


**2010 REGULAR SESSION
ACTUARIAL NOTE SB 594**

<p>Senate Bill 594 SLS 10RS-192 Original</p> <p>Author: Senator D. A. "Butch" Gautreaux Date: April 17, 2010</p> <p>LLA Note SB 594.01</p> <p>Organizations Affected: Louisiana State and Statewide public retirement systems and the Harbor Police Retirement System</p> <p>OR SEE ACTUARIAL NOTE APV</p>	<p>The Note was prepared by the Actuarial Services Department of the Office of the Legislative Auditor.</p> <div style="text-align: right; margin-top: 100px;">  David K. Greer, CPA Assistant Legislative Auditor and Director of Performance Audit and Actuarial Services </div>
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Bill Header: RETIREMENT SYSTEMS: Relative to public retirement systems, provides relative to investments.

Cost Summary:

Actuarial Cost/(Savings) to Retirement Systems and OGB	See Actuarial Analysis Below
Total Five Year Fiscal Cost	
Expenditures	See Actuarial Analysis Below
Revenues	\$0

Estimated Actuarial Impact:

The chart below shows the estimated increase/(decrease) in the actuarial value of benefits, if any, attributable to the proposed legislation. Note: it includes the present value cost of fiscal costs associated with benefit changes. It does **not** include present value costs associated with other fiscal concerns.

<u>Actuarial Cost (Savings) to:</u>	<u>Increase (Decrease) in The Actuarial Present Value</u>
All Louisiana public retirement systems	See Actuarial Analysis Below
Other Post Retirement Benefits	\$0
Total	See Actuarial Analysis Below

Estimated Fiscal Impact:

The chart below shows the estimated fiscal impact of the proposed legislation. This represents the effect on cash flows for government entities including the retirement systems and the Office of Group Benefits, as well as other fiscal concerns.

EXPENDITURES	2010-11	2011-12	2012-13	2013-14	2014-15	5 Year Total
State General Fund	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
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	0	0	0	0	0	0
Annual Total	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0

REVENUES	2010-11	2011-12	2012-13	2013-14	2014-15	5 Year Total
State General Fund	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
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	0	0	0	0	0	0
Annual Total	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0

Bill Information:

Current Law

Under current law, the four state retirement systems, the nine statewide retirement systems and the Harbor Police Retirement System must invest plan assets in accordance with the prudent man rule. This rule is defined as follows:

1. Each fiduciary, acting collectively on behalf of the retirement system, must act with the care, skill, prudence and diligence under prevailing circumstances that a prudent institutional investor in a similar capacity would act.

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2. The standard of care is to be applied to investments not in isolation but in the context of the overall investment strategy.
3. The standard of care shall not prohibit investment in small and emerging businesses, small business investment companies, and venture capital firms.

Under current law, LASERS, TRSL, LSERS and the Assessors' Retirement System are subject to the following investment restrictions:

1. No more than 65% of the total portfolio may be invested in equities.
2. At least 10% of the total equity portfolio must be invested in indexed funds.
3. Equity indexed funds may be divested if the S&P composite index declines more than 10% during the 12 month period immediately before the divestment. However, written notice must be given to the House and Senate Committees on Retirement within ten days following the decision to divest.
4. The 10% requirement for equity indexed funds must be restored if and when the S&P composite index increases by more than 10% as measured from the date of the most recent divestment.

Under current law, the remaining state and statewide retirement systems and the Harbor Police Retirement System are subject to the following investment restrictions

1. No more than 55% of the total portfolio may be invested in equities.
2. A system may increase its equity portfolio to 65% of the total fund but if the investment percentage exceeds 55% then at least 10% of the equity portfolio must be invested in equity indexed funds.

Proposed Law

The prudent man rule under current law is retained.

The investment restrictions under current law are replaced with the following rules applicable to all state and statewide retirement systems and the Harbor Police Retirement System.

