ACTUARIAL REVIEW OF THE 2021 ACTUARIAL VALUATION OF THE MUNICIPAL POLICE EMPLOYEES’ RETIREMENT SYSTEM

ACTUARIAL SERVICES
PRESENTED TO THE PUBLIC RETIREMENT SYSTEMS’ ACTUARIAL COMMITTEE ON FEBRUARY 23, 2022
January 24, 2022

The Honorable Phillip DeVillier
Chairman, Public Retirement Systems’ Actuarial Committee
Louisiana House of Representatives
Post Office Box 94062
Baton Rouge, Louisiana 70804

Re: Actuarial Review of MPERS’ 2021 Actuarial Valuation

Dear Chairman DeVillier and PRSAC Members:

In accordance with La. R.S. 11:127(C) and 24:513(C)(1), the Louisiana Legislative Auditor has conducted an Actuarial Review for the Municipal Police Employees’ Retirement System (MPERS or System).

The following presents the results of our Actuarial Review of MPERS’ June 30, 2021 Actuarial Valuation (prepared by G.S. Curran & Company and dated November 11, 2021). In doing so, we have reviewed certain actuarial assumptions and methods employed by MPERS and its actuary for appropriateness.

I would like to thank MPERS’ executive director, staff, and actuary for the cooperation and assistance provided for this review.

Sincerely,

Michael J. Waguespack, CPA
Legislative Auditor

cc: Mr. Benjamin A. Huxen, II, Executive Director & General Counsel
Municipal Police Employees’ Retirement System

Gregory Curran, FCA, MAAA, ASA
G.S. Curran & Company, LTD
Executive Summary

The Louisiana Legislative Auditor (LLA) performed an Actuarial Review (AR or Review) of the Municipal Police Employees’ Retirement System (MPERS) June 30, 2021 Actuarial Valuation dated November 11, 2021.

This Review is a limited scope review intended to:

1. Evaluate the appropriateness of certain actuarial assumptions and methods adopted by MPERS’ board.
2. Identify potential improvements to these actuarial assumptions and methods.
3. Identify any actuarial assumption or method that clearly violates any relevant Actuarial Standard of Practice (ASOPs).

Summary of Conclusions

We did not identify any actuarial assumption or method that violates any ASOPs. Nevertheless, we offer the following recommendations for consideration by the MPERS’ board and by the Public Retirement Systems’ Actuarial Committee:

1. *Cost-of-Living Adjustments (COLAs).* Currently, MPERS’ board and its actuary do not anticipate future COLAs in the actuarial valuations. By not including actuarially-expected future COLA benefits, the actuarial valuations (a) ignore the reasonable expectation that COLAs will be granted in the future with some frequency and (b) push the cost of providing those COLAs out to future generations of taxpayers.

   We recommend the MPERS board engage its actuary to undertake a quantitative actuarial analysis of the operation of the current gain-sharing provisions, in order to be able to advise the board about the long-term costs and liabilities associated with all expected future gain-sharing COLAs.

2. *Investment Return Assumption.* The System’s assumption remains approximately 65 basis points higher than the investment return benchmark calculated by the LLA. We recommend the System continue to lower its investment return assumption and consider:
   - Incorporating conservatism in the assumption by consistently targeting a rate that is closer to a 60% probability of achieving the assumption over time; and
   - Reflecting the impact of cash flow timing on total expected returns.
Introduction

The Louisiana Legislative Auditor (LLA) performed an Actuarial Review (Review) of the Municipal Police Employees’ Retirement System’s (MPERS or System) June 30, 2021 Actuarial Valuation dated November 11, 2021, as prepared by G.S. Curran & Company. This Review is being performed in accordance with La. R.S. 11:127(C) and 24:513(C)(1). This Review, in conjunction with the System’s full actuarial valuation, is intended to fulfill the requirements of La. R.S. 11:127(C) to the Public Retirement Systems’ Actuarial Committee (PRSAC).

Actuarial Standards of Practice (ASOPs) are principles-based, rather than prescriptive, in nature, and therefore actuarial valuations involve significant use of an actuary’s professional judgement when developing actuarial assumptions and methods. This can result in different actuaries utilizing different assumptions and methodologies when approaching similar, or even the same, benefit structures and legislative constraints.

