2014 REGULAR SESSION
ACTUARIAL NOTE HB 67

House Bill 67 HLS 14RS-441 **Reengrossed with House Floor Amendment #4478** **Author: Representative Jack Montoucet** **Date: May 7, 2014** **LLA Note HB 67.03** **Organizations Affected:** **Firefighters' Retirement System** **RE INCREASE 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 67 provides compliance with the requirements of R.S. 24:521.** Paul T. Richmond **Paul T. Richmond, ASA, MAAA, EA** **Manager Actuarial Services**

<u>Bill Header:</u> RETIREMENT/FIREFIGHTERS: Provides relative to the accrual rate and Deferred Retirement Option Plan participation in the Firefighters' Retirement System

<u>Cost Summary:</u>

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	Increase
Total Five Year Fiscal Cost	
Expenditures	Increase
Revenues	Increase

<u>Estimated Actuarial Impact:</u>

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.

<u>Actuarial Cost to:</u>	**<u>Change in the Actuarial Present Value</u>**
All Louisiana Public Retirement Systems	Increase
Other Post Retirement Benefits	Decrease
Total	Increase

<u>Estimated Fiscal Impact:</u>

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	Increase	Increase	Increase	Increase	Increase	Increase
Stat Deds/Other	0	0	0	0	0	0
Federal Funds	0	0	0	0	0	0
Local Funds	0	Increase	Increase	Increase	Increase	Increase
Annual Total	Increase	Increase	Increase	Increase	Increase	Increase

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	Increase	Increase	Increase	Increase	Increase
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	Increase	Increase	Increase	Increase	Increase

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<u>**Bill Information:**</u>

Current Law

Current law provides for a 3 1/3% accrual rate for all members of Firefighters Retirement System (FRS).

Current law provides that members of the Firefighters' Retirement System (FRS) may remain in Deferred Retirement Option Plan (DROP) for a period of three years.

Proposed Law

Accrual Rate

The accrual rate for members for FRS first employed on or after July 1, 2014 and who retire with less than 30 years of service, will be reduced from 3 1/3% per year of service to 3.0% per year of service.

However, the benefit for a member employed on or after July 1, 2014, who is approved for disability benefits for an injury sustained in the line of duty or who is killed in the line of duty, and for whom the calculation of disability or survivor benefits is based on a benefit accrual rate, shall be calculated under current law.

DROP

The duration of the DROP period will be extended to five years for any member who has at least 30 years of service. Any member with 30 years of creditable service who has completed DROP and who continues to be employed will be allowed to reenter DROP for an additional two years.

Implications of the Proposed Changes

Benefit provisions for some future members of FRS will be reduced. Benefit provisions pertaining to DROP for all existing and future members will be enhanced.

<u>**Cost Analysis:**</u>

Analysis of Actuarial Costs

Retirement Systems

Accrual Rate

This provision of HB 67 is a benefit provision having actuarial savings.

HB 67 has no effect on any current member of FRS. The actuarial present value of future benefit payments for existing members will not change. HB 67 has no effect on accrued liabilities because it applies to members first employed on or after July 1, 2014.

HB 67 provides for lower benefit accrual rates to members first employed on or after July 1, 2014, with less than 30 years of total creditable service. As a result, the present value of future benefit payments for future members will decrease. Future normal costs and future employer contribution requirements will also decrease.

The estimated short term effect of HB 67 is that the employer contribution rate in five years will be 0.51% of pay less than it would be if HB 67 is not enacted.

The long term effect of HB 67 is that the employer contribution rate in 25 to 30 years will be 1.75% of pay less than it will be if HB 67 is not enacted.

This analysis is partially based on information provided to the FRS by G.S. Curran & Company, Ltd.

DROP Participation

DROP provisions of HB 67 contain a benefit provision having an actuarial cost. Members who are continuing to work after exiting DROP will be allowed to re-enter DROP for an additional two years.

Although, the DROP provisions of HB 67 produces offsetting increases and decreases in actuarial costs, the net effect is an increase in actuarial costs.

