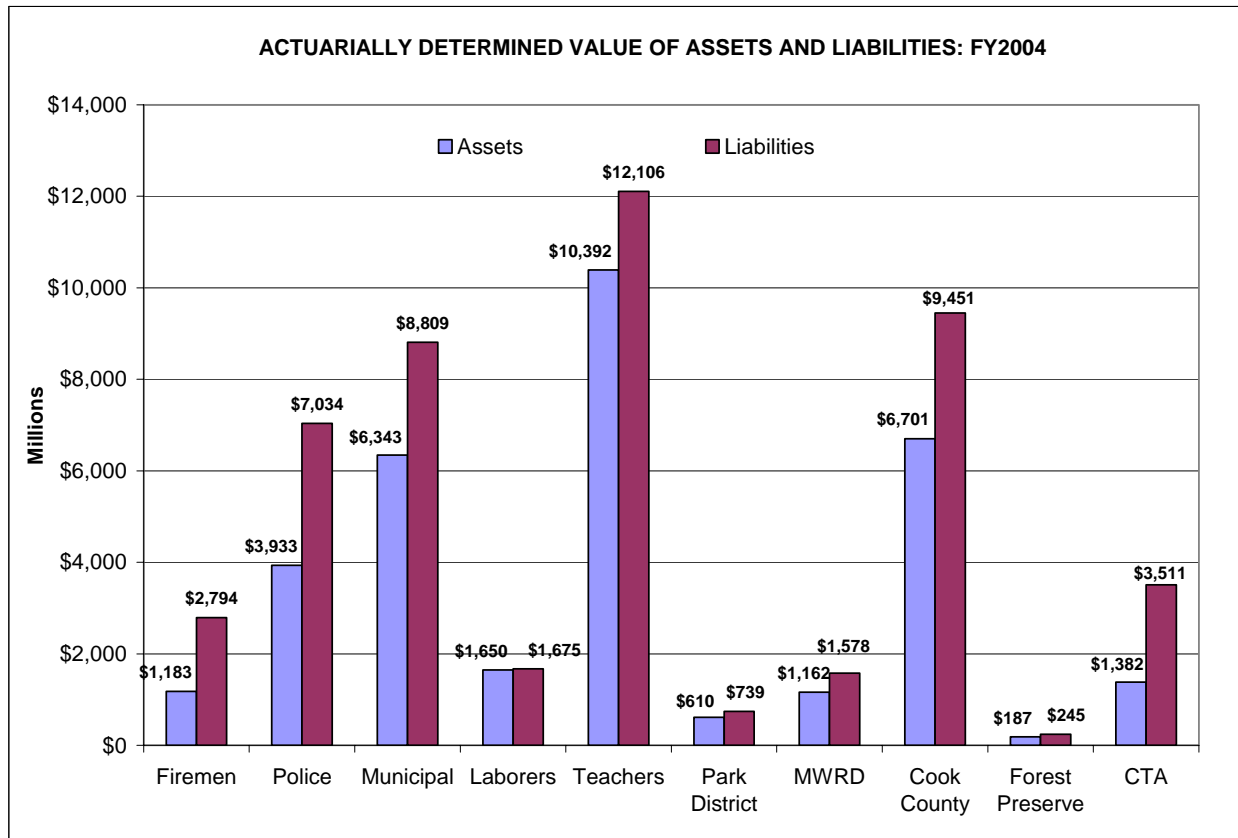
¹⁵ Keith Brainard, *Public Fund Survey Summary of Finding for FY2004*, (National Association of State Retirement Administrators, September 2005), p. 1.

¹⁶ *Report of the Commission on Funding the Vermont State Teachers' Retirement System: Recommendations to the Governor and the General Assembly*, November 2005, p.12.

ASSETS AND LIABILITIES OF LOCAL PENSION FUNDS

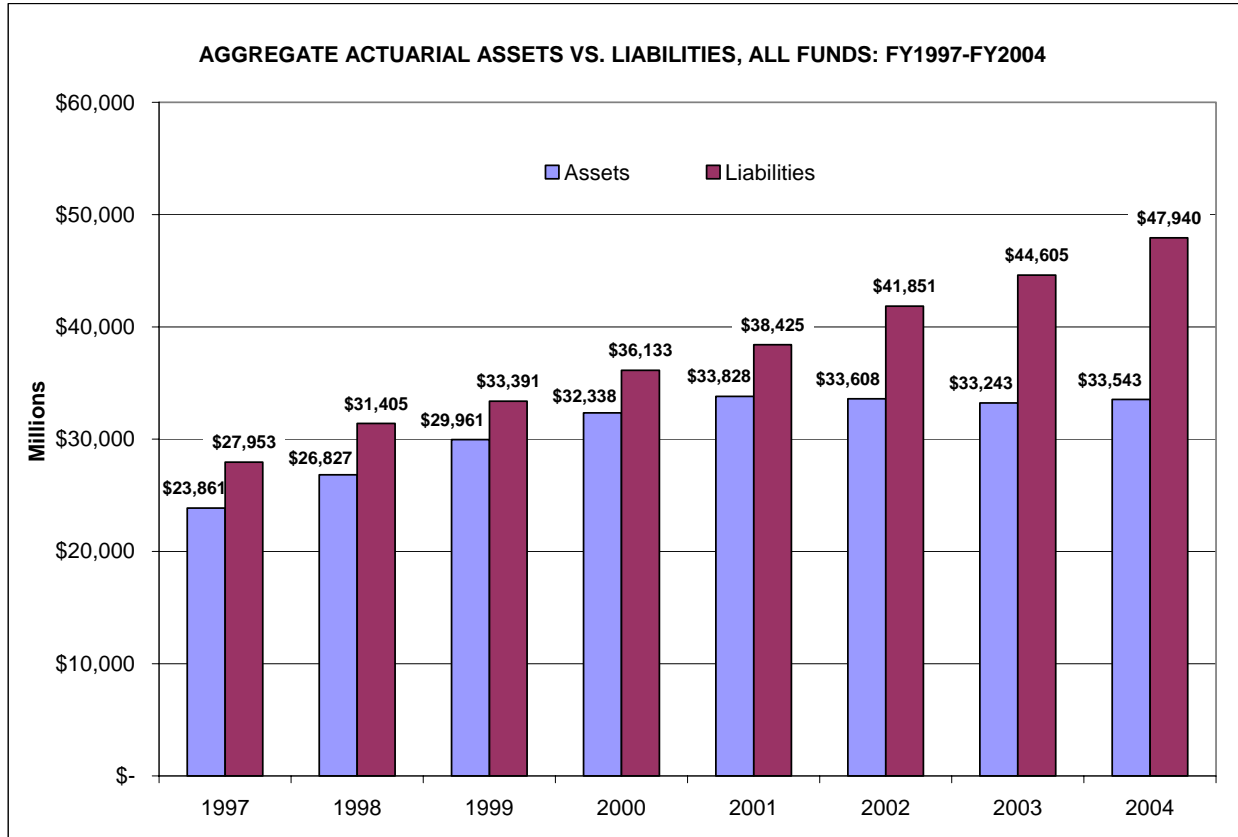
The basic issue at hand is whether or not the pension funds' assets are sufficient to cover total liabilities incurred. Liabilities are determined using actuarial assumptions. The assumptions are used to calculate the value of all future pension payments for both current and retired employees as well as any other beneficiaries. Under GASB Statement No. 25, assets of public pension plans are reported based on the actuarial value, or smoothed market value, of the assets. The actuarial value uses an average of the assets' market values from previous years.¹⁷ The current market value is another measure used to determine the assets of the plan. It reflects the value of the pension fund's assets at the end of the fiscal year. This measure is subject to variations in the market that can be misleading because the variations should average out over the life of the pension plan.

At the close of FY2004, the ten pension funds combined had approximately \$47.9 billion in accrued liabilities. Combined assets had an actuarial value of \$33.5 billion and a market value of \$33.1 billion.

