INPRS
INDIANA PUBLIC RETIREMENT SYSTEM

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December 13, 2013

Members of Indiana General Assembly
Indiana State House
200 West Washington Street
Senate Chambers
House chambers
Indianapolis, IN 46204

Dear Indiana General Assembly,

The financial market crisis of 2008 was a wake-up call to all investors and a stark reminder of the risks inherent in today's financial markets. As stewards of $28 billion in public retirement assets, risk management has been a top priority of the Indiana Public Retirement System (INPRS) Board of Trustees (Board). As promulgated in Indiana law, the Board has a fiduciary obligation to prudently manage the plan in a manner that insures assets are available to pay promised benefits.

Over the past 18 months the Board has undertaken a review of the Annuity Savings Account (ASA) annuitization option available to retirees of PERF and TRF. The ASA is one part of a two-part retirement benefit. The primary part is a defined benefit (DB). The DB is a monthly payment made to the member based upon the member's years of service and average compensation. The second part is called the ASA. The ASA is a member directed account comprised of member contributions and investment gains/losses. Upon or after retirement, the member has a one-time option to withdraw, rollover, or convert the ASA account balance to a monthly annuity stream on top of the DB monthly benefit. The ASA annuitization program is optional and incremental to the DB benefit.

After an extensive study of the matter, the Board unanimously concluded that changes to the ASA annuitization program were necessary to preserve the financial integrity of PERF and TRF. In its current form, ASA annuitizations are calculated at an assumed interest rate of 7.5%. This rate is well above prevailing private market rates. Past practice has already created $143M in unfunded liabilities. A continuation of this practice adds another $343M of additional unfunded liabilities.

One factor in meeting the Board's fiduciary obligation was to understand how others manage similar options. To the best of our knowledge, only three other public plans in the nation even offer such an option. Of the three that offer the option, all three calculate the annuities at market-based rates at or close to US 20-year treasury notes. The largest of the three plans, the Federal Savings Thrift Plan, provides their optional annuities via a third party insurance provider. The other two plans, manage the optional annuities in-house, but at market based rates.

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The Board's first and foremost conclusion was that the rate needed to be set at a market-based rate, whether provided by a third party or kept in-house. Given the necessity to establish market based rates, the Board then determined that the use of insurance companies would avoid the creation of unfunded liabilities. No matter the rate, if kept in-house, there is a chance of creating unfunded liabilities. Whether provided in-house or by an insurance company, the member will receive the same market rate. The insurance company option maintains the same level of benefit to the member, while also immunizing the funds from additional unfunded liabilities.

Indiana laws provide protection to members' in the extremely unlikely event of an insurance company default. All annuity providers with policies in the State of Indiana must register with the Indiana Life and Health Guarantee Association. Should an insurance company fail, the Indiana Insurance Guarantee Fund provides up to $250,000 of guaranteed protection per annuitant.

The Pension Management Oversight Commission (PMOC) studied this topic and in its final report recommended that INPRS 1) "keep the annuitization of ASAs in-house" AND 2) "periodically establish an interest rate that will not create an unfunded liability". INPRS believes that the two recommendations conflict with each other. No matter the rate, maintaining these annuities in-house will always have the risk of creating unfunded liabilities.

The Board of trustees has a strict obligation to comply with Indiana laws. The Board's decision to transition ASA annuitizations to an insurance company is expressly permitted in Indiana law. IC 5-10.5-4-2(a)(5) provides that the board may specifically ***"enter into agreements with one (1) or more insurance companies to provide annuities for retired members of the fund, and upon a members authorization, transfer the amount credited to the member in the annuity savings account to the insurance companies."***.

The Board recognizes that one or more bills on this topic could be introduced in the 2014 legislative session. As always, INPRS staff is readily available to educate, assist and advise members of the General Assembly.

Sincerely,

Ken Cochran
Chairman, INPRS Board of Trustees

AS ADOPTED THE INPRS BOARD OF TRUSTEES ON DECEMBER 13, 2013

7 Yes 0 NO