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Reducing the Cost of Tomorrow

A Practical Guide to Pension Reform in Jefferson, Orleans and St. Tammany Parishes

BGR PENSION SERIES

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BGR

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EXECUTIVE SUMMARY

The mounting costs of public employee pensions, coupled with the disparity between public and private sector retirement benefits, have inspired pension reforms across the nation. From 2009 to 2016, the public's pension plan costs increased for all but one of the 18 plans in which the governments in Jefferson, Orleans and St. Tammany parishes participate. The City of New Orleans alone will put $105.5 million toward pension costs in 2016, almost all coming from its general fund. In fact, pensions absorb 16 cents of every dollar citizens send to the general fund – a pot of money that also must be used to pay for basic municipal services.

In many cases, these same citizens are helping to pay for public sector retirement benefits that are far more generous and secure than their own. In fact, in the eight-parish New Orleans area, roughly half of the private sector workers lack access to any form of employer-supported retirement plan.

In 2012, BGR launched a series of reports to explore public employee pension plans and their costs. This report, the fourth in the series, presents options for reforming the 18 public pension plans in which local government employers in Jefferson, Orleans and St. Tammany parishes participate (the Plans). BGR examines potential reforms to traditional defined benefit pension plans and then analyzes entirely different kinds of retirement plans that reduce or eliminate the financial risks to public employers. We take as a starting premise that public retirement plans should aim to strike a balance between the need to provide retirement benefits and the efficient use of taxpayer dollars.

This report presents a range of options that can be applied to new hires and, in some cases, current employees. It is a practical guide towards smarter benefit programs. This report does not resolve the multitude of specific legal questions that can arise for each reform option when applied to a particular plan. Nor does it attempt to perform the actuarial analyses to project the cost savings each reform option would yield. Finally, the report does not evaluate pension reforms in the context of an employer's total compensation package, nor does it analyze offsetting adjustments in salary and other benefits that may be necessary to attract and retain qualified employees.

Options to Reform Defined Benefit Plans

The vast majority of public employees nationwide participate in defined benefit plans, which provide retirees with a specified level of annual retirement income. Employer contributions, investment earnings and usually employee contributions fund defined benefit plans. Market declines, unfunded liabilities and poor funding decisions increase a public employer's pension cost. Taxpayers primarily bear the burden of that cost, through increased taxes or cuts to services.

But there is another key driver of pension costs: the generosity of plan benefits. This report looks at the factors that determine the generosity of a defined benefit plan and presents options to align the Plans with national medians and other norms. Policymakers can reduce the costs and risks associated with public pension plans by making the following changes:

- Require employees to contribute at least the national median – 6% for Social Security-Supplemented Plans and 8% for Unsupplemented Plans. Employee contribution rates should be set above the median for the more generous plans.
- Set multipliers – the rate at which retirement benefits accrue – no higher than the national medians, 1.9% for Supplemented Plans and 2.4% for Unsupplemented Plans.
- Consider implementing a longer final average compensation period and cap year-over-year salary increases for benefit calculation purposes at 10%.
- Establish benefit caps on a sliding scale based on an employee's pre-retirement income – generally targeting 70% income replacement from pension benefits in an Unsupplemented Plan, with higher replacement percentages attainable for employees at lower salaries. Implement an absolute cap on benefits to prevent excessive payments to the highest paid employees.
- Establish a fixed retirement age more in line with the normal retirement age under Social Security, currently 66 for employees born after 1943 and 67 for employees born after 1959. Establish a sliding scale reducing benefits for those who wish to retire early. Limited exceptions could be provided for public safety personnel.
- Eliminate publicly-funded cost of living

adjustments; instead, allow employees to arrange the payment of their benefits in a manner that steps up over time.
- Eliminate deferred retirement options.

Alternative Plan Structures

Even if a defined benefit plan were aligned with the national medians for public pension plans, it would still produce a retirement benefit more generous than the benefit received by a private sector employee contributing the same amount toward retirement. A hypothetical public sector employee hired in 2016 at a starting salary of $40,000 could expect a 27% higher retirement benefit in a defined benefit plan supplemented by Social Security, and an 11% higher benefit in an unsupplemented plan.

Importantly, the risks associated with defined benefit plans remain squarely on the shoulders of the public. This has prompted some governments nationwide to switch to alternative plan designs. This report explores the following alternatives:

- *Defined contribution plans*, the predominant private-sector model, shift all of the risks associated with investments to employees. Government responsibility ends with its upfront contributions to employee retirement accounts.
- *Hybrid plans* combine defined contributions with a reduced defined benefit component so that employers and employees share in the risks.
- *Cash balance plans* function like defined contribution plans but provide a guaranteed minimum return – a floor – on employee contributions. This protects the employee while reducing, but not eliminating, the employer's risk.

Policymakers should seriously consider these alternative plan designs as a way to contain future costs and risks to local governments and taxpayers.

Conclusion

In looking to craft pension reforms, citizens and policymakers should keep in mind the vast gulf between public and private sector employees when it comes to retirement benefits. It is critical that reformers strive to provide public employee benefits that, as part of a total compensation package, will attract and retain high-quality employees – while also ensuring that the level of benefits and their costs are fair to taxpayers.

Defined benefit pension plans for public employees in Louisiana as currently structured are in desperate need of reform. In most cases, the multipliers exceed the national median by wide margins, significantly increasing the rate at which employee benefits accrue and significantly reducing the amount of time that an employee needs to work in order to receive 100% of pre-retirement income.

It remains true that the Plans in which local governments participate are more generous than national public sector medians in most respects. That generosity has contributed to ballooning costs – with employer contributions as high as 118% of total employee pay – threatening state and local government budgets. In other words, the cost of yesterday's pension promises can diminish government's ability to provide public services today and in the future.

Both public employees and private citizens alike bear the cost of past generations' pension excesses. Policymakers ought to consider alternative pension plan designs that, in the long run, halt this generational cost transfer.

These plan designs would shift some, if not all, risk away from public employers. While employees take on additional risk, they also would enjoy greater plan portability. Under a defined contribution or cash balance plan, changing jobs would not mean having to start saving for retirement all over again. These plan designs may also better reflect the evolving expectations and career patterns of the work force.

At a minimum, policymakers should pursue reforms to the existing defined benefit offerings to bring them to a more reasonable level. That implies lowering multipliers to at least the national public sector median, raising the minimum retirement age, eliminating perks such as lump sum payment programs, limiting the income replacement to a need-based percentage of an employee's salary, implementing a cap on benefits and leaving it to employees to self-fund cost of living adjustments.

INTRODUCTION

From 2009 to 2016, the public's pension plan costs increased for all but one of the 18 plans in which the governments in Jefferson, Orleans and St. Tammany parishes participate. (See Table 1.) The City of New Orleans alone will put $105.5 million toward pension costs in 2016, almost all coming from its general fund.[1] In fact, pensions absorb 16 cents of every dollar citizens send to the general fund[2] – a pot of money that also must be used to pay for the basic municipal services upon which citizens rely.[3]

As BGR detailed in a 2013 report, the meltdown surrounding the firefighter pensions in New Orleans provides a case study in what can go wrong with defined benefit pension plans.[4] In that case, the factors included poor investment decisions, overly optimistic assumptions on investment returns, chronic underfunding and highly generous pension benefits. Between 2009 and 2015, the funded ratio of the New Orleans Firefighters' Plan declined from an already low 54% to a dismal 12%, causing the cost of the pension fund to skyrocket.[5] Today, employer contributions to the fund equal 118% of active firefighter pay.[6]

It is close to impossible to eliminate pension obligations incurred in the past.[7] But state and local officials can make changes to reduce future costs and redirect the financial risks inherent in providing a defined benefit pension.

In 2012, BGR launched a series of reports to explore public employee pension plans and their costs. The first report, *Understanding Pensions: A Primer on Public Employee Pension Plans*, introduced the subject. The second report, *The Rising Cost of Yesterday: Metro Area Pension Costs and the Factors that Drive Them*, surveyed local pension plans and explained the causes and scope of local pension woes. In 2013, BGR published a third report focused solely on the New Orleans Firefighters' Pension and Relief Fund called *Sound the Alarm: New Orleans Firefighter Pension Woes and the Legislative Session.* All of these reports are available on BGR's website, www.bgr.org.

This report is the fourth in the public pension series. It builds on BGR's 2012 survey work and revisits the 18

TABLE 1: RISING COSTS FOR GOVERNMENT EMPLOYERS
Employer Contribution Rates as a Percentage of Projected Payroll, 2009 and 2016

Plan	2009	2016
New Orleans Firefighters (New)	48.2%	118.6%
Lasers Judges	18.5%	39.3%
Lasers Regular	18.5%	37.2%
School Employees	17.8%	30.2%
Municipal Police*	9.5%	29.5%
Teachers Plan B	15.5%	28.8%
Louisiana Firefighters*	12.5%	27.3%
Teachers Regular	15.5%	26.3%
S&WB	12.4%	22.6%
New Orleans Municipal	14.9%	22.5%
Registrars of Voters**	2.0%	22.5%
Municipal Employees Plan A**	13.5%	19.8%
Clerks of Court**	11.8%	19.0%
Sheriffs**	11.0%	13.8%
Assessors**	13.5%	13.5%
Parochial Employees Plan A**	12.3%	13.0%
Municipal Employees Plan B	6.8%	9.5%
District Attorneys	0.0%	3.5%

* Fiscal Year 2016 reflects the rate for employees with earnings above the poverty level. Employers must contribute at a slightly higher rate for those at or below the poverty level.
** For 2016, these plans elected to require employers to contribute at a rate above the minimum rate recommended by the plan's actuary.

Sources: Systems' actuarial valuation reports and annual financial reports.

"The City of New Orleans alone will put $105.5 million toward pension costs in 2016, almost all coming from its general fund. In fact, pensions absorb 16 cents of every dollar citizens send to the general fund – a pot of money that also must be used to pay for the basic municipal services upon which citizens rely."

public pension plans in which local government employers in Jefferson, Orleans and St. Tammany parishes participate (the Plans).[8] (For a breakdown of participation by parish, see Appendix A.) In 2012, BGR found that the benefits available to local government employees in 17 of the 18 Plans exceeded national medians for the public sector. The benefits far exceeded what is available to most private sector employees. (See the sidebar.)

In this report, BGR updates several of the comparisons in the 2012 report and presents options to align the Plans with national medians and other norms. While national medians may not always achieve the highest and best efficiencies, they are a useful benchmark considering the costs, features and benefit levels of our Plans.

In this context, BGR examines potential reforms to traditional defined benefit plans and then analyzes entirely different kinds of plans that reduce or eliminate the financial risks to public employers. We take as a starting premise that public retirement plans should aim to strike a balance between the need to provide retirement benefits and the efficient use of taxpayer dollars.

BACKGROUND: DEFINED BENEFIT PLANS

The vast majority of public employees nationwide participate in *defined benefit* plans.[17] A defined benefit plan provides workers with a specified level of annual retirement income until they (or, in some cases, their beneficiaries) die.

Defined benefit plans are funded through employer contributions, investment earnings and usually employee contributions. Ideally, these contributions, combined with the plan's investment earnings, will cover the entire cost of an employee's pension.[18]

AN IMBALANCE BETWEEN PUBLIC AND PRIVATE SECTOR EMPLOYEES

In *The Rising Cost of Yesterday*, BGR noted that public sector employees enjoy a level of financial security in retirement that is unavailable to most private sector workers.[9] Where private sector workers do have access to an employer-supported plan, it is usually a defined contribution plan, which does not provide any guaranteed benefit level. Those benefits tend to fall far short of what public sector employees receive.

BGR compared public and private employees with the same pay and equivalent retirement contributions. Among the Plans, BGR found differences in annual benefits ranging from 18% to 71% higher than what the private sector employee would receive.[10] For instance, a Sewerage & Water Board employee who is hired at a salary of $40,000 and works for 30 years would receive a combined annual pension and Social Security benefit of $47,400, nearly $20,000 more than a private sector employee under the same circumstances.[11] Also, all but one of the Plans were more generous than the national median for publicly funded pensions.[12]

In some cases, BGR found that public employees can earn more in retirement than while they were working.[13] However, because expenses usually decrease in retirement, a retiree generally needs less than his pre-retirement income to maintain his quality of life.[14]

As BGR's 2012 report pointed out, private sector employees are helping to pay for public sector retirement benefits that are far more generous and secure than their own. Nationwide, more than 40% of private sector workers lack access to an employer-supported retirement plan. In the eight-parish New Orleans area, the situation is worse: Roughly half of the private sector workers lack access to such a plan.[15] These workers must rely solely on Social Security and their own savings to meet their needs in retirement, yet their tax dollars fund public pensions.

Some argue that generous public sector retirement benefits are necessary to offset wage differentials between the public and private sectors. However, whether such a gap exists in the local area would require further study. Moreover, if public sector pay is too low, it is unclear that richer pensions are the best way to address the issue.

The disparity between public and private sector retirement benefits grows when other benefits, such as retiree health insurance, are considered. Only a small minority of corporations still pay for retiree health care.[16] In contrast, post-employment benefit plans remain popular in the public sector. However, governments have set little money aside to pay their future costs. This report does not address post-employment benefits.

But if the amounts contributed to the plan during an employee's years of service, combined with the plan's net investment earnings, are insufficient to pay for the promised benefit, the employer must make up the difference. Taxpayers primarily bear the burden of that cost, either through increased taxes or cuts to services.[19]

Investment losses from the 2008 financial crisis buried public pensions nationwide under obligations for which they no longer had sufficient funding.[20] This problem is typically measured based on the ratio of a plan's assets to the benefits it owes to present and future retirees, known as its funded ratio.[21] In 2014, the most recent year available, public pension plans nationally were 74% funded in the aggregate.[22] The funded ratio for the 18 Plans in the aggregate was lower: 67%.[23] Only seven of the Plans exceeded the 80% minimum funded ratio prescribed by the U.S. Government Accountability Office (GAO) and one (District Attorneys) reached the 100% funding that the American Academy of Actuaries calls for.[24] Any unfunded pension liabilities must be amortized over time and paid for by future taxpayers. Appendix B lays out the Plans' funded ratios.

