# TREASURER OF THE STATE OF LOUISIANA

**John Neely Kennedy**
State Treasurer

P. O. Box 44154
Baton Rouge, LA 70804
(225) 342-0010
www.latreasury.com

**FUNDING REVIEW PANEL**
**Established by Act No. 448 (HB 682) of the 2005 Regular Session**
**Revised by Act No. 93 (HB 515) of the 2010 Regular Session**

Minutes of Meeting
Friday, September 17, 2010

## I. CALL TO ORDER AND ROLL CALL

Mr. Jim Napper, Chairman, called the meeting to order at 10:10 a.m. in Committee Room 2 of the State Capitol, Baton Rouge, Louisiana. Ms. Karen Stephens called the roll.

**Recommendations Committee: voting members**

***Members Present:***
Mr. Stacy Birdwell - member of the Firefighters' Retirement System (FRS)
*selected by the FRS board of trustees*
Lt. Henry Dean - member of the Municipal Police Employees' Retirement System (MPERS)
*selected by the MPERS board of trustees*
Mayor J. Lynn Lewis of Delhi
*selected by the Louisiana Municipal Association (LMA)*
Mr. James H. Napper II
*designee of state treasurer John Kennedy*
Dr. Steven Procopio
*appointed by the governor*
Mayor Randy Roach of Lake Charles
*selected by the Louisiana Conference of Mayors*
Mr. Bob Rust - member of the Municipal Employees' Retirement System (MERS)
*selected by the MERS board of trustees*

**Advisory Committee: non-voting members**

***Members Present:***
Sen. Dan Claitor - member of the Senate Committee on Retirement
*appointed by Senate President Joel Chaisson*
Rep. Page Cortez - member of the House Committee on Retirement
*appointed by House Speaker Jim Tucker*
Mr. Charlie Fredieu

*selected by the Professional Fire Fighters Association (PFFA)*
Rep. Kevin Pearson
*Chairman, House Committee on Retirement*

***Members Absent:***
Mr. Chris Gillott
*appointed by the governor*
Sen. Elbert Guillory
*designee of Sen. Butch Gautreaux, Chairman, Senate Committee on Retirement*
Mr. Chris Nassif
*selected by the International Union of Police Associations (IUPA) from nominations submitted by the Louisiana organizations affiliated with the IUPA*

**Staff Members Present:**
Miss Laura Gail Sullivan - Attorney
Ms. Karen Stephens - Secretary
Mr. Matt Tessier - House Committee on Retirement Attorney
Mr. Paul Richmond - Manager of Actuarial Services, Office of Legislative Auditor
Mr. Danny Leming - Sergeant at Arms

## II. APPROVAL OF MINUTES

Rep. Pearson offered a motion to approve the minutes of the following meetings, seconded by Dr. Procopio: August 23, 2005, October 18, 2005, December 13, 2005, and August 20, 2010. There were no objections and the Recommendations Committee approved the minutes by a vote of 7 yeas and 0 nays. Those voting yea were Messrs. Birdwell, Dean, Lewis, Napper, Procopio, Roach, and Rust.

## III. PRESENTATIONS AND DISCUSSION

Mr. Napper welcomed Mayor Roach to the panel.

*Transcription follows:*

**Roach:** I think that we all know why we are here and I can tell you, just from the perspective of a medium-size city, that the increases in retirement contributions for fire and police are really hitting us pretty hard. We [city of Lake Charles] just adopted a budget with a $4 million deficit, which is pretty significant for a city our size, and roughly $2.3 million of that is [from] a decline in sales tax revenue. The remainder of that [$1.7 million of the $4 million] is the increase in the retirement contributions for fire and police. This is an issue that hits us really pretty hard and I think that it is in the best interest of not only the community, but the employees, that we come up with some type of long-term solution. Sometimes I feel like there is the elephant in the room - and we sometimes dance around - but I think we all know that it is a pretty tough nut to crack, and we have a lot of work that we have to do. I am here to work with members of the committee and looking forward to it.

**Napper:** Thank you so much. As I was telling the LMA people this morning, this is your panel - it is not mine - I am here to try to help facilitate this. It is a tough nut to crack. We have a problem with these systems and other systems, but staff and I, with your suggestions, are going to try to put everything we know of on the table. If there are things in that pile that we do not want to talk about, that is fine. Again, I want to invite all of you and the people in the audience too, to make suggestions or give us ideas about what you want to hear about and look at if we are not covering it otherwise.

**Roach:** I know that there are a lot of ideas out there. I think that we probably have a responsibility if we are really going to do what we have been asked to do - if we are going to accomplish what this committee needs to accomplish - that there should not be any sacred cow that we do not look at. I think we as a committee ought to at least look at it. If we do not think that it is something that we can really recommend to the legislature that they deal with then we need to say that. If we think it is too politically challenging to deal with then we have to say that. I don't think that we can afford not to talk about it. I think we have to talk about it. We have to put those issues on the table. Then we let the legislature take it from there, but I think we owe it to them, as well as to ourselves, to look at all of the factors.

*Mr. Napper welcomed Rep. Cortez to the meeting.*

**Cortez:** I appreciate the opportunity to serve and thank the speaker for appointing me. I just left the Joint [Legislative Committee on the] Budget meeting and I will be jumping back and forth, but I appreciate the opportunity to serve with all of you and I hope that I can provide something to the issue.

**Napper:** Also, before we start, if there's anyone in the audience who would like to make a comment or come to the table, we would welcome that ... no takers? Then I'll ask Miss Sullivan to proceed with the next item on the agenda. During these presentations please feel free to interrupt and ask questions - we are trying to provide you with information and to also get your input on these things.

**Sullivan:** Mayor Harris is here with us, and I know that he has taken a big interest in this as to his city (Gretna), and I think we should say that we are glad that he is here because he has a real good handle on the effects that this is going to have on his own city. If anybody needs an example of how what is going on might affect an individual city besides Lake Charles, Mayor Harris can also give his input on what he is seeing.

**Napper:** Mayor, welcome. If at anytime you have any questions or want to ask anything, please let us know.

**Sullivan:** I want to start with a quick review of what happened last time. Generally, this panel is charged with making recommendations to the legislature. The due date for the recommendations is March 15, 2011, and the recommendations are supposed to be of a dual nature: increasing the actuarial soundness of these three systems and providing an affordable benefit for the members of the systems. The statute requires that the panel take into consideration five things as a part of a comprehensive review of actuarial funding in the benefit structure. The review has to include 1) eligibility for retirement, 2) benefit calculation including final average compensation (FAC), 3) contributions - and I will talk about those in a minute, 4) information about actuarial assumptions, and 5) cost-of-living adjustment (COLA) criteria. Mr. Gary Curran (FRS & MERS actuary) is going to make a "part one" presentation about the actuarial assumptions and the kinds of things that influence the actuarial process. It is going to be an overview of theory. Next month Mr. Curran and Mr. Charles Hall (MPERS actuary) will be coming here to talk about applying those theories to the three systems and in what way each system is sensitive to changes in various elements of the cost structure or to "missing" the assumptions that are put in place. Today you are going to get at least a little bit of information about the five elements that you are required to look at.

***Miss Sullivan continued:*** Last month I talked about the fact that anybody that starts work like this has to ask themselves three questions: 1) Where are we? 2) Where do we want to be? 3) How are we going to get there? Mr. Richmond gave extensive information on the actuarial side and I presented some other general information that you may want to consider and one question that was asked was, "Does this panel want in engage in finding permanent reductions in the cost structure of the system or does the panel want to focus on finding temporary relief from fiscal pressures for the cities?" The panel's answer last month was "both." Just as a focus as you go forward, and as Mr. Richmond indicated - he said it in an actuarial equation but I'll say it in two sentences - **to cut pension costs, liabilities must be reduced**. **Any action that has the effect of reducing your current payments without reducing the current liabilities is not cost "cutting", but cost "shifting."** You said you want to look at both temporary fiscal pressure, which would be more of a cost shift, and you also want to look at permanent reduction in the cost structure [cost cutting], which would involve reducing the liabilities.

**Napper:** We are going to talk about this a little bit further today, but this is a key point and I think it is key for our legislative members to realize that, if we do have recommendations, what they are, and what the effect will be. Some of these are what we are going to call "temporary" possible relief and that is a cost-shifting item instead of a real reduction in liabilities.

**Sullivan:** The [cost] shift can be either shifting to a different source of funds, shifting to a different payor, or shifting the timing of paying the debt. Last month I read out a list of concepts that have been considered either in this state or in other places in response to the increased contribution requirements. We are going to go back over those a little bit later in the presentation. We are going to have an extensive presentation about the latest state action here. We are going to go over the provisions of House Bill No. 1337 and what the state did in the past legislative session with regard to providing an affordable benefit for state employees. Every concept that comes up needs to be evaluated to determine whether the implementation will provide increased actuarial soundness or will advance the policy of providing an affordable benefit. If you are going to measure something, you need a system or a yardstick against which to measure it. For the panel to determine whether a concept meets actuarial soundness or helps provide an affordable benefit you have to have a common understanding of what actuarial soundness means, and you need to say what you think it means to provide an affordable benefit. I reviewed minutes from these panel meetings as well as some of the things I've gone through with the actuaries and I did sort of vet these with all of the actuaries who are involved. For a retirement system to be on an actuarially sound footing the following, at a minium, must be true: 1) The liabilities and the assets are accurately identified and measured at regular, short intervals. 2) There is a methodical, systematic plan for assuring the system has assets sufficient to cover the liabilities. 3) The actuaries responsible for implementation, as well as any entity with oversight, agree that the plan is reasonable in both the amounts and timing of required contributions and is not unduly dependent on generational cost shifting. 4) There is a mechanism for enforcing contribution requirements in the event of a default. You have to identify how much money you have and how much money you are going to pay out, you have to have a plan for making sure you have enough money to pay the benefit, and the plan has to be reasonable without generationally shifting the cost, and reasonable in the eyes of your actuary. And, there is a mechanism for getting the payment in the event of a default.

