Report on Alternative Funding Mechanisms for Permanent Benefit Increases (PBIs)/Cost-of-Living Adjustments (COLAs)

Senate Resolution 15/House Resolution 21

Presented to Joint Retirement Committee

December 17, 2020

TRSL Teachers' Retirement System of Louisiana

LASERS Louisiana State Employees' Retirement System

LSERS LOUISIANA SCHOOL EMPLOYEES' RETIREMENT SYSTEM

TROOPER LOUISIANA STATE POLICE

LA State Police Retirement System (LSPRS)

Senate Resolution 15/House Resolution 21

"…hereby urge and request the four state retirement systems, working together as appropriate, to study alternative mechanisms for providing meaningful benefit increases on a regularly scheduled basis, designed to preserve the purchasing power of the recipients."

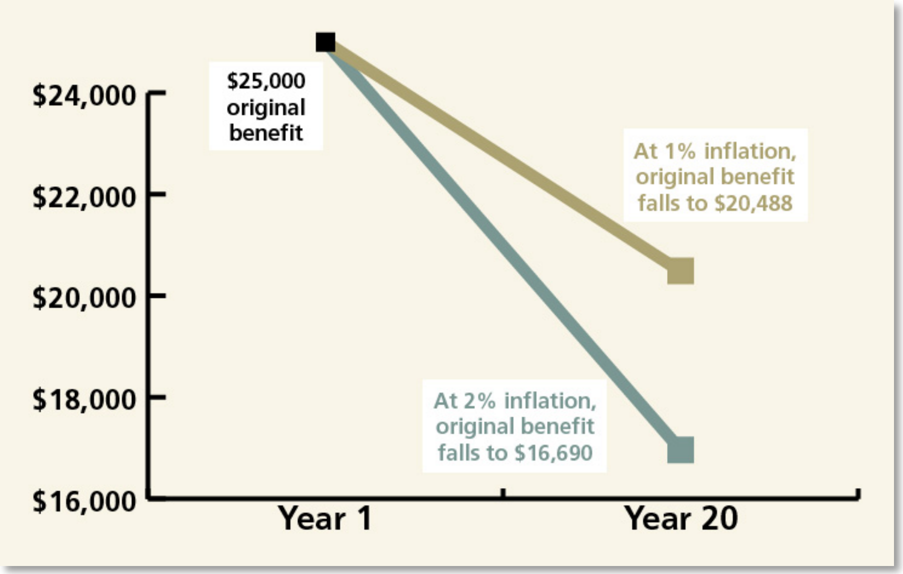
Note about PBI/COLA terminology: *The term "cost-of-living adjustment" (COLA) is widely used among policymakers and the general public. However, COLA and PBI (permanent benefit increase) are used interchangeably in this presentation and the report.*

Overview

- About the Report
- Louisiana at a Glance
- Alternative PBI Funding Options
- Questions

Report: Purpose of PBIs

- PBIs/COLAs protect the purchasing power of a retirement benefit from inflation.
- Benefits that were sufficient to pay living expenses at time of retirement can become inadequate over time.



The chart shows how inflation can erode the purchasing power of retirement income. After 20 years, a $25,000 benefit at retirement falls to 67% of its original value at 1% inflation, and 82% of its original value at 2% inflation.

SOURCE: NASRA Issue Brief: Cost-of-Living Adjustments, June 2020, www.nasra.org/colabrief

Report: PBI Types

Type	Key features
Ad Hoc	Requires governing body to approve a post-retirement benefit increase
Automatic or Fixed Rate	Occurs without action, and is typically pre-determined by a fixed rate (e.g., 3%) or formula
Based on CPI	COLA provided automatically as some proportion of the CPI increase each year
Based on Investment Earnings or Gain Sharing	COLA provided when annual investment earnings exceed some benchmark (e.g., exceeds the approved actuarial rate of return)
Based on Funded Status	COLA granted when funded status is over an agreed upon threshold
Purchasing Power Protection	Supplementary benefit paid when a retiree's benefit falls below a set percentage (most commonly 75%) of the purchasing power of the benefit at time of retirement
One-time or 13th Check	One-time payment granted for a variety of reasons, including addressing retiree benefit amount or the availability of reserve funds
Self-Funded Annuity Option	Allows a retiring employee the option to "self-fund" a fixed-rate COLA as an optional form of payment; lower monthly annuity payments provided with promise of a guaranteed future annual COLA at a fixed rate