Since 2008, all 50 states have implemented some degree of pension reform.[25] Most have dialed back the benefits they offer employees and increased employee contributions.[26] Some have replaced existing defined benefit plans with entirely new plan structures.[27]

For current retirees, a government's best option to control costs is reducing or eliminating cost of living adjustments; the Louisiana Constitution protects accrued benefits. For active employees, it may be legally permissible for policymakers to make other changes that reduce future accruals of pension benefits; it may also be permissible to increase employee contributions.[28] Policymakers are largely unhindered when making changes that affect only new hires.[29]

This report presents a range of options that can be applied to new hires and, in some cases, current employees. It is a practical guide towards smarter benefit programs. This report does not resolve the multitude of specific legal questions that can arise for each reform option when applied to a particular plan. Nor does it attempt to perform the actuarial analyses to project the cost savings each reform option would yield. Finally,

CALCULATING CONTRIBUTIONS

Each year, actuaries determine how much participating government employers in defined benefit plans should pay to meet pension costs accruing in that year and cover a portion of any unfunded accrued liabilities. For many of the Plans, the amount that the employer currently contributes to the retirement benefits of active employees accruing in a given year, called the "normal cost," is significantly smaller than the amount that the employer contributes to cover unfunded liabilities. For example, employers participating in the Teachers' Retirement System of Louisiana contributed 28% of payroll to the plan in 2015, but only 5.3% of payroll was attributed to normal cost.[30] The vast majority of employer contributions to the pension plan in a given year are for its unfunded liabilities; 81 cents of every taxpayer dollar these employers contribute pays for obligations incurred in past years.

Actuaries make a number of assumptions when calculating employer contribution rates. Those assumptions include the age at which employees will retire, how markets will perform and how long retirees will live.[31] When plan experience deviates from these assumptions, the unfunded liabilities may grow (or decrease).

Expected market performance is a particularly influential assumption.[32] Earnings on investments represent a significant portion of plan funding.[33] Between 1985 and 2014, investment returns provided 64% of the $6.7 trillion in state pension revenues nationally, compared to 25% from employer contributions and 11% from employee contributions.[34]

There is some debate over what expected rate of return should be applied to pensions. The higher the rate of return, the lower the public cost to keep plans on a sound footing. Most plans assume a rate of return between 7% and 8%.[35] However, some observers suggest that even 7% may be too high.[36]

Plans discount the expected pension liability to present value using the assumed rate of return. Plans use this discounted pension liability to determine how much money employers and employees need to contribute to satisfy future plan obligations.

Seemingly small changes in the discount rate can have a significant effect on the amount an employer must pay into the fund to cover currently accruing benefits as well as the unfunded liabilities of the plans. For example, if the Louisiana State Employees' Retirement System lowered its discount rate by one percentage point, its reported liabilities would increase by 26%.[37] A 27% jump would occur with Teachers.[38]

Because the public – and in some cases, current employees – must pick up the cost, there may be political pressure not to lower the Plans' assumed rate of return, even if doing so would more accurately reflect the amount of money a plan needs to meet its obligations.

the report does not evaluate pension reforms in the context of an employer's total compensation package, nor does it analyze offsetting adjustments in salary and other benefits that may be necessary to attract and retain qualified employees.

CHANGES TO DEFINED BENEFIT PLANS

Beyond the effects of market declines, unfunded liabilities and poor funding decisions, there is another key driver of pension costs: the generosity of plan benefits.

The factors that determine the generosity of a defined benefit plan include:

- Employee contribution rates.
- The benefit multiplier.
- The final average compensation calculation.
- The maximum benefit.
- Eligibility to receive benefits.
- Cost of living adjustments.
- Deferred retirement programs that provide lump-sum payments.

In *The Rising Cost of Yesterday*, BGR made comparisons to defined benefit plans nationwide and found that the Plans in Jefferson, Orleans and St. Tammany parishes were generous when it came to almost all of these factors. This section suggests potential options to align the Plans' benefit characteristics with national medians and norms.

It should be noted that the vast majority of the Plans are controlled at the state level.[39] The Louisiana Legislature controls plan design through legislation, and the Public Retirement Systems' Actuarial Committee recommends employer contribution rates and amounts based on the systems' actuarial reports.[40] But in most cases, the employers who pay into the system are local entities such as municipalities and school boards.

Employee Contributions

For most of the Plans, employees are required to contribute a percentage of their salaries. The contribution rates are set in most cases by state and local laws.[41]

Unsupplemented Plans are not supplemented by Social Security. Nationally, the median employee contribution

PUBLIC PENSIONS AND SOCIAL SECURITY

When the Social Security Act was passed in 1935, Congress was unsure whether the United States Constitution would permit the states to participate in the federal retirement program. As a result, state and municipal employers were excluded.[44]

Between 1951 and 1956, Congress made a series of changes to the Social Security Act that ultimately allowed state and local government employees to participate in Social Security.[45] Under the program, a participating employer has no obligations beyond its contributions, and employees are guaranteed a minimum income in retirement. Both participating employers and employees make Social Security contributions through a payroll tax. The total tax rate is 12.4%, with employers and employees each paying 6.2% of each paycheck toward Social Security. An employee who participates in Social Security must have contributed to the program for at least 10 years in order to be eligible for retirement benefits. Those years need not be consecutive.[46]

Social Security can supplement any pension plan type an employer offers. However, state and local public employers are not required to participate in Social Security if they provide comparable retirement benefits.[47]

Nationwide, about 70% of public employees are covered by Social Security.[48] State and local governments that participate in Social Security may include all employees or just some, subject to a member vote.[49] They may also choose to add Social Security benefits without reducing employer-provided retirement benefits[50] or to offset the employer-provided plan with Social Security.[51]

The latter approach shifts some of the risks associated with defined benefit plans to the federal government. Employers are limited to paying only their share of the Social Security tax.

It should be noted that Social Security provides automatic cost of living adjustments, protecting the Social Security portion of retirees' benefits against inflation.

Joining Social Security does come with potential drawbacks. The federal government could raise the Social Security tax or raise the total amount of salary on which Social Security taxes are applied, thereby increasing the employer's contribution costs.[52] Further, under certain circumstances Social Security may increase the current costs of a plan. For example, in May 2014, the Center for Retirement Research found that, if the California State Teachers' Retirement System were to participate in Social Security, it would increase employer contributions as a percentage of payroll by about 2.6%, a 25% increase in employer cost.[53]

In the New Orleans area, only four of the 18 Plans participate in Social Security.[54] Of those four, two layer Social Security benefits on top of other benefits, rather than using Social Security to offset plan benefits.[55]

rate for Unsupplemented Plans was 8% in 2013.[42] This is slightly lower than the median in 2010.[43]

As of 2014, only one Unsupplemented Plan in which local government employers participate had an employee contribution rate below the national median. The rest were at or above the national median. See Table 2. As discussed later, these plans also provide significantly higher benefits than national norms.

In Supplemented Plans, employees participate in Social Security in addition to the local plan. Because these employees pay 6.2% Social Security taxes, their plan contribution rates are typically lower. The national median for employee contributions to Supplemented Plans nationwide is 6%.[56]

Two of the four Supplemented Plans currently have contribution rates of 6%. The other two are set at 5%.

State law gives employers in three Plans – Assessors, Clerks of Court and Sheriffs – the option of paying all or part of their employees' contributions.[57] The assessors in Jefferson, Orleans and St. Tammany, and the St. Tammany Clerk of Court have chosen to pay the entire employee contribution. The Jefferson Parish Sheriff's

TABLE 2: EMPLOYEE CONTRIBUTION RATES, 2016

PLAN	Employee Contribution Rate, 2016
Unsupplemented Plans:	
Lasers Judges	Judges elected on or after 1/1/2011 pay 13%, while all others pay 11.5%.
Sheriffs	10.25%
New Orleans Firefighters (New)	10%
Louisiana Firefighters*	10% if income is above poverty level, 8% if income is at or below poverty level.
Municipal Police*	All employees hired prior to 1/1/13 and hazardous duty employees hired on or after 1/1/13 pay 10% if income is above poverty level, 7.5% if income is at or below poverty level. Nonhazardous duty employees hired on or after 1/1/13 pay 8%.
Municipal Employees Plan A	9.50%
Parochial Employees Plan A	9.50%
Clerks of Court	8.25% / 0%**
Assessors	8% / 0%***
District Attorneys	8%
Teachers Regular	8%
Lasers Regular	8% for those hired on or after 7/1/2006 and 7.5% for those hired prior to that date.
School Employees	8% for those hired on or after 7/1/2010 and 7.5% for those hired prior to that date.
National Median	**8%**
Registrars of Voters	7%
Supplemented Plans:	
S&WB	6%
New Orleans Municipal	6%
National Median	**6%**
Municipal Employees Plan B	5%
Teachers Plan B	5%

* The rate for members earning at or below the poverty level is fixed. The rate for members earning above the poverty level can range from 8% to 10% for Louisiana Firefighters and 7.5% to 10% for Municipal Police. See La. R.S. 11:62(3) and (6).
** In St. Tammany Parish, the employee contribution rate is effectively zero because the clerk of court pays the employee's share.
*** In Jefferson, Orleans and St. Tammany parishes, the employee contribution rate is effectively zero because the assessor pays the employee's share.

Sources: Louisiana Revised Statutes, City of New Orleans Code of Ordinances, the Rules and Regulations of the Employee Retirement System of the Sewerage & Water Board, and individual Plans.

Office pays 7% of the 10.25% required employee contribution for employees hired before July 1999.[58] Jefferson Parish government, which participates in Parochial Employees Plan A, pays the entire employee contribution for employees hired prior to 1986.[59]

Contributions are one of the few ways that employees and employers can share the risk in a defined benefit plan. Most of the Plans have fixed employee contribution rates. Some experts have suggested that it would be better to tie the employee contribution rate to the overall health of the fund.[60] For example, the statewide Firefighters Plan does this by setting its employee contributions relative to the total contribution rate.[61] Thus, when the employer's costs increase, the employee's costs also increase, spreading the burden of funding the plan.

It is in the best interest of employees to support the fiscal health of their retirement plans. Poorly funded plans drive up costs for employers and reduce their ability to increase wages.

Reform Option. All Plans should require employees to pay at a contribution rate that at least equals the national median. This change would increase the contribution rate for Registrars of Voters from 7% to 8%. It would increase the contribution rates for Municipal Employees Plan B and Teachers Plan B from 5% to 6%.[62] Employee contribution rates should be set above the median for the more generous plans.

It is reasonable for employees to cover at least part of the cost of their retirement benefits. Eliminating the practice of employers covering all or part of the employee contribution would effectively increase employee contributions from 0% to 8% for the Assessors plan in Jefferson, Orleans and St. Tammany, and from 0% to 8.25% for the Clerks of Court plan in St. Tammany.

Further, employee contribution rates could be tied to the employer contributions to spread the burden of funding the Plans.

Unlike the changes to other benefit levers, changes to contribution rates would have easily determined financial benefits for government employers. But BGR estimates that bringing employee contributions in line with the medians, in isolation, would not yield large financial benefits. (See Table 3.)

TABLE 3: ANNUAL COST SAVINGS FROM BRINGING EMPLOYEE CONTRIBUTIONS TO NATIONAL MEDIAN

	St. Tammany	Jefferson	Orleans
Municipal Employees Plan B	$7,791	--	--
Teachers Plan B	--	$50,159	$18,403
Registrars of Voters	$1,528	$4,082	$2,729
Assessors	$186,137	$137,569	$241,194
Clerks of Court*	$409,317	--	--
Total	**$604,772**	**$191,810**	**$262,326**

* The number reflects estimated contributions at the 8.25% contribution rate for the Clerks of Court Plan, rather than the national median of 8%.

BGR calculations based on information in the Plans' Governmental Accounting Standards Board Statement No. 68 reports for 2014 and information provided by Teachers and Clerks of Court. BGR estimated the cost savings for plans other than Clerks of Court by first dividing the total employer contributions by the contribution rate to determine total covered payroll. BGR then calculated the dollar value of additional employee contributions from total covered payroll.

Benefit Multipliers

In a defined benefit plan, retirees receive a guaranteed annual benefit based on the following formula:

Final Average Compensation x Multiplier x Years of Service

The multiplier represents the rate at which retirement benefits accrue – the higher the multiplier, the faster the retirement benefit grows. Small changes in the multiplier can significantly change the resulting annual benefit.[63] For example, reducing the multiplier from 2.2% to 2% reduces the retirement benefit by 9%.

The national median multiplier for Unsupplemented plans is 2.4%, and the median multiplier for Supplemented plans is 1.9%.[64]

Plans for police and firefighters tend to provide slightly higher multipliers than plans for other government workers.[65] This is because a higher multiplier usually allows for earlier retirement, and the work life of public safety employees is typically shorter than normal, due

to the hazards and physical demands of their jobs.[66]

Multipliers are a key factor in determining the adequacy of retirement benefits. Because of lower living expenses, retirees generally need 70% to 80% of their pre-retirement income.[67] An employee in an Unsupplemented Plan who retires after 30 years at the national median multiplier of 2.4% would replace 72% of his final average compensation. The same employee in a Supplemented Plan at the median multiplier of 1.9% would replace 57% of his final average compensation. Assuming conservatively that Social Security replaces 30% of pre-retirement income, this employee would achieve at least an 87% replacement ratio.[68]

However, most of the Plans are far more generous than the national median. As shown in Table 4, the multipliers used by all of the Plans for new hires will produce initial annual benefits that exceed the relevant national medians, most by wide margins.

