2013 REGULAR SESSION
ACTUARIAL NOTE HB 56

House Bill 56 HLS 13RS-379
Original

Author: Representative Sam Jones

Date: April 15, 2013

LLA Note HB 56.01

Organizations Affected:
Municipal Employees' Retirement System

OR DECREASE APV

This Note has been prepared by the Actuarial Services Department of the Office of the Legislative Auditor. The attachment of this Note to HB 56 provides compliance with the requirements of R.S. 24:521.

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<u>Bill Header:</u> RETIREMENT/MUNICIPAL EMP: Provides for a divided benefit for members of the Municipal Employees' Retirement System when certain earnings increases occur.

Cost Summary:

The estimated actuarial and fiscal impact of the proposed legislative is summarized below. Actuarial costs pertain to changes in the ***actuarial present value of future benefit payments***. A cost is denoted by "Increase" or a positive number. Savings are denoted by "Decrease" or a negative number.

Actuarial Cost/(Savings) to Retirement Systems and OGB	Decrease
Total Five Year Fiscal Cost	
Expenditures	Decrease
Revenues	Decrease

Estimated Actuarial Impact:

The chart below shows the estimated change in the ***actuarial present value of future benefit payments***, if any, attributable to the proposed legislation. A cost is denoted by "Increase" or a positive number. Savings are denoted by "Decrease" or a negative number. Present value costs associated with administration or other fiscal concerns are not included in these values.

Actuarial Cost/(Savings) to:	Change in the Actuarial Present Value
All Louisiana Public Retirement Systems	Decrease
Other Post Retirement Benefits	Decrease
Total	Decrease

Estimated Fiscal Impact:

The chart below shows the estimated fiscal impact of the proposed legislation. This represents the effect on cash flows for government entities including the retirement systems and the Office of Group Benefits. Fiscal costs include estimated administrative costs and costs associated with other fiscal concerns. A fiscal cost is denoted by "Increase" or a positive number. Fiscal savings are denoted by "Decrease" or a negative number.

EXPENDITURES	2013-14	2014-15	2015-16	2016-17	2017-2018	5 Year Total
State General Fund	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Agy Self Generated	Decrease	Decrease	Decrease	Decrease	Decrease	Decrease
Stat Deds/Other	0	0	0	0	0	0
Federal Funds	0	0	0	0	0	0
Local Funds	0	Decrease	Decrease	Decrease	Decrease	Decrease
Annual Total	Decrease	Decrease	Decrease	Decrease	Decrease	Decrease

REVENUES	2013-14	2014-15	2015-16	2016-17	2017-2018	5 Year Total
State General Fund	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Agy Self Generated	0	Decrease	Decrease	Decrease	Decrease	Decrease
Stat Deds/Other	0	0	0	0	0	0
Federal Funds	0	0	0	0	0	0
Local Funds	0	0	0	0	0	0
Annual Total	$ 0	Decrease	Decrease	Decrease	Decrease	Decrease

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Bill Information:

Current Law

Current law establishes the Municipal Employees' Retirement System (MERS) and provides for benefit calculations, average compensation, and anti-spiking provisions.

Current law generally provides for a calculation of benefits for members of MERS as follows:

- Accrual Rate x Final Compensation x Years of Service

This benefit calculation is used when a member retires, enters DROP, files for disability benefits, or dies while in active service.

Under current law, the final average compensation (FAC) for members of MERS is based on average salary over a period of 60 months with a 115% anti-spiking provision during the FAC period. The FAC is then used in the calculation of benefits.

Proposed Law

HB 56 provides for a "divided benefit" for any member whose monthly earnings are 15% or more above his average monthly earnings for the immediately preceding twelve months. The "divided benefit" calculation is the sum of the following:

1. Total years of service prior to the 15% or greater increase in monthly earnings times the final compensation for those particular years of service times the accrual rate for those years of service.

2. Years of service on and after the 15% or greater increase in monthly earnings times the final compensation for those particular years of service times the accrual rate for those years of service.

3. A benefit shall also be calculated in a similar manner for any period between two increases of 15% or more.

For members with a divided benefit, his total years of service within the system are aggregated for purposes of retirement eligibility. HB 56 requires the divided benefit to be used to calculate all benefits earned by the member, including normal retirement benefits, disability benefits, and survivor benefits.

The final compensation provisions under current law are applicable to all periods of service for the member's divided benefit. For any period of service less than 60 months, the final compensation is the average monthly earnings of the member during the number of months worked for such portion of the divided benefit.

For disability and survivor benefits, HB 56 defines the final compensation to mean the sum of all average compensation calculations required under the proposed legislation with each calculation weighted in proportion to the relation between the number of years of service attributable to each calculation and the total number of years of service of the member.

