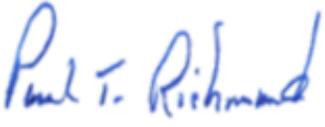


**2012 REGULAR SESSION  
ACTUARIAL NOTE for SB 749**

<p><b>SB 749 SLS 12RS-2590 Engrossed</b></p> <p><b>Author: Senator Elbert L. Guillory Date: April 29, 2012</b></p> <p><b>LLA Note SB 749.02</b></p> <p><b>Organizations Affected: Louisiana State Employees' Retirement System (LASERS) Teachers' Retirement System of Louisiana (TRSL)</b></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 Manager Actuarial Services</b> </div>
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**Bill Header:** RETIREMENT BENEFITS. Provides for retirement eligibility for certain state employees. (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 (Savings) 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 749 will be unsuccessful.

**Actuarial Note Highlights**

1. Employees affected by SB 749 may have to work longer to be able to retire.

**2012 REGULAR SESSION  
ACTUARIAL NOTE for SB 749**

2. Employer contribution requirements to LASERS will be reduced by \$56.8 million a year (2.2% of pay) and employer contribution requirements to TRSL will be reduced by \$16.3 million a year (0.4% of pay).
3. Savings to the state 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 749 be declared unconstitutional or issue a caveat with his report indicating that all potential liabilities have not been accounted for.

**Bill Information:**

**Current Law**

Members of the rank and file sub plan of LASERS must attain the age and service amounts shown below in order to retire.

1. Members first employed on or before June 30, 2006:
  - a. A member may retire at age 60 if he has 10 or more years of service.
  - b. A member may retire at age 55 if he has 25 or more years of service.
  - c. A member may retire at any age if he has 30 or more years of service.
  - d. A member may retire at any age if he has 20 or more years of service, but benefits are actuarially reduced from the earliest age he would have been able to retire with unreduced benefits had he remained in service.
2. Members first employed on or after July 1, 2006:
  - a. A member may retire at age 60 if he has 5 or more years of service.
  - b. A member may retire at any age if he has 20 or more years of service, but benefits are actuarially reduced from the earliest age he would have been able to retire with unreduced benefits had he remained in service.

Members of TRSL who are employed in higher education who have not elected to participate in the Optional Retirement Plan (ORP) must attain the age and service amount shown below in order to retire with unreduced benefits.

1. Members first employed on or before June 30, 1999:
  - a. To be entitled a 2.00% accrual rate:
    - 1) A member may retire at age 60 with 5 years of service
    - 2) A member may retire at any age with 20 or more years of service.
  - b. To be entitled to a 2.50% accrual rate:
    - 1) A member may retire at age 65 if he has 20 or more years of service.
    - 2) A member may retire at age 55 if he has 25 or more years of service.
    - 3) A member may retire at any age if he has 30 or more years of service.
    - 4) A member may retire at any age if he has 20 or more years of service, but benefits are actuarially reduced from the earliest age he would have been able to retire with unreduced benefits had he remained in service.
2. Members first employed on or after July 1, 1999 and before January 1, 2011:
  - a. A member may retire at age 60 if he has 5 or more years of service.
  - b. A member may retire at age 55 if he has 25 or more years of service.
  - c. A member may retire at any age if he has 30 or more years of service.
  - d. A member may retire at any age if he has 20 or more years of service, but benefits are actuarially reduced from the earliest age he would have been able to retire with unreduced benefits had he remained in service.
3. Members first employed on or after January 1, 2011:
  - a. A member may retire at age 60 if he has 5 or more years of service.
  - b. A member may retire at any age if he has 20 or more years of service, but benefits are actuarially reduced from the earliest age he would have been able to retire with unreduced benefits had he remained in service.

**Proposed Law**

The provisions of SB 749 apply to the following members who retire on or after July 1, 2012:

1. Members of the rank and file sub plan of LASERS.
2. Members of TRSL who are employed in higher education who have not elected to participate in the Optional Retirement Plan (ORP).

The provisions of SB 749 will not apply to the following members:

1. A member born on or before June 30, 1957.

**2012 REGULAR SESSION  
ACTUARIAL NOTE for SB 749**

2. A member who is an elected judge.
3. A member of a hazardous duty sub plan.

A member of LASERS, affected by SB 749, first employed on or before June 30, 2006 will be able to retire with an unreduced benefit at any age with 30 or more years of service **OR** at the age specified below in accordance with his years of service on June 30, 2012.