Lowering the multiplier would reduce the cost of the Plans over time. Using the median multipliers, BGR calculated the annual benefit in the first year of retirement

TABLE 4: REDUCING THE PLANS' MULTIPLIERS TO THE NATIONAL MEDIAN

Plan	Current Multiplier for New Hires as of 9/1/16	% Reduction in Initial Benefit Using Median Multiplier*
Unsupplemented Plans:		
District Attorneys	3.50%	-28%
Lasers Judges	3.50%	-28%
Louisiana Firefighters**	3.33%	-26%
Assessors***	3.00% / 3.33%	-28%
Municipal Police (hazardous duty)***	3.00% / 3.33%	-28%
Registrars of Voters***	3.00% / 3.33%	-28%
Sheriffs***	3.00% / 3.33%	-28%
Clerks of Court	3.00%	-20%
Municipal Employees Plan A	3.00%	-20%
Parochial Employees Plan A	3.00%	-20%
Lasers Regular	2.50%	-4%
Municipal Police (nonhazardous duty)	2.50%	-4%
New Orleans Firefighters (New)****	2.50%	-4%
School Employees	2.50%	-4%
Teachers Regular	2.50%	-4%
National Median	**2.40%**	
Supplemented Plans:		
S&WB*****	2.50% / 4.00%	-31%
New Orleans Municipal*****	2.50% / 4.00%	-31%
Municipal Employees Plan B	2.00%	-5%
Teachers Plan B	2.00%	-5%
National Median	**1.90%**	

* BGR assumed a hypothetical employee who begins work on September 1, 2016 at $40,000 per year and averages a 3% annual pay increase during a 30-year career. His initial benefit in each case is determined by applying these variables to each Plan's current retirement benefit formula. The national median benefit assumes the relevant median multiplier and a final average compensation period of five years. BGR adjusted for the effect of inflation by discounting the benefit to present value using a 3% discount rate.
** The benefit reduction is slightly less for Louisiana Firefighters because the plan's benefits are calculated on a three-year, rather than five-year, final average compensation period.
*** For those with 30 or more years of service, the multiplier changes to 3.33% for all years.
**** The Legislature reduced the multiplier from 2.75% to 2.5% for those hired on or after August 15, 2016.
***** The S&WB and New Orleans Municipal plans provide a multiplier of 2.5% for the first 25 years of service and 4% for each year thereafter.

Sources: The Plans' most recent actuarial valuation reports and enabling statutes.

for a hypothetical employee who begins work today at $40,000 per year and who works for 30 years. If the multipliers were decreased to the national median, the initial annual benefit for 12 Plans would decline by 20% or more – yielding significant savings to the public.

As shown in Table 5, lowering the multiplier slows the rate at which the benefit accrues. In addition to reducing the value of the initial benefit, this would also encourage workers to retire later. The later an employee retires, the fewer years he spends in retirement, reducing the overall cost of providing retirement benefits.

It is interesting to note, however, that by targeting income replacement at 80% of final average compensation, it would take 33.3 years to reach that level at the national median 2.4% multiplier for Unsupplemented plans. Assuming a person entered the workforce at age 25, he could retire at that level at age 58. This indicates that the median multiplier is adequate.

TABLE 5: EFFECT OF REDUCING THE MULTIPLIER

Multiplier for Unsupplemented Plan	Years to 80% Final Average Compensation
3.5%	22.9
3.4%	23.5
3.3%	24.2
3.2%	25.0
3.1%	25.8
3.0%	26.7
2.9%	27.6
2.8%	28.6
2.7%	29.6
2.6%	30.8
2.5%	32.0
2.4%	33.3

Multiplier for Supplemented Plan	Years to 80% Final Average Compensation*
2.5%	20.0
2.4%	20.8
2.3%	21.7
2.2%	22.7
2.1%	23.8
2.0%	25.0
1.9%	26.3

* The 80% replacement rate for the Supplemented Plan assumes that Social Security replaces 30% of preretirement income and the pension benefit replaces 50%.

BGR calculations.

Reform Option. Each of the Plans should have a benefit multiplier at or below the national medians of 2.4% for Unsupplemented Plans and 1.9% for Supplemented Plans. This will require reductions in the multipliers of every one of the Plans. As shown in Table 4, reducing multipliers to the national median would reduce the benefits in most of the Plans, though some would see reductions as small as 4%. As the percentage changes in employee benefits suggest, the cost reductions could be significant over time.

Final Average Compensation Calculation

Final average compensation is the calculation of an employee's average earnings over a set period of time, and is a component of the retirement benefit calculation. The period is usually based on the relevant number of years leading up to retirement, which tend to be the years of highest pay. A longer final compensation period typically results in a lower annual benefit, because it usually captures earlier years in which the employee was paid less.[69] In addition, the types of pay counted as compensation can affect the generosity of the benefit.[70]

A 2012 study conducted by the Wisconsin Legislative Council of 87 state retirement plans nationwide found that 50% of the defined benefit plans use a five-year final average compensation period, and 36% use a three-year period.[71] While the vast majority of plans nationwide used either three- or five-year averages, the survey also found lower and higher compensation periods. Illinois and Florida have the longest final average compensation periods, each set at eight years.[72]

Sixteen of the 18 Plans currently use a five-year final average compensation period. Only the Louisiana Firefighters and the S&WB plans use a three-year final average compensation period; the S&WB plan will move to a five-year period in 2018. Most of the state and statewide Plans also cap all their members' year-over-year salary increases for benefit calculation purposes at levels ranging from 10% to 25%.[73] The caps prevent any steep spike in salary at the end of an employee's service from

inflating his pension benefit and creating an unforeseen actuarial cost to the plan. The three local Plans – New Orleans Municipal, S&WB and New Orleans Firefighters (New) – do not cap year-over-year salary increases.

Social Security takes an average of an employee's highest 35 years of earnings; however, Social Security also adjusts amounts an employee earns before he turns 60 to account for inflation.[74]

Reform Option. By 2018, only the Louisiana Firefighters plan will be out of step with the national median. While the Plans' final average compensation periods are consistent with the national norm, employers should consider imposing a longer final average compensation period, perhaps the eight-year period used in places like Florida and Illinois. Switching from a five-year average to an eight-year average would result in a 4.2% reduction in an employee's benefit for most plans.[75]

The New Orleans Municipal, S&WB and New Orleans Firefighters (New) plans should cap their members' year-over-year salary increases for benefit calculation purposes at 10%. This would prevent any steep spike in salary at the end of an employee's service from inflating his pension benefit.

Maximum Benefit

As noted above, most retirees need at least 70% to 80% of their pre-retirement income in order to live comfortably.

Benefit caps allow employers to limit the annual pension payment to a reasonable level. They are most commonly expressed as a percentage of pre-retirement income; however, they can also be expressed as a flat dollar amount or a cap on the years of service that can be applied to a benefit calculation.[76]

Another approach is to combine a fixed dollar cap with a cap based on final average compensation. For example, the Illinois Municipal Retirement Fund caps an employee's benefit at 75% of final average compensation, and also caps the amount of an employee's pre-retirement income covered by the plan. In that fund, the employee contributes to the fund only from the first $111,572 of his salary, and earns a benefit only on income below that wage cap.[77] In short, the highest benefit an employee in the Illinois Municipal Retirement Fund can receive is $83,679.[78]

Caps set at a percentage of pre-retirement income might leave lower-paid employees with an inadequate retirement benefit.

A remedy may be to establish benefit caps on a sliding scale. Social Security implements a sliding scale by replacing more of an employee's lower earnings than an employee's higher earnings. Social Security replaces 90% of the first $856 of an employee's final average monthly earnings, but significantly less than 90% for earnings above that amount.[79] As a result, employees who earn less while working receive a greater percentage of their pre-retirement income once they stop working.

Finally, if not properly structured, a benefit cap could reduce an employee's incentive to continue working once he reaches his maximum benefit. This could encourage earlier retirements, increasing the numbers of years employees draw a pension and thereby increasing costs to the public. As discussed in the following section, a reasonable minimum age to collect retirement benefits can eliminate this outcome.

The 2012 Wisconsin study found that 70% of defined benefit plans had either a 100% cap or no cap at all.[80]

"All of the Plans allow members to earn benefits equal to 100% of their final average compensation. Indeed, the pension benefit offered by the New Orleans Municipal and S&WB plans, when combined with Social Security, allows employees to earn more in retirement than they did while working."

All of the Plans allow members to earn benefits equal to 100% of their final average compensation. Indeed, the pension benefit offered by the New Orleans Municipal and S&WB plans, when combined with Social Security, allows employees to earn more in retirement than they did while working.

Reform Option. None of the plans currently have meaningful caps in place. Imposing them would reduce the long-term costs associated with the Plans. At a minimum, the Plans should prevent a retiree from earning more in annual pension payments than he earned in salary. But policymakers should go further and establish benefit caps on a sliding scale based on an employee's pre-retirement income. The scale should generally target 70% income replacement from pension benefits in an Unsupplemented Plan, with higher replacement percentages attainable for employees at lower salaries.

In addition, to prevent excessive payments to the highest paid employees, an absolute cap should be imposed on pension benefits.

Eligibility to Collect Benefits

The age at which employees retire can affect the overall cost of a plan. The later an employee retires, the fewer years he spends receiving retirement benefits before he dies. Thus, an increase in the retirement age decreases the number of years during which the plan would have to pay out benefits to retirees.

To begin collecting benefits, an employee must meet eligibility requirements based on years of service or a combination of age and years of service. Typically, the older the employee, the fewer the years he must have worked to become eligible to retire.

Most of the plans in a 2013 national survey provided multiple paths to eligibility, and approximately half of public sector plans nationwide allow employees to retire at any age with 20 to 35 years of service.[81]

In Jefferson, Orleans and St. Tammany parishes, all but six of the Plans offer multiple paths to eligibility. Each of the Plans includes eligibility criteria that require employees to have both reached a certain age and completed a certain number of years of service. For example, the District Attorneys plan allows employees to retire with 10 years of service at age 60, 24 years of service at age 55, or 30 years of service at any age.[82] Five of the Plans allow employees to retire regardless of age once they have served 25 or 30 years. This means that an employee who starts working at the age of 18 could retire as early as 43 and begin collecting pension payments. (See Appendix C for the Plans' various paths to eligibility.)

The eligibility criteria for the Plans remain more generous than for Social Security. All of the Plans allow retirement at age 62 or younger. Under Social Security, workers can receive a reduced benefit as early as age 62, but the age for receiving full Social Security benefits is 66 for employees born after 1943, and rises to 67 for employees born after 1959. All of the Plans, by contrast, offer the possibility of retiring before the age of 66 with full benefits.

The Center for Retirement Research at Boston College has found that Americans are living about seven years longer than they did when Social Security began paying benefits in 1940. At that time, the retirement age was 65. The Center for Retirement Research calculated that, factoring in the increase in life expectancy and a constant ratio of working years to years in

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> **"The Plans should establish a fixed retirement age more in line with the higher retirement age required by Social Security."**

retirement, the Social Security retirement age should be changed to 70.[83]

It should be noted that allowing public safety personnel to collect benefits at an earlier age is not uncommon. As previously stated, the work lives of those employees tend to be shortened by the hazards and physical demands of their occupations.[84]

Simplifying the eligibility criteria to a single age, rather than a variety of combinations of ages and years of service, would place public employees on the same footing with most private sector employees. And, as discussed later in this report, it would eliminate the need for potentially costly deferred retirement programs.

Reform Option. The Plans should establish a fixed retirement age more in line with the higher retirement age required by Social Security. The Plans could grant limited exceptions for public safety personnel.

Plans could adopt a sliding scale as used for Social Security. This would allow employees to retire somewhat earlier with an actuarially reduced benefit, or retire later with an actuarially increased benefit.

Cost of Living Adjustments

Cost of living adjustments (COLAs) are occasional or periodic increases to retirees' annual benefit payments. COLAs are intended to help offset inflation's impact on the value of pension benefits during retirement.[85]

These post-employment benefit increases can be automatic each year or at the discretion of a decision-making body such as the state legislature or the pension board. The size of the increase can be a fixed percentage, or it can be tied to the Consumer Price Index.[86]

While most public sector plans nationally grant some form of automatic COLA,[87] only one of the Plans grants automatic COLAs. The S&WB ties its COLAs to the change in the Consumer Price Index. However, it caps them at 2% and limits them to the first $10,000 of a retiree's benefit. The effect is to cap COLAs at $200 per year.

The other Plans grant the increases at the discretion of each plan's board of trustees, subject to producing excess investment earnings, achieving minimum criteria for plan funding and complying with generosity limits.[88] In the case of the state Plans, COLAs also need to receive the Legislature's approval. These approaches prioritize plan health over funding a COLA.

Discretionary COLAs give plans flexibility in whether or how often they will offer an increase. However, they also come with their own problems. In contrast to automatic COLAs, discretionary increases are not prefunded, or paid for in advance as an actuarial cost of the plan.

Rather, the Plans fund their discretionary benefit increases using "excess" investment returns: When investment returns exceed expectations in a given year, a portion of the earnings that exceed the expected rate of return is set aside to satisfy a future cost of living adjustment.[89]

But the expected rate of return does not reflect what the Plans expect to earn in just a single year. Rather, it reflects what the Plans' actuaries believe pension fund investments will earn over the long term.[90] The "excess" investment returns in any given year compensate for returns below the expected amount in another year. Consequently, dedicating a portion of that "excess" to fund a cost of living adjustment hurts the overall financial health of the plan, making the plan less financially stable for active employees.[91]

The discretionary COLA shifts costs from one generation of employees to another, benefiting retirees who did not contribute toward the COLA at the expense of active employees. By contrast, a COLA that is prefunded during an employee's working life ensures that the beneficiary pays at least a portion of its cost.

In Louisiana, some employees can self-fund increases in their pension payments by agreeing to take a lesser

payment in early years of retirement and higher payments in later years. Self-funded, escalating benefits shift the responsibility of funding permanent benefit increases from the employer to the employee. This option is available in all of the 15 state and statewide Plans, where employees are allowed to take an actuarially reduced benefit that increases 2.5% each year.[92]

Reform Option. Instead of paying COLAs, Plans should allow employees the choice to structure benefits to step up over time. This would eliminate COLA costs to taxpayers and introduce predictability for both retirees and employers. Over time, this change would ultimately lower the cost of all Plans, but to differing degrees because some give more frequent and more generous COLAs than others.

However, any plan that intends to continue granting COLAs should arrange for them to be prefunded, or built into the cost of the pension plan. Plans should permit COLAs only when a plan has a healthy funding ratio and prohibit the payment of COLAs out of "excess" annual investment returns.

It should be noted that eliminating plan-provided COLAs in conjunction with reducing plan multipliers to the national median would lower the percentage of income replaced by the pension benefit. This would occur over time with the effect of inflation on level benefit payments or immediately in the case of a self-funded COLA.

