INDIANA PUBLIC RETIREMENT SYSTEM FUNDING POLICY

I. POLICY AND OBJECTIVES

The Indiana Public Retirement System (INPRS) Board of Trustees (Board) intends for this policy to document both the funding methodology for each of the following eight (8) INPRS' Defined Benefit (DB) retirement plans (Pension Trust Funds) and the Board's financial decisions related to the Funding Policy.

- Public Employees' Retirement Fund (PERF)
- Teachers' Retirement Fund Pre-1996 Account (TRF Pre-1996)
- Teachers' Retirement Fund 1996 Account (TRF 1996)
- 1977 Police Officers' and Firefighters' Pension and Disability Fund (1977 Fund)
- Judges' Retirement System (JRS)
- State Excise Police, Gaming Agent, Gaming Control Officer, and Conservation Enforcement Officers' Retirement Plan (EG&C Plan)
- Prosecuting Attorneys' Retirement Fund (PARF)
- Legislators' Retirement System – Defined Benefit Plan (LEDB Plan)

The objectives of this policy for the DB retirement plans (referenced above) are to:

- Define the funding policy components to be used to develop the Actuarially Determined Contribution (ADC) for each of the INPRS DB retirement plans.
  - Require an annual actuarial valuation be completed for each DB retirement plan and use the ADC as the minimum contribution required when establishing employer contribution rates including appropriations from the State of Indiana for all plans except TRF Pre-1996.
  - Teachers' Retirement Fund Pre-1996 Account is a pay as you go DB retirement plan. This DB retirement plan is funded by the State. State appropriations are made in accordance with IC 5-10.4-2-4 for each year. A three percent year over year increase is being provided through State appropriations.

- Ensure current plan assets, future contributions and projected investment returns are sufficient to provide for all benefits expected to be paid to members and their beneficiaries over the life of the plan.
  - Contributions should include the cost of current service plus a series of amortization payments to fully fund or recognize any unfunded past service costs.

- Seek a reasonable allocation of the cost of benefits and the required funding to the years of service.
  - Seek to have each generation of taxpayers incur the cost of benefits for the members who provide services to those taxpayers, rather than deferring those costs to future taxpayers.

- Seek to manage and control future contribution volatility to the extent reasonably possible.
  - Seek to have the cost incurred by current taxpayers compare equitably to the cost for past and future taxpayers.

- Support public policy goals of accountability and transparency.
  - Each element of the funding policy should be clear, both as to intent and effect, and that each should allow an assessment of whether, how and when the plan sponsor is expected to meet the funding requirements of the plan.

- Take into consideration the nature of public sector pension plans and their governance.
  - Seek to enhance a retirement board's ability to resist and defend against efforts to influence the determination of plan costs.

II. <u>FUNDING POLICY METHODOLOGY COMPONENTS</u>

A. The Board approves the following three (3) funding policy methodology components based on the advice of the actuary.

   1. Actuarial Cost Method – A procedure used to determine the actuarial present value of plan benefits and expenses, which then is used for the attribution of benefits over a member's working life, which split the present value of benefits into past, current, and future liability.

   2. Asset Valuation Method – A procedure used to determine the actuarial value of assets that represents an average of assets over a specified time period. A smoothing approach of investment gains or losses, along with a market corridor, is used to reduce year-over-year volatility in the calculation of funded status and contribution rates.

   3. Amortization Method / Period – The payment of a present value financial obligation on an installment basis over a future number of years. The amortization period is determined by the Board and is used to amortize the unfunded actuarial accrued liability over a specified time period.
      a. Per IC 5-10.5-4-2(a)(8) [Board: Powers and Duties], the Board may amortize prior service liability over a period of thirty (30) years or less.

      b. Per IC 5-10.2-2-9(c) [PERF and TRF: Actuarial Investigation and Valuation], the actuarial investigation must include in the determination of the liability and the rates of contribution the amount necessary to fully fund past and estimated future cost of living increases for members of the Public Employees' Retirement Fund amortized over a term determined by the Board that does not exceed thirty (30) years.

