

Funding and Plan Design Changes for Kentucky Retirement Systems

1

KENTUCKY PUBLIC PENSIONS TASK FORCE

11/20/2012

Funding → KERS/SPRS Phase-In Schedule

2

- **Current Phase-In Schedule from HB 1 (2008)**
 - Established goal to incrementally increase the funds paid by the state to reach the full actuarially required contribution (ARC) for KERS and SPRS over time.
 - ✦ FY 2024-2025 for KERS non-hazardous
 - ✦ FY 2018-2019 for KERS hazardous
 - ✦ FY 2019-2020 for SPRS
 - Not paying the full ARC creates additional unfunded liabilities and higher costs to employers each time the full ARC is not paid.
- **Funding recommendation: Begin paying the full ARC in FY 2014-2015 for KERS non-hazardous, KERS hazardous, and SPRS.**

Retiree Cost of Living Adjustment (COLA)

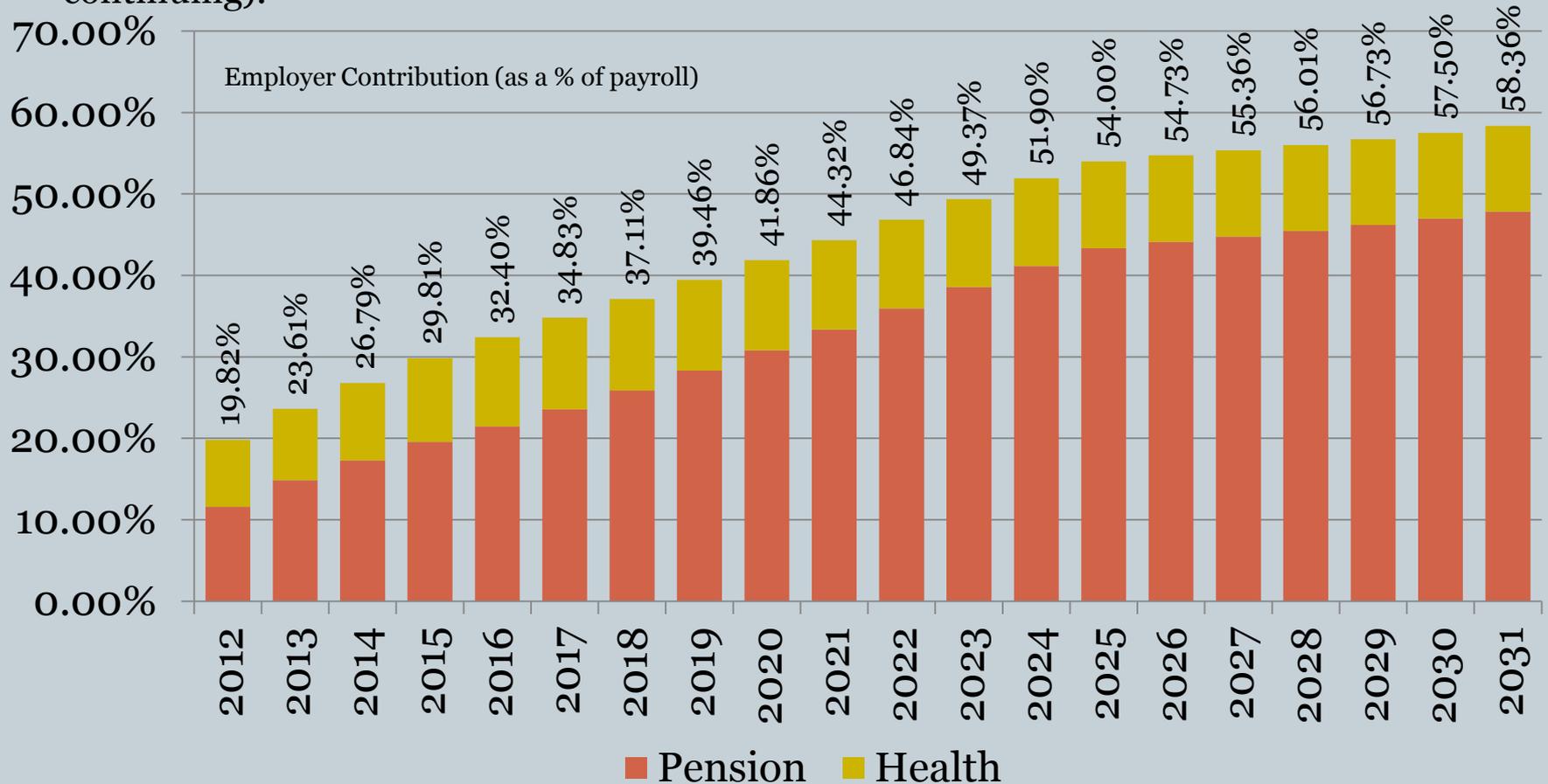
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- **COLA provisions have been modified in recent years.**
 - HB 1 modified COLA calculation from annual increase based upon the change in the CPI-U to a flat 1.5%.
 - HB 265 (2010) suspended the COLA provided on July 1, 2012 and July 1, 2013.
- **Current Funding of COLAs:**
 - No prefunding which creates additional unfunded liabilities and higher costs to employers each time a COLA is awarded.
- **COLA Recommendation: Repeal the COLA provisions.**

