STATE OF ILLINOIS

OFFICE OF THE AUDITOR GENERAL

2013 ANNUAL REVIEW

INFORMATION SUBMITTED BY THE RETIREMENT PLAN FOR CTA EMPLOYEES

NOVEMBER 2013

WILLIAM G. HOLLAND

AUDITOR GENERAL

SPRINGFIELD OFFICE:
ILES PARK PLAZA
740 EAST ASH • 62703-3154
PHONE: 217/782-6046
FAX: 217/785-8222 • TTY: 888/261-2887
FRAUD HOTLINE: 1-855-217-1895

CHICAGO OFFICE:
MICHAEL A. BILANDIC BLDG. • SUITE S-900
160 NORTH LASALLE • 60601-3103
PHONE: 312/814-4000
FAX: 312/814-4006
FRAUD HOTLINE: 1-855-217-1895

OFFICE OF THE AUDITOR GENERAL
WILLIAM G. HOLLAND

To the Legislative Audit Commission, the Speaker and Minority Leader of the House of Representatives, the President and Minority Leader of the Senate, the members of the General Assembly, and the Governor:

This is our 2013 Annual Review of Information Submitted by the Retirement Plan for Chicago Transit Authority Employees.

The review was conducted pursuant to Public Act 95-708 which amended the Illinois State Auditing Act by adding a requirement for the Auditor General to annually review and report on information submitted by the Board of Trustees of the Retirement Plan for Chicago Transit Authority Employees.

The report for this review is transmitted in conformance with Section 5/3-2.3(e) of the Illinois State Auditing Act.

WILLIAM G. HOLLAND
Auditor General

Springfield, Illinois
November 2013

STATE OF ILLINOIS
OFFICE OF THE
AUDITOR GENERAL
William G. Holland, Auditor General

SUMMARY REPORT DIGEST

REVIEW OF INFORMATION SUBMITTED BY THE RETIREMENT PLAN FOR CHICAGO TRANSIT AUTHORITY EMPLOYEES

2013 ANNUAL REVIEW
Release Date: November 2013

SYNOPSIS

The Illinois State Auditing Act requires the Retirement Plan for Chicago Transit Authority Employees (Retirement Plan) to submit to the Office of the Auditor General (OAG) an audit, an annual statement, and an actuarial statement by September 30 of each year. On September 30, 2013, the OAG received these documents from the Retirement Plan. The OAG reviewed these documents and concluded that the Retirement Plan had complied with the requirements established in the Auditing Act.

The Illinois Pension Code (40 ILCS 5/22-101(e)(3)) requires the Retirement Plan to determine, based on a report prepared by an enrolled actuary, the estimated funded ratio of the Retirement Plan's total assets to its total actuarially determined liabilities. The Plan is also required to determine the employee and employer contribution rates needed to meet funding requirements established by the Pension Code. The Auditor General is required to review the determination and the assumptions on which it is based and determine whether they are *"unreasonable in the aggregate"*. This report does not constitute an audit as that term is defined in generally accepted government auditing standards.

- The OAG and our consultants, Aon Hewitt, reviewed the Retirement Plan's assumptions contained in the January 1, 2013 Actuarial Valuation and concluded that they were not unreasonable in the aggregate.
- However, the 8.50 percent investment return assumption used by the Plan is an aggressive assumption. We followed up with the Plan to determine what analysis was done to show that the assumption was still a reasonable assumption and whether any consideration was given to reduce it. The Plan's Executive Director stated that there have been no changes to the Plan's investment policy or asset allocation during the past year and the Plan's previous assumption was determined to be in line with actuarial standards of practice. The Executive Director further noted that the investment return assumption, along with all other assumptions, will be reviewed as part of the experience review which is currently underway, the results of which will be implemented with the January 1, 2014 Actuarial Valuation.
- The contribution rates adopted by the Retirement Plan Board for 2014 remained unchanged from the 2013 contribution rates: 14.250 percent of pay for the employer rate (which is net of the employer debt service credit of 6% of pay) and 10.125 percent of pay for employees. The January 1, 2013 Actuarial Valuation concluded that the contribution rates applicable for Plan year 2014 should result in the Plan's funded ratio reaching the statutorily required 60 percent level by 2022.
- The funded ratio of the Retirement Plan increased slightly from 59.2 percent as of January 1, 2012, to 59.4 percent as of January 1, 2013. The actuarial value of assets was $1.662 billion at January 1, 2012. At January 1, 2013, the actuarial value of assets was $1.703 billion and the actuarial accrued liability was $2.867 billion, according to the Plan's January 1, 2013 Actuarial Valuation.

ANNUAL REVIEW
RESULTS AND CONCLUSIONS

STATUTORY REQUIREMENTS

The Illinois State Auditing Act (30 ILCS 5/3-2.3(e)) requires the Retirement Plan for Chicago Transit Authority Employees (Retirement Plan) to submit to the Office of the Auditor General (OAG) an audit, an annual statement, and an actuarial statement by September 30 of each year.

The OAG reviewed the documents submitted by the Retirement Plan and concluded the Retirement Plan had complied with the Auditing Act.

- On September 30, 2013, the OAG received these documents from the Retirement Plan.

- The OAG reviewed these documents and concluded that the Retirement Plan had complied with the requirements established in the Auditing Act.

In addition, the Illinois Pension Code (40 ILCS 5/22-101(e)(3)) requires the Retirement Plan to determine, based on a report prepared by an enrolled actuary, the estimated funded ratio of the Retirement Plan's total assets to its total actuarially determined liabilities.

- The Plan is also required to determine the employee and employer contribution rates needed to meet funding requirements established by the Pension Code.

