

PUBLIC RETIREMENT SYSTEMS' ACTUARIAL COMMITTEE

Monday, September 28, 2015

1:30 p.m.

House Committee Room 1

State Capitol

Baton Rouge, Louisiana

MINUTES

1. Call to Order

The meeting was called to order by Chairman Daryl Purpera at 1:35 p.m.

2. Roll Call

Members Present: Mr. Daryl Purpera, Chairman, Louisiana Legislative Auditor (LLA)
Mr. Benjamin Huxen, Vice Chairman, Designee for Commissioner Kristy Nichols,
Senator Elbert Guillory, Designee for Senate President John Alario
Representative Kevin Pearson, Designee for House Speaker Charles Kleckley
Mr. John Broussard, Designee for Treasurer John Kennedy
Mr. Gary Curran, FCA, MAAA, ASA, EA
Mr. Charles Hall, FCA, MAAA, ASA, EA

Also Present: Mr. Paul Richmond, MAAA, ASA, EA, Manager of Actuarial Services, LLA
Ms. Liz Martin, Secretary

3. Approval of Minutes

Senator Guillory moved to approve the minutes for the August 13, 2015, meeting. Mr. Huxen seconded the motion, and with no objection, the motion was approved.

4. Presentations by:

a. The PEW Charitable Trusts

David Draine, Senior Researcher, Public Sector Retirement Systems Project, said the national non-profit conducts public policy research in a number of areas including public safety, collections, environments, state finance, taxes and public sector retirement systems. Starting in 2007 with their first report and they have continued to track not only funding of public sanctions of retiring health benefits but also the contribution policies, investments, governments' practice, employee preferences and plan design. In 2011, they began doing direct technical assistance with states and cities looking at these issues giving guidance to policy makers. Their research is based on the two principals: 1) there is no one-size-fits-all solution to these issues, and 2) any good pension and retirement policy will be fiscally sustainable and give retirement security to workers. Mr. Draine proceeded to present an overview of their 50 state research via PowerPoint.

Discussion regarding the shift to risk assets, and how other states have made changes to Defined Benefit (DB) plans. Representative Pearson said that Louisiana's systems have raised retirement ages to 62 from 55 over the recent years and asked if that would help with the Other Post-Employment Benefits (OPEB). Mr. Draine said it took decades for the states to get into their situation so it will take time and will eventually have effects on the OPEB liabilities.

Mr. Purpera asked if there are any studies that show the best mix of risky and safe investments. Mr. Draine pointed out balancing returns and risks, and how complicated it is today and difficult to be transparent. Mr. Broussard asked if he is advocating better transparency on fees. Mr. Draine said a clear statement of investment strategies is important, as is better reporting on returns with a breakdown of fees to give a clear picture of net and gross fees, and provide by asset class for diverse portfolios. Mr. Purpera said Louisiana is one of the 24 states that increased their employee contribution for current members.

b. Laura and John Arnold Foundation

Mr. Josh McGee, Vice President of Public Accountability and Senior Fellow of the Manhattan Institute, started with a value statement that everyone who works hard and plays by the rules should have a retirement plan that puts them on the path to retirement security. Retirement benefits are an important and valued part of workers' compensation and promoting workforce wide is a worthy public policy goal. Mr. McGee said he has expertise in the pension area and overall retirement savings is much larger than it has been in the past. The Laura and John Arnold Foundation have funded work to extend retirement benefits to private sector workforce who do not have plans through their employment. By and large, the nation is better prepared for retirement than at any time in the past. This is true for government plans as well, and promises to public workers are larger today than they have ever been in history, and thus the ability to make up for any shortfalls have diminished. Unfortunately, public retirement benefits are underfunded by at least \$1.3 trillion.

Mr. McGee said that this is not a crisis, but does require immediate remediation to bring the systems back in line. Governments, on average, have failed to adequately pay for their retirement promises and have seen a lot of movement to rectify that situation. Rising pension costs particularly for debt service costs are straining state and local budgets. Service and benefit cuts, wage and hiring freezes are some methods used. If steps are taken today, we can avoid big consequences of this underfunding. Employer contributions have increased and Louisiana has experienced a steeper growth. Because of this growth, governments are paying more for legacy costs to pay for past service and leaving less money for current and future workers. He said a problem is the spreading of unfunded liability over a long time horizon, therefore not making progress for many years. Due to investments in the markets, we must deal with volatility. Mr. McGee gave some historical market information and suggested adoption of a more forward-looking investment rate of return as recommended by the Society of Actuary's Blue Ribbon Panel.

