Pension Pointers

Statutory Minimum Funding of Firefighter and Police Pension Funds: The Unfinished Business of Pension Reform

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It has now been over four years since the Illinois Consolidation Feasibility Task Force issued its report to Governor Pritzker in October 2019, and the Illinois General Assembly enacted P.A. 101-610, which consolidated the investments of over 650 individual firefighter and police pension funds into two statewide investment systems. In those four years, Firefighters' Pension Investment Fund of Illinois ("FPIF") and Illinois Police Officers' Pension Investment Fund ("IPOPIF") have nearly completed the transition of assets from the individual Article 3 and 4 funds and already met two critical goals of decreased investment costs and improved investment returns for most participating funds.

While welcome, improving investment returns is only one part of ensuring the health of Illinois' public pension funds. When the Task Force issued its report, it recognized the seriousness of the more pressing concern for Illinois' firefighters and police pension funds—funding—but left that issue unresolved. It remains unresolved to this day and may actually be taking a turn for the worse.

House Bill 1185 is a measure currently pending in Illinois' House of Representatives. It passed the Personnel & Pensions Committee 7-3 and at the time of writing is awaiting its third reading before the full chamber. If passed by the House and the Senate and is signed by the Governor, the bill would amend Articles 3 and 4 of the Illinois Pension Code to extend the 90% funding date from year 2040 to year 2050. This would decrease the statutory minimum calculations on paper in the near term but would not deal with the underlying funding crisis.

Championed by the Illinois Municipal League as "common sense pension reform," this push to re-amortize the funding schedule is premised on IML's belief that it would statutorily place downstate firefighter and police pension funds in line with other funds in Illinois and help ensure municipalities are better equipped to continue their obligations to adequately fund retirements for public safety personnel.[1]

But how does extending the amortization period ensure adequate funding? And why would municipalities and fire protection districts seek to be placed "in line" with other Illinois pension funds, which have notoriously been deemed some of the worst funded pension systems in the country?

At the time of its study on consolidation of firefighter and police pension funds, the Task Force noted concerns regarding the "funding ramp" currently set forth in Sections 3-125 and 4-118 of the Illinois Pension Code, which as of 2011, modified the actuarial approach to the financing of police and firefighter pension funds by the underlying municipality or fire protection district to a "statutory minimum approach."

Under the Illinois Pension Code, the required minimum employer contribution for downstate police and firefighter pension funds is calculated using the projected unit credit ("PUC") actuarial method as a "level percentage of payroll" sufficient to bring the assets of the fund to 90% of the fund's total actuarial liabilities by the year 2040. Explaining its concerns, the Task Force stated that "additional time may be needed on the required employer contribution schedule for the pension plans to benefit from improved year-over-year investment returns."

While hedging on the initial expected favorable impact consolidated asset returns may bring to the pension funds, the Task Force clearly advocated for additional time beyond the year 2040 for employers to make their required contributions under the current statutory scheme. In other words, it was only a matter of time before a bill would be pushed by the municipal community to extend the funding date.

A factor in all of this, of course, is the poor statutory choice of projected unit credit as the actuarial method to prepare the contribution calculation. PUC is not well suited for use in the

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public pension fund setting, because of its low contribution requirement at the beginning of a public employee's career, with a steep increase in that contribution requirement at the end of the employee's career.

The Securities and Exchange Commission famously condemned the State of Illinois' use of PUC and the 90-percent funding target in its order issued in March of 2013, in which the state was directed to cease its misleading information about the adequacy of its statutory plan to fund its pension obligations to the statewide systems in its bond documents. Calling it "structural underfunding," the SEC said that "the PUC method results in less funding for active employees, accumulates assets more slowly, produces more volatile measures of contributions rates, and results in rising rather than level contribution rates."[2]

While this methodology may have provided temporary relief to municipalities and fire protection districts in the years initially following 2011, this funding scheme has caused pension funds that have been funded at 90% using the projected unit credit methodology to accumulate more unfunded liability—because only 90% of the recommended contribution is being remitted to the fund—but also is resulting in intergenerational inequity in the form of deferred costs to future taxpayers.

Historically, the Illinois legislature has endorsed a statutory framework for funding for the downstate firefighter and police pension funds, but also most of the statewide and Cook County pension systems, that has favored deferred pension contributions for decades. The consequences are forgone investment earnings which now must be made up in the form of escalating employer contributions. When the choice is made to disregard professional actuarial advice to *front-load contributions*, the outcome is more costly pension systems for taxpayers.

The Pension Protection Clause of Illinois' Constitution is one of the strongest legal protections of pension benefits in the nation. Ill. Const. 1970, Art. XIII, § 5. Despite legislative efforts to diminish previously promised pension benefits to Illinois public employees, the Pension Protection Clause has withstood myriad challenges and continues to foreclose efforts to reform the Illinois Pension Code that would modify benefit structures to offload risk from employers onto participants, as has occurred in many other states.

While the impetus to adopt the Pension Protection Clause may have been to provoke improved funding of Illinois pension funds, the protection the clause provides to the *benefit* and not necessarily to the *funding* of the benefit did not produce its intended effect.

Meanwhile, proponents of HB 1185 have sought pension *funding* relief by filing the same bill year over year since at least early 2019. This current iteration modifies Sections 3-125 and 4-118 of the Pension Code and extends the funding target date 10 years to year 2050. The immediate effect will be a decrease in the statutory minimum calculations produced by FPIF and IPOPIF. Yet, this has little bearing on the health of local pension funds.

These efforts opt for political expediency at the risk of potentially delivering a death blow to those firefighter and police pension funds that are substantially underfunded. It therefore remains incumbent on every fiduciary involved with Illinois' public pension funds to recognize their legal obligation to speak up on these issues. If the fiduciaries to the pension funds fail to demand proper funding, no one will. ■

[1] See Illinois Municipal League's Fact Sheet, *Article 3 and 4 Pension Reamortization Common Sense Pension Reform,* December 20, 2023.

[2] In the Matter of State of Illinois, SEC Administrative Proceeding File No. 3-15237 (March 11, 2013).

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