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STATE OF ILLINOIS

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OFFICE OF THE AUDITOR GENERAL

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2015 ANNUAL REVIEW

INFORMATION SUBMITTED BY THE  
CHICAGO TRANSIT AUTHORITY'S  
RETIREE HEALTH CARE TRUST

DECEMBER 2015

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WILLIAM G. HOLLAND

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AUDITOR GENERAL

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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 2015 Annual Review of Information Submitted by the Chicago Transit Authority Retiree Health Care Trust.

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 Chicago Transit Authority Retiree Health Care Trust.

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

A handwritten signature in blue ink, appearing to read "William G. Holland". The signature is stylized and fluid.

WILLIAM G. HOLLAND  
Auditor General

Springfield, Illinois  
December 2015





STATE OF ILLINOIS  
**OFFICE OF THE  
AUDITOR GENERAL**

William G. Holland, Auditor General

**SUMMARY REPORT DIGEST**

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**REVIEW OF INFORMATION SUBMITTED BY THE  
CHICAGO TRANSIT AUTHORITY'S RETIREE HEALTH CARE TRUST**

**2015 ANNUAL REVIEW**

**Release Date: December 2015**

**SYNOPSIS**

The Board of Trustees of the Chicago Transit Authority Retiree Health Care Trust is required by the Illinois Pension Code to submit a report to the Office of the Auditor General (OAG). The report is intended to annually assess the funding level of the Retiree Health Care Trust.

The Illinois State Auditing Act (Section 5/3-2.3(f)) requires the OAG to examine the information on the funding level of the Retiree Health Care Trust submitted pursuant to Section 22-101B(b)(3)(iii) of the Illinois Pension Code.

The OAG is required to review the Retiree Health Care Trust's assumptions to ensure they are not unreasonable in the aggregate. This report does not constitute an audit as that term is defined in generally accepted government auditing standards.

- The Retiree Health Care Trust submitted its Actuarial Valuation Report as of January 1, 2015 to the Office of the Auditor General on October 1, 2015.
- The Report concluded that the actuarial present value of projected contributions, trust income, and assets, in excess of the statutory reserve, exceeded the actuarial present value of the projected benefits. Consequently, no change in benefits or contributions was required.
- We examined the assumptions in the Retiree Health Care Trust's Actuarial Valuation Report and found that they were not unreasonable in the aggregate.



**ANNUAL REVIEW**  
**RESULTS AND CONCLUSIONS**

**STATUTORY REQUIREMENTS**

The Illinois State Auditing Act (30 ILCS 5/3-2.3(f)) requires the Auditor General to annually examine the information on the funding level of the Retiree Health Care Trust (RHCT) submitted pursuant to Section 22-101B(b)(3)(iii) of the Illinois Pension Code. The Pension Code requires the Retiree Health Care Trust to prepare a report that meets the requirements delineated in the Code and to submit it to the Auditor General at least 90 days prior to the end of its fiscal year.

The Pension Code (Section 22-101B(b)(3)(iv)) provides the OAG 90 days to review the information submitted by the RHCT. If the RHCT projects a funding shortfall, it shall provide a plan which may (1) increase contributions by employees, retirees, dependents, or survivors, or (2) decrease benefits, or (3) make other plan changes, or (4) any combination thereof to cure the shortfall within 10 years. If the RHCT projects a surplus, it may decrease contributions, increase benefits, or make other plan changes, to the extent of the surplus.

If the OAG review determines the RHCT's assumptions are not unreasonable in the aggregate, the Trust shall implement the plan. Otherwise, the OAG shall explain the basis for its determination to the RHCT and may recommend an alternative plan.

This report does not constitute an audit as that term is defined in generally accepted government auditing standards. The scope of the OAG's review, established by the Pension Code, focused on whether the actuarial assumptions used in the RHCT report were not unreasonable in the aggregate.

