REPORT DIGEST

Annual Review

INFORMATION SUBMITTED BY THE CTA'S EMPLOYEE RETIREMENT PLAN

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State of Illinois
Office of the Auditor General

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AUDITOR GENERAL

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SYNOPSIS

Public Act 95-708 requires the Chicago Transit Authority's Employee Retirement Plan (Retirement Plan) to annually submit certain information to the Auditor General for review. Our review was limited to the specific conclusions required by the Act. This report does not constitute an audit as that term is defined in generally accepted government auditing standards. This is our second year of review.

The Illinois Pension Code requires the Retirement Plan to determine the Plan's funded ratio of assets to liabilities and determine employee and employer contribution rates needed to meet the Pension Code's funding requirements. The OAG is required to review the Board's determination and the assumptions on which it is based and determine whether they are "unreasonable in the aggregate".

The conclusions reached in this report are based on the Actuarial Valuation as of January 1, 2009, prepared by the Board's actuary, including its determination of increases in contribution rates needed for the CTA and its employees to comply with the funding requirements of the Pension Code. This Actuarial Valuation was presented to the Retirement Plan Board at its August 27, 2009 meeting but was not formally acted upon by the Board. Further, as of the conclusion of our review, **no formal action had yet been taken by the Board to set employee and employer contribution rates to meet the Pension Code's funding requirements**. Readers of this report, therefore, are cautioned that this report's conclusions are contingent upon the Board's approval of the Actuarial Valuation and implementation of its recommendations for changes in contribution rates.

The OAG's review of the Retirement Plan's Actuarial Valuation as of January 1, 2009 concluded its assumptions were not unreasonable in the aggregate. However, we do note that the investment return assumption (i.e., expected rate of return) of 8.75 percent, while selected using established standards for pension plans and not unreasonable in the aggregate, is an **optimistic** assumption and should be viewed as such.

The Pension Code requires the CTA to contribute 12 percent of pay to the Plan, less up to a 6 percent credit for debt service paid on the bonds issued in 2008 to fund the Plan; employees are required to pay 6 percent of pay. If the funded ratio is projected to decline below 60 percent prior to 2040, the CTA is required to pay two-thirds and employees one-third of the required contribution. The actuary determined that increases in employer and employee contributions will be necessary in 2010 to meet the 60 percent funding requirement: the employer contribution rate would need to increase to 10.690 percent (which is net of the employer debt service credit of 6% per pay); and the employee contribution rate would need to increase to 8.345 percent.

REVIEW OF RETIREMENT PLAN SUBMISSIONS

The Illinois State Auditing Act (30 ILCS 5/3-2.3(e)) requires the Retirement Plan to submit to the Office of the Auditor General (OAG) the following documents: the most recent audit, an annual statement (see inset with Section 1A-109 of the Illinois Pension Code), and an actuarial statement by September 30 of each year. The OAG reviewed the documents submitted and concluded that the Retirement Plan had complied with the requirements established in the Auditing Act.

ILLINOIS PENSION CODE REQUIREMENTS

The Auditing Act requires the CTA Retirement Plan to annually file with the Auditor General the following information specified in Section 1A-109 of the Pension Code:

(1) a financial balance sheet as of the close of the fiscal year;
(2) a statement of income and expenditures;
(3) an actuarial balance sheet;
(4) statistical data reflecting age, service, and salary characteristics concerning all participants;
(5) special facts concerning disability or other claims;
(6) details on investment transactions that occurred during the fiscal year covered by the report;
(7) details on administrative expenses; and
(8) such other supporting data and schedules as in the judgement of the Division may be necessary for a proper appraisal of the financial condition of the pension fund and the results of its operations. The annual statement shall also specify the actuarial and interest tables used in the operation of the pension fund.

Source: Pension Code (40 ILCS 5/1A-109) and Auditing Act (30 ILCS 5/3-2.3(e))

The Illinois Pension Code requires the Retirement Plan to determine the Plan's funded ratio of assets to liabilities and determine employee and employer contribution rates needed to meet the Pension Code's funding requirements. The OAG is required to review the Board's determination and the assumptions on which it is based and determine whether they are "unreasonable in the aggregate".

