

Police Pension Fund Funding Policy January 22, 2018

I. Purpose

The Village has historically funded the Kenilworth Police Pension Fund in response to an actuarially recommended contribution (ARC) that is performed annually. However, the fund assets have not grown significantly over recent years while liabilities have increased over the same period. The Village recognizes both the significance of the unfunded liability generated by the defined benefit plan and the benefit of a structured plan for addressing the long-term liability. Therefore, the Village Board of Trustees have adopted this policy to serve as a guideline for future decision-makers for determining the Police Pension Fund liability, calculating a responsible contribution to mitigate the un-funded liability in a defined period, and ensuring that the financial data is easily accessible to interested parties.

II. Overview

In 1949, the Village created a police pension plan via a referenda of the voters. The plan provides a defined retirement benefit, as determined by the state, for all full-time sworn police personnel. By statute, eligible employees contribute a portion of their salary (9.9 % in 2018) and the Village contributes the remaining amounts necessary to provide the statutory benefit for retirees and their spouses in the event of the death of the retiree.

Determining the long-term liabilities of the police pension fund requires complex calculations that are typically performed by an actuary experienced with public pension funds. The actuary utilizes a series of actuarial assumptions to determine the unfunded liability of the pension fund over time and calculate the contribution amount required to achieve a specific funding objective. The actuarially recommended contribution, as calculated by the actuary is commonly referred to as the ARC. Prior to Governmental Accounting Standards Board (GASB) Statements number 67 & 68, the ARC was the primary indicator utilized to determine if a community was adequately funding their pension obligations. While the GASB statements modified the way in which governments analyze and report their pension liabilities, the ARC remains an important guidepost – assuming that the actuarial assumptions are reasonable. Changes in assumptions concerning, expected rate of return, mortality, and asset/liability smoothing methods, among other assumptions, can

significantly change the resulting ARC. To that end, the Village Board desires to define a number of the variables used to calculate the ARC, to ensure a true and accurate picture of the long-term liability.

In developing the guidelines herein, the Village examined best practices as well as prior pension fund actuarial reports. Among the documents reviewed was, *Pension Funding: A guide for Elected Officials* which was developed by the Pension Funding Task Force in 2013. The task force was a joint effort of eleven national groups including, the National Governor's Association, U.S. Conference of Mayors, and the International City/County Management Association. Additionally, input was sought from the Kenilworth Police Pension Fund Board and Chief of Police. It is the intent of this policy to follow current best practices to the extent possible.

III. Objective

The Village desires to contribute funds to the Police Pension Fund in a relatively stable annual amount calculated to fully fund the expected long-term liabilities of the fund by 2040, and to a reasonable extent ensure that the cost of police employee benefits is assumed by the generation of taxpayers receiving the services.

IV. Funding Analysis

Annually, the Village and/or the Kenilworth Police Pension Fund shall employ the services of an actuary to, among other required tasks, calculate an actuarially recommended contribution (ARC). The actuary firm shall be licensed to provide actuary services in the state of Illinois, ensure that one or more of the actuaries providing service are either certified as an Enrolled Actuary per ERISA, or be a Fellow of the Society of Actuaries, have demonstrated experience with public pension plans in Illinois. Further, neither the firm nor the actuaries providing the service shall have either been censured or charged with any offense involving fraud, theft, or dishonesty in the past 10 years.

The firm contracted to provide the actuarial analysis should be selected through a competitive process. Absent cause, the firm should ideally be retained for an extended period of years to provide both consistency of analysis and avoid any appearance of making decisions based upon unfavorable contribution recommendations.

The Village desires to obtain the most accurate valuations of the financial position of the police pension fund (Fund). Therefore, the actuary shall produce an annual actuarial valuation of the Fund in accordance with generally accepted actuarial principles and practices, and follow the applicable guidelines of the Actuarial Standards Board. This shall be in addition to following the Illinois Pension Code as well as applicable federal laws and regulations.

In conducting the actuarial valuation, a number of actuarial assumptions are applied. While many of the assumptions are rightfully selected by the actuary firm in performing their analysis, there are a number of key assumptions that the Village Board feels should be jointly agreed upon due to the fact that the assumptions utilized are critical to the quality of the analysis. Therefore, the following are key assumptions which shall be utilized in calculating the ARC:

1. Actuarial Cost Method – Entry Age Normal
2. Asset Smoothing Method – A five-year period shall be used to value assets with an adjustment made to assets to uniformly spread actuarial investment gains and losses.
3. Amortization Method – Level percentage of pay, closed.
4. Amortization Policy - The difference between the actuarial value of asset and accrued liability shall be amortized to achieve 100% funding in 2040, based upon a level percentage of payroll.
5. Projected Rate of Return – Shall be 6.0% compounded annually, net of investment expenses.
6. Payroll Growth – Shall be 3.5% per year.

