PENSION MANAGEMENT OVERSIGHT COMMISSION

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MEETING MINUTES[1]

Meeting Date:	**August 22, 2006**
Meeting Time:	**10:00 A.M.**
Meeting Place:	**State House, 200 W. Washington St., Room 404**
Meeting City:	**Indianapolis, Indiana**
Meeting Number:	**1**

Members Present: **Rep. Lawrence Buell, Chairperson; Rep. Woody Burton; Rep. Win Moses; Sen. R. Michael Young; Sen. Gary Dillon; Sen. Allie Craycraft; Sen. Larry Lutz; Steve Meno; Kip White; Gary Lewis; Randy Novak.**

Members Absent: **Rep. Thomas Kromkowski.**

Representative Buell, the Chair, called the meeting of the Pension Management Oversight Commission (PMOC) to order at 10:10 a.m. Members of PMOC and the staff were introduced. Representative Buell commented that the PMOC had a full agenda for this interim. Ms. Peggy Piety, the PMOC staff attorney, reviewed legislation recommended by the PMOC for introduction in the 2006 Session, along with pension legislation which did not originate with the PMOC. In addition, Ms. Piety reviewed the study topics assigned to the PMOC by the Legislative Council. Exhibit A, PMOC Meeting Notice/Agenda, identifies these topics. Responding to a question by Senator Craycraft, Mr. Doug Todd, actuary for the Police and Fire Funds, told the PMOC that converted members of the Old Police and

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[1] Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of $0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is http://www.in.gov/legislative/. No fee is charged for viewing, downloading, or printing minutes from the Internet.

Fire Funds received a one year extension for the Delayed Retirement Option Program (DROP).

Public Employees' Retirement Fund

The Chair recognized Mr. David Adams, Director of the Public Employees' Retirement Fund (PERF), for the 2006 update of PERF. Mr. Adams distributed his presentation to the Commission members, which is Exhibit B, Pension Management Oversight Commission Meeting, August 22, 2006. Exhibit B includes the 2006 PERF Update, the Legislator's Pilot Program Update, press announcements, and the 2005 PERF Annual Report. Mr. Adams told the PMOC that there are 220,000 members of PERF, with 69% active employees. There are 1,200 PERF employers, with the top five employers having 35% of the members, while 64% of the employers have fewer than 50 employees.

Commenting about target asset allocation, Mr. Adams told the PMOC that the Alternatives is the only asset area not currently on target. PERF has five classes of investments: 1) Domestic equities; 2) International equities; 3) Global equities; 4) Fixed Income; and 5) Alternatives. Total assets (unaudited) for PERF as of June 30, 2006, amounted to $14.7 B, an increase of 9.5% over June 30, 2005.

Mr. Adams told the PMOC that the funded ratio (assets compared to liabilities) of the six funds managed by PERF averaged 95.3%. He said that 90% is considered well-funded. The total unfunded liabilities (unaudited for 2006) for the six funds amounted to $623.3 M, an increase of 8% over 2005. Mr. Adams told the PMOC that PERF and the 1977 Police and Fire Funds are pre-funded, while the other funds are pay-as-you-go, that is, funds are appropriated each year to cover the earned benefits. In response to Senator Young's question, Mr. Adams told the PMOC that there are three approaches to increase the funding ratio: 1) increase contributions; 2) change investment allocation; and 3) modify benefits.

Commenting further about PERF, Mr. Adams said that the PERF web design was changed to allow more transactions to be completed on-line, with about 25% of all transactions currently done on-line. He said that the issue of the retirement check time (the time between retirement and the receipt of the retiree's first check) has been reduced by 44% and that the current error rate is five percent, down from an error rate of 68% as reported by the State Board of Accounts in their 2002 audit of PERF. Mr. Adams said that he wants to align crediting (creditable years of member service) with data collected quarterly. He said that the fiscal impact of this would be less than $15 M. Mr. Adams said that the Board of Trustees is looking at technology upgrades, with the current system approaching obsolescence. New upgrades may take three to five years to implement. Mr. Adams told the PMOC that his goal is to have a clean audit report for FY 2007, and to obtain an unqualified financial opinion. In response to a question from the Chair, Mr. Adams said that the data at PERF has not been compromised because of internal controls. Commenting on a question from Senator Young, Mr. Adams said that an increase in the PERF multiplier would increase the unfunded liabilities.

Mr. Adams told the PMOC that Alternative Investments consist of private equity, venture capital, buyouts, commodities and other equities. The key is protecting the asset through diversification. Mr. Adams said that PERF saved $1 M in administrative costs in FY 2006 by efficiencies and streamlining without hiring additional staff. He said that PERF did not replace employees who left. Commission member Mr. White wanted to know how the Annuity Savings Account (ASA) affects the multiplier. Mr. Adams said that one must look at Social Security, the Defined Benefit, and the ASA payment for the overall impact, rather than just the multiplier.

