STATE OF ILLINOIS

OFFICE OF THE AUDITOR GENERAL

ANNUAL REVIEW

INFORMATION SUBMITTED BY THE CHICAGO TRANSIT AUTHORITY'S EMPLOYEE RETIREMENT PLAN AND RETIREE HEALTH CARE TRUST

DECEMBER 2008

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

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

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 Annual Review of Information Submitted by the Chicago Transit Authority's Employee Retirement Plan and Retiree Health Care Trust.

The review was conducted pursuant to Public Act 95-708 which amended the Illinois State Auditing Act by adding requirements 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 and the Board of Trustees of the Retiree Health Care Trust.

The report for this review is transmitted in conformance with Sections 5/3-2.3(e) of the Illinois State Auditing Act and Section 22-101B(b)(3)(iv) of the Illinois Pension Code.

WILLIAM G. HOLLAND
Auditor General

Springfield, Illinois
December 2008

REPORT DIGEST

Annual Review

INFORMATION SUBMITTED BY THE CTA'S EMPLOYEE RETIREMENT PLAN AND RETIREE HEALTH CARE TRUST

Released: December 2008

State of Illinois
Office of the Auditor General

WILLIAM G. HOLLAND
AUDITOR GENERAL

To obtain a copy of the report contact:
Office of the Auditor General
Iles Park Plaza
740 East Ash Street
Springfield, IL 62703
(217) 782-6046 or
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SYNOPSIS

Public Act 95-708 requires the Chicago Transit Authority's Employee Retirement Plan and the Retiree Health Care Trust to submit certain information each year 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 the first year of our review.

The Auditing Act required the **Retirement Plan** for CTA Employees to submit the following documents:

- The most recent audit or examination; an annual statement containing information specified in Section 1A-109 of the Illinois Pension Code; and a complete actuarial statement for the prior plan year.
- We reviewed the information submitted by the Retirement Plan and concluded that it met the specified requirements.

The above documents showed that the financial condition of the Retirement Plan declined in calendar year 2007:

- The net assets for both the Retirement Plan and Retiree Health Care Trust were $1.02 billion as of December 31, 2007, down $100 million from December 31, 2006.
- The actuarial value of assets for pension benefits as of December 31, 2007 was $942 million and the actuarial liability was $2.5 billion.
- The funded ratio was 37 percent on December 31, 2007, down from 41 percent on December 31, 2006.
- The Retirement Plan's investments earned a rate of return of 9.8 percent in 2007.

The Auditing Act also required the Auditor General to annually examine a report from the **Retiree Health Care Trust** which shows the projected benefits, contributions, trust income, and required reserves.

- The actuarial present value of projected benefits was $1.45 billion while the actuarial present value of projected contributions and trust income plus assets was $665 million.
- The Trust concluded that the projected benefits **exceeded** the projected contributions.
- The Trust noted that it had only recently been established and had not yet developed the plan required by Public Act 95-708 to cure the funding shortfall.

RETIREMENT PLAN

Public Act 95-708 amended the Illinois State Auditing Act by adding requirements 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 and submit a report to the General Assembly. The State Auditing Act requires the Retirement Plan to submit to the Auditor General by September 30 of each year the following documents:

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 documents submitted by the CTA's Employee Retirement Plan met the requirement in the Illinois State Auditing Act.

The Office of the Auditor General reviewed documents submitted by the Retirement Plan and concluded that 2007 Audited Financial Statements submitted met the requirement for the most recent audit of the Retirement Plan required by Section 5/3-2.3(e)(1) of the Auditing Act. In addition, the Actuarial Valuation as of January 1, 2008 met the requirement for the complete actuarial statement for the prior plan year required by Section 5/3-2.3(e)(3) of the Auditing Act.

Regarding the required *"annual statement containing the information specified in Section 1A-109 of the Illinois Pension Code,"* based upon information subsequently provided by the Retirement Plan, we concluded that the annual statement information required by the Pension Code was provided.

The documents showed that the financial condition of the Retirement Plan continued to decline in calendar year 2007.

