STATE OF ILLINOIS

OFFICE OF THE AUDITOR GENERAL

2013 ANNUAL REVIEW

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

DECEMBER 2013

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AUDITOR GENERAL

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OFFICE OF THE AUDITOR GENERAL
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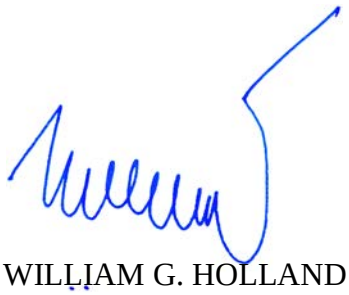
To the Legislative Audit Commission, the Speaker and Minority Leader of the House of Representatives, the President and Minority Leader of the Senate, the members of the General Assembly, and the Governor:

This is our 2013 Annual Review of Information Submitted by the Chicago Transit Authority Retiree Health Care Trust.

The review was conducted pursuant to Public Act 95-708 which amended the Illinois State Auditing Act by adding a requirement for the Auditor General to annually review and report on information submitted by the Board of Trustees of the Chicago Transit Authority Retiree Health Care Trust.

The report for this review is transmitted in conformance with Section 5/22-101B(b)(3)(iv) of the Illinois Pension Code.



WILLIAM G. HOLLAND
Auditor General

Springfield, Illinois
December 2013

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

SUMMARY REPORT DIGEST

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

2013 ANNUAL REVIEW
Release Date: December 2013

SYNOPSIS

The Board of Trustees of the Chicago Transit Authority Retiree Health Care Trust is required by the Illinois Pension Code to submit a report to the Office of the Auditor General (OAG). The report is intended to annually assess the funding level of the Retiree Health Care Trust.

The Illinois State Auditing Act (Section 5/3-2.3(f)) requires the OAG to examine the information on the funding level of the Retiree Health Care Trust submitted pursuant to Section 22-101B(b)(3)(iii) of the Illinois Pension Code.

The OAG is required to review the Retiree Health Care Trust's assumptions to ensure they are not unreasonable in the aggregate. This report does not constitute an audit as that term is defined in generally accepted government auditing standards.

- The Retiree Health Care Trust submitted its Actuarial Valuation Report as of January 1, 2013 to the Office of the Auditor General on October 2, 2013.

- The Report concluded that the actuarial present value of projected contributions, trust income, and assets, in excess of the statutory reserve, exceeded the actuarial present value of the projected benefits. Consequently, no change in benefits or contributions was required.

- We examined the assumptions in the Retiree Health Care Trust's Actuarial Valuation Report and found that they were not unreasonable in the aggregate.

ANNUAL REVIEW
RESULTS AND CONCLUSIONS

STATUTORY REQUIREMENTS

The Illinois State Auditing Act (30 ILCS 5/3-2.3(f)) requires the Auditor General to annually examine the information on the funding level of the Retiree Health Care Trust (RHCT) submitted pursuant to Section 22-101B(b)(3)(iii) of the Illinois Pension Code. The Pension Code requires the Retiree Health Care Trust to prepare a report that meets the requirements delineated in the Code and to submit it to the Auditor General at least 90 days prior to the end of its fiscal year.

The Pension Code (Section 22-101B(b)(3)(iv)) provides the OAG 90 days to review the information submitted by the RHCT. If the RHCT projects a funding shortfall, it shall provide a plan which may (1) increase contributions by employees, retirees, dependents, or survivors, or (2) decrease benefits, or (3) make other plan changes, or (4) any combination thereof to cure the shortfall within 10 years. If the RHCT projects a surplus, it may decrease contributions, increase benefits, or make other plan changes, to the extent of the surplus.

If the OAG review determines the RHCT's assumptions are not unreasonable in the aggregate, the Trust shall implement the plan. Otherwise, the OAG shall explain the basis for its determination to the RHCT and may recommend an alternative.

This report does not constitute an audit as that term is defined in generally accepted government auditing standards. The scope of the OAG's review, established by the Pension Code, focused on whether the actuarial assumptions used in the RHCT report were not unreasonable in the aggregate.

REPORT DETERMINATION

The RHCT's Actuarial Valuation Report concluded that the actuarial present value of projected contributions and trust income plus assets in excess of the statutory reserve exceeded the actuarial present value of the projected benefits.

The Board of Trustees of the Chicago Transit Authority RHCT submitted its Actuarial Valuation Report as of January 1, 2013 to the Office of the Auditor General on October 2, 2013. The Actuarial Valuation Report included information required by the Pension Code. As shown in Digest Exhibit 1, the Actuarial Valuation Report concluded that the actuarial present value of projected contributions and trust income plus assets in excess of the statutory reserve exceeded the actuarial present value of the projected benefits:

- The net actuarial present value of projected benefits was $645,710,391.
- The actuarial present value of projected active contributions, trust income, and assets was $813,380,403 (after subtracting $32,599,547 for the required statutory reserve).

- Consequently, projected income and assets exceeded projected benefits by 26.0 percent, and as such, no reduction in benefits or increase in contributions was necessary.

