KENTUCKY RETIREMENT SYSTEMS

David L. Eager, Executive Director

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March 7, 2019

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

RE: House Bill 457 (2019 RS BR 395)
AA Statement Required by KRS 6.350
AA Statement 1 of 2

Dear Ms. Carney:

House Bill 457 (2019 RS BR 395) creates a new section of KRS 6.145 to 6.237 to allow individuals who become members of the General Assembly on or after April 1, 2019, to make a one-time irrevocable election to not participate in the Legislators' Retirement Plan or the Kentucky Employees Retirement System (KERS) for their service to the General Assembly; allows members of the General Assembly who began contributing to the Legislators' Retirement Plan or the KERS prior to April 1, 2019, to make a one-time irrevocable election by December 31, 2019, to discontinue participation in the Legislators' Retirement Plan or the KERS for their service to the General Assembly and receive a refund of accumulated contributions; provides that the election to not participate or discontinue participation in the Legislators' Retirement Plan or the KERS applies to all future service of the General Assembly; and amends KRS 6.505, 61.510, and 61.525 to conform. The bill contains an Emergency clause.

Kentucky Retirement Systems staff members have examined House Bill 457 (2019 RS BR 395). Our analysis only pertains to KERS. 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 not increase the participation in benefits in any of the retirement systems administered by Kentucky Retirement Systems, but would decrease participation if individuals choose to make the election to not participate in KERS.

House Bill 457 (2019 RS BR 395) could potentially have a detrimental impact on the actuarial liability of the KERS plan. If new legislators choose not to participate there would be no new liability created because they would not earn credit toward a retirement benefit. However, KERS 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 KERS Nonhazardous plan, the actuarially recommended combined Pension and Insurance contribution rate for Fiscal Year 2019 is 83.43%, with 74.73% of that total allocated toward the unfunded liability (66.56% for Pension and 8.17% for Insurance). New legislators would be placed in Tier 3. Based on the 2018 Plan Actuarial Valuation, the Employer Normal Cost Rates for this Tier (the “Employer Normal Cost Rate” is the annual employer cost of providing retirement benefits for today’s members net of the employee contribution) are 2.50% for Pension and 0.55% for Insurance in the KERS Nonhazardous plan.[1] Therefore, while the actuarial liability created by adding another member to the KERS Nonhazardous system is 3.05% (2.50% plus 0.55%), the System would lose 74.73% of the member's salary that would have otherwise been paid and allocated toward paying down the unfunded liability for that System.

In addition to the actuarial impact, part (1)(b) beginning on Line 15 of Section 1 of House Bill 457 (2019 RS BR 395) would potentially violate the Internal Revenue Service (IRS) "cash or deferred arrangement" (CODA) rule, and risk the tax-qualification of the overall KERS 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 KERS coverage, the employee's required contribution (5% for Tier 1 members and 6% of pay for Tier 2 and Tier 3 members) would not be withheld and deposited to the KERS trust (pre-tax) as with all other eligible employees, but would be included and taxed as regular pay, and no employer contribution (83.43%, FY 2019) would be contributed to the KERS trust. The IRS position is that the employee is effectively receiving a 5% (or 6%) pay increase by electing out of KERS coverage, and thus is not permissible. We believe a Private Letter Ruling from the IRS would be required in order to implement this part of the bill.

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

1. According to the Judicial Form Retirement System's website, as of July 1, 2018 there were 80 active members of the Legislators Retirement Defined Benefit Plan and 22 members of the Legislators Retirement Hybrid Cash Balance Plan (the plan in effect for General Assembly members elected to a term commencing on or after January 1, 2014). Therefore, the estimated number of individuals affected by this bill are 102 active members and any future members of the General Assembly who decide to participate in LRP or KERS, as well as approximately 90 legislators who are also members of KERS;

2. There is no estimated change in benefit payments;

3. There is no estimated change to employer costs; and

4. There is no estimated change to administrative expenses.

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[1] *Excludes employee contributions and administrative expenses*

We have not requested any further actuarial analysis of House Bill 457 (2019 RS BR 395) by the Systems' independent actuary. Please let me know if you have any questions regarding our analysis of House Bill 457 (2019 RS BR 395).

Sincerely,

David L. Eager
Executive Director
Kentucky Retirement Systems