State Actuary’s Report of the

Actuarial Assumptions and Valuations of the State-Funded Retirement Systems

December 22, 2021
You can obtain reports by contacting:

Office of the Auditor General
Iles Park Plaza
740 E. Ash
Springfield, IL 62703

217-782-6046 or TTY: 1-888-261-2887

OR

This Audit Report and a Report Digest are also available on the worldwide web at http://www.auditor.illinois.gov
To 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 2021 report on the actuarial assumptions and valuations of the State-funded retirement systems.

This report was conducted pursuant to Public Act 097-0694 which amended the Illinois State Auditing Act by adding a requirement for the Auditor General to annually review assumptions and valuations prepared by the actuaries of the five State-funded retirement systems. In addition, Public Act 100-0465 added a similar requirement to review the Public School Teachers’ Pension and Retirement Fund of Chicago. The report is based on reports prepared by Cheiron, the State Actuary, on each of the State-funded retirement systems.

The report is transmitted in conformance with Section 5/2-8.1(c) of the Illinois State Auditing Act.

Springfield, Illinois
December 2021
State Actuary's Report of the

**Actuarial Assumptions and Valuations of the State-Funded Retirement Systems**

**Background:**

On June 18, 2012, Public Act 097-0694 was signed into law, which directed the Auditor General to contract with or hire an actuary to serve as the State Actuary. Cheiron was selected as the State Actuary. The Public Act directed the State Actuary to:

- Review assumptions and valuations prepared by actuaries of the State-funded retirement systems;
- Issue preliminary reports to the boards of trustees of the State-funded retirement systems concerning proposed certifications of required State contributions; and
- Identify recommended changes to actuarial assumptions that the boards must consider before finalizing their certifications of the required State contributions.

On August 31, 2017, Public Act 100-0465 was signed into law, which added a sixth retirement system to be reviewed by the State Actuary. The Illinois Pension Code was revised to require the Chicago Teachers’ Pension Fund (CTPF) to submit information to the State Actuary similar to the requirement for the other State-funded retirement systems.

**Key Findings:**

- The State Actuary, Cheiron, reviewed the actuarial assumptions used in each of the six systems’ actuarial valuations for the year ended June 30, 2021, and **concluded that they generally were reasonable.** Cheiron did not recommend any changes to the assumptions used in the June 30, 2021 actuarial valuations.
- The combined total of the required Fiscal Year 2023 State contribution for the six retirement systems was **$10.97 billion, an increase of $0.14 billion over the previous year.** Cheiron verified the arithmetic calculations made by the systems’ actuaries to develop the required State contribution and reviewed the assumptions on which it was based.
- The Illinois Pension Code (for TRS, SURS, SERS, JRS, and GARS) establishes a **method that does not adequately fund the systems,** back loading contributions and targeting the accumulation of assets equal to 90% of the actuarial liability in the year 2045. This contribution level does not conform to generally accepted actuarial principles and practices. Generally accepted actuarial funding methods target the accumulation of assets equal to 100% of the actuarial liability, not 90%.
- According to the systems’ 2021 actuarial valuation reports, the funded ratio of the retirement systems ranged from 47.5% (CTPF) to 19.3% (GARS), based on the actuarial value of assets as a ratio to the actuarial liability. If there is a significant market downturn, the unfunded actuarial liability and the required State contribution rate could both increase significantly, putting the sustainability of the systems further into question.
- The interest rate assumption (also called the investment return or discount rate) is the most impactful assumption affecting the required State contribution amount. The retirement systems use varying interest rate assumptions ranging from 6.50 percent to 7.00 percent. The interest rate assumption was lowered by two of the systems (SURS and CTPF) for the 2021 actuarial valuations.
- One of the persistent sources of the increase in unfunded actuarial liability is due to actual contributions to the System being less than the tread water contribution (the amount needed to prevent the unfunded actuarial liability from increasing if all assumptions are met). Actual contributions have been significantly less than the tread water cost. Each year that total contributions remain below the tread water cost, the unfunded actuarial liability is expected to grow.
Key Recommendations:

Cheiron made recommendations for additional disclosures for the 2021 valuations and recommended changes for future valuations. This year’s report contains 36 recommendations compare to 37 in last year’s report. Recommendations included the following:

- While making adequate contributions in the future to fully fund the systems will be challenging, Cheiron continues to recommend that the funding method be changed to fully fund plan benefits.
- Cheiron recommends the Boards continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly. All of the systems complied with this recommendation prior to conducting the 2021 actuarial valuations.
- Because it is reasonable to anticipate future reductions in the discount rate, Cheiron recommended that future stress testing include the impact to the required State contribution of potential reductions in the discount rate.
- Because experience studies are performed every three years, Cheiron recommended that the phase-in period for the impact of assumption changes be reduced to three years.
- Cheiron assessed compliance with both ASOP 51 (assessment and disclosure of risk) and made recommendations to improve the disclosures related to that standard.
Background

On June 18, 2012, Public Act 097-0694 was signed into law, which directed the Auditor General to contract with or hire an actuary to serve as the State Actuary. The Public Act amended the Illinois State Auditing Act as well as sections of the Illinois Pension Code for each of the following State-funded retirement systems:

- The Teachers’ Retirement System (TRS);
- The State Universities Retirement System (SURS);
- The State Employees’ Retirement System (SERS);
- The Judges’ Retirement System (JRS); and
- The General Assembly Retirement System (GARS).

Requirements of Public Act 097-0694

Public Act 097-0694 requires the State Actuary to conduct an annual review of the valuations prepared by the actuaries of the State-funded retirement systems. Specifically the Act requires the State Actuary to:

- Review assumptions and valuations prepared by actuaries retained by the boards of trustees of the State-funded retirement systems;
- Issue preliminary reports to the boards of trustees of the State-funded retirement systems concerning proposed certifications of required State contributions submitted to the State Actuary by those boards; and
- Identify recommended changes to actuarial assumptions that the boards must consider before finalizing their certifications of the required State contributions.

On or before November 1 of each year, beginning November 1, 2012, the boards of each of the systems must submit to the State Actuary a proposed certification of the amount of the required State contribution to the system for the next fiscal year, along with all of the actuarial assumptions, calculations, and data upon which that proposed certification is based.

On or before January 1, 2013, and each January 1 thereafter, the Auditor General shall submit a written report to the General Assembly and Governor documenting the initial assumptions and valuations prepared by actuaries retained by the boards of trustees of the State-funded retirement systems, any changes recommended by the State Actuary in the actuarial assumptions, and the responses of each Board to the State Actuary's recommendations.

On or before January 15, 2013, and every January 15 thereafter, each Board shall certify to the Governor and the General Assembly the amount of the required State contribution for the next fiscal year. The Boards’ certification must note any deviations from the State Actuary’s recommended changes, the reason or reasons for not following the State Actuary's recommended changes, and the
fiscal impact of not following the State Actuary's recommended changes on the required State contribution.

Requirements of Public Act 100-0465

On August 31, 2017, Public Act 100-0465 was signed into law, which added a sixth retirement system to be reviewed by the State Actuary. The Illinois Pension Code was revised to require the Chicago Teachers’ Pension Fund (CTPF) to submit information to the State Actuary similar to the requirement for the other State-funded retirement systems. Public Act 100-0465 specified the following regarding the Chicago Teachers’ Pension Fund:

- For State fiscal year 2018, the State shall contribute $221,300,000 for the employer normal cost.
- Beginning in State fiscal year 2019, the State shall contribute an amount equal to the employer normal cost for that fiscal year.
- On or before November 1 of each year, beginning November 1, 2017, the Board shall submit to the State Actuary, the Governor, and the General Assembly a proposed certification of the amount of the required State contribution to the Fund for the next fiscal year, along with all of the actuarial assumptions, calculations, and data upon which that proposed certification is based.
- On or before January 1 of each year, beginning January 1, 2018, the State Actuary shall issue a preliminary report concerning the proposed certification and identifying, if necessary, recommended changes in actuarial assumptions that the Board must consider before finalizing its certification of the required State contributions.
- On or before January 15, 2018, and each January 15 thereafter, the Board shall certify to the Governor and the General Assembly the amount of the required State contribution for the next fiscal year. The Board's certification must note any deviations from the State Actuary's recommended changes, the reason or reasons for not following the State Actuary's recommended changes, and the fiscal impact of not following the State Actuary's recommended changes on the required State contribution.

Contracting with the State Actuary

On July 12, 2012, the Office of the Auditor General issued a Request for Proposals for the services of a State Actuary. On August 24, 2012, the contract was awarded to Cheiron. Cheiron is a full-service actuarial and consulting firm with offices in seven locations throughout the United States. Cheiron has experience working with multiple public pension plans around the country.
Review of the Actuarial Assumptions

Cheiron reviewed the actuarial assumptions used in each of the six systems’ actuarial valuations for the year ended June 30, 2021, and concluded that they were reasonable. Cheiron did not recommend any changes to the assumptions used in the June 30, 2021 actuarial valuations.

Cheiron did recommend additional disclosures for the 2021 valuations and also recommended changes for future valuations. The systems’ responses to Cheiron’s preliminary reports can be found in Appendix C of this report.

Digest Exhibit 1 summarizes the recommendations made to the retirement systems. At the end of each of the reports located in Chapters One through Six is a chart summarizing the status of recommendations made by the State Actuary in last year’s 2020 report. This year’s report contains 36 recommendations compared to 37 recommendations made in last year’s report.

The following sections discuss some of the key assumptions and recommendations. Further details on the assumptions and recommendations are contained in the State Actuary’s preliminary reports for each of the retirement systems, found in Chapters One through Six of this report.
# RECOMMENDATIONS TO THE RETIREMENT SYSTEMS

<table>
<thead>
<tr>
<th>Recommendations</th>
<th>TRS</th>
<th>SURS</th>
<th>SERS</th>
<th>JRS</th>
<th>GARS</th>
<th>CTPF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Recommended Changes to Actuarial Assumptions used in the 2021 Actuarial Valuations:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cheiron reviewed the actuarial assumptions and concluded that they were reasonable. Consequently, Cheiron did not have any recommended changes to assumptions this year.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Recommended Additional Disclosures for the 2021 Actuarial Valuations:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Include a more detailed explanation of how the new entrant assumption was developed</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Recommended Changes for Future Actuarial Valuations:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Annually review the economic assumptions (interest rate and inflation rate) and adjust assumptions accordingly</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>• Future stress testing include the impact to the required State contribution of potential reductions in the discount rate</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>• To better comply with ASOP 51, explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>• Related to ASOP 51, for each identified risk, provide an assessment, preferably quantitative, that considers the specific circumstances of this plan</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>• Provide additional information about the new entrant population used in the projection such as the average age and service of the population each year</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Revise the inactive vested buyout assumption for future valuations so members who have already been offered a buyout and not taken it are not assumed to take a buyout</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Increase the Full-Time future service accrual rate assumption to 1.0 years of service and consider changes to non-full-time member future service accrual rates</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Disclose historical values of the maturity measures that are significant to understanding the risks identified</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Provide additional explanation and justification for methods used to develop the mortality assumptions</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Other Recommendations:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Change the funding method to fully fund plan benefits and increase contributions to a level that is expected to prevent the unfunded actuarial liability from growing</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>• Reduce the phase-in period for the impact of assumption changes to three years</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>• Given the changes to the accelerated pension benefit assumption, include in the report the basis for the changes</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: OAG summary of Cheiron’s preliminary reports to the six retirement systems.
Economic Assumptions

Cheiron reviewed the economic assumptions utilized in the actuarial valuations for each of the six retirement systems. The following sections discuss two of those assumptions – the interest rate assumption and the inflation assumption.

Interest Rate Assumption

The interest rate assumption (also called the investment return or discount rate) is the most impactful assumption affecting the required State contribution amount. This assumption is used to value liabilities for funding purposes. The retirement systems use varying interest rate assumptions. Digest Exhibit 2 shows the interest rate assumptions for each of the six retirement systems for every year since 2011. As can be seen in the exhibit, the interest rate assumption was lowered by two of the systems (SURS and CTPF) for the 2021 actuarial valuations.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>TRS</td>
<td>8.50%</td>
<td>8.00%</td>
<td>7.50%</td>
<td>7.00%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SURS</td>
<td>7.75%</td>
<td>7.25%</td>
<td>6.75%</td>
<td>6.50%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SERS</td>
<td>7.75%</td>
<td>7.25%</td>
<td>7.00%</td>
<td>6.75%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>JRS</td>
<td>7.00%</td>
<td>6.75%</td>
<td>6.50%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GARS</td>
<td>7.00%</td>
<td>6.75%</td>
<td>6.50%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CTPF</td>
<td>8.00%</td>
<td>7.75%</td>
<td>7.25%</td>
<td>7.00%</td>
<td>6.75%</td>
<td>6.50%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Retirement system actuarial reports.

Cheiron concluded that the interest rate assumptions for all of the systems were reasonable. However, because it is reasonable to anticipate future reductions in the discount rate, Cheiron recommended that future stress testing include the impact to the required State contribution of potential reductions in the discount rate.

As it did in last year’s report, Cheiron again recommended that the Boards annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly. All of the systems complied with this recommendation prior to conducting the 2021 actuarial valuations.

Cheiron noted that declining interest rates have forced pension plans to either reduce their discount rates, increase their exposure to investment risk, or some combination of the two. For example, in 2001 the yield on 10-year Treasury
bonds (a proxy for a risk free investment) was 5.3%. To achieve an assumed return of 8.0%, a system’s investments had to outperform the yield on the 10-year Treasury by 2.7%. As of June 2021, the yield on the 10-year Treasury is now 1.5%, and to achieve an assumed return of 6.5%, a system’s investments need to exceed the 10-year Treasury yield by 5.0%. So, even though, in this example, a system reduced its assumption by 150 basis points, it still has to take more investment risk in 2021 to meet its assumption than it did in 2001.

Cheiron discussed the nationwide movement among pension plans to lower the interest rate assumption. The Public Plans Database is maintained by a partnership between the Center for State and Local Government Excellence and the Center for Retirement Research at Boston College with support from the National Association of State Retirement Administrators. This database contains historical information on large public pension plans, including key assumptions used in their actuarial valuations. Digest Exhibit 3 shows the change in the interest rate assumptions for 177 public pension plans from 2002 through 2020 as of October 27, 2021.

The exhibit shows the shift to lower interest rate assumptions. In 2002, 134 of the 177 plans (76%) used an interest rate assumption of 8.0% or higher. The data as of October 27, 2021, shows that this number has dropped to only 2 of 177 plans.

Digest Exhibit 3
CHANGE IN INTEREST RATE ASSUMPTIONS SINCE 2002
177 Pension Plans in the Nation’s Largest Public Retirement Systems

Source: Public Pension Database as of October 27, 2021.
(1%) that use an interest rate of 8.0% or higher. The median assumption has fallen to 7.25%. Since 2016, 132 of the 177 plans have reduced the interest rate assumption with an average reduction of 0.43%. In addition, in 2020, 80 plans have adopted a rate of 7.0% or lower.

**Inflation Assumption**

The six retirement systems all use an inflation assumption of 2.25% (see Digest Exhibit 4). One of the systems (TRS) lowered the inflation assumption for the 2021 valuations.

Cheiron concluded that the inflation assumptions used by the six retirement systems were reasonable. Cheiron’s rationale for concurring with the inflation assumptions includes the following:

- The August 2021 Old-Age, Survivors, and Disability Insurance Trustees Report projects that over the long-term (next 75 years), inflation will average between 1.8% and 3.0%. Under the intermediate cost projection, the Social Security Administration uses an assumption of 2.4%.

- Cheiron presented three inflation comparisons: 1) the distribution of inflation expectations for the Third Quarter 2021 survey of professional economic forecasters published by the Philadelphia Federal Reserve; 2) the 2021 Horizon survey of investment consultant capital market assumptions (20-year); and 3) the 2020 inflation assumptions used by plans in the Public Plans Database. The 2.25% rate used by the six systems is near the middle of the range projected by professional economic forecasters and investment consultants, and is on the low end of the range used by other public plans.

The inflation assumption primarily impacts the salary increase assumption. The salary increase assumption is generally comprised of the inflation assumption and a productivity, or real wage growth assumption.

### Digest Exhibit 4

**INFLATION ASSUMPTIONS**

**June 30, 2021 Valuation**

<table>
<thead>
<tr>
<th>System</th>
<th>Inflation Rate</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Teachers’ Retirement System</td>
<td>2.25%</td>
<td>Lowered from 2.50% for the June 30, 2021 actuarial valuation</td>
</tr>
<tr>
<td>State Universities Retirement System</td>
<td>2.25%</td>
<td>Lowered from 2.75% for the June 30, 2018 actuarial valuation</td>
</tr>
<tr>
<td>State Employees’ Retirement System</td>
<td>2.25%</td>
<td>Lowered from 2.50% for the June 30, 2019 actuarial valuation</td>
</tr>
<tr>
<td>Judges’ Retirement System</td>
<td>2.25%</td>
<td>Lowered from 2.50% for the June 30, 2019 actuarial valuation</td>
</tr>
<tr>
<td>General Assembly Retirement System</td>
<td>2.25%</td>
<td>Lowered from 2.50% for the June 30, 2019 actuarial valuation</td>
</tr>
<tr>
<td>Chicago Teachers’ Pension Fund</td>
<td>2.25%</td>
<td>Lowered from 2.50% for the June 30, 2020 actuarial valuation</td>
</tr>
</tbody>
</table>

**Source:** Retirement system actuarial reports.
Demographic Assumptions

The retirement systems utilize a number of demographic assumptions such as mortality rates, disability rates, and termination rates. Cheiron reviewed the demographic assumptions and concluded that they were reasonable. Cheiron included additional analysis in its reports on each of the systems. Cheiron collected data from past valuation reports and presented a historical review of past demographic and salary increase experience gains and losses. Results were presented in a chart which showed the pattern of annual gains and losses attributable to different sources. These charts can be found in Chapters One through Six. Different measures were used for each system depending on the information available but sources used included:

- Active and retiree mortality;
- Disability;
- New entrants;
- Benefit recipients;
- Salary increases;
- Retirement; and
- Terminations.

An examination of these trends can be used to determine if adjustments need to be made to assumptions or if additional disclosures need to be made in the actuarial valuation reports. Additional details on the demographic assumptions examined can be found in the chapters for each of the six retirement systems.
Proposed Certification of Required State Contribution

Each of the six retirement systems submitted to the State Actuary a proposed certification of the amount of the required State contribution for that system. Cheiron verified the arithmetic calculations made by the systems’ actuaries to develop the required State contribution and reviewed the assumptions on which it was based. Digest Exhibit 5 shows the amounts of proposed State contributions submitted by the systems for Fiscal Year 2023 and compares it to the previous year’s contribution. Overall, the required State contribution increased from $10.83 billion to $10.97 billion, an increase of $0.14 billion.

Digest Exhibit 5
AMOUNTS OF STATUTORILY REQUIRED STATE CONTRIBUTIONS

<table>
<thead>
<tr>
<th>System</th>
<th>State Contribution (for Fiscal Year 2022)</th>
<th>State Contribution (for Fiscal Year 2023)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Teachers’ Retirement System</td>
<td>$5,694,106,973</td>
<td>$5,894,032,209</td>
</tr>
<tr>
<td>State Universities Retirement System</td>
<td>$2,106,648,000</td>
<td>$2,123,615,000</td>
</tr>
<tr>
<td>State Employees’ Retirement System</td>
<td>$2,586,086,000</td>
<td>$2,484,585,000</td>
</tr>
<tr>
<td>Judges’ Retirement System</td>
<td>$152,422,000</td>
<td>$142,659,000</td>
</tr>
<tr>
<td>General Assembly Retirement System</td>
<td>$27,820,000</td>
<td>$27,174,000</td>
</tr>
<tr>
<td>Chicago Teachers’ Pension Fund¹</td>
<td>$264,848,000</td>
<td>$295,302,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$10,831,930,973</strong></td>
<td><strong>$10,967,367,209</strong></td>
</tr>
</tbody>
</table>

¹The State contribution for CTPF is limited to the employer normal cost for that fiscal year.
Source: 2021 Retirement system actuarial valuation reports.

Cheiron noted that, in accordance with 30 ILCS 5/2-8.1, its review does not include a replication of the actuarial valuation results. Beginning with the December 2014 State Actuary Report, Cheiron recommended that the Boards periodically undertake a full scope actuarial audit, utilizing the services of a reviewing actuary. Such an audit should fully replicate the original actuarial valuation, based on the same census data, assumptions, and actuarial methods used by the Systems’ actuaries. This does not apply to CTPF as Cheiron’s review of CTPF is more limited in scope.

Prior to this year, two of the systems (TRS and SURS) complied with this recommendation but SERS, JRS, and GARS had not. However, the Boards have retained an independent actuary to perform a full scope actuarial audit which is expected to be completed by January 2022.
Actuarial Funding Methods

Actuarial funding methods consist of three components: (1) the actuarial cost method, which is the attribution of total costs to past, current, and future years; (2) the asset valuation method (i.e., asset smoothing); and (3) the amortization method.

Actuarial Cost Method

All of the retirement systems use the Projected Unit Credit cost method to assign costs to years of service. This method is required under the Illinois Pension Code. Cheiron had no objection to using the Projected Unit Credit cost method as it is an acceptable method that is used by other public sector pension funds. However, Cheiron would prefer the Entry Age Normal funding method as it is more consistent with the Pension Code’s requirement for level percentage of pay funding.

Under the Projected Unit Credit method, the benefits of active participants are calculated based on their compensation projected with assumed annual increases to ages at which they are assumed to leave the active workforce by any of these causes: retirement, disability, turnover, or death. Only past service (through the valuation date but not beyond) is taken into account in calculating these benefits. The present value of these benefits based on past service and future compensation is the actuarial accrued liability for a given active participant. Under the Projected Unit Credit cost method, the value of an active participant’s benefits tends to increase more sharply over their later years of service than over their earlier ones.

As a result of this pattern of benefit values increasing, while the Projected Unit Credit method is not an unreasonable method, more plans use the Entry Age Normal funding method to mitigate this effect. It should also be noted that the Entry Age Normal method is the required method to calculate liability for the Governmental Accounting Standards Board Statements 67 and 68.

Asset Valuation Method

The actuarial value of assets for the systems is a smoothed market value. Unanticipated changes in market value are recognized over five years for all of the systems except CTPF, which smooths over four years. The primary purpose for smoothing out gains and losses over multiple years is so fluctuations in the contributions will be less volatile over time than if based on the market value of assets. Cheiron concurred with the use of the asset smoothing method noting that smoothing the market gains and losses over a period of years to determine the actuarial value of assets is a generally accepted approach in determining actuarial cost.

Amortization Method

The mandated State contribution is based on a determination of the level percentage of payroll that is expected to achieve a 90% funded ratio in 2045 (2059 for CTPF). While not a traditional amortization method, this methodology
effectively amortizes a portion of the unfunded actuarial liability over the remaining period until 2045, which is currently 25 years.

One of the principles of funding public plans identified by the American Academy of Actuaries is that there should be “a plan to make up for any variations in actual assets from the funding target within a defined and reasonable time period.” Because it only targets 90%, the State method does not include a plan to achieve the funding target over any period of time.

Typical public plan amortization methods are designed to increase each year by expected payroll growth. Under the State mandated method, however, the effective amortization payment increases each year by more than the expected growth in payroll. As a result, the State mandated method defers payments on the unfunded actuarial liability further into the future than under typical public plan amortization methods.
State Mandated Funding Method

The Illinois Pension Code (for TRS, SURS, SERS, JRS, and GARS) establishes a method that does not adequately fund the systems, back loading contributions and targeting the accumulation of assets equal to 90% of the actuarial liability in the year 2045. This contribution level does not conform to generally accepted actuarial principles and practices. Generally accepted actuarial funding methods target the accumulation of assets equal to 100% of the actuarial liability, not 90%.

Cheiron continues to recommend that the funding method be changed to fully fund plan benefits. The funding method should ultimately target 100% of the actuarial liability, and contributions should ramp up as quickly as possible to a level that is expected to prevent the unfunded actuarial accrued liability from growing and remain high enough to reduce the unfunded actuarial liability each year until the plans are ultimately 100% funded. While making adequate contributions will be challenging, continuing the practice of underfunding the systems increases the risk of needing even larger contributions in the future that may make the systems unsustainable.

In the actuarial valuation reports, the systems’ actuaries discuss their concerns with the State mandated funding method. The actuarial valuation reports include recommended funding policies that conform to a goal of full funding within a reasonable time period and conform with generally accepted actuarial principles and practices.

Based on the systems’ 2021 actuarial valuation reports, the funded ratio of the systems ranged from 47.5% (CTPF) to 19.3% (GARS) based on the actuarial value of assets as a ratio to the actuarial liability (see Digest Exhibit 6). If there is a significant market downturn, the unfunded actuarial liability and the required State contribution rate could both increase significantly, putting the sustainability of the systems further into question. Cheiron recommended stress testing be done to better understand risks to the sustainability of the systems.

Recognition of Changes in Actuarial Assumptions

Public Act 100-0023, effective July 6, 2017, modified the State’s funding policy to require that the contribution impact of all assumption changes be phased-in over a five-year period. As such, the Act delays the funding of the System. Assumption changes are intended to more accurately anticipate the obligations for funding based on the most recent experience analysis and forward-looking changes to future investment returns. However, only one-fifth of the impact of these changes is now recognized from the date of adoption. The remainder of the impact is recognized over four additional years such that the full impact is
only recognized at the end of a five-year period beginning at the date of adoption. This phase-in provides time to adjust to a higher level of contributions.

However, the Conference of Consulting Actuaries White Paper on Actuarial Funding Policies and Practices for Public Pension Plans recommends that the “phase-in period should be no longer than the time period until the next review of assumptions.” Because experience studies are performed every three years, Cheiron recommended that the phase-in period for the impact of assumption changes be reduced to three years. However, changing the funding method is under the jurisdiction of State law and not the Retirement Systems.

Assessment and Disclosure of Risk

A new Actuarial Standard of Practice (ASOP) was introduced, ASOP 51, and was effective for the systems’ actuarial valuation starting June 30, 2019. ASOP 51 provides guidance to actuaries on the assessment and disclosure of risks to help readers of the actuarial valuation report “understand the effects of future experience differing from the assumptions used” and “the potential volatility of future measurements resulting from such differences.”

Cheiron assessed compliance with ASOP 51 for five of the systems (TRS, SERS, SERS, JRS, and GARS.) For four of the systems (SERS, SERS, JRS and GARS), Cheiron recommended:

- The actuary explain how each risk identified would significantly affect the specific plan’s future financial condition.
- For each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of this plan.
Analysis Of Funding Adequacy

Cheiron examined the adequacy of the funding for the systems, including funded ratio, the sources of changes in the unfunded actuarial liability, and projections of the unfunded actuarial liability. This analysis is contained in the State Actuary’s preliminary reports for each of the retirement systems, found in Chapters One through Six of this report.

One of the persistent sources of the increase in unfunded actuarial liability is due to actual contributions to the System being less than the tread water contribution (the amount needed to prevent the unfunded actuarial liability from increasing if all assumptions are met).

Digest Exhibit 7 shows the combined historical and projected contributions for five of the systems (TRS, SURS, SERS, JRS, and GARS). As the chart below shows, actual contributions have been significantly less than the tread water cost. Each year that total contributions remain below the tread water cost (blue line), the unfunded actuarial liability is expected to grow. As shown in the graph below, the contributions from the State will need to increase before the total contribution reaches the tread water contribution and begins to pay down the unfunded actuarial liability.

<table>
<thead>
<tr>
<th>Fiscal Year Ending</th>
<th>Historical and Projected Contributions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Billions</td>
</tr>
<tr>
<td>2011</td>
<td>$4.3</td>
</tr>
<tr>
<td>2013</td>
<td>$5.7</td>
</tr>
<tr>
<td>2015</td>
<td>$6.9</td>
</tr>
<tr>
<td>2017</td>
<td>$7.6</td>
</tr>
<tr>
<td>2019</td>
<td>$8.4</td>
</tr>
<tr>
<td>2021</td>
<td>$9.8</td>
</tr>
<tr>
<td>2023</td>
<td>$10.6</td>
</tr>
<tr>
<td>2025</td>
<td>$10.8</td>
</tr>
<tr>
<td>2027</td>
<td>$10.9</td>
</tr>
<tr>
<td>2029</td>
<td>$11.3</td>
</tr>
<tr>
<td>2031</td>
<td>$11.7</td>
</tr>
<tr>
<td>2033</td>
<td>$12.1</td>
</tr>
<tr>
<td>2035</td>
<td>$13.3</td>
</tr>
<tr>
<td>2037</td>
<td>$13.8</td>
</tr>
<tr>
<td>2039</td>
<td>$14.4</td>
</tr>
<tr>
<td>2041</td>
<td>$15.0</td>
</tr>
<tr>
<td>2043</td>
<td>$15.6</td>
</tr>
<tr>
<td>2045</td>
<td>$16.3</td>
</tr>
</tbody>
</table>

Source: Cheiron analysis of system funding adequacy.
Responses to the Recommendations

Each of the six retirement systems provided responses to Cheiron’s recommendations contained in the preliminary reports. The systems generally agreed with Cheiron’s recommendations. The complete responses are in Appendix C.

This annual review was conducted by Cheiron, the State Actuary, with the assistance of the staff of the Office of the Auditor General.

---

SIGNED ORIGINAL ON FILE

JOE BUTCHER
Division Director

This report is transmitted in accordance with Section 5/2-8.1(c) of the Illinois State Auditing Act.

---

SIGNED ORIGINAL ON FILE

FRANK J. MAUTINO
Auditor General

FJM:DBJ
## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Report Highlights</td>
<td></td>
</tr>
<tr>
<td>Report Digest</td>
<td>iii</td>
</tr>
<tr>
<td>Glossary</td>
<td></td>
</tr>
<tr>
<td>Chapter One: Preliminary Report on the Teachers' Retirement System</td>
<td>1</td>
</tr>
<tr>
<td>Chapter Two: Preliminary Report on the State Universities Retirement System</td>
<td>45</td>
</tr>
<tr>
<td>Chapter Three: Preliminary Report on the State Employees' Retirement System</td>
<td>91</td>
</tr>
<tr>
<td>Chapter Four: Preliminary Report on the Judges’ Retirement System</td>
<td>139</td>
</tr>
<tr>
<td>Chapter Five: Preliminary Report on the General Assembly Retirement System</td>
<td>177</td>
</tr>
<tr>
<td>Chapter Six: Preliminary Report on the Chicago Teachers’ Pension Fund</td>
<td>215</td>
</tr>
<tr>
<td>Appendix A: Illinois State Auditing Act</td>
<td>245</td>
</tr>
<tr>
<td>Appendix B: Materials Reviewed by Cheiron</td>
<td>247</td>
</tr>
<tr>
<td>Appendix C: Responses from the Retirement Systems</td>
<td>253</td>
</tr>
</tbody>
</table>
### Glossary

<table>
<thead>
<tr>
<th><strong>Term</strong></th>
<th><strong>Definition</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Actuarial Assumptions</strong></td>
<td>Estimates of future experience with respect to rates of mortality, disability, turnover, retirement, investment income, and salary increases. Demographic assumptions (rates of mortality, disability, turnover, and retirement) are generally based on past experience, often modified for projected changes in conditions. Economic assumptions (salary increases and investment income) consist of an underlying rate in an inflation-free environment plus a provision for a long-term average rate of inflation.</td>
</tr>
<tr>
<td><strong>Actuarial Gain (Loss)</strong></td>
<td>A measure of the difference between actual experience and that expected based upon a set of Actuarial Assumptions, during the period between two actuarial valuation dates, as determined in accordance with a particular Actuarial Cost Method.</td>
</tr>
<tr>
<td><strong>Actuarial Liability</strong></td>
<td>The Actuarial Liability is the Actuarial Present Value of all benefits accrued as of the valuation date using the methods and assumptions of the valuation. It is also referred to by some actuaries as the “accrued liability” or “actuarial accrued liability.”</td>
</tr>
<tr>
<td><strong>Actuarial Present Value</strong></td>
<td>The amount of funds currently required to provide a payment or series of payments in the future. It is determined by discounting future payments at predetermined rates of interest and by probabilities of payment.</td>
</tr>
<tr>
<td><strong>Actuarial Value of Assets (AVA)</strong></td>
<td>The Actuarial Value of Assets equals the Market Value of Assets adjusted according to the smoothing method in accordance with Illinois Law. The smoothing method is intended to smooth out the short-term volatility of investment returns in order to stabilize contribution rates and the Funded Ratio.</td>
</tr>
<tr>
<td><strong>Actuarial Cost Method</strong></td>
<td>A mathematical budgeting procedure for allocating the dollar amount of the Present Value of Future Benefits between the Present Value of Future Normal Cost and the Actuarial Liability. This is sometimes referred to as the “actuarial funding method.”</td>
</tr>
<tr>
<td><strong>Asset Smoothing Method</strong></td>
<td>A method of asset valuation where the annual fluctuation in the Market Value of Assets is averaged over a period of years. See Actuarial Value of Assets above.</td>
</tr>
<tr>
<td><strong>Entry Age Normal (EAN)</strong></td>
<td>A method under which the Present Value of Future Benefits of each individual included in an actuarial valuation is allocated on a level basis over the earnings or service of the individual between entry age and assumed exit age(s). The portion of this Present Value of Future Benefits</td>
</tr>
</tbody>
</table>
allocated to a valuation year is called the Normal Cost. The portion of this Present Value of Future Benefits not provided for at a valuation date by the Present Value of Future Normal Costs is called the Actuarial Liability.

<table>
<thead>
<tr>
<th>Glossary Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Funded Ratio</strong></td>
<td>The Actuarial Value of Assets divided by the Actuarial Liability. The Funded Ratio represents the percentage of assets in the System compared to the budgeted amount under the Projected Unit Credit Actuarial Cost Method. The Funded Ratio can also be calculated using the Market Value of Assets.</td>
</tr>
<tr>
<td><strong>Governmental Accounting Standards Board</strong></td>
<td>The Governmental Accounting Standards Board (GASB) defines the accounting and financial reporting requirements for governmental entities. GASB Statement No. 67 defines the plan accounting and financial reporting for governmental pension plans, and GASB Statement No. 68 defines the employer accounting and financial reporting for participating in a governmental pension plan.</td>
</tr>
<tr>
<td><strong>Market Value of Assets (MVA)</strong></td>
<td>The fair value of the System’s assets assuming that all holdings are liquidated on the measurement date.</td>
</tr>
<tr>
<td><strong>Normal Cost</strong></td>
<td>The annual cost assigned, under the Actuarial Cost Method, to current and subsequent plan years. Sometimes referred to as “current service cost.” Any payment toward the Unfunded Actuarial Liability is not part of the Normal Cost.</td>
</tr>
<tr>
<td><strong>Present Value of Future Benefits</strong></td>
<td>The estimated amount of assets needed today to pay for all benefits promised in the future to current members of the System assuming all Actuarial Assumptions are met.</td>
</tr>
<tr>
<td><strong>Present Value of Future Normal Costs</strong></td>
<td>The Actuarial Present Value of retirement system benefits allocated to future years of service.</td>
</tr>
<tr>
<td><strong>Projected Unit Credit (PUC)</strong></td>
<td>A method under which the benefits of each individual included in an actuarial valuation are allocated by a consistent formula to the years in which they are earned. The Actuarial Present Value of benefits allocated to a valuation year is called the Normal Cost. The Actuarial Present Value of benefits allocated to all periods prior to a valuation year is called the Actuarial Liability.</td>
</tr>
<tr>
<td><strong>Unfunded Actuarial Liability (UAL)</strong></td>
<td>The Unfunded Actuarial Liability represents the difference between the Actuarial Liability and Actuarial Value of Assets. This is sometimes referred to as “unfunded accrued liability.”</td>
</tr>
</tbody>
</table>
Chapter One

Preliminary Report on the Teachers’ Retirement System

In accordance with 30 ILCS 5/2-8.1, Cheiron, the State Actuary, submitted a preliminary report to the Board of Trustees of the Teachers’ Retirement System (TRS) concerning proposed certifications of required State contributions submitted to Cheiron by the Board. The preliminary report was submitted to TRS on November 30, 2021. The preliminary report was based on Cheiron’s review of actuarial assumptions included in TRS’ 2021 Actuarial Valuation Report.

Following is Cheiron’s final preliminary report on the Teachers’ Retirement System. TRS’ written response, provided on December 10, 2021, can be found in Appendix C.

<table>
<thead>
<tr>
<th>OVERVIEW</th>
<th>TEACHERS’ RETIREMENT SYSTEM</th>
</tr>
</thead>
<tbody>
<tr>
<td>as of June 30, 2021</td>
<td></td>
</tr>
</tbody>
</table>

| Actuarial accrued liability | $138,914,274,917 |
| Actuarial value of assets    | $58,979,922,966  |
| Unfunded liability          | $79,934,351,951  |
| Funded ratio                | 42.5%            |

| Employer normal cost        | $1,225,163,940   |
| State contribution (FY23)   | $5,894,032,209   |

| Active members              | 162,949          |
| Inactive members            | 144,574          |
| Current benefit recipients  | 126,594          |
| Total membership            | 434,117          |

| Interest rate assumption    | 7.00%            |
| Inflation assumption        | 2.25%            |
| Actuarial cost method       | Projected Unit Credit |
| Asset valuation method      | 5-year Smoothing  |

Executive Director Stan Rupnik
Actuarial Firm Segal Consulting

Source: June 30, 2021 TRS actuarial valuation report.
December 15, 2021

Mr. Frank Mautino  
Auditor General  
740 East Ash Street  
Springfield, Illinois 62703

Board of Trustees  
Teachers’ Retirement System of the State of Illinois  
2815 West Washington Street  
Springfield, Illinois 62702

Dear Trustees and Auditor General:

In accordance with the Illinois State Auditing Act (30 ILCS 5/2-8.1), Cheiron is submitting this preliminary report concerning the proposed certification prepared by Segal Consulting (Segal) of the required State contribution to the Teachers’ Retirement System of the State of Illinois (TRS or System) for Fiscal Year 2023.

In summary, we believe that the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable. We also find that the certified contributions, notwithstanding the inadequate State funding requirements that do not conform to generally accepted actuarial principles and practices, were properly calculated in accordance with State law.

Section I of this report describes the review process undertaken by Cheiron. Section II summarizes our findings and recommendations. Section III provides the supporting analysis for those findings and presents more details on our assessment of the actuarial assumptions and methods employed in Segal’s Actuarial Certification, as well as our assessment of Segal’s determination of the required State contribution for Fiscal Year 2023. Section III also includes comments on other issues impacting the funding of the Teachers’ Retirement System, including the implications of Article 16 of the Illinois Pension Code, which establishes the statutory minimum funding requirements for the System. We agree with Segal’s opinion that the statutory mandated minimum funding requirements have produced inadequate funding of the Plan resulting in TRS being among the worst funded retirement systems in the country. In addition, this past inadequate funding has resulted in current and future contribution levels, measured as a percent of payroll, to be amongst the highest in the country. Making adequate contributions in the future to fully fund the system will be challenging. Section IV reviews the projections contained in the draft June 30, 2021 Actuarial Valuation. Finally, Section V provides an analysis of funding adequacy.

In preparing this report, we relied on information (some oral and some written) supplied by TRS and Segal. This information includes actuarial assumptions and methods adopted by the TRS Board, plan provisions, the draft June 30, 2021 Actuarial Valuation, minutes of the 2021 plan year TRS Board of Trustee meetings, Segal’s investment assumption presentation of June 2021,
and various studies and memos prepared by the System’s advisors, staff, and Executive Director. A detailed description of all information provided for this review is contained in Appendix B.

This report and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices and our understanding of the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board as well as applicable laws and regulations. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this report. This report does not address any contractual or legal issues. We are not attorneys, and our firm does not provide any legal services or advice.

This report was prepared exclusively for the Office of the Auditor General and the Teachers’ Retirement System of the State of Illinois for the purpose described herein. Other users of this report are not intended users as defined in the Actuarial Standards of Practice, and Cheiron assumes no duty or liability to any other user.

Sincerely,

Cheiron

SIGNED ORIGINAL ON FILE

Coralie A. Taylor, FSA, FCA, MAAA, EA
Consulting Actuary

William R. Hallmark, ASA, FCA, MAAA, EA
Consulting Actuary
THE STATE ACTUARY’S PRELIMINARY REPORT ON THE
TEACHERS’ RETIREMENT SYSTEM OF THE STATE OF ILLINOIS
PURSUANT TO 30 ILCS 5/2-8.1

SECTION I – REPORT SCOPE

Illinois Public Act 097-0694 (the Act) amended the Illinois State Auditing Act (30 ILCS 5/2-8.1) and requires Cheiron, as the State Actuary, to review the actuarial assumptions and valuation of the Teachers’ Retirement System of the State of Illinois (TRS or System) and to issue to the TRS Board this preliminary report on the proposed certification prepared by Segal Consulting (Segal) of the required State contribution for Fiscal Year (FY) 2023. The purpose of this review is to identify any recommended changes to the actuarial assumptions and methods for the TRS Board to consider before finalizing its certification of the required State contribution for FY 2023.

While the Act states that just the actuarial assumptions and valuation are to be reviewed, we have also reviewed the actuarial methodologies (funding and asset smoothing methods) employed in preparing the Actuarial Certification, as these methods can have a material effect on the amount of the State contribution being certified. Finally, we have offered our opinion on the implications of Article 16-158 of the Illinois Pension Code, which impacts the contribution amount certified by Segal.

In conducting this review, Cheiron reviewed the draft June 30, 2021 Actuarial Valuation prepared by Segal, minutes of the 2021 Board of Trustees meetings, and various studies and memos prepared by the System’s advisors, staff, and Executive Director. A detailed description of all information reviewed is contained in Appendix B.

In addition to reviewing the Actuarial Certification of the required State contribution to TRS, the Act requires the State Actuary to conduct a review of the “actuarial practices” of the Board. While the term “actuarial practices” was not defined in the Act, we continue to interpret this language to mean that we reviewed: (1) the use of a qualified actuary (as defined in the Qualification Standards of the American Academy of Actuaries) to prepare the annual actuarial valuation for determining the required State contribution; and (2) the conduct of periodic formal experience studies to justify the assumptions used in the actuarial valuation. In addition, we have included comments on actuarial communication and compliance with Actuarial Standards of Practice (ASOP) reflected in the draft June 30, 2021 Actuarial Valuation.
SECTION II – SUMMARY OF RECOMMENDATIONS

This section summarizes recommendations from our review of the actuarial assumptions and methods employed in the draft June 30, 2021 Actuarial Valuation of TRS as well as the “actuarial practices” of the TRS Board. Section III of this report provides detailed analysis and rationale for these recommendations.

Proposed Certification of the Required State Contribution

Segal has determined that the FY 2023 required State contribution calculated under the current statutory funding requirements is $5,894,032,209. We have verified the arithmetic calculations made by Segal to develop this required State contribution and have reviewed the assumptions on which it was based. We have accepted Segal’s annual projections of future payroll, total normal costs, employee contributions, combined benefit payments and expenses, and total contributions.

State Mandated Funding Method

1. We continue to recommend that the funding method be changed to fully fund plan benefits. We recognize that increasing contributions may be challenging, but continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the System becoming unsustainable. Consequently, we recommend that the funding method require contributions at a level that is expected to reduce the unfunded actuarial liability each year until the plan is ultimately 100% funded. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Recognition of Changes in Actuarial Assumptions

Public Act 100-0023 (P.A. 100-0023), effective July 6, 2017, modified the State’s funding policy to require that the contribution impact of all assumption changes be phased-in over a five-year period.

2. Because experience studies are performed every three years, we recommend that the phase-in period for the impact of assumption changes be reduced to three years. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Optional Hybrid Plan

P.A. 100-0023 created an Optional Hybrid Plan for current Tier 2 members and future new hires. The Optional Hybrid Plan consists of a reduced defined benefit plan and a defined contribution plan. Segal has not reflected the Hybrid Plan in the June 30, 2021 Actuarial Valuation. We understand that TRS will not implement the Optional Hybrid Plan until clarifying legislation is passed. Given the need for clarifying legislation, we believe it is reasonable not to reflect the Hybrid Plan in the current valuation.
Earnings That Exceed the Governor’s Salary

P.A. 100-0023 requires employers to make an additional contribution for participants who have annual earnings that currently exceed, or are projected to exceed, the Governor’s current or projected salary. The additional contribution is equal to the employer normal cost rate multiplied by salary in excess of the Governor’s current or projected salary.

We have verified that Segal has reflected these additional employer contributions in the development of the net State contribution.

Accelerated Pension Benefit Payments

P.A. 100-0587 created two accelerated pension benefit payment options. Inactive vested members have the option of receiving a lump-sum equal to 60% of the present value of their benefits in lieu of their annuity benefits, and Tier 1 members have the option upon retirement of accepting a reduced automatic increase in exchange for a lump-sum equal to 70% of the present value of the reduced annuity benefits. Eligible members must make an election by June 30, 2024 if they want to receive the accelerated pension benefit payments.

On a preliminary basis, Segal had opted to use the same assumptions as the Illinois Legislature that 22% of inactive vested members will elect the accelerated pension benefit payment in lieu of their annuity benefits, and 15% (from 25% used by the Legislature) of eligible retiring Tier 1 members will elect the accelerated pension benefit payment for a reduction in their automatic annual increases. For the June 30, 2021 Actuarial Valuation, the assumptions have been set to 5% for the inactive vested member buyout, and 20% for the Automatic Annual Increase buyout based on recent plan experience. Segal will continue to monitor actual experience and may revise this assumption as experience emerges. We believe this approach is reasonable.

Assessment of Actuarial Assumptions Used in the 2021 Valuation

30 ILCS 5/2-8.1 requires the State actuary to identify recommended changes in actuarial assumptions that the TRS Board must consider before finalizing its certification of the required State contribution. We have reviewed all the actuarial assumptions used in the draft June 30, 2021 Actuarial Valuation and conclude that the assumptions are reasonable in general, based on the evidence provided to us.
Recommended Additional Disclosures for the 2021 Valuation

3. We recommend that Segal include a more detailed explanation of how the new entrant assumption was developed.

Recommended Changes for Future Valuations

4. We continue to recommend that Segal provide additional information in the valuation report about the new entrant population used in its projection such as the average age and service of the population each year.

5. We recommend the TRS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation. However, we also recommend that Segal take into consideration the TRS investment consultant’s expected returns in developing the investment return assumptions.

6. We recommend that future stress testing include the impact to the required State contribution of potential reductions in the discount rate.

7. We recommend that Segal revise the inactive vested buyout assumption for future valuations so members who have already been offered a buyout and not taken it are not assumed to take a buyout in the future.

8. We recommend that Segal increase the Full-Time future service accrual rate assumption to 1.0 years of service and consider non-full-time member future service accrual rates that reflect recent experience on an individual basis.

9. We recommend that Segal disclose historical values of the maturity measures that are significant to understanding the risks identified along with projections of these measures to the extent they are readily available from the current projections.

GASB 67 and 68

The 2021 TRS GASB Nos. 67 and 68 information was provided in the 2021 Valuation. We find that the assumptions and methods used to prepare the 2021 TRS GASB Nos. 67 and 68 schedules are reasonable based on the materials provided to us.
In this section, we provide detailed analysis and supporting rationale for the recommendations that were presented in Section II of this report.

**Proposed Certification of the Required State Contribution**

As stated in our summary of recommendations in Section II, we have verified the arithmetic calculations made by Segal to develop the required State contribution, reviewed the assumptions on which it is based, and accepted Segal’s annual projections of future payroll, total normal costs, benefits, expenses, and total contributions. However, in accordance with 30 ILCS 5/2-8.1, our review does not include a replication of the actuarial valuation results.

**State Mandated Methods**

The Illinois Pension Code (40 ILCS 5/14-131) establishes a method that does not adequately fund the System, back loading contributions and targeting the accumulation of assets equal to 90% of the Actuarial Liability in the year 2045. This contribution level does not conform to generally accepted actuarial principles and practices. Generally accepted actuarial funding methods target the accumulation of assets equal to 100% of the Actuarial Liability, not 90%.

We continue to recommend that the funding method be changed to fully fund plan benefits (Recommendation #1). The funding method should ultimately target 100% of the actuarial accrued liability. Contributions should ramp up as quickly as possible to a level that is expected to prevent the unfunded actuarial liability from growing and remain high enough to reduce the unfunded actuarial liability each year until the plan is ultimately 100% funded. While making adequate contributions will be challenging, continuing the practice of underfunding the System increases the risk of needing even larger contributions in the future that may make the System unsustainable.

In its draft June 30, 2021 Actuarial Valuation on page 9, Segal comments that the statutory funding method calls for contributions in fiscal year 2022 that are insufficient to reduce the unfunded actuarial liability. In the same report on pages 14 through 17, Segal also demonstrates the implications of the statutory funding amounts on the growth of the unfunded actuarial liability. With support of the TRS Board, Segal reports on an alternative funding policy that they consider adequate and refers to this method as the Board-Adopted Actuarial Funding Policy. Using this methodology, the State’s contribution amount would be $9,101,633,224 for FY 2023. While we concur with Segal’s recommendations and demonstration of an alternative funding approach, we do not believe that requesting the nearly $9 billion in State contributions for FY 2023 is plausible. We would seek to modify this recommended funding policy to one that ramps up towards full funding in a manner that is plausible.

The method Segal calls the Board-Adopted Actuarial Funding Policy is described in Section 2 beginning on page 39 of their Actuarial Valuation Report with the cost developed on page 39. The method includes the following provisions:
SECTION III – SUPPORTING ANALYSIS

- The use of the Entry Age Normal Method (EAN) instead of the Projected Unit Credit (PUC) method. This is the same method required for the GASB Nos. 67 and 68 disclosures. Actuarial methods differ in how they allocate the cost of benefits over a participant’s lifetime. PUC, which is called for in the statutory contribution determination, determines the cost of benefits at the participant’s attained age. Therefore, as a participant gets older and the anticipated benefits are discounted over a decreasing period from expected retirement to attained age, their cost—the normal cost—will increase. With a large group and stable population, the actual normal costs don’t necessarily increase because the average age of the population remains constant. Under EAN, the normal cost is determined as a level percent of pay from age at entry into the system to normal retirement. This method typically provides a more stable cost as a percent of pay and is the same method adopted by GASB for the Statement 67 and 68 disclosures.

- The unfunded liability under the Board-Adopted Actuarial Funding Policy is amortized over 20 years on an increasing basis, with the annual payments scheduled to increase by 2.0%. The rate of 2.0% is to reflect, according to Segal, the expected State revenue growth rate. This assumption should be documented, and a reference cited for the source in the valuation report, as well as an explanation of why revenue growth is expected to be lower than inflation. Amortizing the unfunded liability on an increasing basis can be an issue because it can result in the initial payments not being sufficient to cover the interest cost. However, selection of the 20 years and use of 2.0% as a proxy for the annual increase rate expected for the State’s general revenue results in the first and all future payments of each amortization base covering the interest cost on the unfunded liability as well as a portion of the principal. We have confirmed TRS’ statement that, based on this method of amortization, the principal on the unfunded liability would begin to be paid down in the first year.

- All future changes to the unfunded liability not attributable to the current amortization amounts such as experience, benefit changes, and changes in assumptions are to be amortized using the same 20-year amortization methodology.

Based on the draft June 30, 2021 Actuarial Valuation and the State mandated funding method, the funded ratio, measured as the ratio of the Actuarial Value of Assets to the Actuarial Liability, is currently at 42.5%. The unfunded actuarial liability is currently about $80 billion and is expected to decrease in the future as asset gains are recognized. The required State contribution rate is 45.8% of payroll for FY 2021 and is projected to increase to about 50.5% of payroll for FY 2023. The required State contribution rate is expected to increase to about 51.6% of payroll for FY 2034 when the pension obligation bonds have been paid off. If there is a significant market downturn, the unfunded actuarial liability and the required State contribution rate could both increase significantly, putting the sustainability of the system further into question. Stress testing should be performed to better understand these risks and the potential advantages of additional contributions in the near term to maintain the sustainability of the system.
Recognition of Changes in Actuarial Assumptions

Public Act 100-0023 (P.A. 100-0023), effective July 6, 2017, modified the State’s funding policy to require that the contribution impact of all assumption changes, including changes prior to P.A. 100-0023, be phased-in over a five-year period. As such, the Act delays the funding of the System. Assumption changes are intended to more accurately anticipate the obligations for funding based on the most recent experience analysis and forward-looking changes to future investment returns. However, only one-fifth of the impact of these changes are now recognized from the date of adoption. The remainder of the impact is recognized over four additional years such that the full impact is only recognized at the end of a five-year period beginning at the date of adoption. This phase-in provides time to adjust to a higher level of contributions. However, the Conference of Consulting Actuaries White Paper on Actuarial Funding Policies and Practices for Public Pension Plans recommends that the “phase-in period should be no longer than the time period until the next review of assumptions.” Since experience studies are performed every three years, we recommend the phase-in period for the impact of assumption changes be reduced to three years (Recommendation #2).

Optional Hybrid Plan

P.A. 100-0023 created an Optional Hybrid Plan (Tier 3) for current Tier 2 members and future new hires. The Optional Hybrid Plan consists of a reduced defined benefit plan and a defined contribution plan. In general, the defined benefit component is based on a ten-year final average pay (compared to an eight-year final average pay and unlimited pay for Tier 2), a 1.25% multiplier compared to 2.2% for Tier 2.

Segal has not reflected the Tier 3 Optional Hybrid Plan in the June 30, 2021 Actuarial Valuation. We understand that TRS will not implement the Optional Hybrid Plan until clarifying legislation is passed. Given the need for additional legislation, we believe it is reasonable not to reflect the Optional Hybrid Plan in the current valuation.

Earnings That Exceed the Governor’s Salary

P.A. 100-0023 requires employers to make an additional contribution for participants who have annual earnings that currently exceed, or are projected to exceed, the Governor’s current or projected salary. The additional contribution is equal to the employer normal cost rate multiplied by salary in excess of the Governor’s current or projected salary. This provision has the effect of shifting contributions from the State to the employers.

We have verified that Segal has reflected these additional employer contributions in the development of the net State contribution.
Accelerated Pension Benefit Payments

P.A. 100-0587 created two accelerated pension benefit payment options. Inactive vested members have the option of receiving a lump sum equal to 60% of the present value of their benefits in lieu of their annuity benefits, the “Total Buyout.” The “COLA Buyout” program provides Tier 1 members the option upon retirement of accepting the reduced Tier 2 automatic annual increase (AAI) provision instead of their current three percent automatic annual increases. In exchange for electing the reduced AAI, members will receive a lump-sum equal to 70% of the present value of the reduced annuity benefits. Eligible members must make an election by June 30, 2024 if they want to receive the accelerated pension benefit payments. PA 101-0010 extended the time period to June 30, 2024 provided if that bond proceeds (limited to $1 billion for all systems) are still available to fund the buyouts.

On a preliminary basis, Segal had opted to use the same assumptions as the Illinois Legislature that 22% of inactive vested members will elect the accelerated pension benefit payment in lieu of their annuity benefits, and 15% (from 25% used by the Legislature) of eligible retiring Tier 1 members will elect the accelerated pension benefit payment for a reduction in their automatic annual increases. For the June 30, 2021 Actuarial Valuation, the assumptions have been set to 5% for the inactive vested member buyout, and 20% for the Automatic Annual Increase buyout based on recent plan experience. Segal will continue to monitor actual experience and may revise this assumption as experience emerges. We believe this approach is generally reasonable although we have added a recommendation on the inactive buyout assumption.

Actuarial Standard of Practice 51

A new Actuarial Standard of Practice (ASOP) became effective for TRS’ actuarial valuations starting June 30, 2019. ASOP 51 provides guidance to actuaries on the assessment and disclosure of risks to help readers of the actuarial valuation report “understand the effects of future experience differing from the assumptions used” and “the potential volatility of future measurements resulting from such differences.”

ASOP 51’s first requirement is to “identify risks that, in the actuary’s professional judgment, may reasonably be anticipated to significantly affect the plan’s future financial condition.” Segal identified four sources of risk to TRS: investment risk, longevity risk, contribution risk, and demographic risk. With the exception of the contribution risk due to the statutorily required amount of contributions, the risks Segal identified are relatively generic and would apply to most pension plans. There are other risks specific to TRS that we believe Segal should also address. For example, the current projected growth rate for contributions under the statutorily required method significantly exceeds the projected growth rate for State revenues under TRS’ assumptions, creating what appears to be a significant risk to future contributions.
ASOP 51 requires the actuary to assess each of the risks identified. While the assessment does not have to be quantitative, it does have to take into account the specifics of the individual plan. ASOP 51 also describes several quantitative methods that may be used to assess risk.

- **Investment Risk.** Segal describes the impact of a 1% variation in the investment return in the next year, quantifies the impact of a 10% investment gain or loss, and references the additional sensitivity projections in Section 1 of their report. These sensitivity projections provide an appropriate but limited assessment of investment risk.

