

Public Pension Oversight Board



Research Memorandum No. 519

Legislative Research Commission
Frankfort, Kentucky

December 2015

Public Pension Oversight Board

2015 Report

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Foreword

The 2013 General Assembly passed Senate Bill 2, which established the Public Pension Oversight Board. The purpose of the board is to review, analyze, and provide oversight to the General Assembly on the benefits, administration, investments, funding, laws, administrative regulations, and legislation pertaining to the state-administered retirement systems. Its work resulted in the policy recommendations reflected within this report.

The board co-chairs would like to thank the board members; all those who attended the board meetings; and those who provided research, testimony, and input to the board.

David A. Byerman
Director

Legislative Research Commission
Frankfort, Kentucky
December 31, 2015

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Summary

The 2013 General Assembly passed Senate Bill 2, which established the Public Pension Oversight Board as a statutory committee. The purpose of the board is assist the General Assembly with its review, analysis, and oversight of the administration, benefits, investments, funding, laws, administrative regulations, and legislation pertaining to the state-administered retirement systems. The board's oversight functions were initially limited to the Kentucky Retirement Systems (KRS), which administers the Kentucky Employees Retirement System (KERS), the County Employees Retirement System, and the State Police Retirement System (SPRS). However, legislative changes in 2015 expanded the board's oversight functions to include the Kentucky Teachers' Retirement System (KTRS) and the Judicial Form Retirement System (JFRS) which administers the Legislators' Retirement Plan and the Judicial Retirement Plan.

The oversight board met 10 times in 2015, and the material covered included overviews of benefits and funding; two semi-annual investment reviews required by statute; legislative updates; a review of the KRS personnel and compensation system; a review of the KRS Asset Liability Modeling study; a review of anticipated budget needs for the state-administered retirement systems; a review of KERS nonhazardous pension fund cash flow issues and potential funding options; a review of the actuarial auditing process and the results of actuarial audits conducted for KRS and KTRS in 2015; testimony on recommendations from employee groups, retiree groups, and other interested groups; testimony from the KTRS funding work group actuary; and the results and data from the 2015 actuarial valuation and financial audits. A summary of the benefits, funding, investments, and testimony before the Public Pension Oversight Board is provided in Chapters 1 to 5 of this publication.

At the December 17, 2015, meeting, the board adopted legislative recommendations for the 2016 Regular Session of the General Assembly. The board also adopted several administrative recommendations for the state-administered retirement systems. The recommendations are provided in detail in Chapter 6 of this publication.

Legislative recommendations from the board included the following:

- Supporting measures to provide additional funding to improve the financial health of state-administered systems, specifically the KERS, SPRS, and KTRS pension funds
- Evaluating the KTRS Funding Work Group findings and recommendations and adopting a financially sound approach to address issues facing the KTRS pension fund
- Enacting a budget that includes the KERS and SPRS employer contribution rates to the pension fund at the 6.75 percent assumed rate of return established by the KRS board of trustees
- Enacting legislation to make KRS and KTRS subject to state procurement laws under Kentucky Revised Statutes Chapters 45 and 45A
- Enacting legislation to require Senate confirmation of KRS and KTRS directors and appointed members of the KRS and KTRS board of trustees

- Enacting legislation to specify the required investment expertise of appointed members of the KRS board of trustees
- Enacting legislation to increase membership on the KTRS board of trustees to include gubernatorial appointees, with some of the appointees having investment experience
- Enacting the KRS, KTRS, and JFRS housekeeping bills
- Enacting legislation to address KRS pension “spiking” issues
- Enacting legislation to require all state-administered plans to establish placement agent disclosure policies
- Requiring, and providing funding for, a performance audit of KRS
- Enacting legislation to standardize, modify, and expand the actuarial and financial reporting requirements of the state-administered retirement systems
- Enacting legislation to require that an actuarial audit be completed on the state-administered retirement systems at least once every 10 years and to require a review of the biennial budgeting needs of the systems, with both to be completed by an actuary retained by the Public Pension Oversight Board
- Enacting legislation to address paid volunteer issues within KRS

The oversight board also approved the following administrative recommendations, with an expectation that legislation could be introduced during the 2016 Regular Session:

- KRS should study agency participation issues, including the use of contract employees, and provide a list of agencies that are attempting to avoid participation. Based on the findings, legislation to address participation and loss of contributions should be enacted.
- JFRS should develop a website to provide access to information and transparency. Legislation to require specific information to be posted to the website, similar to current statutory requirements for the KRS/KTRS websites, should be enacted.

Administrative recommendations for the state-administered retirement systems included the following:

- KRS, KTRS, and JFRS should report all investment returns on a net of fee basis.
- The KRS board of trustees should provide three options for addressing the current KERS nonhazardous pension fund cash flow issue by January 25, 2016.
- KRS, KTRS, and JFRS should study and report on the investment fees paid directly and indirectly, making a consensus recommendation on a standard for reporting by January 25, 2016.

Chapter 1

Overview Of Kentucky Retirement Systems Administration And Benefits

Composition Of Kentucky Retirement Systems

The Public Pension Oversight Board has oversight responsibilities for the three systems administered by Kentucky Retirement Systems (KRS). These systems include the Kentucky Employees Retirement System (KERS), the County Employees Retirement System (CERS), and the State Police Retirement System (SPRS).

Kentucky Employees Retirement System

KERS was established in 1956, and its membership includes employees of state government; nonteaching staff at regional state-supported universities such as Eastern Kentucky University; and employees of local health departments, regional mental health centers, and other quasi-state agencies. KERS includes both nonhazardous and hazardous-duty benefits and contribution structures. It is governed by Kentucky Revised Statutes 61.510 to 61.705 and Title 105 of the Kentucky Administrative Regulations.

County Employees Retirement System

CERS was established in 1958, and its membership includes employees of city and county governments, police and firefighters, nonteaching staff of local boards of education, circuit clerks, local library employees, and other local government agency employees. CERS includes both nonhazardous and hazardous-duty benefits and contribution structures. It is governed by Kentucky Revised Statutes 78.510 to 78.852 and Title 105 of the Kentucky Administrative Regulations.

State Police Retirement System

SPRS was established in 1958, and its membership includes all uniformed state police officers. SPRS is governed by Kentucky Revised Statutes 16.505 to 16.652 and Title 105 of the Kentucky Administrative Regulations.

These retirement systems, along with Social Security benefits, if applicable, and other sources of retirement income, such as other retirement accounts and postretirement employment, serve as the basis for providing income to state and local public employees during their retirement years.