Digest Exhibit 1
RETIREE HEALTH CARE TRUST
ANNUAL ASSESSMENT
January 1, 2013 RHCT Actuarial Valuation Report

ACTUARIAL PRESENT VALUE OF PROJECTED BENEFITS		**ACTUARIAL PRESENT VALUE OF PROJECTED INCOME AND ASSETS**	
Actuarial present value of projected benefits prior to reduction for retiree contributions	$1,058,031,221	Actuarial present value of projected active contributions and trust income plus assets	$845,979,950
Less: Projected current and future retiree contributions	($412,320,830)	Less: Statutory Reserve[1]	($32,599,547)[1]
Net actuarial present value of projected benefits	$645,710,391	Actuarial present value of projected income and assets, net of statutory reserve	$813,380,403
Projected income and assets exceed projected benefits by 26.0%			

Note: [1] The Statutory Reserve is net of retiree contributions.
Source: Retiree Health Care Trust Actuarial Valuation Report as of January 1, 2013.

The assumptions used in the RHCT's Actuarial Valuation Report were not unreasonable in the aggregate.

With the assistance of our consulting actuary, Aon Hewitt, we examined the RHCT's assumptions in the Actuarial Valuation Report. Overall, these assumptions were not unreasonable in the aggregate. Pages 4 – 9 of our 2013 Annual Review contain observations on the specific assumptions used in the Actuarial Valuation Report.

WILLIAM G. HOLLAND
Auditor General

WGH:JFS

This Annual Review was conducted by OAG staff with the assistance of our consultants, Aon Hewitt.

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2013 Annual Review

Information Submitted by the CTA Retiree Health Care Trust

The Board of Trustees of the Chicago Transit Authority Retiree Health Care Trust is required by the Illinois Pension Code to submit a report to the Office of the Auditor General (OAG) each year. The report is intended to annually assess the funding level of the Retiree Health Care Trust.

STATUTORY REQUIREMENTS

The Illinois State Auditing Act (30 ILCS 5/3-2.3(f)) requires the Auditor General to annually examine the information on the funding level of the Retiree Health Care Trust submitted pursuant to Section 22-101B(b)(3)(iii) of the Illinois Pension Code. The Pension Code requires the Retiree Health Care Trust to prepare a report that meets the requirements delineated in the Code (see inset) and to submit it to the Auditor General at least 90 days prior to the end of its fiscal year.

The Pension Code (Section 5/22-101B(b)(3)(iv)) provides the OAG 90 days to review the information submitted by the Retiree Health Care Trust. If the Retiree Health Care Trust projects a funding shortfall, it **shall** provide a plan which may (1) increase contributions by employees, retirees, dependents, or survivors, or (2) decrease benefits, or (3) make other plan changes, or (4) any combination thereof to cure the shortfall within 10 years. If the Retiree Health Care Trust projects a surplus, it **may** decrease contributions, increase benefits, or make other plan changes, to the extent of the surplus.

ILLINOIS PENSION CODE REQUIREMENTS

(iii) The Board of Trustees shall make an annual assessment of the funding levels of the Retiree Health Care Trust and shall submit a report to the Auditor General at least 90 days prior to the end of the fiscal year. The report shall provide the following:

(A) the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors;

(B) the actuarial present value of projected contributions and trust income plus assets;

(C) the reserve required by subsection (b)(3)(ii); and

(D) an assessment of whether the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors exceeds or is less than the actuarial present value of projected contributions and trust income plus assets in excess of the reserve required by subsection (b)(3)(ii).

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

If the OAG review determines the Retiree Health Care Trust's assumptions are *not unreasonable in the aggregate*, the Trust shall implement the plan. Otherwise, the OAG shall explain the basis for its determination to the Retiree Health Care Trust and may recommend an alternative plan.

REPORT DETERMINATION

The Board of Trustees of the Chicago Transit Authority Retiree Health Care Trust submitted its Actuarial Valuation as of January 1, 2013 to the Office of the Auditor General on October 2, 2013. The Report included information required by the Pension Code. As shown in Exhibit 1, the Report concluded that the actuarial present value of **projected contributions** and trust income plus assets in excess of the statutory reserve **exceeded** the actuarial present value of the **projected benefits**:

- The net actuarial present value of projected benefits was $645,710,391.
- The actuarial present value of projected active contributions, trust income, and assets was $813,380,403 (after subtracting $32,599,547 for the required statutory reserve).
- Consequently, projected income and assets exceeded projected benefits by 26 percent, and as such, no reduction in benefits or increase in contributions was necessary.

