2013 REGULAR SESSION
ACTUARIAL NOTE SB 11

Senate Bill 11 SLS 13RS-12 **Original** **Author: Senator Elbert L. Guillory** **Date: April 29, 2013** **LLA Note SB 11.01** **Organizations Affected:** **State Retirement Systems** **OR DECREASE APV**	**This Note has been prepared by the Actuarial Services Department of the Office of the Legislative Auditor. The attachment of this Note to SB 11 provides compliance with the requirements of R.S. 24:521.** Paul T. Richmond **Paul T. Richmond, ASA, MAAA, EA** **Manager Actuarial Services**

Bill Header: Provides relative to funding of and eligibility for post-retirement benefit increases for certain employees and teachers. (6/30/13)

Cost Summary:

The estimated actuarial and fiscal impact of the proposed legislation is summarized below. Actuarial costs pertain to changes in the ***actuarial present value of future benefit payments***. A cost is denoted by "Increase" or a positive number. Savings are denoted by "Decrease" or a negative number.

Actuarial Cost/(Savings) to Retirement Systems and OGB	Decrease
Total Five Year Fiscal Cost	
Expenditures	Increase
Revenues	Increase

Estimated Actuarial Impact:

The chart below shows the estimated change in the ***actuarial present value of future benefit payments***, if any, attributable to the proposed legislation. A cost is denoted by "Increase" or a positive number. Savings are denoted by "Decrease" or a negative number. Present value costs associated with administration or other fiscal concerns are not included in these values.

Actuarial Cost/(Savings) to:	**Change in the Actuarial Present Value**
All Louisiana Public Retirement Systems	Decrease
Other Post Retirement Benefits	Decrease
Total	Decrease

This bill complies with the Louisiana Constitution which requires unfunded liabilities created by an improvement in benefits to be amortized over a period not to exceed ten years.

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. Fiscal costs include estimated administrative costs and costs associated with other fiscal concerns. A fiscal cost is denoted by "Increase" or a positive number. Fiscal savings are denoted by "Decrease" or a negative number.

EXPENDITURES	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-2018**	**5 Year Total**
State General Fund	$ 0	Increase	Increase	Increase	Increase	Increase
Agy Self Generated	Decrease	Decrease	Decrease	Decrease	Decrease	Decrease
Stat Deds/Other	0	0	0	0	0	0
Federal Funds	0	0	0	0	0	0
Local Funds	0	Increase	Increase	Increase	Increase	Increase
Annual Total	Decrease	Increase	Increase	Increase	Increase	Increase

REVENUES	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-2018**	**5 Year Total**
State General Fund	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Agy Self Generated	Increase	Increase	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	Increase	Increase	Increase	Increase	Increase	Increase

<u>Bill Information:</u>

Current Law

A. COLA Benefits

Cost-of-living adjustments are provided by the four state retirement systems through a process called gain sharing in which a portion of investment gains are diverted from the regular pool of assets and used to pay for cost-of-living adjustments. To be granted, COLAs must be approved by the boards of trustees, the actuary for the Legislative Auditor, and the legislature. However, approval has always been given whenever gain-sharing and other criteria have been satisfied.

Even though there is a clear process for diverting assets from the retirement systems to pay for COLA benefits, they are not considered to be guaranteed. As a result, no liability has been recognized by the retirement systems for the systematic diversion of assets that occurs under current law.
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The maximum COLA benefit that can be provided is 3% of the benefit payable to an eligible retiree, beneficiary, or survivor. Eligible retirees, beneficiaries and survivors are defined below.

1. Retirees:

   a. Must have been receiving benefits for at least one year, and

   b. Be at least age 60.

2. Beneficiaries and Survivors:

   a. Member and/or beneficiary/survivor must have been receiving benefits for at least one year, and

   b. The member would have been at least age 60 had he not died.

COLAs are payable only on the first $70,000 of benefit for LASERS and TRSL and the first $85,000 of benefit for LSERS and STPOL. The LASERS and TRSL limits are adjusted by the CPI from July 1, 1999. The LSERS and STPOL limits are adjusted by the CPI from July 1, 2007.

B. Five Year Final Average Compensation

Retirement benefits are based in part on a member's final average compensation (FAC). Rules for calculating the FAC are summarized below.

1. LASERS

   - The FAC period for a Rank and File member of LASERS first employed on or before June 30, 2006, is 36 months under current law. The anti-spiking percentage is 25%.

2. TRSL

   - The FAC period for a member of TRSL first employed on or before December 31, 2010, is 36 months under current law. The anti-spiking percentage is 10%.