Mr. McGee pointed out that in Louisiana there has been a divergence between assets and liabilities in the state. Since 2001, assets have not grown at the same rate as liabilities. The state should be given credit for taking action to remediate the situation. However, coming out of a bull market, assets have not tilted up to liabilities in a meaningful way, which should be cause for concern. Another issue is the underpayment in recent years. Allowable practice in actuarially determining the contribution is fairly broad so there are many choices in the calculation of the annual contribution. The fact that assets and liabilities have diverged so heavily would indicate that the amount of money going into the fund on an annual basis is too low in Louisiana.

Mr. McGee noted that in recent years Louisiana systems have underpaid because rates have been rising, but if they continually undershoot the investment rate of return, the systems will never hit their arc because of the two year lag in calculation of payment of those funds. The state has made changes to its retirement plans in recent years, lowering cost of benefits for new employees; however, the cost of paying off the pension debt is increasing. Today more than 80% of the annual contributions going into the plans are not for new benefits for employees but rather for legacy costs to pay off pension debt.

He encouraged the Legislature to analyze future cost uncertainty and make a determination as to whether the current funding policy takes appropriate risk relative to Louisiana's ability to pay.

Mr. McGee commented that the current benefit structure of final average salary defined benefit is very back loaded meaning that workers do not earn by way of retirement benefits until later in career. This puts early and mid-career workers off the path to a secure retirement and if the workers should leave employment with the state, they would have a difficult task in reaching a secure retirement. This is especially troublesome in a state that does not participate in social security. He encouraged state systems' to pay down the pension debt as quickly as possible and to be diligent in making those contributions annually. The risk should be kept to a minimum and the state should have the resources to make up for the down side of the investment returns. The state needs a retirement system that is affordable, sustainable, and secure that places all workers on the path to retirement security.

Mr. McGee continued his presentation comparing the Defined Contribution (DC) plan and the Defined Benefit (DB) plan and stressed the importance of looking at data and not making assumptions that drive results. Representative Pearson asked if the systems could be using too high of a discount rate for the annuities provided. Mr. McGee responded in detail. Mr. Curran gave factors to consider for pricing of conversion of annuities. Mr. McGee said he believes a conversion to a DC plan is a viable option, and the state could require everyone to convert.

Representative Sam Jones asked if Mr. McGee recommended the state systems consider mixing Social Security with current retirement plans or if that is a viable option. Mr. McGee said he did not make that recommendation but Social Security is a nationwide DB plan that is entirely portable so in that respect it is very good for workers who move between states and between private and public careers so it would be a consideration for the state of Louisiana.

Representative Jones asked what caused Louisiana to drop from 33 to 46 in the funded rankings after the 2008 economic crisis. Mr. McGee responded it could be due to the size of the liability relative to payroll, and the funded ratio today is a real cause for concern. Representative Jones commented that was partially due to the discount rate being lowered but questioned if it could also be due to the loss of 25,000 state employees who are no longer paying into the system. Mr. McGee said that he did not analyze the specifics of Louisiana's system other than to look at assets and liabilities. Representative Jones asked if Mr. McGee saw anything outside of the norm for the state. Mr. McGee pointed out that Louisiana uses a rate of return above the median so annual contributions are relatively lower than the median plan in the public sector so that could lead to further deterioration of the unfunded liability.

Mr. Purpera questioned if the presentation indicates that neither the Defined Benefit (DB) nor the Defined Contribution (DC) are the most effective, but both could be effective. Mr. McGee concurred and explained that the current final average salary model is not inherently the most effective plan designed, and the empirical evidence does not support that. Assumptions could be made that would result in charts showing that the current model is the best thing but both practical experience and empirical evidence does not support that view. Mr. Purpera asked if a DC plan could be designed that is effective. Mr. McGee

responded that some states manage both DC and DB plans if well designed and limit pool options and offers annuities at the end. Recently in Colorado the state auditor commissioned a report looking at different plan designs produced by the actuarial firm Gabriel Roeder Smith & Company (GRS). The report states that the current plan is best and offers better benefits and choosing anything else would be offering a lower benefit at higher cost. But they did not look at Colorado's own DC plan and assumed that the state would sacrifice returns if they chose to do anything else, but did not support with empirical data.

Mr. Purpera stated that Senator Guillory and Representative Pearson stopped the “kicking of the can down the road” and made responsible changes which certainly increased the current outflow of cash. Mr. McGee said many states are lowering their investment rate of return, as well as more responsible handling of amortization schedules which are more responsible but these positive actions are still too few and far between for worker benefit.