Kentucky Retirement Systems Administration

As provided by statute, a thirteen-member board of trustees oversees the administration of KRS, with 6 trustees being elected by the membership, 6 being appointed by the governor, and 1 being the secretary of the Personnel Cabinet. The six elected trustees are two trustees elected by the

KERS membership, three elected by the CERS membership, and one elected by the SPRS membership. Of the six trustees appointed by the governor, two must have at least 10 years of investment experience as defined by statute, one must be knowledgeable about the effects of pensions on local governments, and three are selected from lists submitted by the Kentucky League of Cities, the Kentucky Association of Counties, and the Kentucky School Boards Association. Elected and appointed trustees serve 4-year terms and may serve no more than three consecutive terms.

The board annually elects a chair and vice chair and appoints members to various committees of the board, including the investment committee, retiree health plan committee, disability appeals/administrative appeals committee, legislative and budget committee, human resources committee, and audit committee. The current composition of the board is provided in Table 1.1. The board appoints an executive director to oversee day-to-day operations and to staff the needs of the systems. The current executive director is Bill Thielen, and as of June 30, 2015, KRS consisted of 258 employees.

Table 1.1
Members Of The Kentucky Retirement Systems Board Of Trustees
December 2015

Member Name	Appointment/Election
Thomas K. Elliott, chair	Governor appointee
Dr. Daniel Bauer, vice chair	Governor appointee
Mike Cherry	Governor appointee
J.T. Fulkerson	Governor appointee, KLC
Joseph Hardesty	Governor appointee, KSBA
Randy K. Stevens	Governor appointee, KACo
Vince Lang	KERS elected trustee
Mary Helen Peter	KERS elected trustee
Edwin Davis	CERS elected trustee
David Rich	CERS elected trustee
William Summers	CERS elected trustee
Keith Peercy	SPRS elected trustee
Thomas Stephens	Personnel Cabinet secretary

Note: KLC is the Kentucky League of Cities, KSBA is the Kentucky School Boards Association, and KACo is the Kentucky Association of Counties.

Source: Kentucky Retirement Systems.

Kentucky Retirement Systems Employer And Employee Membership

As of June 30, 2015, 354 agencies participated in KERS and 1,136 agencies participated in CERS. For both systems, state statute defines the types of agencies that are eligible for participation, with final approval in the process being granted or denied by the KRS board. In the case of KERS, an executive order declaring the agency eligible for participation is required, while CERS agencies must meet statutory definitions in order to participate (the board determines whether the agency meets the definition). Once an agency begins participating, the

agency is not allowed to discontinue participation, unless the agency is eligible to voluntarily discontinue participation or is required to discontinue participation by the systems. If an agency discontinues participation, it must pay all actuarial costs for leaving the system.

All regular full-time employees hired after the agency’s participation date are required to contribute to the systems. For KERS and CERS, the term “regular full-time” means an employee who averages 100 hours of work per month over a calendar or fiscal year, except that a school board employee is required to average 80 hours per month over the months represented by the days worked.¹ All regular full-time state police officers participate in SPRS. The number of employees (often referred to as active members), former employees with accounts but not retired (often referred to as inactive members), and retired members by system is provided in Table 1.2.

Table 1.2
Number Of Active, Inactive, And Retired Members, By System, June 30, 2015

System	Active Members	Inactive Members	Retired Members	Total
KERS nonhazardous	39,289	42,479	38,827	120,595
KERS hazardous	3,932	3,761	2,575	10,268
CERS nonhazardous	82,969	72,965	48,515	204,449
CERS hazardous	9,188	2,142	6,389	17,719
SPRS	940	257	1,324	2,521
Total	136,318	121,604	97,630	355,552

Source: June 30, 2015, KRS Annual Report.

KRS Employee Participation Requirements

Employees earn service credit for months and days worked in regular full-time positions. With the exception of school board employees, all employees earn 1 month of service credit in the systems for every month worked in a regular full-time position. School board employees working in regular full-time positions earn service credit based on their days worked, with 180 days worked in a regular full-time position equaling 12 months of service credit (less service credit is given for days worked fewer than 180).

Within KERS and CERS, there are both nonhazardous and hazardous-duty benefit and contribution structures. For a job to be classified as hazardous duty, it must meet the definition and requirements established by state law, the employing agency must request hazardous-duty coverage for the position and agree to pay the higher employer contribution rates, and the KRS Board of Trustees must review and adopt the position as hazardous. In general, hazardous-duty positions in KERS and CERS primarily cover police, fire, emergency medical services, and corrections employees.

¹ Certain exceptions apply to the regular full-time requirement such as seasonal, temporary, and interim positions that are not subject to the participation requirements. However, statute limits the duration and frequency of use of these positions by agencies.

Retirement Eligibility

Employees must meet certain age or service credit requirements before they can retire and begin receiving benefits. In KRS, the retirement eligibility requirements vary based on type of coverage (nonhazardous or hazardous duty) and the date the employee first began participating in the systems. Table 1.3 shows eligibility requirements for nonhazardous employees, and Table 1.4 shows eligibility requirements for hazardous-duty employees. Both tables show the requirements to earn an unreduced benefit (no penalties) and the requirements for a reduced benefit (penalties are actuarially determined and based on how many years the employee is short of reaching an unreduced benefit).

Table 1.3
**Retirement Eligibility Requirements For Kentucky Employees Retirement System/
County Employees Retirement System Nonhazardous Members**

Participation Date	Unreduced Benefit	Reduced Benefit
Prior to Sept. 1, 2008	Any age with at least 27 years of service, or age 65 with at least 4 years of service	Age 55 with at least 5 years of service, or any age with at least 25 years of service
Participating on or after Sept. 1, 2008 but prior to Jan. 1, 2014	Rule of 87 (age + service = 87) and at least 57 years of age, or age 65 with at least 5 years of service	Age 60 with at least 10 years of service
Participating on or after January 1, 2014	Rule of 87 (age + service = 87) and at least 57 years of age, or age 65 with at least 5 years of service	No reduced benefit provisions

Source: Kentucky Retirement Systems.

Table 1.4
**Retirement Eligibility Requirements For Kentucky Employees Retirement System/
County Employees Retirement System Hazardous-Duty
And State Police Retirement System Members**

Participation Date	Unreduced Benefit	Reduced Benefit
Prior to Sept. 1, 2008	Any age with at least 20 years of service, or age 55 with at least 5 years of service	Age 50 with at least 15 years of service
Participating on or after Sept., 1, 2008 but prior to Jan. 1, 2014	Any age with at least 25 years of service, or age 60 with at least 5 years of service	Age 50 with at least 15 years of service
Participating on or after January 1, 2014	Any age with at least 25 years of service, or age 60 with at least 5 years of service	No reduced benefit provisions

Source: Kentucky Retirement Systems.