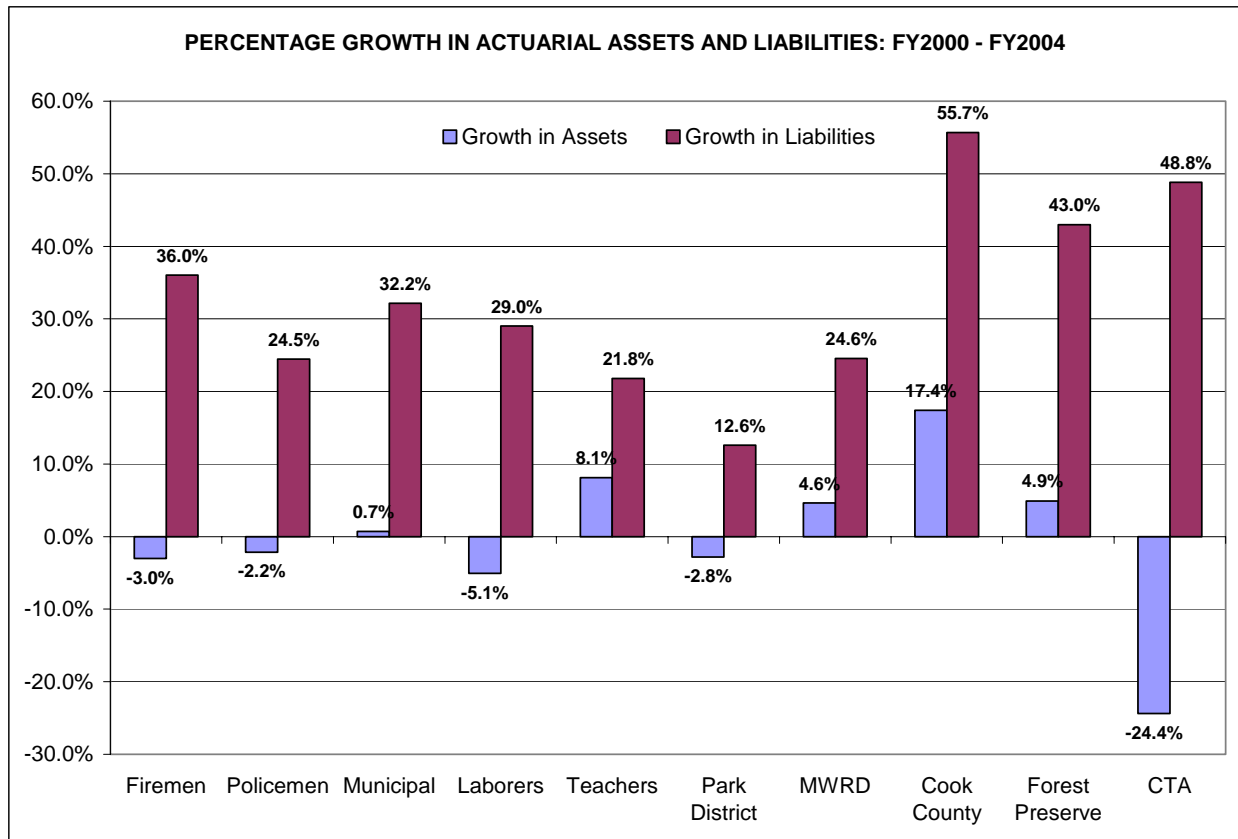


¹⁷ In November 1994, the Government Accounting Standards Board (GASB) issued Statement No. 25 that established new standards for the reporting of a pension fund's assets. The requirement became effective June 15, 1996. Up until that statement, most pension funds used two measurements for determining the net worth of assets, book value (recognizing investments at initial cost or amortized cost) and market value (recognizing investments at current value). In Statement No. 25, GASB recommends a "smoothed" market value, also referred to as the actuarial value of assets, in calculations for reporting pension costs and actuarial liabilities. The smoothed market value or actuarial value of assets accounts for assets at market values by averaging unexpected gains or losses over a period of 3 to 5 years.

The following figure shows the growth of aggregate actuarial assets and liabilities for all funds combined, from FY1997 to FY2004. Aggregate liabilities increased by \$20.0 billion, or 71.5%, over the 8-year period, while assets increased by \$9.7 billion, or 40.6%, and actually declined in FY2002 and FY2003.



The Cook County Fund and the CTA Fund have experienced the greatest growth rates for liabilities over the past five years, with growth rates of 55.7% and 48.8%, respectively. The CTA Fund has also experienced a 24.4% decline in its actuarial assets during the same period. Between 2000 and 2004, growth in liabilities has significantly exceeded growth in assets for all ten funds.



Another point of comparison is the difference between the current market value of assets and the actuarial value of assets. The FY2004 market value of assets remains slightly below the actuarial value of assets. This is because under actuarial value reporting, unexpected gains or losses are averaged over a period of 3 to 5 years.¹⁸ In this case, the losses experienced in fiscal years 2001 and 2002, as well as the gains of 2003 and 2004, have not yet been fully recognized in the actuarial value. In fiscal year 2004, however, the difference between aggregate actuarial value for all funds and current market value narrowed to just \$455.7 million, from \$2.4 billion in FY2003.

¹⁸ The Teachers' pension fund uses a 4-year smoothing period. The nine other funds reviewed here use a 5-year smoothing period.

COMPARISON OF CURRENT MARKET VALUE VS. ACTUARIAL VALUE OF ASSETS AT THE CLOSE OF FY2004		
Fund	Current Market Value	Actuarial Value
Firemen	\$ 1,206,177,759	\$ 1,182,578,954
Police	\$ 3,865,809,257	\$ 3,933,031,342
Municipal	\$ 6,242,741,942	\$ 6,343,076,159
Laborers	\$ 1,637,369,008	\$ 1,649,959,130
Teachers	\$ 10,321,555,491	\$ 10,392,193,115
Park District	\$ 573,870,138	\$ 610,293,849
MWRD	\$ 1,150,768,446	\$ 1,161,778,511
Cook County	\$ 6,618,941,068	\$ 6,700,845,111
Forest Preserve	\$ 184,966,738	\$ 186,560,109
CTA	\$ 1,284,662,081	\$ 1,382,264,000
TOTAL	\$ 33,086,861,928	\$ 33,542,580,280

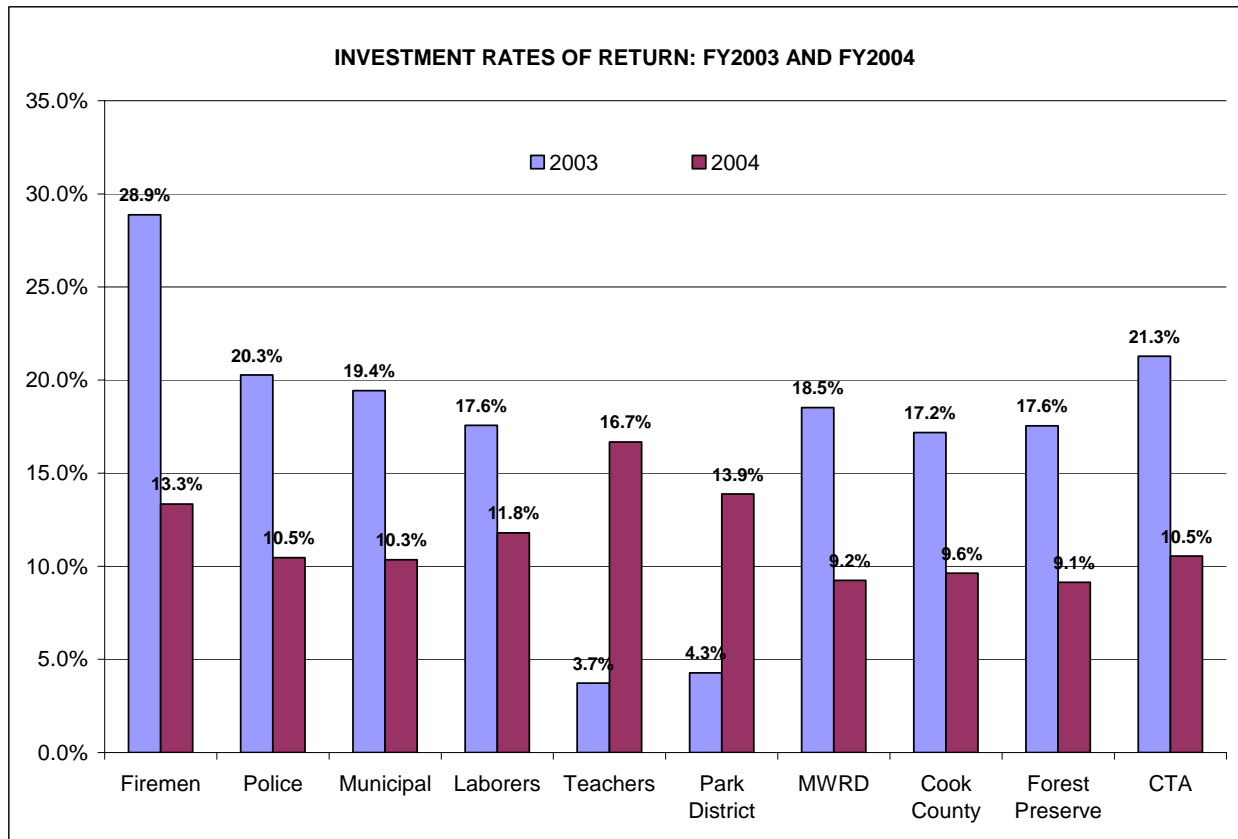
INVESTMENT RATE OF RETURN¹⁹

During FY2004, each of the ten pension funds yielded a positive rate of return. In aggregate, the funds generated a combined investment rate of return of 12.3%, slightly less than the 13.8% aggregate return for FY2003.²⁰ *It is important to note that the Park District and the Teachers' Funds use a July 1 – June 30 fiscal year instead of the calendar year used by the eight other funds, thus their rates of return reflect the last half of 2003 and the first half of 2004. Significant market growth occurred in the third and fourth quarters of 2003, while yields flattened somewhat in the latter part of 2004. Thus, the investment rates of return for the Teachers and Park Funds are not strictly comparable to those of the other eight funds.*

The FY2004 investment returns generated a total of \$3.7 billion for the ten funds combined. A comparison of the investment rates of return for FY2003 and FY2004 shows that for the eight funds using a calendar year fiscal year, investment returns fell 6 to 11 percentage points in FY2004, but still remained above the standard 8% expected average rate of return.

