Kentucky Judicial Form Retirement System

JUDICIAL RETIREMENT PLAN
LEGISLATORS RETIREMENT PLAN

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M E M O R A N D U M

To: Mary C. Yaeger, Office of Special Projects
From: Donna S. Early, Executive Director
RE: **2015 HB 400/BR 1529**
AA Statement 1 and 2 of 4
Date: February 25, 2015

The provisions in **2015 HB 400** are significantly the same as those proposed in 2013 HB 237 – the primary difference is the effective date of the proposals changing from 2013 to 2015. Therefore, the February 19, 2013 *Memorandum Report* of BPS&M is the response of the Kentucky Judicial Form Retirement System to your request for an actuarial analysis regarding 2015 HB 400.

Please let me know if you have any questions regarding this communication.

MEMORANDUM REPORT

TO: Donna S. Early

FROM: BPS&M, LLC

DATE: February 19, 2013

RE: Actuarial Analysis of Proposed Legislation 13RS HB 237

As Applicable to 2015 HB 400

BPS&M, LLC was asked to prepare an actuarial analysis in compliance with KRS 6.350 with regard to the recent proposed legislation ("13RS HB 237") that makes changes to the Kentucky Legislators Retirement Plan ("KLRP").

It is our understanding that 13RS HB 237 makes the following changes to KLRP:

1. Effective July 1, 2013, KLRP shall be closed to new members. A legislator who has not contributed to KLRP prior to July 1, 2013, shall not be eligible to participate in KLRP.
2. Allows members who began contributing to KLRP prior to July 1, 2013, to make a one-time election to discontinue participation, take a refund of employee contributions and cease future participation.

Comments

Item 1, closing the Plans to new entrants, we are assuming:

- This change will not impact current members.
- New members will not participate in KLRP, nor will they participate in KERS.
- For purposes of this analysis, it is assumed that new members will not be covered by a pension or medical benefits plan.

Item 2, allowing KLRP participants to opt out of future participation and take a refund of employee contributions:

- Members that opt out of future participation would be given a refund of employee contributions, give up all future benefits and withdraw from the plan. It is assumed that the members that would elect to opt out of the plan would be those that are not currently vested in plan benefits, have relatively small benefits and so have no material impact on any projections. Therefore, item 2 is not reflected in the attached projections.

Actuarially Sound

KRS 6.350 requires us to comment on whether the proposed changes would make KLRP actuarially unsound or, if already actuarially unsound, if such changes would make KLRP "more unsound".

A plan that has adopted a reasonable funding method, uses reasonable assumptions and contributes at a rate at or above the recommended contribution rate (based on these reasonable methods and

assumptions), could be considered to be actuarially sound. Whether or not the changes reflected in this study are or are not adopted, will not necessarily impact the "actuarial soundness" of KLRP.

In order to ensure KLRP is funded in an "actuarially sound manner", we would recommend:

1. Reflect a 1.5% future COLA assumption when calculating the funding requirement for KLRP (only a minimal COLA, as described in the July 1, 2011 valuation report, is currently assumed).
2. Revise the actuarial funding method to amortize all past unfunded as well as new liabilities over a period not more than 30 years (in accordance with currently applicable Governmental Account Standards 25 and 27) and amortize future gains and losses over a period not more than 15 years.
3. Contribute at least the minimum recommended contribution each year.

Deviations from these recommendations could result in an "actuarially unsound" approach to funding KLRP and may eventually result in KLRP becoming insolvent – that is, exhausting assets at which time all future benefits would be made on a pay as you go basis.

Although the Actuarial Standards of Practice 4 "Measuring Pension Obligations" allows for plan liabilities to be calculated under a legally prescribed method, the statement goes on to say,

> "If, in the actuary's professional judgment, such an actuarial cost method or amortization method is significantly inconsistent with the plan accumulating adequate assets to make benefit payments when due, assuming that all actuarial assumptions will be realized and that the plan sponsor or other contributing entity will make contributions when due, the actuary should disclose this."

It is our professional actuarial opinion that the current legally prescribed method which requires contributions of normal cost plus interest on the unfunded liability plus 1% of the unfunded liability (per KRS 21.525) and which (per KRS 21.405) does not recognize cost of living increases effective after the most recent valuation, is inconsistent with the plan accumulating adequate assets to make benefit payments when due, assuming all actuarial assumptions are realized.

