PUBLIC RETIREMENT SYSTEMS' ACTUARIAL COMMITTEE

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Public Retirement Systems' Actuarial Committee

APPROVED
Minutes of Meeting
January 9, 2018

I. CALL TO ORDER

Senator Peacock, Chairman of the committee, called the meeting to order in Senate Committee Room A at the State Capitol in Baton Rouge, Louisiana, at 9:00 A.M. The secretary called the roll.

II. ROLL CALL

MEMBERS PRESENT

Senator Barrow Peacock, Designee for Senate President John Alario
Representative Kevin Pearson, Designee for House Speaker Taylor Barras
Mr. Daryl Purpera, Louisiana Legislative Auditor (LLA)
Rick McGimsey, Designee for Commissioner Jay Dardenne
Mr. John Broussard, Designee for Treasurer Ron Henson
Mr. Gary S. Curran, Actuary
Ms. Shelley R. Johnson, Actuary

STAFF MEMBERS PRESENT

Margaret Corley, Senate Attorney
Kelsey Rome, PRSAC Secretary
Annie Smith, House Attorney
Jennifer Watson, House Secretary

WITNESSES PRESENT- INFORMATION ONLY

Representative Barry Ivey, Louisiana House of Representatives
Irwin Felps, Louisiana State Police Retirement System
Charles Bujol, LSERS
James Rizzo, LLA - GRS
Paul T. Richmond, LLA

III. APPROVAL OF MINUTES

John Broussard moved that the minutes of the September 26, 2017, meeting be approved to which Rick McGimsey seconded. There being no objection, the minutes were approved.

IV. DISCUSSION ITEM

Senator Peacock Gary Curran to present the 2017 Actuarial Valuation for the Louisiana State Police Retirement System.

Mr. Curran summarized the findings including the census summary, payroll, benefits in payment, present value of future benefits, actuarial accrued liability, unfunded actuarial accrued liability, experience account, actuarial value of assets, market value of assets, ratio of AVA to actuarial accrued liability, market rate of return, actuarial rate of return, non-money market drop account interest credit rate, employers' normal cost, amortization cost, projected administrative expenses, insurance premium taxes, net direct employer actuarially required contributions, projected payroll, actuarially required net direct employer contribution rate, and actual employee contribution rate. He stated that the minimum recommended net direct employer contribution rate for 2019 is 43.1%. He then asked if there were any questions.

Senator Peacock directed to page 2 of the valuation and asked Mr. Curran to explain the statement, "However, actuarial funding methods, for pension plans all allow for periodic corrections of assumptions to conform with reality as it unfolds."

Mr. Curran explained it is important for people to understand that this is a self correcting process– they are making estimates and invariably those estimates could be wrong. If they simply did nothing to adjust, they would find themselves in a position down the road where reality would be substantially different than what they expected. Each year there are corrections to the estimates in terms of gains and losses which are typically amortized over some period and then a further correction of estimates in terms of assumption revisions. It is a dynamic process– they are not just guessing, but are going through it in a way as to converge on a funding that will be sufficient to pay benefits as they come to. This is something that they have been doing for over 30 years.

Mr. Purpera referred to the 5 year and 10 year geometric average market rates of return on page 7 of the valuation and asked if he knew what the long term was.

Mr. Curran said that he did not and just took this system over from Mr. Hall for the first year and based on the published numbers that they had available at the time, this is what they could put together. They will look and see over the course of this year if they can get longer range of historical numbers and include those as far back as they can find them.

Representative Pearson asked for the historical discount rate going back 10 years (now at 7%). He asked if there was a change in adjustment.

Mr. Curran said he is not certain as he just took over and asked Mr. Irwin Felps to speak.

Irwin Felps, Director of State Police Retirement System, stated that the 30 year average that they use according to their investment consultant for their investment rate of return is 7.63% over those 30 years so it has been in excess of their discount rate or actuarial rate of return. In response to the question concerning the discount rate, he stated that as a result of going through about 5 years of no pay raises for troopers from about 2010 to 2014-15, their actuary at the time, Mr. Charles Hall, recommended that they reduce their rate of return from 7.5% to 7% and that adjustment was made. They were grateful this change was made as their goal is always to keep that rate as low as possible, while understanding the impact on unfunded liabilities as well as employer contribution rates.

Paul Richmond from the Louisiana Legislative Auditor then presented the Comprehensive Actuarial Review (CAR) for the Louisiana State Police Retirement System, in which, they recommend that PRSAC should not accept the LSPRS' funding valuation prepared by G.S. Curran & Company for June 30, 2017, and instead recommend that PRSAC request LSPRS to revise its actuarial valuation report to include a recognition of future COLAs with a significantly lower return assumption.