- **Longevity Risk.** Segal applies a benchmark for a 10% reduction in mortality to TRS to provide an assessment of the impact on the unfunded actuarial liability.

- **Contribution Risk.** Segal discusses several issues with the statutorily required contribution amounts in the risk section as well as in other parts of the valuation report and quantifies the impact of the statutorily required contributions versus the board-adopted contribution policy.

- **Demographic Risk.** Segal provides an explanation of demographic risks and uses the Plan’s historical experience to provide an assessment of the risk.

ASOP 51 requires the actuary to recommend a more detailed assessment of risks if it “would be significantly beneficial.” While there is a fair amount of risk assessment included in the valuation report, Segal recommends an additional more detailed assessment.

ASOP 51 requires the actuary to “calculate and disclose plan maturity measures that ... are significant to understanding the risks associated with the plan.” Segal calculates the Full-Time actives to non-active ratio, the retired life liability as a percentage of total liability, and the current year’s net cash flow. There is a brief explanation of how these measures indicate a greater reliance on investment returns and a higher volatility in contribution requirements. There are also other maturity measures, such as the assets to payroll ratio and the actuarial liability to payroll ratio that provide significant information about the potential effects of investment risk and demographic risk. Segal discusses the importance of monitoring the continued maturation of the plan but doesn’t provide any projections of any of these maturity measures even though most are readily available given the projections required to determine the statutory contribution amounts.
SECTION III – SUPPORTING ANALYSIS

ASOP 51 requires the actuary to “identify and disclose relevant historical values of the plan’s actuarial measurements that, in the actuary’s professional judgment, are significant to understanding the risks identified....” Segal uses some relevant historical information in the assessment of each risk except longevity. No historical information is provided on net cash flow or any of the maturity measures except a brief mention of the highest level in the last 10 years for the active to non-active member ratio. Historical and projected information would give some context to the current maturity measures.

Thus, we recommend Segal disclose historical values of the maturity measures that are significant to understanding the risks identified along with projections of these measures to the extent they are already available from the current projections (Recommendation #9).
Assessment of Actuarial Assumptions Used in the 2021 Valuation

A. Economic Assumptions

1. The Interest Rate

The interest rate assumption (also called the investment return or discount rate) is the most impactful assumption affecting the required State contribution amount. This assumption, which is used to value liabilities for funding purposes, was reduced to 7.00% for the June 30, 2016 Actuarial Valuation. This change was recommended by Segal and supported by their report and presentation to the Board in August of 2016.

This assumption has been reviewed annually, and most recently was reviewed concurrent with an experience study presented August 2021. Segal recommended that the assumption remain at 7.00%.

After reviewing all the materials (see Appendix B of the report) that were made available, Cheiron concludes that the interest rate of 7.00% for this valuation is reasonable. Because it is reasonable to anticipate future reductions in the discount rate, we recommend that future stress testing include the impact to the required State contribution of potential reductions in the discount rate (Recommendation #6).

We recommend that the TRS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation. However, we also recommend that Segal take into consideration the TRS investment consultant’s expected returns in developing the investment return assumptions. (Recommendation #5).

The items we considered and our rationale for this recommendation are as follows:

- A review of the interest and inflation rates does not involve the collection of significant data and can be updated annually. In addition, it keeps the Board focused more closely on these very important assumptions.

- In Segal’s September 30, 2021 Experience Review, Segal’s analysis of the expected return starts with the median 10-year and 20-year capital market assumptions from the 2020 Horizon survey of capital market assumptions. We encourage Segal to supplement this analysis with the capital market assumptions used by TRS’ investment consultant. While it is important to get a broader context of capital market assumptions, often the System’s investment consultant knows the actual investments for the System in more detail and can develop more refined capital market assumptions, particularly for non-public asset classes.
TRS’ investment consultant, RVK, develops capital market assumptions for a 10 to 20-year horizon. Based on those assumptions, TRS’ target portfolio is expected to earn a 6.2% compound return.

As is the case with most maturing pension plans, TRS is experiencing negative cash flows measured as contributions less benefits and expenses. TRS’ negative cash flow is currently 1.8% and projected to average about 2.3% of assets. When short-term returns are expected to be lower than the long-term expectations, which is the case with TRS, a plan with negative cash flows will have actuarial returns (i.e., dollar weighted returns) that are less than their “time weighted” returns. We concur with Segal’s adjustments to reflect the impact of negative cash flows.

While the discount rate assumption should be based on the future expected investment returns for the System’s investment portfolio, survey information can provide an important context for evaluating the assumption. The Public Plans Database is maintained by a partnership between the Center for State and Local Government Excellence (SLGE) and the Center for Retirement Research at Boston College with support from the National Association of State Retirement Administrators (NASRA). This database contains historical information on large public pension plans, including key assumptions used in their actuarial valuations. The following chart shows the distribution of investment return assumptions for the 177 plans in the Public Plans Database with consistent information from 2002 through 2020 as of October 27, 2021.
Over the period shown, there continues to be a pattern of reducing discount rates partially reflecting long-term changes in capital markets, interest rates and underlying inflation. Of the 177 plans shown, 132 have reduced their discount rate assumption since 2016. For these 132 plans, the average reduction is 0.43%.

- Declining interest rates have forced pension plans to either reduce their discount rates, increase their exposure to investment risk, or some combination of the two. For example, as shown in the following chart, in 2001, the yield on 10-year Treasury bonds (a proxy for a risk-free investments) was 5.30%. To achieve TRS’ then assumed return of 8.50%, the System’s investments had to outperform the yield on the 10-year Treasury by 3.20%. As of June 2021, the yield on the 10-year Treasury is now 1.50%, and to achieve TRS’ now assumed return of 7.00%, the System’s investments need to exceed the 10-year Treasury yield by 5.50%. Even though TRS reduced its return assumption by 150 basis points over the period shown, it still has to take more investment risk in 2021 to meet its assumption than it did in 2001. By reducing the investment return assumption, plans are better able to meet their funding goals without requiring investment performance so much in excess of the risk-free rate.

**Historical Implied Risk Premium**

- While pension plans are long-term propositions, approximately 40% of the projected benefit payments for members as of the valuation date will be paid within the next 10
years and the System’s assets will be affected by investment returns within the next 10 years. Consequently, in setting the interest rate assumption, we believe TRS should consider shorter time horizon estimates as well as the 20-year capital market assumptions. The likelihood of achieving 7.0% returns over the next 10 years is less than 50% under most capital market assumptions while over longer periods, the probability is higher.

Segal’s analysis based on the average capital market assumptions from the Horizon survey support the current assumption of 7.0%. TRS’ investment consultant’s assumptions, however, are lower and would indicate that a reduction in the assumption is appropriate. While 7.0% is reasonable, consideration should be given to a lower assumption.

2. Inflation Assumption

As recommended in Segal’s September 30, 2021 Experience Review, the inflation assumption was reduced from 2.50% to 2.25% for the June 30, 2021 Actuarial Valuation.

We find the 2.25% inflation assumption to be reasonable.

The items we considered and our rationale for concurring with the assumption are as follows:

- The August 2021 Old-Age, Survivors, and Disability Insurance (OASDI) Trustees Report projects that over the long-term (next 75 years), inflation will average between 1.8% and 3.0% ([http://www.ssa.gov/oact/tr/2021/tr2021.pdf](http://www.ssa.gov/oact/tr/2021/tr2021.pdf)). Under the intermediate cost projection, the Social Security Administration uses an assumption of 2.4%.

- The following chart shows the distribution of inflation expectations for the Third Quarter 2021 survey of professional economic forecasters published by the Philadelphia Federal Reserve, the 2021 Horizon survey of investment consultant capital market assumptions (20-year), and the 2020 inflation assumptions used by plans in the Public Plans Database compared to the TRS assumption (indicated by the gold diamonds). The assumption of 2.25% is near the middle of the range projected by professional economic forecasters and investment consultants and is on the low end of the range used by other public pension plans.
3. Salary (Annual Compensation) Increase Assumption

As recommended in Segal’s September 30, 2021 Experience Review, the salary increase assumption was decreased for the June 30, 2021 draft of the actuarial valuation. The salary assumption, which is service based, ranges from 8.50% (at one-year of service) to 3.50% (at 20 or more years of service) and includes an inflation component of 2.25% and a real wage growth component of 1.25%.

We find the assumption to be reasonable.

The items we considered and our rationale for finding the salary increase assumption to be reasonable are as follows:

- Based on the actuarial valuation reports, actual salaries have been lower than expected in nine of the last ten years. Based on the pattern of experience, the salary increase assumption was reduced in 2015, increased in 2018, and reduced again in 2021.

- To develop this assumption, Segal analyzed the real wage increase experience of the System over the prior three years, subtracting actual inflation of 2.0% from the actual...
salary increases. Segal developed an assumed real rate of increase for each service group that was generally between the prior assumption and the three-year experience. Then, Segal added its assumed inflation of 2.25% to develop the nominal salary increase assumption.

- We expect the relationship between inflation and wage increases to be more stable over longer periods, but over short periods it can be volatile. In the prior experience study, real wage increases were relatively high because inflation was lower than anticipated by bargaining agreements and by Segal. During the current three-year period, inflation was only slightly lower than anticipated. Given the recent increase in inflation, using the same Segal methodology, the next study is likely to show relatively low real wage increases simply because inflation was higher than anticipated. Over longer periods, real wage growth is more consistent.

- The following chart shows the average nominal and real increases in wages over the last 10 and 20 years for State governments, local governments, and National Average Wages. State and local government data is from the Quarterly Census of Employment and Wages as published by the Bureau of Labor Statistics. National Average Wages is published by the Social Security Administration.

![Average Wage Increases](image)

- The August 2021 Old-Age, Survivors, and Disability Insurance (OASDI) Trustees Report projects that over the long-term (next 75 years), real wage differential will average somewhere between 0.53% and 1.77%. Under the intermediate cost projection, the Social Security Administration uses an assumption of 1.15%. 
While the current assumption is reasonable, we encourage Segal to modify their methodology to develop an across-the-board wage inflation assumption that is composed of price inflation plus real wage growth over a longer period of time and to study the merit and longevity component of salary increases separately from the across-the-board salary increases during the three-year experience study period. Such an approach would prevent short-term fluctuations in actual inflation from affecting the long-term salary scale assumption.

4. **Cost of Living for Tier 2 Assumption**

For Tier 2 participants, benefits are increased annually equal to 50% of the consumer price index urban rates with a maximum of 3.0%. Therefore, the COLA assumption is 50% of assumed inflation, or 1.125%.

We find the assumption and the basis for setting it reasonable.

5. **Tier 2 Capped Pay Assumption**

Benefits for members hired after January 1, 2011, are calculated using pay that is capped under 40 ILCS 5/1-160. The pay cap increase assumption is 1.125%.

We find the assumption and the basis for setting it reasonable.

6. **Severance Pay Assumption**

18% percent of retirees are expected to receive additional pay of 8% of compensation in the final year before retirement.

We find the assumption and the basis for setting it reasonable.
B. Demographic Assumptions

All demographic assumptions were reviewed as part of an experience study with appropriate assumption changes adopted by the Board in September 2021.

In its annual actuarial valuation reports, TRS regularly reports sources of liability gains and losses. In the 2021 report, these are shown in Section 2 on page 38. In the chart below, we have collected similar data from TRS valuation reports dating back to 2012 and use these to present a historical review of past demographic and salary increase experience gains and losses.

The following chart shows the pattern of historical gains and losses attributable to seven different sources as shown in the legend. When the colored bar slices appear above zero on the Y-axis, they represent experience losses with the values representing the increases in liabilities over what was expected. When the bar slices are below zero, they represent experience gains with the values representing the reductions in the liabilities for that year versus what was expected. The net liability (gain)/loss is shown by the black line on the graph above. This net (gain)/loss as a percent of liability for each year is shown as the percentage above the bars.

The percentages shown above the bars refer to net (gain)/loss as a percentage of liability.
SECTION III – SUPPORTING ANALYSIS

As a result of the experience study and assumption changes implemented in the June 30, 2015 Actuarial Valuation, a number of the consistent prior trends have been addressed. However, retirement experience continues to generate consistent losses, even after the changes made in 2018. Additional changes made this year may address the pattern of retirement losses. The “other” loss for 2016 is primarily due to the change in actuary, and the significant “other” loss for 2018 is due to “programming enhancements” that affected a subgroup of members. The “other” gain for 2021 is primarily attributable to the buyout program. Salary increases continue to generate gains on the liability, but these gains, which have declined significantly in the last few years, may be partially or wholly offset by the lower contributions received due to the lower-than-expected salaries. Reductions in the salary scale for the 2021 valuation may further reduce this consistent source of gains.

The demographic assumptions are summarized below. We reviewed the development of these assumptions based on the experience study dated September 30, 2021, and we have concluded all of the demographic assumptions are reasonable and meet the requirements of ASOP No. 35, Section 3.3.4. We have noted comments on specific assumptions below, but do not believe they would have a material effect.

1. Rates of Termination

Termination rates based on service, for causes other than death, disability, or retirement.

<table>
<thead>
<tr>
<th>Age</th>
<th>Under 5 Years of Service</th>
<th>5 or More Years of Service</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Male</td>
<td>Female</td>
</tr>
<tr>
<td>25</td>
<td>6.50%</td>
<td>6.25%</td>
</tr>
<tr>
<td>30</td>
<td>6.75%</td>
<td>6.75%</td>
</tr>
<tr>
<td>35</td>
<td>7.00%</td>
<td>7.25%</td>
</tr>
<tr>
<td>40</td>
<td>9.50%</td>
<td>7.25%</td>
</tr>
<tr>
<td>45</td>
<td>11.25%</td>
<td>7.25%</td>
</tr>
<tr>
<td>50</td>
<td>11.75%</td>
<td>8.50%</td>
</tr>
<tr>
<td>55</td>
<td>11.25%</td>
<td>10.25%</td>
</tr>
<tr>
<td>60</td>
<td>12.25%</td>
<td>13.00%</td>
</tr>
<tr>
<td>65</td>
<td>29.25%</td>
<td>32.50%</td>
</tr>
</tbody>
</table>

Comment: We support Segal’s recommendation of reducing termination rates indicated by the most recent experience.

2. Rates of Mortality

Healthy Post-Retirement: PUB-T-2010 Retiree Mortality Table projected generationally with Scale MP-2020, with female rates multiplied by 91% for ages under 75 and 109% for ages 75 and older and male rates multiplied by 105% for ages under 85 and 115% for ages 85 and older.
SECTION III – SUPPORTING ANALYSIS

Disabled Post-Retirement: PubNS-2010 Non-Safety Disabled Retiree Table projected generationally with Scale MP-2020, with no adjustments to female and male rates.

Beneficiary Post-Retirement: Pub-2010 Contingent Survivor Mortality Table projected generationally with Scale MP-2020, with female rates multiplied by 98% for all ages and male rates multiplied by 110% for all ages.

Pre-Retirement: PubT-2010 Employee Mortality Table projected generationally with Scale MP-2020, with female and male rates multiplied by 90% for all ages.

Comment: Normally a published mortality table is adjusted for a system’s individual experience by multiplying the mortality rate for each age by a constant factor such that the shape of the curve of mortality rates from the published table is maintained. Segal, however, applied different factors for different groups of ages. TRS has sufficient data, and Segal provides a breakdown of experience based on the two age groups they selected to justify the different factors. We suggest that in future studies, Segal provide the data on 5-year age groups so that the rationale for the particular age groups Segal selected is clearer. In addition, we suggest Segal consider a transition period between the factors so that mortality rates do not jump abruptly when switching from one factor to another.

3. Rates of Disability

<table>
<thead>
<tr>
<th>Age</th>
<th>Males</th>
<th>Females</th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td>0.01%</td>
<td>0.02%</td>
</tr>
<tr>
<td>30</td>
<td>0.01%</td>
<td>0.03%</td>
</tr>
<tr>
<td>35</td>
<td>0.02%</td>
<td>0.05%</td>
</tr>
<tr>
<td>40</td>
<td>0.02%</td>
<td>0.06%</td>
</tr>
<tr>
<td>45</td>
<td>0.04%</td>
<td>0.09%</td>
</tr>
<tr>
<td>50</td>
<td>0.08%</td>
<td>0.15%</td>
</tr>
<tr>
<td>55</td>
<td>0.11%</td>
<td>0.17%</td>
</tr>
<tr>
<td>60</td>
<td>0.14%</td>
<td>0.23%</td>
</tr>
<tr>
<td>65</td>
<td>0.19%</td>
<td>0.26%</td>
</tr>
</tbody>
</table>

Comment: The result is reasonable, but it appears that more credibility is being given to recent experience for males than for females even though there is less experience for males. In the future, we suggest Segal consider applying limited fluctuation credibility procedures similar to what they do for mortality to adjust the current assumption. The result this year would be very similar for females but would produce higher assumptions for males.
4. Rates of Retirement

a. For Members Hired before January 1, 2011:

<table>
<thead>
<tr>
<th>Age</th>
<th>5 – 18</th>
<th>19 - 29</th>
<th>30-33</th>
<th>34+</th>
</tr>
</thead>
<tbody>
<tr>
<td>54</td>
<td>0%</td>
<td>7%</td>
<td>8%</td>
<td>45%</td>
</tr>
<tr>
<td>55</td>
<td>0%</td>
<td>6%</td>
<td>8%</td>
<td>44%</td>
</tr>
<tr>
<td>56</td>
<td>0%</td>
<td>6%</td>
<td>7%</td>
<td>46%</td>
</tr>
<tr>
<td>57</td>
<td>0%</td>
<td>7%</td>
<td>8%</td>
<td>46%</td>
</tr>
<tr>
<td>58</td>
<td>0%</td>
<td>8%</td>
<td>12%</td>
<td>45%</td>
</tr>
<tr>
<td>59</td>
<td>0%</td>
<td>33%</td>
<td>40%</td>
<td>48%</td>
</tr>
<tr>
<td>60</td>
<td>21%</td>
<td>33%</td>
<td>46%</td>
<td>44%</td>
</tr>
<tr>
<td>61</td>
<td>17%</td>
<td>28%</td>
<td>35%</td>
<td>41%</td>
</tr>
<tr>
<td>62</td>
<td>17%</td>
<td>28%</td>
<td>43%</td>
<td>41%</td>
</tr>
<tr>
<td>63</td>
<td>16%</td>
<td>29%</td>
<td>35%</td>
<td>44%</td>
</tr>
<tr>
<td>64</td>
<td>26%</td>
<td>40%</td>
<td>50%</td>
<td>40%</td>
</tr>
<tr>
<td>65</td>
<td>27%</td>
<td>40%</td>
<td>52%</td>
<td>43%</td>
</tr>
<tr>
<td>66</td>
<td>23%</td>
<td>42%</td>
<td>42%</td>
<td>38%</td>
</tr>
<tr>
<td>67</td>
<td>25%</td>
<td>39%</td>
<td>43%</td>
<td>38%</td>
</tr>
<tr>
<td>68</td>
<td>23%</td>
<td>39%</td>
<td>40%</td>
<td>35%</td>
</tr>
<tr>
<td>69</td>
<td>28%</td>
<td>38%</td>
<td>32%</td>
<td>44%</td>
</tr>
<tr>
<td>70</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>31%</td>
</tr>
<tr>
<td>71</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>39%</td>
</tr>
<tr>
<td>72</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>24%</td>
</tr>
<tr>
<td>73</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>36%</td>
</tr>
<tr>
<td>74</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>36%</td>
</tr>
<tr>
<td>75</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

b. For Members Hired on or after January 1, 2011:

<table>
<thead>
<tr>
<th>Age</th>
<th>9 – 18</th>
<th>19 - 30</th>
<th>Service</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>31</td>
<td>32-33</td>
<td>34+</td>
</tr>
<tr>
<td>≤ 61</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>62</td>
<td>13%</td>
<td>15%</td>
<td>20%</td>
</tr>
<tr>
<td>63</td>
<td>8%</td>
<td>10%</td>
<td>15%</td>
</tr>
<tr>
<td>64</td>
<td>8%</td>
<td>10%</td>
<td>15%</td>
</tr>
<tr>
<td>65</td>
<td>8%</td>
<td>10%</td>
<td>15%</td>
</tr>
<tr>
<td>66</td>
<td>20%</td>
<td>10%</td>
<td>15%</td>
</tr>
<tr>
<td>67</td>
<td>20%</td>
<td>40%</td>
<td>70%</td>
</tr>
<tr>
<td>68</td>
<td>20%</td>
<td>40%</td>
<td>40%</td>
</tr>
<tr>
<td>69</td>
<td>20%</td>
<td>40%</td>
<td>40%</td>
</tr>
<tr>
<td>70</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Comment: There have been consistent losses due to retirement experience. This year Segal changed its analysis of retirement rates from headcount-weighted to benefit-weighted. The
SECTION III – SUPPORTING ANALYSIS

impact of this change appears to be minimal, and the proposed changes to retirement rates are also relatively minor. Segal also reported that the impact of actual compared to expected final salary for retiring members was minor, but that there were additional increases in eligibility service for optional service purchases and sick leave service credit that were not factored into the programming. Segal expects the programming changes they have made to reflect this experience will substantially mitigate the retirement losses.

5. Percent Married

For valuation purposes, 85% of members are assumed to be married. Male members are assumed to be three years older than their spouses, and female members are assumed to be three years younger than their spouses.

6. Inactive Vested Buyout

Five percent of eligible inactive vested members are assumed to receive a lump-sum buyout in lieu of an annuity at retirement.

Comment: The assumption was reduced from 22 to 5 percent. While inactive vested members are eligible to elect a buyout until June 30, 2024, all current inactive vested members have already been offered a buyout and decided not to take it. We believe a better assumption for these members is 0 percent. Instead, an assumption should be applied to active members who are expected to terminate and become eligible for the buyout program before June 30, 2024. Segal’s data indicates that approximately 15 percent of such members would likely accept the buyout although we suspect there is significant variation based on service. We recommend that Segal revise the inactive vested buyout assumption for future valuations so members who have already been offered a buyout and not taken it are not assumed to take a buyout in the future (Recommendation #7).

7. Automatic Annual Increase Buyout

Twenty percent of eligible retiring Tier 1 members are assumed to receive a lump-sum buyout and a retirement annuity with automatic annual increases of 1.5% of the originally granted retirement benefit starting at the later of January 1 following age 67 and the first anniversary of retirement.

Comment: The assumption was increased from 15 to 20 percent. Based on the data presented, the assumption appears reasonable.

8. Optional Service Purchases

The liability for retirement benefits for active members who have not previously purchased optional service is increased to cover the employer cost of out-of-system service purchased in the last two years prior to retirement. The amount purchased varies by the amount of regular
service at retirement. Representative amounts purchased at retirement, and other assumptions used, are as follows:

<table>
<thead>
<tr>
<th>Regular Service at Retirement</th>
<th>Maximum Service Purchased</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 years</td>
<td>0.158 years</td>
</tr>
<tr>
<td>20 years</td>
<td>0.531 years</td>
</tr>
<tr>
<td>25 years</td>
<td>0.712 years</td>
</tr>
<tr>
<td>30 years</td>
<td>0.673 years</td>
</tr>
<tr>
<td>34 or more</td>
<td>None</td>
</tr>
</tbody>
</table>

a. Actual optional service credit for each current member is provided by TRS;
b. No additional service purchases will be assumed for members who currently have optional service credit;
c. Members will not purchase service if it does not improve their pension benefit; and
d. When optional service is purchased within the last two years prior to retirement, 25% of the cost is covered by member payments and the remaining cost is the responsibility of the employer.

9. Sick Leave Service Credit

The assumed unused and uncompensated sick leave service credit at retirement varies by the amount of regular service at retirement. Representative assumed amounts of unused and uncompensated sick leave service are as follows:

<table>
<thead>
<tr>
<th>Regular Service at Retirement</th>
<th>Sick Leave Service Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 years</td>
<td>0.963 years</td>
</tr>
<tr>
<td>25 years</td>
<td>1.154 years</td>
</tr>
<tr>
<td>30 years</td>
<td>1.369 years</td>
</tr>
<tr>
<td>34 years</td>
<td>1.612 years</td>
</tr>
<tr>
<td>35 or more</td>
<td>None</td>
</tr>
</tbody>
</table>

10. Future Service Accrual Rate:

0.98 years of service per year for Full-time and Regular Part-Time members.
0.275 years of service per year for Substitute, Part-Time, and Hourly-Paid members

Comment: This assumption was not studied in the prior experience study and has not been disclosed in Segal’s prior actuarial valuation reports but has been added to the 2021 actuarial valuation report. Based on the experience study, the average service accrual rate was 0.993 for full-time and regular part-time members and 0.317 for substitute, part-time and hourly-paid members. Segal applied 50% credibility to the prior assumption to develop the proposed assumption, but since it isn’t clear when the assumption was last studied, we don’t believe it
SECTION III – SUPPORTING ANALYSIS

should be given credibility. It also is not clear why full-time members and regular part-time members should have the same future service accrual assumption. Finally, for non-full-time members, we believe it is more common to assume future service accrual rates reflect recent experience on an individual basis rather than an average over the entire population. 

We recommend that Segal increase the Full-Time future service accrual rate assumption to 1.0 years of service and consider non-full-time member future service accrual rates that reflect recent experience on an individual basis (Recommendation #8).

11. Administrative Expenses

The $40,892,235 of administrative expenses is expected to be paid for the year beginning July 1, 2021. $39,887,064 of administrative expenses is expected to be paid for the year beginning July 1, 2022. Each year thereafter, administrative expenses are assumed to increase by the rate at which payroll is expected to increase.

12. 2.2 Upgrade Assumption

For those active members who have already made a payment to upgrade past service prior to June 30, 1998, their benefits are based on their upgrading at the valuation date. For all other active members, they are assumed to upgrade at retirement.

13. Census and Assets

The current actuarial valuation was based on the latest membership data available, which were submitted by the System for active, inactive, and retired members as of the prior valuation date. The valuation assumptions were used to project results to account for the one-year difference in the census date and the valuation date. Any change in liability due to changes in census between the collection date of the census information and the valuation date is captured in the next actuarial valuation.

14. New Entrant Assumption for Projections

The State contribution is based on the projected Actuarial Liability as of June 30, 2045. A critical set of assumptions used in projecting the Actuarial Liability are the demographic characteristics of projected new entrants. Segal assumes that the active population will remain constant and describes the demographic characteristics of projected new hires on page 120 of the report. The rationale provided for these demographic characteristics is just that they were “based on previous plan experience.” It is unclear from the disclosure in the report what period is analyzed for the new entrant profile, and no analysis was provided in the experience study. New entrant salaries are assumed to increase at 2.25% to align with the inflation assumption.

Given the critical nature of these assumptions in developing the State contribution, we recommend that Segal include a more detailed explanation of how the new entrant assumption was developed (Recommendation #3).
The additional detail provided in the 2020 and 2021 valuations gave us more confidence in the new entrant assumptions selected, but doesn’t provide much information about how the population’s demographic characteristics are assumed to change over time. These changes can have a material impact on the projections, and as a result, on the State’s contribution. We continue to recommend that Segal provide additional information in the valuation report about the new entrant population used in its projection such as the average age and service of the population each year (Recommendation #4).
C. Funding Method

Actuarial funding methods consist of three components: (1) the actuarial cost method, which is the attribution of total costs to past, current, and future years; (2) the asset valuation method (i.e., asset smoothing); and (3) the amortization method.

1. Actuarial Cost Method

The System uses the Projected Unit Credit (PUC) cost method to assign costs to years of service, as required under the Pension Code (40 ILCS 5/16). We have no objections with respect to using the PUC method, although we, as Segal does, would prefer the Entry Age Normal (EAN) cost method as it is more consistent with the requirement in 40 ILCS 5/16-158 for level percentage of pay funding.

Under the PUC method, which is used by some public sector pension funds, the benefits of active participants are calculated based on their compensation projected with assumed annual increases to ages at which they are assumed to leave the active workforce by any of these causes: retirement, disability, turnover, or death. Only past service (through the valuation date but not beyond) is taken into account in calculating these benefits. The present value of these benefits based on past service and future compensation is the actuarial liability for a given active participant. Under the PUC cost method, the value of an active participant’s benefits tends to increase more sharply over his or her later years of service than over his or her earlier ones. While the PUC method is not an unreasonable method, as a result of this pattern of benefit value increasing, more plans use the EAN cost method to mitigate this effect. It should also be noted that the EAN cost method is the required method to calculate liability for GASB Nos. 67 and 68.

2. Asset Valuation Method

The Actuarial Value of Assets for the System is a smoothed market value. Unanticipated changes in market value are recognized over five years in the Actuarial Value of Assets. The primary purpose for smoothing out gains and losses over multiple years is so fluctuations in the contributions will be less volatile over time than if based on the Market Value of Assets.

The 2020 Public Retirement Systems Study by the National Conference on Public Employee Retirement Systems (NCPERS) survey of 138 public retirement funds found that the majority of plans responding to the survey have a five-year smoothing period.

Smoothing the market gains and losses over a period of five years to determine the Actuarial Value of Assets is a generally accepted approach in determining actuarial cost, and we concur with its use.
3. **Amortization Method**

The mandated State contribution is based on a determination of the level percentage of payroll that is expected to achieve a 90% funded ratio in 2045. While not a traditional amortization method, this methodology effectively amortizes a portion of the unfunded actuarial liability over the remaining period until 2045, which is currently 25 years.

One of the principles of funding public plans identified by the American Academy of Actuaries is that there should be “a plan to make up for any variations in actual assets from the funding target within a defined and reasonable time period.” Because it only targets 90%, the State method does not include a plan to achieve the funding target over any period of time.

Typical public plan amortization methods are designed to increase each year by expected payroll growth. Under the State mandated method, however, the effective amortization payment increases each year by more than the expected growth in payroll. As a result, the State mandated method defers payments on the unfunded actuarial liability further into the future than under typical public plan amortization methods.
This section reviews the projections contained in the draft June 30, 2021 Actuarial Valuation of TRS. These projections are fundamental to the development of the required State contribution calculated under the current statutory funding requirement.

The following graphs are independent approximations of the projections performed by the State actuary to verify that the System’s funding projections are reasonable. They do not reflect all the precision of the projections applied by the System’s actuary, but instead they are intended to verify the reasonableness of the Modeling done by the System’s actuary.

The graph below shows our projection of the expected future liabilities and assets in the System through 2045. As seen in the graph on page 15 and the detailed figures in Section 5 of the draft June 30, 2021 Actuarial Valuation, the majority of the funding of the System occurs in the later years of the projections. The lines show the projected assets (market value and actuarial value), and the bars show the projected liabilities of the System. The funded ratio is shown at the top of the bars. For example, in 2033, the funded ratio is projected to be approximately 61% with assets being approximately $119 billion and liabilities being approximately $190 billion.

Source: Cheiron projection analysis.
When we compare our projected funded ratio against the results shown in the draft June 30, 2021 Actuarial Valuation, we find a close match in expected funded ratio. This close match of the funded ratio supports that the projections done by the System’s actuary are reasonable and the fact we show slightly different funded ratios is a function of Cheiron’s approximation.

Source: Cheiron projection analysis.
SECTION IV – PROJECTION ANALYSIS

The following graph shows the expected contributions calculated under the statutory method. The values shown for the fiscal year ending 2022 was set based on the June 30, 2020 Actuarial Valuation. The current valuation is the basis for setting the rates starting July 1, 2022 (Fiscal Year Ending June 30, 2023). The contribution requirement has two components: 1) the employer normal cost, which is the value of the amount of benefits to be accrued by participants in the upcoming year, less employee contributions, based on the statutory funding method; and 2) an amortization payment on the unfunded liability. The normal cost amounts are shown by the green bars and the amortization payments of the unfunded actuarial liability (UAL) by the yellow bars. The percentages shown are the total contribution rates as a percentage of payroll calculated by Cheiron, which are equal to the sum of the bars. The graph shows that larger percentages of the total contribution are being made toward the UAL payments later in the period. The blue line shows the projected contribution rates as percentages of payroll from the System actuary’s draft June 30, 2021 Actuarial Valuation. The difference between Cheiron’s approximation and the System’s projections is the difference between the top of the bars and the line. In this instance, there is virtually no difference. The contributions are being limited by the maximum contribution described in the General Obligation Bond Act prior to 2033, which is why the rate increases after 2033.

Source: Cheiron projection analysis.

Our conclusion is that the projections performed by the System’s actuary are reasonable.
In this section, we examine the adequacy of the funding for the System, including funded ratio, the sources of changes in the unfunded actuarial liability (UAL), projections of the UAL, and statutory funding requirements compared to contributions needed to pay down the UAL.

The actuarial valuation report prepared by Segal includes traditional actuarial measurements, that should be enhanced by the additional stress testing and projections that we have suggested. Given the unique and substantial funding challenges faced by the Illinois pension systems, this section on funding adequacy supplements the information from the Segal report to better inform the legislature and other stakeholders about the adequacy of the System’s funding.

**System Funded Ratio**

The first funding adequacy measure is the historical trend of the System’s funded ratio for the past ten years. Funded ratio for this measure is defined as the ratio of the Market Value of Assets to the Actuarial Liability, referred to as the funded ratio. The chart below shows that TRS’ funded ratio decreased from 2012 to 2020 but in 2021 increased to 46.2%. In addition to showing the funded ratio, for 2012 and later, this chart also shows the breakdown of the Plan’s liabilities by membership status for years after 2012 when the breakdown was provided in the valuation report:

- Active liability – the liability (attributable to service already performed) for future payments to members who are currently working in the System,
- Deferred Vested liability – the liability for future payments to members who are no longer working in the System, and
- In-Pay liability – the liability for future payments to retirees and beneficiaries who are currently receiving benefits.

This breakdown shows that today plan assets only cover about 66% of the liabilities for just those members currently receiving benefits.
Sources of Changes in the UAL

As shown in the chart below, TRS’ unfunded actuarial liability (UAL) has grown from about $43.5 billion in 2011 to $79.9 billion in 2021, an increase of $36.4 billion. In order to understand how to reverse this trend, it is important to understand the sources contributing to it.

**Historical Growth in UAL**

Source: Cheiron analysis of funding adequacy.

The changes to the UAL from June 30, 2011 to June 30, 2021 can be separated into the following components:

- **Contribution Deficiencies** – Contributions that are less than the tread water contribution cause the UAL to increase. The tread water contribution consists of two components: the normal cost, which is the cost of benefits earned in a given year, and the interest on the unfunded actuarial liability. This sum is referred to as the tread water contribution because it is the contribution necessary so that the UAL will remain constant, or “tread water” (absent experience gains or losses). The differences between actual contributions and the tread water contributions increased the UAL by $18.6 billion over this period.

- **Assumption Changes** – Changes to actuarial assumptions as the System updated expectations, primarily on future investment returns and life expectancy. A positive aspect of the UAL increases due to assumption changes is that they are expected to result in liability measurements that more accurately reflect future expectations. Over this period, assumption changes have increased the UAL by $16.1 billion.

- **Plan Changes** – Modifications to the design of the Plan. Since most of the changes to the System’s plan affect only future benefits, the impact has been negligible during this period, reducing the liability by $0.4 billion over this period.
SECTION V – ANALYSIS OF FUNDING ADEQUACY

- **Liability (Gain) or Loss** – Changes in the UAL due to liability experience (i.e., mortality, terminations, salary increases, etc.). These were generally small, but increased the UAL by $1.9 billion over this period.

- **AVA (Actuarial Value of Assets) Investment (Gain) or Loss** – Net investment gains or losses due to assets earning more or less than assumed. These have increased the UAL over this period by $0.1 billion.

The chart below shows the changes in UAL each year broken into these five components. The sum of all the components, as the total change in UAL, is shown as the black line. Values of each component as well as total by year are shown in the chart along with the totals for the period.

In the last 10 years, the UAL has increased every single year. Factors that reduce the UAL have been relatively infrequent and smaller than the factors increasing the UAL. The persistent contribution deficiencies compared to the tread water amount have been the largest contributor to the growth of the UAL in the last 10 years followed by assumption changes (primarily reducing the discount rate).

We expect that this chart will help stakeholders understand the sources of growth in the UAL over the past decade and inform discussions about the current funding requirements and adequacy.
Actual Contributions Compared to Tread Water Contribution

One of the persistent sources of the increase in UAL is due to actual contributions to the System being less than the tread water contribution (the amount needed to prevent the UAL from increasing if all assumptions are met). These contribution deficiencies have added between $1.4 and $2.7 billion to the UAL each year over the historical period shown.

As the chart below shows, actual contributions have been significantly less than the tread water cost. Each year that total contributions remain below the tread water cost (blue line), the UAL is expected to grow. As shown in the graph below, the contributions from the State will need to increase before the total contribution reaches the tread water contribution and begins to pay down the UAL based on the market value of assets.

![Historical and Projected Contributions](chart.png)

Source: Cheiron analysis of funding adequacy.
The next chart shows that if the Minimum Required Contributions continue to be made each year and all other assumptions are met, the UAL based on the actuarial value of assets is projected to decrease in future years. The decrease over the next few years is due to the recognition of investment gains in the asset smoothing method. Without the recognition of those deferred gains, the UAL would be projected to increase. The UAL based on the market value of assets is projected to increase over the next several years.

Source: Cheiron analysis of funding adequacy
Net Cash Flow Analysis

The Plan’s net cash flow is defined as State and employee contributions less benefit payments and administrative expenses. The more negative net cash flow is as a percentage of the Plan’s assets, the more vulnerable the Plan is to market downturns. This is because when a pension plan has more payouts than contributions and suffers an investment loss, it is left with fewer assets to invest and recapture during a recovery.

Looking at the chart below, TRS has mildly negative net cash flow (black line). If contributions increase as quickly as benefit payments, the net cash flow will remain stable. But if contributions do not continue to grow either because the plan has become better funded or because the expected contributions are not made, negative net cash flow may become a more significant issue, therefore it should continue to be monitored. The teal line shows net cash flow as a percent of Market Value of Assets on the right-side axis. The greater the negative cash flows are relative to plan assets, the more vulnerable a plan is to market downturns. This is because once there is a market downturn, the Plan assets lose on both the return and the negative cash flow, leaving a lower asset base from which to recover from the loss.
Response to Recommendations in 2020

In the State Actuary’s Preliminary Report on the Teachers’ Retirement System of Illinois dated December 21, 2020, Cheiron made several recommendations. Below we summarize how these recommendations were reflected in either the System’s comments last year or in this year’s draft June 30, 2021 Actuarial Valuation.

<table>
<thead>
<tr>
<th>Recommendations to Retirement System from 2020 State Actuary Report</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. We continue to recommend that the funding method be changed to fully fund plan benefits. We recognize that increasing contributions during the current pandemic may be challenging but continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the System becoming unsustainable. Consequently, we recommend that the funding method increase contributions as quickly as possible to a level that is expected to prevent the unfunded actuarial liability from growing and remain high enough to reduce the unfunded actuarial liability each year until the plan is ultimately 100% funded. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.</td>
<td>Not Implemented</td>
<td>The System has adopted a funding policy referred to as the Board-Adopted Actuarial Funding Policy that would meet the recommendation; however, the actual funding of the System is based on State statute and a change in the funding method and funding policy would require a statutory change. The Board-Adopted Actuarial Funding Policy targets full funding after 20 years and is considered actuarially sound. Recommendation repeated.</td>
</tr>
<tr>
<td>2. We recommend that Segal include a more detailed explanation of how the new entrant assumption was developed.</td>
<td>Not Implemented</td>
<td>Segal noted that a more detailed explanation of analysis of the new entrant assumption would be more appropriate to include in the next experience study report. However, no additional information was provided in the 2021 experience study. Recommendation Repeated</td>
</tr>
</tbody>
</table>
THE STATE ACTUARY’S PRELIMINARY REPORT ON THE
TEACHERS’ RETIREMENT SYSTEM OF THE STATE OF ILLINOIS
PURSUANT TO 30 ILCS 5/2-8.1

STATUS OF RECOMMENDATIONS FROM THE 2020 STATE ACTUARY REPORT

<table>
<thead>
<tr>
<th>Recommendations to Retirement System from 2020 State Actuary Report</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. As required by section 3.3 of ASOP 51, we recommend that Segal provide an assessment for each of the key risks they have identified.</td>
<td>Implemented</td>
<td>Segal provided an assessment for each of the key risks identified in the 2021 valuation report. Recommendation Removed</td>
</tr>
<tr>
<td>4. We continue to be concerned with the assumption for salary increases which is at the very high end of a reasonable range. We recommend the TRS Board consider reducing the salary increase assumption in future valuations or provide additional analysis to support the increased assumption.</td>
<td>Implemented</td>
<td>Segal’s analysis in the 2021 experience study recommends a reduction in the salary increase assumptions to a reasonable level. Recommendation Removed</td>
</tr>
<tr>
<td>5. We continue to recommend that Segal provide additional information in the valuation report about the new entrant population used in its projection such as the average age and service of the population each year.</td>
<td>Not Implemented</td>
<td>Segal and TRS indicated that they will consider adding this information in the 2019 valuation, but the additional information has not been added in neither the 2019 valuation nor the 2020 valuation. Segal states that the additional information would not provide value in the actuarial valuation report. Recommendation Repeated</td>
</tr>
<tr>
<td>6. We recommend the TRS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation. However, we also recommend that the Board adopt the economic assumptions recommended by Segal, which was not the case this year. Segal had recommended a drop in the interest rate from 7.00% to 6.75% and a drop in the inflation rate from 2.50% to 2.25%. The Board declined to adopt either recommendation and we found no</td>
<td>Implemented</td>
<td>The economic assumptions were reviewed at the August 2021 Board meeting. Segal recommended and the Board decided to continue use of a 7.00% rate of return. We note that the asset allocation changed from the prior year, which may have reversed Segal’s prior recommendation to reduce the expected return. We will continue to include this recommendation each year. Recommendation continued.</td>
</tr>
</tbody>
</table>
### STATUS OF RECOMMENDATIONS FROM THE 2020 STATE ACTUARY REPORT

<table>
<thead>
<tr>
<th>Recommendations to Retirement System from 2020 State Actuary Report</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>rationale as to why this decision was made.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. We recommend an explanation should be provided as to how the maturity measures calculated and disclosed by Segal help the reader to understand the risks identified. We also recommend that significant historical values be disclosed to help the reader understand the risks identified by Segal.</td>
<td>Partially Implemented</td>
<td>Segal provided more discussion on maturity measures but did not disclose historical values to aid in understanding the risks. <strong>Recommendation modified.</strong></td>
</tr>
<tr>
<td>8. We recommend that Segal review its disclosures related to ASOP 56 for the next valuation report to ensure that the disclosures clearly identify the purpose of each model, any material limitations of each model, and any other applicable required disclosures under ASOP 56.</td>
<td>Implemented</td>
<td>In Segal’s Preliminary June 30, 2021 Actuarial Valuation Report, the recommended ASOP 56 disclosures were made. <strong>Recommendation removed.</strong></td>
</tr>
</tbody>
</table>
Chapter Two
Preliminary Report on the State Universities Retirement System

In accordance with 30 ILCS 5/2-8.1, Cheiron, the State Actuary, submitted a preliminary report to the Board of Trustees of the State Universities Retirement System (SURS) concerning proposed certifications of required State contributions submitted to Cheiron by the Board. The preliminary report was submitted to SURS on November 30, 2021. The preliminary report was based on Cheiron’s review of actuarial assumptions included in SURS’ 2021 Actuarial Valuation Report.

Following is Cheiron’s final preliminary report on the State Universities Retirement System. SURS’ written response, provided on December 10, 2021, can be found in Appendix C.

## OVERVIEW
### STATE UNIVERSITIES RETIREMENT SYSTEM

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial accrued liability</td>
<td>$48,898,480,000</td>
</tr>
<tr>
<td>Actuarial value of assets</td>
<td>$21,484,798,600</td>
</tr>
<tr>
<td>Unfunded liability</td>
<td>$27,413,681,400</td>
</tr>
<tr>
<td>Funded ratio</td>
<td>43.9%</td>
</tr>
<tr>
<td>Employer normal cost</td>
<td>$451,200,000</td>
</tr>
<tr>
<td>State contribution (FY23)</td>
<td>$2,123,615,000</td>
</tr>
<tr>
<td>Active members</td>
<td>73,443</td>
</tr>
<tr>
<td>Inactive members</td>
<td>96,753</td>
</tr>
<tr>
<td>Current benefit recipients</td>
<td>70,111</td>
</tr>
<tr>
<td>Total membership</td>
<td>240,307</td>
</tr>
<tr>
<td>Interest rate assumption</td>
<td>6.50%</td>
</tr>
<tr>
<td>Inflation assumption</td>
<td>2.25%</td>
</tr>
<tr>
<td>Actuarial cost method</td>
<td>Projected Unit Credit</td>
</tr>
<tr>
<td>Asset valuation method</td>
<td>5-year Smoothing</td>
</tr>
<tr>
<td>Executive Director</td>
<td>Suzanne Mayer</td>
</tr>
<tr>
<td>Actuarial Firm</td>
<td>Gabriel, Roeder, Smith &amp; Company</td>
</tr>
</tbody>
</table>

Source: June 30, 2021 SURS actuarial valuation report.
December 15, 2021

Mr. Frank Mautino
Auditor General
740 East Ash Street
Springfield, Illinois 62703

Board of Trustees
State Universities Retirement System of Illinois
1901 Fox Drive
P.O. Box 2710
Champaign, Illinois 61825-2710

Dear Trustees and Auditor General:

In accordance with the Illinois State Auditing Act (30 ILCS 5/2-8.1), Cheiron is submitting this preliminary report concerning the proposed certification prepared by Gabriel, Roeder, Smith & Company (GRS), of the required State contribution to the State Universities Retirement System of Illinois (SURS or System) for Fiscal Year 2023.

In summary, we believe that the assumptions and methods used in the June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable. We also find that the certified contributions, notwithstanding the inadequate State funding requirements that do not conform to generally accepted actuarial principles and practices, were properly calculated in accordance with State law.

Section I of this report describes the review process undertaken by Cheiron. Section II summarizes our findings and recommendations. Section III provides the supporting analysis for those findings and presents more details on our assessment of the actuarial assumptions and methods employed in GRS’s Actuarial Certification, as well as our assessment of GRS’s determination of the required State contribution for Fiscal Year 2023. Section III also includes comments on other issues impacting the funding of the State Universities Retirement System, including the implications of Article 15 of the Illinois Pension Code, which establishes the statutory minimum funding requirements for the System. We agree with GRS that the statutory mandated minimum funding requirements have been and continue to be inadequate. In addition, the past inadequate funding has resulted in current and future contribution levels, measured as a percent of payroll, to be among the highest in the country. Making adequate contributions in the future to fully fund the system will be challenging. Section IV reviews the projections contained in the June 30, 2021 Actuarial Valuation. Finally, Section V provides an analysis of funding adequacy.

In preparing this report, we relied on information (some oral and some written) supplied by SURS and GRS. This information includes actuarial assumptions and methods adopted by the SURS Board, plan provisions, the June 30, 2021 Actuarial Valuation, the 2021 Experience
Review Report, the August 3, 2021 letter on buyout assumptions, the Meketa 2021 Asset-Liability Study, 2021 minutes of the SURS Board of Trustee meetings, and various memos prepared by the System’s advisors, staff, and Executive Director. A detailed description of all information provided for this review is contained in Appendix B.

This report and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices and our understanding of the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board as well as applicable laws and regulations. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this report. This report does not address any contractual or legal issues. We are not attorneys, and our firm does not provide any legal services or advice.

This report was prepared exclusively for the Office of the Auditor General and the State Universities Retirement System of Illinois for the purpose described herein. Other users of this report are not intended users as defined in the Actuarial Standards of Practice, and Cheiron assumes no duty or liability to any other user.

Sincerely,
Cheiron

SIGNED ORIGINAL ON FILE

Michael J. Noble, FSA, FCA, MAAA, EA
Principal Consulting Actuary

SIGNED ORIGINAL ON FILE

Jana R. Austin, ASA
Associate Actuary
Illinois Public Act 097-0694 (the Act) amended the Illinois State Auditing Act (30 ILCS 5/2-8.1) and requires Cheiron, as the State Actuary, to review the actuarial assumptions and valuation of the State Universities Retirement System of Illinois (SURS or System), and to issue to the SURS Board this preliminary report on the proposed certification prepared by Gabriel, Roeder, Smith & Company (GRS) of the required State contributions for Fiscal Year (FY) 2023. The purpose of this review is to identify any recommended changes to the actuarial assumptions for the SURS Board to consider before finalizing its certification of the required State contribution for FY 2023.

While the Act states that just the actuarial assumptions and valuation are to be reviewed, we have also reviewed the actuarial methodologies (funding and asset smoothing methods) employed in preparing the Actuarial Certification, as these methods can have a material effect on the amount of the State contribution being certified. Finally, we have offered our opinion on the implications of Article 15-155 of the Illinois Pension Code, which impacts the contribution amount certified by GRS.

In conducting this review, Cheiron reviewed the June 30, 2021 Actuarial Valuation prepared by GRS, the 2021 Experience Review Report, the August 3, 2021 letter on buyout assumptions, the Meketa 2021 Asset-Liability Study, 2021 minutes of the SURS Board of Trustees meetings, and various memos prepared by the System’s advisors, staff, and Executive Director. The specific materials we reviewed are listed in Appendix B.

In addition to reviewing the actuarial certification of the required State contribution to SURS, the Act requires the State Actuary to conduct a review of the “actuarial practices” of the Board. While the term “actuarial practices” was not defined in the Act, we continue to interpret this language to mean that we review: (1) the use of a qualified actuary (as defined in the Qualification Standards of the American Academy of Actuaries) to prepare the annual actuarial valuation for determining the required State contribution; and (2) the conduct of periodic formal experience studies to justify the assumptions used in the actuarial valuation. In addition, we have included comments on actuarial communication and compliance with Actuarial Standards of Practice (ASOP) reflected in the June 30, 2021 Actuarial Valuation.
SECTION II – SUMMARY OF RECOMMENDATIONS

This section summarizes recommendations from our review of the actuarial assumptions and methods employed in the June 30, 2021 Actuarial Valuation of SURS as well as the “actuarial practices” of the SURS Board. Section III of this report provides detailed analysis and rationale for these recommendations.

Proposed Certification of the Required State Contribution

Gabriel, Roeder, Smith & Company (GRS) has determined that the FY 2023 required State contribution calculated under the current statutory funding requirements is $2,123,615,000. We have verified the arithmetic calculations made by GRS to develop this required State contribution and have reviewed the assumptions on which it was based. We have accepted GRS’s annual projections of future payroll, total normal costs, employee contributions, combined benefit payments and expenses, and total contributions.

State Mandated Funding Method

1. We continue to recommend that the funding method be changed to fully fund plan benefits. Continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the System becoming unsustainable. Consequently, we recommend that the funding method maintain contributions at a level that is expected to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Recognition of Changes in Actuarial Assumptions

Public Act 100-0023 (P.A. 100-0023), effective July 6, 2017, modified the State’s funding policy to require that the contribution impact of all assumption changes be phased-in over a five-year period.

2. Because experience studies are performed every three years, we recommend that the phase-in period of the impact of assumption changes be reduced to three years. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Optional Hybrid Plan

P.A. 100-0023 created an Optional Hybrid Plan for current Tier 2 members and future new hires. The Optional Hybrid Plan consists of a reduced defined benefit plan and a defined contribution plan. Employers are required to contribute the normal cost plus an additional 2% of pay for each employee who participates in the Optional Hybrid Plan or Tier 2 in lieu of the Optional Hybrid Plan, for fiscal year 2021 and after.
GRS reflected the hybrid plan in the June 30, 2017 valuation and Cheiron commented that this was appropriate since the State mandated funding method requires projecting the liabilities of the System to 2045. However, in their draft June 30, 2018 through June 30, 2021 valuations, GRS did not reflect provisions related to the Optional Hybrid Plan because SURS will not implement the Plan until clarifying legislation is passed to enable SURS to implement the Plan.

**Earnings that Exceed the Governor’s Salary**

P.A. 100-0023 requires employers to make an additional contribution for participants who have annual earnings that currently exceed, or are projected to exceed, the Governor’s current or projected salary. The additional contribution is equal to the employer normal cost rate multiplied by salary in excess of the Governor’s current or projected salary.

GRS notes that the estimated additional contribution has been calculated and provided by SURS. This includes a component in which the contribution is adjusted down for members whose employers are already make normal cost adjustments. We have verified that GRS has reflected these additional employer contributions in the development of the net State contribution.

**Accelerated Pension Benefit Payments**

P.A. 100-0587 created two accelerated pension benefit payment options. Inactive vested members have the option of receiving a lump-sum equal to 60% of the present value of their benefits in lieu of their annuity benefits, and Tier 1 members have the option upon retirement of accepting a reduced automatic annual increase in exchange for a lump-sum equal to 70% of the present value of the reduction in annuity benefits. Eligible members must make an election by June 30, 2024, if they want to receive the accelerated pension benefit payments.

GRS continues to assume that no participant will elect to take an accelerated pension benefit payment option. The analysis of experience through June 30, 2021 showed an immaterial number of eligible members elected buyout options which supports the continued use of this assumption. We believe this approach is reasonable.

**Assessment of Actuarial Assumptions Used in the 2021 Valuation**

30 ILCS 5/2-8.1 requires the State Actuary to identify recommended changes in actuarial assumptions that the SARS Board must consider before finalizing its certification of the required State contribution. We reviewed the experience study completed this year and conclude that the recommended assumptions are reasonable in general, based on the evidence provided to us.
SECTION II – SUMMARY OF RECOMMENDATIONS

**Recommended Changes for Future Valuations**

3. We recommend that future stress testing include the impact to the required State contribution of potential reductions in the discount rate.

4. Section 3.2 of ASOP 51 requires the actuary to identify risks that “may reasonably be anticipated to significantly affect the plan’s future financial condition.” [emphasis added]. The risks currently identified appear to largely duplicate the list of examples in ASOP 51 and could apply to almost any pension plan. In future valuations, we recommend that the actuary explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition.

5. For each risk identified above, Section 3.3 of ASOP 51 requires the actuary to provide an assessment that takes into account “circumstances specific to the plan.” For some of the identified risks, the actuary has provided a quantitative assessment specific to the plan while for other identified risks, the actuary has only provided a generic statement that could apply to any plan. We recommend that for each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of this plan.

6. We recommend that the SURS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation.

**GASB 67 and 68**

The 2021 SURS GASB 67 and 68 information was provided in a separate report. We find that the assumptions and methods used to prepare the 2021 SURS GASB 67 and 68 schedules are reasonable based on the evidence provided to us.
SECTION III – SUPPORTING ANALYSIS

In this section, we provide detailed analysis and supporting rationale for the recommendations that were presented in Section II of this report.

Proposed Certification of the Required State Contribution

As stated in our summary of recommendations in Section II, we have verified the arithmetic calculations made by GRS to develop the required State contribution, reviewed the assumptions on which it is based, and accepted GRS’s annual projections of future payroll, total normal costs, benefits, expenses, and total contributions. However, in accordance with 30 ILCS 5/2-8.1, our review does not include a replication of the actuarial valuation results.

State Mandated Methods

The Illinois Pension Code (40 ILCS 5/15-155) establishes a method that does not adequately fund the System. This law requires the actuary to calculate the employer contribution as the level percentage of projected payroll that would accumulate assets equal to 90% of the Actuarial Accrued Liability in the year 2045 if all assumptions are met. This contribution level does not conform to generally accepted actuarial principles and practices. Generally accepted actuarial funding methods target the accumulation of assets equal to 100% of the Actuarial Accrued Liability, not 90%.

We continue to recommend that the funding method be changed to fully fund plan benefits (Recommendation #1). The funding method should ultimately target 100% of the actuarial accrued liability. Contributions should remain at a level that is expected to prevent the unfunded actuarial liability from growing and remain high enough to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded. While making adequate contributions will be challenging, continuing the practice of underfunding the System increases the risk of needing even larger contributions in the future that may make the System unsustainable.

The GRS June 30, 2021 Actuarial Valuation includes a recommended funding policy which would contribute the normal cost plus an amortization payment that would seek to fully pay off the total unfunded accrued liability over a closed period by the year 2045. Under this recommendation, GRS calculated a fiscal year 2023 State contribution amount of $2,524,525,000 (including Retirement Savings Plan (RSP) and Employer contributions). We concur with GRS’s recommendation and demonstration of an alternative funding approach. It conforms to a goal of full funding within a reasonable time period and with generally accepted actuarial principles and practices.

Recognition of Changes in Actuarial Assumptions

Public Act 100-0023 (P.A. 100-0023), effective July 6, 2017, modified the State’s funding policy to require that the contribution impact of all assumption changes, including changes prior to P.A. 100-0023, be phased-in over a five-year period. As such, the Act delays the funding of the
System. Assumption changes are intended to more accurately anticipate the obligations for funding based on the most recent experience analysis and forward-looking changes to future investment returns. However, only one-fifth of the impact of these changes are now recognized from the date of adoption. The remainder of the impact is recognized over four additional years such that the full impact is only recognized at the end of a five-year period beginning at the date of adoption. This phase-in provides time to adjust to a higher level of contributions. However, the Conference of Consulting Actuaries White Paper on Actuarial Funding Policies and Practices for Public Pension Plans recommends that the “phase-in period should be no longer than the time period until the next review of assumptions.” Since experience studies are performed every three years, we recommend the phase-in period for the impact of assumption changes be reduced to three years (Recommendation #2).