Deferred Retirement Programs

Employees can receive lump sum payments for additional service beyond retirement eligibility through Deferred Retirement Option Plans (DROPs) and Back-DROPs.[93]

DROP enables an employee who is eligible for retirement to continue working while having his pension payments set aside. The payments are credited to an account during his continued employment, typically three to five years, and paid to him either in a lump sum or as an annuity when he retires.[94] The retirement benefit is calculated as if the employee had retired at the beginning of the DROP period.[95] The employee does not contribute to the retirement plan while he is in DROP. If an employee continues working after his DROP period expires, he again becomes a contributing member of the Plan and accrues supplemental benefits.

Back-DROP allows an employee to retroactively elect to take a DROP option. In Back-DROP, an employee who is eligible for retirement, but wishes to continue working, remains a contributing member of the plan until he actually retires. At that point, the plan gives the retiring member a lump sum payment equal to up to three years of the retirement benefits calculated as if he had retired at the beginning of the Back-DROP period. For example, an employee who retires at 65 and elects to take a three-year Back-DROP will be treated as if he had retired at age 62. In exchange for the resulting reduced annuity, he would receive three years' worth of retirement payments in a lump sum.

Nationwide, fewer than 30% of state and local plans offer DROP.[96] By contrast, all of the Plans offer some form of DROP: 15 of the Plans offer DROP and three of the Plans offer Back-DROP.[97]

It is common for DROP plans nationally to provide employees with interest accruals during the DROP period. This can create cost when the market does not deliver the interest rate promised by the employer.[98] In particular, plans that guarantee interest at the assumed rate of return for the plan risk losing money because they have guaranteed a long-term interest rate on a short-term investment, the latter of which is more sensitive to market fluctuations.[99] Among the Plans, only the New Orleans Municipal and S&WB plans pay interest during the DROP period.[100]

"Nationwide, fewer than 30% of state and local plans offer DROP. By contrast, all of the 18 New Orleans-area Plans offer some form of DROP."

REFORMING THE NEW ORLEANS FIREFIGHTERS' PENSION AND RELIEF FUND

The New Orleans Firefighters (New) Plan is far and away the worst funded of the Plans. As of January 1, 2016, it was a mere 12% funded.[106] In order to keep the plan afloat, the City of New Orleans is required to contribute 118% of total firefighter payroll in 2016.[107] By comparison, local governments that participate in the Louisiana Firefighters' plan – including Jefferson and St. Tammany parishes – are required to pay up to 29% of payroll in Fiscal 2016.[108]

The current condition of the New Orleans Firefighters (New) Plan is a result of poor investment decisions, inadequate funding and overly generous benefits.[109] In recent years, the pension fund, the firefighters' union and the City of New Orleans have locked horns over the New Fund: The firefighters wanted the City to pay its full actuarially required contributions and the City wanted the firefighters to rein in their pension benefits.

In March 2016, the pension fund, the union and the City of New Orleans entered into a cooperative endeavor agreement resolving a long-running dispute over the management of the pension fund and decades of unpaid longevity raises.[110] As part of that agreement, the pension system, the union and the City agreed to changes to the plan's benefits, governance and funding. Many of these changes required legislative approval. The following summarizes significant changes made under the agreement and by 2016 legislation.

Reducing the Multiplier. The Legislature lowered the plan's multiplier for new employees from 2.75% to 2.5% as called for in the agreement.[111] This puts the plan more in line with the national median and reduces a retiree's annual benefit by 9%.[112]

Worker's Compensation Offset. Prior to the agreement, disabled retirees could simultaneously collect a disability benefit (provided by the pension fund) and a pension benefit. Under the agreement, the disability benefit will be offset against the pension benefit paid to future disabled retirees, such that the retiree will not receive more than 100% of his final average compensation.[113] The parties have agreed to litigate whether or not the offset can be applied to retirees currently receiving a disability benefit.[114]

COLAs. The agreement prohibits the pension fund from approving any COLA until the plan is at least 80% funded, and does not permit an adjustment that would cause the plan to dip below 80%. COLAs would be capped at 2% of the recipient's pension.[115]

DROP. As called for under the agreement, the Legislature passed legislation prohibiting participants from electing both DROP and an initial lump sum retirement benefit.[116] In addition, the interest rate for accounts of employees who have exited DROP is now tied to the money-market rates used by the Louisiana Firefighters Plan, rather than the investment returns of New Orleans Firefighters (New) Plan. In addition, negative as well as positive returns would be recognized.[117]

Interpretation of Benefits. In its 2013 report, *Sound the Alarm*, BGR pointed out that the firefighter's interpretation of how their benefits accrued did not seem to reflect state law.[118] The City and the firefighters have agreed to let a court determine the proper interpretation of benefits.[119] Even if the plan were to apply the statute as written just to active employees, it could save the city an estimated $1.2 to $1.3 million per year.[120]

Governance. The agreement calls for a number of changes to the fund's governance. It obligates the pension fund not to seek legislative changes to the benefit structure or funding terms.[121] It prohibits the pension fund from implementing any enhancements to the fund's benefit structure or reductions of employee contributions until the fund is at least 80% funded and would remain that way if the modification were made.[122] And the agreement directs the pension fund to seek City Council approval of any changes to the plan; council approval is not currently required by state law.[123]

Furthermore, the agreement requires the pension fund to regularly hone its estimates of pension liabilities. It requires the fund to conduct periodic comparisons of plan assumptions to actual experience, beginning in 2016 and at least every three to five years thereafter.[124]

To help avoid a repeat of past investment debacles, the agreement obligates the pension fund to establish an independent investment advisory board.[125] The board would consist of five members, one appointed by the city, one by the union and three by unspecified "community/taxpayer groups."

Funding. The City has agreed to make its full actuarially required contributions, not to exceed $36 million for the first six years.[126] In addition, the agreement calls for determining those contributions using conservative actuarial assumptions.[127] In April 2016, voters rejected a new, 2.5-mill property tax to support the cost of the pension plan, but the agreement requires the city to resubmit a tax proposition to voters before 2019.[128] The city plans to ask voters to reconsider the 2.5-mill tax in December 2016.

Eligibility. The Legislature raised the retirement age for new employees to "Social Security less 10."[129] The Social Security retirement age varies depending on an employee's birth year, currently 66 for employees born after 1943 and 67 for employees born after 1959.[130] The change means that a new hire born after 1959 can retire (with at least 12 years of service) at 57, up from 50 or 52 for current employees, depending on when they were hired.[131]

A DROP program can also create costs when plan experience deviates from actuarial assumptions. For example, individuals with access to DROP may enter the program earlier than the age at which they would have retired if DROP had not been available.[101] These employees would otherwise have stayed on as members of the plans, contributing for a longer time and drawing retirement for fewer years.[102]

Plans nationwide are taking a hard look at DROP programs and in some cases eliminating them altogether.[103] In part, that's because it is unclear whether DROP is necessary. One of the original arguments for DROP was to give an experienced employee time to train his replacement, but it is unclear how this has worked in practice. Another argument for DROP was to encourage public safety employees who are eligible to retire to continue working if they were physically able to do so.[104] This reasoning does not apply to employees in low-risk positions. While DROP may be a way to encourage public safety employees to continue working beyond a stated retirement age, there may be better alternatives. For example, under Social Security, an employee may elect to retire later than the normal retirement age, and is rewarded with an actuarially increased benefit.[105]

To the extent that a plan elects to keep DROP, the plan should tie eligibility to a reasonable retirement age. This would help reduce the risk that employees who would have stayed on anyway will participate in the program. DROP eligibility under the Plans is tied to retirement eligibility, but because many of the Plans allow employees to retire at any age with 25 or 30 years of service, some employees could sign up for DROP in their 40s.

Reform Option. Deferred retirement programs should be eliminated altogether, particularly if the Plans are subject to an appropriate fixed retirement age with actuarially increased benefits for those who stay beyond that age.

Summary

Public employers that want to continue to offer a defined benefit plan should strongly consider changes to those plans to make them more affordable to the public.

Policymakers can reduce the cost of pension benefits significantly by setting multipliers at or below the national median for public employees and raising the retirement

OPTIONS FOR REFORM: DEFINED BENEFIT PLANS

Benefit Lever	Reform Option
Employee Contributions	Require employees to contribute at least the national median – 6% for Supplemented Plans and 8% for Unsupplemented Plans. Employee contribution rates should be set above the median for the more generous plans.
Benefit Multiplier	Set multipliers no higher than the national medians – 1.9% for Supplemented Plans and 2.4% for Unsupplemented Plans.
Final Average Compensation Period	Consider implementing a longer final average compensation period and cap year-over-year salary increases for benefit calculation purposes at 10%.
Benefit Maximum	Establish benefit caps on a sliding scale based on an employee's pre-retirement income – generally targeting 70% income replacement from pension benefits in an unsupplemented plan, with higher replacement percentages attainable for employees at lower salaries. Implement an absolute cap on benefits to prevent excessive payments to highest paid employees.
Eligibility Requirements	Establish a fixed retirement age more in line with the normal retirement age under Social Security, currently 66 for employees born after 1943 and 67 for employees born after 1959. Establish a sliding scale reducing benefits for those who wish to retire early. Limited exceptions could be provided for public safety personnel.
Cost of Living Adjustments	Eliminate; instead, allow employees to arrange the payment of their benefits in a manner that steps up over time.
DROP and Back-DROP	Eliminate.

age. A handful of Plans can further reduce costs to the public by increasing employee contributions.

The public sector can realize further savings by limiting employees' retirement benefit to a reasonable percentage of pre-retirement income, establishing caps on benefits to prevent excessive payments to the highest-paid employees, eliminating COLAs in favor of an employee-driven approach, and eliminating DROP and Back-DROP.

But even if a defined benefit plan were aligned with the national medians, it would still produce a retirement benefit more generous than the benefit received by a private sector employee contributing the same amount toward retirement. A hypothetical public sector employee hired in 2016 at a starting salary of $40,000 could expect an 11% higher retirement benefit in an Unsupplemented defined benefit plan, and a 27% higher benefit in a Supplemented Plan.[132]

ALTERNATIVE PLAN STRUCTURES

The risks associated with defined benefit plans have made them increasingly rare outside of the public sector. When viewed in this broader context, dialing back plan benefits as outlined above is a modest option for containing the future costs of public pensions. Deeming the risks unacceptable, some governments nationwide have switched to alternative pension designs.

There are a variety of alternatives to a traditional defined benefit pension plan. Each of these alternatives diminishes or eliminates the risk to taxpayers associated with pension plans. Some alternative structures also eliminate the temptation of government to balance budgets by underfunding pension obligations.

It should be noted that, in considering alternative plan designs, public employers must analyze the overall compensation package to ensure it is sufficient to attract and retain high-quality employees. As part of this analysis, employers should keep in mind the evolving expectations and career patterns of the work force.

POSSIBLE REFORM AFOOT AT S&WB

The Sewerage & Water Board plans to study the comparative cost of switching its employees from a defined benefit plan to a defined contribution plan in conjunction with an overall review of job classifications and compensation. The study will look at the possibility of applying the change to both current, non-vested employees and new employees.

Defined Contribution Plans

In a defined contribution plan, the employer and employee contribute to the employee's individual retirement account. However, unlike a defined benefit plan, a defined contribution plan does not guarantee the employee any more than the value of the individual account. All contributions to the employee's retirement account are invested during his tenure.[133] The employee may elect to receive the balance of his retirement account as a lump sum, in periodic payments or as an annuity.[134]

While the employer bears all of the risks in a defined benefit plan, defined contribution plans place those risks with the employee. As a result, employers that offer a defined contribution plan are protected from increased plan costs.

Employees derive at least one key advantage from defined contribution plans in that they are portable. When an employee participating in a defined contribution plan switches jobs, he can take the accumulated balance of his account with him. Defined benefit plans don't offer this advantage to employees, leaving those who switch jobs with only their own contributions, plus limited interest in some cases; they are not entitled to receive the employer's contributions or the plan's investment earnings.

Defined contribution plans already exist in the public sector. They are most commonly used to supplement a core defined benefit plan, but rarely used to provide a primary retirement benefit.[135] The opposite is the case in the private sector.

Supplemental defined contribution plans are optional, and are not intended to fully support an employee's retirement.[136] In fact, federal law limits the amount of money that an employee may contribute to these types of defined contribution plans.[137] They are offered by most defined benefit plans nationwide.[138] Louisiana offers a supplemental defined contribution plan to all public employees.[139]

Several states offer employees the option of participating in a defined contribution plan instead of a defined benefit plan.[140] In Louisiana, higher education employees who are eligible to participate in Teachers are allowed to choose between participating in the traditional defined benefit plan or a defined contribution plan.[141]

Only two states – Alaska and Michigan– provide core retirement benefits solely through a defined contribution plan.[142] That said, there are also some local public employers, such as certain charter schools, that offer only defined contribution plans as well. (See discussion of charter schools on page 20.)

While a defined contribution approach limits an employer's pension liability, contributions to the plan would need to be significant to replace 70% or more of an employee's pre-retirement income. According to one study, employers and employees together would have to contribute at least 12% of payroll to a defined contribution plan supplemented by Social Security in order to replace 75% to 85% of pre-retirement income.[143] The overall contribution rate for employers and employees in that case, when Social Security is included, is 24.4% of payroll.[144] If split evenly, both employers and employees would have to make contributions at a rate of 12.2% of salary. According to the same study, required contributions to an Unsupplemented defined contribution plan would be 18% to 20% of payroll.[145]

With these estimates in mind, Table 6 provides exam-

TABLE 6: A COMPARISON OF 2016 EMPLOYER COSTS IN DEFINED BENEFIT VS. DEFINED CONTRIBUTION
Figures are expressed as percentage of projected payroll.