**Napper:** Explain further what you mean by "generational cost shifting".

**Sullivan:** I think the example I gave last time was a 100-year amortization period. I said it is a policy determination to what extent that the benefits the current actives are going to receive should be fully funded within the working lifetime of those actives. Another example I gave is that MPERS has a 30-year amortization period, but no one thinks that the average working lifetime is 30 years for the people in the system. To some extent an amortization period that extends extensively beyond the working lifetime of the actives is a generational cost shift because the people that are receiving benefits - the retirees - end up dependent on another cohort, another generation to put money in the system to ensure that their benefit is fully paid out. The actuaries can explain it better than I can I'm sure.

**Richmond:** Another aspect of cost shifting or not having generational shifting occurs if you - ideally what you would have is that benefits are paid for as they are earned or accrued. Shifting occurs when you start a plan brand-new and give retroactive service. Service is granted that was earned in the past and is going to be paid for by a future generation. Or if you retroactively improve a benefit after a plan has been in place for awhile. Increase a plan benefit accrual rate from 2.5% to 3% or 3-1.3% and apply that retroactively to all past service. What happens is a future generation is going to pay for costs that are attributable to an earlier generation for earlier years. It also can occur when [for instance] policemen are paid for partially by state funds and partially by local funds and in the past in some plans, they know that those local funds were included in the compensation for FAC purposes and an amendment was made to say "we will include all funds". That creates an unfunded liability in the past and creates some generational cost shifting. To repeat what Miss Sullivan said about if we delay paying off that unfunded liability for too long a period of time then there is generational cost shifting. One of the things that occurs is when you have an amortization payment schedule, and when you have a debt and you pay that off with increasing payments, that's a generational cost shifting because you are delaying- with those types of things you don't really pay off the debt until the last three to five years of the amortization period. Your debt actually increases because the payments are not sufficient to even pay for the principal. Those are all things that occur in shifting cost from one generation of workers to another. Ideally benefits are paid at the time the benefits are accrued.

**Roach:** When we talk about the generational cost shifting, the question that comes to my mind is "Is it really practical for us to assume that we should have a retirement system that is fully funded?" Is that really something that we should set as a goal and an objective and something that we want to achieve, or, as a practical matter, it would seem to me that almost any retirement system is going to have some generational cost [shifting] associated with it. I think Social Security probably has some of that in it. I do not know whether we want to set a goal that is not practical for us to reach. I would think we want to minimize generational cost shifting - there has to be some rule of thumb that would be a standard, or some policy that we could go by, but I do not know whether we could actually, realistically expect to have a retirement system that did not involve some generational cost in it.

**Napper:** I think what Miss Sullivan said is "not unduly dependent" on generational cost shifting. I think what you said is correct. There are not many systems of them in Louisiana that do not have a UAL which basically comes from that.

**Richmond:** I think the question you asked really becomes a policy issue that obviously needs to be considered by the appropriate legislative body as to what level do we think is appropriate to be "safe" and not lead to radical swings or a time of crisis in a retirement plan. The federal government standard for governmental plans for funding - the federal government passed the Employee Retirement Income Security Act (ERISA) in 1974 - that is layered on top of existing law. There is a big division between what the federal government can control relative to state plans, but there is one basic rule that applies: a plan, in order to be qualified, must be contributing to the plan an amount equal to contributions plus interest on the UAL. If you look at that standard it says that whatever extent we are underfunded now we will keep that under funding and we will just pay the cost of interest on our debt and we will maintain the debt as it is. That is kind of a minimum floor that might be looked at as a policy. Is that a good one? I am a little uncomfortable with it, as an actuary, but I am not a policy maker. Ideally, as an actuary, I would like to see a plan 100% funded and have its UAL completely gone. The reason for that is that it allows flexibility so that when we have times like we had 2000-2002 and in the recent two years of economic downturn in the markets you do not have a time of crisis. Those are the two ends of the spectrum.

**Napper:** Last month you discussed the proposed changes in the accounting methods that are going to be applied to systems in the future. Do you think those proposed changes, with what we know about them now, will perhaps change how we look at this issue we are talking about as a policy issue?

**Richmond:** Most definitely. It will change primarily because the local governmental entities will have to carry their portion of the UAL associated on their balance sheet, as well as show an expense, under some pretty stringent standards, that will be significantly larger in many cases than what the funding dollars are. Right now each local government essentially expenses whatever they contribute. If these preliminary views are adopted [local entities] will, at least for a short period of time in the future, expense much larger amounts than they are funding.

**Pearson:** It seems like, from my research, the last time the plans were fully funded in about 2000-2001, we increased benefits?

**Napper:** We will go over legislation that has been applied to these three systems as a part of some future presentations.

**Pearson:** Regarding the funding issues of the plans, all of these assumptions are based on actuarial assumed rates of return (AAAR) of 7.50% to 8.0% and when I look at the past 10 years of returns - and I know it was a horrendous decade - what if we do not hit these numbers? I think these numbers are assumed to be a little bit high, perhaps? I would like to ask you if that is perceived as a high rate of return.

**Richmond:** Let me just give a little bit of history: Actuaries for a long time, going back to the 1950s and 1960s, and even the 1970s, were using 4% as an actuarial valuation interest rate. I think a lot of that was because in that time frame pension assets were invested very conservatively in fixed income and did not get into equity investments to any extent. During the 1970s we had double-digit inflation, and the interest began to gradually rise and then it really took off in the 1980s and 1990s when we began year after year of double-digit rates of return in the marketplace. Actuaries gradually became less and less conservative, and we saw increases in the valuation discount rate - increasing from the traditional 4% up to the levels of - I did some valuations back in the 1980s and early 1990s using 12% or 13% - I was uncomfortable with it but was pressured by clients. Over the last decade we have begun to realize that we were probably too aggressive and probably actuaries, particularly in public retirement systems, are beginning to really question whether or not a 7.5%, 8%, or 8.25% can be supported. **At the end of the day it is not the assumptions that matter. It is what actually occurs that matters. Regardless of whether we assume 7% or 8% or 9%, what is going to dictate the cost is what we actually earned.** I believe it is prudent for the actuary to use something that is a best estimate of what we can earn, because if we use something significantly higher than what we are going to actually earn, we will have generational cost shifting.

**Napper:** We are going to talk about this much more.

*Mr. Steven Stockstill, FRS executive director, came to the witness table to provide testimony.*

**Stockstill:** The inter-generational cost shifting is certainly a discussion that is healthy to have. There is one other component of cost shifting that I think you need to include in that equation and that is that intergenerational cost shifting presupposes one debt that is paid across generations of a plan. That typically is born by the plan as a whole, and all paying components of the plan go toward paying for that one debt. By the same token there is another concept that is the flip side of that coin that is the **inter-employer cost** shifting. That is something that I wish you would really take a close look at because - I will explain what it is and explain why it is important for you to address and perhaps even legislatively. Inter-employer cost shifting is where you have what FRS, MERS, and MPERS have - we are multi-employer plans - we are not single-employer plans. For FRS we have 120 employers that participate. If one employer does something that causes a cost impact to the plan, then in theory, all the employers share in that cost. We presently have a lawsuit pending in Natchitoches right now where they allegedly did not include the appropriate earnings for purposes of making contributions to the retirement system. The employees sued, and that is in court right now, and they sued as a class-action. That means if the employer is held liable then the employer would have to make a lump-sum back payment of the correct contributions and we would have to correct the benefits going forward, which is going to cause a liability. Because of that one employer, if they are held liable, then Lake Charles is going to pay for that and so will Denham Springs, and all the employers will, because of an internal administrative error in one employer all of the employers will pay for that one employer's error. I think that causes an inter-employer cost shifting, whereas instead of isolating that cost to that one employer who made a mistake, all employers bear the risk. In that lawsuit we called Mr. Curran to testify along with our system's certified public accountant (CPA) and the chairman of the board regarding the inequity of doing that, saying that the court should isolate that cost, but there is no law on the books giving the courts authority to do that so we are not sure how that is going to unfold. We also had Mr. Curran testify with regard to those things that are appropriate for inter-employer cost shifting and those things that are not appropriate. If you do decide to get into a discussion of inter-employer cost shifting as the flip side to the token of intergenerational cost shifting, then you may want to ask the actuaries about what is appropriate for sharing costs amongst the employers. I think that is an important part of the discussion.

**Napper:** That concept would include - how many [employers] did you say you had, 120? - if sometime during this year 15 of them could not make their payments, you would have the same situation.

**Stockstill:** That is correct.

*Mr. Tom Ed McHugh, executive director for the Louisiana Municipal Association (LMA), came to the witness table to provide testimony.*

**McHugh:** It is certainly not what I wanted to do this morning - I was waiting for later on in the process before I put my two cents in but ...