<u>Assumptions</u>

Future results will vary from projections to the extent future experience varies from the assumptions used in the projections. The longer the period of the forecast, the more variation is likely to occur and the less likely future results will match projections.

1. Data for projections is as of July 1, 2011.
2. Assets for projections are as of June 30, 2012.
3. A valuation will be performed July 1 of each odd numbered year (2011, 2013, etc). The dollar amount of recommended contribution will be contributed each year for two plan years beginning one year after the valuation date.
4. Except as mentioned herein, all assumptions are consistent with the assumptions and methods used for the July 1, 2011 valuation report.
5. Although future valuation assumptions used in the projections of the defined benefit plan do not reflect the current 1.5% COLA increases, those increases have been reflected in rolling data forward to future years. Other experience assumptions are consistent with the July 1,

2011 valuation assumptions.

6. It is assumed the total population remains constant over the period of the forecast, although the population of the plan is assumed to decline, since there are assumed to be no future entrants.
7. Since the changes under 13RS HB 237 are effective July 1, 2013, the first year impacted by a valuation recognizing the changes is July 1, 2015; however, the changes would be recognized in the July 1, 2014 Accrued Liability.
8. Certain changes under 13RS HB 237, may or may not be allowed under state law. Whether or not all changes under 13RS HB 237 are permissible is a legal issue, and we provide no opinion in this regard. For purposes of the attached projections, we have assumed such changes are allowable.

Definitions

Accrued Liability – based on the methods and assumptions used, the amount of assets that would be needed to satisfy future projected benefit payments based on service as of the valuation date.

Normal Cost – cost of benefits earned in the year following the valuation for current active members

Actuarial Asset Value – A smoothed asset value which smoothes in asset gains and losses over a 5 year period (for purposes of this study). For projection years 5 or more years in the future, the actuarial and market value would be the same (assuming assets earn the 7% rate of return which is assumed). As the Plans experienced significant losses over the past few years, the current Actuarial Asset Value is larger than the market value since all prior losses have not yet been recognized.

Current – projections reflecting current rules and regulations, without regards to 13RS HB 237

Proposed – projections reflecting item 1 above from 13RS HB 237

Conclusions

0% of members opt out of future participation/ take refund of employee contributions (i.e. 100% continue to participate and earn future benefits).

Adopting the changes put forth under 13RS HB 237 item 1 will:

1. Reduce the Accrued Liability for KLRP by approximately $0.5M as of July 1, 2014,
2. Reduce future benefit accruals under KLRP, since there will be no new entrants,
3. Reduce future recommended employer contributions (as shown on the attached forecast),
4. Lead to a small immediate reduction in the total unfunded accrued liability followed by a gradual increase for the same reasons listed in #5 below and
5. Lead to a small initial increase in the funded ratio, reflecting the reduction in liabilities followed by a continued decrease in the funded ratio (meaning the assets will represent a smaller portion of the liabilities at the end of the projection period). The decrease in the funded ratio occurs as liabilities begin to grow faster than assets due to the combination of the current legally required funding method, no normal cost (as new entrants are excluded and current members benefits are frozen), exclusion of the 1.5% future COLA as well as the medical trend rates which are well in excess of inflation.

Professional Qualifications

This report has been prepared under the supervision of Alan C. Pennington and David L. Shaub. Both are members of the American Academy of Actuaries, Fellows of the Society of Actuaries, and consulting actuaries with Bryan, Pendleton, Swats and McAllister, LLC who have met the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions herein. To the best of our knowledge this report has been prepared in accordance with generally accepted actuarial standards, including the overall appropriateness of the analysis, assumptions, and results and conforms to appropriate Standards of Practice as promulgated from time to time by the Actuarial Standards Board, which standards form the basis for the actuarial report. We are not aware of any direct or material indirect financial interest or relationship, including investment management or other services that could create, or appear to create, a conflict of interest that would impair the objectivity of our work.

Alan C. Pennington, F.S.A.