Further questioning and discussion ensued regarding budgeting methodologies, logic of changing teachers or other government work force to social security, future sustainability of the social security system, and whether the investment rate of return should be tied to economic conditions and prevailing interest rates. Mr. McGee said he has no crystal ball but knows that the higher the investment rate of return is, the lower annual contributions are, and the higher risk that you will have additional unfunded liabilities and costs will rise in the future. Actuaries have a 50% probability of hitting their assumed rate of return, and lowering the rate would get more money in the plan, and take some funding risk off the table and better secure workers' benefits. He suggested that Louisiana should strongly consider lowering the rate.

Representative Jones asked if 80% funding is a good number. Mr. McGee said that the actuarial profession has strongly stated that the 80% number is a myth for a benchmark for good funding, and that benefits should be fully funded. Even more than 100% funding would be better to have a cushion against the volatile investment returns.

Mr. Curran said the Blue Ribbon Panel is a rather narrow group that came to be after the shift in the GASB standards. The problem is the use of GASB as a benchmark for funding when it was never intended for that. Louisiana has constitution provisions requiring funding at certain levels, but other governmental plans have no such benchmark. When the GASB 67/68 standards shifted from 25 to 27, and the accountants basically abandoned the concept of even setting forth a benchmark, it left many actuaries with no mooring. So the Blue Ribbon Panel originated in California and its recommendations are only internal and have not been adopted as an official statement by the Society of Actuaries although it may be moving in that direction. Deciding where the assumed rate of return needs to be is a very complicated question. One of the biggest challenges faced by actuaries in setting those benchmarks is the fairly large disparity between the underlying economic facts in terms of what Consumer Price Index (CPI) is now and if it bears any relation to what is considered a long time component of inflation. Actuaries have been very cautious because remember fighting against 8.75%, 9%, and 9.25% in the 90's coming from the outside trying to push actuaries to more “realistic rates of return.” A governor's commissioned study told actuaries what to do to save the pension plans and to save the state money was to get valuation interest rate up. At that time, actuaries were reluctant to do this because the implications were important and paradigm shifts. But there is no magic number and no actuary group can tell exactly where the rate should be.

c. National Institute on Retirement Security (NIRS)

Executive Director Diane Oakley explained that NIRS is a non-profit organization created to do research on retirement security overall, and the economic impact of retirement security for workers, employers and employees. Ultimately the legislature has the responsibility for all its citizens and in fact, more assets in

retirement assets in the U.S. economy according to mutual fund publication data. When looking at retirement security overall, one reason for the increases is that the population is aging so hopefully saving today for retirements in the future. There are other safeguards in our economy to take care of elderly poverty through Medicare and Medicaid, as well as pensions are more available. In the last 15 years, in the private sector nationally, retirement coverage has been lost. Social security benefits have continually decreased because of changes made in 1987 as the retirement age gradually moved higher. She sees shifts out of DB plans which is putting more responsibilities on millions of workers who are in retirement plans to become their own investment advisor and actuary when they retire to figure out how to make their income last for as long as they live. One positive point about public pensions is that it has a more stable workforce, so that means DB plans have improved the productivity and beneficial because experience matters, for example teachers and first responders.

Ms. Oakley explained that changing to a DC plan would change the recruitment, retention, and productivity of the workforce, which has been documented in a number of labor studies. The DB plan encourages efficient retirement, helps people withdraw when their productivity declines, and also has not provided job lock. In the public sector tax revenue shrunk, individuals can still retire. More employees in the private sector are trying to continue working for as long as they can because their DC plan does not provide an adequate retirement income. For people who are within 10 years of retirement, as per the data from the Federal Reserve, the median savings for households headed by someone between ages 55-64 is only \$14,500.

NIRS has done public opinion surveys regarding the retirement crisis, asking what is important to the public and private employees and there is a large divergence. Public employees responded that their retirement benefits are extremely important and only 57% of public workers felt the same way about their salaries. The private sector workers value their salary much higher than retirement security. Employees covered by DB plan anticipate a longer term career with their current employer than individuals that are covered by a DC plan only.

Ms. Oakley said the models suggest that both DC and DB plans can be adequately funded but underfunding can occur on both sides. But underfunding is not seen in a DC plan until someone retires and they do not have enough money or cannot afford to retire. Most actuaries for public pensions have been anticipating mortality rates improving over time and incorporated that into their factors and costs. In a DC plan, as the retiree ages, they change to less risky and more conservative investments, therefore decreasing their returns. Whereas in a DB plan, the overall investment returns would continue at a higher rate. An advantage to the DB plan is the pooling of longevity risks and developing an optimal balanced investment portfolio and not having to adjust for age as an individual has to do. Strong empirical evidence shows that individuals as investors do not do as well as professional money managers, and the DB plan overall has lower fees. She further explained the target date fund asset allocation fees, and individual investment behavior research results.