**Napper:** I think we are already at "later on".

**McHugh:** I think we are later on in this respect: Mr. Stockstill, being an attorney and me not being one, I am not going to talk to you about legal issues, but I can assure you the reason it is in the court is because they have some points on both sides that are very important to the process. If you will look at, if you are going to consider all of the factors, maybe you want to look at the complexity that the state imposes upon local government as it relates to fire and police and municipal civil service, retirement, and all the other issues intermixed in that whole equation. Natchitoches did not do that because they wanted to do it. Natchitoches did it because it is a complex process, and it was a misunderstanding that many of our communities have. FRS was very much aware that there were some discrepancies across the state on that issue, and they were aware of it for a long period of time. When you start looking at those issues and you have clouded the water with a court case, it bothers me a little bit, and I felt like I needed to come up and make sure we understood that.

**Napper:** Thank you, and I hope what we would recommend would apply to all of the systems and would not create any inter-employer problems.

**Sullivan:** Back to where we were before, we were talking about what is actuarial soundness. The four points that I made based on what the actuaries have informed me is that, at a minimum, you have to be able to accurately identify and measure your assets and liabilities at regular intervals, you have to have a methodical, systematic plan for assuring you have assets to cover those liabilities, the plan has to be reasonable in both the amounts and timing of required contributions and not unduly dependent on generational cost shifting - and that would be in consultation with the actuaries and any other entity that has oversight - and you have to have a mechanism for enforcing the contribution requirement if there is a default. A system could have these four characteristics and still have some structural problem that still makes it not actuarially sound but if one of these components is lacking then the lack probably causes the system to be actuarially unsound. As the panel goes forward, you are supposed to be making recommendations for increasing the actuarial soundness of the system, and I would submit that these are four things to think about. ...

**Napper:** We are going to move on to the next part of this procedure: affordable benefits.

**Sullivan:** The panel is charged with giving recommendations about providing an affordable benefit, and the panel needs to decide what that means. You may also want to talk about "Affordable for whom?"

**Napper:** Does anybody have any ideas or comments at this time about affordable benefits?

**Roach:** When you talk about affordability, I assume what we are talking about is the rate that the employees and employers contribute.

**Napper:** We are also talking about the actual benefit itself. Part of this problem we are in is a question of how much we can afford - that is the other side of "What is an affordable benefit." For example, a hypothetical example, this panel could recommend, I guess, that we reduce benefits. I don't know if that would ever happen but that is part of the question that we are dealing with here.

**Roach:** Affordability is in terms of how much we pay in and how much we pay out, would that be fair to say?

**Napper:** It is a product of what the rates are and what the accrual rates are and so forth, that is correct.

**Roach:** If you want to talk about affordability then you would also factor in the retirement age. Fire and police retire with 20 years at any age, am I correct? Okay, 20 at age 50. That is a part of the equation.

**Richmond:** The three retirement plans under discussion have several levers that help determine cost. One is the "benefit multiplier" or the "accrual rate". The other is the FAC period, whether it is three, four, or five years. The third is the retirement eligibility age for un-reduced benefits - the earlier someone retires, the more costly the benefit is. Those are the three primary levers of cost and depending upon where you set those factors will dictate the cost.

**Roach:** On the issue of affordability, hypothetically, if you take the schedule for retirement with MERS [for instance] and 10 years at age 60 - if you said 15 years at age 60, from an actuarial standpoint, does that make any measurable difference in terms of the contribution rate?

**Richmond:** The short answer is yes because you would eliminate some people from being eligible to retire and that reduces cost. If you allow them to retire at age 65 with 10 years you essentially eliminate five years of payment to those people, so again, that reduces cost. One of the things I think would be helpful would be if we come back from this meeting with some numbers - give the panel some order of magnitude of some of these levers - of what the implications would be.

**Napper:** We are going to try to do that. Another comment I have is, as we do things and recommend things, we need to look at the other side of the equation. Is the benefit affordable?

**Rust:** I don't want to jump ahead of schedule but, the way I look at it and the way I think most of our board looks at it, is it's not any different than buying any other product, like a car. There are various types of cars - you can afford some and can't afford others. Some have more accessories on them than others and some of those accessories you can afford and some of them you can't. You still need transportation - you still need a retirement system, but it's kind of how you put it together that creates a product that is usable and economical. We focus on that a lot because we are a voluntary system and if it doesn't provide those people can exit stage left. Because we are kind of flailing around a little bit about what are the costs and how does this affect it - I don't know where Mr. Curran is going to come in on this whole thing - but he did a presentation for our board at the last board meeting articulating exactly what factors affected cost and if you changed some of those factors what effect it would have on the total cost of the system. Not so much for employees - employee [rate] is frozen now legislatively, but it was extremely helpful for our board, and I think would be for this committee as well.

**Napper:** We are going to have that. That is a good analogy - Miss Sullivan has shared one with me, and I'll ask her to share it with you all as well.

**Sullivan:** This week the analogy of what is going on at the retirement systems is about your pants. The benefits are your lower body and the pants are the assets. The last time that things got a little snug, even with the elastic, your actuaries let the seams out as far as they could. I am going to talk about benefit and contribution structure, and Mr. Curran is going to give the first half of the presentation that he gave at MERS today, and in October, he and Mr. Charles Hall will give the second half of that MERS presentation, but for all three systems. It will show how when you press on certain levers - the levers that Mr. Richmond talked about - what happens to the retirement system. At this point, because the pants don't fit anymore, you either have to lose weight or you have to get bigger pants. The system costs what it costs. You can't adjust the cost of the system without reducing the liability. Anything else is a cost shifting - letting the seams out, adding some elastic, or wearing your shirt tail out. What I hear Mr. Napper and Mayor Roach saying is that what this panel is focusing on is whether the cities can pay for the benefit structure as it currently exists.

**Roach:** I don't want to speak just for the cities because I feel like I have a responsibility to the employees and the taxpayer - at the end of the day it's the taxpayer who is footing the bill - but the employees do contribute to that, and it's their benefit and they do have a contribution so I don't want to overstate the cities' role. **I think the crisis has been driven in large part because the employees' contribution is fixed and doesn't change and the employers' is floating and that is what has created the crisis.** I think irrespective of why we're here - we would be here if both of them were fixed by statute because the system would be going broke. So I think we have to look at it in the context of we are all in the same boat together, we all have a vested interest in making sure that this system works. It would be terrifically unfair to the employee to allow a system to continue - rock along, patch it here, patch it there - simply to get a contribution rate down and have the system go bankrupt in the middle of their retirement. Nobody wants that to happen. It's unfair to the taxpayer to expect them to pay more taxes or to suffer less services if there are other alternatives and other things that need to be done. I think one only needs to look at the paper and see what other states are doing and other states are taking drastic action. I think we all recognize that is something that we are going to have to deal with sooner or later. I don't think Louisiana is alone in this problem. Other states are acting and taking initiative, and we need to be able to do that as well.

**Napper:** Very well said.

**Sullivan:** If you will look at the side-by-side eligibility and benefit calculation comparison - the formula for benefits involves looking at the FAC, the years of service, and the accrual rate. You can see that MERS Plan A has a 3% accrual rate and Plan B has a 2% accrual rate, whereas MPERS and FRS have a 3.33% accrual rate. Certain elected officials at MERS have a higher accrual rate - I think it is an extra one-half percent - elected officials in Plan A are at 3.5% and in Plan B are at 2.5%. You can see the employee contribution that is set in statute for MERS Plan A is 9.25% and Plan B is 5%. MERS Plan B is the plan in which the employer participates in Social Security as well as having this "reduced" defined benefit (DB) portion of the compensation. The statute provides that both FRS and MPERS [employees] pay 8%, however, in Act No. 465 of the 1991 Regular Session, MPERS received the "25 [years] and out" and at that time the MPERS contribution was set at 8% with the understanding that they would pay 8% instead of 7.5% for 30 years or until the system was 100% funded. When the system reached 100% funded the actuary automatically moved the employee contribution rate down to 7.5% and there is no place in the statute where you can find that - it is just in an uncodified Act. MPERS has been paying 7.5% since that time but the statute still says 8%. All three of the systems receive money from other places besides the employee and the employer [contributions] and the investment earnings. At MERS it's not that much - they receive ad valorem and revenue sharing - but FRS and MPERS share in the Insurance Premium Tax Fund (IPTF) that we talked about last time. FRS gets about $6 million for mergers and then both FRS and MPERS get about $15 million to help defray the cost that would otherwise be borne by the employers. When you look at the employer contribution rate each year - it's a little easier for me with MPERS and FRS because they use a formula that separates the "normal cost" from everything else. If you look at FRS and MPERS you will see I have divided the employer contribution into a portion that's this year's accruals and a portion that's for past plan experience. At MERS - I think the way Mr. Curran usually says it is that they dump everything into the normal cost - but I asked Mr. Curran to give me a break out of if we had to take the employer contribution and show the piece that is being paid for this year's active employees to accrue this year's benefit, and the other piece of that normal cost and the UAL payment that's due to past plan experience, and he broke it out in the chart. For Plan A the employer contribution for this year's accrual is only about 2.5% of pay and about 11.28% is a contribution for past "stuff". In Plan B the amount for this year's accrual is below 1% of pay and the contribution for past plan experience is a little over 5%. You can see that something that was referred to earlier that the actuarial interest rate, the valuation interest rate, the actuarially assumed rate of return (AAAR) at MERS is 8%, and 7.5% for FRS and MPERS. FRS and MPERS did have a 7% AAAR - and remember this goes both ways. That's the interest that we assumed you would earn on the assets that you have, but it goes to the other piece too. If we have a deficit - the assumption is if we had your money we'd be making 7% or 7.5% or 8% and so that's the interest rate you're charged on the debt that's owed when the amortization payments are calculated. At MERS there's a five-year smoothing period, and you can think of smoothing as the time it takes to recognize something that happened - a certain event in a single year - we take five years to begin to recognize that at MERS and FRS. At MPERS it's - I think the actuary talked about a three-year smoothing period - but I believe it takes actually four years for full recognition of the event. And that's a good event or a bad event - a positive or a negative. The amortization period tells you how long does it take you, well, how long does the event - positive or negative - continue to affect your contribution rate. At MPERS it's 30 years. And going back to the actuarial soundness requirement about not unduly depending on generational cost shifting, the Governmental Accounting Standards Board (GASB) does not allow an amortization period that's longer than 30 years. That's a way to sort of gauge that we're not unduly shifting the cost. It's not necessarily an absolute but it's one way to gauge it. MPERS is already at the longest amortization period that is allowed under GASB standards. FRS has a 15-year amortization generally, but last year in an effort to recognize that the cities were suffering some fiscal pressures they extended it to the longer of 15 years or 2030 so that the 2010 stuff is being amortized over 20 years and then the next will be 19, 18, until they sort of snap back to 15 years being the regular amortization period. MERS has a different valuation method, and I would defer to the actuaries about this but their valuation method involves funding everything, all the new stuff. They froze their UAL and all the new stuff is funded over the working lifetime of the present cohort of employees. You generally wouldn't have a problem with generational cost-shifting in that - the amortization for MERS Plan A is about 11 years and is about five years for MERS Plan B. Roughly 45% of the actives are over age 55 and that's why these amortization periods are so short, you are amortizing over the future working lifetime of everybody, and since half of your people are close to retirement that means that the relative amortization period is much shorter. The "tails" will be long, but you will pay the bulk of it in that shorter period. That's eligibility and benefit calculation.

