STATE OF ILLINOIS

OFFICE OF THE AUDITOR GENERAL

2014 ANNUAL REVIEW

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

DECEMBER 2014

WILLIAM G. HOLLAND

AUDITOR GENERAL

SPRINGFIELD OFFICE:
ILES PARK PLAZA
740 EAST ASH • 62703-3154
PHONE: 217/782-6046
FAX: 217/785-8222 • TTY: 888/261-2887
FRAUD HOTLINE: 1-855-217-1895

CHICAGO OFFICE:
MICHAEL A. BILANDIC BLDG. • SUITE S-900
160 NORTH LASALLE • 60601-3103
PHONE: 312/814-4000
FAX: 312/814-4006
FRAUD HOTLINE: 1-855-217-1895

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 2014 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.

WILLIAM G. HOLLAND
Auditor General

Springfield, Illinois
December 2014

STATE OF ILLINOIS
OFFICE OF THE
AUDITOR GENERAL
William G. Holland, Auditor General

SUMMARY REPORT DIGEST

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

**2014 ANNUAL REVIEW**
**Release Date: December 2014**

## 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, 2014 to the Office of the Auditor General on September 30, 2014.

- 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.

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, 2014 to the Office of the Auditor General on September 30, 2014. 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 $755,354,701.
- The actuarial present value of projected active contributions, trust income, and assets was $794,352,793 (after subtracting $34,072,490 for the required statutory reserve).

- Consequently, projected income and assets exceeded projected benefits by 5.2 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, 2014 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 | $1,302,164,965 | Actuarial present value of projected active contributions and trust income plus assets | $828,425,283 |
| Less: Projected current and future retiree contributions | ($546,810,264) | Less: Statutory Reserve[1] | ($34,072,490)[1] |
| Net actuarial present value of projected benefits | $755,354,701 | Actuarial present value of projected income and assets, net of statutory reserve | $794,352,793 |
| **Projected income and assets exceed projected benefits by 5.2%** | | | |

Note: [1] The Statutory Reserve is net of retiree contributions.
Source: Retiree Health Care Trust Actuarial Valuation Report as of January 1, 2014.

**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 2014 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.

## TABLE OF CONTENTS

**2014 Annual Review**

# Information Submitted by the CTA Retiree Health Care Trust

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.

## 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 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.

**ILLINOIS PENSION CODE REQUIREMENTS**

(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).

Source: 40 ILCS 5/22-101B(b)(3)(iii).

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.

# REPORT DETERMINATION

The Board of Trustees of the Chicago Transit Authority Retiree Health Care Trust submitted its Actuarial Valuation as of January 1, 2014 to the Office of the Auditor General on September 30, 2014. 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 $755,354,701.
- The actuarial present value of projected active contributions, trust income, and assets was $794,352,793 (after subtracting $34,072,490 for the required statutory reserve).
- Consequently, projected income and assets exceeded projected benefits by 5.2 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, 2014 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 | $1,302,164,965 | Actuarial present value of projected active contributions and trust income plus assets | $828,425,283 |
| Less: Projected current and future retiree contributions | ($546,810,264) | Less: Statutory Reserve [1] | ($34,072,490)[1] |
| Net actuarial present value of projected benefits | $755,354,701 | Actuarial present value of projected income and assets, net of statutory reserve | $794,352,793 |
| **Projected income and assets exceed projected benefits by 5.2%** | | | |

Note: [1] The Statutory Reserve is net of retiree contributions.
Source: Retiree Health Care Trust Actuarial Valuation report as of January 1, 2014.

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 $52.4 million for *"12 months of expected claims and administrative expenses,"* and $1.4 million for *"incurred and unreported claims,"* for a claims expense total of $53.8 million, it subtracts $19.7 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 5.2 percent. However, the statutory reserve increases from $34.1 million to $53.8 million when expected claims are not reduced by expected retiree contributions of $19.7 million. Even increasing the statutory reserve to $53.8 million, the actuarial present value of projected income and assets of $774.6 million exceeds the actuarial present value of projected benefits of $755.4 million by 2.6 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 Exhibit III of the January 1, 2014 Actuarial Valuation. There were many assumption changes this year due to a CTA Retirement Plan Experience Study that was completed by the Retirement Plan's actuary related to the demographic assumptions such as mortality, termination, and retirement rates. There were other assumption changes based on a review completed by the RHCT's actuary pursuant to medical program specific assumptions, such as participation rates and plan elections. Aon Hewitt concluded that the assumptions utilized are not unreasonable in the aggregate.

### Assumptions Reviewed in the Retirement Plan Experience Study

In 2014, the Retirement Plan's actuary completed an Experience Study evaluating the key demographic assumptions of the Retirement Plan. The review examined 5 years of plan history, from January 1, 2008 to December 31, 2012. It is common practice for the health plan valuation for the same population to follow the retirement plan demographic assumptions, as the RHCT Valuation has done in the past. The RHCT Valuation has adopted the newly recommended demographic assumptions, as shown below. Aon Hewitt reviewed that Experience Study and determined that the assumptions utilized are not unreasonable in the aggregate.

