Presentation at October 20, 2016, Board of Trustees Special Meeting
College of DuPage ("COD")
Overview of SURS & Impact on COD
October 20, 2016

Prepared by Aon Hewitt
Retirement and Investment

Preparation to College of DuPage
Discussion Outline—Overview of SURS & Impact on COD

1. Introductions
2. Pension “Climate” in Illinois
3. Recent Illinois Court Cases Impacting Pensions
4. Actuarial Concepts and Terms
5. Alternative Funding Methods
6. Pension Cost Sharing Approaches
7. High-Level Summary of the State Universities Retirement System ("SURS") Plans
   a. Actuarial Value of Benefits Earned
   b. Benefit Examples
   c. Financial Graphs
8. SURS Impact on COD
9. Potential Plan Design Ideas & Funding Options for COD
10. Questions & Wrap-Up
11. Appendix – SURS Tier 1 vs. Tier 2 Defined Benefit Comparison
12. About This Material
Pension “Climate” in Illinois

Hefty Pension Tab
Illinois Unfunded Liabilities, in billions

- Teachers' Fund, $62.7
- State Employees' Fund, $26
- State Universities Fund, $22.4
- Judges' Fund, $1.5
- General Assembly Fund, $0.28

- $113 Billion Unfunded Liability, 6/30/2015
- Grows by $8.3 of Interest in Next Year
- $7.8 Billion Current Annual Contribution

Source: Commission on Government Forecasting and Accountability

* Statutory State contributions are based on attaining 90% funded in 2045
Pension “Climate” in Illinois

§ Some recent news headlines:

“State gets another credit downgrade due to pension woes” (Sun-Times, 10/3/2016)
- Another day, another downgrade for Illinois amid its budgetary and pension problems.
- S&P Global Ratings on Friday dropped the state’s credit rating one notch — from BBB+ to BBB.

“There's no escape, Illinois: It's time to pay for those pensions” (Crains’, 10/1/2016)

“Illinois Pension Shifts Further Pressure State Government – Changes in assumed investment return rates at four of Illinois' five state employee pension funds, as well as other revised assumptions in areas like life expectancy, are raising pressure on the state to tackle pension reforms.” (Bondbuyer, 9/27/2016)

“Illinois SURS in danger of running out of money to pay retirees, CIO says” (Pensions & Investments, 11/30/2015)
Recent Illinois Court Cases Impacting Pensions

§ Pension Protection Clause in the Illinois State Constitution
   - “Benefits shall not be diminished or impaired”

§ Contractual employment rights
   - Benefit promised at hire date cannot be changed

§ Several public pension funds in Illinois have recently attempted various “reforms”, which have all been ruled unconstitutional by the Illinois Supreme Court
   - State bill to modify pensions for current members in the Teachers’ Retirement Systems (“TRS”)
   - City of Chicago bill to modify pensions for current members in the Municipal and Laborers Funds (MEABF & LABF)
Assumptions and funding methods affect only the timing of costs.

Contributions (C) + Investment Return (I) = Benefits (B) + Expenses (E)

- Employer contributions
- Employee contributions
- Administrative Expenses
- Benefit Payments
- Net Investment Returns (Net of investment management fees)
- Assets
Actuarial Terms – Current Funded Percentage

Current Assets \( \text{Divided by} \) Accrued Liabilities \( \text{Equals} \) Funded Percentage
Alternative Funding Methods

§ Pay-As-You-Go
  § No funding – No assets – No investment income
  § Contributions equal benefits paid plus expenses
  § Timing mismatch between benefit accruals and contributions

§ Advance Funding
  § Contributions are made as benefits are earned
  § Contributions are invested
  § Invested assets generate returns and accumulate during members’ working years
  § Facilitates contribution equity over time among groups of members and taxpayers

§ Current State funding policy causes
  § increases in unfunded liabilities for next several years
  § results in back-loaded contribution schedules
Pension Cost Sharing Approaches

§ Cost Sharing Plan (SURS Model)  **Full cost sharing**
- Plan has members who are employees of many employers, i.e., a multi-employer plan
- Plan assets are commingled in a trust and may pay for the benefits of any of the members
- Members contribute while working and the State of Illinois bears all the risks of the plan for investments and liabilities