3. LSERS

   - The FAC period for a member of LSERS first employed on or before June 30, 2006, is 36 months under current law. The anti-spiking percentage is 10%.

4. STPOL

   - The FAC period for a member of STPOL 36 months under current law. The anti-spiking percentage is 25%.

C. Employee Contributions

All employees contribute to the retirement systems in order to help pay for the benefits they will receive at retirement. Employee contributions rules are summarized below.

1. LASERS

   a. Rank and file members - 7.5% of pay for members first employed on or before June 30, 2006, and 8.0% for members first employed thereafter.

   b. For legislators, judges, the governor, lieutenant governor, the House clerk or sergeant at arms, and the Senate secretary or sergeant at arms – rates that range from 8.0% of pay to 13.5% of pay.

   c. For persons employed in hazardous duty positions – rates that range from 7.5% of pay to 9.5% of pay.

2. TRSL

   a. For regular teachers – 8.0% of pay.

   b. For members of Lunch Plan A – 9.1% of pay.

   c. For members of Lunch Plan B – 5.0% of pay.

3. LSERS

   a. 7.5% of pay for members first employed on or before June 30, 2010.

   b. 8.0% of pay for members first employed on or after July 1, 2010.

4. STPOL

   a. 8.0% of pay for members first employed on or before December 31, 2010.

   b. 9.5% of pay for members first employed on or after January 1, 2011.

D. Funding Rules

The four state retirement systems are actuarially funded by the employers participating in each system. Rules under current law are summarized below

1. COLA benefits under current law are not actuarially funded.

2. The treatment of investment gains in the calculation of contribution requirements is summarized below.

   a. LASERS

      1) A credit amortization base is established equal to 50% of the investment gain with a credit schedule based level payments over a 30-year period.

      2) The OAB charge base is credited with the remaining investment gain up to a maximum of $50 million.

      3) The EAAB is credited any residual investment gain up to a maximum of $50 million.

      4) If any investment gain remains, it is transferred to the Experience Account.

   b. TRSL

      1) A credit amortization base is established equal to 50% of the investment gain with a credit schedule based level payments over a 30-year period.

      2) The OAB charge base is credited with the remaining investment gain up to a maximum of $100 million.

      3) The EAAB is credited any residual investment gain up to a maximum of $100 million.

      4) If any investment gain remains, it is transferred to the Experience Account.

   c. LSERS and STPOL

      1) A credit amortization base is established equal to 50% of the investment gain with a credit schedule based level payments over a 30-year period.

      2) The remaining 50% is transferred to the Experience Account.

3. The employer contribution rate is measured after all other sources of contributions (employee contributions and ad valorem taxes) have been accounted for.

Proposed Law

A. COLA Benefits

Cost-of-living adjustments under SB 11 will be provided by the four state retirement systems in accordance with the following rules. Gain sharing and COLA benefit rules under current law will be repealed.

1. COLA Benefit Formula

   a. All COLA adjustments will be given on July 1.

   b. The COLA benefit is based on a formula that will generally provide a percentage increase of 2% every other year.

c. Benefit Limitations

1) The COLA adjustment will only be applied to the first $50,000 of a member's annual benefit.

2) The $50,000 limit will be adjusted in accordance with increases in the CPI-U that occur on or after September 2018.

2. COLA Dates

a. For all members who terminated employment, became disabled, died, or retired on or before June 30, 2013 (i.e., members whose entire benefit is based on service earned on or before June 30, 2013).

1) The first COLA will be granted July 1, 2013.

2) COLAs will be granted every July 1 of odd numbered years thereafter.

b. For all other members.

1) The first COLA will be granted July 1, 2019.

2) COLAs will be granted every July 1 of odd numbered years thereafter.

3. COLA Eligibility

a. To be eligible for a COLA on a COLA Date, a retiree:

1) Must have been separated from employment and must have been receiving an annuitized benefit for at least 5 years, and

2) Must be at least age 65.

b. A beneficiary of a non-disability retiree shall be eligible for a COLA on a COLA Date only if:

1) The an annuitized benefit has been received by the retiree and beneficiary for at least 5 years, and

2) The member would have attained age 65 had he not died.

c. A beneficiary of a disability retiree shall be eligible for a COLA on a COLA Date only if:

- The annuitized benefit has been received by the retiree and beneficiary for at least 5 years.

d. A survivor shall be eligible for a COLA on a COLA Date only if:

- The annuitized benefit has been received by the survivor for at least 5 years.

4. Funding

- COLA benefits will be actuarially funded as part of annual employer contribution requirements.

B. Five Year Final Average Compensation

Under SB 11, benefits for all members of the state retirement systems will be based on final average compensation (FAC) calculated over a five year period. Changes in FAC rules for each system are summarized below.

