BOBBY JINDAL
GOVERNOR

PAUL W. RAINWATER
COMMISSIONER OF ADMINISTRATION

State of Louisiana
Division of Administration
Office of the Commissioner

FUNDING REVIEW PANEL

Minutes of Meeting
Friday, September 30, 2011

I. CALL TO ORDER

The meeting was called to order by Dr. Steven Procopio, designee of Commissioner Paul W. Rainwater, at 9:40 AM in Senate Committee Room A of the State Capitol, Baton Rouge, Louisiana.

II. ROLL CALL

<u>Recommendations Committee: voting members</u>

Members Present:

Capt. Henry Dean – member of the Municipal Police Employees' Retirement System (MPERS),
selected by the MPERS board of trustees
Dr. Steven Procopio, Chair
designee of Commissioner Paul W. Rainwater
Mayor Randy Roach of Lake Charles
selected by the Louisiana Conference of Mayors (LCM)
Mr. Bob Rust – member of the Municipal Employees' Retirement System (MERS)
selected by the MERS board of trustees
Ms. Rina Thomas
appointed by the Governor

Members Absent:

Mr. Stacy Birdwell – member of the Firefighters' Retirement System (FRS)
selected by the FRS board of trustees
Mayor J. Lynn Lewis of Delhi
selected by the Louisiana Municipal Association (LMA)

<u>Advisory Committee: non-voting members</u>

Members Present:

Senator Elbert Guillory, member of the Senate Retirement Committee
appointed by Senate President Joel Chaisson

Representative Paige Cortez – member of the House Retirement Committee
appointed by House Speaker Jim Tucker
Mr. Chris Nassif
selected by the International Union of Police (IUPA) from nominations submitted by the Louisiana organizations affiliated with the IUPA
Representative Kevin Pearson
chairman, House Retirement Committee
Mr. Dirk Thibodeaux
appointed by the Governor

Members Absent:
Senator Butch Gautreaux
chairman, Senate Retirement Committee
Mr. Charlie Fredieu
selected by the Professional Fire Fighters Association (PFFA)

Staff Members Present
Ms. Sue Israel – Secretary
Ms. Laura Gail Sullivan – Senate Counsel
Mr. Paul Richmond – Manager, Actuarial Services, Office of Legislative Auditor
Ms. Sylvia McKee – Senate Sergeant at Arms

Others Present
Mr. Steven Stockstill – Executive Director, Firefighters Retirement System
Mr. Tom Ed McHugh – Executive Director, LA Municipal Association
Mr. Gary Curran – Actuary, G.S. Curran and Company, Ltd.

III. INTRODUCTORY COMMENTS

Dr. Procopio appointed Mr. Chris Nassif of the advisory committee to serve at this meeting in the place of the absent Mr. Stacy Birdwell of the recommendations committee; and he appointed Mr. Dirk Thibodeaux of the advisory committee to serve in the place of the absent Mayor Lynn Lewis of the recommendations committee.

Dr. Procopio informed the panel that he had been advised that a Department of Wildlife and Fisheries agent had been shot and killed somewhere in the Felicianas early that morning, although there was still little information on exactly what had occurred. Dr. Procopio asked for everyone to observe a moment of silence for the agent and his family.

IV. ELECTION OF OFFICERS

Dr. Procopio called for nominations for chairman. Mayor Roach nominated Dr. Procopio as chairman; seconded by Capt. Dean. With no other nominations, Dr. Procopio closed the nominations for chairman. With no objections, Dr. Procopio was elected chairman by acclamation.

In response to Dr. Procopio's call for nominations for vice-chairman, Capt. Dean nominated Mayor Roach; seconded by Mr. Rust. With no other nominations, Dr. Procopio closed the nominations. With no objections, Mayor Roach was elected vice-chairman by acclamation.

Rep. Cortez joined the meeting.

V. ECONOMIC OUTLOOK PRESENTATION

Dr. Procopio stated that it was requested at the last meeting that an economic outlook of some sort be presented at this meeting to help everyone understand what the systems and the boards, which are investing bodies, understand what they are facing ahead. In response, Dr. Procopio asked Dr. Dek Terrell, a professor at LSU, to make a presentation to the panel today. Dr. Terrell provided handouts for the panel and utilized the projector for his presentation.

Transcription follows:

Terrell: Ok, I really enjoy giving these kinds of presentations, so I appreciate the invitation to come down and make this presentation.

Dr. Terrell presented several PowerPoint slides (Exhibit A), beginning at approximately the four-minute mark of the recording: http://senate.legis.state.la.us/video/2011/september.htm#30.

Terrell: I was up last night making a few changes to it as I got in to town, so you'll see a couple of things that I mention that I've changed. First thing is in terms of the order of what I want to talk about in the presentation; first thing I want to start with…I had someone on my staff download the consensus forecast for the US. So I want to talk a little about the Livingston Survey Consensus forecast for the US. They're always being updated from time to time, so this was the latest thing that was available on the Philadelphia Fed's web page. I'll talk a little bit about how they're changing from now. The other thing I wanted to … do is go over a quick review of the current economic data. So what does the data look like in the US for now? I also wanted to use that to say a little bit about how we should interpret consensus forecast. So what do these consensus forecasts mean? Where do these consensus forecasts come from? And I think looking at some charts of the data and thinking about long term averages of how things work will give you an idea of a little bit of behind the scenes how economists come up with long term forecasts. And finally looking at the data will give us an idea of trends and implications for the future. And then I'm going to end by cautiously giving you my view of where things are headed.

It's nice to see the consensus forecast because one person's view of things and one person's analysis is always just one person's analysis. So, I'll give you some reasons why I think things are where they are. But I also wanted to give you a good view of what other people think. Before we look at what I think or what anybody else thinks, it's worth looking at a quote that gives you an idea, that's relevant for forecasting. So, a sixth century B.C. poet tells us: "Those who have knowledge don't predict. Those who predict don't have knowledge." So we want to be a little bit cautious about viewing any of these predictions…. "This is a disclaimer that we don't' know what's going to happen in the future. So what I do want to tell you is there's some things we have a pretty good idea about, and some things we have less certainty about. And as we go through some of these Livingston forecasts, I want to tell you a little bit about the uncertainty associated with a forecast as well as the forecasts themselves. Also, if I could predict what the S&P was going be in six months, I probably wouldn't tell you. I'd probably bet on the S&P and be a very wealthy man. I would have to tell some of you to borrow some money to be able to make all of these profits, but other than that….

So, let's take a look at the Livingston Survey results. I can tell you that both the Livingston Survey and one thing I wanted you to see is that the GDP forecast, are tending to hover around 3%. As I look at the graph, when we look at the graphs a little bit later, we're going to see that the long term over about a 50-year period, the average growth rate of GDP on an annual basis; real GDP has grown by 3.1%. What that will tell you is that, if I'm an economist or I'm any kind of forecast, the best thing for me to start with is a forecast that's about what's been done in the past. So 3.1% is kind of a base line of what people would forecast. If you're coming out of a recession and starting to improve you're…. Let me say a little bit more about what a 3% GDP means. A 3% GDP number means that we're sort of at a steady state in the economy. So that means that … only the unemployment rate is stable. It's neither going up nor going down. We're fully utilizing our resources.

If you want the unemployment rate to go down, you're going to need a GDP growth that's a little higher than 3%. So you tend to see coming out of recessions GDP growth rates that are higher than 3%. If you are going into a recession, you've got a GDP growth that's below 3%, you could see unemployment rates that are higher, or unemployment rates that tend to be rising. So that 3% number should be in your mind as a key number that's kind of the historical long-term average of GDP. That's really reflecting two things. It's reflecting population growth of about 1%. You've got to get new workers into the work force.

And the other thing is productivity growth. So every year we get better and getting better and better at producing the things that we produce, and that leads to some GDP growth. So you put, maybe 1% population growth, maybe 2 % generated by productivity growth, and that takes us up to 3%. Nominal GDP, which is including inflation, these numbers started out at about 5%, the forecast tended to be on the high side in the first half of 2011, and they've started to fall. So I would expect when we see new Livingston Survey numbers that they're going to be in the 2% to 2.5% range. The feds forecast has been falling, and the forecast of by Moody's has been falling as well for the latter half of 2011. And that's reflecting the slightly worse performance than anticipated in the second quarter of 2011.

Here are a couple of other forecasts from Livingston. The unemployment rate, I noticed when I was looking over my presentation, is that I pulled the wrong line on that one.. Disregard the Unemployment Rate. All of these other items are just giving you information from the Livingston Survey. Maybe the most important one is the consumer price index. These are all in growth rates, so the consumer price index is projected to grow. There're looking at 2%, one number of 3%. I think most people would revise down to 2% for the 2010-2011 period. The growth rate for the CPI is of course the inflation rate. If you look at the difference between on the previous slide, real GDP and nominal GDP, what you see is that nominal GDP is about 2% higher than real GDP, reflecting that increase in prices. Here, the Livingston survey results with regard to bond yields and stock prices. The forecast was, as of this time that I obtained this data for, at the end of 2012, for an increase in the ten year treasury yields.

