

INDIANA PUBLIC RETIREMENT SYSTEM

# Understanding Indiana's Largest Pension System

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January 2024



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## Funds Overview

The Indiana Public Retirement System (INPRS) includes the two largest public retirement plans in the state. These plans trace their existence back more than a generation to the early and middle parts of the 20<sup>th</sup> Century. The Indiana State Teachers' Retirement Fund (TRF) was created in 1921 and the Indiana Public Employees' Retirement Fund (PERF) was created in 1945. In 2011, the Indiana General Assembly integrated the management of the two systems under INPRS. Combined, the integrated system includes eight defined benefit (DB) retirement plans, representing more than 201,000 active members and approximately 171,000 benefit recipients.

INPRS also includes five defined contribution (DC) plans. However, the focus of this paper is the system's defined benefit pension plans.

### System Membership: Defined Benefit Active & Retired

Fund	Active Members	Benefit Recipients
Public Employees' Retirement Fund (PERF) DB	119,398	99,635
Teachers' Retirement Fund (TRF) '96 DB	60,057	10,127
Teachers' Retirement Fund (TRF) Pre-'96 DB	6,287	53,282
1977 Police Officers' and Firefighters' Retirement Fund ('77 Fund)	14,503	6,993
Excise, Gaming and Conservation Officers' Retirement Fund (EG&C)	431	275
Judges' Retirement System (JRS)	480	426
Prosecuting Attorneys' Retirement Fund (PARF)	210	203
Legislators' Defined Benefit Fund (LE DB)	3	74
<b>TOTAL DB</b>	<b>201,369</b>	<b>171,015</b>

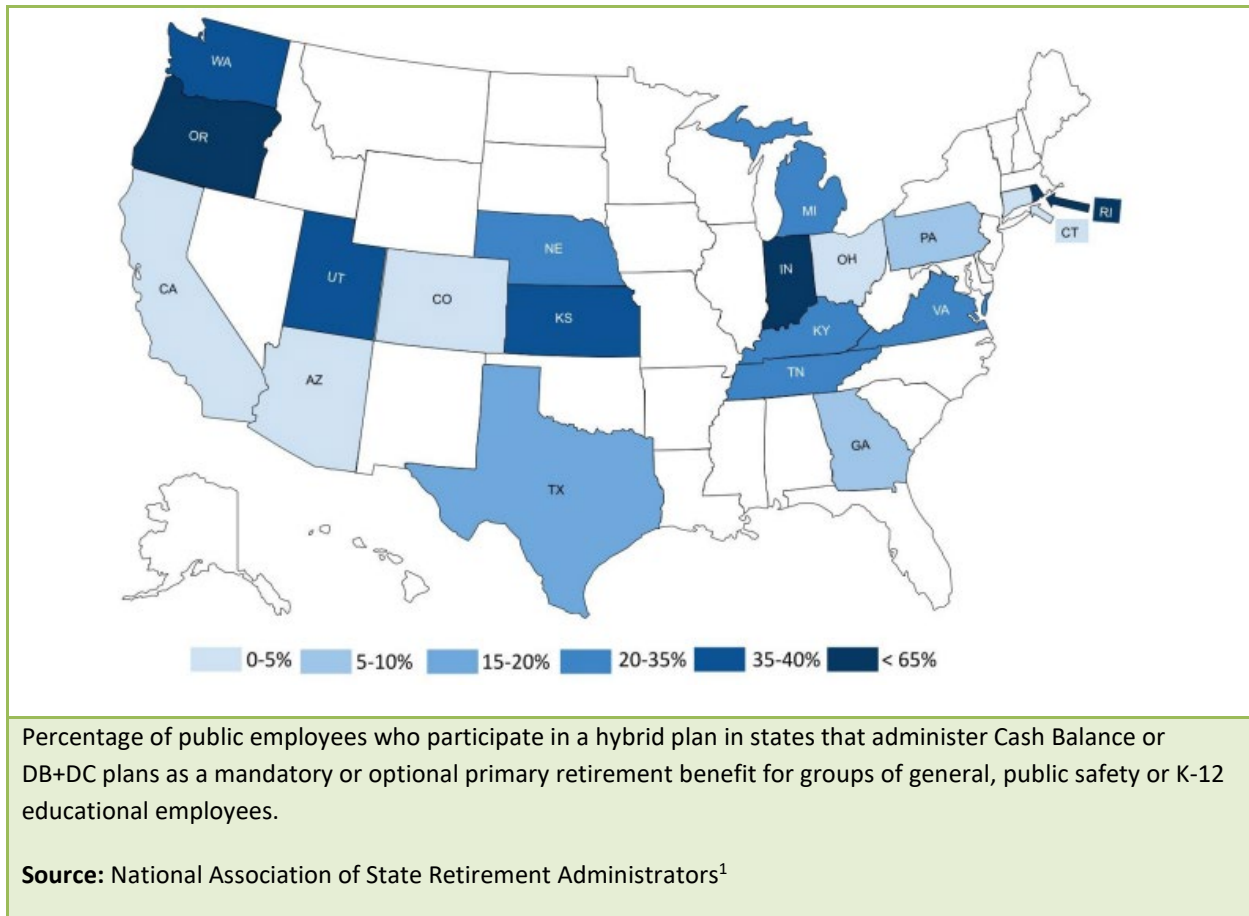
Source: [Actuarial valuations](#) as of June 30, 2023

