2020 REGULAR SESSION
ACTUARIAL NOTE HB 19

House Bill 19 HLS 20RS-118 **Engrossed** **Author: Representative Bacala** **Date: May 11, 2020** **LLA Note HB 19.02** **Organizations Affected:** **Municipal Police Employees' Retirement System (MPERS)** **EG DECREASE APV**	**This Note has been prepared by the Actuarial Services Department of the Louisiana Legislative Auditor (LLA) with assistance from either the Fiscal Notes staff of the Legislative Auditor or staff of the Legislative Fiscal Office (LFO). The attachment of this Note provides compliance with the requirements of R.S. 24:521 as amended by Act 353 of the 2016 Regular Session.** **Lowell P. Good, ASA, EA, MAAA** **Actuarial Services Manager**

<u>Bill Header:</u> RETIREMENT BENEFITS. Establishes a funding deposit account for the Municipal Police Employees' Retirement System and authorizes the board of trustees of the system to modify required employer contribution rates.

<u>Cost Summary:</u>

The estimated net actuarial and fiscal impact of this proposed legislation on the retirement systems and their plan sponsors is summarized below. Net actuarial costs pertain to estimated changes in the ***net actuarial present value of future benefit payments and administrative expenses incurred by the retirement system***. Net fiscal costs or savings pertain to changes to all cash flows over the next five year period including retirement system cash flows, OPEB cash flows, or cash flows related to local and state government entities.

An increase in actuarial costs is denoted throughout the actuarial note by "Increase" or a positive number. Actuarial savings are denoted by "Decrease" or a negative number. An increase in expenditures or revenues (fiscal impact) is denoted by "Increase" or a positive number. A decrease in expenditures or revenues is denoted by "Decrease" or a negative number.

<u>Estimated Actuarial Impact:</u>

The top part of the following chart shows the estimated change in the ***net actuarial present value of future benefit payments and expenses***, if any, attributable to the proposed legislation. The bottom part shows the effect on cash flows (i.e., contributions, benefit payments, and administrative expenses).

Net Actuarial Costs (Liabilities) Pertaining to:		**<u>Net Actuarial Cost</u>**
The Retirement Systems		Decrease
Other Post-employment Benefits (OPEB)		0
Total		Decrease
Five Year Net Fiscal Cost Pertaining to:	**<u>Expenditures</u>**	**<u>Revenues</u>**
The Retirement Systems	0	Increase
Other Post-employment Benefits (OPEB)	0	0
Local Government Entities	Increase	0
State Government Entities	0	0
Total	Increase	Increase

<u>Bill Information</u>

Current Law

Current law provides for determining employer contribution rates annually for statewide public retirement systems.

Current law (R.S. 11:105(B)) grants certain statewide retirement systems, *not including MPERS*, the authority to maintain net direct employer contribution rates which would otherwise be decreased.

Under current law (R.S. 11:105(C)), any excess funds resulting from the board's exercise of its authority, *not including MPERS*, will be combined with any contribution surplus, or offset by any contribution shortfall, and the resulting balance, if greater than zero, will be applied for the following purposes:

1. To reduce system frozen unfunded accrued liabilities or
2. To reduce the outstanding amortization charge base or bases or
3. To establish or add to a contribution surplus base, or to reduce the present value of future normal costs.

Current law (R.S. 11:106) grants certain statewide retirement systems, *not including MPERS*, the authority to increase required employer contribution rates up to 3% more than the net direct employer contribution rate otherwise determined pursuant to R.S. 11:103.

Under current law (R.S. 11:107), in any fiscal year during which the recommended employer contribution rate would otherwise be decreased, the board of trustees of certain statewide retirement systems, *not including MPERS*, can set the employer contribution rate at any point between the previous year's rate and the decreased rate otherwise determined pursuant to R.S. 11:103 and 104.

Current law (R.S. 11:107.1) establishes a "funding deposit account" (FDA) in certain statewide systems, *not including MPERS*. Funds collected pursuant to the current law in excess of minimum required employer contribution rates are credited to this account and may be used by the board of trustees of the system for the following purposes:

1. Reduce system unfunded accrued liabilities.
2. Reduce future employer contribution rates.
3. Pay all or a portion of any future net direct employer contributions.
4. Provide cost-of-living increases.

Current law (R.S. 11:2225(A)(7)) also provides that MPERS' board is authorized to provide a cost-of-living increase from interest earnings in excess of normal requirements to retirees, survivors and beneficiaries. The amount of the increase is permitted to be up to 3% of the original benefits.

