


**2010 REGULAR SESSION
ACTUARIAL NOTE HB 930**

<p>House Bill 930 HLS 10RS-558 Original</p> <p>Author: Representative Jim Tucker Date: May 11, 2010</p> <p>LLA Note HB 930.01</p> <p>Organizations Affected: RETIREMENT/STATE SYSTEMS</p> <p>OR -\$88,536,000 FC EX</p>	<p>The Note was prepared by the Actuarial Services Department of the Office of the Legislative Auditor.</p> <div style="text-align: center;">  David K. Greer, CPA Assistant Legislative Auditor and Director of Performance Audit and Actuarial Services </div>
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Bill Header: RETIREMENT/STATE SYSTEMS: Relative to the state retirement systems, establishes a defined contribution plan for new hires.

Cost Summary:

Actuarial Cost/(Savings) to Retirement Systems and OGB	Actuarial Savings, See Actuarial Analysis Below
Total Five Year Fiscal Cost	
Expenditures	\$ (381,540,000)
Revenues	\$ (301,235,000)

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	Actuarial Savings, See Actuarial Analysis Below
Other Post Retirement Benefits	\$ 0
Total	Actuarial Savings, 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	\$ (7,000,000)	\$ (63,000,000)	\$ (92,000,000)	\$ (119,000,000)	\$ (122,000,000)	\$ (403,000,000)
Agy Self Generated	1,407,000	1,588,000	3,464,000	5,967,000	9,034,000	21,460,000
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	\$ (5,593,000)	\$ (61,412,000)	\$ (88,536,000)	\$ (113,033,000)	\$ (112,966,000)	\$ (381,540,000)

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	(2,929,000)	(50,788,000)	(71,647,000)	(90,506,000)	(85,365,000)	(301,235,000)
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	\$ (2,929,000)	\$ (50,788,000)	\$ (71,647,000)	\$ (90,506,000)	\$ (85,365,000)	\$ (301,235,000)

Bill Information:

Current Law

Employees of the state of Louisiana become members of one of the following systems:

1. Louisiana State Employees' Retirement System (LASERS)
2. Teacher's Retirement System of Louisiana (TRSL).
3. Louisiana School Employees' Retirement System (LSERS).

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4. State Police Pension and Retirement System (STPOL)

These systems currently provide a defined benefit plan for their members, whereby:

1. Members contribute to the retirement plans at rates that range from 7.5% of pay to 9.5% of pay depending on the type of employee, the system in which he participates, and whether or not his position is considered to be hazardous.
2. Employers also contribute to the plan.
3. Employee contributions (7.5% to 9.5% of pay) for new members of the two largest retirement systems LASERS and TRSL are generally larger than employer normal costs. Significantly more than half of the benefits provided under these plans are funded by employee contributions.
4. Benefits payable at termination of employment, retirement, death or disability are determined according to a formula. The benefit formulas, in general, are based on a member's years of credited service, a benefit multiplier and the member's final average compensation.
5. Retirement benefits are payable for life. The member cannot consume his entire retirement wealth and run out of money before death. A retired member's benefit will be paid monthly until death.
6. Members who become disabled or who die before retirement are entitled to special benefits designed to provide members with the assurance that their families will continue to have income. These benefits generally have more value than the benefit a member has accrued to date under the regular retirement benefit formula.
7. Plan assets are commingled and invested by professionals trained in managing retirement funds. Investment costs are approximately 0.50% of the asset pool.
8. An employee's risk is limited to the mandate that he must contribute toward his own retirement. All other risks, mortality risks, investment risks, etc., are borne by the state.

Proposed Law

HB 930 creates a defined contribution plan that will become effective January 1, 2011. Any employee hired on or after that date will become a member of the new defined contribution plan, the characteristics of which are summarized below.