**REPORT DETERMINATION**

**The RHCT's Actuarial Valuation Report concluded that the actuarial present value of projected contributions and trust income plus assets in excess of the statutory reserve exceeded the actuarial present value of the projected benefits.**

The Board of Trustees of the Chicago Transit Authority RHCT submitted its Actuarial Valuation Report as of January 1, 2015 to the Office of the Auditor General on October 1, 2015. The Actuarial Valuation Report included information required by the Pension Code. As shown in Digest Exhibit 1, the Actuarial Valuation Report concluded that the actuarial present value of projected contributions and trust income plus assets in excess of the statutory reserve exceeded the actuarial present value of the projected benefits:

- The net actuarial present value of projected benefits was \$803,808,862.
- The actuarial present value of projected active contributions, trust income, and assets was \$873,383,638

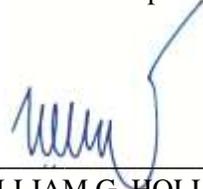
(after subtracting \$32,929,853 for the required statutory reserve).

- Consequently, projected income and assets exceeded projected benefits by 8.7 percent, and as such, no reduction in benefits or increase in contributions was necessary.

Digest Exhibit 1 RETIREE HEALTH CARE TRUST ANNUAL ASSESSMENT January 1, 2015 RHCT Actuarial Valuation Report			
ACTUARIAL PRESENT VALUE OF PROJECTED BENEFITS		ACTUARIAL PRESENT VALUE OF PROJECTED INCOME AND ASSETS	
Actuarial present value of projected benefits prior to reduction for retiree contributions	\$1,300,856,464	Actuarial present value of projected active contributions and trust income plus assets	\$906,313,491
<u>Less:</u> Projected current and future retiree contributions	(\$497,047,602)	<u>Less:</u> Statutory Reserve <sup>1</sup>	(\$32,929,853) <sup>1</sup>
Net actuarial present value of projected benefits	\$803,808,862	Actuarial present value of projected income and assets, net of statutory reserve	\$873,383,638
<b>Projected income and assets exceed projected benefits by 8.7%</b>			
Note: <sup>1</sup> The Statutory Reserve is net of retiree contributions. Source: Retiree Health Care Trust Actuarial Valuation Report as of January 1, 2015.			

The assumptions used in the RHCT’s Actuarial Valuation Report were not unreasonable in the aggregate.

With the assistance of our consulting actuary, Aon Hewitt, we examined the RHCT’s assumptions in the Actuarial Valuation Report. Overall, these assumptions were not unreasonable in the aggregate. Pages 4 – 8 of our 2015 Annual Review contain observations on the specific assumptions used in the Actuarial Valuation Report.



WILLIAM G. HOLLAND  
Auditor General

WGH:JFS

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

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# Information Submitted by the CTA Retiree Health Care Trust

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The Board of Trustees of the Chicago Transit Authority Retiree Health Care Trust is required by the Illinois Pension Code to submit a report to the Office of the Auditor General (OAG) each year. The report is intended to annually assess the funding level of the Retiree Health Care Trust.

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## STATUTORY REQUIREMENTS

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The Illinois State Auditing Act (30 ILCS 5/3-2.3(f)) requires the Auditor General to annually examine the information on the funding level of the Retiree Health Care Trust submitted pursuant to Section 22-101B(b)(3)(iii) of the Illinois Pension Code. The Pension Code requires the Retiree Health Care Trust to prepare a report that meets the requirements delineated in the Code (see inset) and to submit it to the Auditor General at least 90 days prior to the end of its fiscal year.

The Pension Code (Section 5/22-101B(b)(3)(iv)) provides the OAG 90 days to review the information submitted by the Retiree Health Care Trust. If the Retiree Health Care Trust projects a funding shortfall, it **shall** provide a plan which may (1) increase contributions by employees, retirees, dependents, or survivors, or (2) decrease benefits, or (3) make other plan changes, or (4) any combination thereof to cure the shortfall within 10 years. If the Retiree Health Care Trust projects a surplus, it **may** decrease contributions, increase benefits, or make other plan changes, to the extent of the surplus.