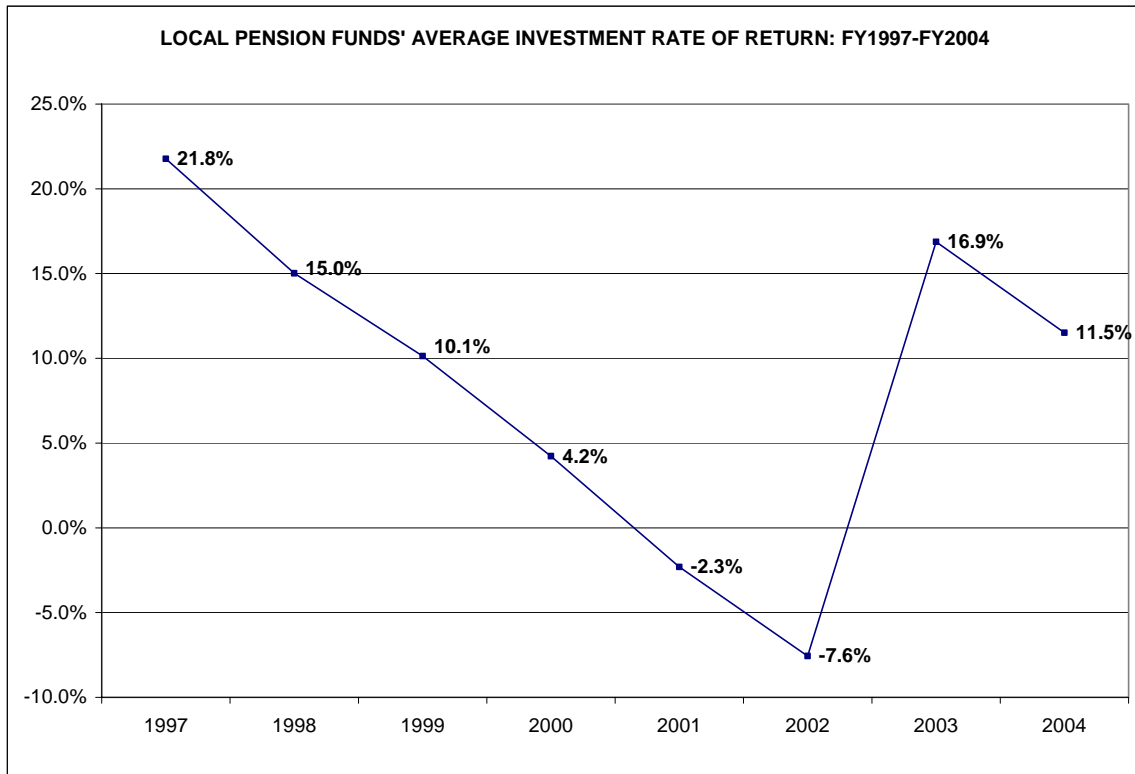
¹⁹ The Civic Federation calculates investment rate of return using the following formula for all funds: Current Year Rate of Return = Current Year Gross Investment Income / (0.5*(Previous Year Market Value of Assets + Current Year Market Value of Assets - Current Year Gross Investment Income)). Although this is a standard actuarial formula, it not necessarily the one used by all funds' actuaries, thus investment rates of return reported here may differ from those reported in a fund's actuarial statements.

²⁰ The "aggregate" rate of return calculates the rate based on the combined investment income of all the pension funds. In contrast, the "average" rate of return calculates each fund's rate of return separately and averages the results.

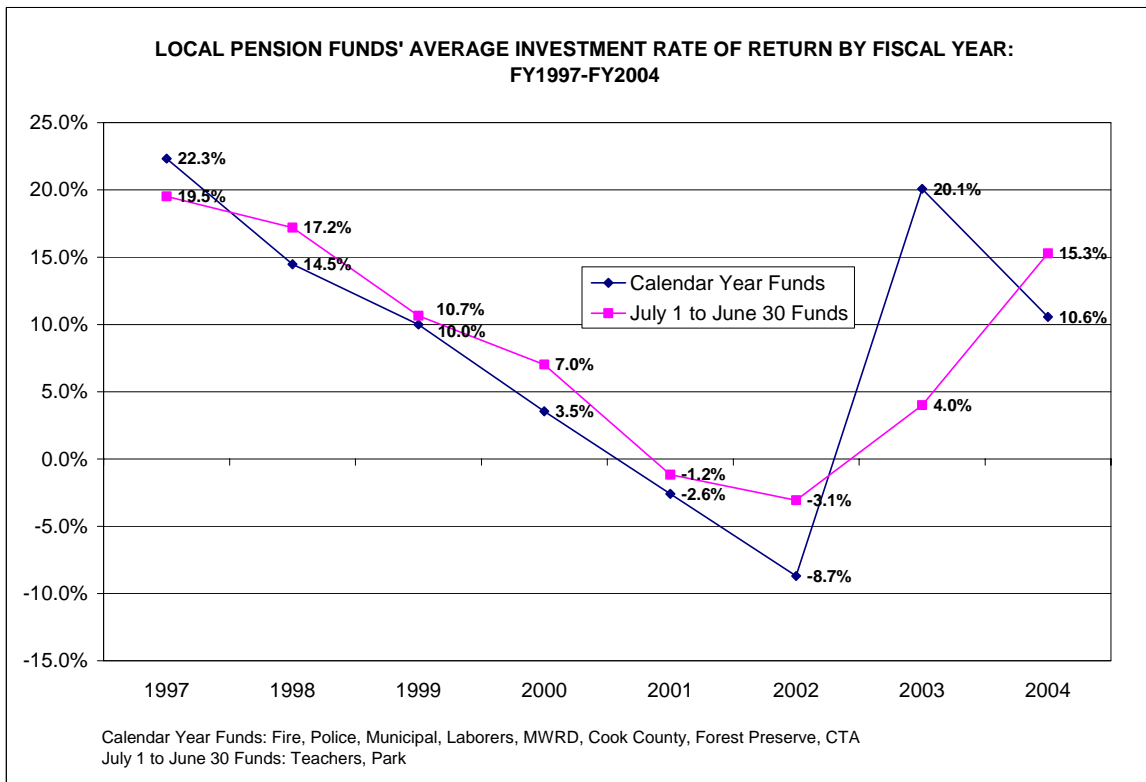


Historical Trends

The recent improvement in investment rates of return should be considered from a historical perspective. During the latter half of the 1990s, strong financial markets increased local pension funds' assets significantly. In 1997, the ten funds experienced rates of return ranging from 18.5% to 37.3%. That positive trend reversed, however, and by the close of FY2002 every fund had a negative rate of return, ranging from -3.4% to -12.9%. In FY2003, the rates of return for all funds turned positive again, with an average rate of 16.9%. The average rate of return fell to 11.5% in FY2004.



The following figure also presents the average investment rate of return, but splits the ten funds into two groups: those with calendar year fiscal years and those with July 1 to June 30 fiscal years.



REVENUES AND EXPENDITURES

Of the three primary sources of revenue for the pension plans studied here (investment income, employer contributions, and employee contributions) investment income is the primary driver of total income for all of the pension funds.

The increases in asset values experienced in the late 1990's, the subsequent declines in 2001 and 2002, and the recovery in 2003 caused significant shifts in the sources of pension fund revenue. In FY2003, strong investment returns generated positive income for all of the pension funds for the first time since FY2000. FY2004 income for all funds totaled \$5.1 billion, essentially flat from FY2003. Investment income represented 72.8% of total income for all funds combined in FY2004.²¹ Employee and employer contributions represented 12.9% and 13.7% of total income, respectively. See Appendix A for detail on the sources for revenue and expenditure figures presented in this report.