Current 20 Year Employer Projection

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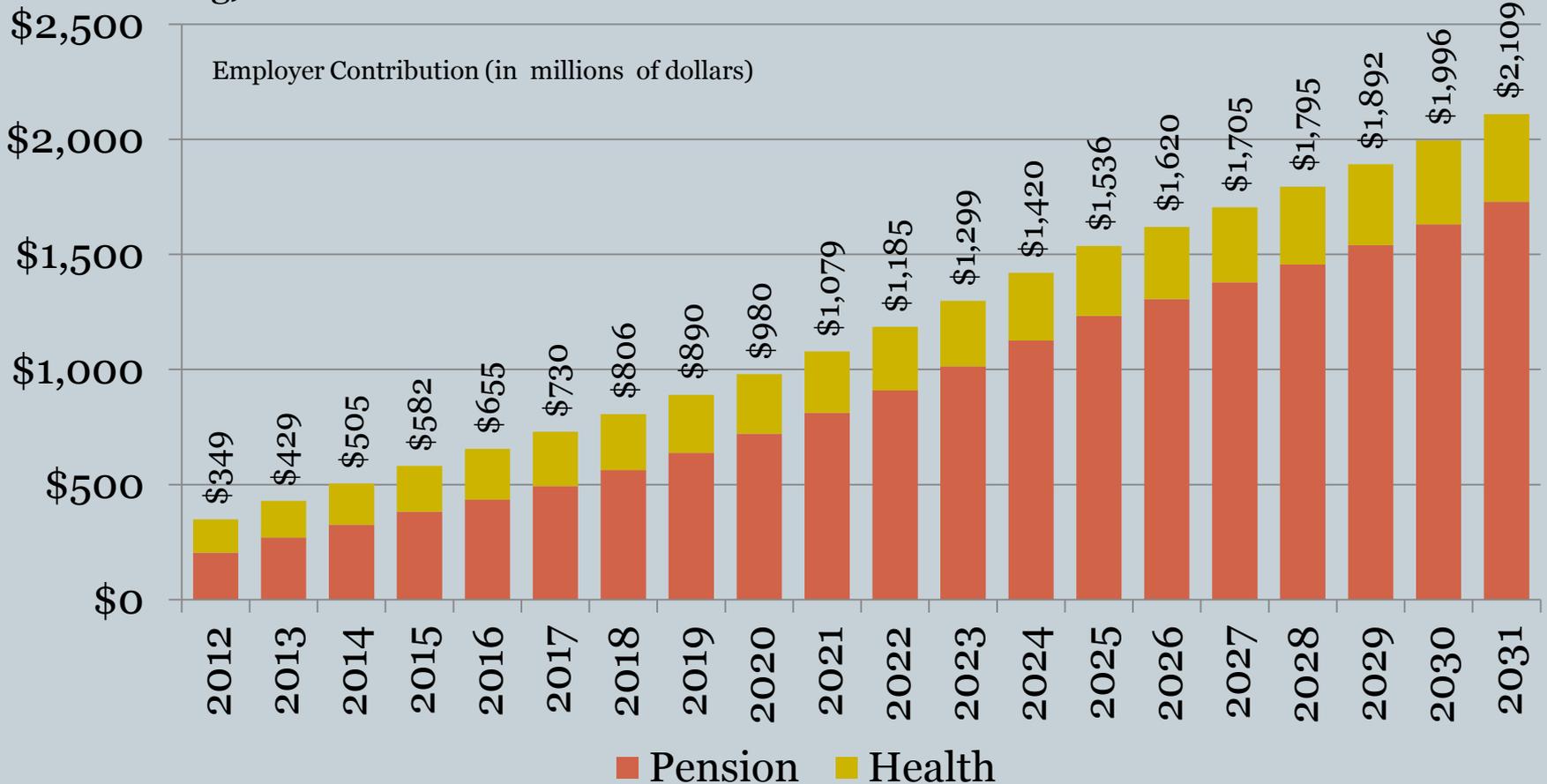
- KERS Non-Hazardous with no changes (phase-in through 2024-2025 with COLAs continuing).