This Review is a limited scope review intended to:

1. Evaluate the appropriateness of certain actuarial assumptions and methods adopted by MPERS’ board.
2. Identify potential improvements to these actuarial assumptions and methods.
3. Identify any actuarial assumption or method that clearly violates any relevant ASOPs.

We hope the recommendations help the MPERS board in its decision-making process, as well as PRSAC in its “review and study” of the retirement systems.

As a limited scope review, we relied on previously-published LLA analyses and, where necessary, reasonable estimating techniques to advance the analysis to the current valuation date. We did not attempt to replicate the System actuary’s results; perform a full actuarial valuation using alternative assumptions and methods developed by the LLA; nor did we perform a full and detailed analysis of any assumptions or methods.

Further, the discussion included in this Review is limited to (1) the treatment of future COLA benefits and (2) the investment return assumption. The limited discussion does not indicate that other assumptions and methods were not considered, nor that recommendations for improvement in other assumptions and methods will not be included in future reviews.

This Review was prepared by Kenneth J. Herbold, Director of Actuarial Services for the LLA; and by James J. Rizzo, Senior Consultant and Actuary, and Piotr Krekora, Senior Consultant and Actuary, both employed by Gabriel, Roeder, Smith & Company (GRS). GRS is under contract with the LLA to provide backup, research, calculations, actuarial services, and advice.
Our Recommendations

We did not identify any actuarial assumption or method that violates any ASOPs. Nevertheless, we offer the following recommendations for consideration by the MPERS board and by PRSAC:

1. **Cost-of-Living Adjustments (COLAs)**

La. R.S. 11:241, 11:243, 11:246, and 11:2225(A)(7), outline the provisions for the funding and granting of COLAs. The board may grant ad-hoc COLAs subject to certain limitations. We are calling the ad-hoc COLAs outlined in statute a statutory “template” for granting COLAs.

**MPERS’ Methodology**

Currently, MPERS’ board and its actuary do not anticipate future COLAs in the actuarial valuations. Future COLAs are recognized only after they are granted.

Ad-hoc COLAs are a unique benefit feature that require significant professional judgement when determining if, and to what extent, they should be recognized in the liability measurement. Often, actuaries look for a pattern from the past, as one of several factors when deciding whether to assume COLAs would be granted in the future. In MPERS’ case, the board has not granted any template-driven COLAs for the past six years (through 2020). However, the board was not permitted to do so by operation of the statutory template. Therefore, this should not be viewed as a pattern of “no COLAs.”

Given the statutory limitations, the next analysis would look to if, and when, the natural operation of the statutory template will permit COLAs in the future and if it is reasonable to assume the board will grant them. There is considerable pressure to grant COLAs when and if they are permitted, due to (a) the board responding to retirees’ current needs, (b) COLAs being granted by Social Security and other Louisiana retirement systems, and (c) a lack of COLAs granted for MPERS members in the recent past. Refer to the explanations below for the workings of the statutory template that support the reasonable expectation of future COLAs being permitted under the statutory template.

Further, the actuary must determine if including a particular provision in a model is appropriate for the purpose of the measurement. We believe it is appropriate and more transparent to recognize the frequency and magnitude of all reasonably likely future COLAs in the actuarial valuation for MPERS, given the current statutory template. The expectation of the board’s inclination to grant COLAs when permitted may change, however, such as may be caused by increased employer contribution rates and/or a year or two when the board waives its right to grant a COLA when otherwise permitted. A decreased expectation that the board would always grant a COLA when permitted in the future can be reflected in the actuarial valuations while still recognizing some COLAs are still reasonably likely, if not always when permitted. As it stands currently, such circumstances have not occurred and there is still considerable weight to an assumption that whenever the board would be permitted to grant a COLA it would do so.

Finally, “excess investment earnings” are needed to finance current plan benefits. By not recognizing future COLA benefits that are reasonably likely to occur, the current MPERS actuarial valuations (a) ignore the reasonable expectation that COLAs will be granted in the future with
some frequency and (b) push the cost of providing those COLAs out to future generations of taxpayers.