1. Members will contribute 10% of pay.
2. Employers will contribute 5.25% of pay.
3. An account balance will be maintained for each member. Each member will invest his own retirement funds selecting from an array of investment choices.
4. The portion of the account balance attributable to the employee's own contributions is 100% vested and immediately portable if he should leave state employment.
5. The portion of the account balance attributable to the employer's contribution is vested after 5 years. Employer contribution's that are forfeited will be used to offset employer contributions in the aggregate that would otherwise be required for other plan members.
6. Benefits payable at termination of employment, retirement, death, or disability are based completely on the member's account balance. The member's account balance is distributed to him to use in whatever manner he or she deems appropriate.
7. No provision is made to provide supplemental benefits in the event a member becomes disabled or dies. He and or his family will only receive the account balance. Typically, these amounts will be small and not sufficient to provide a meaningful income for the family.
8. A member may enjoy his retirement accumulations only for as long as they last. Members may potentially run out of money before death.
9. Each member will manage his or her own account balance, selecting from an array of choices in which to invest. Expense charges will be paid by individual members and will vary depending on the investment choices made. Conservative investments (fixed income) typically have low investment returns and low expense charges. Aggressive investments (equities) have larger rates of return and higher expense charges. Expense charges typically range from about 50 basis points to 150 basis points (0.50% to 1.50% of the assets invested).
10. The state's risk relative to retirement is limited to the contributions it is required to make to the retirement system for each employee. All other risks – investment risk, mortality risk, etc. – will be transferred to individual employees.

State employees who became members of the retirement systems before January 1, 2011 will continue to participate in the defined benefit plans that are available under current law.

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Implications of the Proposed Changes

Enactment of HB 930 will result in a major change in the way retirement benefits are delivered to employees of the state hired on or after January 1, 2011.

Cost Analysis

Analysis of Actuarial Costs

Retirement Systems

The Office of the Louisiana Legislative Auditor (LLA) as directed by the Chairmen of the Senate and House Retirement Committees and the Speaker of the House engaged Buck Consultants (Buck), a retirement benefit consulting firm, to work with actuarial staff of the LLA office to:

1. Compare retirement benefits delivered under the proposed defined contribution plan with retirement benefits delivered under the current defined benefit plan (hereinafter called the legacy DB plan).
2. Compare annual contribution requirements over the next 20 years if HB 930 is enacted with annual costs should the bill not be enacted.
3. Identify investment and funding policies for the legacy plans that may have to change in order to stabilize contribution requirements as participation in the legacy plans diminishes and participation in the defined contribution plan increases.

Buck and the LLA office have jointly prepared a power point presentation that has been delivered to the two Chairs, the Speaker, and legislative staff. This report can be found on the LLA office website at http://www.lla.la.gov/reports_data/actuaryreports/. A summary of the major conclusions drawn from this report is given below.

Costs Associated with HB 930

1. HB 930 will have the following effect on employer contribution requirements:
 - Employer contributions to LASERS will increase. If HB 930 is enacted, annual employer contributions will increase to about \$950 million by 2014-15 and then level off for the remainder of the 20 year projection period. If the bill is not enacted, annual employer contributions will increase to about \$800 million by 2014-15 and then level off. HB 930 will cost about \$100 million a year for participating employers of LASERS.
 - Employer contributions to TRSL will decrease. If HB 930 is enacted, annual employer contributions will increase to about \$1.3 billion by 2014-15 and then level off. If the bill is not enacted, annual employer contributions will increase to about \$1.5 billion by 2014-15 before leveling off. HB 930 will produce savings of about \$200 million a year for participating employers of TRSL.
 - Employer contributions to LSERS will decrease. If HB 930 is enacted annual employer contributions will increase to about \$100 million by 2014-15 and then level off. If HB 930 is not enacted employer contributions will increase to about \$120 million before leveling off. HB 930 will produce savings of about \$20 million a year for LSERS.
 - Employer contributions to STPOL will decrease. If HB 930 is enacted annual employer contributions will increase to about \$50 million a year and then level off. If HB 930 is not enacted, employer contributions will level off at about \$55 million. HB 930 will produce savings of about \$5 million a year for STPOL.
 - Net savings in employer contributions will be approximately \$125 million a year.
2. HB 930 produces net savings because the employer contribution rate for the proposed defined contribution plan (5.25%) is less than the normal costs that would have been required had the legacy DB plans been continued. The accrued liability associated with the legacy DB plans does not change. Amortization payment amounts that currently exist will continue to exist and new UAL payments or credits will be applied as gains or losses occur.