System Benefits

Each system is designed to provide three types of benefits: a monthly retirement benefit for life, disability/death benefits, and health insurance benefits after retirement. Benefits vary based on type of coverage (nonhazardous or hazardous duty) and the date the employee first began participating in the system. Information on each of these benefits is provided on the following pages.

Monthly Retirement Benefits For Members Participating Prior To January 1, 2014

Benefits for members who began participating in the systems prior to January 1, 2014, are based on the following formula established by statute:

$$\text{Final Compensation} \times \text{Benefit Factor} \times \text{Years of Service Credit} = \text{Annual Benefit}$$

Retirement benefit calculations for members under this formula are provided in Tables 1.5 to 1.8.

Table 1.5
**Retirement Benefit Calculation For Kentucky Employees Retirement System/
County Employees Retirement System Nonhazardous Employees
Participating Prior To September 1, 2008**

Final Compensation	Benefit Factor	Service Credit
Average of highest 5 fiscal years of salary	KERS: 1.97 percent, except that the value is 2 percent for employees with 13 months of service between January 1998 and January 1999 CERS: 2.2 percent if participating prior to August 1, 2004; 2 percent if participating on or after August 1, 2004, but prior to September 1, 2008	Service earned for time worked in a regular full-time position, purchased service, and service credit for accumulated sick leave at retirement

Source: Kentucky Retirement Systems.

Table 1.6
**Retirement Benefit Calculation For Kentucky Employees Retirement System/
County Employees Retirement System Nonhazardous Employees
Participating On Or After September 1, 2008, But Prior To January 1, 2014**

Final Compensation	Benefit Factor		Service Credit
	Years Of Service	Factor	
Average of 5 complete fiscal years of salary immediately preceding retirement	10 or less	1.10%	Service earned for time worked in regular full-time position, purchased service, and up to 12 months of service credit for accumulated sick leave at retirement
	More than 10, but no more than 20	1.30	
	More than 20, but no more than 26	1.50	
	More than 26, but no more than 30	1.75	
	Additional years above 30	2.00*	

*The 2.00 benefit factor applies only to service above 30 years of service credit.

Source: Kentucky Retirement Systems.

Table 1.7
**Retirement Benefit Calculation For State Police Retirement System
And Kentucky Employees Retirement System/County Employees Retirement System
Hazardous-Duty Employees Participating Prior To September 1, 2008**

Final Compensation	Benefit Factor	Service Credit
Average of highest 3 years of salary	<ul style="list-style-type: none"> • KERS: 2.49% • CERS: 2.50% • SPRS: 2.50% 	Service earned for time worked in regular full-time position, purchased service, and service credit for accumulated sick leave at retirement

Source: Kentucky Retirement Systems.

Table 1.8
**Retirement Benefit Calculation For State Police Retirement System
And Kentucky Employees Retirement System/County Employees Retirement System
Hazardous-Duty Employees Participating On Or After September 1, 2008,
But Prior To January 1, 2014**

Final Compensation	Benefit Factor		Service Credit
	Years Of Service	Factor	
Average of highest 3 complete fiscal years of salary	10 or less	1.30%	Service earned for time worked in regular full-time position, purchased service, and up to 12 months of service credit for accumulated sick leave at retirement
	More than 10, but no more than 20	1.50	
	More than 20, but less than 25	2.25	
	25 or more years	2.50	

Source: Kentucky Retirement Systems.

The annual benefit resulting from the calculations in Tables 1.5 to 1.8 is paid to the retiree in monthly installments. At retirement, a retiree may choose to take a reduced benefit to provide

a monthly benefit to a beneficiary upon death, either for a period certain or for the life of the beneficiary.

Retirement Benefit Calculation For Members Participating On Or After January 1, 2014

Members who begin participating in the systems on or after January 1, 2014, are provided retirement benefits through a cash balance plan that provides benefits based on an account balance, rather than on a formula. This change was enacted in Senate Bill 2 during the 2013 Regular Session.

The cash balance plan is not a defined contribution plan but rather a type of defined benefit plan that operates as another benefit tier within the retirement systems. While it is a type of defined benefit plan, it does have several characteristics of a defined contribution plan with individual employee accounts, benefits based on the employee's account balance at retirement (employee and employer contributions and investment returns), and some variability in benefits due to investment returns. It differs from a defined contribution plan in that a minimum level of investment return is guaranteed on the employee accounts, the retirement systems rather than the employee manage investments, and employees can annuitize their account balance upon retirement (to receive it in the form of a monthly benefit).

In the cash balance plan, employees contribute the same amount as newer employees who began participating prior to January 1, 2014, except that the 5 percent of pay (8 percent hazardous-duty) they contribute to fund pension benefits will go into their individual accounts, along with an employer pay credit of 4 percent of their salary (7.5 percent hazardous-duty). Employees receive a guaranteed return of 4 percent annually and 75 percent of the excess returns above 4 percent (the excess returns are calculated on a 5-year smoothed return). The combined guaranteed returns and excess return resulted in an interest credit for FY 2015 of 7.77 percent to 7.84 percent, based on individual system investment return data.

Employees in the cash balance plan are vested for employer contributions and investment returns on those employer contributions after 5 years. Upon reaching retirement eligibility, employees can take their account balance in a lump sum or have it annuitized into one of the monthly benefit payment options currently available through the retirement systems for other members.

Retiree Health Insurance Benefits

The systems also provide access to group rates and medical insurance for retired members, spouses, and dependents. Coverage for retirees not eligible for Medicare is provided through the Kentucky Employees' Health Plan, the same health plan provided to state and school board employees. Coverage for Medicare-eligible retirees is provided through a plan administered or contracted through KRS, which then coordinates with Medicare for delivery of health benefits.

As provided by statute, the systems also subsidize medical coverage for the retiree and in some cases for the dependents of the retiree, most often if the member retires with hazardous-duty service credit. In general, employees participating prior to July 1, 2003, receive a percentage of

the premium paid upon retirement based on their service credit, while employees who begin participating after that date receive a set dollar amount per month for each year of service credit. Tables 1.9 and 1.10 provide details about the benefits for nonhazardous and hazardous-duty members based on their participation dates.

In 2016, the maximum retiree health subsidy for a nonhazardous retiree with 20 years of service who began participating prior to July 1, 2003, is \$721.14 per month in the Kentucky Employees' Health Plan and \$244.25 per month for the Medicare-eligible plan. For a hazardous-duty retiree on a family plan in the Kentucky Employees' Health Plan, the maximum subsidy is \$1,738.40 per month.

