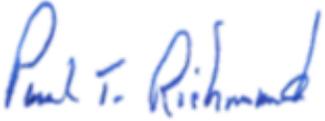


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ACTUARIAL NOTE SB 47**

<p><b>Senate Bill 47 SLS 12RS-129</b> Engrossed with Senate Committee Amendment #2571</p> <p><b>Author: Senator Elbert L. Guillory</b> <b>Date: April 19, 2012</b></p> <p><b>LLA Note SB 47.02</b></p> <p><b>Organizations Affected:</b> Louisiana State Employees' Retirement System (LASERS) Teachers' Retirement System of Louisiana (TRSL)</p> <p><b>EG DECREASE APV</b></p>	<p>The Note was prepared by the Actuarial Services Department of the Office of the Legislative Auditor.</p> <div style="text-align: center;">   <b>Paul T. Richmond, ASA, MAAA, EA</b>  <b>Manager Actuarial Services</b> </div>
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**Bill Header:** RETIREMENT SYSTEMS. Provides relative to final average compensation (6/30/12)

**Cost Summary:**

Actuarial Cost to Retirement Systems and OGB	Decrease
Total Five Year Fiscal Cost	
Expenditures	Decrease
Revenues	Decrease

**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 administration or other fiscal concerns.

<b><u>Actuarial Cost to:</u></b>	<b><u>Increase (Decrease) in The Actuarial Present Value</u></b>
All Louisiana Public Retirement Systems	Decrease
Other Post Retirement Benefits	Decrease
Total	Decrease

**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.

<b>EXPENDITURES</b>	<b>2012-13</b>	<b>2013-14</b>	<b>2014-15</b>	<b>2015-16</b>	<b>2016-2017</b>	<b>5 Year Total</b>
State General Fund	Decrease	Decrease	Decrease	Decrease	Decrease	Decrease
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	0	0	0	0	0
Annual Total	Decrease	Decrease	Decrease	Decrease	Decrease	Decrease

<b>REVENUES</b>	<b>2012-13</b>	<b>2013-14</b>	<b>2014-15</b>	<b>2015-16</b>	<b>2016-2017</b>	<b>5 Year Total</b>
State General Fund	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
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	0	0	0	0	0
Annual Total	Decrease	Decrease	Decrease	Decrease	Decrease	Decrease

Note: All actuarial and fiscal cost information shown in this actuarial note is based on the assumption that any challenges to the constitutionality of SB 47 will be unsuccessful.

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**Actuarial Note Highlights**

1. Employees affected by SB 47 will have to work about one more year to replace benefits lost due to the bill's enactment.
2. Employer contribution requirements to LASERS will be reduced by \$25.7 million per year (1.0% of pay) and contribution requirements to TRSL will be reduced by \$2.9 million per year (0.1% of pay).
3. Savings may be delayed due to constitutional challenges.
4. An actuary providing an actuarial valuation for LASERS or TRSL may be required under actuarial standards of practice to either establish a contingency reserve for the potential liability should SB 47 be declared unconstitutional or issue a caveat with his report indicating that all potential liabilities have not been accounted for.

**Bill Information:**

**Current Law**

Louisiana State Employees' Retirement System (LASERS) and Teachers' Retirement System of Louisiana (TRSL) provide various rules for the calculation of final average compensation (FAC). These rules vary from one member group to another. The differences in rules generally pertain to the number of months used in the average and in anti-spiking percentages used to control enhancements of pension benefits resulting from artificial increases in pay levels near retirement.

**Proposed Law**

***Final Average Compensation***

Current and proposed rules pertaining to calculations of final average compensation are compared below:

**Comparison of Final Average Compensation Periods and Anti-Spiking Percentages**

	<b>Current Law</b>	<b>Senate Bill 47</b>
LASERS – Rank and file members hired on or before July 1, 2006.	FAC Period: 3 yrs; Anti-Spiking Percentage: 25%	FAC Period: 5 yrs; Anti-Spiking Percentage: 15%
TRSL - Members employed in higher education before January 1, 2011	FAC Period: 3 yrs; Anti-Spiking Percentage: 10%	

Final average compensation and anti-spiking percentages for the following members of LASERS will continue to be 3 years and 25% respectively.

1. Judges elected prior to June 30, 2012, for the term of office.
2. The governor.
3. The lieutenant governor
4. The clerk and sergeant at arms for the House.
5. The secretary and sergeant at arms for the Senate.
6. Members of the legislature.
7. Members of LASERS employed in hazardous duty positions.

In no event will the final average compensation of an existing member affected by SB 47 be less than what it would have been on June 30, 2012 had he terminated employment on that date.