Current law (R.S. 11:246) also provides that certain statewide systems, including MPERS, may provide an additional or supplemental cost-of-living increase from interest income on investments to all retirees and beneficiaries who are 65 years of age or over provided certain requirements are met. The amount of the increase is to be 2% of the original benefit, provided the interest income sufficiently exceeds the valuation interest rate applied to the actuarial value of assets.

Cost-of-living adjustments (COLAs) financed with investment earnings in excess of the stated threshold are commonly called Gain-sharing COLAs, while COLAs financed with surplus contributions in FDA could be called FDA COLAs.

Proposed Law

HB 19 establishes a cost-of-living adjustment pre-funding account for MPERS. The balance in the account is set equal to zero as of December 31, 2019.

Notwithstanding the provisions of R.S. 11:103 and 104, the board of trustees may require a net direct contribution rate of up to 0.85% more than the rate determined under R.S. 11:103.

For any fiscal year terminating on or after December 31, 2019, in which the board of trustees sets the direct employer contribution rate higher than the rate determined under R.S. 11:103, an amount equal to the amount by which the actual board-authorized rate exceeds the rate determined under R.S. 11:103 multiplied by the total actual payroll for the fiscal year will be transferred to the cost-of-living adjustment pre-funding account.

The funds in the cost-of-living adjustment pre-funding account will earn interest annually at the board-approved valuation interest rate, and the interest will be credited to the cost-of-living adjustment pre-funding account at least once a year.

Beginning with the June 30, 2020 valuation, the board of trustees may, in any fiscal year when criteria of R.S. 11:243 (D), (E), and (G) are met, authorize the cost-of-living adjustment pre-funding account to be charged to provide a cost-of-living adjustment.

For funding purposes, any asset value utilized in the calculation of the actuarially required employer contribution will be reduced by the cost-of-living adjustment pre-funding account balance as of the asset determination date for such calculation.

Notwithstanding the provisions of R.S. 11:241 and R.S. 11:246, after June 30, 2020, the board of trustees may only provide cost-of-living adjustments to all retirees and beneficiaries who are sixty-five years of age or over, in an amount equal to 2% of the benefit that was originally paid to the beneficiary. The first cost-of-living increase provided after June 30, 2020, may be provided only if the board has received a rate of return in excess of the valuation interest rate based on the actuarial value of assets for that fiscal year, and the cost-of-living increase may be payable from the investment income in excess of that determined by the application of the valuation interest rate to the actuarial value of assets. Thereafter, all cost-of-living adjustments will be provided only from the cost-of-living adjustment pre-funding account when sufficient funds are available. In either case, the requirements of R.S. 11:243 (D), (E), and (G) must be met.

As of the effective date of the proposed bill, June 30, 2020, R.S. 11:2225(A)(7) is repealed. No Gain-sharing COLAs under that section would be permitted thereafter.

Implications of the Proposed Changes

HB 19 provides the opportunity for MPERS to set the employer contribution rate up to 0.85% above the minimum rate otherwise determined under current law, to accumulate all surplus funds in a cost-of-living adjustment pre-funding account, and then to use that fund exclusively to provide COLAs.

I. ACTUARIAL IMPACT ON RETIREMENT SYSTEMS AND OPEB [Completed by LLA]

A. Analysis of Net Actuarial Costs
(Prepared by LLA)

This section of the actuarial note pertains to net actuarial costs or savings associated with the retirement systems and with OPEB.

1. Retirement Systems

The net actuarial cost or savings of the proposed legislation associated with the retirement systems is estimated to be a decrease in cost. The actuary's analysis is summarized below.

HB 19 allows MPERS to set the employer contribution rate up to 0.85% above the rate otherwise determined under current law, to accumulate all surplus funds in a cost-of-living adjustment pre-funding account, and to use the cost-of-living adjustment pre-funding account balance exclusively for cost-of-living increases.

The existence of the cost-of-living adjustment pre-funding account may have an effect on minimum required employer contribution requirements as calculated by the system's actuary. If the actual earnings of the fund are less than the board-approved valuation interest rate, then there will be an additional loss to the fund due to crediting interest to the cost-of-living adjustment pre-funding account at the valuation interest rate. Alternatively, if actual earnings on the fund are greater, then there will be an additional gain. However, the source of funding for the cost-of-living adjustment pre-funding account is surplus employer contributions that MPERS will be allowed to require from its participating employers. Therefore, while it may not be certain, it can be reasonably expected that the MPERS board of trustees will exercise its authority to fund the cost-of-living adjustment pre-funding account by establishing contribution rates in the future that are higher than the minimum employer rate otherwise determined under current law. In addition, while it may not be certain, it can be reasonably expected that sometime after accumulating sufficient funds in the cost-of-living adjustment pre-funding account, the MPERS board would then grant a COLA from the cost-of-living adjustment pre-funding account balance.