Current 20 Year Employer Projection

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- KERS Non-Hazardous with no changes (phase-in through 2024-2025 with COLAs continuing).

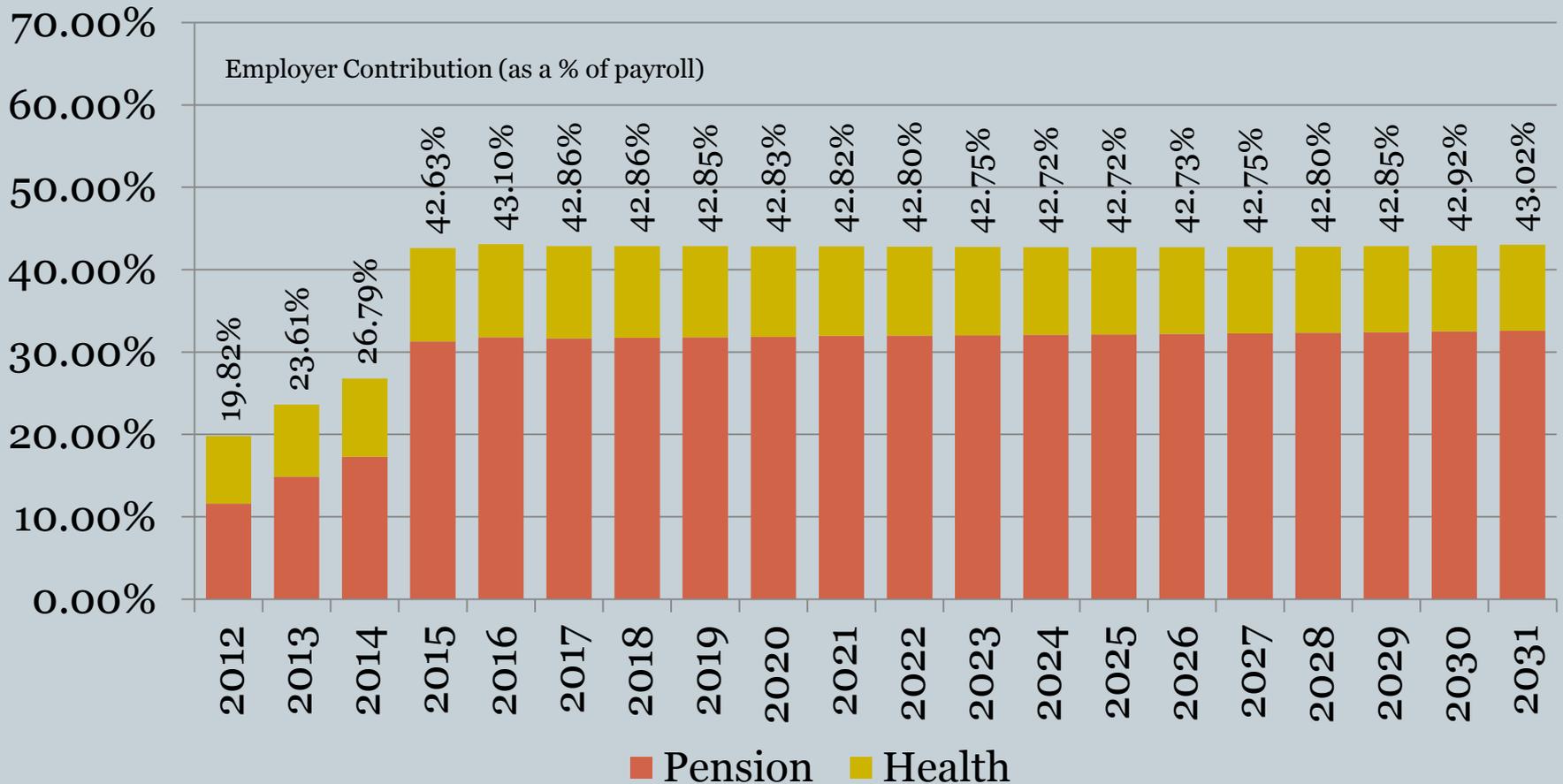


Source: Cavanaugh MacDonald Consulting, KRS Consulting Actuary, 20 year rate projections, November 30, 2011, applied against KRS projected payroll