If the OAG review determines the Retiree Health Care Trust's assumptions are *not unreasonable in the aggregate*, the Trust shall implement the plan. Otherwise, the OAG shall explain the basis for its determination to the Retiree Health Care Trust and may recommend an alternative plan.

ILLINOIS PENSION CODE REQUIREMENTS
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| (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:<br>(A) the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors;<br>(B) the actuarial present value of projected contributions and trust income plus assets;<br>(C) the reserve required by subsection (b)(3)(ii); and<br>(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). |
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Source: 40 ILCS 5/22-101B(b)(3)(iii).
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**REPORT DETERMINATION**

The Board of Trustees of the Chicago Transit Authority Retiree Health Care Trust submitted its Actuarial Valuation as of January 1, 2015 to the Office of the Auditor General on October 1, 2015. The Report included information required by the Pension Code. As shown in Exhibit 1, the Report concluded that the actuarial present value of **projected contributions** and trust income plus assets in excess of the statutory reserve **exceeded** the actuarial present value of the **projected benefits**:

- The net actuarial present value of projected benefits was \$803,808,862.
- The actuarial present value of projected active contributions, trust income, and assets was \$873,383,638 (after subtracting \$32,929,853 for the required statutory reserve).
- Consequently, projected income and assets exceeded projected benefits by 8.7 percent, and as such, no reduction in benefits or increase in contributions was necessary.

Exhibit 1 RETIREE HEALTH CARE TRUST ANNUAL ASSESSMENT OF ADEQUACY OF TRUST FUNDING January 1, 2015 RHCT Actuarial Valuation Report			
ACTUARIAL PRESENT VALUE OF PROJECTED BENEFITS		ACTUARIAL PRESENT VALUE OF PROJECTED INCOME AND ASSETS	
Actuarial present value of projected benefits prior to reduction for retiree contributions	\$1,300,856,464	Actuarial present value of projected active contributions and trust income plus assets	\$906,313,491
Less: Projected current and future retiree contributions	(\$497,047,602)	Less: Statutory Reserve <sup>1</sup>	(\$32,929,853) <sup>1</sup>
Net actuarial present value of projected benefits	\$803,808,862	Actuarial present value of projected income and assets, net of statutory reserve	\$873,383,638
<b>Projected income and assets exceed projected benefits by 8.7%</b>			
Note: <sup>1</sup> The Statutory Reserve is net of retiree contributions. Source: Retiree Health Care Trust Actuarial Valuation report as of January 1, 2015.			

With the assistance of our consulting actuary, Aon Hewitt, we examined the Retiree Health Care Trust’s Actuarial Valuation and concluded that:

- The Board of Trustees of the Retiree Health Care Trust has made an assessment of the funding levels of the Retiree Health Care Trust which concluded that the actuarial present value of projected benefits expected to be paid to current and

future retirees and their dependents and their survivors are less than the actuarial present value of projected contributions and Trust income plus assets in excess of the reserve required by Section 22-101B(b)(3)(ii) of the Illinois Pension Code, and

- The assumptions stated in the Actuarial Report submitted pursuant to Section 22-101B(b)(3)(iii) of the Pension Code are not unreasonable in the aggregate.

### Calculation of the Statutory Reserve

The Pension Code requires the Retiree Health Care Trust to establish “*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*” (40 ILCS 5/22-101B(b)(3)(ii)) [emphasis added]. The Actuarial Report submitted by the Trust contains a calculation of the statutory reserve. While the calculation includes \$49.3 million for “*12 months of expected claims and administrative expenses,*” and \$1.2 million for “*incurred and unreported claims,*” for a claims expense total of \$50.5 million, it subtracts \$17.6 million from the claims expense for “*12 months of expected retiree and dependent contributions.*” The netting or subtraction of expected contributions from the expected claims and administrative expenses is not specifically delineated in the Pension Code.