- The Auditor General is required to review the determination and the assumptions on which it is based and determine whether they are *"unreasonable in the aggregate"*. (pages 3-4)

REVIEW OF ACTUARIAL VALUATION

The Retirement Plan submitted the Actuarial Valuation as of January 1, 2013, to the OAG on September 30, 2013. This Actuarial Valuation was presented to the Retirement Plan Board at its August 13, 2013 meeting. At that meeting, the Board of Trustees accepted the January 1, 2013 Actuarial Valuation and certified the employer and employee contribution rates for 2014.

The Retirement Plan's assumptions were not unreasonable in the aggregate.

The OAG and our consultants, Aon Hewitt, reviewed the Retirement Plan's assumptions contained in the January 1, 2013 Actuarial Valuation and concluded that they were not unreasonable in the aggregate. This Report does not constitute an audit as that term is defined in generally accepted government auditing standards.

However, the 8.50 percent investment return assumption used by the Plan is an aggressive assumption. We followed up with the Plan to determine what analysis was done to show that the assumption was still a reasonable assumption and whether any consideration was given to reduce it. The Plan's Executive Director stated that there have been no changes to the Plan's investment policy or asset allocation during the past year and the Plan's previous assumption was determined to be in line with actuarial standards of practice. The Executive Director further noted that the investment return assumption, along with all other assumptions, will be reviewed as part of the experience review which is currently underway, the results of which will be implemented with the January 1, 2014 Actuarial Valuation.

Since 1990, the Plan's return on investments has averaged 8.9 percent, according to the Plan's 2012 Investment Performance Report. However, we continue to conclude that the 8.50 percent rate of return assumption is at the upper range of investment return assumptions for comparable plans.

January 1, 2013:
- **Assets . . . . $1.703 billion**
- **Liabilities . . . .$2.867 billion**
- **Funded Ratio 59.4%**

The funded ratio of the Retirement Plan increased slightly from 59.2 percent as of January 1, 2012, to 59.4 percent as of January 1, 2013. The actuarial value of assets was $1.662 billion at January 1, 2012. At January 1, 2013, the actuarial value of assets was $1.703 billion and the actuarial accrued liability was $2.867 billion, according to the Plan's January 1, 2013 Actuarial Valuation. (pages 5-9, 11)

CONTRIBUTION RATES

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 for contribution to the Retirement Plan; employees are required to pay 6 percent of pay. The Pension Code further requires that contribution rates be increased if the funded ratio declines, or is projected to decline, below 60 percent prior to 2040, with the CTA paying two-thirds and employees one-third of the required contribution.

Since the funded ratio of the Plan declined below 60 percent, the Pension Code requires the Plan to *"determine the increased contribution required each year as a level percentage of payroll during the years after the then current year . . . so the funded ratio is projected to reach at least 60% no later than 10 years after the then current year and include that determination in its report."*

The funded ratio declined below 60 percent in the January 1, 2012 Valuation. In 2012, the Retirement Plan increased the employer and employee contribution rates for 2013: the employer rate increased from 11.3 to 14.250 percent (which is net of the employer debt service credit of 6% of pay); the

The employee and employer contribution rates remained unchanged for 2014: the employee contribution rate was 10.125% of pay and the employer contribution rate was 14.250% of pay (the employer contribution rate is net of the debt service credit of 6% of pay).

employee rate increased from 8.65 to 10.125 percent. The contribution rates adopted by the Retirement Plan Board for 2014 remained unchanged from the 2013 contribution rates. The January 1, 2013 Actuarial Valuation concluded that the contribution rates applicable for Plan year 2014 should result in the Plan's funded ratio reaching the statutorily required 60 percent level within 10 years of 2012 (i.e., by 2022). (pages 9 - 10)

A draft of this Review was provided to the Retirement Plan for their review.

WILLIAM G. HOLLAND
Auditor General

WGH:JS

This Annual Review was conducted by OAG staff with the assistance of our consultants, Aon Hewitt.

TABLE OF CONTENTS

2013 Annual Review

Information Submitted by the Retirement Plan for CTA Employees

The Illinois State Auditing Act (30 ILCS 5/3-2.3(e)), as amended by Public Act 95-708, requires the Auditor General to review certain documents submitted by the Board of Trustees of the Retirement Plan for Chicago Transit Authority Employees (Retirement Plan). In addition, the Illinois Pension Code (40 ILCS 5/22-101(e)(3)) requires the Retirement Plan to determine, based on a report prepared by an enrolled actuary, the estimated funded ratio of the Retirement Plan's total assets to its total actuarially determined liabilities. The Plan is also required to determine the employee and employer contribution rates needed to meet funding requirements established by the Pension Code. The Auditor General is then required to review the determination and the assumptions on which it is based and determine whether they are "unreasonable in the aggregate".

REPORT CONCLUSIONS

The Auditing Act (30 ILCS 5/3-2.3(e)) requires the Retirement Plan to submit to the Office of the Auditor General (OAG) an audit, an annual statement, and an actuarial statement by September 30 of each year. On September 30, 2013, the OAG received these documents from the Retirement Plan. The OAG reviewed these documents and concluded that the Retirement Plan had complied with the requirements established in the Auditing Act.

In addition, the Illinois Pension Code (40 ILCS 5/22-101(e)(3)) requires the Retirement Plan to determine, based on a report prepared by an enrolled actuary, the estimated funded ratio of the Retirement Plan's total assets to its total actuarially determined liabilities. The Plan is then required to determine the employee and employer contribution rates needed to meet funding requirements established by the Pension Code. The Auditor General is required to review the determination and the assumptions on which it is based and determine whether they are "unreasonable in the aggregate".