The frequency and magnitude of future COLAs can be actuarially modelled using well-accepted techniques. Assuming boards will recommend template-driven COLAs when permitted by the statutes (either 100% of the time permitted or with less regularity), it is actuarially appropriate to recognize the frequency and magnitude of future COLAs when performing an annual actuarial valuation of MPERS’ costs and liabilities.

**MPERS’ Statutory Template**

The following exhibit illustrates the recent history of tests and rules relating to MPERS’ COLAs. While there are numerous trigger-points and moving parts in the statutory template mechanism, this exhibit illustrates the two primary statutory rules that govern how the statutes have not permitted the board of trustees in recent years to grant a gain-sharing COLA:

1. **The Window Rule.** This rule prevents a COLA from being permitted every year based on the funded ratio of the plan. Based on the current funded ratio of 77.78%, a COLA may be granted (provided other conditions are satisfied) as long as a COLA has not been granted in any of the three most recent fiscal years. The window is now “open” and would then “close” for a few years after a COLA is granted, then re-open. As the funded ratio improves in future years, the number of years the window remains closed becomes shorter, so that the window is open more frequently.

2. **The Sufficient Actuarial Return Rule.** A pension investment return assumption is a type of average return expected over the future, sometimes higher than the average and sometimes lower. After actuarially smoothing out the actual returns, an actual actuarial return is calculated for a given year. If the actuarially smoothed investment earnings for the year exceeds the assumed earnings, the Sufficient Actuarial Return Rule is satisfied.

   For example, the 2020 actuarial valuation assumed a 6.95% return. For the year ending June 30, 2021, the actuarially smoothed rate of return was 9.6%. This Rule was satisfied for the 2021 valuation, the first time since 2017.

   In the future, the fund’s investment performance is fully expected to exceed the current 6.75% rate in some years, and fall short in other years. In years when the actual actuarial rate exceeds assumed actuarial rate, the Sufficient Actuarial Return Rule is satisfied.

Notice in the following exhibit, the Window Rule and the Sufficient Actuarial Return Rule must both be satisfied in a given year in order to be permitted to grant a COLA. While the Sufficient Actuarial Return Rule was satisfied for three of the four years during 2014 through 2017, the Window was closed and, thus, no template COLA was permitted. For the year 2018 through 2020, the Window was open but the Actuarial Return was not sufficient, thus, no template COLA was permitted either. For the year ending 2021, both rules are satisfied, and the board appears to be permitted to grant a COLA (subject to legal review).
<table>
<thead>
<tr>
<th>Actuarial Measurement Date</th>
<th>The Window Rule(^1) for any COLA</th>
<th>Statutory Conditions for Gain-Sharing COLA Under:</th>
<th>Authorizing Gain-sharing (G-s) COLAs Pct and Recipients(^1)</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Satisfied (For YE 2022)</td>
<td>The Sufficient Actuarial Return Rule(^2) for G-s COLAs</td>
<td>R.S. 11:2225(A)(7) G-s COLA [Up to 3%, to All Elg]</td>
<td>Amount Granted by Board</td>
</tr>
<tr>
<td>6/30/2021</td>
<td>Satisfied (9.6% vs. 6.95%)</td>
<td>3% Permitted [To All Eligibles]</td>
<td>2% Permitted [To Elg Over 65]</td>
<td>TBD</td>
</tr>
<tr>
<td>6/30/2020</td>
<td>Satisfied (4.6% vs. 7.125%)</td>
<td>Not Satisfied (All Eligibles)</td>
<td>None Permitted [To Elg Over 65]</td>
<td>NA</td>
</tr>
<tr>
<td>6/30/2019</td>
<td>Satisfied (4.6% vs. 7.2%)</td>
<td>Not Satisfied (All Eligibles)</td>
<td>None Permitted [To Elg Over 65]</td>
<td>NA</td>
</tr>
<tr>
<td>6/30/2018</td>
<td>Satisfied (6.9% vs. 7.325%)</td>
<td>Not Satisfied (All Eligibles)</td>
<td>None Permitted [To Elg Over 65]</td>
<td>NA</td>
</tr>
<tr>
<td>6/30/2017</td>
<td>Not Satisfied (7.7% vs. 7.5%)</td>
<td>Satisfied (All Eligibles)</td>
<td>None Permitted [To Elg Over 65]</td>
<td>NA</td>
</tr>
<tr>
<td>6/30/2016</td>
<td>Not Satisfied (5.7% vs. 7.5%)</td>
<td>Not Satisfied (All Eligibles)</td>
<td>None Permitted [To Elg Over 65]</td>
<td>NA</td>
</tr>
<tr>
<td>6/30/2015</td>
<td>Not Satisfied (10.6% vs. 7.5%)</td>
<td>Satisfied (All Eligibles)</td>
<td>None Permitted [To Elg Over 65]</td>
<td>NA</td>
</tr>
<tr>
<td>6/30/2014(^4)</td>
<td>Not Satisfied (11.9% vs. 7.5%)</td>
<td>Satisfied (All Eligibles)</td>
<td>None Permitted [To Elg Over 65]</td>
<td>3.0%</td>
</tr>
</tbody>
</table>