Risk Abatement

1. Enactment of HB 930 will lower the state's financial risk over the long term relative to retirement plan obligations.
2. Initially the state's risk relative to the legacy DC plans will increase for the following reasons:
 - LASERS and TRSL both use the Projected Unit Credit funding method. Under this method, employer contribution requirements will increase as the average age of members covered by the legacy plans increases.
 - Current investment strategies for legacy DB plans will eventually become too volatile for the size of the plans and such volatility may ultimately jeopardize the plans' ability to satisfy monthly retiree payrolls.
3. For the intermediate term, state risks will be decrease for the following reason:
 - Financial risks associated with the legacy DB plans will gradually diminish; investment, mortality and other risks will be transferred to employees; and the only remaining risk to the state will be to make required employer contributions.

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4. Financial risks will increase in the long term for the following reasons
- Retirement benefits delivered under the HB 930 defined contribution plan are likely to be smaller than benefits available under the current legacy DB plans (see below for further information).
 - Retirement benefits available from the HB 930 defined contribution plans are quite likely to be fully consumed before retirees dies. HB 930 provides no protection against spendthrift consumption, poor investment choice, investment market volatility, or consumption due to a medical crisis for the retiree and/or his spouse.
 - Retirees who run out of money may become wards of the state. The need to care for the indigent elderly will become an unplanned, unfunded obligation. However, if the legacy DB plans had continued in operation, the obligation to provide end of life services will be supported by benefits payable from the DB plans; fewer retirees will become wards of the state; and the state's unplanned unfunded obligation to care for the elderly will be smaller.

Retirement Benefits under HB 930

1. Benefits available to members at retirement will be less under HB 930 than what will be available under current law. Smaller benefits will be delivered at retirement for the following reasons:
- Contributions from employers and employees will be significantly reduced under HB 930 for members of LSERS and STPL. Smaller contributions produce smaller benefits.
 - Defined contribution plan assets cannot and/or will not be invested as efficiently as defined benefit plan assets.
 - Investment expenses will be 3 to 4 times as large under a defined contribution plan as under a defined benefit plan.
- Therefore, dollars contributed to a defined contribution plan will not be as efficient at producing benefit payments as the current defined benefit program.
2. HB 930 does not provide for either disability or survivor benefits. Additional contributions (about \$85 million a year toward the middle of the 20 year projection period) will be necessary to provide these benefits.
3. Benefits available to personnel employed in hazardous duty positions such as corrections and state police will be substantially less under HB 930 than under the current defined benefit plans.

Other Post Retirement Benefits

There are no actuarial costs or savings associated with HB 930 for other post employment benefits.

Analysis of Fiscal Costs

HB 930 will have the following effects on revenues and expenditures over the five year measurement period.

1. Employee contributions to the retirement systems will increase to about \$36,635,000 a year by the end of the five year fiscal measurement period.
2. Employer contributions (State General Fund expenditures) in the aggregate to the four retirement systems will decrease by about \$122,000,000 per year by the end of the measurement period.
3. Retirement System revenues (Agency Self Generated revenues) will decrease about \$85,365,000 per year by the end of the measurement period.
4. Retirement System expenditures (Agency Self Generated) will increase because refunds of employee contributions will increase. Employees will be contributing more funds and will have larger account balances. Annual refunds will be about 9,034,000 a year at the end of the measurement period.
5. The retirement systems report significant costs to implement HB 930. One system reports a start up cost of about \$500,000. Assets set aside in the legacy DB plans cannot be used to pay for implementation and there are no defined contribution plan assets to pay for the start up. A funding allocation directly from the state will necessary to implement this bill. For the four systems, start up costs could exceed \$1,000,000.

Dual Referral

Senate

- 13.5.1 \geq \$100,000 Annual Fiscal Cost
- 13.5.2 \geq \$100,000 Annual Tax or Fee Change

House

- 6.8(F) \geq \$100,000 Annual Fiscal Cost
- 6.8(G) \geq \$100,000 Tax or Fee Increase or a Net Fee Decrease