In addition to the funds noted above, INPRS manages the Local Public Safety Pension Relief Fund, created by the Indiana General Assembly in 1980 to address the unfunded pension obligations of the police officers' and firefighters' pension systems of Indiana's cities and towns. Administered by the INPRS Board of Trustees, this fund derives its revenues from a portion of cigarette and alcohol taxes, lottery revenue, investment income, and appropriations from the General Assembly. A fixed distribution formula provides for relief payments two times per year and is based on the number of retirees and the amount of benefits paid the previous year.

INPRS is not responsible for the administration of those local pension funds addressed by the Local Public Safety Pension Relief Fund. Those local funds have been closed to new membership since the creation of the 1977 Police Officers' and Firefighters' Pension and Disability Fund.

### Hybrid Plans: Members Share Risk

Both PERF and TRF are hybrid plans in which both the employer and member have funds at risk. While a Defined Benefit (DB) pension plan places the financial risk of funding a potential lifetime benefit on the employer, a Defined Contribution (DC) plan, similar to DC plans such as 403(b)s and 401(k)s, places the risk on members. This concept has been part of the Indiana system for a generation. In this system, employers pay a mandatory contribution rate to fund the members' potential DB plan benefit that, when eligible, will provide a member a fixed benefit for life based on average pay and years of service. In addition, Indiana law requires PERF and TRF members to contribute a minimum of 3 percent of salaries to individual DC accounts. This contribution may be made by the employer, the member, or shared by both. Members make the investment decisions in their DC accounts, selecting from options ranging from a Stable Value Fund to a range of target date funds. Increases or losses in the DC account impact the member, but not employers.



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## **Actuarially Funded vs. Pay-As-You-Go**

Defined benefit (DB) pension plans at INPRS are funded in one of two ways. First, the main PERF plan as well as the 1996 TRF fund are actuarially pre-funded, meaning money is set aside today to fund projected benefits years in the future. Actuaries – using data ranging from gender and age to compensation and likely investment returns – project the amount of benefit payouts years in the future and what funding must be set aside today to fund the future benefit. Funded status reported for an actuarially funded plan is the ratio of the actuarial value of assets to the actuarial accrued liability. Often this number is reported as a percent.

A funded status of 100% means a plan is on target to fund benefit obligations. A funded status of less than 100% means it is behind and must make up shortfalls. A funded status of more than 100% means it is ahead of target and may be able to reduce contributions or build a buffer against future adverse experience.

