Illinois Municipal Retirement Fund

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GENERAL MEMORANDUM

Number: 608

Date: January 31, 2010

To: All Authorized Agents

Subject: Impact of 2010 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.

Executive Summary

This preliminary information is based on unaudited investment return data and projected actuarial information. Finalized information will be available in early May 2011.

The financial markets in 2010 continued their recovery from the sharp drops suffered in 2008.

The **estimated 2010 investment return for IMRF is 13%**. This return translates into **investment income of approximately $3.0 billion**. These investment gains will help to moderate future increases in employer contribution rates beginning in 2012.

Approximately $1.7 billion will be credited to employer reserve balances. **On average, employer accounts will be credited approximately 26% 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 2012 rate purposes.

Beginning on April 19, 2011, 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. We will also discuss other current topics impacting IMRF and pension plans in general. IMRF will also present the same information at two webinars in early May.

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, 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.

Investment Returns

Financial markets in 2010 continued the 2009 rebound from the financial returns of 2008 which produced unprecedented investment losses.

IMRF’s estimated 2010 investment return on a market basis is 13%. However, for actuarial purposes, IMRF uses a common pension industry practice of five-year averaging of actual market returns to arrive at the achieved actuarial return of 7% for 2010.

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%.

IMRF will begin 2011 with $828 million of unrecognized gains for actuarial rate-setting purposes, which will be recognized over the next four years. (IMRF began 2010 with $473 million of unrecognized losses due to the severe losses in 2008.)

As these unrecognized gains are flowed into actuarial calculations, they will help to increase funded status and help to moderate future employer contribution rate increases beginning in 2012.

Employer Funding Status

IMRF’s 2010 overall funded status on an actuarial basis is expected to increase from 83.2% as of year-end 2009 to 83.6% at year-end 2010.

However, on a market value basis (which does not reflect the five-year averaging technique), IMRF’s funded status is projected to increase from 81.6% to 86.4%, which reflects the 13% market return in 2010.

Absent any significant changes in actuarial experience, most individual employers can expect that the funded status of their plan to remain basically unchanged on an actuarial basis but to increase 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.

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Impact on Employer Reserves

By statute, IMRF must credit member and retiree reserves with 7.5% interest (approximately $1,159 million for 2010). After providing for these credits and covering administrative and direct investment expenses of approximately $83 million, approximately $1,750 million will be credited to employer reserve balances. The $1,750 million credit is the amount by which 2010 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 26% 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. The actual amount credited to individual employers will vary from the average due to differences in annuitant reserve amounts.

Over the last eight years, IMRF employers have been credited or (charged) the following amounts—$1,7150 million in 2010, $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 8.48% of payroll in 2011. Put another way, for each dollar of service an employee renders, the employer also incurs a pension cost of 8.48 cents. To the extent an employer is overfunded, the 8.48 cents is reduced to amortize its surplus. To the extent an employer is under funded, the 8.48 cents is increased to collect the shortfall.

The average employer rate for the regular plan was 10.76% for 2010 and is 11.47% for 2011, an increase in the rate of .71%. On a percentage basis, the average rate increased 6.6%. The average rates for 2010 and 2011 reflect 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 2011 is 8%.) The 11.47% rate reflects the fact that the regular plan was less than 100% funded on an actuarial basis as of December 31, 2009.

The impact of 2010 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 2012 employer contribution rates.

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With regard to the Regular plan, there are three employer groups to consider when discussing the impact of 2010 investment returns on 2012 employer contribution rates:

- *Employers who are contributing using the ARC in 2011*
  For employers who are contributing using the ARC in 2011, the average ARC rate from 2011 for 2012 is estimated to remain unchanged at 12.14%. 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 2011*
  For employers who are contributing using an optional phase-in rate in 2011, 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 2012 ARC rate may be less than a 10% increase from their 2011 rate. In these cases, their 2012 rate will be the ARC rate.

- *Employers who were over funded at the end of 2009 and were contributing at less than the full cost of the IMRF program (approximately 8.48% of payroll) but who will be under funded at the end of 2010*
  Finally for a small group of employers who were over funded at the end of 2009 but who will be under funded at the end of 2010, their 2012 rate increase will not be subject to a cap. Similar to prior years, these employers will have to contribute the full cost of the program which is approximately 8.48% of payroll. While this group's percentage increase will exceed 10%, their absolute rate will be lower than most employers in the first two groups.

IMRF Meetings

In order to discuss the potential impact on individual employers in 2012 and beyond, IMRF is conducting a series of Employer Rate meetings throughout the state beginning April 19, 2011. We will also discuss other current topics impacting IMRF and pension plans in general.

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

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Executive Director