LOUISIANA FIREFIGHTERS' RETIREMENT SYSTEM HR 136 COMMITTEE REPORT AND RECOMMENDATIONS FOR COST-OF-LIVING ADJUSTMENTS FOR RETIRED FIREFIGHTERS AND BENEFICIARIES

Preliminary Statement and Authority for the Committee

On May 26, 2022, House Resolution 136 was adopted creating a committee composed of designated officials and stakeholder representatives, as well as members of the Board of Trustees of the Firefighters' Retirement System (FRS), to study alternative means of providing a cost-of-living adjustment (COLA) to FRS retirees.

In the House Resolution, the Legislature noted that since a 2.21% increase in January 2015, there have been no cost-of-living increases to retirees. Since that time, the House Resolution concluded that inflation has eroded the purchasing power of the retirement benefits, particularly the most elderly and economically vulnerable. At the same time, the Social Security benefits, which most Louisiana firefighters do not receive, have increased on several occasions, keeping pace with increases in the cost of living.

The Resolution charges the Committee with studying various forms of cost-of-living benefits and recommends to the Legislature alternatives to the current statutory COLA provision which is dependent on "excess" investment earnings.

Executive Summary

Following a comprehensive review of the existing COLA provision, a variety of forms of one-time, nonrecurring lump sum payments and a longer terms prefunded COLA benefit, the Committee concluded the following:

1. The current COLA in R.S. 11:2260(A)(7) has a present value of future payments of $32.5 million. Absent some alternate source of funding this would result in a recurring cost of 1.17% of payroll in perpetuity.

2. The Committee recommended the Legislature consider adopting a statute providing for a one-time, nonrecurring payment of $2,000 payable to all 1,693 service retirees, service-connected disability retirees and eligible surviving beneficiaries who have been in pay status for at least five (5) years. This will have a projected $3,386,000 increase in the actuarially determined employer contribution rate of 0.12% unless an alternate funding source is provided.

3. The Committee recommended adoption of a statute specific to the needs of FRS, modeled after the Municipal Police Employees' Retirement System (MPERS) funding deposit account legislation.

The Study Performed by the Committee

As directed by the resolution, the Committee convened its initial meeting on August 10, 2022. At that time, the Committee appointed the FRS fiduciary counsel to assist the Committee. The Committee also directed its actuary Greg Curran of Curran Actuarial to provide specific examples of COLA formats (the Curran Study).

The Current COLA

The current COLA is found in R.S. 11:2260(A)(7) payable at the discretion of the Board of Trustees based on interest earnings "in excess of normal requirements" as determined by the actuary. Based on the most recent actuarial valuation, that benefit would have a present value of future payments of $32.5 million. That is an equivalent increase in the employer contribution, absent some other funding source, of 1.17% of covered payroll, payable in perpetuity. This has proven an unsatisfactory arrangement given the continued existence of the frozen unfunded accrual actuarial liability. This has placed the Board of Trustees, as fiduciaries of the FRS, in the untenable position of adding cost to the System for the relief of retirees when prudence dictated use of investment gain to strengthen the funded status of the System and stabilize employer contribution rates. As a result, HR 136 was commissioned to study an alternative approach to offsetting inflationary effects on retiree benefits.

Options Reviewed by the Committee

In the course of its review, the Committee looked at the following:

1. Ad Hoc COLA - a flat dollar payment of a fixed amount. This is likely to place money in the hands of retirees most quickly. The question considered by the Committee is whether this would apply to all retirees or only those who have been retired for a set number of years.

   The Committee reviewed a number of options for the Ad Hoc COLA, based on a variety of factors including age, income, and number of years since retired.