- The net assets held in trust for both retirement and retiree health care benefits totaled $1.02 billion as of December 31, 2007, compared to $1.12 billion at December 31, 2006.
- The actuarial value of assets for pension benefits under GASB 25, as of December 31, 2007, was $942 million and the actuarial liability was $2.5 billion.
- This results in a funded ratio for retirement benefits of 37 percent for 2007, which is a decrease from the 41 percent funded ratio for the year end December 31, 2006. The Plan's actuarial valuation projects that the funded ratio will increase to 80 percent in 2009,

The Retirement Plan's funded ratio was 37% in 2007, down from 41% in 2006.

The Retirement Plan expects it to be 80% funded in 2009 with the infusion of $1.1 billion in bond proceeds.

with the infusion of $1.1105 billion in pension obligation bond proceeds.

- The Retirement Plan's audit report notes that the decline in funded ratios has been developing over the past 27 years and has become more pronounced in recent years.

The Retirement Plan's invested assets were $1.0 billion at year-end 2007, a decrease of $98 million over 2006. The Retirement Plan experienced a rate of return of 9.8 percent on its investments in 2007. This rate of return predates the economic downturn in 2008.

Additional Reporting Requirement Beginning in 2009

The Illinois Pension Code (40 ILCS 5/22-101(e)(3)) places an additional reporting requirement on the Auditor General, which becomes effective in 2009. The Code requires that the Retirement Plan, *"By September 15 of each year beginning in 2009 . . . 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 then requires the Auditor General to review the determination and its assumptions to determine whether it meets the requirements established by the Pension Code.

Next year we will report on the funded ratio of the Retirement Plan.

Since the requirement does not become effective until 2009, this report does not make that determination. However, subsequent reports issued by the Auditor General will address this requirement.

RETIREE HEALTH CARE TRUST

Public Act 95-708 also added reporting requirements for the Auditor General regarding the Board of Trustees of the Retiree Health Care Trust. Section 5/3-2.3(f) of the State Auditing Act requires the Auditor General to examine the report from the Board on the annual assessment of the funding levels of the Retiree Health Care Trust, as delineated in Section 22-101B(b)(3)(iii) of the Illinois Pension Code. Section 22-101B(b)(3)(iv) requires the Auditor General to review the report on the information submitted by the Board within 90 days.

The Retiree Health Care Trust submitted a report on October 2, 2008 to the Office of the Auditor General. The report included information required by Section 22-101B(b)(3)(iii) (A)-(D) of the Pension Code:

- Subsection (A): The actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors totaled $1.45 billion;
- Subsection (B): The actuarial present value of projected contributions and trust income plus assets totaled $665 million; and
- Subsection (C): The reserve required by subsection (b)(3)(ii) of the Pension Code was $0 as of January 1, 2008 and $85 million as of January 1, 2009.

Retiree Health Care Trust:
- **Projected benefits: $1.45 billion.**
- **Projected contributions and income plus assets: $665 million.**

Regarding Subsection (D),which requires both an assessment of whether projected benefits exceed or are less than projected contributions and income, as well as a plan to cure any funding shortfall, the Retiree Health Care Trust's report concluded the following:

> . . . the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors **exceeds** the actuarial present value of projected contributions and trust income plus assets in excess of the reserve required by subsection (b)(3)(ii).
>
> At this point in time, the **Board of Trustees has not yet developed** the details of the plans of benefits to be provided beginning next year or the initial contribution levels for retirees, dependents and survivors for each of those benefit plan options. **Therefore, it is not possible at this time to provide additional specifics concerning a plan to cure the funding shortfall.** [emphasis added]

Since the Retiree Health Care Trustees have not developed a plan to cure the funding shortfall, the Auditor General will be unable to review the plan as required by Section 22-101B(b)(3)(iv).

Since the Board of Trustees has not developed the required plan to cure the funding shortfall, the Auditor General is unable to review the plan as required by Section 22-101B(b)(3)(iv). The Board indicates that it is presently working on developing a plan to address the funding shortfall.

The Retiree Health Care Trust notes in its report submitted to the Auditor General, that it was *". . . unclear whether the Pension Code contemplates the submission of a report this year because the Health Care Trust was only just recently established and does not, and is not yet authorized to, begin providing benefits until next year."*

As part of its planned issuance of bonds to help fund the Retirement Plan and Retiree Health Care Trust, in May 2008 the Trust submitted to the Office of the Auditor General an Actuarial Report as of January 1, 2008 which explored various funding and benefit scenarios for the Trust. The development of the scenarios indicates that the Retiree Health Care Trust has begun undertaking the analysis necessary to develop a plan to cure the shortfall.