**Roach:** Just one clarification - on your list, you've identified what is controlled by state statute and what is not?

**Sullivan:** No, I put in the statutes that control the employee and employer contribution rates.

***Miss Sullivan continued:*** I did not get a chance to analyze this for MERS and I'm really constrained by my experience with systems that have an actual UAL. MERS doesn't add anything to its UAL as a matter of funding but the next two tables are tables of contributions, one is for FRS and one is for MPERS. Again, this is what I pulled out of the [June 30, 2009] valuation. I asked Mr. Hall and Mr. Curran to review it, and I put some caveats on here. Some of it's a little bit of rounding. I didn't really prepare these numbers with regard to interest or administrative costs. The main thing to see is the way that things are shared. If you will look there are several columns, and I differentiate who pays - the employee, the state, or the employer and whether that gets applied to the normal cost or the amortization payments, the dollar amount, and the percent of this year's payroll. Then I divided out and show you who is paying which part of the normal cost, who is paying which part of the UAL payment, and who is paying which portion of this year's total payment. For both systems you can see that the cost structure this year is around 38% of pay. When you look at the share of the normal cost - and remember the normal cost at these two systems is this year's accrual for your actives - the share of the normal cost is about 65% / 35% at FRS and about 60% / 40% at MPERS. The share of the UAL is about 75% / 25% with the state paying 75% of the UAL at FRS and part of that is because the state is making those merger payments. Over at police you can see that the employers are bearing about 73% of the UAL payment. When you look at the total cost structure you can see that for FRS the employers are paying about 49% of the cost structure and the other 51% comes from the state and the employees. For MPERS the employers are paying about 67% of the cost structure and the other 33% is being borne by the state through the IPTF and the employees through their contributions.

**Curran:** On this whole thing of cost shifting and when is the appropriate time to pay for things, I think Mr. Rust's car analogy is really worth considering. Let's say an automobile has a useful life of seven years, who would really be comfortable buying the car with a nine-year note? That works all right for the first car. The problem is what happens when you need car number two? Now you are trying to pay it off and of course this was actually done in practice - this is what got a lot of people in trouble - when you start forwarding the sort of residual part of the debt on making purchases. This is what got people in trouble on equity loans with their homes, it got people in trouble with their cars, and it's gotten some people in trouble with their pension plans. The reason a lot of the corporate pension plans have blown up and destroyed some of the corporations involved is because of generational cost-shifting. If the cost is not ascribed to the current generation that means that when you get to generation number two it's trying to bear its cost plus a piece of generation one. Of course, unless it shoves that off to generation number three. Now the whole problem is compounded even more. Eventually somebody's got to pay. I think one of the difficulties we have is that process of generational cost-shifting is an enabler to sort of wallpaper over the true cost of what the benefits are - to make them look lower than they are by forwarding costs to somebody else. One of the difficulties I think we face is this sort of idea that governmental plans are perpetual, and we don't have to worry about those types of things. There is a kernel of truth in there but people thought about organizations like General Motors as being perpetual as well. It wound up being a pension plan that had a side business of building automobiles. The scope and size of the pension and health care plans became larger than the entire corporation. If we're not careful we could find the government in that posture. In fact the federal government is nearing that posture with Medicare and Social Security. I think trying to use them as an example is probably the worst possible case. One of the good things that Louisiana did was establish under the constitution the fact that we are to actuarially fund these retirement funds, and although we are in a very bad situation now with regard to cost and so forth, it would be demonstrably worse if we had not addressed the cost when we did and to the extent that we did. I think that's something we have to be very careful about. There's always this temptation to put off until tomorrow but eventually tomorrow arrives.

**Sullivan:** If you want to see an example of this you can look back at the table of contributions for MPERS and you can see that the employer's portion of the amortization payment this year is $40 million. That represents about 15% of pay. They have an amortization period of 30 years. They have some other credits that are involved in that $40 million and those credits are going to start to roll off and then there's the jump from the 15-year amortization to the 30-year amortization, so this amortization payment is going to go up and then it will start to come back down and if the system makes 7.5% forever and meets all its other assumptions, this payment is still going to have to be made every year for the next 30 years. That means this piece won't be paid off until I'm 75. The 30 years is the outside that GASB allows. So that's a piece that right now the employer bears the full brunt of that, and that has to be figured into what is going on. That is only the first part of the smoothing of the losses that the system suffered as of June 30, 2009. Whatever losses are acknowledged in the valuations to be presented in December will also be amortized over 30 years. So, if it's a credit, then that's great - it will reduce this amount. But if it's another debt, then that will be another 30-year amortization of some other amount similar to this that the cities will need to make up. MPERS went from a $200 million UAL to a $600 million UAL in one fell swoop. That's a huge amount of money but because you've got the 30-year smoothing period instead of the 15-year that is going to affect the employer's contribution rate for 30 years instead of 15. Is that a generational cost-shift? I don't know.

*Mr. Curran presented several PowerPoint slides (Exhibit A), beginning at approximately the one hour-seven minute mark of the recording: http://house.louisiana.gov/H_Video/2010/Sep2010.htm.*

**Curran:** ... What I'm trying to get across here is not the specifics - not the particular numbers - but more the qualitative size or the leverage - what affects these plans to a great degree and what items are fairly small in terms of impact. The item that affects all of these plans the most is asset performance right now. That is a function of the fact that the plans are relatively well funded. A very poorly funded plan - asset performance doesn't impact very much because if the plan is really poorly funded there's not that much asset there, and you don't have that much leverage. When you get a plan up to 80%-90%-100% funded, the assets have all of the leverage in the plan, and they are going to push things around. I think one of the unfortunate realities is that we've got some control on that by what you invest in and your smoothing period, but at the end of the day you are at the mercy of the markets. The markets have been volatile, and I think there's an expectation that we're going to see more volatility in markets, and we're going to have to deal with more volatility in the cost structure of the plans.

**Dean:** Is that true to all plans?

**Curran:** Qualitatively, yes. Certainly the numbers would be different for different plans but the general relationships are fairly true.

**Dean:** Which 1% shift dynamic had the biggest impact?

**Curran:** Assets, no doubt. We do the reconciliation process each year between what we expected to happen, and what really does happen. When we do that calculation of gain or loss it's usually separated into two pieces - asset gain or loss and liability gain or loss. Ten or 15 years ago the magnitude of those numbers were fairly close to each other. What's so much different now? Well, two things. Over the last 10-15 years the plans have gotten better funded. That increased the leverage of assets on the plan. The other part of it is the markets have gotten more volatile. Ten, 15, 20 years ago - most of the plans were in bonds. Most of the bonds were carried because of the accounting rules that amortized cost. You had almost zero volatility. You bought the bond, you put it in the safety deposit box, you sold it when it matured, and you knew at each point along that schedule what that bond would be worth. If it went up and down by the market it didn't really matter because you weren't going to sell it anyway. In the early nineties we started mark to market accounting and it's kind of a chicken and egg as to what drove things. When the accountants started marking things to market and you had this huge decrease in interest rates which ran the market value of the bonds up tremendously - you had systems that had 10%, 12%, 13% bonds in their portfolio - interest rates had collapsed down to a level of maybe 7%-8% lower - the market value of the bonds had increased tremendously. They became a sales point for the asset reps and consultants when they came in saying, "If you actively trade and mark them to market we can show you how to decrease your costs." In effect what we did was sell all of that capital and put it into the balance sheet at one time, whereas, prior to that, the profit was released at different increments and that means that you had a stable, predictable source of income. With the movement to outside management to achieve greater gains and the movement to put more equities into the portfolio what you got was more volatility in the process. The markets themselves became more volatile on top of that. That's meant that the big leverage item in the structure of the plan is the asset side.