Exhibit 1
RETIREE HEALTH CARE TRUST
ANNUAL ASSESSMENT OF ADEQUACY OF TRUST FUNDING
January 1, 2013 RHCT Actuarial Valuation Report

ACTUARIAL PRESENT VALUE OF PROJECTED BENEFITS		**ACTUARIAL PRESENT VALUE OF PROJECTED INCOME AND ASSETS**	
Actuarial present value of projected benefits prior to reduction for retiree contributions	$1,058,031,221	Actuarial present value of projected active contributions and trust income plus assets	$845,979,950
Less: Projected current and future retiree contributions	($412,320,830)	Less: Statutory Reserve [1]	($32,599,547)[1]
Net actuarial present value of projected benefits	$645,710,391	Actuarial present value of projected income and assets, net of statutory reserve	$813,380,403
Projected income and assets exceed projected benefits by 26.0%			

Note: [1] The Statutory Reserve is net of retiree contributions.
Source: Retiree Health Care Trust Actuarial Valuation report as of January 1, 2013.

With the assistance of our consulting actuary, Aon Hewitt, we examined the Retiree Health Care Trust's Actuarial Valuation and concluded that:

- The Board of Trustees of the Retiree Health Care Trust has made an assessment of the funding levels of the Retiree Health Care Trust which concluded that the actuarial present value of projected benefits expected to be paid to current and

future retirees and their dependents and their survivors are less than the actuarial present value of projected contributions and Trust income plus assets in excess of the reserve required by Section 22-101B(b)(3)(ii) of the Illinois Pension Code, and

- The assumptions stated in the Actuarial Report submitted pursuant to Section 22-101B(b)(3)(iii) of the Pension Code are not unreasonable in the aggregate.

Calculation of the Statutory Reserve

The Pension Code requires the Retiree Health Care Trust to establish *"an appropriate funding reserve level which **shall not be less than the amount of incurred and unreported claims plus 12 months of expected claims and administrative expenses**"* (40 ILCS 5/22-101B(b)(3)(ii)) [emphasis added]. The Actuarial Report submitted by the Trust contains a calculation of the statutory reserve. While the calculation includes $47.85 million for *"12 months of expected claims and administrative expenses,"* and $1.76 million for *"incurred and unreported claims,"* for a claims expense total of $49.6 million, it subtracts $17.0 million from the claims expense for *"12 months of expected retiree and dependent contributions."* The netting or subtraction of expected contributions from the expected claims and administrative expenses is not specifically delineated in the Pension Code.

The statutory reserve is one of the figures used in the annual assessment of the Trust funding level required by Section 22-101B(b)(3)(iii) of the Pension Code. A change in the statutory reserve figure, therefore, impacts the calculation as to whether the Trust is adequately funded. As shown in Exhibit 1, when the statutory reserve is calculated by netting expected retiree contributions from expected claims (benefit payments), the actuarial present value of projected income and assets exceeds the actuarial present value of projected benefits by 26 percent. However, the statutory reserve increases from $32.6 million to $49.6 million when expected claims are not reduced by expected retiree contributions of $17.0 million, which results in the actuarial present value of projected income and assets of $796.4 million being 23.3 percent more than the actuarial present value of projected benefits of $645.7 million.

As part of our 2009 Annual Review, we inquired of Trust officials why the statutory reserve was calculated by netting out expected retiree contributions. The Trust's actuary responded that they interpreted *"12 months of expected claims and administrative expenses"* to mean 12 months of net expenses. They noted that their understanding is that "contributions" means active contributions and "benefits" or "claims" to be net of retiree and dependent self-pay contributions. The actuary stated they used this interpretation for the initial January 1, 2008 Actuarial Valuation under Section 3-2.3(a)(7) of the Auditing Act as well as the January 1, 2009 Actuarial Valuation under Section 22-101B(b)(3) of the Pension Code. Our actuarial advisors, Aon Hewitt, indicated that it is not unreasonable to subtract out the contributions from the anticipated benefit payments when calculating a reserve, because no benefits could be paid without corresponding contributions being received.

Actuarial Assumptions

With the assistance of our consulting actuary, Aon Hewitt, we examined the Retiree Health Care Trust's assumptions as disclosed in the January 1, 2013 Actuarial Valuation. Overall, we found that the assumptions are not unreasonable in the aggregate. Aon Hewitt provided the following observations about specific assumptions.

(A) **Net Investment Return.** The net investment return assumption for the Retiree Health Care Trust is seven percent. At the Board's February 28, 2013 Board meeting, the Investment Consultant stated that the RHCT has had an annual return from inception to date of 7.34 percent.

Aon Hewitt calculated the investment return that could be expected based on the target asset allocation in the Chicago Transit Authority (CTA) Retiree Health Care Plan financial statements and supplementary information for years ended December 31, 2012 and 2011. Aon Hewitt looked at two different sets of expected returns:

1. The expected return based on the Aon Hewitt Expected Return Model (as of the first quarter of 2013).
2. A report done by Wilshire Consulting, titled "2013 Report on State Retirement Systems: Funding Levels and Asset Allocation".

