REPORT DIGEST

Annual Review

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

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State of Illinois
Office of the Auditor General

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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 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.

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,

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.

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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