KENTUCKY RETIREMENT SYSTEMS

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March 27, 2018

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

RE: BR 465 SB 113 HCS
AA Statement 1 of 1

Dear Ms. Carney:

Senate Bill 113 HCS (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; 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; and amends KRS 61.645 to allow the Kentucky Retirement Systems board to promulgate an administrative regulation to conduct trustee elections by electronic ballot and sets the election dates and term of office for the CERS Board member elected in accordance with 2013 Kentucky Acts chapter 120, sec. 82. The bill has an Emergency clause.

Kentucky Retirement Systems (KRS) had previously provided an actuarial impact of the original legislation on March 13, 2018 and an Amended Analysis on March 19, 2018. The Amended Analysis included additional legal information about our concerns with this bill violating the Internal Revenue Service's "cash or deferred arrangement" (CODA) rule.

The HCS version of Senate Bill 113 (2018 RS BR 465) includes additional language amending KRS 61.645 that we have reviewed internally. We have determined that this new language creating Sections 3 and 4 of the bill will not increase or decrease benefits or the participation in benefits in any of the retirement systems administered by Kentucky Retirement Systems. Furthermore, Sections 3 and 4 of Senate Bill 113 HCS (2018 RS BR 465) will not change the actuarial liability of any of the retirement plans administered by Kentucky Retirement Systems. However, our concerns with the original version of the bill remain.

Kentucky Retirement Systems staff members previously consulted with their actuaries and legal staff concerning the original version of Senate Bill 113 (2018 RS BR 465). At that time we determined that the bill would not increase or decrease benefits in any of the retirement systems administered by Kentucky Retirement Systems, but 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. This is still accurate.

Senate Bill 113 HCS (2018 RS BR 465) could still 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 elected officials 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 HCS (2018 RS BR 465) would still 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 HCS (2018 RS BR 465) still 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 an estimated change to administrative expenses. Savings to the Systems would be realized because electronic ballots would reduce the number of paper ballots that would need to be printed and mailed to CERS members.

We have not requested any further actuarial analysis of Senate Bill 113 HCS (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 HCS (2018 RS BR 465).

Sincerely,

David Eager

David L. Eager
Interim Executive Director
Kentucky Retirement Systems

**excludes employee contributions and administrative expenses.*