      c. Per IC 5-10.2-2-11(a)(4) [PERF and TRF: Contribution Rate Determination; Contribution Rate Groups; Supplemental Contributions; Contributions and Contribution Rate Report], the Board shall determine the period, which must be thirty (30) years or a shorter period, necessary to amortize the unfunded accrued liability.

      d. Per IC 5-10.4-2-4(b) [TRF: Required Appropriation], the actuarial investigation and the Board shall include in the determination of the liability, contribution rate, and appropriation the amount necessary to fully fund any past and estimated future cost of living increases for members of the Pre-1996 Account and the 1996 Account, amortized over a term determined by the Board that does not exceed thirty (30) years.

e. Per IC 2-3.5-4-9(3) [LEDB Plan: Actuarial Valuation; Annual Determinations], based on an annual valuation, the Board shall annually determine the payments necessary to amortize the unfunded accrued liability over a term determined by the Board that does not exceed thirty (30) years.

f. Per IC 36.8.8.18(a)(1) [1977 Fund: Credit for Service Prior to Participation in 1977 Fund; Rollover Distributions; Trustee to Trustee Transfers], the unit contributes to the 1977 fund the amount necessary to amortize prior service liability over a period of not more than forty (40) years, the amount and period to be determined by the system board.

B. The current Board-approved funding policy methodology components for each of the Defined Benefit retirement plans are detailed as follows:

1. Actuarial Cost Method:
For all INPRS Defined Benefit retirement plans except the LEDB Plan, the actuarial cost method is Entry Age Normal – Level Percent of Payroll. For the LEDB Plan, the actuarial cost method is Traditional Unit Credit (TUC).

For all retirement plans except the LEDB Plan, the normal cost is calculated separately for each active member and is equal to the level percentage of payroll needed as an annual contribution from entry age to retirement age to fund projected benefits. The actuarial accrued liability on any valuation date is the accumulated value of such normal costs from entry age to the valuation date.

For the LEDB Plan, the normal cost is calculated separately for each active member and is equal to actuarial present value of additional benefits expected to be accrued during the year following the valuation date. The actuarial accrued liability on any valuation date is the actuarial present value of the benefits earned for service prior to the valuation date. Since the LEDB fund is a frozen plan and member benefits are no longer increasing, the TUC cost method is more appropriate to use.

2. Asset Valuation Method:
For all of the INPRS Defined Benefit retirement plans, the Actuarial Value of Assets is equal to a five (5)-year smoothing of gains and losses on the Market Value of Assets subject to a 20% corridor. Accordingly, the Actuarial Value of Assets is limited to no more than 20 percent greater than or 20 percent less than the Market Value of Assets.

3. Amortization Method:
For all INPRS Defined Benefit retirement plans that are less than 100% funded and are open to new members, the amortization method is level dollar, with a closed amortization period of twenty (20) years.

Gains and losses occurring from census experience different than assumed, actuarial assumption changes, and benefit changes are amortized over a twenty (20) year period with level payments each year. A new gain or loss base is established each year based on the additional gain or loss during that year and that base is amortized over a new twenty (20) year period. The change to 20 years amortization is to be prospective; therefore existing layers will not be modified. The purpose of the method is to give a smooth progression of the costs from year-to-year and, at the same time, provide for an orderly funding of the unfunded liabilities.

For the TRF Pre-1996 and the LEDB Plan defined benefit retirement plans, the amortization method is level dollar, with a closed amortization period of five (5) years.

Gains and losses occurring from census experience different than assumed, actuarial assumption changes, and benefit changes are amortized over a five (5) year period with level payments each year. A new gain or loss base is established each year based on the additional gain or loss during that year and that base is amortized over a new five (5) year period. The purpose of the method is to provide plans that are closed to new members a smooth progression of the costs from year-to-year and, at the same time, provide for an orderly funding of the unfunded liabilities.

For all INPRS Defined Benefit retirement plans that are equal to or greater than 100% funded the amortization method is level dollar, with an open amortization period of 30 years. Existing Unfunded Actuarial Accrued Liability (UAAL) amortization bases will be wiped out and a new amortization base equal to the surplus will be created. The resulting ADC is only slightly lower than the normal cost rate. The purpose is to treat existing UAAL amortization bases as fully amortized, since the liability of the plan is fully funded, and to simplify the ADC calculation.