Jim Rizzo, senior consultant with Gabriel, Rotor, Smith and Company under contract with the LLA's office, further reviewed the CAR. He explained three primary observations that they had. The first was that the cost of future COLAs is currently not included in the 2017 Funding Valuation and recommend that the board adopt a method to explicitly recognize future COLAs in the actuarial valuation of costs and liabilities. The second was that the net inflation assumption, which is one of the building blocks included within the net investment return assumption, is at the highest end of our range, being higher than all but one source of inflation forecasting. The board's 7.00% net investment return assumption is also outside of the consensus mainstream of professional forecasters. It is, in their opinion, overly optimistic. They believe a more appropriate net return assumption should be 6.00% per year. And the final observation was that while the current mortality assumption is acceptable, the process used to determine the mortality assumption is not as current as it should be.

Gary Curran moved that the committee adopt the actuarial valuation as submitted by G.S. Curran & Company for the Louisiana State Police Retirement System with the contribution rates set forward for 2019 at 43.1% for the employer rate. Ms. Johnson seconded the motion. With no objections, the motion is carried.

Daryl Purpera moved that the committee urge and request the board to re-evaluate their assumed rate of return going forward giving consideration to the midterm and long-term horizons. Representative Pearson seconded the motion. With no objection, the motion is carried.

Mr. Curran noted that its always appropriate to re-evaluate things and he does not have a problem with it as long as they are not prejudicial in terms of what outcome they expect.

Senator Peacock agreed and noted that this is just an urge and request. Then took a brief 10 minute recess.

Upon returning from recess, Senator Peacock asked that the secretary re-call the roll. All members were present.

Senator Peacock then asked Mr. Curran to present the valuation for the Louisiana School Employees' Retirement System.

Mr. Curran presented the findings including the census summary, payroll, benefits in payment, present value of future benefits, actuarial accrued liability, unfunded actuarial accrued liability, experience account, actuarial value of assets, market value of assets, ratio of AVA to actuarial accrued liability, market rate of return, actuarial rate of return, non-money market drop account interest credit rate, employers' normal cost, amortization cost, projected administrative expenses, insurance premium taxes, net direct employer actuarially required contributions, projected payroll, actuarially required net direct employer contribution rate, and actual employee contribution rate. He stated that the minimum recommended net direct employer contribution rate for 2019 is 28%. He then asked if there were any questions.

Mr. Rizzo then presented the Louisiana Legislative Auditor's CAR of the 2017 Actuarial valuation in which they recommend that PRSAC should not accept the LSERS' funding valuation prepared by G.S. Curran and Company for June 30, 2017. Instead, they recommend that PRSAC request LSERS to revise its actuarial valuation report to include a recognition of future COLAs and a significantly lower return assumption. He explained that they had similar observations as they did with the State Police valuation. First, the cost of future COLAs was not included in the valuation and they recommend that the board adopt the method to explicitly recognize future COLAs in the actuarial valuation. Second, they found that the net inflation assumption, which is one of the building blocks included within the net investment return assumption, is an outlier and higher than the estimates from eight independent professional inflation forecasters. The board's 7.125% net investment return assumption is also outside the consensus mainstream of professional investment forecasters. It is, in their opinion, overly optimistic and believe a more appropriate net return assumption would be 6.25% per year. Finally, they found the current mortality assumption to be acceptable, however, the process used to determine the mortality assumption is not as current as it could be.

Representative Pearson asked what is the history of the discount rate for LSERS.

Charles Bujol, the director of LSERS, stated that when he came to the system in 2005 the discount rate was 7.5% and is down to 7.25% and they are working with their actuaries to find ways to get it lower without effecting the school systems.

Representative Pearson asked if in the earlier days was there some type of surplus in retroactive benefit increase that was brought to the system that changed. He asked when it went from 2.5 to 3 and 1/3.

Mr. Bujol said that was in 2003. Then in 2007 they changed it back to the 2.5.

Representative Pearson asked if that had some effect on the funded ratio of the system and if their were assets being used for certain purposes.

Mr. Richmond said that back when the benefit was changed, the system was over-funded and they used the excess assets as a means to pay for the benefit increase and after that increase was granted, they were roughly 100% funded.

Gary Curran moved that the committee adopt the Actuarial Valuation as submitted by G.S. Curran & Company for the Louisiana School Employees' Retirement System with the contribution rates set at 28.0% for 2019. Mr. Broussard seconded the motion. There being no objections, the motion is carried.