**Dean:** I know Miss Sullivan said that we agreed last time to look at both short-term and long-term solutions to the current situation. Anywhere in your presentation did you focus on short-term? Because a lot of that seems to be hell bent on long-term, and that's not going to help the cities right now.

**Curran:** There is a limit to what can be done in the short run. We've got a cost structure which has evolved and is dependent on the benefit structure. What's been used in the past to deal with a lot of this has been to defer costs and part of the problem we face now is picking up the deferred cost from the past.

**Dean:** You've got to face it at some point.

**Curran:** Right. We're dealing with it sort of doubly because of that. I don't think it's all doom and gloom and I think to a certain extent we've avoided the worst case abuses of the cost deferrals. States like Illinois and New Jersey did not, and they're in demonstrably difficult postures with plans with really dangerous funded ratios and under new accounting rules a lot of those funded ratios are going to decrease significantly. Remember, GASB is studying a new revision to the accounting rules and that's going to have an impact also on the reported liabilities of these plans. It really won't directly affect the funding but it is going to affect what appears on the cities' balance sheet in terms of liabilities and unfunded liabilities and costs. Probably within the next three to five years - as that new GASB standard is promulgated that will be an additional concern to the entities that have to deal with those reported liabilities on their balance sheets.

**Napper:** I will tell you, as one who deals in the financial realm, that will affect your credit rating.

**Dean:** Is long-term a relative term or can it be defined?

**Curran:** It's definitely relative and **one of the problems we face is that the horizon for the liabilities is always much longer than the horizon that the asset consultants are comfortable dealing with.** Long-term for an asset guy is five to seven years. Long-term for us is 50-60 or 70 years. When you look at the life of these plans - one of my clients is [dealing with liabilities of] a pension plan that closed to new entrants in 1980 - it's likely that the plan will continue to exist for another 40-50 years when the last survivor of the last participant finally dies. That's how long the tail on the distribution is.

**Roach:** ... You said as far as the 1% changes that you were describing that had ... the most favorable impact would be when you consider the affect on assets, is that correct?

**Curran:** The strongest impact is the asset side, right.

**Roach:** But your assumption was that those changes would affect only new hires ...

**Curran:** No, for the asset calculations, they involve the entire block.

**Roach:** But I'm talking about in comparing it to the others ...

**Curran:** You're talking about in terms vis-a-vis benefit restructuring?

**Roach:** Correct.

**Curran:** Benefit restructurings typically are done for new hires. We've had at least one plan in the state - the Clerks' of Court Retirement and Relief Fund (Clerks') - which this year adopted a benefit restructuring for the existing cohort and that was a change to five-year FAC for that group. **Even very significant cuts to new hires are not going to result in immediate significant reductions in the cost structure of the plan.** It ultimately will, but ...

**Roach:** You just said new hires - you're talking about new hires or you're talking about existing?

**Curran: What I'm saying is even severe cuts to benefits for new hires will not result in immediate, sharp reductions in costs of the plan.**

**Roach:** What about to existing?

**Curran:** Just on a magnitude basis we've looked at very little of that. There's certainly legal constraints to what can be done for existing hires and there's probably going to be a legal fight or dispute on what has been done in the case of the Clerks', but by way of example - and we did do this study for MERS - if we did a phased-in forward change from a 3-year to a 5-year FAC for MERS, it was about a 2% and a fraction immediate cut to costs to the plan at large.

**Roach:** I understand the legal question or issue when you make a change that affects the existing employees. I guess this is really a legal question as opposed to an actuarial question, but I would think at least you could consider - or we at least should maybe answer the question as to whether or not you made a change with respect to those existing employees who are in the system who have not vested in the system.

**Curran:** I don't know whether that threshold of being vested matters an awful lot. It may. Also, in the past there have been some court decisions that have defined vesting in a rather peculiar way. There have been at least some decisions that have defined vesting in such a way that you're not vested until you're actually eligible to retire. That could be another subset but that may beg the issue anyway. I think the real issue will stand or fall on the interpretation in the constitution, the guarantee of accrued benefits, basically saying whatever you've earned is protected. Then the question mark is what about those benefits you have yet to earn. Are they [protected] or not? I think litigation will ultimately settle that issue.

**Roach:** Or a constitutional amendment.

**Curran:** Possibly.

**Roach:** That may help us in trying to deal with some of these issues.

**Curran:** I can just tell you that at large there are jurisdictions now outside of Louisiana that have looked at some of these issues and things that would have been considered totally off bounds or not under consideration - because the plans in some of these cases are just in danger of collapse - they've had to go forward with things that years ago they would not have considered.

**Roach:** You mentioned something a moment ago that I've always had a problem with for other reasons in other situations, but when you talk about "mark to market", can you kind of enlighten us as to how that rule applies within the retirement systems today?

**Curran:** The raw assets that are fed through the system are on a market-value basis. This was a result of the shift from GASB 5 to [GASB] 25. Part of it's a function of the accounting rules. Part of it's a function of the asset reality. If you sort of rewind the clock to the early 1980s or 1970s, almost all of these governmental and private systems had migrated more to equities. Certainly the statewide systems and even the state systems to a large extent in the early 1980s were mostly fixed income securities. Historical reasons for that were that it was just felt more appropriate for pensions. The cash flows were predictable and dependable. In particular it was a very attractive situation by the mid-1980s because you had the best of all possible worlds - high bond yields, inflation was somewhat tamed, and you could get a really good rate of return on bonds that was virtually guaranteed.

**Roach:** My question would be is if we're marking to market your portfolio and it's not a portfolio that is available for sale - it's a hold-to-maturity portfolio - are you marking that portfolio to market?

**Curran:** I don't know that we have any hold-to-maturity portfolios anymore. There may be a few exceptions to that but keep in mind, with regard to the statewide systems with one exception that

I'm aware of, all the asset management is external and the turnover on those portfolios - what they describe as long-term or low turnover would be rates of maybe 25%.

**Roach:** The concern I would have is if we're marking everything to market and as a practical matter you're going to ... hold that investment as opposed to selling it, by marking it to market when there's no other evidence of the impairment of the security ... then that can create part of the problem.

**Curran:** I think it has but I think the only way to avoid that would be to have a dedicated portfolio with the idea that it would not be turned over. If you wanted to transition to that now the coupon yields on the fixed-income securities available just would make it untenable, really. We could have done that - we could have put up dedicated portfolios in the early 1990s and immunized, in effect, some of the liability structure of the plan, but if we attempt to do an immunization now at the interest rates that are available it would be cost prohibitive. We could get rid of a lot of the volatility that we have but the cost to get rid of that volatility is, under current market conditions, it makes it not do-able.

**Roach:** We can discuss that another day ... if you had in your portfolio 7% bonds and just because the bond market has gone to the dogs you have to mark it down, but you're not going to sell that 7% bond. You'll continue to collect it - it's triple A and it's secured - why do you have to mark it to market?

**Curran:** I don't think you do.

**Sullivan:** I'm just trying to clarify a little bit. There are two provisions in the constitution with regard to the benefits. One is that the accrued benefits of members of any state or statewide public retirement system shall not be diminished or impaired. Generally an accrued benefit is something you earned in the past. There is also a provision that says that membership in any retirement system of the state or of a political subdivision thereof shall be a contractual relationship between employee and employer, and I would ask Mayor Roach to be clear about whether he is talking about changing the protection of past earnings or perhaps changing something on the contract. I know that Mr. Curran was trying to make the distinction that in some other states what the constitution protects is benefits. Blanket benefits, not "accrued" benefits. Our constitution makes the distinction that it is the accrued benefits that can't be diminished or impaired. The contents of your contract might have a greater protection than just your past service accrual. Accrued benefit means past service accrual.

**Curran:** Yes.

**Roach:** I didn't know how to answer the question from a legal standpoint. I think it's probably something that we need to take a look at because obviously there's a legal implication when you talk about adjusting existing benefits, and that will probably be a question somebody's going to ask at some point - did you consider making any adjustments to existing - and if the reason that we can't do that is legal and constitutional or whatever, then we need to be able to say that.

**Sullivan:** Let me make a distinction. The only thing we're talking about is future benefit [accruals], whether that is for new hires or for existing employees. You're not talking about existing benefits which have already been accrued [as a result of past service].

**Fredieu:** Mr. Curran, according to the figures I've got here, the spike in the employer's contributions for this past year was 7% for FRS, which amounted to about $12.2 million. At that particular point in time we had no idea what our portfolio was going to bring in but in fact it brought in somewhere around $45 million, which is almost four times as much as what the spike was. What will that do to the employer contributions for successive years? Will that be spread out or will it come down significantly or what? There's a lot of difference between 1% of the portfolio and 1% of the employer contributions.