§ Alternative Models
- Single Employer Plan:  **No cost sharing**
- Agent Plan:  **Some cost sharing**

For more information about the types of cost sharing, please see GASB Statement No. 68, Accounting and Financial Reporting for Pensions
High-Level Summary of SURS Plans

§ SURS members are not covered under Social Security; SURS provides their entire retirement benefit (non-taxable in Illinois)

§ SURS includes both Defined Benefit (“DB”) & Defined Contribution (“DC”) plans

§ Members must select to participate in the DB or DC (“SMP”) plan within their first 6 months of employment
High-Level Summary of SURS Plans

§ Default participation election is in the Traditional Plan
§ Current participation as of June 30, 2015
   - 85% in DB plan (81% of salaries)
   - 15% in DC plan (19% of salaries)
§ DB Plan coverage by benefit tier based on hire date
   - “Tier 1” covers members hired before January 1, 2011
   - “Tier 2” covers members hired after December 31, 2010 (provides less generous benefits than Tier 1)
   - See Appendix for Tier 1 vs. Tier 2 Defined Benefit comparison summary
High-Level Summary of SURS Plans

§ DB Plans (Traditional & Portable); plan is 43% funded as of June 30, 2015
- Required employee contributions are 8% of covered member salaries ($0.3 billion)
- FY 2016 Statutory State contribution to SURS is $1.6 billion (35% of total salaries)
- Defined Benefit is 2.2% of Final Average Pay (“FAP”) times years of service
- Portable plan offers a lump sum cash out option (not actuarially equivalent)

§ DC Plans (Self Managed Plan – “SMP”); plan is 100% funded at all times
- Required employee contributions are 8% of covered member salaries
- State Defined Contribution is 7.6% of covered member salaries (includes 0.3% for disability insurance)
- Total retirement contribution of 15.3%
- But State is in effect paying a total 42.6% contribution for the DC members
Actuarial Value of Annual Benefits Earned ("Normal Cost")

§ Total Normal Costs are around 20% of the total salaries of DB members
§ Tier 1 and older members have higher gross normal costs
§ Traditional & Portable formula members pay 8% of their salaries into SURS
§ State is responsible to pay the remaining net normal costs (i.e., 12% of DB member salaries)
§ Based on COD annual payroll of around $110 million
  - Annual 8% COD employee contributions total $8.8 million
  - COD’s pro-rata share of the State’s annual contribution
    • $38.5 million for FY 2015
    • $45.8 million for FY 2016 (+20%)
  - If the State would ever shift the 12% net normal costs back to the districts, COD would need to contribute $13.2 million annually
### SURS – Benefit Examples for Traditional Plan (Member Retires at 65)

#### Sample Benefit – Tier 1 (Hired Before 1/1/2011)

<table>
<thead>
<tr>
<th>Age</th>
<th>65</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service</td>
<td>15</td>
</tr>
<tr>
<td>Final Pay</td>
<td>$106,000</td>
</tr>
<tr>
<td>Annual Benefit</td>
<td>$35,000 (2.2% * FAP * Service)</td>
</tr>
<tr>
<td>Early Retirement Reduction</td>
<td>0%</td>
</tr>
<tr>
<td>SURS Final Benefit</td>
<td>$35,000</td>
</tr>
<tr>
<td>Social Security</td>
<td>$0</td>
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</tbody>
</table>

#### Sample Benefit – Tier 2 (Hired After 1/1/2011)

<table>
<thead>
<tr>
<th>Age</th>
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</thead>
<tbody>
<tr>
<td>Service</td>
<td>15</td>
</tr>
<tr>
<td>Final Pay</td>
<td>$106,000</td>
</tr>
<tr>
<td>Annual Benefit</td>
<td>$35,000 (2.2% * FAP * Service)</td>
</tr>
<tr>
<td>Early Retirement Reduction</td>
<td>12% (6% * 2 years)</td>
</tr>
<tr>
<td>SURS Final Benefit</td>
<td>$30,800</td>
</tr>
<tr>
<td>Social Security</td>
<td>$0</td>
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#### Projected Annual Benefit Amounts