Plans	Defined Benefit		Defined Contribution	
Unsupplemented Plans	**Employer Normal Cost**	**Total Employer Contributions (Including Unfunded Accrued Liability)**	**Total Employer Contributions**	**Difference**
New Orleans Firefighters (New)	14.1%	118.6%	10.0%	-108.6%
Lasers Judges	5.9%	39.3%	10.0%	-29.3%
Lasers Regular	3.7%	37.2%	10.0%	-27.2%
School Employees	9.1%	30.2%	10.0%	-20.2%
Teachers Regular	4.4%	26.3%	10.0%	-16.3%
Supplemented Plans	**Employer Normal Cost and Social Security Tax Payments**	**Total Employer Contributions (Including Unfunded Accrued Liability)**	**Total Employer Contributions and Social Security Tax Payments**	**Difference**
Teachers Plan B	13.0%	35.0%	12.2%	-22.8%
S&WB	11.8%	28.8%	12.2%	-16.6%
New Orleans Municipal	8.4%	28.7%	12.2%	-16.5%

Note: The table includes only state and local Plans' actuarially determined employer contributions owed during the 2016 fiscal year. The statewide Plans are not included because each of those Plans' reported "normal cost" reflects both the cost of liabilities accruing that year and a portion of the unfunded accrued liability. Costs of Supplemented Plans include the employer's 6.2% Social Security tax payment. Defined contribution plan scenarios assume employer and employee split the cost of contributions of 20% of payroll in Unsupplemented Plans and 12% of payroll in Supplemented Plans. The table shows only the long-term difference in employer costs; the defined contribution rates do not reflect employer payments required on any unfunded accrued liability that may persist in the defined benefit plan.

Source: Information gathered from the Plans' actuarial valuations; projected employer contributions to defined contribution plan are based on calculations in TIAA-CREF Institute, *Defined Contribution Plans in the Public Sector: A Best Practice Benchmark Analysis*, April 2008.

ples of the differences in employer costs as a percent of payroll under a defined contribution plan versus the existing state and local defined benefit Plans. In most cases, employers pay significantly more for a single year's worth of benefits under a defined contribution plan (the normal cost). But the costs to employers of providing a defined contribution plan pale in comparison to the total amount employers owe in fiscal 2016. That year, employers will pay up to 10 times the normal cost because of past underfunding and the risks they've taken on by offering a defined benefit plan. In other words, if history is a guide, a defined contribution plan would be a much cheaper option in the long run.[146]

In a defined contribution plan, employees bear the risk that their retirement investment funds will not perform well enough to provide an adequate retirement benefit. This risk is amplified by the fact that employees are expected to make their own investment selection.[147]

Employers can help mitigate investment risk by having employees select from tailored investment fund options and by having investments default to "target date lifecycle funds."[148] Researchers have found that employees tend to be overwhelmed when offered too many options,[149] and recommend that defined contribution investment option menus contain no more than 10 funds.[150]

Target date lifecycle fund investments change over time to ensure that the level of risk is appropriate for each stage in an employee's career, in light of that employee's retirement goals.[151] Other fund types would require an employee to make investment decisions throughout his employment. He would have to manage the risk levels of his fund selections on his own and periodically rebalance[152] his investments. Most people lack this type of expertise.

Another potential risk to employees under a defined contribution plan is that a retiree will outlive his retirement savings. In a defined contribution plan, employers can help mitigate this risk by offering an annuity as the default retirement distribution option.

Finally, defined contribution plans typically allow employees to withdraw money from their accounts at

ANNUITIES

Annuities allow a retiree to buy a guaranteed, periodic payment either over a specified number of years or for the rest of his life. An employer or a third-party entity can offer the annuity.

Annuities are priced depending on current interest rates. When interest rates are high, annuities are more affordable. When interest rates are low, annuities are more expensive. How "expensive" an annuity is will determine how small or large the monthly annuity payments will be.

Offering an annuity is similar to offering a guaranteed benefit under a defined benefit plan. However, the monthly payments under the annuity are calculated once some of the key assumptions, such as how old an employee will be when he retires, have already been determined. This is less risky than projecting lifetime benefits while that employee is working.

TRANSITIONING TO AN ALTERNATIVE PLAN DESIGN

States have usually limited mandatory participation in alternative plans to new hires because of the legal protections afforded to pre-existing employees and retirees in the defined benefit plan. In some cases, they have given pre-existing, active employees the option of transferring to the new plan.

Moving to an alternative plan requires government employers to contribute to both the new and old plans. Furthermore, if the defined benefit plan closes to new members,[154] employers will likely see their costs rise in the short term for at least two reasons. One is that the drop in employee contributions to the old plan will force employers to pick up a greater portion of the annual required contribution. Another reason is that the old plan must amortize any unfunded accrued liability over a shorter period because the plan is no longer adding new employees.

Over time, these extra costs will dissipate as the defined benefit plan pays its obligations. The magnitude of these employer transition costs will depend on the funded status of the plan at the point of transition.

any time, even during employment, although income tax penalties may apply to early withdrawal. Still, the ability to withdraw creates the danger that employees will prematurely deplete their retirement. Here again, the employer can mitigate the risk. Employers can limit employees' ability to make early withdrawals from their defined contribution account balances. Public employers that offer a defined contribution option generally do not permit early withdrawals.[153]

Reform Option. Public employers should seriously consider offering a defined contribution plan for new hires. Employers might also follow the private sector in moving toward a defined contribution model for all new hires, reducing risk and cost to the public over the long term.

COMPARING PLANS IN NEW ORLEANS SCHOOLS

Certain New Orleans schools provide a real-world illustration of the difference in cost between a defined benefit plan versus a defined contribution plan. Currently, more than 90% of New Orleans' public schools are charter schools. These schools have the option of either participating in the state plans or hiring their own administrators and offering a defined contribution plan.[155]

To compare the cost of employer contributions, BGR selected three Recovery School District schools that participate in the Teachers Regular plan and three Recovery School District schools that offer employees a defined contribution plan.[156] Each of the schools selected offers grade levels from pre-kindergarten through eighth grade. The comparison pairs schools of the same approximate size based on number of students enrolled at the beginning of the 2013-14 school year.[157]

The difference in overall cost is startling. Each of the employers that participates in the state's defined benefit plans contributes between two and four times as much as the employers that offer a defined contribution plan. The cost of providing a guaranteed benefit to teachers is even more striking when viewed as a percentage of school funding. Schools are funded on a per-pupil basis. Each of the six schools received $8,985 per pupil for the 2013-14 school year. The schools that participate in defined contribution plans spent between 4% and 6% of their funding on pensions, while schools participating in Teachers spent between 13% and 17% of their funding on pensions.

TABLE 7: THE HIGH COST OF DEFINED BENEFIT PLANS IN SCHOOLS

RSD Charter School	Oct. 1, 2013 Pupil Count	DB/ DC?	Total Contribution, 2013-14	Per-Pupil Cost	Pension Cost as % of State and Local Funding
Fannie C. Williams Charter School	569	DC	$326,875	$574	6%
James M. Singleton Charter School	569	DB	$671,801	$1,181	13%
Mary D. Coghill Charter School	621	DC	$216,863	$349	4%
William J. Fischer Elementary School	645	DB	$960,226	$1,489	17%
ReNEW SciTech Academy at Laurel	748	DC	$330,209	$441	5%
Dwight D. Eisenhower Elementary	783	DB	$1,065,534	$1,361	15%

Note: For schools with defined contribution plans, total contribution amounts include both employer plan contributions and employer Social Security taxes. For schools participating in defined benefit plans, the contributions are to both Teachers and School Employees. However, only William J. Fischer Elementary School made employer contributions to School Employees. Per-pupil state and local funding for 2013-14 was $8,985. James M. Singleton Charter School terminated its participation in Teachers following the 2013-14 school year.

Source: BGR calculations based on information the Louisiana Department of Education Annual Financial Data Report for the 2013-14 school year and School-Level Per Pupil Expenditures (State, Local & Federal Funds), Enrollment Data, and Staffing Data for the 2013-14 school year; James M. Singleton Charter School, Financial and Compliance Audit for the year ended June 30, 2014, p. 14.

Hybrid Plans

In a hybrid plan, employees participate in both a defined benefit component and a defined contribution component.[158] The employer and employee each make contributions to both the defined benefit and defined contribution portions of the plan.[159] At retirement, an employee is entitled to both a defined benefit until death and the balance of his defined contribution account. The defined benefit portion is smaller than what it would be under a traditional defined benefit plan, thereby reducing the employer's long-term risk.

A 2015 study identified 12 state plans nationwide that had established a hybrid option.[160] Multipliers for the defined benefit portion of the plans range from 1% to 2%. In five of the 12 plans, the employer contributes exclusively to the defined benefit portion, while the employee directs most or all of his contributions to the defined contribution account. In the other plans, employer and employee contribute to both components.[161]

Instead of separating the defined contribution account from the defined benefit as these plans do, the Center for Retirement Research at Boston College has suggested "stacking" the components in a hybrid scheme.[162] In a stacked hybrid, an employer and an employee would make contributions to the defined benefit plan from a fixed amount of the employee's salary, and make contributions for the defined contribution from any earnings above that amount.[163] This would be a way of capping the defined benefit. For example, if the threshold level in a stacked hybrid plan were set at $40,000, an employee making that amount each year would participate only in the defined benefit portion of the plan. If an employee made more than $40,000 a year, he and his employer would still contribute a percentage of the first $40,000 of his salary to the defined benefit plan; however, a set percentage of any earnings over $40,000 would go toward the defined contribution portion of the plan.

In any hybrid plan, an employee is guaranteed a minimum level of benefits through the defined benefit component. The defined benefit portion of a hybrid plan can become underfunded, but the employer's overall risk exposure is smaller than it would be in a stand-alone defined benefit plan.

For example, BGR calculates that an employee with 30 years of service whose final average compensation is $40,000 would receive $12,000 in his first year of retirement from the defined benefit component of a hybrid plan using a 1% multiplier. Assuming that employee collects benefits for 30 years, the present value of benefits he collects during retirement would be $209,500. The same employee participating in a traditional defined benefit plan offering a 2.4% multiplier would collect $28,800 in his first year of retirement, and a present-value total of $502,800. In short, the employer-guaranteed portion of the benefit would be 140% larger in a traditional defined benefit plan versus a hybrid plan.[164]

Employers would also be responsible for their payments to the defined contribution portion of the plan, but responsibility to fund defined contribution benefits would end there.

In a hybrid plan, employees take on a degree of risk that they would not have under a defined benefit plan. On the other hand, the risk is less than they would encounter under a defined contribution plan. Furthermore, despite its risks, the defined contribution portion in a hybrid plan offers a measure of portability to short-term employees by providing benefits that employees can transfer to a new retirement plan when they leave.

Reform Option. Employers can reduce risk and long-term costs to the public by moving to a hybrid plan. While hybrid plans retain some degree of financial exposure for public employers, they are a step closer to private sector norms.

Cash Balance Plans

Cash balance plans are defined benefit plans that are structured like a defined contribution plan with a floor. Employees are guaranteed a minimum return on their contributions, as well as any additional market returns their accounts may earn.

Both the employee and the employer make contributions in a typical cash balance plan.[165] The contributions accrue interest throughout the employee's career, either at a rate fixed by statute or at a rate tied to some benchmark, such as the actual rate of return on the assets.[166] The funds are pooled with those of other employees

and invested by the employer, but an individual account is maintained on paper.[167]

Once the employee retires, he is entitled to the balance of his retirement account, either as a lump sum or as an annuity.[168] Public plans must provide the option of an annuity, and are able to limit an employee's ability to take a lump sum at retirement.[169]

Vested employees who terminate their employment before retirement can take their entire account balance with them. This includes employee and employer contributions, as well as interest credits from plan investment returns.[170] Non-vested employees may withdraw only their own contributions plus minimal interest, similar to what happens in defined benefit plans.

The key difference between a defined benefit plan and a cash balance plan is that the former guarantees a fixed benefit level in retirement, while the latter only guarantees a fixed rate of return on contributions. This reduces – but does not eliminate – risk to the employer.

Five states offer cash balance plans: California, Kansas, Kentucky, Nebraska and Texas.[171] In 2012, Louisiana attempted to add a cash balance plan for new employees in three of the four state Plans.[172] The reform would have added a cash balance option as a new "tier" to the Teachers, Lasers and School Employees systems. Only certain new employees would have been automatically enrolled in the cash balance plan; no current employees would have been able to opt-in.[173]

However, the Louisiana Supreme Court nullified the law creating the cash balance plan. Under the Louisiana State Constitution, changes to the state pension plans that will create an actuarial cost to the state must be approved by a two-thirds majority in both the House and the Senate.[174] The court relied on the Legislative Auditor's actuarial note, which said that a cash balance plan would be more costly than the existing defined benefit plan, and concluded that the state constitution would have required a two-thirds vote in order for the creation a cash balance plan to be valid.[175]

It is important to note that the cash balance plan itself was never ruled unconstitutional. Rather, the court found that passing the cash balance legislation would have required a supermajority under the Louisiana State Constitution. The cash balance plan won only a simple majority. [176]

As noted above, cash balance plans do not eliminate the employer's risk. Investment returns might not cover the interest promised to employees' accounts each year. Employees are entitled to interest accruals regardless of how plan investments actually perform, so it is possible for a cash balance plan to be underfunded.[177]

One way to ameliorate this concern is to tie the interest credits to the actual performance of the investments. For example, a plan could guarantee the actual rate of return, less administrative costs. However, because employees would be guaranteed at least the amount of the contributions, the employer would remain subject to investment risk in years where there is a negative return.[178]

The benefits provided under a cash balance plan tend to be smaller than those provided under a defined benefit plan. In a defined benefit plan, employees accrue more towards their retirement as they approach eligibility than they do early in their careers.[179]

This means that employees in the middle of their careers will have earned more in benefits under a cash balance plan than they would have under a defined benefit plan, while older employees will have earned less overall under cash balance than they would have under a defined benefit plan.[180]

Cash balance plans, like defined contribution plans, will provide adequate retirement benefits only if the employer and employee make sufficient contributions. Contribution rates should be set at levels that will provide appropriate income replacement for the employee in retirement.

Reform Option. While a cash balance plan is a more modest approach than a defined contribution or hybrid plan, it can reduce risk and may in some cases reduce long-term costs to the public.

> **“Defined benefit pension plans for public employees in Louisiana as currently structured are in desperate need of reform.”**

CONCLUSION

In looking to craft pension reforms, citizens and policymakers should keep in mind the vast gulf between public and private sector employees when it comes to retirement benefits. It is critical that reformers strive to provide public employee benefits that, as part of a total compensation package, will attract and retain high-quality employees – while also ensuring that the level of benefits and their costs are fair to taxpayers.