The provision of HB 67 allowing members to re-enter DROP for an additional two years has an actuarial cost. These members will not receive pension benefits under current law for as long as they continue to be employed. However, under HB 67, their pension benefits will be paid into the DROP account. As of June 30, 2013, there were 221 members who continue to work after DROP. Their length of service is not known. The cost associated with this provision of HB 67 is likely to be significant.

The following information is presented to put some context to our analysis of actuarial costs for members who have not yet entered DROP.

1. FRS has 200 active members who have 25 to 30 years of service. The average salary of these members is $71,000 a year.

2. FRS has 53 active members with 30 or more years of service. The average salary of these members is $81,000.

3. FRS has 203 members who are in DROP and are under age 60. The average service and average pay associated with these members are not available.

4. FRS has 8 members in DROP who are between age 60 and age 65. Average service and average pay are not available.

5. The average annual salary of new firefighters is $29,460.

The following case is presented to illustrate the basis for our cost conclusions.

A 58 year old member with 30 years of service before entering DROP has been in DROP for 3 years. He is earning $60,000 a year and has been earning that amount for the past 6 years. If he continues to be a firefighter, he will continue to earn $60,000 a year for the foreseeable future.

Situation A

Let's first suppose that the member intends to continue to work two more years regardless of whether or not HB 67 is enacted. HB 67 will then have the following effects on the member, FRS, and the employer.

The following analysis shows that if HB 67 enacted, the employer avoids paying $35,100 in contributions to the system, FRS liability increases by $115,100, and the plan member gains an additional $80,000 in benefits.

Effect On:		**HB 67 Is Not Enacted**	**HB 67 Is Enacted**
The Member:			
	Deposits into DROP Account	$ 0	$60,000 x 2 = $ 120,000
	Member Contributions to FRS	$(60,000) x 2 x 10% = $ (12,000)	$ 0
	Value of Additional Benefit Accruals	2 x 3 1/3% x $60,000 x 13 = $52,000	$ 0
	Increase/(Decrease) in Wealth	$ 40,000	$ 120,000
FRS:			
	Payments to member's DROP account.	$0	2 x $(60,000) = $(120,000)
	Contributions received from the member	$60,000 x 2 x 10% = $ 12,000	$ 0
	Contributions received from the employer	$60,000 x 2 x 29.25% = $ 35,100	$ 0
	Value of additional benefits granted to the employee	2 x 3 1/3% x $(60,000) x 13 = $ (52,000)	$ 0
	Increase/(Decrease) in Assets	$ (4,900)	$ (120,000)
The Employer:			
	Contributions paid by the employer to FRS	$ (35,100)	$ 0

Situation B

On the other hand, let's suppose that the member will quit immediately if HB 67 is not enacted, but will continue to work if it is enacted. HB 67 will then have the following effects on the member, FRS, and the employer.

The following analysis shows that if HB 67 enacted, the employer will incur $42,450 of additional payroll costs, FRS liability will increase $20,850, and the member has no gain or loss.

Effect On:		HB 67 Is Not Enacted	HB 67 Is Enacted
The Member:			
	Deposits into DROP Account or pension payments	$ 120,000	$ 120,000
	Member Contributions to FRS	$ 0	$ 0
	Value of Additional Benefit Accruals	$ 0	$ 0
	Increase/(Decrease) in Wealth	$ 120,000	$ 120,000
Effect On:		**HB 67 Is Not Enacted**	**HB 67 Is Enacted**
FRS:			
	Payments to member DROP account.	$(120,000)	$(120,000)
	Contributions received from the member or his replacement assuming replacement earns $30,000 a year	$30,000 x 2 x 10% = $ 6,000	$ 0
	Contributions received from the employer on member's salary or on his replacement's salary	$30,000 x 2 x 29.25% = $ 17,550	$ 0
	Value of additional benefits earned	2 x 3 % x $(30,000) x 1.5 = $ (2,700)	$ 0
	Increase/(Decrease) in Assets	$ (99,150)	$ (120,000)
The Employer:			
	Salary paid to the member and/or his replacement	2 x $(30,000) = $(60,000)	2 x $(60,000) = $(120,000)
	Contributions paid by the employer to FRS	$ (17,550)	$ 0
	Increase/(Decrease in Assets)	$ (77,550)	$ (120,000)

Therefore, in both situations, FRS incurs an actuarial cost as a result of HB 67. Employer contribution requirements will have to be increased in the future in order to accommodate greater expenditures from the retirement system. The precise amount cannot be determined. Currently FRS has 211 members in DROP. Many of these are likely to be in Situation A. They will work two more years regardless of HB 67. Enactment will provide them with a windfall and FRS will pay out significantly more money in pension benefits.