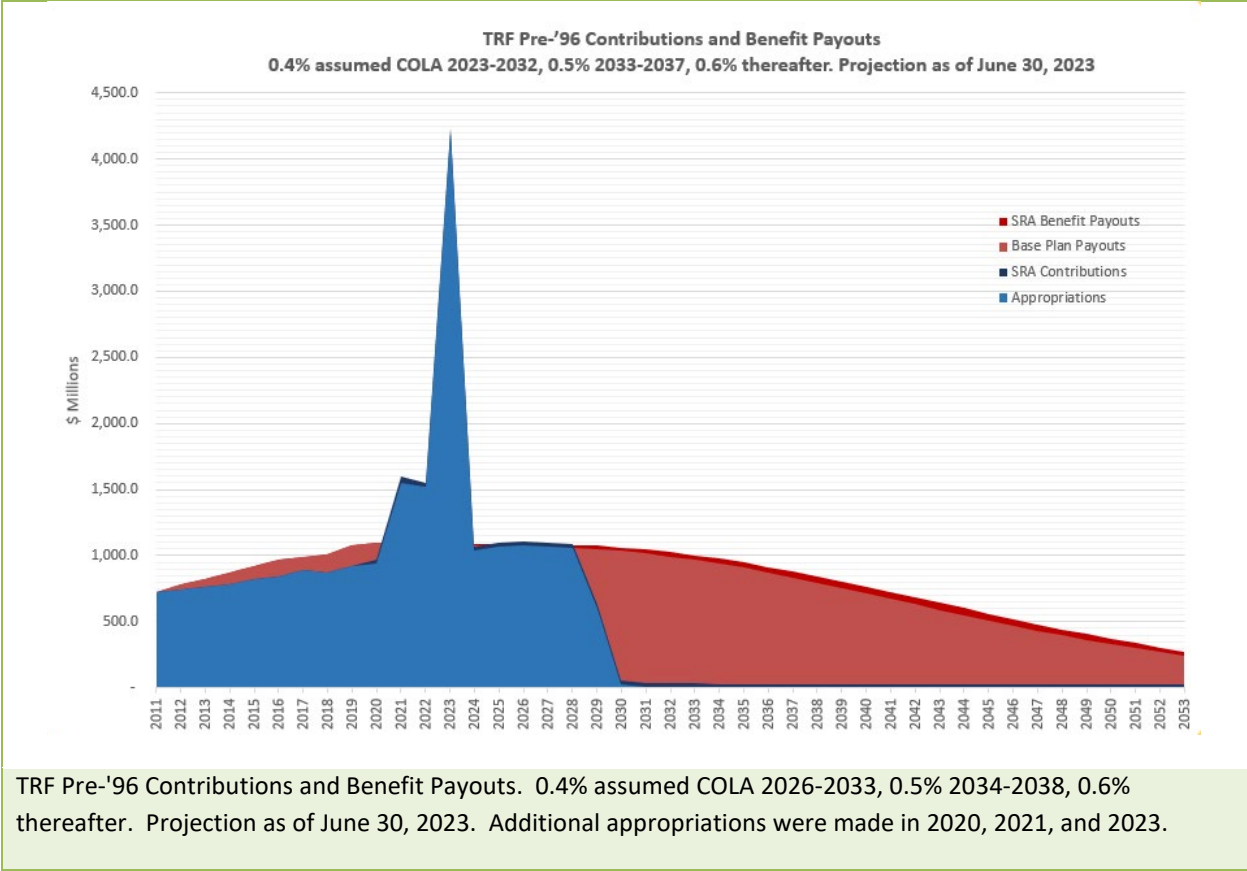
TRF's pre-1996 fund is a pay-as-you-go plan that has been in place since 1921. It is not pre-funded, and its funded status was designed to be low. Typically, in pay-as-you-go plans, no funds are set aside today to fund projected benefits years in the future. Instead, these plans are funded in the year the benefit payment is provided to the member. The federal Social Security system is pay-as-you-go.

The actuarial accrued liability measure is designed for plans to pre-fund their benefits over an employee's career. Therefore, the funded status on TRF Pre-'96 is low because the assets are not accumulated to pre-fund the plan in the same way. Instead, INPRS produces an annual analysis to show how the legally-required contributions will be sufficient to meet benefit payments, or what shortfalls exist. Social Security performs a similar analysis annually.