Ms. Oakley mentioned the Colorado study by actuaries that was managed by the state auditor. The actuaries had to justify their assumptions to the auditor and looked at the DB plan that has a small hybrid feature and also the side-by-side hybrid plan. The report results stated that if they switched to a hybrid plan so there would be some DB plan and some DC plan with employee money, and trying to target so the benefit for the career employee would be the same, the cost would be 60% higher to keep the same benefit. There would be a trade off if do not have the cost efficiency, because lower benefits.

Congress set 80% funding in federal law for private funding in retirement plans. Changing from a DB plan to a DC plan did not help an existing underfunding problem, and in fact the data showed that costs

increased. Louisiana has tried to implement a responsible funding policy, moving toward making the full actuarial determined contribution every year. Illinois has a well-funded DB plan for the municipal employees' retirement system because the state required full funding for that plan. It is 94% funded and on the way to being over 100% funded. Ms. Oakley continued giving other states' funding situations for their DB and DC plans, where some situations showed that the DC plans left public employees with fewer funds than if they had stayed in the DB plan. Overall, the DB plans do deliver better returns, and pull the investment aspects together.

Ms. Oakley said based on data from the Congressional Budget Office, if the state systems that are not in social security and provide their own pension benefits would change to social security, then about half of those funds would not return to their retirees. So by states having their own retirement plans they keep the money for their own workforce. Social security typically uses today's money to provide benefits for today's retirees and is not prefunded, and only has a small trust fund. Representative Pearson agreed and said he believes that social security is not based on earnings but rather benefits are based on lack of earnings. Ms. Oakley said it is ultimately related to earnings but progressive benefits so lower income individuals may pay more in social security tax than in total income tax. Benefits in the tax code to encourage savings tend to only work for those on the top end of the income scale.

Ms. Oakley said in the public sector there has always been a cost sharing in the contribution and risk, and having to put more to cover the unfunded liability, and the trade-off for that is that employees receive less benefits. She has seen across the majority of the states that they maintain the DB plan or some incorporate some flexibility to a DC plan. However, adjusting the DB plans by lowering the cola, or adjusting the age of retirement, have been the predominate changes. In the private sector most 401K plans today typically will give a 3% match to the employee and that is all.

Representative Pearson asked what to do with employees who do not plan to work for the state for 30 years and will only work a few years then go into the private sector, so the little that they have vested in the retirement system will not help them in the future and some will withdraw their employee contributions completely. Ms. Oakley said the younger employees have more in the public retirement plans that most peers receive in the private sector. Unfortunately, there is phenomenal problem that young workers who leave the public sector withdraw their DB or DC contributions rather than roll it over to an IRA. That is the other benefit of a DB plan: to encourage employees to stay employed longer and be forced to contribute to their retirement.

5. Discussion of Prior Reforms Made to the Louisiana State Employees' Retirement System and Teachers' Retirement System of Louisiana

Maureen Westgard, Executive Director for Teachers' Retirement System of Louisiana (TRSL), and Cindy Rougeou, Executive Director for Louisiana State Employees' Retirement System (LASERS) presented a similar presentation to what they presented to Senate and House Retirement Committees during the 2015 Legislative Session. Ms. Westgard and Ms. Rougeou explained the recent legislative changes including newly passed legislation that has impacted the retirement systems and resulting improvements to funding and savings.

Shelley Johnson, actuary for LASERS and TRSL, explained the numeric impacts from the pension reforms by legislators over the recent years and the decrease in unfunded actuarial liabilities.

Senator Guillory thanked TRSL and LASERS for being excellent partners and providing excellent stewardship of the pensions. He requested copies of their presentations be sent to the three guests who presented previously, as well as the four candidates for governor.

Ms. Westgard said that TRSL is having a full asset liability study and review of capital market study, and will be glad to share with the committee.

Mr. Richmond presented graphs and explained the effect of the enactment of Act 399 for TRSL and LASERS on projected actuarial cost factors for projected employer contributions in dollars, projected unfunded accrued liability, and projected transfers to the experience account.

6. Other Business

No other business was discussed.

7. Public Comments

No public comments were presented.

8. Adjournment

Senator Guillory moved to adjourn, and Representative Pearson seconded the motion. With no objection, the meeting was adjourned at 4:54 p.m.

Approved by PRSAC: _____ **December 1, 2015**
Date

The video recording of this meeting is in House of Representatives Broadcast Archives:
http://house.louisiana.gov/H_Video/VideoArchivePlayer.aspx?v=house/2015/Sep/0928_15_PRSAC

The PowerPoint presentations from this meeting are available for viewing on the DOA PRSAC page:
<http://www.doa.la.gov/Pages/prsac/Resources.aspx>