A plan which consistently has projected benefits in excess of projected contributions is not sustainable. Although it may be viable in the short run, eventually the required benefit payments will dwarf the annual contributions.

Consequences of Ongoing Shortfall

A plan which consistently has projected benefits in excess of projected contributions is not sustainable. Although it may be viable in the short run, eventually the required benefit payments will dwarf the annual contributions and plan costs will increase. The systematic underfunding of the CTA Retirement Plan, and its resultant financial condition, serves as an excellent example of the need to adopt a plan to adequately fund the Retiree Health Care Trust.

WILLIAM G. HOLLAND
Auditor General

WGH:AD
December 2008

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Public Act 95-708 amended the Illinois State Auditing Act by adding requirements 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 and the Board of Trustees of the Retiree Health Care Trust.

SUBMISSION BY THE BOARD OF TRUSTEES OF THE RETIREMENT PLAN FOR CHICAGO TRANSIT AUTHORITY EMPLOYEES

The Illinois State Auditing Act (30 ILCS 5/3-2.3(e)) requires the Auditor General to annually review documents submitted by the Board of Trustees of the Retirement Plan for Chicago Transit Authority Employees (Retirement Plan Board) and submit a report of the analysis thereof to the General Assembly. The Auditing Act requires the Retirement Plan Board to annually submit, no later than September 30th of each year, to the Auditor General, the following documents:

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.

On September 30, 2008, the Retirement Plan Board submitted three documents to the Auditor General which they stated were responsive to the requirements of Section 5/3-2.3 of the Auditing Act. The documents submitted by the Retirement Plan Board were as follows:

- The Audited Financial Statements for the Year Ended December 31, 2007;
- The Investment Performance Report for the Plan for the Year Ended December 31, 2007; and
- The Actuarial Valuation for the Plan as of January 1, 2008.

The Office of the Auditor General reviewed the submitted documents and concluded that the Plan's submission of the December 31, 2007 year end Audited Financial Statements met the requirement for the most recent audit of the Plan required by Section 5/3-2.3(e)(1) of the Auditing Act. In addition, the Actuarial Valuation as of January 1, 2008 met the requirement for the complete actuarial statement for the prior plan year required by Section 5/3-2.3(e)(3) of the Auditing Act.

However, regarding compliance with Section 5/3-2.3(e)(2) of the Auditing Act, which requires "*an annual statement containing the information specified in Section 1A-109 of the Illinois*

Pension Code," it was not readily apparent that the information submitted by the Plan complied with this requirement. Rather than submitting an "annual statement" that contained the information required by Section 1A-109 of the Illinois Pension Code (40 ILCS 5/1A-109), the Plan submitted the three documents cited above (the latest audit, investment report, and actuarial valuation) with no reference as to where in the reports the information required by the Pension Code was contained.

Section 1A-109 of the Illinois Pension Code requires that public pension funds file annual statements with the Department of Financial and Professional Regulation's Public Pension Division. The Pension Code (40 ILCS 5/1A-102) exempts *"transit authorities or agencies operating within or within and without cities with a population over 3,000,000"* from the definition of *"governmental unit."* However, requirements added by Public Act 95-708 require the CTA Retirement Plan to now file such a statement annually with the Office of the Auditor General. The annual statement is required to contain the following information:

(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.

On October 29, 2008 the Auditor General's Office requested that the Retirement Plan identify specifically where in the three documents submitted each of the required eight items were addressed. The Plan's Executive Director stated he would either identify where the eight points were addressed in the three documents submitted, or if they were not addressed, he would submit additional documents addressing those items. The Auditor General's Office followed up with the Plan on three occasions inquiring of the status of the information requested.

On November 17 and 20, 2008, the Retirement Plan provided specific cites for where information in the three documents were responsive to the information required by 1A-109 of the Illinois Pension Code. We reviewed the cited information in the three reports and concluded that the information required by the Pension Code was provided.

The documents submitted by the Retirement Board showed that the financial condition of the Retirement Plan continued to decline in calendar year 2007.

- The net assets held in trust for both retirement and retiree health care benefits totaled $1.02 billion as of December 31, 2007, compared to $1.12 billion at December 31, 2006.