## **Pension Stabilization Fund**

In the case of Indiana TRF, the state's General Assembly recognized potential risks of the pay-as-you-go approach and, in 1995, established the Pension Stabilization Fund (PSF) to protect TRF retirees against any disruption in payments and to smooth out payments from the state as the baby boomer generation retires. At that time, the TRF Pre-'96 plan was closed to new entrants and the actuarially funded TRF '96 fund was established for all new members.

The PSF was initially funded from \$425 million of employer reserves from the TRF Pre-'96 Account. By law, additional contributions come from the Indiana State General Fund, the Indiana State Lottery, interest earned from the investment of PSF assets and a provision that directs 50 percent of state reserve balances above 10 percent of appropriations into the PSF. State law does not allow the PSF balance to be negative.



**System Funded Status: 6/30/2023**

Fund	Actuarial Funded Status %
Teachers' Retirement Fund (TRF) '96	92.6%
Public Employees' Retirement Fund (PERF)	85.4%
1977 Police Officers' and Firefighters' Retirement Fund ('77 Fund)	93.2%
Judges' Retirement System	92.7%
Excise, Gaming and Conservation Officers' Retirement Fund (EG&C)	95.8%
Prosecuting Attorneys' Retirement Fund (PARF)	67.9%
Legislators' Defined Benefit Fund (LE DB)	118.4%
<b>Total Pre-Funded Defined Benefit Retirement Plans</b>	<b>89.1%</b>
Teachers' Retirement Fund (TRF) Pre-1996 Account (Pay-As-You-Go)	63.6%
<b>Total Defined Benefit Retirement Plans</b>	<b>82.2%</b>

Nationally, state pension plans were funded at about 75.3 percent according to the 2023 Wilshire Report on State Retirement Systems.<sup>2</sup>

While pension plans must fund their promised benefits when they are due, there is no single level of funded status considered "healthy". Instead, stakeholders should consider a variety of factors and their trends, including but not limited to the funded status, the relative size of the liabilities to the sponsor and their revenue, the strength of the funding policy, and the investment risk inherent in the assumptions.<sup>3</sup>

**Actuarially Determined Contribution**

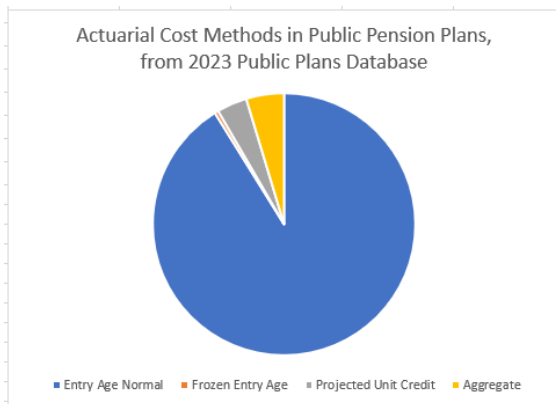
The actuarially determined contribution (ADC) is the amount an employer is required to contribute each year to fund the plan liabilities over time. The ADC, in effect, recognizes that pension benefits are “earned” and are financial obligations accrued during an employee’s entire period of service. The ADC is the annual amount the plan would have to pay to fund its liabilities over time. The ADC also includes adjustments to fund any shortfalls or clear any surpluses that may have developed.

Both the PERF and TRF systems have a long and solid track record of paying the ADC as required for plan health and stability.

**Actuarial Assumptions**

The amount of funding that INPRS pension funds must set aside each year for future benefits is driven by the work of actuaries assisting the funds by determining how costs should be allocated to a particular year.

With the help of their actuaries, plans choose one of several actuarial cost methods to set this allocation. Different cost methods have different goals. INPRS uses the Entry Age Normal cost method for most purposes. This is the same cost method used by 90% of large public sector pension plans<sup>5</sup> and is the method mandated by the Government Accounting Standards Board (GASB) for its measurements. The Entry Age Normal method spreads out the projected benefit cost as a percentage of payroll over a member's career. This allows for more even costs as the sponsor can budget a percentage of payroll to cover these retirement benefits.