Impact of Phase-In Elimination & COLA Changes

6

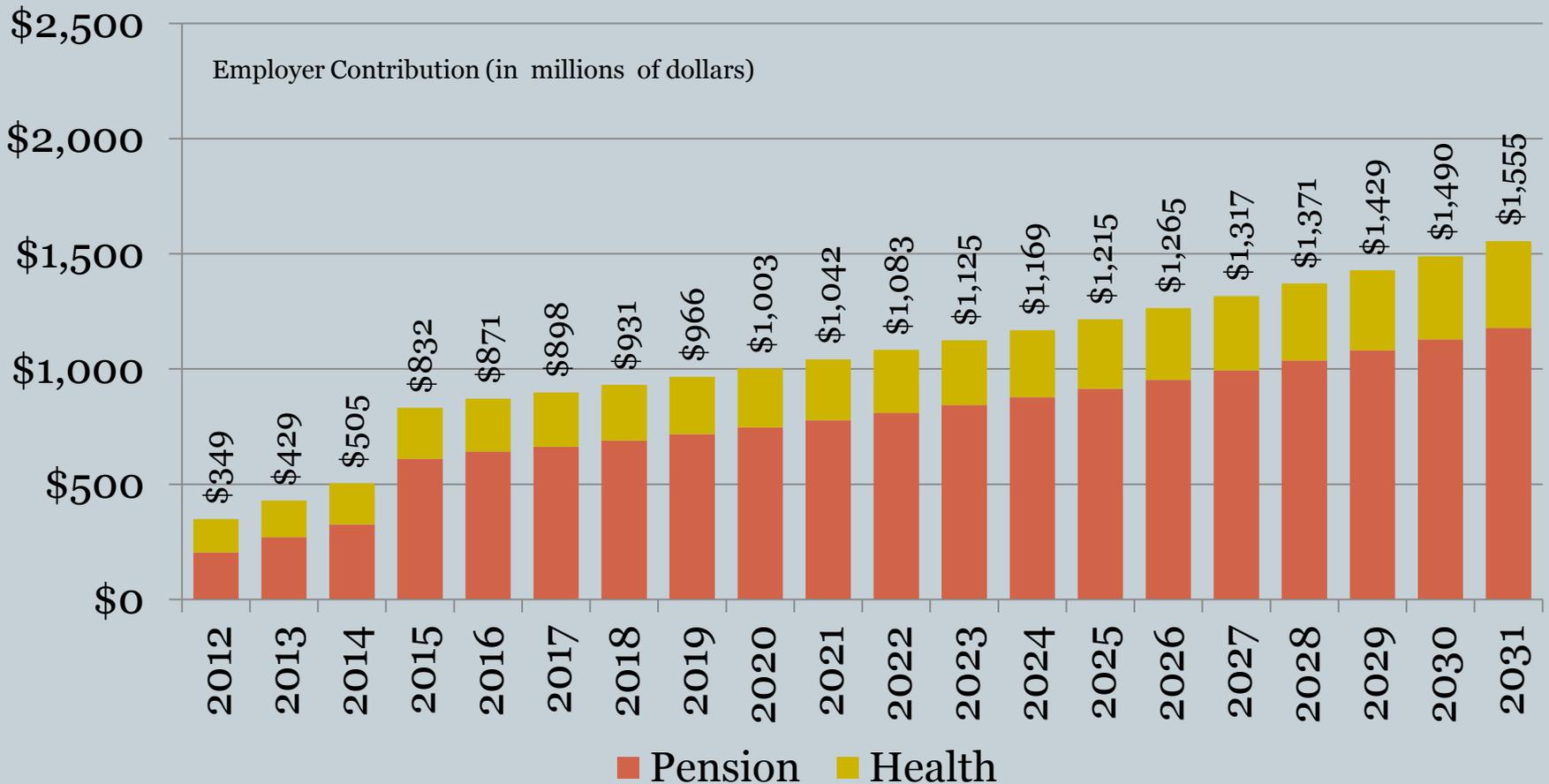
- KERS Non-Hazardous with Full ARC Pmt. in 2014 & COLAs repealed