One of the things that we've seen recently is that the Fed has been intervening more in long-term treasury. So that's something I want to say a little bit more about later. Long-term survey results, and I'll come back to these, it turns out one of the more interesting things in economics is that, if you ask me, what's going to happen in the short term. I'm going to have a hard time being precise [as to] what's going to happen to GDP, what's going to happen to the stock market over the next year. If you ask me, where we're going to be in 10 years, often I can do a better job of predicting [that]. In particular GDP growth, because we know that over a 50-year period, the average GDP growth has been 3.1%. We're a little bit safer using, applying the long-term growth rates over longer periods of time than we are over shorter periods of time. You do see these periods where we move into recessions, but you tend to see recoveries from those as well.

So the key questions that you are interested in that I think everybody's interested in is: there is a risk of—I don't know if it's really a double dip at this point—but there is a risk of the economy going back into recession. So how big is that risk, to the extent that there is a risk? What are the major risks to our economy, and what are the things that are going to determine where our economy is headed? And what is the long-term outlook for the economy in markets? So, we'll add one more useful quote: "I've seen the future, and it is very much like the present, only longer."

So what we do in terms of our statistical models is we essentially take data and we just extrapolate that out into the future, hopefully, in a somewhat sophisticated way. What we also do mentally is we attempt to go back to times in history that had very similar circumstances and ask the question: Can we use our knowledge of what happened in the past to say something about what's going on now? If we take a look at real GDP, I want to show you three pictures of real GDP.

The first one I think is a little bit hard to interpret. If I presented nominal GDP—I did this in class the other day—it's $14.7 trillion. One of the things that I tell my class is that it's very difficult for me, for any of us, to think what is $14.7 trillion without putting that … We can talk about things as percentage of GDP, we can say that that's $46 thousand per capita. So dividing by population could allow us to interpret GDP as a number. I do want to call your attention to the fact that the general pattern is that over very long periods of time, it's reassuring to see that GDP tends to be rising, but that we do see these dips from time to time. And the most recent recession was particularly severe. If we look at the growth rate in GDP—if I just drew a line through the middle of that graph, that would occur—[that would be] remembered at about 3%, because a long time growth rate in GDP on average has been about 3%, although we've seen a good bit of variation in periods of time.

What we're interested in often, if I'm talking about the short run, we're worried about business cycles; and I've applied something that sounds sophisticated called the Horgrid Prescott Filter to draw that red trend line there. That's just a bit of a complicated way to say that there's some sort of long-term growth rate. There's some sort of long-term rate of GDP that we anticipate, and we anticipate the economy returning to the long-term rate. And in the short term, there will be variations around long-term growth. The factors that determine long term growth are different from the factors that determine short term growth. In the long term growth rate is going to depend on things like how much our economy saves. So the rate of capital accumulation is going to depend crucially on technological advances. So if we make great new discoveries, that's one of the reasons that that red line is always sloping up. So those are the factors that are really driving the long run.

The short- run policy interventions, like government spending, like short-term changes in government policy, like monetary policy, are going to have a pretty big impact on what goes on. Or things like the financial crisis are going to tend to be a short-term blip that pushes us above or below that red line. So we're really concerned about two things: We're concerned about that red long-term trend and then we're concerned about deviation from that long-run trend.

So that's why economists divide things into two components. If we take a look at the unemployment rate here, the unemployment rate gets a lot of press and there's a lot of interest in the unemployment rate because this gives us a measure of how many people in our society are out of work. You'll see the unemployment rate, top ten percent, it's dropped a bit; and again for the unemployment rate to come down further, the growth rate of GDP is going to have to be topping 3%. And as we said before, in terms of forecasts of this unemployment rate in the near future for the next year, there aren't a lot of economists who are predicting GDP growth rates that are very high that would generate that significant improvement in the unemployment rate.

So, my general summary across a lot of economists would be that there's not a projection for significant improvement in the unemployment rate because there's not a projection for enough growth in GDP in the short run. And that's really—again, remember that's talking about this green line and deviation from trend , it's not talking about that red line, which is how we're going to do, how the US is going to do in the long run.

I thought I would put an S&P, as everybody knows the S&P has shown a good bit of volatility in recent periods, so this is just a graph of how the S&P has done. And I guess "volatility" is the word to use for the S&P. Everyone's aware that the feds have been pushing 3-month T-Bill rates close to zero. That's been—this is an area that the Fed has a great deal of control over, and the policy action is to keep interest rates very close to zero. So that's something. The idea in terms of economics would be that there's a trend of between unemployment and inflation and the feds trying to use monetary policy to stimulate the economy as much as possible to generate that higher GDP growth, to push down the unemployment rate.

Again, the potential cost in the long run is a potential for inflation. So that's something right now, we see a low inflation rate, the feds more willing to take that trade off. Ten-year treasuries: This is a rate that the Fed has not intervened in traditionally. The Fed has shown, has made policy statements that they're going to be more willing to intervene at longer horizons now. So that's one issue to be aware of in the economy.

Finally, the inflation rate. Remember the inflation rate peaked. I show this graph to my students. Most of you guys will actually remember back in the 1980s when we had inflation rates toping 10%. The Whip Inflation Now campaign of Gerald Ford, I've been reading books about this. I mention that to my students, and my students have no idea what any of that is about. So the whole concept of inflation for very long periods of time. In fact, over the entire lifetime of many of my students at LSU, inflation has not been a significant issue. It is something you want to keep on the radar screen, particularly in light of how aggressive the Fed has had to be in recent periods.

So what's my view as far where the economy is headed? My view is that the economy is going to be weaker than projected by the Livingston Survey in the short term. I would project lower GDP growth. I think most people are lowering their forecast. I think there's a higher risk of recession, and I think following that, there's a bit of a higher risk of the economy moving into an inflationary period. So I think, to put it simply, as you go around and talk—and as I said early on, I don't want to just give you my view; I want to give you a view of what economists in general think. If you talk to economists around Louisiana, around the nation, one of the things that you'll find is that there is a greater concern about risk of inflation and risk of things out of the ordinary occurring in the economy. So there's a little bit more risk in the economy than normal. That's somewhat reflected in the large movements in the market and so forth.

The other thing that I'm going to project that might surprise you a little bit is, that my projection is that in the long term I see things as strong and maybe stronger than projected by the Livingston Survey. That's tempered a bit by the fact that, if things are weaker, if you take the average of 10 years growth and you have three years near zero and you have seven years near 4% to5%, you're still going to be, you still might be a little below the 3% due to the fact that you had those weak years.

The reason for my optimism about the long run, and the reason that I am always optimistic about the long term of the US, is really driven by—I'll try to find it here—by this thing. When I was in graduate school, I had to apply for an account on a super computer to run a program for 30 days. My dissertation ran for 30 days on a super computer at the University of Illinois. Today it will run on this iPhone. So I have no doubt, I can't tell you what's going to happen ten years from now, 15 years from now, 20 years from now. The innovations that are going to occur are going to be impressive. And some of those things are going to be simple things that make our chemical plants run more efficiently. That makes other manufacturing run more efficiently. Some of the things are going to be obvious things in society.

So one of the things that I do know is that, if I go back and look at that red line, there are technological advances, and they are going to be a key thing that moves our economy future forward; and that's one of the key things that helps to solve some of our long-term crisis that we're really worried about. Like Social Security and like Medicaid—you can't ignore these problems, but you're hopeful that these technological advances and higher growth rate will contribute to helping on that.

So again, I think I wanted to mention the reasons for my particular view before we finish out, and in the short-term part of my concern, and in particular the reason that I would say that there's a higher than normal risk of going back into recession, is due to the fact that there's a lot of uncertainty in the economy and there have been structural changes in the US economy In particular, there's a lot of uncertainty with regard to issues like tax policies, healthcare reform. You can certainly make a case for healthcare reform that, in the sense that it's a good thing to provide healthcare coverage to additional coverage. One of the challenges, though, that it is a major shock to the US economy. So regardless of what position you take on healthcare reform, that healthcare reform in terms of being a major shock to the US economy and in terms of redistributing resources from one part of the economy to the other part of the economy, is likely to be a drain on the growth in the economy.

Banking regulation is also another feature where you can make arguments that there was a need for some banking regulation, you can debate particular parts of the banking regulation, but that's a significant structural change in how things are operating in the economy. And when you make these changes. [they] don't have the effect of improving the economy in the short run. You're trying to work on some sort of long-term issue there; in the short run, just the adaptation to that, the fact that the community bank has to go out and hire an additional person just to maintain the records, they may or may not be able to do that. And you may see a merger of a small bank because they can't operate with that. So these structural changes and the adjustment for those structural changes is a bit of a concern in the short run.