Based on the asset allocation in the Trust's investment policy, Wilshire and Aon Hewitt predicted a **weighted average** net investment return of 5.47 percent and 5.78 percent, respectively, both less than the actual assumption of 7.00 percent. However, Aon Hewitt's Expected Return Model indicated the **median** return based on the target asset allocation is 6.44 percent and that the probability of achieving a return of 7.00 percent or greater is 38.5 percent. The weighted average net investment return assumes that the asset classes are one hundred percent correlated, while the median and percentile returns take into account that the asset classes are not one hundred percent correlated. Therefore, Aon Hewitt believes the median is a better representation of the true expected return. Also, the Wilshire report states that it is important to note that Wilshire's long-term asset assumptions do not include any expectations from active management and are targeted at a 10-year time horizon. Given this information, we believe the 7.00 percent net investment return assumption is on the high end of the reasonable range, and that this assumption should be monitored closely in the future.

(B) **Salary Inflation.** The wage inflation assumption is consistent with the Retirement Plan assumption. Also, the overall salary increase assumption is consistent with the Retirement Plan assumption, except that the Retirement Plan assumption for years 2015 and after is dependent upon service (shorter service individuals are assumed to have larger increases) but the Retiree Health Care Trust assumes a flat 5 percent for everyone. We have now noted this difference for the past three years and no changes have occurred, as suggested to gain consistency. The Retiree Health

actuary should review this assumption with the Retirement Plan actuary on an annual basis to ensure consistency.

(C) **Disability and Withdrawal Rates.** Disability and withdrawal rates matched those of the Retirement Plan. These assumptions were all analyzed in the Retirement Plan's last experience study which examined seven years of plan history from January 1, 2001 to December 31, 2007. Aon Hewitt reviewed that experience study and the assumptions as part of its 2009 assumption review. These assumptions are unchanged from the prior year. An experience study is being performed by the Retirement Plan's actuary and some changes may occur with the next Retirement Plan actuarial valuation. As such, the RHCT actuary should be in communication with the Retirement Plan's actuary as part of the next valuation cycle to ensure any changes indicated by the experience study are implemented.

(D) **Mortality.** Pre-retirement mortality rates are set at 90 percent of the 1994 Group Annuity Mortality Table and post-retirement mortality rates follow the 1994 Group Annuity Mortality Table. Actuarial Standard of Practice No. 35 (ASOP 35) provides guidance that future mortality improvement should be included as part of an actuarial valuation. As stated on page 18 of the RHCT's valuation report, "The above mortality tables were determined to reasonably provide for future mortality improvement, based on a review of experience for the Retirement Plan for CTA Employees for the seven-year period ended December 31, 2007." In addition, Segal stated separately that they would be performing an experience study related to mortality prior to the next annual valuation. We recommend that the mortality assumption be specifically monitored in the future to ensure compliance with ASOP 35.

(E) **Retirement Rates.** Active retirement rates matched those of the Retirement Plan. This assumption was analyzed in the Retirement Plan's experience study that has been reviewed previously and will be part of the upcoming experience study.

(F) **Retirement Age.** Selecting age 65 as the expected retirement age for inactive participants is not unreasonable.

(G) **Participation Rates.** The participation assumption for retirees and spouses is based on service at retirement. The assumed participation rates decrease as retiree and dependent contributions increase. Participation rates for 2013 have changed so that there are now separate participation assumptions for non-Medicare eligible and Medicare eligible participants. They have also changed relative to changes in the percent of costs paid by retirees and dependents for 2013. The RHCT's actuary stated that "The percent assumed to decline coverage is assumed to be 50% of the percent of full cost paid by retirees and 100% of the percent of full cost paid by spouses (e.g. retirees paying 80% of the cost of coverage are assumed to decline coverage 40% of the time, and spouses paying 80% are assumed to decline coverage 80% of the time)." The Plan's actuary also indicated that this assumption will be reviewed in detail before the next annual valuation. Without more data on actual

plan experience, it is difficult to fully assess this assumption, although it is not unreasonable.

(H) **Dependents.** The percent married assumption of 75 percent for future retirees and a 3 year age difference is consistent with commonly used values.

(I) **Plan Election.** The plan election assumption is that 75 percent of future pre-Medicare retirees are assumed to elect PPO coverage and 25 percent are assumed to elect HMO coverage. The RHCT has indicated that currently about 72 percent of pre-Medicare retirees are in the PPO and 28 percent are in the HMO.

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

(K) **Per Capita Claims.** The methodology used to calculate the pre-Medicare per capita claims for the self-insured medical and prescription drug benefits utilizes two years of experience (8/1/2010 – 7/31/2012) adjusted for plan design changes and health care trend. This methodology is consistent with the prior valuation. Per capita claims for the fully insured HMO and Medicare Advantage plans are based on the premium rates for 2013. Per capita claims for the Medicare prescription drug fully insured Employer Group Waiver Plan (EGWP) plus self-insured wrap plan for prescription drug coverage are based on the fully insured premiums plus the self-funded claim estimate for 2013.

The changes in per capita health costs are reasonable for most types of coverage. However, Aon Hewitt notes that the per capita health costs for other prescription drug coverage decreased 23 percent from the 2012 amounts. The RHCT's actuary indicated this was due to favorable retiree paid prescription drug experience for the period August 1, 2011 through July 31, 2012.

