

Senate Bill 616 Amendment 1

October 30, 2019

Below are a few of the key points, both positive and concerning, about the recently posted legislation regarding consolidation of Article 4 pension investments.

Funds for Expenses

The Bill calls for the transfer of funds from the consolidated funds back to the local pension fund to make necessary payments. It is assumed that the rules will allow for the value of these funds to meet the needs of the pension fund.

Requires the transfer of funds back to the pension funds for the required benefit payments and expenses. (p119)

However, a further section requires all assets to be transferred to the consolidated fund.

Within 90 days after the end of the transition period, IDOI and the consolidated fund will cooperate in transferring all pension fund assets in the custody of the local pension fund. (p123)

Strictly interpreted, the requirement on page 123 may eliminate the ability to maintain assets to fund known expenses by the local pension board. *This could be easily remedied by further clarifying language.*

Actuarial Reports

Currently, those with standing (the pension board and employer) have the ability to have an actuarial report completed, in addition to the IDOI report. Many funds and employers have taken this step. The one caveat is that the actuarial report used by the pension board may not indicate a contribution less than that of IDOI. Due to a number of factors - including actuarial method (PUC v. EAN), rate of return, target percentage of funding and target funding window – these reports may indicate a higher annual funding level than IDOI.

Once consolidated, requires the consolidated fund to obtain the actuary report and removes the ability of the local fund and employer to obtain one (pp56-57).

and

The consolidated actuary report will be determining for the contribution required by the employer (p58).

Not having the ability to conduct an actuarial report may have a negative impact on some funds. For example, if a fund was increasing the funding target and shortening the window to attempt to better fund a pension now and avoid higher costs later, this could prevent the ability to do this by restricting the amount that could be levied for the pension fund.

To alleviate this problem, either allow the pension fund to direct the parameters of the report commissioned by the consolidated fund or allow an actuarial report, at the expense of the local fund.

As indicated above, the method by which the report is conducted is instrumental in determining the amount of funding. This is realized in the legislation:

Requires changes from actuarial reports by the consolidated fund to be initially implemented over three years. (pp57-58).

However, it is possible that the three year smoothing period does not go far enough. For some funds, this actuarially change – depending on the factors listed above, may be beyond the ability for some employers to meet. One solution might be to place a cap on the increase, for example, leave the three year smoothing in the legislation but add: *if the funding requirement is increase by more than 10% then the pension fund has the ability to implement the changes over five years.*

Annual Compliance Fee

Currently, the compliance fee is two basis points, with a maximum of \$8000. This means that any pension fund with less than \$40,000,000 in assets is paying less than \$8000 annually.

After consolidation, the annual compliance fee shall be \$8000 (was .02% NTE \$8000) payable by the consolidated fund (p58-59).

For smaller pension funds, this may be a significant expense. In fact, for the 650 consolidated funds (both Article 3 and 4) this is a combined \$5.2 million expense. Consideration should be given to maintaining the current formula.

Tier 2 Changes

The survivor benefit changes to assure that the survivors of those who suffer a non-duty death will receive an adequate benefit. Currently, if the Tier 2 firefighter dies prior to having ten years of service he does not have any earned pension benefits therefor there are no benefits to pay the 66-2/3% on. This has been a known issue.

For Tier 2 adds the survivor benefit for non-duty death to be the greater of 54% of salary or 66-2/3% of earned pension benefits (previously 66-2-3% of earned benefits). Adds in children clauses, total benefit cannot be greater than 75% of final salary (pp82-83).

The other changes related to the total pension amount for Tier 2 pensions.

For Tier 2, removes the "one-half" from the increase in the total pensionable salary making the increase CPI-U up to 3% annually, retroactive to the start of Tier 2 (p75).

This will cause the annual pensionable salary to increase by CPI-U up to 3%.

For Tier 2, adds the option to take the greater pensionable salary from prior four of five years or eight of ten (previously only 8/10), provides that this change does not result in retroactive payments (p75).

This will reduce the swing of pensionable salary and cause an increase in individual's pension.

Both of these changes are items we have discussed in the past. They are believed to be necessary to avoid Tier 2 potentially disqualified plan by the IRS/SSA. If this were to happen, the employer may be required to retroactively fund the Social Security for all Tier 2 members. The IFCA has previously supported these changes.

Transfer of Assets

The transfer of assets from the pension funds to the consolidated funds is a significant concern. Details on the fund transfers are not clear and will likely be part of the rulemaking process. There basics are here:

Transfers investment authority to the new consolidated firefighter fund (section 22C). Requires transfer of all investment funds within 30 months of effective date. Effective date currently June 1, 2020 – all funds would need to be transferred by December 31, 2022. Local fund then has no control of investments (p84).

The "how" of the transfers has been a subject we have focused on throughout this process. We feel this is potentially the most expensive part of the move to a consolidated fund. While the consolidated fund has \$7.5 million in a loan to address this and other expenses (we assume), we are unable to get a good concept on the actual cost to complete this process. Done improperly, this has the ability to reduce the assets of even the best maintained pension fund. This is the most significant concern with the consolidation and we are unable to quiet these concerns because the answer to how the funds will be transferred is not available in the legislation.

Investments

The consolidated board has the ability to invest as a prudent person, following the requirements with investments in all State pension funds:

The board may not delegate management functions but may compensate others for financial services. The consolidated board is not restricted in investing funds in public, private, real estate or other investments authorized by the code. The funds are restricted by the requirements of the investment portions of the code, but not the restrictions placed on Article 4 pensions. Custodians are required to meet certain qualifications. (pp126-128)

The ability to extend the investment authority to all funds has long been an ask of the IFCA. Allowing all funds to invest as a prudent person will open up opportunities to realize more gains, however it will also increase the risk side of the equation. It is important that the board not be tempted to overextend and to assure a balanced portfolio. With the funds being consolidated, it is thought that the diversification will be sufficient to weather any market downturns.

Two Key Requirements

We had a number of concerns when the concept of this legislation was suggested. Two of the primary concerns were addressed below:

Requires the separation and accounting for each individual fund. Investment returns will be distributed equally based on the value of each fund. (pp118)

Assets shall be maintained in funds outside the State treasury. Funds are not subject to administrative charges or chargebacks. (pp125-126)

We feel that any consolidation that did not include these two points would not be successful. Our goal is to assure that the pension funds are able to provide the benefits earned by our members and those they lead. We were encouraged to see these two issues addressed.

Missing Items

We are concerned that some issues are not addressed in this legislation but may have a direct impact on the ability to invest in a consolidated fund, are contradictory or create unnecessary expense to the pension fund. These include:

- 40 ILCS 5/1-109.3 – Pension Trustee training requirements
- 40 ILCS 5/4-123 – Investment portions of the pension fund duties
- 40 ILCS 5/41128 – Investment of funds
- 40 ILCS 5/4-128 – Investment of funds
- 40 ILCS 5/4-129.1 – Ability to accept donations
- 40 ILCS 5/4-130 – Treasurer of the pension board
- 40 ILCS 5/4-134 – Report for tax levy

Consideration should be given to amending some or all of these sections.

As of this writing, we do not know when this will be posted for a hearing – it will be no sooner than November 12th. We continue to work through the legislation and other concerns may arise. At this time, we stick with our current request to the Governor that this legislation is given due consideration during hearings in the Spring session. However, we continue to evaluate that position.

If you have comments or questions, email John Buckley at jrbuckleyjr@gmail.com