Under current law, while it may not be certain, it can also be reasonably expected that one or both types of Gain-sharing COLAs (R.S. 2225(A)(7) and R.S. 246) would be granted whenever permitted.

However, under the proposed bill R.S. 11:2225(A)(7) and R.S. 246 Gain-sharing COLAs are prohibited. That in itself would constitute a decrease in future benefits otherwise expected and future contribution requirements that would otherwise be required to finance the grants of COLAs. At the same time, the proposed bill authorizes COLAs to be paid from surplus contributions accumulating in the cost-of-living adjustment pre-funding account.

Under current practice, the contributions to support Gain-sharing COLAs would commence whenever such an increase is granted and continue thereafter. This can be considered pay-as-you-go funding, whereas the proposed bill is tantamount to advance-funding. Given the length of time needed to accumulate sufficient cost-of-living adjustment pre-funding account balances and the flexibility in granting increases from the cost-of-living adjustment pre-funding account in subsequent years, the proposed bill can be reasonably expected to result in a decrease of actuarial costs over time.

2. Other Post-employment Benefits (OPEB)

The net actuarial cost or savings of the proposed legislation associated with OPEB, including retiree health insurance premiums, is estimated to be $0. The actuary's analysis is summarized below.

The liability for post-retirement medical insurance protection provided to retirees is not affected by the establishment of a cost-of-living adjustment pre-funding account.

B. Actuarial Data, Methods and Assumptions
(Prepared by LLA)

Unless indicated otherwise, the actuarial note for the proposed legislation was prepared using actuarial data, methods, and assumptions as disclosed in the most recent actuarial valuation report adopted by the Public Retirement Systems' Actuarial Committee (PRSAC). The data, methods and assumptions are being used to provide consistency with the actuary for the retirement system who may also be providing testimony to the Senate and House retirement committees. With certain exceptions, the actuary for the LLA finds the assumptions used by the retirement systems and PRSAC to be reasonable.

C. Actuarial Caveat
(Prepared by LLA)

There is nothing in the proposed legislation that will compromise the signing actuary's ability to present an unbiased statement of actuarial opinion.

II. FISCAL IMPACT ON RETIREMENT SYSTEMS AND OPEB [Completed by LLA]

This section of the actuarial note pertains to fiscal (annual) costs or savings associated with the retirement systems (Table A) and with OPEB (Table B). Fiscal costs or savings in Table A include benefit-related actuarial costs and administrative costs incurred by the retirement systems.

A. Estimated Fiscal Impact – Retirement Systems
(Prepared by LLA)

1. Narrative

Table A shows the estimated fiscal impact of the proposed legislation on the retirement systems and the government entities that sponsor them. A fiscal cost is denoted by "Increase" or a positive number. Fiscal savings are denoted by "Decrease" or a negative number. A revenue increase is denoted by "Increase" or a positive number. A revenue decrease is denoted by "Decrease" or a negative number.

Retirement System Fiscal Cost: Table A

EXPENDITURES	2020-21	2021-22	2022-23	2023-24	2024-25	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	Increase	Increase	Increase	Increase
Annual Total	$ 0	$ 0	Increase	Increase	Increase	Increase

REVENUES	2020-21	2021-22	2022-23	2023-24	2024-25	5 Year Total
State General Fund	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Agy Self Generated	0	0	Increase	Increase	Increase	Increase
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	Increase	Increase	Increase	Increase

All expenditures for employer contributions are reflected on a single line in the table above. The actual sources of funding (e.g., Federal Funds, State General Fund) may vary by employer and are not differentiated on the table.

The proposed legislation will have the following effects on retirement related fiscal costs and revenues during the five year measurement period.

2. Expenditures:

   a. Expenditures from MPERS are not expected to change during the next five years as a result of the proposed bill. We assume that assets in the cost-of-living adjustment pre-funding account will not be used by MPERS until a substantial pool of assets is accumulated for the payment of COLAs. Therefore, we conclude that expenditures from the cost-of-living adjustment pre-funding account for the granting of COLAs will be $0 during the five-year fiscal measurement period.

   b. Expenditures from Local Funds will increase under the proposed bill for fiscal years in which the board requires an employer contribution rate that is greater than the minimum actuarially required rate. This increase may be expected to commence some time during the next five years.