Report: PBI Funding

Common sources:

Employer contributions

Employee contributions

Investment earnings

Direct appropriation
(i.e. general fund dollars or dedicated funds)

Report: PBI Eligibility Criteria

Common criteria:

- Age
- Years since retirement
- Years of service

Louisiana at a Glance

Overview:

- Louisiana pensions are modest and reliable, enabling retirees to purchase goods and services.
- Most Louisiana public employees cannot participate in Social Security through their public employment.
- Also, Louisiana public employees may be affected by Social Security offsets: Windfall Elimination Provision (WEP) and Government Pension Offset (GPO).

Louisiana at a Glance

Overview:

- Current funding/granting provisions have resulted in unpredictable and infrequent PBIs.
- Louisiana retirees haven't been able to rely on PBIs to help protect the purchasing power of their retirement benefits.
- Since 2010, TRSL and LASERS have paid two regular PBIs; LSERS and LSPRS have paid three regular PBIs. *(In comparison, Social Security has paid nine COLAS in the last 10 years.)*
- The irregularity of granting PBIs can be linked to how the state has chosen to fund them.

Louisiana at a Glance

PBIs in Louisiana

- Louisiana grants ad hoc PBIs with funds in retirement system experience accounts.
  - » Experience accounts credited with excess system investment earnings
  - » Must have sufficient funds in experience accounts to pay a PBI
  - » PBIs must be approved by the Legislature
- Over the years, more excess investment earnings have been steered toward reduction of the UAL rather than credited to experience accounts. Granting criteria has also become more complex.
- The current statutory quantitative hurdles imposed on crediting experience accounts makes it highly unlikely that a PBI will be granted in the foreseeable future.

Changes: Experience Account & Granting Criteria

1992	▪ **Experience account:** Created and credited with 50% of excess investment earnings ▪ **COLA granting:** Tied to investment performance and inflation
2009	▪ **Experience account:** Credited with 50% of excess investment earnings after first $200M of TRSL and $100M of LASERS excess earnings applied to UAL ▪ **PBI granting:** Added system funding level to existing granting criteria
2014	▪ **Experience account:** » Indexed TRSL/LASERS hurdles to the increase in actuarial value of assets » Established dollar hurdles for LSERS/LSPRS; account credited with 50% of excess investment earnings after first $15M for LSERS and $5M for LSPRS applied to UAL; indexed hurdles to the increase in actuarial value of assets ▪ **PBI granting:** Created granting matrix that integrated funding level, investment performance, and last PBI paid to determine PBI frequency and amount

NOTE: Experience accounts for LSERS and LSPRS created in 2007.

Current: Granting Criteria

For illustration purposes

Funding Level	Last PBI Granted	System earns actuarial rate of return is:		
		At least 8.25%	Equal to or greater than AVR*, but not 8.25%	Less than AVR*
Less than 55%	N/A	None	None	None
At least 55%, but less than 65%	None in preceding FY	Lesser of 1.5% or CPI-U	Lesser of 1.5% or CPI-U	None
At least 65%, but less than 75%	None in preceding FY	Lesser of 2% or CPI-U	Lesser of 2% or CPI-U	None
At least 75%, but less than 80%	None in preceding FY	Lesser of 2.5% or CPI-U	Lesser of 2% or CPI-U	None
At least 80%, but less than 85%	None in preceding FY	Lesser of 3% or CPI-U	Lesser of 2% or CPI-U	Lesser of 2% or CPI-U
85% or greater	N/A	Lesser of 3% or CPI-U	Lesser of 2% or CPI-U	Lesser of 2% or CPI-U

