RESET
LOUISIANA'S FUTURE

Pension Reform

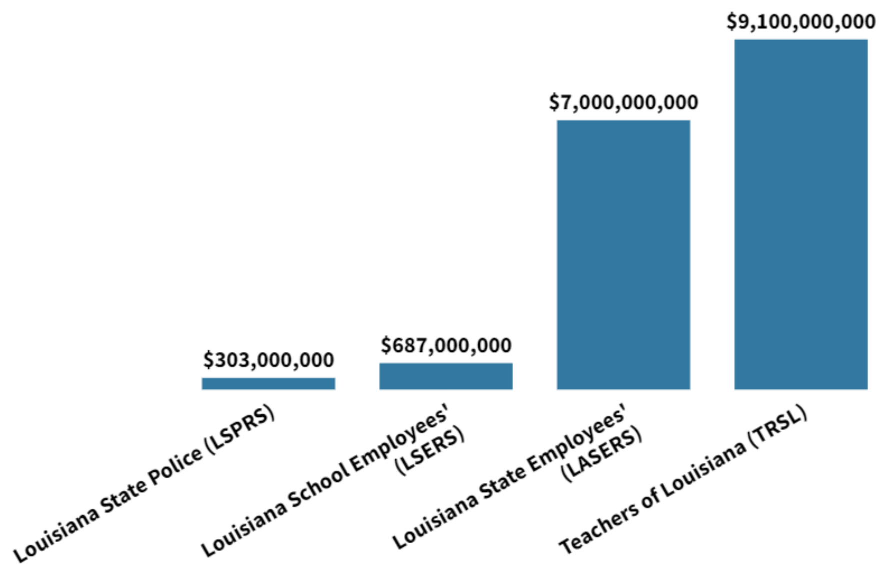
Louisiana should improve the state pension system to reduce the risk of increasing debt, better serve the state's workforce recruitment needs and provide a more competitive system for employees.

Transform State Retirement Systems for a New Era

Louisiana's statewide retirement systems are underfunded at levels below the national average and well below measures of sound financial health. State policies exacerbate the debt problem and risk to taxpayers while offering uncompetitive, inadequate plans for many employees.

Actuarial reports from 2022 show the state's four major retirement systems have a total debt, or unfunded accrued liability (UAL), of $17 billion. That's the gap between how much the retirement systems need to pay promised benefits minus assets such as stocks and bonds.

The two largest state retirement systems – the Louisiana State Employees' Retirement System and the Teachers' Retirement System of Louisiana – have only 66% and 74% of the money needed to meet their long-term obligations to retirees.



Source: Actuarial Reports Filed With the Louisiana Legislative Auditor

By comparison, the national funded ratio for state and local public pension funds was estimated to be 77% in 2022, according to the New York-based Equable Institute, which tracks public retirement systems. Only 15 states had a lower funding level than Louisiana for its statewide retirement plans and large municipally managed plans, the data shows.

Through taxpayer dollars and fees, the state and its public school districts are responsible for meeting these debts. Louisiana's debt payments – at more than $1 billion annually – take dollars away from priorities such as education, health care and public safety. Meanwhile, these payments siphon away dollars that could otherwise pay for higher salaries or new employees.

Most Louisiana government workers and teachers are enrolled in a defined benefit plan, where employees receive a guaranteed monthly income for the rest of their lives after they retire. The income is based on a

formula that includes an employee's years of service and the average salary of the employee's highest-earning years.

This system, while providing protection for employees, places the full financial risk on state agencies and school districts. If investments nosedive or anything goes wrong with actuarial assumptions, the result is larger pension debts and a corresponding higher annual payment from the government.

To pay for the retirement plans, the state assesses agencies, public school systems and colleges a charge for each employee or teacher. The current charge per teacher is about 26% of salary, with more than four-fifths of that amount paying for debt, according to the Louisiana Legislative Auditor's Office. For state workers, the charge is 41%, according to the Louisiana State Employees' Retirement System. Unfortunately, even these big charges are inadequate.

