ACTUARIAL NOTE
REGULAR SESSION 2009

House Bill 96: HLS 09RS-546
Enrolled

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LA # 1.04
STATE/STATEWIDE RETIREMENT SYSTEMS- Guaranteed Cost-of-Living Benefit Adjustments Option

EN 5yr SF See note

Preparation of this Note was directed by the Actuarial Services Division of this office

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Bill Header: Relative to state and statewide retirement systems, provides for retirement option with guaranteed cost-of-living adjustments subject to an actuarial reduction of benefits.

Estimated Fiscal Impact

EXPENDITURES:	2009-10	2010-11	2011-12	2012-13	2013-14	5 Yr Total
State General fund	See below	See below	See below	See below	See below	See below
Agy Self Generated	0	0	0	0	0	0
Stat Deds/Other	0	0	0	0	0	0
Federal Funds	0	0	0	0	0	0
Local Funds	See below	See below	See below	See below	See below	See below
Annual Total	See below	See below	See below	See below	See below	See below

REVENUES	2009-10	2010-11	2011-12	2012-13	2013-14	5 Yr Total
State General fund	See below	See below	See below	See below	See below	See below
Agy Self Generated	0	0	0	0	0	0
Stat Deds/Other	0	0	0	0	0	0
Federal Funds	0	0	0	0	0	0
Local Funds	See below	See below	See below	See below	See below	See below
Annual Total	See below	See below	See below	See below	See below	See below

Purpose:

To enact R.S. 11:247 to permit retirees from the state and statewide retirement systems the selection of a retirement option that would provide for automatic cost-of-living adjustments subject to an actuarial reduction of benefits and to provide for related matters. This guaranteed cost-of-living adjustment option is available upon retirement or upon participation in the Deferred Retirement Option Plan (DROP.)

Bill Provisions:

Relative to the state and statewide retirement systems, provides for a retirement option with guaranteed cost-of-living adjustments subject to an actuarial reduction of benefits.

Existing Provisions:

There are no current provisions that would allow a retiree to select a retirement option that would provide for automatic cost-of-living adjustments.

R.S. 11:241 provides a formula for distribution of cost-of-living benefits that may be granted by the systems to its retirees.

R.S. 11:242 grants authority to amend a statewide system to provide for cost-of-living increases in calendar years when the legislature fails to enact legislation granting cost-of-living adjustments.

R.S. 11:246 provides that the board of trustees of a statewide retirement system may grant a supplemental 2% cost-of-living adjustment to all retirees and beneficiaries who are sixty-five years of age or over.

Proposed Provisions:

Proposed law provides for a retirement option that would allow a retiree to receive an actuarially reduced retirement allowance plus an annual 2.5% cost-of-living adjustment (COLA).

Proposed law provides that the retiree would receive the 2.5% COLA annually on his retirement anniversary date. Such COLA would only be payable to retirees who are 55 and older.

Proposed law provides that any retiree who has exercised the option provided by proposed law shall also receive any additional COLA that may be granted by the system's board of trustees pursuant to present law. In such case the additional COLA shall be based on the retiree's monthly benefit as it exists when such additional COLA is granted. However, the 2.5% COLA provided by the option per proposed law shall be calculated on amounts which exclude the additional COLA.

Proposed law provides that any member may request from the system actuarial estimates of how much his benefit will be pursuant to proposed law for the 5th, 10th and 15th year following his retirement, provided he certifies that he is considering availing himself of proposed law.

Proposed law provides that participants in the DROP plan may also select the retirement option with guaranteed cost-of-living adjustments.

Actuarial Impact

Actuarial Cost Impact:

As explained below, there is an actuarial cost impact and an administrative cost impact to HB 96.

1. Actuarial Cost due to Adverse Selection: The cost of adverse selection is not readily measurable. The normal form of benefit for all state and statewide retirement systems, except for STPOL, is a life annuity which provides monthly benefits for the life of the retiree. When a member selects an option he is actually reducing his monthly benefit to purchase insurance that will pay a benefit to his beneficiary after his death. Insurance is available in the marketplace only if the proposed insured's health is compatible with the underwriting standards of the insurer as determined by the insurer's underwriting process. For state and statewide retirement systems the optional forms of benefit are provided without the member having to satisfy a health requirement. Therefore there is likely to be a tendency for the system members who are healthy to receive a normal life annuity benefit and for members with poorer health to select an optional form of benefit that would provide the largest payoff up front or that would provide for benefits to their surviving beneficiary. This is known as adverse selection because it is financially adverse to the system.

