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FISCAL IMPACT STATEMENT

LS 7009
BILL NUMBER: HB 1004

NOTE PREPARED: Mar 4, 2024
BILL AMENDED: Feb 29, 2024

SUBJECT: Pension Matters.

FIRST AUTHOR: Rep. Cherry
FIRST SPONSOR: Sen. Buchanan

BILL STATUS: 2nd Reading - 2nd House

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: *Deferred Compensation:* The bill provides that a state employee may affirmatively elect to enroll in the deferred compensation plan prior to the auto enroll date on day 31 of the state employee's employment.

Employer Surcharge for Thirteenth Checks and Cost of Living Adjustments (COLAs): The bill removes a provision that sets a maximum employer surcharge for the Legislators' Defined Benefit Plan (LE DB); State Excise Police, Gaming Agent, Gaming Control Officer, and Conservation Enforcement Officers' Retirement Plan (EG&C); Public Employees' Retirement Fund (PERF); and Indiana State Teachers' Retirement Fund (TRF).

This bill requires the board of trustees of the Indiana Public Retirement System (INPRS) to develop the technological and administrative capabilities sufficient to categorize fund members into separate groups in which:

(1) certain members receive a service based thirteenth check; and
(2) certain members receive a cost of living adjustment (COLA).

The bill requires the board to set the surcharge rates at a level to actuarially prefund:

(1) annual indexed thirteenth checks for all current retired members and beneficiaries retired before July 1, 2025; and
(2) 1% annual cost of living adjustments to future in-payment members and beneficiaries retired on or after July 1, 2025.

It provides that the board shall not reduce the surcharge rates from the prior year. It also allows the board to increase the surcharge rates by not more than 0.1% of payroll from the prior year.

Delinquent Local Pensions: The bill requires certain political subdivisions to present to the Interim Study Committee on Pension Management Oversight (PMOC) regarding a delinquent employee retirement plan offered by the political subdivision.

State Police Supplemental Allowance Reserve Account: The bill requires, effective July 1, 2025, the trustee of the state police pension trust to maintain a supplemental allowance reserve account for the purpose of paying postretirement benefit adjustments.

DROP Period: The bill increases the maximum date that a member or participant of certain retirement funds can participate in the deferred retirement option plan (DROP) from 36 to 60 months. It requires the member or participant to notify their employer if the member or participant elects to enter or extend the DROP.

Effective Date: Upon passage; July 1, 2024; July 1, 2025.

Explanation of State Expenditures: *Employer Surcharge for Thirteenth Checks and COLAs:* The bill tasks INPRS with setting the employer contribution surcharge rate at a level to actuarially prefund an annual indexed thirteenth check for members and beneficiaries who retire prior to July 1, 2025, and a 1% COLA for members and beneficiaries who retire on or after July 1, 2025. The bill removes the cap on the surcharge rate which is set at 1% of payroll under current law. Beginning July 1, 2025, the board may only increase the surcharge rate by up to 0.1% of payroll per year and may not reduce the surcharge rate. Further legislation would be required to provide any thirteenth checks or COLAs for members of these funds and to determine the timing and amount of the thirteenth checks, and the timing of the COLAs.

INPRS anticipates adjusting assumptions for future COLAs and thirteenth checks due to the bill. Recognizing liabilities for potential future annual thirteenth checks and COLAs will increase the unfunded liability and reduce the funded status of PERF (state), TRF Pre-‘96, EG&C, and LE DB. The liability estimates will change depending on the details and timing of further legislation which would be required to provide any future thirteenth checks or COLAs. Changing the assumptions for future thirteenth checks and COLAs to reflect the proposal to provide an indexed thirteenth check or 1% COLA based on the July 1, 2025 retirement date is estimated to increase the unfunded liability for the state share of PERF by $158 M, TRF Pre-‘96 by $15 M, and EG&C by $2 M (Cavanaugh Macdonald Consulting, 2024a). The estimate assumes that payments for the thirteenth checks and COLAs would begin in FY 2025 and that the thirteenth check would increase at a rate of 2% per year beginning in the second year.

While the employer contribution surcharge rate would increase for PERF and EG&C, there is sufficient margin in the employer contribution rate for PERF and for EG&C to increase the surcharge rate without increasing the overall employer contribution rate for state employers. The employer contribution rate for PERF is set at 11.2% through June 30, 2025. The employer contribution rate for the EG&C Fund is set at 20.75% for CY 2024 and is expected to decrease to 17.9% for CY 2025. This change may reduce or delay potential future decreases in the employer contribution rates for these funds.

INPRS will have additional workload and expenditures to develop the technological and administrative capabilities to provide thirteenth checks for certain members and a COLA for other fund members based on the date of retirement. This would apply to members of PERF, TRF, EG&C, and LE DB. The administrative costs of making those changes would come from the respective pension funds.