Mr. Adams next discussed the Legislator's Defined Benefit Contribution Plan Pilot program. The program has 200 accounts. He said that the members want to trade more than once per quarter, but that they are not day traders. Mr. Adams said that a third party record keeper will be necessary, along with on-line changes. Legislation in 2005 allows the PERF Board to make the changes by rule. He said that a legislator survey revealed that: 1) 88% of the legislators like changing options more frequently than once per quarter; 2) legislators like on-line usage; and 3) legislators would like changes in the service levels. Mr. Adams outlined the options for the program: 1) rebuild the system internally which would take three to five years to implement; 2) hire a third party record-keeper; and 3) extend the pilot program another year. Mr. Adams said that PERF needs to evaluate the options and that the Defined Benefit and the Defined Contributions plans are intertwined. Mr. Adams expressed concern over whether or not a third party could accommodate the changes. In response to a question from Senator Young, Mr. Adams said few states have both the Defined Benefit and Defined Contribution combination. He said that current technology is reaching obsolescence. He said that PERF wants to evaluate the options and make recommendations. This would take six to nine months to accomplish. Mr. Adams told the PMOC that when the current pilot program ends, PERF will take the program in-house and currently does not have the capabilities to change investment selections more often than quarterly.

Senator Craycraft raised a question about beneficiary designation within the state's Deferred Compensation program. Mr. Jeff Heinzman, Deputy State Auditor and General Counsel to the State Auditor, told the PMOC that the officials constantly monitor such things. He said that there are inherent problems with the mapping of large amounts of data. Senator Craycraft suggested that legislators check their designations in the Deferred Compensation program. Representative Burton said that he has far fewer complaints this year about PERF's performance and that things are moving in the right direction.

Teachers' Retirement Fund

The Chair called upon Ms. Christie Wheeler, Executive Director of the Teachers' Retirement Fund (TRF). Ms. Wheeler distributed Exhibit C, Indiana State Teachers' Retirement Fund presentation to the Pension Management Oversight Commission August 22, 2006. Ms. Wheeler told the PMOC that she has been Executive Director of TRF for nine months. Exhibit C contains highlights of TRF's goals and objectives. Ms. Wheeler said that TRF has maintained good records, provided timely benefit checks during the same time that TRF experienced a large increase in services for baby boomers. They did this without an increase in administrative costs. She said that customer service improvements and retiree counseling help provide more than just a check to the TRF retiree. Ms. Wheeler said that cyclical retirement dates coincide with the end of the school year. She also said that TRF has added summer counseling sessions. Ms. Wheeler noted that this was done without changing check delivery.

Ms. Wheeler told the PMOC that the target rate of return is 7.5%. She said that it took an 18-month project to eliminate a five-year backlog of scanning documents into their computer system. Ms. Wheeler said that TRF used a state vendor for the project. Ms. Wheeler said that the annual benefit payout for the closed pre-1996 Fund amounted to $607 M in FY 2005. One of the current TRF projects is to locate "lost" members. Currently, there are 74,000 active members, with an annual payroll of $4 B. Ms. Wheeler said that the 1996 Fund is actuarially funded. This was brought about by a $715 M transfer from the Pension Stabilization Fund (PSF) to the 1996 Fund. The liabilities in the 1996 Fund represented transferred members who brought no assets to cover the liabilities. The funding ratio of the 1996 Fund is in the high 90s. The PSF is to help the pre-1996 Fund. The governing statute allows an appropriation up to 6% over the previous year's appropriation. Ms. Wheeler said that projections for FY 2007 show more than a six-percent increase, so the TRF will start drawing from the PSF. The anticipated life of the PSF is through 2023, with a peak benefit payout of $1.5 B. She suggested that policy makers look at the PSF to determine whether the PSF is able to deliver what is was designed to deliver. Ms. Wheeler also said that there will be an update of the actuarial assumptions.

Senator Young asked why the unfunded liabilities of both plans were down. Ms. Wheeler said that the employers of participants in the 1996 Fund contribute 7% of payroll. With the pre-1996 Fund, there is no employer contribution. In response to another question from Senator Young, Ms. Wheeler said that the three-percent contribution is for the employee Annuity Savings Account and is typically paid by the employer, the dollar amount of which is based on the employee's salary. She said that employees do pay into the Defined Benefit Plan either. Senator Young requested from Ms. Wheeler an analysis of the State of Wisconsin Report on State Pension Plans. The cost to fund the TRF COLA (Cost-of-Living-Adjustment) granted in the 2006 Session ranged from $50 M to $60 M.