The other thing as far as inflation, and this is just a sense that I had. I went over to the Federal Reserve Bank, and they had a lot of regional economists in their region to give speeches and short presentations like this on the local economy. One of the things that struck me is that their presentation was very strongly saying over and over again that we can, we are confident that we can fully control the money supply, and that we're going to be able to back off when it's time to back off in terms of money supply and control inflation. The fact that they're so strongly saying that to our group just made me a little concerned. And the fact that they were thinking about doing it at that point, and then their forecast that the economy was going to grow, and they were going to have to start pulling back on money supply early on, makes me a little concerned that, when the time comes and the economy starts growing, it may be difficult to control inflation just because of the analysis that you get if you look at the Fed's balance sheet.

And finally, in the long run innovation. What really determines a lot about some of the major problems in our economy, like Social Security and Medicaid, is this innovation. Over a long period of time, you certainly have to be concerned about the short run solvency of programs. But over a long period of time, it's those innovations that are going to be very important to the growth and productivity of our work force, as well as just the math of the number of workers. It is going to be crucial in addressing some of those major problems. And with that, I'd be happy to, if you have time to take any questions.

Procopio: Yes, let's see if the panel members have any questions. And I do have a quick one. So the optimistic [forecast] is that we'll return to our norm, and I'm worried about the example of Japan, that you know their norm has been pretty bad for ten years. Are they different? We don't have to worry about that? Or is there a chance we could slip into a lost decade?

Terrell: I don't see it as likely that we would slip into a lost decade. But the difference between a lost five years and a lost decade is debatable. So I would be hesitant to forecast exactly when you recover because there are policy changes where we really don't know how these policies are going to affect the economy when they actually start to take place. I do think things like healthcare reform is going to have … some positive impacts in that some people are going to be covered by insurance. There are also going to be some impacts when employers are required to provide coverage, and … some employers of large corporations are doing calculations right now and reacting and making plans. Some other employers maybe haven't done the calculations on exactly what they're going to do, and I think when legislation like that takes place, one of the things that we really have to wait and see is how in 2012 things kick in.

Procopio: Representative Pearson.

Pearson: Thank you, Dr. Procopio. Dr. Dek Terrell, really two questions, but the first one is: with technology innovations, with those also come the benefit of increased life expectancies, which I'm trying to understand how that would relate to helping Social Security, and we have similar issues with our pensions.

Terrell: Right, I would say that, in terms of both state pensions and Social Security and all of those programs, every government body is going to have to consider raising retirement ages and accounting for the change in life expectancy. Because if you don't take into account that change in life expectancy, the amount of innovation and just the amount of productivity that you have to get from one young worker to support somebody who is retired for 30 years is going to be a significant problem. So I think that's, when I say that the innovation is going to help solve the problem, that's assuming that government bodies do rational things with regard to addressing life expectancy.

Pearson: Thank you. One other question: I was curious about because … many of our retirement systems are under the actuarial assumptions of a return between 7.5% and 8.25%, portfolios vary, but I mean typically maybe 50% to 60% equity, and 40% in that area… a considerable portion anyway, 25 plus percent and fixed income. Now with inflation coming—I mean, fixed income is paying very little in many cases now—and with inflation coming, I guess I'd just like to hear from you is, there in a portfolio such as that, is there maybe quite a bit of expectation in expecting a return of in the 7.5% to 8.25% rates of return?

Terrell: So you're talking about the nominal return of 7.5% to 8.25%. So the thing that I would worry about is that the portfolio might continue to return, have a similar return. But the inflation rate might go up, and if inflation rate goes up and you're giving workers a cost of living increase or retirees a cost of living increase, then the system has the same return but the amount that you're paying out is going up. So that would be my concern particularly with regard to those…

Pearson: …Social Security, with bonds, with the portfolios, which … most must have, …you gather alternative investments. …Could we see a decade of bond yields with considerably negative returns, due to inflation and then from the current level that they're at now?

Terrell: I think that you could, depending on your portfolio, and you obviously are probably doing some sophisticated things with regard to the duration of the portfolio. But if you had a portfolio with a long duration, you would obviously have a lot of risk to inflation.

Pearson: Thank you so much.

Procopio: Mayor Roach.

Roach: Dr. Terrell, thank you for your presentation, very interesting. [I have] just two questions, actually. I guess everything is relative, but when you made your presentation, you talked short term, then you talked long term, and I guess that depends on the eye of the beholder. But how do you define long term and short term?

Terrell: That's a good question. John Maynard Keynes said that in the long run we're all dead. So I tend to try and do something a little bit different. I would think the short run would be the three- to five-year horizon, and then after, somewhere after three to five years is the long-term horizon. It's interesting, though, that when I took macro economics in the—I guess this is a long time ago, it doesn't seem like a long time ago—in the 80s, we really focused extensively on the short term and Keynes and models. Today when I teach macro economics, we start with the long-term models, and then we go to the short-term models. So there's been a real shift in macro economics as far as what problems we're concerned about; and I think that's somewhat due to the fact that, until recently, … we've had recession, but they've been fairly short in duration and not really severe as far as the decline. So….

Roach: What I have read about this recovery, I've seen a couple of charts here and there, but that the recovery that we're experiencing right now is slower in terms of the rate of recovery than it has historically been, which I guess leads you to the conclusion that it's going to take a little bit longer then it might have taken in the past to get out of this recession. Of course, the recession was deeper than it has been in the past; so again, a lot of ground that we have to cover, and I guess going forward it's going to take a while. And, I don't know, I guess what concerns me in a way, when you say three to five years, is the public's appetite for a three- to five-year recovery without making it worse than it really is—I guess that those remain to be seen. The other thing that I would ask you is, in your presentation I didn't see anything on it, but can you touch on what's going on in Europe and how that could possibly affect what we might experience here within that short-term/long-term analysis?

Terrell: Right, I see what's going on in Europe as primarily a short-term issue, a lot like our financial crisis. I think … there's several reasons that we're experiencing slower recovery. One reason is because of the source of the initial recession was a financial crisis; and I think the federal government, I've said this several times, but when I talk to virtually any economist about the policy action that was probably the best policy action, it was TARP. So on the US side implementing TARP, though some people don't like TARP, was a very positive thing to stabilize our financial system. I think on the European side, as long as they react in a strong way, not necessarily bailing out Greece, but making sure that the French and German banks and the large banks in Europe don't fail, then I think there will be a limited period of one to two years, as some of these countries go through the inevitable problems that they're going to go through. And that is going to be a negative because one of the things you see, even in Louisiana, is that … one of the reasons we weathered the storm a little bit better than some of the other states is the dollar's been weak, natural gas has been cheap relative to crude oils, and so our chemicals have been more competitive in Europe; and if Europe's economy is weak, that's going to affect lots of different US products.

Roach: Okay, thank you.

Procopio: I don't think I see any questions from the panel, but I do want to just quickly … see if anyone in the audience [has questions], because I think it was Steve Stockstill who actually requested this [presentation] in the first place. Steve, do you want to come up?

Mr. Steven Stockstill, executive director, FRS, comes to the table to offer testimony.

Stockstill: Good morning, Dr. Terrell. If we could go back to your presentation, maybe the third or fourth slide … shows the consensus for the S&P. [Terrell get's the requested slide up on the screen.] Right there, the stock prices, on the last line is the S&P and … let me ask, if the chart shows that as of June 30 2012, the consensus of economists that were surveyed in the Livingston Survey project the S&P 500 to be at 1413.5. Is that the correct way to read that?

Terrell: In June, so this was … when they were surveyed—and my guess is the survey was about January or February because this data is running a little bit behind—they were forecasting … better performance than we actually observed because we can look back.… I think you're making a good point that, if we take a look at the actual S&P 500, it's below the levels that they were projecting.

Stockstill: All right, and those were for [calendar year] '12. Dr. Terrell, do we have, or did the Livingston economists who were surveyed, give projections further out than '12 so that … their target audience would know what the '13, '14. '15 years, or maybe the '20 year would look like for the S&P?

Terrell: I'll check into that. My impression is that they have a fairly short horizon on… Now, the good thing about this is the Livingston Survey will be updated fairly soon, and I can also check and see if … there are more recent results than what I just pulled from the Philadelphia Fed webpage.

Stockstill: Well, if their initial projections were more optimistic than expected and they got negative surprises, would you say that the same would correlate for the fixed income market, or is there any type of survey that would show us the corollary to the fixed income market?

Terrell: With regard to yield, or with regard…

Stockstill: With regard to yield.

Terrell: I think in terms of the fixed income market, the Fed is, I don't think you're likely in the short-term horizon to see significant increases in the fixed income yield just because the Fed has a policy it's focused on keeping those rates down to stimulate the economy.

Stockstill: Okay, and I appreciate that. What I was wondering is if the consensus, the broad consensus that was made part of the Livingston Survey, had a particular projection for yield as part of the survey?

Terrell: They do have, there … may be one more yield. I should … probably just look up the information and send it to you, if you want to give me your card.

Stockstill: I'll be glad to, and really what I was looking at is, say, the next three to five years if we can get in that range. But, yes, I'll be glad to follow up. Thank you, Doctor.

Procopio: Are there any other question or… Dek, did you have any other final comments?

Terrell: No.

