P: 469.524.0000 | www.grsconsulting.com

December 3, 2020

Board of Trustees
Kentucky Retirement Systems
Perimeter Park West
1260 Louisville Road
Frankfort, KY 40601

Re: GASB No. 74 Reporting – Actuarial Information

Dear Members of the Board:

The reports provided herein contain certain information for the Kentucky Employees Retirement System (KERS), the County Employees Retirement System (CERS), and the State Police Retirement System (SPRS) in connection with the Governmental Accounting Standards Board (GASB) Statement No. 74, "Financial Reporting for Postemployment Benefit Plans Other than Pension Plans" for the fiscal year ending June 30, 2020. Separate reports will be provided at a later date with additional accounting information determined in accordance with GASB Statement No. 75, "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions".

Basis of Calculations

The liability calculations presented in the reports were performed for the purpose of satisfying the requirements of GASB No. 74 and are not applicable for other purposes, such as determining the plans' funding requirements. The plan's liability for other purposes may produce significantly different results.

The total OPEB liability, net OPEB liability, and sensitivity information are based on an actuarial valuation date of June 30, 2019. The total OPEB liability was rolled-forward from the valuation date to the plan's fiscal year ending June 30, 2020 using generally accepted actuarial principles.

Assumptions

The discount rates used to calculate the total OPEB liability decreased for all Funds (see further discussion on the calculation of the single discount rate later in this letter). The assumed increase in future health care costs, or trend assumption, was reviewed during the June 30, 2019 valuation process and was updated to better reflect more current expectations relating to anticipated future increases in the medical costs. Also, the June 30, 2020 GASB No. 74 actuarial information reflects the anticipated savings from the repeal of the "Cadillac Tax" and "Health Insurer Fee", which occurred in December of 2019. The assumed load on pre-Medicare premiums to reflect the cost of the Cadillac Tax was removed and the Medicare premiums were reduced by 11% to reflect the repeal of the Health Insurer Fee. There were no other material assumption changes and it is our opinion that these procedures are reasonable and appropriate, and comply with applicable requirements under GASB No. 74.

Plan Provisions

House Bill 1 passed during the 2019 Special Legislative Session and allowed certain agencies in the KERS Non-Hazardous plan to elect to cease participating in the System as of June 30, 2020 under different provisions than were previously established. Senate Bill 249 passed during the 2020 Legislative Session and delayed the effective date of cessation for these provisions to June 30, 2021. Since each employer's election is unknown at this time, we did not make any adjustment to the Total OPEB Liability to reflect this legislation.

Senate Bill 249 also changed the funding period for the amortization of the unfunded liability to 30 years as of June 30, 2019. Gains and losses incurring in future years will be amortized over separate 20-year amortization bases. This change does not impact the calculation of the Total OPEB Liability and only impacts the calculation of the contribution rates that would be payable starting July 1, 2020. There were no other material plan provision changes and it is our opinion that these procedures are reasonable and appropriate, and comply with applicable requirements under GASB No. 74.

Implicit Employer Subsidy for non-Medicare retirees

The fully-insured premiums KRS pays for the Kentucky Employees' Health Plan are blended rates based on the combined experience of active and retired members. Because the average cost of providing health care benefits to retirees under age 65 is higher than the average cost of providing health care benefits to active employees, there is an implicit employer subsidy for the non-Medicare eligible retirees. GASB No. 74 requires that the liability associated with this implicit subsidy be included in the calculation of the Total OPEB Liability.

Discount Rates

The following single discount rates were used to measure the total OPEB liability for the fiscal year ending June 30, 2020.

KERS Non-Hazardous	5.43%
KERS Hazardous	5.28%
CERS Non-Hazardous	5.34%
CERS Hazardous	5.30%
SPRS	5.40%

The single discount rates are based on the expected rate of return on OPEB plan investments of 6.25% and a municipal bond rate of 2.45%, as reported in Fidelity Index's "20-Year Municipal GO AA Index" as of June 30, 2020. Based on the stated assumptions and the projection of cash flows as of each fiscal year ending, the plan's fiduciary net position and future contributions were projected to be sufficient to finance the future benefit payments of the current plan members. Therefore, the long-term expected rate of return on insurance plan investments was applied to all periods of the projected benefit payments paid from the retirement system. However, the cost associated with the implicit employer subsidy is not currently being included in the calculation of the System's actuarial determined contributions, and it is our understanding that any cost associated with the implicit subsidy will not be paid out of the System's trust. Therefore, the municipal bond rate was applied to future expected benefit payments associated with the implicit subsidy.

The projection of cash flows used to determine the single discount rate must include an assumption regarding actual employer contributions made each future year. Except where noted below, the future contributions are projected assuming that each participating employer in the System contribute the actuarially determined employer contribution rate each future year calculated in accordance with the current funding policy, as most recently revised by Senate Bill 249, passed during the 2020 Legislative Session. This includes the phase-in provisions from House Bill 362 (passed in 2018) that applies to the CERS Funds as well as the provisions from Senate Bill 249 (passed in 2020) which kept CERS contributions level for fiscal year ending 2021.

If there is a pattern of legislation that has a resulting effect of employers making contributions less than the actuarially determined rate, we may be required to project contributions that are reflective of recent actual contribution efforts regardless of the stated funding policy (as required by paragraph 50 of GASB Statement No. 74). Legislation has been enacted three times (for FY 18/19, FY 19/20, and FY 20/21) that allowed certain employers (referred to as "Quasi" agencies) in the KERS Non-Hazardous Fund to contribute 8.41% of pay into the insurance fund, which is less than the actuarially determined contribution rate. We believe this constitutes a pattern and as such, the projection for the KERS Non-Hazardous Fund assumes these Quasi agencies contribute no more than 8.41% of pay throughout the entire projection.

401(h) Subaccount

Based on guidance issued by GASB in connection with GASB Statement No. 74, the 1% of pay member contributions for Tier 2 and Tier 3 members to a 401(h) subaccount is considered as an OPEB asset. As a result, the reported fiduciary net position includes these 401(h) assets. Additionally, these member contributions and associated investment income are included in the reconciliation of the fiduciary net position.

Additional Disclosures

The reports are based upon information, furnished to us by the Retirement System, which includes benefit provisions, membership information, and financial data. We did not audit this data and information, but we did apply a number of tests and concluded that it was reasonable and consistent. GRS is not responsible for the accuracy or completeness of the information provided by the Retirement System. Please see the "Actuarial Valuation Report as of June 30, 2019" for additional discussion of the nature of the actuarial calculations and more information related to participant data, economic and demographic assumptions, and benefit provisions. These reports should be considered together as a complete report for KRS's fiscal year ending June 30, 2020.

To the best of our knowledge, the reports are complete and accurate and are in accordance with generally recognized actuarial practices and methods. Mr. Newton, Mr. Riazi, and Mr. White are Enrolled Actuaries. All of the undersigned are independent actuaries and consultants and members of the American Academy of Actuaries and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion herein. They are also experienced in performing valuations for large public retirement system. This communication shall not be construed to provide tax advice, legal advice or investment advice.

Sincerely,

Joseph P. Newton, FSA, EA, MAAA
Pension Market Leader and Actuary

Daniel J. White, FSA, EA, MAAA
Senior Consultant and Actuary

Janie Shaw, ASA, MAAA
Consultant and Actuary

Mehdi Riazi, FSA, EA, MAAA
Consultant and Actuary