The Retirement Plan submitted the Actuarial Valuation as of January 1, 2013, to the OAG on September 30, 2013. This Actuarial Valuation was presented to the Retirement Plan Board at its August 13, 2013 meeting. At that meeting, the Board of Trustees accepted the January 1, 2013 Actuarial Valuation and certified the employer and employee contribution rates for 2014.

The OAG and our consultants, Aon Hewitt, reviewed the Retirement Plan's assumptions contained in the January 1, 2013 Actuarial Valuation and concluded that they were not unreasonable in the aggregate. However, the 8.50 percent investment return assumption used by the Plan is an aggressive assumption. We followed up with the Plan to determine what analysis was done to show that the assumption was still a reasonable assumption and whether any consideration was given to reduce it. The Plan's Executive Director stated that there have been no changes to the Plan's investment policy or asset allocation during the past year and the Plan's previous assumption was determined to be in line with actuarial standards of practice. The Executive Director further noted that the investment return assumption, along with all other assumptions, will be reviewed as part of the experience review which is currently underway, the results of which will be implemented with the January 1, 2014 Actuarial Valuation. In this Review we continue to conclude that the 8.50 percent rate of return assumption is at the upper range of investment return assumptions for comparable plans.

In future Actuarial Valuations, the Plan should provide additional details as to the analysis conducted to justify its investment rate of return assumption. The need for increased disclosure in the Plan's Actuarial Valuation regarding the reasonableness of the investment rate of return assumption was also raised in our 2012 Annual Review.

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 for contribution to the Retirement 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 funded ratio of the Retirement Plan increased slightly from 59.2 percent as of January 1, 2012, to 59.4 percent as of January 1, 2013. The actuarial value of assets was $1.662 billion at January 1, 2012. At January 1, 2013, the actuarial value of assets was $1.703 billion and the actuarial accrued liability was $2.867 billion, according to the Plan's January 1, 2013 Actuarial Valuation.

Since the funded ratio of the Plan declined below 60 percent, the Pension Code requires the Plan to "determine the increased contribution required each year as a level percentage of payroll during the years after the then current year . . . so the funded ratio is projected to reach at least 60% no later than 10 years after the then current year and include that determination in its report." The funded ratio declined below 60 percent in the January 1, 2012 Valuation. In 2012, the Retirement Plan increased the employer and employee contribution rates for 2013: the employer rate increased from 11.3 to 14.250 percent (which is net of the employer debt service credit of 6% of pay); the employee rate increased from 8.65 to 10.125 percent. The contribution rates adopted by the Retirement Plan Board for 2014 remained unchanged from the 2013 contribution rates. The January 1, 2013 Actuarial Valuation concluded that the contribution rates applicable for Plan year 2014 should result in the Plan's funded ratio reaching the statutorily required 60 percent level within 10 years of 2012 (i.e., by 2022).

BACKGROUND

The Retirement Plan for CTA Employees was significantly underfunded, with a funded ratio of 34 percent as of January 1, 2006. In addition, the Plan was responsible for administering both the retirement benefits and retiree health care benefits. Public Act 94-839 required the CTA to separate the funding for retiree health care benefits from the funding of the retirement system by January 1, 2009.

Public Act 95-708 made sweeping changes to the Retirement Plan for CTA Employees. Public Act 95-708 gave the CTA the authority to issue bonds to help fund both the retirement and retiree health care plans. Public Act 95-708 also established the Retiree Health Care Trust to handle the retiree health care benefits. The Retiree Health Care Trust was established in May 2008.

The legislation required that the contributions from the CTA and employees must be at a level so that the funded ratio of the Retirement Plan does not decline below 60 percent in any year before 2040, and achieve 90 percent funding by the end of 2059. If the Plan's funded ratio declines below 60 percent, the Pension Code requires the Board to "determine the increased contribution required each year as a level percentage of payroll during the years after the then current year . . . so the funded ratio is projected to reach at least 60% no later than 10 years after the then current year and include that determination in its report." It also stipulates that employees are required to pay one-third of the annual required contribution and the CTA is required to pay two-thirds of the required contribution. During the time period 2009 through 2040, the amount paid by the CTA with respect to debt service on bonds issued for contribution to the Retirement Plan shall be treated as a credit against the amount of required contribution, up to an amount not to exceed six percent of the compensation paid by the CTA in the following year.

REVIEW OF RETIREMENT PLAN SUBMISSIONS

The Illinois State Auditing Act (30 ILCS 5/3-2.3(e)) requires the Retirement Plan to submit certain specific documents to the Auditor General by September 30 of each year:

1. **Audit.** The most recent audit or examination of the Retirement Plan;

2. **Annual Statement.** An annual statement containing the information specified in Section 1A-109 of the Illinois Pension Code (see inset); and

3. **Actuarial Statement.** A complete actuarial statement applicable to the prior plan year, which may be the annual report of an enrolled actuary retained by the Retirement Plan specified in Section 22-101(e) of the Illinois Pension Code.

On September 30, 2013, the OAG received the three documents listed below from the Retirement Plan. We reviewed the documents and concluded the information required by Section 5/3-2.3(e) of the Auditing Act was contained in these reports:

- Audited Financial Statements for the Retirement Plan for the year ended December 31, 2012;

- Investment Performance Report for the period ended December 31, 2012; and

- January 1, 2013 Actuarial Valuation for the Retirement Plan.