The statutory reserve is one of the figures used in the annual assessment of the Trust funding level required by Section 22-101B(b)(3)(iii) of the Pension Code. A change in the statutory reserve figure, therefore, impacts the calculation as to whether the Trust is adequately funded. As shown in Exhibit 1, when the statutory reserve is calculated by netting expected retiree contributions from expected claims (benefit payments), the actuarial present value of projected income and assets exceeds the actuarial present value of projected benefits by 8.7 percent. However, the statutory reserve increases from \$32.9 million to \$50.5 million when expected claims are not reduced by expected retiree contributions of \$17.6 million. Even increasing the statutory reserve to \$50.5 million, the actuarial present value of projected income and assets of \$855.8 million exceeds the actuarial present value of projected benefits of \$803.8 million by 6.5 percent.

As part of our 2009 Annual Review, we inquired of Trust officials why the statutory reserve was calculated by netting out expected retiree contributions. The Trust’s actuary responded that they interpreted “*12 months of expected claims and administrative expenses*” to mean 12 months of net expenses. They noted that their understanding is that “contributions” means active contributions and “benefits” or “claims” to be net of retiree and dependent self-pay contributions. The actuary stated they used this interpretation for the initial January 1, 2008 Actuarial Valuation under Section 3-2.3(a)(7) of the Auditing Act as well as the January 1, 2009 Actuarial Valuation under Section 22-101B(b)(3) of the Pension Code. Our actuarial advisors, Aon Hewitt, indicated that it is not unreasonable to subtract out the contributions from the anticipated benefit payments when calculating a reserve, because no benefits could be paid without corresponding contributions being received.

## Actuarial Assumptions

Aon Hewitt examined the Retiree Health Care Trust's assumptions as disclosed in the January 1, 2015 Actuarial Valuation. Overall, Aon Hewitt found that the assumptions are not unreasonable in the aggregate. Aon Hewitt did note that while they recognize the Plan's policy of completing an experience study every five years, Aon Hewitt believes the investment return and mortality assumptions should continue to be monitored and justified on an annual basis. Further, Aon Hewitt recommends that a mortality analysis be completed in time to reflect the results in the assumptions used for next year's Valuation.

Aon Hewitt has the following observations regarding specific assumptions:

- (A) **Net Investment Return.** The net investment return assumption for the Plan is 7 percent. This assumption is unchanged from the previous Valuation, but is based on a new target asset allocation, as approved by the Board of Trustees of the RHCT on December 18, 2014. The Plan's Investment Consultant prepared an analysis based on the new allocation and found an expected 10 year return of 7.09 percent, which includes 0.2 percent of expected return from active management.

We inquired of the RHCT whether the RHCT's actuary had conducted any analysis to support the reasonableness of the 7 percent expected return on assets. The Plan's Executive Director responded that the RHCT's actuary reviewed the reasonableness of the 7 percent expected return on assets as part of the assumption review that was completed prior to the January 1, 2014 Valuation. In the assumption review material prepared and provided by the RHCT's actuary, at that time, they calculated the median return over a 20 year time horizon to be 7.2 percent. However, this was not based on the updated asset allocation approved on December 18, 2014.

Aon Hewitt calculated the investment return that could be expected based on the RHCT's new target asset allocation. Aon Hewitt reviewed the expected return based on the Aon Hewitt Expected Return Model (as of the first quarter of 2015). Based on the target asset allocation and Aon Hewitt's expected return assumptions by asset class, Aon Hewitt predicted a weighted average net investment return of 5.59 percent. However, Aon Hewitt's Expected Return Model indicates that the **median** return over a 30 year time horizon based on the target asset allocation is 6.21 percent and that the probability of achieving a return of 7.00 percent or greater over a 30 year time horizon is 34.5 percent. Further, Aon Hewitt found that the 25<sup>th</sup> to 75<sup>th</sup> percentile range of investment returns was 7.55 percent to 4.88 percent. The weighted average net investment return assumes that the asset classes are one hundred percent correlated, while the median and percentile returns take into account that the asset classes are not one hundred percent correlated. Therefore, Aon Hewitt believes the median is a better representation of the true expected return.