Impact of Phase-In Elimination & COLA Changes

7

- KERS Non-Hazardous with Full ARC Pmt. In 2014 & COLAs repealed



Impact of Phase-In and COLA Changes

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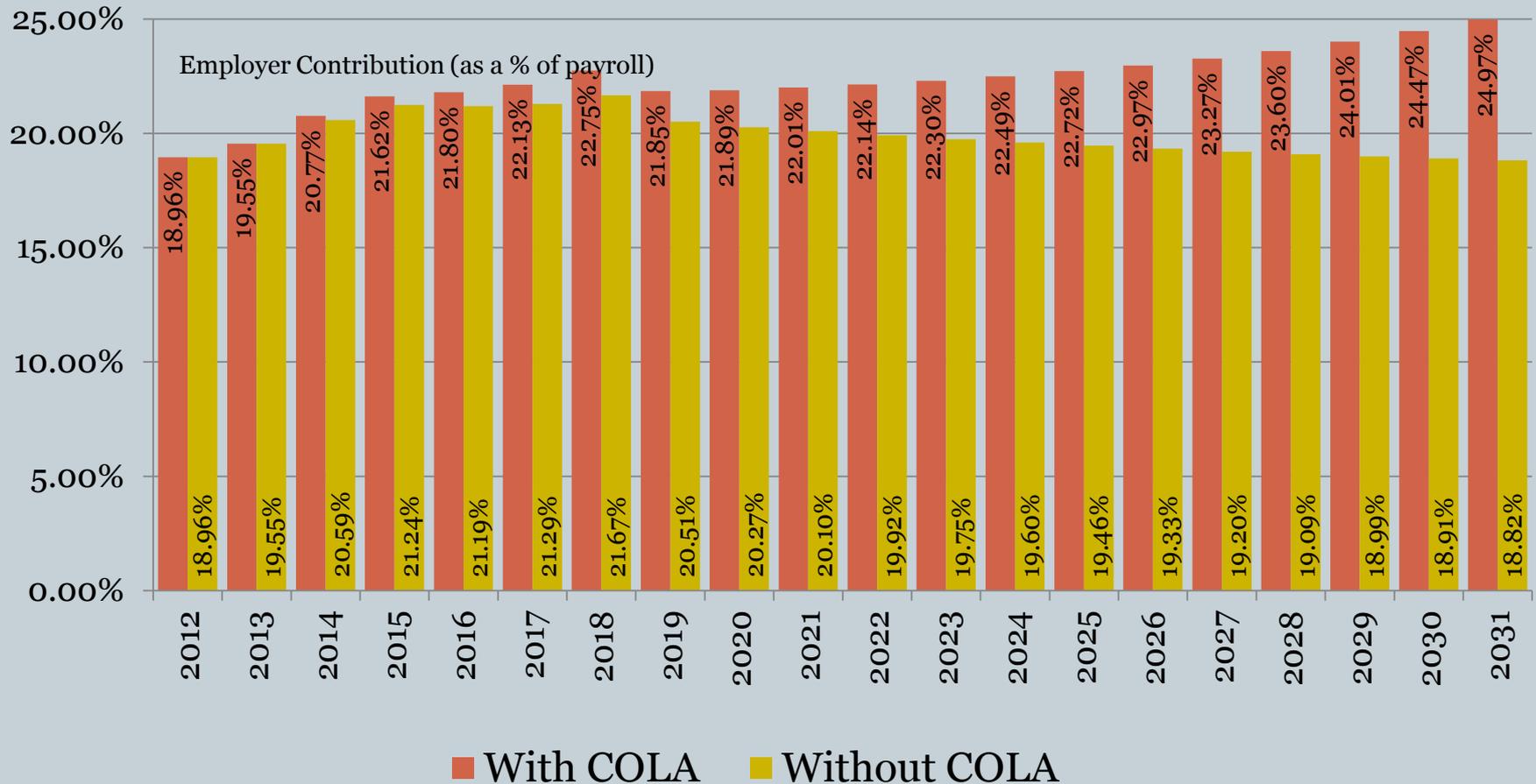
- Projections were provided by the KRS consulting actuary.
 - Include a projected investment return of 7.75% in all future years and a payroll growth assumption of 4.5%.
 - Additional costs for KERS non-hazardous, KERS hazardous, and SPRS for FY 2014-2015 from the KRS projections.
 - ✦ KERS non-hazardous: \$327.1 million all funds
 - ✦ KERS hazardous: \$9.7 million all funds
 - ✦ SPRS: \$8.6 million all funds
 - Numbers will change in December when the 2012 valuation comes out and can change in the future based upon plan experience or if plan assumptions change.

Impact of COLA Changes on CERS

Non-Hazardous Employers

9

- CERS Non-Hazardous (With COLAs and without COLAs)