The assumptions list is not intended to be exhaustive. The Village Board recognized that there are a number of additional assumptions (e.g., mortality rates) that the actuary will utilize to conduct the valuation of the Fund. These assumptions shall be determined in conjunction with the Village to reflect realistically anticipated experiences.

V. **Funding Guidelines**

Upon conclusion of the calendar year, and as the Village begins the audit of its financial activity for the prior fiscal year, the police pension fund actuary begins the financial analysis of the Police Pension Fund. Typically, the Police Pension Board and Village management receive a draft actuarial report of the prior calendar year activities in April. The report will provide, among other important financial data, the ARC for the next fiscal year (i.e., in April 2017 the ARC for CY 2018 is calculated.)

The actuary shall provide village management with a draft of the valuation as soon as practical after the conclusion of the fiscal year. Once finalized, the Village Board shall be provided with a copy of the actuarial valuation and the results shall be included in the annual financial reports of the Village for the applicable year.

Funding the ARC

Annually, the Village budgets contributions to the Fund with the intent to fund at least 100% of the ARC. The Village Manager projects the future fiscal year ARC typically in October, based upon available data including prior trend and five-year projections. The final ARC is not received until

the actuary completes the analysis six months later, well after the fiscal year commenced. It has been the practice of the Village since 2013 to fund the future year ARC (released in May) during the current fiscal year to the extent financially possible.

Funding for the ARC comes from a combination of property tax revenue and the General Fund via an inter-fund transfer. Property tax revenue is typically stable, but rarely results in the Village receiving the full amount requested. If the 100% of the tax revenue budgeted for the Police Pension Fund line of the levy is not received, Village action will be required to adjust for any shortfall. This is especially true if the levy plus any General Fund transfers were budgeted to exactly meet the ARC. Due to this, the Village Manager must review the property tax projections provided by Cook County during the fiscal year to determine if a budget amendment should be recommended due to a shortfall in projected property tax levy revenue. The Village Board has the authority to approve or deny any recommended budget amendments.

Contributions in Excess of the ARC

In recent years, the Village Board has made additional contributions to the Fund in excess of the ARC. This has been done in recognition of Fund assets remaining relatively stable as liabilities increase. The potential to make additional contributions to the Fund is typically considered during the annual budget process and then again after evaluating the audited financial performance of the Village and the Police Pension Fund.

A number of items are considered when determining if an additional contribution to the Fund should be made. The considerations include:

1. Progress of the Fund toward achieving the goal of zero net liabilities by 2040;
2. Percentage of non-restricted General Fund fund balance to budgeted expenditures vis-à-vis the Fund Balance Policy;
3. Current or reasonably anticipated capital improvement projects; and
4. Regional and State economic indicators.

No less than twice per year (typically November and June), the Village Manager shall review the most recent financials for the Fund and the overall Village financial position in order to determine if a recommendation for additional contributions to the Fund should be forwarded to the Board of Trustees. Even in years where an additional contribution is not recommended, the Village Manager shall notify the Village Board of Trustees of the recommendation and contributing factors.

The Village Manager is encouraged to research and investigate options to fund additional contributions to the police pension fund in order to further the Objective herein. Examples of alternative funding sources include:

1. Designation of a portion of one-time or ongoing expenditure reductions toward the Fund for a designated period;
2. Designation of a portion of new revenue sources toward the Fund for a designated period; and
3. Designating a portion of future contribution savings realized by accelerating contributions to the Illinois Municipal Retirement Fund.

In making recommendations, the Village Manager shall evaluate the financial considerations listed herein as well as the overall financial condition of the Village, and progress of the Fund toward the identified Objective.

VI. Accessibility of Financial Reports

The Village Board of Trustees strongly supports efforts to ensure that key financial information is easily available to interested parties in conformance with state laws and regulations. To that end, the Village has invested in providing access to electronic documents online via the Village website at kenilworthil.org.

The Village Manager shall ensure that the current approved or adopted versions and prior five years of data for the following documents are available on the Village website:

1. Actuarial Valuation for the Kenilworth Police Pension Fund;
2. Annual Financial Report for the Village;
3. Annual Budget;
4. Minutes of the Police Pension Board
5. Data reflecting the net assets, liabilities and funded ratio of the Police Pension Fund; and
6. Police Pension Fund Funding Policy.

VII. Periodic Evaluation

While this document was adopted on a specific date, it is the intention of the Village Board that it serves as a guidepost for the management staff and future Village Boards for making contribution decisions for the Kenilworth Police Pension Fund. Therefore, it is recommended that this document be reviewed by the Village Board approximately every three years during the budget consideration process to determine if any adjustments are warranted.

As with any significant financial matter, periodic audits are best practice. To that end, the Village Manager shall cause to be conducted a periodic

audit of the benefit payments made for compliance with the Illinois Pension Code. Additionally, the Village Board may wish to have a periodic audit of the Fund conducted to supplement any audits conducted by the Police Pension Board or State of Illinois.

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This policy was approved by the Village Board on January 22, 2018.