***Other Provisions***

SB 47 will also require PRSAC to reset the employer contribution rate for 2012-13 to reflect the provisions of the bill. PRSAC will be allowed to adopt a revised actuarial valuation or a revised employer contribution rate prepared by an actuary, who is a member of the American Academy of Actuaries, engaged by the Division of Administration.

**Implications of the Proposed Changes**

SB 47 will reduce benefits payable to active rank and file members of LASERS first employed before July 1, 2006 and active members of TRSL employed in higher education who were first employed before January 1, 2011. These employees will have to work for about one additional year in order to replace the benefit lost due to SB 47. Unless the courts find SB 47 to be unconstitutional, these benefit changes will reduce future normal costs, the unfunded accrued liability of the retirement systems, and future employer contributions toward the UAL.

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**Cost Analysis:**

**Analysis of Actuarial Costs**

**Retirement Systems**

SB 47 will have the following effect on the various measures of actuarial cost.

**LASERS**

	<b>Before Change</b>	<b>After Change</b>	<b>Increase/(Decrease)</b>
Accrued Liability	\$ 15,862,100,000	\$ 15,672,800,000	\$ (189,300,000)
Total Normal Cost	372,900,000	364,000,000	(8,900,000)
Employer Normal Cost	172,900,000	164,000,000	(8,900,000)
Amortization of Accrued Liability	545,900,000	529,200,000	(16,700,000)
Employer Contribution Requirements	718,900,000	693,200,000	(25,700,000)
Payroll for Normal Costs	2,549,600,000	2,549,600,000	0
Payroll for Amortization Costs	2,549,600,000	2,549,600,000	0
Employer Normal Cost Rate	6.7827%	6.4311%	(0.3516)%
Employer Amortization Rate	21.4130%	20.7563%	(0.6567)%
Total Employer Rate	28.2%	27.2%	(1.0)%

**TRSL**

	<b>Before Change</b>	<b>After Change</b>	<b>Increase/(Decrease)</b>
Accrued Liability	24,942,200,000	24,928,700,000	\$ (13,500,000)
Total Normal Cost	568,000,000	566,500,000	(1,500,000)
Employer Normal Cost	239,100,000	237,600,000	(1,500,000)
Amortization of Accrued Liability	877,200,000	875,800,000	(1,400,000)
Employer Contribution Requirements	1,116,300,000	1,113,400,000	(2,900,000)
Payroll for Normal Costs	4,119,000,000	4,119,000,000	0
Payroll for Amortization Costs	4,702,300,000	4,702,300,000	0
Employer Normal Cost Rate	5.8055%	5.7697%	(0.0358)%
Employer Amortization Rate	18.6537%	18.6244%	(0.0293)%
Total Employer Rate	24.5%	24.4%	(0.1)%

Total savings from SB 47 for LASERS and TRSL combined are summarized below:

1. The accrued liability in total will decrease \$202.8 million.
2. Employer normal costs will decrease \$10.4 million.
3. Amortization costs will decrease \$18.1 million.
4. Employer contribution requirements will decrease \$28.6 million.

Realization of these savings may be delayed or may never occur. It is very likely that the constitutionality of SB 47 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](http://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.

The uncertainty regarding the constitutionality of SB 47 poses a dilemma for the retirement systems and the actuaries that provide advice to them. How should they respond to the uncertainty? SB 47 provides that PRSAC shall meet to adopt revised valuations for LASERS and TRSL prepared in accordance with R.S. 11:102, applying the provisions contained in the

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bill. On the other hand, the Article X, §29(E)(1) makes the following statement about Actuarial Soundness: “The actuarial soundness of state and statewide retirement systems shall be attained and maintained and the legislature shall establish, by law, the particular method of actuarial valuation to be employed for purposes of this Section.”

An actuary employs many actuarial methods in preparing a valuation – the actuarial funding method, the method used to establish the actuarial value of assets, methods for dealing with difficult benefit provisions that are not easily modeled, methods to account for contingent liabilities, etc. The only actuarial method specifically established by the law is the actuarial funding method which for LASERS and TRSL is the Projected Unit Credit Funding Method. The actuary is free to use whatever other techniques, acceptable under Actuarial Standards of Practice, to maintain actuarial soundness in compliance with the Louisiana Constitution.

Implementing the provisions of SB 47, without any recognition of the constitutional challenges, may not be actuarially sound. The actuary may have two choices – prepare the valuation as required by SB 47 with a caveat that the valuation may not maintain the actuarial soundness of the retirement system, or prepare the valuation as required by SB 47 with due allowance for a contingency reserve in the event the law is declared unconstitutional.