<u>Cost methods</u>	<u># Plans</u>	<u>% Plans</u>
Entry Age Normal	196	91.2%
Frozen Entry Age	1	0.5%
Projected Unit Credit	8	3.7%
Aggregate	10	4.7%

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Entry age normal can also be modified to spread the cost as a flat dollar over time, which may be useful in some circumstances, however INPRS uses the percent of payroll method, which is mandated by GASB.

Single-employer private sector plans are required to use a different method called the Unit Credit method. The goal of this method is to ensure that accrued benefits are funded. The reason is that single-employer plan sponsors (private companies) can go bankrupt – quickly, in some cases – and therefore it is critical that any promised benefits have been funded at each measurement. Because large governments rarely go bankrupt, this method's goal is not appropriate for the Indiana Public Retirement System.

### Plan Health: Comparing Apples to Oranges

Two key factors having a significant influence on the reported actuarially funded status for a plan include Assumed Investment Return (AIR) and Cost of Living Adjustments (COLA). If a plan assumes there will be an annual COLA, this is built into the actuarial assumptions with the result being higher actuarial liabilities. If a plan assumes a higher investment return rate, the result can again impact projected liabilities.

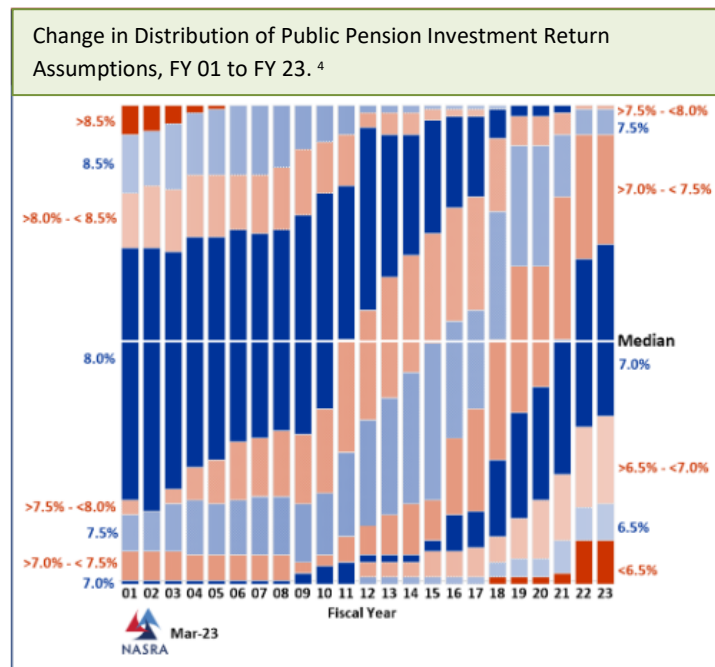
### Assumed Rate of Return

INPRS is among systems with the most conservative investment return assumptions in the nation.<sup>4</sup>

In May 2021, INPRS board members approved an assumed rate of return of 6.25%. The previous target of 6.75%, was set in 2012 and reaffirmed in 2015.

An assumed rate of return is what is considered achievable in the long-term for pension fund investments. It recognizes that some years may be significantly better or worse, but will average the assumed rate over many years.

Higher assumed returns on investment means employers may contribute less to properly fund a pension.



A high assumed rate of return, however, can make a plan appear healthier on paper, and allow lower employer contribution rates. To achieve higher rates of return, the plan must take on more investment risk. However, if pension systems do not achieve the assumed return in the long-term, a significant financial problem may be created.

Accrued liability is sensitive to changes in the discount rate, and to illustrate the potential impact the following table presents the net pension liability of each defined benefit pension plan calculated using the discount rate of 6.25 percent, as well as what each plan’s net pension liability would be if it were calculated using a discount rate that is one percentage point lower (5.25%), or one percentage point higher (7.25%) than the current rate.