**Board-approved actuarial valuation Rate (AVR)*

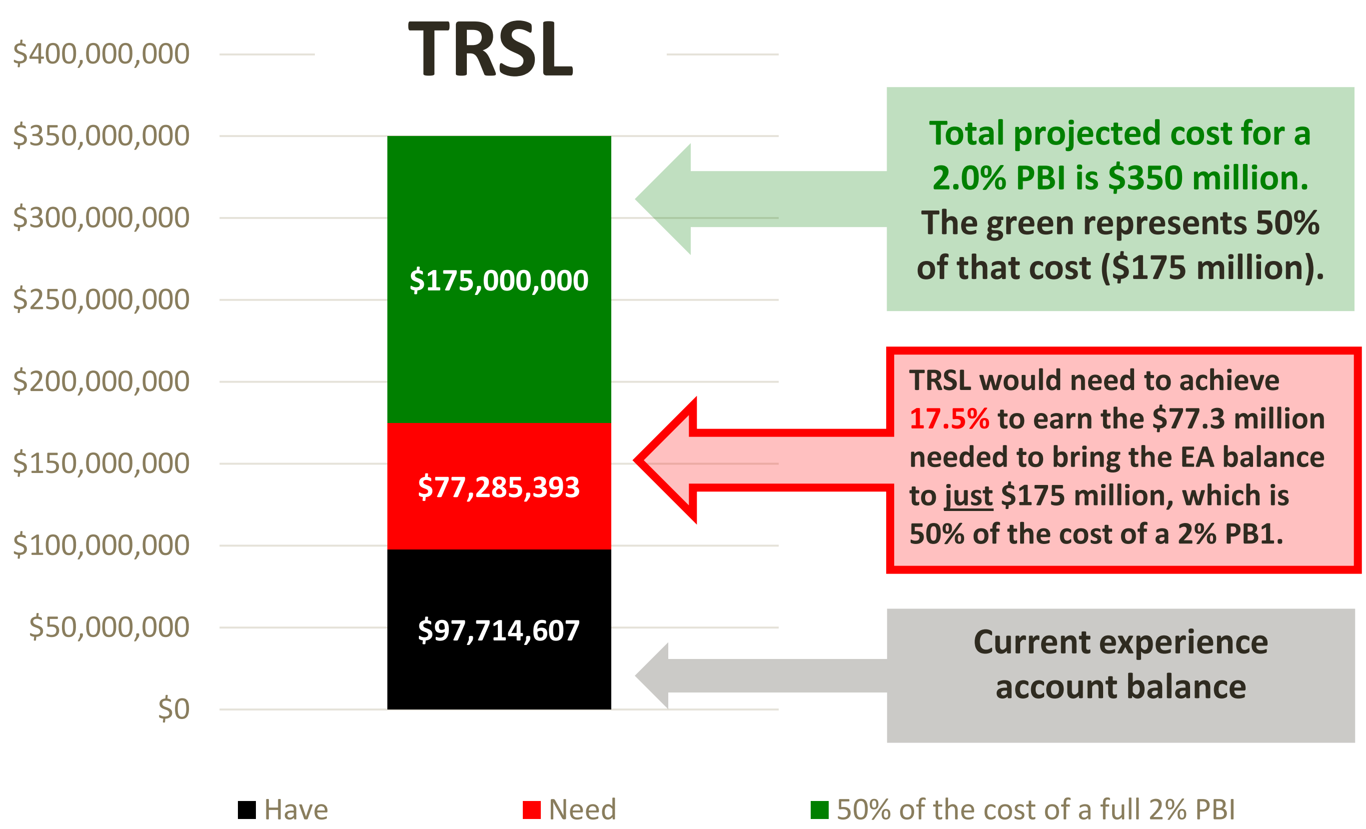
NOTE: LSERS and LSPRS have slightly different granting criteria. See Appendix B in the report for information specific to each system.

Current: Experience Account Crediting

System	Original Hurdles	Current Hurdles	Percentage Change since 2014	Experience Account Balance
TRSL	$200 M	$249.6 M	24.8%	$97.7 M
LASERS	$100 M	$110.4 M	10.4%	$12.3 M
LSERS	$15 M	$16.3 M	9.1%	$5.4 M
LSPRS	$5 M	$7.2 M	45.5%	$2.2 M

Funding challenges

TRSL would need a 17.5% market return in FY 2021 to deposit enough funds in its experience account to produce a balance that would equal just half the cost of funding a 2% PBI.