(L) **Health Care Cost Trends.** The RHCT Valuation utilizes the same trend curve for all benefits, including pre- and post-Medicare medical and prescription drugs. The health care trend rates assumed for medical and pharmacy combined are in line with Aon Hewitt's expectations for the pre-Medicare medical benefits, pre-Medicare prescription drug benefits and post-Medicare prescription drug benefits. However, due to Medicare Advantage funding cuts passed in the Patient Protection and Affordable Care Act (PPACA), it is possible that after the rate guarantee expires at the end of 2013 that the CTA could experience double digit trend increases for the new Medicare Advantage plan for a few years. The RHCT and its actuary should continue to monitor expected increases for this plan carefully and consider adopting a separate trend curve for this plan for future valuations. The 5 percent ultimate trend is reached in 2019. The 5 percent ultimate trend is reasonable, however Aon Hewitt expects a longer period until the ultimate trend is reached than the current seven year period that is assumed. The RHCT's actuary should consider this for the next valuation.

(M) **Retiree Drug Costs.** The Valuation assumes that the effect of annual CPI adjustment of prescription drug copays, annual deductibles, and annual out-of-pocket maximums is to decrease health care trend rates by 0.3%.

(N) **Retiree Contribution Increase Rate.** The application of the medical trend rate to the retiree and dependent contributions is a common practice. Actual contribution increases in the future should be compared against this assumption to ensure that it continues to be reasonable.

(O) **Administrative Expense.** The administrative expense assumption in the January 1, 2013 Valuation increased 33 percent over the amount in the January 1, 2012 Valuation. The RHCT indicated this was due to higher recurring administrative costs and including an adjustment for the Transitional Reinsurance and Patient Centered Outcomes Research Institute (PCORI) fees enacted as part of PPACA. The resulting administrative expense assumption is not unreasonable.

(P) **Lifetime Maximum Benefits.** The assumption of no lifetime maximum benefits in the plan is not unreasonable, as past information was not available on accumulated benefits.

(Q) **Excise Tax.** As part of the Patient Protection and Affordable Care Act (PPACA), there is a provision that will take effect in 2018 for high cost health plans called the Excise Tax. It is a 40 percent tax on health plan costs that exceed certain thresholds written into the law. It has been Aon Hewitt's experience that the large audit firms have indicated they expect that excise tax to be included in actuarial valuations now even though regulations have not been released and the tax is not effective until 2018. In addition, Aon Hewitt guidelines related to retiree valuation work require inclusion of the Excise Tax unless the thresholds are not projected to be exceeded or there is clear evidence of a communication to the plan members that any such tax will be passed on to participants.

In follow-up questions related to the original submission, the RHCT actuary stated the following when asked whether the excise tax has been included in the current valuation: "In order to test the potential effect of the excise tax, we ran liabilities assuming that the Trustees limited benefits (changed plan design) so as to avoid the tax. The net liability decreased by less than 0.5%, so we consider the effect of the excise tax to be *de minimis*."

GASB Statement No. 43 states in paragraph 34.a.(1) that "the actuarial present value of total projected benefits should include all benefits to be provided to plan members or beneficiaries in accordance with the current substantive plan (the plan terms as understood by the employer and plan members) at the time of each valuation, including any changes to plan terms that have been made and communicated to employees". GASB further states that "calculations should be made based on the types of benefits in force at the time of the valuation and the pattern of cost sharing of benefit costs between the employer and plan members to

that point". Also, ASOP 6 states in 3.2.1(f) Anticipated Future Changes—"After discussion with the plan sponsor, and depending upon the purpose of the measurement, the actuary may take into account future changes that the plan sponsor has represented an intention to implement or that are required by law to be implemented within a specified period".

Given this language, Aon Hewitt is concerned whether it is reasonable to just assume that the Trustees would change the plan designs or cost-sharing to avoid the tax given that such changes have not been directly communicated to participants and may not be part of the substantive plan as understood by the plan members, which is supposed to be the basis for the GASB calculations. In additional follow-up questions related to the original submission, the RHCT Executive Director, with input from the RHCT actuary and Plan Counsel, stated the following:

> "There are limits to how much can be charged by way of retiree, dependent, and survivor contributions to the total cost of benefits, but there is no suggestion that the Trustees cannot change benefits, and no suggestion that they cannot reduce benefits. The statute does require Trustees to either boost contributions or cut benefits if the plan is projected to dip below a certain funding level, but this does not in Fund Counsel's view detract from their general authority to set and change the level of benefits provided.
>
> The Trustees also have the authority to change the level of cost-sharing between the Trust and the retirees. The current level of cost-sharing borne by retirees is below the limitations imposed by the enabling legislation. Since the level of cost-sharing has historically varied from year to year, we believe it is understood by the participants that the level of cost-sharing may change in future years as well."

Based on its calculations, Aon Hewitt expects that both pre-Medicare plans (HMO and PPO) would exceed the Excise Tax threshold in 2018 and be subject to the Excise Tax that would continue to grow over time, absent any changes. In additional follow-up related to the original submission, the RHCT actuary and Executive Director also indicated that "with no changes to plan design or levels of participant cost-sharing, the pre-Medicare plans may exceed the excise tax thresholds in 2018." They further indicated that without assuming plan design or cost-sharing changes that the Excise Tax is expected to increase the total liability by less than 1.5 percent, which they have considered to be de minimis for valuation purposes.