The underlying inflation assumption used in Aon Hewitt's Expected Return Model as of the first quarter of 2015 is 2.1 percent, compared to the Plan's assumption of 3.25 percent. If the results of the model are adjusted for this difference in inflation assumption, the resulting 25<sup>th</sup> to 75<sup>th</sup> percentile range of investment returns is 8.72 percent to 6.05 percent, with the median return equal to 7.37 percent. The probability of achieving a return of 7.00 percent or greater is then 57.5 percent.

Actuarial Standard of Practice No. 27 (ASOP No. 27) provides guidance on the selection of economic assumptions for measuring pension obligations, and is referenced as part of Actuarial Standard of Practice No. 6, Measuring Retiree Group Benefit Obligations (ASOP No. 6). ASOP No. 27 was recently revised and effective for plans with a measurement date on or after September 30, 2014. ASOP No. 27 states that each economic assumption should be reasonable and have no significant bias, but also recognizes that a range of reasonable assumptions may develop across actuarial practice. Further, the ASOP also states that it should not be assumed that superior returns will be achieved from an active investment management strategy compared to a passive investment management strategy unless the actuary believes, based on relevant supporting data, that such superior or inferior returns represent a reasonable expectation over the measurement period. Aon Hewitt has not seen such support for the 0.2 percent return related to active management that the RHCT's Investment Consultant has included as part of their expected 10 year return.

Given this information, Aon Hewitt believes the 7.00 percent net investment return assumption is on the high end of the reasonable range, and that the RHCT's actuary should perform an analysis to support this assumption on an annual basis, separate from the analysis conducted by the Plan's Investment Consultant.

- (B) **Inflation and Salary Increase:** The inflation and salary increase assumptions are consistent with the Retirement Plan assumptions. As noted above in the commentary regarding the net investment return assumption, the inflation assumption of 3.25 percent is higher than Aon Hewitt's long-term inflation expectation of 2.1 percent and should be monitored closely in the future, especially as it relates to the assumed net investment return assumption.
- (C) **Disability and Withdrawal Rates:** Disability and withdrawal rates matched those of the Retirement Plan. These assumptions were all analyzed in the last experience study performed by the Retirement Plan's actuary, which examined 5 years of plan history, from January 1, 2008 to December 31, 2012. Aon Hewitt reviewed that experience study and the assumptions selected as part of our 2014 report. These assumptions are unchanged from the prior year.
- (D) **Mortality:** Pre-retirement and post-retirement mortality rates follow the RP-2000 Blue Collar Table, generational to 2016 based on Scale BB and then fully generational, and mortality rates for disabled employees are set at the RP-2000 Disabled Table, generational to 2016 based on Scale BB and then fully generational. Actuarial Standard of Practice No. 35 (ASOP No. 35) provides guidance with respect to mortality improvement before and after the measurement date.

The Plan's current mortality assumption was chosen before the final RP-2014 and MP-2014 reports were issued by the Society of Actuaries (SOA). The 2014 SOA report stated that it is not inappropriate for actuaries to consider one or more of the RP-2014 tables for public plan use. The SOA has since released an update to MP-2014 called MP-2015, and has further indicated their intention to provide annual updates to their mortality model. Consistent with the RP-2000 tables, the new RP-2014 tables are prepared on a benefits-weighted basis, and experience studies using these tables (either RP-2000 or RP-2014) should generally also be performed on a benefits-weighted basis, rather than a headcount-weighted basis. Due to significant changes in mortality rates that were found in the SOA's recent studies and released in their recent reports, Aon Hewitt recommends that a new mortality analysis be conducted for this Plan, on a benefits-weighted based, in time to reflect the results in the assumptions that are adopted and used for next year's valuation.

- (E) **Active Retirement Rates:** Active retirement rates are consistent with those of the Retirement Plan. This assumption was analyzed in the Retirement Plan's experience review that Aon Hewitt previously reviewed.
- (F) **Retirement Age.** Selecting age 65 as the expected retirement age for inactive participants is not unreasonable.
- (G) **Participation Rates for Retirees.** The participation assumption for future retirees is based on service at retirement. The assumed participation rates decrease as retiree contributions increase. Participation rates for 2015 have changed so that there are now separate participation assumptions for non-Medicare eligible and Medicare eligible participants. The RHCT's actuary stated that effective January 1, 2015, the percent of full cost paid by pre-Medicare retirees is not the same as the percent paid by Medicare retirees, so the participation rate varies.