Optional Hybrid Plan

P.A. 100-0023 created an Optional Hybrid Plan for current Tier 2 members and future new hires. The Optional Hybrid Plan consists of a reduced defined benefit plan and a defined contribution plan. Employers are required to contribute for each employee who participates in the Optional Hybrid Plan or Tier 2 in lieu of the Optional Hybrid Plan, the normal cost plus for fiscal year 2021 and after an additional 2% of pay.

As stated in Section II of this report, GRS reflected the hybrid plan in the June 30, 2017 valuation by anticipating that future participants elect the Optional Hybrid Plan. However, in subsequent valuations, GRS has not reflected the Optional Hybrid Plan because SURS is still not moving forward with the implementation of the Optional Hybrid Plan until additional clarifying legislation is adopted. Based on consultation with SURS staff, GRS has assumed that, when available, 0% of new members will elect the Optional Hybrid Plan. In the 2021 Experience Review Report, GRS studied Plan election and has adopted appropriate assumption for the election of Tier 2 Plan and the Retirement Saving Plan (formerly Self-Managed Plan). The assumption that no members will elect the Optional Hybrid Plan is reasonable based on the Plan design and the expectations of GRS and SURS staff.

Earnings That Exceed the Governor’s Salary

P.A. 100- 0023 requires employers to make an additional contribution for participants who have annual earnings that currently exceed, or are projected to exceed, the Governor’s current or projected salary. The additional contribution is equal to the employer normal cost rate multiplied by salary in excess of the Governor’s current or projected salary.

GRS notes that the estimated additional contribution has been calculated and provided by SURS. This includes a component in which the contribution is adjusted down for members whose employers are already make normal cost adjustments. We have verified that GRS has reflected these additional employer contributions in the development of the net State contribution.
SECTION III – SUPPORTING ANALYSIS

Accelerated Pension Benefit Payments

P.A. 100-0587 created two accelerated pension benefit payment options. Inactive vested members have the option of receiving a lump-sum equal to 60% of the present value of their benefits in lieu of their annuity benefits, and Tier 1 members have the option upon retirement of accepting a reduced automatic increase in exchange for a lump-sum equal to 70% of the present value of the reduced annuity benefits. Eligible members must make an election by June 30, 2024 if they want to receive the accelerated pension benefit payments.

While the valuation report identifies experience under this payment option, the number of take-ups of the option remains immaterial relative to the total eligible population (see Actuarial Methods and Assumptions for the supporting information). GRS therefore continues to assume that no participant will elect to take an accelerated pension benefit payment option. We believe this approach is reasonable.

Stress Testing

Based on the June 30, 2021 Actuarial Valuation, the funded ratio, measured as the ratio of the actuarial value of assets to the actuarial liability, is currently at 43.9%. The unfunded actuarial liability is currently about $27.4 billion and is expected to drop slowly in future years. The required State contribution rate is currently 42.65% of payroll and scheduled to decrease to 37.72% of payroll in 2027 and remain level thereafter until 2045. However, if there is a significant market downturn, the unfunded actuarial liability and the required State contribution rate would increase, putting the sustainability of the system further into question. Stress testing was performed and included in the 2021 final Actuarial Valuation report in Appendix J to allow the users and public better understand these risks and the potential advantages of additional contributions in the near term to maintain the sustainability of the system.

Actuarial Standard of Practice 51

A new Actuarial Standard of Practice (ASOP) became effective for SURS actuarial valuations starting June 30, 2019. ASOP 51 provides guidance to actuaries on the assessment and disclosure of risks to help readers of the actuarial valuation report “understand the effects of future experience differing from the assumptions used” and “the potential volatility of future measurements resulting from such differences.”

ASOP 51’s first requirement is to “identify risks that, in the actuary’s professional judgment, may reasonably be anticipated to significantly affect the Plan’s future financial condition.” GRS identified six sources of risk to SURS: investment risk, asset/liability mismatch risk, contribution risk, salary and payroll risk, longevity risk and other demographic risks.

ASOP 51 requires the actuary to assess each of the risks identified. While the assessment does not have to be quantitative, it does have to take into account the specifics of the individual plan. ASOP 51 also describes several quantitative methods that may be used to assess risk.
SECTION III – SUPPORTING ANALYSIS

- **Investment Risk.** GRS included additional stress testing in the last year’s final actuarial valuation report that adequately assessed the investment risk with various investment return scenarios.

- **Asset/Liability Mismatch Risk.** GRS does not appear to provide an assessment of asset/liability mismatch risk other than to indicate that asset value changes that do not match liability changes will either increase or decrease costs. If GRS continues to identify this as a key risk, ASOP 51 requires that they also provide an assessment that takes into account “circumstances specific to the plan.”

- **Contribution Risk.** GRS discusses several issues with the statutorily required contribution amounts in the risk section as well as in other parts of the valuation report. The stress testing included in last year’s final actuarial valuation report adequately assessed the impact of a declining contribution base (i.e., payroll).

- **Salary and Payroll Risk.** The stress testing included in last year’s final actuarial valuation report adequately assessed the salary and payroll risk with alternative projected decreases in the active population.

- **Longevity Risk.** GRS does not appear to provide an assessment of longevity risk. The valuation report simply states that experience that differs from the assumptions will either increase or decrease costs. If GRS continues to identify this as a key risk, ASOP 51 requires that they also provide an assessment that takes into account “circumstances specific to the plan.”

- **Other Demographic Risk.** GRS provides an explanation of demographic risks. The stress testing included in last year’s final actuarial valuation report adequately assessed the impact of participants selecting the SMP (now RSP). However, the report does not appear to provide an assessment of other demographic risk. If GRS continues to identify this as a key risk, ASOP 51 requires that they also provide an assessment that takes into account “circumstances specific to the plan.”

ASOP 51 requires the actuary to recommend a more detailed assessment of risks if it “would be significantly beneficial.” GRS adequately identified the primary drivers of these risks, provided background information and assessments about these identified risks, but did not in our opinion adequately communicate the significance of all of these risks to this Plan. The stress testing included in last year’s final actuarial valuation report provided a quantitative assessment of the investment risk, contribution risk, and salary and payroll risk and we anticipate similar stress testing will be included in this year’s valuation actuarial valuation report. However, the other risks were only assessed with a generic statement that could apply to any pension plan.

Section 3.2 of ASOP 51 requires the actuary to identify risks that “may reasonably be anticipated to significantly affect the plan’s future financial condition.” The risks currently identified appear...
to largely duplicate the list of examples in ASOP 51 and could apply to almost any pension plan. **In future valuations, we recommend that the actuary explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition (Recommendation #4).**

For each risk identified above, Section 3.3 of ASOP 51 requires the actuary to provide an assessment that takes into account “circumstances specific to the plan.” For investment, salary and payroll, and plan selection risks, the actuary has provided a quantitative assessment specific to the plan while for other asset/liability mismatch, longevity, and other demographic risks, the actuary has only provided a generic statement that could apply to any plan. **We recommend that for each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of this plan (Recommendation #5).**
Assessment of Actuarial Assumptions Used in the 2021 Valuation

A. Economic Assumptions

1. The Interest Rate

The interest rate assumption (also called the investment return or discount rate) is the most impactful assumption affecting the required State contribution amount. This assumption, which is used to value liabilities for funding purposes, was reduced from 6.75% to 6.50% for the June 30, 2021 Actuarial Valuation.

After reviewing all the materials (see Appendix B of the report) that were made available, Cheiron concludes that reducing the interest rate from 6.75% to 6.50% for this valuation is reasonable. Because it is reasonable to anticipate future reductions in the discount rate, we recommend that future stress testing include the impact to the required State contribution of potential reductions in the discount rate (Recommendation #3).

We recommend that the SURS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly (Recommendation #6).

Our rationale for these recommendations:

- A review of the interest and inflation rates does not involve the collection of significant data and can be updated annually. In addition, it keeps the Board focused more closely on these very important assumptions.

- GRS’s 2021 Experience Review Report presented the expectations for the SURS portfolios based on their 2021 Capital Market Assumption Modeler (CMAM). This modeler uses the forward-looking expectations from 12 independent investment consultants. The CMAM produces expected returns for the portfolios on both a 10-year and 20-year plus basis. As GRS notes it is appropriate to give considerable weight to the 10-year expectations since 44% of the liabilities are expected to be paid out in the next 10 years. The expectations were presented based on two proposed asset portfolios by Meketa. Based on these portfolio, the expected 10-year geometric average return would be 6.00% using proposed Portfolio C and 6.20% using proposed Portfolio D. The probability of meeting or exceeding the 6.50% assumption over a 10-year time horizon is only 40.07% with Portfolio C and 42.95% with Portfolio D. This is why we find it is reasonable to anticipate a future reduction in the discount rate and recommend additional stress testing of a possible discount rate change in future valuations.
SECTION III – SUPPORTING ANALYSIS

- Adjusting for volatility the average expected geometric return for the SURA portfolio using the 10-year assumption for a 20-year period is 6.60% using portfolio C and 6.80% using Portfolio D. This analysis estimated SURA has a 53% chance of meeting or exceeding the 6.50% assumption over a 20-year time horizon using Portfolio C and a 54% chance of meeting or exceeding the 6.50% assumption using Portfolio D.

- While the discount rate assumption should be based on the future expected investment returns for the System’s investment portfolio, survey information can provide an important context for evaluating the assumption. The Public Plans Database is maintained by a partnership between the Center for State and Local Government Excellence (SLGE) and the Center for Retirement Research at Boston College with support from the National Association of State Retirement Administrators (NASRA). This database contains historical information on large public pension plans, including key assumptions used in their actuarial valuations. The following chart shows the distribution of investment return assumptions for the 177 plans in the Public Plans Database with consistent information from 2002 through 2020 as of October 27, 2021. Over the period shown, there continues to be a pattern of reducing discount rates partially reflecting long-term changes in capital markets, interest rates and underlying inflation. Of the 177 plans shown, 132 have reduced their discount rate assumption since 2016. For these 132 plans, the average reduction is 0.43%.
SECTION III – SUPPORTING ANALYSIS

- Declining interest rates have forced pension plans to either reduce their discount rates, increase their exposure to investment risk, or some combination of the two. For example, as shown in the chart below, in 2001 the yield on 10-year Treasury bonds (a proxy for a risk-free investment) was 5.30%. To achieve SURS’ then assumed return of 8.50%, the System’s investments had to outperform the yield on the 10-year Treasury by 3.20%. As of June 2021, the yield on the 10-year Treasury is now 1.50%, and to achieve SURS’ assumed return of 6.50%, the System’s investments need to exceed the ten-year Treasury yield by 5.00%. So, even though SURS reduced its assumption by 200 basis points over the period shown, it still has to take more investment risk in 2021 to meet its assumption than it did in 2001. By reducing the investment return assumption, plans are more likely to meet their funding goals without requiring investment performance so much in excess of the risk-free rate.

2. Inflation Assumption

As recommended in the 2021 Experience Review Report, SURS maintained its inflation assumption at 2.25% in the June 30, 2021 Actuarial Valuation.

We find the 2.25% inflation assumption to be reasonable.

Our rationale for concurring with the 2.25% assumption:
The August 2021 Old-Age, Survivors, and Disability Insurance (OASDI) Trustees Report projects that over the long-term (next 75 years), inflation will average between 1.8% and 3.0% (http://www.ssa.gov/oact/tr/2021/tr2021.pdf). Under the intermediate cost projection, the Social Security Administration uses an assumption of 2.4%.

The following chart shows the distribution of inflation expectations for the Third Quarter 2021 survey of professional economic forecasters published by the Philadelphia Federal Reserve, the 2021 Horizon survey of investment consultant capital market assumptions (20-year), and the 2020 inflation assumptions used by plans in the Public Plans Database compared to the SURS assumption (indicated by the gold diamonds). The assumption of 2.25% is near the middle of the range projected by professional economic forecasters and investment consultants and is on the low end of the range used by other public pension plans.
3. **Salary (Annual Compensation) Increase Assumption**

The Annual Compensation Increase assumption was reduced from 3.25% to 3.00% for the June 30, 2021 Actuarial Valuation. This assumption which is also called wage inflation is comprised of an inflation assumption of 2.25% per annum and 0.75% per annum productivity or real wage growth assumption.

Additionally, GRS split the Annual Compensation Increase assumption to those under age 50 and age 50 and Older.

Salary Increases for the 2021 valuation and are shown below.

Illustrative rates of increase per individual employee per annum, compounded annually:

<table>
<thead>
<tr>
<th>Service Year</th>
<th>Total Increase Under Age 50</th>
<th>50 and Older</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>12.75%</td>
<td>12.00%</td>
</tr>
<tr>
<td>1</td>
<td>12.75%</td>
<td>12.00%</td>
</tr>
<tr>
<td>2</td>
<td>9.00%</td>
<td>8.25%</td>
</tr>
<tr>
<td>3</td>
<td>7.75%</td>
<td>7.00%</td>
</tr>
<tr>
<td>4</td>
<td>6.75%</td>
<td>6.00%</td>
</tr>
<tr>
<td>5</td>
<td>6.25%</td>
<td>5.50%</td>
</tr>
<tr>
<td>6</td>
<td>6.00%</td>
<td>5.25%</td>
</tr>
<tr>
<td>7</td>
<td>5.50%</td>
<td>4.75%</td>
</tr>
<tr>
<td>8-10</td>
<td>5.00%</td>
<td>4.25%</td>
</tr>
<tr>
<td>11-14</td>
<td>4.50%</td>
<td>3.75%</td>
</tr>
<tr>
<td>15-18</td>
<td>4.25%</td>
<td>3.50%</td>
</tr>
<tr>
<td>19</td>
<td>4.00%</td>
<td>3.25%</td>
</tr>
<tr>
<td>20-33</td>
<td>3.75%</td>
<td>3.25%</td>
</tr>
<tr>
<td>34+</td>
<td>3.50%</td>
<td>3.00%</td>
</tr>
</tbody>
</table>

The assumed rate of total payroll growth is 3.00%.

**We find the assumption to reduce real wage growth to 0.75% and the basis for setting it as reasonable and consistent with the inflation assumption.**

**Our rationale for concurring with GRS’s recommended salary increase assumption:**

- Lowering the total salary increase assumption to 3.00% is supported the analysis shown on pages 21-26 of the 2021 Experience Review Report performed by GRS.

- Page 26 of the 2021 Experience Review Report shows that members at age 50 and above have generally lower salary increases based on service that members below age 50, which supports distinct assumptions for these groups.
The following chart shows the average nominal and real increases in wages over the last 10 and 20 years for State governments, local governments, and National Average Wages. State and local government data is from the Quarterly Census of Employment and Wages as published by the Bureau of Labor Statistics. National Average Wages is published by the Social Security Administration.

The August 2021 Old-Age, Survivors, and Disability Insurance (OASDI) Trustees Report projects that over the long-term (next 75 years), real wage differential will average somewhere between 0.53% and 1.77%. Under the intermediate cost projection, the Social Security Administration uses an assumption of 1.15%.

During the year ending June 30, 2021, there was an experience gain from this assumption (i.e., salary increases were less than assumed) as shown on page 31 of the June 30, 2021 Actuarial Valuation. The table on page 32 shows that there had been gains due to salary increases in three out of the four prior years.

In our own experience with our public sector pension plans (about 60 large plans), we have witnessed a continued trend of lower salary increases for public sector employees.

4. **Cost-of-Living Adjustment Assumption**

Benefits are increased annually as described on page 59 of the June 30, 2021 Actuarial Valuation. Annual increases are 3.0% for those hired prior to January 1, 2011 and based upon ½ of the Consumer Price Index for those hired on or after January 1, 2011, which is 1.125% based on the inflation assumption of 2.25%.
SECTION III – SUPPORTING ANALYSIS

We find the assumption and the basis for setting it reasonable.

5. *Capped Pay Assumption*

Benefits for members hired after January 1, 2011 are calculated using pay that is capped under 40 ILCS 5/1-160. The pay cap is shown on page 71 of the June 30, 2021 Actuarial Valuation to be $116,740.42 for 2021. The Optional Hybrid Plan pay cap is equal to the Social Security Wage Base, which is $142,800 for 2021.

We find the assumption and the basis for setting it reasonable.

6. *Effective Rate of Interest*

The Effective Rate of Interest ("ERI") is the interest rate that is applied to member contribution balances. The ERI, for the purpose of determining the money purchase benefit, is established by the State Comptroller annually. The ERI for other purposes such as the calculation of purchases of service credit, refunds for excess contributions, portable plan refunds, and lump-sum portable retirements is determined by the SURS Board annually and certified to the Governor. For purposes of the actuarial valuation, the assumed ERI is 6.50%.

While we find this assumption and the basis for setting it as reasonable, we would like to point out that crediting member accounts with an annual rate of 6.50% is generous given today’s low interest rate environment.
B. Demographic Assumptions

All demographic assumptions were reviewed as part of the 2021 Experience Review with appropriate assumption changes adopted by the Board in June 2021.

In its annual actuarial valuation reports, GRS regularly reports sources of liability gains and losses. In the June 30, 2021 Actuarial Valuation, these are shown on page 32. In the chart below, we have collected similar data from GRS’s past valuation reports dating back to 2012 and presented a historical review of past demographic and salary increase experience gains and losses.

The chart below shows the pattern of annual gains and losses attributable to eight different sources as shown in the legend. When the colored bar slices appear above zero on the Y-axis, it represents an experience loss with the value representing the increase in liabilities over what was expected. When the bar is below zero, it represents an experience gain for that year with liabilities less than expected. This net liability (gain)/loss is shown by the black line. This net (gain)/loss as a percent of liability is shown above the bars.

Key observations from this chart are as follows:

1. In every year, there have been experience losses attributable to new entrants joining SURS. New entrant losses are expected because participants are hired and accrue service between
SECTION III – SUPPORTING ANALYSIS

valuations. However, there is also an offsetting asset gain to this loss due to contributions made on behalf of these new entrants.

2. A trend of salary gains had appeared in most years. A change in the salary increase assumption in 2021 should mean that these gains will remain small in future years.

3. Since 2012, termination from employment experience has consistently shown losses, but they have been relatively small. This assumption was reexamined in the recent GRS 2021 Experience Review and was slightly modified to produce fewer expected number of terminations. This change is better reflective of the actuarial experience of the System except perhaps for the continued losses attributable to new entrants.

4. Disability and active mortality experience are too small to be noticed on the chart, given their insignificant size relative to other experience items. Since there have been both gains and losses in each of these areas during the period shown, they are not an immediate area of concern.

5. The net liability (gain)/loss is shown by the black line on the graph above. This net (gain)/loss as a percent of liability is shown above the bars. The percent is generally quite small and there is not a consistent pattern of either gains or losses.

The demographic assumptions are summarized below. We reviewed the development of these assumptions based on the Experience Review Report dated June 1, 2021, and we have concluded all are reasonable and meet the requirements of ASOP No. 35, Section 3.3.4. We have noted comments on specific assumptions below, but do not believe they would have a material effect.

For the analysis of demographic assumptions in the 2021 Experience Review Report, GRS split the analysis to consider Academic and Non-Academic employees separately. This is reasonable and the analysis showed that each of these groups has distinct experience. In the selection of assumptions GRS appropriately selected assumptions based on the experience of each classification. We believe this is an improvement over the prior method of using assumptions for the entire SURS population.

1. Mortality

The mortality assumptions are as follows:

Employee Type of Academic:

<table>
<thead>
<tr>
<th>Base Table with 2010 Base Year</th>
<th>Male Multiplier</th>
<th>Female Multiplier</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pub-2010 Employee Mortality Table (for Teachers) (pre-retirement)</td>
<td>101%</td>
<td>97%</td>
</tr>
<tr>
<td>Pub-2010 Healthy Retiree Mortality Table (for Teachers) (non-disabled post-retirement)</td>
<td>99%</td>
<td>105%</td>
</tr>
</tbody>
</table>
THE STATE ACTUARY’S PRELIMINARY REPORT ON THE STATE UNIVERSITIES RETIREMENT SYSTEM OF ILLINOIS PURSUANT TO 30 ILCS 5/2-8.1

SECTION III – SUPPORTING ANALYSIS

| Pub-2010 Disabled Retiree Mortality Table (for Non-Safety Employees) (disabled post-retirement) | 112% | 110% |

Employee Type of Non-Academic:

<table>
<thead>
<tr>
<th>Base Table with 2010 Base Year</th>
<th>Male Multiplier</th>
<th>Female Multiplier</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pub-2010 Employee Mortality Table (for General Employees) (pre-retirement)</td>
<td>114%</td>
<td>105%</td>
</tr>
<tr>
<td>Pub-2010 Healthy Retiree Mortality Table (for General Employees) (non-disabled post-retirement)</td>
<td>99%</td>
<td>107%</td>
</tr>
<tr>
<td>Pub-2010 Disabled Retiree Mortality Table (for Non-Safety Employees) (disabled post-retirement)</td>
<td>112%</td>
<td>110%</td>
</tr>
</tbody>
</table>

*The provision for future mortality improvement is based on the generational application of the MP-2020 improvement scales.*

Comment: The development of the adjusted base tables for mortality including the reflection of appropriate credibility is shown on pages 57-69 of the 2021 Experience Review Report.

<table>
<thead>
<tr>
<th>Age</th>
<th>Male Academic Future Life Expectancy (years) in 2021</th>
<th>Female Academic Future Life Expectancy (years) in 2021</th>
<th>Male Non-Academic Future Life Expectancy (years) in 2021</th>
<th>Female Non-Academic Future Life Expectancy (years) in 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>35</td>
<td>53.42</td>
<td>55.17</td>
<td>51.01</td>
<td>53.34</td>
</tr>
<tr>
<td>40</td>
<td>48.18</td>
<td>49.91</td>
<td>45.74</td>
<td>48.04</td>
</tr>
<tr>
<td>45</td>
<td>42.94</td>
<td>44.67</td>
<td>40.51</td>
<td>42.76</td>
</tr>
<tr>
<td>50</td>
<td>37.74</td>
<td>39.44</td>
<td>35.39</td>
<td>37.59</td>
</tr>
<tr>
<td>55</td>
<td>32.61</td>
<td>34.31</td>
<td>30.50</td>
<td>32.64</td>
</tr>
<tr>
<td>60</td>
<td>27.65</td>
<td>29.37</td>
<td>25.79</td>
<td>27.82</td>
</tr>
<tr>
<td>65</td>
<td>22.90</td>
<td>24.57</td>
<td>21.31</td>
<td>23.14</td>
</tr>
<tr>
<td>70</td>
<td>18.38</td>
<td>19.90</td>
<td>17.06</td>
<td>18.65</td>
</tr>
<tr>
<td>75</td>
<td>14.18</td>
<td>15.49</td>
<td>13.15</td>
<td>14.46</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Age</th>
<th>Male Academic Future Life Expectancy (years) in 2035</th>
<th>Female Academic Future Life Expectancy (years) in 2035</th>
<th>Male Non-Academic Future Life Expectancy (years) in 2035</th>
<th>Female Non-Academic Future Life Expectancy (years) in 2035</th>
</tr>
</thead>
<tbody>
<tr>
<td>35</td>
<td>54.48</td>
<td>56.13</td>
<td>52.30</td>
<td>54.46</td>
</tr>
<tr>
<td>40</td>
<td>49.23</td>
<td>50.88</td>
<td>47.03</td>
<td>49.17</td>
</tr>
<tr>
<td>45</td>
<td>43.99</td>
<td>45.64</td>
<td>41.77</td>
<td>43.88</td>
</tr>
<tr>
<td>50</td>
<td>38.78</td>
<td>40.41</td>
<td>36.63</td>
<td>38.70</td>
</tr>
<tr>
<td>55</td>
<td>33.65</td>
<td>35.27</td>
<td>31.70</td>
<td>33.72</td>
</tr>
<tr>
<td>60</td>
<td>28.65</td>
<td>30.29</td>
<td>26.92</td>
<td>28.84</td>
</tr>
<tr>
<td>65</td>
<td>23.82</td>
<td>25.42</td>
<td>22.32</td>
<td>24.07</td>
</tr>
<tr>
<td>70</td>
<td>18.65</td>
<td>20.67</td>
<td>17.06</td>
<td>19.48</td>
</tr>
<tr>
<td>75</td>
<td>14.46</td>
<td>16.17</td>
<td>13.87</td>
<td>15.17</td>
</tr>
</tbody>
</table>

2. Marriage Assumption

Members are assumed to be married in the following proportions:

<table>
<thead>
<tr>
<th>Age</th>
<th>Males</th>
<th>Females</th>
</tr>
</thead>
<tbody>
<tr>
<td>20-24</td>
<td>10%</td>
<td>25%</td>
</tr>
<tr>
<td>25-29</td>
<td>35</td>
<td>45</td>
</tr>
<tr>
<td>30-34</td>
<td>60</td>
<td>65</td>
</tr>
<tr>
<td>35-39</td>
<td>70</td>
<td>70</td>
</tr>
<tr>
<td>40-44</td>
<td>75</td>
<td>75</td>
</tr>
<tr>
<td>45-59</td>
<td>80</td>
<td>75</td>
</tr>
<tr>
<td>60-89</td>
<td>80</td>
<td>70</td>
</tr>
</tbody>
</table>
3. Termination Rates

The termination rates have been updated to reflect the differences between Academic and Non-Academic behavior on based on the most recent experience study period. The assumption is a table of turnover rates for each classification by years of service.

A sample of these rates follows:

<table>
<thead>
<tr>
<th>Years of Service</th>
<th>Academic</th>
<th>Non-Academic</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>15.00%</td>
<td>15.00%</td>
</tr>
<tr>
<td>1</td>
<td>15.00</td>
<td>15.00</td>
</tr>
<tr>
<td>2</td>
<td>12.00</td>
<td>15.00</td>
</tr>
<tr>
<td>3</td>
<td>11.00</td>
<td>14.00</td>
</tr>
<tr>
<td>4</td>
<td>10.00</td>
<td>12.00</td>
</tr>
<tr>
<td>5</td>
<td>9.00</td>
<td>10.00</td>
</tr>
<tr>
<td>6</td>
<td>8.00</td>
<td>9.00</td>
</tr>
<tr>
<td>7</td>
<td>7.00</td>
<td>8.00</td>
</tr>
<tr>
<td>8</td>
<td>6.00</td>
<td>7.00</td>
</tr>
<tr>
<td>9</td>
<td>5.00</td>
<td>6.00</td>
</tr>
<tr>
<td>10</td>
<td>4.00</td>
<td>5.00</td>
</tr>
<tr>
<td>11</td>
<td>4.00</td>
<td>5.00</td>
</tr>
<tr>
<td>12</td>
<td>3.00</td>
<td>3.50</td>
</tr>
<tr>
<td>13</td>
<td>3.00</td>
<td>3.50</td>
</tr>
<tr>
<td>14</td>
<td>3.00</td>
<td>3.50</td>
</tr>
<tr>
<td>15</td>
<td>2.50</td>
<td>3.00</td>
</tr>
<tr>
<td>16</td>
<td>2.50</td>
<td>3.00</td>
</tr>
<tr>
<td>17</td>
<td>2.50</td>
<td>3.00</td>
</tr>
<tr>
<td>18</td>
<td>2.50</td>
<td>3.00</td>
</tr>
<tr>
<td>19</td>
<td>2.50</td>
<td>3.00</td>
</tr>
<tr>
<td>20</td>
<td>2.00</td>
<td>2.00</td>
</tr>
<tr>
<td>21</td>
<td>2.00</td>
<td>2.00</td>
</tr>
<tr>
<td>22</td>
<td>2.00</td>
<td>2.00</td>
</tr>
<tr>
<td>23</td>
<td>2.00</td>
<td>2.00</td>
</tr>
<tr>
<td>24</td>
<td>2.00</td>
<td>2.00</td>
</tr>
<tr>
<td>25</td>
<td>1.50</td>
<td>1.50</td>
</tr>
<tr>
<td>26</td>
<td>1.50</td>
<td>1.50</td>
</tr>
<tr>
<td>27</td>
<td>1.50</td>
<td>1.50</td>
</tr>
<tr>
<td>28</td>
<td>1.50</td>
<td>1.50</td>
</tr>
<tr>
<td>29</td>
<td>1.50</td>
<td>1.50</td>
</tr>
</tbody>
</table>

A termination rate of 100 percent is assumed at three years of service for members classified as part time for valuation purposes.

Members that terminate with at least five years of service (10 years of service for Tier 2 members) are assumed to elect the most valuable option on a present value basis, either refund of contributions or a deferred benefit.
Termination rate for 29 years of service used for Tier 2 members until retirement eligibility is met.

4. Retirement Rates

Upon eligibility, active members are assumed to retire as follows:

<table>
<thead>
<tr>
<th>Age</th>
<th>Under 40 Years</th>
<th>40+ Years</th>
<th>Under 40 Years</th>
<th>40+ Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>50</td>
<td>55.0%</td>
<td>-</td>
<td>55.0%</td>
<td>-</td>
</tr>
<tr>
<td>50</td>
<td>55.0%</td>
<td>-</td>
<td>40.0%</td>
<td>-</td>
</tr>
<tr>
<td>51</td>
<td>40.0%</td>
<td>-</td>
<td>30.0%</td>
<td>-</td>
</tr>
<tr>
<td>52</td>
<td>40.0%</td>
<td>-</td>
<td>30.0%</td>
<td>-</td>
</tr>
<tr>
<td>53</td>
<td>30.0%</td>
<td>-</td>
<td>30.0%</td>
<td>-</td>
</tr>
<tr>
<td>54</td>
<td>30.0%</td>
<td>-</td>
<td>30.0%</td>
<td>-</td>
</tr>
<tr>
<td>55</td>
<td>20.0%</td>
<td>30.0%</td>
<td>7.0%</td>
<td>25.0%</td>
</tr>
<tr>
<td>56</td>
<td>20.0%</td>
<td>30.0%</td>
<td>5.5%</td>
<td>25.0%</td>
</tr>
<tr>
<td>57</td>
<td>20.0%</td>
<td>30.0%</td>
<td>4.0%</td>
<td>25.0%</td>
</tr>
<tr>
<td>58</td>
<td>20.0%</td>
<td>30.0%</td>
<td>5.0%</td>
<td>25.0%</td>
</tr>
<tr>
<td>59</td>
<td>20.0%</td>
<td>30.0%</td>
<td>5.5%</td>
<td>25.0%</td>
</tr>
<tr>
<td>60</td>
<td>13.0%</td>
<td>19.5%</td>
<td>20.0%</td>
<td>30.0%</td>
</tr>
<tr>
<td>61</td>
<td>13.0%</td>
<td>19.5%</td>
<td>15.0%</td>
<td>22.5%</td>
</tr>
<tr>
<td>62</td>
<td>13.0%</td>
<td>19.5%</td>
<td>15.0%</td>
<td>22.5%</td>
</tr>
<tr>
<td>63</td>
<td>13.0%</td>
<td>19.5%</td>
<td>15.0%</td>
<td>22.5%</td>
</tr>
<tr>
<td>64</td>
<td>13.0%</td>
<td>19.5%</td>
<td>15.0%</td>
<td>22.5%</td>
</tr>
<tr>
<td>65</td>
<td>17.0%</td>
<td>25.5%</td>
<td>25.0%</td>
<td>37.5%</td>
</tr>
<tr>
<td>66</td>
<td>17.0%</td>
<td>25.5%</td>
<td>25.0%</td>
<td>37.5%</td>
</tr>
<tr>
<td>67</td>
<td>17.0%</td>
<td>25.5%</td>
<td>25.0%</td>
<td>37.5%</td>
</tr>
<tr>
<td>68</td>
<td>17.0%</td>
<td>25.5%</td>
<td>25.0%</td>
<td>37.5%</td>
</tr>
<tr>
<td>69</td>
<td>17.0%</td>
<td>25.5%</td>
<td>25.0%</td>
<td>37.5%</td>
</tr>
<tr>
<td>70</td>
<td>17.0%</td>
<td>25.5%</td>
<td>20.0%</td>
<td>30.0%</td>
</tr>
<tr>
<td>71-79</td>
<td>15.0%</td>
<td>22.5%</td>
<td>20.0%</td>
<td>30.0%</td>
</tr>
<tr>
<td>80+</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>
SECTION III – SUPPORTING ANALYSIS

<table>
<thead>
<tr>
<th>Age</th>
<th>Members Hired before January 1, 2011</th>
<th>Members Hired on or After January 1, 2011 and Eligible for Normal Retirement</th>
<th>Early Retirement</th>
<th>Members Hired on or After January 1, 2011 and Eligible for Normal Retirement</th>
<th>Early Retirement</th>
<th>Members Hired on or After January 1, 2011 and Eligible for Normal Retirement</th>
<th>Early Retirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>60</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>60.0%</td>
<td></td>
</tr>
<tr>
<td>61</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>25.0%</td>
<td></td>
</tr>
<tr>
<td>62</td>
<td>-</td>
<td>25.0%</td>
<td>-</td>
<td>35.0%</td>
<td>-</td>
<td>25.0%</td>
<td></td>
</tr>
<tr>
<td>63</td>
<td>-</td>
<td>10.0%</td>
<td>-</td>
<td>15.0%</td>
<td>-</td>
<td>25.0%</td>
<td></td>
</tr>
<tr>
<td>64</td>
<td>-</td>
<td>10.0%</td>
<td>-</td>
<td>15.0%</td>
<td>-</td>
<td>25.0%</td>
<td></td>
</tr>
<tr>
<td>65</td>
<td>-</td>
<td>10.0%</td>
<td>-</td>
<td>15.0%</td>
<td>-</td>
<td>15.0%</td>
<td></td>
</tr>
<tr>
<td>66</td>
<td>-</td>
<td>10.0%</td>
<td>-</td>
<td>15.0%</td>
<td>-</td>
<td>15.0%</td>
<td></td>
</tr>
<tr>
<td>67</td>
<td>35.0%</td>
<td>-</td>
<td>35.0%</td>
<td>-</td>
<td>-</td>
<td>15.0%</td>
<td></td>
</tr>
<tr>
<td>68</td>
<td>17.0%</td>
<td>-</td>
<td>25.0%</td>
<td>-</td>
<td>-</td>
<td>25.0%</td>
<td></td>
</tr>
<tr>
<td>69</td>
<td>17.0%</td>
<td>-</td>
<td>25.0%</td>
<td>-</td>
<td>-</td>
<td>25.0%</td>
<td></td>
</tr>
<tr>
<td>70</td>
<td>17.0%</td>
<td>-</td>
<td>20.0%</td>
<td>-</td>
<td>-</td>
<td>20.0%</td>
<td></td>
</tr>
<tr>
<td>71-79</td>
<td>15.0%</td>
<td>-</td>
<td>20.0%</td>
<td>-</td>
<td>-</td>
<td>20.0%</td>
<td></td>
</tr>
<tr>
<td>80+</td>
<td>100.0%</td>
<td>-</td>
<td>100.0%</td>
<td>-</td>
<td>-</td>
<td>100.0%</td>
<td></td>
</tr>
</tbody>
</table>

A rate equal to 1.5 times the Tier 2 rate shown is used if a member has 40 or more years of service and is less than 80 years old. The rates shown above are for members with less than 40 years of service.

Members that retire are assumed to elect the most valuable option on a present value basis, either refund of contributions (or portable lump-sum retirement, if applicable) or a retirement annuity.

For purposes of the projections in the actuarial valuation, members of the Retirement Savings Plan are assumed to retire in accordance with the Tier 1 and Tier 2 retirement rates (based on hire date).
5. Disability Rates

A table of disability incidence with sample rates follows:

<table>
<thead>
<tr>
<th>Age</th>
<th>Academic Males</th>
<th>Academic Females</th>
<th>Non-Academic Males</th>
<th>Non-Academic Females</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>0.00741%</td>
<td>0.01640%</td>
<td>0.02717%</td>
<td>0.037720%</td>
</tr>
<tr>
<td>21</td>
<td>0.00759%</td>
<td>0.01735%</td>
<td>0.02783%</td>
<td>0.039905%</td>
</tr>
<tr>
<td>22</td>
<td>0.00777%</td>
<td>0.01830%</td>
<td>0.02849%</td>
<td>0.042090%</td>
</tr>
<tr>
<td>23</td>
<td>0.00795%</td>
<td>0.01925%</td>
<td>0.02915%</td>
<td>0.045295%</td>
</tr>
<tr>
<td>24</td>
<td>0.00813%</td>
<td>0.02020%</td>
<td>0.02981%</td>
<td>0.046460%</td>
</tr>
<tr>
<td>25</td>
<td>0.00831%</td>
<td>0.02115%</td>
<td>0.03047%</td>
<td>0.048645%</td>
</tr>
<tr>
<td>26</td>
<td>0.00849%</td>
<td>0.02210%</td>
<td>0.03113%</td>
<td>0.050830%</td>
</tr>
<tr>
<td>27</td>
<td>0.00867%</td>
<td>0.02305%</td>
<td>0.03179%</td>
<td>0.053015%</td>
</tr>
<tr>
<td>28</td>
<td>0.00885%</td>
<td>0.02405%</td>
<td>0.03245%</td>
<td>0.055315%</td>
</tr>
<tr>
<td>29</td>
<td>0.00900%</td>
<td>0.02500%</td>
<td>0.03300%</td>
<td>0.057500%</td>
</tr>
<tr>
<td>30</td>
<td>0.00945%</td>
<td>0.02705%</td>
<td>0.03465%</td>
<td>0.062215%</td>
</tr>
<tr>
<td>31</td>
<td>0.00990%</td>
<td>0.02910%</td>
<td>0.03630%</td>
<td>0.066930%</td>
</tr>
<tr>
<td>32</td>
<td>0.01035%</td>
<td>0.03115%</td>
<td>0.03795%</td>
<td>0.071645%</td>
</tr>
<tr>
<td>33</td>
<td>0.01077%</td>
<td>0.03320%</td>
<td>0.03949%</td>
<td>0.076360%</td>
</tr>
<tr>
<td>34</td>
<td>0.01122%</td>
<td>0.03525%</td>
<td>0.04114%</td>
<td>0.081075%</td>
</tr>
<tr>
<td>35</td>
<td>0.01185%</td>
<td>0.03725%</td>
<td>0.04345%</td>
<td>0.085675%</td>
</tr>
<tr>
<td>36</td>
<td>0.01245%</td>
<td>0.03930%</td>
<td>0.04565%</td>
<td>0.090390%</td>
</tr>
<tr>
<td>37</td>
<td>0.01308%</td>
<td>0.04135%</td>
<td>0.04796%</td>
<td>0.095105%</td>
</tr>
<tr>
<td>38</td>
<td>0.01371%</td>
<td>0.04340%</td>
<td>0.05027%</td>
<td>0.099820%</td>
</tr>
<tr>
<td>39</td>
<td>0.01431%</td>
<td>0.04545%</td>
<td>0.05247%</td>
<td>0.10435%</td>
</tr>
<tr>
<td>40</td>
<td>0.01608%</td>
<td>0.04750%</td>
<td>0.05896%</td>
<td>0.109250%</td>
</tr>
<tr>
<td>41</td>
<td>0.01785%</td>
<td>0.04955%</td>
<td>0.06545%</td>
<td>0.113965%</td>
</tr>
<tr>
<td>42</td>
<td>0.01962%</td>
<td>0.05160%</td>
<td>0.07194%</td>
<td>0.118680%</td>
</tr>
<tr>
<td>43</td>
<td>0.02139%</td>
<td>0.05365%</td>
<td>0.07843%</td>
<td>0.123395%</td>
</tr>
<tr>
<td>44</td>
<td>0.02316%</td>
<td>0.05570%</td>
<td>0.08492%</td>
<td>0.128110%</td>
</tr>
<tr>
<td>45</td>
<td>0.02535%</td>
<td>0.05775%</td>
<td>0.09295%</td>
<td>0.132825%</td>
</tr>
<tr>
<td>46</td>
<td>0.02757%</td>
<td>0.05980%</td>
<td>0.10109%</td>
<td>0.137540%</td>
</tr>
<tr>
<td>47</td>
<td>0.02979%</td>
<td>0.06185%</td>
<td>0.10923%</td>
<td>0.142255%</td>
</tr>
<tr>
<td>48</td>
<td>0.03198%</td>
<td>0.06390%</td>
<td>0.11726%</td>
<td>0.146970%</td>
</tr>
<tr>
<td>49</td>
<td>0.03420%</td>
<td>0.06595%</td>
<td>0.12540%</td>
<td>0.151685%</td>
</tr>
<tr>
<td>50</td>
<td>0.03642%</td>
<td>0.06800%</td>
<td>0.13354%</td>
<td>0.156400%</td>
</tr>
<tr>
<td>51</td>
<td>0.03861%</td>
<td>0.07005%</td>
<td>0.14157%</td>
<td>0.161115%</td>
</tr>
<tr>
<td>52</td>
<td>0.04083%</td>
<td>0.07210%</td>
<td>0.14971%</td>
<td>0.165830%</td>
</tr>
<tr>
<td>53</td>
<td>0.04305%</td>
<td>0.07415%</td>
<td>0.15785%</td>
<td>0.170545%</td>
</tr>
<tr>
<td>54</td>
<td>0.04524%</td>
<td>0.07620%</td>
<td>0.16588%</td>
<td>0.175260%</td>
</tr>
<tr>
<td>55 and older</td>
<td>0.04656%</td>
<td>0.07825%</td>
<td>55 and older</td>
<td>0.17072%</td>
</tr>
</tbody>
</table>

Disability rates apply during the retirement eligibility period.
Members are assumed to first receive disability benefits and then receive disability retirement annuity benefits.

6. **Operational Expenses**

The amount of operational expenses for administration incurred in the latest fiscal year are supplied by SURS staff and incorporated in the normal cost. Estimated administrative expenses for FY 2023 and after are assumed to increase by 3.00%.

7. **Spouse’s Age**

The female spouse is assumed to be three years younger than the male spouse.

8. **Missing Data**

Members with an unknown gender are assumed to be female. Active and inactive members with an unknown date of birth are assumed to be 37 years old at the valuation date. An assumed spouse date of birth is calculated for current service retirees in the traditional plan for purposes of calculating future survivor benefits. The female spouse is assumed to be three years younger than the male spouse. Seventy percent of current total male retirees and 80% of current total female retirees in the traditional plan that have not elected a survivor refund are assumed to have a spouse at the valuation date.

9. **Benefit Commencement Age**

Inactive members eligible for a deferred benefit are assumed to commence benefits at their earliest normal retirement age. For Tier 1 members, this is age 62 with at least five years of service, age 60 with at least eight years of service, or immediately with at least 30 years of service. For Tier 2 members, this is age 67 with 10 or more years of service.

10. **Load on Final Average Salary**

No load is assumed to account for higher than assumed pay increases in final years of employment before retirement.

11. **Load on Liabilities for Service Retirees with Non-finalized Benefits**

A load of 10% on liabilities for service retirees whose benefits have not been finalized as of the valuation date is assumed to account for finalized benefits that on average are 10% higher than 100% of the preliminary estimated benefit. A load of 5% is used if a “best formula” benefit was provided in the data by Staff.
12. Valuation of Inactives

An annuity benefit is estimated based on information provided by staff for Tier 1 inactive members with five or more years of service and Tier 2 members with 10 or more years of service.

13. Reciprocal Service

Reciprocal service is included for current inactive members for purposes of determining vesting eligibility and eligibility age to commence benefits.

The recently updated actuarial assumptions (including retirement and termination rates) were based on SURS service only. Therefore, reciprocal service was not included for current active members.

14. Projection Assumptions

The number of total active members throughout the projection period will remain the same as the total number of active members in the defined benefit plans and the RSP in the current valuation.

Future new hires are assumed to elect to participate in the offered plans as follows:

- **Academic**
  - 45% are assumed to elect to participate in the Retirement Saving Plan.
  - 55% are assumed to elect to participate in the Tier 2 Plan

- **Non-Academic**
  - 25% are assumed to elect to participate in the Self-Managed Plan.
  - 75% are assumed to elect to participate in the Tier 2 Plan

New entrants have an average age of 36.8 and average capped pay of $43,292 and average uncapped pay of $45,565 (2021 dollars). These values are based on the average age and average pay of current members. The range profile is based on the age at hire and assumed pay at hire (using the actuarial assumptions, inflated to 2021 dollars) of current active members with service between one and four years.
### Summary of New Entrants - Academic

<table>
<thead>
<tr>
<th>Age</th>
<th>Number Males</th>
<th>Average Pay Male</th>
<th>Number Females</th>
<th>Average Pay Female</th>
<th>Total Number</th>
<th>Average Pay Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;20</td>
<td>2</td>
<td>$46,423</td>
<td>2</td>
<td>$34,714</td>
<td>4</td>
<td>$40,568</td>
</tr>
<tr>
<td>20 - 24</td>
<td>74</td>
<td>28,716</td>
<td>96</td>
<td>30,642</td>
<td>170</td>
<td>29,804</td>
</tr>
<tr>
<td>25 - 29</td>
<td>308</td>
<td>45,082</td>
<td>393</td>
<td>44,061</td>
<td>701</td>
<td>43,856</td>
</tr>
<tr>
<td>30 - 34</td>
<td>427</td>
<td>59,409</td>
<td>574</td>
<td>56,549</td>
<td>1,001</td>
<td>54,814</td>
</tr>
<tr>
<td>35 - 39</td>
<td>424</td>
<td>53,116</td>
<td>475</td>
<td>51,976</td>
<td>899</td>
<td>50,336</td>
</tr>
<tr>
<td>40 - 44</td>
<td>266</td>
<td>52,270</td>
<td>300</td>
<td>47,122</td>
<td>566</td>
<td>47,465</td>
</tr>
<tr>
<td>45 - 49</td>
<td>191</td>
<td>43,273</td>
<td>212</td>
<td>44,675</td>
<td>403</td>
<td>46,950</td>
</tr>
<tr>
<td>50 - 54</td>
<td>141</td>
<td>33,655</td>
<td>151</td>
<td>35,193</td>
<td>292</td>
<td>34,635</td>
</tr>
<tr>
<td>55 - 59</td>
<td>122</td>
<td>44,509</td>
<td>130</td>
<td>36,664</td>
<td>252</td>
<td>44,482</td>
</tr>
<tr>
<td>60 - 64</td>
<td>90</td>
<td>33,655</td>
<td>79</td>
<td>35,193</td>
<td>169</td>
<td>32,399</td>
</tr>
<tr>
<td>65 - 69</td>
<td>10</td>
<td>23,525</td>
<td>2</td>
<td>8,223</td>
<td>12</td>
<td>20,975</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,055</strong></td>
<td><strong>$49,267</strong></td>
<td><strong>2,414</strong></td>
<td><strong>$44,026</strong></td>
<td><strong>4,469</strong></td>
<td><strong>$46,436</strong></td>
</tr>
</tbody>
</table>

### Summary of New Entrants - Non-Academic

<table>
<thead>
<tr>
<th>Age</th>
<th>Number Males</th>
<th>Average Pay Male</th>
<th>Number Females</th>
<th>Average Pay Female</th>
<th>Total Number</th>
<th>Average Pay Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;20</td>
<td>45</td>
<td>$21,401</td>
<td>47</td>
<td>$19,229</td>
<td>92</td>
<td>$20,291</td>
</tr>
<tr>
<td>20 - 24</td>
<td>646</td>
<td>32,652</td>
<td>1,094</td>
<td>30,919</td>
<td>1,740</td>
<td>31,562</td>
</tr>
<tr>
<td>25 - 29</td>
<td>1,239</td>
<td>41,746</td>
<td>1,866</td>
<td>40,292</td>
<td>3,105</td>
<td>40,960</td>
</tr>
<tr>
<td>30 - 34</td>
<td>976</td>
<td>47,297</td>
<td>1,449</td>
<td>43,326</td>
<td>2,425</td>
<td>43,878</td>
</tr>
<tr>
<td>35 - 39</td>
<td>598</td>
<td>50,844</td>
<td>1,089</td>
<td>44,588</td>
<td>1,687</td>
<td>47,414</td>
</tr>
<tr>
<td>40 - 44</td>
<td>466</td>
<td>50,584</td>
<td>794</td>
<td>45,626</td>
<td>1,260</td>
<td>48,246</td>
</tr>
<tr>
<td>45 - 49</td>
<td>419</td>
<td>49,900</td>
<td>719</td>
<td>44,169</td>
<td>1,138</td>
<td>47,676</td>
</tr>
<tr>
<td>50 - 54</td>
<td>353</td>
<td>48,657</td>
<td>553</td>
<td>42,475</td>
<td>906</td>
<td>46,260</td>
</tr>
<tr>
<td>55 - 59</td>
<td>253</td>
<td>50,351</td>
<td>423</td>
<td>42,725</td>
<td>676</td>
<td>48,769</td>
</tr>
<tr>
<td>60 - 64</td>
<td>120</td>
<td>49,463</td>
<td>165</td>
<td>42,040</td>
<td>285</td>
<td>49,282</td>
</tr>
<tr>
<td>65 - 69</td>
<td>4</td>
<td>66,862</td>
<td>5</td>
<td>20,099</td>
<td>9</td>
<td>40,882</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>5,119</strong></td>
<td><strong>$45,115</strong></td>
<td><strong>8,204</strong></td>
<td><strong>$41,302</strong></td>
<td><strong>13,323</strong></td>
<td><strong>$42,238</strong></td>
</tr>
</tbody>
</table>
SECTION III – SUPPORTING ANALYSIS

15. Retirement Savings Plan (RSP) Contribution Assumptions

The projected RSP contributions are equal to 7.6% of RSP payroll, plus estimated RSP expenses minus RSP employer forfeitures. Estimated RSP expenses for FY 2022 are $1,043,478 and actual FY 2021 RSP employer forfeitures used to reduce the certified contributions for FY 2023 are $7,175,000. Estimated RSP expenses for FY 2023 and after are assumed to increase by 3.00%. Estimated RSP employer forfeitures used to reduce the certified contributions for FY 2024 and after are assumed to be 7.5% of the gross RSP employer contribution.

16. Pensionable Earnings Greater than 6%

The participant’s employer is required to pay the present value of the increase in benefits resulting from the portion of the increase in excess of 6.00% for earnings used in the calculation of the final average salary. The projections include a component paid for by employers for earnings increases greater than 6.00% in the calculation of the final average salary.

17. Governor’s Pay

The Governor’s pay is $181,700 as of June 30, 2021, and budgeted as of $184,800 as of June 30, 2022, and is expected to increase each year by the assumed rate of Tier 2 capped payroll growth of 1.125%.


Zero percent of eligible Tier 1 active members are assumed to elect to receive a reduced and delayed AAI benefit at retirement and an accelerated pension benefit option in accordance with Public Act 100-0587 and 101-0010. Zero percent of eligible inactive members are assumed to elect to receive an accelerated pension benefit option in lieu of an annuity at retirement in accordance with Public Act 100-0587 and 101-0010.

Comment: This year GRS studied buyout option elections for the two options available in the Plan:

i) The vested inactive member buyout (VIB) which provides vested inactive members a payment equal to 60% of the present value of their pension benefit in lieu of any future payments, and

ii) The automatic annual increase buyout which provides Tier 1 members a payment equal to 70% of the difference between the present value of their current AAI provisions and the revised provision available to Tier 2 members

Their analysis showed that very few members have been approved for buyouts through 6/30/201. We find this assumption and the basis for setting it as reasonable.

The benefit amounts in excess of the IRC Section 415 limits for current retirees are paid through the Excess Benefit Arrangement (EBA) and are not reported in the actuarial valuation data. Therefore, the liabilities and the required contributions for these EBA benefits are not reflected in the actuarial valuation results. The amount of the estimated EBA payments for the upcoming fiscal year are provided by SURS Staff and included in the statutory contribution requirement.
C. Funding Methods

Actuarial funding methods consist of three components: (1) the actuarial cost method, which is the attribution of total costs to past, current, and future years; (2) the asset valuation method (i.e., asset smoothing); and (3) the amortization method.

1. Actuarial Cost Method

The System uses the projected unit credit cost method (PUC) to assign costs to years of service, as required under the Pension Code (40 ILCS 5/15). We have no objections with respect to using the PUC method, although we would prefer the Entry Age Normal (EAN) cost method as it is more consistent with the requirement in 40 ILCS 5/15-155 requirement for level percentage of pay funding.

Under the PUC method, which is used by some public sector pension funds, the benefits of active participants are calculated based on their compensation projected with assumed annual increases to ages at which they are assumed to leave the active workforce by any of these causes: retirement, disability, turnover, or death. Only past service (through the valuation date but not beyond) is taken into account in calculating these benefits. The present value of these benefits based on past service and future compensation is the actuarial liability for a given active participant. Under the PUC cost method, the value of an active participant’s benefits tends to increase more sharply over his or her later years of service than over his or her earlier ones. While the PUC method is not an unreasonable method, as a result of this pattern of benefit values increasing, more plans use the EAN cost method to mitigate this effect. It should also be noted that the EAN cost method is the required method to calculate liability for GASB Nos 67 and 68.

2. Asset Valuation Method

The Actuarial Value of Assets for the System is a smoothed market value. Unanticipated changes in market value are recognized over five years in the Actuarial Value of Assets. The primary purpose for smoothing out gains and losses over multiple years is so fluctuations in the contributions will be less volatile over time than if based on the Market Value of Assets.

The 2020 Public Retirement Systems Study by the National Conference on Public Employee Retirement Systems (NCPERS) survey of 138 public retirement funds found that the majority of plans responding to the survey have a five-year smoothing period.

Smoothing the market gains and losses over a period of five years to determine the Actuarial Value of Assets is a generally accepted approach in determining actuarial cost, and we concur with its use.
3. **Amortization Method**

The mandated State contribution is based on a determination of the level percentage of payroll that is expected to achieve a 90% funded ratio in 2045. While not a traditional amortization method, this methodology effectively amortizes a portion of the unfunded actuarial liability over the remaining period until 2045, which is currently 25 years.

One of the principles of funding public plans identified by the American Academy of Actuaries is that there should be “a plan to make up for any variations in actual assets from the funding target within a defined and reasonable time period.” Because it only targets 90%, the State method does not include a plan to achieve the funding target over any period of time.

Typical public plan amortization methods are designed to increase each year by expected payroll growth. Under the State mandated method, however, the effective amortization payment increases each year by more than the expected growth in payroll. As a result, the State mandated method defers payments on the unfunded actuarial liability further into the future than under typical public plan amortization methods.
SECTION IV– PROJECTION ANALYSIS

This section reviews the projections contained in the June 30, 2021 Actuarial Valuation of SURS. These projections are fundamental to the development of the required State contribution calculated under the current statutory funding requirement.

The following graphs are independent approximations of the projections performed by the State actuary to verify that the System’s funding projections are reasonable. They do not reflect all the precision of the projections applied by the System’s actuary, but instead they are intended to verify the reasonableness of the modeling done by the System’s actuary.

The graph below shows our projection of the expected future liabilities and assets in the System through 2045. As pointed out on page 10 of the June 30, 2021 Actuarial Valuation, the majority of the funding of the System occurs in the later years of the projections. The lines show the projected assets (market value and actuarial value), and the bars show the projected liabilities of the System. The funded ratio for every other year is shown at the top of the bars. For example, in 2033, the funded ratio is projected to be approximately 58%, with assets being approximately $31 billion and liabilities being approximately $54 billion.

Source: Cheiron projection analysis.
When we compare our projected funded ratio against the results shown in the June 30, 2021 Actuarial Valuation, we find a very close match in expected funded ratio. This close match of the funded ratio indicates that the projections done by the System’s actuary are reasonable and the fact we show slightly different funded ratios is a function of Cheiron’s approximation.

Source: Cheiron projection analysis.
The following graph shows the expected contributions calculated under the statutory method. The contribution as a percentage of payroll is shown above each bar. The value shown for the fiscal year ending 2022 was set based on the June 30, 2020 Actuarial Valuation. The current valuation is the basis for setting the rates starting July 1, 2022 (Fiscal Year Ending June 30, 2023). The contribution requirement has two components: 1) the employer normal cost, which is the approximate value of the amount of benefits accrued by participants not covered by employee contributions based on the statutory funding method; and 2) an amortization of the unfunded liability. The normal cost amounts are shown by the green bars and the amortization of the unfunded actuarial liability (UAL) amounts by the yellow bars. The percentages shown are the total contribution rates calculated by Cheiron which are equal to the sum of the bars. The graph shows that a larger percentage of the total contribution is being made toward the UAL payment later in the period. The blue line shows the projected contribution rates as a percentage of payroll from the June 30, 2021 Actuarial Valuation. The difference between Cheiron’s approximation and the System’s projections is the difference between the top of the bars and the line.

Source: Cheiron projection analysis.

