Frankfort Fire Protection District
Firefighters' Pension Fund

Minutes of the Special Meeting of the Board of Trustees of the Frankfort Firefighters' Pension Fund of the Frankfort Fire Protection District, Will County, Illinois, held on Tuesday, September 16, 2014 at 9:30 a.m. at Fire Station One, located at 333 W. Nebraska Street, Frankfort, IL 60423.

I. CALL TO ORDER

II. ROLL CALL

Present: Daniel Faber, President
Leonard Todd Hamm, Secretary
Michael Kavanagh, Treasurer
Robert Wilson, Trustee
Alphonso Jackson, Trustee

Also Present: Kristina Farnum, Recording Secretary
Robert Jacobs, District Trustee
Donald Lorenz, District Trustee
Daniel Rossi, District Trustee
Michelle Selvaggio, District Recording Secretary
Carolyn Clifford, Attorney
Tom Sawyer, Investment Manager
Todd Schroeder, Lauterbach & Amen
Sherri Lauterbach, Lauterbach & Amen
Colleen Trela, Lauterbach & Amen

III. PUBLIC COMMENTS

None.

IV. DISCUSSION OF PENSION FUNDING POLICY

- Lauterbach and Amen present the aspects of an optimum funding policy. Dollars could be discussed in a separate meeting.
- Goals and Objectives of a Funding Policy
  - Benefit Security
  - Affordable and Budget Stability
  - Effective Funding of Costs
  - Inter-period Equity
- Relying on a funded percentage is not good
  - Easily manipulated
  - Politically dangerous – lawmakers changed how we paid in 1993, which changed how we look at pension funds, suddenly they looked better; in 1993 interest rates were high, but in 2008 when the rates plummeted the pension funding crisis began
  - For Frankfort Fire, recent State changes put the fund way over 100%
- Pension funding crisis's are caused by interest returns
- A stable policy = benchmark of progress
- Cash flow is a much better monitor of benefit security than funded percentage
  - A Cash Flow Analysis can be provided to the Pension Board along with the Actuarial Report
- Government Accounting Standards Board (GASB) changes were made in response to the worldwide pension crisis
  - Now define what should be used for standards in the Actuarial Report
  - Should be charging today's taxpayers for benefits earned today

  - Defined the interest rate to be used for unfunded liability as the municipal borrowing rate, currently 3-3.5%**.** A blended rate for funded and unfunded amounts will be used. This will result in an estimated liability increase of about 20%.
  - The unfunded amount will be reported on the Balance Sheet
  - The funding policy can be disclosed, along with what it brings to the table and the extent to which it is followed
- The State usually sets the Funding Policy, but the adoption of the Projected Unit Credit (PUC) method of actuarial valuation has shown lack of good guidance, and it is advised to step away from politics for the funding policy. There are 15 Lauterbach and Amen clients that have adopted a funding policy so far. The GASB changes force agencies to come up with a policy – the District establishing a policy is good practice and shows responsibility to debt issuers that are reviewing the financials.
- A composite picture of acceptable ranges will be presented for policy aspects.
- Normal Cost vs. Amortization
  - Normal Cost is today's cost
  - Amortization is the liability from the past
  - For Frankfort Fire, the focus is on Normal Cost which represents about 90% of the recommended contribution, but the liability should be understood also
  - State Statute treats Normal Cost and Amortization the same and keeps shifting amortization costs further into the future.
  - Normal Cost calculates how much should be contributed this year so that payments can be made in the future.
  - The different methods of calculation determine the pattern of money going in for the future. They all get to the same level, but the source of the contributions is distributed differently. Since 2008 about 30% of Frankfort Pension Fund income has been from investments.
    - **Entry Age Normal** is most commonly used in the public sector because it's easy to budget for. This method is equitable because it accounts for the inflation component, and counts employees with more years of experience as more valuable.
      - **Level Dollar** is where state funding started. This is the most aggressive method and basis. Costs are front loaded, which is not good for taxpayer equity, but money is saved in the long run. As pay increases, contributions increase. Level Dollar is better for amortization.
      - In 1993 the State changed to **Level Percent of Pay** for both Normal Cost and past liabilities. This makes sense for normal cost, but not for past liabilities. If used for liabilities, it would cause them to grow, and would defer the payment resulting in a significant increase in cost. The shift was made because of over-funding. This type of method and basis is the most common. Pay and contributions increase at the same rate.
    - **Projected Unit Credit** (PUC) does not provide budgetable contributions. Less is contributed early on, and then more is paid later.
      - The State changed to PUC, **Level Percent of Pay** in 2011. This method causes funds to lose out on investment returns, putting more of a burden on the taxpayer. It is not budget manageable. This is actually more costly to the taxpayers in the long run; and results in cost deferral.
      - It might be beneficially for a small district with high turnover to use the **Level Dollar** PUC method.
  - Frankfort Fire's unfunded liabilities represent about 10-12% of the recommended contribution. 100% funding should always be worked towards. Payoff should be affordable, stable, and effective. This amortized amount represents past costs and fairness to the taxpayers is lost with it.
- Concern was expressed that the percent funding of Frankfort's Pension Fund has been dropping drastically