(A) **Salary Increase Assumption:** The overall salary increase assumption is consistent with the Retirement Plan assumption. The revised assumption is based on years of service instead of calendar year. The result is higher salary increases assumed for three years of service or less.

(B) **Disability and Withdrawal Rates:** Disability and withdrawal rates match those of the Retirement Plan. The revised assumptions no longer suppress disability rates for service greater than 25 years, and have decreased withdrawal rates by .5 percent for all ages from the prior Valuation. According to the Study, the revised rates more closely match actual experience.

(C) **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. 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 that future mortality improvement should be included as part of an actuarial valuation, effective for any actuarial valuation with a measurement date on or after June 30, 2011. Coincident with this current Experience Study, the plan adopted generational mortality tables to account for future mortality improvement.

The Plan's new mortality assumption was chosen before the final RP-2014 and MP-2014 reports were issued by the Society of Actuaries (SOA). The new SOA reports state that it is not inappropriate for actuaries to consider one or more of the RP-2014 tables for public plan use. We suggest that the plan's mortality experience be

reviewed again based on the new available tables. 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. Not enough data was provided for us to determine whether the Plan's most recent mortality study was performed on a benefits-weighted or headcount weighted basis. However, since an RP-2000 table was adopted as a result of that study and since RP-2014 tables will also be considered in the future, we would expect next year's mortality analysis to be done on a benefits-weighted basis.

(D) **Active Retirement Rates:** Active retirement rates were consistent with those of the Retirement Plan. Since the prior Valuation, the rates for those with at least 25 years of service have been decreased from ages 55 to 74. For participants with less than 25 years of service the retirement rates have been decreased from ages 68 to 74 and the previous adjustments for reduced retirement leading up to 25 years of service have been removed. Overall, the Experience Study for the Retirement Plan found that actual retirement rates were less volatile than assumed, and the adjustment to this assumption reflects that trend.

## Other Assumptions Reviewed

(E) **Net Investment Return.** The net investment return assumption for the Retiree Health Care Trust is seven percent. Aon Hewitt calculated the investment return that could be expected based on the target asset allocation in the RHCT's financial statements and supplementary information for years ended December 31, 2013 and 2012. Aon Hewitt reviewed the expected return based on the Aon Hewitt Expected Return Model (as of the first quarter of 2014).

Based on the asset allocation in the Trust's investment policy, and Aon Hewitt's expected return assumptions by asset class, Aon Hewitt predicted a **weighted average** net investment return of 5.98 percent, which is less than the actual assumption of 7.00 percent. However, Aon Hewitt's Expected Return Model indicated the **median** return based on the target asset allocation is 6.65 percent and that the probability of achieving a return of 7.00 percent or greater over a 30 year time horizon is 42.8 percent. Further, Aon found that the $25^{th}$ to $75^{th}$ percentile range of investment returns is 7.97 percent to 5.34 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.

In the assumption review material prepared and provided by the RHCT's actuary, the median return over a 20 year time horizon was calculated to be 7.2 percent. It is not uncommon for different firms to have different outlooks with respect to capital market expectations which will give rise to variances in the expected return.

(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 retirees is based on service at retirement. The assumed participation rates decrease as retiree contributions increase. Participation rates for 2014 have changed back to consolidated participation assumptions for non-Medicare eligible and Medicare eligible participants. 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 (e.g. retirees paying 80 percent of the cost of coverage are assumed to decline coverage 40 percent of the time). In the assumption review material prepared and provided by the RHCT actuary, actual participation experience for 2010 – 2013 has been close to expected experience.

(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 2014 have changed back to consolidated participation assumptions for non-Medicare eligible and Medicare eligible participants. In addition, the methodology for setting the dependent participation rates has changed, which results in higher participation rates than in the prior Valuation. Previously, the methodology was that the percent assumed to decline coverage was assumed to be 100 percent of the percent of full cost paid by dependents. The new methodology is the percent that are assumed to decline coverage is 80 percent of the percent of full cost paid by dependents. In the assumption review material prepared and provided by the RHCT's actuary, actual dependent participation experience for 2010 – 2013 was somewhat greater than expected experience, which prompted the change.

(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. The plan election assumption of 97 percent of future Medicare eligible retirees selecting the EN Medicare Advantage Plan and 3 percent selecting the PPN Medicare Advantage Plan is not unreasonable. The RHCT actuary's assumption review materials indicate both assumptions are in line with actual experience.

(K) **Missing Participant Data.** The methodology for assigning values for missing participant data is not unreasonable.