3. Revenues:

   MPERS revenues (Agy Self Generated) will increase under the proposed bill to the extent that the employer contribution rate is greater than the minimum actuarially required rate

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B. <u>Estimated Fiscal Impact – OPEB</u>
(Prepared by LLA)

1. Narrative

   Table B shows the estimated fiscal impact of the proposed legislation on actuarial benefit and administrative costs or savings associated with OPEB and the government entities that sponsor these benefit programs. A fiscal cost is denoted by “Increase” or a positive number. Fiscal savings are denoted by “Decrease” or a negative number. A revenue increase is denoted by “Increase” or a positive number. A revenue decrease is denoted by “Decrease” or a negative number.

OPEB Fiscal Cost: Table B

EXPENDITURES	2020-21	2021-22	2022-23	2023-24	2024-25	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	2020-21	2021-22	2022-23	2023-24	2024-25	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

All expenditures for employer contributions are reflected on a single line in the table above. The actual sources of funding (e.g., Federal Funds, State General Fund) may vary by employer and are not differentiated on the table.

The proposed legislation will have the following effects on OPEB related fiscal costs and revenues during the five year measurement period.

2. Expenditures:

   No measurable effects.

3. Revenues:

   No measurable effects.

III. FISCAL IMPACT ON LOCAL GOVERNMENT ENTITIES [Completed by LLA]

This section of the actuarial note pertains to annual fiscal costs, cost savings, and revenue impacts incurred by local government entities other than those included in Tables A and B. See Table C.

Estimated Fiscal Impact - Local Government Entities (other than the impact included in Tables A and B)
(Prepared by Bradley Cryer, Director of Local Government Services)

1. Narrative

   From time to time, legislation is proposed that has an indirect effect on expenditures and revenues associated with local government entities (other than the impact included in Tables A and B). Table C shows the estimated fiscal impact of the proposed legislation on such local government entities. A fiscal cost is denoted by "Increase" or a positive number. Fiscal savings are denoted by "Decrease" or a negative number. A revenue increase is denoted by "Increase" or a positive number. A revenue decrease is denoted by "Decrease" or a negative number.

Fiscal Costs for Local Government Entities: Table C

EXPENDITURES	2020-21	2021-22	2022-23	2023-24	2024-25	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	2020-21	2021-22	2022-23	2023-24	2024-25	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

The proposed legislation will have the following effects on fiscal costs and revenues related to local government entities during the five year measurement period.

2. Expenditures:

   No measurable effects.

3. Revenues:

   No measurable effects.

IV. FISCAL IMPACT ON STATE GOVERNMENT ENTITIES [Completed by LFO]

This section of the actuarial note pertains to annual fiscal costs, cost savings, and revenue impacts incurred by state government entities other than those included in Tables A and B. See Table D.

Estimated Fiscal Impact − State Government Entities (other than the impact included in Tables A and B)
(Prepared by John Carpenter, Legislative Fiscal Officer)

1. Narrative

   Legislation may be proposed that has an indirect effect on expenditures and revenues associated with state government entities (other than the impact included in Tables A and B). Table D shows the estimated fiscal impact of the proposed legislation on such state government entities. A fiscal cost is denoted by "Increase" or a positive number. Fiscal savings are denoted by "Decrease" or a negative number. A revenue increase is denoted by "Increase" or a positive number. A revenue decrease is denoted by "Decrease" or a negative number.

Fiscal Costs for State Government Entities: Table D

EXPENDITURES	**2020-21**	**2021-22**	**2022-23**	**2023-24**	**2024-25**	**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	**2020-21**	**2021-22**	**2022-23**	**2023-24**	**2024-25**	**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

The proposed legislation will have the following effects on fiscal costs and revenues related to state government entities during the five year measurement period.

2. Expenditures:

   N/A - This bill only impacts local government and therefore, has no state impact. The LFO does not review local government bills.

3. Revenues:

   N/A - This bill only impacts local government and therefore, has no state impact. The LFO does not review local government bills.

Credentials of the Signatory Staff:

Lowell P. Good is the Actuary for the Louisiana Legislative Auditor. He is an Enrolled Actuary, a member of the American Academy of Actuaries, an Associate of the Society of Actuaries and has met the Qualification Standards of the American Academy of Actuaries necessary to render the actuarial opinion contained herein.