Funding challenges

LASERS would need a 28.8% market return in FY 2021 to deposit enough funds in its experience account to produce a balance that would equal just half the cost of funding a 2% PBI.

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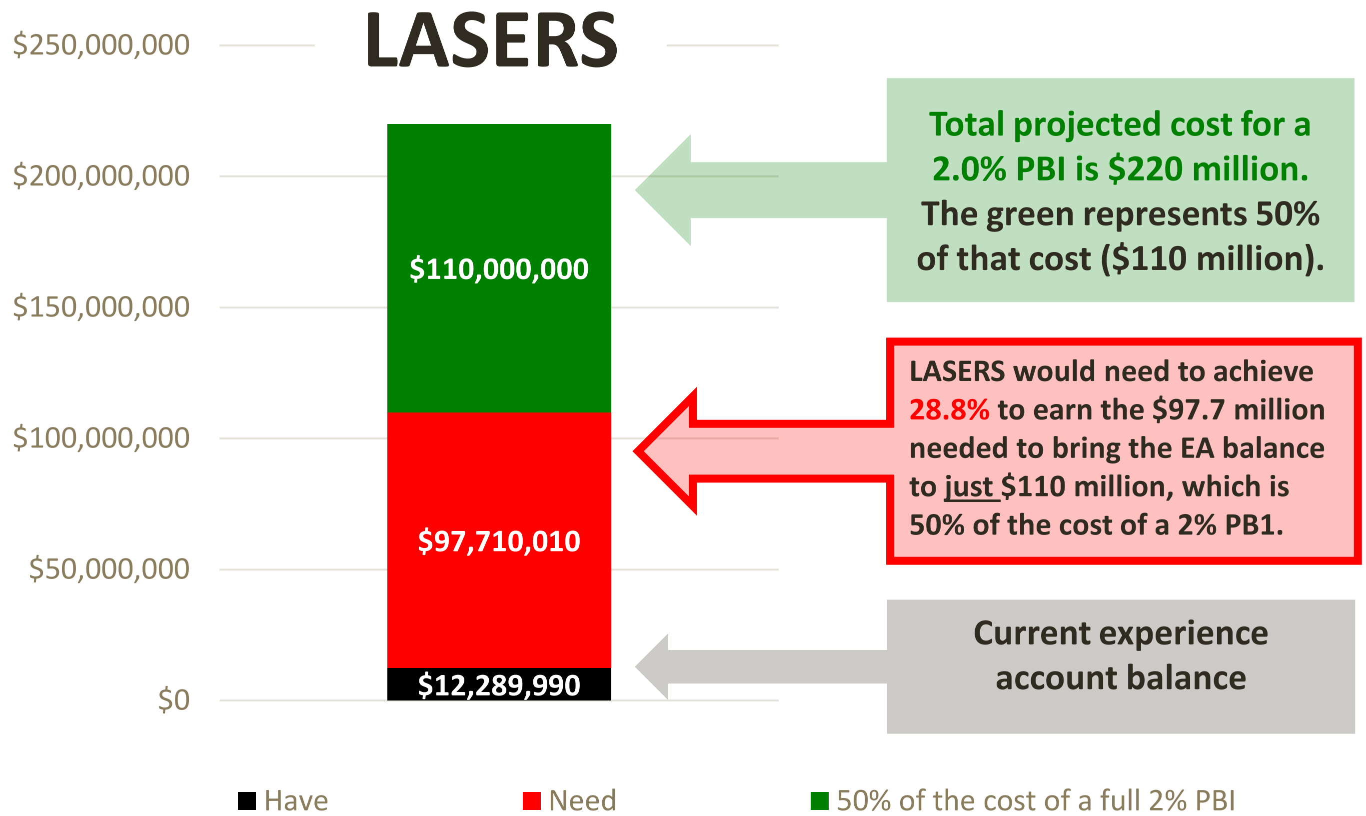
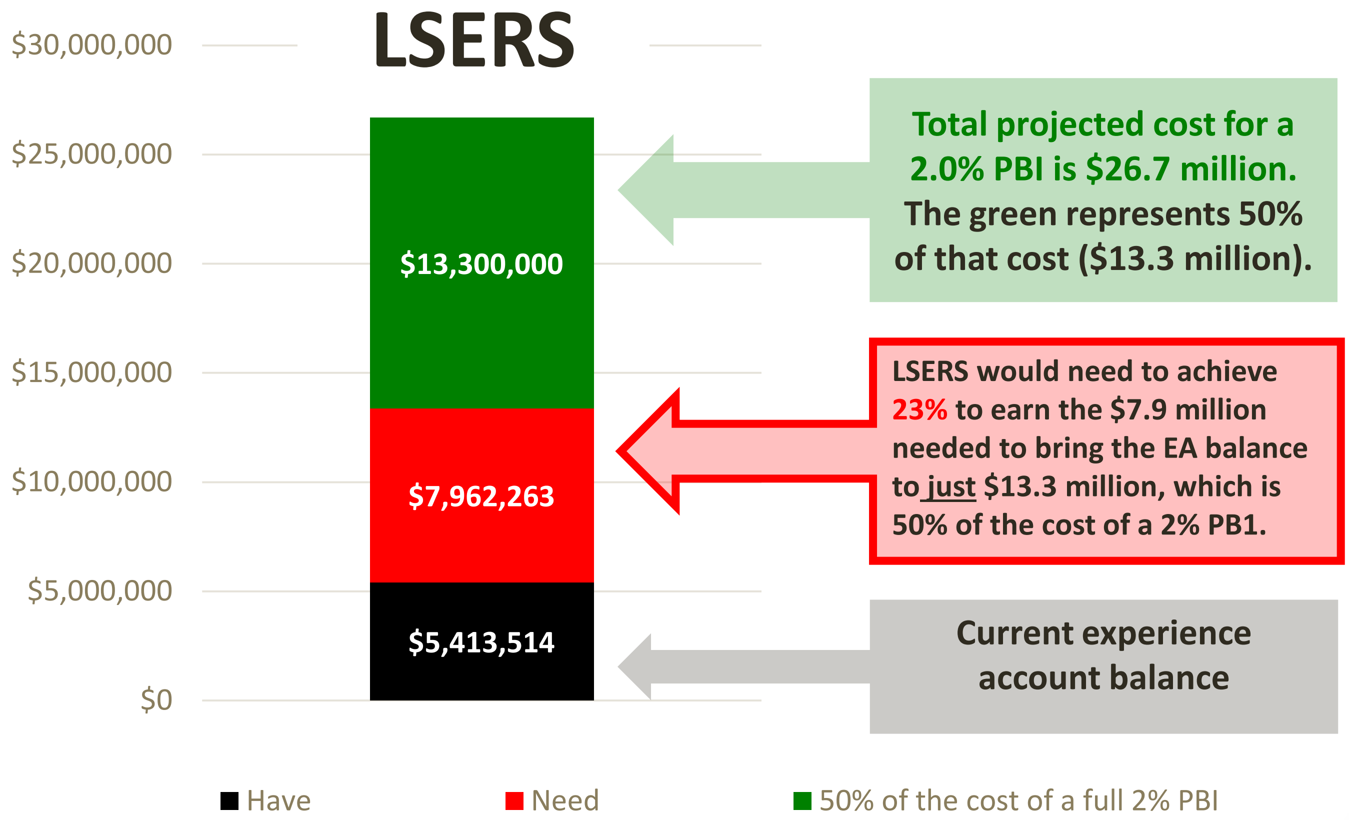