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February 19, 2013
Date

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February 19, 2013
Date

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Kentucky Legislators Retirement Plan
Cost Projections - HB 237
Prepared by Bryan, Pendleton, Swats & McAllister, LLC
February 19, 2013

	Contribution ($M)		Contribution (%)		Accrued Liability ($M)		Unfunded Liability ($M)		Funded Ratio (Assets/Liabilities)	
Year Beginning July 1	Current	Proposed	Current	Proposed	Current	Proposed	Current	Proposed	Current	Proposed
2012	$ 3.2	$ 3.2	64.6%	64.6%	$ 89.9	$ 89.9	$ 26.6	$ 26.6	75%	75%
2013	$ 3.2	$ 3.2	63.6%	63.6%	$ 91.7	$ 91.7	$ 26.6	$ 26.6	76%	76%
2014	$ 3.6	$ 3.6	69.5%	69.5%	$ 94.1	$ 93.6	$ 24.8	$ 24.3	76%	76%
2015	$ 3.6	$ 3.6	67.9%	67.9%	$ 96.9	$ 96.0	$ 23.8	$ 22.9	76%	77%
2016	$ 3.3	$ 2.9	61.4%	53.3%	$ 98.9	$ 97.4	$ 23.5	$ 22.1	76%	77%
2017	$ 3.3	$ 2.9	59.6%	51.8%	$ 102.3	$ 99.6	$ 25.6	$ 23.4	75%	77%
2018	$ 4.0	$ 2.9	69.8%	51.1%	$ 104.7	$ 100.7	$ 26.7	$ 23.8	75%	76%
2019	$ 4.0	$ 2.9	67.8%	49.6%	$ 107.2	$ 101.6	$ 27.4	$ 24.2	74%	76%
2020	$ 4.3	$ 2.9	71.3%	47.1%	$ 109.6	$ 102.1	$ 28.0	$ 24.3	74%	76%
2021	$ 4.3	$ 2.9	69.1%	45.7%	$ 112.8	$ 103.1	$ 29.0	$ 25.0	74%	76%
2022	$ 4.6	$ 2.9	71.6%	44.5%	$ 115.8	$ 103.7	$ 29.8	$ 25.5	74%	75%
2023	$ 4.6	$ 2.9	69.2%	43.1%	$ 121.1	$ 105.5	$ 32.5	$ 27.1	73%	74%
2024	$ 5.9	$ 3.2	85.2%	45.6%	$ 125.5	$ 106.1	$ 34.3	$ 27.8	73%	74%
2025	$ 5.9	$ 3.2	82.4%	44.2%	$ 130.3	$ 106.6	$ 35.1	$ 28.2	73%	74%
2026	$ 6.4	$ 3.0	86.5%	40.7%	$ 135.2	$ 106.7	$ 36.2	$ 28.5	73%	73%
2027	$ 6.4	$ 3.0	83.8%	39.4%	$ 140.1	$ 106.5	$ 37.0	$ 28.9	74%	73%
2028	$ 6.6	$ 2.7	84.0%	34.8%	$ 144.8	$ 105.7	$ 37.9	$ 29.2	74%	72%
2029	$ 6.6	$ 2.7	81.2%	33.6%	$ 149.5	$ 104.5	$ 38.6	$ 29.6	74%	72%
2030	$ 7.0	$ 2.6	82.6%	31.3%	$ 154.1	$ 102.9	$ 39.5	$ 29.9	74%	71%
2031	$ 7.0	$ 2.6	79.8%	30.2%	$ 158.9	$ 101.2	$ 40.5	$ 30.3	75%	70%
Sum of Contributions	$ 98.8	$ 60.7								

Assumes 7% future asset returns beginning July 1, 2012
Unfunded Liability is calculated as Accrued Liability minus the Actuarial Assets Value
Funded Ratio is calculated as Market Value of Assets divided by Accrued Liability
Contribution(%) is calculated as the Contribution($) divided by total payroll for both Current and Proposed

Notes on Proposed Projections (HB 237 effective 7/1/2013)

Close Pension Plan to new entrants after 7/1/2013 (21 new entrants 7/1/2012)
No pension plan or retiree health care benefits for new hires after 7/1/2013
Assume 0% of active members elect to cease future benefit accruals and take refunds effective 7/1/2013
The actual number that elect to opt out could be 0%, 100% or somewhere in between