Defined benefit pension plans for public employees in Louisiana as currently structured are in desperate need of reform. In most cases, the multipliers exceed the national median by wide margins, significantly increasing the rate at which employee benefits accrue and significantly reducing the amount of time that an employee needs to work in order to obtain 100% of his pre-retirement income.

It remains true that the Plans in which local governments participate are more generous than national public sector medians in most respects. That generosity has contributed to ballooning costs – with employer contributions as high as 118% of total employee pay – threatening state and local government budgets. In other words, the cost of yesterday’s pension promises can diminish government’s ability to provide public services today and in the future.

Both public employees and private citizens alike bear the cost of past generations’ pension excesses. Policymakers ought to consider alternative pension plan designs that, in the long run, halt this generational cost transfer.

These plan designs – defined contribution, hybrid and cash balance plans – would shift some, if not all, risk away from public employers. While employees take on additional risk, they also would enjoy greater plan portability. Under a defined contribution or cash balance plan, changing jobs would not mean having to start saving for retirement all over again. These plan designs may also better reflect the evolving expectations and career patterns of the work force.

At a minimum, policymakers should pursue reforms to the existing defined benefit offerings to bring them to a more reasonable level. That implies lowering multipliers to at least the national public sector median, raising the minimum retirement age, eliminating perks such as lump sum payment programs, limiting the income replacement to a need-based percentage of an employee’s salary, implementing a cap on benefits and leaving it to employees to self-fund COLAs.

APPENDIX A: LOCAL PARTICIPATION IN THE PLANS

Local government entities in all three parishes participate in Plans offered by the three state systems. Government employers in Jefferson and St. Tammany parishes participate in all nine statewide systems. In Orleans Parish, employers participate in six of the statewide systems and three local systems. The following table provides a breakdown by parish. It also gives the shorthand names by which BGR will refer to each Plan.

Retirement Systems in Which Local Governments Participate, by Parish

		Does at least one local government entity in the parish participate?		
SYSTEM	**SHORTHAND NAME**	Jefferson	Orleans	St. Tammany
State Systems				
Louisiana School Employees' Retirement System	School Employees	✓	✓	✓
Louisiana State Employees' Retirement System	Lasers	✓	✓	✓
Regular Plan	Lasers Regular	✓	✓	✓
Judges' Plan	Lasers Judges	✓	✓	✓
Teachers' Retirement System of Louisiana	Teachers	✓	✓	✓
Regular Plan	Teachers Regular	✓	✓	✓
Plan B	Teachers Plan B	✓	✓	
Statewide Systems				
Louisiana Assessors' Retirement System	Assessors	✓	✓	✓
Louisiana Clerks of Court Retirement & Relief Fund	Clerks of Court	✓	✓	✓
Louisiana District Attorneys' Retirement System	District Attorneys	✓	✓	✓
Louisiana Firefighters' Retirement System	Louisiana Firefighters	✓		✓
Municipal Employees' Retirement System	Municipal Employees	✓		✓
Plan A	Municipal Employees Plan A	✓		✓
Plan B	Municipal Employees Plan B			✓
Municipal Police Employees' Retirement System	Municipal Police	✓	✓	✓
Parochial Employees' Retirement System (Plan A)	Parochial Employees Plan A	✓		✓
Registrars of Voters Employees' Retirement System	Registrars of Voters	✓	✓	✓
Sheriffs' Retirement System	Sheriffs	✓	✓	✓
Local Systems				
Employees' Retirement System of the City of New Orleans	New Orleans Municipal		✓	
Employees' Retirement System of the Sewerage & Water Board of the City of New Orleans	S&WB		✓	
Firefighters' Pension and Relief Fund in the City of New Orleans – New Fund	New Orleans Firefighters (New)		✓	

APPENDIX B: FISCAL HEALTH OF THE PLANS

The following table compares the actuarial value of a plan's assets to its "projected benefit obligation." The projected benefit obligation is the present value of retirement benefits owed to current retirees and the benefits accrued to date by current employees and former employees who are not yet eligible to draw benefits. The measure also takes into account the impact that projected salary increases will have on the accrued benefits of current employees. The measure adjusts for different actuarial methods of calculating accrued liabilities and makes the Plans' funded ratios more comparable. BGR did not adjust the Plans' investment return assumptions.

Funded Ratios (Actuarial Value of Assets to Projected Benefit Obligations), 2007 to 2015

	Funded Ratio by Fiscal Year				
Plan	**2007**	**2009**	**2011**	**2013**	**2015**
District Attorneys	109.6%	91.6%	90.0%	90.7%	101.5%
American Academy of Actuaries Recommended Level					**100%**
Parochial Employees Plan A	101.6%	93.4%	90.0%	94.9%	99.7%
Sheriffs	90.1%	80.0%	81.0%	80.7%	91.0%
Assessors	77.8%	82.0%	79.7%	83.7%	90.3%
S&WB	96.8%	88.2%	82.6%	79.5%	80.7%
Registrars of Voters	97.2%	83.6%	78.0%	72.8%	80.3%
Municipal Employees Plan B	94.7%	91.1%	88.4%	83.1%	80.1%
GAO Recommended Minimum					**80.0%**
Clerks of Court	78.9%	70.8%	74.2%	71.8%	79.3%
Louisiana Firefighters	88.6%	78.4%	76.4%	73.0%	78.5%
Municipal Employees Plan A	87.9%	84.4%	81.8%	76.8%	75.5%
New Orleans Municipal	94.0%	80.9%	74.8%	73.6%	72.4%
School Employees	80.0%	65.5%	59.9%	62.1%	70.7%
Municipal Police	93.5%	65.2%	58.1%	64.1%	69.9%
Lasers*	67.2%	60.8%	57.6%	60.2%	62.1%
Teachers*	71.3%	59.1%	55.1%	56.4%	60.9%
New Orleans Firefighters (New)	81.0%	54.4%	40.3%	30.1%	11.9%

* Teachers and Lasers report the financial results for their Plans on a combined basis.

Sources: For the state and statewide Plans, BGR drew data from the annual reports of the Louisiana Legislative Auditor through 2013 and the Plans' actuarial valuation reports for 2015, with the asset valuations of the state Plans adjusted to exclude funds set aside by law for certain purposes, such as the payment of cost of living adjustments. For the local Plans, BGR drew information from each Plan's actuarial valuation reports.

APPENDIX C: MINIMUM ELIGIBILITY REQUIREMENTS FOR COLLECTING ACCRUED BENEFITS

PLAN	For New Members, as of 9/1/16
Non-Public Safety Plans	
Assessors	12 years of service at age 60, or 30 years of service at age 55.
Clerks of Court	12 years of service at age 60.
District Attorneys	10 years of service at age 60, 24 years of service at age 55, or 30 years of service at any age.
Lasers Judges	5 years of service at age 62.
Lasers Regular	5 years of service at age 62.
Municipal Employees Plan A	7 years of service at age 65, 10 years of service at age 62, or 30 years of service at age 55.
Municipal Employees Plan B	7 years of service at age 65, 10 years of service at age 62, or 30 years of service at age 55.
New Orleans Municipal	5 years of service at age 65, 10 years of service at age 60, 30 years of service at any age; or any combination of years of service plus age equal to or greater than 80.
Parochial Employees Plan A	7 years of service at age 67, 10 years of service at age 62, or 30 years of service at age 55.
Registrars of Voters	10 years of service at age 62, 20 years of service at age 60, or 30 years of service at age 55.
School Employees	5 years of service at age 62.
S&WB	Age 70 regardless of years of service, 5 years of service at age 65, 10 years of service at age 60, 30 years of service at any age; or any combination of years of service plus age equal to or greater than 80.
Teachers Regular	5 years of service at age 62.
Teachers Plan B	5 years of service at age 60, or 30 years of service at age 55.
Public Safety Plans	
Louisiana Firefighters	12 years of service at age 55, 20 years of service at age 50, or 25 years of service at any age.
Municipal Police	Hazardous duty employees: 12 years of service at age 55, or 25 years of service at any age. Nonhazardous duty employees: 10 years of service at age 60, 25 years of service at age 55, or 30 years of service at any age.
New Orleans Firefighters (New)	12 years of service at age "Social Security less 10," calculated by subtracting 10 years from the Social Security retirement age based on the employee's birth year (currently age 67 for employees born after 1959). Effective for those employees hired on or after August 15, 2016.
Sheriffs	12 years of service at age 62, 20 years of service at age 60, or 30 years of service at age 55.

Sources: Louisiana Revised Statutes, Plans' actuarial valuation reports and La. Acts 2016, Reg. Sess., No. 651.

ENDNOTES

1 For 2016, the City has budgeted $32 million for the New Orleans Firefighters' New Fund and $11.2 million for the New Orleans Firefighters' Old Fund. It has budgeted $21.7 million for Municipal Police. City of New Orleans, 2016 Annual Operating Budget, pp. 204, 228. The City has budgeted $23.5 million for New Orleans Municipal, excluding contributions it makes on behalf of outside agencies. Information provided by the City of New Orleans and the Employees Retirement System of the City of New Orleans. The City is scheduled to pay $17.1 million in debt service on New Orleans Firefighters' (Old) debt. City of New Orleans, Louisiana, Taxable Limited Tax Refunding Bonds, Series 2012, October 23, 2012, Appendix F: Combined Debt Service Schedule.

2 BGR estimated that $8 million of contributions to New Orleans Municipal will come from operating funds other than the General Fund. Excluding those dollars, the total pension costs borne by the General Fund are $97.5 million. Anticipated General Fund revenue in 2016 for the City of New Orleans is $601.7 million. New Orleans City Council, Ord. Cal. No. 30,990, adopted December 1, 2015.

3 The City's challenge is exacerbated by tax dedications to a multitude of special entities and purposes, as BGR recently noted in its report *The $1 Billion Question: Do the Tax Dedications in New Orleans Make Sense?*

4 Bureau of Governmental Research, *Sound the Alarm: New Orleans Firefighter Pension Woes and the Legislative Session*, April 2013.

5 New Orleans Firefighters' Pension and Relief Fund (New Fund), *Annual Actuarial Valuations as of January 1, 2010 and 2016,* Exhibit IV.

6 New Orleans Firefighters' Pension and Relief Fund (New Fund), *Annual Actuarial Valuation as of January 1, 2015*, p. 9.

7 In rare cases, such as the City of Detroit's recent bankruptcy, pensioners have taken a modest reduction in their benefits. See Bomey, Nathan*, Detroit Resurrected: To Bankruptcy and Back* (New York: W.W. Norton & Co., 2016).

8 See BGR's *The Rising Cost of Yesterday: Metro Area Pension Costs and the Factors that Drive Them*, November 2012, pp. 8-9 for a more detailed description of the Plans.

9 Ibid., p. 4.

10 Ibid.

11 Ibid., p. 31.

12 Ibid., p. 25.

13 Ibid., p. 28.

14 Munnell, Alicia, *State and Local Pensions: What Now?* (Washington, D.C.: Brookings Institution Press, 2012), p. 161.

15 The Pew Charitable Trusts, *A Look at Access to Employer-Based Retirement Plans in the Nation's Metropolitan Areas*, May 2016, pp. 1, 4 and 13.

16 Miller, Girard, "Strategies to consider as OPEB costs escalate," *Government Finance Review*, February 2011.

17 According to the Bureau of Labor Statistics, 83% of state and local government employees have access to and 75% participate in a defined benefit plan. This compares to 33% of state and local government employees having access to a defined contribution plan, with a participation rate of 16%. Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in the United States – March 2014, Bulletin 2779*, September 2014, State and Local Government Tables: Table 2.

18 See Munnell, *State and Local Pensions: What Now?*, p. 48.

19 Defined benefit plans differ significantly from the predominant private-sector model, known broadly as *defined contribution* plans, discussed later in this report. According to the Bureau of Labor Statistics, 60% of private sector employees have access to a defined contribution plan. Only 19% of private sector workers also have access to a defined benefit plan. Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in the United States – March 2014, Bulletin 2779*, September 2014, Private Industry Tables: Table 2.

20 Munnell, *State and Local Pensions: What Now?*, pp. 20-21.

21 Specifically, the funded ratio equals the value of plan assets divided by a measure of the pension obligation. A funded ratio of 100% means a system has sufficient assets to pay all benefits earned so far by all members. See American Academy of Actuaries, *Issue Brief: The 80% Pension Funding Standard Myth*, July 2012.

22 See National Association of State Retirement Administrators (NASRA), *Public Fund Survey 2014*, March 2016, www.nasra.org/publicfundsurvey.

23 BGR compiled each plan's actuarial value of assets and its projected benefit obligation. It then compared the aggregate asset value of $42.8 billion to the aggregate projected benefit obligation of $64.1 billion to estimate the combined funded ratio. Numbers were obtained from individual plan actuarial reports.

24 U.S. Government Accountability Office, *State and Local Government Retiree Benefits: Current Funded Status of Pension and Health Benefits*, GAO-08-223, January 2008, p. 3; American Academy of Actuaries, *Issue Brief: The 80% Pension Funding Standard Myth*. The academy argues that the 100% funding standard is preferable to the 80% minimum set forth in the GAO report because actuarial funding methods are based on the objective of moving a plan to full funding.

25 Standard & Poor's Rating Services, *U.S. State Pension Funding: Strong Investment Returns Could Lift Funded Ratios, But Longer-Term Challenges Remain*, June 24, 2014, p. 10.

26 See ibid., and National Conference of State Legislatures, Pension and Retirement State Legislation Database, www.ncsl.

org/research/fiscal-policy/pension-legislation-database.aspx.

27 See Munnell, Alicia H., Jean-Pierre Aubry and Mark Cafarelli, *Defined Contribution Plans in the Public Sector: An Update*, Center for Retirement Research at Boston College, April 2014.

28 See, for example, *Smith v. Board of Trustees of Louisiana State Employees' Retirement System*, 851 So.2d 1100 (La. 2003).

29 Employers who do not want to participate in Social Security must provide benefits that are at least comparable to Social Security. Defined benefit plans with a multiplier of at least 1.5% and a three-year final average compensation period are generally considered comparable to Social Security. Social Security Administration, *Introduction to Section 218: State and Local Coverage*, 2008, p. 17.