1 Per R.S. 11:2225(A)(7), the Board is authorized to provide a COLA of up to 3% to all eligible pensioners. Additionally, per R.S. 11:246, the Board is authorized to provide an additional or supplemental COLA of 2% to eligible pensioners over age 65. No COLA may be provided during any fiscal year until the lapse of at least one-half of the fiscal year.

2 Per R.S. 11:243(G)(1) and (3), the Board may grant a benefit increase only if any of the following apply: (a) the system has a funded ratio of at least 90% and has not granted a benefit increase to retirees, survivors, or beneficiaries in the most recent fiscal year, (b) the system has a funded ratio of at least 80% and has not granted such an increase in any of the two most recent fiscal years, or (c) the system has a funded ratio of at least 70% and has not granted a benefit increase to retirees, survivors, or beneficiaries in any of the three most recent fiscal years. The funded ratio as of any fiscal year is the ratio of the actuarial value of assets to the actuarial accrued liability under the funding method prescribed by the office of the legislative auditor.

3 Per R.S. 11:2225(A)(7), the Board is authorized to use interest earnings on investments of the system in excess of normal requirements to provide a supplemental COLA of up to 3% to all eligible pensioners. Additionally, per R.S. 11:246, the Board has the authority to provide an additional COLA of 2% to eligible pensioners over age 65 if there is sufficient excess interest earnings to fund the entire 2% additional COLA.

4 The 6/30/14 valuation date marks the first year that Act 170 applies, after the trustees elected to be covered under R.S. 11:243 by 12/31/13.
Recommended Actuarial Method

The following summarizes two explicit methods of recognizing expected future COLAs in advance, under the current statutory template for MPERS. Both methods use the same type of Monte Carlo stochastic simulation.

1. **Single equivalent annual COLA assumption.** An open group forecast valuation simulation spins off information about the frequency and magnitude of each year’s potential transfer to the Experience Account. The mean (average) transfer amount can be considered a benefit stream. Solving for $x$, an annual equivalent COLA having the same actuarial present value over the next 30 years as the average simulated transfer amount can be determined. That single equivalent annual COLA becomes an actuarial assumption built into the usual actuarial valuation procedures.

2. **Single equivalent benefit load assumption.** Dividing that same mean (average) transfer stream for each year by its regular benefits payable for that year, as spun off from the open group forecast valuation simulation, provides an estimate of the “load” on regular benefits that approximates the average transfer amount. That load estimate becomes an actuarial assumption built into the usual actuarial valuation procedures.

In other words, method 1 assumes a small annual COLA is granted, which is approximately equal to the present value of a semi-regular COLA granted less frequently than annually, while method 2 calculates how much the same present value would be as a percentage of the present value and then increases the total liability and normal cost by that percentage. Both methods 1 and 2 expect experience gains (in years when a COLA is not granted) and experience losses (in years when a COLA is granted) – but their volatility is dampened by recognizing both experience gains and losses, which are expected to offset each other.

**Conclusion**

Currently, MPERS’ board and its actuary do not anticipate future COLAs in the actuarial valuations. By not including actuarially-expected future COLA benefits in the liabilities, MPERS is not fully reflecting all significant plan benefits. We recommend the MPERS board engage its actuary to undertake a quantitative actuarial analysis of the operation of the gain-sharing provisions, in order to be able to advise the board about the long-term costs and liabilities associated with future template COLAs.