The methodology for setting the retiree participation rates remains the same, although the actual participation rates are slightly different than the prior valuation. The methodology is that the percent assumed to decline coverage is assumed to be 50 percent of the percent of full cost paid by retirees.

- (H) **Participation Rates for Dependents.** The participation assumption for dependents is based on retiree service at retirement. The assumed participation rates decrease as dependent contributions increase. Participation rates for 2015 have changed so that there are now separate participation assumptions for non-Medicare eligible and Medicare eligible participants. The methodology for setting the dependent participation rates remains the same, although the actual participation rates are slightly different than the prior Valuation. The methodology is that the percent assumed to decline coverage is assumed to be 80 percent of the percent of full cost paid by dependents.
- (I) **Married Assumption:** The percent married assumption of 75 percent for future retirees and a 3 year age difference is consistent with commonly used values.
- (J) **Plan Election.** The plan election assumption of 70 percent of future pre-Medicare retirees assumed to elect PPO coverage and 30 percent assumed to elect HMO coverage is not unreasonable.

- (K) **Disabled Retirees Medicare Eligibility:** There is an assumption that upon retirement, 50 percent of pre-65 disabled retirees are eligible for Medicare, increasing to 90 percent eligible for Medicare two years after retirement.
- (L) **Missing Participant Data.** The methodology for assigning values for missing participant data is not unreasonable.
- (M) **Per Capita Claims.** The methodology used to calculate the pre-Medicare per capita claims for the self-insured medical and prescription drug benefits utilizes two years of experience (5/1/2012 – 4/30/2014) adjusted for plan design changes and health care trend. This methodology is consistent with the prior Valuation. Per capita claims for the fully insured HMO and Medicare Advantage plan are based on the premium rates for 2015.

The changes in per capita health costs are reasonable for most types of coverage. However, Aon Hewitt noted that the per capita health costs for Medicare participants are decreasing about 17 percent due to provider plan changes. Aon Hewitt also noted that the per capita health costs for the HMO plan are changing between -1 percent and 67 percent for male participants and increasing between 5 percent to 46 percent for female participants due to about an 18 percent increase in premium rates compared to the previous year and varying these costs by age and gender versus the flat amounts in the prior valuation. Applying the age and gender factors for the HMO plan is consistent with the updated Actuarial Standard of Practice No. 6.

- (N) **Health Care Cost Trends.** The RHCT Valuation utilizes different trend curves for pre-Medicare and post-Medicare medical and prescription drug claims. The trend curves for 2015 have changed so that there are now separate trend curves for non-Medicare eligible and Medicare eligible participants.

The initial (first year) health care trend rates assumed for pre-Medicare medical and pharmacy combined are not unreasonable. However, the period of grading down to the ultimate trend of 5.0 percent is three years shorter than in the prior Valuation. The longer period of grading to ultimate trend in the prior Valuation is more consistent with Aon Hewitt internal trend guidance. The initial Medicare Advantage Plan trend of 4.25 percent reflects a known increase in the premiums for 2016. While the Medicare Advantage Plan trend is not unreasonable, Aon Hewitt would expect a longer period of grading to ultimate trend.

- (O) **Retiree Drug Costs.** The Valuation assumes that the effect of annual CPI adjustment of prescription drug copays, annual deductibles, and annual out-of-pocket maximums is to decrease health care trend rates by 0.3 percent for all plans except the HMO plan.
- (P) **Retiree Contribution Increase Rate.** The application of the medical trend rate to the retiree and dependent contributions is a common practice. Actual contribution increases in the future should be compared against this assumption to ensure that it continues to be reasonable.
- (Q) **Administrative Expense.** The administrative expense assumption for 2015 increased 29 percent from the 2014 amount. The RHCT's actuary indicated that

administrative fees of \$50 per year had been included in prior valuations and in 2015, but were missing in 2014.