Table 1.9
Retiree Health Insurance Premium Payments
**For Kentucky Employees Retirement System/
County Employees Retirement System Nonhazardous Members**

Participation Date In Systems	Eligibility Requirements	Percent Or Dollars Of Premium Paid For Retiree	
Before July 1, 2003	Must be drawing monthly benefit	Years Of Service	% Of Premium
		At Retirement	Paid For Retiree
		Less than 4	0%
		4, but less than 10	25
		10, but less than 15	50
		15, but less than 20	75
		20 or more	100
On or after July 1, 2003, but prior to September 1, 2008	Must be drawing monthly benefit and must have at least 10 years of service	\$10 per month paid toward the health premium for each year of earned service. Amount is adjusted by 1.5% annually from date of participation.	
On or after September 1, 2008	Must be drawing monthly benefit and must have at least 15 years of service	\$10 per month paid toward the health premium for each year of earned service. Amount is adjusted by 1.5% annually from date of participation.	

Source: Kentucky Retirement Systems.

Table 1.10
Retiree Health Insurance Premium Payments For State Police Retirement System
And Kentucky Employees Retirement System/County Employees Retirement System
Hazardous-Duty Members

Participation Date In Systems	Eligibility Requirements	Percent Or Dollars Of Premium Paid For Retiree And Dependents Of Retiree		
Before July 1, 2003	Must be drawing monthly benefit	Years Of Service At Retirement	% Of Premium Paid For Retiree	% Of Premium Paid For Dependents
		Less than 4	0%	0%
		4, but less than 10	25	25
		10, but less than 15	50	50
		15, but less than 20	75	75
		20 or more	100	100
On or after July 1, 2003, but prior to September 1, 2008	Must be drawing monthly benefit and must have at least 10 years of service	<ul style="list-style-type: none"> • \$15 per month paid toward the health premium for each year of earned service • Upon death of retiree, surviving spouse receives \$10 per month paid toward health premium for each year of earned hazardous-duty service credit. • Amounts are adjusted by 1.5% annually from date of participation 		
On or after September 1, 2008	Must be drawing monthly benefit and must have at least 15 years of service	<ul style="list-style-type: none"> • \$15 per month paid toward health premium for each year of earned service • Upon death of retiree, surviving spouse receives \$10 per month paid toward the health premium for each year of earned hazardous-duty service credit. • Amounts are adjusted by 1.5% annually from date of participation. 		

Note: Percent/dollar amount paid on behalf of a hazardous-duty retiree's spouse/dependents is based solely on retiree's hazardous service at retirement.

Source: Kentucky Retirement Systems.

Disability And Death Benefits

Like most defined benefit plans, the systems provide benefits for those employees who become disabled or who die prior to retirement, including in the line of duty disability and death benefits. After retirement, the benefits left to the retiree's beneficiary vary based on the payment option selected at retirement. For example, retiring employees may select to provide a lifetime benefit to a surviving spouse upon his or her death by taking an actuarially reduced monthly benefit. In addition, the systems provide a \$5,000 lump-sum death benefit for members who retire with at least 4 years of service.

Cost Of Living Adjustments On Monthly Retirement Benefits

After the passage of Senate Bill 2 in the 2013 Regular Session of the General Assembly, members of the systems will no longer receive automatic annual increases of 1.5 percent on their monthly retirement benefits. Language in SB 2 did provide that a 1.5 percent cost of living adjustment (COLA) could be granted if an individual system is 100 percent funded, and subsequent legislation authorizes the use of surplus funds to provide the 1.5 percent COLA, or if the General Assembly appropriates or directs payment of funds to prefund the COLA in the year it is provided.

Service Purchases And Sick Leave Service Credit

Many employees participating in the systems can choose to purchase service credit for other public employment or service as established by law, such as military service, federal service, university service, and nonqualified service, provided certain requirements established by state statute are met. In addition, employees of KERS/SPRS agencies and many CERS agencies receive additional service credit for accumulated sick leave at retirement. The costs for sick leave service credit are paid by the last participating employer.

Legislative changes in 2002, 2004, 2008, and 2013 have limited the use and impact on retirement eligibility of service purchases and sick leave service credit, particularly for new participants in the systems. The most recent changes in 2013 via SB 2 eliminated service purchases and sick leave service credit for new participants entering the system on or after January 1, 2014, with the exception of omitted service and recontributions of refunds.

Reemployment After Retirement

State statute places restrictions on retirees returning to work after retirement with a participating KRS employer. As a result of House Bill 1, passed during the 2008 Special Session, the following restrictions and requirements are applicable to employees who retire and return to work on or after September 1, 2008:

Required Break In Employment. The employee must have a 3-month break in employment before returning to any position with an employer participating in the systems, except that hazardous-duty KERS or CERS and SPRS retirees who return to work in a full-time hazardous-duty position are required to observe only a 1-month break in employment. If the break is not observed, the employee's retirement is voided and all benefit payments issued in error shall be repaid to the systems. Both the employee and employer must certify that no prearranged agreement for the employee to return to work existed prior to the employee's retirement. For elected officials, a reelection to the same office is considered a prearranged agreement if the official retires following the election but prior to taking office.

How It Works For The Employee. Provided the break is observed, the employee can return to work and draw a pension but will not contribute to the systems or earn a second pension.

How It Works For The Employer. If the employee has returned to work in a position that would have qualified for participation in the systems, the employer is required to pay contributions to the systems and to reimburse the systems for the cost of health insurance premiums paid by the systems for the retiree (not to exceed the cost of the single premium). If the employee takes health coverage through the employer and waives coverage with the systems, then no reimbursement is required. However, in 2014 and 2015 the General Assembly passed exemptions to the required employer contributions and health reimbursements for qualifying deputy sheriffs and for the required health reimbursements for classified school board employees who work less than 80 days per year.

Reciprocity

Members who have service in more than one retirement plan administered by the Commonwealth of Kentucky can combine service in the plans to determine eligibility for retirement and final compensation (years of highest salary). Each system will pay a benefit based on the amount of service in that system.

Taxation Of Benefits

Monthly benefits from all systems are subject to federal income tax. If a member made contributions with after-tax dollars (usually service purchases), then a portion of the monthly benefit at retirement will not be subject to federal income tax.

All benefits attributable to service earned on or before December 31, 1997, are exempt from Kentucky income tax. The portion of the member's benefits earned on January 1, 1998, and after is subject to Kentucky income tax. However, an annual pension exclusion of \$41,110 applies to this portion and to other retirement income sources.

2015 Legislative Changes

Four measures that directly affected Kentucky Retirement Systems passed during the 2015 Regular Session: House Bills 62, 163, and 181, and Senate Bill 62.

HB 62 allows certain agencies (which include mental health centers and some quasi-state agencies in KERS, and non-stock non-profit agencies in KERS and CERS) to voluntarily discontinue participation in KERS or CERS, provided they pay the actuarial costs for no longer participating. The bill also provides a consistent process in both KERS and CERS that allows the KRS board to require an agency to discontinue participation (and pay the actuarial costs of discontinuing participation) if it is determined to no longer be eligible to participate in a governmental plan or if the agency fails to follow the requirements established for participating agencies under state law.