- The actuarial value of assets for pension benefits under GASB 25, as of December 31, 2007, was $942 million and the actuarial liability was $2.5 billion.
- This results in a funded ratio for retirement benefits of 37.2 percent for 2007, which is a decrease from the 40.85 percent funded ratio for the year end December 31, 2006. The Plan's actuarial valuation projects that the funded ratio will increase to 80 percent in 2009, with the infusion of $1.1105 billion in pension obligation bond proceeds.
- The Plan's audit report notes that the decline in funded ratios has been developing over the past 27 years and has become more pronounced in recent years. It notes the steady decline in the Plan's funded ratio from 1981 to the present included insufficient employer and employee contributions, several early retirement programs, increased benefits, and significant increases in the cost of health care.

The Plan's assets held for investment were $1.0 billion at year-end 2007, a decrease of $97.6 million over 2006. The Plan experienced a rate of return of 9.8 percent on its investments in 2007. This rate of return predates the economic downturn experienced in 2008, where significant declines were seen in many classes of investment assets. The Plan's allocation of investment assets in 2007 was as follows: 46 percent in domestic equity; 5 percent in international equity; 10 percent in real estate; 6 percent in private equity; 6 percent in hedge funds; and 27 percent in fixed income.

Additional Reporting Requirement Beginning in 2009

The Illinois Pension Code (40 ILCS 5/22-101(e)(3)) places an additional reporting requirement on the Auditor General, which becomes effective in 2009. The Code requires that the Retirement Plan, *"By September 15 of each year beginning in 2009 . . . 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 then requires the Auditor General to review the determination and the assumptions on which it is based to determine whether it meets the requirements established by the Pension Code. Since the requirement does not become effective until 2009, this report does not make that determination. However, subsequent reports issued by the Auditor General will address this requirement.

SUBMISSION BY THE BOARD OF TRUSTEES OF THE RETIREE HEALTH CARE TRUST

Public Act 95-708 also added reporting requirements for the Auditor General regarding the Board of Trustees of the Retiree Health Care Trust. Section 5/3-2.3(f) of the Auditing Act requires the Auditor General to annually examine the report from the Board on the annual assessment of the funding levels of the Retiree Health Care Trust, as delineated in Section 22-101B(b)(3)(iii) of the Illinois Pension Code.

Section 22-101B(b)(3)(iii) requires the following:

(iii) The Board of Trustees shall make an annual assessment of the funding levels of the Retiree Health Care Trust and shall submit a report to the Auditor General at least 90 days prior to the end of the fiscal year. The report shall provide the following:

(A) the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors;

(B) the actuarial present value of projected contributions and trust income plus assets;

(C) the reserve required by subsection (b)(3)(ii); and

(D) an assessment of whether the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors exceeds or is less than the actuarial present value of projected contributions and trust income plus assets in excess of the reserve required by subsection (b)(3)(ii).

If the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors exceeds the actuarial present value of projected contributions and trust income plus assets in excess of the reserve required by subsection (b)(3)(ii), then the report shall provide a plan of increases in employee, retiree, dependent, or survivor contribution levels, decreases in benefit levels, or both, which is projected to cure the shortfall over a period of not more than 10 years. . . .

Section 22-101B(b)(3)(iv) requires the Auditor General to review the information submitted by the Board and issue a determination within 90 days of receiving the report and plan. Specifically, if the Trust's report and plan projects a shortfall and the Auditor General determines that the assumptions stated in the report are not unreasonable in the aggregate and that the plan of increases in employee, retiree, dependent, or survivor contribution levels, decreases in benefit levels, or both, is reasonably projected to cure the shortfall over a period of not more than 10 years, then the Board of Trustees shall implement the plan. However, if the Auditor General determines that the assumptions stated in the report are unreasonable in the aggregate, or that the plan of increases in employee, retiree, dependent, or survivor contribution levels, decreases in benefit levels, or both, is not reasonably projected to cure the shortfall over a period of not more than 10 years, then the Board of Trustees shall not implement the plan, the Auditor General shall explain the basis for such determination to the Board of Trustees, and the Auditor General may make recommendations as to an alternative report and plan. A similar process is to be followed if a surplus is projected.

The Chicago Transit Authority Retiree Health Care Trust submitted a report on October 2, 2008 to the Office of the Auditor General. The report included information required by Section 22-101B(b)(3)(iii) (A)-(D) of the Pension Code. Specifically, the report stated the following:

- Subsection (A): The actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors totaled $1.45 billion.

