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FISCAL IMPACT STATEMENT

LS 6125 | **NOTE PREPARED:** Apr 1, 2011
BILL NUMBER: HB 1048 | **BILL AMENDED:** Mar 31, 2011

SUBJECT: Public Pension Funds.

FIRST AUTHOR: Rep. Niezgodski | **BILL STATUS:** CR Adopted - 2nd House
FIRST SPONSOR: Sen. M. Young

FUNDS AFFECTED: GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) The bill makes the following changes:

(1) The bill establishes a Defined Contribution Plan as an option for new state employees. A state employee who does not elect to become a member of the Plan becomes a member of the Public Employees' Retirement Fund (PERF). It requires the PERF Board of Trustees to establish the same investment options for the Plan that are available for the investment of a PERF member's annuity savings account. The bill provides that a member's contribution to the plan is 3% of the member's compensation and is paid by the state on behalf of the member. It also provides that the state's employer contribution rate for the Plan is equal to the state's employer contribution rate for PERF. The bill provides that the amount credited from the employer's contribution rate to the member's account shall not be greater than PERF's normal cost with any amount not credited to the member's account applied to PERF's unfunded accrued liability. It establishes a minimum state employer contribution of 3% of the members' compensation. The bill also establishes a five-year vesting schedule for employer contributions, and requires a member who terminates state employment before the member is fully vested to forfeit amounts that are not vested.

(2) The bill requires that the PERF Board specify by rule the interest rate credited to a participant's contributions for: (A) the State Excise Police, Gaming Agent, Gaming Control Officer, and Conservation Enforcement Officers' Retirement Fund (C & E fund); (B) the Judges' Retirement System; (C) the Prosecuting Attorneys Retirement Fund; and (D) the 1977 Police Officers' and Firefighters' Pension and Disability Fund (1977 Fund).

(3) The bill provides that a judge or a magistrate who is a participant in the Judges' Retirement System and who purchases prior PERF service credit waives credit for the PERF service only for the amount of PERF service purchased.

(4) The bill allows a 1977 Fund Member (or survivor of a member) who applied for disability prior to 1990 and is receiving a disability benefit to apply to a local board for a recommendation as to whether the member's disability occurred in the line of duty. It provides that the local board shall make a recommendation of its findings to the 1977 Fund Advisory Committee. It provides that the 1977 Fund Advisory Committee shall make an initial determination of whether the member's disability occurred in the line of duty. The bill also provides that if the 1977 Fund Advisory Committee fails to timely provide an initial determination, the default determination will be made by the PERF medical authority. It provides that the PERF Board makes a final determination of whether the member's disability occurred in the line of duty. Establishes procedures to appeal: (A) a recommendation by the local board; (B) an initial determination by the 1977 Fund Advisory Committee; or (C) an initial default determination made by the PERF medical authority. The bill requires that a member or survivor apply to the local board within two years of the receipt of a PERF Board's notice that the PERF Board has received a favorable ruling from the Internal Revenue Service.

(5) The bill provides that an active member of the 1977 Fund who has entered the deferred retirement option plan (DROP) before July 1, 2011, may elect to exit the DROP and receive a partial lump sum distribution. It provides that a 1977 Fund member who enters the DROP after June 30, 2011, may not elect to receive a partial lump sum distribution.

(6) The bill provides a thirteenth check to C & E fund participants.

(7) The bill urges the Legislative Council to assign to the Pension Management Oversight Commission the study of whether to create a defined contribution plan as an option for new employees of political subdivisions that participate in PERF and for new employees who are eligible to become members of the Teachers' Retirement Fund.

(8) The bill makes technical corrections.

(The introduced version of this bill was prepared by the Pension Management Oversight Commission.)

Effective Date: Upon passage; July 1, 2011.

Explanation of State Expenditures: (Revised) *(1) Defined Contribution Plan:* The impact to the state would depend on how the defined contribution plan might affect the defined benefit plan's actuarial assumptions. The actuarial assumptions include such projections as mortality, interest rates, salary increases, and turnover. If the assumptions changed due the creation of the defined contribution plan, then there could be some change in the state costs. If turnover in the defined benefit plan is reduced because new employees who expect to be long-term employees tend to choose the defined benefit plan, then the cost to the state would increase. When the economy turns down and to the extent the assets of PERF are under a defined contribution plan, there would be no state fiscal impact. However, to the extent the assets are under a defined benefit plan, the unfunded accrued liability would increase as the value of assets decrease, and state costs would increase.

The state would contribute the same rate of contribution into the defined contribution plan as was contributed into the defined benefit plan. The employee amount credited from the employer's contribution rate to the member's account shall not be greater than the normal cost of the PERF defined benefit plan. The employer's contribution amount not credited to the member's account is applied to PERF's unfunded accrued liability. For FY 2011 the normal cost for the defined benefit plan is about 6.36% of payroll, and the total employer contribution rate is 8.6%. The bill would deposit 6.36% of a defined contribution plan employee's salary into their account and the remaining 2.24% of their salary would be used to reduce the unfunded accrued liability in the defined benefit plan.