  - PUC makes the fund look better and some municipalities have been using PUC since the State allowed
  - The PUC method asks for less now and then more later
  - Using PUC to get a minimum requirement is what caused the fiscal crisis
- The Pension Board requested that the Rate of Return Assumption be dropped from 7% to 6.75% because of high administrative fees, increased volatility due to the 50/50 split in stock and bond investments, the addition of 2 pensioners to the fund, and the 7.2% expected return as determined by the Investment Managers.
- The Pension Trustees and the District Trustees should work towards the shared goal that what the Pension Board requests is what the District puts in, and all assumptions are agreed upon.
- Currently, the Frankfort Actuarial Valuation uses the Entry Age Normal method, Level Percent of Pay basis for Normal Cost; and Level Dollar basis, 100% funding by 2040 for liabilities – which fits into the acceptable range. It's best to pay 100% of the liability, but not necessarily affordable or equitable. Plus or minus 100% funding is acceptable in the short-term. The unfunded liability spreads risk out.
- Actuarial Value of Assets – Smoothed vs. Actual Market Value
  - Short-term volatility, healthy over the long-term
  - 5-year Smoothing spreads the interest rate out over time for budget stability
  - Choose a method and stick with it
  - Frankfort uses 5-year Smoothing, and recognizes anything over 10% immediately
- If Assumptions aren't close to actual, requested contributions are not stable. There's only so much money, so if contributions aren't stable, spending isn't stable. Lauterbach and Amen did a current study on Assumptions and compared that to Frankfort's Assumptions to see what best reflects reality. This study will be done every 5 years.
  - A change in Frankfort's Mortality Tables was made. According to the recent study done by Lauterbach and Amen, firefighters are living longer than police and the average blue collar worker; this will affect when payments stop.
  - Other private actuaries and the Department of Insurance have different assumptions. Until recently, the Department of Insurance was using a study from 30 years ago.
  - The fund pays out based on actual results, not expected.
  - With the Interest Rate Assumption, a little change makes a big difference. This is affected by the portfolio size, short-term/long-term history and expected future returns, portfolio mix, administrative expenses, and market volatility.
    - Since June of 2008, Frankfort has experienced a 7.4% rate of return, and is expecting a 7.2% rate net of investment fees. The Actuary consulted Frankfort's Investment Manager to get to a final expected rate of 7%. The pension Board decided at the last board meeting that this rate should be lowered even further to 6.75% in order to cover administrative expenses and the increased volatility from having more in equities. The 45 basis point difference from the 7.2% expected rate to the 6.75% net assumption is pretty common according to the actuary.
    - If pension benefits become a large percent of the assets, the Interest Rate Assumption should be updated.
    - The Actuary Assumption should follow the policy put together by the investment managers.
    - A sensitivity analysis can be done to show the impact if the rate is off.
    - The unfunded liability should not be allowed to grow.
    - The Interest Rate Assumption should be attainable. Even if it's too conservative in any year, you have choices as to what to do with the extra – reduce your unfunded liability, etc.
    - 6.5 – 6.75% is a range that others have been using.
    - Lauterbach and Amen sets a flat fee for actuary services, not a percent of assets. Sawyer Falduto Asset Management is market value based; 7.2% is gross of fees. Different professionals show different investment returns: net of fees, smoothed, average, etc. This can differ, just like funding percent can differ because it's based on different assumptions.

- With this informational meeting, the District and Pension Trustees should have a better understanding of Actuarial Assumptions and methods. By having both Boards attend, there is a shared process of putting the Funding Policy together.

V. CLOSED SESSION

None.

VI. ADJOURNMENT

At 12:50 p.m. a Motion was made by Leonard Todd Hamm and seconded by Daniel Faber to:

"Adjourn the meeting."

VOICE VOTE. MOTION CARRIED.

Minutes taken by: Recording Secretary Kristi Farnum

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Secretary, Pension Board

Approved by the Board of Trustees at a meeting held on Tuesday, November 4, 2014.