PUBLIC RETIREMENT SYSTEMS' ACTUARIAL COMMITTEE

Thursday, March 7, 2013
9:00 a.m.
Senate Committee Room A
State Capitol
Baton Rouge, Louisiana

MINUTES

1. Call to Order

Committee Chairman, Senator Elbert Guillory called the meeting to order at 9:05 AM

2. Roll Call

Members Present: Ron Henson for Treasurer Kennedy, Dr. Procopio for Commissioner Rainwater, Rep. Kevin Pearson for Speaker Kleckley, Mr. Gary Curran, Mr. Charles Hall, and Mr. Daryl Purpera.

Also Present: Ms. Clarissa Moore, Secretary;

Mr. Paul Richmond, Manager of Actuarial Services, Office of Legislative Auditor; and Ms. Shelley Johnson, LASERS and Stuart Cagle, Deputy Director at Teacher's Retirement Systems

3. Discussion:
   Discussion and approval of the June 30, 2012 annual actuarial valuations and the required contributions and dedication of revenues contained therein for statewide and state retirement systems.

Laura Gail Sullivan, Senate counsel explained the statute created that defines the purpose and procedures for the Public Retirement Systems' Actuarial Committee. Two major areas Chapter 3 and Section 124 in the Louisiana Statute.

Paul Richmond, legislative auditor's office, gave a statement to make a proposal to committee as well as explained the systems valuation report. He explained that his office produced the LASERS and Teachers Retirement systems valuation that matched what was produced by the systems actuary. After careful office review the LASERS and Teachers valuation, they produced their own valuations and liability values. Two responsibilities that he has are to conduct an actuarial audit of the systems work and to confirm that work is done correctly and within actual standards of practice. The second part of responsibility that his office has is to provide this committee with information as it pertains to producing a separate valuation. In the case of the discussion at hand it is not needed if he would have use the same set of assumptions and methods in producing his valuation as Ms Johnson did. He explained that they both operate differently and have different sets of responsibility to their respective clients.

Mr. Richmond talked about the proposal for change that he recommends if he were conducting an evaluation would first be a need for reduction in the discount rate. Both systems are recommending the use of 8% discount rate to which he thinks is too high. Mr. Richmond suggested 7.25% for FY2014. He also stated that he would reduce the salary inflation assumption rate by 50 basis points. Measure gains for the Experience Account purposes would use 8.25% and not the assumed discount rate. In his opinion, gain sharing would be eliminated all together because it creates actuarial problems and is very expensive.

Mr. Richmond began to explain his reasons for reducing the discount rate to 7.25%. He stated that the past isn't a good indicator of what is to come in the future. The investment community is not as optimistic as they used to be in the past. Discount rates for public retirement systems are coming down throughout the country. Investment community is saying that they aren't as optimistic as they were several years ago. Then the conclusion was that the discount rate be between 7-7.50%. Also if it gets to 8% it would probably have to be 8.25% due to administrative expenses being paid out of investment earnings, which amounts to twenty-five basis points. Gain sharing was measured in the past as being roughly equivalent to one hundred basis points in the discount rate which will put us at an effective 9.25%. This is all compared to other states' retirement systems as well as what the investment community is supporting/recommending.
We want to have a discount rate that will give a 50% chance that you are going to win and a 50% chance that you are going lose in any given year. Discount rates for public retirement systems are coming down dramatically. The median rate 10 years ago was 8%. The median rate now is about 7.8%. We are seeing a reduction in the rate that's driven by economic conditions and the accounting community. He stated that if we question using a discount rate for accounting purposes that's the same or different from funding purposes, it wouldn't matter because it's the same process in determining what an acceptable discount rate is and then apply a range from that initial basis point. The private sector is another indicator of the change in the discount rate. IRS is setting rates that are much lower than in the public sector. He doesn't think that 9.25% can realistically be earned.

Mr. Richmond also explained his reasoning for suggesting the reduction of the salary inflation assumption by fifty basis points. One of the underlying assumption in both of the salary increase assumption and the discount rate, is what you are assuming about inflation. One of the building blocks in place that supports the 8% discount rate is the inflation assumption of 3% for both. If the discount rate is lowered to 7.25%, that would put us in a different economic environment.

Mr. Richmond explained that a lot of work goes into the actuaries producing the valuations that are prepared for the committee. The impact of what the changes would have on Employer contribution rates for 2013-14. The System valuation projects 31.7% for LASERS. Changing the discount rate would increase the contribution rate to 4.1% to 35.8%. Decreasing the salary increase assumption by 50 basis points would save 0.8%. Changing the Asset Valuation method would reduce it to 2.4% for a net change 0.9%. The Valuation produced for this meeting will show a rate of 32.6% instead of 31.7%. If the law is changed to EAN from PUC, would save another 0.8% which would bring us down to 31.8%, which is where we are as of today. This shows that for the previously mentioned reasons, we should maintain contribution requirements going forward. TRSL would be at 27.1%, the result is similar to LASERS. They would have an increase in contribution requirements by going to EAN to 0.3% and would end up at 27.8%.

