



KENTUCKY RETIREMENT SYSTEMS

David L. Eager, Interim Executive Director

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March 19, 2018

Ms. Katie Carney
Office of Fiscal Statement Review
Legislative Research Commission
Capitol Annex, Room 104
Frankfort, KY 40601

**RE: BR 465 SB 113 GA-Amended
AA Statement 1 of 1**

Dear Ms. Carney:

Senate Bill 113 (2018 RS BR 465) amends KRS 61.637 to allow a mayor or member of a city legislative body who does not have service credit in the County Employees Retirement System (CERS) for their service to the city to retire and draw benefits from CERS for other covered employment without resigning from their position as mayor or member of a city legislative body; and amends KRS 78.540 to allow a mayor or member of a city legislative body who has been required to participate in CERS due to other covered employment, or because of failure to make an election to not participate, to elect to not participate in CERS for service as mayor or member of the city legislative body and to receive a refund of contributions for their service. The bill has an Emergency clause. Please note that we have included additional legal information (page 2).

Kentucky Retirement Systems staff members have consulted with their actuaries and legal staff concerning Senate Bill 113 (2018 RS BR 465). We have determined that the bill will not increase or decrease benefits in any of the retirement systems administered by Kentucky Retirement Systems. The bill would decrease the participation in benefits in the CERS plans as of the effective date of the bill and thereafter if future mayors or members of city legislative bodies elect to not participate for their service as mayor or as a member of a city legislative body.

Senate Bill 113 (2018 RS BR 465) could potentially have a detrimental impact on the actuarial liability of the CERS plan. If mayors and members of city legislative bodies elect not to participate there would be no new liability created because they would not earn credit toward a retirement benefit. However, CERS would also not receive the employer contributions that otherwise would have been received: the majority of which are used to pay for the existing unfunded liability. For example, in the CERS Non-Hazardous plan, the actuarially recommended combined Pension and Insurance contribution rate for Fiscal Year 2019 is 28.05%, with 24.72% of that total allocated toward the unfunded liability for the Pension fund. New legislators would be placed in Tier 3, as determined by their original participation date with an agency participating in CERS. Based on the 2017 Plan Actuarial Valuations, the Employer Normal Cost Rates for Tier 3 (the "Employer Normal Cost Rate" is the annual employer cost of providing retirement benefits for today's members net of the employee contribution) are 1.27% for

Pension and 1.17% for Insurance in the CERS Non-Hazardous plan.* Therefore, while the actuarial liability created by adding another member to the CERS Non-Hazardous system in Tier 3 is 2.44% (1.27% plus 1.17%), the System would lose 25.61% of the member's salary that would have otherwise been paid on their behalf and allocated toward paying down the unfunded liability for that System.

In addition to the actuarial impact, Senate Bill 113 (2018 RS BR 465) would violate the Internal Revenue Service (IRS) "cash or deferred arrangement" (CODA) rule, and risk the tax-qualification of the overall CERS plan. IRS rules treat any tax-qualified pension plan that allows an eligible employee to waive participation and instead receive cash as a violation of the CODA rule. That is, if an employee were permitted to "elect out" of CERS coverage, the employee's required contribution (5% of pay) would not be withheld and deposited to the CERS trust (pre-tax) as with all other eligible employees, but would be included and taxed as regular pay, and no employer contribution (18.68%, FY 2017) would be contributed to the CERS trust. The IRS position is that the employee is effectively receiving a 5% pay increase by electing out of CERS coverage, and thus is not permissible.

Finally, Senate Bill 113 (2018 RS BR 465) provides that an employee who is eligible to retire under any KRS-administered plan before becoming a mayor or member of a city legislative body, is not required to resign the position of mayor or member of a city legislative body in order to begin drawing benefits from any pension plan administered by KRS (including the CERS plan). Currently the law allows a mayor or city legislative member who is eligible for a pension under KERS or SPRS to draw benefits from those plans without having to resign his or her position as mayor or member of a city legislative body. Current law includes this provision because the mayor or member of city legislative body is eligible to receive a pension from a non-CERS employer, or otherwise would violate the KRS plan rules about working and receiving a benefit from the same employer at the same time.

In accordance with KRS 6.350 (2)(c), Kentucky Retirement Systems certifies the following:

1. The estimated number of individuals affected as of June 30, 2017 are 84,401 active members; 78,940 inactive members; and 54,018 retired members in the CERS Non-Hazardous plan.
2. There is no estimated change in benefit payments;
3. There is an estimated change to employer costs, as the costs would be minimally lower because employers would not contribute to the CERS plan for those elected officials;
4. There is no estimated change to administrative expenses.

We have not requested any further actuarial analysis of Senate Bill 113 (2018 RS BR 465) by the Systems' independent actuary. Please let me know if you have any questions regarding our analysis of Senate Bill 113 (2018 RS BR 465).

Sincerely,

A handwritten signature in black ink that reads "David Eager". The signature is written in a cursive, flowing style.

David L. Eager
Interim Executive Director
Kentucky Retirement Systems

**excludes employee contributions and administrative expenses.*