   Consideration was given to whether this should be confined to those retirees who are below the "Poverty Level" as determined by the U.S. Department of Labor, Bureau of Labor Statistics for Louisiana. Of the current retirees, 77 service retirees are below the poverty level of $18,310; 51 disabled retirees are below the poverty level; and 199 survivors are below the poverty level. A one-time, non-recurring cash payment of $2,000 to these 327 individuals would be $654,000. With appropriate legislative authority, the Committee believes that the cost of this benefit would not prove an actuarially material cost to the various participating employers. Given the limited dollar amount and its application to the most financially vulnerable beneficiaries, it may be an appropriate matter for a specific legislative grant. If the payment is expanded beyond the poverty level class, however, the cost could increase substantially.

   The Committee also considered that there may be flaws in the logic of using the poverty level. Some retirees were merged from other systems or separated shortly after reaching vested status.

   Recognizing that no suggested recommendation will satisfactorily address all of the competing claims for inflation relief, the Committee examined the cost of a one-time, nonrecurring 13th check (one additional payment based on the current monthly benefit) based on each individual's monthly benefit to all 2,520 retirees and survivors in pay status for greater than one year. This would have a cost of $8,742,924. The estimated impact on the actuarially determined employer contribution rate of the System for this benefit would be 0.31% of payroll. This COLA payment would benefit more recent retirees with higher monthly retirement benefits than it would older retirees and survivors.

The Committee also considered a one-time, non-recurring payment of $2,000 to all current retirees and survivors who have been in pay status for greater than one year. This would have a fixed cost of $5,040,000. This estimated impact on the actuarially determined employer contribution rate would be 0.18% of payroll. A fixed amount unrelated to the amount of the monthly retirement would have the greatest impact on lower paid (and generally older) retirees and survivors.

Lastly, the Committee looked at the idea of a one-time nonrecurring $2,000 payment only to retirees and survivors in pay status for greater than five (5) full years. This would mean that the retiree has been retired for five years; the survivor is the beneficiary of a five-year retiree; or the combination benefit payment years of the member and survivor equals or exceed five years. This would affect 1,693 retirees and survivors and have a fixed cost of $3,386,000. This would increase the actuarially determined employer contribution rate by 0.12% of payroll.

The Committee has no authority to increase any stakeholder's contribution, but the cost of the one-time payment, absent another source, is the constitutional obligation of the participating employers. The amount could be based on the number of recipients of the benefit on an individual employer basis to assure that one employer is not paying the cost of this one-time payment for former employees of another employer.

In whatever manner this fixed ad hoc payment is ultimately determined, the Committee concluded that this is not a long-term solution to the absence of a reliable COLA.

2. Fixed rate COLA - A fixed rate, recurring COLA has a significant actuarial cost. The Committee members observed that many of the contributing employers in FRS are currently struggling to make their actuarially required contributions. The cost can be ameliorated by placing limits on the portion of the benefit which would be the base for a COLA calculation. For example, a COLA could be limited to a maximum dollar amount of the base benefit; could require a material elimination period (period of years after retirement); or could be based on attainment of minimum age, such as age 65. The Curran Study outlined several of these options

and their respective costs. That study is attached to and incorporated in this report.

Increased Employee Contribution. This would assist in offsetting the employer contribution cost. The issue was raised about employees increasing their contributions as a means of partially funding or offsetting the employer cost of a COLA. While the Committee believed that was a matter worthy of further discussion, it was clear that an increase in employee contributions would not address the needs of current retirees.

3. Performance based COLAs. The Committee considered and rejected the concept of a COLA based on "excess" investment performance. In any plan with an unfunded, accrued actuarial liability, there is no such thing as excess earnings. The Committee discussed and concluded that basing a COLA on a portion of investment gain effectively deprived the Fund as a whole of needed asset growth.