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))

Review of Actuarial Determination and Assumptions

The Illinois Pension Code (40 ILCS 5/22-101(e)(3)) places an additional reporting requirement on the Auditor General. The Code requires that the Retirement Plan, *"By September 15 of each year beginning in 2009 and ending on December 31, 2039, on the basis of a report prepared by an enrolled actuary retained by the Plan, the Board of Trustees of the Retirement Plan shall determine the estimated funded ratio of the total assets of the Retirement Plan to its total actuarially determined liabilities. A report containing that determination and the actuarial assumptions on which it is based shall be filed with the . . . Auditor General . . . ."* The Pension Code requires the Auditor General to review the determination and the assumptions on which it is based to determine whether they are unreasonable in the aggregate.

The January 1, 2013 Actuarial Valuation was presented to the Retirement Plan Board at its August 13, 2013 meeting. At that meeting, the Board of Trustees accepted the January 1, 2013 Actuarial Valuation and certified the employer and employee contribution rates for 2014. The 2014 rates adopted were unchanged from the 2013 contribution rates: the employer contribution rate was 14.25 percent (which is net of the employer debt service credit of 6% of pay) and the employee contribution rate was 10.125 percent.

Review of Actuarial Assumptions Used

On September 30, 2013, the Retirement Plan submitted to the Auditor General its Actuarial Valuation as of January 1, 2013, pursuant to 40 ILCS 5/22-101(e)(3). We reviewed the assumptions used in the Retirement Plan's Actuarial Valuation and found that the assumptions used were not unreasonable in the aggregate.

Investment Return Assumption

While the assumptions used in the January 1, 2013 Actuarial Valuation were not unreasonable in the aggregate, one assumption, the investment return assumption, warrants additional discussion. In our 2009 and 2010 Annual Reviews, we noted that the Retirement Plan's investment return assumption of 8.75 percent, while selected using established standards for pension plans and not unreasonable in the aggregate, was an optimistic assumption. In the January 1, 2011 Actuarial Valuation, the Board's actuary recommended, and the Board approved, a reduction in the investment return assumption to 8.5 percent.

In the January 1, 2012 and January 1, 2013 Actuarial Valuations, the investment return assumption remained at 8.50 percent. Both Valuations contained no analysis justifying the reasonableness of the 8.50 percent rate of return or a presentation of different rates of return and the impact they would have on the required contribution rates.

The investment rate of return assumption is comprised of two components: the projected rate of inflation and the expected real rate of return. For example, other public pension plans with a rate of return assumption of 8.50 percent use an inflation assumption of 3 percent and an assumed real rate of return of 5.50 percent, which yields a total return assumption of 8.50 percent.

According to the Plan's Executive Director, the inflation assumption used in the January 1, 2013 Valuation was unchanged from the January 1, 2012 Valuation, which was 3.25 percent. Therefore, a 5.25 percent real rate of return is assumed to yield the Plan's total investment return of 8.50 percent. However, the Plan's Investment Performance Report for the period ending December 31, 2012 stated that "**The Fund should achieve real (in excess of inflation) rate of return of 4% per year over long**

periods of time." [emphasis added] Adding the 3.25 percent inflation assumption and the 4 percent projected real rate of return would yield a total rate of return of 7.25 percent, not the 8.50 percent used in the Actuarial Valuation.

In his review of the draft Report, the Plan's Executive Director noted that the 4.00 percent real return in the Investment Performance Report is an oversight. He noted that it should have been 5.25 percent. We asked the Executive Director to provide documentation supporting the 5.25 percent real rate of return. He noted that the Plan's Investment Policy contains a goal of 6 percent real rate of return, but that too is outdated in that the Plan's expected return has been lowered several times over the past five years. He provided an analysis prepared by the Plan's investment consultant that a real return rate of 5.25 percent has been achieved over the past 30 year period. The Plan should take immediate action to document and clearly state the assumed real rate of return in its Investment Performance Report, its Investment Policy, and Actuarial Valuations.

Regarding the Actuarial Valuation, we followed up with the Plan during the course of our Review to determine what analysis was done to show that the assumption was still a reasonable assumption and whether any consideration was given to reduce it. The Plan's Executive Director stated that there have been no changes to the Plan's investment policy or asset allocation during the past year and the Plan's previous assumption was determined to be in line with actuarial standards of practice. The Executive Director further noted that the investment return assumption, along with all other assumptions, will be reviewed as part of the experience review which is currently underway, the results of which will be implemented with the January 1, 2014 Actuarial Valuation. An experience review provides critical information to the actuary by assessing how well assumptions used by the plan align with the actual experience of the plan.

Comparison with Rates of Returns for Other Pension Plans

An investment return assumption of 8.50 percent is at the upper range of investment return assumptions for comparable plans. The Public Fund Survey includes data on 126 public pension plans. The CTA Retirement Plan's use of an 8.50 percent rate of return is at the upper bounds of a dwindling number of Plans using an 8.50 percent return rate. As of October 30, 2013, the highest investment return assumption found in the Public Fund Survey data online was 8.50 percent. The 8.50 percent rate was used by only 3 of 126 plans, which was down from 11 plans that used an 8.50 percent rate a year earlier. The median investment return assumption for the 126 plans reported in October 2013 Public Fund Survey data was 7.90 percent. The *Public Fund Survey Summary of Findings for FY 11* states "Since 2009 especially, an unprecedented number of plans have reduced their investment return assumption."

Further, the CTA Retirement Plan's assumed real rate of return of 5.25 percent was toward the upper range of rates used by other public pension plans in the October 2013 Public Fund Survey data. The Public Fund Survey's median assumed *real rate of* *return* was 4.5 percent. The highest real rate of return in the Public Fund Survey was 5.50 percent (6 systems).

Wilshire Consulting's *2013 Report on State Retirement Systems: Funding Levels and Asset Allocation* examined the asset allocation and funding levels for 134 state retirement systems. Wilshire estimated that the median state pension fund has an expected return of 6.90 percent. This median expected return is lower than the current median actuarial interest rate assumption of 7.8 percent used by the plans in the study and is lower than the 8.50 percent assumption selected for the CTA Retirement Plan. This Wilshire report also notes that Wilshire's assumptions range over a conservative 10+ year time horizon, while pension plan interest rate assumptions typically project over 20 to 30 years.