- Subsection (B): The actuarial present value of projected contributions and trust income plus assets totaled $665 million; and
- Subsection (C): The reserve required by subsection (b)(3)(ii) of the Pension Code was $0 as of January 1, 2008 and $85 million as of January 1, 2009.

Regarding Subsection (D), the Retiree Health Care Trust's report concluded that *"the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors* ***exceeds*** *the actuarial present value of projected contributions and trust income plus assets in excess of the reserve required by subsection (b)(3)(ii)."* [emphasis added] The report concludes that *"At this point in time, the* ***Board of Trustees has not yet developed*** *the details of the plans of benefits to be provided beginning next year or the initial contribution levels for retirees, dependents and survivors for each of those benefit plan options.* ***Therefore, it is not possible at this time to provide additional specifics concerning a plan to cure the funding shortfall.****"* *[emphasis added]*

Since the Board has not developed a plan to cure the funding shortfall, the Auditor General will be unable to review the plan as required by Section 22-101B(b)(3)(iv). The Board indicates that it is presently working on developing a plan to address the funding shortfall.

The Retiree Health Care Trust notes in its report submitted to the Auditor General, that it was *"unclear whether the Pension Code contemplates the submission of a report this year because the Health Care Trust was only just recently established and does not, and is not yet authorized to, begin providing benefits until next year."* Since it was just recently established, it is understandable that additional time may be needed to develop a plan to cure the funding shortfall of the Retiree Health Care Trust.

As part of its planned issuance of bonds to help fund the Retirement Plan and Retiree Health Care Trust, in May 2008 the Trust submitted to the Office of the Auditor General an Actuarial Report for the Retiree Health Care Trust, as of January 1, 2008. The Actuarial Report explored various funding and benefit scenarios for the Trust. These included:

(A) Scenario A included the effects of Section 22-101B(b)(4) of the Illinois Pension Code (40 ILCS 5/) which requires a minimum of age 55 with 10 years of service for non-disability retirees, and includes employee contributions equal to 3 percent of compensation. Scenario A also included the provision that the plan cannot provide more than 90 percent coverage for in-network services or 70 percent coverage for out-of-network services after deductible. Under Scenario A, the Trust's assets would be depleted in 11 years.

(B) Scenario B included the provisions of Scenario A, and increased retiree contributions to 44 percent of the prior year's benefits. The scenario assumed that, as a result of the new contribution structure, approximately 20 percent of retirees will decline coverage. Under Scenario B, the Trust's assets would be depleted in 21 years.

(C) Scenario C included the provisions of Scenario B, but with further increases in employee contributions of 9 percent of compensation. Scenario C noted that this level of active contributions would immediately cure the projected shortfall.

(D) Scenario D included the provisions of Scenario B, but incorporated a 29 percent decrease in benefit levels. Scenario D concluded that reducing benefits by this amount would immediately cure the projected shortfall.

The development of the four scenarios indicates that the Retiree Health Care Trust has begun undertaking the analysis necessary to develop a plan to cure the shortfall.

Consequences of Ongoing Shortfall

A plan which consistently has projected benefits in excess of projected contributions is not sustainable. Although it may be viable in the short run, eventually the required benefit payments will dwarf the annual contributions and plan costs will increase. The systematic underfunding of the CTA Retirement Plan, and its resultant financial condition, serves as an excellent example of the need to adopt a plan to adequately fund the Retiree Health Care Trust.

The Government Finance Officers Association (GFOA) has a Committee on Retirement and Benefits Administration which has actively analyzed best practices for governmental entities such as the CTA. In particular, the GFOA's Executive Board approved a recommended practice for Prefunding OPEB Obligations. OPEB Obligations are promises made under plans of Other (than pension) Post Employment Benefits (OPEB), such as those provided under the CTA Retiree Health Care Trust.

The recommended practice maintains:

> . . . that the financing of [OPEB] benefits as they are earned (i.e., prefunding v. pay-as-you-go funding) offers significant advantages from the vantage point of equity and sustainability. Just as important, the earnings on the resources thus accumulated will lower the amount that ultimately must be budgeted by the employer.
>
> GFOA strongly recommends that OPEB involving explicit benefit payments be prefunded on an actuarial basis, as discussed in GFOA's Recommended Practice, Ensuring the Sustainability of Other Postemployment Benefits.
>
> … Prefunding provides equity among generations of taxpayers, levels annual retiree healthcare costs and helps ensure sustainability of the benefit.

