# Illinois Municipal Retirement Fund

2211 York Road Suite 500 Oak Brook IL 60523-2337

Member Services Representatives 1-800-ASK-IMRF

www.imrf.org


## GENERAL MEMORANDUM

**Number:** 594

**Date:** January 26, 2010

**To:** All Authorized Agents

**Subject:** Impact of 2009 Investment Return 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.**

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### Executive Summary

This preliminary information is based on unaudited investment return data and projected actuarial information. Finalized information will be available in early May 2010.

The financial markets in 2009 rebounded significantly from the sharp drops suffered in 2008.

The **estimated 2009 investment return for IMRF is 24.5%**. This return translates into **investment income of approximately $4.4 billion**. The magnitude of these investment gains will help to cushion the ongoing impact of the severe losses suffered in 2008.

Approximately $3.5 billion will be credited to employer reserve balances. **On average, employer accounts will be credited approximately 99% on their beginning of the year employer reserve balance**. These credits reflect the fact that, as a member of a defined benefit plan, IMRF employers share all the risks and rewards of investment returns.

The phase-in plan adopted by the IMRF Board of Trustees in 2009 will remain in effect for 2011 rate purposes.

Beginning on April 19, 2010, IMRF will present a series of Employer Rate meetings throughout the state. At these meetings we will discuss the impact of year-end financial and actuarial data on IMRF as a whole and its estimated impact on individual employers. IMRF will also present the same information at two webinars in early May.


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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

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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 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 (no more than 30 years).

**Investment Returns**

Financial markets in 2009 rebounded significantly from the financial returns of 2008 which produced unprecedented investment losses.

IMRF's estimated 2009 investment return on a *market* basis is 24.5%. 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 5.9%.

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 20% 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 $22 billion, the actuarial value of plan assets must be between $17.6 billion and $26.4 billion.)

For 2009, IMRF will be reducing its assumed investment income of $1,614 million (a 7.5% return on the beginning of the year actuarial value of IMRF investments) by $347 million. Thus, for actuarial purposes, IMRF's investment return will be an approximate return of $1,267 million. IMRF will begin 2010 with $487 million of unrecognized losses for actuarial rate-setting purposes, which will be recognized over the next four years. (IMRF began 2009 with $3,600 million of unrecognized losses due to the severe losses in 2008.)

As these unrecognized losses are flowed into actuarial calculations, they will place downward pressure on funded status and upward pressure on future employer contribution rates.

**Employer Funding Status**

IMRF's 2009 overall funded status on an actuarial basis is expected to decrease from 84.3% as of year-end 2008 to 83.2% at year-end 2009. This decrease is due to the fact that on an actuarial basis, IMRF earned 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 increase from 70.4% to 81.4%, which reflects the 24.5% market return in 2009.

Most individual employers can expect the funded status of their plan to decrease slightly on an actuarial basis but increase significantly on a market value basis.

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

**Impact on Employer Reserves**

By statute, IMRF must credit member and retiree reserves with 7.5% interest (approximately $1,075 million for 2009). After providing for these credits and covering administrative and direct investment expenses of approximately $75 million, approximately $3,461 million will be credited to employer reserve balances. The $3,461 million credit is the amount by which 2009 investment income exceeds the interest credited to member and retiree reserves and the administrative and direct investment expenses of the plan.

On average, employers will be credited approximately 99% based on their beginning of the year employer reserve balance. This credit 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 last seven years, IMRF employers have been credited or (charged) the following amounts—$3,461 million in 2009, ($7,100) million in 2008, $871 million in 2007, $1,879 million in 2006, $753 million in 2005, $1,300 million in 2004, and $2,393 million in 2003.

**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 8.52% of payroll in 2010. Put another way, for each dollar of service an employee renders, the employer also incurs a pension cost of 8.52 cents. To the extent an employer is overfunded, the 8.52 cents is reduced to amortize its surplus. To the extent an employer is under funded, the 8.52 cents is increased to collect the shortfall.

The average employer rate for the Regular plan was 9.27% for 2009 and is 10.76% for 2010, an increase in the rate of 1.49%. On a percentage basis, the average rate increased 16.1%. The average rate for 2010 reflects both employers who are contributing using the actuarial required contribution (ARC) rate and also employers who are contributing using the lower optional phase-in rate. (The percentage increase for employers who chose the phase-in rate in 2010 is 8.3%.) The 10.76% rate reflects the fact that the Regular plan was less than 100% funded on an actuarial basis as of December 31, 2008.

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The impact of 2009 investment returns on individual employer contribution rates is difficult to forecast, since each employer has a unique rate affected by its own demographics and funded status. The phase-in plan adopted by the IMRF Board of Trustees in 2009 remains in effect for 2011 employer contribution rates.

With regard to the Regular plan, there are three employer groups to consider when discussing the impact of 2009 investment returns on 2011 employer contribution rates:

- **Employers who are contributing using the ARC in 2010**
  The average increase in the ARC rate from 2010 to 2011 is estimated to be approximately 5%. However, this projection is based on IMRF-wide averages and individual employers could vary widely.

- **Employers who are contributing based upon optional phase-in rates in 2010**
  The phase-in plan will remain in effect and any increase will be limited to 10%. For some of the employers in this group, their 2011 ARC rate may be less than a 10% increase from their 2010 rate. In these cases, their 2011 rate will be the ARC rate.

- **Employers who were over funded at the end of 2008 and were contributing at less than the full cost of the IMRF program (approximately 8.52% of payroll) but who will be under funded at the end of 2009**
  For this small group of employers, their 2011 rate increase will not be subject to a cap. Similar to last year, these employers will have to contribute the full cost of the program which is approximately 8.52% of payroll. While this group's percentage increase will exceed 10%, their absolute rate will be lower than that of the employers in the first two groups.

**IMRF Meetings**

In order to discuss the potential impact on individual employers in 2011 and beyond, IMRF is conducting a series of Employer Rate meetings throughout the state beginning April 19, 2010.

Also in early May, IMRF will present two webinars in which this information will also be discussed. Details concerning these meetings and webinars will be furnished in a subsequent General Memorandum.

IMRF will publish the time, date and locations of the Employer Rate meetings and the time and date of the related webinars in early to mid-March.

**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,

Louis W. Kosiba
Executive Director