The National Conference on Public Employee Retirement Systems and Cobalt Community Research released the *2013 NCPERS Public Retirement System Study*. NCPERS is a trade association for public sector pension funds, representing more than 550 funds in the United States and Canada. The 2013 Study includes responses from 241 state, local, and provincial government pension funds with assets exceeding $1.4 trillion. According to the Study, the average investment return assumption was 7.60 percent in 2013, which was down 0.1 percent from 2012. The inflation assumption fell to 3.30 percent in 2013, down from 3.40 percent in 2012. Similar to the findings from the Public Fund Survey, the *2013 NCPERS Public Retirement System Study* found that there was increased activity over the 2012 study with respect to lowering the actuarial assumed rate of return.

Aon Hewitt Analysis

Actuarial Standard of Practice No. 27 (ASOP No. 27) provides guidance on the selection of economic assumptions for measuring pension obligations and dictates that "each economic assumption selected by the actuary should be reasonable," and should have "no significant bias." It does recognize that "different actuaries will apply different professional judgment and may choose different reasonable assumptions. As a result, a range of reasonable assumptions may develop . . . across actuarial practice."

Using Aon Hewitt's Expected Return Tool (as of the 1st Quarter of 2013 with an inflation assumption of 2.40%) and the Target Asset Allocation found in the CTA Retirement Plan's Investment Performance Report for the Period Ending December 31, 2012, Aon Hewitt determined that the 25th to 75th percentile range of the CTA Retirement Plan's investment returns to be 5.77 percent to 8.81 percent, with the 50th percentile rate equal to 7.27 percent. The Retirement Plan's investment return assumption of 8.50 percent represented the 29th percentile in Aon Hewitt's tool. The Aon Hewitt Expected Return Tool calculates the expected portfolio growth rate (50th percentile, geometric return) before any value added from active management.

Historical Rates of Return Experienced by the Plan's Investments

Over the past 23 years, the rate of return on Retirement Plan investments has exceeded its current 8.5 percent assumed rate of return. Since 1990, the Plan's return on investments has averaged 8.9 percent, according to the Plan's 2012 Investment Performance Report.

Conclusion: Investment Return Assumption

The 8.50 percent investment rate of return assumption used by the Retirement Plan is an agressive assumption. Historical rates of return experienced by the Retirement Plan on its investments have averaged 8.9 percent over the past 23 years, which exceeds its 8.50 percent rate of return assumption. Also, the Plan's actuary has concluded that the rate of return assumption complies with the Actuarial Standards of Practice. However, the 8.50 percent rate of return assumption is at the upper end of rates of return used by other retirement plans in the United States. Consequently, while this investment return assumption is not unreasonable in the aggregate, it is an agressive assumption and should be viewed as such.

The Plan indicated that the experience review in 2013 will review the 8.50 percent rate of return assumption. In future Actuarial Valuations, the Plan should provide additional details as to the analysis conducted to justify its investment rate of return. The need for increased disclosure in the Plan's Actuarial Valuation regarding the reasonableness of the investment rate of return assumption was also raised in our 2012 Annual Review.

Other Actuarial Assumptions

As with its investment rate of return assumption, the Plan's actuary noted that the assumptions and methods used for the January 1, 2013 Valuation were unchanged from the prior Valuation. The January 1, 2013 Actuarial Valuation provided certain actuarial (gain) or loss information with respect to specific demographic assumptions. We requested and the Plan provided Aon Hewitt with supplemental information regarding the (gains) or losses due to new entrants, retirement and other separation experience, as well as other demographic (gain) or loss. Exhibit 1 provides information regarding the source of gains and losses related to demographic actuarial assumptions in the January 1, 2013 Actuarial Valuation for the preceding year as a percentage of the actuarial accrued liability. The largest gain or loss outside of asset returns was a loss due to payroll growth being greater than expected, although this loss is lower than the prior two years.

Exhibit 1 (Gain) Loss Due to Demographic Actuarial Assumptions Year Ended 12/31/2012	
Actuarial Assumption	**Percentage of Actuarial Accrued Liability**
Payroll	0.3%
Retirement and Other Separation Experience	0.0%
Retiree Mortality Experience	0.2%
New Entrants	0.1%
Other Demographic	-0.2%
Source: Aon Hewitt from CTA Retirement Plan Information.	

The Actuarial Valuation as of January 1, 2013 states the mortality assumption as follows:

(a) Active Members: The 1994 Group Annuity Mortality Table for males and females multiplied by 90 percent
(b) Retirees & Survivors: The 1994 Group Annuity Mortality Table for males and females
(c) Disabled Employees: The 1994 Group Annuity Mortality Table for males and females multiplied by 110 percent

Actuarial Standard of Practice No. 35 (ASOP No. 35) was recently amended to provide guidance with respect to mortality improvement before and after the measurement date. The revisions to ASOP No. 35 are effective for any actuarial valuation with a measurement date on or after June 30, 2011 (i.e., the Plan's January 1, 2013 Actuarial Valuation reviewed in this report). The Plan's actuary stated in the January 1, 2013 Actuarial Valuation, "Our initial conclusion is that the mortality tables currently in use and adopted by the Board provides for some future mortality improvements." While we do not have actual plan experience to compare the assumption to, the Plan did experience a small loss with regards to retiree mortality experience during 2012 (as noted in Exhibit 1 above). Aon Hewitt has not performed an independent analysis of the mortality improvement in use to determine to what extent it compares to either Scale AA or Scale BB mortality improvement scales as published by the Society of Actuaries. We recommend that this be more fully addressed as part of the assumption review currently in process.