Our conclusion is that the projections performed by the System’s actuary are reasonable.
In this section, we examine the adequacy of the funding for the System, including funded ratio, the sources of changes in the unfunded actuarial liability (UAL), and projections of the UAL and statutory funding requirements compared to contributions needed to pay down the UAL.

The actuarial valuation report prepared by GRS includes both traditional actuarial measurements, as well as additional risk measurements that are shown on pages 15, 16, and 17 in their 2021 valuation report. Given the unique and substantial funding challenges faced by the Illinois pension systems, this additional information is quite important and supplements the information we present here on funding adequacy to better inform the legislature and other stakeholders about the adequacy of the System’s funding.

**System Funded Ratio**

The first funding adequacy measure we present is a historical funded ratio trend for the past ten years. Funded ratio for this measure is defined as the ratio of the Market Value of Assets to the actuarial liability. The chart below shows SURS’ funded ratio since 2012 has gone from 41.3% funded to 48.6% funded in 2021, an increase in funded ratio of 7.3%. In addition to showing the funded ratio, this chart also shows the breakdown of the plan’s liabilities by membership status:

- **Active liability** – the liability (attributable to service already performed) for future payments to members who are currently working in the System,
- **Deferred Vested liability** – the liability for future payments to members who are no longer working in the system, and
- **In-Pay liability** – the liability for future payments to retirees and beneficiaries who are currently receiving benefits.

This breakdown shows that today plan assets only cover about 71% of the liabilities for just those members currently in-pay status.

---

**Source:** Cheiron analysis of funding adequacy.
Sources of Changes in the UAL

As shown in the chart below, SURS’ unfunded actuarial liability (UAL) has grown from about $17.6 billion in 2011 to $27.4 billion in 2021, an increase of $9.8 billion. In order to understand how to reverse this trend, it is important to understand the sources contributing to it.

![Historical Growth in UAL](chart)

Source: Cheiron analysis of funding adequacy.

The changes to the UAL from June 30, 2011 to June 30, 2021 can be separated into the following components:

- **Contribution Deficiencies** – Contributions that are less than the tread water contribution causes the UAL to increase. The tread water contribution consists of two components: the normal cost, which is the cost of benefits earned in a given year, and the interest on the unfunded actuarial liability. This sum is referred to as the tread water contribution because it is the contribution necessary so that the UAL will remain constant, or “tread water” (absent experience gains or losses). The difference between actual contributions and the tread water contributions have increased the UAL by $4.71 billion over this period.

- **Assumption Changes** are changes to actuarial assumptions as the System updated expectations on future investment returns and life expectancy. A positive aspect of the UAL increases due to assumption changes is that they will result in liability measurements that more accurately reflect future expectations. Over this period assumption changes have increased the UAL by $5.15 billion

- **Plan Changes** are any modifications of the design of the Plan, which have affected benefits already accrued. Since most of the changes to the System’s plan affect only future benefits the impact has been negligible during this period.
**Liability (Gain) or Loss** are the changes in the UAL due to liability experience (i.e., mortality, terminations, salary increases, etc.). These were generally small and had a net effect of increasing the UAL by $0.76 billion during this period.

**AVA (Actuarial Value of Assets) Investment (Gain) or Loss** is the net investment gain or loss due to assets earning more or less than assumed. These have decreased the UAL over this period by $0.78 billion.

The chart below shows the changes in UAL each year broken into these five components. The sum of all the components (total change in UAL) is shown as the black line.

![Sources of Changes in UAL](chart)

We expect that this chart will help stakeholders understand the sources of growth in the UAL over the past decade and inform discussions about the current funding requirements and adequacy.

---

**Sources of Changes in UAL**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Contributions</td>
<td>0.80</td>
<td>0.51</td>
<td>0.43</td>
<td>0.46</td>
<td>0.46</td>
<td>0.43</td>
<td>0.46</td>
<td>0.52</td>
<td>0.37</td>
<td>0.28</td>
<td>$ 4.71</td>
</tr>
<tr>
<td>Assumptions</td>
<td>-</td>
<td>(0.16)</td>
<td>1.79</td>
<td>0.97</td>
<td>-</td>
<td>-</td>
<td>2.18</td>
<td>-</td>
<td>-</td>
<td>0.36</td>
<td>$ 5.15</td>
</tr>
<tr>
<td>Investments</td>
<td>0.48</td>
<td>0.39</td>
<td>(0.80)</td>
<td>(0.56)</td>
<td>0.15</td>
<td>(0.14)</td>
<td>(0.09)</td>
<td>0.23</td>
<td>0.23</td>
<td>(0.67)</td>
<td>$ (0.78)</td>
</tr>
<tr>
<td>Plan Changes</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>$ 0.00</td>
</tr>
<tr>
<td>Liabilities</td>
<td>0.38</td>
<td>0.15</td>
<td>0.06</td>
<td>(0.04)</td>
<td>0.19</td>
<td>(0.25)</td>
<td>0.11</td>
<td>0.12</td>
<td>0.10</td>
<td>(0.05)</td>
<td>$ 0.76</td>
</tr>
<tr>
<td>Total</td>
<td>$ 1.65</td>
<td>$ 0.89</td>
<td>$ 1.47</td>
<td>$ 0.83</td>
<td>$ 0.81</td>
<td>$ 0.04</td>
<td>$ 2.65</td>
<td>$ 0.87</td>
<td>$ 0.71</td>
<td>$ (0.08)</td>
<td>$ 9.85</td>
</tr>
</tbody>
</table>

Source: Cheiron analysis of funding adequacy.
**Actual Contributions Compared to Tread Water Contribution**

One of the persistent sources of the increase in UAL is due to actual contributions to the System being less than the tread water contribution (the amount needed to prevent the UAL from increasing if all assumptions are met). These contribution deficiencies have added between $280 to $800 million to the UAL each year over the historical period shown.

As the chart below shows, actual contributions have been significantly less than the tread water cost, and this trend is projected to continue until 2025. Each year that total contributions remain below the tread water cost (blue line), the UAL is expected to grow. As shown in the graph below the contributions from the State will need to increase before the total contribution reaches the tread water contribution and begins to pay down the UAL based on the market value of assets.

Source: Cheiron analysis of funding adequacy.
The next chart shows that if the Minimum Required Contributions continue to be made each year and all other assumptions are met, the UAL based on the actuarial value of assets is projected to decline from $27 billion in 2021 to $5 billion in 2045. The decrease over the next few years is due to a combination of contributions and recognition of investment gains in the asset smoothing method.

Source: Cheiron analysis of funding adequacy
SECTION V– ANALYSIS OF FUNDING ADEQUACY

Net Cash Flow Analysis

The plan’s net cash flow is defined as State and member contributions less benefit payments and administrative expenses. The more negative net cash flow is as a percentage of the plan’s assets, the more vulnerable the Plan is to market downturns. When a pension plan has more payouts than contributions and suffers an investment loss, it is left with fewer assets to invest and recapture during a recovery.

Looking at the chart below, SURS has slightly negative net cash flow (black line). If contributions increase as quickly as benefit payments, the net cash flow will remain stable. But if contributions do not continue to grow either because the Plan has become better funded or because the expected contributions are not made, negative net cash flow may become a more significant issue, therefore it should continue to be monitored. The teal line shows net cash flow as a percent of Market Value of Assets on the right-side axis. The greater the negative cash flows are relative to plan assets the more vulnerable a plan is to market downturns. This is because once there is a market downturn, the plan assets lose both on the return and the negative cash flow, leaving it with a lower asset base from which to recover from the loss.

Source: Cheiron analysis of funding adequacy.
Response to Recommendations in 2020

In the State Actuary’s Preliminary Report on the State Universities Retirement System of Illinois presented December 16, 2020, Cheiron made several recommendations. Below we summarize how these recommendations were reflected in either the System’s comments last year or in this year’s June 30, 2021 Actuarial Valuation.

<table>
<thead>
<tr>
<th>Recommendations to Retirement System from 2020 State Actuary Report</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. We continue to recommend that the funding method be changed to fully fund plan benefits. We recognize that increasing contributions during the current pandemic may be challenging but continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the System becoming unsustainable. Consequently, we recommend that the funding method increase contributions as quickly as possible to a level that is expected to prevent the unfunded actuarial liability from growing, and remain high enough to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.</td>
<td>Partially Implemented</td>
<td>The System has adopted a funding policy that would meet recommendation; however, the actual funding of the System is based on State statute and a change in the funding method and funding policy would require a statutory change. GRS continues to include strong language throughout their report recommending the use of an actuarially sound method and stating clearly that the statutory method is not actuarially sound. We find these statements to be appropriate and support their continuation. Recommendation repeated.</td>
</tr>
<tr>
<td>2. We recommend that the SURS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation.</td>
<td>Implemented</td>
<td>This review has been performed, evidenced and recommendation made by Meketa, the investment consultant to the fund in the June 2021 Experience Review Report and presentation. We will continue to include this recommendation each year. Recommendation continued.</td>
</tr>
</tbody>
</table>
### Status of Recommendations from the 2020 State Actuary Report

<table>
<thead>
<tr>
<th>Recommendations to Retirement System from 2020 State Actuary Report</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. We recommend that GRS review its disclosures related to ASOP 56 for the next valuation report to ensure that the disclosures clearly identify the purpose of each model, nay material limitations of each model, and any other applicable required disclosures under ASOP 56.</td>
<td>Implemented</td>
<td>In its transmittal letter to the June 30, 2021 Actuarial Valuation Report, the recommended ASOP 56 disclosures were made. Recommendation removed</td>
</tr>
</tbody>
</table>
Chapter Three

Preliminary Report on the State Employees’ Retirement System

In accordance with 30 ILCS 5/2-8.1, Cheiron, the State Actuary, submitted a preliminary report to the Board of Trustees of the State Employees’ Retirement System (SERS) concerning proposed certifications of required State contributions submitted to Cheiron by the Board. The preliminary report was submitted to SERS on November 30, 2021. The preliminary report was based on Cheiron’s review of actuarial assumptions included in SERS’ 2021 Actuarial Valuation Report.

Following is Cheiron’s final preliminary report on the State Employees’ Retirement System. SERS’ written response, provided on December 10, 2021, can be found in Appendix C.

| OVERVIEW STATE EMPLOYEES’ RETIREMENT SYSTEM as of June 30, 2021 |
|--------------------|------------------|
| Actuarial accrued liability | $51,828,480,404 |
| Actuarial value of assets | $21,323,630,719 |
| Unfunded liability | $30,504,849,685 |
| Funded ratio | 41.1% |
| Employer normal cost | $630,211,311 |
| State contribution (FY23) | $2,484,585,000 |
| Active members | 62,253 |
| Inactive members | 28,322 |
| Current benefit recipients | 75,939 |
| Eligible for deferred benefits | 174 |
| Total membership | 166,688 |
| Interest rate assumption | 6.75% |
| Inflation assumption | 2.25% |
| Actuarial cost method | Projected Unit Credit |
| Asset valuation method | 5-year Smoothing |
| Executive Director | Tim Blair |
| Actuarial Firm | Gabriel, Roeder, Smith & Company |

Source: June 30, 2021 SERS actuarial valuation report.
December 16, 2021

Mr. Frank Mautino
Auditor General
740 East Ash Street
Springfield, Illinois 62703

Board of Trustees
State Employees’ Retirement System of Illinois
2101 South Veterans Parkway
P.O. Box 19255
Springfield, Illinois 62794-9255

Dear Trustees and Auditor General:

In accordance with the Illinois State Auditing Act (30 ILCS 5/2-8.1), Cheiron is submitting this preliminary report concerning the proposed certification prepared by Gabriel, Roeder, Smith & Company (GRS) of the required State contribution to the State Employees’ Retirement System of Illinois (SERS or System) for Fiscal Year 2023.

In summary, we believe that the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable. We also find that the certified contributions, notwithstanding the inadequate State funding requirements that do not conform to generally accepted actuarial principles and practices, were properly calculated in accordance with State law.

Section I of this report describes the review process undertaken by Cheiron. Section II summarizes our findings and recommendations. Section III provides the supporting analysis for those findings and presents more details on our assessment of the actuarial assumptions and methods employed in GRS’s Actuarial Certification, as well as our assessment of GRS’s determination of the required State contribution for Fiscal Year 2023. Section III also includes comments on other issues impacting the funding of SERS, including the implications of Article 14 of the Illinois Pension Code, which establishes the statutory minimum funding requirements for the System. We agree with GRS that the statutory mandated minimum funding requirements have been and continue to be inadequate. In addition, the past inadequate funding has resulted in current and future contribution levels, measured as a percent of payroll, to be among the highest in the country. Making adequate contributions in the future to fully fund the system will be challenging. Section IV reviews the projections contained in the draft June 30, 2021 Actuarial Valuation. Finally, Section V provides an analysis of funding adequacy.

In preparing this report, we relied on information (some oral and some written) supplied by SERS and GRS. This information includes actuarial assumptions and methods adopted by the SERS Board, System provisions, the draft June 30, 2021 Actuarial Valuation, the draft 2021 GASB 67/68 Report, the 2021 Valuation Results presentation, the 2018 Actuarial Experience Review, the 2021 Economic Assumption Update Review, and minutes of the 2021 plan year SERS Board of Trustee meetings. A detailed description of all information provided for this review is contained in Appendix B.
This report and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices and our understanding of the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board as well as applicable laws and regulations. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this report. This report does not address any contractual or legal issues. We are not attorneys, and our firm does not provide any legal services or advice.

This report was prepared exclusively for the Office of the Auditor General and the State Employees’ Retirement System of Illinois for the purpose described herein. Other users of this report are not intended users as defined in the Actuarial Standards of Practice, and Cheiron assumes no duty or liability to any other user.

Sincerely,
Cheiron

Christian Benjaminson, FSA, MAAA, EA
Principal Consulting Actuary

Kenneth A. Kent, FSA, FCA, MAAA, EA
Principal Consulting Actuary
SECTION I – REPORT SCOPE

Illinois Public Act 097-0694 (the Act) amended the Illinois State Auditing Act (30 ILCS 5/2-8.1) and requires Cheiron, as the State Actuary, to review the actuarial assumptions and valuation of the State Employees’ Retirement System of Illinois (SERS or System) and to issue to the SERS Board this preliminary report on the proposed certification prepared by Gabriel, Roeder, Smith & Company (GRS) of the required State contributions for Fiscal Year (FY) 2023. The purpose of this review is to identify any recommended changes to the actuarial assumptions for the SERS Board to consider before finalizing its certification of the required State contributions for FY 2023.

While the Act states that just the actuarial assumptions and valuation are to be reviewed, we have also reviewed the actuarial methodologies (funding and asset smoothing methods) employed in preparing the Actuarial Certification, as these methods can have a material effect on the amount of the State contribution being certified. Finally, we have offered our opinion on the implications of Article 14-131 of the Illinois Pension Code, which impacts the contribution amount certified by GRS.

In conducting this review, Cheiron reviewed the draft June 30, 2021 Actuarial Valuation, the draft 2021 GASB 67/68 Report, the 2021 Actuarial Results presentation, the 2018 Actuarial Experience Study, the 2021 Economic Assumption Update Review, and minutes of the plan year 2021 SERS Board of Trustees meetings. The materials we reviewed are listed in Appendix B.

In addition to reviewing the Actuarial Certification of the required State contribution to SERS, the Act requires the State Actuary to conduct a review of the “actuarial practices” of the Board. While the term “actuarial practices” was not defined in the Act, we continue to interpret this language to mean that we review: (1) the use of a qualified actuary (as defined by the Qualification Standards of the American Academy of Actuaries) to prepare the annual actuarial valuation for determining the required State contribution; and (2) the conduct of periodic formal experience studies to justify the assumptions used in the actuarial valuation. In addition, we have included comments on actuarial communication and compliance with Actuarial Standards of Practice (ASOP) reflected in the draft June 30, 2021 Actuarial Valuation.
SECTION II – SUMMARY OF RECOMMENDATIONS

This section summarizes recommendations from our review of the actuarial assumptions and methods employed in the draft June 30, 2021 Actuarial Valuation of SERS as well as the “actuarial practices” of the SERS Board. Section III of this report contains detailed analysis and rationale for these recommendations.

Proposed Certification of the Required State Contribution

Gabriel, Roeder, Smith & Company (GRS) has determined that the FY 2023 required State contribution calculated under the current statutory funding requirements is $2,484,585,000. We have verified the arithmetic calculations made by GRS to develop this required State contribution and have reviewed the assumptions on which it was based. We have accepted GRS’s annual projections of future payroll, total normal costs, employee contributions, combined benefit payments and expenses, and total contributions.

It is our understanding the SERS Board has retained an independent actuary to undertake an audit of the System commencing in January 2022 as previously recommended.

State Mandated Funding Method

1. We continue to recommend that the funding method be changed to fully fund plan benefits. Continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the System becoming unsustainable. Consequently, we recommend that the funding method maintain contributions at a level that is expected to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Recognition of Changes in Actuarial Assumptions

Public Act 100-0023 (P.A. 100-0023), effective July 6, 2017, modified the State’s funding policy to require that the contribution impact of all assumption changes be phased-in over a five-year period.

2. Because experience studies are performed every three years, we recommend that the phase-in period for the impact of assumption changes be reduced to three years. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Optional Hybrid Plan

P.A. 100-0023 created an Optional Hybrid Plan for current Tier 2 members and future new hires. The Optional Hybrid Plan consists of a reduced defined benefit plan and a defined contribution plan. Employers are required to contribute the normal cost plus an additional 2% of pay for each employee who participates in the Optional Hybrid Plan or Tier 2 in lieu of the Optional Hybrid Plan for fiscal year 2021 and after.
SECTION II – SUMMARY OF RECOMMENDATIONS

GRS identified in the draft June 30, 2021 report that, given the uncertainty of the election behavior and the small population eligible for the Optional Hybrid Plan, they have assumed all members will remain in Tier 2. In the assumptions used for projections, they have also assumed that future members will elect to remain in Tier 2.

Accelerated Pension Benefit Payments

P.A. 100-0587 created two accelerated pension benefit payment options. Inactive vested members have the option of receiving a lump-sum equal to 60% of the present value of their benefits in lieu of their annuity benefits, and Tier 1 members have the option upon retirement of accepting a reduced automatic annual increase in exchange for a lump-sum equal to 70% of the present value of the reduction in annuity benefits. Eligible members must make an election by June 30, 2024 if they want to receive the accelerated pension benefit payments.

For the draft June 30, 2021 report, GRS has assumed that 2% of inactive participants will elect the “Total Buyout” of their pension benefit. Further, GRS has assumed that 20% of eligible Regular formula members and 40% of eligible Alternative formula members are assumed to elect the "COLA Buyout" at retirement. The election percentages are assumed to apply until the end of the Buyout Programs. GRS notes these “COLA Buyout” assumptions are based upon experience through July 2021 provided by the System, but no information or discussion is provided on the actual experience. In addition, no explanation is provided for the 2% “Total Buyout” assumption.

3. We recognize that there is very little experience on which to base these assumptions, however given the changes in the assumptions in 2021 there must be some basis for the changes which should either be included in the report or referenced to another public document that includes the information supporting these changes.

Assessment of Actuarial Assumptions Used in the 2021 Valuation

30 ILCS 5/2-8.1 requires the State Actuary to identify recommended changes in actuarial assumptions that the SERS Board must consider before finalizing its certification of the required State contribution. We have reviewed all the actuarial assumptions used in the draft June 30, 2021 Actuarial Valuation and conclude that the assumptions are reasonable in general, based on the evidence provided to us.

Recommended Changes for Future Valuations

4. Section 3.2 of ASOP 51 requires the actuary to identify risks that “may reasonably be anticipated to significantly affect the plan’s future financial condition.” [emphasis added]. The risks currently identified appear to largely duplicate the list of examples in ASOP 51 and could apply to almost any pension plan. In future valuations, we recommend that the actuary explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition.
SECTION II – SUMMARY OF RECOMMENDATIONS

5. For each risk identified above, Section 3.3 of ASOP 51 requires the actuary to provide an assessment that takes into account “circumstances specific to the plan.” For some of the identified risks, the actuary has provided a quantitative assessment specific to the plan while for other identified risks, the actuary has only provided a generic statement that could apply to any plan. We recommend that for each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of this plan.

6. We recommend GRS provide additional explanation and justification for methods used to develop the mortality assumptions used in the valuation.

7. We recommend the SERS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation.

GASB 67 and 68

The 2021 SERS GASB Nos. 67 and 68 information was provided in a separate report. We find that the assumptions and methods used to prepare the 2021 SERS GASB Nos. 67 and 68 schedules are reasonable based on the materials provided to us.
In this section, we provide detailed analysis and supporting rationale for the recommendations that were presented in Section II of this report.

**Proposed Certification of the Required State Contribution**

As stated in our summary of recommendations in Section II, we have verified the arithmetic calculations made by GRS to develop the required State contribution, reviewed the assumptions on which it is based, and accepted GRS’s annual projections of future payroll, total normal costs, benefits, expenses, and total contributions. However, in accordance with 30 ILCS 5/2-8.1, our review does not include a replication of the actuarial valuation results.

Given the size of SERS, the System’s low funded ratio, the recent changes in legal requirements, and guidance issued by the Government Finance Officers Association, we had been recommending that the Board periodically undertake a full scope actuarial audit, utilizing the services of a reviewing actuary. We have been recently informed that the Board has selected an independent actuary to perform a full scope actuarial audit which is expected to be completed by January 2022.

**State Mandated Funding Method**

The Illinois Pension Code (40 ILCS 5/14-131) establishes a method that does not adequately fund the System, backloading contributions and targeting the accumulation of assets equal to 90% of the actuarial liability in the year 2045. This contribution level does not conform to generally accepted actuarial principles and practices. Generally accepted actuarial funding methods target the accumulation of assets equal to 100% of the actuarial liability, not 90%.

We continue to recommend that the funding method be changed to fully fund plan benefits (Recommendation #1). The funding method should ultimately target 100% of the actuarial accrued liability. Contributions should remain at a level that is expected to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded. While making adequate contributions will be challenging, continuing the practice of underfunding the System increases the risk of needing even larger contributions in the future that may make the System unsustainable.

The SERS Board of Trustees has agreed with this recommendation and adopted a separate funding policy to calculate an Actuarially Determined Contribution (ADC). We have reviewed the adopted policy. We agree that the policy is a reasonable method that conforms to the Actuarial Standards of Practice, and we agree with its use in the GASB report as an ADC. The funding policy calls for a funding amount equal to the normal cost plus a closed 25-year amortization as a level percentage of uncapped payroll of the unfunded actuarial liability. This policy defines a method that would ultimately fully fund the Plan and falls within generally accepted actuarial funding methods currently in use for public plans. As of June 30, 2021, the remaining amortization period is 19 years. According to this methodology, the State’s contribution amount would be $3,045,940,587 for FY 2023 compared to the statutory contribution amount of $2,484,585,000. It is important though to recognize that the ADC does not affect the actual funding of the System.
Recognition of Changes in Actuarial Assumptions

Public Act 100-0023 (P.A. 100-0023), effective July 6, 2017, modified the State’s funding policy to require that the contribution impact of all assumption changes, including changes prior to P.A. 100-0023, be phased-in over a five-year period. As such, the Act delays the funding of the System. Assumption changes are intended to more accurately anticipate the obligations for funding based on the most recent experience analysis and forward-looking changes to future investment returns. However, only one-fifth of the impact of these changes are now recognized from the date of adoption. The remainder of the impact is recognized over four additional years such that the full impact is only recognized at the end of a five-year period beginning at the date of adoption. This phase-in provides time to adjust to a higher level of contributions. However, the Conference of Consulting Actuaries White Paper on Actuarial Funding Policies and Practices for Public Pension Plans recommends that the “phase-in period should be no longer than the time period until the next review of assumptions.” Since experience studies are performed every three years, we recommend the phase-in period for the impact of assumption changes be reduced to three years (Recommendation #2).

Optional Hybrid Plan

P.A. 100-0023 created an Optional Hybrid Plan for current Tier 2 members and future new hires. The Optional Hybrid Plan consists of a reduced defined benefit plan and a defined contribution plan. Employers are required to contribute the normal cost plus an additional 2% of pay for each employee who participates in the Optional Hybrid Plan or Tier 2 in lieu of the Optional Hybrid Plan for fiscal year 2021 and after.

As stated in Section II of this report, GRS anticipates that 0% of current and future participants elect the Optional Hybrid Plan. While the valuation notes that Tier 3 is expected to be available beginning in fiscal year 2020, we understand that SERS will not implement the Optional Hybrid Plan until clarifying legislation is passed. Given the need for additional legislation, we believe it is reasonable not to reflect the Optional Hybrid Plan in the current valuation.

Accelerated Pension Benefit Payments

P.A. 100-0587 created two accelerated pension benefit payment options. Inactive vested members have the option of receiving a lump-sum equal to 60% of the present value of their benefits in lieu of their annuity benefits, the “Total Buyout”. This program is available until June 30, 2024. The “COLA Buyout” program provides Tier 1 members the option upon retirement of accepting the reduced Tier 2 automatic annual increase (AAI) provision instead of their current 3% automatic annual increases. In exchange for electing the reduced AAI, members will receive a lump-sum equal to 70% of the present value of the reduction in annuity benefits. The State finances the program by issuing bonds up to certain limits. Lump-sum payments will be made directly from the bond proceeds. This program expires June 30, 2024, or earlier if funds are no longer available.
SECTION III – SUPPORTING ANALYSIS

For the draft June 30, 2021 report, GRS has assumed that 2% of inactive participants will elect the “Total Buyout” of their pension benefit. Further, GRS has assumed that 20% of eligible Regular formula members and 40% of eligible Alternative Formula members will elect the "COLA Buyout” at retirement. The election percentages are assumed to apply until the end of the Buyout Programs.

We recognize that there is very little experience on which to base these assumptions, however given the changes in the assumptions in 2021 there must be some basis for the changes which should either be included in the report or referenced to another public document that includes the information supporting these changes (Recommendation #3).

Finally, the date of expiration of the accelerated pension benefit payment options in P.A. 101-0010 is June 30, 2024, therefore the references in draft Actuarial Report may need to be updated.

Stress Testing

We anticipate GRS will continue including stress testing of the System within the valuation report and include an explanation of the implications that volatile investment returns and a variety of other stressors (e.g., membership declines, lower salary growth, assumption changes) can have on future State costs. The tests illustrate the potential stresses on the System and its contributing sponsors so that an assessment of sustainability can be made.

We note that GRS has included stress testing in the final report for the past two years, but the stress testing section has not been completed in this year’s draft report. Last year, a separate letter dated December 8, 2020 was subsequently provided that contained the stress testing that was ultimately included in the final report. We anticipate that similar stress testing will be included in the final June 30, 2021 Actuarial Valuation.

Actuarial Standard of Practice 51

A new Actuarial Standard of Practice (ASOP) became effective for SERS actuarial valuations starting June 30, 2019. ASOP 51 provides guidance to actuaries on the assessment and disclosure of risks to help readers of the actuarial valuation report “understand the effects of future experience differing from the assumptions used” and “the potential volatility of future measurements resulting from such differences.”

ASOP 51’s first requirement is to “identify risks that, in the actuary’s professional judgment, may reasonably be anticipated to significantly affect the Plan’s future financial condition.” GRS identified six sources of risk to SERS: investment risk, asset/liability mismatch risk, contribution risk, salary and payroll risk, longevity risk, and other demographic risks. With the exception of the contribution risk due to the statutorily required amount of contributions, the risks SERS identified are relatively generic and would apply to most pension plans.
SECTION III – SUPPORTING ANALYSIS

ASOP 51 requires the actuary to assess each of the risks identified. While the assessment does not have to be quantitative, it does have to take into account the specifics of the individual plan. ASOP 51 also describes several quantitative methods that may be used to assess risk.

- **Investment Risk.** GRS included additional stress testing in the last year’s final actuarial valuation report that adequately assessed the investment risk with various investment return scenarios.

- **Asset/Liability Mismatch Risk.** GRS does not appear to provide an assessment of asset/liability mismatch risk other than to indicate that asset value changes that do not match liability changes will either increase or decrease costs. If GRS continues to identify this as a key risk, ASOP 51 requires that they also provide an assessment that takes into account “circumstances specific to the plan.”

- **Contribution Risk.** GRS discusses several issues with the statutorily required contribution amounts in the risk section as well as in other parts of the valuation report. The stress testing included in last year’s final actuarial valuation report adequately assessed the impact of a declining contribution base (i.e. payroll).

- **Salary and Payroll Risk.** The stress testing included in last year’s final actuarial valuation report adequately assessed the salary and payroll risk with alternative projected decreases in the active population.

- **Longevity Risk.** GRS does not appear to provide an assessment of longevity risk. The valuation report simply states that experience that differs from the assumptions will either increase or decrease costs. If GRS continues to identify this as a key risk, ASOP 51 requires that they also provide an assessment that takes into account “circumstances specific to the plan.”

- **Other Demographic Risk.** GRS provides an explanation of demographic risks but does not appear to provide any assessment of these risks. If GRS continues to identify this as a key risk, ASOP 51 requires that they also provide an assessment that takes into account “circumstances specific to the plan.”

ASOP 51 requires the actuary to recommend a more detailed assessment of risks if it “would be significantly beneficial.” GRS adequately identified the primary drivers of these risks, provided background information and assessments about these identified risks, but did not in our opinion adequately communicate the significance of all of these risks to this Plan. The stress testing included in last year’s final actuarial valuation report provided a quantitative assessment of the investment risk, contribution risk, and salary and payroll risk and we anticipate similar stress testing will be included in this year’s valuation actuarial valuation report. However, the other risks were only assessed with a generic statement that could apply to any pension plan.
SECTION III – SUPPORTING ANALYSIS

Section 3.2 of ASOP 51 requires the actuary to identify risks that “may reasonably be anticipated to significantly affect the plan’s future financial condition.” The risks currently identified appear to largely duplicate the list of examples in ASOP 51 and could apply to almost any pension plan. **In future valuations, we recommend that the actuary explain how each risk identified would significantly affect the specific plan’s future financial condition** (Recommendation #4).

For each risk identified above, Section 3.3 of ASOP 51 requires the actuary to provide an assessment that takes into account “circumstances specific to the plan.” For some of the identified risks, the actuary has provided a quantitative assessment specific to the plan while for other identified risks, the actuary has only provided a generic statement that could apply to any plan. **We recommend that for each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of this plan** (Recommendation #5).
Assessment of Actuarial Assumptions Used in the 2021 Valuation

A. Economic Assumptions

1. Interest Rate

The interest rate assumption (also called the investment return or discount rate) is the most impactful assumption affecting the required State contribution amount. This assumption, which is used to value liabilities for funding purposes, remained at 6.75% for the draft June 30, 2021 Actuarial Valuation.

After reviewing all the materials (see Appendix B of this report) that were made available, Cheiron concludes that the interest rate of 6.75% for this valuation is reasonable.

We recommend that the SERS Board continue to annually review the economic assumptions (interest rate and inflation), as was done for this valuation, prior to commencing the valuation work and adjust assumptions accordingly (Recommendation #7).

The items we considered and our rationale for this recommendation are as follows:

- A review of the interest and inflation rates does not involve the collection of significant data and can be updated annually. In addition, it keeps the Board focused more closely on these Critical assumptions.

- In GRS’s July 9, 2021 review of economic assumptions, they presented the expectations for the SERS portfolio of the Illinois State Board of Investment’s investment consultant Meketa Investment Group. Meketa’s expected 20-year geometric average return of the SERS portfolio is 6.60% (See Exhibit A of the GRS’s July 9, 2021 review of economic assumptions). Based on the capital market assumptions provided by Meketa, SERS has a 47.72% chance of meeting or exceeding the assumption of 6.75%. Given that SERS is only 45.97% funded on a market asset value, an expectation of achieving the investment return only 48% of the time could result in cost increases following years that the returns are below the assumption.

- GRS’s July 9, 2021 review of economic assumptions also presented the expectations for the SERS portfolio based on capital market assumptions for a 10-year or shorter time horizon of twelve independent investment consultants and concluded that, adjusting for GRS’s assumed rate of inflation, the average expected geometric return for the SERS portfolio is 5.92% (See Exhibit C of GRS’S July 9, 2021 review of economic assumptions). This analysis estimated SERS has a 40.56% chance of meeting or exceeding the 6.75% assumption over a 10-year time horizon. In the future,
we suggest that GRS disclose more information about these capital market assumptions, including a list of the investment consulting firms included and the dates of the capital market assumptions.

- GRS also presented the expectations for the SERS portfolio based on capital market assumptions for a 20-year or longer time horizon of six independent investment consultants. Based on these longer-term assumptions, the average 20-year geometric mean for the SERS portfolio was 6.69% and SERS is estimated to have a 49.17% chance of meeting or exceeding the updated 6.75% assumption (See Exhibit C of GRS’s July 9, 2021 review of economic assumptions). In the future, we suggest that GRS disclose more information about these capital market assumptions, including a list of the investment consulting firms included and the dates of the capital market assumptions.

### Distribution of 20-year Average Geometric Net Nominal Return

<table>
<thead>
<tr>
<th>Investment Consultant</th>
<th>Distribution of 20-Year Average Geometric Net Nominal Return</th>
<th>Probability of exceeding 6.75 %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>40th</td>
<td>50th</td>
</tr>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>1</td>
<td>5.57%</td>
<td>6.24%</td>
</tr>
<tr>
<td>2</td>
<td>5.88%</td>
<td>6.54%</td>
</tr>
<tr>
<td>3</td>
<td>5.94%</td>
<td>6.60%</td>
</tr>
<tr>
<td>4</td>
<td>6.07%</td>
<td>6.80%</td>
</tr>
<tr>
<td>5</td>
<td>6.17%</td>
<td>6.82%</td>
</tr>
<tr>
<td>6</td>
<td>6.54%</td>
<td>7.14%</td>
</tr>
<tr>
<td>Average</td>
<td>6.03%</td>
<td>6.69%</td>
</tr>
</tbody>
</table>

- The combination of the expectations from the Illinois State Board of Investment’s investment consultant and the expectations from a variety of independent investment consultants supports the reasonableness of assuming a 6.75% interest rate for the current year.

- SERS is projected to have slightly negative cash flow (contribution income less benefit and expense payouts) in Fiscal Year Ending 2022. The cash flow is expected to grow increasingly negative over time to about $1.1 billion dollars by 2033 as shown in the graph on page 13 and table 4d on pages 32 and 33 of the draft 2021 Actuarial Valuation Report. When short-term returns are expected to be lower than the long-term expectations, which is the current case with SERS, a plan with negative cash flows will tend to have dollar-weighted returns that are less than their “time-weighted” returns.

- While the discount rate assumption should be based on the future expected investment returns for the System’s investment portfolio, survey information can provide an important context for evaluating the assumption. The Public Plans Database is
SECTION III – SUPPORTING ANALYSIS

maintained by a partnership between the Center for State and Local Government Excellence (SLGE) and the Center for Retirement Research at Boston College with support from the National Association of State Retirement Administrators (NASRA). This database contains historical information on large public pension plans, including key assumptions used in their actuarial valuations. The following chart shows the distribution of investment return assumptions for the 177 plans in the Public Plans Database with consistent information from 2002 through 2021 as of October 27, 2021.

Over the period shown, there continues to be a pattern of reducing discount rates partially reflecting long-term changes in capital markets, interest rates and underlying inflation. Of the 177 plans shown, 132 have reduced their discount rate assumption since 2016. For these 132 plans, the average reduction is 0.43%.

- Declining interest rates have forced pension plans to either reduce their discount rates, increase their exposure to investment risk, or some combination of the two. For example, as shown in the following chart, in 2001, the yield on 10-year Treasury bonds (a proxy for a risk-free investment) was 5.30%. To achieve SERS’ then assumed return of 8.50%, the System’s investments had to outperform the yield on the 10-year Treasury by 3.20%. As of June 2021, the yield on the 10-year Treasury is now 1.50%, and to achieve SERS’ now assumed return of 6.75%, the System’s investments need to exceed the 10-year Treasury yield by 5.25%. Even though SERS reduced its return assumption by 175 basis points over the period shown, it still has to take more...
investment risk in 2021 to meet this assumption than it did in 2001. By reducing the investment return assumption, plans are better able to meet their funding goals without requiring investment performance so much in excess of the risk-free rate.

2. **Inflation Assumption**

As recommended in GRS’s July 9, 2021 review of economic assumptions, the inflation assumption remained at 2.25% in the draft June 30, 2021 Actuarial Valuation.

**We find the 2.25% inflation assumption to be reasonable.**

*The items we considered and our rationale for concurring with the 2.25% assumption are as follows:*

- GRS’s July 9, 2021 review of economic assumptions included a survey of the inflation assumptions of independent investment consultants. The 6 investment consulting firms with longer time horizons (20+ years) reported an average of 2.27% and ranged from 1.80% to 2.60%. The 12 firms with a shorter time horizon reported an average of 2.08% and ranged from 1.75% to 2.30%. In the future, we suggest that GRS disclose more information about this survey, including a list of the investment consulting firms included and the dates of the inflation assumptions.
SECTION III – SUPPORTING ANALYSIS

- GRS’s July 9, 2021 review of economic assumptions also included the forward-looking inflation forecasts from the Federal Reserve Bank of Cleveland as of December 1, 2020. This forecast shows inflation over the next 10 years of 1.42% increasing to 1.90% over 30 years.

- The August 2021 Old-Age, Survivors, and Disability Insurance (OASDI) Trustees Report projects that over the long-term (next 75 years), inflation will average between 1.8% and 3.0% (http://www.ssa.gov/oact/tr/2021/tr2021.pdf). Under the intermediate cost projection, the Social Security Administration uses an assumption of 2.4%.

- The following chart shows the distribution of inflation expectations for the Third Quarter 2021 survey of professional economic forecasters published by the Philadelphia Federal Reserve, the 2021 Horizon survey of investment consultant capital market assumptions (20-year), and the 2020 inflation assumptions used by plans in the Public Plans Database compared to the SERS assumption (indicated by the gold diamonds). The assumption of 2.25% is near the middle of the range projected by professional economic forecasters and investment consultants and is on the low end of the range used by other public pension plans.

<table>
<thead>
<tr>
<th></th>
<th>Economic Forecasters</th>
<th>Horizon Survey</th>
<th>Public Plans Database</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum</td>
<td>2.00%</td>
<td>1.70%</td>
<td>2.25%</td>
</tr>
<tr>
<td>25th Percentile</td>
<td>2.25%</td>
<td>2.00%</td>
<td>2.50%</td>
</tr>
<tr>
<td>50th Percentile</td>
<td>2.44%</td>
<td>2.10%</td>
<td>2.50%</td>
</tr>
<tr>
<td>75th Percentile</td>
<td>2.60%</td>
<td>2.20%</td>
<td>2.75%</td>
</tr>
<tr>
<td>Maximum</td>
<td>3.00%</td>
<td>3.00%</td>
<td>3.75%</td>
</tr>
</tbody>
</table>
SECTION III – SUPPORTING ANALYSIS

3. Salary (Annual Compensation) Increase Assumption

The salary increase assumption consists of inflation (2.25%), real wage growth (0.50%) and merit or longevity increases that vary by age. Illustrative rates of increase per individual employee per annum, compounded annually are shown in the table below:

<table>
<thead>
<tr>
<th>Age</th>
<th>Annual Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td>7.17%</td>
</tr>
<tr>
<td>30</td>
<td>5.70%</td>
</tr>
<tr>
<td>35</td>
<td>4.80%</td>
</tr>
<tr>
<td>40</td>
<td>4.47%</td>
</tr>
<tr>
<td>45</td>
<td>4.08%</td>
</tr>
<tr>
<td>50</td>
<td>3.76%</td>
</tr>
<tr>
<td>55</td>
<td>3.55%</td>
</tr>
<tr>
<td>60</td>
<td>3.35%</td>
</tr>
<tr>
<td>65</td>
<td>2.97%</td>
</tr>
<tr>
<td>70</td>
<td>2.75%</td>
</tr>
</tbody>
</table>

These increases include the wage inflation assumption of 2.75% comprised of an inflation assumption of 2.25% per annum and 0.50% per annum productivity or real wage growth assumption.

We find the assumption of 0.50% real wage growth and 2.75% wage inflation and the basis for setting them as reasonable and consistent with the inflation assumption. We accept the rationale in the 2018 experience study for maintaining the age-based merit/longevity component of the assumption until the next experience study.

The items we considered and our rationale for concurring with GRS’s recommendation of 0.50% real wage growth and 2.75% wage inflation are:

- The following chart shows the average nominal and real increases in wages over the last 10 and 20 years for State governments, local governments, and National Average Wages. State and local government data is from the Quarterly Census of Employment and Wages as published by the Bureau of Labor Statistics. National Average Wages is published by the Social Security Administration.
The August 2021 Old-Age, Survivors, and Disability Insurance (OASDI) Trustees Report projects that over the long-term (next 75 years), real wage differential will average somewhere between 0.53% and 1.77%. Under the intermediate cost projection, the Social Security Administration uses an assumption of 1.15%.

In our own experience with our public sector pension plans (about 60 large plans), we have witnessed a continued trend of lower salary increases for public sector employees. Given the recent experience in SERS and the continued budget pressures in Illinois, we believe the 2.75% wage inflation assumption is reasonable.

4. Cost of Living Adjustment Assumption

Benefits are increased annually as described on pages 57 and 59 through 64 of the draft June 30, 2021 Actuarial Valuation. Annual increases are 3% for those hired prior to January 1, 2011 and the lesser of 3% or ½ of the Consumer Price Index for those hired on or after January 1, 2011, which is 1.125% based on the inflation assumption of 2.25%.

We find the assumption and the basis for setting it reasonable.

5. Expenses

As estimated and advised by SERS staff, assumed plan expenses are based on current expenses and are expected to increase in proportion to the projected capped payroll.

We find the assumption reasonable; however, more information on the expected expenses as a function of capped payroll would be a valuable additional disclosure.
B. Demographic Assumptions

In its annual actuarial valuation reports, GRS regularly reports sources of liability gains and losses. In the draft June 30, 2021 Actuarial Valuation, these are shown on page 25. In the chart below, we have collected similar data from GRS’s past valuation reports dating back to 2012 and use these to present a historical review of past demographic and salary increase experience gains and losses.

The following chart shows the pattern of annual gains and losses attributable to eight different sources as shown in the legend. When the colored bar slices appear above zero on the Y-axis, they represent experience losses with the values representing the increases in liabilities over what was expected. When the bar slices are below zero, they represent experience gains with the values representing the reductions in the liabilities for that year versus what was expected. The net liability (gain)/loss is shown by the black line. This net (gain)/loss as a percent of liability for each year is shown as the percentage above the bars.

The percentages shown above the bars refer to net (gain)/loss as a percentage of liability.

Key observations from this chart are as follows:

1. SERS has experience two consecutive years of net losses after five years of consecutive net gains. These 2021 net loss is primarily due to salary increasing more than expected (dark blue area). The prior net gains were also from the salary increase assumption being
SECTION III – SUPPORTING ANALYSIS

less than expected. We expected the gains to be reduced after the salary increase assumption was changed in 2019, but certainly this assumption will need to be reviewed again with the upcoming experience study.

2. During this period, there have been consistent losses for retirement. The changes based on the 2018 Actuarial Experience Study appear to have reduced these losses at least for 2020 and 2021.

3. There have also been consistent gains due to retiree mortality reflecting additional conservatism in the expected longevity of retirees. The changes based on the 2018 Actuarial Experience Study will likely reduce these gains in future years.

4. In every year, there have been small experience losses attributable to new entrants joining SERS. This continuing source of losses due to new entrants is expected for most pension plans. This is because members who are hired after the valuation date may earn a partial year of service credit that does not show up until the following valuation, at which point the extra liabilities for their initial partial year are treated as a liability loss. These losses could be anticipated in future assumptions through a load developed in anticipation that new entrants will begin on average with some past service credits.

The demographic assumptions are summarized below. We reviewed the development of these assumptions based on a full experience study for the three-year period ending June 30, 2018, and we have concluded all are reasonable and meet the requirements of ASOP No. 35, Section 3.3.4.

1. Mortality
   
   *Post-Retirement Mortality*

   The mortality basis was updated with the June 30, 2019 Actuarial Valuation and uses different tables for general retirees covered under the Regular Benefit Formula and Public Safety retirees covered under the Alternative Benefit Formula.

   The mortality assumption for general retirees is based on the Pub-2010 General Healthy Retiree Mortality tables, sex distinct, set forward zero years for males and one year for females multiplied by 111% for males and females. Generational mortality improvement is applied using the MP-2018 two-dimensional mortality improvement scales.

   In the 2018 Experience Study, the analysis of mortality by GRS begins with the mortality tables from the Pub-2010 Public Retirement Plans Mortality Tables Report published by the Society of Actuaries and the Retirement Plans Experience Committee. For General Healthy Retirees, GRS modifies the published table to use as a baseline table before performing its analysis by setting the mortality rates forward one year for males and two years for females. There is no explanation or justification for why this alteration is made to the published table before developing scaling factors based on the Plan’s actual
SECTION III – SUPPORTING ANALYSIS

experience and level of credibility. We recommend GRS provide an explanation and justification for modifying the published General Healthy Retiree table for use as a baseline table to develop the scaling factor for the proposed mortality table.

In addition, once the scaling factors have been developed, they appear to be applied to a different modified version of the published table with no set forward for males and one year set forward for females. No explanation is given as to why the set forward amounts are different from the table used to develop the scaling factors or why the scaling factors would still be appropriate for a different table. The result of this adjustment after the analysis is that the actual-to-expected ratios are 111% and 112% for male and female retirees respectively. Ideally, when using a generational mortality table, these ratios would target 100%.

The mortality assumption for Public Safety retirees is based on the Pub-2010 Public Safety Healthy Retiree Mortality tables, sex distinct, multiplied by 110% for males and 105% for females. Generational mortality improvement is applied using the MP-2018 two-dimensional mortality improvement scales. The base table is based on an appropriate published mortality table, with scaling factors developed reflecting the Plan’s experience and credibility. Mortality improvement is projected on a generational basis using the most recent mortality improvement scale published by the Society of Actuaries. In our opinion, the mortality assumption for Public Safety retirees is reasonable.

Pre-Retirement Mortality, including terminated vested members prior to attaining age 50

The mortality basis was updated with the June 30, 2019 Actuarial Valuation and uses different tables for general employees covered under the Regular Benefit Formula and Public Safety employees covered under the Alternative Benefit Formula.

The mortality assumption for general active members is based on the Pub-2010 General Employee Mortality headcount-weighted tables, sex distinct, and set back two years for males and one year for females, multiplied by 89% for males and 95% for females. Generational mortality improvement is applied using the MP-2018 two-dimensional mortality improvement scales. The base table is a published mortality table, and scaling factors were developed reflecting the Plan’s experience and credibility. It is not clear why the published mortality table GRS selected is headcount-weighted as opposed to salary-weighted. An explanation should be provided.

Similar to the recommended mortality table for retirees, the pre-retirement mortality table proposed by GRS has setbacks of two years for males and one year for females. However, there is no explanation of why the proposed table has setbacks. The scaling factors are developed on the published table with no setback and there is no analysis of why these factors would be appropriate for the altered proposed table, or how the setbacks were determined. The effect of applying these setbacks for pre-retirement mortality is to assign greater credibility to the Plan’s experience than the credibility analysis GRS performed.
indicates is warranted. We recommend GRS provide an explanation and justification for using the setbacks that were applied after the development of the scaling factors in the proposed tables for post-decrement and pre-decrement mortality.

The mortality assumption for Public Safety employees is based on the Pub-2010 Public Safety Healthy Employee Mortality headcount-weighted tables, sex distinct, multiplied by 96% for males and 108% for females. Generational mortality improvement is applied using the MP-2018 two-dimensional mortality improvement scales. The base table is a published mortality table, and scaling factors were developed reflecting the Plan’s experience and credibility. It is not clear why the published mortality table GRS selected is headcount-weighted as opposed to salary-weighted. An explanation should be provided. In our opinion, the mortality assumption for Public Safety retirees is reasonable.

We recommend GRS provide additional explanation and justification for the methods used to develop the mortality assumptions used in the valuation (Recommendation #6).

Specifically, an explanation and justification should be provided for:

1. Modifying the published General Healthy Retiree table for use as a baseline table to develop the scaling factor for the proposed mortality table is needed.
2. Selecting a headcount-weighted as opposed to salary-weighted published mortality table for the pre-retirement mortality analysis.
3. Using additional setbacks to the baseline table that were applied after the development of the scaling factors in the proposed tables for post-decrement and pre-decrement mortality.
### 2. Termination

Assumed rates of withdrawal from the System for Tier 1 members are as follows:

<table>
<thead>
<tr>
<th>Service (Beginning of Year)</th>
<th>Service Based Withdrawal</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Regular Formula Employees</td>
<td>Alternate Formula Employees</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Males</td>
<td>Females</td>
<td>Males</td>
</tr>
<tr>
<td>0</td>
<td>0.2400</td>
<td>0.2200</td>
<td>0.0525</td>
</tr>
<tr>
<td>1</td>
<td>0.0900</td>
<td>0.0900</td>
<td>0.0425</td>
</tr>
<tr>
<td>2</td>
<td>0.0750</td>
<td>0.0650</td>
<td>0.0425</td>
</tr>
<tr>
<td>3</td>
<td>0.0650</td>
<td>0.0550</td>
<td>0.0425</td>
</tr>
<tr>
<td>4</td>
<td>0.0600</td>
<td>0.0450</td>
<td>0.0425</td>
</tr>
<tr>
<td>5</td>
<td>0.0460</td>
<td>0.0450</td>
<td>0.0300</td>
</tr>
<tr>
<td>6</td>
<td>0.0450</td>
<td>0.0400</td>
<td>0.0300</td>
</tr>
<tr>
<td>7</td>
<td>0.0400</td>
<td>0.0400</td>
<td>0.0300</td>
</tr>
<tr>
<td>8</td>
<td>0.0300</td>
<td>0.0350</td>
<td>0.0200</td>
</tr>
<tr>
<td>9</td>
<td>0.0300</td>
<td>0.0350</td>
<td>0.0200</td>
</tr>
<tr>
<td>10</td>
<td>0.0300</td>
<td>0.0300</td>
<td>0.0150</td>
</tr>
<tr>
<td>11</td>
<td>0.0250</td>
<td>0.0300</td>
<td>0.0150</td>
</tr>
<tr>
<td>12</td>
<td>0.0250</td>
<td>0.0250</td>
<td>0.0150</td>
</tr>
<tr>
<td>13</td>
<td>0.0250</td>
<td>0.0250</td>
<td>0.0150</td>
</tr>
<tr>
<td>14</td>
<td>0.0200</td>
<td>0.0250</td>
<td>0.0150</td>
</tr>
<tr>
<td>15</td>
<td>0.0200</td>
<td>0.0250</td>
<td>0.0150</td>
</tr>
<tr>
<td>16</td>
<td>0.0200</td>
<td>0.0200</td>
<td>0.0150</td>
</tr>
<tr>
<td>17</td>
<td>0.0200</td>
<td>0.0200</td>
<td>0.0150</td>
</tr>
<tr>
<td>18</td>
<td>0.0200</td>
<td>0.0200</td>
<td>0.0150</td>
</tr>
<tr>
<td>19</td>
<td>0.0200</td>
<td>0.0200</td>
<td>0.0125</td>
</tr>
<tr>
<td>20</td>
<td>0.0200</td>
<td>0.0150</td>
<td>0.0125</td>
</tr>
<tr>
<td>21</td>
<td>0.0200</td>
<td>0.0150</td>
<td>0.0125</td>
</tr>
<tr>
<td>22</td>
<td>0.0200</td>
<td>0.0150</td>
<td>0.0025</td>
</tr>
<tr>
<td>23</td>
<td>0.0200</td>
<td>0.0150</td>
<td>0.0100</td>
</tr>
<tr>
<td>24</td>
<td>0.0150</td>
<td>0.0150</td>
<td>0.0100</td>
</tr>
<tr>
<td>25</td>
<td>0.0150</td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
<tr>
<td>26</td>
<td>0.0150</td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
<tr>
<td>27</td>
<td>0.0150</td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
<tr>
<td>28</td>
<td>0.0150</td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
<tr>
<td>29</td>
<td>0.0150</td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
<tr>
<td>30+</td>
<td>0.0150</td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
</tbody>
</table>

It is assumed that terminated employees will not be rehired. The rates apply only to employees who have not fulfilled the service requirement necessary for retirement at any given age.
Assumed rates of withdrawal from the System for Tier 2 members are as follows:

<table>
<thead>
<tr>
<th>Service (Beginning of Year)</th>
<th>Service Based Withdrawal</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Males</td>
<td>Females</td>
<td>Females</td>
<td>Males</td>
<td>Females</td>
</tr>
<tr>
<td>0</td>
<td>0.3000</td>
<td>0.2700</td>
<td></td>
<td>0.0800</td>
<td>0.1100</td>
</tr>
<tr>
<td>1</td>
<td>0.1650</td>
<td>0.1600</td>
<td></td>
<td>0.0700</td>
<td>0.0800</td>
</tr>
<tr>
<td>2</td>
<td>0.0700</td>
<td>0.0900</td>
<td></td>
<td>0.0575</td>
<td>0.0700</td>
</tr>
<tr>
<td>3</td>
<td>0.0700</td>
<td>0.0800</td>
<td></td>
<td>0.0550</td>
<td>0.0600</td>
</tr>
<tr>
<td>4</td>
<td>0.0650</td>
<td>0.0750</td>
<td></td>
<td>0.0325</td>
<td>0.0500</td>
</tr>
<tr>
<td>5</td>
<td>0.0550</td>
<td>0.0650</td>
<td></td>
<td>0.0300</td>
<td>0.0500</td>
</tr>
<tr>
<td>6</td>
<td>0.0500</td>
<td>0.0600</td>
<td></td>
<td>0.0300</td>
<td>0.0500</td>
</tr>
<tr>
<td>7</td>
<td>0.0500</td>
<td>0.0500</td>
<td></td>
<td>0.0300</td>
<td>0.0325</td>
</tr>
<tr>
<td>8</td>
<td>0.0300</td>
<td>0.0350</td>
<td></td>
<td>0.0200</td>
<td>0.0200</td>
</tr>
<tr>
<td>9</td>
<td>0.0300</td>
<td>0.0350</td>
<td></td>
<td>0.0200</td>
<td>0.0200</td>
</tr>
<tr>
<td>10</td>
<td>0.0300</td>
<td>0.0300</td>
<td></td>
<td>0.0150</td>
<td>0.0200</td>
</tr>
<tr>
<td>11</td>
<td>0.0250</td>
<td>0.0300</td>
<td></td>
<td>0.0150</td>
<td>0.0175</td>
</tr>
<tr>
<td>12</td>
<td>0.0250</td>
<td>0.0250</td>
<td></td>
<td>0.0150</td>
<td>0.0175</td>
</tr>
<tr>
<td>13</td>
<td>0.0250</td>
<td>0.0250</td>
<td></td>
<td>0.0150</td>
<td>0.0175</td>
</tr>
<tr>
<td>14</td>
<td>0.0200</td>
<td>0.0250</td>
<td></td>
<td>0.0150</td>
<td>0.0175</td>
</tr>
<tr>
<td>15</td>
<td>0.0200</td>
<td>0.0250</td>
<td></td>
<td>0.0150</td>
<td>0.0175</td>
</tr>
<tr>
<td>16</td>
<td>0.0200</td>
<td>0.0200</td>
<td></td>
<td>0.0150</td>
<td>0.0150</td>
</tr>
<tr>
<td>17</td>
<td>0.0200</td>
<td>0.0200</td>
<td></td>
<td>0.0150</td>
<td>0.0150</td>
</tr>
<tr>
<td>18</td>
<td>0.0200</td>
<td>0.0200</td>
<td></td>
<td>0.0150</td>
<td>0.0150</td>
</tr>
<tr>
<td>19</td>
<td>0.0200</td>
<td>0.0200</td>
<td></td>
<td>0.0125</td>
<td>0.0125</td>
</tr>
<tr>
<td>20</td>
<td>0.0200</td>
<td>0.0150</td>
<td></td>
<td>0.0125</td>
<td>0.0125</td>
</tr>
<tr>
<td>21</td>
<td>0.0200</td>
<td>0.0150</td>
<td></td>
<td>0.0125</td>
<td>0.0125</td>
</tr>
<tr>
<td>22</td>
<td>0.0200</td>
<td>0.0150</td>
<td></td>
<td>0.0125</td>
<td>0.0125</td>
</tr>
<tr>
<td>23</td>
<td>0.0200</td>
<td>0.0150</td>
<td></td>
<td>0.0125</td>
<td>0.0125</td>
</tr>
<tr>
<td>24</td>
<td>0.0150</td>
<td>0.0150</td>
<td></td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
<tr>
<td>25</td>
<td>0.0150</td>
<td>0.0100</td>
<td></td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
<tr>
<td>26</td>
<td>0.0150</td>
<td>0.0100</td>
<td></td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
<tr>
<td>27</td>
<td>0.0150</td>
<td>0.0100</td>
<td></td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
<tr>
<td>28</td>
<td>0.0150</td>
<td>0.0100</td>
<td></td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
<tr>
<td>29</td>
<td>0.0150</td>
<td>0.0100</td>
<td></td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
<tr>
<td>30+</td>
<td>0.0150</td>
<td>0.0100</td>
<td></td>
<td>0.0100</td>
<td>0.0100</td>
</tr>
</tbody>
</table>
SECTION III – SUPPORTING ANALYSIS

3. Unused Sick Leave and Optional Service Purchases

Current and future active member’s service is increased by 4.5 months to account for increases of service at retirement due to converting unused sick leave and vacation days and purchasing applicable optional service.

