

Kentucky Judicial Form Retirement System

JUDICIAL RETIREMENT PLAN LEGISLATORS RETIREMENT PLAN

Donna S. Early
Executive Director

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MEMORANDUM

To: Josh Nacey, Office of Fiscal Statement Review
From: Donna S. Early, Executive Director
RE: **2017 SB 104 SCS**
AA Statement 1 & 2 of 3
Date: February 8, 2017

I have examined **Sections 1 and 2 of 2017 SB 104 (BR 264)** and have formed the opinion that the proposals contained therein will not *increase or decrease the benefits or increase or decrease participation in the benefits or change the actuarial accrued liability* of the Legislators Retirement Plan or the Judicial Retirement Plan. Consequently, I have not requested an actuarial analysis by the System's independent actuary.

I have also examined **Sections 4, 5 and 9 of 2017 SB 104 (BR 264)**. The proposals contained therein are identical to the proposals contained in 2016 SB 172. Consequently, I respectfully submit the March 7, 2016 *Actuarial Analysis* of 2016 SB 172 (applicable to the Legislators Retirement Plan and the Judicial Retirement Plan) to satisfy the requirements of KRS 6.350.

If enacted, compliance and implementation of **2017 SB 104** could increase administrative costs and professional fees.

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

MEMORANDUM REPORT

TO: Donna S. Early
FROM: BPS&M, LLC
DATE: March 7, 2016
RE: Actuarial Analysis of Proposed Legislation 2016 SB 172

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
Fellow, Society of Actuaries
Enrollment No. 14-05458
Phone 615.665.5363

March 7, 2016

Date



David L. Shaub
Fellow, Society of Actuaries
Phone 615.665.5309

March 7, 2016

Date

February 9, 2017

Ms. Katie Carney
Executive Assistant, Director's Office
Legislative Research Commission
Capitol Annex, Room 104
Frankfort, KY 40601

**RE: Senate Bill 104 SCS (2017 RS BR 264)
AA Statement 3 of 3**

Dear Ms. Carney:

Senate Bill 104 SCS (2017 RS BR 264), in part, amends KRS 61.598 to provide that members of the Kentucky Employees Retirement System (KERS), the County Employees Retirement System (CERS), and the State Police Retirement System (SPRS) who retire on or after January 1, 2018, shall be limited to a 10% growth in the creditable compensation earned during their last five years of employment if that compensation is used to calculate their retirement benefits; provides that only creditable compensation earned on or after July 1, 2017, shall be subject to the creditable compensation growth limitations; exempts bona fide promotions or salary advancements, alternative sick leave payments, and lump-sum payments for compensatory time from the compensation growth limitation; exempts from the compensation growth limitation those years of compensation where in the immediately preceding fiscal year the member was paid worker's compensation benefits, was on leave without pay for any reason, earned increases directly attributable to overtime hours worked under a federal grant, grant pass-through, or similar program, or earned increases directly attributable to overtime performed during a state of emergency; provides that the Kentucky Retirement Systems (KRS) shall refund employee contributions and interest on contributions for any reductions in creditable compensation provided by this section; provides that the KRS shall determine what constitutes a bona fide promotion or salary advancement and allow the member to appeal a decision of the system to the board; and removes provisions charging employers for creditable compensation growth greater than 10% during the employee's last five years of employment.

The bill also creates a new section of KRS 61.510 to 61.705 to permit a member of KERS, CERS, or SPRS 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, shall 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 KRS 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 private letter ruling by the IRS is received; makes the benefit election under this section irrevocable; amends KRS 6.525,

16.583, 16.645, 61.597 and 78.545 to make technical and conforming amendments; provides for severability among provisions of the Act; and contains an Emergency clause.

Senate Bill 104 SCS (2017 RS BR 264)
AA Statement Required by KRS 6.350
Page 2

KRS staff and our consulting actuary have examined Senate Bill 104 SCS (2017 RS BR 264) and have determined that the bill will not increase benefits in any of the retirement systems administered by Kentucky Retirement Systems. It is possible that members may experience a decrease in benefits if they elect to move from the traditional defined benefit plan (Tier 1) to the hybrid cash balance plan (Tier 3) and forfeit some of the benefits currently guaranteed under the inviolable contract statute (KRS 61.692). 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 members receiving benefits. According to the KRS actuary, it is not possible to determine the exact actuarial cost impact of Senate Bill 104 SCS (2017 RS BR 264), 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 (Tier 1) would switch to the hybrid cash balance plan because it would not increase their expected retirement benefit. If 100% of the members who began participating in the Systems on or after September 1, 2008, but before January 1, 2014 (Tier 2 members) elected to participate in the hybrid cash balance plan, the actuarial liability of the Systems would not change significantly.

Although there would be no material impact on the actuarial liabilities of the Systems from implementing Senate Bill 104 SCS (2017 RS BR 264), there would be administrative costs to the Systems to cover the expense of both the pension spiking and the tier option change. Pension spiking will require technology expenses for designing and testing a second pension spiking module. In addition, there would likely be an administrative cost to each of the Systems' 1,499 participating employers to modify their monthly reporting files. Related to the election of Tier 3, KRS anticipates it would need to notify as many as 226,000 Tier 1 & 2 members at an average mailing cost of \$0.50 to \$1.00 per letter. It would also require an estimated two hours of benefit counselor analysis time at a cost of \$40-\$45 per hour (including benefits) for those members requesting a retirement benefit comparison between their existing Tier to Tier 3. For example, if 25% of this number (56,500 members) requested estimates, it could cost the Systems between \$4.5 million to \$5.1 million in counselor analysis. Also, such inquiries would put an undue burden on our benefits consulting capacity.

Please let me know if you have any questions regarding our analysis of Senate Bill 104 SCS (2017 RS BR 264).

Sincerely,



David L. Eager
Interim Executive Director, Kentucky Retirement Systems