



Illinois Municipal Retirement Fund

Suite 500 2211 York Road Oak Brook IL 60523-2337

Member Services Representatives 1-800-ASK-IMRF

www.imrf.org

IMRF's 100% Funding Goal in Difficult Financial Markets

In conjunction with the Illinois Municipal Retirement Fund's (IMRF) 2006 – 2007 Strategic Plan, the IMRF Board of Trustees formally adopted a 100 percent funding goal for IMRF as a whole and, by extension, for each of the individual employers in the IMRF agent multiple-employer retirement system. While the 100 percent funding goal was formally adopted in conjunction with the 2006 – 2007 Strategic Plan, the Board of Trustees and management has consistently operated IMRF with that goal in mind. Perhaps the simplest definition of 100 percent funding is that the assets of the retirement plan equal the benefits earned by and promised to active and retired members. When plan assets are less than promised benefits, the plan is less than 100 percent funded and has an unfunded actuarial accrued liability (UAAL).

Funding status can be viewed in two different ways based upon how one measures the assets available to pay benefits. The first and most straight forward way of measuring IMRF assets is market or fair value. In short, the market or fair value of IMRF's assets is what one would receive in an arms length exchange between a willing buyer and a willing seller. Due to the volatility in market values, many pension plans use an averaging technique that smoothes the ups and downs that occur in the market place. This measure is called the actuarial value of assets. IMRF uses a five-year smoothing technique that adjusts for the difference between the actual market based investment return in a year and the expected return based upon a long-term investment return assumption of 7.5 percent.

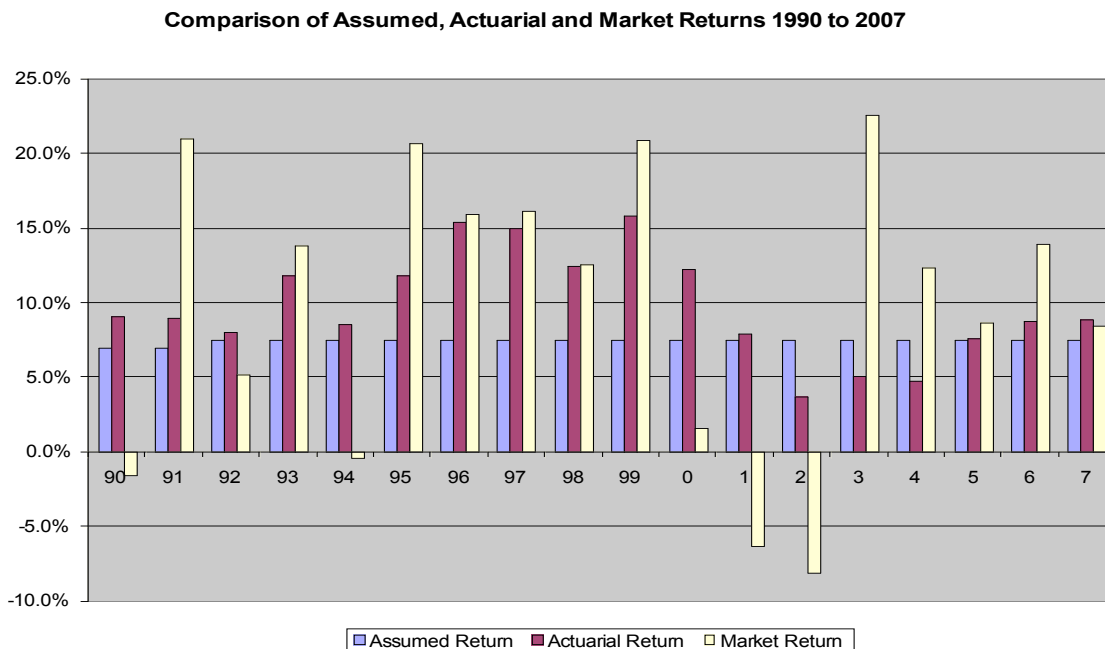
IMRF's employer rate setting mechanism is designed to collect on a current basis the normal cost associated with retirement benefits earned on a current basis as well as a provision for death and disability benefits. The rate setting mechanism also provides for recovering any unfunded actuarial accrued liability on an employer-by-employer basis. The UAAL is measured as the difference between the actuarial accrued liability and the value of IMRF's assets measured on an actuarial basis.

The Illinois Pension Code in Section 5/7-172(b) 2 indicates that the employer contribution rate should be adjusted to recover the UAAL. It states: "This adjustment shall be spread over the remainder of the period that is allowable under generally accepted accounting principles." The Governmental Accounting Standards Board (GASB) in GASB Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans," stated that the maximum period over which the UAAL can be spread is 30 years (effective 2006). The accounting literature requires that the entire balance of the UAAL be amortized, which mathematically results in setting employer contributions rates designed to achieve 100 percent funding status over time.