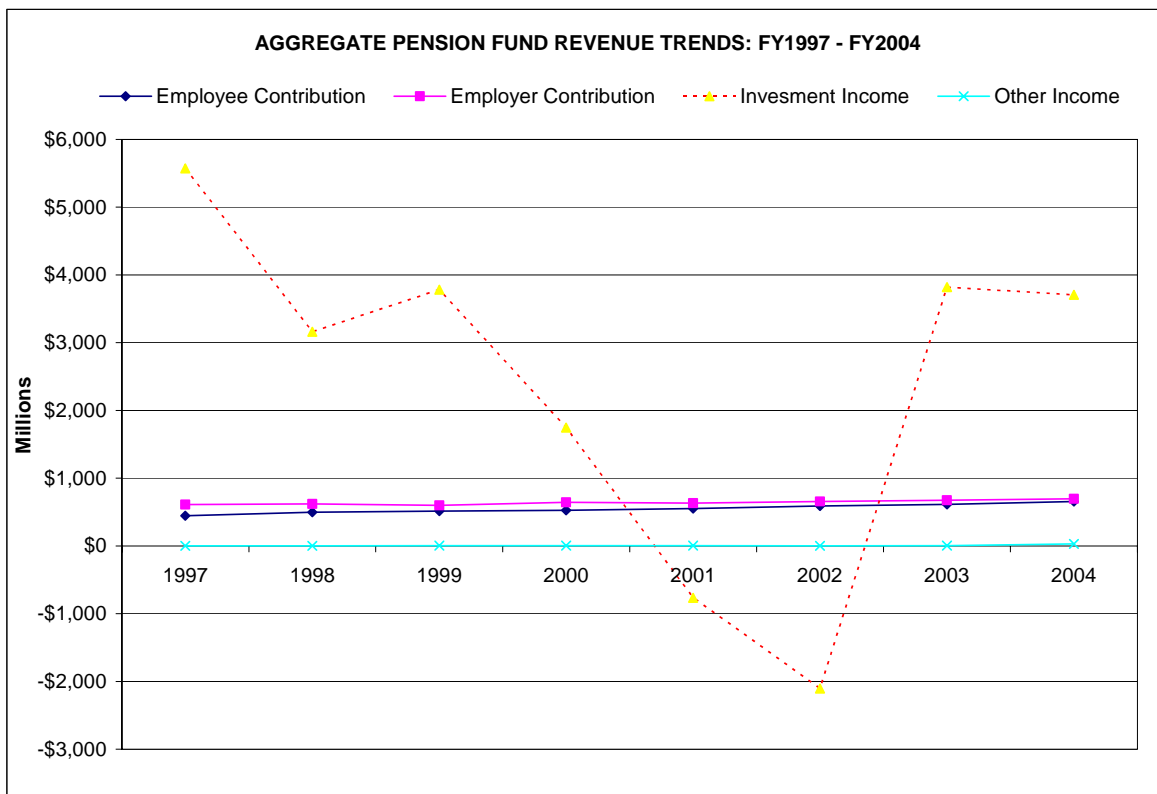
FY2004 REVENUES BY SOURCE					
Fund Name	Employee Contribution	Employer Contribution	Investment Income	Other Income	TOTAL INCOME
Fire	\$ 37,734,425	\$ 55,532,454	\$ 144,849,743	\$ 24,322,475	\$ 262,439,097
Police	\$ 78,800,816	\$ 135,668,860	\$ 376,047,992	\$ 75,313	\$ 590,592,981
Municipal	\$ 155,884,575	\$ 153,919,476	\$ 598,364,141	\$ -	\$ 908,168,192
Laborers	\$ 22,591,435	\$ -	\$ 177,538,349	\$ 202,684	\$ 200,332,468
Teachers	\$ 169,598,212	\$ 78,127,273	\$ 1,507,342,352	\$ 86,285	\$ 1,755,154,122
Park District	\$ 10,593,581	\$ 9,840,681	\$ 72,282,612	\$ -	\$ 92,716,874
MWRD	\$ 15,150,846	\$ 30,982,232	\$ 98,895,448	\$ 3,945	\$ 145,032,471
Cook County	\$ 148,924,055	\$ 198,117,042	\$ 582,725,493	\$ 4,630,425	\$ 934,397,015
Forest Preserve	\$ 2,018,255	\$ 3,890,143	\$ 15,812,606	\$ 9,186	\$ 21,730,190
CTA	\$ 15,315,771	\$ 30,575,996	\$ 133,294,026	\$ -	\$ 179,185,793
TOTAL	\$ 656,611,971	\$ 696,654,157	\$ 3,707,152,762	\$ 29,330,313	\$ 5,089,749,203

The following table shows each fund's fiscal 2004 revenue by source as a percent of total income. For each fund, investment income constitutes the greatest portion of total income. Some funds report "Other" income, which includes sources such as transfers from other governments with reciprocal agreements, interest income from operating accounts, and other miscellaneous revenue. In FY2004, investment income represented the clear majority of income for all ten funds.

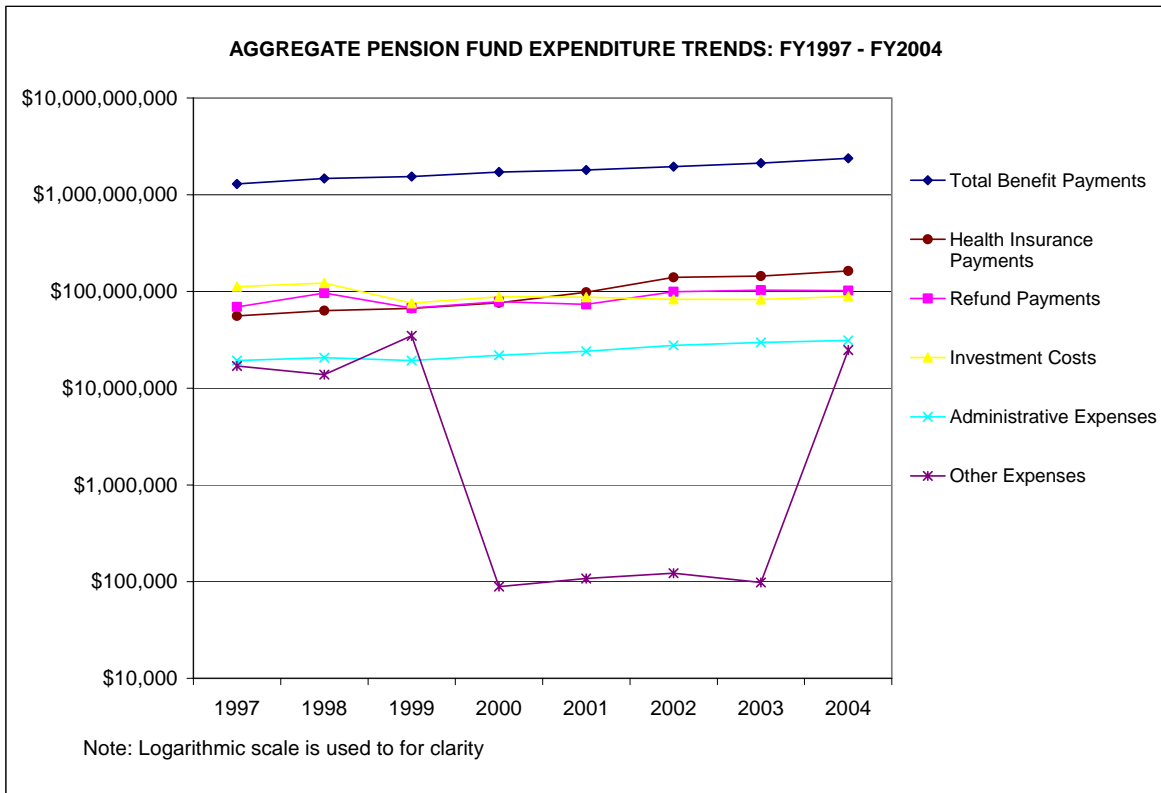
²¹ Investment income is presented as a gross figure, not net of investment costs. Investment costs are counted as an expense, alongside administrative costs and other types of expenditures.

FY2004 REVENUES BY SOURCE AS % OF TOTAL					
Fund Name	Employee Contribution	Employer Contribution	Investment Income	Other Income	TOTAL INCOME
Fire	14.4%	21.2%	55.2%	9.3%	100.0%
Police	13.3%	23.0%	63.7%	0.0%	100.0%
Municipal	17.2%	16.9%	65.9%	0.0%	100.0%
Laborers	11.3%	0.0%	88.6%	0.1%	100.0%
Teachers	9.7%	4.5%	85.9%	0.0%	100.0%
Park District	11.4%	10.6%	78.0%	0.0%	100.0%
MWRD	10.4%	21.4%	68.2%	0.0%	100.0%
Cook County	15.9%	21.2%	62.4%	0.5%	100.0%
Forest Preserve	9.3%	17.9%	72.8%	0.0%	100.0%
CTA	8.5%	17.1%	74.4%	0.0%	100.0%
TOTAL	12.9%	13.7%	72.8%	0.6%	100.0%

The following chart illustrates that while historically investment income has fluctuated considerably, aggregate employer and employee contributions have remained relatively constant at approximately \$500-\$600 million each.



In contrast to the fluctuating revenues, aggregate pension fund expenditures have grown steadily by an average of 8.7% each year between 1997 and 2004. The primary expenditure of the pension funds is benefit payments, which constituted roughly 85.0% of the ten funds' aggregate expenditures between FY1997 and FY2004. The total amount of benefit payments made has increased by 84.8% since 1997, from \$1.3 billion to \$2.4 billion. Other types of expenses include retiree health insurance payments, refund payments, administrative expenses and investment costs.



The following two tables show fund expenditures by type, and as a percent of total expenditures. Total expenditures for all funds were \$2.8 billion, of which 85.3% was for benefit payments. The Teachers', Cook County, Forest Preserve, and CTA funds provide full or partial reimbursements for annuitant health insurance costs.

FY 2004 EXPENDITURES BY TYPE							
Fund Name	Benefit Payments	Health Ins. Payments	Refund Payments	Other Expenses	Administrative Expenses	Investment Costs	TOTAL EXPENDITURES
Fire	\$ 156,355,227	n/a	\$ 2,017,047	\$ -	\$ 2,096,598	\$ 5,353,001	\$ 165,821,873
Police	\$ 401,519,101	n/a	\$ 5,781,659	\$ -	\$ 2,626,056	\$ 8,139,882	\$ 418,066,698
Municipal	\$ 498,839,889	n/a	\$ 40,070,355	\$ 24,201,945	\$ 5,470,007	\$ 19,634,053	\$ 588,216,249
Laborers	\$ 99,260,643	n/a	\$ 6,697,268	\$ -	\$ 2,872,450	\$ 6,494,070	\$ 115,324,431
Teachers	\$ 589,111,548	\$ 53,106,379	\$ 23,326,721	\$ -	\$ 7,214,467	\$ 28,482,561	\$ 701,241,676
Park District	\$ 51,741,193	n/a	\$ 2,923,613	\$ -	\$ 1,199,194	\$ 2,527,707	\$ 58,391,707
MWRD	\$ 78,113,259	n/a	\$ 1,320,740	\$ -	\$ 1,243,182	\$ 1,993,289	\$ 82,670,470
Cook County	\$ 307,974,685	\$ 36,663,724	\$ 18,049,094	\$ -	\$ 6,513,917	\$ 10,126,948	\$ 379,328,368
Forest Preserve	\$ 9,690,482	\$ 1,669,160	\$ 1,305,039	\$ 578,286	\$ 57,347	\$ 321,461	\$ 13,621,775
CTA	\$ 191,629,332	\$ 71,413,210	\$ 859,196	\$ -	\$ 1,883,434	\$ 5,740,670	\$ 271,525,842
TOTAL	\$2,384,235,359	\$ 162,852,473	\$ 102,350,732	\$ 24,780,231	\$ 31,176,652	\$ 88,813,642	\$ 2,794,209,089