2. **Investment Return Assumption**

The last comprehensive analysis of the investment return assumption was prepared and presented in the LLA’s *Comprehensive Actuarial Review of the 2020 Actuarial Valuation of the Municipal Police Employees’ Retirement System* dated December 23, 2020, using forecasts published in 2020. Two significant changes have occurred since that analysis was completed: (i) professional investment forecasters have continued lowering their expectations for the mid-term and longer-term and (ii) MPERS made certain changes to its asset allocation.
For this Review, a detailed analysis of independent experts’ 2021 forecasts for MPERS’ portfolio was not undertaken. Instead, we provide an estimate of the return assumption calculated using the same methodology as prior LLA analyses, for consistency and illustrative purposes. Those results can be found in the section below entitled Benchmark Investment Return Assumption. We also present observational commentary.

Selecting an Investment Return Assumption

ASOP No. 27 provides guidance for selecting “reasonable” economic assumptions. The ASOP outlines multiple characteristics to define what constitutes a reasonable assumption, including that it “is expected to have no significant bias (i.e., it is not significantly optimistic or pessimistic).” However, the ASOP specifically allows assumptions to be adjusted for conservatism.

This is particularly important when considering an appropriate investment return assumption, because the investment return assumption is tied directly to the discount rate, which has the single largest impact on the development of the liability. Small changes in the assumption can have a large impact, which is why an overly optimistic investment return assumption, applied repeatedly, can (a) create repeated actuarial losses, (b) cause underfunding by understating the required contribution, (c) impede the scheduled progress to pay off the unfunded liability and achieve full funding, and (d) undermine the actuarial integrity of the pension-promise.

MPERS’ board and actuary have consistently lowered the investment return assumption over the past few years, from 7.20% as of June 30, 2018 to 6.75% for the June 30, 2021 valuation. We commend MPERS for lowering its investment return assumption.

Benchmark Investment Return Assumption

In the supporting documentation for the investment return assumption, MPERS’ actuary used the long-term (20-30 years) capital market assumptions from various investment consulting firms.

The LLA has historically developed an investment return assumption that falls between the mid-term (10 years) and long-term expectations. The consensus average expected return is based on the capital market assumptions of several respected and independent professional investment forecasters, each of which was applied to a plan’s own asset allocation and its own expected benefit cash flow. Following are the professional investment forecasters whose capital market assumptions inform us in deriving a consensus average.

<table>
<thead>
<tr>
<th>Participating Professional Investment Forecasters</th>
</tr>
</thead>
<tbody>
<tr>
<td>AonHewitt</td>
</tr>
<tr>
<td>Blackrock</td>
</tr>
<tr>
<td>BNY Mellon</td>
</tr>
<tr>
<td>Callan</td>
</tr>
<tr>
<td>Cambridge</td>
</tr>
<tr>
<td>J.P. Morgan</td>
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<tr>
<td>Meketa</td>
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<tr>
<td>Mercer</td>
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<tr>
<td>RVK</td>
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<tr>
<td>NEPC</td>
</tr>
<tr>
<td>Verus</td>
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<tr>
<td>Wilshire</td>
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</tbody>
</table>

For this Review, an estimate of the benchmark return assumption was developed based on (a) the most recent comprehensive analyses for MPERS (2020), (b) our general understanding of the direction and change-magnitude of forecasters’ expectations in recent years (from 2020 to 2021)
applied to MPERS’ prior asset allocation, (c) the change in the System’s asset allocation, and (d) a slight increase in the expected rate of inflation embedded in return expectations (from 2020 to 2021). As outlined in the LLA’s 2020 Comprehensive Actuarial Review, the benchmark return falls between the mid-term (10 years) expectations and the longer-term (20-30 years) expectations.

