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: 634

Date: January 31, 2013

To: All Authorized Agents

Subject: Impact of 2012 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 2013.

The estimated 2012 investment return for IMRF is 13.7%. This return translates into investment income of approximately $3.4 billion after expenses. From an actuarial basis, IMRF assumed it would earn $1.9 billion. The fact that IMRF earned approximately $1.5 billion more than its anticipated actuarial return will help to moderate future employer contribution rates.

Member and annuitant reserves will be credited approximately $1.4 billion as required by the Illinois Pension Code. Employer reserve balances will be credited with the balance, approximately $1.9 billion.

On average, employer accounts will be credited approximately 30% on their beginning of the year employer reserve balance. These credits reflect the fact that, as a sponsor 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 (and modified in 2011) will remain in effect for 2014 rate purposes.

Beginning on April 22, 2013, 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 a webinar in early May.

- over -

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.

Investment Returns

Financial markets in 2012 were relatively stable. Over the first four months of 2012, IMRF earned approximately $2.1 billion but lost $1.3 billion in May. The remainder of the year was positive except for a loss in October. As noted earlier, for the full year IMRF earned approximately $3.4 billion after direct investment and administrative expenses.

IMRF's estimated 2012 investment return on a *market* basis is a 13.7%. 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 7.8%.

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 have to be within plus or minus 20% of the market value of assets. For example, if the market value of plan assets is $25 billion, the actuarial value of plan assets must be between $20 billion and $30 billion.)

For 2012, IMRF will be increasing its *assumed* investment income of $1.92 billion (a 7.5% return on the beginning of the year actuarial value of IMRF investments) by $69 million. Thus, for actuarial purposes, IMRF's investment return will be an approximate return of $1.99 billion. IMRF will begin 2013 with approximately $497 million of unrecognized gains for actuarial rate-setting purposes, which will be recognized over the next four years. (IMRF began 2012 with $878 million of unrecognized losses.)

As these unrecognized gains are flowed into actuarial calculations, they will help to increase the actuarial funded status and moderate future employer contribution rates.

- over -

Employer Funding Status

IMRF's 2012 aggregate funded status on an actuarial basis is expected to increase from 83.0% as of year-end 2011 to 83.9% at year-end 2012.

However, on a *market value* basis (which does not reflect the five-year averaging technique or the 20% corridor), IMRF's aggregate funded status is projected to increase from 80.2% to 85.4%, which reflects the 13.7% market return in 2012.

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. This information will disclose both the actuarial and market based funded status for all plans for their active and inactive members.

Impact on Employer Reserves

By statute, IMRF must credit member and retiree reserves with 7.5% interest (approximately $1.38 billion for 2012). After providing these credits and covering administrative and direct investment expenses of approximately $105 million, approximately $1.9 billion will be credited to employer reserve balances. The $1.9 billion credit is the amount by which 2012 investment income exceeded 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 30% based on their beginning of the year employer reserve balance. This credit reflects the fact that, as a sponsor 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 ten years, IMRF employers have been credited or (charged) the following amounts—$1,927 million in 2012, ($1,436) million in 2011, $1,713 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
- 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 8.69% of payroll in 2013. Put another way, for each dollar of service an employee renders, the employer also incurs a pension cost of 8.69 cents. To the extent an employer is overfunded, the 8.69 cents is reduced to amortize its surplus. To the extent an employer is underfunded, the 8.69 cents is increased to collect the shortfall.

The average employer rate for the regular plan was 12.09% for 2012 and is 12.68% for 2013, an increase in the rate of .59%. On a percentage basis, the average rate increased 4.89%. The average rates for 2012 and 2013 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 2012 is 7.49%.) The 12.68% rate reflects the fact that the regular plan was less than 100% funded on an actuarial basis as of December 31, 2011.

The impact of 2011 investment returns on individual employer 2013 contribution rates is difficult to forecast, since each employer has a unique rate affected by its own demographics and funded status as well as its mix of Tier 1 and Tier 2 members.

Phase-in plan remains in effect, modified in 2011

The phase-in plan adopted by the IMRF Board of Trustees in 2009 remains in effect for 2014 employer contribution rates with one modification.

At its July 2011 Board meeting, the IMRF Trustees adopted the following modification to the phase-in plan adopted in 2009:

- For 2014
  Employers who were on the phase-in plan in 2013 will see their 2014 rate increase by 10% from their 2013 rate or by one-half of the difference between their 2013 rate and their actuarial required contribution for 2014 whichever is greater. In all cases, the total increase will not exceed the actuarial required contribution for 2014.

- For 2015
  All employers will pay the actuarial required contribution.

With regard to the Regular plan, there are three employer groups to consider when discussing the impact of 2012 investment returns on 2014 employer contribution rates:

- *Employers who are contributing using the ARC in 2013*
  For employers who are contributing using the ARC in 2013, the average ARC rate is estimated to decrease from 2013 to 2014 by approximately 2.18%. However, this projection is based on IMRF-wide averages and individual employers could vary widely based upon their percentage of Tier 2 members.

- *Employers who are contributing based upon optional phase-in rates in 2013*
  For employers who are contributing using an optional phase-in rate in 2013, the phase-in plan will remain in effect. Any increase will be limited to 10%, except for those employers impacted by the modification noted above. For some of the employers in this group, their 2014 ARC rate may be less than a 10% increase from their 2013 rate. In these cases, their 2014 rate will be the ARC rate.

- *Employers who were over funded at the end of 2011 and were contributing at less than the full cost of the IMRF program (approximately 8.69% of payroll) but who will be under funded at the end of 2012*
  A small group of employers were over funded at the end of 2011 but will be under funded at the end of 2012. Their 2014 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 8.69% 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

To discuss the potential impact on individual employers in 2014 and beyond, IMRF will conduct a series of Employer Rate meetings throughout the state beginning April 22, 2013. We will also discuss other current topics impacting IMRF and pension plans in general.

In early May, IMRF will present a webinar in which this information will also be discussed. Details concerning these meetings and the webinar 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 webinar 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