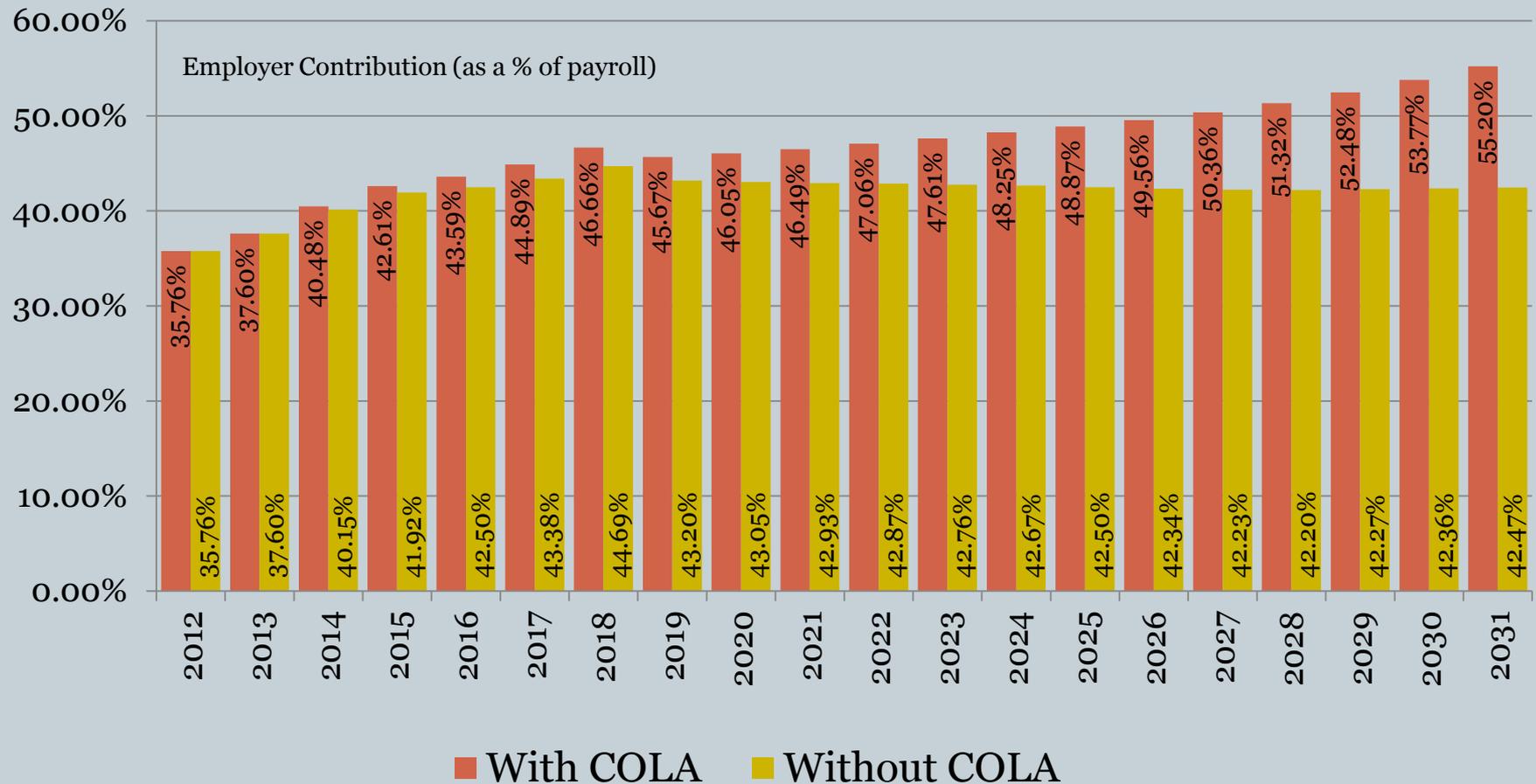


Impact of COLA Changes on CERS

Hazardous Employers

10

- CERS Hazardous (With COLAs and without COLAs)



Funding → Amortization Period

11

- Currently KRS has 26 years remaining on the amortization period (as of the June 30, 2011 actuarial valuation).
- Recommendation: Reset the amortization period for KERS, CERS, and SPRS.
 - Will reduce costs in the short-term but will require additional costs in the long-run.

Other Items

12

- Reemployment after retirement
- Current Provisions (passed in 2008 in HB 1)
 - 3 mo. break in employment required before returning to work (except 1 mo. Hazardous full-time retired to hazardous full-time employment).
 - No second retirement account.
 - Employer must pay employer contributions during period of reemployment and reimburse systems for costs of retiree's health care if the retiree takes coverage through the systems.
- Reemployment after retirement option: Same except extend required break in employment to 2 years for retirees who are reemployed on or after 7/1/2013 (exception- 1 year full-time retired hazardous to full-time hazardous employment).

Other Items

- “Pension Spiking”
 - Current Provisions
 - ✦ Benefits are based upon salary earned during the last 3 or 5 years of employment. Values include overtime, job changes, etc.
 - ✦ HB 1—compensatory payouts not included for new participants on or after 9/1/08.
 - Employer pays the employer contribution on the additional salary earned.
 - Recommended Change: Employers required to also pay any additional actuarial costs for salary increases above 10% during the last 5 years of employment.
- Transparency Item: Require KRS to establish a web page(s) with information that is easily available and understood by the public regarding its financial and actuarial condition.