<b>Pension Liability: Return Assumption Sensitivity</b>			
<b>Pre-Funded Defined Benefit Pension Trust Funds</b>	<b>1% Decrease (5.25%)</b>	<b>Current Discount Rate (6.25%)</b>	<b>1% Increase (7.25%)</b>
PERF DB	\$ 20,637,607,592	\$ 18,415,248,366	\$ 16,562,238,273
TRF '96 DB	\$ 10,375,086,841	\$ 8,832,826,874	\$ 7,586,173,936
'77 Fund	\$ 10,158,937,204	\$ 8,796,328,724	\$ 7,696,188,538
JRS	\$ 813,626,391	\$ 728,136,595	\$ 656,327,879
EG&C	\$ 220,968,110	\$ 194,827,168	\$ 173,287,685
PARF	\$ 142,708,216	\$ 126,749,070	\$ 113,590,231
LE DB	\$ 2,845,305	\$ 2,675,684	\$ 2,525,065
<b>Pay-As-You-Go Defined Benefit Pension Trust Fund</b>			
TRF Pre-'96	\$ 14,915,587,364	\$ 13,703,295,417	\$ 12,656,381,309
<i>Source: June 30, 2023 actuarial valuations</i>			

**Cost of Living Adjustments (COLA)**

Of the eight INPRS defined benefit plans, only two have automatic COLAs – the '77 Fund and JRS. These COLAs are tied to different measures of inflation as outlined in their governing statutes. PARF has no history of a COLA.

The remaining plans - PERF DB, TRF Pre-'96 DB, TRF '96 DB, EG&C, and LE DB - have ad hoc COLAs and a special funding mechanism for them. Ad hoc COLAs (or 13th checks, or any other form of post-retirement benefit increase) are granted by the Indiana General Assembly each time one is issued. Each of these plans has a subaccount called a Supplemental Reserve Account (SRA) which takes in contributions to fund these post-retirement benefit increases. Only when enough funding has accumulated in the SRAs can the General Assembly grant an



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increase. This mechanism mitigates the risk of granting increases without paying for them, helping to assure funding for future benefits.

## **Conclusion**

Many researchers rely on actuarial data supplied via public records requests or pulled from plan annual reports from throughout the nation. It is essential that the researcher understand – before comparing data – that there may be significant differences in the underlying assumptions that generated the numbers.

INPRS has chosen methods and assumptions to balance the needs of its stakeholders and ensure that promised DB benefits are fulfilled. Comparisons with other systems may not be appropriate without first considering the differences in the goals, methods, and assumptions between the systems. With careful management, INPRS will fulfill our mission of having engaged members able to realize their retirement dreams.

Ultimately, conservative actuarial assumptions avoid artificially low employer contributions, prevent the publishing of an artificially positive funded status, and lead to more stable and sustainable retirement systems.

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## Citations

- <sup>1</sup> Brainard, Keith. Brown, Alex. "NASRA Issue Brief: State Hybrid Retirement Plans." *National Association of State Retirement Administrators*. September 2023, 3. Available from <https://www.nasra.org/hybridbrief> Internet; accessed 6 September 2023
- <sup>2</sup> "2023 Report on State Retirement Systems: Funding Levels and Asset Allocations." *Wilshire*. Available from [https://assets-global.website-files.com/60f8038183eb84c40e8c14e9/645527ecd133d1cdf9a5fa48\\_Wilshire%202023%20Report%20n%20State%20Retirement%20Systems%20Funding%20Levels%20and%20Asset%20Allocations.pdf](https://assets-global.website-files.com/60f8038183eb84c40e8c14e9/645527ecd133d1cdf9a5fa48_Wilshire%202023%20Report%20n%20State%20Retirement%20Systems%20Funding%20Levels%20and%20Asset%20Allocations.pdf) Internet; accessed 21 December 2023.
- <sup>3</sup> "Issue Brief: The 80% Pension Funding Myth." *American Academy of Actuaries*. October 2021. Available from [https://www.actuary.org/sites/default/files/2021-10/80percent\\_Myth\\_Issue\\_Brief.pdf](https://www.actuary.org/sites/default/files/2021-10/80percent_Myth_Issue_Brief.pdf) Internet; accessed December 2023.
- <sup>4</sup> Brainard, Keith. "Public Pension Plan Investment Return Assumptions." NASRA Issue Brief. March 2023. <https://www.nasra.org/returnassumptionsbrief> Internet; accessed 11 December 2023.
- <sup>5</sup> Public Plans Data. Available from <https://publicplansdata.org> Internet; accessed December 2023.