FY 2004 EXPENDITURES BY TYPE: as % of Total							
Fund Name	Benefit Payments	Health Ins. Payments	Refund Payments	Other Expenses	Administrative Expenses	Investment Costs	TOTAL EXPENDITURES
Fire	94.3%	n/a	1.2%	0.0%	1.3%	3.2%	100.0%
Police	96.0%	n/a	1.4%	0.0%	0.6%	1.9%	100.0%
Municipal	84.8%	n/a	6.8%	4.1%	0.9%	3.3%	100.0%
Laborers	86.1%	n/a	5.8%	0.0%	2.5%	5.6%	100.0%
Teachers	84.0%	7.6%	3.3%	0.0%	1.0%	4.1%	100.0%
Park District	88.6%	n/a	5.0%	0.0%	2.1%	4.3%	100.0%
MWRD	94.5%	n/a	1.6%	0.0%	1.5%	2.4%	100.0%
Cook County	81.2%	9.7%	4.8%	0.0%	1.7%	2.7%	100.0%
Forest Preserve	71.1%	12.3%	9.6%	4.2%	0.4%	2.4%	100.0%
CTA	70.6%	26.3%	0.3%	0.0%	0.7%	2.1%	100.0%
TOTAL	85.3%	5.8%	3.7%	0.9%	1.1%	3.2%	100.0%

FUNDED RATIOS

This report uses two measurements of the pension plans funded ratios: the actuarial value of assets measurement and the market value of assets measurement.

The actuarial value of assets measurement looks at the ratio of assets to liabilities and accounts for assets by averaging unexpected gains and losses over a period of three to five years (see note 17, page 8 for an explanation of actuarial value of assets). The market value of assets measurement looks at the ratio of assets to liabilities by recognizing investments only at current value.

Actuarial Value of Assets

Nine of the ten funds lost ground in terms of their actuarially funded ratios in FY2004. The Cook County fund's ratio increased from 67.5% in FY2003 to 70.9% in FY2004 due to a change in actuarial methodology that boosted the actuarial value of assets.²² The 39.4% CTA funded ratio is of serious concern due to that fund's rapid decline from an 80.0% ratio in FY1999. As noted on page 11, however, a large part of the decline is attributable to a change in actuarial assumptions to more fully recognize healthcare liabilities. Taking into account healthcare liabilities, the FY1999 actuarial funded ratio was closer to 65.0%.²³

The low funded ratios of the Firemen's and Policemen's pension funds are also a continuing cause for concern, since these ratios have fallen to 42.3% and 55.9%, respectively, although their decline has been less precipitous than that of the CTA. On the high end of the scale, the Laborers' Fund dipped below 100% funded for the first time in many years, at 98.5%. The employer contribution to this fund had been waived for several years when the plan was over 100% funded.²⁴

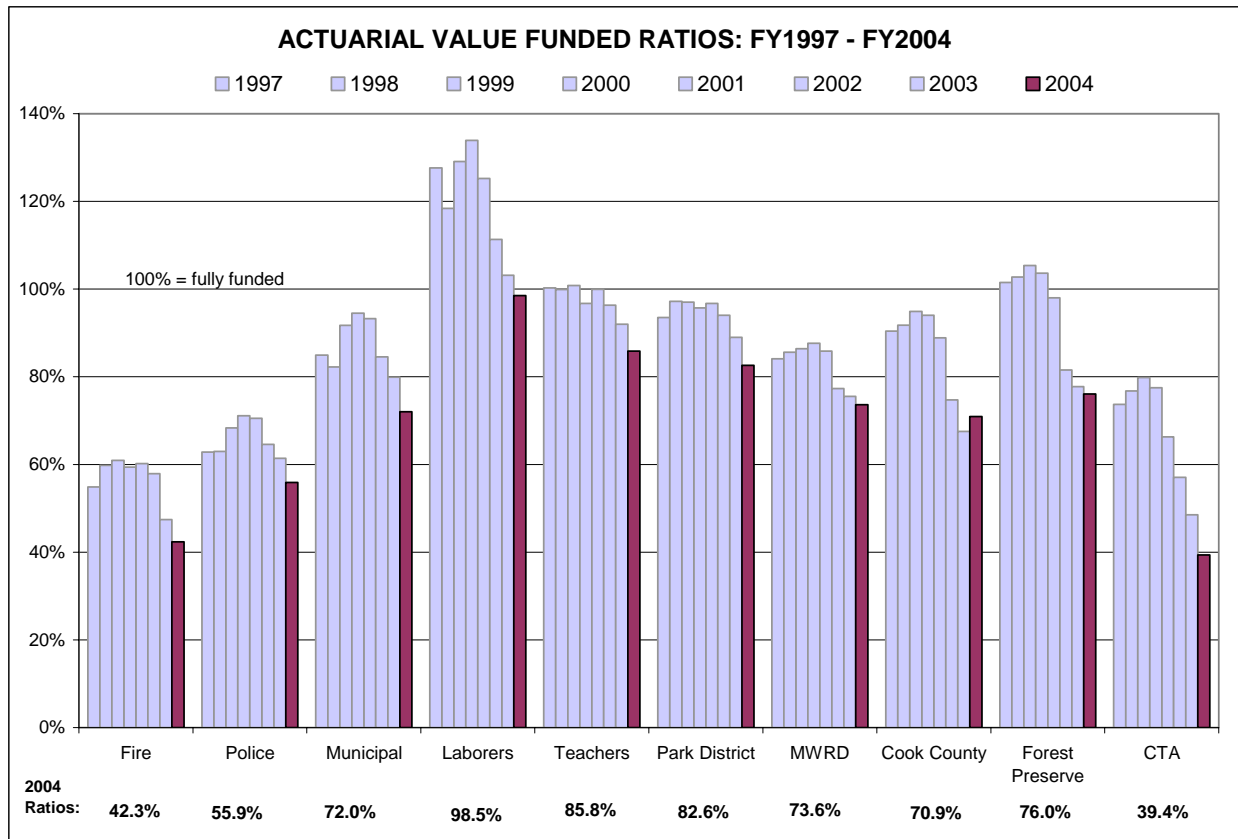
The actuarial funded ratio for the aggregate of all funds' assets and liabilities was 70.0%, down from 74.5% in FY2003.

It is important to consider actuarial funded ratios over time. The following chart illustrates the ten funds' actuarial standing since FY1997.

²² The net actuarial assets as of January 1, 2004 were \$6.5 billion according to the County's new actuary, and \$5.9 billion under the previous actuary's method. *County Employees' Annuity and Benefit Fund of Cook County Actuarial Valuation as of December 31, 2004*, p. 9.

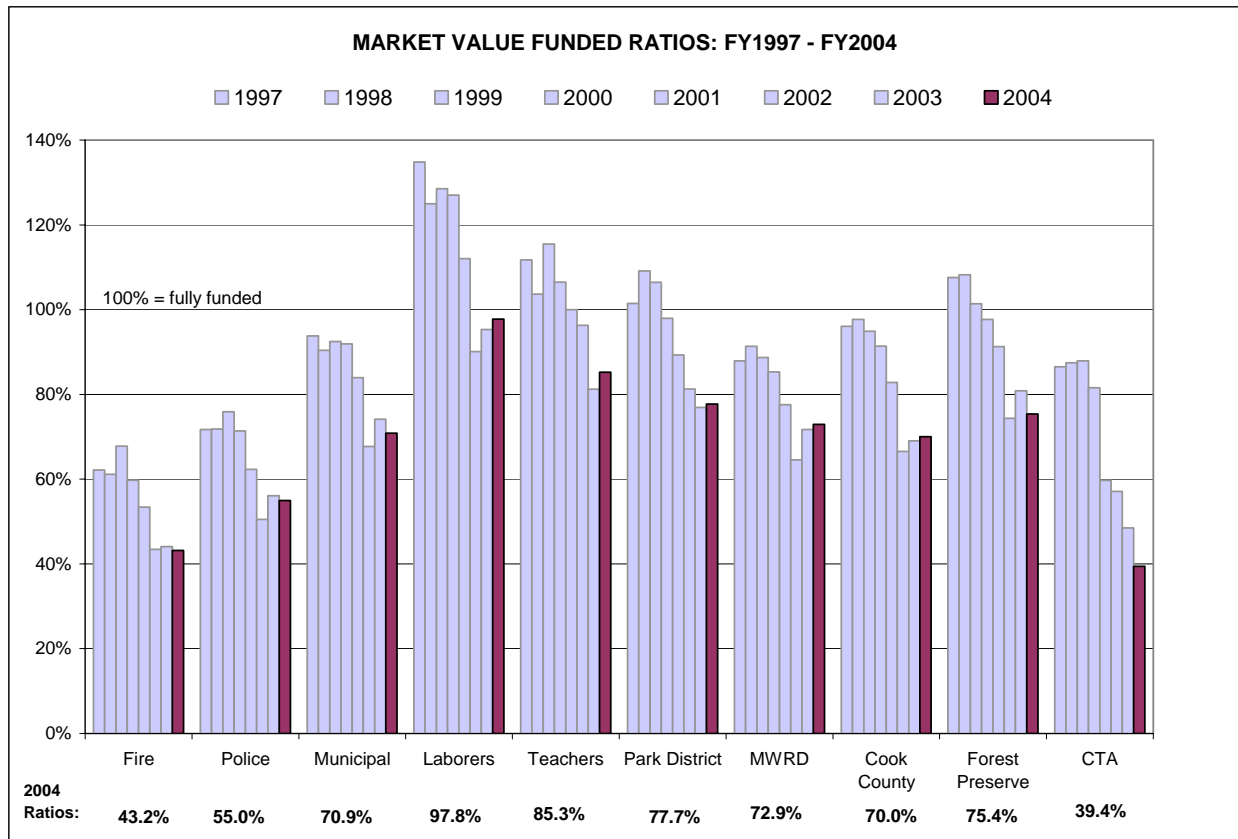
²³ "Historical Information for the Retirement Plan for CTA Employees, 1977-2005," provided by the Retirement Plan for Chicago Transit Authority Employees, February 16, 2006.