Retiree as of 1/1/2017
Age 65 – Annual Benefit of $35,000

Tier 1 receives a 3% annual increase (compound interest)
Tier 2 receives increase of 1/2 of inflation starting at age 67 (simple)
Average lifespan based on funds mortality assumptions

Tier 1: Total payments = $1,100,000; PV @ 7.25% = $500,000
SURS Financial Graphs – Projected Contribution Inflows & Fund Outflows

Projected Contribution Inflows & Fund Outflows ($, millions)
Results from SURS June 30, 2015 Actuarial Valuation – 7.25% Assumed Asset Returns

Projected Contribution Inflows ($, millions)
- State Contributions – 35% of Total Payroll
- Employee Contributions – 8% of DB Payroll

Projected Fund Outflows ($, millions)
- Benefit Payments
- Admin Expenses
SURS Financial Graphs – Projected Assets and Liabilities

Projected Assets and Liabilities ($, millions)
Results from SURS June 30, 2015 Actuarial Valuation – 7.25% Assumed Asset Returns

- **Assets**
- **Unfunded Liability**
- **Funded Percentage**

$0
$10,000
$20,000
$30,000
$40,000
$50,000
$60,000

2015
2020
2025
2030
2035
2040
2045

$0
20%
40%
60%
80%
100%
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%

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SURS Financial Graphs – Fund Outflows as Percentage of Assets

Fund Outflows as a Percentage of Assets ($, millions)

- Total Assets
- Benefit Payments & Expenses
- Investable Assets
- Outflow as a Percentage of Assets

<table>
<thead>
<tr>
<th>Year</th>
<th>2015</th>
<th>2020</th>
<th>2025</th>
<th>2030</th>
<th>2035</th>
<th>2040</th>
<th>2045</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td>20,000</td>
<td>30,000</td>
<td>40,000</td>
<td>50,000</td>
<td>60,000</td>
<td>70,000</td>
<td>80,000</td>
</tr>
<tr>
<td>%</td>
<td>0%</td>
<td>2%</td>
<td>4%</td>
<td>6%</td>
<td>8%</td>
<td>10%</td>
<td>12%</td>
</tr>
</tbody>
</table>

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SURS Financial Graphs – “What If” Assets Earn Only 6.25% Each Year?

![Projected State Contributions ($, millions)](image)

- 7.25% Realized Returns
- 6.25% Realized Returns

<table>
<thead>
<tr>
<th>Year</th>
<th>7.25% Realized Returns</th>
<th>6.25% Realized Returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>$72.9</td>
<td>$81.5</td>
</tr>
<tr>
<td>Present Value</td>
<td>$25.8</td>
<td>$32.2</td>
</tr>
</tbody>
</table>
SURS Impact on COD (Traditional & Portable Plans)

- COD does not currently make direct any contributions to SURS
  - COD Staff participate in SURS
  - Traditional & Portable formula covered members pay 8% of their salaries to SURS
  - State makes significant contributions to SURS (currently around 35% of total salaries for FY 2016)
  - Traditional & Portable formula retirees lifetime pension benefits plus Automatic Annual Increases

- SURS is “Severely Underfunded” per the June 30, 2015 GRS report (page 9)
  - Total pension liability of about $39 billion
  - Market assets of roughly $17 billion
  - Total unfunded liability (“UAAL”) of $22 billion; 43% funded

- Unfunded liability allocated to COD as of June 30, 2016 is $0.6 billion (2.4% of SURS UAAL)
Potential Plan Design Ideas & Funding Options for COD

§ All plan benefit and funding changes would require changes to:
  – Illinois State constitution; and/or,
  – Illinois Compiled Statutes (i.e., Pension Code)

§ As a result of court rulings, benefit changes may only impact new hires (e.g., Tier 2, a new Tier 3)

§ Other Potential Design & Funding Options
  – Cover all new hires under SMP (fully funds those benefits without creating any new State liability)
  – Cover all new hires under Social Security
    • COD & employees each pay 6.2% of salaries up to the Social Security Wage Base
    • Would reduce future cash inflows to SURS from employee contributions
  – Consider withdrawing from SURS
    • Assume pension liabilities for COD members and receive allocated assets from SURS
    • Make annual contributions sufficient to:
      ✔ Amortize $0.5 billion UAAL; plus,
      ✔ Assume net normal cost payments (currently 12% of salaries)
  – Set aside additional amounts dedicated for pension funding
Questions & Wrap-Up
## Appendix – SURS Tier 1 vs. Tier 2 Defined Benefit Comparison