HB 56 removes the anti-spiking provision for members with a divided benefit since it is equal to the earnings increase trigger for the divided benefit.

Implications of the Proposed Changes

If HB 56 is enacted, a new benefit calculation will be established to further enforce the anti-spiking provisions for members of the Municipal Employees' Retirement System.

Cost Analysis:

Analysis of Actuarial Costs

Retirement Systems

If members of MERS are paid bi-weekly, benefits for retiring members will be based on an average of compensation over an entire career. When paid bi-weekly, an employee receives three paychecks in two months of the year and in some years an employee will receive three paychecks in three months. The pay a member receives in each three paycheck month will exceed the monthly average of pay he receives over the preceding 12 months by more than 15%. As a result, a new divided benefit will be created at least twice a year and in some years three divisions will occur.

If members of MERS are paid bi-monthly, a divided benefit will occur only when an employee receives a pay increase that exceeds 15%.

In either case, any member of MERS who is paid 15% more in a month than the average of his pay over the previous 12 months will receive a smaller benefit under HB 56 than he would have otherwise under current law. Therefore, HB 56 will lead to a decrease in the actuarial present value of future benefit payments (APV) and employer contribution requirements.

If members of MERS are paid bi-weekly, benefits based on final average compensation amounts are estimated to decrease about 60%. As a result, for Plan A:

1. The actuarial present value of future benefit payments (APV) is expected to decrease about $258 million.

2. The frozen unfunded actuarial accrued liability is expected to decrease $33.7 million.

3. The normal cost will be $0.

4. Amortization costs will decrease about $2.6 million.

5. Ad valorem contributions will decrease about $1.2 million.

6. Employer contribution requirements will be $0.

Proportionately similar results would occur for Plan B of MERS.

If members of MERS are paid bi-monthly, benefits will decrease only for individuals who receive a pay raise that exceeds 15%. Benefits for all other members will remain the same. As a result, the actuarial present value of future benefit payments will decrease and employer contribution requirements will decrease. However, the decreases will be small to the point of being negligible.

Realization of these savings may be delayed or may never occur, particularly if members are paid on a bi-weekly basis. It is possible that the constitutionality of HB 56 will be challenged in state or federal courts. According to a memorandum issued by Strasburger, Attorneys at Law to the Office of the Louisiana Legislative Auditor on March 26, 2012, entitled Legal Analysis of 2012 Pension Bills (see www.lla.la.gov/reports_data/actuaryreports) challenges would likely allege violations under:

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

2. The Contract Clause within both the Louisiana and U.S. Constitutions claiming contract impairment due to diminished benefits,

3. The Takings Clause of both the Louisiana and U.S. Constitutions for divesting public employee benefits without just compensation,

4. The Due Process Clauses of both the Louisiana and U.S. Constitution and the Fifth Amendment to the U.S. Constitution for depriving employees of property rights without due process, and

5. 42 U.S.C. §1983 against public officials for enforcing unconstitutional laws.

Other Post Retirement Benefits

If members of MERS are paid bi-weekly, members will be more likely to work longer in order to be able to afford to retire. If this occurs, actuarial accrued liabilities for post-employment benefits other than pensions will decrease as a result of HB 56.

If members are paid bi-monthly, HB 56 should not effect when a member decides to retire. Therefore, it is unlikely that HB 56 will have any effect on the actuarial accrued liabilities associated with post-employment benefits other than pensions.

Analysis of Fiscal Costs

HB 56 will have the following effects on fiscal costs during the five year measurement period.

Expenditures:

1. Expenditures from MERS (Agy Self-Generated) will decrease beginning in FYE 2014 because some members affected by HB 56 will retire with a smaller benefit than they would have had otherwise.

2. Expenditures from Local Funds will decrease beginning in FYE 2015 because employer contribution requirements will be smaller.

Revenues:

- Revenues to MERS (Agy Self-Generated) will decrease beginning in FYE 2015 because employer contribution requirements will be smaller.

Actuarial Credentials:

Paul T. Richmond is the Manager of Actuarial Services for the Louisiana Legislative Auditor. He is an Enrolled Actuary, a member of the American Academy of Actuaries, a member of the Society of Actuaries and has met the Qualification Standards of the American Academy of Actuaries necessary to render the actuarial opinion contained herein.

Dual Referral:

Senate	**House**
☐ 13.5.1 ≥ $100,000 Annual Fiscal Cost	☐ 6.8(F) ≥ $500,000 Annual Fiscal Cost
☐ 13.5.2 ≥ $500,000 Annual Tax or Fee Change	☐ 6.8(G) ≥ $500,000 Annual Tax or Fee Change