**Curran:** Mr. Fredieu, I can't answer you in terms of dollars right now, I just don't have that in front of me, but qualitatively that gain is going to get spread just like the loss got spread, over a five year time frame. It's going to obviously decrease what the rate would have otherwise been had we earned 7.5%, no question about it. Let me say one other thing about volatility and leverage because I think it's important to understand this as well. Let's say you have a plan with 40% of pay cost structure to it and let's say the employer piece of that is 10% of pay and employees and state taxes are paying the other 30% of it. If the cost of the plan goes up 10% from 40% to 44% then because of the way the cost is structured, the employer piece - being the only "elastic" piece - will go up 40% because the other pieces are static ... the employer says "Why is my cost going up 40%? Is the cost of the plan going up that much?" The answer is "no", but the impact is being magnified because the only elastic part of the equation is the employer contribution. The other pieces of it are static. And the reverse is true too ... when costs collapsed ... because of extremely good performance ... the employer's cost might have shrunk down to virtually nothing or got cut in half, and then that became an incentive for benefit increases because it looked like the cost had shrunk so dramatically. This sort of magnification of impact goes in both directions because of the way the cost is structured - you have locked-in costs for the other components of the pay.

*Mr. Napper welcomed Senator Claitor to the committee.*

**Rust:** To the extent that we were talking about mark to market and just having lived through a bunch of these in my lifetime - the markets have changed. This would not have affected retirement plans ... back in the old days by very much because of accounting rules. The fact of the matter is that the mark to market problem exacerbated what had actually happened in our portfolios because of the types of assets we all own now. In 2008 and especially in 2009, those markets ceased to function. You couldn't get a quote because of what was [happening] on Wall Street - there was value there but it wasn't being recognized in a portfolio and unfortunately that's going to go into your cost structure. The problem now is that ... if I have a 7% bond ... and we bought it at par and interest rates go down to 4% ... I'm still getting 7%. But your actuarial assumption is 8% so you are still losing. You may get a mark up in the bond, and that's temporary but that's not going to drain the swamp. As a board, the board has to look at what asset mixes have the greatest probability - not of maximizing your return - but of making your actuarial assumption.

**Roach:** We can talk about mark to market and all of that all day but the point that came to my mind when you said that was that you could almost ... mark to market has now had somewhat of an adverse effect on the overall cost structure of the systems because everything has been depressed. I would almost be worried about a mark to market situation when everything inflated - in other words you have that 7% bond and then interest rates go to 9% and then the value of that bond is marked down. Mark to market - I have concerns about that rule. I understand the rule from an accounting standpoint as it relates to banks and financial institutions like that but I just realize it does have an affect on us ...

**Rust:** The accounting profession wants us to assume that we will liquidate the portfolio in the short run. That's not going to happen and I think that's a real flaw in the way the accounting profession looks at it. The real risk to the retirement systems - and it's one we've seen and it was kind of camouflaged in the 1980s and 1990s because of a strong equity market - the real risk ... is fixed income when you have a situation like you talked about is reinvestment rate risk. You've got 7% bonds ... it goes up in value slightly for awhile, but as it gets closer to maturity that appreciation you saw is going to give way and now you are forced to reinvest your 7% coupons at much, much lower rates. So you are further behind.

**Sullivan:** Mr. Curran's going to talk about COLAs ... MPERS has not given a COLA in quite some time but he is going to talk specifically to the last COLAs that were given by FRS and MERS. **Just to be clear, in Louisiana, in all of our retirement systems, the employers bear the full cost of any COLA.** Because they are on an ad hoc basis, necessarily a COLA is a benefit that is not paid for during the working lifetime of the people who receive the COLA. Mr. Curran can tell you more about the mechanism and where we are on that and how the boards went through their procedure to give the last COLA.

*Mr. Curran presented several PowerPoint slides (Exhibit B), beginning at approximately the 1 hour-57 minute mark of the recording: http://house.louisiana.gov/H_Video/2010/Sep2010.htm.*

**Rust:** The target ratios were put in place as a mechanism to control the growth of the UAL, is that correct?

**Curran:** Yes. Keep this in mind, the timing is important to understand why this was done. In 1986 when it was passed we did not have actuarial funding of the systems. What was going on in 1986 was you had the DB [defined benefit] plan [liability structure] and a defined contribution [funding structure] - we just put an arbitrary amount of money into the plan every year. The legislature looked at and it was pretty grim because that arbitrary amount of money in general was not enough money. The UAL in a lot of systems - I'm generalizing here because it's not true for every system - the UAL was growing, and there was a concern about it and they didn't know what to do about it but they felt like we'd better at least do something about the situation getting worse and part of that is let's put some kind of control on the COLAs because they were perceived to be part of what was driving the process to get worse.

**Rust:** That's my question with regard to MERS, if there's a COLA, what effect does it have on the UAL?

**Curran:** As far as the UAL, none, because of the way MERS is funded. It goes right into normal cost.

**Rust:** So what is the relevance of the target ratio in MERS since any COLAs don't show up in the UAL?

**Curran:** The relevance there is that it is a device to moderate increases in the normal cost - to moderate the increases in the cost structure of the plan. The UAL per se - it has no affect on it, but it does have an affect on the normal cost.

**Rust:** Yes - everything we do has an effect on the normal cost.

**Curran:** It's functional to a benefit increase or an asset loss or gain - all of those things are affecting your normal cost.

**Sullivan:** Two things, Mr. Curran - I want you to talk about who is eligible for a COLA in these two systems so that people get an idea about that because you can change COLA eligibility as well ... to affect the cost of the system ... In the constitution now the target ratio was put in place before the 1987 amendment requiring actuarially sound funding, but in the provisions about actuarially sound funding there is a provision that allows COLAs to be granted to retirees as provided by law provided the retirement system is approaching actuarial soundness and the granting of such increase does not cause an increase in the actuarially required contribution rate. ... The UAL was not the only thing looked at by the legislature with regard to COLAs but also how does it affect the contribution rate. The caveat in here is that you can do these things as long as doing these things does not cause the actuarial present value of expected future expenditures to exceed or further exceed the sum of the current actuarial value of assets and the actuarial present value of expected future receipts. The COLA could be given even if the funding - even if it doesn't have anything to do with the UAL. There's a measurement also that does the COLA affect the contribution rate or does - as long as you're getting the expected future receipts you're okay. Pushing up the contribution rate meets the beginning, but COLAs can even be granted if they don't affect the contribution rate even if you don't increase the expected future receipts. By function of the normal cost - by everything ending up in the normal cost - you do affect the contribution rate at MERS when you give a COLA.

**Curran:** You are going to affect the contribution rate for anybody when you give a COLA post-1989. The whole problem when you start facing that period between 1986 and 1989 was you could grant the COLA and not increase your cost and of course then you've got ... an additional UAL and no mechanism to pay for it. When the constitutional change was made in 1989 the funding mechanisms became automatic so that if you grant the COLA it became part of the cost structure of the plan and was put into the contribution rate to offset that cost. Each system has its own COLA provisions but there is one provision common to all systems as well, and that's you can grant a COLA to people over the age of 65 in the form of 2% of their benefit and that's applicable - it's 2% of their base benefit and it's applicable to FRS, MPERS, and MERS. Generally that COLA is less costly because it affects less people. ... In the case of MERS ... there's a system-specific COLA in MERS which is ... 2% of the original benefits for persons who have been retired one full year. In the case of FRS, that system-specific COLA is 3% of the current benefit for persons who have been retired for one full year. There's also what's referred to as the A+B COLA which I'm not sure that - in theory at least could be granted in lieu of the other COLAs - and that is a COLA of $1 per year for each year of service and each year of retirement. So that if a person had 25 years of service and had been retired 10 years they would, under this formula, would get $35 per month. A COLA in that form has not been granted by either FRS or MERS. It's available instead of the other COLAs but the boards have never chosen to do it.

**Sullivan:** If you're retired one year, regardless of age, you're eligible for a COLA at these two systems?

**Curran:** Yes.

**Rust:** The only reason I wanted to mention that is because, with regard to MERS, and I can't comment on the others, with regard to MERS there's two things that have to take place in order for us to grant a COLA, and we take COLAs very seriously because our board writes those checks and we understand what that's all about. Number one is you have to actually earn the money to pay the COLA and that's in the statute and that's great. The other one is this artificial number which is the target ratio which for us is less meaningful because our UAL is frozen and any increases in COLAs don't affect that. They only affect the contribution rate of the normal cost so it's a real problem for us because we can get in a situation like we may be now where we - in years coming up if we have good years and have excess earnings - we can't grant a COLA to the retirees, not because we can't afford it, just because of that artificial barrier there. I don't think we'll be granting one for quite some time because we're concerned, not only about the retirees, but about employer costs. Our board - that's just how they work. But that artificial barrier which is irrelevant to us has an effect on our ability to take care of our retirees.