(L) **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 (5/1/2011 – 4/30/2013) 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 plans are based on the premium rates for 2014. Per capita claims for the Medicare prescription drug fully insured Employer Group Waiver Plan (EGWP), plus self-insured wrap plan for

prescription drug coverage, are based on the fully insured premiums plus the self-funded claim estimate for 2014.

The changes in per capita health costs are reasonable for most types of coverage. However, we note that the per capita health costs for other medical coverage over age 65 are increasing 43 percent due to significant premium increases for the Medicare Advantage plans. We also note that the per capita health costs for other prescription drug coverage over age 65 are increasing between 5 percent to 31 percent for male participants, and changing between -11 percent to 3 percent for female participants due to varying these costs by age and gender versus the flat amounts in the prior Valuation. The RHCT actuary indicated this change was made in order to be in compliance with the updated ASOP No. 6, which is effective for measurement dates on or after March 31, 2015.

We believe that the variation in claims by age, as required by the updated ASOP No. 6, may also need to apply for HMO Illinois per capita health costs prior to age 65. Given the effective date for the updated ASOP No. 6 is for measurements on or after March 31, 2015, this can be reviewed as part of a future valuation.

(M) **Health Care Cost Trends.** The RHCT Valuation utilizes the same trend curve for all benefits, including pre- and post-Medicare medical and prescription drugs. The health care trend rates assumed for medical and pharmacy combined are in line with our expectations for the pre-Medicare medical benefits, pre-Medicare prescription drug benefits, and post-Medicare prescription drug benefits. However, due to Medicare Advantage funding cuts passed in the Patient Protection and Affordable Care Act (PPACA), it is possible that double digit trend increases for the Medicare Advantage plans could be experienced in the near future, such as the increase that was experienced for the current year. The RHCT and its actuary should continue to monitor expected increases for this group carefully and consider adopting a separate trend curve for this group for future valuations. The 5 percent ultimate trend is reached in 2024, which is not unreasonable.

(N) **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%.

(O) **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.

(P) **Active Contributions.** Active contributions are assumed to be 3 percent of pay in all future years. In the prior Valuation, active contributions were assumed to increase from 3 percent of pay to 6 percent of pay by 2021. This change was made under the direction of the RHCT Board of Trustees. The Executive Director of the RHCT indicated that the Trustees believe that the benefit plan designs that have been implemented, along with subsequent changes that have been adopted, now allow for a more stable approach to active contributions.

(Q) **Administrative Expense.** The administrative expense assumption for 2014 decreased 33 percent from the 2013 amount. The RHCT actuary indicated this is due to removing an adjustment for the Transitional Reinsurance and Patient Centered Outcomes Research Institute (PCORI) fees enacted as part of the Patient Protection and Affordable Care Act (PPACA). The Transitional Reinsurance fee is now valued as a separate amount for pre-65 participants only.

(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 PPACA, 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 2060 for pre-65 beneficiaries and 2047 for post-65 beneficiaries. Therefore, no liability for Excise Tax has been included in the current Valuation.

Overall, we do 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, 2014 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, 2013 audit of the RHCT, the aggregate amount of retiree, dependent, and survivor contributions for 2013 was $16.1 million. The total cost of retiree health benefits paid from the Trust in 2012 was $47.4 million. The Valuation calculated that the retiree self-pay as a percentage of total cost of benefits was 33.9 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.

## SCOPE OF ANNUAL REVIEW

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, 2014, submitted by the RHCT Board on September 30, 2014. 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, 2014 Actuarial Valuation.

In our *2012 Review of Information Submitted by the Chicago Transit Authority's Retiree Health Care Trust,* we noted that the Retirement Board approved a payroll audit in 2011. The Board's Executive Director expected the audit to be completed by the end of 2012. The purpose of the audit is to ensure that the employers are accurately withholding and remitting employee and employer contributions to the Retirement Plan and Retiree Health Care Trust. The Executive Director stated a draft report was provided to the Trustees of the Retirement Plan in December 2013. The Trustees set a deadline of January 17, 2014 for comments by the remitting employers (the CTA and Local Unions 241 and 308). The Board appointed a subcommittee to consider issues relating to the draft reports and comments received. The subcommittee for the Retirement Plan met several times during 2014 and requested additional information from the parties. At the Board meeting in September 2014, the Retirement Plan Trustees voted to have an arbitrator selected to address certain issues related to the audit.

We inquired of the Executive Director as to whether there were any pending court proceedings that may have a significant impact on the funding of the RHCT. The Executive Director responded that the *Matthews* case, which is before the Illinois Supreme Court, could have a significant impact on either the Retirement Plan or the Retiree Health Care Trust, in the magnitude of $100 million or more. 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

## 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.

(Source: P.A. 95-708, eff. 1-18-08.)

## ILLINOIS PENSION CODE

**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, 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%.

(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.)