The GFOA Recommended Practice on Ensuring the Sustainability of OPEB further recommends that governments develop *". . . principles and priorities to guide decision-making for OPEB that considers benefit design, funding approaches, and the needs of all stakeholders."* This appears to be exactly what was contemplated by the Illinois Pension Code requirement (40 ILCS 22-101B(b)(3)(iii) (A)-(D)) that CTA develop a plan to increase contributions or reduce benefits in cases such as this where the plan is projected to be unsustainable.

The Retiree Health Care Trust's Actuarial Report as of January 1, 2008 analyzed several scenarios to remedy the shortfall. In order to comply with the Illinois Pension Code and enhance the likelihood of sustainability, the Board of Trustees would need to adopt a plan to fund the Trust.

GASB 43 and 45 require public entities to complete a valuation of their OPEB liabilities and disclose the shortfall, if any, as a liability in their accounting statements. Credit rating agencies have stated that unfunded liabilities, especially those with no corresponding plan in place to reduce the liability, are likely to have a negative impact on the entity's ability to issue bonds. Such credit rating agencies consider the amount of unfunded OPEB liability when determining the rating issued in relation to credit-worthiness.

Given all the above factors, it is important that such a plan be set forth shortly in order to cure the financial shortfall most effectively.

SCOPE OF ANNUAL REVIEW

Pursuant to the Illinois State Auditing Act, the Office of the Auditor General conducted an annual review of information submitted by the Board of Trustees of the Retirement Plan for Chicago Transit Authority Employees and the Board of Trustees of the Retiree Health Care Trust. This report does not constitute an audit as that term is defined in generally accepted government auditing standards. Aon Consulting assisted the Office of the Auditor General in this annual review. The Retirement Plan and Retiree Health Care Trust were provided a draft of this report for their review.

APPENDIX A

Statutory Authority

ILLINOIS STATE AUDITING ACT

30 ILCS 5/3-2.3(e)

(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.

(g) In fulfilling the duties under Sections 3-2.3(e) and (f) the Auditor General may request additional information and support pertaining to the data and conclusions contained in the submitted documents and the Authority, the Board of Trustees of the Retirement Plan and the Board of Trustees of the Retiree Health Care Trust shall cooperate with the Auditor General and provide additional information as requested in a timely manner. The Auditor General's review shall not be in the nature of a post-audit or examination and shall not lead to the issuance of an opinion as that term is defined in generally accepted government auditing standards. Upon request of the Auditor General, the Commission on Government Forecasting and Accountability and the Public Pension Division of the Illinois Department of Financial and Professional Regulation shall cooperate with and assist the Auditor General in the conduct of his review.

(h) The Auditor General shall submit a bill to the Authority for costs associated with the examinations and reports specified in subsections (b) and (c) of this Section 3-2.3, which the Authority shall reimburse in a timely manner. The costs associated with the examinations and reports which are reimbursed by the Authority shall constitute a cost of issuance of the bonds or notes under Section 12c(b)(1) and (2) of the Metropolitan Transit Authority Act. The amount received shall be deposited into the fund or funds from which such costs were paid by the Auditor General. The Auditor General shall submit a bill to the Retirement Plan for Chicago Transit Authority Employees for costs associated with the examinations and reports specified in subsection (e) of this Section, which the Retirement Plan for Chicago Transit Authority Employees shall reimburse in a timely manner. The amount received shall be deposited into the fund or funds from which such costs were paid by the Auditor General. The Auditor General shall submit a bill to the Retiree Health Care Trust for costs associated with the determination specified in subsection (f) of this Section, which the Retiree Health Care Trust shall reimburse in a timely manner. The amount received shall be deposited into the fund or funds from which such costs were paid by the Auditor General.

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

ILLINOIS PENSION CODE

40 ILCS 5/1A-109

Sec. 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.

A pension fund that fails to file its annual statement within the time prescribed under this Section is subject to the penalty provisions of Section 1A-113. (Source: P.A. 90-507, eff. 8-22-97.)