Procopio: Thank you very much. It's a lot of information, and I know the panel appreciates it. If you have any other information, you can send it to me and I'll send it out to everyone.

Terrell: Thank you very much.

VI. DISCUSSION OF POSSIBLE DEVELOPMENT OF NEW RETIREMENT PLANS FOR NEW HIRES

Procopio: One of the things that we had on the agenda—discussion on the possible development of new retirement plans for new hires—this was something that was also raised at the last meeting we had. What we did is, in your packet you should see testimony from a previous funding review panel. [It] has a lot of information in it…. Probably most people didn't get a chance to review it, but I would suggest that [you do]. There's a lot of information from a lot of different sources, including from Matt [Tessier, attorney for the House Retirement Committee] and Paul [Richmond, manager of actuarial services, Office of Legislative Auditor]. Particularly on the development of a new retirement plan, but there's a lot of information on cost shifting and those sort of things. That being said, one of the things I think you, Mayor Roach, … had talked about was looking at the previous Funding Review Panel, [which] kind of made changes to the existing system. One of the objectives possibly of this panel would be to look at a new system going forward for new employees, and I was wondering if you had any more thoughts on that you'd want to share.

Roach: Mr. Procopio, I have asked the staff with the LMA to take a look at Act 992 of the 2010 regular session to see if they could come up with an outline that they could suggest to the committee for consideration, and they're doing that right now. They're going through the analysis. And I think by the time we have our next meeting, they would be in a position to discuss that in detail. But I think the analysis that you have here in the minutes—and I certainly appreciate you circulating that with the members—has a pretty good explanation of what Act 992 did and what was the motivation behind it. One of the comments that was made in here—and I was looking for my copy and I couldn't find it—but I remember in reading, it they talked about the fact that it felt like that legislation could be adapted to the municipal plans that we have both for our police and municipal employees. …But, in order for us to do this, it would take a lot of work; and I wouldn't want to go through that exercise if the committee wasn't receptive to it. But I think it is certainly something that we should consider and look at. It's a plan that affects new hires only; it does not affect existing benefits for existing employees in existing systems. But it would be a new hire program that would be structured in a manner similar to what the legislature did in 2010. So, I just throw that out for consideration by the committee and would … like some feedback because, like I said, it will take staff a pretty good effort to adapt it, or at least present something for us to look at. But I don't want to ask them to do that if the committee is really not interested in doing that.

Procopio: All right, so what does the committee think? Mr. Dean.

Dean: I do believe, Dr. Procopio, that you sent out an email, and I don't know which document it was, but I can tell you what page it was—page 23—and it was a dissertation given by Mr. Tessier relative to changes, I believe, under Act 992. I don't think this board should discount this at all, but I think it's incumbent upon this board to look at alternatives. I'm not asking us to reinvent the wheel, but if we do, we ought to have several options before us. So I know, Mayor Roach, you said the LMA is looking at the provisions under 992 and possibly breaking them down for presentation to the board. I would ask that we somehow—and I don't know if the board has to do it themselves or not—also look at other alternatives, because some of the points that were brought up under 992 were not anything drastic, but it was hazardous vs. non-hazardous; final average compensation from three to five years. I believe that you went from a retirement at 50 or 55 to 60; you could do that at 10 years, if I'm recalling the right facts of the document that I read. If that worked for those particular systems—and one of the things that was pointed out in Mr. Tessier's presentation [was] that it was based on uniformity, and that seemed to be the goal or the objective at that particular time when *(momentary loss of video feed)* …alternatives, that there are a lot of suggestions not specifically at this time, and I don't mind bringing some to the board to myself or by myself. I can do two things: I can research it myself and really show you my ignorance when it comes to this arena, or we could ask maybe our actuary to do it, if he's familiar with other plans and not only in the Louisiana State system. And Gary [Curran], I didn't mean to put you on the spot, but that's our relationship buddy *(laughs).*

Procopio: Okay … Mr. Curran, do you want to come up for a second?

Mr. Gary Curran, actuary, G.S. Curran and Company, Ltd., comes to the table to offer testimony.

Procopio: So the question is do you think, other than 992, there are alternative models we could maybe look at that might serve the purpose of at least fostering discussion on what a new system might look like?

Curran: An infinite variety. I think … to me, the best way to approach this is to look at the components of assembling benefits and to make decisions based on those components to assemble it. When you break it down, there are probably five to six big drivers of costs. Eligibility age is one of the real important ones, obviously. Accrual rates, final average compensation measurement periods—those are, you know the things that really drive it. Also… things like disability and survivor are in there, but not to that extent. So, when you're talking about re-design in terms of whether it be a new system or just new tiers within existing systems which, you know, [are] financially equivalent, I think it makes … a lot of sense to try and, rather than just coming up with arbitrarily set of parameters, to look at the pieces and see where you're headed with it. Now, you need to coordinate to a certain extent, but be a somewhat independent decision. We know what the general eligibility standards are right now for these plans, and … if we want to save costs, then … we're going to have to pick on some of these parameters to achieve those cost savings. So… final average [compensation]—possibilities to lengthen that. Accrual rates—one possibility is to reduce eligibility ages. One possibility is to raise them or a combination of those things, but to the extent, how far do you want to go in terms of developing something that's workable—this is certainly a subjective judgment. There's no magic place to be; it's trying to put it all in place. And also I think you have to be careful too because it's not just a retirement issue, it's a workforce issue. I've seen a lot of times where we've had plan designs that work in cross purposes to each other. We design plans that let people out early, and then we're faced with labor shortages and trying to put some kicker in the plan to have them stay around. It's sort of like with the Teachers Retirement System. You have a 20-year retirement, then we have the educational establishment saying we can't hold on to our teachers. Well, guess why? You let them retire at 20 years. And then you have a policy to try and achieve the objective of having them stay longer, and you get competing elements within the plan that just don't make any sense at all. I think you not only need to go at this from the standpoint of trying to save money, but to also build a program that makes sense with regard to workforce issues that you're facing; you have to be very careful because you could push the workforce in one direction and the other that you can create collateral problems.

Procopio: Okay, we're having… Mr. Roach you wanted to come up and we're also having a couple of questions if we can get to the questions, maybe then Mr. Roach, Mr. Rust?

Rust: Gary, you know we've looked at this ad nauseum in our board meetings, as we did, I guess, the day before yesterday. If you put a new structure—and we don't want it how it is, but later retirement, lower accrual, all of that—in the three systems that you're the actuary for…. How long would it take to have a reasonable… I mean what's reasonable, what's meaningful… an impact on cost, and what would that be? Can you guess?

Curran: Well, I mean, it's so dependent on what you're talking about, but generally these new-hire-only provisions, before you get much of any measurable effect, it's usually three to five years … because the replacement of that population, the turnover is not that rapid…

Rust: Would it pick up after that?

Curran: Yes … yes, it would grow, yes, right, as the cohort grows as a part of the population, there may be a fair difference in terms of rate of roll-in as in cases like MERS versus Firefighters. Firefighters might take a lot longer to roll in a new benefit because they probably don't have the turnover that, say, MERS might have. Police, I'm not as familiar with stats on it, but maybe somewhere between the two. So, the rate at which that new hire benefit structure effects cost could be slower for public safety if they've got lower turnover, because you're not replacing the population with the new people. The others side is, I've been here before, I guess, having been around for about 25 years with the public systems, that I've seen sometimes decisions were not made because it just didn't seem like it was worth the trouble and it was going to take forever to have an effect. But, you know, 10 or 15 years ultimately gets here. If somebody made a decision to do some of this 10 years ago or 15 years ago, we wouldn't be sitting where we are. So it may seem like it's not sort of worth the effort to deal with some of this in that fashion, but you eventually do get down the road. But to answer your question, I think … from what we've seen in typical systems …, and it depends on the benefit, the change in the structure, but new hires only, I would say most of these systems would turn over enough so that about—and this is strictly a wild estimate—but I would guess somewhere in the 10- to 12-year range you'd have about half of the population turned over and you'd see about half of the savings. And then it's kind of a slow curve because you get the full savings when the last person of the existing cohort retires 35 years from now, but by that time, that population is very think.

Rust: That'd be 20 to 25 years, I think, till they retire, not 35…

Curran: No, you have people that do hang on, believe me (laughing), but you know, most of them do sort of a thin edge at that point.

Rust: Yes, some people are working longer. I signed a refund for a city worker who had passed away the other day, and to refund the money, and was still working for the city at the age of 83.

Curran: We have retired people, because the calculations come from all but some of these systems, in their 90's. I think the word that I stuck out, we had a person with 64 years of service credit (laughs)…. You know the old saying, we're working for nothing, you know, you just like the job.

Procopio: All right. Senator Guillory.

Guillory: Thank you, sir. Last year you made a major presentation to us, gave us a number of optional factors. If you can tell us what meeting that was, we can refer to those minutes. I'd like to go back and review those minutes also.

Procopio: We'll try and go back and find those minutes for you.

Curran: Yeah, I'm not sure I could give you the exact meeting or date.