Daryl Purpera moved that the committee urge and request the board to re-evaluate the assumed rate of return and including the cost for future COLAs. Representative Pearson seconded the motion. There being no objection, the motion is carried.

Senator Peacock noted that there was a request to make time for public comment before moving onto other agenda items. He opened the floor to public comment, limiting all comments to 5 minutes per item.

There being no comments, Senator Peacock noted that there will be another time reserved for public comment after the rest of the agenda items and asked Ms. Shelley Johnson to present the valuation for the Teachers' Retirement System of Louisiana.

Ms. Johnson noted that there are a couple of things different in this valuation than in previous years. The first being that Pat McDonald, her colleague in their Dallas office, assisted her in working on this valuation and also signed off on it. The discount rate is following the plan that the board has adopted to gradually reduce the rate. The prior year, 2017, was 7.75% and this valuation was prepared using a 7.70% discount rate and the projected contribution rate for 2019 is prepared with a 7.65% discount rate. The other change involves the direct funding of administrative expenses. Previously the board had supported legislation to directly fund administrative expenses, but the current statutes did not allow that. Senator Peacock was successful in passing Act 95 of 2016 which set the requirements for when direct funding of administrative expenses would begin and this valuation met those requirements.

Beginning with fiscal year ending in 2019, they are preparing the projected contribution rate by directly funding the administrative expenses.

Ms. Johnson then summarized the findings including membership census, annual benefits, current payroll, market value of assets, valuation of assets, investment yield, experience account, total normal cost, total normal cost percent of payroll, employer normal cost percent of payroll, unfunded accrued liability, funded percentage, discount rates, employee contribution, employer contribution, and projected employer contribution. They recommend that the projected employer contribution aggregate rate be set at 26.5% for 2019.

Mr. Purpera asked what is the long-term expected return that is needed to finance the benefits, COLAs, and administrative expenses.

Ms. Johnson said she laid out a little bit differently some of the sections to make it very clear what the assumptions are in the funding valuation and the G.A.S.B. valuation and referred to pages 48-49. She noted that the discount rate for 2017 was 7.70% and has been reduced for 7.65% for 2019. They are anticipating that they will be sharing 40 basis points of their investment earnings with the experience account. So in developing the discount rate, they are anticipating that some of the investment experience gains will be allocated to the experience account. And their analysis shows that they can expect over the next 30 years about an average of 40 basis points to be allocated to the experience account to fund COLAs– in other words to not fund regular plan benefits. For 2017, they also anticipated another 0.10% to offset the plans administrative expenses because when the administrative expenses are not directly funded, actuarial standards of practice say that the assumptions should be modified to take that into account. So they need to be sure they have a significant margin in the discount rate so that their expected investment earnings will cover regular plan benefits, the gain sharing, and administrative expenses.

Mr. Richmond then presented the Comprehensive Actuarial Review of the 2017 Actuarial Valuation of the Teachers' Retirement System of Louisiana which recommends that PRSAC not accept the TRSL's funding valuation prepared by Foster & Foster for June 30, 2017. Instead they recommend that PRSAC accept the valuation prepared by the LLA.

Mr. Rizzo summarized the LLA's five findings. First, they were able to replicate– almost exactly– head counts, salaries, benefits, normal costs and liabilities, amortization payments, and contribution rates presented in the 2017 Funding Valuation and the supplemental details provided by the board's actuary. They recommend that more detailed exhibits be presented in valuation reports to disclose each step in maintaining the experience account. There are numerous statutory thresholds, triggers, caps and other rules that have formulas. The application of these should be more clearly and thoroughly disclosed in the funding valuation report. A step-by-step exhibit would provide interpretations made by the board, its actuary, or its legal counsel in areas requiring interpretations of statutes. For example, the order in which certain rules are applied is not clear in the statutes but makes a significant difference in valuation results.

Next, Mr. Rizzo referred to the return assumption and discount rate. For several years, the board has adopted an assumed expected rate of return on assets that differs from the discount rate. For FYE

2017, the board has assumed the expected return on assets to be 8.20%, while the discount rate has been assumed to be 7.70%. The difference has occurred because of the actuarial method the board has chosen to reflect the cost of future gain sharing COLAs (and administrative costs up until FYE 2019). While they commend the board for advance recognition of future gain sharing COLAs in its funding valuation, this method may cause unnecessary misunderstandings. Examples of this confusion are evident from published surveys by the National Association if State Retirement Administrators (NASRA), by studies prepared by the state of Wisconsin, and by studies prepared by the National Education Association (NEA). Refer to Section 2: Return Assumption versus Discount Rate of the report for more details.