Normal Cost Rates are another factor to look at. LASERS would be at 6.09% and end up at a normal cost of 3.18% at the end of it all. The reason for the change is that the cost of the benefit program hasn't changed, which is dictated by the benefits provided under the plan. How the cost is recognized has been shifted. Under EAN there would be an increase in cash service liability and a decrease in normal cost. TRSL would go from 5.74% to 3.91%.

Amortization Cost Rates are allocated and shared equally among each of the entities participating in the plans. LASERS cost rate for amortization is 25.57%. Under the valuation that was performed by Mr. Richmond the rate would be 25.3% after EAN it would increase 3% which would end it at 28.6%. TRSL would have a similar end result.

The Unfunded Accrued Liability Rate would show a projected UAL of $7.1 billion as of June 2013. Under the proposed methodology it would increase to $7.4 billion, going to EAN would increase it to $8.4 billion, which would increase the Unfunded Accrued liability to about $.5 billion and ultimately shifts the costs and how it is recognized. TRSL would increase from $11.5 billion to $13.6 billion if changed.

In conclusion of presentation by Mr. Richmond, he explained that there are several steps that the body can take. 1) to approve the system valuations for FYE 2014 and do nothing. 2) Approve system valuation for FYE 2014 with a resolution to reconvene in July to reconsider for FYE 2015 or 3) Approve the valuation brought forth by LLA for FYE 2014. His recommendation is to approve the system valuation and reconvene in July to give the retirement systems and the legislative actuary and auditors a chance to meet together to have a discussion to come back before this body with a recommendation on what the group proposes for assumption and methods going forward. No changes in these major economic and funding methods in 25 years. It is time to take a fresh look to see if it still works after all this time. He would also recommend that the body approve resolution to recommend to legislature to adopt EAN and put a cap on the gain sharing rate during the 2013 regular session. Only gains above 8.25% return will be used to fund the experience account. If the discount rate is reduced we won't be able to reach the anticipation of stabilization with the intent of reducing the discount rate.

Senator Guillory questioned if adopted and there is an increase in the UAL of approximately $3 billion, would we reap long benefits as a result and is the bump in the UAL worth it? Mr. Richmond replied that it would, contributions aren't going to change. The benefits have their value and the difference has to be paid. It's a matter of allocating the dollars and spreading them around.

Mr. Purpera wanted to clarify that the proposal has five moving parts and two of them, the body cannot move forward on. On page five of Mr. Richmond's handout, under the proposal the LASERS contribution rate would be 31.8% and if items 4 and 5 aren't decided on by the body today then the 31.8% would probably have to greater? To which Mr. Richmond explained that if gain sharing was prefunded, then the contribution requirement would be 4 or 5 percent higher than what we have today. Mr. Purpera explained that the reason for future discussion being required is due to the need to have point 4 and 5 in order to make the proposal work well.

Representative Pearson explained anyone that works with the systems should recognize that 8.25% is excessively high. The 2.5% assumption of the last 4 years, for example in LASERS, has generally produced no salary increase for state employees. He questioned if that was a type of moving mechanism in the system valuation? Mr. Richmond explained that the salary increase assumption in the public sector is has challenges in developing a good salary increase assumption. In the private sector, most people get reviewed every year and their pay increase is paid out by merit etc. on an individual basis. In a state environment, it's more consistent with everyone getting an increase or no one getting an increase, which makes it more difficult to isolate a component on pay due to an individual's own merit. Four components in a salary increase assumption: 1) Inflation, 2) Natural productivity, 3) Individual Merit and 4) Catch up or slow down (what extent has the pay of my profession gained or lost relative to other professions). Representative Pearson questioned if the assumptions in these valuations, have they calculated and taken into consideration that there has been no increase in pay in the last four years and how possibly will payments in retirement lower twenty years from now, to which Mr. Richmond replied yes. Representative Pearson also stated that he believes that there should be some type of mechanism in place when there may be the need for catching up in salary due to a freeze etc. Mr. Richmond explained that that is an automatic in the valuation process. For example, if the smoothing mechanism was changed this year, it would help offset the increases that would take place in the discount rate. The actual value of the assets calculated in the current smoothing mechanism is significantly below the market value. The recommended smoothing mechanism would bring the value above the market value for this year, next year the picture could be different, there is no way to predict that. The smoothing method proposed would allow better prediction in the future. Mr. Richmond went on to explain the difference with an analogy with whole and term life insurance to which helped with Rep Pearson's questions.