Funded Ratio

The funded ratio of the Retirement Plan as of January 1, 2013 increased slightly from the prior year, increasing from 59.2 percent to 59.4 percent. The actuarial value of assets was $1.662 billion at January 1, 2012. At January 1, 2013, the actuarial value of assets was reported at $1.703 billion and the actuarial accrued liability was $2.867 billion.

The Illinois Pension Code (40 ILCS 5/22-101(e)(3)) contains specific requirements regarding the funded ratio of the CTA Retirement Plan. The Code states that:

> (3) . . . If the actual funded ratio declines below 60% in any year prior to 2040, the Board of Trustees shall also determine the increased contribution required each year as a level percentage of payroll during the years after the then current year using the projected unit credit actuarial cost method so the funded ratio is projected to reach at least 60% no later than 10 years after the then current year and include that determination in its report. . . .

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 used 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 Pension Code requires the CTA to pay two-thirds and employees one-third of the required contribution.

The funded ratio of the Plan declined under 60 percent in the January 1, 2012 Actuarial Valuation. In 2012, the Retirement Plan increased the employer and employee contribution rates for 2013: the employer rate increased from 11.3 to 14.250 percent (which is net of the 6% credit given to the CTA for debt service on the pension obligation bonds sold in 2008); the employee rate increased from 8.65 to 10.125 percent. The contribution rates approved by the Board of Trustees for 2014 were unchanged from 2013. According to the Plan's Executive Director, the rates that were adopted were slightly higher than the required minimum contribution rates to reach a 60 percent funded ratio by 2022, which were 14.188 percent for the CTA (which is net of the 6% credit for debt service) and 10.094 percent for employees.

The January 1, 2013 Actuarial Valuation report concluded that contribution rates applicable for plan year 2014 should result in the Plan's funded ratio to be at least equal to 60 percent by 2022. Consequently the January 1, 2013 Actuarial Valuation's projection of the funded ratio reaching 60 percent funding by 2022 meets the statute's 10 year requirement of 60 percent level within 10 years of 2012 (i.e., by 2022).

The January 1, 2013 Actuarial Valuation notes that differences between the expected experience based on the actuarial assumptions and the actual experience create changes in the actuarial accrued liability, the actuarial value of assets, and the unfunded actuarial accrued liability from one year to the next. These changes create an actuarial gain if the experience is favorable, and an actuarial loss if the experience is unfavorable. The Plan experienced a total net actuarial gain of $18.4 million during 2012.

According to the Retirement Plan's January 1, 2013 Actuarial Valuation, the net gain was a combination of two principal factors, demographic experience and investment performance. Demographic experience (such as mortality, turnover, retirement, pay increases, etc.) that differed from actuarial projections resulted in a $9.7 million loss. However, this loss was offset by an asset gain of $28.1 million due to a higher rate of return on assets, 11.27 percent, than the Plan's rate of return assumption of 8.5 percent.

The January 1, 2013 Actuarial Valuation projects the funded ratio of the Plan to be 88.95 percent in year 2039. This is a decrease from last year's projected funded ratio in year 2039 of 96.4 percent, despite an actuarial gain for the year.

Aon Hewitt noted that the decrease in projected active participants between the 2012 and 2013 Valuations (8,751 in the January 1, 2012 Valuation, which decreased to 8,317 in the January 1, 2013 Valuation) was a contributing factor to the decrease in the projected funded status in future years. The Actuarial Valuation uses a constant number of CTA active participants in its projections through 2039. We inquired of the Retirement Plan as to why the number of active participants declined and whether any consideration was given to changing the assumption of a constant active population. The Plan's Executive Director responded that the decrease in participants was due to layoffs in 2012 and that using the current level of participants for future projections is a typical actuarial convention. While assuming a current level of participants for future projections is not unreasonable, the number of active employees in the Plan's Actuarial Valuations has significantly decreased: 9,689 active participants in the January 1, 2009 Valuation to 8,317 active participants in the January 1, 2013 Valuation. A decreasing CTA workforce has a direct impact on the future employee contributions which could have a negative impact on the Plan's funded ratio and on the contribution rates that both employees and employers are required to make in future years.

The *Public Fund Survey Summary of Findings for FY 2011* states "Although a low or declining ratio of actives to annuitants is not, per se, problematic for a pension plan, the cost as a percentage of payroll of amortizing a larger unfunded pension liability typically is higher when the ratio of actives to annuitants is lower." The Plan's actuary assumed a steady future level of active members of 8,317 through the projection period of 2043. To the extent future participation differs from this assumption, the Plan's funded ratio and future contribution levels will be impacted.

In future Valuations, the Board may want the Plan's actuary to more fully examine the factors contributing to the decreasing number of participants and whether that trend is expected to continue. That information or analysis may prove useful to the Board in its consideration of the adequacy of current contribution rates to meet statutorily required funded ratios.

SCOPE OF ANNUAL REVIEW

The Office of the Auditor General conducted an annual review of information submitted by the Retirement Plan pursuant to the Illinois State Auditing Act and the Illinois Pension Code. This report does not constitute an audit as that term is defined in generally accepted government auditing standards. Consequently, while we reviewed the information provided by the CTA Retirement Plan for reasonableness and consistency, we did not conduct an audit of the accuracy of the information provided as that is the responsibility of the Plan.

