Illinois Municipal Retirement Fund
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GENERAL MEMORANDUM

Number: 584

Date: January 26, 2009

To: All Authorized Agents

Subject: Impact of 2008 Investment Returns on Employer Funding Status, Employer Reserves, and Future Employer Contribution Rates

We encourage each Authorized Agent to share this memorandum with the unit of government's chief financial officer, other officials, and governing body members.

Executive Summary

This preliminary information is based on unaudited investment return data and projected actuarial information. Finalized information will be available in early May 2009.

Economic events in 2008 were unprecedented in their scope, speed, and depth. Sharp drops in domestic and global investment markets resulted in significant losses for all investors, large and small. IMRF is not immune to global economic events.

The estimated 2008 investment return for IMRF is -24.8%. This return translates into investment loss of approximately $6.1 billion. The magnitude of this loss has a severe impact on employers' funded status and reserves as of December 31, 2008, and will dramatically impact employer contribution rates for 2010.

The IMRF Board of Trustees recognizes the budget challenges our employers face and is poised to adopt a plan to moderate the impact of the 2008 investment losses on employers. At its January 23, 2009, meeting, the IMRF Board discussed:

- Changing two actuarial techniques which will provide short-term and longer-term relief for employer rates and funded status.
- Adopting a phase-in plan for employer contribution rates which would cap most employer increases at a fixed percentage which will provide immediate rate relief in 2010 and subsequent years.

The Board deferred its final decision until its February 27, 2009, meeting to provide IMRF stakeholders the opportunity to provide input on the Board's approach. Written comments can be directed to IMRF Chief Financial Officer Richard DeCleene at the address above or rdecleene@imrf.org.

IMRF scheduled a series of Employer Rate meetings throughout the state that began on January 26, 2009. In late April, IMRF will present two Webinars in which we will discuss actual year-end financial and actuarial data for IMRF on a whole and its estimated impact on individual employers. You will receive details regarding the Webinars later this year.

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Background

As a defined benefit plan, investment return fluctuations have no impact on the benefits payable to active or retired IMRF members. All member benefits are guaranteed. Also, as a defined benefit plan, IMRF is designed to be pre-funded. The lump sum needed to pay a lifetime pension should be available when a member retires. This differs from "pay-as-you-go" plans—like Social Security—where money collected today is used to pay benefits owed to current retirees.

While investment return fluctuations do not impact member benefits, they do impact funding status, individual employer reserve balances, and employer contribution rates.

IMRF, as a defined benefit plan, is designed to be fully funded. The Illinois Pension Code [40 ILCS-7-172(b)(2)] requires the amortization of any unfunded liabilities over the period allowable under generally accepted accounting principles.

IMRF Board poised to adopt a plan, seeking input

The IMRF Board of Trustees recognizes the budget challenges our employers face and is poised to adopt a plan to moderate the impact of 2008 investment losses on employers. At its January 23, 2009, meeting, the Board considered three changes to the actuarial techniques used to calculate employer funded status and contribution rates:

- Widening the allowable corridor between the market and actuarial value of assets from 15% to 20%;
- Changing the amortization method from a closed one to a rolling one and changing the period to 30 years for taxing bodies and 10 years for non-taxing bodies; and
- Increasing the threshold for the rapid amortization of overfunding credits to reduce employer contribution rates from 100% to 120%.

The Board also considered an optional employer rate phase-in plan. The plan would:

- Cap most employer contribution rate increases at a fixed percentage of their 2009 rate, excluding ERI and SLEP enhancement costs (For example, assuming a 10% cap, an employer with a 10% rate would increase to 11%.);
- Require all employers to pay the full cost for current service regardless of the percentage increase (For example, using the full cost of the IMRF program for 2009, the minimum employer contribution rates for the regular, SLEP and ECO plans for most employers would be 8.37%, 12.58% and 25.69% respectively in 2010);
- Provide employers the option of paying the full actuarial required contribution (the ARC), the phase-in rate or some rate between the ARC and the phase-in rate; and
- Provide the Board the prerogative to review the phase-in plan annually and to modify it based on actual future investment returns and other relevant factors if it so chooses.

To allow for additional input from IMRF stakeholders, the Board decided to defer its final decision on its approach to moderate the impact of 2008 investment returns on employer rates in 2010 and beyond until its February 27, 2009, meeting. Written comments can be directed to IMRF Chief Financial Officer Richard DeCleene at 2211 York Road, Suite 500, Oak Brook, Illinois, 60523 or rdecleene@imrf.org.

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Investment Returns

Economic events in 2008 were unprecedented. Not only did U.S. markets suffer sharp downturns, international markets suffered significant losses as well. Sharp drops in domestic and global investment markets resulted in significant losses for all investors, large and small. IMRF is not immune to global economic events.

IMRF's estimated 2008 investment return on a market basis is -24.8%. However, for actuarial purposes, IMRF uses a common pension industry practice of five-year averaging of actual market returns to arrive at the actuarial return of -10.6%.

The actuarial return is used to determine employer contribution rates and actuarial funding status. This averaging technique, which is employed to moderate fluctuations in employer contribution rates, delays the recognition of market returns that either exceed or fall short of the assumed actuarial return of 7.5% subject to a corridor. (A 20% corridor means that the actuarial value of plan assets has to be within plus or minus 20% of the market value of assets. For example, if the market value of plan assets is $18 billion, the actuarial value of plan assets must be between $14.4 billion and $21.6 billion.)