Procopio: But that was when there was [some sort of] chart. Yes, I remember that.

Curran: I think both Charles [Hall] and I presented alternatives.

Guillory: Very, very thorough.

Curran: Let's see…

Procopio: Looks like it says August 25th.

Curran: What date was that, Henry?

Dean: I'm looking at one, September 17th of '10.

Curran: Yeah, I don't, Tom Ed has just given me a folder, but I don't see in there that presentation, but I know the meeting you're talking about, Senator. But off the top of my head, I just couldn't really tell you.

Procopio: We'll go back. Did you have questions about it? Or just wanted to get another version of it?

Guillory: I'd just like to refer to it. I think it would be relevant to the discussion this morning.

Procopio: We'll try to get the previous…I, there's actually probably a lot of previous discussion. How much of that is on the website still, is there?

Sullivan: I'd have to check the dates.… Video, of course, is immediately available, and Gary made presentations for both of the systems. Charles Hall made a presentation for the police … which we should be able to send out immediately, but those that are individual … (inaudible) probably be used to gather….

Procopio: So between the actuaries and legislative staff, we'll get together and try and find those different presentations, because I think you're right, those are very important to try and kind of get a sense of effect. Mayor Roach?

Roach: Gary, sometimes I feel like—and I know that y'all did a lot of work last year, I think the whole panel did a lot of work—and I think we were all somewhat, I guess, disappointed we didn't maybe come out with some more concrete recommendations that could deal with the problem. But I think we did come out with something, we made a little bit of progress, and I think we're hopefully able to build on that. I think the one thing that maybe we need to do is perhaps simplify the question and ask it maybe a different way, and that would be: What could we do? And this will be a question—maybe not, a question necessarily to you, but you do represent at least two of the systems—but … at least a question to the systems: What do we need to do to get the, given the present structure and the present foundation we're working with, what do we need to do or could we do to get that employer rate down to 18% to 20%?

Curran: Well … there's just a lot of factors there, Mayor Roach. If we just sort of pick an arbitrary number to try and get the rate down to, one of the problems—and I don't know, Bob, did you forward that email that I sent that to Randy—one of the problem's we've got is fixed cost. That is, if we shut the plan down and don't give anybody any more benefits, we've still got a cost to deal with because we've got unliquidated losses. I didn't go on a big dissertation in the email, but there's a lot of sources to that. The big one that we're dealing with right now is investment loss, but there are other pieces to all that that are built up over the years. Let me cover a couple of these for you so there will be a better understanding of the structure of that sort of legacy cost that we're grappling with. As I said, a large part of it that was recently added is investment revenue. But there are other significant segments. Part of it is mortality driven, and that's buried in the fact that we were having to revise mortality assumptions. As mortality improves, that generates assumption losses, which are in with the general liability losses. It's not really a magnitude, but it does add up in its cumulative because it's always moving in the same direction. You know, at least with the assets you have gains and losses. We don't ever have mortality gains, so it's small in magnitude, but overall aggregate direction is negative and against the plans. You have COLA (cost of living) losses, and they're cumulative. Every time we run a COLA, and it depends a lot on what the amortization is for the COLAs too, because some of them are pretty … if we're amortizing these things over periods that are longer than the future life expectancy of retiree's, and in some cases we may very well be de facto doing that. We're taking up existing liabilities, packaging them, and stretching them out for 30 years. You've got payments on these liabilities that are going to stretch well beyond the lifetime of the people receiving the benefits, so those are cumulative. Recently … COLAs are a non issue because everybody's sort of in what I call "COLA hell" because you can't give one because of the way the law is structured and everything. But, if you go back over a 20 or 30 year period, we've got all that cumulative layers of additional liability that we've built up, and those present problems. So these are structural types of things that are creating this sort of fixed cost that's with relation to benefits already earned and accrued, and indeed in some cases with regards to benefits being already paid to people who are already retired. The problem is that we've got so much leverage against us in that regard that I think it's going to be very difficult to get some of these rates down to levels that people think are acceptable, even by turning the benefit dial, because even if we cut future benefits for—just say we just slash benefits for existing persons drastically—you're not going to get a one for one reduction in the cost from that. You might be getting, if you cut the future benefits in half, you might cut your future cost by one-fourth or one-fifth, and that's the problem we're facing is that there's a lot ... I'm giving you generalities. Every system is structured different; every system has its own problems in terms of funding and so forth. It doesn't mean this is all insurmountable. I think one encouraging thing is what we're seeing, at least in some systems, is some unwinding in production of liability gains, which we expected all along, from things like salary increases below expectations, but that's not even uniform. Some systems are experiencing it to a greater extent than others. I guess … time will tell as to whether that persists or not. But at least, in some of the statewide systems, the liability gains, we know what the schedule of future cost increases will be with respect to the past investment losses. We don't know with respect to future investments, but we can schedule those out, and it looks like, in the case of some of the systems, that at least as much as maybe two-thirds of that will be offset by liability gains. And that's not true for all systems, but it's going to be a function of pay increases and other such things, and part of that has to do with the funding structure—what plan to what kind of funding method they're using—as to how that affects it. It's kind of complicated, and it's a little bit difficult to talk in generalities across the three plans because they're different in the way they're funded, and they're different in their demographics, so what's true for one is not necessarily true for the other. But trying to get those rates down, if you've got a system with rates in the mid-20s pushing up near 30%, trying to get that rate down to 18% … I don't think there's anything we can do. Events may unfold that may cause that rate to drop, but I don't think we've got enough control of the situation in and of ourselves from any action we can take to produce that large of a magnitude.

Roach: Okay, and I didn't mean to imply that you can do that on your own; I guess what I was…

Curran: I mean, when I say we can't do it, I mean that is within the purview of even re-structuring benefits. There are outside factors, things like the economy that we have no control over, but they may be bigger drivers of the process than things we do have control over. Obviously, if the market just perpetually has a run for three years and we get 25% sequential rates of return, we're in a different ball game, but not expecting that to occur. I think it's going to be very difficult. I think there's something we can do to reduce cost, but I'm just saying I … don't want to be over optimistic about the degree to which we can effect savings.

Roach: If we were to, and I guess the effort here is to try and do as much as we can…

Curran: Right.

Roach: …and to save as much as we can, but if we were to look at this from a short-term perspective and perhaps try to make some adjustments to the benefits structure short term, to try to see us through this tough period because, if what we're being told, or what has been suggested is a three- to five-year period of time, I don't think—I could be mistaken—but there's not going to be many communities that can afford to pay 25% plus for three to five years, and then … Humpty Dumpty is going to fall off the wall, and we're not going to be able to put him back together. It's going to be bad. It's incumbent upon all of us to try to figure out what to do, and I think what Mr. Dean is asking, and we're here trying to do the best that we can—but we're not actuaries and … we're not experts in retirement—all we can do is look at what others have done. And I think the legislature dealt with a lot of the different nuances of all the issues, and I think the discussion that is within our minutes from last year is a pretty good one about the analysis that we went through. I think the legislature should get a pretty good pat on the back for at least going through it. But somehow we need to get everybody together, and that's really what this Funding Review Panel is about … to come up with some type of, if nothing else, a short-term solution so that we don't break the bank and we don't lose the… we don't throw the baby out with the bathwater, so to speak, and lose the whole system for the retirees that we're trying to protect.

Curran: I understand.

Procopio: All right. Representative Cortez.

Cortez: Thank you. Mr. Curran, you talked about the eligibility age and sort of the moving parts, the accrual rate, the final average comp; but there's nowhere to talk about the required or assumed rates of returns and the affects that those have, and if changed—in my opinion, and I'm not an actuary by any stretch—if changed could actually force those other elements to be changed, it would seem to me. And I know we're living in an environment—and when I say an environment, a climate I'm talking about—is someone a little too early, the ten year loss, ten years of lost decade to that affect, but … it seems that its going, you know, where we're at with the assumed rates of returns, can you give me….

Curran: Yes, well, we have had a lost decade with regard to pensions and returns. Ten year rate of return averages on the geometric basis for most of these systems are down in the range of about 2% to 3% or lower, in some cases, one and a fraction. That's just put huge pressure on the system. It's not that we've had one year, it's just we keep getting bucketed with all this sort of stuff. I think you bring up a very good point because we're not only fighting this short-term problem that … Mayor Roach is talking about, but almost more critical is the potential long-term problem we face if we cannot get earnings that justify the assumed rates of return. And I think we're on the very, very edge of what can be justified; we may be out beyond that edge. It's going to be painful to start bringing in those expectations to lower levels. And at the same time, how do we justify the levels where we are? It's sort of a grave question, and it's a balancing act to deal with. We've recommended to a number of clients to reduce evaluation interest rates, and I'll actually recommend almost to anybody at this time opportunistically that, if it can be done, it be considered, if for those who have rates about 7.5%, it needs to be at least on the table and discussed. The effect is to raise cost, but the problem you face is…

Cortez: Who's the payer in that?

Curran: The payer as always is going to be either the… going to sources of cost, employees and employers or surrogates for the employers…

Cortez: And how many of those two payers want to increase…

Curran: No one wants to increase cost.