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(a) The Chicago Transit Authority (hereinafter referred to in this Section as the "Authority") shall take all actions lawfully available to it to separate the funding of health care benefits for retirees and their dependents and survivors from the funding for its retirement system. The Authority shall endeavor to achieve this separation as soon as possible, and in any event no later than July 1, 2009.

(b) Effective 90 days after the effective date of this amendatory Act of the 95th General Assembly, a Retiree Health Care Trust is established for the purpose of providing health care benefits to eligible retirees and their dependents and survivors in accordance with the terms and conditions set forth in this Section 22-101B. The Retiree Health Care Trust shall be solely responsible for providing health care benefits to eligible retirees and their dependents and survivors by no later than July 1, 2009, but no earlier than January 1, 2009.

(1) The Board of Trustees shall consist of 7 members appointed as follows: (i) 3 trustees shall be appointed by the Chicago Transit Board; (ii) one trustee shall be appointed by an organization representing the highest number of Chicago Transit Authority participants; (iii) one trustee shall be appointed by an organization representing the second-highest number of Chicago Transit Authority participants; (iv) one trustee shall be appointed by the recognized coalition representatives of participants who are not represented by an organization with the highest or second-highest number of Chicago Transit Authority participants; and (v) one trustee shall be selected by the Regional Transportation Authority Board of Directors, and the trustee shall be a professional fiduciary who has experience in the area of collectively bargained retiree health plans. Trustees shall serve until a successor has been appointed and qualified, or until resignation, death, incapacity, or disqualification.

Any person appointed as a trustee of the board shall qualify by taking an oath of office that he or she will diligently and honestly administer the affairs of the system, and will not knowingly violate or willfully permit the violation of any of the provisions of law applicable to the Plan, including Sections 1-109, 1-109.1, 1-109.2, 1-110, 1-111, 1-114, and 1-115 of Article 1 of the Illinois Pension Code.

Each trustee shall cast individual votes, and a majority vote shall be final and binding upon all interested parties, provided that the Board of Trustees may require a supermajority vote with respect to the investment of the assets of the Retiree Health Care Trust, and may set forth that requirement in the trust agreement or by-laws of the Board of Trustees. Each trustee shall have the rights, privileges, authority and obligations as are usual and customary for such fiduciaries.

(2) The Board of Trustees shall establish and administer a health care benefit program for eligible retirees and their dependents and survivors. The health care benefit program for eligible retirees and their dependents and survivors shall not contain any plan which provides for more than 90% coverage for in-network services or 70% coverage for out-of-network services after any deductible has been paid.

(3) The Retiree Health Care Trust shall be administered by the Board of Trustees according to the following requirements:

(i) The Board of Trustees may cause amounts on deposit in the Retiree Health Care Trust to be invested in those investments that are permitted investments for the investment of moneys held under any one or more of the pension or retirement systems of the State, any unit of local government or school district, or any agency or instrumentality thereof. The Board, by a vote of at least two-thirds of the trustees, may transfer investment management to the Illinois State Board of Investment, which is hereby authorized to manage these investments when so requested by the Board of Trustees.

(ii) The Board of Trustees shall establish and maintain an appropriate funding reserve level which shall not be less than the amount of incurred and unreported claims plus 12 months of expected claims and administrative expenses.

(iii) The Board of Trustees shall make an annual assessment of the funding levels of the Retiree Health Care Trust and shall submit a report to the Auditor General at least 90 days prior to the end of the fiscal year. The report shall provide the following:

(A) the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors;

(B) the actuarial present value of projected contributions and trust income plus assets;

(C) the reserve required by subsection (b)(3)(ii); and

(D) an assessment of whether the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors exceeds or is less than the actuarial present value of projected contributions and trust income plus assets in excess of the reserve required by subsection (b)(3)(ii).

If the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors exceeds the actuarial present value of projected contributions and trust income plus assets in excess of the reserve required by subsection (b)(3)(ii), then the report shall provide a plan of increases in employee, retiree, dependent, or survivor contribution levels, decreases in benefit levels, or both, which is projected to cure the shortfall over a period of not more than 10 years. If the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors is less than the actuarial present value of projected contributions and trust income plus assets in excess of the reserve required by subsection (b)(3)(ii), then the report may provide a plan of decreases in employee, retiree, dependent, or survivor contribution levels, increases in benefit levels, or both, to the extent of the surplus.