The Retirement Plan submitted to the Auditor General the Actuarial Valuation as of January 1, 2009, prepared by its actuary. The conclusions reached in this report are based on the Actuarial Valuation as of January 1, 2009, including its determination of increases in contribution rates for the CTA and its employees to comply with the funding requirements of the Pension Code. This Actuarial Valuation was presented to the Retirement Plan Board at its August 27, 2009 meeting but was not formally acted upon or accepted by the Board. Further, as of the conclusion of our review, no formal action had yet been taken by the CTA Retirement Plan Board to set employee and employer contribution rates to meet funding requirements established by the Pension Code. Readers of this report, therefore, are cautioned that the conclusions reached in this report are contingent upon the Board's

No formal action has been taken by the CTA Retirement Plan Board to set employee and employer contribution rates to meet funding requirements established by the Pension Code.

approval of the Actuarial Valuation as of January 1, 2009, and implementation of its recommendations for changes in contribution rates.

The OAG's review of the Retirement Plan's Actuarial Valuation as of January 1, 2009 concluded its assumptions were not unreasonable in the aggregate.

The Retirement Plan's investment return assumption of 8.75% is optimistic.

Investment Return Assumption

The actuarial valuation has one assumption that warrants additional discussion. The Retirement Plan's actuary wrote that *"the current assumed rate of 8.75 percent falls within the range of reasonable assumptions,"* but noted that *"this assumption may be viewed as being very aggressive."*

- **The Retirement Plan's actuary noted only a 27% chance of achieving a return of 8.75%.**
- **They found the median investment return to be 7.63%.**

We concur that the investment return assumption (i.e., expected rate of return) of 8.75 percent, while selected using established standards for pension plans and not unreasonable in the aggregate, is an **optimistic** assumption and should be viewed as such. An 8.75 percent investment return rate is very aggressive, based both on the data contained in the Retirement Plan's experience study, as well as with respect to other government pension plans. In fact, the Retirement Plan's actuary noted that an investment return rate of 8.75 percent had only a 27 percent chance of occurring over the next 30 years. The Retirement Plan's actuaries found the **median investment return** over 30 years to be **7.63 percent**.

Funded Ratio

The Illinois Pension Code (40 ILCS 5/22-101(e)(3)) contains specific requirements regarding the funded ratio of the CTA Retirement Plan. The Pension Code states that: *"(3). . . . If the funded ratio is projected to decline below 60% in any year before 2040, the Board of Trustees shall also determine the increased contribution required each year as a level percentage of payroll over the years remaining until 2040 using the projected unit credit actuarial cost method so the funded ratio does not decline below 60% . . . ."*

The Pension Code requires the CTA to contribute 12 percent of pay, less up to a 6 percent credit for debt service paid on the bonds issued in 2008 to fund the Plan; employees are required to pay 6 percent of pay. The Pension Code further requires that contribution rates be increased if the funded ratio is projected to decline below 60 percent prior to 2040, with the CTA paying two-thirds and employees one-third of the required contribution.

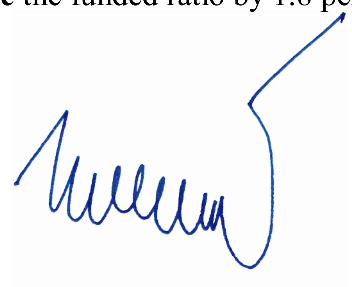
The Actuarial Valuation report concluded that without an increase in employee and employer contribution rates, the Retirement Plan's funded ratio would decline below 60 percent prior to 2040. The Plan's actuary determined that the contribution rates would need to increase beginning in 2010: the employer contribution rate would need to increase to 10.690 percent (which is net of the employer debt service credit of 6% per pay); and the employee contribution rate would need to increase to 8.345 percent. The January 1, 2009 Actuarial Valuation was presented to the Board at its August 27, 2009 meeting. As noted above, the Board did not formally act to enact or approve these increased rates.

Retirement Plan actuary:

- **Employer contribution rate would need to increase to 10.690% (which is net of the employer debt service credit of 6% per pay); and**
- **Employee contribution rate would need to increase to 8.345%.**

As of January 1, 2009, the actuarial value of assets for pension benefits was approximately $2 billion and the actuarial liability was $2.6 billion, according to the Actuarial Valuation by the Retirement Plan's actuary.

- The funded ratio **increased** from 37.2 percent as of January 1, 2008 to 75.8 percent as of December 31, 2008, primarily due to a one-time extraordinary employer contribution of $1.11 billion from the issue of debt.
- Investment losses **decreased** the funded ratio by 2.4 percent.
- Changes due to assumptions **decreased** the funded ratio by 1.1 percent.
- Lowering the investment return assumption from 8.75 percent to 8.50 percent **would** also **decrease** the funded ratio by 1.8 percent.



WILLIAM G. HOLLAND
Auditor General

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November 2009