State of Illinois
Office of the
Auditor General
Frank J. Mautino, Auditor General

REPORT DIGEST

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ANNUAL REVIEW

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EXECUTIVE SUMMARY

Review of Information Submitted by the Retirement Plan for Chicago Transit Authority Employees

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. The OAG reviewed the documents submitted by the Retirement Plan and concluded that they met the requirements of the Auditing Act.

The funded ratio of the Retirement Plan decreased from 58.2 percent in the January 1, 2015 Valuation to 53.3 percent in the January 1, 2016 Valuation. When the funded ratio declines below 60 percent, the Pension Code requires that contribution rates be increased so that the funded ratio is projected to reach 60 percent within 10 years. The contribution rates adopted by the Retirement Plan Board for 2017 were **increased** from the 2016 contribution rates. The employer contribution rate (which is net of the employer debt service credit of 6% of pay) increased from 14.25 percent in 2016 to 17.925 percent in 2017 and the employee contribution rate increased from 10.125 percent in 2016 to 11.962 percent in 2017.

The OAG and our consultants, Aon Hewitt, reviewed the Retirement Plan's assumptions contained in the January 1, 2016 Actuarial Valuation and concluded that they were not unreasonable in the aggregate. However, we believe that three of the assumptions should continue to be monitored and justified on an annual basis.

- Investment return assumption: The 8.25 percent investment return assumption used by the Plan remains at the upper end of investment return assumptions used by other plans. Both the Plan's actuary and Investment Consultant conducted projections that concluded the Plan's investments have a reasonable likelihood of achieving an investment return of 8.25 percent over a 10 to 20 year period. We recommend that the Plan continue to annually review the reasonableness of its investment return assumption.

- Mortality assumption: The mortality assumptions used by the Plan were chosen before final 2014 mortality tables were issued by the Society of Actuaries. We recommend that a new mortality analysis be conducted for the Plan, on a benefits-weighted basis, in time to reflect the results in the assumptions that are adopted and used for next year's valuation.

- Active participant assumption: The active participant headcount decreased from the prior year and the ratio of active participants to annuitants continued to decrease. Given the impact such a decline can have on future contribution levels, we recommend that the Plan continue to monitor the use of a constant headcount assumption.

This report does not constitute an audit as that term is defined in generally accepted government auditing standards.

ANNUAL REVIEW
RESULTS AND CONCLUSIONS

STATUTORY REQUIREMENTS

The OAG reviewed the documents submitted by the Retirement Plan and concluded that they met the requirements of the Auditing Act.

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.

- On September 30, 2016, the OAG received these documents from the Retirement Plan.
- The OAG reviewed these documents and concluded that they met the requirements of 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 3-5)

REVIEW OF ACTUARIAL VALUATION

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

The Retirement Plan submitted the Actuarial Valuation as of January 1, 2016, to the OAG on September 30, 2016. This Actuarial Valuation was presented to the Retirement Plan Board at its September 22, 2016 meeting. At that meeting, the Board of Trustees accepted the January 1, 2016 Actuarial Valuation and certified the employer and employee contribution rates for 2017.

The OAG and our consultants, Aon Hewitt, reviewed the Retirement Plan's assumptions contained in the January 1, 2016 Actuarial Valuation and concluded that they were not unreasonable in the aggregate. While recognizing the Plan's policy of completing an experience study every five years, we believe that three of the assumptions – investment return, mortality, and number of active future participants – should continue to be monitored and justified on an annual basis. Further, we recommend that a mortality analysis be completed in time to reflect the results in the assumptions used for next year's actuarial valuation.

In 2014, the Plan's actuary completed an experience study for the five year period ending December 31, 2012. An experience study assesses how well assumptions used by the Plan align with the actual experience of the Plan. If past experience differs from the assumptions used, then the actuary may recommend revisions to the assumptions used in future valuations.