Next, he referred to the gain sharing recognition methods. Two methods for explicitly recognizing future COLAs are described in the body of this report. They recommend that the board adopt either of these alternative methods to explicitly recognize future COLAs in the actuarial valuation of costs and liabilities. These methods will reduce or eliminate the confusion and lack of transparency created by methods currently being used. Refer to Section 4: Overly Optimistic Return Assumption of the report.

Finally, the current mortality assumption is acceptable. However, the process used to determine the mortality assumption is not as current as it could be. Refer to Section 5: Mortality Assumption of the report.

Mr. Richmond noted that there are two key differences between what Ms. Johnson is doing and what they are doing. In selecting the discount rate, they are assuming a midterm horizon where she is assuming a longer term horizon. The second thing is they are using the average capital market assumptions of 11 investment consultants, where they use 35– where only 12 provide long term. He referred to page 5 of the valuation report.

Senator Peacock asked if they would come up with a handout explaining what changes they can make for future potential legislation at a later date.

Mr. Richmond and Mr. Rizzo agreed and then recommend the board accept the LLA's valuation.

Representative Ivey asked for an opportunity to speak to which Senator Peacock noted that the floor was already opened to public comment and no one stepped forward, but there would be time for public comment again at the end.

Ms. Johnson moved that the committee adopt the valuation as provided by Foster & Foster with an aggregate employer contribution rate for fiscal year ending 2019 of 26.5%, an interest rate for purposes of crediting the drop accounts of 8.65%, and aggregate employer normal cost rate of 4.2653%. Mr. McGimsey seconded the motion. Mr. Purpera objected the motion. After a roll call vote, the motion passed with 6 yeas and 1 nay.

After a ten minute recess, the roll was called with all members still present. Then Senator Peacock asked Ms. Johnson to present for LASERS.

Ms. Johnson again noted that her colleague, Pat Johnson, also helped her to prepare the LASERS valuation. Similarly to the TRSL valuation, they are in a similar situation with revisions to the discount rate. This valuation was prepared with a 7.70% discount rate, the projected funding requirements were determined using a 7.65% discount rate, which is in line with the vote that was taken at the PRSAC meeting in 2016– which the board supported– to gradually reduce the discount rate. Also similar to TRSL, the direct funding of administrative expenses is also allowed for in the 2017 valuation. Going forward, they will have 15 basis points less they will have to consider in the margin for the discount rate.

Ms. Johnson then summarized the findings including membership census, annual benefits, total payroll, valuation assets, experience account, investment yield, marker values, actuarial value, DROP, total normal costs, employer normal cost, unfunded actuarial accrued liability, funded percentage, funding requirements, discount rates, employee contribution, average employee contribution rate, employer contribution, aggregate rate, and projected employer contribution rates. They recommend that the projected employer contribution aggregate rate be set at 37.9% for 2019.

Mr. Purpera asked if the long term expected rate of return is 8.25.

Ms. Johnson said yes that is correct.

Mr. Purpera then referred to page 6 that shows the geometric average for the last 30 years has been 8.02 and we are using the NEPC rate of return number adjusted by the board which is 8.16. He asked what the unadjusted NEPC number was.

Ms. Johnson said if they just used NEPC's assumptions that they used for all plans, they would have been around 7.69 – about 50 basis points less. But she did not feel it would be fair to characterize that as what they think they should use. In determining the reasonableness of the discount rate, they use the capital market assumptions that LASERS' investment consultant, NEPC, uses for their clients and compares them to those assumptions for other investment consulting companies to make sure they are reasonable and in line with what other investment firms are using. In discussions with LASERS' investment staff and NEPC, they felt like their standard private equity assumption does not apply to LASERS due to the differences in LASERS private equity assumptions. NEPC agreed that their adjustments were reasonable.

Mr. Purpera asked if they approved the valuation today, would they be approving a valuation with an expected rate of return with 8.25.

Ms. Johnson said that was correct. She clarified that while it has an inherent assumption of 8.25% as of June 30, 2017, for the projected contribution rate for fiscal year ending 2019 the assumed return inherent in the valuation is 8.05%. That is because they will no longer need the 0.15% administrative expense and the discount rate is coming down another 5 basis points. So going forward it will be 8.05%.

