

Governor Quinn Signs Legislation Creating Two Tier Pension System

Governor Pat Quinn has signed into law, measures contained in Senate Bill 3538 which will dramatically overhaul pension benefits for firefighters and police officers throughout the State who are hired on or after January 1st, 2011.

The following synopsis of the new law has been compiled by Illinois Public Pension Advisory Committee General Counsel, Attorney Cary J. Collins.

Highlights of the new law as it pertains to Article 3 and Article 4 pension funds are as follows:

- I. **Creation of Two Tier System for Firefighters and Police Officers**
 - A. ***The benefits for current police officers and firefighters and for those currently receiving a pension have not changed.***
 - B. Changes apply to police officers and firefighters hired after December 31, 2010.
 - C. Minimum retirement age – 55 years
 - D. Minimum of 10 years service as police officer or firefighter is required to be eligible to receive a retirement pension.
 - E. Retirement pension based upon 2.5% of “final average salary” for a maximum of 75%
 - F. Can retire after age 50 with minimum of 10 years service, but penalty of ½ of 1% for each month police officer/firefighter age is under 55.
 - G. Final average salary is defined as:

“The average monthly salary obtained by dividing the total salary of the police officer/firefighter during the 96 consecutive months of service within the last 120 months of service in which the total salary was the highest by the number of months of service in that period.”

Meaning, the officer or firefighter’s pension will be based upon his/her best eight consecutive years out of the last ten years of his/her service.

- H. Beginning January 1, 2011 - Salary Cap – police officers’/firefighters’ salary for pension purposes is capped at \$106,800, however that amount shall annually be increased by the lesser of ½ of the annual CPI-U or 3% (but not less than zero) for the 12 months ending with the September preceding each November 1 (compounded).
- I. Cost of Living Increases – Payable at age 60 either on the January 1st after police officer/firefighter retires or the first anniversary of pension starting date, whichever is later. Non-compounding increases will occur annually, each January thereafter. The increase will be the lesser of 3% or ½ of CPI-U for proceeding calendar year. Meaning, if CPI-U is 0%, the retiree will receive no increase. However, there will never be a reduction in benefits.
- J. Surviving spouse benefits – Initial benefit is 66 2/3% of police officer’s/firefighter’s earned pension at date of death. However, surviving spouses will receive cost of living increases in the same manner described above.

In addition to creating a two-tier benefit structure, the General Assembly expanded the investment authority of existing downstate police and fire pension funds with a t least \$10 million in net assets. The expanded investment authority is summarized as follows:

II. Changes to Article 3 and 4 Pension Fund Investment Authority.

- A. Can invest in interest bearing funds or pooled accounts of the Illinois Metropolitan Investment Funds.
- B. Can invest in corporate bonds through an investment advisor (not a consultant)
- C. Corporate bonds managed through an investment advisor must meet the following requirements:
 - 1. Rated as investment grade by 1 of the 2 largest rating services at time of purchase.
 - 2. If securities are downgraded subsequent to purchase below investment grade must be liquidated from the portfolio within 90 days of downgrade.

The next section may have a following legislation to accommodate the City of Chicago. Will it change for local municipalities? The Illinois Municipal League (IML) is following these provisions seeking a change for Downstate Funds.

III. Municipal Funding Provisions

- A. Amends 5/3-125 and 5/4-118 of the Pension Code.
- B. Pension funds must be 90% funded by 2040.
- C. Annual Municipal contributions to be calculated as level percentage of payroll under “projected unit credit actuarial cost method.”
- D. If a municipality fails to remit required municipal contributions within 90 days after payment is due:
 - 1. Commencing fiscal year 2016, Pension fund certifies to state comptroller the amount delinquent;
 - 2. Comptroller must deliver and deposit to pension fund the certified amounts or portion of amounts from “grant of state funds” owed to the municipality
 - i. In fiscal year 2016 – 1/3 of total amount of grant of state funds;
 - ii. In fiscal year 2017 – 2/3 of total amount of grant of state funds; and
 - iii. In fiscal year 2018 – the total amount of grant of state funds (not to exceed the amount of the delinquent payments certified to the state comptroller by the pension funds.)

List of additional permitted investments for Article 3 and 4 pension funds with assets of \$10,000,000 or more.

- a. In addition to the items in Sections 1-113.2 and 1-113.3, a pension fund established under Article 3 or 4 that has net assets of at least \$10,000,000 and has appointed an investment adviser, as defined under Sections 1-101.4 and 1-113.5, may, through that investment adviser, invest an additional portion of its assets in common and preferred stocks and mutual funds.
- b. The stocks must meet all of the following requirements:
 1. The common stocks must be listed on a national securities exchange or board of trade (as defined in the Federal Securities Exchange Act of 1934 and set forth in paragraph G of Section 3 of the Illinois Securities Law of 1953) or quoted in the National Association of Securities Dealers Automated Quotation System National Market System.
 2. The securities must be of a corporation in existence for at least 5 years.
 3. The market value of stock in any one corporation may not exceed 5% of the cash and invested assets of the pension fund, and the investments in the stock of any one corporation may not exceed 5% of the total outstanding stock of that corporation.
 4. The straight preferred stocks or convertible preferred stocks must be issued or guaranteed by a corporation whose common stock qualifies for investment by the board.
- c. The mutual funds must meet the following requirements:
 1. The mutual fund must be managed by an investment company registered under the Federal Investment Company Act of 1940 and registered under the Illinois Securities Law of 1953.
 2. The mutual fund must have been in operation for at least 5 years.
 3. The mutual fund must have total net assets of \$250,000,000 or more.

4. The mutual fund must be comprised of a diversified portfolio of common or preferred stocks, bonds or money market instruments.
- d. A pension fund's total investment in the items authorized under this Section and Section 1-113.3 (pension funds with net assets of \$2,500,000 or more) shall not exceed 50% effective July 1, 2011 and 55% effective July 1, 2012 of the market value of the pension fund's net present assets stated in its most recent annual report on file with the Department of Insurance.
- e. A pension fund that invests funds under this Section shall electronically file with the Division any reports of its investment activities that the Division may require, at the time and in the format required by the Division.

Sect. 1-165. Commission on Government Forecasting and Accountability study. The Commission on Government Forecasting and Accountability shall conduct a study on the feasibility of:

1. The creation of an investment pool to supplement and enhance the investment opportunities available to boards of trustees of the pension funds organized under Articles 3 and 4 of this Code; the study shall include an analysis on any cost or cost savings associated with establishing the system and transferring assets for management under the investment pool; and
2. Enacting a contribution cost-share component wherein employing municipalities and members of funds established under Articles 3 and 4 of this Code each contribute 50% of the normal cost of the defined benefit plan.

The Commission shall issue a report of its findings on or before December 31, 2011.

As a result of these changes, the following questions are raised:

- A. What pension fund procedures must be changed to address the new system?
- B. Will pension funds be required to keep two sets of files?
- C. Will fund assets need to be kept separate for each tier?
- D. Will there be a need for two separate tax levies?

As always, IPPAC urges pension funds to seek input and assistance from appropriate legal and financial experts in addressing these and other related matters.

To view the full text of this legislation, go to:

<http://www.ilga.gov/legislation/fulltext.asp?DocName=&SessionId=76&GA=96&DocTypeId=SB&DocNum=3538&GAID=10&LegID=51488&SpecSess=&Session=>