Other Items

14

Current KRS Board Structure

- 9 member board:
- Five elected (2 KERS, 2 CERS, 1 SPRS)
 - Three appointed by Governor of which:
 - 2 must have 10 years “investment experience” as defined by statute
 - 1 must be knowledgeable about the impact of pensions on local governments.
 - Sec. of State Personnel Cabinet

Proposed KRS Board Structure

- 11 member board:
- Five elected (2 KERS, 2 CERS, 1 SPRS)
 - Five appointed by Governor of which:
 - 2 must have 10 years “investment experience” as defined by statute who cannot be participating or retired from KERS, CERS, or SPRS.
 - 1 appointed by the Gov. from a list of 3 individuals recommended by the Kentucky League of Cities.
 - 1 appointed by the Gov. from a list of 3 individuals recommended by the Kentucky Association of Counties.
 - 1 appointed by the Gov. from a list of 3 individuals recommended by the Kentucky School Board Association.
 - Sec. of State Personnel Cabinet

New Hire Plan: Non-Hazardous Employees

Effective July 1, 2013

15

| Provision | Current Plan for New Hires | Proposed Plan for New Hires | |
|---------------------------|--|--|---------------|
| Plan Type | Defined Benefit | Hybrid Cash Balance Plan | |
| Administration | Kentucky Retirement Systems | <i>Same as current plan</i> | |
| Employee Contribution | 5% to pension <u>1% to retiree health</u> 6% total | <i>Same as current plan</i> | |
| Employer Contribution | Varies annually as determined by the actuary and as set by funding policies. | <ul style="list-style-type: none"> •Varies annually as determined by the actuary and as set by funding policies. •4% employer credit to employee's account. | |
| Benefit Calculation | <u>KERS & CERS Formula</u> Final Compensation X Benefit Factor X Years of Service = Annual Benefit | Employee accounts include employee (5%) and employer contributions (4%) and are guaranteed a 4% annual return. These accounts receive 75% of returns above 4%. Employee would be vested for employer contributions and investment return after 5 years. Upon retirement, employees would be able to purchase an annuity based on the contents of their account. The annuity would be based on the current mortality and investment assumptions used by KRS. | |
| | <u>Final Compensation</u> Avg. of the 5 complete fiscal years immediately preceding retirement; cannot not include compensatory time payouts. | | |
| | <u>Benefit Factor</u> | | |
| | <i>Yrs. Service At Retirement</i> | | <i>Factor</i> |
| | 10 or less | | 1.10% |
| | >10, but no more than 20 | | 1.30% |
| | >20, but no more than 26 | | 1.50% |
| > 26, but no more than 30 | 1.75% | | |
| Additional years above 30 | 2.00% | | |

New Hire Plan: Non-Hazardous Employees (cont.)

Effective July 1, 2013

16

| Provision | Current Plan for New Hires | | Proposed Plan for New Hires |
|---------------------------|--|---|------------------------------------|
| Retirement Age/Service | <p><u>Unreduced benefit</u></p> <ul style="list-style-type: none"> •Rule of 87: Age + service must equal 87 years at retirement except that the employee must be at least 57 years of age to retire under this provision; or •Age 65 w/5 years of service. | <p><u>Reduced benefit</u></p> <p>Age 60 w/10 years of service</p> | <p><i>Same as current plan</i></p> |
| COLA | <p>Annual increase of 1.5%; may be suspended by Legislature.</p> | | <p>No COLA</p> |
| Disability/Death Benefits | <p><u>Disability Benefits</u></p> <p>Minimum 5 years service to apply</p> <p>Benefit Calculation-Higher of benefit calculated using actual service or 20% of member's final pay.</p> <p><u>Death Benefits (Before Retirement)</u></p> <p>Benefit payable if at the time of death the employee:</p> <ul style="list-style-type: none"> Was eligible to retire; or Had 5 year service and was working; or Had 12 years of service and was not working. <p><u>Death Benefits (After Retirement)</u></p> <p>Benefit payable to beneficiary based upon payment option selected at retirement.</p> <p>\$5,000 Death benefit if retired with at least 4 years service.</p> <p><i>Special line of duty disability/death benefits.</i></p> | | <p><i>Same as current plan</i></p> |

New Hire Plan: Non-Hazardous Employees (cont.)