For Louisiana's retirement systems to work properly, the state must anticipate how much retirement money will be needed and then invest enough annually to keep up with those predictions and prevent a ballooning debt load. Over the past three decades, politicians and retirement system officials wisely made and stuck to payment plans. Unfortunately, the state adopted a too-rosy outlook on investments and the payment plans have been inadequate.

Problems with the pension systems stretch back for generations.

Louisiana's retirement systems started off in debt as soon as they were created decades ago, paying benefits to retirees almost immediately without properly funding them. Then, lawmakers and governors worsened the problems by increasing pension benefits for some, adding more retirees into the systems and making insufficient payments.

Until 1989, the systems were not financed according to actuarial projections, creating a massive debt. A constitutional amendment adopted in 1987 required that accumulated retirement debt to be paid off by 2029. Louisiana is currently making those payments.

The 40-year payment plan, however, started out low and increased over time, shifting the heaviest costs to the future. The state arranged for payments in the early years that were less than the interest charged on the balance, so the debt grew.

Louisiana is on track to retire the initial debt on schedule in 2029. But the old debts are only part of the problem. A new unfunded accrued liability has grown, driven largely by investment performance.

The retirement systems do not need to lose money in their investments to create debt; they just need to earn less on their investments than they assumed. The state retirement systems haven't done a poor job of investing, but their expectations have been too optimistic.

For many years, the state's expected rate of return over time was above 8%. The state has finally made some strides in this area, dropping to a current expected rate of return of about 7%. That's equivalent to the median long-term assumed rate of return among the nation's large public retirement systems in 2022, according to the Reason Foundation. Louisiana's two largest statewide retirement systems must reach a

7.6% return on their investments to avoid incurring additional debt. Many systems around the country are more conservative in their assumptions.

Investment losses are complicated by the odd way the state handles cost-of-living-adjustments (COLAs), which are given to retirees to help cover inflation. COLAs are a necessary part of a sound retirement plan, but Louisiana's system for providing them is unreliable.

Louisiana pays for COLAs through a mechanism created in 1992. When retirement systems have particularly good investment returns, some investment earnings are credited to a separate account, called the "experience account." When that account builds to a certain level, a COLA may be given. Because market gains are siphoned off in good years to pay for future cost-of-living adjustments, fewer dollars are available to offset losses from bad years. When investment gains don't stay far enough ahead of the losses, more debt accumulates. Louisiana's method for COLAs is rarely used elsewhere and is widely criticized by pension analysts.

Changes to the COLA system would not eliminate the current unfunded liability but would benefit retirees and taxpayers by reducing the risk of generating additional retirement debt.

The retirement plan structure also gives Louisiana state workers and teachers no investment portability. The less time workers spend in public service, the bigger the problem. A 2018 Louisiana State Employees' Retirement System estimate showed only 5% of state government employees in the pension program work long enough to receive full benefits while 70% will get no retirement benefit because they leave government service before qualifying and simply receive a refund of their contributions.

While not accruing a useful pension is problematic enough, it is worsened because state employees and teachers in Louisiana are among a very small percentage of American workers who are not enrolled for benefits through the federal Social Security program.

In other words, the state punishes employees or teachers who work only a few years in government service before changing jobs, leaving them with no employer-funded retirement plan or Social Security benefits. In the private sector and the public systems of many other states, retirement plan portability and an agile workforce are recognized facts of life.

In recent years, the state has made improvements. For example, lawmakers placed limits on salary spikes and the use of overtime pay toward final average compensation calculations. New employees must wait until they are 62 before collecting retirement benefits. Still, the state continues to carry the entire financial risk of the pensions.

The RESET

To break the cycle of indebtedness and establish a better system, Louisiana should:

- **Reform the state pension systems to reduce the risk of growing unfunded liabilities.**
- **Adopt a more portable hybrid system for new employees, combining a traditional defined benefit plan with a defined contribution plan.**
- **Adopt a better, predictable cost-of-living methodology that doesn't worsen debt.**
- **Move to more conservative investment earnings assumptions.**