MEMORANDUM REPORT

TO: Donna S. Early

FROM: BPS&M, LLC

DATE: January 20, 2016

RE: Actuarial Analysis of Proposed Legislation 2016 SB 73 GA/BR 821
AA Statement 1 of 1

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 73" BR821) that makes changes to the Kentucky Legislators Retirement Plan ("KLRP").

It is our understanding that 2016 SB 73 makes the following changes to KLRP:

1. Allows members who began contributing to KLRP prior to January 1, 2014 to make a one-time election to have their KLRP benefit based solely on their legislative salary and any salary earned in another state-administered retirement system prior to January 1, 2014.

<u>Comments.</u>

Item 1, allowing KLRP participants to have the option to opt out of future non-legislative pay:

- This option has historically been available to members. By choosing a different day of retirement for their KLRP benefit and other non-legislative benefit, pay from both sources would not be combined. Any assumption as to the percentage of participants who will make this election is highly speculative.
- The current funding valuation assumes a 40% increase (loading factor) to be applied to active and terminated vested liability and normal cost to estimate the additional liability which is likely to occur based on members with non-legislative service using pay from those non-legislative periods towards their final salary when calculating their KLRP pension benefit. While a significant portion of this loading is to account for future non-legislative pay, we believe a portion of the additional liability may also be attributable to members that have earned past non-legislative service that has not been reported. At this time we have no credible information to determine the portion of future liability which will arise from past non-legislative pay and what may arise from non-legislative pay earned in the future.
- The 40% loading factor is an estimate provided by the prior actuary which we have not validated due to insufficient availability of experience.
- Without further information to determine the number of members who may elect this option, and/or the impact of past non-legislative pay compared to future non-legislative pay, we would conclude that **this change will not materially impact the liabilities in the plan**.

<u>Actuarially Sound</u>

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. 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 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) 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. ______________________ January 20, 2016

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