4. Marriage Assumption

85.0% of active male participants and 65.0% of active female participants are assumed to be married. Actual marital status at benefit commencement is used for retirees.

5. Social Security Offset for Survivor Benefits

There is no offset assumption for male surviving spouses because it is assumed their own primary insurance amount (PIA) is as great as their spouses’ PIA. 60% of married male members are assumed to have a dual income household. For the dual income household, it is assumed the offset at age 60 is 45.0% of the original survivor benefit. It is assumed the offset at age 62 is 10.0% of the original survivor benefit. Furthermore, it is assumed that 50% of retirees on or after July 1, 2009 will elect to remove the offset provision. In exchange for the removal, the member’s retirement annuity is reduced by 3.825% monthly as mandated by Statutes (40 ILCS 5/14-121).

Comment: We did not see any development of this assumption in the 2018 Experience Study.

6. Disability

Because members who receive disability benefits typically spend less than one year on disability, they are considered active members. Therefore, a load of 1.65% of pay on the normal cost is applied to reflect the near-term cash flow. This assumption is based on 110% of the most recent disability benefit payment information as a percent of payroll and will be updated at each valuation date as experience emerges.

Comment: Next experience study should review the duration of disability for both occupational and non-occupational disabilities to verify that this approach remains reasonable.

7. Retirement

Employees are assumed to retire in accordance with the rates shown below. The rates apply only to employees who have fulfilled the service requirement necessary for retirement at any given age. Based on the 2018 Actuarial Experience Study, these rates were updated to reflect recent plan experience. It is anticipated that these changes will reduce the losses on retirement in the future compared to recent past experience.
### Retirement Rates for Regular Formula Employees

<table>
<thead>
<tr>
<th>Age</th>
<th>Males</th>
<th>Females</th>
</tr>
</thead>
<tbody>
<tr>
<td>50</td>
<td>15.00%</td>
<td>27.50%</td>
</tr>
<tr>
<td>51</td>
<td>25.00%</td>
<td>27.50%</td>
</tr>
<tr>
<td>52</td>
<td>25.00%</td>
<td>35.00%</td>
</tr>
<tr>
<td>53</td>
<td>25.00%</td>
<td>27.50%</td>
</tr>
<tr>
<td>54</td>
<td>25.00%</td>
<td>22.50%</td>
</tr>
<tr>
<td>55</td>
<td>25.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>56</td>
<td>18.00%</td>
<td>24.00%</td>
</tr>
<tr>
<td>57</td>
<td>18.00%</td>
<td>19.00%</td>
</tr>
<tr>
<td>58</td>
<td>18.00%</td>
<td>19.00%</td>
</tr>
<tr>
<td>59</td>
<td>18.00%</td>
<td>19.00%</td>
</tr>
<tr>
<td>60</td>
<td>13.00%</td>
<td>17.00%</td>
</tr>
<tr>
<td>61</td>
<td>12.00%</td>
<td>13.50%</td>
</tr>
<tr>
<td>62</td>
<td>20.00%</td>
<td>23.00%</td>
</tr>
<tr>
<td>63</td>
<td>17.50%</td>
<td>19.00%</td>
</tr>
<tr>
<td>64</td>
<td>17.50%</td>
<td>20.00%</td>
</tr>
<tr>
<td>65</td>
<td>25.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>66</td>
<td>25.00%</td>
<td>29.00%</td>
</tr>
<tr>
<td>67</td>
<td>25.00%</td>
<td>27.00%</td>
</tr>
<tr>
<td>68</td>
<td>25.00%</td>
<td>27.00%</td>
</tr>
<tr>
<td>69</td>
<td>25.00%</td>
<td>22.00%</td>
</tr>
<tr>
<td>70</td>
<td>25.00%</td>
<td>22.00%</td>
</tr>
<tr>
<td>71</td>
<td>20.00%</td>
<td>22.00%</td>
</tr>
<tr>
<td>72</td>
<td>20.00%</td>
<td>22.00%</td>
</tr>
<tr>
<td>73</td>
<td>20.00%</td>
<td>22.00%</td>
</tr>
<tr>
<td>74</td>
<td>20.00%</td>
<td>22.00%</td>
</tr>
<tr>
<td>75</td>
<td>100.00%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

### Early Retirement Rates for Regular Formula Employees

<table>
<thead>
<tr>
<th>Age</th>
<th>Males</th>
<th>Females</th>
</tr>
</thead>
<tbody>
<tr>
<td>55</td>
<td>3.50%</td>
<td>2.00%</td>
</tr>
<tr>
<td>56</td>
<td>3.50%</td>
<td>3.00%</td>
</tr>
<tr>
<td>57</td>
<td>5.00%</td>
<td>4.00%</td>
</tr>
<tr>
<td>58</td>
<td>6.00%</td>
<td>5.00%</td>
</tr>
<tr>
<td>59</td>
<td>6.50%</td>
<td>6.00%</td>
</tr>
</tbody>
</table>
## SECTION III – SUPPORTING ANALYSIS

<table>
<thead>
<tr>
<th>Age</th>
<th>Retirement Rates for Alternative Formula Employees</th>
<th>Retirement Rates for Regular Formula Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Eligible for Alternate Formula Benefits Only</td>
<td>Eligible for Regular Formula Benefits Only</td>
</tr>
<tr>
<td></td>
<td>Males</td>
<td>Females</td>
</tr>
<tr>
<td>50</td>
<td>65.00%</td>
<td>42.50%</td>
</tr>
<tr>
<td>51</td>
<td>50.00%</td>
<td>30.00%</td>
</tr>
<tr>
<td>52</td>
<td>40.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>53</td>
<td>40.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>54</td>
<td>35.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>55</td>
<td>42.00%</td>
<td>45.00%</td>
</tr>
<tr>
<td>56</td>
<td>30.00%</td>
<td>30.00%</td>
</tr>
<tr>
<td>57</td>
<td>30.00%</td>
<td>30.00%</td>
</tr>
<tr>
<td>58</td>
<td>30.00%</td>
<td>30.00%</td>
</tr>
<tr>
<td>59</td>
<td>30.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>60</td>
<td>30.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>61</td>
<td>30.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>62</td>
<td>30.00%</td>
<td>40.00%</td>
</tr>
<tr>
<td>63</td>
<td>35.00%</td>
<td>30.00%</td>
</tr>
<tr>
<td>64</td>
<td>35.00%</td>
<td>40.00%</td>
</tr>
<tr>
<td>65</td>
<td>35.00%</td>
<td>50.00%</td>
</tr>
<tr>
<td>66</td>
<td>35.00%</td>
<td>50.00%</td>
</tr>
<tr>
<td>67</td>
<td>35.00%</td>
<td>50.00%</td>
</tr>
<tr>
<td>68</td>
<td>35.00%</td>
<td>50.00%</td>
</tr>
<tr>
<td>69</td>
<td>45.00%</td>
<td>50.00%</td>
</tr>
<tr>
<td>70</td>
<td>50.00%</td>
<td>50.00%</td>
</tr>
<tr>
<td>71</td>
<td>50.00%</td>
<td>50.00%</td>
</tr>
<tr>
<td>72</td>
<td>100.00%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

Members hired after December 31, 2010, eligible for the regular formula benefits will retire according to the following age-based retirement rates:

<table>
<thead>
<tr>
<th>Age</th>
<th>Retirement Rates for Regular Formula Employees – Tier 2 Members</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Employees Eligible for Normal Retirement</td>
</tr>
<tr>
<td>67</td>
<td>50.0%</td>
</tr>
<tr>
<td>68</td>
<td>35.0</td>
</tr>
<tr>
<td>69</td>
<td>35.0</td>
</tr>
<tr>
<td>70</td>
<td>35.0</td>
</tr>
<tr>
<td>71</td>
<td>20.0</td>
</tr>
<tr>
<td>72</td>
<td>20.0</td>
</tr>
<tr>
<td>73</td>
<td>20.0</td>
</tr>
<tr>
<td>74</td>
<td>20.0</td>
</tr>
<tr>
<td>75</td>
<td>100.0</td>
</tr>
</tbody>
</table>
SECTION III – SUPPORTING ANALYSIS

Members hired after December 31, 2010, eligible for the alternate formula benefits will retire according to the following age-based retirement rates:

<table>
<thead>
<tr>
<th>Age</th>
<th>Males</th>
<th>Females</th>
</tr>
</thead>
<tbody>
<tr>
<td>60</td>
<td>50.0%</td>
<td>50.0%</td>
</tr>
<tr>
<td>61</td>
<td>30.0</td>
<td>25.0</td>
</tr>
<tr>
<td>62</td>
<td>30.0</td>
<td>40.0</td>
</tr>
<tr>
<td>63</td>
<td>35.0</td>
<td>30.0</td>
</tr>
<tr>
<td>64</td>
<td>35.0</td>
<td>40.0</td>
</tr>
<tr>
<td>65</td>
<td>35.0</td>
<td>50.0</td>
</tr>
<tr>
<td>66</td>
<td>35.0</td>
<td>50.0</td>
</tr>
<tr>
<td>67</td>
<td>35.0</td>
<td>50.0</td>
</tr>
<tr>
<td>68</td>
<td>35.0</td>
<td>50.0</td>
</tr>
<tr>
<td>69</td>
<td>45.0</td>
<td>50.0</td>
</tr>
<tr>
<td>70</td>
<td>50.0</td>
<td>50.0</td>
</tr>
<tr>
<td>71</td>
<td>50.0</td>
<td>50.0</td>
</tr>
<tr>
<td>72</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

8. Spouse’s Age

The female spouse is assumed to be three years younger than the male spouse.

9. Children

It is assumed that married members have 2.2 children, one year apart in age.

The age of the youngest child of a deceased employee at his or her date of death is assumed to be as follows:

<table>
<thead>
<tr>
<th>Age at Death of Employee</th>
<th>Age of Youngest Child</th>
<th>Age at Death of Employee</th>
<th>Age of Youngest Child</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>2</td>
<td>40</td>
<td>6</td>
</tr>
<tr>
<td>25</td>
<td>3</td>
<td>45</td>
<td>8</td>
</tr>
<tr>
<td>30</td>
<td>4</td>
<td>50</td>
<td>10</td>
</tr>
<tr>
<td>35</td>
<td>5</td>
<td>55</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td></td>
<td>60</td>
<td>14</td>
</tr>
</tbody>
</table>

Comment: We did not see any development of this assumption in the 2018 Experience Study.
SECTION III – SUPPORTING ANALYSIS

10. Overtime and Shift Differentials

Reported earnings include base pay alone. It is assumed that overtime and shift differentials will increase total payroll by 3.5% over reported earnings.

Comment: We did not see any development of this assumption in the 2018 Experience Study.

11. Load for Inactive Members Eligible for Deferred Vested Pension Benefits

Load of 11% for Regular Formula members and 9% for Alternative Formula members to the liability attributable to inactive members eligible for deferred vested pension benefits for increase in final average salary due to participation in a reciprocal system after termination. The change in this assumption is supported by analysis on page C-77 of the June 17, 2019 report on the 2018 Experience Study.

12. Missing Data

If year-to-date earnings are not available, then the monthly pay rate is used. If both year-to-date earnings and the monthly pay rate are not available, the annual rate of pay is assumed to be the rate of pay for the population as a whole on the valuation date. For members with less than a year of service, the annual rate of pay is based on the greater of year-to-date earnings or annualized pay rate.

For the 2021 valuation, the earnings reported for the fiscal year ending June 30, 2021 includes retroactive pay for many active members. Consequently, for continuing active members, GRS set valuation pay for projecting future compensation to equal the lesser of: (1) last year’s annual pay increased by the greater of the change in monthly pay rate or 2.75% and (2) reported year-to-date earnings. We agree that this approach is reasonable for this valuation.

If a birth date was not available, the member was assumed to be age 35.

13. Decrement Timing

All decrements are assumed to occur mid-year.

14. Decrement Relativity

Decrement rates are used directly from the experience study, without adjustment for multiple decrement table effects.
15. Decrement Operation

Disability and turnover decrements do not operate after member reaches retirement eligibility.

16. Eligibility Testing

Eligibility for benefits is determined based upon the age nearest birthday and service on the date the decrement is assumed to occur.

17. 415(b) and 401(a)(17) Limits

No explicit assumption is made with respect to these items.

18. Buyout Election Assumption

With respect to the COLA Buyout, 20% of Regular Formula eligible Tier 1 active members and 40% of Alternative Formula eligible Tier 1 active members are assumed to elect to receive a reduced and delayed AAI benefit at retirement and an accelerated pension benefit option in accordance with Public Act 100-0587.

With respect to the Total Buyout, 2% of eligible inactive members are assumed to elect to receive an accelerated pension benefit option in lieu of an annuity at retirement in accordance with Public Act 100-0587. The election percentages apply until the end of each Buyout Program, i.e., June 1, 2024 for the COLA Buyout and May 31, 2024 for the Total Buyout.

GRS notes the “COLA Buyout” assumptions are based upon experience through July 2021 provided by the System, but no information or discussion is provided on the actual experience. In addition, in the 2018 Experience Study the recommendation for the Total Buyout was 10% of all inactive members would elect the total buyout, and no explanation is provided for the change from 10% to 5%. Furthermore, the assumption was decreased this year from 5% to 2% without explanation. It is unclear what experience was used as the basis for this assumption, and thus we cannot evaluate its appropriateness. We recognize that there is very little experience on which to base an assumption and as experience emerges, the assumption may need to be revised. We will monitor the accuracy of this assumption as experience emerges and comment on whether revisions should be made at that point (Recommendation #3).
19. Population Projection

For purposes of determining annual appropriations as a percentage of total covered payroll, the size of the active group is assumed to remain level at the number of actives as of the valuation date. New entrants are assumed to enter with an average age and an average pay as disclosed below. New entrants are assumed to have the same demographic profile as actual new entrants over the 15 years prior to the valuation date. The average increase in uncapped payroll for the projection period is 2.75% per annum. New entrants not covered by Social Security are assumed to participate in the Tier 2 defined benefit plan.

<table>
<thead>
<tr>
<th>Age Group</th>
<th>New Entrants Eligible for Regular Formula Benefits who are Covered by Social Security</th>
<th>New Entrants Eligible for Regular Formula Benefits who are not Covered by Social Security</th>
<th>New Entrants in Positions Formerly Eligible for Alternate Formula Benefits who are Covered by Social Security and are now Eligible for Regular Formua Benefits</th>
<th>New Entrants in Positions Formerly Eligible for Alternate Formula Benefits who are not Covered by Social Security and are now Eligible for Regular Formua Benefits</th>
<th>New Entrants Eligible for Alternate Formula Benefits who are not Covered by Social Security</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 20</td>
<td>27,021</td>
<td>1,443,569</td>
<td>114</td>
<td>7,053</td>
<td>7,534</td>
<td>434,934</td>
</tr>
<tr>
<td>20-24</td>
<td>141</td>
<td>5,334</td>
<td>22</td>
<td>1,136</td>
<td>1,831</td>
<td>95,804</td>
</tr>
<tr>
<td>25-29</td>
<td>4,866</td>
<td>235,945</td>
<td>33</td>
<td>1,927</td>
<td>2,091</td>
<td>115,474</td>
</tr>
<tr>
<td>30-34</td>
<td>4,234</td>
<td>226,277</td>
<td>23</td>
<td>1,510</td>
<td>1,174</td>
<td>68,957</td>
</tr>
<tr>
<td>35-39</td>
<td>3,728</td>
<td>207,131</td>
<td>6</td>
<td>285</td>
<td>790</td>
<td>48,919</td>
</tr>
<tr>
<td>40-44</td>
<td>3,440</td>
<td>198,153</td>
<td>8</td>
<td>590</td>
<td>632</td>
<td>41,015</td>
</tr>
<tr>
<td>45-49</td>
<td>3,067</td>
<td>177,436</td>
<td>6</td>
<td>417</td>
<td>446</td>
<td>28,774</td>
</tr>
<tr>
<td>50-54</td>
<td>2,560</td>
<td>150,623</td>
<td>5</td>
<td>392</td>
<td>289</td>
<td>19,103</td>
</tr>
<tr>
<td>55-59</td>
<td>1,655</td>
<td>95,259</td>
<td>11</td>
<td>796</td>
<td>145</td>
<td>9,439</td>
</tr>
<tr>
<td>60-64</td>
<td>591</td>
<td>33,239</td>
<td>41</td>
<td>2,605</td>
<td>15</td>
<td>1,007</td>
</tr>
<tr>
<td>65-69</td>
<td>42</td>
<td>2,390</td>
<td>7</td>
<td>450</td>
<td>2</td>
<td>162</td>
</tr>
</tbody>
</table>

Avg. Age | 37.82 | 33.60 | 31.70 | 34.07 | 28.77 | 27.57 | 36.12 |
Percent Male | 42% | 84% | 71% | 687 | 90% | 100% | 50% |
C. Funding Methods

Actuarial funding methods consist of three components: (1) the actuarial cost method, which is the attribution of total costs to past, current, and future years; (2) the asset valuation method (i.e., asset smoothing); and (3) the amortization method.

1. **Actuarial Cost Method**

The System uses the projected Unit Credit cost method (PUC) to assign costs to years of service, as required under the Pension Code (40 ILCS 5/14). **We have no objections with respect to using the PUC method, although we would prefer the Entry Age Normal (EAN) cost method as it is more consistent with the requirement in 40 ILCS 5/14-131 for level percentage of pay funding.**

Under the PUC method, which is used by some public sector pension funds, the benefits of active participants are calculated based on their compensation projected with assumed annual increases to ages at which they are assumed to leave the active workforce by any of these causes: retirement, disability, turnover, or death. Only past service (through the valuation date, but not beyond) is taken into account in calculating these benefits. The present value of these benefits based on past service and future compensation is the actuarial liability for a given active participant. Under the PUC cost method, the value of an active participant’s benefits tends to increase more sharply over his or her later years of service than over his or her earlier ones. While the PUC method is not an unreasonable method, as a result of this pattern of benefit values increasing, more plans use the EAN cost method to mitigate this effect. It should also be noted that the EAN cost method is the required method to calculate liability for GASB Nos. 67 and 68.

2. **Asset Valuation Method**

The Actuarial Value of Assets for the System is a smoothed market value. Unanticipated changes in market value are recognized over five years in the Actuarial Value of Assets. The primary purpose for smoothing out gains and losses over multiple years is so fluctuations in the contributions will be less volatile over time than if based on the Market Value of Assets.

The 2020 Public Retirement Systems Study by the National Conference on Public Employee Retirement Systems (NCPERS) survey of 138 public retirement funds found that the majority of plans responding to the survey have a five-year smoothing period.

**Smoothing the market gains and losses over a period of five years to determine the Actuarial Value of Assets is a generally accepted approach in determining actuarial cost, and we concur with its use.**
3. **Amortization Method**

The mandated State contribution is based on a determination of the level percentage of payroll that is expected to achieve a 90% funded ratio in 2045. While not a traditional amortization method, this methodology effectively amortizes a portion of the unfunded actuarial liability over the remaining period until 2045, which is currently 25 years.

One of the principles of funding public plans identified by the American Academy of Actuaries is that there should be “a plan to make up for any variations in actual assets from the funding target within a defined and reasonable time period.” Because it only targets 90%, the State method does not include a plan to achieve the funding target over any period of time.

Typical public plan amortization methods are designed to increase each year by expected payroll growth. Under the State mandated method, however, the effective amortization payment increases each year by more than the expected growth in payroll. As a result, the State mandated method defers payments on the unfunded actuarial liability further into the future than under typical public plan amortization methods.
SECTION IV – PROJECTION ANALYSIS

This section reviews the projections contained in the draft June 30, 2021 Actuarial Valuation of SERS. These projections are fundamental to the development of the required State contribution calculated under the current statutory funding requirement.

The following graphs are independent approximations of the projections performed by the State Actuary to verify that the System’s funding projections are reasonable. They do not reflect all the precision of the projections applied by the System’s actuary, but instead they are intended to verify the reasonableness of the modeling done by the System’s actuary.

The graph below shows our projection of the expected future liabilities and assets in the System through 2045. As pointed out on page 12 of the draft June 30, 2021 Actuarial Valuation, the majority of the funding of the System occurs between 2034 and 2045. The lines show the projected assets (market value and actuarial value), and the bars show the projected liabilities of the System. The funded ratio for each five years is shown at the top of the bars. For example, in 2035, the funded ratio is projected to be approximately 62% with assets of approximately $39 billion and liabilities of approximately $63 billion.

Source: Cheiron projection analysis.
When we compare our projected funded ratio against the results shown in the draft June 30, 2021 Actuarial Valuation, we find a close match in expected funded ratio. This close match of the funded ratio supports that the projections done by the System’s actuary are reasonable and the fact we show slightly different funded ratios is a function of Cheiron’s approximation.

Source: Cheiron projection analysis.
SECTION IV – PROJECTION ANALYSIS

The following graph shows the expected contributions calculated under the statutory method. The values shown for the fiscal year ending 2022 were set based on the June 30, 2020 Actuarial Valuation. The current valuation is the basis for setting the rates starting July 1, 2022 (Fiscal Year Ending June 30, 2023). The contribution requirement has two components: 1) the employer normal cost, which is the approximate value of the amount of benefits accrued by participants in the upcoming year, less employee contributions, based on the statutory funding method; and 2) an amortization payment on the unfunded liability. The normal cost amounts are shown by the green bars and the amortization payments of the unfunded actuarial liability (UAL) amounts by the yellow bars. The percentages shown are the total contribution rates as a percentage of payroll calculated by Cheiron, which are equal to the sum of the bars. The graph shows that larger percentages of the total contribution are being made toward the UAL payments later in the period. The blue line shows the projected contribution rates as percentages of payroll from the System actuary’s draft June 30, 2021 Actuarial Valuation. The difference between Cheiron’s approximation and the System’s projections is the difference between the top of the bars and the line. In this instance, there is virtually no difference. The contributions are being limited by the maximum contribution described in the General Obligation Bond Act prior to 2033, which is why the rate increases after 2033.

Source: Cheiron projection analysis.

Our conclusion is that the projections performed by the System’s actuary are reasonable.
SECTION V – ANALYSIS OF FUNDING ADEQUACY

In this section, we examine the adequacy of the funding for the System, including funded ratio, the sources of changes in the unfunded actuarial liability (UAL), projections of the UAL, and statutory funding requirements compared to contributions needed to pay down the UAL.

The actuarial valuation report prepared by GRS includes both traditional actuarial measurements, as well as additional risk measurements that are shown on pages 18 to 21 of the draft June 30, 2021 Actuarial Valuation report. Given the unique and substantial funding challenges faced by the Illinois pension systems, this additional information is quite important and supplements the information we present here on funding adequacy to better inform the legislature and other stakeholders about the adequacy of the System’s funding.

System Funded Ratio

The first funding adequacy measure we present is the trend in funded ratio for the past 10 years. Funded ratio for this measure is defined as the ratio of the Market Value of Assets to the actuarial liability. The chart below shows SERS’ funded ratio since 2012 has gone from 33.1% funded to 46.0% funded in 2021, an increase in funded ratio of 12.9%. In addition to showing the funded ratio, this chart also shows the breakdown of the Plan’s liabilities by membership status:

- Active liability – the liability (attributable to service already performed) for future payments to members who are currently working in the System,
- Deferred Vested liability – the liability for future payments to members who are no longer working in the system, and
- In-Pay liability – the liability for future payments to retirees and beneficiaries who are currently receiving benefits.

This breakdown shows that today plan assets only cover about 64% of the liabilities for just those members currently in pay status.

Source: Cheiron analysis of funding adequacy.
Sources of Changes in the UAL

As shown in the chart below, SERS’ unfunded actuarial liability (UAL) has grown from about $20.2 billion in 2011 to $30.5 billion in 2021, an increase of $10.3 billion, $9.7 billion of which occurred from 2011-2016. In order to understand how to reverse this trend, it is important to understand the sources contributing to it.

The changes to the UAL from June 30, 2011 to June 30, 2021 can be separated into the following components:

- **Contribution Deficiencies** – Contributions that are less than the tread water contribution cause the UAL to increase. The tread water contribution consists of two components: the normal cost, which is the cost of benefits earned in a given year, and the interest on the unfunded actuarial liability. This sum is referred to as the tread water contribution because it is the contribution necessary so that the UAL will remain constant, or “tread water” (absent experience gains or losses). The differences between actual contributions and the tread water contributions have increased the UAL by $5.88 billion over this period.

- **Assumption Changes** - Changes to actuarial assumptions as the System updated expectations, primarily on future investment returns and life expectancy. A positive aspect of the UAL increases due to assumption changes is that they are expected to result in liability measurements that more accurately reflect future expectations. Over this period, assumption changes have increased the UAL by $6.21 billion.

- **Plan Changes** - Modifications of the design of the Plan, which have affected benefits already accrued. Since most of the changes to the System’s plan affect only future benefits the impact has been negligible during this period, reducing the liability by $0.40 billion over this period.
SECTION V – ANALYSIS OF FUNDING ADEQUACY

- **Liability (Gain) or Loss** - Changes in the UAL due to liability experience (i.e., mortality, terminations, salary increases, etc.). These were generally small but decreased the UAL by $0.78 billion over this period.

- **AVA (Actuarial Value of Assets) Investment (Gain) or Loss** - Net investment gains or losses due to assets earning more or less than assumed. These have decreased the UAL over this period by $0.64 billion.

The chart below shows the changes in UAL each year broken into these five components. The sum of all the components, as the total change in UAL, is shown as the black line. Values of each component as well as total by year are shown in the chart along with the totals for the period.

We expect that this chart will help stakeholders understand the sources of growth in the UAL over the past decade and inform discussions about the current funding requirements and adequacy.
Actual Contributions Compared to Tread Water Contribution

One of the persistent sources of the increase in UAL is due to actual contributions to the System being less than the tread water contribution (the amount needed to prevent the UAL from increasing if all assumptions are met). These contribution deficiencies have added between $160 to $930 million to the UAL each year over the historical period shown.

As the chart below shows, actual contributions have been significantly less than the tread water cost, however this trend has reversed this year. When the total contributions are above the tread water cost (blue line), the UAL is expected to decline.

Source: Cheiron analysis of funding adequacy.
The next chart shows that if the minimum required contributions continue to be made each year and all other assumptions are met, the UAL is projected to decline from $30.5 billion in 2021 to $6.4 billion in 2045. As illustrated on the prior chart, the UAL is projected to decline because the total contributions are projected to beginning paying down the interest and some principal in the years beginning in 2022.

Source: Cheiron analysis of funding adequacy.
Net Cash Flow Analysis

The Plan’s net cash flow is defined as State and employee contributions less benefit payments and administrative expenses. The more negative net cash flow is as a percentage of the plan’s assets, the more vulnerable the Plan is to market downturns. When a pension plan has more payouts than contributions and suffers an investment loss, it is left with fewer assets to invest and recapture during a recovery.

Looking at the chart below, SERS has slightly negative net cash flow (black line). If contributions increase as quickly as benefit payments, the net cash flow will remain stable. But if contributions do not continue to grow either because the Plan has become better funded or because the expected contributions are not made, negative net cash flow may become a more significant issue, therefore it should continue to be monitored. The teal line shows net cash flow as a percent of Market Value of Assets on the right-side axis. The greater the negative cash flows are relative to plan assets, the more vulnerable a plan is to market downturns. This is because once there is a market downturn, the plan assets lose on both the return and the negative cash flow, leaving a lower asset base from which to recover from the loss.

Source: Cheiron analysis of funding adequacy.
Response to Recommendations in 2020

In the State Actuary’s Preliminary Report on the State Employees’ Retirement System of Illinois presented December 16, 2020, Cheiron made several recommendations. Below we summarize how these recommendations were reflected in either the System’s comments last year or in this year’s draft June 30, 2021 Actuarial Valuation.

<table>
<thead>
<tr>
<th>Recommendations to Retirement System from 2020 State Actuary Report</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. We continue to recommend that the SERS Board periodically retain the services of an independent actuary to conduct a full scope actuarial audit. Such an audit should fully replicate the original actuarial valuation, based on the same census data, assumptions, and actuarial methods used by the System’s actuary.</td>
<td>Implemented</td>
<td>We have been informed by SRS Executive Secretary Tim Blair that an independent actuary has been retained to perform an audit and is expected to present their results to the SERS Board in January 2022. <strong>Recommendation removed.</strong></td>
</tr>
<tr>
<td>2. We continue to recommend that the funding method be changed to fully fund plan benefits and discontinue the systematic underfunding of SERS. Continuing the practice of underfunding future accruals such that the unfunded liability is expected to continue to grow and targeting a funded percentage less than 100% increases the risk of the System becoming unsustainable. We understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.</td>
<td>Partially Implemented</td>
<td>The System has adopted a funding policy that would provide for annual State contributions, the “Actuarially Determined Contribution”, and is used for informational purposes only. GRS continues to include strong language throughout their report recommending the use of an actuarially sound method and stating clearly that the statutory method is not actuarially sound. We find these statements to be appropriate and support their continuation. <strong>Recommendation repeated.</strong></td>
</tr>
<tr>
<td>3. We continue to recommend that GRS include stress testing of the System within the valuation report and include a thorough explanation of the implications that volatile investment returns and a variety of other stressors (e.g., membership declines, lower</td>
<td>Implemented</td>
<td>SERS added stress testing in appendices to the final Actuarial Valuation Report in a letter dated December 8, 2020 which adequately assessed the impact of various risks. We anticipate that similar stress testing will be included in the final June 30, 2021 Actuarial Valuation.</td>
</tr>
<tr>
<td>Recommendation to Retirement System from 2020 State Actuary Report</td>
<td>Status</td>
<td>Comments</td>
</tr>
<tr>
<td>---------------------------------------------------------------</td>
<td>-------</td>
<td>----------</td>
</tr>
<tr>
<td>Salary growth) can have on future State costs. In particular, the tests should illustrate the potential stresses on the System and its contributing sponsors so that an assessment of sustainability can be made. GRS did include stress testing in last year’s final report but did not include such stress testing in this year’s draft report, or in any supplemental report.</td>
<td></td>
<td><strong>Recommendation removed.</strong></td>
</tr>
<tr>
<td>4. As required by section 3.3 of ASOP 51, we recommend that GRS provide an assessment for each of the six key risks they have identified.</td>
<td><strong>Not Implemented</strong></td>
<td>While the System noted in its December 11, 2020 response that the ASOP 51 disclosure may be expanded to address many of Cheiron’s recommendations, the final 2020 Actuarial Valuation Report did not provide the recommended assessments. <strong>Recommendation modified.</strong></td>
</tr>
<tr>
<td>5. We recommend GRS provide additional explanation and justification for the methods used to develop the mortality assumptions used in the valuation.</td>
<td><strong>Not Implemented</strong></td>
<td>GRS indicated agreement with the recommendation and that they would expand the discussion in future experience studies and valuation reports. There has been no change in the description in the valuation report, but we expect the next experience study report will provide the additional explanation and justification. <strong>Recommendation repeated.</strong></td>
</tr>
<tr>
<td>6. We recommend the SERS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly.</td>
<td><strong>Implemented</strong></td>
<td>GRS has continued to do this, most recently providing a review in the 2020 Actuarial Experience Study report dated July 9, 2021. We will continue to include this recommendation each year. <strong>Recommendation continued.</strong></td>
</tr>
</tbody>
</table>
# Status of Recommendations from the 2020 State Actuary Report

<table>
<thead>
<tr>
<th>Recommendations to Retirement System from 2020 State Actuary Report</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
</table>
| 7. We recommend that GRS use more recent capital market assumptions from the investment consultant for the Illinois State Board of Investment in its analysis of the interest rate assumption. In addition, we recommend that GRS disclose the list of other investment consultants used and the dates of the capital market assumptions used in their analysis. | Implemented | GRS noted in its response that the capital market assumptions used were the most recent available at the time of the economic review and agree with the recommendation to disclose the list of other consultants and the dates of the assumptions used in their analysis. Recommendation removed. *  
* We assume the list of other consultants and the dates of the assumptions used in their analysis will be listed in the forthcoming Experience Study similar to the 2021 Study for SURS. |
| 8. We recommend that an explanation be provided as to how the maturity measures calculated and disclosed by GRS help the reader to understand the risks identified and that historical values that are significant to understanding the risks identified be disclosed along with an explanation of how they help the reader understand the risks identified by GRS | Implemented | GRS expanded its description of maturity measures in the final Actuarial Valuation Report dated January 4, 2021. Recommendation removed. |
| 9. We recommend that GRS review its disclosures related to ASOP 56 for the next valuation report to ensure that the disclosures clearly identify the purpose of each model, any material limitations of each model, and any other applicable required disclosures under ASOP 56. | Implemented | In its transmittal letter to the June 30, 2021 Actuarial Valuation Report GRS the recommended ASOP 56 disclosures were made. Recommendation removed. |
Chapter Four

Preliminary Report on the Judges’ Retirement System

In accordance with 30 ILCS 5/2-8.1, Cheiron, the State Actuary, submitted a preliminary report to the Board of Trustees of the Judges’ Retirement System (JRS) concerning proposed certifications of required State contributions submitted to Cheiron by the Board. The preliminary report was submitted to JRS on November 30, 2021. The preliminary report was based on Cheiron’s review of actuarial assumptions included in JRS’ 2021 Actuarial Valuation Report.

Following is Cheiron’s final preliminary report on the Judges’ Retirement System. JRS’ written response, provided on December 10, 2021, can be found in Appendix C.

### OVERVIEW

<table>
<thead>
<tr>
<th>JUDGES’ RETIREMENT SYSTEM as of June 30, 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial accrued liability</td>
</tr>
<tr>
<td>Actuarial value of assets</td>
</tr>
<tr>
<td>Unfunded liability</td>
</tr>
<tr>
<td>Funded ratio</td>
</tr>
</tbody>
</table>

| Employer normal cost | $33,033,376 |
| State contribution (FY23) | $142,659,000 |

| Active members | 944 |
| Inactive members | 29 |
| Current benefit recipients | 1,298 |
| Total membership | 2,271 |

| Interest rate assumption | 6.50% |
| Inflation assumption | 2.25% |
| Actuarial cost method | Projected Unit Credit |
| Asset valuation method | 5-year Smoothing |

Executive Director: Tim Blair
Actuarial Firm: Gabriel, Roeder, Smith & Company

Source: June 30, 2021 JRS actuarial valuation report.
December 15, 2021

Mr. Frank Mautino
Auditor General
740 East Ash Street
Springfield, Illinois 62703

Board of Trustees
Judges' Retirement System of Illinois
2101 South Veterans Parkway
P.O. Box 19255
Springfield, Illinois 62794-9255

Dear Trustees and Auditor General:

In accordance with the Illinois State Auditing Act (30 ILCS 5/2-8.1), Cheiron is submitting this preliminary report concerning the proposed certification prepared by Gabriel, Roeder, Smith & Company (GRS) of the required State contribution to the Judges’ Retirement System of Illinois (JRS or System) for Fiscal Year 2023.

In summary, we believe that the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable. We also find that the certified contributions, notwithstanding the inadequate State funding requirements that do not conform to generally accepted actuarial principles and practices, were properly calculated in accordance with State law.

Section I of this report describes the review process undertaken by Cheiron. Section II summarizes our findings and recommendations. Section III provides the supporting analysis for those findings and presents more details on our assessment of the actuarial assumptions and methods employed in GRS’s Actuarial Certification, as well as our assessment of GRS’s determination of the required State contribution for Fiscal Year 2023. Section III also includes comments on other issues impacting the funding of the Judges’ Retirement System, including the implications of Article 18 of the Illinois Pension Code, which establishes the statutory minimum funding requirements for the System. We agree with GRS that the statutory mandated minimum funding requirements have been and continue to be inadequate. In addition, the past inadequate funding has resulted in current and future contribution levels, measured as a percent of payroll, to be among the highest in the country. Making adequate contributions in the future to fully fund the system will be challenging. Section IV reviews the projections contained in the draft June 30, 2021 Actuarial Valuation. Finally, Section V provides an analysis of funding adequacy.

In preparing this report, we relied on information (some oral and some written) supplied by JRS and GRS. This information includes actuarial assumptions and methods adopted by the JRS Board, System provisions, the draft June 30, 2021 Actuarial Valuation, the draft 2021 GASB 67/68 Report, the 2021 Valuation Results presentation, the 2018 Actuarial Experience Review, and minutes of the plan year 2021 JRS Board of Trustee meetings. A detailed description of all information provided for this review is contained in Appendix B.
This report and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices and our understanding of the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board as well as applicable laws and regulations. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this report. This report does not address any contractual or legal issues. We are not attorneys, and our firm does not provide any legal services or advice.

This report was prepared exclusively for the Office of the Auditor General and the Judges’ Retirement System of Illinois for the purpose described herein. Other users of this report are not intended users as defined in the Actuarial Standards of Practice, and Cheiron assumes no duty or liability to any other user.

Sincerely,
Cheiron

**Signed Original on File**

Gene Kalwarski, FSA, FCA, MAAA, EA  
Principal Consulting Actuary

Matthew Wells, FSA, MAAA, EA  
Associate Actuary
Illinois Public Act 097-0694 (the Act) amended the Illinois State Auditing Act (30 ILCS 5/2-8.1) and requires Cheiron, as the State Actuary, to review the actuarial assumptions and valuation of the Judges’ Retirement System of Illinois (JRS or System) and to issue to the JRS Board this preliminary report on the proposed certification prepared by Gabriel, Roeder, Smith & Company (GRS) of the required State contributions for Fiscal Year (FY) 2023. The purpose of this review is to identify any recommended changes to the actuarial assumptions for the JRS Board to consider before finalizing its certification of the required State contributions for FY 2023.

While the Act states that just the actuarial assumptions and valuation are to be reviewed, we have also reviewed the actuarial methodologies (funding and asset smoothing methods) employed in preparing the Actuarial Certification, as these methods can have a material effect on the amount of the State contribution being certified. Finally, we have offered our opinion on the implications of Article 18-131 of the Illinois Pension Code, which impacts the contribution amount certified by GRS.

In conducting this review, Cheiron reviewed the draft June 30, 2021 Actuarial Valuation, the draft 2021 GASB 67/68 Report, the 2021 Actuarial Results presentation, the 2018 Actuarial Experience Review, and minutes of the plan year 2021 Board of Trustees meetings. The materials we reviewed are listed in Appendix B.

In addition to reviewing the Actuarial Certification of the required State contribution to JRS, the Act requires the State Actuary to conduct a review of the “actuarial practices” of the Board. While the term “actuarial practices” was not defined in the Act, we continue to interpret this language to mean that we review: (1) the use of a qualified actuary (as defined by the Qualification Standards of the American Academy of Actuaries) to prepare the annual actuarial valuation for determining the required State contribution; and (2) the conduct of periodic formal experience studies to justify the assumptions used in the actuarial valuation. In addition, we have included comments on actuarial communication and compliance with Actuarial Standards of Practice (ASOP) reflected in the draft June 30, 2021 Actuarial Valuation.
This section summarizes recommendations from our review of the actuarial assumptions and methods employed in the draft June 30, 2021 Actuarial Valuation of JRS as well as the “actuarial practices” of the JRS Board. Section III of this report contains detailed analysis and rationale for these recommendations.

**Proposed Certification of the Required State Contribution**

Gabriel, Roeder, Smith & Company (GRS) has determined that the FY 2023 required State contribution calculated under the current statutory funding requirements is $142,659,000. We have verified the arithmetic calculations made by GRS to develop this required State contribution and have reviewed the assumptions on which it was based. We have accepted GRS’s annual projections of future payroll, total normal costs, employee contributions, combined benefit payments and expenses, and total contributions.

**State Mandated Funding Method**

1. We continue to recommend that the funding method be changed to fully fund plan benefits. Continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the System becoming unsustainable. Consequently, we recommend that the funding method maintain contributions at a level that is expected to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

**Recognition of Changes in Actuarial Assumptions**

Public Act 100-0023 (P.A. 100-0023), effective July 6, 2017, modified the State’s funding policy to require that the contribution impact of all assumption changes be phased-in over a five-year period.

2. Because experience studies are performed every three years, we recommend that the phase-in period of the impact of assumption changes be reduced to three years. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

**Assessment of Actuarial Assumptions Used in the 2021 Valuation**

30 ILCS 5/2-8.1 requires the State Actuary to identify recommended changes in actuarial assumptions that the JRS Board must consider before finalizing its certification of the required State contribution. We have reviewed all the actuarial assumptions used in the draft June 30, 2021 Actuarial Valuation and conclude that the assumptions are reasonable in general, based on the evidence provided to us.
Recommended Additional Disclosures for the 2021 Valuation

3. We continue to recommend that GRS include stress testing of the System within the valuation report and include a thorough explanation of the implications that volatile investment returns and a variety of other stressors (e.g., membership declines, lower salary growth) can have on future State costs. In particular, the tests should illustrate the potential stresses on the System and its contributing sponsors so that an assessment of sustainability can be made. These stress tests should include the impact to the required State contribution of potential reductions in the discount rate. GRS did not include stress testing in this year’s valuation report. In 2020 GRS also didn’t include stress testing in their initial report which Cheiron reviewed, but they did include stress testing in a final report submitted on January 4, 2021. We recommend that the final 2021 report include the stress testing.

Recommended Changes for Future Valuations

4. Section 3.2 of ASOP 51 requires the actuary to identify risks that “may reasonably be anticipated to significantly affect the plan’s future financial condition.” [emphasis added]. The risks currently identified appear to largely duplicate the list of examples in ASOP 51 and could apply to almost any pension plan. In future valuations, we recommend that the actuary explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition.

5. For each risk identified above, Section 3.3 of ASOP 51 requires the actuary to provide an assessment that takes into account “circumstances specific to the plan.” For some of the identified risks, the actuary has provided a quantitative assessment specific to the plan while for other identified risks, the actuary has only provided a generic statement that could apply to any plan. We recommend that for each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of this plan.

6. We recommend the JRS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation.

GASB 67 and 68

The 2021 JRS GASB 67 and 68 information was provided in a separate report. We find that the assumptions and methods used to prepare the 2021 JRS GASB 67 and 68 schedules are reasonable based on the evidence provided to us.
In this section we provide detailed analysis and supporting rationale for the recommendations that were presented in Section II of this report.

**Proposed Certification of the Required State Contribution**

As stated in our summary of recommendations in Section II, we have verified the arithmetic calculations made by GRS to develop the required State contribution, reviewed the assumptions on which it is based, and accepted GRS’s annual projections of future payroll, total normal costs, benefits, expenses, and total contributions. However, in accordance with 30 ILCS 5/2-8.1, our review does not include a replication of the actuarial valuation results.

In our reports since 2014, given the size of JRS, the System’s low funded ratio, the recent changes in legal requirements, and guidance issued by the Government Finance Officers Association, we had been recommending that the Board periodically undertake a full scope actuarial audit, utilizing the services of a reviewing actuary. We have been recently informed that the Board has selected an independent actuary to perform a full scope actuarial audit which is expected to be completed by January 2022.

**State Mandated Funding Method**

The Illinois Pension Code (40 ILCS 5/18-131) establishes a method that does not adequately fund the System, backloading contributions and targeting the accumulation of assets equal to 90% of the actuarial liability in the year 2045. This contribution level does not conform to generally accepted actuarial principles and practices. Generally accepted actuarial funding methods target the accumulation of assets equal to 100% of the Actuarial Liability, not 90%.

We continue to recommend that the funding method be changed to fully fund plan benefits (Recommendation #1). The funding method should target 100% of the actuarial accrued liability. Contributions should ramp up as quickly as possible to a level that is expected to prevent the unfunded actuarial liability from growing and remain high enough to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded. While making adequate contributions will be challenging, continuing the practice of underfunding the System increases the risk of needing even larger contributions in the future that may make the System unsustainable.

We have reviewed the funding policy adopted by the Board of Trustees. We agree that the policy is a reasonable method that conforms to the Actuarial Standards of Practice, and we agree with its use in the GASB report as an Actuarially Determined Contribution (ADC). The funding policy calls for a funding amount equal to the normal cost plus a closed 25-year amortization as a level percentage of capped payroll of the unfunded actuarial liability. This policy defines a method that would ultimately fully fund the Plan and falls within generally accepted actuarial funding methods currently in use for public plans. As of June 30, 2021, the remaining amortization period is 19 years. According to this methodology, the State’s contribution amount would be $174,869,681 for FY 2023. It is important though to recognize that this change does not affect the actual funding of the System. The board adopted funding policy conforms to a goal of full funding within a reasonable time period and with generally accepted actuarial principles and practices.
Recognition of Changes in Actuarial Assumptions

Public Act 100-0023 (P.A. 100-0023), effective July 6, 2017, modified the State’s funding policy to require that the contribution impact of all assumption changes, including changes prior to P.A. 100-0023, be phased-in over a five-year period. As such, the Act delays the funding of the System. Assumption changes are intended to more accurately anticipate the obligations for funding based on the most recent experience analysis and forward-looking changes to future investment returns. However, only one-fifth of the impact of these changes are now recognized from the date of adoption. The remainder of the impact is recognized over four additional years such that the full impact is only recognized at the end of a five-year period beginning at the date of adoption. This phase-in provides time to adjust to a higher level of contributions. However, the Conference of Consulting Actuaries White Paper on Actuarial Funding Policies and Practices for Public Pension Plans recommends that the “phase-in period should be no longer than the time period until the next review of assumptions.” Since experience studies are performed every three years, we recommend the phase-in period for the impact of assumption changes be reduced to three years (Recommendation #2).

Stress Testing

Based on the draft June 30, 2021 Actuarial Valuation, the funded ratio, measured as the ratio of the actuarial value of assets to the Actuarial Liability, is currently at 42.03%. The unfunded actuarial accrued liability is currently about $1.7 billion which is expected to decrease in the future. The required State contribution rate is currently 97.32% of payroll and is scheduled to decrease to 86.20% of payroll. However, if there is a significant market downturn, the unfunded actuarial liability could increase substantially and the required State contribution rate could increase significantly, putting the sustainability of the system further into question. Stress testing should be performed to better understand these risks and the potential advantages of additional contributions in the near term to maintain the sustainability of the system.

We continue to recommend that GRS include stress testing of the System within the valuation report and include a thorough explanation of the implications that volatile investment returns and a variety of other stressors (e.g., membership declines, lower salary growth) can have on future State costs. In particular, the tests should illustrate the potential stresses on the System and its contributing sponsors so that an assessment of sustainability can be made (Recommendation #3).

This should include an analysis and discussion of the impact on the annual contribution requirement of the alternative scenarios tested. As mentioned in Section II of this report, GRS did include the recommended stress testing on their final valuation report for 2020 delivered in January of 2021. We recommend that the final 2021 report also include the stress testing outlined here.
Actuarial Standard of Practice 51

A new Actuarial Standard of Practice (ASOP) became effective for JRS actuarial valuations starting June 30, 2019. ASOP 51 provides guidance to actuaries on the assessment and disclosure of risks to help readers of the actuarial valuation report “understand the effects of future experience differing from the assumptions used” and “the potential volatility of future measurements resulting from such differences”.

ASOP 51’s first requirement is to “identify risks that, in the actuary’s professional judgment, may reasonably be anticipated to significantly affect the plan’s future financial condition.” GRS identified six sources of risk to JRS: investment risk, asset/liability mismatch risk, contribution risk, salary and payroll risk, longevity risk and other demographic risks. With the exception of the contribution risk due to the statutorily required amount of contributions, the risks JRS identified are relatively generic and would apply to most pension plans. We believe JRS should stress the net cash flow situation as that is expected to become a problem in the future.

ASOP 51 requires the actuary to assess each of the risks identified. While the assessment does not have to be quantitative, it does have to take into account the specifics of the individual plan. ASOP 51 also describes several quantitative methods that may be used to assess risk.

- **Investment Risk.** GRS included additional stress testing in the last year’s final actuarial valuation report that adequately assessed the investment risk with various investment return scenarios.

- **Asset/Liability Mismatch Risk.** GRS does not appear to provide an assessment of asset/liability mismatch risk other than to indicate that asset value changes that do not match liability changes will either increase or decrease costs. If GRS continues to identify this as a key risk, ASOP 51 requires that they also provide an assessment that takes into account “circumstances specific to the plan.”

- **Contribution Risk.** GRS discusses several issues with the statutorily required contribution amounts in the risk section as well as in other parts of the valuation report. The stress testing included in last year’s final actuarial valuation report adequately assessed the impact of a declining contribution base (i.e., payroll).

- **Salary and Payroll Risk.** The stress testing included in last year’s final actuarial valuation report adequately assessed the salary and payroll risk with alternative projected decreases in the active population.

- **Longevity Risk.** GRS does not appear to provide an assessment of longevity risk. The valuation report simply states that experience that differs from the assumptions will either increase or decrease costs. If GRS continues to identify this as a key risk, ASOP 51 requires that they also provide an assessment that takes into account “circumstances specific to the plan.”

- **Other Demographic Risk.** GRS provides an explanation of demographic risks but does not appear to provide any assessment of these risks. If GRS continues to identify this as a key...
SECTION III – SUPPORTING ANALYSIS

risk, ASOP 51 requires that they also provide an assessment that takes into account “circumstances specific to the plan.”

ASOP 51 requires the actuary to recommend a more detailed assessment of risks if it “would be significantly beneficial.” GRS adequately identified the primary drivers of these risks, provided background information and assessments about these identified risks, but did not in our opinion adequately communicate the significance of these risks to this Plan. That could have been achieved if GRS included additional stress testing for each risk identified in the report. GRS indicated that an additional risk assessment was performed. However, there is no communication about the findings from the additional risk assessment or any indication of where to find the additional risk assessment.

Section 3.2 of ASOP 51 requires the actuary to identify risks that “may reasonably be anticipated to significantly affect the plan’s future financial condition.” The risks currently identified appear to largely duplicate the list of examples in ASOP 51 and could apply to almost any pension plan.

In future valuations, we recommend that the actuary explain how each risk identified would significantly affect the specific plan’s future financial condition (Recommendation #4).

For each risk identified above, Section 3.3 of ASOP 51 requires the actuary to provide an assessment that takes into account “circumstances specific to the plan.” For some of the identified risks, the actuary has provided a quantitative assessment specific to the plan while for other identified risks, the actuary has only provided a generic statement that could apply to any plan. We recommend that for each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of this plan (Recommendation #5).
Assessment of Actuarial Assumptions Used in the 2021 Valuation

A. Economic Assumptions

1. Interest Rate

The interest rate assumption (also called the investment return or discount rate) is the most impactful assumption affecting the required State contribution amount. This assumption, which is used to value liabilities for funding purposes, remained at 6.50% for the June 30, 2021 Actuarial Valuation.

After reviewing all the materials (see Appendix B of this report) that were made available, Cheiron concludes that the interest rate of 6.50% for this valuation is reasonable. Because it is reasonable to anticipate future reductions in the discount rate, we recommend that future stress testing include the impact to the required State contribution of potential reductions in the discount rate (Recommendation #3).

We recommend that the JRS Board continue to annually review the economic assumptions (interest rate and inflation), as was done for this valuation, prior to commencing the valuation work and adjust assumptions accordingly (Recommendation #6).

The items we considered and our rationale for these two recommendations are as follows:

- A review of the interest and inflation rates does not involve the collection of significant data and can be updated annually. In addition, it keeps the Board focused more closely on these critical assumptions.

- In GRS’s July 9, 2021 Economic Assumption Update Review, they presented the opinions of six independent investment consultants on the future long term expected earnings of the System and concluded that, the 20-year expected geometric mean of the JRS portfolio is 6.69% (See Exhibit C of the 2021 Economic Assumption Update Review). They also presented the distribution of the 20-year average geometric net nominal return for these six consultants. This showed that JRS has a 52.98% chance of meeting or exceeding the reduced 6.50% assumption (See the fifth column, bottom row). However, GRS in that same review presented a 10-year outlook which produced a 5.92% expected geometric mean with only 43.34% chance of meeting or exceeding 6.50%. This is why we find it is reasonable to anticipate a future reduction in the discount rate and recommend additional stress testing of a possible discount rate change in future valuations.
Distribution of 20-year Average Geometric Net Nominal Return

<table>
<thead>
<tr>
<th>Investment Consultant</th>
<th>Distribution of 20-Year Average Geometric Net Nominal Return</th>
<th>Probability of exceeding 6.50%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>40th</td>
<td>50th</td>
</tr>
<tr>
<td>1</td>
<td>5.57%</td>
<td>6.24%</td>
</tr>
<tr>
<td>2</td>
<td>5.88%</td>
<td>6.54%</td>
</tr>
<tr>
<td>3</td>
<td>5.94%</td>
<td>6.60%</td>
</tr>
<tr>
<td>4</td>
<td>6.07%</td>
<td>6.80%</td>
</tr>
<tr>
<td>5</td>
<td>6.17%</td>
<td>6.82%</td>
</tr>
<tr>
<td>6</td>
<td>6.54%</td>
<td>7.14%</td>
</tr>
<tr>
<td>Average</td>
<td>6.03%</td>
<td>6.69%</td>
</tr>
</tbody>
</table>

- GRS’s July 9, 2021 report on the 2021 Economic Assumption Update Review also presented the expectation of the Illinois State Board of Investment’s investment consultant Meketa Investment Group. After adjusting for GRS’s assumed rate of inflation, Meketa’s expected 20-year geometric average return of the JRS portfolio is 6.60% (See Exhibit A of the GRS 2021 Economic Assumption Update Review). Based on the capital market assumptions provided by Meketa, JRS has a 51.54% chance of meeting or exceeding the assumption of 6.50%. Given that JRS is only 42.03% funded on a market asset value, an expectation of achieving the investment return only 51% of the time could result in cost increases following years that the returns are below the assumption.

- The combination of the expectations from the Illinois State Board of Investment’s investment consultant and the expectations from a variety of independent investment consultants supports the reasonableness of assuming a 6.50% interest rate for the current year.

- While the discount rate assumption should be based on the future expected investment returns for the System’s investment portfolio, survey information can provide an important context for evaluating the assumption. The Public Plans Database is maintained by a partnership between the Center for State and Local Government Excellence (SLGE) and the Center for Retirement Research at Boston College with support from the National Association of State Retirement Administrators (NASRA). This database contains historical information on large public pension plans, including key assumptions used in their actuarial valuations. The following chart shows the distribution of investment return assumptions for the 177 plans in the Public Plans Database with consistent information from 2002 through 2021 as of October 27, 2021.
Over the period shown, there continues to be a pattern of reducing discount rates partially reflecting long-term changes in capital markets, interest rates and underlying inflation. Of the 177 plans shown, 132 have reduced their discount rate assumption since 2016. For these 132 plans, the average reduction is 0.43%.

- Declining interest rates have forced pension plans to either reduce their discount rates, increase their exposure to investment risk, or some combination of the two. For example, as shown in the chart on the following page, in 2001 the yield on 10-year Treasury bonds (a proxy for a risk-free investment) was 5.3%. To achieve JRS’ assumed return of 8.0%, the System’s investments had to outperform the yield on the 10-year Treasury by 2.7%. As of June 2021, the yield on the 10-year Treasury is now 1.5%, and to achieve JRS’ assumed return of 6.5%, the System’s investments need to exceed the 10-year Treasury yield by 5.0%. So, even though JRS has reduced its assumption by 150 basis points, it still has to take more investment risk in 2021 to meet its assumption than it did in 2001. By reducing the investment return assumption, plans are more likely to meet their funding goals without requiring investment performance so much in excess of the risk-free rate.
JRS has experienced a slightly negative cash flow for FY 2021 (contribution income less benefits and expense payouts). The negative cash flow of JRS is currently -0.82% of assets. Negative cash flow is expected to grow in the coming years as shown in the graph on page 10 and table 4d of the draft 2021 Actuarial Valuation. When short-term returns are expected to be lower than the long-term expectations, which is the current case with JRS, a plan with negative cash flows will have actuarial returns (i.e., dollar-weighted returns) that are less than their “time-weighted” returns.

2. Inflation Assumption

As recommended in the GRS July 9, 2021 report on the 2020 Experience Study, the inflation assumption of 2.25% was maintained for the June 30, 2021 Actuarial Valuation.

We find the 2.25% inflation assumption to be reasonable.