The employer surcharge funds supplemental reserve accounts (SRAs) which were established by SEA 373-2018 for PERF, TRF, EG&C, and the Legislator's Defined Benefit Fund as a way to pre-fund COLAs and thirteenth checks. Under current law, the SRAs are funded by employer contributions as a surcharge as determined by the INPRS Board, in an amount not to exceed 1% of the employers' payroll that is attributable to those employees who are members of PERF, TRF '96, or EG&C. Beginning on January 1, 2023, the surcharge rates are 0.66% of payroll for PERF employers, 0.21% of payroll for TRF '96 employers, and 1.00% of payroll for EG&C employers. Additionally, $30 M annually of surplus revenue from the State Lottery Commission is transferred to the SRA to pre-fund thirteenth checks and COLAs for members of the TRF Pre-'96 Fund. The INPRS Board has flexibility to use the lottery revenue for other SRAs funds as well, including for members of the Legislators' Defined Benefit Fund.

DROP Period for EG&C and Old Police and Fire Funds: Based on an actuarial cost estimate provided by INPRS, increasing the DROP period from a maximum of three years to a maximum of five years for the EG&C Fund could increase the present value of future benefits by an estimated $1.1 M, increase the actuarial accrued liability of the EG&C Fund by an estimated $3.1 M, and reduce the funded status of the EG&C Fund by 1.52%. The employer contribution rate is not expected to increase; however, under current law and funding policy, the employer contribution rate for the EG&C Fund is expected to decrease from 20.75% in CY 2024 to 17.90% in CY 2025. This change could result in a smaller decrease in future employer contribution rates for the EG&C Fund than is expected under current law. The estimate assumes that people would enter the DROP one to two years earlier than they do under current law (See Table 1).

Table 1. Estimated Fiscal Impact of Increasing the EG&C Fund DROP Length Maximum from Three Years to Five Years.

$ Millions	Baseline under Current Law	Proposed	Change
Actuarial Accrued Liability	$194.8 M	$198.0 M	$3.1 M
Funded Status	95.8%	94.3%	(1.52%)

Source: Cavanaugh Macdonald Consulting. Results are shown as of June 30, 2023.

INPRS administers the 1977 Police Officers' and Firefighters' Pension and Disability Fund ('77 Fund) and the EG&C Fund and may have increased administrative workload related to the change in the DROP for members of these funds made under the bill. The administrative costs of the '77 Fund and the EG&C Fund are paid from the fund.

Any impact due to DROP changes by members of the 1925 Police Pension Fund, 1937 Firefighters' Pension Fund, and 1953 Police Pension Fund would be minor. As of January 2023 there were fewer than five active members remaining in these funds who would be eligible to enter the DROP. These police and firefighter funds are administered at the local level and are funded through General Fund appropriations to the Pension Relief Fund.

DROP is an optional pension benefit that allows fund members who are eligible for an unreduced retirement benefit to continue to work and earn a salary and then retire with a pension benefit calculated as of the date the individual entered the DROP, plus receive an additional amount equal to the total of the pension benefits that the member would have been paid during the same period had the member retired at the time they entered the DROP. The DROP benefit is payable either in a lump sum or three equal annual payments. The bill would allow members currently in the DROP to extend their DROP period to 60 months total and allow new entrants into the DROP after June 30, 2024, to enter the DROP for up to 60 months.

Delinquent Local Pensions: INPRS would have increased workload to send delinquency notices to political subdivisions that have delinquent employee retirement plans. INPRS could likely fulfill that requirement within their current state General Fund appropriation to complete a local pension report. INPRS receives a state General Fund appropriation of $30,000 in FY 2024 and FY 2025 to complete a local pension report that identifies political subdivisions that are making insufficient contributions to their local pension plans.

If PMOC were to hold additional meetings to address political subdivisions with delinquent pensions, there would be additional expenditures for legislator per diem and travel reimbursement for the committee members. Any additional expenditures must be within the committee's budget, which is established by the Legislative Council.

State Police Supplemental Allowance Reserve Account: The bill establishes a supplemental reserve account for state police pension funds beginning July 1, 2025. The account would consist of amounts appropriated or transferred by the General Assembly. The bill does not make an appropriation. Further legislation would be required to make an appropriation for this purpose or to provide postretirement benefit increases, thirteenth checks, or other pension benefit changes or adjustments for retirees and beneficiaries of state police pensions.

Additional Information - A thirteenth check is a supplemental retirement allowance. Unlike a COLA, a thirteenth check does not increase the pension base. Historically, thirteenth check payments have typically ranged from $150 to $450 depending on a member's years of creditable service.

A cost-of-living adjustment (COLA) is a perpetual increase in an individual's monthly pension benefit. A COLA is calculated by multiplying an individual's monthly pension benefit—which already includes any previously-granted COLAs—by the COLA rate.

