

Introduction

Senate Bill 2520 affords current and future Chicago Police Officers the opportunity to purchase (port) service credit earned in other law enforcement capacities within the State of Illinois prior to their appointment to the Chicago Police Department. If you are a current Chicago Police Officer, to be eligible to purchase service, several conditions that must be met:

- You must be an active police officer, on or before the effective date of the Act becoming law.
- You must have been a contributing member working in a "law enforcement capacity" under Article 40 sections 3, 7, 9, 10, 13, 14, 15, Division 1 of Article 22 or a law enforcement officer with the CHA Police, Metropolitan Transit Authority and Local Mass Transit District Pension Fund within the Illinois Pension Code.
- You may establish up to 10 years of additional service credit, in increments of six months time.

All of these conditions must also be met:

- Service credit is not available for employment under any other provisions in Section 5-214 (leave of absence service credit reinstatement in conjunction with temporary police assignments).
- Service credit for the previous employment is terminated.
- The officer applies for this credit, in writing, within one year after the effective date.
- The officer pays to the Fund, within five years after the date of application an amount to be determined by the Fund.

Similar conditions apply to future Chicago Police Officers. Newly hired members will have two years following the date of hire to apply for credit.

Administrative steps

The following is a brief overview of the service purchase process:

1. Member applies for service purchase.
2. PABF determines the member cost and provides calculation results to the member.
3. Member decides to proceed or withdraws request. If member decides to proceed, service must be terminated at the prior fund and a refund requested (if not done already).
4. Member pays cost within five years of application.
5. At time of retirement, or separation from service for other reason, a cost adjustment is performed. Original payment is compared to the newly determined cost, and PABF provides refund of excess, if any.

How is the cost determined?

The statutes require that the cost of the additional service purchased results in no significant increase to the Policemen's Annuity and Benefit Fund (PABF) unfunded actuarial accrued liability. Actuarial accrued liability, in the simplest terms, is the amount of funds that the PABF should have on hand at this point in your career in order to pay benefits at retirement, termination or other contingent events. The actuarial liability is determined using actuarial assumptions about the rate of return the Fund will earn on their assets, salary increases that you will get in the future, and demographic assumptions that determine the probability that the Fund will pay a certain type of benefit (service retirement, disability retirement, deferred retirement, widow's annuity, etc.). Projected benefits are calculated for each different type of retirement, a probability is assigned to each, and the present value (taking into account the different probabilities and the time value of money) is calculated.

The costs to you equals the difference in projected actuarial liability, with and without the service purchased, assuming you retire at the earliest possible retirement date. This amount is discounted from the earliest possible retirement date to service purchase date at an annual rate of eight percent. The service purchased amount is to be paid within five years of application (adjusted with interest at three percent).

At the time of actual retirement, or separation from service for another reason, your actual service and salary history with Chicago Police will be used to recalculate the actuarial liability and cost to purchase service. Reasons for the cost to be different from the original amount that you paid are:

- Salary increases that deviated from the salary increase assumption used.
- Retirement date is different from that assumed.
- Updates are made to the assumptions used to develop the unfunded actuarial liability.
- Changes are made to the plan provisions.

The value of the amount that you paid in, adjusted with interest, will be compared to the newly computed cost and any excess amount that you paid will be refunded to you.

What individual factors affect the cost?

The following are items that will affect your individual service purchase calculation:

Amount of service purchased – service purchased will increase your benefit multiplier, and in addition, may allow you to retire at an earlier age.

Salary – because benefits are pay-related, the higher your salary, the higher the cost.

Years from retirement eligibility – the farther you are from retirement eligibility, the lower the cost. This is because the funds you pay in will have a longer time to accrue interest in order to be able to pay benefits at retirement.

What are you paying for?

The costs you are paying are used to fund the additional benefits you will receive due to the increased service and percentage of pay that will be used to determine your final benefit *as well as the potential for retirement at an earlier age (extra years of benefit payments and fewer years of regular funding).*

Example

An example may help illustrate some of the prior ideas.

Consider a police officer who is age 45 with 10 years of service with the Chicago Police Department who is currently receiving a salary of approximately \$80,000. Given his current age and service, he will be eligible for normal retirement in 10 years when he reaches age 55 with 20 years of service.

He also worked five years as a police officer with a small village in Illinois and was covered under IMRF at the time. Under the new service purchase provisions, he can purchase the five years of service so that he can retire five years earlier at age 50 with 20 years of service.