In summary, the RHCT has taken the position that inclusion of the Excise Tax assuming no plan design or cost-sharing changes is de minimis since the liability impact is less than 1.5 percent. They have also taken the position that they believe participants understand that the level of cost-sharing may change in future years, and that participants understand that the Trustees have the ability to change benefits and therefore future changes needed to avoid Excise Tax could be considered part of

the substantive plan. Therefore, no Excise Tax impact is included in the current liability.

Aon Hewitt is concerned regarding the position that participants understand the substantive plan to include plan design or cost-sharing changes that would avoid the Excise Tax in all future years given there has not been direct communication to participants on this topic. Aon Hewitt recommends that prior to the next valuation, the Trustees communicate directly to participants that any applicable Excise Tax will be passed on to participants in the form of increased cost-sharing or reductions in plan design so there is no question as to whether participants understand this as part of the substantive plan. Aon Hewitt is not in a position to determine whether the 1.5 percent liability impact without assuming plan design or cost-sharing changes is de minimis. Aon Hewitt requested that the RHCT contact its auditor to determine whether the auditor considers the 1.5 percent increase to the liability to be de minimis. The RHCT's Executive Director responded that the auditor "did not look at the issue of whether a projected increase in liability in the year 2018 is de minimis. As a result, they offer no opinion on the projection." Prior to the next valuation we would look for the RHCT auditor to opine as to whether the projected 1.5 percent liability impact is de minimis.

Overall, we do not find the RHCT's assumptions unreasonable in the aggregate.

Limitation on Retiree Contributions

The Pension Code (40 ILCS 5/22-101B(b)(5)) requires that the *"aggregate amount of retiree, dependent and survivor contributions to the cost of their health care benefits shall not exceed more than 45% of the total cost of such benefits."* The Pension Code goes on to define *"total cost of such benefits"* as the *"total amount expended by the retiree health benefit program in the prior plan year, as calculated and certified in writing by the Retiree Health Care Trust's enrolled actuary . . . ."*

The January 1, 2013 Valuation prepared by the Trust's actuary contained the results of the actuary's calculation of whether the 45 percent limitation established by the Pension Code was met. The Valuation noted that according to the preliminary December 31, 2012 audit of the RHCT, the aggregate amount of retiree, dependent, and survivor contributions for 2012 was $18.1 million. The total cost of retiree health benefits paid from the Trust in 2011 was $61.6 million. The valuation calculated that the retiree self-pay as a percentage of total cost of benefits was 29.3 percent, which did not exceed the statutory limit of 45 percent.

SCOPE OF ANNUAL REVIEW

The Office of the Auditor General has conducted this annual review of information submitted by the Board of Trustees of the Chicago Transit Authority Retiree Health Care Trust pursuant to the Illinois State Auditing Act (30 ILCS 5/3-2.3(f)): *"The*

Auditor General shall annually examine the information submitted pursuant to Section 22-101B(b)(3)(iii) of the Illinois Pension Code and shall prepare the determination specified in Section 22-101B(b)(3)(iv) of the Illinois Pension Code." The OAG's review, the scope of which is established by the Pension Code, focused on whether the actuarial assumptions used in the Retiree Health Care Trust's report were not unreasonable in the aggregate.

This report does not constitute an audit as that term is defined in generally accepted government auditing standards. Consequently, while we reviewed the information provided by the CTA Retiree Health Care Trust for reasonableness and consistency, we did not conduct an audit of the accuracy of the information provided as that is the responsibility of the Trust. The Retiree Health Care Trust was provided a draft of this report for review and comment.

The scope of our work included reviewing the RHCT Actuarial Valuation as of January 1, 2013, submitted by the RHCT Board on October 2, 2013. We conducted follow-up with the RHCT on various questions we had based upon our review of the Valuation. Our consultants, Aon Hewitt, reviewed the reasonableness of the actuarial assumptions used by the RHCT in its January 1, 2013 Actuarial Valuation.

In our *2012 Review of Information Submitted by the Chicago Transit Authority's Retiree Health Care Trust*, we noted that the Retirement Board approved a payroll audit in 2011. The Board's Executive Director expected the audit to be completed by the end of 2012. The purpose of the audit is to ensure that the employers are accurately withholding and remitting employee and employer contributions to the Retirement Plan and Retiree Health Care Trust. In this Review, we inquired of the Executive Director as to whether the audit had been completed and whether there were any findings that impacted the RHCT. The Executive Director stated that the fieldwork had been completed and initial findings had been submitted to the affected parties (Local 241, Local 308 and the CTA). The Executive Director noted that it is customary to allow the affected parties an opportunity to review the findings and provide comment and additional information or documentation, particularly if they disagree with any of the initial findings. The potential impact on the plans would be for additional monies to be either received or refunded, and for participant credits to be affected accordingly.