   The guaranteed cost-of-living adjustments option with an actuarially reduced initial benefit that the proposed law would enact could persuade a retiring member to select it as an alternative to other options if it is in his best interest in light of his health status which could then result in the adverse selection impact on the retirement system.

   We are unable to estimate the extent of antiselection and are therefore unable to determine a potential actual cost. However we would anticipate that it will be negligible and not significant.

2. Actuarial costs associated with DROP: There already is an adverse effect on the retirement systems for any person who elects to participate in DROP under the current law. The adverse effect results from the following:

   - When an employee enters DROP and selects an optional form of benefit, he is actually purchasing insurance to provide a benefit to a potential survivor. The cost of this insurance is based on the member's age and survivor's age when he enters DROP.

   - After three years in DROP, the employee begins to earn a supplemental benefit.

   - When the employee eventually retires, he is charged the same premium rate on the supplemental benefit as he was charged on the original benefit.

   - Because he is older at retirement than he was when he entered DROP, the premium rate should be larger.

   This premium bias will be extended to the retirement option with guaranteed cost-of-living adjustments if this proposed legislation is enacted.

3. Administrative Cost: This option will require more complex calculation work than a straight life annuity option. If the process is automated the additional work would be less than if the process depends on manual calculation. To the extent that this would be an additional option it would place more work requirement on the retirement system's personnel than currently required by the retirement options which are now available.

   If software is actuarially programmed to accommodate the retirement option provided by the proposed law, we anticipate that additional administrative costs will not be significant. We are unable to estimate the additional administrative cost that would be required for necessary programming work.

Actuarial Analysis:

Proposed law would provide for an additional retirement option which a retiring member or a member participating in DROP could select for purposes of receiving retirement benefits. This option would:

1. provide for lower initial monthly benefits than a straight life income option. Thereafter monthly benefits, exclusive of the amount corresponding to any discretionary COLAS previously granted to the retiree, would be increased by 2.5% each retirement anniversary date of the retiree on a guaranteed basis. The retiring member would also be entitled to receive an increase in the monthly benefit should the retirement system grant a discretionary COLA. The discretionary COLA percent would be applied to the monthly benefit that the retired member is receiving at the time the discretionary COLA percent takes effect. This will mean that:

i. the initial monthly benefit under this new option will initially be less than the straight life income benefit would have been;

ii. at some future point the monthly benefit under this new option will exceed what the straight life income benefit would have been. The point in time at which the crossover occurs will depend on the age at retirement of the retiring member.

2. for members participating in DROP who select this retirement option:

   i. the guaranteed annual cost-of-living shall be credited to the participant's DROP account.

   ii. following participation in DROP the guaranteed annual cost-of-living shall be applied to the monthly benefit allowance exclusive of the amount corresponding to any discretionary COLAs previously granted to the retiree.

   iii. upon retirement of a DROP participant, the annual cost-of-living shall also be applied to any supplemental benefit earned.

3. provide that the guaranteed annual cost-of-living increase will occur each retirement anniversary date of the retiree. Since the law provides that the retiring member will receive an "actuarially reduced" benefit amount, the actual date of retirement will need to be taken into account in calculating the actuarially reduced benefit amount.

4. provide that the guaranteed annual cost-of-living adjustment shall be payable only to retirees who are age fifty-five and older and not before the retiree would have attained such age if the beneficiary is receiving the retirement allowance. This implies that retired members who have not yet attained age fifty-five and/or beneficiaries of a retired member who would not yet have attained age fifty-five will receive an actuarially reduced level monthly benefit until such time as the retired member attains or, if deceased, would have attained age fifty-five, and will receive guaranteed annual cost-of-living increases in their monthly benefit after that date.

Fiscal Impact: None. See Actuarial Cost and Actuarial Analysis, above**.**

Dual Referral Rules:

Estimated Fiscal Impact>= $500,000? **NO**