- (R) **Lifetime Maximum Benefits.** The assumption of no lifetime maximum benefits in the plan is not unreasonable, as past information was not available on accumulated benefits.
- (S) **Excise Tax.** As part of the Patient Protection and Affordable Care Act, there is a provision that will take effect in 2018 for high cost health plans called the Excise Tax. It is a 40 percent tax on health plan costs that exceed certain thresholds written into the law. It has been Aon Hewitt’s experience that the large audit firms have indicated they expect that Excise Tax to be included in actuarial valuations now even though regulations have not been released and the tax is not effective until 2018. In addition, Aon Hewitt guidelines related to retiree valuation work require inclusion of the Excise Tax unless the thresholds are not projected to be exceeded or there is clear evidence of a communication to the plan members that any such tax will be passed on to participants.

As part of the current Valuation, the RHCT’s actuary performed an analysis to determine the potential impact of the Excise Tax. The results of their analysis indicate that if retirees under age 65 and over age 65 are treated as “similarly situated” beneficiaries, the Excise Tax thresholds would not be exceeded until 2071 for pre-65 beneficiaries and 2050 for post-65 beneficiaries. Therefore no liability for Excise Tax has been included in the current valuation.

It should be noted that currently no regulations or guidance has been issued related to Excise Tax determination. Therefore, Aon Hewitt does not explicitly know how the governmental agencies will interpret or define what it means to be considered “similarly situated” beneficiaries or whether/how other adjustments may apply that are mentioned in the law itself. It is good that the RHCT’s actuary has performed the analysis and discussed this in the Valuation report. However, in future reports, Aon Hewitt believes it should also be mentioned that there is uncertainty surrounding the projections and that actual results could vary from these projections given that regulations have not yet been released.

Overall, Aon Hewitt does not find the RHCT’s assumptions unreasonable in the aggregate.

### **Limitation on Retiree Contributions**

The Pension Code (40 ILCS 5/22-101B(b)(5)) requires that 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 Pension Code goes on to define “*total cost of such benefits*” as 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 . . . .*”

The January 1, 2015 Valuation prepared by the Trust’s actuary contained the results of the actuary’s calculation of whether the 45 percent limitation established by the Pension Code was met. The Valuation noted that according to the preliminary December 31, 2014 audit of the RHCT, the aggregate amount of retiree, dependent, and survivor contributions for 2014 was \$18.16 million. The total cost of retiree health benefits paid from the Trust in 2013 was \$49.48 million. The Valuation calculated that the retiree self-pay as a percentage of total cost of benefits was 36.70 percent, which did not exceed the statutory limit of 45 percent. The Valuation notes that dental benefits and contributions are excluded from dollar amounts used in this calculation, since the Fund does not provide dental benefits, but only serves as a “pass-through” for dental premiums.

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## SCOPE OF ANNUAL REVIEW

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The Office of the Auditor General has conducted this annual review of information submitted by the Board of Trustees of the Chicago Transit Authority Retiree Health Care Trust pursuant to the Illinois State Auditing Act (30 ILCS 5/3-2.3(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.*” The OAG’s review, the scope of which is established by the Pension Code, focused on whether the actuarial assumptions used in the Retiree Health Care Trust’s report were not unreasonable in the aggregate.

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 Retiree Health Care Trust for reasonableness and consistency, we did not conduct an audit of the accuracy of the information provided as that is the responsibility of the Trust.

The scope of our work included reviewing the RHCT Actuarial Valuation as of January 1, 2015, submitted by the RHCT Board on October 1, 2015. Our consultant, Aon Hewitt, followed-up with the RHCT on various questions they had based upon their review of the Valuation. Aon Hewitt reviewed the reasonableness of the actuarial assumptions used by the RHCT in its January 1, 2015 Actuarial Valuation.