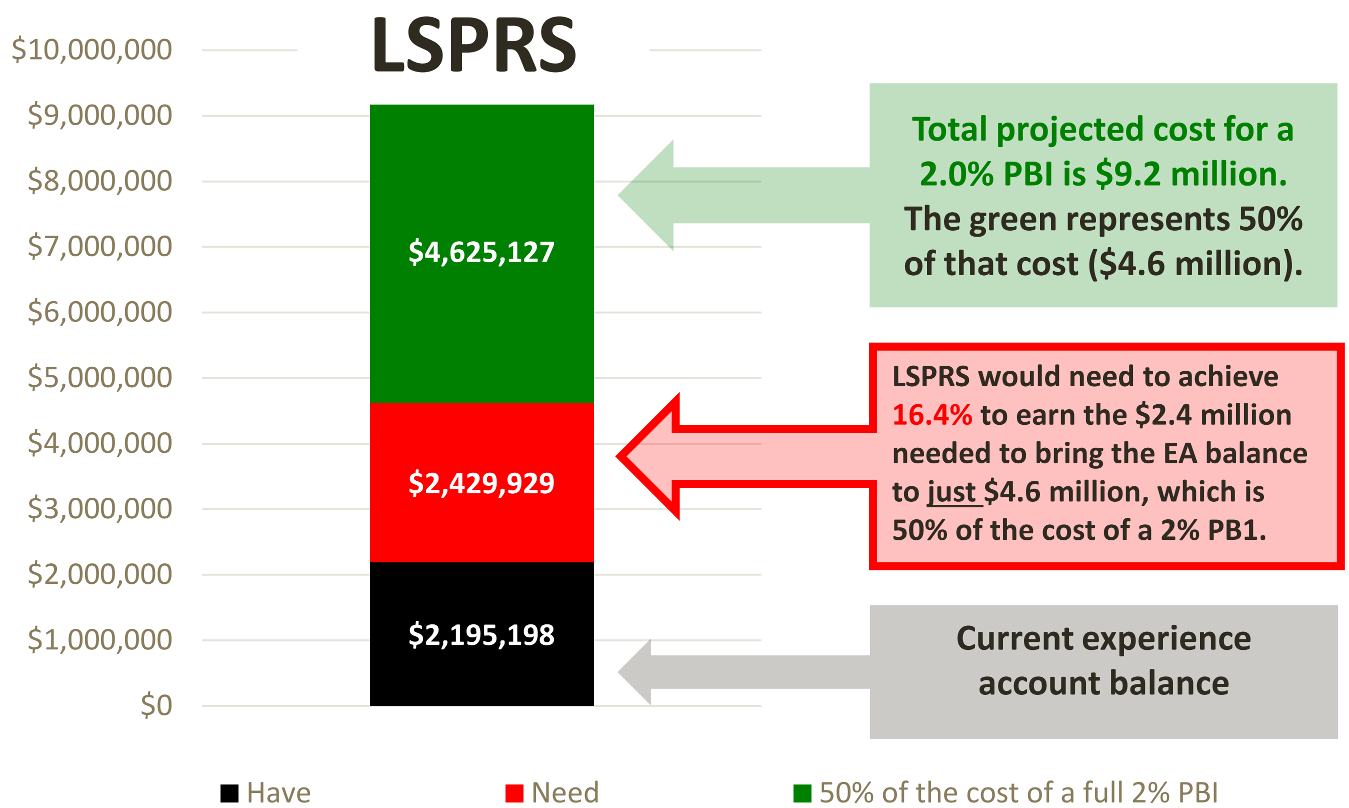
Funding challenges

LSERS would need a 23% market return in FY 2021 to deposit enough funds in its experience account to produce a balance that would equal just half the cost of funding a 2% PBI.



Funding challenges

LSPRS would need a 16.4% market return in FY 2021 to deposit enough funds in its experience account to produce a balance that would equal just half the cost of funding a 2% PBI.



NOTE: LSPRS experience account includes two separately defined PBIs. The supplemental PBI is for retirees at least age 65 who retired on or before June 30, 2001. The projected cost above is for the value of both defined PBIs at the 2% level.