²⁴ Pursuant to Public Act 93-0654, the Laborer's Fund is not required to make employer contributions unless the funded ratio *excluding early retirement initiative liabilities* drops below 100%. The FY2004 Laborer's fund funded ratio excluding early retirement initiative liabilities was just over 100%.



Market Value of Assets

It is also useful to evaluate the pension plans' market value funded ratios over time. The following table illustrates the fluctuations in the market value funded ratio since 1997. Market value funded ratios are more volatile than the actuarial funded ratios due to the smoothing effect of the three-to-five year average in the actuarial value. The FY2004 market value funded ratios are slightly below or equal to the FY2004 actuarial funded ratios, indicating that the losses of FY2001 and FY2002 are being compensated for by the gains of FY2003 and FY2004 in the actuarial smoothing over 3-5 years.

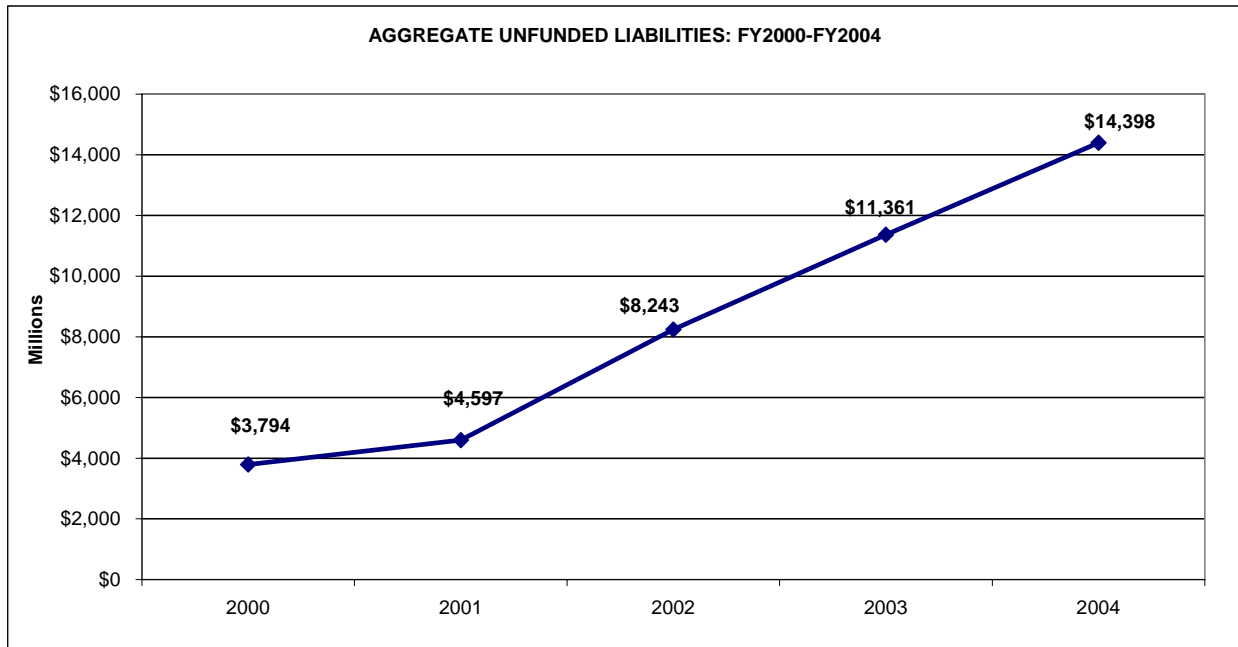


UNFUNDED ACTUARIAL LIABILITIES

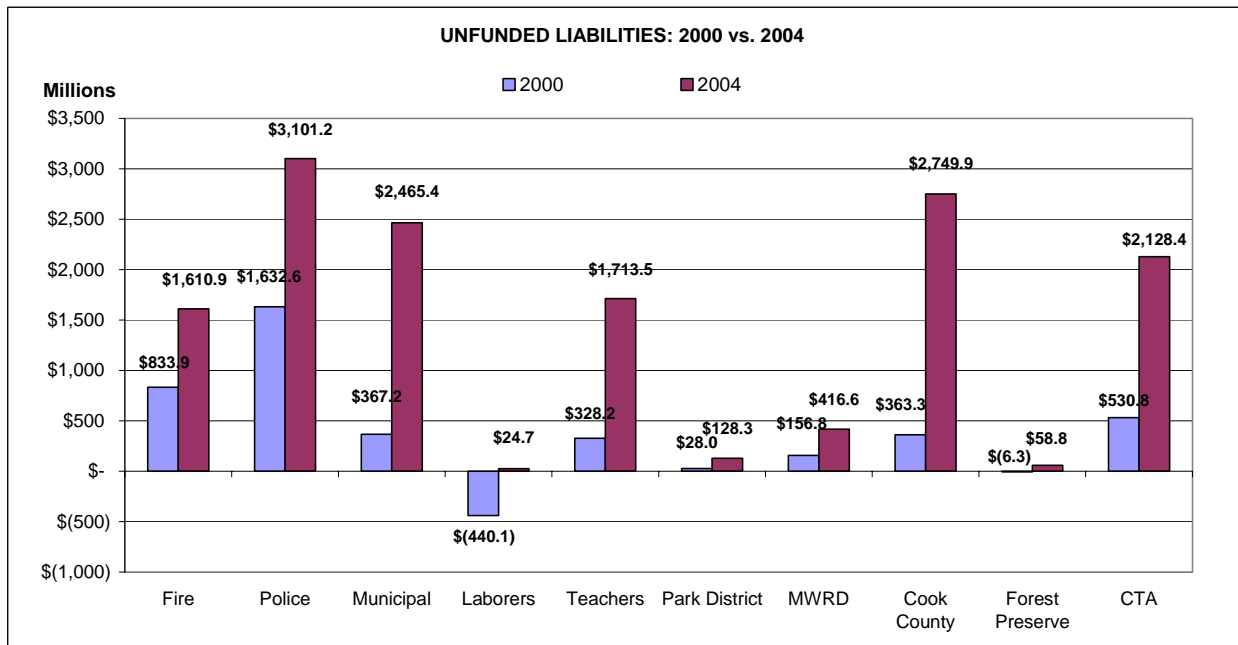
The difference between assets and liabilities is known as the unfunded liability. This figure is derived by subtracting the actuarial value of the assets from the accrued liability of each fund.

One of the functions of this indicator is to measure a fund's ability to bring assets in line with liabilities. Healthy funds are ones that are able to reduce their liabilities over time; substantial and sustained increases in liabilities are cause for concern.

The aggregate unfunded liability of the ten pension funds has increased rapidly in recent years, as shown in the following chart. Between FY2000 and FY2004, aggregate unfunded liabilities have nearly quadrupled, rising from \$3.8 billion to \$14.4 billion. Between FY2003 and FY2004, unfunded liabilities for the ten funds grew by 26.7%, or \$3.0 billion.