(Revised) *(2) Interest Setting:* The provisions involving the interest rate credited for the funds other than the Prosecuting Attorneys' Retirement Fund (PARF), there will be no fiscal impact. However, for PARF, the interest rate is currently specified in statute. The bill allows PERF to specify the rate. This could impact the interest rate credited to a participant's contributions.

(Revised) *(3) Magistrates:* The bill also provides that a judge or a magistrate who is a participant in the Judges' Retirement System and who purchases prior service credit in PERF waives credit for the PERF service only for the amount of PERF service purchased. This provision is clarifying language and will have no fiscal impact.

(4) Pre-1990 Line-of-Duty Disability Determinations- As administrators of the 1977 Police Officers' and Firefighters' Pension and Disability Fund, PERF will incur a minimal expenditure $16,500 for filing fees and an outside counsel.

(Revised) *(6) 13th Check:*The provisions involving the interest rate credited for the funds other than the Prosecuting Attorneys' Retirement Fund, there will be no fiscal impact. However, for PARF, the interest rate is currently specified in statute. The bill allows PERF to specify the rate. This could impact the interest rate credited to a participant's contributions.

The bill also provides that a judge or a magistrate who is a participant in the Judges' Retirement System and who purchases prior service credit in PERF waives credit for the PERF service only for the amount of PERF service purchased. This provision is clarifying language and will have no fiscal impact.

(Revised) (7) *Study Committee:* The study of whether to provide an optional defined contribution plan for local PERF employers and the Indiana State Teachers' Retirement Fund for new employees would be done by the Pension Management Oversight Commission within the commission's budget as established by the Legislative Council. This provision should result in no additional expenditures unless an additional meeting is required in order to study the topic.

Explanation of State Revenues:

Explanation of Local Expenditures: *(5) DROP and the Partial Lump Sum Distribution-* The summary table below shows the impact of the DROP provisions and the partial lump sum distribution.

Summary Table	
Increase in Unfunded Actuarial Unfunded Accrued Liability	$5 M
Decrease in Funded Ratio	97.99% to 97.84%
No Change in Contribution Rate	19.50%

Background Information-

1977 Police Officers' and Firefighters' Pension and Disability Fund Impact of Proposed Benefit Changes as of July 1, 2009 Total ($ in millions)			
	7/1/2009 Valuation Results Before Change Baseline	**Description of Proposed Change**	
Actuarial Accrued Liability		Impact of Change	After Change
Active & Inactive Members	$2,539.5	$5.0	$2,544.5
Pay Status Members	793.2	-	$793.2
Total	$3,332.7	$5.0	$3,337.7
Actuarial Value of Assets	$3,265.6	-	$3,265.6
Unfunded Actuarial Accrued Liability	$67.1	$5.0	$72.1
Funded Ratio	97.99%	-0.15%	97.84%
Valuation Payroll	$649.0		$649.0
Actual Contribution Rate, after smoothing	19.50%		19.50%
Total cost after smoothing	$126.6		$126.6

Up until June 30, 2012, members in the DROP program as of July 1, 2011, (or actual amendment date) are allowed the option to elect between the DROP program or a benefit payable at retirement without reference to the DROP program payable under the partial lump sum option under the Plan.

The $5 M estimate for the impact of the change in the actuarial accrued liability is a high-level estimate based on the assumed first-class salary of $50,000 for all participants in the DROP. The estimate assumes approximately 270 members in the DROP for three years who are younger in age and service when electing the DROP (i.e., more heavily weighted to a retirement age of 52 and 20 years of service at the time of the DROP election). The actual impact will depend on the age and service of the participants in the DROP and the opportunity level of adverse selection due to adding the option to elect partial lump sum distribution.

The partial lump sum distribution option is actuarially equivalent to the benefit amount payable at retirement without the DROP.

Due to contribution rate smoothing under the plan, the contribution as a percentage of salary would remain at 19.50%.

Explanation of Local Revenues:

State Agencies Affected: All; Legislative Council; PERF as administrators of the 1977 Fund.

Local Agencies Affected: Units with members in the 1977 Fund.

Information Sources: Cindy Fraterrigo; Amy Beert, Price Waterhouse Coopers, actuaries for PERF and the PERF-managed funds; Chicago, IL 312-298-2134; www.pwc.com; Doug Todd, McCready & Keene, Inc., actuaries for the State Police, 317-576-1508; www.mcak.com

Fiscal Analyst: Chuck Mayfield, 317-232-4825.

DEFINITIONS

Actuarial Accrued Liability – The actuarial accrued liability of a retirement system at any time is the excess of the present value of all benefits thereafter payable under the system over the present value of future normal cost accruals, determined by the actuarial cost method.

Lump Sum Distribution: a payment to a plan participant or beneficiary for the entire amount in a retirement account as a single cash payment versus a series of payments over time.

Smoothing - An actuarial technique used to help plan sponsors manage cost volatility in benefit programs.