HB 163 exempts school districts from paying retiree health reimbursements for retirees reemployed for less than 80 days per year.

House Bill 364, passed in 2014, allows local sheriff's offices to establish a program to reemploy KERS and CERS retirees as deputy sheriffs, provided they meet certain requirements, and exempts the sheriff's offices from paying employer contributions and health reimbursements to KRS for retirees reemployed under the program. In 2015, HB 181 was passed to extend these provisions to SPRS retirees reemployed under the program.

Senate Bill 62 provides that an elected official who is reelected to a new term of office in the same position, and who retires following the election but prior to taking the new term of office, is deemed to have a prearranged agreement and shall have his or her retirement voided.

Chapter 2

Overview Of Kentucky Teachers' Retirement System Administration And Benefits

Composition Of Kentucky Teachers' Retirement System

The Public Pension Oversight Board has oversight responsibilities for the Kentucky Teachers' Retirement Systems (KTRS). KTRS is the oldest statewide pension fund in Kentucky, established by the 1938 General Assembly. KTRS administers pension and retiree health benefits to certified employees of local school districts, and employees of higher education agencies, educational cooperatives, and other public educational agencies. It is governed by Kentucky Revised Statutes 161.220 to 161.716 and Title 102 of the Kentucky Administrative Regulations.

KTRS includes both university and nonuniversity benefit and contribution rate structures, with the majority of nonuniversity membership coming from certified employees of local school districts. University employees include teaching and administrative staff of regional state-supported universities and the community college employees of the Kentucky Community and Technical College System (KCTCS). Nonuniversity employees do not participate in or earn benefits from Social Security while working in a KTRS-eligible position. University employees do participate and earn benefits in Social Security while working in a KTRS eligible position.

KTRS (along with other sources of retirement income such as personal retirement accounts, postretirement employment, or Social Security, if applicable) serves as the basis for providing income to KTRS employees during their retirement years.

Kentucky Teachers' Retirement System Administration

As provided by statute, a nine-member board of trustees oversees the administration of KTRS, with seven trustees being elected by the membership, one being the state treasurer, and one being the commissioner of education. The seven elected trustees include four active members, one retired member, and two "lay trustees" who are outside of the teaching profession. Elected trustees serve 4-year terms and may serve no more than three consecutive terms.

The board annually elects a chair and vice chair and appoints members to various committees of the board, including the investment committee, insurance committee, governance and audit committee, legislative committee, personnel committee, and special committee on benefits and funding. The current composition of the board is provided in Table 2.1. The board appoints an executive secretary to oversee day-to-day operations and to staff the needs of the system. The current executive secretary is Gary Harbin, and as of December 2015, KTRS consisted of 94 full-time employees.

Table 2.1
Members Of The Kentucky Teachers' Retirement System Board Of Trustees
December 2015

Member	Appointment/Election
Arthur Green, chair	Elected retired teacher
Jay Morgan, vice chair	Elected active teacher
Quin Sutton	Elected active teacher
Ali Wright	Elected active teacher
Mary Adams	Elected active teacher
Hollis Gritton	Elected lay trustee
Ronald Sanders	Elected lay trustee
Stephen Pruitt	Commission of education
Todd Hollenbach	State treasurer

Source: Kentucky Teachers' Retirement System.

Kentucky Teachers' Retirement System Employer And Employee Membership

As of June 30, 2015, 208 employers participated in KTRS, including 173 local school districts, 15 state agencies, 6 higher education agencies that include regional state-supported universities and KCTCS, 8 educational cooperatives, and 6 other educational organizations. State statute lists the agencies that are required to participate in KTRS.

The number of employees (often referred to as active members), former employees with accounts but not retired (often referred to as inactive members), and retired members of KTRS is provided in Table 2.2. School districts represent more than 92% of the active members participating in KTRS.

Table 2.2
Number Of Active, Inactive, And Retired Members of KTRS
June 30, 2015

	Active Members	Inactive Members	Retired Members	Total
KTRS	72,246	27,771	49,822	149,839

Source: June 30, 2015, KTRS Actuarial Valuation.

KTRS Employee Participation Requirements

For nonuniversity employees, participation is mandatory for full-time positions with a KTRS employer that require certification or graduation from a 4-year college. *Full time* is defined as employment in a position that requires services on a continuing basis equal to at least seven-tenths of the normal full-time contract for any fiscal year. Employees of nonuniversity employers providing part-time or substitute teaching services are also required to participate in KTRS.

For university employees, participation is optional for full-time positions with a KTRS employer that require certification or graduation from a 4-year college.

Retirement Eligibility

Employees must meet certain age or service credit requirements before they can retire and begin receiving benefits. In KTRS, the retirement eligibility requirements vary based on the date the employee first began participating in the system. Table 2.3 shows eligibility requirements for KTRS members to earn an unreduced benefit (no penalties) and the requirements for a reduced benefit (penalties are based on how many years the employee is short of reaching an unreduced benefit).

Table 2.3
Retirement Eligibility Requirements For Kentucky Teachers' Retirement System

Participation Date	Unreduced Benefit	Reduced Benefit
Participating prior to Sept. 1, 2008	Any age with at least 27 years of service, or age 60 with at least 5 years of service	Age 55 with at least 5 years of service; reduction set by statute of 5% per year
Participating on or after Sept. 1, 2008	Any age with at least 27 years of service, or age 60 with at least 5 years of service	Age 55 with at least 10 years of service; reduction set by statute of 6% per year

Source: Kentucky Teachers' Retirement System.

System Benefits

KTRS is designed to provide three types of benefits: a monthly retirement benefit for life, disability/death benefits, and health insurance benefits after retirement. Benefits vary based on the date the employee first began participating in the system. Information on each of these benefits is provided on the following pages.

Monthly Retirement Benefits For Members

Pension benefits for system members provide a percentage of the employee's salary at retirement for each year of service credit. The formula for calculating the benefit is as follows:

$$\text{Final Average Salary} \times \text{Benefit Factor} \times \text{Years of Service Credit} = \text{Annual Benefit}$$

Retirement benefit calculations for members under this formula are provided in Tables 2.4 and 2.5.