In last year’s review, we reported that the Plan’s Executive Director noted that the *Matthews* case could have a significant impact on either the Retirement Plan or the Retiree Health Care Trust in the magnitude of \$100 million or more. We inquired of the Executive Director for an update on the status of the *Matthews* case. The Executive Director responded that the Supreme Court heard the Plan’s appeal in May 2015, and the Plan is awaiting the Court’s decision. The plaintiffs in the *Matthews* case are current and former employees of the CTA who argue that after years of fully paid health care benefits for retired CTA employees, they are now being asked to pay for a portion of their health care benefits and are no longer entitled to the same level of health care coverage as active CTA employees. The changes to their coverage occurred as a result of an arbitration award and related amendments to the Pension Code made by Public Act 95-708.

The Retiree Health Care Trust was provided a draft of this report for review and comment.

**APPENDIX A**  
**Statutory Authority**



<b>ILLINOIS STATE AUDITING ACT</b>
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**30 ILCS 5/3-2.3**

- (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.)

<b>ILLINOIS PENSION CODE</b>
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**40 ILCS 5/22-101B**

Sec. 22-101B. Health Care Benefits.

(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 upon the exhaustion of the account established by the Retirement Plan for Chicago Transit Authority Employees pursuant to Section 401(h) of the Internal Revenue Code of 1986, but no earlier than January 1, 2009 and no later than July 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. Any health care benefit program established by the Board of Trustees for eligible retirees and their dependents and survivors effective on or after July 1, 2009 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, except that coverage through a health maintenance organization ("HMO") may be provided at 100%.

(2.5) The Board of Trustees may also establish and administer a health reimbursement arrangement for retirees and for former employees of the Authority or the Retirement Plan, and their survivors, who have contributed to the Retiree Health Care Trust but do not satisfy the years of service requirement of subdivision (b)(4) and the terms of the retiree health care plan; or for those who do satisfy the requirements of subdivision (b)(4) and the terms of the retiree health care plan but who decline coverage under the plan prior to retirement. Any such health reimbursement arrangement may provide that: the retirees or former employees of the Authority or the Retirement Plan, and their survivors, must have reached age 65 to be eligible to participate in the health reimbursement arrangement; contributions by the retirees or former employees of the Authority or the Retirement Plan to the Retiree Health Care Trust shall be considered assets of the Retiree Health Care Trust only; contributions shall not accrue interest for the benefit of the retiree or former employee of the Authority or the Retirement Plan or survivor; benefits shall be payable in accordance with the Internal Revenue Code of 1986; the amounts paid to or on account of the retiree or former employee of the Authority or the Retirement Plan or survivor shall not exceed the total amount which the retiree or former employee of the Authority or the Retirement Plan contributed to the Retiree Health Care Trust; the Retiree Health Care Trust may charge a reasonable administrative fee for processing the benefits. The Board of Trustees of the Retiree Health Care

Trust may establish such rules, limitations and requirements as the Board of Trustees deems appropriate.

(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, to be implemented over a period of not more than 10 years from each valuation date, which would make the actuarial present value of projected contributions and trust income plus assets equal to or exceed the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors. The plan may consist of increases in employee, retiree, dependent, or survivor contribution levels, decreases in benefit levels, or other plan changes or any combination thereof. 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 other plan changes, or any combination thereof, 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 other plan changes, or any combination thereof, to be implemented over a period of not more than 10 years from each valuation date, is reasonably projected to make the actuarial present value of projected contributions and trust income plus assets equal to or in excess of the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors, 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 other plan changes to be implemented over a period of not more than 10 years from each valuation date, is not reasonably projected to make the actuarial present value of projected contributions and trust income plus assets equal to or in excess of the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors, 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 hired on or before September 5, 2001 who retires with 25 years or more of continuous service shall be eligible for retiree health care benefits upon retirement in accordance with any rules or regulations adopted by the Board of Trustees; provided he or she retires prior to the full execution of the successor collective bargaining agreement to the collective bargaining agreement that became effective January 1, 2007 between the Authority and the organizations representing the highest and second-highest number of Chicago Transit Authority participants. 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; 96-1254, eff. 7-23-10; P.A. 98-1164, eff. 6-1-15.)