Effective July 1, 2013

17

| Provision | Current Plan for New Hires | Proposed Plan for New Hires |
|---------------------------|--|---|
| Retiree Health Benefits | <p>FOR NEW HIRES AFTER 09/08:</p> <ul style="list-style-type: none"> • Medical Insurance Eligibility: 15 years earned service at retirement. • Benefit of \$10 per month for each year of earned service without regard to maximum dollar amount; adjusted by 1.5% annually. | <p><i>Same as current plan</i></p> |
| Inviolable Contract | <p>“Inviolable contract” language covers all benefits except COLA and retiree health benefits after 07/03.</p> | <p>Accrued benefits would remain protected but the GA could change prospective benefits if fiscal circumstances call for it.</p> |
| Portability | <ul style="list-style-type: none"> • Employee can take refund of contributions plus accumulated interest (2.5% annually) | <ul style="list-style-type: none"> • Employee contributions and investment return immediately vested; employer contribution and investment returns vested after 5 years (no sliding scale-0% until 5 years when it goes to 100%). • Vested employees can withdraw their account as a lump sum (including employer and employee contributions and earned interest) or leave account with state to access benefits upon retirement. |
| Investment Responsibility | <p>Systems</p> | <p>Systems</p> |

New Hire Plan: Hazardous Employees

Effective July 1, 2013

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|-----------------------|--|--|
| Plan Type | Defined Benefit | Hybrid Cash Balance Plan |
| Administration | Kentucky Retirement Systems | <i>Same as current plan</i> |
| Employee Contribution | 8% to pension <u>1% to retiree health</u> 9% total | <i>Same as current plan</i> |
| Employer Contribution | Varies annually as determined by the actuary and as set by funding policies. | <ul style="list-style-type: none"> •Varies annually as determined by the actuary and as set by funding policies. •7.5% employer credit to employee's account. |
| Benefit Calculation | <u>KERS & CERS Formula</u> Final Compensation X Benefit Factor X Years of Service = Annual Benefit <u>Final Compensation</u> Avg. of the 5 complete fiscal years immediately preceding retirement; cannot not include compensatory time payouts. <u>Benefit Factor</u> | |
| | <i>Yrs. Service At Retirement</i> | <i>Factor</i> |
| | 10 or less | 1.30% |
| | >10, but no more than 20 | 1.50% |
| | >20, but less than 25 | 2.25% |
| | 25 or more | 2.50% |
| | | Employee accounts include employee (8%) and employer contributions (7.5%) and are guaranteed a 4% annual return. These accounts receive 75% of returns above 4%. Employee would be vested for employer contributions and investment return after 5 years. Upon retirement, employees would be able to purchase an annuity based on the contents of their account. The annuity would be based on the current mortality and investment assumptions used by KRS. |

New Hire Plan: Hazardous Employees (cont.)

Effective July 1, 2013

19

| Provision | Current Plan for New Hires | | Proposed Plan for New Hires |
|---------------------------|--|--|-----------------------------|
| Retirement Age/Service | <u>Unreduced benefit</u> <ul style="list-style-type: none"> • Any age w/25 years of service or • Age 60 w/5 years or service | <u>Reduced benefit</u> Age 50 w/15 years of service | <i>Same as current plan</i> |
| COLA | Annual increase of 1.5%; may be suspended by Legislature. | | No COLA |
| Disability/Death Benefits | <u>Disability Benefits</u> Minimum 5 years service to apply Benefit Calculation-Higher of benefit calculated using actual service or 25% of member's final pay. <u>Death Benefits (Before Retirement)</u> Benefit payable if at the time of death the employee: Was eligible to retire; or Had 5 year service and was working; or Had 12 years of service and was not working. <u>Death Benefits (After Retirement)</u> Benefit payable to beneficiary based upon payment option selected at retirement. \$5,000 Death benefit if retired with at least 4 years service. <i>Special line of duty disability/death benefits.</i> | | <i>Same as current plan</i> |

New Hire Plan: Hazardous Employees (cont.)

Effective July 1, 2013

20

| Provision | Current Plan for New Hires | Proposed Plan for New Hires |
|---------------------------|---|---|
| Retiree Health Benefits | <p>FOR NEW HIRES AFTER 09/08:</p> <ul style="list-style-type: none"> •15 years of earned service at retirement to be eligible for insurance benefits. •Benefit of \$15 per month for each year of earned service without regard to a maximum dollar amount; adjusted by 1.5% annually. •\$10 per month for each year of hazardous service for surviving spouse of deceased member. | <p><i>Same as current plan</i></p> |
| Inviolable Contract | <p>“Inviolable contract” language covers all benefits except COLA and retiree health benefits after 07/03.</p> | <p>Accrued benefits would remain protected but the GA could change prospective benefits if fiscal circumstances call for it.</p> |
| Portability | <ul style="list-style-type: none"> • Employee can take refund of contributions plus accumulated interest (2.5% annually) | <ul style="list-style-type: none"> • Employee contributions and investment return immediately vested; employer contribution and investment returns vested after 5 years (no sliding scale-0% until 5 years when it goes to 100%). • Vested employees can withdraw their account as a lump sum (including employer and employee contributions and earned interest) or leave account with state to access benefits upon retirement. |
| Investment Responsibility | <p>Systems</p> | <p>Systems</p> |