30 Teachers' Retirement System of Louisiana, *Component Unit Financial Report, for Fiscal Years ended June 30, 2015 and 2014*, p. 24.

31 Peng, Jun, *State and Local Pension Fund Management* (Boca Raton, Fla.: Taylor & Francis Group, LLC, 2009), pp. 58-60.

32 NASRA, *Issue Brief: Public Pension Plan Investment Return Assumptions*, February 2016, p. 1.

33 Ibid. Also see Standard & Poor's, *U.S. State Pension Funding*, p. 10.

34 NASRA, *Issue Brief: Public Pension Plan Investment Return Assumptions*, p. 3.

35 The median rate has fallen from 8% to slightly more than 7.6% since the 2008 financial crisis. Ibid.

36 Some investment experts suggest pension funds could see generally lower future investment returns compared to historical averages. Munnell, Alicia H., Jean-Pierre Aubry and Josh Hurwitz, *How Sensitive Is Public Pension Funding to Investment Returns,* Center for Retirement Research at Boston College, September 2013, p. 3. The Louisiana Legislative Auditor's actuary noted the growing consensus in the investment community that returns will average 5% to 6% over the next decade. The actuary further noted that both Lasers' and Teachers' discount rates still exceed 8% before deducting investment expenses and are among the highest in the country. See p. 4 of both the *2015 Actuarial Valuation Report on the Louisiana State Employees' Retirement System* and *2015 Actuarial Valuation Report on the Teachers' Retirement System of Louisiana*, issued by the Louisiana Legislative Auditor in January 2016.

37 Lasers' net pension liability for 2015 would have increased from $6.80 billion to $8.58 billion. See Louisiana State Employees' Retirement System, *Component Unit Financial Report for Fiscal Years Ended June 30, 2015 and 2014*, p. 17.

38 Teachers' net pension liability for 2015 would have increased from $10.8 billion to $13.6 billion. See Teachers' Retirement System of Louisiana, *Component Unit Financial Report for Fiscal Years Ended June 30, 2015 and 2014*, p. 15.

39 The exceptions are the three New Orleans Plans. The Legislature controls plan design for New Orleans Firefighters (New), and the plan's actuary recommends and board adopts the employer contribution amount. The S&WB plan is subject to a basic statutory framework, but the plan's board of trustees controls most aspects of plan design. The plan's actuary recommends and board adopts the employer contribution rate. The City Council established the New Orleans Municipal plan by ordinance. The plan's actuary recommends and board of trustees adopts the employer contribution rate.

40 State law allows some statewide systems to keep the employer contribution rate at the prior year level even if a lower rate is recommended in their actuarial valuation report. La. R.S. 11:105 directs the additional funding to certain purposes, including the reduction of unfunded accrued liability.

41 For Parochial Employees Plan A, Sheriffs, Municipal Employees Plan A and Plan B, and Registrars of Voters, the rate is set by each Plan's board of trustees within a statutory range of percentages. The employee contribution rate for the S&WB Plan is set forth in regulations promulgated by its board of trustees.

42 BGR calculated median employee contribution rates for Unsupplemented plans using 2013 data compiled and presented by the NASRA Public Fund Survey. 2013 is the most recent year for which data are available. See www.publicfundsurvey.org.

43 The median contribution rate in 2010 was 9%. BGR, *The Rising Cost of Yesterday*, p. 16.

44 Munnell, *State and Local Pensions: What Now?*, p. 24.

45 Social Security Administration, *Introduction to Section 218: State and Local Coverage*, 2008, p. 3.

46 Social Security Administration, *How You Earn Your Credits*, SSA Publication No. 05-10072, 2015, pp. 2-4.

47 Defined benefit plans with a multiplier of at least 1.5% and a three-year final average compensation period are generally considered comparable to Social Security, as are defined contribution plans that provide for at least 7.5% in combined employer and employee contributions. Social Security Administration, *Introduction to Section 218*, p. 17.

48 Munnell, *State and Local Pensions: What Now?*, p. 25.

49 In order for a public plan to add Social Security, its members must vote whether to add the program. Plan members can hold one of two kinds of referenda. The first option is called a majority vote referendum. In that case, if the majority of the members vote in favor of adding Social Security, the entire fund will be covered under the program. In the alternative, plan members can hold a divided vote referendum. If the majority of members vote to add Social Security, the fund is divided in two, with those who voted in favor of Social Security moving to a covered plan and those who voted against staying in the uncovered plan. The state, at its option, may allow future employees to choose between the covered and uncovered plans. Social Security Administration, *Introduction to Section 218*, pp. 18-19.

50 Munnell, Alicia H., Jean-Pierre Aubry and Anek Belbase, *The Impact of Mandatory Coverage on State and Local Budgets*, Center for Retirement Research at Boston College, Working Paper 2014-9, May 2014, p. 2.

51 Clark, Robert L., Lee A. Craig, and Neveen Ahmed, "The Evolution of Public Sector Pensions," in Mitchell, Olivia S. and Gary Anderson, eds., *The Future of Public Employee Retirement Systems* (Oxford: Oxford University Press 2009), p. 244; Slusher, Chuck, "Pension Integration and Social Security Reform," *Social Security Bulletin*, Vol. 61, No. 3 (1998).

52 Social Security has been amended numerous times since its inception in the 1930s. In 1987, the National Bureau of Economic Research published a study that suggested that employers were taking on risk by integrating Social Security. Merton, Robert C., Zvi Bodie, Alan Marcus, "Pension Plan Integration as Insurance Against Social Security," in Bodie, Zvi, John B. Shoven, and David Wise, eds., *Issues in Pension Economics* (Chicago: University of Chicago Press, 1987) www.nber.org/chapters/c6857.pdf.

53 The Center for Retirement Research assumed that the California State Teachers' Retirement System would reduce the generosity of its employer-provided benefit to account for the benefit provided under Social Security. The employer cost of the defined benefit plan was 10.3% of payroll at the time of the Center for Retirement Research Study. Adding Social Security while reducing the employer-provided benefit to keep the overall retirement benefit roughly the same would result in employer costs increasing to 12.9% of payroll, a 25% jump. Munnell, et al., *The Impact of Mandatory Coverage on State and Local Budgets*, Table 4.

54 Members of Municipal Employees Plan B, Teachers Plan B, New Orleans Municipal, and S&WB participate in Social Security.

55 The two plans that layer Social Security benefits are New Orleans Municipal and S&WB.

56 The national median for employee contributions to U.S. Supplemented plans has risen from 5% to 6% since *The Rising Cost of Yesterday* was published. BGR calculated median employee contribution rates for Supplemented plans using 2013 data compiled and presented by the NASRA Public Fund Survey. 2013 is the most recent year for which data are available. See www.publicfundsurvey.org.

57 La. R.S. 11:1481(2)(b)(i); La. R.S. 11:1562(C) and La. R.S. 11:2174(B)(3)(b).

58 These contributions totaled $1.4 million in fiscal year 2015. Employees hired after 1999 are responsible for covering 100% of their own contributions. Jefferson Parish Sheriff's Office, *Comprehensive Annual Financial Report for the Year Ended June 30, 2015*, pp. 95-96.

59 For employees hired after 1986, the portion of the employee contribution paid on the employee's behalf is limited to 0.25%. Information provided by the Jefferson Parish budget office.

60 Ambachtsheer, Keith P., *Pension Revolution: A Solution to the Pensions Crisis* (Hoboken, NJ: Wiley Finance, 2007), p. 82; The Government of New Brunswick, *Rebuilding New Brunswick: A Case for Pension Reform*, February 2013, pp. 19, 20; The Center for Retirement Research at Boston College. *Sharing Risk: The Netherlands' New Approach to Pensions*, April 2007, p. 2; The Center for Retirement Research at Boston College, *New Brunswick's New Shared Risk Pension Plan*, August 2013, pp. 2-3.

61 La. R.S. 11:62(3). Louisiana Firefighters sets contributions for employees earning more than amounts reported in the United States Department of Health and Human Services poverty guidelines anywhere between 8% and 10%, depending on the total contribution rate. For example, if total required contributions equal 25% of payroll or less, employees contribute 8%; if total contributions are 27.26% to 28%, employees contribute 9%; and if total contributions are 30.26% or above, employees contribute 10%.

62 State law fixes the employee contribution rate for Teachers Plan B at 5%. It allows a contribution rate of 7% to 9% for Registrars of Voters and 5% to 6% for Municipal Employees Plan B. See La. R.S. 11:62.

63 Peng, p. 30.

64 BGR calculations based on data presented in the NASRA Public Fund Survey for Fiscal Year 2013, www.publicfundsurvey.org.

65 Munnell, *State and Local Pensions: What Now?*, p. 30.

66 Peng, p. 30. A 2012 sampling BGR conducted of 20 Unsupplemented plans for public safety personnel produced a median multiplier of 2.5%, compared to a national median of 2.4% for non-public safety employees. BGR, *The Rising Cost of Yesterday*, p. 19.

67 A 2008 study found that an individual retiring at $50,000 to $90,000 needs to replace approximately 80% of that pay to maintain living standards in retirement. Lower-salaried workers need higher percentages. Aon Consulting and Georgia State University, *2008 Replacement Ratio Study: A Measurement Tool for Retirement Planning*. According to the Social Security Administration, "most financial advisors say retirees will need 70 percent or more of pre-retirement earnings to live comfortably." Social Security Administration, *Understanding The Benefits*, 2016, p. 4, available at www.ssa.gov/pubs/EN-05-10024.pdf. .

68 The 30% estimate is based on the average public retiree's salary. Retirees with lower salaries would replace greater proportions of their earnings through Social Security. Peng, pp. 53-54.

69 Ibid., p. 33.

70 BGR found no common definition of compensation among the 18 Plans. Some plans limit it to base pay, while others include compensation beyond base pay, such as state supplemental pay or overtime pay. BGR did not determine the effect of the definition

of compensation on plan generosity.

71 Seventy-nine of the 87 plans were defined benefit plans. Wisconsin Legislative Council, *2012 Comparative Study of Major Public Employee Retirement Systems*, December 2013, pp. 25 and 27. The council's 2010 study found that 55% of plans it surveyed used a three-year period, while 25% used a five-year period. Wisconsin Legislative Council, *2010 Comparative Study of Major Public Employee Retirement Systems*, December 2011, p. 25. This represents a significant shift over a short period of time.

72 Wisconsin Legislative Council, *2012 Comparative Study*, pp. 27-28.

73 The Registrars of Voters Plan imposes a cap of 25% on members hired before July 1, 2006. The Assessors Plan imposes a 25% cap on those hired before October 1, 2006. They impose no cap on those hired on or after that date. La. R.S. 11:231.

74 Social Security Administration, *Your Retirement Benefit: How It's Figured,* 2016, and *Benefit Calculation Examples For Workers Retiring in 2016*, https://www.ssa.gov/oact/progdata/retirebenefit1.html. BGR's forward-looking calculations all assume that the hypothetical employee's annual salary increases will track inflation. Consequently, using Social Security's inflation-adjusted average would have resulted in the equivalent of using a one-year final average compensation period. The annual benefit would be 6% higher than the benefit produced by the national median plan with a five-year final average compensation period.

75 BGR calculated the annual benefit using a five-year and eight-year final average compensation period for an employee assumed to start today at $40,000 per year and average a 3% annual pay increase during a 30-year career. BGR assumed the national median multiplier for Unsupplemented Plans of 2.4%. The annual benefit, discounted to today's dollars assuming 3% annual inflation, would be $25,271 for the eight-year period, 4.2% lower than $26,379 for the five-year period. A similar 4.2% decrease in annual benefit would occur for Supplemented Plans, assuming the national median multiplier of 1.9%. The reduction would be slightly greater for S&WB and Louisiana Firefighters because they currently have three-year, instead of five-year, final average compensation periods.

76 Wisconsin Legislative Council, *2012 Comparative Study*, pp. 27-28.

77 The cap increases each year by the lesser of 3% or one-half of the increase in the Consumer Price Index-Urban. Illinois Municipal Retirement Fund, *Retirement Benefits for Tier 2 Regular Plan Members*, available at www.imrf.org/en/members/tier-2-regular-plan/retirement-benefits.

78 This amount is 75% of the current wage cap of $111,572.

79 Social Security Administration, *Benefit Calculation Examples*. Social Security uses an inflation-adjusted average of an employee's highest 35 years of covered earnings. That average compensation is then used to calculate benefits based off the following formula, assuming a person becomes eligible for benefits in 2016: 90% of the first $856 of average monthly earnings; plus 32% of the next $4,301 of average monthly earnings; plus 15% of the average monthly earnings above $5,157.

80 Seventy-nine of the 87 plans in the study were defined benefit plans. Wisconsin Legislative Council, *2012 Comparative Study*, pp. 27-28.

81 BGR analysis of data presented in the NASRA Public Fund Survey for Fiscal Year 2013, www.publicfundsurvey.org.

82 La. R.S. 11:1633(A).

83 Munnell, Alicia H., *Social Security's* Real *Retirement Age is 70*, Center for Retirement Research at Boston College, Brief No. 13-15, October 2013.

84 Peng, p. 30.

85 NASRA, *Issue Brief: Cost-of-Living Adjustments*, July 2015, p. 1.

86 Peng, p. 41.

87 Munnell, Alicia H., Jean-Pierre Aubry and Mark Cafarelli, *COLA Cuts in State/Local Pensions*, Center for Retirement Research at Boston College, May 2014, p. 1.

88 All 15 state and statewide Plans award discretionary COLAs up to percentage caps. State law caps the increases at 3% for state Plans. Statewide Plans can grant two types of COLAs: one for all retirees under a plan-specific statute, with caps ranging from 2% to 3%, and another under a general statute that allows an additional 2% COLA for retirees over age 65. Nine state and statewide Plans also impose a flat-dollar cap on the COLA amount or a limit on the annual benefit amount to which the COLA is applied. By local law, New Orleans Municipal can grant a COLA up to 3%. By policy, the plan's board of trustees may also impose a limit on the annual benefit amount to which the COLA is applied. The New Orleans Firefighters (New) plan is allowed by state law to grant a COLA of up to 3% to all retirees, plus an additional 2% to retirees over age 65. Earlier this year, the plan's board agreed to subject any COLA to a cap of 2% of the pension benefit. Cooperative Endeavor Agreement between the City of New Orleans, the New Orleans Firefighters Pension & Relief Fund, and New Orleans Firefighters Local 632, signed March 3, 2016, Sec. (I)(A)(5)-(6).