For 2008, IMRF will be reducing its assumed investment income of $1,739 million (a 7.5% return on the beginning of the year actuarial value of IMRF investments) by $4,202 million. Thus, for actuarial purposes, IMRF's investment return will be an approximate loss of $2,463 million. IMRF will begin 2008 with $2,693 million of unrecognized losses for actuarial rate-setting purposes, which will be recognized over the next four years. As these unrecognized losses flow into actuarial calculations, they will place downward pressure on funded status and upward pressure on future employer contribution rates.

Employer Funding Status

IMRF's 2008 overall funded status on an actuarial basis is expected to decrease from 96.1% as of year-end 2007 to 80.2% at year-end 2008. This decrease is due to the fact that on an actuarial basis, IMRF earned significantly less than its assumed return of 7.5%.

However, on a market value basis (which does not reflect the five-year averaging technique or the 20% corridor), IMRF's funded status is projected to decrease from 100% to 69.7%, which reflects the -24.8% market return in 2008.

Most individual employers can expect that the funded status of their plan to decrease on both an actuarial and market basis, with a dramatic drop in the market value funded status.

In April, we will furnish each employer its annual GASB footnote information which will disclose the actuarial and market value funded status for all plans.

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Impact on Employer Reserves

By statute, IMRF must credit member and retiree reserves with 7.5% interest (approximately $1,007 million for 2008). After providing for these credits and covering administrative and direct investment expenses of approximately $73 million, approximately $7,100 million will be charged to employer reserve balances. The $7,100 million charge covers the interest credited to member and retiree reserves, administrative and direct investment expenses of the plan and the $6,100 million investment loss for 2008.

On average, employers will be charged approximately 67% based on their beginning of the year employer reserve balance. This charge reflects the fact that, as a member of a defined benefit plan, IMRF employers share all the risks and rewards of investment returns.

Over the five years prior to 2008, IMRF employers have received significant financial benefits from the distribution of interest and investment income—$871 million in 2007, $1,879 million in 2006, $753 million in 2005, $1,300 million in 2004, and $2,393 million in 2003—a total of $7,196 million.

Employer Contribution Rates

Employer contribution rates consist of as many as six parts:

- Normal retirement costs,
- Death in service benefits,
- Temporary disability benefits,
- Supplemental retirement benefits (13th payment),
- Amortization of over or under funding, and
- Early retirement incentives (employer option).

The ongoing cost of the IMRF benefit package for the regular plan covering normal retirement costs, death in service benefits, temporary disability benefits and supplemental retirement benefits, is 8.37% of payroll in 2009. Put another way, for each dollar of service an employee renders, the employer also incurs a pension cost of 8.37 cents. To the extent an employer was overfunded, the 8.37 cents is reduced to amortize its surplus. To the extent an employer was underfunded, the 8.37 cents is increased to collect the shortfall.

The average employer rate for the regular plan was 9.47% for 2008 and is 9.27% for 2009, a decrease of 20 basis points or 2.1%. This reflects the fact that the regular plan was less than 100% funded on an actuarial basis as of December 31, 2007.

The impact of 2008 investment losses on individual employer contribution rates is difficult to forecast, since each employer has a unique rate affected by its own demographics and funded status. Since IMRF's actuarial return was -10.6% in 2008, significantly less than the 7.5% assumed return, the average employer rate for the regular plan is expected to increase to 16.63% in 2010.

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If the Board adopts the new actuarial techniques that are being considered, we estimate the average employer contribution rate for the regular plan will be 14% for 2010, an increase of 51%.

Because of this dramatic increase, the Board is considering the phase-in plan discussed above. Most employers will see their 2010 contribution rates increase by a fixed percentage from their 2009 rates. For example, if a 10% cap is approved and an employer had a 10% contribution rate in 2009, the optional phase-in rate would be 11% for 2010. The phase-in plan would apply to all three of IMRF's plans—the regular plan, the Sheriff's Law Enforcement plan and the Elected County Officials plan.

IMRF Meetings

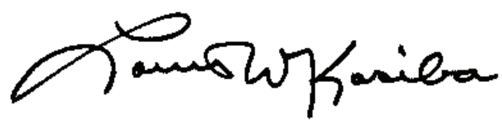
In order to discuss the potential impact on individual employers in 2010 and beyond, as well solicit input from IMRF stakeholders, IMRF is conducting a series of Employer Rate meetings throughout the state that began January 26, 2009. These meetings were discussed in General Memorandum 582, dated December 22, 2008. Since that memorandum was issued, an 11th meeting was scheduled for February 6, 2009 at 2 p.m. at the Weber Leisure Center, 9300 Weber Park Place, Skokie, Illinois.

In late April, IMRF will present two Webinars in which we will discuss actual year-end financial and actuarial data for IMRF on a whole and its estimated impact on individual employers. You will receive details regarding the Webinars later this year.

Questions

If you have any questions regarding the information presented in this memorandum, please call or e-mail Chief Financial Officer Richard DeCleene at (630) 368-5345 or rdecleene@imrf.org.

Sincerely,



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