Age	Service on June 30, 2012
55	At least 25 years but less than 30
58	At least 20 years but less than 25
61	At least 15 years but less than 20
64	At least 10 years but less than 15
67	Fewer than 10 years

A member of LASERS, affected by SB 749, first employed on or after July 1, 2006 but before June 30, 2012 will be able to retire with an unreduced benefit at age 60 with 30 or more years of service **OR** at the age specified below in accordance with his years of service on June 30, 2012.

Age	Service on June 30, 2012
64	At least 10 years
67	Fewer than 10 years

A member of LASERS, affected by SB 749, first employed on or after July 1, 2012 will be able to retire with an unreduced benefit at age 67 if he has 5 or more years of service.

A member of TRSL, affected by SB 749, first employed on or before December 30, 2010 will be able to retire with an unreduced benefit at any age with 30 or more years of service **OR** at the age specified below in accordance with his years of service on June 30, 2012.

Age	Service on June 30, 2012
55	At least 25 years but less than 30
58	At least 20 years but less than 25
61	At least 15 years but less than 20
64	At least 10 years but less than 15
67	Fewer than 10 years

A member of TRSL, affected by SB 749, first employed on or after January 1, 2011 will be able to retire with an unreduced benefit at age 67.

An affected member will be able to retire when he attains the age and service requirements of current law, but a portion of his benefit may be actuarially reduced from age 67 or the age specified in the above tables. A member who retires early may elect the following options regarding the actuarial reduction.

1. Phased Benefit Option
  - a. Phase 1 – The member’s Frozen Benefit will begin on his retirement date.
  - b. Phase 2 – The member’s Post 2012 Benefit will begin when he attains an unreduced retirement age in accordance with the above schedules.
  - c. The Frozen Benefit and the Post 2012 Benefit are defined as follows:
    - 1) Frozen Benefit = 2.5% x service on June 30, 2012 x Final Average Compensation (FAC) on June 30, 2012.
    - 2) Post 2012 Benefit = 2.5% x service after June 30, 2012 x FAC at retirement.
2. Actuarially Reduced Benefit Option
  - a. The member’s total benefit will begin on his retirement date. The benefit will be equal to the sum of the following two amounts.
    - 1) The Frozen Benefit unreduced, plus
    - 2) The Post 2012 Benefit actuarially reduced from the age when he would have been able to collect an unreduced benefit in accordance with the above schedules.

SB 749 will apply the savings that result of the reduction in benefits to reduce employer contribution requirements for FY 2013.

**Implications of the Proposed Changes**

Rank and file members of LASERS who are less than age 55 on July 1, 2012 may have to delay their retirement in order to receive unreduced retirement benefits. Members of TRSL employed in higher education who have not elected to participate in ORP and who are less than age 55 on July 1, 2012 may have to delay their retirement in order to receive unreduced retirement

**2012 REGULAR SESSION  
ACTUARIAL NOTE for SB 749**

benefits. Unless the courts find SB 749 to be unconstitutional, the benefit changes will reduce future normal costs, the unfunded accrued liability of the retirement systems, and future employer contributions toward the UAL.