Mr. Richmond presented the CAR of the 2017 Actuarial Valuation of the Louisiana State Employees' Retirement System by the LLA in which they recommend that PRSAC should not accept the LASERS' funding valuation as prepared by Foster & Foster for June 30, 2017. Instead, they recommend that PRSAC accept the valuation prepared by the LLA. He also noted that they have identified many of the reasons for their differences and can boil them down to horizon and the average number of firms they use in their average in determining capital market assumptions. While he doesn't know if they can resolve those differences, they can work toward coming to a meeting of the minds to come to this committee and say here are the two or three primary differences between us and here is how you decide to use that information.

Senator Peacock noted that he welcomes that as something they will look at and where possible, push that legislation through.

Mr. Rizzo presented the summary of their findings. First they replicated the results shown in the acutarial funding valuation and identified a minor problem with the salary scale. The board's actuary indicated that the errors were merely typographical, and that the actual computer runs used the intended salary increases. They recommend that the more detailed exhibits be presented in valuation reports to disclose each step in maintaining the experience account. There are numerous statutory thresholds, triggers, caps, and other rules that have formulas. The application of these should be more clearly and thoroughly disclosed in the funding valuation report. A step-by-step exhibit would provide interpretations made by the board, its actuary, or its legal counsel in areas requiring interpretations of statutes. For example, he order in which certain rules are applied is not clear in the statutes but makes a significant difference in valuation results.

Next Mr. Rizzo referred to the return assumption and discount rates. For several years, the board has adopted an assumed expected rate of return on assets that differs from the discount rate. For FYE 2017, the board has assumed the expected return on assets to be 8.25%, while the discount rate has been assumed to be 7.70%. The difference has occurred because of the actuarial method the board has chosen to reflect the cost of future gain sharing COLAs (and administrative costs up until FYE 2019). While they commend the board for advance recognition of future gain sharing COLAs in its funding valuation, this method may cause unnecessary misunderstandings. Examples of this confusion are evident from published surveys by the National Association of State Retirement Administrators (NASRA), by studies prepared by the state of Wisconsin, and by studies prepared by the National Education Association (NEA). Refer to Section 2: Return Assumption verus Discount Rate.

Next Mr. Rizzo noted that two methods for explicitly recognizing future COLAs are described in the body of the report. They recommend that the board adopt either of the alternative methods to explicitly recognize future COLAs in the actuarial valuation of costs and liabilities. These methods will reduce or eliminate the confusion and lack of transparency created by methods currently being used. Refer to Section 3: Gain-sharing Recognition Methods.

The net inflation assumption, which is one of the building blocks included within the net investment return assumption, is an outlier. The board's 8.25% net investment return assumption is also outside of the consensus mainstream of professional forecasters. It too is an outlier, and in their opinion, overly optimistic. Refer to Section 4.

Finally, the current mortality assumption is acceptable, however, the process used to determine the mortality assumption is not as current as it could be.

Ms. Johnson moved that the committee adopt the valuation as presented by Foster & Foster with the DROP account rate of 7.12%, the aggregate employer normal cost rate of 3.7573% with a rank-and-file rate of 3.8516%, and an aggregate employer contribution rate of 37.9%. Mr. McGimsey seconded the motion. Mr. Purpera objected to the motion. After a roll call vote, the motion passed with 6 yeas and 1 nay.

V. CONSIDERATION OF ANY OTHER MATTERS THAT MAY COME BEFORE THE COMMITTEE

Senator Peacock thanked the actuaries, LLA, and members for the work they have done and welcomes any suggestions they have to make the retirement systems stronger. He believes Louisiana has made great strides to improve, but there is more that can be done and will embrace those changes going forward.

Senator Peacock then opened the floor for public comment.

Representative Barry Ivey spoke to his attempts at pension reform. All of his efforts are to mitigate the risk to the taxpayer and to ensure the viability of the systems for the beneficiaries. He noted that in the past, Louisiana did not even fund our plans at all. Thankfully, the legislature constitutionally amended to actuarial fund the plans. However, he believes the solution has also created problems. It is the fiduciary responsibility of the boards to make the recommendations based on the health of the plan and of the system. This has nothing to do with whether or not the state can afford it. He believes we should sever the cost factor and do what is a little more cautious with regard to some of these assumptions. He appreciates the systems efforts to bring some of them down so we are moving in the right direction, but we don't want to wait until its too late to turn the ship around.

VI. ADJOURNMENT

Mr. Broussard moved the meeting to adjourn to which Mr. Curran seconded. There being no objection, the meeting was adjourned.

APPROVED

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Senator Barrow Peacock, Chairman

Date: ______________________________