Cortez: So, therefore, we get to that point where we have unrealistic—let's get realistic first. Once we get realistic, then everybody has to agree to pay more or take less.

Curran: Those are really the only two alternatives. There's nothing else you can do. I also want to say this: that we went through, around in the early '90s, where people were really trying to push up evaluation interest rates, there's sort of a school of thought that says a lot of this stuff should be market driven. My response is yes, to some extent, but you need to be very, very slow about it because often conditions change and you can create more problems than you solve. So I don't think we just want to come in, slash and burn, cut the evaluation interest rate to 6% or 6.5%, but I do think we need to have our hand on the dial and ready to turn it. If we can get through the short-term problem and then address that long-term problem in the not too distant future, I think that's all that we need to look at.

Cortez: You've mentioned that over the last decade most systems are realizing about at two point something percent, think you said over the decade, and yet their assumed or required is in the seven and seven-to-eight, somewhere in that; anyway … and I don't know the math behind it, but it just seems to me, knowing when I have a loss in a given month in business or two months or three months, it seems like it could be multiple decades to recoup that, maybe 50 years, if you don't adjust.

Curran: Well, we've also looked at the 20-year returns, and they're a little bit more encouraging. In the case of 20 years, most of the returns are in the seven and a fraction range. So to the extent that this is cyclical, it made, the recovery could be there. We've got long-term structural economic problems in the country; they're going to be rippling through the pension community. If, on the other hand, if we're in some sort of cyclical downturn and get back into what could be referred to as something near normal, then the problem won't be as severe. I don't think anyone knows the answer to that issue at this point. We have assumed rates of returns that are, as I've said, that I consider the end of the envelope. No one knows the number. We have to pick something that's reasonable. There's some envelope that makes some kind of sense, with that envelope where it is, certainly I think everybody, well not everybody, but I think most actuaries in systems would go back five, six, seven, eight years ago, and said envelopes somewhere between 7.5% to 8.5%, eight was kind of like dead center. If eight is anywhere right now, it's at the very edge. So we've got this short-term problem, we've also got some potential long-term problems, and we need to work our way through both of them in order for the plans to survive.

Cortez: I just, I feel … I feel that we're backing ourselves into a position of needing lottery years going forward for many, many years to get back to where we need to be or, as Mayor Roach said, Humpty Dumpty is going to fall. And that's the scenario that I guess—personally, I'm sitting here [and] my concern is to not leave my fingerprints on the possibility of … do nothing and let Humpty Dumpty fall, but rather try to do something to fix it so that … when I'm gone from here and the 30 years comes, that there's still a system around for many of the members.

Procopio: Representative Pearson.

Pearson: Thank you, Mr. Procopio. Gary, one thing that, when you were discussing how the systems are working, here we're primarily talking about the three systems: Firefighters, MERS, and Police. But did you say at some point in time, because I know in the state we kind of have frozen salaries, but do you have different—or is this your area—where we would have actually some cities, all of them are saying how they can' afford the employer contributions. But there are actually still those that are saying that to me on one hand, but … increases…

Curran: We're still, I know in the case of Firefighters, we have not seen what I would call significant liability gains yet from the system, sort of much to my surprise, but I don't know, I don't know whether those conditions will change or not. I'm just trying to get a copy of the report up so I can give you, see if we have a… where we stood on that. We had a very small—actually, looking at last year's valuation for Firefighters, we had a small liability loss for them. And I think that we either had a situation where salaries were probably fairly near projection or slightly over. I don't want to comment on it too much without having my notes in front of me, but just through recollection, when we did the valuations it, in contrast with some other systems, we actually had significant under-increase, if you will, on salaries, and that presented gains. We didn't see that as far as last year, and quite frankly, I was surprised that we didn't.

Pearson: Okay, that was pretty much it, thank you.

Procopio: Mr. Richmond, you have been waiting patiently.

Mr. Paul Richmond, manager of actuarial services for the Office of Legislative Auditor, comes to the table to give testimony.

Richmond: I think we need to step back a little bit and ask some fundamental questions about our pension plans. The first question I think we need to ask is how much is enough? How much should—no, how much do employees or how much do people *need* in retirement? How much income? There's two competing theories. One is that pensions are a reward for service, for long service. The second is that pensions are a benefit to provide to your employees when they're no longer able to be gainfully employed. It's sort of like a de facto disability. You reach a certain age in which you're presumed not to be able to be, you know, substantially employed; and therefore, we need to provide for you, and so you provide a pension to take care of them. The average working lifetime of a person is from twenty to sixty-five, twenty-two to sixty-five, sixty-seven, and it's getting longer. That's when the presumed health should exist. So the first question I think that you need to ask is how much does a person need in retirement relative to the income they earned before retirement? Studies for long periods of time, studies have shown that a replacement income, a retirement income of 70 to 75%, 80%, in the 70% to 80% range for over a career, that is a reasonable replacement income for somebody in retirement, based upon what they earned immediately before retirement. The second question is when should they get that benefit? Should they get that benefit at age 50, at age 55, at age 65, age 70? And that gets the fundamental questions—got to respect the fundamental question of what is the purpose of pensions? Is it a reward for service or is it a benefit for when you're presumed no longer able to be gainfully employed? So that's the second fundamental question. The third question is how much can we afford? How much can the state afford or the governmental entity that's supporting these employees or paying for these pensions, how much can you afford? And there are two components to that. One is how much can we afford if everything goes according to the actuarial assumptions, normal cost of 5%, 6%, 7%, 8% of pay or, well, the second question is recognizing that there's extreme volatility in those contribution requirements, the normal cost on a normal basis. That volatility because of the market, because of pay increases, all sorts of reasons that normal cost of 7% of pay can range as high as 25% of pay in some years to zero. It can fluctuate that widely. So, if you put a pension plan in, you've got to recognize that some years you're going to be … you may have to contribute 20, even though the cost, the predicted cost is only six or seven. Other years you may have zero. So that's another fundamental question. The third is, or the next question is, what can I control today? Well, you've got to look at what you've promised to date, and what you're going to promise in the future. What have you promised? What you promise today is all the service credits that have been earned and promised the people right now. When you change the promises for future people and say for future employees, that affects those future employees. As Gary has spoken, if you change a pension plan from a 2.5% per year of service to 2% per year of service and the normal cost was 8 and it went down to 6, it doesn't really affect cost all that radically where the cost of savings is dealing with the cost, the promises that have already been made and how, if you really getting back to Mayor Roach's question , if you really have to get back to an 18% contribution rate or a limit of 18% or whatever you set the limit, the only way to do that is to reduce benefits or to go back on the promises that have been made to date. And that's tough. That's the realities of it. Now, other strategies that you can make are, well, let's defer contributions—you know, if it goes over, if the rate goes over 18, let's not pay, lets only pay 18—that exacerbates the problem next year and down the road. Bottom line is there's some tough, tough choices that, as leaders of, as governmental leaders, that we all have to make; and those choices are just not going to be very pleasant. But that's the reality of either we address these questions, we ask these questions, we come up with the answers, or we will allow events and factors to control our lives.

Procopio: Mayor Roach.

Roach: Yeah, I kind of, a thought occurred as I was listening to your comment that there's really two ways to handle the problem, and that is to either ignore it and let it fail, or propose a solution and keep it alive. That's, I mean, if we don't change anything—and I would like to ask this of both of you—if we don't make any changes, then in all probability, it's going to get to a point where we can't afford it, would you agree with that?

Richmond: I would agree with that, and the painful changes are going to be changing some of the promises. The only thing you can really do to effect the near term, unless you want to kick the can down the road, the only thing you can do to change the near term is to change some of the promises that have already been extended.

Roach: I think we had a series of meetings last year, and in one of those meetings we talked about changing the promises. And I think we're pretty well locked in with the constitution that we can't change those promises, we have to fund those promises one way or the other. And if we don't fund them, I guess we'll, in an indirect way, we can change them just by saying we go bankrupt and then we have to deal with those consequences. But, and nobody up here is suggesting that—I want to make sure everybody understands that—but I think that the point is that we … I told a group of people yesterday I would rather be talking about something else, I got plenty to do back home, plenty to do. I can promise you. And that doesn't even touch on retirement. That touching on retirement, and if I don't deal with this problem, it's going to affect everything I'm doing back home. That's just the reality, and so I'm looking for suggestions. And I don't want to, I don't want this—and this will be, I think Steven understands this—we're not here to do this *to* anybody. We want to do it *with* everybody. And come to some sort of reasonable understanding. And I think that there's probably this misconception out there historically, and if we've fostered it one way or another, that the government's just made out of money and we've got money here, we got money there. But I think the reality is that the chickens are coming home to roost, not only at the local level, but the federal level as well. There was an article in the *USA Today* yesterday that talked about the fact that the pension benefits for federal employees is … the unfunded liability is almost as bad as Social Security. I don't know how the government's going to deal with that. And … anyway, we're looking for constructive suggestions, we're looking for solutions. I put the item on the agenda today to talk about making changes in a, in the benefit plans, the structured benefits for the various systems that we have , prospectively going forward, and I think that that discussion will at least enable us to talk about some of these component of the cost of retirement, and talking about how much we accrue each year, talk about the age of retirement, talk about those things both of you have touched on. But at least it gets us into that exercise of looking at those things. And then I think both of you are saying that, until we deal with the benefit structure for existing employees going forward, that we're not going to see those rates, those employer rates or those contribution rates in totality coming down any time soon.