1. The investments policies for each system shall be structured to preserve and enhance principal over the long term and provide liquidity and cash flow for the payment of benefits.
2. Investments shall be diversified to minimize the risk of significant losses unless it is clearly prudent not to do so.
3. The term equities shall not include alternative investments such as:
 - Privately placed investment pools including private investment funds.
 - Leveraged buyout funds.
 - Mezzanine funds.
 - Workout funds.
 - Debt funds.
 - Venture capital funds.
 - Merchant banking funds.
 - Funds of funds and secondary funds.
 - Distressed debt and equity investments including cases in which the investor may take control of the issuer.
 - Debt derivative and equity derivative instruments of all types.
4. At least 15% of the portfolio must be invested in core fixed-income securities with an average quality rating of "A" or better.
5. No more than 65% of the total portfolio shall be invested in equities.
6. At least 10% of the total equity portfolio must be invested in indexed funds.
7. No more than 20% of the portfolio may be invested in alternative investments inclusive of committed capital.
8. No System shall use financial leverage in the purchase of real estate.
9. There shall be no direct ownership of real estate after June 30, 2010 except for an office building used by the System.

All Systems must comply with the provisions of SB 594 within two years.

Implications of the Proposed Changes

SB 594 significantly restricts System investments in alternative funds and real estate. The percentage of total portfolio assets invested in alternative funds and real estate by state and statewide retirement systems, as well as the Harbor Police Retirement System, has increased significantly over the past several years. SB 594 will allow the Systems to invest no more than 20% of total assets in alternative investments and will prohibit direct ownership of real estate except to provide for its own office space.

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Cost Analysis

Analysis of Actuarial Costs

Retirement Systems

Many, if not all, of the retirement systems will have to revise their investment strategies and restructure their portfolios to comply with SB 594. The percentage of assets invested in alternative funds for many of the systems exceeds the 20% limit that will be imposed. The effect of the new requirements will vary from system to system.

The most fundamental actuarial equation is:

$$\text{Benefits} = \text{Contributions} + \text{Investment Earnings}$$

According to this formula, benefits must be paid from contributions and/or investment earnings. And, the greater the investment earnings of a plan, the lower contributions will be.

If SB 594 is intended to reduce investment risk and contribution volatility, then long term investment returns on restructured portfolios may be smaller than returns expected on current portfolios. Asset and contribution stability will be achieved, but investments returns may be compromised.

An analysis showing the effect of the risk reduction contemplated by SB 594 on expected investment returns could not be completed in the time frame allowed for the preparation of this actuarial note. Nevertheless, plan liabilities and contribution requirements are very sensitive to investment earnings. If a new investment strategy reduces investment expectations by 25 basis points (one quarter of one percent), then the actuary for the plan should decrease his valuation interest assumption accordingly. A 0.25% decrease in the valuation interest assumption will have the following effects on cost elements for LASERS and TRSL.

<u>Increase in Cost Elements Attributable to 0.25% Decrease in Valuation Interest</u>	<u>LASERS</u>	<u>TRSL</u>
Employer Normal Cost	\$ 17.5 million	\$ 21.5 million
Unfunded Accrued Liability	399.5 million	743.8 million
Employer Normal Cost	\$ 17.5 million	\$ 21.5 million
Amortization Cost	35.5 million	64.0 million
Total Employer Contribution	\$ 53.0 million	\$ 85.5 million
Employer Normal Cost Percentage	0.6%	0.5%
Employer Amortization Cost Percentage	1.3%	1.3%
Total Employer Contribution Percentage	1.9%	1.8%

It is not intended to suggest that SB 594 will lead to a reduction in the valuation interest assumption. SB 594 may or may not lead to a reduction of expected earnings and therefore may or may not lead to a reduction in valuation interest rates. The purpose of this chart is merely to illustrate how sensitive cost factors are to expected investment returns.

Other Post Retirement Benefits

SB 596 will have no effect on actuarial costs associated with other post retirement benefits.

Analysis of Fiscal Costs

According to the retirement systems, there will be no additional administrative costs associated with SB 594.

Dual Referral

Senate

13.5.1 ≥ \$500,000 Annual Fiscal Cost

13.5.2 ≥ \$500,000 Annual Tax or Fee Change

House

6.8(F) ≥ \$500,000 Annual Fiscal Cost

6.8(G) ≥ \$500,000 Tax or Fee Increase or a Net Fee Decrease