The following table compares the System’s investment return assumption and the LLA developed benchmark:

<table>
<thead>
<tr>
<th>Actuarial Valuation Date</th>
<th>Investment Return Assumption</th>
<th>Benchmark</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 30, 2021</td>
<td>6.75%</td>
<td>6.10%</td>
<td>0.65%</td>
</tr>
<tr>
<td>June 30, 2020</td>
<td>6.95%</td>
<td>6.13%</td>
<td>0.82%</td>
</tr>
<tr>
<td>June 30, 2019</td>
<td>7.125%</td>
<td>6.50%</td>
<td>0.625%</td>
</tr>
<tr>
<td>June 30, 2018</td>
<td>7.20%</td>
<td>6.50%</td>
<td>0.70%</td>
</tr>
</tbody>
</table>

**Conclusion**

The System’s assumption remains approximately 65 basis points higher than the investment return benchmark calculated by the LLA. We recommend the System continue to lower its investment return assumption and consider:

- Incorporating conservatism in the assumption by consistently targeting a rate that is closer to a 60% probability of achieving the assumption over time; and
- Reflecting the impact of cash flow timing on total expected returns.
Actuarial Certification

This Actuarial Review constitutes a Statement of Actuarial Opinion. It has been prepared by actuaries who have substantial experience valuing public employee retirement systems. To the best of our knowledge the information contained in this report is accurate and fairly presents information it is purported to present. This review was performed in conformity with generally accepted actuarial principles and with the Actuarial Standards of Practice issued by the Actuarial Standards Board.

Kenneth J. Herbold, James J. Rizzo, and Piotr Krekora are members of the American Academy of Actuaries and meet the US Qualification Standards necessary to render the actuarial opinions contained herein.

The signing actuaries are independent of the Municipal Police Employees’ Retirement System.

_________________________   January 24, 2022
Kenneth J. “Kenny” Herbold, ASA, EA, MAAA
Director of Actuarial Services
Louisiana Legislative Auditor

_________________________   January 24, 2022
James J. Rizzo, ASA, EA, MAAA
Senior Consultant and Actuary
Gabriel, Roeder, Smith & Company

_________________________   January 24, 2022
Piotr Krekora, ASA, EA, MAAA, PhD
Senior Consultant and Actuary
Gabriel, Roeder, Smith & Company
Appendix

Qualifications and Caveats

This Actuarial Review was prepared in accordance with La. R.S. 11:127(C) and 24:513(C)(1). This Review, in conjunction with the System’s full actuarial valuation, is intended to fulfill the requirements of La. R.S. 11:127(C) to the Public Retirement Systems’ Actuarial Committee (PRSAC) for 2021 and is intended for use by PRSAC and those designated or approved by PRSAC. This Actuarial Review may be provided to parties other than PRSAC only in its entirety and only with the permission of PRSAC. The Louisiana Legislative Auditor is not responsible for unauthorized use of this Actuarial Review.

This Actuarial Review should not be construed as providing tax advice, legal advice, or investment advice. It should not be relied on for any purpose other than the purposes described herein. This Actuarial Review assumes the continuing ability of MPERS to collect the contributions necessary to fund this Plan. A determination regarding whether or not MPERS is actually willing and able to do so in the future is outside our scope of expertise and was not performed.

The findings in this Actuarial Review are based on data and other information as of June 30, 2021, and forecasts published for 2021. This Actuarial Review was based upon information furnished by MPERS, the System’s investment consultant, the System’s actuary, and by numerous external inflation and investment forecasters. We checked for internal reasonability and year-to-year consistency, but did not audit the data. We are not responsible for the accuracy or completeness of the information provided by outside parties.

All calculations have been made in conformity with generally accepted actuarial principles and practices, and with the Actuarial Standards of Practice issued by the Actuarial Standards Board and with applicable statutes.

At the time of this writing, we consider the 2021 forecasts of the future inflation and capital market assumptions (including future investment returns) from the subject matter experts to be suitable for development of the benchmark return assumption for the 2021 actuarial valuation. All actuarial projections have a degree of uncertainty because they are based on the probability of occurrence of future contingent events. Accordingly, actual results will be different from the results contained in the analysis to the extent actual future experience varies from the experience implied by the assumptions.

This Actuarial Review was prepared using GRS proprietary capital market asset model and related software which in our professional judgment has the capability to provide results that are consistent with the purposes of this report and has no material limitations or known weaknesses. We performed tests to ensure that the model reasonably represents that which is intended to be modeled. We are relying on the GRS actuaries and Internal Software, Training, and Processes Team who developed and maintain the model.