Procopio: Thank you. Representative Pearson.

Pearson: Thank you, Mr. Procopio. Gentlemen, and I guess Paul and especially Gary, I think last year, and based on what Mayor Roach was just saying, we're discussing promised benefits; and I do recall, I believe it was last year, at some point in time at a Funding Review Panel meeting, there was perhaps a difference in agreement. Two attorneys said that the benefits that are promised are those benefits that are promised to date. I mean, if an employee could be terminated tomorrow, there's really no promised benefits; otherwise, he'd be able to collect benefits even though he was terminated. But under the assumption that, as I believe, two out of three attorneys, one was indifferent, but two said that they did believe that respectively, perspective future benefits are not necessarily promised in their current form, assuming that, is there room to make adjustment? That is an area that could make a considerable difference. Is there a way by changing, obviously probably not the retirement age, but the accrual rate? … On future, and I mean on future years.

Richmond: There are, first of all, that battle is being fought throughout the country with state and public retirement systems because it's long been held that the promise is a promise. It's—in generalities, it's part of the contract. But the language supporting that contract varies widely from state to state and governmental entity to governmental entity. Obviously, various governmental entities are taking steps to cut back on the benefit promises, and that's being fought out in the courts. Who knows where that's going to shake out? So I'm not going to comment … I have no idea where we'd shake out in Louisiana. But there are two things that you, for promises that have been made to date, there are two ways of dividing that. One is the promises that have been made to date and looking at the benefit that has actually been earned to date. If you will, pensions are a form of differed compensation…. And the extent that I've earned rendered service and given up direct compensation in exchange for the deferred compensation of my benefit accrual based upon my years of service, you know, that's probably pretty solid. Okay? But open to question is, well, what about if I change the accrual rate for Paul Richmond from 2.5% per year of service for the coming years to 2% per year of service for the coming years, but I protect what I've accrued to date, that's guaranteed. All right? That's perhaps where the … I think that's where the battle is being fought.

Pearson: That is the question.

Procopio – Steven, do you want to [comment]? I think you may have been one of those three attorneys.

Stockstill: At the time we went through that hearing, I was very cautious, Rep. Pearson, because I've been practicing law for 20 years, and one of the things I learned is not to let someone who is anxious for information to drive you to draw a conclusion when there are not enough facts to be certain about the conclusion. And so, for that reason, I was somewhat ambiguous in my responses. But when House Bill 332 was filed, when I read the bill—I believe it was on the day it was filed—the first thing I did was, I got on the phone and I called Tom Ed McHugh. And I said I just want to tell you, so that we have this understanding between you and I now, that I've seen HB 332; I think the way it is drafted is legal. So once we had something concrete that I could pass an opinion on, I did. And I called him to let him know that because I think he and others were somewhat frustrated that I wouldn't land on a bright line while we were just talking in concepts. But I do believe—and let me tell you the opinion that I express to you today is not uniform amongst all the attorneys in the statewide systems, I can tell you there are those that disagree with me—but I believe that, if you were to take Mr. Richmond and say, all right, his benefit accrual rate to this date is this, so you protect that, but then you change it prospectively, I do believe the courts would find that to be consistent with the rights that are protected in the Constitution. So I don't think that that would be held, in my opinion, I don't think that that would be held unconstitutional by the court now that we have something in place to judge that by. So I…

Pearson: And we're not picking on Mr. Richmond. I mean, it might be unconstitutional if we only did it to him. *(Laughter.)*

Stockstill: So please accept a professional apology for ambiguity in prior circumstances, but please see that I am certain when we have something that we can look at and say, all right, based on this, what is your opinion?

Pearson: And I didn't even recall who was the ambiguous one, so I wasn't directing that at you in anyway. I just remember there were two that were like, "Yeah, you can do that," and one that couldn't, but that helps, thank you.

Stockstill: And let me go back to the point, really when I came up to the table, Mr. Chairman, if you don't mind, I'd like to express a point having to deal with the benefits.

Procopio: Okay.

Stockstill: There is a famous poet who has passed on named Ronnie Van Zant who wrote a poem called "Free Bird," and the opening sentence, two sentences to the poem is, "If I were to leave tomorrow, would you still remember me?" And I'll be gone in a couple of years, and I hope that I can plant some seeds here that people will remember maybe, and that is the idea of not only stratifying the benefits, but also stratifying the cost. If Humpty Dumpty is a couple of—I'm sorry, I don't want to assign a number to it. If Humpty Dumpty is some smaller municipalities who are being burdened with a tremendous cost that is going to cause them to become insolvent, I'd like to know the feasibility of taking the cost structure of a plan and stratifying it to where you have larger employees, middle employees, and smaller employees, and assigning a contribution rate based on their impact to the plan; and perhaps that I don't know the feasibility of it, but it's something that we haven't explored. It may be totally unfeasible, but I learned in school that you look at all the options and then rule those that are not feasible out. So perhaps there could be some merit to that theory if we would have the opportunity to look at it; and I don't think it's totally unprecedented in concept, because the legislature did that with LASERS. Now LASERS is a multi-employer plan with its several divisions that feed into the one plan, and the law that was enacted, as you all well know, for that plan gave different rates for the different participants of the plan. So it's not a totally wild concept, it's been done. I just don't think it's been explored yet as it applies to the other systems. And, you know, in trying to be a good faith partner here and working with the employer, I'd like at least … to see or hear a dialogue along those lines, as whether the employers even think that's a feasible idea, and if they do, whether … they do think it's a feasible idea; perhaps that's something we could have a discussion about. Thank you.

Procopio: Mr. Dean.

Dean: I'd like to thank all three of you for dragging that guerilla into the room. Mayor Roach started on it, Mr. Cortez hit on it a little bit more, and the bottom line is, Gary, you mentioned it earlier. This board is tasked with several things, but one of the things is knowledge and gaining the knowledge relative to the different components to the different systems and how they're going to affect the municipalities and how they're going to affect the employees. Mr. Richmond, I am definitely aware of promises made; in fact, there are a couple of us sitting on this board right now that will guarantee you, when we slap that big guerilla in the face, it's going to end up in court and we know it. I think Steve alluded to that. I'm sorry you're not wearing a black robe right now, and you could make the final judgment. But I think promises made have to be looked at. And if we don't look at it, at this board, let's not just convene anymore. Just forget it. We're wasting our time here. Just because we make a recommendation doesn't mean it's going to go into the legislature or into the Senate. And if we make our recommendation and it does get in, it doesn't mean it's going to pass in any shape or form. But we're not doing our job if we just totally ignore it, . [If] we stick our head in the sand, this problem is going to be up here next year and the year after, and you know what? Maybe this committee won't exist anymore because some municipalities won't' be around anymore. That's the truth. Some of the components that we have to look at, from my perspective as a police officer, is recruitment and retention. But you know what? It's not always a police officer. Mayors have to look at it; the legislature has to look at it also. I mean, they're serving their public, and part of the service that they deliver to … them and we have to deliver to them also, is to take all facets of this particular problem and look at them. We can't ignore them. So let's bring the guerilla in the room, let's look at it, and let's not only look at a copy of Bill 992, but let's look at some of the promises made and whether or not we're going to have to propose something to break those promises. Thank you.

Procopio: All right, if we don't have any other comments or questions from the panel, good discussion. Wait. I spoke too quickly. Mayor Roach.

Roach: Okay, I think we started the discussion when we got to the agenda item about the, [about] what we do with respect to a retirement plan for new hires. So I guess I would ask of the committee, from the discussion we've had this morning, is that something that the committee would like to consider; and if so, we will work on that and be prepared to deal with that at the next meeting.

Procopio: What would you like to do? Do you just want to open for comments….

Roach: I'll make a motion and see if I can get a second, how about that? I'll make a motion that we develop, that we request LMA and Louisiana Conference of Mayors to present their proposal relative to the retirement plan for new hires.

Procopio: And let me just put on this, because we had some precedent last time when the funding review panel met. We had, it was really a motion to look at things. It was not saying you were endorsing this idea, but it was an idea for further research. I just want to make that clear—and we've done that before—I just wanted to make sure that was clear for everyone. So Mr. Dean seconds. Do we have any discussion?

Roach: I think we have one comment.

Procopio: All right.

Roach: The man that's going to put it together, he might have something to ask of us.

Tom Ed McHugh, executive director of the Louisiana Municipal Association, comes to the table to testify.