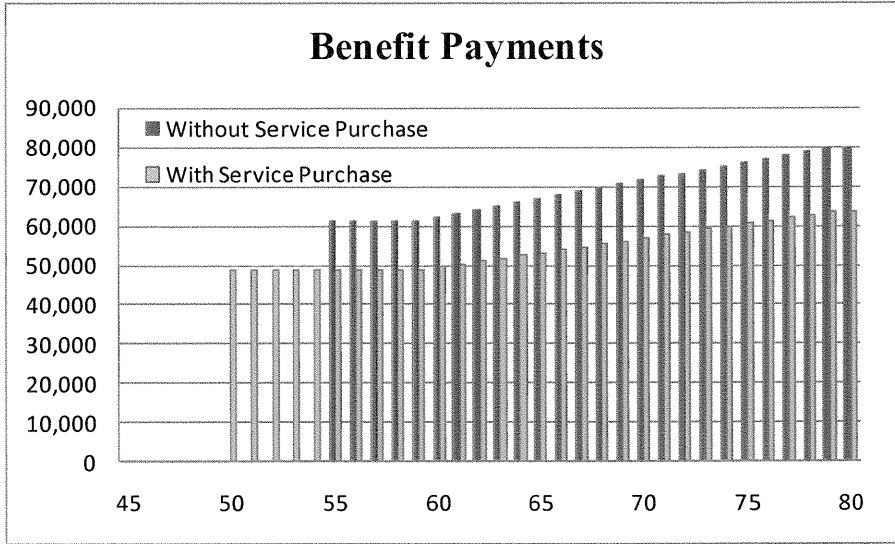
The service purchase would cost him approximately \$150,000, or approximately 37 percent of salary for each year of service purchased. This amount is required so that the change in the total cost of his benefits is paid entirely by the member. The \$150,000 goes towards several components in the cost of benefits:

1. Increased service used to calculate the final benefit
2. Earlier start date of benefit payments (in this case five years)
3. Related to item 2, there is less time spent in active member status during which regular employee and employer contributions can be used to fund the member's benefits

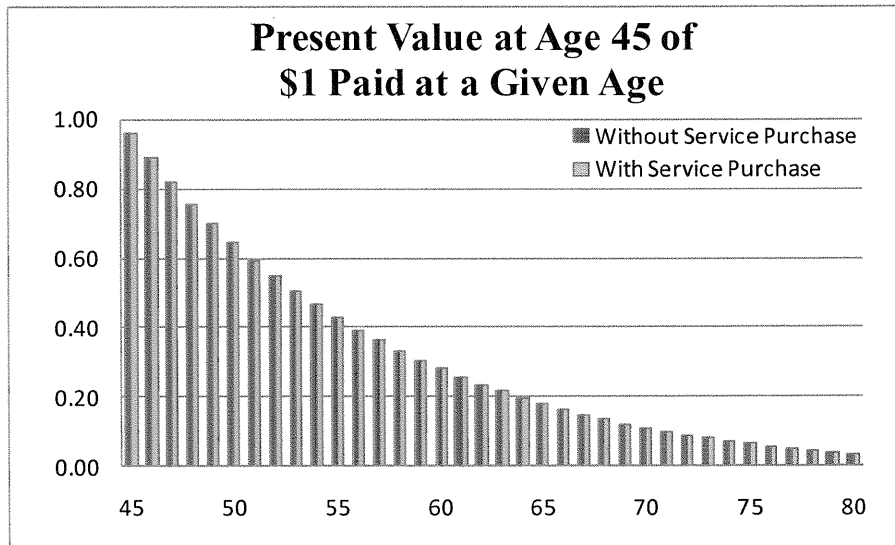
Based on the projected growth in the service purchased amount, earlier start date of benefit payments, and a projected benefit of \$49,000 at age 50, the member is expected to recover the service purchase cost in approximately 4.5 years.

For this particular example, the projected benefit without the service purchase at age 55 is approximately \$61,000, which compares to the projected benefit with the service purchase at age 50 of approximately \$49,000. At first, this may seem counterintuitive that the benefit with the service purchase benefit would be lower. Both benefits are based on 20 years of service, but the benefit without the service purchase is paid five years later and allows for five additional years of salary increases. Despite the lower benefit paid, the total benefits paid starting at age 50 are still worth significantly more since they are paid for five extra years. A graphical example to help illustrate this is shown on the following pages.