<table>
<thead>
<tr>
<th></th>
<th>Tier 1 Benefit (Hired Before 1/1/2011)</th>
<th>Tier 2 Benefit (Hired After 12/31/2010)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual % of FAP / Maximum %</td>
<td>2.2% / 80%</td>
<td>2.2% / 80%</td>
</tr>
<tr>
<td>Months Included in FAP</td>
<td>48 (4-years)</td>
<td>96 (8-years)</td>
</tr>
<tr>
<td>Automatic Annual Increases</td>
<td>3% (Compound)</td>
<td>Starting at age 67 – 50% of CPI up to a maximum of 3% (Simple)</td>
</tr>
</tbody>
</table>
| Unreduced Retirement Age for Minimum Formula Annuity | Age 62 & 5 years of service  
Age 60 & 8 years of service  
30 years of service                                           | Age 67 & 10 years of service                                             |
| Reduced Retirement Age for Minimum Formula Annuity | Age 55 & 8 years of service                                                | Age 62 & 10 years of service                                                |
| Reductions for Early Retirement | 6% per year from age 60                                                   | 6% per year from age 67                                                    |
| Employee Contributions    | 8.0% of salary                                                              | 8.0% of salary                                                              |
| Death Benefit             | Annuity to spouse                                                           | Annuity to spouse                                                           |
| Disability Benefit        | Payable upon “inability to perform occupation”                             | Payable upon “inability to perform occupation”                             |
| Pay Cap                   | IRS limit – $265,000 increased with CPI                                      | Plan limit – $111,572 increased with \( \frac{1}{2} \) of CPI               |
| Plan Funding Policy       | Achieve a funding ratio of 90% by the end of FY 2045 based on State contributions determined as a level percentage of payroll (Projected Unit Credit) | Achieve a funding ratio of 90% by the end of FY 2045 based on State contributions determined as a level percentage of payroll (Projected Unit Credit) |
About This Material

§ This material is intended to assist The College of DuPage (“COD”) review financial and other considerations related to the State Universities Retirement System of the State of Illinois (“SURS”), and its use may not be appropriate for other purposes. The content of this material is necessarily a summary and does not deal with every important topic nor cover every aspect of this subject.

§ Aon Hewitt has taken care in the production of this document and the information contained in it has been obtained from sources that we believe to be reliable. In preparing this report, we have relied upon publicly available information including the June 30, 2015 SURS actuarial valuation report prepared by the Fund’s actuary, Gabriel Roeder Smith & Company (“GRS”). Aon Hewitt does not make any representation as to the accuracy of the information received from third parties and is unable to accept liability for any loss incurred by anyone who relies on it. The recipient of this document is responsible for their use of it.

§ These estimates were prepared using summary data of the covered members and streamlined calculation techniques. As such, they only provide an approximate indication of the impact of the changes contemplated in this analysis. The results of more refined calculations may yield a result and conclusions different than suggested by this streamlined methodology. This analysis did not include the collection of data required to confirm the appropriateness of the methods and actuarial assumptions used by SURS since that was beyond the scope of our assignment.

§ This report has been conducted in accordance with generally accepted actuarial principles and practices, including the applicable Actuarial Standards of Practice (ASOP’s) as issued by the Actuarial Standards Board. The primary authors of this report are Mark D. Meyer, JD, FSA, Partner, Kenneth K. Lining, FCA, MAAA, EA, Consulting Actuary, and Kevin Quinn, FSA, EA, Consultant with Hewitt Associates, LLC, operating as Aon Hewitt. The authors are familiar with the near-term and long-term aspects of pension valuations and meet the Qualification Standards of the American Academy of Actuaries necessary to render the actuarial opinions contained herein.

§ To our knowledge, no associate of Aon Hewitt providing services to COD has any direct financial interest or indirect material interest in COD.