James J. Rizzo is a Senior Consultant and Actuary with Gabriel, Roeder, Smith & Company, which currently serves as staff for the Actuarial Services Department of the Louisiana Legislative Auditor. He is an Enrolled Actuary, a member of the American Academy of Actuaries, an Associate of the Society of Actuaries and has met the Qualification Standards of the American Academy of Actuaries necessary to render the actuarial opinion contained herein.

2020 REGULAR SESSION
ACTUARIAL NOTE HB 19

Actuarial Disclosure: Risks Associated with Measuring Costs

This Actuarial Note is an actuarial communication, and is required to include certain disclosures in compliance with Actuarial Standards of Practice (ASOP) No. 51.

A full actuarial determination of the retirement system's costs, actuarially determined contributions and accrued liability require the use of assumptions regarding future economic and demographic events. The assumptions used to determine the retirement system's contribution requirement and accrued liability are summarized in the system's most recent Actuarial Valuation Report accepted by the respective retirement board and by the Public Retirement Systems' Actuarial Committee (PRSAC).

The actual emerging future experience, such as a retirement fund's future investment returns, may differ from the assumptions. To the extent that emerging future experience differs from the assumptions, the resulting shortfalls (or gains) must be recognized in future years by future taxpayers. Future actuarial measurements may also differ significantly from the current measurements due to other factors: changes in economic or demographic assumptions; increases or decreases expected as part of the natural operation of the methodology used for these measurements (such as the end of an amortization period; or additional cost or contribution requirements based on the system's funded status); and changes in plan provisions or applicable law.

Examples of risk that may reasonably be anticipated to significantly affect the plan's future financial condition include:

1. Investment risk – actual investment returns may differ from the expected returns (assumptions);
2. Contribution risk – actual contributions may differ from expected future contributions. For example, actual contributions may not be made in accordance with the plan's funding policy or material changes may occur in the anticipated number of covered employees, covered payroll, or other relevant contribution base;
3. Salary and Payroll risk – actual salaries and total payroll may differ from expected, resulting in actual future accrued liability and contributions differing from expected;
4. Longevity and life expectancy risk – members may live longer or shorter than expected and receive pensions for a period of time other than assumed;
5. Other demographic risks – members may terminate, retire or become disabled at times or with benefits other than assumed, resulting in actual future accrued liability and contributions differing from expected.

The scope of an Actuarial Note prepared for the Louisiana Legislature does not include an analysis of the potential range of such future measurements or a quantitative measurement of the future risks of not achieving the assumptions. In certain circumstances, detailed or quantitative assessments of one or more of these risks as well as various plan maturity measures and historical actuarial measurements may be requested from the actuary. Additional risk assessments are generally outside the scope of an Actuarial Note. Additional assessments may include stress tests, scenario tests, sensitivity tests, stochastic modeling, and a comparison of the present value of accrued benefits at low-risk discount rates with the actuarial accrued liability.

However, the general cost-effects of emerging experience deviating from assumptions can be known. For example, the investment return since the most recent actuarial valuation may be less (or more) than the assumed rate, or a cost-of-living adjustment may be more (or less) than the assumed rate, or life expectancy may be improving (or worsening) compared to what is assumed. In each of these situations, the cost of the plan can be expected to increase (or decrease).

The use of reasonable assumptions and timely receipt of actuarially determined contributions are critical to support the financial health of the plan. However, employer contributions made at the actuarially determined rate do not necessarily guarantee benefit security.

Information Pertaining to Article (10)(29(F) of the Louisiana Constitution

[X] HB 19 contains a retirement system benefit provision having an actuarial cost.

Some members of the Municipal Police Employees' Retirement System could receive a larger benefit with the enactment of HB 19 than what they would have received without HB 19.

Dual Referral Relative to Total Fiscal Costs or Total Cash Flows:

The information presented below is based on information contained in Tables A, B, C, and D for the first three years following the 2020 regular session.

Senate			House		
X	13.5.1	Applies to Senate or House Instruments. If an annual fiscal cost ≥ \$100,000, then bill is dual referred to: **Dual Referral: Senate Finance**		6.8F	Applies to Senate or House Instruments. If an annual General Fund fiscal cost ≥ \$100,000, then the bill is dual referred to: **Dual Referral to Appropriations**
	13.5.2	Applies to Senate or House Instruments. If an annual tax or fee change ≥ \$500,000, then the bill is dual referred to: **Dual Referral: Revenue and Fiscal Affairs**		6.8G	Applies to Senate Instruments only. If a net fee decrease occurs or if an increase in annual fees and taxes ≥ \$500,000, then the bill is dual referred to: **Dual Referral: Ways and Means**