89 Louisiana Legislative Auditor, *2013 Actuarial Report on Louisiana Public Retirement Systems*, July 2014, p. 48.

90 Pension funds' return assumptions are usually based on a 30- to 50-year period. NASRA, *Issue Brief: Public Pension Plan Investment Return Assumptions*, p. 2.

91 See Louisiana Legislative Auditor, *2013 Actuarial Report*, p. 130.

92 La. R.S. 11:247.

93 Eight Plans offer employees the option of receiving part of their retirement benefits in a lump sum upon retirement, in

exchange for an actuarial reduction in benefits going forward. Unlike DROP and Back-DROP, a partial lump-sum payment option program (PLOP) does not require employees to work beyond retirement eligibility; it only restructures how they receive their normal retirement benefits. The eight Plans offering PLOP are Lasers (Regular and Judges), Teachers (Regular and Plan B), School Employees, Louisiana Firefighters, Municipal Police and New Orleans Firefighters (New). The maximum lump-sum payment is 36 months of retirement benefits, with the exception of 60 months for New Orleans Firefighters (New). None of the eight Plans currently allow retirees to take PLOP if they participated in DROP. See La. R.S. 11:446 (Lasers), 11:783 (Teachers), 11:1152.1 (School Employees), 11:2224 (Municipal Police), 11:2259 (Louisiana Firefighters), and 11:3385.1-3385.2 (New Orleans Firefighters), as amended by La. Acts, 2016 Reg. Sess., No. 652, effective June 17, 2016.

94 The annuity may be calculated over a fixed period or for life. Peng, p. 48.

95 Bolton, Robert G., and Thomas B. Lowman, *Design and Actuarial Aspects of Deferred Retirement Option Programs*, prepared for the Society of Actuaries, 2003, Section 1.1.

96 National Conference on Public Employee Retirement Systems, *Public Retirement Systems Study*, November 2015, p. 13.

97 The three plans offering Back-DROP are Assessors, District Attorneys and Sheriffs.

98 Samson, Alva, Norma B. Coe and Anthony Webb, *The Impact of a DROP Program on the Age of Retirement and Employer Pension Costs*, The Center for Retirement Research at Boston College, September 2010, p. 20.

99 Interview with Emily Kessler, Senior Staff Fellow, Intellectual Capital, Society of Actuaries.

100 Both New Orleans Municipal and S&WB provide interest earned at short-term rates on the invested DROP funds. Thirteen of the 16 other plans pay interest on DROP account balances only for members who have exited DROP but not yet terminated employment. The two Lasers plans provide for DROP funds to be shifted to members' self-directed investment accounts, and one plan, Registrars of Voters, does not pay interest.

101 Samson, et al., p. 7.

102 *The Rising Cost of Yesterday* noted a study in which DROP cost the City of Philadelphia's pension system between $24,000 and $39,000 per participant, primarily because employees who would have continued working regardless of DROP entered the program. Samson, et al., p. 21.

103 Interview with Emily Kessler, Society of Actuaries; interview with Tom Lowman, Bolton Partners.

104 Peng, p. 49.

105 Social Security Administration, *How Delayed Retirement Affects Your Social Security Benefits*, www.ssa.gov/planners/retire/1943-delay.html#delay.

106 New Orleans Firefighters' Pension and Relief Fund (New Fund), *Annual Actuarial Valuation as of January 1, 2016*, p. 25.

107 New Orleans Firefighters' Pension and Relief Fund (New Fund), *Annual Actuarial Valuation as of January 1, 2015*, p. 3.

108 Firefighters' Retirement System, *Actuarial Valuation as of June 30, 2014*, p. 1.

109 For a discussion of historical problems with the New Orleans Firefighter pensions, see BGR, *Sound the Alarm*.

110 Cooperative Endeavor Agreement between the City of New Orleans, the New Orleans Firefighters Pension & Relief Fund, and New Orleans Firefighters Local 632, signed March 3, 2016.

111 La. Acts, 2016 Reg. Sess., No. 651.

112 BGR calculation. The change would result in a 0.25% reduction in the multiplier, or 9% of 2.75.

113 The benefit offset applies only to the cash disability benefit. The medical benefit of worker's compensation is not offset.

114 Cooperative Endeavor Agreement, Sec. (I)(A)(19) and (I)(D)(3).

115 Ibid., Secs. (I)(A)(4) and (I)(A)(5).

116 Ibid., Sec. (I)(D)(5) and La. Acts, 2016 Reg. Sess., No. 652.

117 La. Acts, 2016 Reg. Sess., No. 652.

118 See BGR, *Sound the Alarm*.

119 Cooperative Endeavor Agreement, Sec. (I)(D)(2).

120 The Kapoor Company, *New Orleans Firefighter Pension Fund Final Analysis and Recommendations*, presentation to New Orleans Firefighters Pension Reform Working Group, April 6, 2015, p. 26.

121 Cooperative Endeavor Agreement, Sec. (I)(A)(3).

122 Ibid.

123 Ibid., Sec. (I)(A)(6).

124 Ibid., Sec. (I)(A)(8).

125 Ibid., Sec. (I)(A)(15).

126 Ibid., Sec. (I)(B)(7).

127 Ibid., Sec. (I)(A)(2).

128 Ibid., Sec. (I)(B)(9).

129 La. Acts, 2016 Reg. Sess. No. 651.

130 Social Security Administration, *The Full Retirement Age Is Increasing*, www.ssa.gov/planners/retire/ageincrease.html.

131 Employees hired on or after January 1, 1968, but prior to January 1, 2015, can retire at 50. Those hired on or after January

1, 2015, can retire at 52. The increase to "Social Security less 10" will apply to those hired on or after the effective date of the legislation, August 15, 2016.

132 BGR assumed the hypothetical employee is hired in 2016 at a salary of $40,000 and works for 30 years. The defined benefit calculations are based on the national medians for unsupplemented and supplemented plans, an estimate of Social Security benefits and assumptions of the private sector worker's IRA. To calculate the expected annual benefit from an IRA, BGR assumed that the worker's employer contributed an amount equal to 3% of his salary each year to the IRA. It assumed that the worker himself contributed to his IRA an amount equal to the difference between his public sector peer's required pension contribution rate and a Social Security contribution of 6.2%. BGR assumed the IRA will earn an annual rate of return of 7%. BGR discounted all expected future benefits to 2012 dollars using an assumed annual rate of inflation of 3%. For the IRA, it then converted the account balance to an annuity using an annuity calculator.

133 Munnell, Alicia H., et al., *Why Have Some States Introduced Defined Contribution Plans?* Center for Retirement Research at Boston College, January 2008, p. 5.

134 Munnell, Alicia H., et al., *A Role for Defined Contribution Plans in the Public Sector*, Center for Retirement Research at Boston College, April 2011, p. 2.

135 Munnell, Alicia H., et al., *Why Have Some States Introduced Defined Contribution Plans?* Center for Retirement Research at Boston College, January 2008, p. 2.

136 International City/County Management Association Retirement Corporation, *457 Deferred Compensation Plans*, available at www.icmarc.org/products-and-services/457-deferred-compensation-plans.html. Hoops, Matthew, Irina Stefanescu and Ivan Vidangos, *Defined-Contribution Pension Plans for State and Local Government Employees in the Financial Accounts of the United States*, Board of Governors of the Federal Reserve FEDS Notes, April 20, 2015.

137 Internal Revenue Service, *Topics for Retirement Plans: IRC 457(b) Deferred Compensation Plans*, available at www.irs.gov/Retirement-Plans/IRC-457(b)-Deferred-Compensation-Plans.

138 Munnell, et al., *Why Have Some States Introduced Defined Contribution Plans?* p. 2.

139 Louisiana Public Employees Deferred Compensation Plan, *Plan Features and Highlights*, www.dcprovider.com/PDF/louisiana/Plan_Highlights.pdf.

140 Munnell, et al., *Defined Contribution Plans in the Public Sector*, Appendix B. Eight plans in seven states – Colorado, Florida, Montana, North Dakota, Ohio, South Carolina and Utah – offer a defined contribution option to employees.

141 Teachers' Retirement System of Louisiana, Optional Retirement Plan Brochure, www.trsl.org/uploads/File/Brochures/orp_WEB.pdf.

142 Munnell, Alicia H., Jean-Pierre Aubry and Mark Cafarelli, *Defined Contribution Plans in the Public Sector: An Update*, Center for Retirement Research at Boston College, April 2014, p. 2. Teachers in West Virginia hired between 1991 and 2005 participate in a defined contribution plan. www.wvretirement.com/TDC.html.

143 TIAA-CREF Institute, *Defined Contribution Pension Plans in the Public Sector: A Best Practice Benchmark Analysis*, April 2008, p. 15. The study assumes a 7% pre-retirement investment rate of return.

144 The current tax rate for Social Security is 12.4% of payroll, split evenly between the employer and employee. Internal Revenue Service, *Tax Topic 751 - Social Security and Medicare Withholding Rates*, available at www.irs.gov/taxtopics/tc751.html.

145 TIAA-CREF, p. 15.

146 In the shorter term, the shift to a defined contribution plan would not necessarily result in a substantial decrease in employer contributions because payments to cover unfunded liabilities would persist.

147 TIAA-CREF, p. 16-17; Beshears, John, et al., *Behavioral Economics Perspectives on Public Sector Pension Plans*, National Bureau of Economic Research Working Paper No. 16728, January 2011, p. 12; Chen, Gang, et al., "The Management of Defined Contribution Pension Plans in Local Government," *Public Budgeting & Finance*, Fall 2013, p. 77; Ambachtsheer, p. xxix.

148 TIAA-CREF, pp. 9-10, 19.

149 Ambachtsheer, p. 71.

150 Defined Contribution Institutional Investment Association, *Defined Contribution Plan Success Factors: Framework for Plans with an Objective of Retirement Income Adequacy*, May 2015, p. 5.

151 TIAA-CREF, pp. 19.

152 Rebalancing an investment portfolio ensures that the overall riskiness of the portfolio remains roughly the same in light of the performance of various assets. Vanguard, *Best Practices for Portfolio Rebalancing*, July 2010, p. 1.

153 TIAA-CREF, pp. 30-31.

154 In adopting a cash balance plan, it is not necessary to close the existing defined benefit plan. Instead, new hires would enroll in a new benefit "tier" within the existing plan. Contributions could be pooled with other plan assets for investment purposes. Pew Charitable Trusts, *Public Pension Cash Balance Plans: A Primer*, February 2014, p. 6.

155 The pension systems that apply to school employees are Teachers and School Employees. R.S. 17:3997(3)(a).

156 The schools either offer a 403(b) or 401(k) plan to employees. Each of them also participates in Social Security.

Those costs are included in BGR's analysis.

157 BGR reviewed all Orleans Parish schools in the RSD and found no obvious correlation between school performance and type of retirement benefit. The qualitative impact of retirement benefits on school performance requires further and different analysis building on these initial observations.

158 The Pew Charitable Trusts, *Hybrid Public Pension Plans: A Primer*, April 2015, p. 1.

159 Ibid.

160 Ibid.

161 One plan contributes the difference between 10% and the cost of the defined benefit portion of the plan. Ibid.

162 Munnell, et al., *A Role for Defined Contribution Plans in the Public Sector*, p. 6.

163 Ibid.

164 BGR based its calculation on a hypothetical employee who retires today with a $40,000 final average compensation and receives a 2% cost of living adjustment each year for 30 years of retirement. Using a discount rate of 3% to adjust for future inflation, BGR calculated the present value of the total benefits the employee would receive under each plan over a 30-year retirement. The present value of total benefits under the traditional defined benefit plan is $502,841, while the present value of benefits under the defined benefit portion of the hybrid plan is $209,517. The difference between these two amounts is $293,324, or 140% of the present value of the defined benefit portion of the hybrid plan.

165 The Pew Charitable Trusts, *Public Pension Cash Balance Plans: A Primer*, February 2014, p. 1.

166 Ibid., p. 8.

167 Cahill, Kevin E., and Mauricio Soto, *How Do Cash Balance Plans Affect the Pension Landscape?* Center for Retirement Research at Boston College, December 2003, p. 2.

168 The Pew Charitable Trusts, *Public Pension Cash Balance Plans*, p. 2.

169 Ibid., p. 6.

170 Ibid., p. 2.

171 Munnell, et al., *Defined Contribution Plans in the Public Sector*, Appendix B; California State Teachers' Retirement System, Cash Balance Benefit Program, www.calstrs.com/cash-balance-benefit-program.

172 La. Acts 2012, Reg. Sess., No. 483.

173 Act 483 of 2012 mandated participation in the cash balance plan by (i) all new hires eligible to participate in School Employees; (ii) new hires eligible to participate in Lasers, except for hazardous duty workers; and (iii) new hires at higher education institutions eligible to participate in Teachers and electing not to enroll in Teachers' Optional Retirement Program (its defined contribution plan for higher education employees). The act excluded K-12 school employees eligible to participate in Teachers.

174 La. Const. Article 10, Sec. 29(F).

175 *The Ret. State Employees Assn. v. The State of Louisiana*, 119 So. 3d 568 (La. 2013).

176 Ibid.

177 The relevant accounting rules allow these interest payments to appear "costless" on paper so long as the plan's expected rate of return would cover them. Platte Institute, *Public Pension Plans in Nebraska: Are Cash Balance Plans the Answer?* October 2011, p. 6.

178 Currently, only the Texas Municipal Retirement Systems tie any part of their interest credits to the actual investment performance. In that case, investment credits on only the portion of the account contributed by the employer are tied to investment performance. The Pew Charitable Trusts, *Public Pension Cash Balance Plans*, p. 11.

179 Platte Institute, p. 4.

180 Elliott, Kenneth R., and James H. Moore, Jr., "Cash Balance Pension Plans: The New Wave," Bureau of Labor Statistics, *Compensation and Working Conditions,* Summer 2000, p. 4.

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