Our rationale for concurring with the 2.25% assumption:

- GRS’s July 9, 2021 review of economic assumptions included a survey of the inflation assumptions of independent investment consultants. The 6 investment consulting firms with longer time horizons (20+ years) reported an average of 2.27% and ranged from 1.80% to 2.60%. The 12 firms with a shorter time horizon reported an average of 2.08% and ranged from 1.75% to 2.30%.
GRS’s July 9, 2021 review of economic assumptions also included the forward-looking inflation forecasts from the Federal Reserve Bank of Cleveland as of December 1, 2020. This forecast shows inflation over the next 10 years of 1.42% increasing to 1.90% over 30 years.

The August 2021 Old-Age, Survivors, and Disability Insurance (OASDI) Trustees Report projects that over the long-term (next 75 years), inflation will average between 1.8% and 3.0% ([http://www.ssa.gov/oact/tr/2021/tr2021.pdf](http://www.ssa.gov/oact/tr/2021/tr2021.pdf)). Under the intermediate cost projection, the Social Security Administration uses an assumption of 2.4%.

The chart below shows the distribution of inflation expectations for the Third Quarter 2021 survey of professional economic forecasters published by the Philadelphia Federal Reserve, the 2021 Horizon survey of investment consultant capital market assumptions (20-year), and the 2020 inflation assumptions used by plans in the Public Plans Database compared to the JRS assumption (indicated by the gold diamonds). The assumption of 2.25% is near the middle of the range projected by professional economic forecasters and investment consultants and is on the low end of the range used by other public plans.

<table>
<thead>
<tr>
<th>Economic Forecasters</th>
<th>Horizon Survey</th>
<th>Public Plans Database</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum</td>
<td>2.00%</td>
<td>1.70%</td>
</tr>
<tr>
<td>25th Percentile</td>
<td>2.25%</td>
<td>2.00%</td>
</tr>
<tr>
<td>50th Percentile</td>
<td>2.44%</td>
<td>2.10%</td>
</tr>
<tr>
<td>75th Percentile</td>
<td>2.60%</td>
<td>2.20%</td>
</tr>
<tr>
<td>Maximum</td>
<td>3.00%</td>
<td>3.00%</td>
</tr>
</tbody>
</table>
3. Salary (Annual Compensation) Increase Assumption

The salary increase assumption for uncapped payroll is 2.50% per year, compounded annually for all active members, regardless of age or service. It includes components of 2.25% per annum for inflation and 0.25% per annum for productivity.

We find the assumption and the basis for setting the assumption reasonable and consistent with the inflation assumption.

*Our rationale for concurring with GRS’s recommended salary increase assumption:*

- The following chart shows the average nominal and real increases in wages over the last 10 and 20 years for State governments, local governments, and National Average Wages. State and local government data is from the Quarterly Census of Employment and Wages as published by the Bureau of Labor Statistics. National Average Wages is published by the Social Security Administration.

<table>
<thead>
<tr>
<th>Average Wage Increases</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Govt Wages</td>
</tr>
<tr>
<td>10 years</td>
</tr>
<tr>
<td>Avg Nominal Increases</td>
</tr>
<tr>
<td>3.3% 3.3%</td>
</tr>
<tr>
<td>3.3% 3.2%</td>
</tr>
<tr>
<td>3.3% 3.2%</td>
</tr>
</tbody>
</table>

- The August 2021 Old-Age, Survivors, and Disability Insurance (OASDI) Trustees Report projects that over the long-term (next 75 years), real wage differential will average somewhere between 0.53% and 1.77%. Under the intermediate cost projection, the Social Security Administration uses an assumption of 1.15%.

- In our own experience with our public sector pension plans (about 60 large plans), we have witnessed a continued trend of lower salary increases for public sector employees.
SECTION III – SUPPORTING ANALYSIS

4. **Cost of Living Adjustment Assumption**

   While Tier 1 members receive an annual automatic three percent COLA, Tier 2 members receive an annual increase equal to the lesser of the three percent received by Tier 1 and the annual change in the Consumer Price Index for all Urban Consumers.

   **We find the assumption and the basis for setting it reasonable.**

5. **Capped Pay Assumption**

   The Tier 2 capped payroll growth is 2.25% per year, compounded annually, which is the inflation assumption.

   **We find the assumption reasonable.**

6. **Expenses**

   Expenses are expected to increase with the projected capped payroll at 2.25% and are included in the service cost.

   **We find the assumption reasonable.**
B. Demographic Assumptions

In its annual actuarial valuation reports, GRS regularly reports sources of liability gains and losses. In the draft June 30, 2021 Actuarial Valuation, these are shown on page 21. In the chart below, we have collected similar data from past valuation reports dating back to 2012 and use these to present a historical review of past demographic and salary increase experience gains and losses.

The following chart shows the pattern of annual gains and losses attributable to eight different sources as shown in the legend. When the colored bar slices appear above zero on the Y-axis, it represents an experience loss with the value representing the increase in liabilities over what was expected. When the bar is below zero, it represents an experience gain for that year with liabilities less than expected. The net liability (gains)/losses are shown by the black line. This net (gain)/loss as a percent of liability is shown above the bars.

Key observations from this chart are as follows:

1. There have been salary losses the last two years after consistent gains earlier in the period shown. However, as discussed in the salary assumption section, this is likely to be a reflection of economic environment rather than a problem with the long-term assumption.

2. There has been a loss due to retirement in each of the last seven years.

3. Retiree mortality and termination have both been volatile over recent years.
Below we summarize the demographic assumptions that we reviewed, and we have concluded all are reasonable and meet the requirements of ASOP No. 35, Section 3.3.4.

1. Mortality

*Post-Retirement Mortality*

The mortality basis was updated with the June 30, 2019 Actuarial Valuation and is based on the Pub-2010 Above-Median Income General Healthy Retiree Mortality tables, sex distinct, with scaling factors of 102 percent for males and 98 percent for females, with generational mortality improvement using the MP-2018 two-dimensional mortality improvement scales.

*Pre-Retirement Mortality*

The mortality basis was updated with the June 30, 2019 Actuarial Valuation and is based on the Pub-2010 Above-Median Income General Employee Mortality tables, sex distinct, with scaling factors of 99 percent for males and females, and with generational mortality improvement using the MP-2018 two-dimensional mortality improvement scales.

Future mortality improvements are found by projecting the base mortality tables forward from the base year of 2010 using the MP-2018 mortality improvement scale.

2. Termination

Overall termination rates were decreased based on the 2018 Actuarial Experience Study for valuations beginning with the June 30, 2019 Actuarial Valuation.

Illustrative rates of withdrawal from the Plan are as follows:

<table>
<thead>
<tr>
<th>Termination Rates</th>
<th>Males</th>
<th>Females</th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td>0.0129</td>
<td>0.0162</td>
</tr>
<tr>
<td>35</td>
<td>0.0124</td>
<td>0.0162</td>
</tr>
<tr>
<td>40</td>
<td>0.0108</td>
<td>0.0162</td>
</tr>
<tr>
<td>45</td>
<td>0.0095</td>
<td>0.0162</td>
</tr>
<tr>
<td>50</td>
<td>0.0083</td>
<td>0.0158</td>
</tr>
<tr>
<td>55</td>
<td>0.0071</td>
<td>0.0092</td>
</tr>
<tr>
<td>60</td>
<td>0.0059</td>
<td>0.0074</td>
</tr>
<tr>
<td>65</td>
<td>0.0047</td>
<td>0.0057</td>
</tr>
</tbody>
</table>

It is assumed that terminated employees will not be rehired. The rates apply only to employees who have not fulfilled the service requirement necessary for retirement at any given age.
3. Retirement

Overall retirement rates were decreased based on the 2018 Actuarial Experience Study for valuations beginning with the June 30, 2019 Actuarial Valuation.

Assumed retirement rates are as follows:

<table>
<thead>
<tr>
<th>Retirement Rates – Tier 1</th>
<th>Males</th>
<th>Females</th>
</tr>
</thead>
<tbody>
<tr>
<td>55-59</td>
<td>5.50%</td>
<td>8.50%</td>
</tr>
<tr>
<td>60</td>
<td>9.00%</td>
<td>9.00%</td>
</tr>
<tr>
<td>61-65</td>
<td>11.00%</td>
<td>11.00%</td>
</tr>
<tr>
<td>66-70</td>
<td>12.00%</td>
<td>12.00%</td>
</tr>
<tr>
<td>70-74</td>
<td>13.00%</td>
<td>13.00%</td>
</tr>
<tr>
<td>75-79</td>
<td>14.00%</td>
<td>14.00%</td>
</tr>
<tr>
<td>80+</td>
<td>100.00%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Retirement Rates – Tier 2</th>
<th>Male &amp; Female</th>
</tr>
</thead>
<tbody>
<tr>
<td>62</td>
<td>11.00%</td>
</tr>
<tr>
<td>63</td>
<td>12.00%</td>
</tr>
<tr>
<td>64</td>
<td>13.00%</td>
</tr>
<tr>
<td>65</td>
<td>14.00%</td>
</tr>
<tr>
<td>66</td>
<td>14.00%</td>
</tr>
<tr>
<td>67</td>
<td>30.00%</td>
</tr>
<tr>
<td>68-69</td>
<td>12.00%</td>
</tr>
<tr>
<td>70</td>
<td>13.00%</td>
</tr>
<tr>
<td>71</td>
<td>10.00%</td>
</tr>
<tr>
<td>72</td>
<td>11.00%</td>
</tr>
<tr>
<td>73</td>
<td>12.00%</td>
</tr>
<tr>
<td>74</td>
<td>13.00%</td>
</tr>
<tr>
<td>75-79</td>
<td>14.00%</td>
</tr>
<tr>
<td>80</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

4. Disability

No assumption for disability was assumed.

5. Spouse’s Age

The female spouse is assumed to be four years younger than the male spouse.
SECTION III – SUPPORTING ANALYSIS

6. New Entrants

The new entrant profile includes uncapped and capped salary information. New entrants are assumed to enter with an average age of 47.75, average uncapped pay of $209,603, average capped pay of $126,375, and with 65.39% male. The size of the active group is assumed to remain level at the number of actives as of the valuation date. The average increase in uncapped payroll for the projection period is 2.50% per annum. The average increase in capped payroll for the projection period is 2.25% percent per year.

7. Decrement Timing

All decrements are assumed to occur beginning of year.

8. Decrement Relativity

Decrement rates are used directly from the experience study, without adjustment for multiple decrement table effects.

9. Decrement Operation

Turnover decrements do not operate after member reaches retirement eligibility.

10. Eligibility Testing

Eligibility for benefits is determined based upon the age nearest birthday and service on the date the decrement is assumed to occur.

11. Marriage Assumption

80.0 percent of active and retired participants are assumed to be married.

12. Employee Contribution Election

All judges are assumed to elect to contribute only on increases in salary when eligible for this provision.

13. 415(b) and 401(a)(17) Limits

No explicit assumption is made with respect to these items.
SECTION III – SUPPORTING ANALYSIS

Other Assumptions as a result of Public Act 96-0889

Members hired after December 31, 2010 are assumed to make contributions on salary up to the final average compensation cap in a given year until this plan provision or administrative procedure is clarified.

State contributions, expressed as a percentage of pay, are calculated based upon capped pay.
C. Funding Methods

Actuarial funding methods consist of three components: (1) the actuarial cost method, which is the attribution of total costs to past, current, and future years; (2) the asset valuation method (i.e., asset smoothing); and (3) the amortization method.

1. Actuarial Cost Method

The System uses the projected unit credit cost method (PUC) to assign costs to years of service, as required under the Pension Code (40 ILCS 5/18). We have no objections with respect to using the PUC method, although we would prefer the Entry Age Normal (EAN) cost method, as it is more consistent with the requirement in 40 ILCS 5/18-131 for level percentage of pay funding.

Under the PUC method, which is used by some public sector pension funds, the benefits of active participants are calculated based on their compensation projected with assumed annual increases to ages at which they are assumed to leave the active workforce by any of these causes: retirement, disability, turnover, or death. Only past service (through the valuation date, but not beyond) is taken into account in calculating these benefits. The present value of these benefits based on past service and future compensation is the actuarial liability for a given active participant. Under the PUC cost method, the value of an active participant’s benefits tends to increase more sharply over his or her later years of service than over his or her earlier ones. While the PUC method is not an unreasonable method, as a result of this pattern of benefit values increasing, more plans use the EAN cost method to mitigate this effect. It should also be noted that the EAN cost method is the required method to calculate liability for GASB Nos 67 and 68.

2. Asset Valuation Method

The Actuarial Value of Assets for the System is a smoothed market value. Unanticipated changes in market value are recognized over five years in the Actuarial Value of Assets. The primary purpose for smoothing out gains and losses over multiple years is so fluctuations in the contributions will be less volatile over time than if based on the Market Value of Assets.

The 2020 Public Retirement Systems Study by the National Conference on Public Employee Retirement Systems (NCPERS) survey of 138 public retirement funds found that the majority of plans responding to the survey have a five-year smoothing period.

Smoothing the market gains and losses over a period of five years to determine the Actuarial Value of Assets is a generally accepted approach in determining actuarial cost, and we concur with its use.
3. *Amortization Method*

The mandated State contribution is based on a determination of the level percentage of payroll that is expected to achieve a 90% funded ratio in 2045. While not a traditional amortization method, this methodology effectively amortizes a portion of the unfunded actuarial liability over the remaining period until 2045, which is currently 25 years.

One of the principles of funding public plans identified by the American Academy of Actuaries is that there should be “a plan to make up for any variations in actual assets from the funding target within a defined and reasonable time period.” Because it only targets 90%, the State method does not include a plan to achieve the funding target over any period of time.

Typical public plan amortization methods are designed to increase each year by expected payroll growth. Under the State mandated method, however, the effective amortization payment increases each year by more than the expected growth in payroll. As a result, the State mandated method defers payments on the unfunded actuarial liability further into the future than under typical public plan amortization methods.
This section reviews the projections contained in the draft June 30, 2021 Actuarial Valuation of JRS. These projections are fundamental to the development of the required State contribution calculated under the current statutory funding requirement.

The following graphs are independent approximations of the projections performed by the State Actuary to verify that the System’s funding projections are reasonable. They do not reflect all the precision of the projections applied by the System’s actuary, but instead they are intended to verify the reasonableness of the modeling done by the System’s actuary.

The graph below shows our projection of the expected future liabilities and assets in the System through 2045. As pointed out on page 9 of the draft June 30, 2021 Actuarial Valuation, the majority of the funding of the System occurs in the 2nd half of the projections. The lines show the projected assets (market value and actuarial value), and the bars show the projected liabilities of the System. The funded ratio for every other year is shown at the top of the bars. For example, in 2032, the funded ratio is projected to be approximately 58% with assets being approximately $1.7 billion and liabilities being approximately $3.0 billion.

Source: Cheiron projection analysis.
When we compare our projected funded ratio against the results shown in the draft June 30, 2021 Actuarial Valuation, we find a close match in expected funded ratio. This close match of the funded ratio indicates that the projections done by the System’s actuary are reasonable.

Source: Cheiron projection analysis.
SECTION IV – PROJECTION ANALYSIS

The following graph shows the expected contribution calculated under the statutory method. The contribution as a percentage of payroll is shown above each bar. The value shown for the fiscal year ending 2022 was set based on the June 30, 2020 Actuarial Valuation. The current valuation is the basis for setting the rates starting July 1, 2022 (Fiscal Year Ending June 30, 2023). The contribution requirement has two components: 1) the employer normal cost, which is the approximate value of the amount of benefits accrued by participants not covered by employee contributions based on the statutory funding method; and 2) an amortization of the unfunded liability. The normal cost amounts are shown by the green bars and the amortization of the unfunded actuarial liability (UAL) amounts by the yellow bars. The percentages shown are the total contribution rates calculated by Cheiron, which are equal to the sum of the bars. The graph shows that a larger percentage of the total contribution is being made toward the UAL payment later in the period. The blue line shows the projected contribution rates as percentages of payroll from the draft June 30, 2021 Actuarial Valuation. The difference between Cheiron’s approximation and the System’s projections is the difference between the top of the bars and the line.

Our conclusion is that the projections performed by the System’s actuary are reasonable.
In this section, we examine the adequacy of the funding for the System, including funded ratio, the sources of changes in the unfunded actuarial liability (UAL), and projections of the UAL and statutory funding requirements compared to contributions needed to pay down the UAL.

The actuarial valuation report prepared by GRS includes both traditional actuarial measurements, as well as additional risk measurements that are shown on pages 13 to 17 of the draft June 30, 2021 Actuarial Valuation report. Given the unique and substantial funding challenges faced by the Illinois pension systems, this additional information is quite important and supplements the information we present here on funding adequacy to better inform the legislature and other stakeholders about the adequacy of the System’s funding.

**System Funded Ratio**

The first funding adequacy measure is the historical trend of the System’s funded ratio for the past ten years. Funded ratio for this purpose is defined as the ratio of the Market Value of Assets to the Actuarial Liability. The chart below shows JRS’ funded ratio since 2012 has gone from 28.6% funded to 47.2% funded in 2021, an increase in funded ratio of 18.6%. In addition to showing the funded ratio, this chart also shows the breakdown of the Plan’s liabilities by membership status:

- **Active liability** – the liability (attributable to service already performed) for future payments to members who are currently working in the System,
- **Deferred Vested liability** – the liability for future payments to members who are no longer working in the System, and
- **In-Pay liability** – the liability for future payments to retirees and beneficiaries who are currently receiving benefits.

This breakdown shows that today plan assets only cover about 62% of the liabilities for just those members currently in pay status.

![Liability and Funded Ratio](chart)

Source: Cheiron analysis of funding adequacy.
**SECTION V – ANALYSIS OF FUNDING ADEQUACY**

**Sources of Changes in the UAL**

As shown in the chart below, JRS’ unfunded actuarial liability (UAL) has grown from about $1.34 billion in 2011 to $1.69 billion in 2021, an increase of about $355 million. In order to understand how to reverse this trend, it is important to understand the sources contributing to it.

![Historical Growth in UAL](chart)

Source: Cheiron analysis of funding adequacy.

The changes to the UAL from June 30, 2011 to June 30, 2021 can be separated into the following components:

- **Contribution Deficiencies** – Contributions that are less than the tread water contribution causes the UAL to increase. The tread water contribution consists of two components: the normal cost, which is the cost of benefits earned in a given year, and the interest on the unfunded actuarial liability. This sum is referred to as the tread water contribution because it is the contribution necessary so that the UAL will remain constant, or “tread water” (absent experience gains or losses). The difference between actual contributions and the tread water contributions increased the UAL by $218.2 million over this period.

- **Assumption Changes** – Changes to actuarial assumptions over this period increased the UAL by $169.9 million. A positive aspect of the UAL increases due to assumption changes is that they will result in liability measurements that more accurately reflect future expectations.

- **Plan Changes** – Modifications to the design of the Plan had a negligible impact over this period as most of the changes only affected future benefits.
• **Liability (Gain) or Loss** – The changes in the UAL due to liability experience (i.e., mortality, terminations, salary increases, etc.) were generally small and only increased the UAL by $14.7 million over this period.

• **AVA (Actuarial Value of Assets) Investment (Gain) or Loss** – The net investment gain or loss due to assets earning more or less than assumed increased the UAL over this period decreased the UAL by $47.6 million.

The chart below shows the changes in UAL each year broken into these five components. The sum of all the components (total change in UAL) is shown as the black line. Values of each component as well as total by year are shown in the chart along with the totals for the period.

We expect that this chart will help stakeholders understand the sources of growth in the UAL over recent years and inform discussions about the current funding requirements and adequacy.
Actual Contributions Compared to Tread Water Contribution

One of the persistent sources of the increase in UAL is due to actual contributions to the System being less than the tread water contribution (the amount needed to prevent the UAL from increasing if all assumptions are met). Until 2021, these contribution deficiencies added between $0.3 and $75 million to the UAL each year over the historical period shown.

As the chart below shows, actual contributions had been significantly less than the tread water cost prior to 2014. Each year that total contributions remain below the tread water cost (blue line), the UAL is expected to grow. As shown in the graph below the contributions from the State have increased significantly and the total contribution reached the tread water contribution in 2021 and has begun to pay down the UAL.

Source: Cheiron analysis of funding adequacy.
The next chart shows that if the Minimum Required Contributions continue to be made each year and all other assumptions are met, the UAL is projected to decline each year.

Source: Cheiron analysis of funding adequacy.
Net Cash Flow Analysis

The Plan’s net cash flow is defined as State and Member contributions less benefit payments and administrative expenses. The more negative net cash flow is as a percentage of the plan’s assets, the more vulnerable the Plan is to market downturns. When a pension plan has more payouts than contributions and suffers an investment loss, it is left with fewer assets to invest and recapture during a recovery.

Looking at the following chart, JRS is neither mature nor immature on a net cash flow basis (black line), as the net cash flow has been close to zero relative to the size of the System’s assets. This measure should continue to be monitored as negative cash flow increases the System’s vulnerability to market downturns. The teal line shows net cash flow as a percent of Market Value of Assets on the right-side axis. The greater the negative cash flows are relative to plan assets the more vulnerable a plan is to market downturns. This is because once there is a market downturn, the plan assets lose both on the return and the negative cash flow, leaving it with a lower asset base from which to recover from the loss.

Source: Cheiron analysis of funding adequacy.

GRS’s graph of cash flows on page 10 of the June 30, 2021 Actuarial Valuation shows that benefit payments and expenses in the years 2031 to 2036 are expected to come close to exceeding investment income at 6.50%. This should be monitored closely as assets can deteriorate quickly if investments earn less than what is assumed.
**Response to Recommendations in 2020**

In the State Actuary’s Preliminary Report on the Judges’ Retirement System of Illinois presented December 18, 2020, Cheiron made several recommendations. Below we summarize how these recommendations were reflected in either the System’s comments last year or in this year’s draft June 30, 2021 Actuarial Valuation.

<table>
<thead>
<tr>
<th>Recommendations to Retirement System from 2020 State Actuary Report</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. We continue to recommend that the JRS Board periodically retain the services of an independent actuary to conduct a full scope actuarial audit. Such an audit should fully replicate the original actuarial valuation, based on the same census data, assumptions, and actuarial methods used by the System’s actuary</td>
<td>Implemented</td>
<td>We have been informed by SRS Executive Secretary Tim Blair that an independent actuary has been retained to perform an audit and is expected to present their results to the JRS Board in January 2022. Recommendation removed.</td>
</tr>
<tr>
<td>2. We continue to recommend that the funding method be changed to fully fund plan benefits and discontinue the systematic underfunding of JRS. Continuing the practice of underfunding future accruals increases the risk of the System becoming unsustainable. We understand that changing the funding method is under the jurisdiction of State law and not the Retirement System</td>
<td>Partially Implemented</td>
<td>The System has adopted a funding policy that would provide for annual State contributions, the “Actuarially Determined Contribution”, and is used for informational purposes only. GRS continues to include strong language throughout their report recommending the use of an actuarially sound method and stating clearly that the statutory method is not actuarially sound. We find these statements to be appropriate and support their continuation. Recommendation repeated.</td>
</tr>
<tr>
<td>3. We continue to recommend that GRS include stress testing of the System within the valuation report and include a thorough explanation of the implications that volatile investment returns and a variety of other stressors (e.g., membership declines, lower salary growth) can have on future State costs. In particular, the tests</td>
<td>Implemented</td>
<td>JRS added stress testing in appendices to the final Actuarial Valuation Report in a letter dated December 10, 2020. Recommendation continued.</td>
</tr>
</tbody>
</table>
## STATUS OF RECOMMENDATIONS FROM THE 2020 STATE ACTUARY REPORT

<table>
<thead>
<tr>
<th>Recommendations to Retirement System from 2020 State Actuary Report</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>should illustrate the potential stresses on the System and its contributing sponsors so that an assessment of sustainability can be made. GRS did include stress testing in last year’s final report but did not include such stress testing in this year’s draft report or in any supplemental report.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. As required by section 3.3 of ASOP 51, we recommend that GRS provide an assessment for each of the six key risks they have identified.</td>
<td>Not Implemented</td>
<td>While, the System noted in its December 11, 2020 response that the ASOP 51 disclosure may be expanded to address many of Cheiron’s recommendations, the final 2020 Actuarial Valuation Report did not provide the recommended assessments. <strong>Recommendation modified.</strong></td>
</tr>
<tr>
<td>5. We recommend the JRS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly.</td>
<td>Implemented</td>
<td>GRS has continued to do this, most recently providing a review in the 2020 Actuarial Experience Study report dated July 9, 2021. We will continue to include this recommendation each year. <strong>Recommendation continued.</strong></td>
</tr>
<tr>
<td>6. We recommend that an explanation be provided as to how the maturity measures calculated and disclosed by GRS help the reader to understand the risks identified and that historical values that are significant to understanding the risks identified be disclosed along with an explanation of how they help the reader understand the risks identified by GRS.</td>
<td>Implemented</td>
<td>GRS expanded its description of maturity measures in the final Actuarial Valuation Report dated January 4, 2021. <strong>Recommendation removed.</strong></td>
</tr>
<tr>
<td>Recommendations to Retirement System from 2020 State Actuary Report</td>
<td>Status</td>
<td>Comments</td>
</tr>
<tr>
<td>---------------------------------------------------------------------</td>
<td>-------------</td>
<td>------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>7. We recommend that GRS review its disclosures related to ASOP 56 for the next valuation report to ensure that the disclosures clearly identify the purpose of each model, any material limitations of each model, and any other applicable required disclosures under ASOP 56.</td>
<td>Implemented</td>
<td>In its transmittal letter to the June 30, 2021 Actuarial Valuation Report GRS the recommended ASOP 56 disclosures were made. Recommendation removed.</td>
</tr>
</tbody>
</table>
Chapter Five

Preliminary Report on the General Assembly Retirement System

In accordance with 30 ILCS 5/2-8.1, Cheiron, the State Actuary, submitted a preliminary report to the Board of Trustees of the General Assembly Retirement System (GARS) concerning proposed certifications of required State contributions submitted to Cheiron by the Board. The preliminary report was submitted to GARS on November 30, 2021. The preliminary report was based on Cheiron’s review of actuarial assumptions included in GARS’ 2021 Actuarial Valuation Report.

Following is Cheiron’s final preliminary report on the General Assembly Retirement System. GARS’ written response, provided on December 10, 2021, can be found in Appendix C.

<table>
<thead>
<tr>
<th>OVERVIEW GENERAL ASSEMBLY RETIREMENT SYSTEM as of June 30, 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial accrued liability</td>
</tr>
<tr>
<td>Actuarial value of assets</td>
</tr>
<tr>
<td>Unfunded liability</td>
</tr>
<tr>
<td>Funded ratio</td>
</tr>
<tr>
<td>Employer normal cost</td>
</tr>
<tr>
<td>State contribution (FY23)</td>
</tr>
<tr>
<td>Active members</td>
</tr>
<tr>
<td>Inactive members</td>
</tr>
<tr>
<td>Current benefit recipients</td>
</tr>
<tr>
<td>Total membership</td>
</tr>
<tr>
<td>Interest rate assumption</td>
</tr>
<tr>
<td>Inflation assumption</td>
</tr>
<tr>
<td>Actuarial cost method</td>
</tr>
<tr>
<td>Asset valuation method</td>
</tr>
</tbody>
</table>

Executive Director: Tim Blair
Actuarial Firm: Gabriel, Roeder, Smith & Company

Source: June 30, 2021 GARS actuarial valuation report.
December 15, 2021

Mr. Frank Mautino
Auditor General
740 East Ash Street
Springfield, Illinois 62703

Board of Trustees
General Assembly Retirement System of Illinois
2101 South Veterans Parkway
P.O. Box 19255
Springfield, Illinois 62794-9255

Dear Trustees and Auditor General:

In accordance with the Illinois State Auditing Act (30 ILCS 5/2-8.1), Cheiron is submitting this preliminary report concerning the proposed certification prepared by Gabriel, Roeder, Smith & Company (GRS) of the required State contribution to the General Assembly Retirement System of Illinois (GARS or System) for Fiscal Year 2023.

In summary, we believe that the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable. We also find that the certified contributions, notwithstanding the inadequate State funding requirements that do not conform to generally accepted actuarial principles and practices, were properly calculated in accordance with State law.

Section I of this report describes the review process undertaken by Cheiron. Section II summarizes our findings and recommendations. Section III provides the supporting analysis for those findings and presents more details on our assessment of the actuarial assumptions and methods employed in GRS’s Actuarial Certification, as well as our assessment of GRS’s determination of the required State contribution for Fiscal Year 2023. Section III also includes comments on other issues impacting the funding of the General Assembly Retirement System, including the implications of Article 2 of the Illinois Pension Code, which establishes the statutory minimum funding requirements for the System. We agree with GRS that the statutory mandated minimum funding requirements have been and continue to be inadequate. In addition, the past inadequate funding has resulted in current and future contribution levels, measured as a percent of payroll, to be among the highest in the country. Making adequate contributions in the future to fully fund the system will be challenging. Section IV reviews the projections contained in the draft June 30, 2021 Actuarial Valuation. Finally, Section V provides an analysis of funding adequacy.

In preparing this report, we relied on information (some oral and some written) supplied by GARS and GRS. This information includes actuarial assumptions and methods adopted by the GARS Board, System provisions, the draft June 30, 2021 Actuarial Valuation, the draft 2021 GASB 67/68 Report, the 2021 Valuation Results presentation, the 2018 Actuarial Experience Review, the 2021 Economic Assumption Update Review, minutes of the plan year 2020 and January 2021 GARS
Board of Trustees
December 15, 2021
Page ii

Board of Trustee meetings, and agendas of the April 2021 and October 2021 GARS Board of Trustee meetings. A detailed description of all information provided for this review is contained in Appendix B.

This report and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices and our understanding of the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board as well as applicable laws and regulations. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this report. This report does not address any contractual or legal issues. We are not attorneys, and our firm does not provide any legal services or advice.

This report was prepared exclusively for the Office of the Auditor General and the General Assembly Retirement System of Illinois for the purpose described herein. Other users of this report are not intended users as defined in the Actuarial Standards of Practice, and Cheiron assumes no duty or liability to any other user.

Sincerely,
Cheiron

[Signature]
Jake Libauskas, FSA, FCA, MAAA, EA
Consulting Actuary

[Signature]
Kenneth A. Kent, FSA, FCA, MAAA, EA
Principal Consulting Actuary
Illinois Public Act 097-0694 (the Act) amended the Illinois State Auditing Act (30 ILCS 5/2-8.1) and requires Cheiron, as the State Actuary, to review the actuarial assumptions and valuation of the General Assembly Retirement System of Illinois (GARS or System) and to issue to the GARS Board this preliminary report on the proposed certification prepared by Gabriel, Roeder, Smith & Company (GRS) of the required State contributions for Fiscal Year (FY) 2023. The purpose of this review is to identify any recommended changes to the actuarial assumptions for the GARS Board to consider before finalizing its certification of the required State contributions for FY 2023.

While the Act states that just the actuarial assumptions and valuation are to be reviewed, we have also reviewed the actuarial methodologies (funding and asset smoothing methods) employed in preparing the Actuarial Certification, as these methods can have a material effect on the amount of the State contribution being certified. Finally, we have offered our opinion on the implications of Article 2-124 of the Illinois Pension Code, which impacts the contribution amount certified by GRS.

In conducting this review, Cheiron reviewed the draft June 30, 2021 Actuarial Valuation, the draft 2021 GASB 67/68 Report, the 2021 Actuarial Results presentation, the 2018 Actuarial Experience Review, the 2021 Economic Assumption Update Review, minutes of the plan year 2020 and January 2021 Board of Trustees meetings, and agendas of the April 2021 and October 2021 GARS Board of Trustee meetings. The materials we reviewed are listed in Appendix B.

In addition to reviewing the Actuarial Certification of the required State contribution to GARS, the Act requires the State Actuary to conduct a review of the “actuarial practices” of the Board. While the term “actuarial practices” was not defined in the Act, we continue to interpret this language to mean that we review: (1) the use of a qualified actuary (as defined by the Qualification Standards of the American Academy of Actuaries) to prepare the annual actuarial valuation for determining the required State contribution; and (2) the conduct of periodic formal experience studies to justify the assumptions used in the actuarial valuation. In addition, we have included comments on actuarial communication and compliance with Actuarial Standards of Practice (ASOP) reflected in the draft June 30, 2021 Actuarial Valuation.
SECTION II – SUMMARY OF RECOMMENDATIONS

This section summarizes recommendations from our review of the actuarial assumptions and methods employed in the draft June 30, 2021 Actuarial Valuation of GARS, as well as the “actuarial practices” of the GARS Board. Section III of this report contains detailed analysis and rationale for these recommendations.

Proposed Certification of the Required State Contribution

Gabriel, Roeder, Smith & Company (GRS) has determined that the FY 2023 required State contribution calculated under the current statutory funding requirements is $27,174,000. We have verified the arithmetic calculations made by GRS to develop this required State contribution and have reviewed the assumptions on which it was based. We have accepted GRS’s annual projections of future payroll, total normal costs, employee contributions, combined benefit payments and expenses, and total contributions.

State Mandated Funding Method

1. We continue to recommend that the funding method be changed to fully fund plan benefits. Continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the System becoming unsustainable. Consequently, we recommend that the funding method maintain contributions at a level that is expected to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Recognition of Changes in Actuarial Assumptions

Public Act 100-0023 (P.A. 100-0023), effective July 6, 2017, modified the State’s funding policy to require that the contribution impact of all assumption changes be phased-in over a five-year period.

2. Because experience studies are performed every three years, we recommend that the phase-in period for the impact of assumption changes be reduced to three years. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Assessment of Actuarial Assumptions Used in the 2021 Valuation

30 ILCS 5/2-8.1 requires the State Actuary to identify recommended changes in actuarial assumptions that the GARS Board must consider before finalizing its certification of the required State contribution. We have reviewed all the actuarial assumptions used in the draft June 30, 2021 Actuarial Valuation and conclude that the assumptions are reasonable in general, based on the evidence provided to us.
Recommended Additional Disclosures for the 2021 Valuation

3. We continue to recommend that GRS include stress testing of the System within the valuation report and include a thorough explanation of the implications that volatile investment returns and a variety of other stressors (e.g., membership declines, lower salary growth) can have on future State costs. In particular, the tests should illustrate the potential stresses on the System and its contributing sponsors so that an assessment of sustainability can be made. These stress tests should include the impact to the required State contribution of potential reductions in the discount rate. GRS did not include stress testing in this year’s valuation report. In 2020, GRS also didn’t include stress testing in their initial report which Cheiron reviewed, but they did include stress testing in a final report submitted on January 4, 2021. We recommend that the final 2021 report include the stress testing.

Recommended Changes for Future Valuations

4. Section 3.2 of ASOP 51 requires the actuary to identify risks that “may reasonably be anticipated to significantly affect the plan’s future financial condition.” [emphasis added]. The risks currently identified appear to largely duplicate the list of examples in ASOP 51 and could apply to almost any pension plan. In future valuations, we recommend that the actuary explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition.

5. For each risk identified above, Section 3.3 of ASOP 51 requires the actuary to provide an assessment that takes into account “circumstances specific to the plan.” For some of the identified risks, the actuary has provided a quantitative assessment specific to the plan while for other identified risks, the actuary has only provided a generic statement that could apply to any plan. We recommend that for each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of this plan.

6. We recommend the GARS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation.

GASB 67 and 68

The 2021 GARS GASB 67 and 68 information was provided in a separate report. We find that the assumptions and methods used to prepare the 2021 GARS GASB 67 and 68 schedules are reasonable based on the evidence provided to us.
In this section we provide detailed analysis and supporting rationale for the recommendations that were presented in Section II of this report.

**Proposed Certification of the Required State Contribution**

As stated in our summary of recommendations in Section II, we have verified the arithmetic calculations made by GRS to develop the required State contribution, reviewed the assumptions on which it is based, and accepted GRS’s annual projections of future payroll, total normal costs, benefits, expenses, and total contributions. However, in accordance with 30 ILCS 5/2-8.1, our review does not include a replication of the actuarial valuation results.

In our reports since 2014, given the size of GARS, the System’s low funded ratio, the recent changes in legal requirements, and guidance issued by the Government Finance Officers Association, we had been recommending that the Board periodically undertake a full scope actuarial audit, utilizing the services of a reviewing actuary. We have been recently informed that the Board has selected an independent actuary to perform a full scope actuarial audit which is expected to be completed by January 2022.

**State Mandated Funding Method**

The Illinois Pension Code (40 ILCS 5/2-124) establishes a method that does not adequately fund the System, targeting the accumulation of assets equal to 90% of the actuarial liability in the year 2045. This contribution level does not conform to generally accepted actuarial principles and practices. Generally accepted actuarial funding methods target the accumulation of assets equal to 100% of the Actuarial Liability, not 90%.

**We continue to recommend that the funding method be changed to fully fund plan benefits** (Recommendation #1). The funding method should target 100% of the actuarial accrued liability. Contributions should remain at a level that is expected to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded. While making adequate contributions will be challenging, continuing the practice of underfunding the System increases the risk of needing even larger contributions in the future that may make the System unsustainable.

We have reviewed the funding policy adopted by the Board of Trustees. We agree that the policy is a reasonable method that conforms to the Actuarial Standards of Practice, and we agree with its use in the GASB report as an Actuarially Determined Contribution (ADC). The funding policy calls for a funding amount equal to the normal cost plus a closed 20-year amortization as a level percentage of capped payroll of the unfunded actuarial liability. This policy defines a method that would ultimately fully fund the Plan and falls within generally accepted actuarial funding methods currently in use for public plans. As of June 30, 2021, the remaining amortization period is 14 years. According to this methodology, the State’s contribution amount would be $35,160,750 for FY 2023. It is important though to recognize that this policy does not affect the actual funding of...
the System. The board adopted funding policy conforms to a goal of full funding within a reasonable time period and with generally accepted actuarial principles and practices.

Recognition of Changes in Actuarial Assumptions

Public Act 100-0023 (P.A. 100-0023), effective July 6, 2017, modified the State’s funding policy to require that the contribution impact of all assumption changes, including changes prior to P.A. 100-0023, be phased-in over a five-year period. As such, the Act delays the funding of the System. Assumption changes are intended to more accurately anticipate the obligations for funding based on the most recent experience analysis and forward-looking changes to future investment returns. However, only one-fifth of the impact of these changes are now recognized from the date of adoption. The remainder of the impact is recognized over four additional years such that the full impact is only recognized at the end of a five-year period beginning at the date of adoption. This phase-in provides time to adjust to a higher level of contributions. However, the Conference of Consulting Actuaries White Paper on Actuarial Funding Policies and Practices for Public Pension Plans recommends that the “phase-in period should be no longer than the time period until the next review of assumptions.” Since experience studies are performed every three years, we recommend the phase-in period for the impact of assumption changes be reduced to three years (Recommendation #2).

Stress Testing

Based on the draft June 30, 2021 Actuarial Valuation, the funded ratio, measured as the ratio of the actuarial value of assets to the Actuarial Liability, is currently at 19.3%. The unfunded actuarial accrued liability is currently about $302 million and is expected to decrease over time. The required State contribution rate is currently 286.06% of payroll for the current fiscal year and is scheduled to decrease to 278.65% of payroll for FY 2023. However, if there is a significant market downturn, the unfunded actuarial liability could increase substantially and the required State contribution rate could increase significantly, putting the sustainability of the system further into question. Stress testing should be performed to better understand these risks and the potential advantages of additional contributions in the near term to maintain the sustainability of the system.

We continue to recommend that GRS include stress testing of the System within the valuation report and include a thorough explanation of the implications that volatile investment returns and a variety of other stressors (e.g., membership declines, lower salary growth) can have on future State costs. In particular, the tests should illustrate the potential stresses on the System and its contributing sponsors so that an assessment of sustainability can be made (Recommendation #3).

This should include an analysis and discussion of the impact on the annual contribution requirement of the alternative scenarios tested. As mentioned in Section II of this report, GRS did include the recommended stress testing in their final valuation report for 2020 delivered in January of 2021. We recommend that the final 2021 report also include the stress testing outlined here.
Actuarial Standard of Practice 51

A new Actuarial Standard of Practice (ASOP) became effective for GARS actuarial valuations starting June 30, 2019. ASOP 51 provides guidance to actuaries on the assessment and disclosure of risks to help readers of the actuarial valuation report “understand the effects of future experience differing from the assumptions used” and “the potential volatility of future measurements resulting from such differences”.

ASOP 51’s first requirement is to “identify risks that, in the actuary’s professional judgment, may reasonably be anticipated to significantly affect the plan’s future financial condition.” GRS identified six sources of risk to GARS: investment risk, asset/liability mismatch risk, contribution risk, salary and payroll risk, longevity risk and other demographic risks. With the exception of the contribution risk due to the statutorily required amount of contributions, the risks GARS identified are relatively generic and would apply to most pension plans. We believe GARS should stress the net cash flow situation as that is expected to become a problem in the future.

ASOP 51 requires the actuary to assess each of the risks identified. While the assessment does not have to be quantitative, it does have to take into account the specifics of the individual plan. ASOP 51 also describes several quantitative methods that may be used to assess risk.

- **Investment Risk.** GRS included additional stress testing in the last year’s final actuarial valuation report that adequately assessed the investment risk with various investment return scenarios.

- **Asset/Liability Mismatch Risk.** GRS does not appear to provide an assessment of asset/liability mismatch risk other than to indicate that asset value changes that do not match liability changes will either increase or decrease costs. If GRS continues to identify this as a key risk, ASOP 51 requires that they also provide an assessment that takes into account “circumstances specific to the plan.”

- **Contribution Risk.** GRS discusses several issues with the statutorily required contribution amounts in the risk section as well as in other parts of the valuation report. The stress testing included in last year’s final actuarial valuation report adequately assessed the impact of a declining contribution base (i.e. payroll).

- **Salary and Payroll Risk.** The stress testing included in last year’s final actuarial valuation report adequately assessed the salary and payroll risk with alternative projected decreases in the active population.

- **Longevity Risk.** GRS does not appear to provide an assessment of longevity risk. The valuation report simply states that experience that differs from the assumptions will either increase or decrease costs. If GRS continues to identify this as a key risk, ASOP 51 requires
SECTION III – SUPPORTING ANALYSIS

that they also provide an assessment that takes into account “circumstances specific to the plan.”

- Other Demographic Risk. GRS provides an explanation of demographic risks but does not appear to provide any assessment of these risks. If GRS continues to identify this as a key risk, ASOP 51 requires that they also provide an assessment that takes into account “circumstances specific to the plan.”

ASOP 51 requires the actuary to recommend a more detailed assessment of risks if it “would be significantly beneficial.” GRS adequately identified the primary drivers of these risks, provided background information and assessments about these identified risks, but did not in our opinion adequately communicate the significance of all of these risks to this Plan. The stress testing included in last year’s final actuarial valuation report provided a quantitative assessment of the investment risk, contribution risk, and salary and payroll risk and we anticipate similar stress testing will be included in this year’s valuation actuarial valuation report. However, the other risks were only assessed with a generic statement that could apply to any pension plan.

Section 3.2 of ASOP 51 requires the actuary to identify risks that “may reasonably be anticipated to significantly affect the plan’s future financial condition.” The risks currently identified appear to largely duplicate the list of examples in ASOP 51 and could apply to almost any pension plan. In future valuations, we recommend that the actuary explain how each risk identified would significantly affect the specific plan’s future financial condition. (Recommendation #4)

For each risk identified above, Section 3.3 of ASOP 51 requires the actuary to provide an assessment that takes into account “circumstances specific to the plan.” For some of the identified risks, the actuary has provided a quantitative assessment specific to the plan while for other identified risks, the actuary has only provided a generic statement that could apply to any plan. We recommend that for each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of this plan. (Recommendation #5)
Assessment of Actuarial Assumptions Used in the 2021 Valuation

A. Economic Assumptions

1. Interest Rate

The interest rate assumption (also called the investment return or discount rate) is the most impactful assumption affecting the required State contribution amount. This assumption, which is used to value liabilities for funding purposes, remained at 6.50% for the June 30, 2021 Actuarial Valuation.

After reviewing all the materials (see Appendix B of this report) that were made available, Cheiron concludes that the interest rate of 6.50% for this valuation is reasonable. Because it is reasonable to anticipate future reductions in the discount rate, we recommend that future stress testing include the impact to the required State contribution of potential reductions in the discount rate (Recommendation #3).

We recommend that the GARS Board continue to annually review the economic assumptions (interest rate and inflation), as was done for this valuation, prior to commencing the valuation work and adjust assumptions accordingly (Recommendation #6).

The items we considered and our rationale for this recommendation are as follows:

- A review of the interest and inflation rates does not involve the collection of significant data and can be updated annually. In addition, it keeps the Board focused more closely on these critical assumptions.

- In GRS’s April 15, 2021 Economic Assumption Update Review, they presented the opinions of six independent investment consultants on the future expected earnings of the System and concluded that, adjusting for GRS’s assumed rate of inflation, the 20-year expected geometric mean of the GARS portfolio is 6.69% (See Exhibit C of the 2021 Economic Assumption Update Review). They also presented the distribution of the 20-year average geometric net nominal return for these six consultants. This showed that GARS has a 52.98% chance of meeting or exceeding the 6.50% assumption (See the fifth column, bottom row). However, GRS in that same review presented a 10-year outlook which produced an 5.92% expected geometric mean with only 43.34% chance of meeting or exceeding 6.5%. This is why we find it is reasonable to anticipate a future reduction in the discount rate and recommend additional stress testing of a possible discount rate change in future valuations.
SECTION III – SUPPORTING ANALYSIS

Distribution of 20-year Average Geometric Net Nominal Return

<table>
<thead>
<tr>
<th>Investment Consultant</th>
<th>Distribution of 20-Year Average Geometric Net Nominal Return</th>
<th>Probability of exceeding 6.50%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>40th</td>
<td>50th</td>
</tr>
<tr>
<td>1</td>
<td>5.57%</td>
<td>6.24%</td>
</tr>
<tr>
<td>2</td>
<td>5.88%</td>
<td>6.54%</td>
</tr>
<tr>
<td>3</td>
<td>5.94%</td>
<td>6.60%</td>
</tr>
<tr>
<td>4</td>
<td>6.07%</td>
<td>6.80%</td>
</tr>
<tr>
<td>5</td>
<td>6.17%</td>
<td>6.82%</td>
</tr>
<tr>
<td>6</td>
<td>6.54%</td>
<td>7.14%</td>
</tr>
<tr>
<td>Average</td>
<td>6.03%</td>
<td>6.69%</td>
</tr>
</tbody>
</table>

- GRS’s April 15, 2021 report on the 2021 Economic Assumption Update Review also presented the expectation of the Illinois State Board of Investment’s investment consultant Meketa Investment Group. After adjusting for GRS’s assumed rate of inflation, Meketa’s expected 20-year geometric average return of the GARS portfolio is 6.60% (See Exhibit A of the GRS 2021 Economic Assumption Update Review). Based on the capital market assumptions provided by Meketa, GARS has a 51.54% chance of meeting or exceeding the assumption of 6.50%. Given that GARS is only 21.31% funded on a market asset value basis, an expectation of achieving the investment return only 51% of the time could result in cost increases following years that the returns are below the assumption.

- The combination of the expectations from the Illinois State Board of Investment’s investment consultant and the expectations from a variety of independent investment consultants supports the reasonableness of assuming a 6.50% interest rate for the current year.

- While the discount rate assumption should be based on the future expected investment returns for the System’s investment portfolio, survey information can provide an important context for evaluating the assumption. The Public Plans Database is maintained by a partnership between the Center for State and Local Government Excellence (SLGE) and the Center for Retirement Research at Boston College with support from the National Association of State Retirement Administrators (NASRA). This database contains historical information on large public pension plans, including key assumptions used in their actuarial valuations. The following chart shows the distribution of investment return assumptions for the 177 plans in the Public Plans Database with consistent information from 2002 through 2021 as of October 27, 2021.
Over the period shown, there continues to be a pattern of reducing discount rates partially reflecting long-term changes in capital markets, interest rates and underlying inflation. Of the 177 plans shown, 132 have reduced their discount rate assumption since 2016. For these 132 plans, the average reduction is 0.43%.

- Declining interest rates have forced pension plans to either reduce their discount rates, increase their exposure to investment risk, or some combination of the two. For example, as shown in the chart on the following page, in 2001 the yield on 10-year Treasury bonds (a proxy for a risk-free investment) was 5.3%. To achieve GARS’ assumed return of 8.0%, the System’s investments had to outperform the yield on the 10-year Treasury by 2.7%. As of June 2021, the yield on the 10-year Treasury is now 1.5%, and to achieve GARS’ assumed return of 6.5%, the System’s investments need to exceed the 10-year Treasury yield by 5.0%. So, even though GARS has reduced its assumption by 150 basis points, it still has to take more investment risk in 2021 to meet its assumption than it did in 2001. By reducing the investment return assumption, plans are more likely to meet their funding goals without requiring investment performance so much in excess of the risk-free rate.
GARS has experienced positive cash flow for FY 2021 (contribution income less benefits and expense payouts). The positive cash flow of GARS is currently 2.50% of assets. However, negative cash flow is expected for FY 2023 through FY 2041 as shown in the graph on page 10 of the draft 2021 Actuarial Valuation. When short-term returns are expected to be lower than the long-term expectations, which is the current case with GARS, a plan with negative cash flows will have actuarial returns (i.e., dollar-weighted returns) that are less than their “time-weighted” returns.

2. Inflation Assumption

As recommended in the GRS April 15, 2021 Economic Assumption Update Review, the inflation assumption of 2.25% was maintained for the June 30, 2021 Actuarial Valuation.

We find the 2.25% inflation assumption to be reasonable.

Our rationale for concurring with the 2.25% assumption:

- GRS’s April 15, 2021 Economic Assumption Update Review included a survey of the inflation assumptions of independent investment consultants. The 6 investment consulting firms with longer time horizons (20+ years) reported an average of 2.27% and ranged from 1.80% to 2.60%. The 12 firms with a shorter time horizon reported an average of 2.08% and ranged from 1.75% to 2.30%.
SECTION III – SUPPORTING ANALYSIS

- GRS’s April 15, 2021 Economic Assumption Update Review also included the forward-looking inflation forecasts from the Federal Reserve Bank of Cleveland as of December 1, 2020. This forecast shows inflation over the next 10 years of 1.42% increasing to 1.90% over 30 years.

- The August 2021 Old-Age, Survivors, and Disability Insurance (OASDI) Trustees Report projects that over the long-term (next 75 years), inflation will average between 1.8% and 3.0% (http://www.ssa.gov/oact/tr/2021/tr2021.pdf). Under the intermediate cost projection, the Social Security Administration uses an assumption of 2.4%.

- The chart below shows the distribution of inflation expectations for the Third Quarter 2021 survey of professional economic forecasters published by the Philadelphia Federal Reserve, the 2021 Horizon survey of investment consultant capital market assumptions (20-year), and the 2020 inflation assumptions used by plans in the Public Plans Database compared to the GARS assumption (indicated by the gold diamonds). The assumption of 2.25% is near the middle of the range projected by professional economic forecasters and investment consultants, and is on the low end of the range used by other public plans.

<table>
<thead>
<tr>
<th>Economic Forecasters</th>
<th>Horizon Survey</th>
<th>Public Plans Database</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum</td>
<td>2.00%</td>
<td>1.70%</td>
</tr>
<tr>
<td>25th Percentile</td>
<td>2.25%</td>
<td>2.00%</td>
</tr>
<tr>
<td>50th Percentile</td>
<td>2.44%</td>
<td>2.10%</td>
</tr>
<tr>
<td>75th Percentile</td>
<td>2.60%</td>
<td>2.20%</td>
</tr>
<tr>
<td>Maximum</td>
<td>3.00%</td>
<td>3.00%</td>
</tr>
</tbody>
</table>
3. Salary (Annual Compensation) Increase Assumption

The salary increase assumption for uncapped payroll is 2.50% per year, compounded annually for all active members, regardless of age or service. It includes components of 2.25% per annum for inflation and 0.25% per annum for productivity.

We find the assumption and the basis for setting the assumption reasonable and consistent with the inflation assumption.

Our rationale for concurring with GRS’s recommended salary increase assumption:

- The following chart shows the average nominal and real increases in wages over the last 10 and 20 years for State governments, local governments, and National Average Wages. State and local government data is from the Quarterly Census of Employment and Wages as published by the Bureau of Labor Statistics. National Average Wages is published by the Social Security Administration.

<table>
<thead>
<tr>
<th>Average Wage Increases</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>State Govt Wages</strong></td>
</tr>
<tr>
<td><strong>Local Govt Wages</strong></td>
</tr>
<tr>
<td><strong>National Ave Wages</strong></td>
</tr>
<tr>
<td>10 years</td>
</tr>
<tr>
<td>3.3%</td>
</tr>
<tr>
<td>3.2%</td>
</tr>
<tr>
<td>1.6%</td>
</tr>
<tr>
<td>1.1%</td>
</tr>
<tr>
<td>3.3%</td>
</tr>
<tr>
<td>2.8%</td>
</tr>
<tr>
<td>1.6%</td>
</tr>
<tr>
<td>1.1%</td>
</tr>
</tbody>
</table>

- The August 2021 Old-Age, Survivors, and Disability Insurance (OASDI) Trustees Report projects that over the long-term (next 75 years), real wage differential will average somewhere between 0.53% and 1.77%. Under the intermediate cost projection, the Social Security Administration uses an assumption of 1.15%.

- In our own experience with our public sector pension plans (about 60 large plans), we have witnessed a continued trend of lower salary increases for public sector employees.
4. **Cost of Living Adjustment Assumption**

While Tier 1 members receive an annual automatic three percent COLA, Tier 2 members receive an annual increase equal to the lesser of the three percent received by Tier 1 and the annual change in the Consumer Price Index for all Urban Consumers.

*We find the assumption and the basis for setting it reasonable.*

5. **Capped Pay Assumption**

The Tier 2 capped payroll growth is 2.25% per year, compounded annually, which is the inflation assumption.

*We find the assumption reasonable.*

6. **Expenses**

Expenses are expected to increase with the projected capped payroll at 2.25% and are included in the service cost.

*We find the assumption reasonable.*
SECTION III – SUPPORTING ANALYSIS

B. Demographic Assumptions

In its annual actuarial valuation reports, GRS regularly reports sources of liability gains and losses. In the draft June 30, 2021 Actuarial Valuation, these are shown on page 21. In the chart below, we have collected similar data from past valuation reports dating back to 2012 and use these to present a historical review of past demographic and salary increase experience gains and losses.

The following chart shows the pattern of annual gains and losses attributable to eight different sources as shown in the legend. When the colored bar slices appear above zero on the Y-axis, it represents an experience loss with the value representing the increase in liabilities over what was expected. When the bar is below zero, it represents an experience gain for that year with liabilities less than expected. The net liability (gains)/losses are shown by the black line. This net (gain)/loss as a percent of liability is shown above the bars.

Key observations from this chart are as follows:

1. There have been termination losses in each of the last ten years, which means participants are not terminating. This should continue to be monitored and the assumption may need to be revised if the population continues to decline as expected.
2. Retirement experience has been volatile over the years, but the magnitude of the gains and losses has declined in recent years.

3. Mortality experience has also been volatile over the last several years. In years where there were losses, it means fewer deaths were observed than anticipated. Another way to express this is retirees are living longer than the current mortality assumption predicts. In contrast, in years where there were gains, it means there were more deaths than anticipated.

4. While there have been both salary gains and losses, total payroll has decreased significantly due to the decline in the active membership while the average pay has been relatively stable.

Below we summarize the demographic assumptions that we reviewed, and we have concluded all are reasonable and meet the requirements of ASOP No. 35, Section 3.3.4.

1. Mortality

   **Post-Retirement Mortality**

   The mortality basis was updated with the June 30, 2019 Actuarial Valuation and is based on the Pub-2010 Above-Median Income General Healthy Retiree Mortality tables, sex distinct, with scaling factors of 99 percent for males and females, with generational mortality improvement using the MP-2018 two-dimensional mortality improvement scales.

   **Pre-Retirement Mortality**

   The mortality basis was updated with the June 30, 2019 Actuarial Valuation and is based on the Pub-2010 Above-Median Income General Employee Mortality tables, sex distinct, with no scaling factors and with generational mortality improvement using the MP-2018 two-dimensional mortality improvement scales.

   Future mortality improvements are found by projecting the base mortality tables forward from the base year of 2010 using the MP-2018 mortality improvement scale.

2. Termination

   Rates of withdrawal are assumed to be equal to six percent for all ages 20 through 65 for both Tier 1 and Tier 2 members.

   It is assumed that terminated employees will not be rehired. The rates apply only to employees who have not fulfilled the service requirement necessary for retirement at any given age.
3. **Retirement**

   The overall retirement rates were reduced based on the Actuarial Experience Study for valuations beginning with the June 30, 2019 Actuarial Valuation.