Many of the 211 members in DROP will fall into Situation B. They will not receive a windfall, but FRS still incurs a loss.

Significant actuarial costs will be incurred relative to post DROP members with 30 or more years of service who elect to re-enter DROP. Some actuarial cost will be incurred relative to Situations A and B. Some actuarial savings may arise relative to members of FRS who elect to continue regular employment and defer entry into DROP to obtain the benefit of the extended DROP period. HB 67 may induce members with less than 30 years of service to remain employed in order to reap the benefit of a longer DROP period. If such inducement occurs some savings will be realized to offset the additional benefits that will be provided to such members. There is insufficient evidence, however, to conclude that such savings will be large enough to offset the additional costs associated with post DROP members re-entering DROP and Situation A and B. As a result, HB 67 has an actuarial cost.

The effects on various components of actuarial cost relative to the DROP provisions of HB 67 are summarized below:

1. The actuarial present value of future benefits will increase.
2. The unfunded accrued liability of the plan will increase.
3. Normal costs will increase.

Conclusions

In the near term, actuarial costs associated with the DROP provisions of HB 67 will exceed the savings that will materialize from the Benefit Accrual Rate provisions. There are significant near term actuarial costs.

Ultimately, savings associated with the Benefit Accrual Rate provisions will increase. However, whether the ultimate actuarial savings from the Benefit Accrual Rate changes will exceed or fall short of the additional actuarial costs associated with the changes to DROP cannot be determined.

Other Post Retirement Benefits

Actuarial costs for post-retirement benefits other than pensions will decrease as a result of HB 67 to the extent that employers provide such benefits. Some members will be induced to work a couple more years in order to receive the benefits offered by HB 67. As a result, premiums associated with post-employment benefits will not be paid and actuarial costs will decrease.

Analysis of Fiscal Costs

HB 67 will have the following effect on fiscal costs during the five year measurement period.

Expenditures:

1. Expenditures from FRS (Agy Self-Generated) will increase regardless of whether or not HB 67 induces firefighters with 30 or more years of service to work longer. In either event, benefit payouts to members in DROP affected by HB 67 will increase. Expenditures will also increase relative to post DROP members who elect to re-enter DROP.

2. Expenditures from FRS (Agy Self-Generated) will decrease to the extent that HB 67 encourages firefighters with less than 30 years to work longer before entering DROP.

3. Net expenditures from FRS (Agy Self-Generated) will increase.

4. Expenditures from Local Funds will increase to the extent that employer contribution requirements increase to accommodate larger benefit payments.

5. Expenditures from Local Funds will decrease to the extent that normal costs for new members first employed on or after July 1, 2014 are lower.

6. Net expenditures from Local Funds will increase during the five year measurement period.

Revenues:

- FRS revenues (Agy Self-Generated) will increase to the extent that employer contribution requirements increase.

The net increase in expenditures from FRS over first three years of the fiscal measurement period is expected to exceed $100,000.

Actuarial Data, Methods, and Assumptions

This actuarial note was prepared using actuarial data, methods, and assumptions as disclosed in the most recent actuarial valuation report approved by PRSAC. These assumptions and methods are in compliance with actuarial standards of practice. This data, methods and assumptions are being used to provide consistency with the actuary for the retirement system who may also be providing testimony to the Senate and House retirement committees.

Actuarial Caveat

There is nothing in this bill that has or will compromise the signing actuary's ability to present an unbiased statement of actuarial opinion.

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
[x] 13.5.1: Annual Fiscal Cost ≥ $100,000	[ ] 6.8(F)(1): Annual State Fiscal Cost ≥ $100,000
[ ] 13.5.2: Annual Tax or Fee Change ≥ $500,000	[ ] 6.8(F)(2): Annual State Revenue Reduction ≥ $500,000
	[ ] 6.8(G): Annual Tax or Fee Change ≥ $500,000