As a result of the experience study, the Plan lowered its investment return assumption from 8.50 percent to 8.25 percent in the January 1, 2014 Actuarial Valuation. The January 1, 2016 Actuarial Valuation continues to use the 8.25 percent rate of return.

Our prior reviews have concluded that the investment return assumptions used by the Plan were at the upper range of investment return assumptions for comparable plans. The 8.25 percent investment return assumption remains at the upper end of investment return assumptions used by other plans. The Plan's December 31, 2015 Investment Report shows that the Plan's investments have earned 5.9 percent over the past 10 years. Both the Plan's actuary, as well as the Plan's Investment Consultant, conducted projections that concluded the Plan's investments have a reasonable likelihood of achieving an investment return of 8.25 percent over a 10 to 20 year period. However, we continue to recommend that the Plan annually review the reasonableness of its investment return assumption, rather than wait for the next experience study.

Key Retirement Plan Information

Plan investment return assumption	8.25%
10-year historical rate of return	5.9%
Plan assets	$1.743 billion
Plan liabilities	$3.267 billion
Funded ratio	53.3%
Employee contribution rate (2016)	10.125%
Employee contribution rate (2017)	11.962%
Employer contribution rate (2016)	14.250%
Employer contribution rate (2017)	17.925%

After the 2014 experience study, the Plan adopted generational mortality tables to account for future mortality improvements. The assumptions used in the January 1, 2015 Valuation were also used in the January 1, 2016 Valuation. However, the assumptions were chosen before final 2014 mortality tables were issued by the Society of Actuaries. We recommend that a new mortality analysis be conducted for the Plan, on a benefits-weighted basis, in time to reflect the results in the assumptions that are adopted and used for next year's valuation.

The Retirement Plan's active participant headcount decreased from the prior year and the ratio of active participants to annuitants continued to decrease. A study sponsored by the National Association of State Retirement Administrators titled the *Public Fund Survey Summary of Findings for FY 2014* states "*When combined with an unfunded liability, however, a low or declining ratio of actives to annuitants can cause fiscal distress for a pension plan sponsor….*" We recommend that the Plan continue to monitor the use of a constant headcount assumption. (pages 4 – 10)

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 is projected to decline below 60 percent prior to 2040, with the CTA paying two-thirds and employees paying one-third of the required contribution.

The funded ratio of the Retirement Plan decreased from 58.2 percent in the January 1, 2015 Valuation to 53.3 percent in the January 1, 2016 Valuation. At January 1, 2016, the Plan's assets totaled $1.743 billion and the actuarial accrued liability was $3.267 billion, according to the Plan's January 1, 2016 Actuarial Valuation. The January 1, 2016 Valuation noted that the primary reason why the funded ratio declined was that the Plan's actual rate of return in 2015 was -0.2 percent, which is substantially lower than the 8.25 percent rate of return actuarial assumption used by the Plan.

Since the funded ratio of the Plan declined below 60 percent in the January 1, 2016 Valuation, 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.*" (40 ILCS 5/22-101(e)(3)) The contribution rates adopted by the Retirement Plan Board for 2017 were increased from the 2016 contribution rates. In 2016, 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. For 2017, the rates were increased so that the employer contribution rate will become 17.925 percent (which is net of the employer debt service credit of 6% of pay) and the employee contribution rate will become 11.962 percent. (pages 10 – 11)

AGENCY REVIEW

A draft of this Review was provided to the Retirement Plan for their review. The Retirement Plan commented that, with respect to the review of assumptions, the Plan has adopted a practice of having the actuary perform an experience review every 5 years. The next review will be performed in time to be used for the January 1, 2019 valuation. The Plan will continue to monitor these assumptions with the annual gain and loss process and make changes as needed.

This report does not constitute an audit as that term is defined in generally accepted government auditing standards.

SIGNED ORIGINAL ON FILE

FRANK J. MAUTINO
Auditor General

FJM:DJB

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