

## MEMORANDUM

To: House Financial Institutions and Pension

From: Alan D. Conroy, Executive Director

Date: February 19, 2020

Subject: House Bill 2619

House Bill 2619 changes the required timing of the KPERS actuarial experience study. Currently, state law requires an actuarial experience study to be performed every three years. HB 2619 changes the required timing to every four years, but allows for KPERS Board of Trustees, as fiduciaries to the plan, to decide to complete the experience study after three years or five years if they believe it is prudent.

Completing an experience study every three years is generally on the shorter end of common practice, but is within the recommended time frame for completing experience studies. Changing to a four year schedule would provide an additional year of data in evaluating the actual experience, thus improving the credibility of the results for certain demographic assumptions.

KPERS just completed an actuarial experience study in January, 2020 for the three year period covering calendar years 2016 through 2018. The next scheduled experience study, covering calendar years 2019 through 2022 will commence in the summer of 2022. Under HB 2619, the presumed next experience study would start in the summer of 2023, although that could be adjusted by the Board at their discretion as described above.

Administratively, this change has very little impact on the System.

### **Actuarial Experience Studies**

An actuarial experience study is a common practice for large public pension plans. The experience study process looks at all assumptions and methods used in the actuarial valuation to ensure that the actuarial assumptions are reasonably anticipating the actual experience of the System and that they continue to be the best expectation of future experience.

The actuarial assumptions can generally be divided into two categories:

1. Economic assumptions
2. Demographic assumptions



Economic assumptions include the inflation rate, investment return assumption, and general wage growth. The economic assumptions affect the calculation of liabilities as well as the annual required contribution rates.

Demographic assumptions include mortality, retirement rates, termination rates and benefit selections. Demographic assumptions are generally selected based heavily on the actual experience of the System and are used to calculate liabilities and required contribution rates.

In addition to setting assumptions, part of the experience study is the selection of actuarial methods. Actuarial methods include the amortization method for the unfunded actuarial liability, the asset valuation method and the actuarial cost method (how the costs of benefits are allocated throughout a member's career). These methods essentially create the funding policy used to calculate the annual required contributions.

### **History of KPERS Experience Studies**

When the System was created in 1961, the enacting provisions included the requirement for a "general investigation" of actuarial assumptions every three years. That triennial schedule has been followed since the first experience study was completed in 1962.

### **Experience Study Timing in Other Pension Plans**

There is no external requirement that determines the timing of actuarial experience studies for public plans. KPERS uses a 3-year timeframe because it is required by State law. However, the period between experience studies varies among public pension plans.

KPERS consulting actuary reports that the common timeframe for experience studies is three to five years. Shorter than three years would likely result in an insufficient amount of data to base the analysis. In addition, it can be difficult to analyze trends due to the short time frame. Longer than five years may create a greater risk of using actuarial assumptions that do not reflect the actual experience of the System and could cause the actuary to miss evidence of recent trends.

Ultimately, changing the timing of the actuarial experience study from three years to four years has very little impact on the administration of the System. An experience study is still required under HB 2619, it is just moved to a different schedule.

In addition, allowing the Board of Trustees the flexibility to complete the experience study every three or five years ensures the experience study will be completed as frequently as needed to ensure the assumptions in the annual actuarial valuation are current, reasonably reflect future expected experience, and meet actuarial standards of practice.

I would be pleased to answer any questions the Committee may have regarding House Bill 2619.