



Applied Pension Reform Bill Becomes Law

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On August 29, 2008, Governor Blagojevich signed into law HB 5088, a pension reform law containing several provisions that impact downstate fire and police pension funds. The new law became effective immediately. Originally introduced by the Illinois Municipal League (IML), the bill was the result of negotiations among representatives of IML, the Illinois Public Pension Fund Association (IPPPFA), and fire and police unions. Presented as an agreed bill, both houses of the Illinois General Assembly approved it unanimously on May 31, 2008. Public Act 95-950 contains numerous, more restrictive ethics and transparency requirements for fire and police pension funds, as well as additional oversight, including:

- Prohibition on any "sweeps" of the Division of Insurance's funds by the State
- Fiscal impact assessments on selected municipalities of proposed pension legislation
- Prohibition on fiduciaries causing or advising pension funds to engage in an investment transaction when a fiduciary has any direct financial interest or business relationship with the investment advisor through which the transaction is to be made
- Maximum contract duration for investment consultants with additional required contract disclosures, including fee disclosures for both investment advisors and consultants
- A stricter gift ban that significantly limits gifts to fire and police pension trustees
- More frequent audits of fire and police funds by the Division of Insurance

- Review of police pension benefit determinations by the municipal treasurer
- Additional reporting requirements for pension boards to their underlying municipalities and optional publication of the fund's report on the internet or in the newspaper
- Class A misdemeanor provision for making a false statement or filing a falsified record in an attempt to defraud a pension fund
- A biennial pension study by the Commission on Government Forecasting and Accountability

Investment advisors and consultants

While the Illinois Pension Code has referred to "consultants" for some time, the term has never been clearly defined. Public Act 95-950 attempts to remedy this ambiguity and defines a "consultant" as "a person or entity that provides consulting services to a pension fund regarding the selection of fiduciaries." (40 ILCS 5/1-113.5(a-5)) Consultants must now meet the same statutory qualifications as an investment advisor. (40 ILCS 5/1-113.5(a-5)) Under Public Act 95-950, consultants now have the same contracting requirements as investment advisors, including the acceptance of a fiduciary relationship with the pension fund. (40 ILCS 5/1-113.5(b))

Under the new law, a consultant's contract may not exceed five years. Moreover, a contract -- once awarded -- cannot be renewed or extended; the pension fund is obliged to solicit new proposals at the end of the contract term, whether that term is one year or five years. (40 ILCS

5/1-113.5(b-5)) Consultant contracts, like investment advisor contracts, must now be submitted to the Division of Insurance. (40 ILCS 5/1-113.5(c)) For those pension funds with open-ended contracts with consultants, we recommend proceeding with the new proposal requirements within five years.

By the end of September 2008, each investment advisor and consultant doing business with a pension board must disclose to the pension board all direct and indirect fees, commissions, penalties and other compensation paid by or on behalf of the investment advisor in connection with their services provided to the pension board. All investment advisors and consultants hired in the future are required to provide this same information prior to conducting business with the pension fund. The investment advisor or consultant is required to update this information "promptly" should it change. (40 ILCS 5/1-113.5(b-5))

Municipal oversight and review

Public Act 95-950 adds some responsibility to the underlying municipal government of a pension fund. Police pension funds must now submit their calculation of benefits to its municipal treasurer for approval prior to paying any benefits. (40 ILCS 5/3-141.1) In an apparent oversight, this requirement is not applicable to firefighter pension funds.

Public Act 95-950 increases the information that must be submitted yearly to the municipal government. The funded and unfunded liabilities of the pension fund are among the new information that must be disclosed on a yearly basis. Moreover, unfunded liabilities must be specifically justified with an

actuarial basis. The municipal government is now explicitly authorized to publish this report. (40 ILCS 5/3-143; 40 ILCS 5/4-134)

Gift ban restrictions, prohibited transactions and penalties for fraud

One of the more significant changes that Public Act 95-950 brings is increased restrictions on gifts given to fire and police pension board members. Under the new requirements, Article 3 and 4 trustees are prohibited from accepting gifts from certain persons or entities known as "prohibited sources." (40 ILCS 5/1-125) Public Act 95-950 contains the same definition of prohibited sources as Section 1-5 of the State Officials and Employee Ethics Act (5 ILCS 430/1-5) which lists prohibited sources as: (1) those seeking official action by the board or a board member; (2) those doing business or seeking to do business with the Board; (3) anyone whose interests may be substantially affected by the action or in-action of the board; and (4) any registered lobbyist. (40 ILCS 5/1-125)

Unlike the gift restrictions applicable to other public officials, the only exceptions to the gift ban requirements for pension trustees under this new law are for "educational materials" and "travel expenses" for meetings to discuss official business. (40 ILCS 5/1-125(b)) There are no exceptions to the new gift ban provisions for food, refreshments or other items under a specific dollar value. Moreover, under Public Act 95-950, violation of the gift ban provisions is a Class A misdemeanor, a criminal offense which carries a penalty of up to one year in prison and a fine not to exceed \$2,500. (40 ILCS 5/1-125(d)) Note that the new gift restrictions are the minimum requirements that the trustees must follow. Taxing bodies that have adopted more restrictive requirements or that are subject to the jurisdiction of a local ethics commission with more restrictive rules must continue to comply with those requirements. (40 ILCS 5/1-125(c))

An additional provision set forth under the "prohibited transaction" section of the Illinois Pension Code now prohibits a fiduciary of a pension fund from knowingly causing or advising a pension fund to engage in an investment transaction when the fiduciary (1) has a direct interest in the income, gains or

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profits of the investment advisor through which the transaction is made or (2) has a business relationship with the advisor that would result in a pecuniary benefit to the fiduciary. Violation of this new provision is a Class 4 felony, carrying a penalty of up to three years of imprisonment plus any applicable fines and restitution. (40 ILCS 5/1-110(d))

In new provisions set forth in Articles 3 and 4 of the Illinois Pension Code, anyone knowingly or intentionally making a false statement or falsifying pension fund records in an attempt to defraud the fund commits a Class A misdemeanor criminal offense, carrying a penalty of not more than one year in jail and a fine not to exceed \$2,500. (40 ILCS 5/3-144.5; 40 ILCS 5/4-138.5)

State oversight and review -- In the past, pension fund audits by the Division of Insurance have been infrequent. Public Act 95-950 now requires the Division of Insurance to conduct an audit of every police and fire pension fund at least every three years. In addition to previous audit requirements which remain in place, these triennial audits must now include an examination and approval of the calculation of all benefits paid by the pension fund to its

members. (40 ILCS 5/1A-104 (b))

The new law also contains protection for Division of Insurance funding. In the past, the funds held by the Division of Insurance, including compliance fee funds paid to DOI by fire and police pension boards, could be "swept" away into a general state fund. Public Act 95-950 prohibits this "fund sweeping." (20 ILCS 2105/2105-300(e))

Demonstrating that Public Act 95-950 is the first step in further pension reforms, the Commission on Government Forecasting and Accountability -- whose duties previously included analyzing various aspects of state retirement systems -- is now charged with providing a similar report to the General Assembly regarding fire and police pension funds. Every odd numbered year, the Commission must prepare a report that provides an aggregate analysis of fire and police pension funds, analyzing the fiscal status and forecasting projections for selected individual funds in each system. The report shall also indicate which factors affect the unfunded liability of each selected individual fund. (40 ILCS 5/22-1004) ■