Table 2.4
Retirement Benefit Calculation
For Kentucky Teachers' Retirement System Nonuniversity Employees

Final Average Salary	Benefit Factor	Service Credit
<ul style="list-style-type: none"> • Average of highest 5 years of salary, or • Average of highest 3 years of salary if member is age 55 or more with at least 27 years of service credit 	Participation date prior to July 1, 2002: <ul style="list-style-type: none"> • 2.0% for service credit prior to July 1, 1983 • 2.5% for service credit on or after July 1, 1983 • 3.0% for service credit in excess of 30 years* 	Earned service; purchased service
	Participation date on or after July 1, 2002, but prior to July 1, 2008: <ul style="list-style-type: none"> • 2.0% if service credit is less than 10 years • 2.5% if service credit is more than 10 years • 3.0% for service credit in excess of 30 years* 	
	Participation date on or after July 1, 2008: <ul style="list-style-type: none"> • 1.70% if service credit is 10 years or less • 2.00 % if service credit is more than 10 but not more than 20 years • 2.30% if service credit is more than 20 but not more than 26 years • 2.50% if service credit is more than 26 but not more than 30 years • 3.00% for service credit in excess of 30 years* 	

*The 3.00 benefit factor applies only to service above 30 years of service credit.
Source: Kentucky Teachers' Retirement System.

Table 2.5
Retirement Benefit Calculation For Kentucky Teachers' Retirement System University Employees

Final Average Salary	Benefit Factor	Service Credit
<ul style="list-style-type: none"> • Average of highest 5 years of salary, or • Average of highest 3 years of salary if member is age 55 or more with at least 27 years of Kentucky service credit 	Participation date prior to July 1, 2008: <ul style="list-style-type: none"> • 2.0% 	Earned service; purchased service; sick leave service credit
	Participation date on or after July 1, 2008: <ul style="list-style-type: none"> • 1.50% if service credit is 10 years or less • 1.70% if service credit is more than 10 but not more 20 years • 1.85% if service credit is more than 20 but not more than 26 years • 2.0% if service credit is 27 or more years 	

Source: Kentucky Teachers' Retirement System.

The annual benefit resulting from the calculations in Tables 2.4 and 2.5 is paid to the retiree in monthly installments. At retirement, a retiree may choose to take a reduced benefit to provide a monthly benefit to a beneficiary upon death, either for a period certain or for the life of the beneficiary.

Retiree Health Insurance Benefits

KTRS also provides access to group rates and medical insurance for retired members, spouses, and dependents. Coverage for retirees not eligible for Medicare is provided through the Kentucky Employees' Health Plan, the same health plan provided to state and school board employees. Coverage for Medicare-eligible retirees is provided through a plan administered or contracted through KTRS, which then coordinates with Medicare for delivery of health benefits.

As provided by statute, the system also subsidizes medical coverage for the retiree. However, the level of subsidy is determined by the KTRS board of trustees based on the availability of funding.

Table 2.6 details the percentage of retiree health subsidy provided for KTRS members based on years of service. In 2016, the maximum retiree health subsidy on a single plan is \$654.12 per month in the Kentucky Employees' Health Plan and \$260 per month for the Medicare-eligible plan. In addition, KTRS has elected under authorization provided in the biennial budget to extend an additional subsidy for retired members who cover their dependents in the Kentucky Employees' Health Plan.

Table 2.6
Percent Of Retiree Health Insurance Subsidy Paid
For Kentucky Teachers' Retirement System Members

Years Of Service	Retired And Age 65 By 1/1/2005	Participating Prior To 7/1/2002	Participating On Or After 7/1/2002 But Prior To 7/1/2008	Participating On or After 7/1/2008
Less than 5	0%	0%	0%	0%
5 but less than 10	70	25	10	0
10 but less than 15	80	50	25	0
15 but less than 20	90	75	45	45
20 but less than 25	100	100	65	65
25 but less than 26	100	100	90	90
26 but less than 27	100	100	95	95
27 or more	100	100	100	100

Source: Kentucky Teachers' Retirement System.

House Bill 540, which was passed during the 2010 Regular Session to address retiree health funding issues, increased employee contributions, employer contributions, and state appropriations. In addition, retirees not eligible for Medicare were also required to pay the equivalent of the Medicare Part B premium toward their costs of coverage in the Kentucky Employees' Health Plan, in addition to any other costs required by the plan.

Disability And Death Benefits

Like most defined benefit plans, the system provides benefits for those employees who become disabled or who die prior to retirement, including in the line of duty disability and death benefits as well as minimum benefits payable to the surviving spouse and dependents. After retirement, the benefits left to the retiree's beneficiary vary based on the payment option selected at retirement. For example, retiring employees may select to provide a lifetime benefit to a surviving spouse upon the employee's death by taking an actuarially reduced monthly benefit. In addition, the system provides a \$5,000 life insurance benefit for members who retire under service or disability retirement provisions. A \$2,000 life insurance benefit is provided for active members prior to retirement.

Cost Of Living Adjustments On Monthly Retirement Benefits

A 1.5 percent annual automatic cost of living adjustment is provided each July to retirees who have been retired at least 12 months, with a pro rata increase provided to retirees who have been retired less than 12 months. In the past, legislative action has created additional ad hoc COLAs with the last ad hoc COLA occurring in 2007, which provided an additional 0.6 percent increase in monthly benefits. Costs for prior ad hoc cost of living adjustments are being financed over time with direct appropriations to KTRS.

Service Purchases And Sick Leave

Employees participating in KTRS can choose to purchase service credit for other public employment or service as established by law (such as military service, federal Head Start service, out of state service, and nonqualified service) provided certain requirements established by state statute are met.

School districts may choose to compensate retiring employees for up to 30 percent of their accumulated sick leave, which is then included in the member's final average salary, or the districts may choose to convert accumulated sick leave to service credit for the employee. Currently, all school districts choose to compensate for accumulated sick leave at retirement. All other employers may choose to convert accumulated sick leave to service credit for their retiring employees. Retirement costs for the inclusion of school districts' payments for sick leave are primarily financed over time with direct state appropriations, and costs to convert sick leave to service credit by other employers are paid by the individual employer.

Reemployment After Retirement

State statute places restrictions on retirees returning to work after retirement with a participating employer of KTRS, and the restrictions are different for regional state-supported universities and KCTCS and all other employers.

Except in the case of reemployment with regional state-supported universities and KCTCS, employees who wish to return to work may do so under the following options:

- **Pension Waiver.** Retirees can waive their pension and return to work. During the period of reemployment, additional service and salary is earned and their benefit is recomputed upon subsequent retirement.
- **Part-Time Program.** Retirees can return to work part time after 3 months, retain their pension, and contribute to a second account (part time is no more than 69 percent of the average contract period). If their salary exceeds the daily wage threshold (65 percent of their last annual compensation if they retired with less than 30 years, and 75 percent if they retired with 30 or more years), then their pension benefit is decreased by a corresponding amount.
- **Full-Time Program.** Retirees can return to work full time, retain their pension, and contribute to a second account. The required break in employment is 3 months if returning to work for a different school district or 12 months if returning to work in the same school district. If their salary exceeds the daily wage threshold (65 percent of their last annual compensation if they retired with less than 30 years, and 75 percent if they retired with 30 or more years), then their pension benefit is decreased by a corresponding amount. The full-time program is limited to 3 percent of the agency's employees participating in the system.
- **Critical Shortage Program.** This program is the same as the full time program except that there are no salary limitations and it is limited to 1 percent of the agency's employees participating in the system.