1. LASERS

a. Under SB 11, the FAC period for a Rank and File member of LASERS first employed on or before June 30, 2006, will be 60 months beginning July 1, 2014. The anti-spiking percentage will be lowered to 15%.

b. The FAC period for any such member retiring on or after July 1, 2014, and on or before June 30, 2016, will be 36 months plus the number of full months that the retirement date occurs after July 1, 2014.

c. The FAC period for any such member retiring on or after July 1, 2016, will be 60 months.

2. TRSL

a. Under SB 11, the FAC period for a member of TRSL first employed on or before December 31, 2010, will be 60 months beginning July 1, 2014. The anti-spiking percentage will remain at 10%.

b. The FAC period for any such member retiring on or after July 1, 2014, and on or before June 30, 2016, will be 36 months plus the number of full months that the retirement date occurs after July 1, 2014.

c. The FAC period for any such member retiring on or after July 1, 2016, will be 60 months.

3. LSERS

a. Under SB 11, the FAC period for a member of LSERS first employed on or before June 30, 2006, will be 60 months beginning July 1, 2014. The anti-spiking percentage will remain at 10%.

b. The FAC period for any such member retiring on or after July 1, 2014, and on or before June 30, 2016, will be 36 months plus the number of full months that the retirement date occurs after July 1, 2014.

c. The FAC period for any such member retiring on or after July 1, 2016, will be 60 months.

4. STPOL

a. Under SB 11, the FAC period for a member of STPOL will be 60 months beginning July 1, 2014. The anti-spiking percentage will be lowered to 15%.

b. The FAC period for any such member retiring on or after July 1, 2014, and on or before June 30, 2016, will be 36 months plus the number of full months that the retirement date occurs after July 1, 2014.

c. The FAC period for any such member retiring on or after July 1, 2016, will be 60 months.

C. *Employee Contributions*

Employee contribution requirements will increase under SB 11. These changes are summarized below.

1. Additional employee contributions will begin on July 1, 2013. The additional employee contribution rates are shown below:

a. 3.0% for members of LASERS.
b. 3.0% for members of TRSL.
c. 3.0% for members of LSER.S
d. 3.0% for members of STPOL.

2. Every fifth year, beginning with the June 30, 2018, valuation, the actuary for each state retirement systems shall determine the extent to which the additional employee contributions meet or exceed the liabilities created by the new COLA program. The additional employee contribution rate will be increased or decreased from the specified 3% level to ensure the actuarial solvency of the program.

D. *Funding Rules*

The following new funding rules will be implemented with the June 30, 2013, valuations for the four state retirement systems.

1. COLA benefits will be actuarially funded under SB 11.

2. If SB 11 is enacted, the accrued liability of each retirement system will increase because COLA benefits will be provided to those who retire. Such increases in accrued liability will be amortized over a period of 10 years and employer contribution requirements will be increased accordingly.

3. The treatment of investment gains in the calculation of contribution requirements are summarized below.

a. LASERS

1) A credit amortization base is established equal to 50% of the investment gain with a credit schedule based level payments over a 30-year period.

2) The OAB charge base is credited with the remaining investment gain up to a maximum of $50 million.

3) The EAAB is credited any residual investment gain up to a maximum of $50 million.

4) 50% of any remaining gain will be amortized with level payments over a period of 30 years.

5) The remaining balance of any investment gain occurring before FYE 2023 will be amortized with level payments over a period of 10 years. The amortization period for any gains falling in this category after FYE 2022 will be 30 years.

b. TRSL

1) A credit amortization base is established equal to 50% of the investment gain with a credit schedule based level payments over a 30-year period.

2) The OAB charge base is credited with the remaining investment gain up to a maximum of $100 million.

3) The EAAB is credited any residual investment gain up to a maximum of $100 million.

4) 50% of any remaining gain will be amortized with level payment over a period of 30 years.

5) The remaining balance of any investment gain occurring before FYE 2023 will be amortized with level payments over a period of 10 years. The amortization period for any gains falling in this category after FYE 2022 will be 30 years.

c. LSERS and STPOL

1) A credit amortization base is established equal to 75% of the investment gain with a credit schedule based level payments over a 30-year period.

2) The remaining 25% will be amortized with level payments over a 10 year period.

4. EAAB Employer Contribution – Employers will contribute an additional 1% of pay each year. These contributions will be used to pay down the outstanding balance of the Experience Account Amortization base (EAAB). After each annual payment is made, the outstanding balance of the EAAB for each year will be re-amortized over the remaining amortization period. Employers participating in LSERS and STPOL will not be required to make EAAB Employer Contributions.

