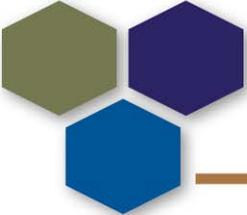


Alternatives For Kentucky Defined Benefit Plans

November 27, 2007

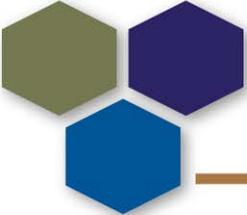


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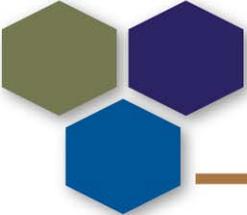
Why No DC Option?

- ◆ GRS considered DC but rejected it for KY
- ◆ Inviolable Contract issue was main reason
- ◆ No immediate cost savings
- ◆ No material investment or administrative expense savings if DC plan is “full featured”
 - ▶ But member typically pays these in DC plan through reduction in their investment earnings



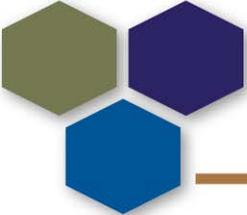
Why No DC Option?

- ◆ DC plan for New Entrants would require closing DB plan to future New Entrants
 - ▶ Active membership in closed DB plan would immediately begin to decline
 - ▶ Benefit payouts would increase rapidly relative to declining payroll & relative to absolute level of contributions
 - ▶ Would require ever-increasing proportion of annual benefit payments to be made from investment income



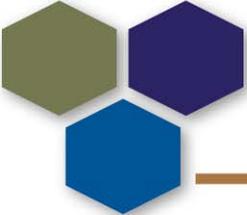
Why No DC Option?

- ◆ DC plan for New Entrants would require closing DB plan to future New Entrants
 - ▶ This in turn would require retirement system to gradually increase its allocation to income-producing fixed-income asset classes
 - ▶ Which in turn would reduce long term return on assets
 - ▶ Which in turn would increase cost of closed plan
 - ▶ And its cost as a % of a declining covered pay



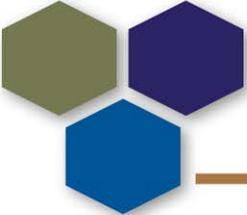
Why No DC Option?

- ◆ Only current plan members who might elect to change to new DC tier would be the younger and/or shorter service ones
 - ▶ Older or longer service members would understand the much greater value of their current DB plan, even after the COLA was gone
 - ▶ But the younger members have the lower DB cost, so the relative cost of the closed DB plan would actually increase



Why No DC Option?

- ◆ Closing DB plan to future (younger) New Entrants would also drive up its relative cost even if its worsening cash flow didn't cause a shift to more fixed income investments
- ◆ GASB # 25 requires that for a closed DB plan, amortization of any unfunded liability must be a level \$ amount, not a level % of pay amount like it is now
 - ▶ Would increase contribution requirement



Why No DC Option?

- ◆ Therefore the restrictions imposed by the Inviolable Contract issue causes a DC option for KY that would create more problems than it would solve