IMRF was established in 1939 and began operations in 1941. IMRF began its operations with a UAAL because newly participating members from existing governmental entities were given service credit for employment prior to their employer joining IMRF. Since this prior service credit had not been funded, a UAAL arose when the employer joined IMRF. Initially IMRF adopted a policy of collecting (amortizing) the unfunded liability over a 40-year rolling period. This rolling technique reset the amortization period to 40 years each year. This amortization approach did not significantly reduce the unfunded liability. In 1990, the Board adopted a new amortization policy that set the amortization period at 40 years, but, instead of a rolling 40-year method, the Board adopted a 40-year closed method. With a closed method, the amortization period is reduced one year each subsequent year. For 2008 employer rate setting purposes, the amortization period for most IMRF employers is 24 years. The amortization period will continue to be lower until it reaches 10 years at which time it will become a 10-year rolling technique, i.e. the amortization period will reset to 10 years each year.

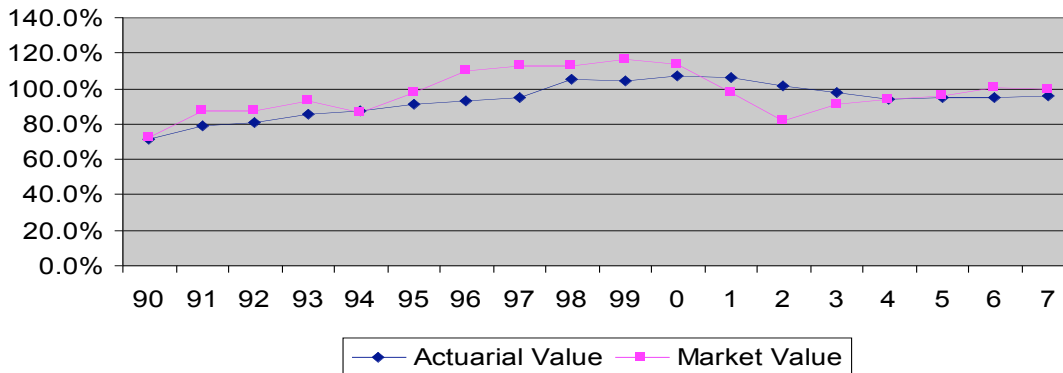
While IMRF's amortization policy since 1990 has had a positive impact on attaining the 100 percent funding goal, the most significant impact on funding has been IMRF's actual investment returns vis á vis its assumed returns. As of December 31, 1990, IMRF's funded status as a whole was 71.7 percent on an actuarial basis and 72.2 percent on a market basis. Over the ensuing 17 years, the actuarial funding status peaked in 2000 at 107.2 percent and the market funding status peaked in 1999 at 116.9 percent. As of December 31, 2007, IMRF's overall funded status was 96.1 percent on an actuarial basis and 100.0 percent on a market basis.

The following chart compares the actual actuarial and market returns over the 18-year period to the assumed returns.



In 15 of the 18 years the actuarial return exceeded the assumed return. In 12 of the 18 years the market return exceeded the assumed return. Whenever the achieved returns exceed the assumed returns, there is a positive impact on funded status as the following chart shows.

Actuarial and Market Values Funded Status 1990 to 2007



The financial markets have been very challenging through the first eight months of 2008. The continuing slowdown in the housing sector combined with the tightening credit markets have led to a slowdown in the overall economy. All major equity indices show significant losses year to date while the Lehman Aggregate fixed income index shows a modest gain. For the eight months ended August 31, 2008, IMRF investments have shown a net loss of approximately 7.6% or about \$1.7 billion. If IMRF were to earn its assumed actuarial return for the remainder of the year, it would incur a loss of approximately 5.1% or \$1.2 billion. Assuming IMRF earns its assumed return over the last four months of 2008, it is projected that its actuarial funded status will drop to 94.9 percent at December 31, 2008 compared to 96.1% for the year earlier. On a market value basis the funded status will drop from 100% to 88.6 percent.

This drop in IMRF's funded status will increase the amount of IMRF's unfunded accrued actuarial liability. Since there is a two-year lag between the date financial information is used to set employer contribution rates and when those rates are effective, the negative investment results from 2008 will not be reflected in employer rates until 2010. (The 2009 employer rates have already been set based on 2007 financial and actuarial data. For most employers, 2009 rates will be less than the 2008 rates.)

When 2010 employer contribution rates are calculated, the adjustment necessary to recover the unfunded actuarial accrued liability as of December 31, 2008, will reflect a 22-year amortization period for most employers. If IMRF were to earn its assumed rate of return over the next 22 years, no more no less, it would be 100 percent funded in 2032. But as noted earlier, actual investment returns seldom coincide with the assumed return. Thus IMRF's funded status will continue to fluctuate on both an actuarial and

market value basis. Nevertheless, IMRF's rate setting approach will continue to strive to achieve the 100 percent funding goal over a reasonable amount of time.

IMRF believes 100 percent funding is the soundest long-term approach for managing its assets and liabilities for the following reasons:

- It enhances investment performance.
- It provides additional assurance that promised benefits will be paid when due.
- It achieves the lowest possible employer contribution rates in the long term.
- It provides intergenerational equity among taxpayers.
- It provides full transparency for the actual cost of promised benefits.
- It complies with the Illinois Pension Code and generally accepted accounting principles.

###