For reemployment with a regional state-supported university and KCTCS, employees who wish to return to work may do so under the following options:

- **Pension Waiver.** Retirees can waive their pension and return to work. During the period of reemployment, additional service and salary is earned and their benefit is recomputed upon subsequent retirement.
- **Part-Time Program.** Retired employees can return to work immediately (no break) in a part-time position (up to 12 semester hours if teaching or 100 days if in an administrative nonteaching position) while retaining their pension but will not contribute to a second account. If employees exceed the part-time threshold hours or days, their pension will be reduced by the dollar amount earned in excess of the threshold.
- **Full-Time Program.** Retired employees can return to work full-time and retain their pension if they observe a 6-month break in employment. The employees will not contribute to KTRS but will instead contribute to the Optional Retirement Plan, a defined contribution plan administered by the university.

Reciprocity

Members who have service in more than one retirement plan administered by the Commonwealth of Kentucky can combine service in the plans to determine eligibility for retirement and final average salary (years of highest salary). Each system will pay a benefit based on the amount of service in that system.

Taxation Of Benefits

Monthly benefits from all systems are subject to federal income tax. If a member made contributions with after-tax dollars (usually service purchases), then a portion of the monthly benefit at retirement will not be subject to federal income tax.

All benefits attributable to service earned on or before December 31, 1997, are exempt from Kentucky income tax. The portion of the member's benefits earned January 1, 1998, and after is subject to Kentucky income tax. However, an annual pension exclusion of \$41,110 applies to this portion and to other retirement income sources.

2015 Legislative Changes

During the 2015 Regular Session, House Bill 47 added KTRS to the systems under the purview of the Public Pension Oversight Board.

Chapter 3

Overview Of Judicial Form Retirement System Administration And Benefits

Composition Of Judicial Form Retirement System

The Public Pension Oversight Board has oversight responsibilities for the two retirement plans administered by the Judicial Form Retirement System (JFRS). These plans include the Legislators' Retirement Plan (LRP) and the Judicial Retirement Plan (JRP).

Judicial Retirement Plan

JRP was established in 1960, and its membership includes justices of the Supreme Court and judges of the Court of Appeals, Circuit Court, Family Court, and District Court. It is governed by Kentucky Revised Statutes 21.345 to 21.580 and Title 4 of the Kentucky Administrative Regulations.

Legislators' Retirement Plan

LRP was established in 1980 for members of the General Assembly. It is governed by Kentucky Revised Statutes 6.500 to 6.577 and Title 4 of the Kentucky Administrative Regulations.

These retirement plans (along with Social Security benefits, and other sources of retirement income, such as other retirement accounts and postretirement employment) serve as the basis for providing income to members during their retirement years.

Judicial Form Retirement System Administration

As provided by statute, an eight-member board of trustees oversees the administration of JFRS, with three trustees appointed by the Supreme Court, two trustees appointed by the governor, one trustee appointed by the speaker of the House of Representatives, one trustee appointed by the president of the Senate, and one trustee appointed jointly by the president and speaker. Gubernatorial appointees cannot be members or benefit recipients of the plans. Elected and appointed trustees serve 4-year terms and may serve no more than three consecutive terms.

The board annually elects a chair and has separate investment committees for each plan as provided by statute. The JRP investment committee consists of board trustees appointed by the Supreme Court and governor. The LRP investment committee consists of board trustees appointed by the Speaker of the House, President of the Senate, and the governor.

The current composition of the board is provided in Table 3.1. The board appoints an executive director to oversee day-to-day operations and to staff the needs of the system. The current executive director is Donna Early, and as of June 30, 2015, JFRS consisted of two employees.

Table 3.1
Members Of The Judicial Form Retirement System Board Of Trustees
December 2015

Member	Appointed By
Judge Lewis G. Paisley, Chair	Supreme Court
Judge Laurance B. VanMeter	Supreme Court
Judge John R. Grise	Supreme Court
Rep. Ted A. Edmonds	Speaker of the House and president of the Senate
Rep. Hubert Collins	Speaker of the House
Sen. Kenneth W. Winters	President of the Senate
Debbie R. Hardesty	Governor
Mark C. Blackwell	Governor

Source: Judicial Form Retirement System.

Judicial Form Retirement System Employer And Employee Membership

Membership in JRP and LRP is limited to judges and legislators, respectively. Participation in JRP and LRP is not automatic, and a newly elected judge or legislator must opt to participate in JRP or LRP within 30 days of taking office. If he or she fails to elect participation, then the judge or legislator will participate in the Kentucky Employees Retirement System, the same system covering state employees. Members who began participating prior to January 1, 2014, whose accrued benefit is equal to 100% of final compensation, the maximum benefit payable by statute, may elect to cease participating in JRP or LRP, as applicable, and begin participating in KERS.

The number of contributing members (referred to as active members), former contributing members with accounts but not yet retired (referred to as inactive members), and retired members by plan is provided in Table 3.2.

Table 3.2
Number Of Active, Inactive, And Retired Members By Plan
June 30, 2015

System	Active Members	Inactive Members	Retired Members	Total
LRP	104	45	194	343
JRP	247	20	329	596
Total	351	65	523	939

Source: June 30, 2015, JFRS Audit Report.

Retirement Eligibility

Plan members must meet certain age or service credit requirements before they can retire and begin receiving benefits. For JRP and LRP, the retirement eligibility requirements vary based on the date the member first began participating in the plans. Table 3.3 shows eligibility

requirements for plan members to earn an unreduced benefit (no penalties) and the requirements for a reduced benefit (penalties are set by statute and vary based on how many years the employee is short of reaching an unreduced benefit).

Table 3.3
Retirement Eligibility Requirements
For Judicial Retirement Plan And Legislators' Retirement Plan Members

Participation Date	Unreduced Benefit	Reduced Benefit*
Participating prior to January 1, 2014	Any age with at least 27 years of service, or normal retirement age** with at least 5 years of service	<ul style="list-style-type: none"> • JRP: 8 years of service • LRP: 5 years of legislative service or 8 years of service
Participating on or after January 1, 2014	Rule of 87 (age + service = 87) and at least 57 years of age, or age 65 with at least 5 years of service	<ul style="list-style-type: none"> • No reduced benefit provisions

* Reduction set by statute of 5% per year.