APPENDIX A

Statutory Authority

ILLINOIS STATE AUDITING ACT

30 ILCS 5/3-2.3

(f) The Auditor General shall annually examine the information submitted pursuant to Section 22-101B(b)(3)(iii) of the Illinois Pension Code and shall prepare the determination specified in Section 22-101B(b)(3)(iv) of the Illinois Pension Code.

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

ILLINOIS PENSION CODE

40 ILCS 5/22-101B

Sec. 22-101B. Health Care Benefits.

(a) The Chicago Transit Authority (hereinafter referred to in this Section as the "Authority") shall take all actions lawfully available to it to separate the funding of health care benefits for retirees and their dependents and survivors from the funding for its retirement system. The Authority shall endeavor to achieve this separation as soon as possible, and in any event no later than July 1, 2009.

(b) Effective 90 days after the effective date of this amendatory Act of the 95th General Assembly, a Retiree Health Care Trust is established for the purpose of providing health care benefits to eligible retirees and their dependents and survivors in accordance with the terms and conditions set forth in this Section 22-101B. The Retiree Health Care Trust shall be solely responsible for providing health care benefits to eligible retirees and their dependents and survivors upon the exhaustion of the account established by the Retirement Plan for Chicago Transit Authority Employees pursuant to Section 401(h) of the Internal Revenue Code, but no earlier than January 1, 2009 and no later than July 1, 2009.

(1) The Board of Trustees shall consist of 7 members appointed as follows: (i) 3 trustees shall be appointed by the Chicago Transit Board; (ii) one trustee shall be appointed by an organization representing the highest number of Chicago Transit Authority participants; (iii) one trustee shall be appointed by an organization representing the second-highest number of Chicago Transit Authority participants; (iv) one trustee shall be appointed by the recognized coalition representatives of participants who are not represented by an organization with the highest or second-highest number of Chicago Transit Authority participants; and (v) one trustee shall be selected by the Regional Transportation Authority Board of Directors, and the trustee shall be a professional fiduciary who has experience in the area of collectively bargained retiree health plans. Trustees shall serve until a successor has been appointed and qualified, or until resignation, death, incapacity, or disqualification.

Any person appointed as a trustee of the board shall qualify by taking an oath of office that he or she will diligently and honestly administer the affairs of the system, and will not knowingly violate or willfully permit the violation of any of the provisions of law applicable to the Plan, including Sections 1-109, 1-109.1, 1-109.2, 1-110, 1-111, 1-114, and 1-115 of Article 1 of the Illinois Pension Code.

Each trustee shall cast individual votes, and a majority vote shall be final and binding upon all interested parties, provided that the Board of Trustees may require a supermajority vote with respect to the investment of the assets of the Retiree Health Care Trust, and may set forth that requirement in the trust agreement or by-laws of the Board of Trustees. Each trustee shall have the rights, privileges, authority and obligations as are usual and customary for such fiduciaries.

(2) The Board of Trustees shall establish and administer a health care benefit program for eligible retirees and their dependents and survivors. Any health care benefit program established by the Board of Trustees for eligible retirees and their dependents and survivors effective on or after July 1, 2009 shall not contain any plan which provides for more than 90% coverage for in-network services or 70% coverage for out-of-network services after any deductible has been paid, except that coverage through a health maintenance organization ("HMO") may be provided at 100%.

(3) The Retiree Health Care Trust shall be administered by the Board of Trustees according to the following requirements:

(i) The Board of Trustees may cause amounts on deposit in the Retiree Health Care Trust to be invested in those investments that are permitted investments for the investment of moneys held under any one or more of the pension or retirement systems of the State, any unit of local government or school district, or any agency or instrumentality thereof. The Board, by a vote of at least two-thirds of the trustees, may transfer investment management to the Illinois State Board of Investment, which is hereby authorized to manage these investments when so requested by the Board of Trustees.

(ii) The Board of Trustees shall establish and maintain an appropriate funding reserve level which shall not be less than the amount of incurred and unreported claims plus 12 months of expected claims and administrative expenses.

(iii) The Board of Trustees shall make an annual assessment of the funding levels of the Retiree Health Care Trust and shall submit a report to the Auditor General at least 90 days prior to the end of the fiscal year. The report shall provide the following:

(A) the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors;

(B) the actuarial present value of projected contributions and trust income plus assets;

(C) the reserve required by subsection (b)(3)(ii); and

(D) an assessment of whether the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors exceeds or is less than the actuarial present value of projected contributions and trust income plus assets in excess of the reserve required by subsection (b)(3)(ii).

If the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors exceeds the actuarial present value of projected contributions and trust income plus assets in excess of the reserve required by subsection (b)(3)(ii), then the report shall provide a plan, to be implemented over a period of not more than 10 years from each valuation date, which would make the actuarial present value of projected contributions and trust income plus assets equal to or exceed the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors. The plan may consist of increases in employee, retiree, dependent, or survivor contribution levels, decreases in benefit levels, or other plan changes or any combination thereof. If the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors is less than the actuarial present value of projected contributions and trust income plus assets in excess of the reserve required by subsection (b)(3)(ii), then the report may provide a plan of decreases in employee, retiree, dependent, or survivor contribution levels, increases in benefit levels, or other plan changes, or any combination thereof, to the extent of the surplus.