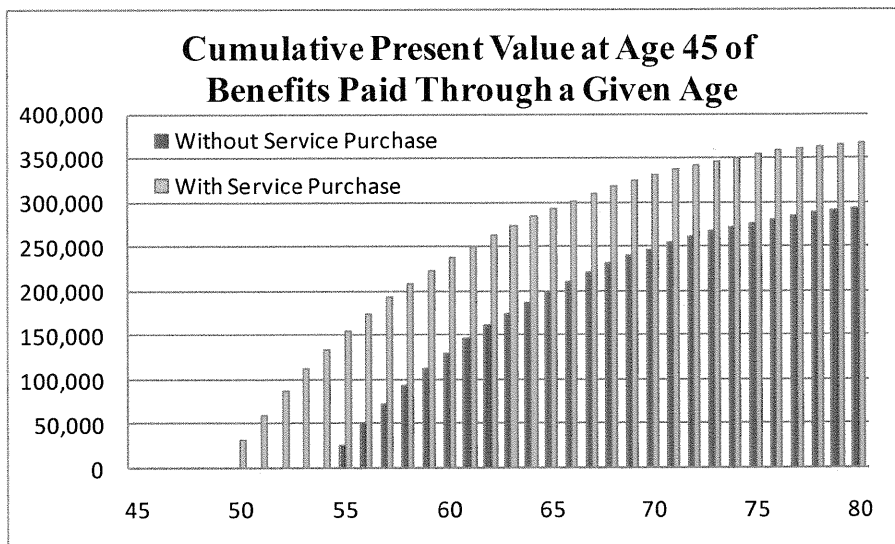
The following graph shows the benefits payable at each age until age 80 under the two scenarios. As you can see, the benefits payable with the service purchase are lower, but there are five years in which these benefits are being paid that would not be paid without the service purchase. The increase in benefits starting at age 60 is due to the cost of living adjustment commencing at this age.



The following graph shows the value of \$1.00 payable at each age. As the saying goes, a dollar today is worth more than a dollar tomorrow. Taking into account an interest rate of assumption of eight percent (the actuarial assumption for PABF) as well as mortality rates used for PABF, the effect of the time value of money is very clear. For someone who is currently age 45, \$1.00 payable at age 46.5 (approximation for benefits paid throughout the age 46 year) is worth approximately \$0.89. For someone who is currently age 45, \$1.00 payable at age 80.5 is worth just \$0.03 in terms of today's money.



The following graph shows the combined effect of the last two graphs. The bars at age 80 show the total present value at age 45 of benefits paid through age 80. As you can see the cumulative value increases rapidly as the initial benefits are paid, giving the service purchase benefits a big head start in value. Ultimately, the higher deferred benefits are not worth as much the lower benefits starting right at age 50. In this case, the present value of service purchase benefits is worth around \$70,000 more. The initial purchase price of \$150,000 goes to fund this \$70,000 as well as provide for funding of regular benefits that would occur during ages 50 to 55 through ongoing employee and employer contributions that would be made during that time.



Because a big portion of the cost is tied to the age at which retirement occurs, if you decide to delay your retirement beyond first eligibility, you may be eligible for a refund of a portion of your initial service purchase contributions. The amount of potential refund will depend on the actual salary increases you received up until the time of retirement, the age at which you decide to retire, and the assumptions and plan provisions in effect.

Weighing the pros and cons

Possible Pros

Accelerated retirement – although you are paying for the full cost of the accelerated retirement, there may be non-monetary value to you personally to be able to retire early with a normal retirement benefit. Health issues, family circumstances, or other circumstances may make it important for you to be able to retire earlier.

Investment return – the actuarial assumption for investment return is eight percent per year. In a sense, the service purchase is similar to investing your initial cost in an investment that guarantees an eight percent return and then using the total value at retirement to purchase annuity benefits. Eight percent is often higher than individual investors can achieve on their own. The additional annuity benefits may also provide the member with an additional sense of security.

Possible Cons

Large initial cost - you simply may not have the money to pay the large sum up front or the measures required to obtain the money would cause unnecessary financial hardship.

Vested benefit at prior fund – if the service you would be transferring over has secured a deferred vested benefit at the prior fund, the value of your deferred benefit may be greater than the amount of employee contributions that would be refunded to you. If you take the refund in order to transfer the service over, you may incur a financial loss.

The preceding illustration provides an example of the potential service purchase cost for a member with the stated age, service, and pay characteristics. The actual service purchase amount and potential refund will depend on the member's individual characteristics, the amount of service purchased, and the plan provisions and actuarial factors then in effect.