Department of Correction

Mr. David Donahue, Commissioner of the Indiana Department of Correction (DOC), was called upon by Representative Buell. Mr. Donahue said that last year the General Assembly changed the law (SEA 332-2006) to recognize all DOC state employees working in adult prisons, juvenile detention facilities, parole, or emergency response operations as holding hazardous duty with positions (with the exception of teachers). SEA 332 also called for the PMOC to review the benefits available to DOC employees with hazardous duty assignments.

Mr. Donahue said that Corrections can be a high risk business. He said that the DOC has a staff of 6,649 in hazardous positions. On average, each year there are 319 physical assaults on staff by adult offenders, and 270 assaults by juvenile offenders. Mr. Donahue said that there have been seven deaths in the last 20 years. The DOC, said Mr. Donahue has been experiencing a high turnover rate (27% for non-custody staff, and 30% for custody staff). He said that competition for DOC staff includes:

1) Jails and Sheriffs Departments
2) Probation Departments
3) Federal Bureau of Prisons (Terre Haute and Robinson, Illinois)
4) State Police
5) Private Correctional Companies
6) Local factories, casinos, and other businesses

Mr. Donahue said that recruitment in an ongoing challenge to replace DOC vacant hazardous duty positions. He said that every neighboring state's benefits and compensation package is better than Indiana's. Mr. Donahue provided the following comparisons of monthly benefits:

IN	$	774.13
Il	$	2,276.00
KY	$	1,752.36
MI	$	1,455.29

Mr. Donahue said he would leave the current PERF as is, but supplement it as separate pension plan for DOC employees in hazardous duty positions. This plan would require no additional match by staff. Once an employee puts in 10 years of hazardous duty, the employee would earn additional supplemental retirement benefit of 0.35% of the average salary times all years of credited service. Those staff that put in 20 years of service in a hazardous duty assignment will receive 0.9% for the entire 20 years (rather than the 0.5% supplement). The proposed plan has a built-in COLA of 1.5%. The plan would cap at 20 years, with any additional increase in benefit coming from an increase in the employee's salary. PERF would administer the fund. The new plan would not impact the Rule of 85. Mr. Donahue provided a visual aid to the PMOC regarding the proposed plan (Exhibit D) which outlines the supplemental hazardous duty DOC benefit. Mr. Donahue also provided the PMOC with a letter from a DOC custody staff member (Exhibit E) in which the staff member says that the current PERF benefit of $774.13 per month does not cover his monthly insurance payments of $1,025.40. Mr. Donahue said that the DOC spends about $15 M in training, much of which applies to training new employees. He said that the low retention rate leads to fewer career employees with a strong working knowledge of Corrections to help monitor new employees.

Mr. Doug Todd from McCready & Keene, said that the proposed plan is estimated to cost $14.7 M per year and would increase unfunded liabilities by an estimated $11.7 M. Mr. Donahue said that the DOC would pay for the new plan by: 1) redirecting current DOC assets, 2) future savings from reduced overtime costs; 3) replacement savings (retiring higher paid staff and replacing with a lower paid staff); and 4) savings in training costs.

The Chair called upon Ms. Mary Beth Braitman, from the firm of Ice Miller. Mr. Braitman distributed Exhibit F Indiana Department of Correction Pension Restructuring. Ms. Braitman said that the proposed plan would bring DOC officers in line with other public safety officers in the state as well as other states.

Ms. Braitman said, in response to a question from the Chair, that the proposed plan is a qualified plan under Internal Revenue Service guidelines. Senator Dillon inquired about the retirement schedule for public safety officers in the 1977 Police Officers' and Firefighters' Fund and was told that the 1977 Fund is 52 with 20 years and the proposed DOC plan would be 55 with 30 years.

Mr. Leo Blackwell, representing the Indiana Fraternal Order of Police (FOP), told the PMOC that while the FOP does not represent the DOC employees, the FOP supports the proposed plan. Representative Buell said that there would be no action on the proposed plan today and that the plan must be put into proper draft from before consideration.

Next the Chair called upon Mr. Matt Brase of the Indiana Association of Cities and Towns (IACT). Mr. Brase stated that the issue of funding sources for pension relief for municipalities was the most important issue on the agenda for IACT. With an approximately $3 B unfunded liability in the Old Police and Fire Plan, Mr. Brase said that he would like to see the issue of the unfunded liabilities resolved. Mr. Tom Hanify of the Indiana Professional Firefighters Union concurred with Mr. Brase's comments as did Mr. Leo Blackwell.

Representative Buell announced that if members have any issues they want the PMOC to review, they should contact the staff and provide them with the suggested items for review.

The next meeting will be Tuesday, September 5, in Room 404, at 10:00 a.m. The Chair adjourned the meeting at 12:35 p.m.