The scope of our work included reviewing the information submitted by the Retirement Board on September 30, 2013. This information included: the Audited Financial Statements for the Plan for the year ended December 31, 2012; the Investment Performance Report for the period ending December 31, 2012; and the January 1, 2013 Actuarial Valuation for the Retirement Plan. We conducted follow-up with the Retirement Plan on various questions we had based upon our review of these documents. Our consultants, Aon Hewitt, reviewed the reasonableness of the actuarial assumptions used by the CTA Retirement Plan in their January 1, 2013 Actuarial Valuation.

We received minutes of the Retirement Board meetings for the period November 2012 through August 2013. In our 2011 Review, we noted that the Retirement Board approved a payroll audit in 2011. The Board's Executive Director expected the audit to be completed by the end of 2012. The purpose of the audit is to ensure that the employers are accurately withholding and remitting employee and employer contributions to the Retirement Plan and Retiree Health Care Trust. In this Review, we inquired of the Executive Director as to whether the audit had been completed and whether there were any findings that impacted the Retirement Plan. The Executive Director stated that the fieldwork has been completed and initial findings have been submitted to the affected parties (Local 241, Local 308 and the CTA). The Executive Director noted that it is customary to allow the affected parties an opportunity to review the findings and provide comment and additional information or documentation, particularly if they disagree with any of the initial findings. The potential impact on the plans would be for additional monies to be either received or refunded, and for participant credits to be affected accordingly.

We also asked the Plan's Executive Director about another matter referenced in the Board minutes and its potential impact, if any, on the funding of the Retirement Plan. The matter related to drug rebate monies that the CTA may owe the Plan. The Executive Director stated that the Plan has filed suit for an accounting regarding monies it paid to the CTA for the cost of health benefits for retirees. This accounting would be for a time-period prior to the passage of Public Act 95-708 and the creation of the Retiree Health Care Trust. The amended complaint provided by the Plan notes that the CTA may owe the Plan approximately $7 million in prescription drug rebates retained by the CTA.

We inquired of the Plan's Executive Director as to whether the CTA was current in making required contributions into the Retirement Plan. The Executive Director responded that the CTA is generally current in all of its required payments to the Retirement Plan. The Plan periodically commissions reviews to determine whether any additional payments may be due.

The OAG performed this Review with assistance from our consultants, Aon Hewitt. Aon Hewitt's review concluded that:

(A) The required documents submitted by the Board of Trustees of the Retirement Plan have been made and meet the statutory requirements of Section 5/3-2.3(e)(1), (2), and (3) of the Auditing Act.

(B) The assumptions stated in the actuarial report submitted pursuant to 40 ILCS 5/22-101(e)(3) are not unreasonable in the aggregate.

(C) The investment return assumption of 8.50 percent, net of expenses, was selected by the Plan's actuary. The Plan's actuary has indicated that the current assumption of 8.50 percent complies with Actuarial Standards of Practice.

(D) The Pension Code (40 ILCS 5/22-101(e)(3)) indicates that the Statutory Minimum Contribution Rates are to be determined so as to keep the projected funded ratio above 60 percent in all years through 2039, based on assumptions which are not unreasonable in the aggregate. The Pension Code also indicates that if the actual funded ratio declines below 60 percent in any year prior to 2040, the Statutory Minimum Contribution shall be increased (each year) as a level percentage of payroll during the years after the current year such that the funded ratio is projected to reach at least 60 percent no later than 10 years after the then current year. The actuarial report submitted by the Plan to the Office of the Auditor General indicates that the funded ratio is below 60 percent for the 2013 Plan year. The funded ratio first fell below 60 percent for the 2012 Plan year. Therefore, the projections indicate that the rates adopted for 2013 are intended to bring the funded status to 60 percent (or higher) by 2022 (i.e., 10 years after the implementation year). The adopted contribution rates for 2013 of 10.125 percent for employees and 14.250 percent for the employer (with the 6% credit for debt service) are stated to be higher than the Statutory Minimum Contribution Rates, which the Plan's Executive Director has indicated to be 10.094 percent for employees and 14.188 percent for the employer.

(E) The requirement to keep the projected funded ratio above 60 percent is not a Governmental Accounting Standards Board ("GASB") approved funding method. GASB Statement No 25 (GASB 25) defines the Annual Required Contribution (ARC) to be the normal cost plus an amortization payment of the unfunded actuarial accrued liability. Normal cost is the cost of the benefits accruing during the current year. The unfunded actuarial accrued liability is the difference between the actuarial accrued liability and the actuarial value of assets. The maximum amortization period for the unfunded actuarial accrued liability is 30 years under GASB 25. Under GASB 25, the Annual Required Contribution funds to 100 percent. Page 25 of the January 1, 2013 Actuarial Report provides a comparison of the actual contributions made for the past 10 years to the Annual Required Contribution as determined under GASB 25. In all years, other than 2008 when the pension obligation bond was purchased, the actual contributions received were less than Annual Required Contribution under GASB 25.

The Retirement Plan was provided a draft of this report for their review.

APPENDIX A

Statutory Authority

ILLINOIS STATE AUDITING ACT

30 ILCS 5/3-2.3(e) and (f)

(e) Annual Retirement Plan Submission to Auditor General. The Board of Trustees of the Retirement Plan for Chicago Transit Authority Employees established by Section 22-101 of the Illinois Pension Code shall provide the following documents to the Auditor General annually no later than September 30:

(1) the most recent audit or examination of the Retirement Plan;

(2) an annual statement containing the information specified in Section 1A-109 of the Illinois Pension Code; and

(3) a complete actuarial statement applicable to the prior plan year, which may be the annual report of an enrolled actuary retained by the Retirement Plan specified in Section 22-101(e) of the Illinois Pension Code.

The Auditor General shall annually examine the information provided pursuant to this subsection and shall submit a report of the analysis thereof to the General Assembly, including the report specified in Section 22-101(e) of the Illinois Pension Code.