**Cost Analysis:**

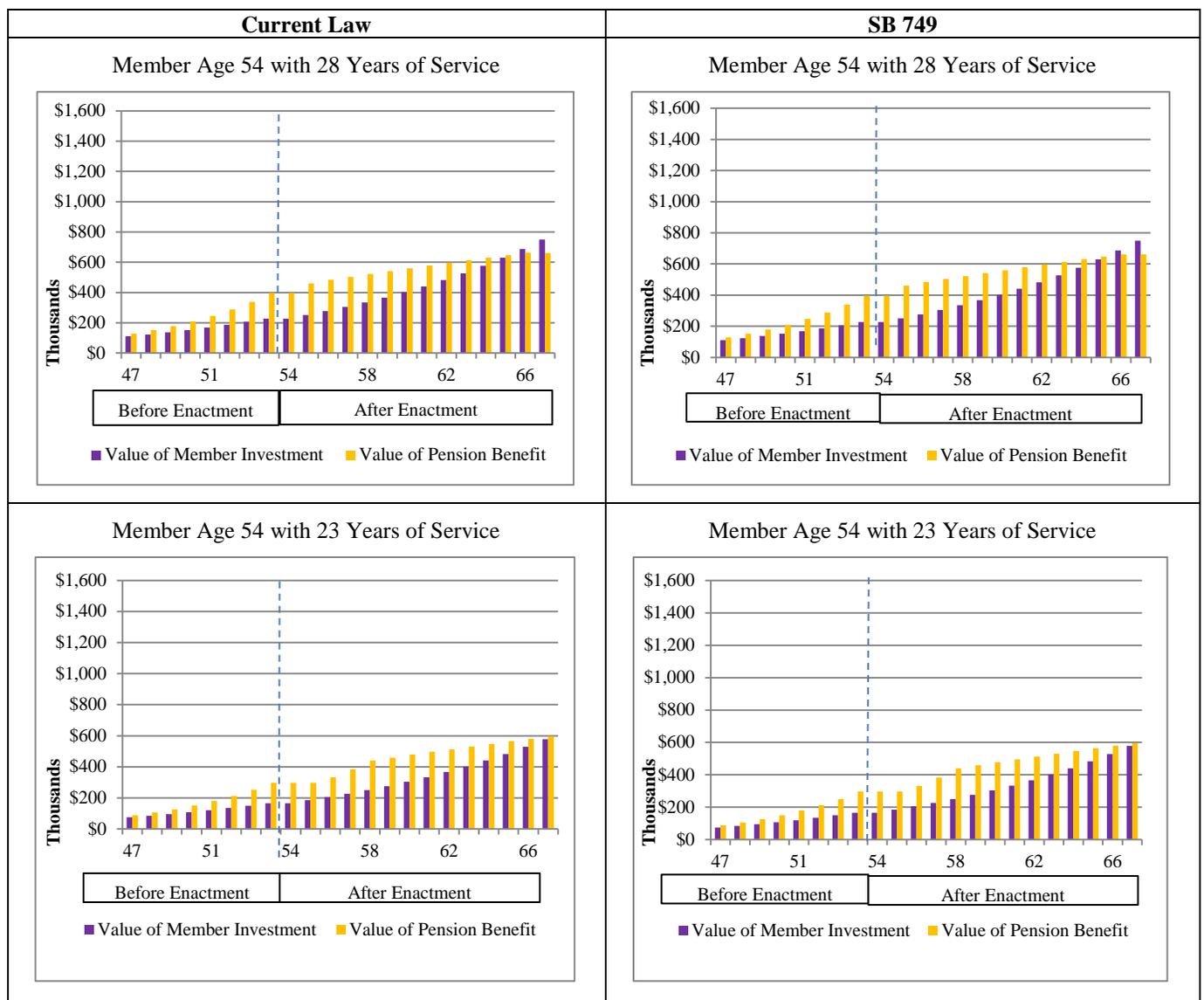
**Analysis of Actuarial Costs**

**Retirement Systems**

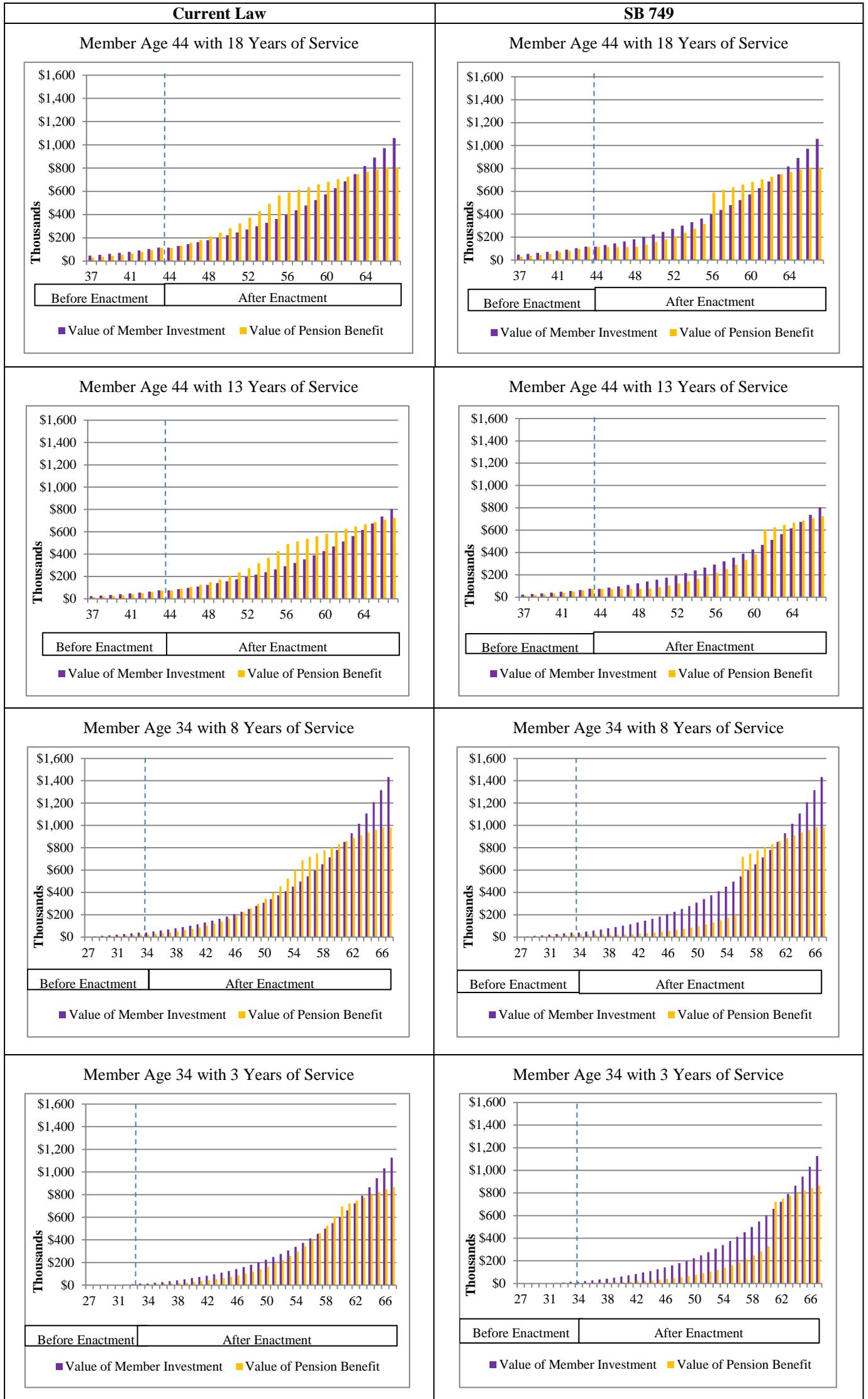
*Effect of SB 749 on Members*

As they work, employees earn three forms of compensation – salary, deferred income in the form of pensions, and other benefits such as health insurance. Part of the deferred income earned by a member is the contributions he has made to the retirement system. The other part is the amount earned by the member from employer contributions. SB 749 retains the amount of deferred compensation that a member will earn to date but reduces the deferred compensation he will earn in the future.

The value of total deferred compensation that a member has already earned and will earn in the future (gold bars) is compared below with the value of the member’s own contributions with interest (blue bars). Each bar in each graph reflects the amount of value the member is entitled to receive should he terminate employment at that moment in time. These comparisons are made under current law (left column) and under SB 749 (right column).



**2012 REGULAR SESSION  
ACTUARIAL NOTE for SB 749**



**2012 REGULAR SESSION  
ACTUARIAL NOTE for SB 749**

The following conclusions can be drawn from these charts.

1. Neither deferred compensation earned to date nor future deferred compensation for a career employee who is just under the grandfathering age of 55 is reduced. A 54 year old with 28 years of service and a 54 year old with 23 years of service will receive the same amount of deferred compensation under SB 749 as they would have received under current law. In both instances, the value of the pension benefit paid by the plan exceeds the value of the member's employee contributions plus interest.
2. The picture changes somewhat for a member who is now age 44 with 18 years of service or age 44 with 13 years of service. If they terminate employment between age 48 and age 62 under current law, the value of their pension benefits will be greater than the value of their own contributions plus interest. However, under SB 749, the value of pension benefits does not exceed employee contributions plus interest until the member attains 30 years of service or the age specified in SB 749.
3. The effect of SB 749 on a member who is 34 years of age is similar to the effect on a 44 year old. Under current law, the value of pension benefits gradually increases throughout a member's career. Under proposed law, there is a gradual increase with a sudden spike in value when the member attains normal retirement age. The penalty for early retirement is quite severe under SB 749.