   Rates of retirement for Tier 1 members are as follows:

<table>
<thead>
<tr>
<th>Age</th>
<th>Retirement Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>55</td>
<td>5.00%</td>
</tr>
<tr>
<td>56-64</td>
<td>15.00%</td>
</tr>
<tr>
<td>65-74</td>
<td>20.00%</td>
</tr>
<tr>
<td>75</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

   Rates of retirement for Tier 2 members are as follows:

<table>
<thead>
<tr>
<th>Age</th>
<th>Retirement Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>62</td>
<td>20.00%</td>
</tr>
<tr>
<td>63</td>
<td>10.00%</td>
</tr>
<tr>
<td>64</td>
<td>12.00%</td>
</tr>
<tr>
<td>65</td>
<td>14.00%</td>
</tr>
<tr>
<td>66</td>
<td>16.00%</td>
</tr>
<tr>
<td>67</td>
<td>35.00%</td>
</tr>
<tr>
<td>68-70</td>
<td>25.00%</td>
</tr>
<tr>
<td>71-74</td>
<td>20.00%</td>
</tr>
<tr>
<td>75</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

4. **Marriage Assumption**

   75.0% of active and retired participants are assumed to be married.

5. **Disability**

   No assumption for disability was assumed.
SECTION III – SUPPORTING ANALYSIS

6. New Entrants

The new entrant profile includes uncapped and capped salary information. New entrants are assumed to enter with an average age (41.27), average uncapped pay of $83,779, and average capped pay of $83,110. Based on the assumption that 50 percent of future members elect to opt out of the pension system, the population is projected to decrease from 122 members as of the valuation date, to 65 members in 2045 and ultimately reach 61 members in 2056. The average increase in uncapped payroll for the projection period is 2.50% per annum.

The 2018 Actuarial Experience Study Report noted the 2018 opt-out experience was 46% which is in line with the current assumption. More historical experience would be helpful to compare the historical trend to the ongoing assumption. We suggest adding the annual opt-out percentage to the Active Membership table on page 11.

7. Spouse’s Age

The female spouse is assumed to be four years younger than the male spouse.

8. Decrement Timing

All decrements are assumed to occur beginning of year.

9. Decrement Relativity

Decrement rates are used directly from the experience study without adjustment for multiple decrement table effects.

10. Decrement Operation

Turnover decrements do not operate after member reaches retirement eligibility.

11. Eligibility Testing

Eligibility for benefits is determined based upon the age nearest birthday and service on the date the decrement is assumed to occur.

12. 415(b) and 401(a)(17) Limits

No explicit assumption is made with respect to these items.
13. Other Assumptions as a result of Public Act 96-0889

Members hired after December 31, 2010 are assumed to make contributions on salary up to the final average compensation cap in a given year until this plan provision or administrative procedure is clarified.

State contributions, expressed as a percentage of pay, are calculated based upon capped pay.
C. Funding Methods

Actuarial funding methods consist of three components: (1) the actuarial cost method, which is the attribution of total costs to past, current, and future years; (2) the asset valuation method (i.e., asset smoothing); and, (3) the amortization method.

1. Actuarial Cost Method

The System uses the projected unit credit cost method (PUC) to assign costs to years of service, as required under the Pension Code (40 ILCS 5/2). We have no objections with respect to using the PUC method, although we would prefer the Entry Age Normal (EAN) cost method, as it is more consistent with the requirement in 40 ILCS 5/2-124 for level percentage of pay funding.

Under the PUC method, which is used by some public sector pension funds, the benefits of active participants are calculated based on their compensation projected with assumed annual increases to ages at which they are assumed to leave the active workforce by any of these causes: retirement, disability, turnover, or death. Only past service (through the valuation date but not beyond) is taken into account in calculating these benefits. The present value of these benefits based on past service and future compensation is the actuarial liability for a given active participant. Under the PUC cost method, the value of an active participant’s benefits tends to increase more sharply over his or her later years of service than over his or her earlier ones. While the PUC method is not an unreasonable method, as a result of this pattern of benefit values increasing, more plans use the EAN cost method to mitigate this effect. It should also be noted that the EAN cost method is the required method to calculate liability for GASB Nos 67 and 68.

2. Asset Valuation Method

The Actuarial Value of Assets for the System is a smoothed market value. Unanticipated changes in market value are recognized over five years in the Actuarial Value of Assets. The primary purpose for smoothing out gains and losses over multiple years is so fluctuations in the contributions will be less volatile over time than if based on the Market Value of Assets.

The 2020 Public Retirement Systems Study by the National Conference on Public Employee Retirement Systems (NCPERS) survey of 138 public retirement funds found that the majority of plans responding to the survey have a five-year smoothing period.

Smoothing the market gains and losses over a period of five years to determine the Actuarial Value of Assets is a generally accepted approach in determining actuarial cost, and we concur with its use.
3. *Amortization Method*

The mandated State contribution is based on a determination of the level percentage of payroll that is expected to achieve a 90% funded ratio in 2045. While not a traditional amortization method, this methodology effectively amortizes a portion of the unfunded actuarial liability over the remaining period until 2045, which is currently 24 years.

One of the principles of funding public plans identified by the American Academy of Actuaries is that there should be “a plan to make up for any variations in actual assets from the funding target within a defined and reasonable time period.” Because it only targets 90%, the State method does not include a plan to achieve the funding target over any period of time.
SECTION IV – PROJECTION ANALYSIS

This section reviews the projections contained in the draft June 30, 2021 Actuarial Valuation of GARS. These projections are fundamental to the development of the required State contribution calculated under the current statutory funding requirement.

The following graphs are independent approximations of the projections performed by the State Actuary to verify that the System’s funding projections are reasonable. They do not reflect all the precision of the projections applied by the System’s actuary, but instead they are intended to verify the reasonableness of the modeling done by the System’s actuary.

The graph below shows our projection of the expected future liabilities and assets in the System through 2045. As pointed out on page 9 of the draft June 30, 2021 Actuarial Valuation, the majority of the funding of the System occurs in the later years of the projections. The lines show the projected assets (market value and actuarial value), and the bars show the projected liabilities of the System. The funded ratio for each year is shown at the top of the graph. For example, in 2033, the funded ratio is projected to be approximately 35% with assets being approximately $108 million and liabilities being approximately $310 million.

Source: Cheiron projection analysis.
SECTION IV– PROJECTION ANALYSIS

When we compare our projected funded ratio against the results shown in the draft June 30, 2021 Actuarial Valuation, we find a close match in expected funded ratio. This close match of the funded ratio indicates that the projections done by the System’s actuary are reasonable.

Source: Cheiron projection analysis.
The following graph shows the expected contribution calculated under the statutory method. The contribution as a percentage of payroll is shown above each bar. The value shown for the fiscal year ending 2022 was set based on the June 30, 2020 Actuarial Valuation. The current valuation is the basis for setting the rates starting July 1, 2022 (Fiscal Year Ending June 30, 2023). The contribution requirement has two components: 1) the employer normal cost, which is the approximate value of the amount of benefits accrued by participants not covered by employee contributions based on the statutory funding method; and 2) an amortization of the unfunded liability. The normal cost amounts are shown by the green bars and the amortization of the unfunded actuarial liability (UAL) amounts by the yellow bars. The percentages shown are the total contribution rates calculated by Cheiron, which are equal to the sum of the bars. The graph shows that a larger percentage of the total contribution is being made toward the UAL payment later in the period. The blue line shows the projected contribution rates as percentages of payroll from the draft June 30, 2021 Actuarial Valuation. The difference between Cheiron’s approximation and the System’s projections is the difference between the top of the bars and the line. The contributions are being limited by the maximum contribution described in the General Obligation Bond Act prior to 2033, which is why the rate increases after 2033.

Source: Cheiron projection analysis.

Our conclusion is that the projections performed by the System’s actuary are reasonable.
SECTION V – ANALYSIS OF FUNDING ADEQUACY

In this section, we examine the adequacy of the funding for the System, including funded ratio, the sources of changes in the unfunded actuarial liability (UAL), and projections of the UAL and statutory funding requirements compared to contributions needed to pay down the UAL.

The actuarial valuation report prepared by GRS includes both traditional actuarial measurements, as well as additional risk measurements that are shown on pages 13 to 17 of the draft June 30, 2021 Actuarial Valuation report. Given the unique and substantial funding challenges faced by the Illinois pension systems, this additional information is quite important and supplements the information we present here on funding adequacy to better inform the legislature and other stakeholders about the adequacy of the System’s funding.

System Funded Ratio

The first funding adequacy measure is the historical trend of the System’s funded ratio for the past ten years. Funded ratio for this purpose is defined as the ratio of the Market Value of Assets to the Actuarial Liability. The chart below shows that GARS’ funded ratio has improved from 17.4% in 2012 to 21.3% in 2021, an increase in funded ratio of 3.9%. In addition to showing the funded ratio, this chart also shows the breakdown of the plan’s liabilities by membership status:

- Active liability – the liability (attributable to service already performed) for future payments to members who are currently working in the System,
- Deferred Vested liability – the liability for future payments to members who are no longer working in the System, and
- In-Pay liability – the liability for future payments to retirees and beneficiaries who are currently receiving benefits.

This breakdown shows that today plan assets only cover about 26% of the liabilities for just those members currently in pay status.

Source: Cheiron analysis of funding adequacy.
Sources of Changes in the UAL

As shown in the chart below, GARS’ unfunded actuarial liability (UAL) has grown from $235.2 million in 2011 to $301.5 million in 2021, an increase of $66 million. In order to understand how to reverse this trend, it is important to understand the sources contributing to it.

The changes to the UAL from June 30, 2011 to June 30, 2021 can be separated into the following components:

- **Contribution Deficiencies** – Contributions that are less than the tread water contribution causes the UAL to increase. The tread water contribution consists of two components: the normal cost, which is the cost of benefits earned in a given year, and the interest on the unfunded actuarial liability. This sum is referred to as the tread water contribution because it is the contribution necessary so that the UAL will remain constant, or “tread water” (absent experience gains or losses). The difference between actual contributions and the tread water contributions increased the UAL by $25.7 million over this period.

- **Assumption Changes** – changes to actuarial assumptions over this period increased the UAL by $34.2 million. A positive aspect of the UAL increases due to assumption changes is that they will result in liability measurements that more accurately reflect future expectations.

- **Plan Changes** – modifications to the design of the plan had a negligible impact over this period as most of the changes only affected future benefits.
THE STATE ACTUARY’S PRELIMINARY REPORT ON THE GENERAL ASSEMBLY RETIREMENT SYSTEM OF ILLINOIS PURSUANT TO 30 ILCS 5/2-8.1

SECTION V – ANALYSIS OF FUNDING ADEQUACY

- **Liability (Gain) or Loss** – the changes in the UAL due to liability experience (i.e., mortality, terminations, salary increases, etc.) were generally small and only increased the UAL by $4.5 million over this period.

- **AVA (Actuarial Value of Assets) Investment (Gain) or Loss** – the net investment gain or loss due to assets earning more or less than assumed increased the UAL over this period increased the UAL by $1.5 million.

The chart below shows the changes in UAL each year broken into these five components. The sum of all the components (total change in UAL) is shown as the black line. Values of each component as well as total by year are shown in the chart along with the totals for the period.

Except for gains due to contributions in 2020 and 2021, investment returns in 2014, 2015, 2017, 2018, and 2021, liability experience gains in 2014, 2016, and 2020, and assumption changes in 2012, 2018, and 2019, all other factors have increased the UAL. The UAL had increased every year prior to 2019 but has decreased in the last three years.

We expect that this chart will help stakeholders understand the sources of growth in the UAL over recent years and inform discussions about the current funding requirements and adequacy.
Actual Contributions Compared to Tread Water Contribution

One of the persistent sources of the increase in UAL is due to actual contributions to the System being less than the tread water contribution (the amount needed to prevent the UAL from increasing if all assumptions are met). These contribution deficiencies have added between $0.1 to $8.9 million to the UAL each year. 2020 was the first year since 2009 in which there was a contribution surplus, so the Plan is now seeing the UAL decrease.

As the chart below shows, actual contributions have been significantly less than the tread water cost through 2016. This trend was reversed beginning in 2017 and into the future. Each year that total contributions remain above the tread water cost (blue line), the UAL is expected to decline.

Source: Cheiron analysis of funding adequacy.
The next chart shows that if the Minimum Required Contributions continue to be made each year and all other assumptions are met, the UAL is projected to decline each year.

Source: Cheiron analysis of funding adequacy.
Net Cash Flow Analysis

The Plan’s net cash flow is defined as State and Member contributions less benefit payments and administrative expenses. The more negative net cash flow is as a percentage of the plan’s assets, the more vulnerable the Plan is to market downturns. When a pension plan has more payouts than contributions and suffers an investment loss, it is left with fewer assets to invest and recapture during a recovery.

Looking at the following chart, GARS is neither mature nor immature on a net cash flow basis (black line), as the net cash flow has been close to zero relative to the size of the System’s assets. This measure should continue to be monitored as negative cash flow increases the System’s vulnerability to market downturns. The teal line shows net cash flow as a percent of Market Value of Assets on the right-side axis. The greater the negative cash flows are relative to plan assets the more vulnerable a plan is to market downturns. This is because once there is a market downturn, the plan assets lose both on the return and the negative cash flow, leaving it with a lower asset base from which to recover from the loss. The net cash flow has been slightly positive for the prior two years, which means that contributions into the plan has exceeded the benefits and expenses paid out.

![Net Cash Flow Chart](chart.jpg)

Source: Cheiron analysis of funding adequacy.
Response to Recommendations in 2020

In the State Actuary’s Preliminary Report on the General Assembly Retirement System of Illinois presented December 16, 2020, Cheiron made several recommendations. Below we summarize how these recommendations were reflected in either the System’s comments last year or in this year’s draft June 30, 2021 Actuarial Valuation.

<table>
<thead>
<tr>
<th>Recommendations to Retirement System from 2020 State Actuary Report</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. We continue to recommend that the GARS Board periodically retain the services of an independent actuary to conduct a full scope actuarial audit. Such an audit should fully replicate the original actuarial valuation, based on the same census data, assumptions, and actuarial methods used by the System’s actuary.</td>
<td>Implemented</td>
<td>We have been informed by SRS Executive Secretary Tim Blair that an independent actuary has been retained to perform an audit and is expected to present their results to the GARS Board in January 2022. Recommendation removed.</td>
</tr>
<tr>
<td>2. We continue to recommend that the funding method be changed to fully fund plan benefits and discontinue the systematic underfunding of GARS. Continuing the practice of underfunding future accruals increases the risk of the System becoming unsustainable. We understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.</td>
<td>Partially Implemented</td>
<td>The System has adopted a funding policy that would provide for annual State contributions, the “Actuarially Determined Contribution”, and is used for informational purposes only. GRS continues to include strong language throughout their report recommending the use of an actuarially sound method and stating clearly that the statutory method is not actuarially sound. We find these statements to be appropriate and support their continuation. Recommendation repeated.</td>
</tr>
<tr>
<td>3. We continue to recommend that GRS include stress testing of the System within the valuation report and include a thorough explanation of the implications that volatile investment returns and a variety of other stressors (e.g. membership declines, lower salary growth) can have on future</td>
<td>Implemented</td>
<td>GARS added stress testing in appendices to the final Actuarial Valuation Report in a letter dated December 8, 2020. Recommendation continued.</td>
</tr>
</tbody>
</table>
### Recommendations to Retirement System from 2020 State Actuary Report

<table>
<thead>
<tr>
<th>Recommendations</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>State costs.</strong> In particular, the tests should illustrate the potential stresses on the System and its contributing sponsors so that an assessment of sustainability can be made. GRS did include stress testing in last year’s final report but did not include such stress testing in this year’s draft report or in any supplemental report.</td>
<td><strong>Not Implemented</strong></td>
<td>While, the System noted in its December 11, 2020 response that the ASOP 51 disclosure may be expanded to address many of Cheiron’s recommendations, the final 2020 Actuarial Valuation Report did not provide the recommended assessments. Recommendation modified.</td>
</tr>
<tr>
<td><strong>4.</strong> As required by section 3.3 of ASOP 51, we recommend that GRS provide an assessment for each of the key risks they have identified.</td>
<td><strong>Implemented</strong></td>
<td>GRS has continued to do this, most recently providing a review in the 2020 Actuarial Experience Study report dated April 15, 2021. We will continue to include this recommendation each year. Recommendation continued.</td>
</tr>
<tr>
<td><strong>5.</strong> We recommend the GARS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly.</td>
<td><strong>Implemented</strong></td>
<td>GRS has continued to do this, most recently providing a review in the 2020 Actuarial Experience Study report dated April 15, 2021. We will continue to include this recommendation each year. Recommendation continued.</td>
</tr>
<tr>
<td><strong>6.</strong> We recommend that an explanation be provided as to how the maturity measures calculated and disclosed by GRS help the reader to understand the risks identified and that historical values that are significant to understanding the risks identified be disclosed along with an explanation of how they help the reader understand the risks identified by GRS.</td>
<td><strong>Implemented</strong></td>
<td>GRS expanded its description of maturity measures in the final Actuarial Valuation Report dated January 4, 2021. Recommendation removed.</td>
</tr>
<tr>
<td>Recommendations to Retirement System from 2020 State Actuary Report</td>
<td>Status</td>
<td>Comments</td>
</tr>
<tr>
<td>---------------------------------------------------------------</td>
<td>-------------</td>
<td>--------------------------------------------------------------------------</td>
</tr>
</tbody>
</table>
| 7. We recommend that GRS review its disclosures related to ASOP 56 for the next valuation report to ensure that the disclosures clearly identify the purpose of each model, any material limitations of each model, and any other applicable required disclosures under ASOP 56. | Implemented | In its transmittal letter to the June 30, 2021 Actuarial Valuation Report GRS the recommended ASOP 56 disclosures were made.  
**Recommendation removed.** |
Chapter Six

Preliminary Report on the Chicago Teachers’ Pension Fund

In accordance with 40 ILCS 5/17-127(e), Cheiron, the State Actuary, submitted a preliminary report to the Board of Trustees of the Chicago Teachers’ Pension Fund (CTPF) concerning proposed certifications of required State contributions submitted to Cheiron by the Board. The preliminary report was submitted to CTPF on November 30, 2021. The preliminary report was based on Cheiron’s review of actuarial assumptions included in CTPF’s 2021 Actuarial Valuation Report.

Following is Cheiron’s final preliminary report on the Chicago Teachers’ Pension Fund. CTPF’s written response, provided on December 9, 2021, can be found in Appendix C.

<table>
<thead>
<tr>
<th>OVERVIEW</th>
<th>CHICAGO TEACHERS’ PENSION FUND</th>
<th>as of June 30, 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial accrued liability</td>
<td>$25,117,988,742</td>
<td></td>
</tr>
<tr>
<td>Actuarial value of assets</td>
<td>$11,925,535,283</td>
<td></td>
</tr>
<tr>
<td>Unfunded liability</td>
<td>$13,192,453,459</td>
<td></td>
</tr>
<tr>
<td>Funded ratio</td>
<td>47.5%</td>
<td></td>
</tr>
<tr>
<td>State contribution (FY23)</td>
<td>$295,302,000</td>
<td></td>
</tr>
<tr>
<td>Active members</td>
<td>31,215</td>
<td></td>
</tr>
<tr>
<td>Inactive members</td>
<td>6,658</td>
<td></td>
</tr>
<tr>
<td>Current benefit recipients</td>
<td>27,610</td>
<td></td>
</tr>
<tr>
<td>Non-vested eligible for refunds</td>
<td>24,997</td>
<td></td>
</tr>
<tr>
<td>Total membership</td>
<td>90,480</td>
<td></td>
</tr>
<tr>
<td>Interest rate assumption</td>
<td>6.50%</td>
<td></td>
</tr>
<tr>
<td>Inflation assumption</td>
<td>2.25%</td>
<td></td>
</tr>
<tr>
<td>Actuarial cost method</td>
<td>Projected Unit Credit</td>
<td></td>
</tr>
<tr>
<td>Asset valuation method</td>
<td>4-year Smoothing</td>
<td></td>
</tr>
</tbody>
</table>

Executive Director
Carlton Lenoir

Actuarial Firm
Gabriel, Roeder, Smith & Company

Source: June 30, 2021 CTPF actuarial valuation report.
December 16, 2021

Mr. Frank Mautino
Auditor General
740 East Ash Street
Springfield, Illinois 62703

Board of Trustees
Public School Teachers’ Pension and Retirement Fund of Chicago
425 S. Financial Place
Suite 1400
Chicago, Illinois 60605-1000

Dear Trustees and Auditor General:

In accordance with Illinois Public Act 100-0465, Cheiron is submitting this preliminary report concerning the proposed certification prepared by Gabriel, Roeder, Smith & Company (GRS) of the required State contribution to the Public School Teachers' Pension and Retirement Fund of Chicago (CTPF or System) for Fiscal Year 2023.

In summary we believe that the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable. We also find that the certified portion of the contribution which the State is responsible for was properly calculated.

We have reviewed the experience analysis covering the 2021 Actuarial Assumption Study performed in recognition of both GRS’s and Cheiron’s recommendation for additional monitoring and agree with the recommendation of GRS to lower the investment return but to make no additional changes to the assumptions.

Section I of this report describes the review process undertaken by Cheiron. Section II summarizes our findings and recommendations. Section III provides the supporting analysis for those findings and presents more details on our assessment of the actuarial assumptions and methods employed in GRS’s Actuarial Certification, as well as our assessment of GRS’s determination of the required State contribution for Fiscal Year 2023. Section III also includes additional comments relating to our findings and recommendations. Section IV provides some analysis of the projected contributions from the State. Finally, Section V provides an analysis of historical trends.

In preparing this report, we relied on information (some oral and some written) supplied by CTPF and GRS. This information includes actuarial assumptions and methods adopted by the CTPF Board, the results of the 2012 through 2017 experience analysis, the 2021 Actuarial Assumptions Study, plan provisions, the draft June 30, 2021 Actuarial Valuation, and minutes of the 2021 CTPF Board of Trustee meetings during the results presentation. A detailed description of all information provided for this review is contained in Appendix B.
This report and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices and our understanding of the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board as well as applicable laws and regulations. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this report. This report does not address any contractual or legal issues. We are not attorneys, and our firm does not provide any legal services or advice.

This report was prepared exclusively for the Office of the Auditor General and the Public School Teachers’ Pension and Retirement Fund of Chicago for the purpose described herein. Other users of this report are not intended users as defined in the Actuarial Standards of Practice, and Cheiron assumes no duty or liability to any other user.

Sincerely,
Cheiron

William R. Hallmark, ASA, FCA, MAAA, EA
Consulting Actuary

Gene Calwarski, FSA, FCA, MAAA, EA
Principal Consulting Actuary
THE STATE ACTUARY’S PRELIMINARY REPORT ON THE
PUBLIC SCHOOL TEACHERS’ PENSION AND RETIREMENT FUND OF CHICAGO
PURSUANT TO 40 ILCS 5/17-127(e)

SECTION I – REPORT SCOPE

Illinois Public Act 100-0465 (the Act) amended the Illinois Pension Code (40 ILCS 5/17-127) and requires Cheiron, as the State Actuary, to review the actuarial assumptions and valuation of the Public School Teachers’ Pension and Retirement Fund of Chicago (CTPF or System) and to issue to the CTPF Board this preliminary report on the proposed certification prepared by Gabriel, Roeder, Smith & Company (GRS) of the required State contribution for Fiscal Year (FY) 2023. Under the Act, the required State contribution consists of 0.544% of Teacher total capped payroll, plus the employer normal cost, plus an amount pursuant to paragraph (3) of Section 17-142.1 to defray health insurance costs. The purpose of this review is to identify any recommended changes to the actuarial assumptions and methods for the CTPF Board to consider before finalizing its certification of the required State contribution for FY 2023.

While the Act states that just the actuarial assumptions and valuation are to be reviewed, we have also reviewed the actuarial funding method employed in preparing the Actuarial Certification, as the funding method can have a material effect on the amount of the State contribution being certified.

In addition to reviewing the Actuarial Certification of the required State contribution to CTPF, we have reviewed the “actuarial practices” of the Board. We have reviewed: (1) the use of a qualified actuary (as defined in the Qualification Standards of the American Academy of Actuaries) to prepare the annual actuarial valuation for determining the required State contribution; and (2) the conduct of periodic formal experience studies to justify the assumptions used in the actuarial valuation. In addition, we have included comments on actuarial communication and compliance with Actuarial Standards of Practice (ASOP) reflected in the draft June 30, 2021 Actuarial Valuation.

Finally, this report is more limited in scope than the State Actuary reviews for the other Illinois Retirement Systems because the State’s responsibility is limited to the 0.544% of Teacher total capped payroll, the employer Normal Cost, and a subsidy to defray health insurance costs. The State is not responsible for the funding of the unfunded actuarial liability of CTPF or the current and future contributions that may be necessary to achieve the legislative requirement that the City fund the Plan to 90% by 2059. The State is responsible for the funding of the other Illinois Systems, which requires the State Actuary to review and analyze the long-term projections and the State mandated funding method.
SECTION II – SUMMARY OF RECOMMENDATIONS

This section summarizes recommendations from our review of the actuarial assumptions and methods employed in the draft June 30, 2021 Actuarial Valuation of CTPF as well as the “actuarial practices” of the CTPF Board. Section III of this report provides detailed analysis and rationale for these recommendations.

**Proposed Certification of the Required State Contribution**

GRS has determined that the FY 2023 required State contribution calculated under the current statutory funding plan is $295,302,000 pursuant to P.A. 100-0465. This amount represents the two cost components of the States funding obligation which includes the net employer normal cost amount including administrative expenses of $230,302,000 plus the $65,000,000 health insurance subsidy. In addition, the State contributes an amount equal to 0.544 percent of pay which is equal to $13,371,000.

We have verified the arithmetic calculations made by GRS to develop this required State contribution except with regard to the adjustment of the total normal cost before expenses from the valuation date to fiscal year 2023 and have reviewed the assumptions on which it was based.

**Assessment of Actuarial Assumptions Used in the 2021 Valuation**

40 ILCS 5/17-127(e) requires the State Actuary to identify recommended changes in actuarial assumptions that the CTPF Board must consider before finalizing its certification of the required State contribution. In response to the experience study performed by GRS in 2018 the Chicago Public Schools (CPS) took exception to two of the changes involving an expectation of continued decline in the number of active participants and the trend toward retiring early. CPS’s argument is that the experience during this period was in part due to the financial crisis and that the membership behavior was in response to that crisis. They identified that the crisis has passed and that the number of active members and retirement behavior should revert back to what has been the trend. The Board accepted GRS’s assumptions with the CPS’s requested modification.

As recommended, GRS’ performed additional analysis of the two assumption changes which were deferred to determine if the CPS’s objective were supported by additional experience analysis. In GRS’s 2021 Actuarial Assumptions Study they presented additional experience that supported CPS’s recommendation to not make the assumption changes identified in the 2018 experience study and we agree with their rationale.

**Recommended Changes for Future Valuations**

1. We recommend that GRS continue to include stress testing of the System within the valuation report and that future stress testing include the impact to the required State contribution of potential reductions in the discount rate.

2. We recommend the CTPF Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation.
SECTION III – SUPPORTING ANALYSIS

In this section, we provide detailed analysis and supporting rationale for the recommendations that were presented in Section II of this report.

Proposed Certification of the Required State Contribution

As stated in our summary of recommendations in Section II, we have verified the arithmetic calculations made by GRS to develop this State required contribution except with regard to the adjustment of the total normal cost before expenses from the valuation date to fiscal year 2023. The State required contribution is clearly identified in the Executive Summary.

Assessment of Actuarial Assumptions Used in the 2021 Valuation

A. Economic Assumptions

1. The Interest Rate

The interest rate assumption (also called the investment return or discount rate) is the most impactful assumption affecting the contribution requirement of the system. The assumption, which is used to value liabilities for funding purposes, was reduced from 6.75% to 6.50% for the draft June 30, 2021 Actuarial Valuation.

After reviewing all the materials (see Appendix B of the report) that were made available, Cheiron concludes that reducing the interest rate from 6.75% to 6.50% for this valuation is reasonable, but further reductions should be considered in future valuations if capital market assumptions remain at the current level. Because it is reasonable to anticipate future reductions in the discount rate, we recommend that future stress testing include the impact to the required State contribution of potential reductions in the discount rate (Recommendation #1).

We recommend that the CTPF Board continue to annually review the economic assumptions (interest rate and inflation), as was done for this valuation, prior to commencing the valuation work and adjust assumptions accordingly (Recommendation #2).

Our rationale for these two recommendations:

- In their September 14, 2021 Actuarial Assumptions Study, GRS presented short-term return expectations of 12 selected investment consultants using a 10-year time horizon adjusted for CTPF inflation assumption. This produced an arithmetic average one-year nominal return of 6.35%. Using the average standard deviation and return expectation GRS concluded that the median 10-year expected geometric return was 5.60% and there is approximately a 41% probability of exceeding 6.50%. This is based on a CTPF assumption of 2.25% as the long-term inflation assumption. GRS notes that because 51% of the actuarial accrued liability as of June 30, 2020, is attributable to benefits
that are projected to be paid in the next 10 years it is appropriate to consider a 10-year time horizon when setting the economic assumptions.

- Using the average 10-year capital market assumptions in the 2021 Horizon survey, we calculated an expected 10-year geometric return of 5.8% for the CTPF asset allocation and approximately a 43% probability of exceeding 6.50%. While we would prefer an assumption with a greater than 50% probability of being met, a 40% probability is at the high end of a reasonable range. We believe it is reasonable to just reduce the discount rate 25 basis points this year, but further reductions should be considered if capital market assumptions remain at the current level.

- While the discount rate assumption should be based on the future expected investment returns for the System’s investment portfolio, survey information can provide an important context for evaluating the assumption. The Public Plans Database is maintained by a partnership between the Center for State and Local Government Excellence (SLGE) and the Center for Retirement Research at Boston College with support from the National Association of State Retirement Administrators (NASRA). This database contains historical information on large public pension plans, including key assumptions used in their actuarial valuations. The following chart shows the distribution of investment return assumptions for the 177 plans in the Public Plans Database with consistent information from 2002 through 2021 as of October 27, 2021.
SECTION III – SUPPORTING ANALYSIS

Over the period shown, there continues to be a pattern of reducing discount rates partially reflecting long-term changes in capital markets, interest rates and underlying inflation. Of the 132 plans shown, 144 have reduced their discount rate assumption since 2016. For these 132 plans, the average reduction is 0.43%.

- Declining interest rates have forced pension plans to either reduce their discount rates, increase their exposure to investment risk, or some combination of the two. For example, as shown in the following chart, in 2001 the yield on 10-year Treasury bonds (a proxy for a risk-free investment) was 5.3%. To achieve CTPF’s assumed return of 8.0%, the System’s investments had to outperform the yield on the 10-year Treasury by 2.7%. As of June 2021 the yield on the 10-year Treasury is now 1.5%, and to achieve CTPF’s assumed return of 6.50%, the System’s investments need to exceed the 10-year Treasury yield by 5.0%. Even though CTPF reduced its assumption by 150 basis points, it still has to take on more investment risk in 2021 to meet its assumption than it did in 2001. By reducing the investment return assumption, as CTPF has done, plans are more likely to meet their funding goals without requiring investment performance so much in excess of the risk-free rate.

![Historical Implied Risk Premium](image)

- As is the case with most maturing pension plans, CTPF is experiencing negative cash flows measured as contributions less benefits and expenses. CTPF’s negative cash flow is 3.74% of assets. When short-term returns are expected to be lower than the long-term expectations, which is the case with CTPF, a plan with negative cash flows will have actuarial returns (i.e., dollar weighted returns) that are less than “time weighted” returns.
2. **Inflation Assumption**

As recommended in the GRS September 14, 2021 report on the 2021 Actuarial Assumptions Study, the inflation assumption was maintained at 2.25% in the draft June 30, 2021 Actuarial Valuation.

**We find the 2.25% inflation assumption to be reasonable.**

The items we considered and our rationale for concurring with the 2.25% assumption are as follows:

- As supported in Pages B-2 to B-6 of the 2021 Actuarial Assumptions Study, GRS provides significant justification to keep the inflation assumption at 2.25%.

- The August 2021 Old-Age, Survivors, and Disability Insurance (OASDI) Trustees Report projects that over the long-term (next 75 years), inflation will average between 1.8% and 3.0% ([http://www.ssa.gov/oact/tr/2021/tr2021.pdf](http://www.ssa.gov/oact/tr/2021/tr2021.pdf)). Under the intermediate cost projection, the Social Security Administration uses an assumption of 2.4%.

- The following chart shows the distribution of inflation expectations for the Third Quarter 2021 survey of professional economic forecasters published by the Philadelphia Federal Reserve, the 2021 Horizon survey of investment consultant capital market assumptions (20-year), and the 2020 inflation assumptions used by plans in the Public Plans Database compared to the CTPF assumption (indicated by the gold diamonds). The assumption of 2.25% is near the middle of the range projected by professional economic forecasters and investment consultants, and is on the low end of the range used by other public plans.
3. **Salary (Annual Compensation) Increase Assumption**

The salary increase assumption is shown in the table below.

Illustrative rates of increase per individual employee per annum, compounded annually:

<table>
<thead>
<tr>
<th>Age</th>
<th>Annual Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>12.60%</td>
</tr>
<tr>
<td>25</td>
<td>7.50%</td>
</tr>
<tr>
<td>30</td>
<td>6.00%</td>
</tr>
<tr>
<td>35</td>
<td>5.25%</td>
</tr>
<tr>
<td>40</td>
<td>4.25%</td>
</tr>
<tr>
<td>45</td>
<td>3.50%</td>
</tr>
<tr>
<td>50</td>
<td>3.00%</td>
</tr>
<tr>
<td>55</td>
<td>2.75%</td>
</tr>
<tr>
<td>60</td>
<td>2.75%</td>
</tr>
<tr>
<td>65</td>
<td>2.75%</td>
</tr>
<tr>
<td>70</td>
<td>2.75%</td>
</tr>
</tbody>
</table>

These increases include the wage inflation assumption of 2.75% comprised of an inflation assumption of 2.25% per annum and 0.50% per annum productivity or real wage growth assumption.

**We find the salary increase assumption consistent with information presented in the 2018 Actuarial Experience Study.** We reference Section E of that report with the supporting historic trends.
4. Cost of Living for Tier 2 Assumption

For Tier 2 participants, benefits are increased annually equal to 50% of the consumer price index urban rates with a maximum of 3.0%. Therefore, the COLA assumption is 50% of assumed inflation, or 1.125%.

We find the assumption and the basis for setting it reasonable.

5. Tier 2 Capped Pay Assumption

Benefits for members hired after January 1, 2011, are calculated using pay that is capped under 40 ILCS 5/1-160. The pay cap increase assumption is 1.125%.

We find the assumption and the basis for setting it reasonable.
Section III – Supporting Analysis

Demographic Assumptions

Based on the 2018 Actuarial Experience Study, GRS made recommendations to the Board on September 20, 2018 for a number of assumption changes covering mortality rates, retirement, turnover, and disability rates. They also made recommendations to reflect the decline in active membership going forward in response to the trends demonstrated during the study period of 2012 through 2017.

The Chicago Public Schools (CPS) also made a presentation with respect to the recommendations putting forth a position that the active population trends and early retirement trends were a direct reflection during this period of study of the financial crisis and suggested that both these trends will revert back to past trends.

The Board adopted GRS’s assumption change recommendations except for the active member reduction assumption and changes to the retirement trends to see if the position of the CPS holds up going forward. GRS committed to monitor these two assumptions and provide information to the Board on experience going forward.

GRS in their 2021 Actuarial Assumption Study provided additional evidence which supported CPS’s concerns regarding these two assumptions resulting in GRS making no change to the assumptions.

We agree with CTPF’s actuary, GRS, that not changing the two assumptions is supported by the 2021 Actuarial Assumption Study and to maintain the assumptions in place prior to the study as suggested by the Chicago Public Schools.

In its annual actuarial valuation reports, CTPF regularly reports sources of liability gains and losses. In the 2021 report, these are shown on pages 24 and 25. In the chart on the following page, we have collected similar data from CTPF’s past valuation reports dating back to 2012 and presented a historical review of past demographic and salary increase experience gains and losses.

The following chart on the next page shows the pattern of annual gains and losses attributable to seven different sources as shown in the legend. When the colored bar slices appear above zero on the Y-axis, it represents an experience loss with the value representing the increase in liabilities over what was expected. When the bar is below zero, it represents an experience gain for that year with liabilities less than expected. This net liability (gain)/loss is shown by the black line. This net (gain)/loss as a percent of liability is shown above the bars.
Key observations from this chart are as follows:

1. A trend of salary gains has appeared in most years. This is likely to be a reflection of the current general economic environment, but if this trend continues the assumption should be reevaluated.

2. Prior to 2019, there were experience losses attributable to retirement. As anticipated by CPS’s expectations, it appears the trend shown here may have changed in the last few years.

3. Note that prior to 2017, New Entrant liability was not separately reported and is included in the ‘Other’ category

Below, we summarize all the demographic assumptions that we reviewed and we have concluded all are reasonable and meet the requirements of ASOP No. 35, Section 3.3.4.

1. Mortality

*Pre-Retirement Mortality*

The RP-2014 White Collar Employee, sex distinct tables with 98% male adjustment and 113% female adjustment is used.
Post-Retirement Disability Mortality

The RP-2014 Disabled Annuitant, sex distinct tables with 103% male adjustment and 106% female adjustment is used.

Post-Retirement Healthy Mortality

The RP-2014 White Collar Healthy Annuitant, sex distinct tables with 108% male adjustment and 94% female adjustment is used.

Future mortality improvements are reflected by projecting the base mortality tables back from 2014 to 2006 using the Society of Actuaries MP-2014 tables and projecting from 2006 using the MP-2017 projection scale. This assumption provides generational mortality tables and includes a margin for future mortality improvements.

2. Termination

Service-based termination rates were used. Select rates are as follows:

<table>
<thead>
<tr>
<th>Service (Beginning of Year)</th>
<th>Rate (%)</th>
<th>Service (Beginning of Year)</th>
<th>Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>30.00%</td>
<td>16</td>
<td>2.25%</td>
</tr>
<tr>
<td>1</td>
<td>16.00%</td>
<td>17</td>
<td>2.25%</td>
</tr>
<tr>
<td>2</td>
<td>13.00%</td>
<td>18</td>
<td>2.25%</td>
</tr>
<tr>
<td>3</td>
<td>12.00%</td>
<td>19</td>
<td>2.25%</td>
</tr>
<tr>
<td>4</td>
<td>9.00%</td>
<td>20</td>
<td>2.25%</td>
</tr>
<tr>
<td>5</td>
<td>9.00%</td>
<td>21</td>
<td>2.25%</td>
</tr>
<tr>
<td>6</td>
<td>8.00%</td>
<td>22</td>
<td>2.25%</td>
</tr>
<tr>
<td>7</td>
<td>6.00%</td>
<td>23</td>
<td>2.25%</td>
</tr>
<tr>
<td>8</td>
<td>5.00%</td>
<td>24</td>
<td>2.25%</td>
</tr>
<tr>
<td>9</td>
<td>5.00%</td>
<td>25</td>
<td>2.25%</td>
</tr>
<tr>
<td>10</td>
<td>4.00%</td>
<td>26</td>
<td>2.25%</td>
</tr>
<tr>
<td>11</td>
<td>3.00%</td>
<td>27</td>
<td>2.25%</td>
</tr>
<tr>
<td>12</td>
<td>3.00%</td>
<td>28</td>
<td>2.25%</td>
</tr>
<tr>
<td>13</td>
<td>3.00%</td>
<td>29</td>
<td>2.25%</td>
</tr>
<tr>
<td>14</td>
<td>3.00%</td>
<td>30</td>
<td>1.75%</td>
</tr>
<tr>
<td>15</td>
<td>3.00%</td>
<td>31 +</td>
<td>1.75%</td>
</tr>
</tbody>
</table>

It is assumed that terminated employees will not be rehired. The rates apply only to employees who have not fulfilled the service requirement necessary for retirement at any given age.
3. Disability

Disability rates, based on recent experience of the Fund, were applied to members with at least 10 years of service. All disabilities are assumed to be non-duty disabilities. Sample rates are as follows:

<table>
<thead>
<tr>
<th>Age</th>
<th>Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>0.04%</td>
</tr>
<tr>
<td>25</td>
<td>0.04%</td>
</tr>
<tr>
<td>30</td>
<td>0.04%</td>
</tr>
<tr>
<td>35</td>
<td>0.05%</td>
</tr>
<tr>
<td>40</td>
<td>0.06%</td>
</tr>
<tr>
<td>45</td>
<td>0.08%</td>
</tr>
<tr>
<td>50</td>
<td>0.19%</td>
</tr>
<tr>
<td>55</td>
<td>0.24%</td>
</tr>
<tr>
<td>60</td>
<td>0.29%</td>
</tr>
</tbody>
</table>
4. Retirement

Employees are assumed to retire in accordance with the rates shown below. The rates apply only to employees who have fulfilled the service requirement necessary for retirement at any given age.

<table>
<thead>
<tr>
<th>Age</th>
<th>&lt;34 Years of Service Rate (%)</th>
<th>34+ Years of Service Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>55</td>
<td>5.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>56</td>
<td>5.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>57</td>
<td>5.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>58</td>
<td>5.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>59</td>
<td>7.00%</td>
<td>20.00%</td>
</tr>
<tr>
<td>60</td>
<td>9.00%</td>
<td>22.50%</td>
</tr>
<tr>
<td>61</td>
<td>11.00%</td>
<td>22.50%</td>
</tr>
<tr>
<td>62</td>
<td>12.00%</td>
<td>22.50%</td>
</tr>
<tr>
<td>63</td>
<td>13.00%</td>
<td>22.50%</td>
</tr>
<tr>
<td>64</td>
<td>14.00%</td>
<td>22.50%</td>
</tr>
<tr>
<td>65</td>
<td>15.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>66</td>
<td>16.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>67</td>
<td>17.00%</td>
<td>25.00%</td>
</tr>
<tr>
<td>68</td>
<td>18.00%</td>
<td>27.50%</td>
</tr>
<tr>
<td>69</td>
<td>19.00%</td>
<td>27.50%</td>
</tr>
<tr>
<td>70</td>
<td>20.00%</td>
<td>30.00%</td>
</tr>
<tr>
<td>71</td>
<td>20.00%</td>
<td>30.00%</td>
</tr>
<tr>
<td>72</td>
<td>20.00%</td>
<td>30.00%</td>
</tr>
<tr>
<td>73</td>
<td>20.00%</td>
<td>30.00%</td>
</tr>
<tr>
<td>74</td>
<td>20.00%</td>
<td>30.00%</td>
</tr>
<tr>
<td>75</td>
<td>100.00%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>
5. Active Member Population as of the Valuation Date

The Tier 2 active population as of the actuarial valuation date of June 30, 2021, was increased by 26 members in order to estimate the total expected number of active members that will be working and making contributions in the upcoming fiscal year. Members who retire at the end of the school year have June retirement dates and are already reflected as retirees in the data received as of June 30, but new active members to replace these members are not hired until August or September and are not included in the census data until the following fiscal year. These members are assumed to have a similar demographic profile as new entrants who have been hired in the last three years.
6. Population Projection

For purposes of determining annual appropriation as a percent of total covered payroll, the size of the active group is assumed to remain level at the number of actives as of the actuarial valuation date including new hires, or 31,241. New entrants are assumed to enter with an average age and an average pay as disclosed below. New entrants are assumed to have a similar demographic profile of recent new entrants to the Fund. The average increase in payroll for the projection period is 2.75 percent per year.

<table>
<thead>
<tr>
<th>Age Group</th>
<th>New Entrant Profile</th>
<th>Salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 20</td>
<td></td>
<td></td>
</tr>
<tr>
<td>20-24</td>
<td>1,138</td>
<td>$55,859,339</td>
</tr>
<tr>
<td>25-29</td>
<td>1,526</td>
<td>78,297,901</td>
</tr>
<tr>
<td>30-34</td>
<td>911</td>
<td>48,392,365</td>
</tr>
<tr>
<td>35-39</td>
<td>552</td>
<td>30,427,846</td>
</tr>
<tr>
<td>40-44</td>
<td>395</td>
<td>20,197,677</td>
</tr>
<tr>
<td>45-49</td>
<td>295</td>
<td>14,869,670</td>
</tr>
<tr>
<td>50-54</td>
<td>253</td>
<td>12,738,150</td>
</tr>
<tr>
<td>55-59</td>
<td>164</td>
<td>7,141,680</td>
</tr>
<tr>
<td>60-64</td>
<td>105</td>
<td>3,478,723</td>
</tr>
<tr>
<td>65-69</td>
<td>16</td>
<td>401,802</td>
</tr>
<tr>
<td>70 &amp; Over</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>5,355</td>
<td>$ 271,805,153</td>
</tr>
</tbody>
</table>

Avg. Salary $ 50,757
Avg. Age 32.99
Percent Female 76%

7. Expenses

Administrative expenses included in the normal cost for fiscal year 2022 are based on the budgeted administrative expense of $23,287,480, as provided by Staff. Future administrative expenses are assumed to increase by 5.75 percent per year for 14 years and then increase at a rate consistent with the increase in projected capped payroll thereafter.

8. Marriage Assumption

75.0 percent of active male participants and 65.0 percent of active female participants are assumed to be married. Actual marital status at benefit commencement is used for retirees.
9. Spouse’s Age

The female spouse is assumed to be two years younger than the male spouse.

10. Total Service at Retirement

A teacher’s total service credit at retirement is assumed to be 103.3 percent of the teacher’s regular period of service at retirement.

11. Valuation of Inactive Members Eligible for Deferred Vested Pension Benefits

Benefits for inactive deferred vested members were determined by projecting the accumulated contribution balance to retirement (age 62 for members hired before January 1, 2011 and age 67 for members hired on or after January 1, 2011) with interest at the assumed investment rate of return, converted to an annuity, and then loaded by 35 percent.

12. Assumption for Missing Data

Members whose gender was not provided are assumed to be female.

13. Benefit Option

Retirees whose record includes a spouse date of birth are assumed to have the automatic 50% Joint and Survivor benefit. All other retirees are assumed to have a straight life benefit.

14. Contribution Timing

Projected employer contributions are assumed to occur based on the following timing:

1. Additional Board of Education Contribution (0.58 percent of pay) - June 30th (End of Year)
2. Additional State Contribution (0.544 percent of pay) - Monthly (Middle of Year)
3. State Normal Cost Contribution - Monthly (Middle of Year)
4. Board of Education Early Payment of Special Tax Levy - March 1st, annually
   a. A portion of the prior year’s tax levy is assumed to occur each March 1st
   i. The payments made through March 31 (which are assumed to be paid on March 1 on average) as provided by CTPF is equal to $245,254,621 for fiscal year 2021 and is assumed to increase three percent per year.
5. Remaining Board of Education Contribution - June 30th (End of Year)

15. Decrement Timing

All decrements are assumed to occur during the middle of the year.
SECTION III – SUPPORTING ANALYSIS

16. Decrement Relativity

Decrement rates are used directly from the experience study, without adjustment for multiple decrement table effects.

17. Decrement Operation

Turnover decrements do not operate after a member reaches retirement eligibility. Disability decrements do not operate after a member reaches normal retirement eligibility.

18. Eligibility Testing

Eligibility for benefits is determined based upon the age nearest birthday and service on the date the decrement is assumed to occur.

19. Assumptions as a result of Public Act 96-0889

Members hired on or after January 1, 2011, are assumed to make contributions on salary up to the final average compensation cap in a given year.

State contributions, expressed as a percentage of pay, are calculated based upon capped pay.

Capped (pensionable) pay was $116,740 for fiscal year 2021 and increases at ½ the annual increase in the Consumer Price Index-U thereafter.

The annual increase in the Consumer Price Index-U is assumed to be 2.25 percent for all years.
C. Funding Methods

Actuarial funding methods consist of three components: (1) the actuarial cost method, which is the attribution of total costs to past, current, and future years; (2) the asset valuation method (i.e., asset smoothing); and, (3) the amortization method.

1. Actuarial Cost Method

The System uses the projected unit credit cost method (PUC) to assign costs to years of service, as required under the Pension Code (40 ILCS 5/17). We have no objections with respect to using the PUC method, although we, as GRS does, would prefer the Entry Age Normal (EAN) cost method as it is more consistent with the requirement in 40 ILCS 5/17-129 for level percent of pay funding.

Under the PUC method, which is used by some public sector pension funds, the benefits of active participants are calculated based on their compensation projected with assumed annual increases to ages at which they are assumed to leave the active workforce by any of these causes: retirement, disability, turnover, or death. Only past service (through the valuation date but not beyond) is taken into account in calculating these benefits. The cost of providing benefits based on past service and future compensation is the actuarial accrued liability for a given active participant. Under the PUC cost method, the value of an active participant’s benefits tends to increase more sharply over his or her later years of service than over his or her earlier ones. As a result of this pattern of benefit value increasing, while the PUC method is not an unreasonable method, more plans use the EAN cost method to mitigate this effect. It should also be noted that the EAN cost method is the required method to calculate liability for GASB 67 & GASB 68.

While there is concern over the mandated funding method conforming to generally acceptable actuarial principles and practices, the State’s obligation to fund CTPF is limited to payment of the future normal cost plus expenses and a health care subsidy. Consequently, we have not reviewed the asset valuation method, the amortization method, or the projection of the unfunded actuarial liability.
This section reviews the projections of the State’s contributions to CTPF. The State’s contributions are equal to the employer normal cost, including a health insurance subsidy, plus an additional contribution equal to 0.544 percent of pay. The chart below compares the State’s projected contributions contained in the June 30, 2021 Actuarial Valuation of CTPF to the same projections from the prior year.

The dark blue bars represent the projection of the State’s normal cost contributions for Tier 1 members, and the teal bars represent the State’s normal cost contributions for Tier 2 members. The green bars represent the additional State contribution, and the gold line represents the total projected State contribution from the 2020 actuarial valuation. The contribution is expected to remain relatively level the next several years before declining as Tier 2 members become the dominant portion of active membership. The Tier 2 normal cost under the projected unit credit method rises as the Tier 2 membership matures, ultimately increasing the State’s contribution.

The increase in projected State contributions from the prior valuation is primarily due to the reduction in the discount rate, but also includes other factors such as higher payroll than previously projected.
SECTION V – ANALYSIS OF HISTORICAL TRENDS

In this section, we examine the historical trends of the funding for the System, including funded ratio, the sources of changes in the unfunded actuarial liability (UAL), sources of contributions, and net cash flow. Because the State’s obligation to fund CTPF is limited to the payment of future normal cost including a health care subsidy and an additional fixed percentage of covered payroll, we have not reviewed the projections or assessed the adequacy of anticipated future contributions. The primary risk to the State is that anticipated future normal costs increase.

Currently the System is 53.2% funded based on the Market Value of Assets. When coupled with the negative cash flow (where benefit payments and expenses exceed the contributions to the fund) of 3.74% of the market asset value, the risk of a declining funded ratio is increased. Even if the expected return on assets of 6.50% is met, only 2.76% of the return will be available to increase the asset value.

Insolvency risk increases if contributions increase to unsustainable levels. The State’s current obligation is fixed at the net employer normal cost plus 0.544% of capped payroll and the health insurance subsidy. However, if the contributions required of the Board of Education become unsustainable, there could be additional risk of the State being called on to provide additional funding assistance through legislation. Therefore, it is important that the State understand the risks within the System, and GRS included stress testing of the System within the valuation report which tested the implications that volatile investment returns and the impact of changes in the active population have on the funded ratio and employer contributions. However, the more direct risk to the State is further reductions in the discount rate which will directly increase the State’s contribution. Using current capital market assumptions, GRS indicated there is only about a 40% chance of achieving a return equal to or greater than the current discount rate of 6.50%. The Board of Education currently bears the risk for the actual investment returns, but it appears highly likely that expected returns (or the discount rate) will need to be reduced further. We recommend that GRS continue to include stress testing of the System within the valuation report and that future stress testing include the impact to the required State contribution of potential reductions in the discount rate (Recommendation #1).

The actuarial valuation report prepared by GRS includes both traditional actuarial measurements, as well as some projections on pages 28 to 33 of the June 30, 2021 Actuarial Valuation report. Given the unique and substantial funding challenges faced by the CTPF and the implications of future reliance on the State for funding, this additional information is quite important and supplements the information we present here on funding adequacy to better inform the legislature and other stakeholders about the adequacy of the System’s funding.
SECTION V – ANALYSIS OF HISTORICAL TRENDS

System Funded Ratio

The first trend measure is the System’s funded ratio for the past 10 years which is also included in the GRS draft report. Funded ratio for this purpose is defined as the ratio of the Market Value of Assets to the Actuarial Liability. The chart below shows that CTPF’s funded ratio has declined from 54.5% in 2012 to 53.2% in 2021, a decline in funded ratio of 1.3%. In addition to showing the funded ratio, this chart also shows the breakdown of the Plan’s liabilities by membership status:

- Active liability – the liability (attributable to service already performed) for future payments to members who are currently working in the System,
- Deferred Vested liability – the liability for future payments to members who are no longer working in the system, and
- In-Pay liability – the liability for future payments to retirees and beneficiaries who are currently receiving benefits.

This breakdown shows that today plan assets only cover about 75% of the liabilities for just those members currently in-pay status.

![Liability and Funded Ratio Chart]

Source: Cheiron analysis of funding adequacy.
**Sources of Contributions**

CTPF receives contributions from the Board of Education as well as the State. The chart below shows the source of employer contributions based on the last 10 actuarial valuations. Beginning in fiscal year 2018, the State began contribution the employer normal cost (blue bars). The Board of Education’s required contribution toward the unfunded actuarial liability (UAL) has continued to grow until the exceptional investment returns for the 2021 fiscal year reduced the contribution beginning with the 2023 fiscal year. At the same time, reductions in the discount rate have increased the State’s contribution for normal cost.

---

![Employer Contributions Chart](chart.png)

**Employer Contributions**

<table>
<thead>
<tr>
<th>Year</th>
<th>Additional State</th>
<th>State NC</th>
<th>Required BoE</th>
<th>Additional BoE</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2022</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2023</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---
Sources of Changes in the UAL

CTPF’s UAL has grown from about $6.8 billion in 2011 to $13.2 billion in 2021, an increase of $6.4 billion. To understand how to reverse this trend, it is important to understand the sources contributing to it. To the extent the sources contributing to the growth in UAL indicate a need to change assumptions, they may also indicate potential short-term risk of increased contributions for the State when assumptions are updated.

The changes to the UAL from June 30, 2011 to June 30, 2021 can be separated into the following components:

- **Contribution Deficiencies** – Contributions that are less than the tread water contribution causes the UAL to increase. The tread water contribution consists of two components: the normal cost, which is the cost of benefits earned in a given year, and the interest on the unfunded actuarial liability. This sum is referred to as the tread water contribution because it is the contribution necessary so that the UAL will remain constant, or “tread water” (absent experience gains or losses). The difference between actual contributions and the tread water contributions increased the UAL by $3.2 billion over this period.

- **Assumption Changes** – changes to actuarial assumptions over this period increased the UAL by $4.0 billion. A positive aspect of the UAL increases due to assumption changes is that they will result in liability measurements that more accurately reflect future expectations. Without the changes a similar UAL increase would show up as experience losses over time.

- **Plan Changes** – modifications to the design of the Plan had a negligible impact over this period as most of the changes only affected future benefits.

- **Liability (Gain) or Loss** – the changes in the UAL due to liability experience (i.e., mortality, terminations, salary increases, etc.) were generally small and decreased the UAL by $0.4 billion over this period.

- **AVA (Actuarial Value of Assets) Investment (Gain) or Loss** – the net investment gain or loss due to assets earning more or less than assumed decreased the UAL over this period increased the UAL by $0.5 billion.

The chart on the next page shows the changes in UAL each year broken into these six components. The sum of all the components (total change in UAL) is shown as the black line. Values of each component as well as total by year are shown in the chart along with the totals for the period.
SECTION V – ANALYSIS OF HISTORICAL TRENDS

Sources of Changes in UAL

<table>
<thead>
<tr>
<th>Contributions</th>
<th>Assumptions</th>
<th>Investments</th>
<th>Plan Changes</th>
<th>Liabilities</th>
<th>Total Increase in UAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.60</td>
<td>-</td>
<td>0.68</td>
<td>0.07</td>
<td>0.03</td>
<td>$1.25</td>
</tr>
<tr>
<td>0.62</td>
<td>1.02</td>
<td>(0.28)</td>
<td>-</td>
<td>0.25</td>
<td>$1.61</td>
</tr>
<tr>
<td>0.31</td>
<td>-</td>
<td>(0.46)</td>
<td>-</td>
<td>0.25</td>
<td>$(0.17)</td>
</tr>
<tr>
<td>0.24</td>
<td>-</td>
<td>(0.05)</td>
<td>-</td>
<td>0.03</td>
<td>$0.16</td>
</tr>
<tr>
<td>0.26</td>
<td>-</td>
<td>(0.08)</td>
<td>-</td>
<td>(0.02)</td>
<td>$0.03</td>
</tr>
<tr>
<td>0.22</td>
<td>-</td>
<td>(0.08)</td>
<td>-</td>
<td>(0.18)</td>
<td>$1.27</td>
</tr>
<tr>
<td>0.23</td>
<td>1.07</td>
<td>(0.13)</td>
<td>-</td>
<td>0.08</td>
<td>$1.06</td>
</tr>
<tr>
<td>0.26</td>
<td>0.62</td>
<td>0.13</td>
<td>-</td>
<td>(0.09)</td>
<td>$0.28</td>
</tr>
<tr>
<td>0.25</td>
<td>-</td>
<td>0.10</td>
<td>-</td>
<td>(0.19)</td>
<td>$0.60</td>
</tr>
<tr>
<td>0.22</td>
<td>-</td>
<td>(0.02)</td>
<td>-</td>
<td>(0.13)</td>
<td>$0.36</td>
</tr>
</tbody>
</table>

*The change in UAL due to the change in actuary for the 7/1/2013 valuation was not reported as a standalone value and is included in the Assumption value.