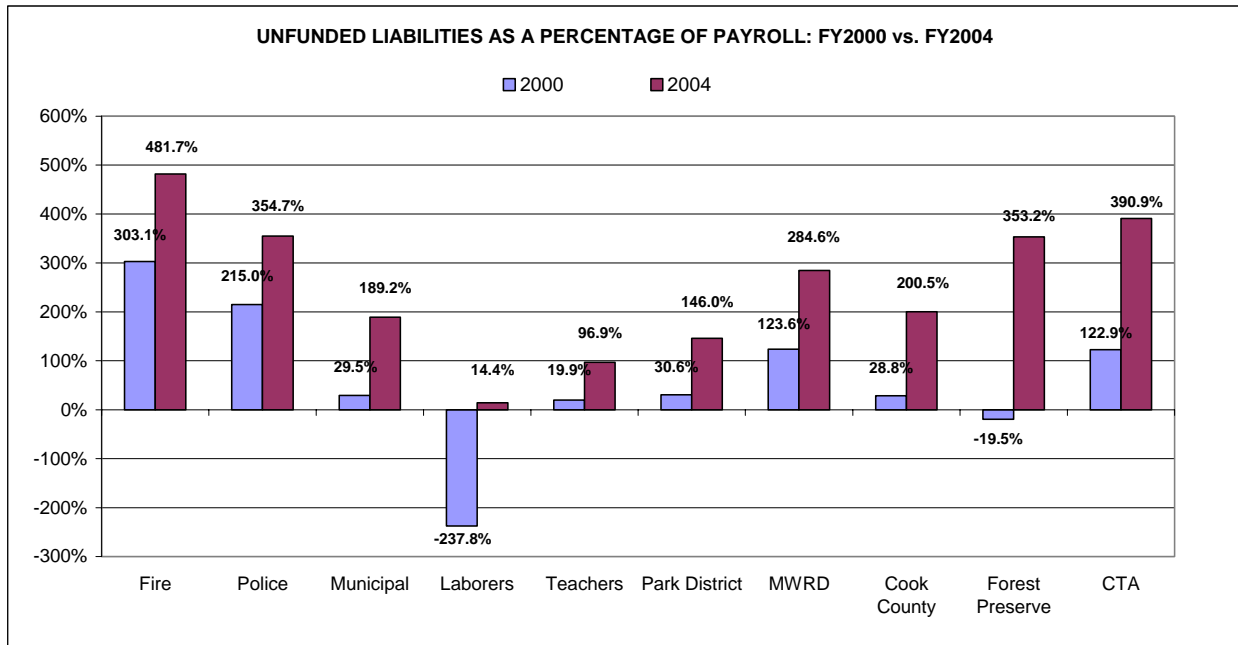


The largest FY2004 unfunded liability is in the Police pension fund at \$3.1 billion, an increase of 90.0% over FY2000. The highest rates of increase in unfunded liability were experienced by the Cook County fund and the Forest Preserve fund. The Forest Preserve fund went from having a \$6.3 million surplus in FY2000, to \$58.8 million in unfunded liabilities in FY2004: more than a tenfold increase. The Cook County fund's unfunded liabilities grew by 657.0% between FY2000 and FY2004, an increase of \$2.4 billion.



Another indicator of funding progress is the reporting of a fund's unfunded liability as a percentage of covered payroll. This measurement expresses the unfunded liability in terms of the current personnel expenditures and demonstrates the relative size of the unfunded liability.

One of the functions of this indicator is to measure a fund's ability to manage or make progress on reducing its unfunded liability. An indication of a reasonable funding strategy would be a gradual decrease in unfunded liability as a percent of covered payroll over time. If the opposite is true, unfunded liability continues to increase as a percentage of covered payrolls, then a new funding strategy and the level of benefits granted by the fund should be considered. Every fund has experienced significant increases in unfunded liabilities as a percentage of payroll in the last five years. The Firemen's Fund has the highest unfunded liabilities as a percentage of payroll, at almost 481.7%. The Forest Preserve Fund has experienced the highest rate of growth in its unfunded liabilities as a percentage of payroll, increasing by 373 percentage points in five years.



CIVIC FEDERATION RECOMMENDATIONS

Growth in liabilities has significantly outpaced growth in assets for local pension funds since 1997, resulting in aggregate unfunded liabilities of \$14.4 billion for the ten major funds in FY2004. There is no indication that this trend will reverse, or even slow, unless substantial changes are made to the pension plans both in terms of benefits provided and contributions made.

Local governments must take action now to control the downward spiral of pension underfunding. In 2005, the State of Illinois adopted several key reforms designed to help the State control mounting employee retirement costs for its five retirement systems. The Civic Federation strongly supported these reforms and believes that the time has come to also apply some of these reforms to local government benefit plans.²⁵ This year, we offer specific

²⁵ The Civic Federation, *State of Illinois Pension Systems*, (Chicago: The Civic Federation), May 2, 2005. http://www.civiefed.org/articles/civiefed_188.pdf. The Civic Federation opposed legislation passed in 2005 allowing the State to reduce its pension contributions by \$1.2 billion in FY2006 and \$1.1 billion in FY2007.

recommendations designed to improve the long-term financial health of the local funds, and address the major causes of funding decline that are within the control of the governments. We urge the local governments to seek such changes through collective bargaining and/or legislation.

Link Benefit Enhancements to Full Funding

Benefit enhancements are a major source of increased liabilities for pension funds. In the collective bargaining process, granting benefit enhancements is often an attractive option for employers, since they create long-term liabilities than can be traded for short-term savings on other personnel costs. However, some local governments have granted benefit enhancements that they simply cannot afford in the long-term. For this reason, the Civic Federation recommends that **governments stop granting any new retirement benefit enhancements unless they also increase employer and/or employee contributions sufficiently to fully fund the enhancements.** The case of the beleaguered San Diego pension system provides a cautionary tale: the fund simultaneously increased benefits while decreasing contributions, an action that consultants concluded “did not make economic or actuarial sense.”²⁶

Public Act 94-0004, Illinois’ 2005 pension reform law, requires that every new benefit increase made to one of the five state retirement systems must identify and provide for additional funding to fund the resulting annual accrued cost of the increase. It also requires that any benefit increase **expire after five years**, subject to renewal. The Civic Federation supports extending this reasonable control on benefit enhancements to the local public pension funds.

Reduce Benefits for New Employees: Establish a Two-Tiered System

Once granted, benefit enhancements cannot be diminished, according to the Constitution of the State of Illinois.²⁷ The only way for an employer to reduce liabilities by reducing retirement benefits is to reduce those benefits for new employees. This is commonly called a “two-tiered” system, where new and existing employees are promised different retirement benefits. By scaling back on retirement benefits for new hires, governments can undo some of the damage done by excessive benefit enhancements granted in the past. For example, an arbitration award reduced benefits for CTA employees hired after September 5, 2001 by setting an age minimum for the early retirement option and eliminating a hospitalization supplement for retirees.²⁸ The Civic Federation urges other local governments to consider similar ways to **scale back on excessive benefits granted in the past by reducing benefits for new hires.**

Limit Annuity Increases for New Hires at the Lesser of 3% or CPI

One reasonable way to curb retirement costs would be to limit annuitants’ annual automatic cost of living increases to the lesser of 3% or the increase in the Consumer Price Index. For example,

²⁶ Karen Kucher, “Pension scheme did not make sense, report finds,” *The San Diego Union-Tribune*, January 20, 2006. See also the Navigant Consulting Report at http://www.sdccers.org/images/pdf/sdccers_investigative_report_full.pdf

²⁷ In Illinois, as in many states, pension benefits granted to public employees are guaranteed by the State Constitution. *Constitution of the State of Illinois, Article XIII Section 5.*

²⁸ For employees hired before September 5, 2001, early retirement is available after 25 years of service; for employees hired after September 5, 2001, early retirement is available after 25 years of service and attainment of age 55. Similarly, employees hired after September 5, 2001 do not receive the hospitalization supplement paid for by the Plan upon retirement. See the plan text, available at <http://www.ctapension.com/about/PlanDocument.asp>.

Cook County pension fund beneficiaries receive 3% annual cost of living increases.²⁹ However, this rate can and does exceed the rate of inflation. To control costs, **annual annuity increases for new hires should be fixed at the equivalent of the projected Consumer Price Index or 3%, whichever is less.**

Require Employer Contributions to Relate to Funding Levels

As described on page 12, the basic employer contributions for eight of the ten local funds analyzed here are simply a multiple of past employee contributions, with no relationship to the funding status of the plan. Only the Teachers' fund has a trigger that requires additional contributions when the funded ratio drops below a certain level; this is a good provision to ensure that contributions do not fall hopelessly behind when funded ratios begin falling. **The Civic Federation recommends that employer contributions for all funds be tied to funded ratios, such that additional contributions are required when the ratio drops below a given level.**

Reform Pension Boards of Trustees to Balance Stakeholder Interests, Safeguard Assets

Achieving serious reforms that can have a real impact on the health of local pension funds will require a strong and unwavering commitment on the part of local governments. It will also require that their efforts not be thwarted by the trustees of the pension funds. The mission of a public pension fund board of trustees should be to safeguard the fund's assets through prudent investments and effective management. Unfortunately, some local pension boards also act as advocates on behalf of fund members, lobbying for benefit enhancements that ultimately increase the funds' liabilities.³⁰

As outlined in the Civic Federation's *Recommendations to Reform Pension Boards of Trustees Composition in Illinois*, the Federation believes that a pension board should not function as an advocate for the interests of one stakeholder, especially when advocating those interests creates increased liabilities for the fund.³¹ Rather, the trustees should focus on conserving and increasing the fund's assets to ensure that sufficient amounts are available to pay promised benefits when they come due. Although not all pension boards produce results favoring one stakeholder over another, board composition is an indicator of whose interests are most likely to be represented in the board's actions. Unfortunately, most Illinois public pension boards' membership does not reflect a balance of interests. On the boards of the ten local funds surveyed here, either half or a majority of trustees are active employees or retirees.

In our view, a pension board of trustees should:

²⁹ Cook County Employees' Annuity and Benefit Fund *Actuarial Valuation as of December 31, 2004*, p. 26. The CTA retirement fund does not have an automatic annual increase, but periodically grants ad hoc dollar amount annuity increases through collective bargaining.

³⁰ The Chicago Public School Teachers' Pension and Retirement Fund's 2004 *Comprehensive Annual Financial Report* states the Trustees' commitment to advocating benefit increases for employees: "The Trustees and Fund administrators will continue to work diligently to represent the interests of the members through further accomplishment of the Trustees' legislative agenda. The Board, in conjunction with Fund consultants, continues to work in Springfield toward improving benefits for the members," page 13.

³¹ The Civic Federation, *Recommendations to Reform Pension Boards of Trustees Composition in Illinois*, (Chicago, IL) February 2006.

- Balance employee and management representation on pension boards;
- Develop a tripartite structure that includes independent citizen representation on pension boards, and
- Include financial experts on pension boards and require financial training for non-experts.