(f) The Auditor General shall annually examine the information submitted pursuant to Section 22-101B(b)(3)(iii) of the Illinois Pension Code and shall prepare the determination specified in Section 22-101B(b)(3)(iv) of the Illinois Pension Code.

(Source: P.A. 95-708, eff. 1-18-08.)

ILLINOIS PENSION CODE

40 ILCS 5/1A-109

Annual statements by pension funds. Each pension fund shall furnish to the Division an annual statement in a format prepared by the Division. The Division shall design the form and prescribe the content of the annual statement and, at least 60 days prior to the filing date, shall furnish the form to each pension fund for completion. The annual statement shall be prepared by each fund, properly certified by its officers, and submitted to the Division within 6 months following the close of the fiscal year of the pension fund.

The annual statement shall include, but need not be limited to, the following:

(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: P.A. 90-507, eff. 8-22-97.)

40 ILCS 5/22-101

Sec. 22-101(e). Retirement Plan for Chicago Transit Authority Employees.

(1) Beginning January 1, 2009 the Authority shall make contributions to the Retirement Plan in an amount equal to twelve percent (12%) of compensation and participating employees shall make contributions to the Retirement Plan in an amount equal to six percent (6%) of compensation. These contributions may be paid by the Authority and participating employees on a payroll or other periodic basis, but shall in any case be paid to the Retirement Plan at least monthly.

(2) For the period ending December 31, 2040, the amount paid by the Authority in any year with respect to debt service on bonds issued for the purposes of funding a contribution to the Retirement Plan under Section 12c of the Metropolitan Transit Authority Act, other than debt service paid with the proceeds of bonds or notes issued by the Authority for any year after calendar year 2008, shall be treated as a credit against the amount of required contribution to the Retirement Plan by the Authority under subsection (e)(1) for the following year up to an amount not to exceed 6% of compensation paid by the Authority in that following year.

(3) By September 15 of each year beginning in 2009 and ending on December 31, 2039, on the basis of a report prepared by an enrolled actuary retained by the Plan, the Board of Trustees of the Retirement Plan shall determine the estimated funded ratio of the total assets of the Retirement Plan to its total actuarially determined liabilities. A report containing that determination and the actuarial assumptions on which it is based shall be filed with the Authority, the representatives of its participating employees, the Auditor General of the State of Illinois, and the Regional Transportation Authority. 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% and include that determination in its report. If the actual funded ratio declines below 60% in any year prior to 2040, the Board of Trustees shall also determine the increased contribution required each year as a level percentage of payroll during the years after the then current year using the projected unit credit actuarial cost method so the funded ratio is projected to reach at least 60% no later than 10 years after the then current year and include that determination in its report. Within 60 days after receiving the report, the Auditor General shall review the determination and the assumptions on which it is based, and if he finds that the determination and the assumptions on which it is based are unreasonable in the aggregate, he shall issue a new determination of the funded ratio, the assumptions on which it is based and 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%, or, in the event of an actual decline below 60%, so the funded ratio is projected to reach 60% by no later than 10 years after the then current year. If the Board of Trustees or the Auditor General determine that an increased contribution is required to meet the funded ratio required by the subsection, effective January 1 following the determination or 30 days after such determination, whichever is later, one-third of the increased contribution shall be paid by participating employees and two-thirds by the Authority, in addition to the contributions required by this subsection (1).

(4) For the period beginning 2040, the minimum contribution to the Retirement Plan for each fiscal year shall be an amount determined by the Board of Trustees of the Retirement Plan to be sufficient to bring the total assets of the Retirement Plan up to 90% of its total actuarial liabilities by the end of 2059. Participating employees shall be responsible for one-third of the required contribution and the Authority shall be responsible for two-thirds of the required contribution. In making these determinations, the Board of Trustees shall calculate the required contribution each year as a level percentage of payroll over the years remaining to and including fiscal year 2059 using the projected unit credit actuarial cost method. A report containing that determination and the actuarial assumptions on which it is based shall be filed by September 15 of each year with the Authority, the representatives of its participating employees, the Auditor General of the State of Illinois and the Regional Transportation Authority. If the funded ratio is projected to fail to reach 90% by December 31, 2059, the Board of Trustees shall also determine the increased contribution required each year as a level percentage of payroll over the years remaining until December 31, 2059 using the projected unit credit actuarial cost method so the funded ratio will meet 90% by December 31, 2059 and include that determination in its report. Within 60 days after receiving the report, the Auditor General shall review the determination and the assumptions on which it is based and if he finds that the determination and the assumptions on which it is based are unreasonable in the aggregate, he shall issue a new determination of the funded ratio, the assumptions on which it is based and the increased contribution required each year as a level percentage of payroll over the years remaining until December 31, 2059 using the projected unit credit actuarial cost method so the funded ratio reaches no less than 90% by December 31, 2059. If the Board of Trustees or the Auditor General determine that an increased contribution is required to meet the funded ratio required by this subsection, effective January 1 following the determination or 30 days after such determination, whichever is later, one-third of the increased contribution shall be paid by participating employees and two-thirds by the Authority, in addition to the contributions required by subsection (e)(1).

(5) Beginning in 2060, the minimum contribution for each year shall be the amount needed to maintain the total assets of the Retirement Plan at 90% of the total actuarial liabilities of the Plan, and the contribution shall be funded two-thirds by the Authority and one-third by the participating employees in accordance with this subsection.

(Source: P.A. 95-708, eff. 1-18-08, P.A. 97-442, eff. 8-19-11; P.A. 97-609, eff. 1-1-12; P.A. 97-813, eff. 7-13-12.)