(iv) The Auditor General shall review the report and plan provided in subsection (b)(3)(iii) and issue a determination within 90 days after receiving the report and plan, with a copy of such determination provided to the General Assembly and the Regional Transportation Authority, as follows:

(A) In the event of a projected shortfall, if the Auditor General determines that the assumptions stated in the report are not unreasonable in the aggregate and that the plan of increases in employee, retiree, dependent, or survivor contribution levels, decreases in benefit levels, or both, is reasonably projected to cure the shortfall over a period of not more than 10 years, then the Board of Trustees shall implement the plan. If the Auditor General determines that the assumptions stated in the report are unreasonable in the aggregate, or that the plan of increases in employee, retiree, dependent, or survivor contribution levels, decreases in benefit levels, or both, is not reasonably projected to cure the shortfall over a period of not more than 10 years, then the Board of Trustees shall not implement the plan, the

Auditor General shall explain the basis for such determination to the Board of Trustees, and the Auditor General may make recommendations as to an alternative report and plan.

(B) In the event of a projected surplus, if the Auditor General determines that the assumptions stated in the report are not unreasonable in the aggregate and that the plan of decreases in employee, retiree, dependent, or survivor contribution levels, increases in benefit levels, or both, is not unreasonable in the aggregate, then the Board of Trustees shall implement the plan. If the Auditor General determines that the assumptions stated in the report are unreasonable in the aggregate, or that the plan of decreases in employee, retiree, dependent, or survivor contribution levels, increases in benefit levels, or both, is unreasonable in the aggregate, then the Board of Trustees shall not implement the plan, the Auditor General shall explain the basis for such determination to the Board of Trustees, and the Auditor General may make recommendations as to an alternative report and plan.

(C) The Board of Trustees shall submit an alternative report and plan within 45 days after receiving a rejection determination by the Auditor General. A determination by the Auditor General on any alternative report and plan submitted by the Board of Trustees shall be made within 90 days after receiving the alternative report and plan, and shall be accepted or rejected according to the requirements of this subsection (b)(3)(iv). The Board of Trustees shall continue to submit alternative reports and plans to the Auditor General, as necessary, until a favorable determination is made by the Auditor General.

(4) For any retiree who first retires effective on or after January 18, 2008, to be eligible for retiree health care benefits upon retirement, the retiree must be at least 55 years of age, retire with 10 or more years of continuous service and satisfy the preconditions established by Public Act 95-708 in addition to any rules or regulations promulgated by the Board of Trustees. Notwithstanding the foregoing, any retiree who retired prior to the effective date of this amendatory Act with 25 years or more of continuous service, or who retires within 90 days after the effective date of this amendatory Act or by January 1, 2009, whichever is later, with 25 years or more of continuous service, shall be eligible for retiree health care benefits upon retirement. This paragraph (4) shall not apply to a disability allowance.

(5) Effective January 1, 2009, the aggregate amount of retiree, dependent and survivor contributions to the cost of their health care benefits shall not exceed more than 45% of the total cost of such benefits. The Board of Trustees shall have the discretion to provide different contribution levels for retirees, dependents and survivors based on their years of service, level of coverage or Medicare eligibility, provided that the total contribution from all retirees, dependents, and survivors shall be not more than 45% of the total cost of such benefits. The term "total cost of such benefits" for purposes of this subsection shall be the total amount expended by the retiree health benefit program in the prior plan year, as calculated and certified in writing by the Retiree Health Care Trust's enrolled actuary to be appointed and paid for by the Board of Trustees.

(6) Effective January 18, 2008, all employees of the Authority shall contribute to the Retiree Health Care Trust in an amount not less than 3% of compensation.

(7) No earlier than January 1, 2009 and no later than July 1, 2009 as the Retiree Health Care Trust becomes solely responsible for providing health care benefits to eligible retirees and their dependents and survivors in accordance with subsection (b) of this Section 22-101B, the Authority shall not have any obligation to provide health care to current or future retirees and their dependents or survivors. Employees, retirees, dependents, and survivors who are required to make contributions to the Retiree Health Care Trust shall make contributions at the level set by the Board of Trustees pursuant to the requirements of this Section 22-101B.

(Source: P.A. 95-708, eff. 1-18-08; 95-906, eff. 8-26-08.)