Source: Cheiron analysis of funding adequacy.

We expect that this chart will help stakeholders understand the sources of growth in the UAL over the past decade and inform discussions about the current funding requirements and adequacy.
Net Cash Flow Analysis

The plan’s net cash flow (NCF) is defined as State and member contributions less benefit payments and administrative expenses. The more negative net cash flow is as a percentage of the plan’s assets, the more vulnerable the Plan is to market downturns. When a pension plan has more payouts than contributions and suffers an investment loss, it is left with fewer assets to invest and recapture during a recovery.

Looking at the chart below, CTPF has a significant negative net cash flow (black line). If contributions increase as quickly as benefit payments, the net cash flow will remain stable. But if contributions do not continue to grow either because the Plan has become better funded or because the expected contributions are not made, negative net cash flow may become even more significant issue, therefore it should continue to be monitored. The teal line shows net cash flow as a percent of Market Value of Assets on the right-side axis. The greater the negative cash flows are relative to plan assets the more vulnerable a plan is to market downturns. This is because once there is a market downturn, the plan assets lose both on the return and the negative cash flow, leaving it with a lower asset base from which to recover from the loss.

Source: Cheiron analysis of funding adequacy.
In the State Actuary’s Preliminary Report on the CTPF presented December 16, 2020, Cheiron made several recommendations. Below we summarize how these recommendations were reflected in either the System’s comments last year or in this year’s draft June 30, 2021 Actuarial Valuation.

<table>
<thead>
<tr>
<th>Recommendations to Retirement System from 2020 State Actuary Report</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. We recommend the CTPF Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation.</td>
<td>Implemented</td>
<td>This recommendation has been addressed in the 2021 Actuarial Assumption Study. Recommendation continued.</td>
</tr>
<tr>
<td>2. We recommend that future stress testing include the impact to the required State contribution and discuss the potential for additional funding subsidies from the State.</td>
<td>Implemented</td>
<td>GRS included as an Appendix in the June 30, 2021 Actuarial Valuation Report Stress Testing Scenarios based on the June 30, 2020 Actuarial Valuation Results. These scenarios include both static and volatile return scenarios as well as scenarios testing an annual change in the number of active member of +1% and -1% for each of the next 10 years. The results show the impact on State and Board of Education contributions separately. Recommendation modified.</td>
</tr>
<tr>
<td>3. We recommend that GRS review its disclosures related to ASOP 56 for the next valuation report to ensure that the disclosures clearly identify the purpose of each model, any material limitations of each model, and any other applicable required disclosures under ASOP 56.</td>
<td>Implemented</td>
<td>Language was modified and clarified extension to projection models. Recommendation removed</td>
</tr>
</tbody>
</table>
Appendix A

Illinois State Auditing Act (30 ILCS 5/2-8.1)

Sec. 2-8.1. Actuarial Responsibilities.

(a) The Auditor General shall contract with or hire an actuary to serve as the State Actuary. The State Actuary shall be retained by, serve at the pleasure of, and be under the supervision of the Auditor General and shall be paid from appropriations to the office of the Auditor General. The State Actuary may be selected by the Auditor General without engaging in a competitive procurement process.

(b) The State Actuary shall:

(1) review assumptions and valuations prepared by actuaries retained by the boards of trustees of the State-funded retirement systems;

(2) issue preliminary reports to the boards of trustees of the State-funded retirement systems concerning proposed certifications of required State contributions submitted to the State Actuary by those boards;

(3) cooperate with the boards of trustees of the State-funded retirement systems to identify recommended changes in actuarial assumptions that the boards must consider before finalizing their certifications of the required State contributions;

(4) conduct reviews of the actuarial practices of the boards of trustees of the State-funded retirement systems;

(5) make additional reports as directed by joint resolution of the General Assembly; and

(6) perform any other duties assigned by the Auditor General, including, but not limited to, reviews of the actuarial practices of other entities.

(c) On or before January 1, 2013 and each January 1 thereafter, the Auditor General shall submit a written report to the General Assembly and Governor documenting the initial assumptions and valuations prepared by actuaries retained by the boards of trustees of the State-funded retirement systems, any changes recommended by the State Actuary in the actuarial assumptions, and the responses of each board to the State Actuary's recommendations.

(d) For the purposes of this Section, "State-funded retirement system" means a retirement system established pursuant to Article 2, 14, 15, 16, or 18 of the Illinois Pension Code.

(Source: P.A. 97-694, eff. 6-18-12.)
Appendix B

Materials Reviewed by Cheiron

Following is a listing of information reviewed by Cheiron for each of the retirement systems. This is the information Cheiron relied upon in preparing the preliminary reports of the retirement systems.

**Teachers’ Retirement System:**

- Illinois Law:
  - Illinois Pension Code (40 ILCS 5/) Article 16: Teachers’ Retirement System of the State of Illinois

- Files received from the Teachers’ Retirement System:
  - RVK 2011-2018 Asset Allocation/Investment Performance Presentations
  - Buck IL TRS 2012-2015 Board Meeting Presentations and Memos
  - Segal IL TRS 2016-2021 Board Meeting Presentations
  - Board Meeting Minutes and Agendas from 2013-2021
  - Buck IL TRS 2007-2015 Valuation Reports
  - Segal IL TRS 2016-2021 Valuation Reports
  - Buck IL TRS 2012-2015 Certifications of Required State Contribution
  - Segal IL TRS 2016-2021 Certifications of Required State Contribution
  - Segal IL TRS Experience Analysis 2016, 2017, 2018, 2021
  - Buck IL TRS spreadsheet with additional details on Section 4 of 2013-2015 AVRs
  - TRS Economic Impact Study of Benefits – May 2015
  - TRS Stress Testing Scenarios

- Other:
  - May 2014 *GFOA Best Practice – Actuarial Audits* published by the Government Finance Officers Association
  - August 2021 *Old-Age, Survivors and Disability Insurance Trustees Report* (OASDI)
  - Public Plans Database as of October 2021
  - Survey of Professional Forecasters, Third Quarter 2021, Federal Reserve Bank of Philadelphia
  - Publication H.15 Selected Interest Rates, Board of Governors of the Federal Reserve System
  - CPI-All Urban Consumers, Bureau of Labor Statistics
  - Quarterly Census of Employment and Wages, Bureau of Labor Statistics
Survey of Capital Market Assumptions, 2020 and 2021 Editions, Horizon Actuarial Services, LLC

**State Universities Retirement System**

- Illinois Law:
  - Illinois Pension Code (40 ILCS 5/) Article 15: State Universities Retirement System of Illinois

- Files received from the State Universities Retirement System:
  - Board Meeting Minutes and Agendas from 2013-2021
  - GRS IL SURS 2008-2021 Valuation Reports
  - GRS IL SURS 2012 - 2021 Certifications of Required State Contribution
  - GRS IL SURS DRAFT 2014-2021 GASB 67/68 Reports
  - GRS SURS 2015 Economic Assumptions Review Presentation & Report
  - GRS SURS 2018 Experience Review Report
  - GRS SURS 2021 Experience Review Report
  - SURS Asset Liability Study, Economic Assumption Review, and Recommendation Memos
  - Segal IL SURS Full Scope Audit of the June 30, 2015 Actuarial Valuation
  - NEPC IL SURS Asset Class Assumptions and Actions annual presentations
  - SURS Investment Plan Update FY 2012 - FY 2021
  - GRS IL SURS GASB 67 Plan Reporting and Accounting Schedules

- Other:
  - May 2014 *GFOA Best Practice – Actuarial Audits* published by the Government Finance Officers Association
  - August 2021 *Old-Age, Survivors and Disability Insurance Trustee’s Report* (OASDI)
  - Public Plans Database as of October 2021
  - Survey of Professional Forecasters, Third Quarter 2021, Federal Reserve Bank of Philadelphia
  - Publication H.15 Selected Interest Rates, Board of Governors of the Federal Reserve System
  - CPI-All Urban Consumers, Bureau of Labor Statistics
  - Quarterly Census of Employment and Wages, Bureau of Labor Statistics
  - Survey of Capital Market Assumptions, 2020 and 2021 Editions, Horizon Actuarial Services, LLC
State Employees’ Retirement System

- Illinois Law:
  - Illinois Pension Code (40 ILCS 5/) Article 14: State Employees’ Retirement System of Illinois

- Files received from the State Employees’ Retirement System:
  - SERS 2018 Experience Review for the Years July 1, 2015 to June 30, 2018
  - Board Meeting Minutes and Agendas from 2013-2021
  - GRS IL SERS 2007-2021 Valuation Reports
  - GRS IL SERS 2012-2021 Certifications of Required State Contribution
  - GRS IL SERS 2021 Economic Assumption Update Review
  - GRS IL SERS spreadsheet with additional details on Tables 4 and 7-10 from 2014 & 2015 Valuation Reports
  - GRS IL SERS DRAFT 2014-2021 GASB 67/68 Reports
  - ISBI Fund Evaluation Reports 2015-2021

- Other:
  - May 2014 GFOA Best Practice – Actuarial Audits published by the Government Finance Officers Association
  - August 2021 Old-Age, Survivors and Disability Insurance Trustees Report (OASDI)
  - Public Plans Database as of October 2021
  - Survey of Professional Forecasters, Third Quarter 2021, Federal Reserve Bank of Philadelphia
  - Publication H.15 Selected Interest Rates, Board of Governors of the Federal Reserve System
  - CPI-All Urban Consumers, Bureau of Labor Statistics
  - Quarterly Census of Employment and Wages, Bureau of Labor Statistics
  - Survey of Capital Market Assumptions, 2020 and 2021 Editions, Horizon Actuarial Services, LLC

Judges’ Retirement System

- Illinois Law:
  - Illinois Pension Code (40 ILCS 5/) Article 18: Judges’ Retirement System of Illinois
Files received from the Judges’ Retirement System:
  - JRS Experience Review for July 1, 2015 to June 30, 2018
  - Board Meeting Minutes and Agendas from 2013-2021
  - Goldstein & Associates JRS 2006 – 2011 Valuation Reports
  - GRS IL JRS 2012 – 2021 Valuation Reports
  - GRS IL JRS 2012 – 2021 Certifications of Required State Contributions
  - GRS IL JRS 2019-2020 Economic Assumption Update Review
  - GRS IL JRS 2021 Valuation Results presentation
  - GRS IL JRS spreadsheet with additional details on Tables 4 and 7-10 from 2014 & 2015 Valuation Reports
  - GRS IL JRS DRAFT 2015 – 2021 GASB 67/68 Reports

Other:
  - May 2014 GFOA Best Practice – Actuarial Audits published by the Government Finance Officers Association
  - August 2021 Old-Age, Survivors and Disability Insurance Trustees Report (OASDI)
  - Public Plans Database as of October 2021
  - Survey of Professional Forecasters, Third Quarter 2021, Federal Reserve Bank of Philadelphia
  - Publication H.15 Selected Interest Rates, Board of Governors of the Federal Reserve System
  - CPI-All Urban Consumers, Bureau of Labor Statistics
  - Quarterly Census of Employment and Wages, Bureau of Labor Statistics
  - Survey of Capital Market Assumptions, 2020 and 2021 Editions, Horizon Actuarial Services, LLC

General Assembly Retirement System

Illinois Law:
  - Illinois Pension Code (40 ILCS 5/) Article 2: General Assembly Retirement System of Illinois

Files received from the General Assembly Retirement System:
  - GARS Experience Review for July 1, 2015 to June 30, 2018
  - Board Meeting Minutes and Agendas from 2013 – 2021
  - Goldstein & Associates GARS 2006 – 2011 Valuation Reports
  - GRS IL GARS 2012 – 2021 Valuation Reports
  - GRS IL GARS 2012 – 2021 Certifications of Required State Contributions
  - GRS IL GARS 2019-2020 Economic Assumption Update Review
  - GRS IL GARS spreadsheet with additional details on Tables 4 and 7-10 from 2014 – 2020 Valuation Reports
o GRS IL GARS DRAFT 2015 – 2021 GASB 67/68 Reports

• Other:
  o May 2014 GFOA Best Practice – Actuarial Audits published by the Government Finance Officers Association
  o August 2021 Old-Age, Survivors and Disability Insurance Trustees Report (OASDI)
  o Public Plans Database as of October 2021
  o Survey of Professional Forecasters, Third Quarter 2021, Federal Reserve Bank of Philadelphia
  o Publication H.15 Selected Interest Rates, Board of Governors of the Federal Reserve System
  o CPI-All Urban Consumers, Bureau of Labor Statistics
  o Quarterly Census of Employment and Wages, Bureau of Labor Statistics
  o Survey of Capital Market Assumptions, 2020 and 2021 Editions, Horizon Actuarial Services, LLC

Chicago Teachers’ Pension Fund

• Illinois Law:
  o Illinois Pension Code (40 ILCS 5/) Article 17: Public School Teachers’ Pension and Retirement Fund – Cities of Over 500,000 Inhabitants
  o Public Act (P.A.) 090-0566, P.A. 090-0582, P.A. 091-0357, P.A. 100-0465

• Files received from the Chicago Teachers’ Pension Fund:
  o Goldstein & Associates CTPF 2007-2011 Valuation Reports
  o Segal CTPF 2012-2016 Valuation Reports
  o GRS 2017-2021 Valuation Reports
  o 2018 Actuarial Experience Study dated May 25, 2018
  o 2021 Actuarial Experience Review dated September 14, 2021

• Other:
  o May 2014 GFOA Best Practice – Actuarial Audits published by the Government Finance Officers Association
  o August 2021 Old-Age, Survivors and Disability Insurance Trustees Report (OASDI)
  o Public Plans Database as of October 2021
  o Survey of Professional Forecasters, Third Quarter 2021, Federal Reserve Bank of Philadelphia
  o Publication H.15 Selected Interest Rates, Board of Governors of the Federal Reserve System
  o CPI-All Urban Consumers, Bureau of Labor Statistics
o Quarterly Census of Employment and Wages, Bureau of Labor Statistics
o Survey of Capital Market Assumptions, 2020 and 2021 Editions, Horizon Actuarial Services, LLC
Appendix C

Responses from the Retirement Systems

The responses from the Retirement Systems to the State Actuary’s recommendations appear on the following pages:

TRS – pages 254-257
SURT – pages 258-262
SERS – pages 263-268
JRS – pages 269-274
GARS – pages 275-280
CTPF – pages 281-284
VIA ELECTRONIC MAIL
Mr. Joe Butcher
Office of the Auditor General
740 East Ash Street, First Floor
Springfield, IL 62703

Dear Mr. Butcher:

We reviewed the draft report prepared by the state actuary on the preliminary 2021 actuarial valuation prepared by Segal. TRS and Segal offer the following joint response to Cheiron’s recommendations.

The TRS board met on December 8, 2021 to provide final certification to the June 30, 2021 actuarial valuation report and the FY 2023 state funding requirements.

**State Mandated Methods**

1. **Cheiron continues to recommend that the funding method be changed to fully fund plan benefits and discontinue the systematic underfunding of TRS.** Continuing the practice of underfunding future accruals increases the risk of the System becoming unsustainable. Cheiron understands that the funding method is under the jurisdiction of state law, not TRS. (Recommendation #1)

   We agree that the current funding methodology does not follow Actuarial Standards of Practice (ASOP). The TRS board consistently expresses concerns over inadequate funding and, in 2012, began certifying alternative state funding requirements that do conform to actuarial standards. Cheiron confirms that the alternative funding method used by the board conforms to a goal of full funding within a reasonable period.

2. **Cheiron recommends the phase-in period for the impact of assumption changes be reduced to three years since experience studies are performed every three years. (Recommendation #2)**

   We agree that the current phase-in period should be reduced from five years to three years based on the required time period between experience studies. However, the phase-in period is determined in Public Act 100-0023 and is under the jurisdiction of State law rather than TRS.
**Recommended Additional Disclosures for the 2021 Valuation**

3. Cheiron recommends that Segal include a more detailed explanation of how the new entrant assumption was developed. *(Recommendation #3)*

The new entrant assumption is based upon an analysis of historical salary data for recent new entrants. Segal included an explanation of how the new entrant pay increase assumption was developed in the experience study report dated September 30, 2021. Upon request, we can separately provide additional information to Cheiron.

**Recommended Changes for Future Valuations**

4. Cheiron continues to recommend Segal provide additional information in the valuation report about the new entrant population used in its projection such as the average age and service of the population each year. *(Recommendation #4)*

Segal included detailed information about the new entrant profile in the preliminary 2021 actuarial valuation report, however Segal will include additional information about the new entrants, such as average age and service for future years, in the final 2021 actuarial valuation report.

5. **Cheiron recommends that the TRS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation. However, they also recommend that Segal take into consideration TRS’ investment consultant’s expected returns in developing the investment return assumptions.** *(Recommendation #5)*

Since 2013, the TRS actuaries have reviewed the interest and inflation assumptions and will continue to do so.

The most recent Segal’s analysis was based on the Horizon Survey of Capital Market Assumptions (2020 Edition). This survey compiles and averages the capital market assumptions of 39 investment consultants (including TRS’ investment consultant, RVK).

Segal will consider supplementing the investment return analysis with RVK’s capital market assumptions for the 2022 valuation.

6. **Cheiron recommends future stress testing to include the impact to the required State contribution of potential reductions in the discount rate.** *(Recommendation #6)*

Segal will consider including additional stress testing related to potential reductions in the discount rate for the 2022 valuation.

7. **Cheiron recommends that Segal revise the inactive vested buyout assumption for future valuations so members who have already been offered a buyout and not taken it are not assumed to take a buyout in the future.** *(Recommendation #7)*
Segal noted in the experience study completed in 2021 that the current administrative practice is to provide a one-time offer of the inactive vested buyout at the time of termination without any subsequent offers. However, for valuation purposes, we apply the inactive vested buyout election percentage assumption to the entire inactive vested population. The current inactive vested buyout election assumption is adjusted by Segal to address the discrepancy between valuation methodology and administrative practices, which we believe to be a reasonable approach given the limited window for the buyout program.

8. **Cheiron recommends that Segal increase the Full-Time future service accrual rate assumption to 1.0 years of service and consider non-full-time member future service accrual rates that reflect recent experience on an individual basis. (Recommendation #8)**

As with other assumptions reviewed during the experience study completed in 2021, the proposed future service accrual rate assumption for full-time members was selected to fall between the current assumption rate and the rate shown by experience during the study period. For valuation purposes, full-time refers to members who were reported as either fulltime or regular part-time status. Regular part-time members make up less than 1% of the total full-time member group and, thus, were deemed immaterial. However, Segal will review the historic service accrual rates for regular part-time members separately as part of the next experience study to determine whether separate assumptions are warranted.

Segal will also review the service accrual rates of non-full-time members as part of the next experience study and consider whether changing the method to reflect recent experience on an individual basis is warranted.

9. **Cheiron recommends Segal disclose historical values of maturity measures that are significant to understanding the risks identified along with projections of these measures to the extent they are already available from the current projections. (Recommendation #9)**

Segal will provide the historical values of maturity measures that are significant to understanding the risks identified in future valuation reports.

Thank you for Cheiron’s thorough review of Segal’s work. We appreciate their focus on the substantial risks caused by eight decades of TRS underfunding. Please let us know if you or Cheiron would like to discuss any of these issues.

Sincerely,

Stan Rupnik
Executive Director and Chief Investment Officer
cc:   Amy Reynolds, TRS
      Jon Fox, OAG
      Dennis Gibbons, OAG
      Heather Powell, BKD
      Bill Hallmark, Cheiron
      Coralie Taylor, Cheiron
      Gene Kalwarski, Cheiron
      Ken Kent, Cheiron
      Matt Wells, Cheiron
      Michael Noble, Cheiron
      Christian Benjaminson, Cheiron
      Jana Austin, Cheiron
      Jake Libauskas, Cheiron
      Matt Strom, Segal
      Tatsiana Dybal, Segal
      David Nickerson, Segal
      Tyler Prestholt, Segal
December 10, 2021

Mr. Frank J. Mautino
Auditor General
740 East Ash Street
Springfield, IL  62703

Re: Response to the State Actuary’s Report on the SURS June 30, 2021 Actuarial Valuation

Dear General Mautino:

This is the official response from the State Universities Retirement System of Illinois (SURS) regarding the December 2021 preliminary report issued by Cheiron – The State Actuary’s Preliminary Report on the State Universities Retirement System of Illinois Pursuant to 30 ILCS 5/2-8.1

What follows is a summary response to each of the recommendations. We have also enclosed a detailed response letter from our actuary, Gabriel Roeder Smith & Company (GRS).

Proposed Certification of the Required State Contribution

The State Actuary accepts the preliminary proposed certification of $2,130,330,000 for the fiscal year 2023 SURS required state contribution.

Assessment of Actuarial Assumptions Used in the 2021 Valuation

The December 2021 report issued by the State Actuary, Cheiron, indicates that they believe that the assumptions used in the June 30, 2021, Actuarial Valuation are reasonable.

State Mandated Funding Method

1. The State Actuary recommends that the funding method be changed to fully fund plan benefits and discontinue the systematic underfunding of SURS.

   **Response:** The funding policy is established by the legislature and is not under the control of the Board. Please note that prior annual valuation reports and the certification letters sent to the State have addressed this concern and we plan to do so again in this year’s communication.

2. Public Act 100-0023 (P.A. 100-0023), effective July 6, 2017, modified the State’s funding policy to require that the contribution impact of all assumptions changes be phased-in over a five-year period. Because experience studies are performed every three year, the State Actuary recommends that the phase-in period of the impact of assumption changes be reduced to three years.

   **Response:** The funding policy is established by the legislature and is not under the control of the Board. GRS recommends eliminating the phase-in period.
Recommended Changes for Future Valuations

3. Cheiron commended GRS for providing stress testing for the System. They recommended that in future valuations these stress tests should include the impact to the required State contribution of potential reductions in the discount rate.

Response: GRS can provide commentary on the estimated impact to the required State contribution of potential reductions in the discount rate as part of next year’s stress testing.

4. As it relates to Actuarial Standard of Practice (ASOP) No. 51, Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions: Cheiron recommends that in future valuations the actuary explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition.

Response: GRS will consider the recommendations from Cheiron and make changes to the fiscal year 2022 actuarial valuation report as appropriate.

5. As it relates to Actuarial Standard of Practice (ASOP) No. 51, Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions: Cheiron recommends that for each identified risk the actuary provide as assessment, preferably quantitative, that considers the specific circumstances of this plan.

Response: GRS will consider the recommendations from Cheiron and make changes to the fiscal year 2022 actuarial valuation report as appropriate.

6. Cheiron recommends that the Board continue to annually review the economic assumptions (interest rate and inflation) each year prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation.

Response: GRS performed an experience study using the June 30, 2017 – June 30, 2020 data and presented their findings to the Board at the March 2021 and June 2021 Board meetings. The updated assumptions were implemented in the June 30, 2021 actuarial valuation.

Please do not hesitate to contact me with any questions or concerns about our response.

Sincerely yours,

Suzanne M. Mayer
Executive Director


cc: Michael Noble, Cheiron
Joe Butcher, Office of the Auditor General
Heather Powell, BKD, LLP
December 1, 2021

Board of Trustees
State Universities Retirement System of Illinois
1901 Fox Drive
Champaign, Illinois 61820


Dear Members of the Board:

At your request, we have reviewed the report issued by Cheiron dated November 30, 2021 – The State Actuary’s Preliminary Report on the State Universities Retirement System of Illinois (“Surs”) Pursuant to 30 ILCS 5/2-8.1. This report consists of a review of the June 30, 2021 actuarial valuation of Surs prepared by Gabriel, Roeder, Smith & Company (“GRS”).

Assessment of Actuarial Assumptions and Methods Used in the 2021 Valuation

This report issued by the State Actuary, Cheiron, indicates that “In summary, we believe that the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable. We also find that the certified contributions, notwithstanding the inadequate State funding requirements that do not conform to generally accepted actuarial principles and practices, were properly calculated in accordance with State law.”

Proposed Certification of the Required State Contribution

In this section, the State Actuary notes that they have verified the arithmetic accuracy of the required State contribution calculated by GRS and the assumptions on which it was based, and accepted the GRS projections of future payroll, total normal costs, employee contributions, combined benefit payments and expenses, and total contributions.

State Mandated Funding Method

In this section, the State Actuary opines on their concern regarding the Statutory funding method and recommends that the Statutory funding method be changed to fully fund plan benefits and discontinue the systematic underfunding of Surs. (Recommendation #1)

The funding method used in the June 30, 2021 actuarial valuation of Surs is prescribed in accordance with Article 15 of the Illinois Pension Code (as noted by Cheiron) and is not under the actuary or the Board’s control; therefore, no action is required. We note that both GRS, in our annual actuarial valuation reports, and the Board, have communicated similar concerns to the State consistently over the years. Therefore, we encourage Cheiron, in their role as the State Actuary, to address this issue directly with the State of Illinois and recommend a statutory change.
Conformance to Statutory Funding Changes of Public Act 100-0023

In this section, the State Actuary recommends that the phase-in of the contribution impact of assumption changes be reduced from five years to three years (since experience studies are performed every three years). (Recommendation #2)

The funding method used in the June 30, 2021 actuarial valuation of SURS is prescribed in accordance with Article 15 of the Illinois Pension Code (as noted by Cheiron) and is not under the actuary or the Board’s control; therefore, no action is required. In our annual actuarial valuation reports, we have recommended eliminating the phase-in of the contribution impact of assumption changes.

Cheiron describes the additional provisions from Public Act 100-0023 (optional hybrid plan and contributions in excess of the Governor’s pay). With regard to contributions in excess of the Governor’s pay, Cheiron states, “We have verified that GRS has reflected these additional employer contributions in the development of the net State Contribution.”

Conformance to Statutory Funding Changes of Public Act 100-0587

Cheiron describes the provisions from Public Act 100-0587 (accelerated pension benefit payment option). They do not note any recommendations in this section. Regarding the assumption used in the June 30, 2021 actuarial valuation of no participants electing the accelerated pension benefit payment option they state, “We believe this approach is reasonable.”

Assessment of Actuarial Assumptions Used in the 2021 Valuation

Cheiron states, “We reviewed the experience study completed this year and conclude that the recommended assumptions are reasonable in general, based on the evidence provided to us. ”

Recommended Changes for Future Valuations

Recommendation #3 is to include the impact to the required State contribution of potential reductions in the discount rate. Cheiron notes, “We commend GRS for providing stress testing of the System and including an explanation of the implications that volatile investment returns and a variety of other stressors (e.g., membership declines, plan selection) can have on future State costs. The tests illustrate the potential stresses on the System and its contributing sponsors so that an assessment of sustainability can be made. We recommend that in future valuations these stress tests should include the impact to the required State contribution of potential reductions in the discount rate.”

GRS can provide commentary on the estimated impact to the required State contribution of potential reductions in the discount rate as part of next year’s stress testing.

Recommendations #4 and #5 relate to Actuarial Standard of Practice (ASOP) No. 51, Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions.

Recommendation #4 Cheiron notes “In future valuations, we recommend that the actuary explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition.”
Recommendation #5 Cheiron notes “We recommend that for each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of this plan.”

Recommendation #6 is that the Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly.

We performed an experience study prior to the June 30, 2021 actuarial valuation and updated assumptions were implemented.

GRS will consider the recommendations from Cheiron and make changes to the 2022 actuarial valuation report, as appropriate.

GASB Statement Nos. 67 and 68
Cheiron indicates, “We find that the assumptions and methods used to prepare the 2021 SURS GASB 67 and 68 schedules are reasonable based on the evidence provided to us.”

Sincerely,

Gabriel, Roeder, Smith & Company

Brian B. Murphy, FSA, EA, FCA, MAAA, PhD
Senior Consultant

Suzanne Mayer, SURS
Tara Myers, SURS
Kristen Brundirks, GRS
Kevin Noelke, GRS

Amy Williams, ASA, FCA, MAAA
Senior Consultant

BBM/AW:bd

cc: Suzanne Mayer, SURS
Tara Myers, SURS
Kristen Brundirks, GRS
Kevin Noelke, GRS
Dear Mr. Butcher,

The management of the State Employees’ Retirement System (SERS) has reviewed the State Actuary’s preliminary report on the draft SERS June 30, 2021 Actuarial Valuation, prepared by Gabriel, Roeder, Smith and Company (GRS). The report notes the State Actuary (Cheiron) believes “the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable.” In addition, Cheiron found “the certified contributions, notwithstanding the inadequate State funding requirements that do not conform to generally accepted actuarial principles and practices, were properly calculated in accordance with State law.”

Listed are Cheiron’s recommendations and SERS management’s responses to those recommendations. In addition, attached are the GRS responses to the recommendations.

**State Mandated Funding Method**

1. **We continue to recommend that the funding method be changed to fully fund plan benefits.** Continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the system becoming unsustainable. Consequently, we recommend that the funding method maintain contributions at a level that is expected to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

   Response: The SERS Board of Trustees agrees with recommendation and in 2015 adopted a funding policy that provides for annual State contributions equal to the projected normal cost of benefits earned in a year plus an amount to amortize the unfunded liabilities over 25 years as a level percent of payroll. This amount is considered the “Actuarially Determined Contribution” (ADC) and for informational purposes is included in the actuarial valuation and the annual certifications of the required State contribution.
2. Because experience studies are performed every three years, we recommend that the phase-in period for the impact of assumption changes be reduced to three years. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Response: The SERS Board of Trustees agrees with the recommendation.

**Recommended Additional Disclosures for 2021 Valuation**

3. We recognize that there is very little experience on which to base these assumptions (buyout program participation rates), however given the changes in the assumptions in 2021 there must be some basis for the changes which should either be included in the report or referenced to another public document that includes the information supporting these changes.

Response: The assumptions for the buyout programs were adopted at the July 2021 Board meeting for the 2021 valuation based on actual experience since the programs were initiated in 2018 (AAI buyout) and 2019 (total buyout). SERS will work with GRS to provide additional justification for these changes in the 2021 valuation.

**Recommended Changes for Future Valuations**

4. Section 3.2 of ASOP 51 requires the actuary to identify risks that “may reasonably be anticipated to significantly affect the plan’s future financial condition.” The risks currently identified appear to largely duplicate the list of examples in ASOP 51 and could apply to almost any pension plan. In future valuations, we recommend that the actuary explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition.

Response: SERS staff will defer to GRS to respond to this recommendation.

5. For each risk identified above, Section 3.3 of ASOP 51 requires the actuary to provide an assessment that takes into account “circumstances specific to the plan.” For some of the identified risks, the actuary has provided a quantitative assessment specific to the plan while for other identified risks, the actuary has only provided a generic statement that could apply to any plan. We recommend that for each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of the plan.

Response: SERS staff will defer to GRS to respond to this recommendation.
6. **We recommend GRS provide additional explanation and justification for methods used to develop the mortality assumptions used in the valuation.**

   Response: SERS and GRS will consider providing more comments and mortality assumptions for the next valuation report.

7. **We recommend the SERS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation.**

   Response: The Board of Trustees will continue to annually review the economic assumptions in a timely manner so adjustments to the assumptions will be included in the next valuation.

Please let me know if you would like to further discuss your recommendations or our responses.

   Sincerely,

   Timothy B. Blair, Executive Secretary
   State Employees’ Retirement System
December 9, 2021

Board of Trustees  
State Employees’ Retirement System of Illinois  
2101 South Veterans Parkway  
P.O. Box 19255  
Springfield, IL  62794-9255

Re: Response to State Actuary Report of 2021 — SERS

Dear Members of the Board:

At your request we have reviewed the report issued by Cheiron – The State Actuary’s Preliminary Report on the State Employees’ Retirement System of Illinois (“SERS”) Pursuant to 30 ILCS 5/2-8.1. This report contains a review of the June 30, 2021, actuarial valuation for SERS.

Assessment of Actuarial Assumptions and Methods Used in the 2021 Valuation

This report issued by the State Actuary, Cheiron, indicates that “In summary, we believe that the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable. We also find that the certified contributions, notwithstanding the inadequate State funding requirements that do not conform to generally accepted actuarial principles and practices, were properly calculated in accordance with State law.”

Page 1 of the transmittal letter of the draft GRS Actuarial Valuation report states:

The System’s current contribution rate determined under the statutory funding policy may not conform to the Actuarial Standards of Practice. Therefore, the Board adopted an actuarial funding policy to be used to calculate the Actuarially Determined Contribution (“ADC”) under GASB Statement Nos. 67 and 68 for financial reporting purposes.

Although the statutory contribution requirements were met, the statutory funding method generates a contribution requirement that is less than a reasonable actuarially determined contribution. Meeting the statutory requirement does not mean that the undersigned agree that adequate actuarial funding has been achieved. We recommend the adherence to a funding policy, such as the Board policy used to calculate the ADC under GASB Statements Nos. 67 and 68, that funds the normal cost of the plan as well as an amortization payment that seeks to pay off any unfunded accrued liability over a closed-period of 25 years.
State Mandated Funding Method

In item 1, the State Actuary recommends that: “the funding method be changed to fully fund plan benefits. Continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the System becoming unsustainable. Consequently, we recommend that the funding method maintain contributions at a level that is expected to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded.”

We agree with the State Actuary’s comment on strengthening SERS funding policy. As stated above, a funding policy that finances the normal cost plus the unfunded actuarial liability over a 25-year closed-period would, in our opinion, strengthen the funded status of SERS. However, a change in the funding method and funding policy would require a statutory change.

In item 2, the State Actuary recommends that the phase-in period for the impact of assumption changes be reduced to three years since experience studies are performed every three years.

The funding method used in the June 30, 2021, actuarial valuation is prescribed in accordance with Public Act 100-0023 and is not under the actuary or the Board’s control; therefore, no action is required. However, we agree with the State Actuary’s recommendation.

In item 3, the State Actuary recommends that the actuarial report include the basis for the changes in the election assumptions for the Accelerated Pension Benefit Payments program or a reference to other supporting documentation.

We agree with the State Actuary’s recommendation to disclose additional information supporting the election assumptions used for the Accelerated Pension Benefit Payments program.

GRS will continue to review experience related to the Optional Hybrid Plan, and if required, recommend updates to assumptions.

Recommended Changes for Future Valuations

In item 4, the State Actuary recommends that GRS “explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition.”

We will consider recommendations from the State Actuary and make changes to the 2022 actuarial valuation report, as appropriate.

In item 5, the State Actuary recommends that for each risk that is identified in item 4, GRS provide an assessment, preferably quantitative, that considers the specific circumstances of the plan.

We will consider recommendations from the State Actuary and make changes to the 2022 actuarial valuation report, as appropriate.
In item 6, the State Actuary recommends that GRS provide additional explanation and justification for methods used to develop the mortality assumptions used in the valuation.

We agree with the State Actuary’s recommendation. For the next full experience study we will consider reflecting the recommendations made by the State Actuary including providing a more detailed disclosure of the methodology, rationale and development of mortality rates. In future actuarial valuation reports we will consider providing more disclosure and rationale on the development of the mortality rates.

In item 7, the State Actuary recommends that SERS annually review the economic assumptions prior to commencing the valuation work, and adjust assumptions accordingly.

We agree with the State Actuary’s recommendation and will continue to provide the SERS Board, on an annual basis, with information necessary to evaluate all economic assumptions, prior to commencing the valuation process.

Respectfully submitted,

Gabriel, Roeder, Smith & Company

Alex Rivera, FSA, EA, MAAA, FCA
Senior Consultant

Heidi Barry, ASA, MAAA, FCA
Senior Consultant

Jeff Tebeau, FSA, EA, MAAA
Consultant
December 10, 2021

Mr. Joe Butcher
Office of the Auditor General
740 East Ash Street, First Floor
Springfield, IL 62703

Dear Mr. Butcher,

The management of the Judges’ Retirement System (JRS) has reviewed the State Actuary’s preliminary report on the draft JRS June 30, 2021 Actuarial Valuation, prepared by Gabriel, Roeder, Smith and Company (GRS). The report notes the State Actuary (Cheiron) believes “the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable.” In addition, Cheiron found “the certified contributions, notwithstanding the inadequate State funding requirements that do not conform to generally accepted actuarial principles and practices, were properly calculated in accordance with State law.”

Listed are Cheiron’s recommendations and JRS management’s responses to those recommendations. In addition, attached are the GRS responses to the recommendations.

State Mandated Funding Method

1. We continue to recommend that the funding method be changed to fully fund plan benefits. Continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the system becoming unsustainable. Consequently, we recommend that the funding method maintain contributions at a level that is expected to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Response: The JRS Board of Trustees agrees with recommendation and in 2015 adopted a funding policy that provides for annual State contributions equal to the projected normal cost of benefits earned in a year plus an amount to amortize the unfunded liabilities over 25 years as a level percent of payroll. This amount is considered the “Actuarially Determined Contribution” (ADC) and for informational purposes is included in the actuarial valuation and the annual certifications of the required State contribution.
2. Because experience studies are performed every three years, we recommend that the phase-in period for the impact of assumption changes be reduced to three years. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Response: The JRS Board of Trustees agrees with the recommendation.

Recommended Additional Disclosures for 2021 Valuation

3. We continue to recommend that GRS include stress testing of the System within the valuation report and include a thorough explanation of the implications that volatile investment returns and a variety of other stressors (e.g. membership declines, lower salary growth) can have on future State costs. In particular, the tests should illustrate the potential stresses on the System and its contributing sponsors so that an assessment of sustainability can be made. These stress tests should include the impact to the required State contribution of potential reductions in the discount rate. GRS did not include stress testing in this year’s valuation report. In 2020 GRS also didn’t include stress testing in their initial report which Cheiron reviewed, but they did include stress testing in a final report submitted on January 4, 2021. We recommend that the final 2021 report include the stress testing.

Response: Stress testing will be included in the final FY 21 valuation.

Recommended Changes for Future Valuations

4. Section 3.2 of ASOP 51 requires the actuary to identify risks that “may reasonably be anticipated to significantly affect the plan’s future financial condition.” The risks currently identified appear to largely duplicate the list of examples in ASOP 51 and could apply to almost any pension plan. In future valuations, we recommend that the actuary explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition.

Response: JRS staff will defer to GRS to respond to this recommendation.

5. For each risk identified above, Section 3.3 of ASOP 51 requires the actuary to provide an assessment that takes into account “circumstances specific to the plan.” For some of the identified risks, the actuary has provided a quantitative assessment specific to the plan while for other identified risks, the actuary has only provided a generic statement that could apply to any plan. We recommend that for each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of this plan.

Response: JRS staff will defer to GRS to respond to this recommendation.
6. **We recommend the JRS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation.**

Response: The Board of Trustees will continue to annually review the economic assumptions in a timely manner so adjustments to the assumptions will be included in the next valuation.

Please let me know if you would like to further discuss your recommendations or our responses.

Sincerely,

[ Signed Original on File ]

Timothy B. Blair, Executive Secretary
Judges’ Retirement System
December 9, 2021

Board of Trustees
Judges’ Retirement System of Illinois
2101 South Veterans Parkway
P.O. Box 19255
Springfield, IL 62794-9255

Re: Response to State Actuary Report of 2021 — JRS

Dear Members of the Board:

At your request, we have reviewed the report issued by Cheiron – The State Actuary’s Preliminary Report on the Judges’ Retirement System of Illinois (“JRS”) Pursuant to 30 ILCS 5/2-8. This report contains a review of the June 30, 2021, actuarial valuation for JRS.

Assessment of Actuarial Assumptions and Methods Used in the 2021 Valuation

This report issued by the State Actuary, Cheiron, indicates that “In summary, we believe that the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable. We also find that the certified contributions, notwithstanding the inadequate State funding requirements that do not conform to generally accepted actuarial principles and practices, were properly calculated in accordance with State law.”

Page 1 of the transmittal letter of the draft GRS Actuarial Valuation report states:

The System’s current contribution rate determined under the statutory funding policy may not conform to the Actuarial Standards of Practice. Therefore, the Board adopted an actuarial funding policy to be used to calculate the Actuarially Determined Contribution (“ADC”) under GASB Statement Nos. 67 and 68 for financial reporting purposes.

Although the statutory contribution requirements were met, the statutory funding method generates a contribution requirement that is less than a reasonable actuarially determined contribution. Meeting the statutory requirement does not mean that the undersigned agree that adequate actuarial funding has been achieved. We recommend the adherence to a funding policy, such as the Board policy used to calculate the ADC under GASB Statement Nos. 67 and 68, that funds the normal cost of the plan as well as an amortization payment that seeks to pay off any unfunded accrued liability over a closed-period of 25 years.
In item 1, the State Actuary recommends that: “funding method be changed to fully fund plan benefits. Continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the System becoming unsustainable. Consequently, we recommend that the funding method maintain contributions at a level that is expected to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded.”

We agree with the State Actuary’s comment on strengthening JRS funding policy. As stated above, a funding policy that finances the normal cost plus the unfunded actuarial liability over a 25-year closed-period would, in our opinion, strengthen the funded status of JRS. However, a change in the funding method and funding policy would require a statutory change.

In item 2, the State Actuary recommends that the phase-in period for the impact of assumption changes be reduced to three years since experience studies are performed every three years.

The funding method used in the June 30, 2021, actuarial valuation is prescribed in accordance with Public Act 100-0023 and is not under the actuary or the Board’s control; therefore, no action is required. However, we agree with the State Actuary’s recommendation.

Recommended Additional Disclosures for the 2021 Valuation

In item 3, the State Actuary recommends that the actuarial valuation report include a section with stress testing information. Stress testing for JRS will be performed prior to the completion of the final valuation report. The stress testing analysis includes scenarios with significant market downturn or significant volatility in investment returns and volatility in future System participation. Stress testing, if done completely and properly, can provide useful information on the level of statutory contributions and funded position of the System under adverse economic conditions.

The Stress Test letter will be included in the appendix of the final June 30, 2021, actuarial valuation report.

Recommended Changes for Future Valuations

In item 4, the State Actuary recommends that GRS “explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition.”

We will consider recommendations from the State Actuary make changes to the 2022 actuarial valuation report, as appropriate.

In item 5, the State Actuary recommends that for each risk that is identified in item 4, GRS provide an assessment, preferably quantitative, that considers the specific circumstances of the plan.
Board of Trustees
Judges’ Retirement System of Illinois
December 9, 2021
Page 3

We will consider recommendations from the State Actuary make changes to the 2022 actuarial valuation report, as appropriate.

In **item 6**, the State Actuary recommends that JRS annually review the economic assumptions prior to commencing the valuation work, and adjust assumptions accordingly.

We agree with the State Actuary’s recommendation and will continue to provide the GARS Board, on an annual basis, with information necessary to evaluate all economic assumptions, prior to commencing the valuation process.

Respectfully submitted,

**Gabriel, Roeder, Smith & Company**

---

**Signed Original on File**

Alex Rivera, FSA, EA, MAAA, FCA
Senior Consultant

Heidi Barry, ASA, MAAA, FCA
Senior Consultant

Jeff Tebeau, FSA, EA, MAAA
Consultant

---
December 10, 2021

Mr. Joe Butcher  
Office of the Auditor General  
740 East Ash Street, First Floor  
Springfield, IL  62703

Dear Mr. Butcher,

The management of the General Assembly Retirement System (GARS) has reviewed the State Actuary’s preliminary report on the draft GARS June 30, 2021 Actuarial Valuation, prepared by Gabriel, Roeder, Smith and Company (GRS). The report notes the State Actuary (Cheiron) believes “the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable.” In addition, Cheiron found “the certified contributions, notwithstanding the inadequate State funding requirements that do not conform to generally accepted actuarial principles and practices, were properly calculated in accordance with State law.”

Listed are Cheiron’s recommendations and GARS management’s responses to those recommendations. In addition, attached are the GRS responses to the recommendations.

**State Mandated Funding Method**

1. We continue to recommend that the funding method be changed to fully fund plan benefits. Continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the system becoming unsustainable. Consequently, we recommend that the funding method maintain contributions at a level that is expected to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Response: The GARS Board of Trustees agrees with recommendation and in 2015 adopted a funding policy that provides for annual State contributions equal to the projected normal cost of benefits earned in a year plus an amount to amortize the unfunded liabilities over 20 years as a level percent of payroll. This amount is considered the “Actuarially Determined Contribution” (ADC) and for informational purposes is included in the actuarial valuation and the annual certifications of the required State contribution.
2. Because experience studies are performed every three years, we recommend that the phase-in period for the impact of assumption changes be reduced to three years. However, we understand that changing the funding method is under the jurisdiction of State law and not the Retirement System.

Response: The GARS Board of Trustees agrees with the recommendation.

Recommended Additional Disclosures for 2021 Valuation

3. We continue to recommend that GRS include stress testing of the System within the valuation report and include a thorough explanation of the implications that volatile investment returns and a variety of other stressors (e.g. membership declines, lower salary growth) can have on future State costs. In particular, the tests should illustrate the potential stresses on the System and its contributing sponsors so that an assessment of sustainability can be made. These stress tests should include the impact to the required State contribution of potential reductions in the discount rate. GRS did not include stress testing in this year’s valuation report. In 2020 GRS also didn’t include stress testing in their initial report which Cheiron reviewed, but they did include stress testing in a final report submitted on January 4, 2021. We recommend that the final 2021 report include the stress testing.

Response: Stress testing will be included in the final FY 21 valuation.

Recommended Changes for Future Valuations

4. Section 3.2 of ASOP 51 requires the actuary to identify risks that “may reasonably be anticipated to significantly affect the plan’s future financial condition.” The risks currently identified appear to largely duplicate the list of examples in ASOP 51 and could apply to almost any pension plan. In future valuations, we recommend that the actuary explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition.

Response: GARS staff will defer to GRS to respond to this recommendation.

5. For each risk identified above, Section 3.3 of ASOP 51 requires the actuary to provide an assessment that takes into account “circumstances specific to the plan.” For some of the identified risks, the actuary has provided a quantitative assessment specific to the plan while for other identified risks, the actuary has only provided a generic statement that could apply to any plan. We recommend that for each identified risk the actuary provide an assessment, preferably quantitative, that considers the specific circumstances of this plan.

Response: GARS staff will defer to GRS to respond to this recommendation.
6. **We recommend the GARS Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation.**

   Response: The Board of Trustees will continue to annually review the economic assumptions in a timely manner so adjustments to the assumptions will be included in the next valuation.

Please let me know if you would like to further discuss your recommendations or our responses.

Sincerely,

Timothy B. Blair, Executive Secretary
Judges’ Retirement System
December 9, 2021

Board of Trustees
General Assembly Retirement System of Illinois
2101 South Veterans Parkway
P.O. Box 19255
Springfield, IL  62794-9255

Re: Response to State Actuary Report of 2021 — GARS

Dear Members of the Board:

At your request, we have reviewed the report issued by Cheiron – The State Actuary’s Preliminary Report on the General Assembly Retirement System of Illinois (“GARS”) Pursuant to 30 ILCS 5/2-8.1. This report contains a review of the June 30, 2021, actuarial valuation for GARS.

Assessment of Actuarial Assumptions and Methods Used in the 2021 Valuation

This report issued by the State Actuary, Cheiron, indicates that “In summary, we believe that the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable. We also find that the certified contributions, notwithstanding the inadequate State funding requirements that do not conform to generally accepted actuarial principles and practices, were properly calculated in accordance with State law.”

Page 1 of the transmittal letter of the draft GRS Actuarial Valuation report states:

The System’s current contribution rate determined under the statutory funding policy may not conform to the Actuarial Standards of Practice. Therefore, the Board adopted an actuarial funding policy to be used to calculate the Actuarially Determined Contribution (“ADC”) under GASB Statement Nos. 67 and 68 for financial reporting purposes.

Although the statutory contribution requirements were met, the statutory funding method generates a contribution requirement that is less than a reasonable actuarially determined contribution. Meeting the statutory requirement does not mean that the undersigned agree that adequate actuarial funding has been achieved. We recommend the adherence to a funding policy, such as the Board policy used to calculate the ADC under GASB Statement Nos. 67 and 68, that funds the normal cost of the plan as well as an amortization payment that seeks to pay off any unfunded accrued liability over a closed-period of 20 years.
State Mandated Funding Method

In item 1, the State Actuary recommends that: “funding method be changed to fully fund plan benefits. Continuing the practice of inadequate contributions and targeting a funded percentage less than 100% increases the risk of the System becoming unsustainable. Consequently, we recommend that the funding method maintain contributions at a level that is expected to reduce the unfunded actuarial liability each year until the Plan is ultimately 100% funded.”

We agree with the State Actuary’s comment on strengthening GARS funding policy. As stated above, a funding policy that finances the normal cost plus the unfunded actuarial liability over a 20-year closed-period would, in our opinion, strengthen the funded status of GARS. However, a change in the funding method and funding policy would require a statutory change.

In item 2, the State Actuary recommends that the phase-in period for the impact of assumption changes be reduced to three years since experience studies are performed every three years.

The funding method used in the June 30, 2021, actuarial valuation is prescribed in accordance with Public Act 100-0023 and is not under the actuary or the Board’s control; therefore, no action is required. However, we agree with the State Actuary’s recommendation.

Recommended Additional Disclosures for the 2021 Valuation

In item 3, the State Actuary recommends that the actuarial valuation report include a section with stress testing information. Stress testing for GARS will be performed prior to the completion of the final valuation report. The stress testing analysis includes scenarios with significant market downturn or significant volatility in investment returns and volatility in future System participation. Stress testing, if done completely and properly, can provide useful information on the level of statutory contributions and funded position of the System under adverse economic conditions.

The Stress Test letter will be included in the appendix of the final June 30, 2021, actuarial valuation report.

Recommended Changes for Future Valuations

In item 4, the State Actuary recommends that GRS “explain how each risk identified would reasonably be anticipated to significantly affect the specific plan’s future financial condition.”

We will consider recommendations from the State Actuary make changes to the 2022 actuarial valuation report, as appropriate.

In item 5, the State Actuary recommends that for each risk that is identified in item 4, GRS provide an assessment, preferably quantitative, that considers the specific circumstances of the plan.
Board of Trustees
General Assembly Retirement System of Illinois
December 9, 2021
Page 3

We will consider recommendations from the State Actuary make changes to the 2022 actuarial valuation report, as appropriate.

In item 6, the State Actuary recommends that GARS annually review the economic assumptions prior to commencing the valuation work, and adjust assumptions accordingly.

We agree with the State Actuary’s recommendation and will continue to provide the GARS Board, on an annual basis, with information necessary to evaluate all economic assumptions, prior to commencing the valuation process.

Respectfully submitted,

Gabriel, Roeder, Smith & Company

Signed Original on File
Alex Rivera, FSA, EA, MAAA, FCA
Senior Consultant

Signed Original on File
Heidi Barry, ASA, MAAA, FCA
Senior Consultant

Signed Original on File
Jeff Tebeau, FSA, EA, MAAA
Consultant
December 9, 2021

Mr. Frank Mautino  Mr. Joe Butcher
Auditor General  Audit Manager
740 East Ash Street  Illinois Office of the Auditor General
Springfield, Illinois 62703  740 E. Ash Street
Springfield, Illinois 62703

Mr. Gene Kalwarski  Mr. Mike Noble
Principal Consulting Actuary  Principal Consulting Actuary
Cheiron, Inc.  Cheiron, Inc.
200 West Monroe Street, Suite 1800  200 West Monroe, Suite 1800
Chicago, Illinois 60606  Chicago, Illinois 60606


The State Actuary’s Recommendations and Report Comment are set out, below:

1. We recommend that GRS continue to include stress testing of the System within the valuation report and that future stress testing include the impact to the required State contribution of reductions in the discount rate.

2. We recommend the CTPF Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation

Report Comment for CTPF Consideration:

1. Actuarial Cost Method

The System uses the projected unit credit cost method (PUC) to assign costs to years of service, as required under the Pension Code (40 ILCS 5/17). We have no objections with respect to using the PUC method, although we, as GRS does, would prefer the Entry Age Normal (EAN) cost method as it is more consistent with the requirement in 40 ILCS 5/17-129 for level percent of pay funding.
Under the PUC method, which is used by some public sector pension funds, the benefits of active participants are calculated based on their compensation projected with assumed annual increases to ages at which they are assumed to leave the active workforce by any of these causes: retirement, disability, turnover, or death. Only past service (through the valuation date but not beyond) is taken into account in calculating these benefits. The cost of providing benefits based on past service and future compensation is the actuarial accrued liability for a given active participant. Under the PUC cost method, the value of an active participant’s benefits tends to increase more sharply over his or her later years of service than over his or her earlier ones. As a result of this pattern of benefit value increasing, while the PUC method is not an unreasonable method, more plans use the EAN cost method to mitigate this effect. It should also be noted that the EAN cost method is the required method to calculate liability for GASB 67 & GASB 68.

While there is concern over the mandated funding method conforming to generally acceptable actuarial principles and practices, the State’s obligation to fund CTPF is limited to payment of the future normal cost plus expenses and a health care subsidy. Consequently, we have not reviewed the asset valuation method, the amortization method, or the projection of the unfunded actuarial liability.

The two report recommendations will be approved by the CTPF Board of Trustees at the December 16, 2021, Board of Trustees meeting. GRS has been directed by CTPF in future stress testing to present separately the impact to the required State contribution and any potential for additional funding subsidies from the State. The Board and GRS will continue to annually review the economic assumptions (interest rate and inflation) utilized in the valuation report prior to the preparation of the report and adjust them accordingly. In addition, as to the Report Comment, the CTPF Board appreciates and supports the effort by the State Actuary to improve the financial condition of the Fund as demonstrated by the call for using a more appropriate statutory actuarial cost method.

If you have any questions, please do not hesitate to contact me at 312-332-3338.

Best regards,

Carlton W. Lenoir Sr.
Executive Director

Enclosure
Cc: (with enclosure)

Lance Weiss – GRS, CTPF Actuary
Alise White – CTPF, Chief Financial Officer
Daniel Hurtado – CTPF, Chief Legal Officer
December 2, 2021

Board of Trustees
Public School Teachers' Pension and Retirement Fund of Chicago
425 South Financial Place, Suite 1400
Chicago, Illinois 60605

Re: Response to 2021 State Actuary Preliminary Report

Dear Members of the Board:

In accordance with your request, we have reviewed the State Actuary’s Preliminary Report (dated November 30, 2021) on the Public School Teachers’ Pension and Retirement Fund of Chicago (“CTPF”), pursuant to Illinois Public Act 100-0465. This preliminary report consists of a review of the June 30, 2021 actuarial valuation prepared by Gabriel, Roeder, Smith & Company (“GRS”).

We are very pleased that this report, issued by the State Actuary, Cheiron, states “In summary, we believe that the assumptions and methods used in the draft June 30, 2021 Actuarial Valuation, which are used to determine the required Fiscal Year 2023 State contribution, are reasonable. We also find that the certified portion of the contribution which the State is responsible for was properly calculated.”

Cheiron had the following two recommendations:

Recommended Changes for Future Valuations

1. We recommend that GRS continue to include stress testing of the System within the valuation report and that future stress testing include the impact to the required State contribution of reductions in the discount rate.

   **GRS RESPONSE:** GRS performed stress testing of the State and Board of Education contributions and funded ratio to illustrate the potential impact of volatile investment returns and changes in the active population. Such stress testing was included in the June 30, 2021 actuarial report.

   GRS believes this recommendation is reasonable and, with the Board’s concurrence, GRS can provide commentary on the estimated impact to the required State contribution of potential reductions in the discount rate as part of next year’s stress testing.

   2. We recommend the CTPF Board continue to annually review the economic assumptions (interest rate and inflation) prior to commencing the valuation work and adjust assumptions accordingly, as they did for this valuation.
GRS RESPONSE: GRS prepared a 2021 Actuarial Assumptions Study in September of 2021 that reviewed the following assumptions:

- Price inflation;
- Investment return;
- Retirement; and
- Projected future active members.

GRS believes this recommendation is reasonable and we will continue to work with the Board to annually review these same assumptions prior to commencing the valuation work.

Sincerely,

Gabriel, Roeder, Smith & Company

SIGNED ORIGINAL ON FILE

Lance J. Weiss, EA, MAAA, FCA
Senior Consultant and Team Leader

Amy Williams, ASA, MAAA, FCA
Senior Consultant

LJW/AW:sc

cc: Kristen Brundirks, Gabriel, Roeder, Smith & Company
    Cassie Rapoport, Gabriel, Roeder, Smith & Company