**Napper:** Mr. Curran, we sure thank you and we look forward to hearing from you again in the future.

**Sullivan:** ... We were going to discuss House Bill No. 1337 (Act 992 of the 2010 Regular Session), but I'll skip into a little bit of information until Mr. Tessier gets here. The panel is supposed to make recommendations with regard to the systems as a whole so what this panel determines is an affordable benefit for the systems - it may be that individual cities ... a particular employer might say "That's still not affordable for me under my present conditions." Because a single employer that's participating in these systems lacks the authority to alter the benefit structure ... they've got to either find a way to pay for the contributions or they may need to make other choices. Some employers in the statewide systems do actually pay their employees contributions for them. Some employers ... also have a match for any employee 457 plan or other deferred compensation plan and so an individual city might have to make choices about reallocation of their present revenues if this panel recommends, as an affordable benefit, something that the individual employer thinks is still unaffordable. An employer may have to make an individual consideration about raising revenues or finding a new revenue stream to dedicate to paying these retirement system contributions - which obviously might include assessments or fees or taxes or even some kind of bond issuance to pay the pension systems. If the employer finds that they still can't pay - if those options are not palatable - at MERS, those systems can get in and out of MERS. At FRS and MPERS, the statutes provide that participation in the systems is a condition of employment although specific municipalities are excepted from that requirement. The panel needs to consider whether it wants to make any statement to the legislature about what would happen to the systems if cities were allowed to get out. The cities would obviously have to get a bill that let them out of FRS or MPERS. This panel may want to consider whether they want to make a statement about how the cities should make these considerations and whether affordable benefit actually means that we can't afford not to compensate people in the form of a pension plan. Again, withdrawal from the two public safety systems would require legislative action. Mr. Tessier, with some help from Mr. Richmond, is going to talk about House Bill No. 1337 from the 2010 Regular Session which took the four state systems and provided just for two different sets of benefits - one set for people who are public safety services type people that are actually performing those hazardous-duty jobs - and one set for employees whose job duties do not include hazardous duty.

**Napper:** ... This is presented just to give you an idea of something the legislature has already done with respect to the state systems.

**Tessier:** ... Act 992 of the 2010 Regular Session was a comprehensive revamp of the benefit structure for members of the four state retirements systems hired on or after January 1, 2011. ... From what I've been able to gather from public discourse on the issues is that the legislature was essentially trying to achieve two goals, one of which was uniformity, and one of which was reasonableness, in the benefit structure. Uniformity, in that every member hired after that date across all four of these systems will have the same benefit, depending on whether they were hazardous duty or nonhazardous duty. Reasonableness, in that - even though there was a lot of compromise during the legislative process - all of the interested parties were able to, I think, agree that the resulting benefit structure was reasonable. A little background might be helpful in how the bill came about: the idea of changing the benefit structure was not a new one. In 2005, following a series of in-depth study sessions on the issue of defined contribution (DC) versus DB [defined contribution] plans, the legislature determined that in lieu of going to a DC plan, maybe there were some things the state could do to the existing DB plan to save money. The legislature passed Act 75 of the 2005 Regular Session, and it applied only to new Louisiana State Employees' Retirement System (LASERS) rank and file hires after July 1, 2006, so it did not apply to any of the special subplans in LASERS and didn't apply to the other three state systems. Some of the Act 75 notable changes were: retirement with ten years of service at age 60 - with that being the only available retirement eligibility going forward, going from a three to a five-year FAC, increasing the employee contribution rate from 7.5% to 8%, and the anti-spiking provisions went from 25% to a 15% limit on the increases that you could receive during your FAC period. That was Act 75 and that only applied to a certain group within LASERS. In 2009, the House and Senate Committees on Retirement jointly conducted yet another series of studies on the DC versus DB issue and during those meetings it was noted that Act 75-type changes across all four of the state systems might have some kind of cost-saving impact. That's a little bit of the backdrop against which House Bill No. 1337 was filed, and even though it was an extremely lengthy bill, the concepts of that bill are extremely simple: make one benefit structure for hazardous duty and one benefit structure for nonhazardous duty, and the benefits have to be reasonable. For nonhazardous duty personnel there were several changes made: five years of service at age 60 as the only regular retirement eligibility, 20 years of service at any age eligibility with an actuarial reduction, five-year FAC, 2.5% accrual rate, employee contribution rate of 8%, 15% anti-spiking provision, and disability provisions that mirrored what was already in LASERS. The survivor benefits were modeled after what was going on in the Teachers' system ... the simple version is if you have a surviving spouse with children that person will get 50% of the retiree's benefit. For hazardous duty personnel, the retirement eligibility was set at 12 years of service at age 55 and 25 years of service at any age, and again the 20-year early retirement with an actuarial reduction. The FAC changed to five years, the accrual rate was set at 3-1/3%, the employee contribution was set at 9.5%, the anti-spiking was set at 15%, disability for in-the-line of service was set at 75% of FAC, and disability for not-in-the-line of service are the same as the nonhazardous duty people. Survivor benefits for a death resulting from action in the line of service was set at 80% of FAC, and for a death sustained not in the line of duty was the same as in the nonhazardous group. Finally, one of the biggest changes that was made was that for a retiree that dies, there was no longer the availability of optional allowances, meaning, when you go to retire you can no longer choose to leave a certain amount to a certain beneficiary. If a retiree dies, it's very simple, the surviving spouse gets 75% of the deceased retiree's benefit. If it happens to be a member who had reached the proper years of service but not the requisite retirement age, the surviving spouse would get 50% of the retiree's benefit. This is all for new hires on or after January 1, 2011.

**Napper:** ... the employee contribution rate for both groups that will be put in place on January 1 - were the contribution rates lower than that - were these increases?

**Tessier:** It depends on which group you are talking about. Some of the subplans in LASERS already had a 9.5% employee contribution rate, but corrections officers and alcohol and tobacco control agents had 9%, bridge police had 8.5%, and it was 8% for hazardous duty workers who weren't in one of the special hazardous duty subplans.

**Napper:** So, for some of these prospective employees, it's a fairly significant increase.

**Tessier:** For most of them, yes.

**Napper:** And what about nonhazardous duty?

**Tessier:** LASERS and Teachers' already had the 8%. It was an increase for Louisiana School Employees' Retirement System (LSERS) from 7.5% to 8%. For the State Police it was an increase from 8.5% to 9.5%.

**Napper:** Will you explain what a 15% anti-spiking provision means?

**Tessier:** That just means that when you take your period of final average compensation - say it's five years - when you look at averaging out your earnings for that five years to calculate your benefit, the anti-spiking is a percentage "cap" on the amount that your earnings can increase in that five years for calculation purposes. Say you have a certain amount of earnings for your first year, your second year you can't have earned more than 15% more for calculation purposes, and the third year you can't have earned more than 15% more than your second year's earnings, and so on.

**Napper:** So if you were to get a salary increase of 20% in one year, 5% of it would just not count for these purposes, is what you're saying.

**Tessier:** Right.

**Rust:** ... After this was passed ... how much did this move the needle on employer contribution rates, do you have any idea?

**Tessier:** I think Mr. Richmond could speak to that - he did a lot of modeling for his actuarial note.

**Richmond:** This bill was a challenging bill to come up with cost structures ... I think there is a widespread impression that state employees get a free ride on their benefits ... that they get all of these wonderful benefits and they don't pay for it ... when actually what happens is the employee contribution rate of 8% covers a very large percentage of the actual cost of the benefit that's being delivered. **For the regular, nonhazardous duty personnel**, the employees may be contributing 8%, but for new persons hired the employer may only need to be contributing 2%-3% throughout their career and then by the time they retire there will be enough money there to take care of their benefits. **The bottom line is the employee [paying 8% and accruing 2.5%] is paying for the vast majority of the cost of the pension plan that's being delivered.** When we went to reduce the benefit structure for new hires, that was one of things that we had to contend with was, you can't reduce the benefit too much because then you'll end up with employees paying more for their benefits than what they're earning, essentially penalizing people. So that was some of the balancing we had to do. That was part of the balancing that occurred with setting the employee contribution rate at 8% for nonhazardous duty and 9.5% for hazardous duty people. ... At the end of the day ... we looked at what would be the annual dollar savings in employer contributions to the system in 20 or 30 years from now when every existing active member is no longer with us and all we have is a group of employees who are "new" as of 2011. What would be the cost savings when everyone who is hired [on or] after [January 1,] 2011, comprises the entire work force? That turned out to be a savings of roughly $70 million a year. Then we looked at how rapidly does the employee work force turn over? We looked at each of the systems and the various types of employees and based on the data we made some assumptions as to how rapidly the work force replaces itself. ... that was how we developed the five-year phase in of cash-flow savings. That's basically the process that was used to come up with the actuarial cost or savings.

**Rust:** I may not have phrased the question properly, let me be more specific. Ms. Westgard (Maureen Westgard, Executive Director of the Teachers' Retirement System of Louisiana), what is the employer contribution rate for Teachers' for this coming year?

**Westgard:** The rate for July 1, 2011, will be 20.2%, that's broken down into the normal cost which is about 5.75% ... and the remaining payment towards the UAL. ...

**Napper:** Do you know what your contribution rate would have been had this act not passed - I think that's the question. ... Do you think you will have that in the future?

**Westgard:** I can certainly ask Ms. Johnson (Teachers' actuary) to take a look at that. ... Recognize that ... it's a future implementation and is affecting future members and so that is a slow process to gain that "savings".

**Napper:** Mr. Rust, it appears that we have some dollar amounts but no ...

**Rust:** We've been talking about long-term and short-term relief and this is certainly a blueprint for long-term relief and I was just curious what the short-term effect would be ...

**Richmond:** The short-term is going to be small ... that is one of the problems with only applying these changes to future hires is that it takes a long time before the savings are realized.