4. Funding Deposit Account. The Committee looked at two variations of a funding deposit account concept. The first is the recently adopted provision for MPERS in Act 360 enacted in 2022. Under this construct, a portion of the employer contribution in excess of that required in R.S. 11:103 would be set aside in a funding deposit account for the sole purpose of providing a future COLA. The Committee also looked at a similar arrangement employed by the Sheriffs' Pension and Relief Fund in R.S. 11:2175.1. The primary difference in the two is that in the former, the money is specifically dedicated to the COLA and in the latter, the Board of Trustees may determine to use a portion of the account to stabilize employer contributions. The Committee recommends that a Firefighters' Retirement System specific bill be drafted using the MPERS legislation as an informative model.

Funding of the Benefit

All benefits are the actuarial responsibility of the plan sponsors, the employer agencies participating in FRS. See, *Louisiana Municipal Association v. State*, No. 2004-CA-0227, 893 So.2d 809 (2005). Several city representatives addressed the Committee concerning their inability to pay more than the current employer contribution.

Representatives of the Louisiana Municipal Association (LMA) and some cities reiterated that an increase in employee contributions would be appropriate to help pre-fund a COLA. The Committee considered that while that may provide a source of future funding for current employees, using current employee contributions to pay benefits to retirees would face significant legal issues including the concept of a taking without just compensation. In addition, use of current employees' contributions for former employees could be viewed as a donation in violation of Article VII, Section 14 of the Constitution. See, *McElveen v. Callhan*, No. 4881, 309 So.2d 379 (La. App. 3 Cir. 1975) (to be legal, bonus payments must be in the form of salary increases in the future and not extra compensation for past services). The proposals do not violate that prohibition as a COLA mechanism is already in the FRS statutory regime.

It is not the charge of the Committee to determine whether a COLA should be paid for by the employing agencies, the plan participants, the State, or some combination of the three. Even a one-time, fixed rate payment to a limited group of poverty level retirees needs a funding source.

A Two-Tiered Approach

There is currently a frozen unfunded liability which will be fully amortized in Fiscal Year 2034. This will result in a reduction to the actuarially determined employer contribution rate of an estimated 23.4% of payroll. Until that time, the Committee recommends that any COLA pay be limited to a lump sum payment. The lump sum benefit should be limited to participants who retired on an unreduced normal service retirement or a service-connected disability retirement and, where a survivorship interest was elected, to the surviving beneficiary of each.

Following the elimination of the frozen accrued unfunded liability, a material employer contribution can be dedicated to establishing a COLA. A question will remain as to the ability to apply that benefit retroactively. However, to assure this second tier of the approach, a funding deposit account should be adopted with a restriction on its use until the frozen unfunded accrued liability is fully amortized.

Recommendation

The Committee recommends that the Legislature consider adopting a one-time, lump sum nonrecurring payment for all normal service and service-connected disability retirees, including survivors, where appropriate, provided the recipient has been in pay status for five (5) full years. Any such bill must address the appropriate funding source or, the cost will be added to the actuarially determined employer contribution. It is further recommended that legislation specific to the needs of FRS, modeled on the MPERS funding deposit account legislation, be adopted for FRS beginning in fiscal year 2023-2024 with payment restricted until such time as the frozen unfunded accrued actuarial liability is exhausted in fiscal year 2034.

The Committee found that a spirited discussion among the interested parties contributed substantially to this process and thanks those who participated for their invaluable input. The Committee encourages continued dialogue among stakeholders (employers, active members, and retirees/survivors) to develop a permanent solution to the COLA question.

The Committee appreciates the assistance of the FRS staff, Board of Trustees, professional advisors, the Office of Legislative Auditor, and the numerous stakeholders of FRS who attended and actively participated in the Committee meetings for their assistance in this process.

Appendix

Accompanying this report is an appendix consisting of the current COLA legislation, the text of the MPERS funding deposit statute, the text of the Sheriffs' Pension and Relief Fund funding deposit account, draft text of the various proposals, and various actuarial studies utilized by the Committee and prepared by Curran Actuarial. The most recent actuarial valuation for FRS may be found at the following link: http://ffret.com/wp-content/uploads/2022/01/FRS-Funding-Valuation-Report-2021-Revised.pdf