5. The minimum employer contribution requirement for LASERS and TRSL shall be 25% of pay until such time as the unfunded accrued liability that existed on June 30, 2012 is fully funded.

Implications of the Proposed Changes

SB 11 will make substantial changes to COLA provisions, final average compensation calculations, employee contribution requirements, and funding rules for employers.

Cost Analysis:

Analysis of Actuarial Costs

Retirement Systems

SB 11 will have the following effect on employer contribution rates for LASERS and TRSL.

Employer Contribution Requirements

	LASERS		TRSL	
Current Employer Rate		31.7%		27.1%
SB 11 Changes				
COLA Benefits	4.4%		4.2%	
Employee Contributions	-2.7%		-2.7%	
5-Year FAC	-1.2%		-0.9%	
EAAB Contribution	1.0%		1.0%	
Total		1.5%		1.6%
Employer Rate under SB 11		33.2%		28.7%

SB 11 will have the following effects on various actuarial measures of cost for LASERS and TRSL. Similar measurements for LSERS and STPOL have not been made but should be roughly proportional to the measurements made for LASERS and TRSL

Increase/(Decrease) in Actuarial Measurements

	LASERS	TRSL	Total
Unfunded Accrued Liability	$ 505,000,000	$ 995,000,000	$ 1,500,000,000
Total Normal Cost	3,000,000	10,000,000)	13,000,000
Employer Normal Cost	(72,000,000)	(112,000,000)	(184,000,000)
Amortization of UAL	85,000,000	157,000,000	242,000,000
Employer Contribution Requirements	13,000,000	45,000,000	58,000,000

As a result of SB 11, $681 million of previously unreported unfunded accrued liabilities associated with COLAs has been eliminated for LASERS and $1.911 billion of unreported accrued liability has been eliminated for TRSL.

In addition to the employer contribution amounts reported above, employers participating in LASERS and TRSL will be required to contribute 1% of pay to help fund the EAAB. Additional employer contributions for LASERS and TRSL will be $25 million and $40 million respectively.

Realization of these savings may be delayed or may never occur. It is possible that the constitutionality of SB 11 will be challenged in state or federal courts. According to a memorandum issued by Strasburger, Attorneys at Law to the Office of the Louisiana Legislative Auditor on March 26, 2012, entitled Legal Analysis of 2012 Pension Bills (see www.lla.la.gov/reports_data/actuaryreports) challenges would likely allege violations under:

1. Article X, §29 of the Louisiana Constitution which protects public pension benefits,

2. The Contract Clause within both the Louisiana and U.S. Constitutions claiming contract impairment due to diminished benefits,

3. The Takings Clause of both the Louisiana and U.S. Constitutions for divesting public employee benefits without just compensation,

4. The Due Process Clauses of both the Louisiana and U.S. Constitution and the Fifth Amendment to the U.S. Constitution for depriving employees of property rights without due process, and

5. 42 U.S.C. §1983 against public officials for enforcing unconstitutional laws.

Other Post Retirement Benefits

Actuarial accrued liabilities associated with post-employment benefits other than pensions are likely to decrease as a result of SB 11. Because benefits payable at retirement will be less under SB 11 than under current law, member will be more likely to delay retirement.

Analysis of Fiscal Costs

SB 11 will have the following effect on fiscal costs during the 5-year measurement period.

Expenditures:

1. Expenditures from the General Fund will increase \$13 million beginning in FYE 2014 because employer contribution requirements for LASERS will increase. Additional increases will also occur for STPOL.

2. Expenditures from LASERS and TRSL will decrease. Benefit payments will be smaller because COLA benefits and retirement benefits will be smaller. Termination benefits will increase but not be sufficient to offset the decreases that will occur otherwise.

3. Expenditures from Local Funds will increase \$45 million in FYE 2014 because employer contribution requirements for TRSL will increase. Additional increases will also occur for LSERS.

Revenues:

- Revenues of the state retirement systems will increase because employee and employer contributions will increase.

Actuarial Credentials:

Paul T. Richmond is the Manager of Actuarial Services for the Louisiana Legislative Auditor. He is an Enrolled Actuary, a member of the American Academy of Actuaries, a member 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.

Dual Referral:

Senate	**House**
[x] 13.5.1 ≥ \$100,000 Annual Fiscal Cost	[x] 6.8(F) ≥ \$500,000 Annual Fiscal Cost
[ ] 13.5.2 ≥ \$500,000 Annual Tax or Fee Change	[ ] 6.8(G ≥ \$500,000 Annual Tax or Fee Change