McHugh: Certainly. I'm Tom Ed McHugh with the Louisiana Municipal Association. [The] LMA stands ready to do that. We would like to do that with representatives of the police, representatives of firefighters, and get some feedback before we take a position, and at least get their ideas for when we come here. We know full well that the things that have been discussed here—final average compensation, employee and employer contribution rate, accrual rate, eligibility in terms of years—those are the issues. And I mean, it's just a matter of putting numbers. We were looking at [Act] 992 to give us … because there's no experts in retirement at LMA, I promise you. We're just doing … looking at what, assuming that the state realizes that they have problems, and that this was not the solution to the problem, but a step in the right direction. I used an analogy yesterday when we were at the mid-city conference and they were discussing retirement: If I could, if I had a big block of granite and if I could with a sledge hammer just hit that rascal one time and everything fell off of it that I didn't want up there and I'd have a masterpiece, that would be a good way to do it. But I don't know of any artists that work that way. What do they do? They have to just chip, chip, chip, away. Now, we have to chip fast enough so that our communities are still there when we get through with the work, but we're going to have to chip away. And so we would like to work with the police and fire to get some feedback in the process of putting our business together, and then—not that they have to approve or endorse it, but at least get their understanding and their take on it—and then bring it to you as a recommendation. And I'd obviously take it through my board and that process to give you a firm recommendation.

Procopio: Questions?

McHugh: That's how we'd do it.

Procopio: All right, Mr. Nassif.

Nassif: It was mentioned earlier, Mr. Cortez I think asked and we never really got a straight answer because nobody knew: Is there any way to find out what if any benefits have been seen by the state systems since they've enacted 992? I know it's only been really a year and there's probably not going to be anything, but it's … are they going to see anything from the changes?

Procopio: I think, and … okay, Laura came up, but I was thinking it may be the actuary. I think there may be an assumed gain, and so there's been a reduction in the rate but the actual.

Laura Gail Sullivan, senate counsel, comes to the table to testify.

Sullivan: Act 992 only went into effect for persons hired on or after January 1, 2011, so there's only been six months that it's been in place. And with the hiring freeze that's kind of across most agencies, I don't think any gains have been seen from that yet, based on only six months and the actuarial evaluation of June 30.

Procopio: You're not going to get in actuals, but it would be nice if we could. Okay, we have a motion. Any further discussion? Okay, do we have any objection … to the motion? All right then, seeing no objection, the motion passes unanimously. And so we'll add that on there, I took that also, that was a motion for a new system for new hires, and I think Mr. Dean also talked about we should also look at the current promises. I don't know if we necessarily have a model for that, so that might be a little tougher to do, but I think that we'll need to leave that for an issue to look at. And if anyone has any issues in the next week or we … come up with some, please let me know and we'll try to get it on the agenda to discuss. So I definitely want to do that. And if the actuaries have anything, suggestions to look at, definitely we want to put that on the next agenda, so please let me know. If you don't have anything now, we can get it on there for next time.

And with that, we've kind of merged the next two agenda items together. So, is there anything else in terms of discussions of future meetings or topics for considerations? Let's just do the topics of consideration for future meetings. So we're going to have maybe that, I think, maybe an issue might be … [that] the actuarial reports are coming out, so I don't know if we're going to want to look at that or not.

Curran: I'm going to suggest … I'm going to suggest one other thing too, because part of the problem obviously is high contribution, but I think another component or problem is volatile contributions. I think nobody wants to pay 25%, but if you're getting there in little bits instead of having it slammed at you at one time and there may be some, we may should look at some of the funding structures to see if we can by law, what's already in the statute in some cases, to try and put in place maybe some kind of reserve accounts that we can use to buffer contributions or some procedures to do that. We've already got some things in the statute, we developed that funding deposit account, but it's really only practical for certain systems. We may want to look at what else may, or whether we need to spin on that concept to try and, you know, reduce contribution volatility. I think that's sort of, its collateral, but it's really a separate issue.

Procopio: Okay, that's a great idea. Mayor Roach.

Roach: Mr. Curran, I'm a little bit hard of hearing, and actually I've been told to get hearing aids, but I can't keep up with the batteries, but when I first heard this discussion about smoothing the rates over time, I thought they were saying schmoozing the rates over time. *(Laughter.)* And I thought, how can they be talking about this in public? Schmoozing. So, maybe what you're suggesting is that we could smooth the contribution, part of the contribution rate, because I can't speak for other communities, but it would be a lot easier for us if we knew that for the next seven years we were going to pay, regardless of what the required rate was, we were going to pay "X." It may be a little bit higher than what it should be, but at least it would give us the time to smooth out this problem a little bit. Is that kind of what you're talking about?

Curran: Yes, I think there's a few things that could be done around those lines and a lot of other people have other suggestions. I think the first step was made with this funding, the positive account concept that we've used, but because of the timing, when it passed, it wasn't hugely effective for most systems, [for] some of them it didn't have as significant impact on, but looking forward, I mean—it's not inconceivable to me at all—we're going to see really volatile returns in the stock market. For example, we may just get these really big years followed by a blow out in the following year, and it may be possible to build some reserve, in other words, to carry you through some of these periods. So I think it's at least worth examining that because, as I said, I believe that other than high contribution, volatile contributions are causing some of the problems as well.

Procopio: Representative Pearson.

Pearson: Gary, I was going to add on to that a little bit because what you're talking about is in years, obviously, when there's the 20% employer contributions or 30% if we do go to contribution, employer contribution rates such as you said, in Dreamland, 0%, we would still make sure that there was certainly a 12% or 15% going in an account.

Curran: Yes, some kind of mechanism to try and avoid the wild swings.

Pearson: But based on actually the smoothing that we do have in the systems, and even though last year, I mean last fiscal year was a good year with the market, in many cases we've still seen, I think based on some of the early reports, the actuarial rates of returns to the systems—that the systems have actually made or not even made that 8.25% or 7.5%, I think I've seen in most cases, because of the smoothing.

Curran: Yeah, and I think for most of these systems it'll probably be the next three years, less than, but maybe not to, you know, it varies, in some cases if you're, again, you get back to the leverage of the plan, a lot of these plans are sort of leveraged, maybe a 1% underperformance might produce something like, in terms of 1% actuarial return underperformance might produce like a half a percent increase in contribution rates, so if we get actuarial rates because of sort of the hangover from before that are down in the range of about 6% or 5% or 4%, you're talking about cost increase of 1% or 2%, not the, you know, 5% and 10% cost increases.

Pearson: But I think these systems, I mean, we can't really be in this false sense of security that next year the employer contribution rates are going to go from 30 to 15. I mean, this…

Curran: No, not going to happen

Pearson: …is going to be a long time, and what you're saying with that stabilizing mechanism is this is something we need to look for, for five and eight years down the road as the employer contribution…

Curran: Right, I mean, even if we do chip away at this and if we have anything near semi-normal markets, then we're expecting contribution rates to sort of plateau out in about three years and maybe start rolling off because we'll be, at that point in time, liquidating some of the gains we've had with the good years in the last year or two. So, you know, I think we should be looking forward to dealing with that when it comes as well but…

Pearson: Yeah, I totally agree. Thank you.

Procopio: All right, thank y'all. All right, anything else under other topics for discussion for the future? Okay, and again, if we think of something in the next week or so, we'll try and start gathering resources to address it. So if you have something, please email me and we'll try to send out a reminder email as well.

All right, so I want to also talk about future meetings. I think we originally had the idea that we might rotate around. I thought that was a good idea, it was my idea, but, and MPERS was quick to volunteer, and I appreciate that. I think we've actually had some feedback, believe it or not, there are actually people watching on the Internet, so if we can get the resources and availability to have it at a legislative meeting [room], I think for greater transparency and for those people that either can't or don't' want to show themselves at these meetings, that we should probably try and have it here if at all possible. I would think everyone that was interested in this meeting, I don't know why you'd spend two hours watching this meeting if you didn't have to, but apparently there are people out there…. *(Laughter.)* All right. So we'll try and have something in the legislative room if we can. Is there any other business going on to, any other business we want to discuss while we're here? Mr. Dean.

Dean: The projected meeting dates, are they always going to be on a Friday?

Procopio: No, we're also… there were a couple of things, if we prefer not to meet on a Friday, that would be fine. The first meeting was on a Tuesday… We didn't get a quorum for that meeting either.

Dean: Friday, I'm not bleeding or anything or crying, it's just Friday is a bad day for me, all day. Thursday is an excellent day.

Procopio: All right, we'll definitely see it and we'll try and rotate it around. We've got a quorum, and I'm not saying it necessarily had anything to do with the LSU game in town tomorrow, but maybe that had an effect, so we'll see what we can do. *(Laughter.)* All right, so we'll definitely look at changing it around. Any other items? Any other business or comments? All right, thank you. Do I have a motion to adjourn? Mr. Dean motions. Do we have a second? Mr. Rust seconds. No objection, the meeting is adjourned. Thank y'all very much for your time.

The meeting was adjourned at 11:32am.

Respectfully submitted,

Dr. Steven T. Procopio, designee of Commissioner Paul W. Rainwater

Date Approved by the Panel: **11/15/11**