ALTERNATIVE METHOD #1: Funded through the employer contribution rate

Retain experience account and supplement the account funding through the employer contribution rate, using additional streams of revenue as outlined below:

- **1A.** When the employer contribution rate is set to decrease, allow all or a portion of the anticipated reduction to remain in effect and be dedicated to fund the experience account.
- **1B.** Add another component to the calculation of the employer contribution rate to fund PBIs. The employer rate would then include (1) the normal cost component, (2) UAL component, (3) non investment-related administrative expenses, and (4) the PBI component. The PBI component would be credited to the experience account.
- **1C.** Apply contribution variance surpluses to fund the experience account, rather than direct application to the UAL, specifically experience account amortization base (EAAB). *TRSL's projected contribution variance surplus for 2021 is $28.6 million; since 2009, total contribution variance surplus is $432 million.*

ALTERNATIVE METHOD #2: Lower and/or cap excess investment earnings hurdles

Retain experience account and direct more investment earnings to the account by relaxing the hurdles the system must overcome before account deposits can be made.

- Lower and/or cap excess investment earnings hurdles that are currently in place to help pay down the UAL more quickly.
- Lowered and/or capped hurdles would result in a larger amount of excess investment earnings credited to the experience account in years where the actuarial rate of return exceeds the target return.

ALTERNATIVE METHOD #3: Funded through employer/employee contributions; hurdle modification/holiday

Establish a PBI structure in which the cost of future PBIs for new hires would be shared by the employee and employer. Current active members and retirees would continue under the current experience account method for a limited time. Immediately grant hurdle holiday(s) to direct more excess investment earnings into experience accounts and enable payment of a PBI to retirees within three years.

- For new hires, increase the employee contribution rate by a certain percentage to earn a PBI every other year starting at some point after retirement. Employers would also pay an additional percentage to cover the higher normal cost of these employees. Increased contributions for employee and employer would be calculated into the normal cost of the benefit.
- Current active members and retirees would continue, for a limited time, under the existing PBI/experience account structure paid through employer contributions.
  - Upon payoff of original amortization base (OAB) in 2029, the experience account would be dissolved and be replaced by a fixed employer contribution. Current gain sharing would end and the direct employer contribution would be credited to a side-fund to pay PBIs when the balance is sufficient to fully fund the increase.
  - Employer contribution rate increase would be incrementally phased in within next 1-2 years until reaching a fixed percentage annual increase.
- With implementation of this method, a hurdle holiday(s) would also be granted to direct 50% of all excess earnings into experience account to assist in funding a PBI within three years.

ALTERNATIVE METHOD #4: PBI Pre-Funding Account through employer contributions

Establish funding deposit account that would pre-fund PBIs with employer contributions. ***This method was proposed for the Municipal Police Employees' Retirement System (MPERS) in House Bill 19 of the 2020 Regular Session.***

- Would establish a PBI pre-funding account, which would allow board to require an employer contribution rate up to a certain percentage higher than the statutorily required employer rate for any given fiscal year.
- When the actual employer contribution rate is set above the minimum recommended employer contribution rate approved by the board and/or PRSAC, the excess contribution would be deposited into the PBI pre-funding account.
- The pre-funding account would earn interest at the board-approved valuation interest rate.
- Once the account is sufficient to fund a PBI, a certain percentage PBI would be granted from it to any retirees or beneficiaries reaching certain age and/or period of retirement status.
- The method does not set a PBI frequency, but it would allow greater predictability related to timing of future PBIs since it does not depend on the investment returns.

ALTERNATIVE METHOD #5: Minimum PBI or 13th Check

The Legislature could choose to use funds in experience account to pay a minimum PBI to current retirees who meet certain age, years retired, and benefit level requirements. ***This method was used in 2009 to lift retirees of TRSL and LASERS to poverty level under Act 144 of 2009 ("Doerge Bill").***

- **Possible eligibility criteria for retirees/beneficiaries:**
  - At least age 60 with 30 or more years of service credit
  - Retired for 15 or more years
  - Monthly benefit is less than $1,430, or $17,240 annually
  - Did not participate in DROP/ILSB.
- The minimum PBI payable to eligible retirees and beneficiaries would be the lesser of $300, or the difference between $1,430 and their current monthly benefit.
- An alternative to providing a minimum PBI would be to use the PBI eligibility in current law and provide eligible retirees/beneficiaries with a 13th check (a one-time additional benefit check).

Questions?

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