III. ACTUARIAL ASSUMPTIONS FOR ACTUARIAL VALUATION PURPOSES

A. At least once every five (5) years (referred to as 5-Year Experience Study), the actuary shall make a separate actuarial investigation for each Defined Benefit retirement plan and make recommendations to the Board for the following economic and demographic actuarial assumptions to be used in the annual actuarial valuations. The experience study is a comparison of the demographic and economic experience for the past three (3) to five (5) years with current assumptions used in the actuarial valuation. The purpose of the experience study is to ensure that appropriate actuarial assumptions are being used to reflect current demographics and behaviors of members, as well as current market conditions. An Asset Liability Study is conducted at least every three (3) years to provide recommendations for some of the economic actuarial assumptions. It is difficult to project forward changes to member demographics and market conditions; however, consideration should be given to anticipate future trends as recommendations are prepared for Board approval.

1. Economic Actuarial Assumptions
    a. Interest Rate / Investment Return
    b. Cost of Living Increases (COLA)
    c. Future Salary Increases
    d. Inflation

2. Demographic Actuarial Assumptions
    a. Mortality (Healthy and Disabled)
    b. Retirement
    c. Withdrawal / Termination
    d. Disability
    e. Dependent (spouse / beneficiary)
    f. ASA Conversions

g. Death in active service

B. The Board approves the economic and demographic assumptions for the annual actuarial valuations for each retirement plan at least every five years; however, the Board can review and approve changes to actuarial assumptions at any time which will be utilized in the preparation of the next actuarial valuation report.

IV. SOFT FREEZE EMPLOYERS

In June 2016, three PERF employers that had implemented a soft freeze for their members, agreed to make additional contributions to PERF in future years. These agreements should be considered when establishing future contribution rates for these employers. The formal agreements are on file with INPRS.

V. INPRS BOARD FINANCIAL DECISIONS

A. In December 2011, Chairman Cochran signed Board Resolution No. 2011-12-01: Repeal of Actuarial Smoothing Rules. The previously-adopted smoothing rule resolutions, including Resolution Nos. 99-07, 01-02, 07-12, 2010-12-05 and 2011-02-01, shall cease to be utilized for the Funds beginning with the actuarial valuation dated June 30, 2011.

B. In December 2013, the INPRS Board implemented a funding objective of no year-over-year decrease in employer (excluding appropriations from the State of Indiana) contribution rates until the DB plan is 100% funded.

C. In October 2015, the INPRS Board implemented a funding objective for plans that are equal to or greater than 105% funded. The employer contribution rate of such plans will be decreased by 25% of the difference between the existing rate and the employer normal cost until the plan reaches 120% funded status. When the plan reaches 120% funded status, decrease the rate to equal the normal cost.

D. In April 2016, the INPRS Board increased the period for smoothing the gains and losses for the actuarial value of assets from four (4) years to five (5) years. The INPRS Board also reduced the amortization period relating to the changes in unfunded liabilities for the defined benefit retirement plans that are less than 105% funded and open to new members, from thirty (30) years to twenty (20) years. For the TRF Pre-1996 and the LEDB Plan defined benefit retirement plans, the amortization period for the changes in unfunded liabilities was reduced from thirty (30) years to five (5) years.

E. In November 2016, the funding policy was modified for the three PERF soft freeze employers, which agreed to make additional contributions to PERF in future years.

F. In October 2017, the INPRS Board made a technical correction to section II.B.3. (Amortization Method) of the Funding Policy. Previously, the policy stated different amortization periods for plans under and over 105% funded. The corrected version of the policy changed this threshold to 100% funded, in line with current practice and the original intent of the policy.

VI. **HISTORY**

- Originally Approved By INPRS Board: April, 2014
- Update Approved By INPRS Board: October, 2015
- Update Approved By INPRS Board: April, 2016
- Update Approved By INPRS Board: November, 2016
- Update Approved By INPRS Board: October, 2017