The unfunded actuarial liability of a retirement system is the excess of its actuarial liability minus the value of its assets.

Explanation of State Revenues:

Explanation of Local Expenditures: *Employer Surcharge for Thirteenth Checks and COLAs:* Local employers with members in TRF '96 would have increased expenditures for teacher pensions if the employer surcharge rate for TRF '96 increases. Under the bill, beginning in FY 2025, the employer surcharge rate may increase by 0.1% of salary annually until the surcharge rate is sufficient to actuarially prefund future thirteenth checks and 1% COLAs. The employer contribution rate for TRF '96 is set at 6.0% through June 30, 2024, and is expected to increase in FY 2025 pending a vote by the INPRS board.

Local employers with members in the PERF hybrid plan would not experience an increase in the employer contribution rate for PERF because there is sufficient margin in the employer contribution rate for PERF to increase the surcharge rate without increasing the employer contribution rate. The employer contribution rate for PERF is set at 11.2% through June 30, 2025.

INPRS anticipates adjusting assumptions for future COLAs and thirteenth checks due to the bill. Recognizing liabilities for potential future annual thirteenth checks and COLAs will increase the unfunded liability and reduce the funded status of PERF (local) and TRF '96. The liability estimates will change depending on the details and timing of further legislation which would be required to provide any future thirteenth checks or COLAs. Changing the assumptions for future thirteenth checks and COLAs to reflect the proposal to provide an indexed thirteenth check or 1% COLA based on the July 1, 2025 retirement date is estimated to increase the unfunded liability for the local share of PERF by $316 M and for TRF '96 by $289 M (Cavanaugh Macdonald Consulting, 2024a). The estimate assumes that payments for the thirteenth checks and COLAs would begin in FY 2025 and that the thirteenth check would increase at a rate of 2% per year beginning in the second year.

DROP Period: Based on an actuarial cost estimate provided by INPRS, increasing the DROP period from a maximum of three years to a maximum of five years could increase the present value of future benefits by an estimated $3.1 M, increase the actuarial accrued liability of the '77 Fund by an estimated $84.9 M, reduce the funded status of the '77 Fund by 0.89%, and increase the employer contribution rate by 0.57%. The estimate assumes that people would enter the DROP one to two years earlier than they do under current law (See Table 2).

Table 2. Estimated Fiscal Impact of Increasing the '77 Fund DROP Length Maximum from Three Years to Five Years.

$ Millions	Baseline under Current Law	Proposed	Change
Actuarial Accrued Liability	$8,796.3 M	$8,881.2 M	$84.9 M
Funded Status	93.2%	92.3%	(0.89%)

Source: Cavanaugh Macdonald Consulting. Results are shown as of June 30, 2023.

As of June 30, 2022 there were 824 active members of the '77 Fund who were in the DROP program. The '77 Fund is funded through employer and employee contributions. For calendar year 2024, the employer contribution rate is 19.1% of salary.

Any administrative impact to local employers due to DROP changes by members of the 1925 Police Pension Fund, 1937 Firefighters' Pension Fund, and 1953 Police Pension Fund would be minor.

Delinquent Local Pensions: Political subdivisions with delinquent local pensions would have increased workload to create a plan to address insufficient funding of the local pension and present to PMOC regarding their delinquent employee retirement plan. Political subdivisions who follow through on plans to sufficiently fund their local pension plan by contributing at least 95% of the actuarially determined contribution amount annually and ensure that the pension plan is at least 50% funded may have increased annual expenditures for employer contributions to their local pension plan.

Explanation of Local Revenues:

State Agencies Affected: Indiana Public Retirement System; PMOC.

Local Agencies Affected: Local units with active members in the 1925 Police Pension Fund, 1937 Firefighters' Pension Fund, or 1953 Police Pension Fund (Indianapolis); local employers with members in TRF '96.

Information Sources: Cavanaugh Macdonald Consulting. (2024, January 12). Estimated Cost of

Supplemental 13th Check with a 1% COLA for Retirees after a Given Cut-off Date; Cavanaugh Macdonald Consulting. (2024, January 30). 1977 Police Officers' and Firefighters' Retirement Fund and Excise, Gaming and Conservation Officers' Retirement Fund – Extend DROP Period (with Adjustment for Contributions during DROP period); Cavanaugh Macdonald Consulting, LLC. Indiana Public Retirement System Local Public Safety Pension Relief Fund. Actuarial Valuation as of January 1, 2023. https://www.in.gov/inprs/files/2023Valuation_IndianaPensionReliefFund.pdf; INPRS. 2023 valuation pension database; INPRS. 2024-2025 Employer Contribution Rate Information. https://www.in.gov/inprs/employers/er-contribution-rate-info/

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