(iv) The Auditor General shall review the report and plan provided in subsection (b)(3)(iii) and issue a determination within 90 days after receiving the report and plan, with a copy of such determination provided to the General Assembly and the Regional Transportation Authority, as follows:

(A) In the event of a projected shortfall, if the Auditor General determines that the assumptions stated in the report are not unreasonable in the aggregate and that the plan of increases in employee, retiree, dependent, or survivor contribution levels, decreases in benefit levels, or other plan changes, or any combination thereof, to be implemented over a period of not more than 10 years from each valuation date, is reasonably projected to make the actuarial present value of projected contributions and trust income plus assets equal to or in excess of the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors, then the Board of Trustees shall implement the plan. If the Auditor General determines that the assumptions stated in the report are unreasonable in the aggregate, or that the plan of increases in employee, retiree, dependent, or survivor contribution levels, decreases in benefit levels, or other plan changes to be implemented over a period of not more than 10 years from each valuation date, is not reasonably projected to make the actuarial present value of projected contributions and trust income plus assets equal to or in excess of the actuarial present value of projected benefits expected to be paid to current and future retirees and their dependents and survivors, then the Board of Trustees

shall not implement the plan, the Auditor General shall explain the basis for such determination to the Board of Trustees, and the Auditor General may make recommendations as to an alternative report and plan.

(B) In the event of a projected surplus, if the Auditor General determines that the assumptions stated in the report are not unreasonable in the aggregate and that the plan of decreases in employee, retiree, dependent, or survivor contribution levels, increases in benefit levels, or both, is not unreasonable in the aggregate, then the Board of Trustees shall implement the plan. If the Auditor General determines that the assumptions stated in the report are unreasonable in the aggregate, or that the plan of decreases in employee, retiree, dependent, or survivor contribution levels, increases in benefit levels, or both, is unreasonable in the aggregate, then the Board of Trustees shall not implement the plan, the Auditor General shall explain the basis for such determination to the Board of Trustees, and the Auditor General may make recommendations as to an alternative report and plan.

(C) The Board of Trustees shall submit an alternative report and plan within 45 days after receiving a rejection determination by the Auditor General. A determination by the Auditor General on any alternative report and plan submitted by the Board of Trustees shall be made within 90 days after receiving the alternative report and plan, and shall be accepted or rejected according to the requirements of this subsection (b)(3)(iv). The Board of Trustees shall continue to submit alternative reports and plans to the Auditor General, as necessary, until a favorable determination is made by the Auditor General.

(4) For any retiree who first retires effective on or after January 18, 2008, to be eligible for retiree health care benefits upon retirement, the retiree must be at least 55 years of age, retire with 10 or more years of continuous service and satisfy the preconditions established by Public Act 95-708 in addition to any rules or regulations promulgated by the Board of Trustees. Notwithstanding the foregoing, any retiree hired on or before September 5, 2001 who retires with 25 years or more of continuous service shall be eligible for retiree health care benefits upon retirement in accordance with any rules or regulations adopted by the Board of Trustees; provided he or she retires prior to the full execution of the successor collective bargaining agreement to the collective bargaining agreement that became effective January 1, 2007 between the Authority and the organizations representing the highest and second-highest number of Chicago Transit Authority participants. This paragraph (4) shall not apply to a disability allowance.

(5) Effective January 1, 2009, the aggregate amount of retiree, dependent and survivor contributions to the cost of their health care benefits shall not exceed more than 45% of the total cost of such benefits. The Board of Trustees shall have the discretion to provide different contribution levels for retirees, dependents and survivors based on their years of service, level of coverage or Medicare eligibility, provided that the total contribution from all retirees, dependents, and survivors shall be not more than 45% of the total cost of such benefits. The term "total cost of such benefits" for purposes of this subsection shall be the total amount expended by the retiree health benefit program in the

prior plan year, as calculated and certified in writing by the Retiree Health Care Trust's enrolled actuary to be appointed and paid for by the Board of Trustees.

(6) Effective January 18, 2008, all employees of the Authority shall contribute to the Retiree Health Care Trust in an amount not less than 3% of compensation.

(7) No earlier than January 1, 2009 and no later than July 1, 2009 as the Retiree Health Care Trust becomes solely responsible for providing health care benefits to eligible retirees and their dependents and survivors in accordance with subsection (b) of this Section 22-101B, the Authority shall not have any obligation to provide health care to current or future retirees and their dependents or survivors. Employees, retirees, dependents, and survivors who are required to make contributions to the Retiree Health Care Trust shall make contributions at the level set by the Board of Trustees pursuant to the requirements of this Section 22-101B.

(Source: P.A. 95-708, eff. 1-18-08; 95-906, eff. 8-26-08; 96-1254, eff. 7-23-10.)