**Pearson:** In the last couple of years, the cost of the two COLAs - of this 20.2% ... what is each one costing in today's contribution?

**Westgard:** I have it by dollar, I don't have it by a contribution rate. The COLA given in 2008, which was a regular, 3% COLA - a little over $304 million for Teachers'. The COLA given this past year, which was more of an increase to the minimum benefit and could not exceed a $300 increase ... that one only impacted 702 members so the cost was quite a bit less - $5.6 million.

**Pearson:** Can you estimate - that one 3% COLA across the board - is that 1% of the 20.2%?

**Westgard:** Again, that's more of an actuarial question ...

**Pearson:** I guess any COLA is going to create an immediate cost for a system ...

**Richmond:** In some analysis that we did for a piece of legislation that was introduced this last session - **we've estimated that past COLAs ... the amortization costs for those ... are about 3% of pay.** We expect it could very well be that if we continue to offer them under the current semiautomatic COLA structure, **that could very well go up to 6% of pay as an annual cost to the retirement system.**

**Pearson:** Which is significant.

**Richmond:** It's significant.

**Pearson: All, in essence, borne by the employer.**

**Richmond:** Borne by the employer, yes.

**Pearson:** Mr. Richmond - all of the calculations ... everything that you say is all based upon earning this actuarial rate of return.

**Richmond:** Benefits = contributions + interest. If you don't make the earnings you're going to have to pay it in contributions.

**Pearson:** When you were talking about the new employees ... that they were in essence paying their entire benefit.

**Richmond:** They're paying a large share of it.

**Pearson:** But once again, that is based upon ...

**Richmond:** Yes, based upon an assumption of earning [8.25% for LASERS and TRSL, 7.5% for LSERS and State Police], that's correct.

**Pearson:** Which is a little uncomfortable to some actuaries.

**Richmond:** Yes.

**Roach:** I had the same thought - you're saying that the employees are picking up a majority of the cost of their retirement - are you talking about existing? Or are you talking about this new system that we're going to affect on January 1?

**Richmond:** I'm really talking about the new employee ... there's no legacy cost associated with a new employee ... and that was one of the discussions that we had with members of the legislature about does it make sense to go to a DC plan for new hires - it's only costing the employers 2%-3% of pay.

**Roach:** Did you guarantee that?

**Richmond:** That's the trade off - in a DC plan there's no guarantee. In a DB plan the employee gets the guarantee of a benefit for a lifetime.

**Roach:** But there's no guarantee that the cost will stay at the current projection of 3%-4%.

**Richmond:** Right. And if our assumptions in coming up with those numbers - and that gets back to the 8% - if we're assuming an 8.25% or 8% assumption and that's not realized, then instead of a 3% employer cost we may be talking about a 4%-5% employer cost.

**Roach:** And is there anything else in the legislation to guarantee that we won't have some of the problems that we have had with the prior systems that have created the situation that we are dealing with today? In other words, you made some changes in here regarding benefits and contributions and eligibility ... did you do anything to make sure that we're not going to find ourselves, from an actuarial standpoint, having the same accounting problems ...

**Richmond:** If we're starting with ... a completely separate system and begin to fund for them, as long as the benefit structure is not changed in any way, the only thing that would cause the cost to deviate from our projections would the fact that our assumptions weren't right.

**Roach:** Or that the quality of the assets - something happens with the markets - or investments ...

**Richmond:** That's when the employer or the state bears the risk of investments, of salary increases, of mortality increases ...

**Roach:** Is there anything in the new system to make sure that the employer does not get affected by any future COLAs in that system? Will the cost of a COLA, as it is now, will it be assessed and passed on to the employer as part of that employer contribution rate?

**Richmond:** The new employees still come under the current [COLA] structure formula, yes.

**Roach:** So essentially, once the new employees start getting COLAs at some point in the future, those COLAs will be passed on to the employer, just like they are today.

**Richmond:** Right and there's a bit of a difference of opinion on this but the potential that a COLA will be paid in the future is not being recognized - there's no liability being measured associated with the fact that we might be giving a COLA in 2013 or 2017 - there's no liability associated with that even though some assets will be diverted out of our account [now] to pay for those if they do occur.

**Roach:** What is the employer contribution rate for LASERS?

**Richmond:** 22%-23%.

**Napper:** 20.2% for Teachers'.

**Tessier:** We had COLA legislation in 2008 authored by Representative Pearson where if you wanted to receive a COLA you could receive an actuarially reduced benefit for the remainder of your life in return for a certain set percentage of an increase for the rest of your life. You did have to take the actuarial reduction - it's completely voluntary ... House Bill No. 1337 did not address COLAs but there were other pieces of legislation that did.

**Birdwell:** ... on Mr. Richmond's report - I'm ignorant on MERS and on MPERS and how they do theirs - but on FRS you're saying that the COLA is borne by the employer contribution, and I guess that's by the design of the program, but I want to point out for the first 22 years of the system's history there was no increase in the employer contribution due to COLAs. That was because when they came into the system there was an understanding that they would get a huge savings because we have the IPTF that was going to kick in and of course excess earnings would help in that area also. I think I pointed this out back in 2005 when we were sitting here in this same committee - part of the heartburn cause to the mayors over the years is there's no mayor sitting today that was around back then and if the Public Retirement Systems' Actuarial Committee (PRSAC) had put the actual figures out of what the employer contribution was each year - the true number - instead of the reduced number ... the reduced number stayed at 9% for 22 years because of the offset. But if they'd put out that true, responsible number that the employer was responsible for and then show down below it that it's reduced down to this amount, I think the heartburn of all of a sudden having the big increase wouldn't be quite as painful. Just wanted to point that out, Mr. Chairman.

**McHugh:** ... If they would have put those numbers out there the choices that were made might have been different. They might not be in FRS right now. There's a lot of "ifs" that we could talk about but I think that what we do know is we're in a system now where we need to do something. The facts are there, and we're going to have to deal with it. As much pain as it brings we're going to have to deal with it.

**Sullivan:** I'll first hit the PRSAC [comment] - PRSAC adopts a valuation every year. That's what PRSAC does. The valuation has always contained the information in it about how much subsidy the systems were receiving from the various places that they get other funds: IPTF, ad valorem, and revenue sharing. Part of the motion at PRSAC is specifically that each system receive its full share of those allocations, and the constitution requires that the legislature determine the taxes to be allocated to that purpose ... I think PRSAC only sends a list of the rates to the system, and the system then communicates the net employer contribution. ... [on COLAs] for FRS and MPERS if you've been retired for a year you get the COLA regardless of your age ... last year the legislature tightened the age requirement for a COLA at Teachers' and LASERS to age 60 and that drove down the cost of the COLA. At Parochial [Employees' Retirement System], you're not eligible for a COLA unless you've attained age 62. **The COLA is something that could be looked at as far as making the benefit more affordable but the COLAs at all of these systems - state systems and statewide - are fully funded by employer contributions, directly or indirectly, and none of them are automatic.** The boards have to take action and for the state systems the legislature also has to take action. There are times when a COLA might be payable but the board would say, "It's not prudent to give a COLA at this time" or in the state systems the boards might recommend it and the legislature might say, "We don't think it's prudent to approve this at this time" so they're not strictly automatic. That's one of the reasons that in previous years they haven't been accounted for ahead of time in the funding.

**Napper:** I think we've had an excellent discussion and probably the best one I've been involved with in all of the meetings we've had. We had several more items to present to you today but I'm going to choose to move those to next month. Just briefly, next month in October we're going to try to have a meeting somewhat like today and discuss all of these items and try to cover the changes that are possible. Some of them we probably don't want to do ... then in November and December we're going to try to present you with some actuarial valuations. In January and February, if necessary, we're going to try to look at, refine, and vote on all the suggestions that we have and get them ready for a report to the legislature. We still welcome your input - anything that you would like us to consider. I think one thing that came up today, Mayor Roach, that I'm interested in, that maybe we can clarify next month, is how far we can go, legally, with changes to existing employees before we get off in the gray areas where we might have litigation and some other things. We intend to ... try to meet on October 13 ... and start a little bit earlier.

**Sullivan:** Next month we'll finish what we [started today] but I wanted to hit something - you all have gone into short-or long-term and that's great, but we'll evaluate those things that we looked at last month, the "laundry list" ... we will defer the actuarial information to November. Next month we'll have the information you saw on the slides prepared for FRS and MPERS and we will provide historical information on three systems that will be presented by a panel of people ... I'd like a motion by the panel to ask the retirement systems to have their attorneys examine that legal issue you want presented next month and to ask them to have their attorneys come and talk about that.

Mayor Roach offered the above motion, seconded by Mayor Lewis. There were no objections and the motion carried by a vote of 7 yeas and 0 nays. Those voting yea were Messrs. Birdwell, Dean, Lewis, Napper, Procopio, Roach, and Rust.

## IV. DISCUSSION OF FUTURE MEETINGS, SCHEDULE, AND TOPICS FOR CONSIDERATION

Mr. Napper set the next meeting of the panel for Wednesday, October 13, 2010.

## V. OTHER BUSINESS

There was no other business.

## VI. ADJOURNMENT

Mr. Napper offered a motion to adjourn the meeting, to which there was no objection. The meeting was adjourned at 1:20 p.m.

Respectfully submitted,

James H. Napper II, designee of John Neely Kennedy
Chairman

/kls

Date approved: ______________________________________