We urge local governments to seek reform of the pension board governance structure to ensure greater balance of interests and ensure that trustees focus on their mission of safeguarding assets, not increasing liabilities.

GLOSSARY

Actuarial Value of Assets: Under Government Accounting Standards Board (GASB) Statement No. 25, assets of public pension plans must be reported based on the actuarial value, or smoothed market value, of the assets. The actuarial value uses an average of the assets' market values from previous years, thus smoothing out fluctuations in the market value. The actuarial value of assets accounts for assets at market values by averaging unexpected gains or losses over a period of 3 to 5 years.

Actuarially Required Annual Employer Contribution (ARC): The employer's share of that year's normal cost (the portion of benefits value attributable to the current year) as well as an amount needed to amortize the unfunded liability over 30 or 40 years.

Defined Benefit Plan: A type of pension plan. In defined benefit plans, employers and employees annually contribute fixed amounts to investments intended to cover future benefit payments. Upon retirement, the employee receives an annuity based upon his or her highest salary (usually based on an average of several years) and length of service. If the amounts contributed to the plan over the term of the employee's employment (plus accrued earnings) are insufficient to support the benefits (including health and survivor's benefits), the former employer is required to pay the difference.

Defined Contribution Plan: A type of pension plan. In a defined contribution plan, the employee and the employer contribute fixed amounts. Upon retirement, the employee receives an annuity and interest based upon the amount contributed to the plan over the term of his or her employment. Once the employee retires, the employer has no further liability to the employee (except, perhaps, for ancillary health benefits). Historically, defined benefit plans were the most common type of plan, but changes in tax laws encouraged numerous conversions in the private sector to defined contribution plans. These plans are known as 401(k) or 403(b) plans, named after the governing sections of the Tax Code. Some public employee funds in the U.S. are now "hybrid" plans, offering a combined defined benefit and defined contribution to employees.

Funded Ratio: The ratio of assets to liabilities. Usually this ratio is expressed in terms of actuarial values, as required by GASB 25. When a pension fund has enough assets to cover all its accrued liabilities, it is considered 100% funded.

GASB 25: The Government Accounting Standards Board (GASB) is an independent, non-profit organization that establishes accounting and reporting guidelines for state and local governments in the United States. GASB Statement 25, issued in November 1994, made a number of changes to reporting requirements for public pension funds. It required, among other things, that assets of public pension plans be reported based on the actuarial value, or smoothed market value, of the assets.

Market Value of Assets: Assets can be reported by their market value, which recognizes unrealized gains and losses immediately in the current year and can produce significant fluctuation year-to-year. This measure is subject to volatility in the market and can be misleading because the variations typically average out over the life of the pension plan. Under Government Accounting Standards Board (GASB) Statement No. 25, assets of public pension

plans must also be reported based on the actuarial value, or smoothed market value, of the assets. The actuarial value uses an average of the assets' market values from previous years, thus smoothing out fluctuations in the market value.

Multiple: For eight of the pension funds analyzed in this report, the basic employer contribution is set in state statute as a multiple of the total employee contribution made two years prior. The statute requires that the employer levy a property tax not to exceed the multiple amount. Employers levy an amount that, when added to the revenue from Personal Property Replacement Taxes, equals the multiple amount. For example, the MWRD must contribute an amount equal to 2.19 times the employee contribution made two years prior.

Two-Tiered System: A pension plan where new and existing employees are promised different retirement benefits. Once granted, benefit enhancements cannot be diminished, according to the Constitution of the State of Illinois. The only way for an employer to reduce liabilities by reducing retirement benefits is to reduce those benefits for new employees, creating a "two-tiered" system.

Unfunded Liabilities: Those liabilities, both current and prospective, not covered by actuarial assets. It is calculated by subtracting the actuarial value of assets from the accrued actuarial liability of a fund.

APPENDIX A: REVENUE AND EXPENDITURE CALCULATIONS

The following two tables list the source documents for pension fund revenue and expenditure amounts presented in this report, as well as the line items included in revenue and expenditure totals. In some cases, the Civic Federation calculates income and expenditures differently than does the fund. For example, the Civic Federation considers investment fees an expenditure rather than a deduction from gross investment income.

FY2004 REVENUES BY SOURCE					
Fund Name	Source Document	Employee Contribution	Employer Contribution	Investment Income	Other Income
Fire	Actuarial Valuation, p. 19	Member contributions	City contributions	Investment income net of expenses + investment expense (Market value)	Misc. revenue, Transfer from MEABF
Police	Actuarial Valuation, p. 19	Member contributions	City contributions	Investment income net of expenses + investment expense (Market value)	Misc. revenue
Municipal	Actuarial Valuation, p. 24	Member contributions	City contributions & Misc.	Investment income net of expenses + investment expense (Market value)	none
Laborers	Actuarial Valuation, p. 26	Member contributions	none, because City contribution not required per P.A. 93-0654	Investment income net of expenses + investment expense (Market value)	City contributions & Misc.
Teachers	Comprehensive Annual Financial Report, p. 25	Employee contributions	Intergovernmental net (Total)	Investment income + investment expense	Miscellaneous
Park District	Comprehensive Annual Financial Report, p. 24	Employee contributions	Employer contributions	Investment income, Securities lending income	none
MWRD	Comprehensive Annual Financial Report, p. 28	Employee contributions	Employer contributions	Gross investment income	Misc. income
Cook County	Actuarial Valuation, p. 9	Employee contributions	Contributions from Cook County	Total investment income	Reciprocal reimbursements, all "Other" additions, Charged to Forest Preserve
Forest Preserve	Actuarial Valuation, p. 9	Employee contributions	Contributions from Forest Preserve District	Total investment income	Misc. income
CTA	Actuarial Valuation, p. 11	Member contributions	CTA contributions	Investment income net of expenses + investment expense	Misc. revenue

FY 2004 EXPENDITURES BY TYPE

Fund Name	Source Document	Benefit Payments	Health Ins. Payments	Refund Payments	Other Expenses	Administrative Expenses	Investment Costs
Fire	Actuarial Valuation, p. 19	Benefit payments	none	Refunds	none	Administration	Investment expense
Police	Actuarial Valuation, p. 19	Benefit payments	none	Refunds	none	Administration	Investment expense
Municipal	Actuarial Valuation, p. 24	Benefit payments	none	Refunds and rollovers	Transfer to FAFB	Administration	Investment expense
Laborers	Actuarial Valuation, p. 26	Benefit payments	none	Refunds and rollovers	none	Administration	Investment expense
Teachers	Comprehensive Annual Financial Report, p. 25	Pension benefits, Death benefits	Refund of insurance premiums	Refunds, 2.2 legislative refunds	none	Administrative and misc. expenses	Investment advisory and custodial fees, Securities lending expense
Park District	Comprehensive Annual Financial Report, p. 24	Total benefits	none	Refund of contributions	none	Administrative and general expenses	Investment expenses, Borrower rebates, Bank fees
MWRD	Comprehensive Annual Financial Report, p. 28	Total annuities and benefits	none	Refunds of employee contributions	none	Administrative expense	Investment expenses
Cook County	Actuarial Valuation, p. 9	Total annuities and benefits minus Group health insurance	Group health insurance	Refunds of employee contributions	none	Administrative expenses	Investment fees
Forest Preserve	Actuarial Valuation, p. 9	Total annuities and benefits minus Group health insurance	Group health insurance	Refunds of employee contributions	Employee transfers to Cook County, Charged to Cook County	Administrative expenses	Investment fees
CTA	Actuarial Valuation, p. 11	Pension and death benefits	Health benefits	Refunds	none	Administration	Investment expense

SOURCES FOR FY2004

1. County Employees' and Officers' Annuity and Benefit Fund of Cook County, *Actuarial Valuation as of December 31, 2004*, Goldstein & Hartman Actuaries and Consultants. October 5, 2005.
2. Firemen's Annuity and Benefit Fund of Chicago, *Actuarial Valuation Report for the Year Ending December 31, 2004*, Gabriel, Roeder, Smith & Co. April 2005.
3. Forest Preserve District Employees' Annuity and Benefit Fund of Cook County, *Actuarial Valuation as of December 31, 2004*, Goldstein & Hartman Actuaries and Consultants. October 5, 2005.
4. Laborers' & Retirement Board Employees' Annuity and Benefit Fund of Chicago, *Actuarial Valuation Report for the Year Ending December 31, 2004*, Gabriel, Roeder, Smith & Co. April 2005.
5. Metropolitan Water Reclamation District Retirement Fund, *Comprehensive Annual Financial Report for the Year Ending December 31, 2004*. May 31, 2005.
6. Municipal Employees' Annuity and Benefit Fund of Chicago, *Actuarial Valuation Report for the Year Ending December 31, 2004*, Gabriel, Roeder, Smith & Co. April 2005.
7. Park Employees' & Retirement Board Employees' Annuity and Benefit Fund, *Comprehensive Annual Financial Report for Fiscal Year Ended June 30, 2004*. Submitted December 31, 2004.
8. Policemen's Annuity and Benefit Fund of Chicago, *Actuarial Valuation Report for the Year Ending December 31, 2004*, Gabriel, Roeder, Smith & Co. April 19, 2005.
9. Public School Teachers' Pension and Retirement Fund, *109th Comprehensive Annual Report, June 30, 2004*. December 8, 2004.
10. Retirement Plan for Chicago Transit Authority Retirees, *Actuarial Valuation Report for the Year Beginning January 1, 2005*, Gabriel, Roeder, Smith & Co. June 23, 2005.