Mr. Hall wanted to share that the systems actuary are currently in the process of conducting 5-year experience studies, at least for school employees, state troopers, teachers and possibly state employees. With regards to the experience studies the suggestions of Mr. Richmond will be taken into consideration and can hopefully be incorporated into the recommendation that will be made to the board of trustees when they receive the experience studies. With the recommendation that the board reconvene in June, with the assumption that the board will embrace and adopt the assumptions that would lead to reduction in the discount rate for the June 30 valuation. The discount rate doesn't just affect the employer contribution rate. Purchaser service costs, transfer service cost and calculation of optional retirement benefits are some of the things that are affected. Throughout the course of business that the retirement systems does, estimates are given for retirement benefits 3 months in advance, which can pose a problem. Mr. Hall further explained the need to have an effective date set to give the retirement system enough time to get the purchaser service costs etc. in place. Mr. Richmond stated that Mr. Hall's discussion is exactly the reason why he recommended the need to reconvene.

Mr. Curran questioned what period would the additional unfunded liability be advertised to which Mr. Richmond answered thirty years. Mr. Curran than questioned Mr. Richmond if that length worried him and Mr. Richmond stated yes. Mr. Curran asked, in terms of legislation, should the amortization period be looked at and Mr. Richmond stated that yes. Mr. Curran wanted to also point that on the shift in unfunded liability in terms of state impact, the unfunded liability of the state plans are going to go up by stated amount anyway. In regards to the change in the smoothing method, some down range will potentially have adverse affects due to the way most of the prior losses were already put into income. Essentially the asset valuation can be used as a tool to offset the discount rate and in the future years the retirement systems could've anticipated gains under the actuary method. The gains are going to be captured now rather than let them fall over the course of the next four to five years to stabilize the contribution requirement. Also for clarification to what Rep Pearson stated, Mr. Richmond wanted to clarify that the salary scale is not going to be changed to 2.5% it is just an inflation component.

Mr. Procopio congratulated Mr. Hall and the legislative auditors. He stated that he agreed that more time is needed for the systems to look at the valuations especially from the aspect of budget. On the discount rate, are other systems adding on additional 25% administration costs as stated necessary by Mr. Richmond in an earlier testimony? Mr. Richmond stated that it actually will vary from plan to plan. Mr. Procopio asked for the difference in the salary inflation rate and smoothing method in a simpler form. Mr. Procopio asked if Mr. Richmond looked at the numbers of the salary levels since administration has gone down. Mr. Richmond stated that the decline in the number of state workers is not factored in a valuation report. The annual report is a snapshot of the existing population. It's factored in after the occurrence not in anticipation. If inflation goes up, then we would have actuary losses due to salary increasing. Gains on the investment side will also go up. Mr. Richmond explained that one system's costs contribution rate is lower primarily due to the benefits structure difference and how well do they perform with the investment of their assets. Actuaries compare what benefit structure is better or worse and what are they trying to accomplish.

Mr. Purpera explained that 31.7% contribution rate for LASERS asked what portion of that is attributed to IUAL. Mr. Richmond stated that he was unsure but that a ballpark figure would be 16-17%.

Shelley Johnson, actuary for Teachers and LASERS explained her opinion on the change in that of the discount rate. She agrees with the general plan to reduce the discount rate as Paul Richmond suggested. She believes that it is a mistake to compare it to the private sector. The investment portfolio of the systems looks nothing like the portfolio of the private sector. They have been forced to take on more risks. Not really an apples to apples comparison, but it is agreed that less risk is probably a good thing for the retirement systems to likely increase gains in the future. He recommendations a year ago put both systems in the neighborhood of 7 ¾% to 8%, which took into account of the gain sharing and administrative costs of the systems. 7.25% for both systems seems a bit low, but she believes she needs to revisit due to study coming from one year ago. She also explained that they are in the process of conducting an experience study for teachers now. The results should be present at the April board meeting. The recommendation on salary was to consider before to be reduced to .5%. This reduction seems reasonable due to the recent freeze in salaries and it also recognizes long term salary patterns. Experience studies for LASERS will be done in the immediate future.

As it relates to asset smoothing, Ms Johnson stated that currently gains and losses are currently being smoothed. It was not recommended to the board years ago because she didn't want to smooth the 8.25% prescribed to the systems. Now that the board adopted a lower discount rate and there is a discussion to lower it even further, she believes that this asset smoothing method will be the best thing going forward. The timing of the change in the asset valuation method is the best because the impact of reducing the contribution rate was roughly 2.5% is something that we will see today. She agreed that the EAN will increase the reported UAL.

In regards to Mr. Curran's comments on the generational shifting of the 30-year amortization, she agrees that it shifts the costs on to future generations. It should be balanced with the state budget and she suggests that the longer term view should be taken to see what's coming in the future.

Mr. Procopio question that if she left out any other major reasons why she wouldn't use one method. She stated that funding stability is the major reason not GASB. Mr. Procopio asked if she would switch an actuarial method to achieve cost savings. Ms. Johnson explained that it's actually called cost shifting. It would increase the contribution rate which wouldn't be viewed as a cost or a savings, but more a shifting.

6. Consideration of any other Business

7. Adjourn

Motion to adjourn by Representative Pearson, to which there was no objection and the meeting was adjourned at approximately 2:30 PM.

Approved by PRSAC: **March 18, 2014**

Date