Some elements of SB 47 can be reversed should the bill be enacted and the courts later declare it unconstitutional. Certainly, the benefit of anyone who retires after the effective date of SB 47 can be recalculated and retirees can be given retroactive payments should the courts declare the bill to be unconstitutional. However, retroactive payments will create a new unfunded accrued liability when such a declaration is made. To avoid this, the retirement systems may elect to establish a contingent liability that would be released only if the constitutionality of SB 47 is upheld. The system actuaries would then prepare their valuations showing the gain relative to the provisions of SB 47, but would also include the contingent liability associated with the constitutionality issue. These amounts would be offsetting and employer contribution requirements would not change until the issue is resolved.

Unless an injunction against implementation is given, the retirement systems certainly must calculate and pay benefits in accordance with the provisions of SB 47, even though the law is being challenged. However, if the retirement systems do not establish contingent liabilities to keep contribution requirements where they are currently, significant new unfunded accrued liabilities will be incurred if the law is declared unconstitutional. Actuarial recognition of the provisions of SB 47 without the establishment of contingent liabilities might be considered imprudent, against actuarial standards of practice, perhaps against GASB accounting standards, and perhaps against actuarial soundness provisions of the Louisiana constitution.

It is unclear what actions may be taken by the courts, by the retirement systems, or by their actuaries to mitigate damages that might be incurred should SB 47 be overturned. It is therefore also unclear whether or not any actuarial savings to the state will materialize from the bill.

### **Other Post Retirement Benefits**

SB 47 should produce a reduction in the actuarial costs associated with post-retirement benefits other than pensions. A cost reduction should occur because retirement benefits will be reduced making it likely that at least some members will postpone retirement until they accumulate a pension equal to what they otherwise would have been entitled without SB 47.

### **Analysis of Fiscal Costs**

The effects of SB 47 on fiscal costs are given below assuming the constitutionality of SB 47 will be upheld should it be challenged.

#### **Expenditures:**

1. Expenditures from state General Funds will decrease because employer contribution requirements will decrease by about \$28.6 million a year.
2. Expenditures from the General Fund will increase to the extent that the state will be required to defend the legal challenges that will be brought to the courts. Additional litigation costs that may be incurred by various government entities relative to SB 47 have been estimated to range from \$750,000 to \$3,000,000.
3. Expenditures from LASERS and TRSL (Agy Self-Generated) will decrease because affected members retiring in the future will receive benefits that are about 5% smaller than they would otherwise receive.
4. Expenditures by LASERS and TRSL (Agy Self-Generated) will increase because of implementation costs which are estimated to be about \$110,000 in FY 2013.

#### **Revenues:**

1. LASERS and TRSL revenues (Agy Self-Generated) will decrease because employer contributions will decrease by about \$28.6 million a year. These revenue decreases will be offset to the extent that employer contribution rates become larger to account for additional administrative costs.

The effect of SB 47 on actuarial and fiscal savings may change from the amounts shown above based on the following:

1. The constitutionality of SB 47 is likely to be litigated.
2. The potential success of such litigation is unknown, but reasonable grounds have been established.

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3. It may take several years for the legal challenges to work through the court system.

The outcome of such litigation may take one of the following forms:

1. SB 47 is challenged in the courts and an injunction is given delaying implementation of the provisions of the bill.
2. The retirement systems, the actuaries, or other regulatory bodies believe it necessary to create a contingency reserve to stabilize employer contribution requirements until constitutionality issues relative to SB 47 are resolved.
3. SB 47 is litigated and is declared unconstitutional.
4. SB 47 is litigated and is declared constitutional.

If any outcome except that last occurs, actuarial and fiscal savings may be delayed or may never materialize.

**Actuarial Caveat**

Actuarial analyses contained in this actuarial note are based on the 8.25% discount rate assumption used by LASERS in the preparation of valuation results as of June 20, 2011 and contribution requirements for FY 2012. Although PRSAC recently adopted a valuation report based on an 8.00% discount rate for estimating contribution requirements for FY 2013, we are continuing to use the 8.25% rate because we started our analysis before the change was approved.

**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 to necessary to render the actuarial opinion contained herein.

**Dual Referral:**

**Senate**

- 13.5.1  $\geq$  \$100,000 Annual Fiscal Cost
- 13.5.2  $\geq$  \$500,000 Annual Tax or Fee Change

**House**

- 6.8(F)  $\geq$  \$500,000 Annual Fiscal Cost
- 6.8(G)  $\geq$  \$500,000 Annual Tax or Fee Change