SB 749 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	\$ 15,580,700,000	\$ (281,400,000)
Total Normal Cost	372,900,000	340,800,000	(32,100,000)
Employer Normal Cost	172,900,000	140,800,000	(32,100,000)
Amortization of Accrued Liability	545,900,000	521,200,000	(24,700,000)
Employer Contribution Requirements	718,800,000	662,000,000	(56,800,000)
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%	5.5241%	(1.2586)%
Employer Amortization Rate	21.4130%	20.4407%	(0.9723)%
Total Employer Rate	28.2%	26.0%	(2.2)%

**TRSL**

	<b>Before Change</b>	<b>After Change</b>	<b>Increase/(Decrease)</b>
Accrued Liability	\$ 24,942,200,000	\$ 24,871,400,000	\$ (70,800,000)
Total Normal Cost	568,000,000	558,100,000	(9,900,000)
Employer Normal Cost	239,100,000	229,200,000	(9,900,000)
Amortization of Accrued Liability	877,200,000	870,800,000	(6,400,000)
Employer Contribution Requirements	1,116,300,000	1,100,000,000	(16,300,000)
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%	5.5665%	(0.2390)%
Employer Amortization Rate	18.6537%	18.5179%	(0.1358)%
Total Employer Rate	24.5%	24.1%	(0.4)%

Total savings from SB 749 for LASERS and TRSL combined are summarized below:

1. The accrued liability in total will decrease \$352.2 million.
2. Employer normal costs will decrease \$42.0 million.
3. Amortization costs will decrease \$31.1 million.
4. Employer contribution requirements will decrease \$73.1 million.

There is unlikely to be a significant exodus of personnel anticipating the implementation of SB 749 because the bill becomes effective July 1, 2012. There is no window of opportunity before the effective date of the bill to retire under current provisions of law.

Realization of these savings may be delayed or may never occur. It is possible that the constitutionality of SB 749 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.la.gov/reports\\_data/actuaryreports](http://www.la.gov/reports_data/actuaryreports)) challenges would likely allege violations under:

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

**2012 REGULAR SESSION  
ACTUARIAL NOTE for SB 749**

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 749 poses a dilemma for the retirement systems and the actuaries that provide advice to them. How should they respond to the uncertainty? SB 749 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 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 749, 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 749 with a caveat that the valuation may not maintain the actuarial soundness of the retirement system, or prepare the valuation as required by SB 749 with due allowance for a contingency reserve in the event the law is declared unconstitutional.

Some elements of SB 749 can be reversed should the bill be enacted and the courts later declare it unconstitutional. For members who do not retire, the loss of deferred compensation in most instances can be restored without harm to the member. However, the retirement systems will be harmed financially if SB 749 is declared unconstitutional. The unfunded accrued liability written off with the enactment of SB 749 will have to be restored, but the system will have failed to collect sufficient contributions between the enactment of the bill and the time the courts rule. A new UAL will be created that is larger than what it would have been otherwise. To avoid this, the retirement systems may elect to establish a contingent liability that would be released only if the constitutionality of SB 749 is upheld. The system actuaries would then prepare their valuations showing the gain relative to the provisions of SB 749, 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 must calculate and pay benefits in accordance with the provisions of SB 749, 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 749 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 749 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 749 should reduce actuarial costs associated with post-retirement benefits other than pensions. Members will in all likelihood retire later than they would have otherwise and, as a result, the liability associated with post-retirement benefits will decrease.

**Analysis of Fiscal Costs**

The effects of SB 749 on fiscal costs are given below assuming the constitutionality of SB 749 will be upheld should it be challenged.

**Expenditures:**

1. Expenditures from state General Funds for FY 2013 will decrease by about \$73.1 million, reflecting savings in employer contributions to the pension plans.
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 749 have been estimated to range from \$750,000 to \$3,000,000.
3. Expenditures from the General Fund may increase to the extent that the Division of Administration engages a third actuary to present an actuarial valuation at the meeting of PRSAC called for under SB 749.

**2012 REGULAR SESSION  
ACTUARIAL NOTE for SB 749**

4. Expenditures from LASERS and TRSL (Agy Self-Generated) will decrease to the extent that payments to retirees will be lower because members will be unable to retire when they had originally planned.
5. 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 \$73.1 million a year.

The effect of Substitute SB 51 on actuarial and fiscal savings may change from the amounts shown above based on the following:

1. The constitutionality of SB 749 is likely to be litigated.
2. The potential success of such litigation is unknown, but reasonable grounds have been established.
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 749 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 749 are resolved.
3. SB 749 is litigated and is declared unconstitutional.
4. SB 749 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 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