

March 3, 2016

Mr. Josh Nacey  
Office of Special Projects  
Legislative Research Commission  
Capitol Annex, Room 34  
Frankfort, KY 40601

RE: SB 172/BR 1397  
AA Statement 1 of 3

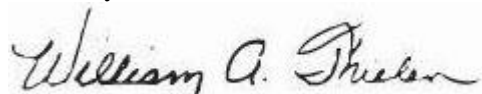
Dear Mr. Nacey:

Senate Bill 172 creates a new section of KRS 61.510 to 61.705 permitting a member of the Kentucky Employees Retirement System, the County Employees Retirement System, or the State Police Retirement System to opt out of the traditional defined benefit plan and elect to participate in the hybrid cash balance plan; provides that, on the member's effective election date, the value of the member's accumulated contributions, less any interest, be deposited into the member's hybrid cash balance account and be considered part of the member's accumulated account balance; provides that on the member's effective election date, an employer pay credit shall be applied to the member's accumulated account balance for each contributing month prior to the effective election date; requires the Kentucky Retirement Systems to provide the electing member with information detailing the consequences of the member's election; provides that a member shall not be eligible to make an election until a letter ruling by the IRS; makes benefit election under this section irrevocable; amends KRS 61.597 and 16.583 to conform; makes technical and conforming amendments to KRS 6.525, 16.645, and 78.545.

The Kentucky Retirement Systems' actuary, Cavanaugh Macdonald, LLC, and the Kentucky Retirement Systems' staff have examined SB 172 and have determined that the bill will not increase or decrease benefits in any of the retirement systems administered by Kentucky Retirement Systems. If members participating in the traditional defined benefit plan elect to participate in the hybrid cash balance plan, participation in the hybrid cash balance plan will increase; however, overall there will not be an increase in participation in benefits. According to the KRS actuary, it is not possible to determine the exact actuarial cost impact of SB 172, since it is not known which members would elect to change plans. The KRS actuary has opined that it is not reasonable to assume that any members who began participating in the Systems prior to September 1, 2008 would switch to the hybrid cash balance plan because it is not in their best interest. They would be giving up considerable value, since they are older members with longer service. Furthermore, even if 100% of the members who began participating in the Systems on or after September 1, 2008, but before January 1, 2014 elected to participate in the hybrid cash balance plan, the actuarial liability of the Systems would not change significantly. Consequently, we have not requested any further actuarial analysis of SB 172 by the System's actuary.

Please let me know if you have any questions regarding our analysis of SB 172.

Sincerely,



William A. Thielen  
Executive Director  
Kentucky Retirement Systems

## MEMORANDUM REPORT

**TO:** Donna S. Early  
**FROM:** BPS&M, LLC  
**DATE:** March 7, 2016  
**RE:** Actuarial Analysis 2 & 3 of 3, 2016 SB 172 (BR 1397)

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BPS&M, LLC was asked to prepare an actuarial analysis in compliance with KRS 6.350 with regard to the recent proposed legislation (“2016 SB 172” BR 1397) that makes changes to the Kentucky Legislators Retirement Plan (“KLRP”), and the Kentucky Judicial Retirement Plan (“KJRP”).

It is our understanding that 2016 SB 172 makes the following change(s) to KLRP and KJRP:

- 1) Create a new section of KRS 21.345 to 21.580 permitting a member of the Legislators' Retirement Plan or the Judicial Retirement Plan to opt out of the traditional defined benefit plan and elect to participate in the hybrid cash balance plan such that:
  - a) on the member's effective election date, the value of the member's accumulated contributions, less any interest, be deposited into the member's hybrid cash balance account and be considered part of the member's accumulated account balance;
  - b) on the member's effective election date, an employer pay credit shall be applied to the member's accumulated account balance for each contributing month prior to the effective election date;
  - c) require the Judicial Form Retirement System to provide the electing member with information detailing the consequences of the member's election;
  - d) a member shall not be eligible to make an election until a letter ruling by the IRS;
  - e) make benefit election under this section irrevocable;
  - f) amend KRS 21.402 to conform.

### Comments.

**Item 1**, allow participants in KLRP and/or KJRP to opt out of the traditional defined benefit plan and elect to participate in the hybrid cash balance plan:

- While the proposed legislation could result in significant reductions in liability in KLRP and/or KJRP, such reductions would be the result of voluntary elections by members to forfeit significant current and potential benefits in the traditional plan as well as forfeiting prior contributions made for post-employment medical benefits. Without further data to support that elections not in the financial interest of the member would actually be made, it appears **this provision will have no material impact on the liabilities in either KLRP or KJRP.**

### Actuarially Sound

KRS 6.350 requires us to comment on whether the proposed changes would make KLRP and/or KJRP actuarially unsound or, if already actuarially unsound, if such changes would make KLRP and/or KJRP “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 and/or KJRP.

In order to ensure KLRP and/or KJRP is funded in an “actuarially sound manner”, we would recommend:

1. 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 Accounting Standards 67 and 68) and amortize future gains and losses over a period not more than 15 years.
2. Contribute at least the minimum recommended contribution each year.

Deviations from these recommendations could result in an “actuarially unsound” approach to funding KLRP and/or KJRP and may eventually result in KLRP and/or KJRP 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) is inconsistent with the plan accumulating adequate assets to make benefit payments when due, assuming all actuarial assumptions are realized.

**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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Phone 615.665.5363

March 7, 2016

Date

*David L. Shaub*

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March 7, 2016

Date