**The normal retirement age is 65, except that it is reduced by 1 year for every 5 years of service and for each year the benefit exceeds 100% of final compensation. The normal retirement age cannot be reduced below age 60.

Source: Judicial Form Retirement System.

Plan Benefits

Each plan is designed to provide three types of benefits: a monthly retirement benefit for life, disability/death benefits, and health insurance benefits after retirement. Benefits vary based on the plan (JRP or LRP) and the date the employee first began participating in the plans. Information on each of these benefits is provided on the following pages.

Monthly Retirement Benefits For Members Participating Prior To January 1, 2014

Benefits for members who began participating in the systems prior to January 1, 2014, are based on the following formula established by statute:

$$\text{Final Compensation} \times \text{Benefit Factor} \times \text{Years of Service Credit} = \text{Monthly Benefit}$$

Retirement benefit calculations for members under this formula are provided in Tables 3.4 and 3.5.

Table 3.4
Retirement Benefit Calculation For Judicial Retirement Plan Members
Participating Prior To January 1, 2014

Final Compensation	Benefit Factor	Service Credit
Monthly average of last 60 months preceding retirement	<ul style="list-style-type: none"> • 5.00% for individual who began participating in plan before July 1, 1978 • 4.15% for individual who began participating in plan on or after July 1, 1978, but prior to June 30, 1980 • 2.75% for all others 	Service credited as member of one of state courts; qualified purchased/transferred service

Source: Judicial Form Retirement System.

Table 3.5
Retirement Benefit Calculation For Legislators' Retirement Plan Members
Participating Prior To January 1, 2014

Final Compensation	Benefit Factor	Service Credit
Monthly average of highest 3 years of salary	<p>Legislators in office as of July 1, 1982:</p> <ul style="list-style-type: none"> • 5.00% if participation in plan began before July 1, 1978 • 4.15% if participation in plan began on or after July 1, 1978 but prior to June 30, 1980 • 3.50% if participation in plan began on or after July 1, 1980 but prior to June 30, 1982. <p>For all other legislative service:</p> <ul style="list-style-type: none"> • 2.75% 	Service credited as member of the General Assembly; qualified purchased/transferred service

Source: Judicial Form Retirement System.

At retirement, a retiree may choose to take an optional benefit to provide additional lifetime monthly benefits to a surviving spouse upon death, or if there is no surviving spouse, to dependent children until they reach age 21, unless a child is disabled.

Retirement Benefit Calculation For Members Participating On Or After January 1, 2014

Members who begin participating in the plans on or after January 1, 2014, are provided retirement benefits through a cash balance plan that provides benefits based on an account balance, rather than on a formula. This change was enacted in Senate Bill 2 during the 2013 Regular Session.

The cash balance plan is not a defined contribution plan but rather a type of defined benefit plan that operates as another benefit tier within the plans. While it is a type of defined benefit plan, it

does have several characteristics of a defined contribution plan with individual member accounts, benefits based on the member's account balance at retirement (member and employer contributions and investment returns), and some variability in benefits due to investment returns. It differs from a defined contribution plan in that a minimum level of investment return is guaranteed on the member accounts, the plans rather than the member manage investments, and members can annuitize their account balance upon retirement (to receive it in the form of a monthly benefit).

In the cash balance plan, members contribute the same amount as newer employees who began participating prior to January 1, 2014, except that 5 percent of pay they contribute to fund pension benefits will go into their individual accounts, along with an employer pay credit of 4 percent of their salary. Members receive a guaranteed return of 4 percent annually and 75 percent of the excess returns above 4 percent (the excess returns are calculated on a 5-year smoothed return). JFRS opted to establish separate funds for hybrid cash balance participants, so the investment return credited as of June 30, 2015 was 4 percent.

Members in the cash balance plan are vested for employer contributions and investment returns on those employer contributions after 5 years. Upon reaching retirement eligibility, members can take their account balance in a lump sum or have it annuitized into a monthly benefit optional payment currently available through the plan.

Retiree Health Insurance Benefits

JFRS also provides access to group rates and medical insurance for retired members, spouses, and dependents. Coverage for retirees not eligible for Medicare is provided through the Kentucky Employees' Health Plan, the same health plan provided to state and school board employees. Coverage for Medicare-eligible retirees is provided through a plan contracted through JFRS, which then coordinates with Medicare for delivery of health benefits.

As provided by state statute, the systems also subsidize medical coverage for the retiree and, in the case of members who began participating prior to January 1, 2014, for qualified dependents of the retiree. In general, members participating prior to January 1, 2014, receive a percentage of the premium paid upon retirement based on their service credit, while members who begin participating after that date receive a set dollar amount per month for each year of service credit. Tables 3.6 and 3.7 provide details about the benefits for JRP and LRP members based on their participation dates.

Table 3.6
Retiree Health Insurance Premium Payments For Judicial Retirement Plan Retirees

Participation Date In Systems	Eligibility Requirements	Percent Or Dollars Of Premium Paid For Retiree And Qualified Dependents Of Retiree		
Before January 1, 2014	Must be drawing monthly benefit	Years Of Service At Retirement	% Of Premium Paid For Retiree	% Of Premium Paid For Dependents
		Less than 4	0%	0%
		4, but less than 10	25	25
		10, but less than 15	50	50
		15, but less than 20	75	75
		20 or more	100	100
On or after January 1, 2014	Must be drawing monthly benefit and have at least 15 years of service	\$10 per month paid toward the health premium for each year of earned service. Amount is adjusted by 1.5% annually from date of participation.		

Source: Judicial Form Retirement System.

Table 3.7
Retiree Health Insurance Premium Payments For Legislators' Retirement Plan Retirees

Participation Date In Systems	Eligibility Requirements	Percent Or Dollars Of Premium Paid For Retiree And Qualified Dependents Of Retiree		
Before January 1, 2014	Must be drawing monthly benefit	Years Of Service At Retirement	% Of Premium Paid For Retiree	% Of Premium Paid For Dependents
		Less than 4	0%	0%
		4, but less than 10	25	25
		10, but less than 11	50	50
		11, but less than 12	55	55
		12, but less than 13	60	60
		13, but less than 14	65	65
		14, but less than 15	70	70
		15, but less than 16	75	75
		16, but less than 17	80	80
		17, but less than 18	85	85
		18, but less than 19	90	90
		19, but less than 20	95	95
		20 or more	100	100
On or after January 1, 2014	Must be drawing monthly benefit and have at least 15 years of service	\$10 per month paid toward the health premium for each year of earned service. Amount is adjusted by 1.5% annually from date of participation.		

Source: Judicial Form Retirement System.

Disability And Death Benefits

Like most defined benefit plans, the plans provide benefits for those members who become disabled or to the qualified survivors of members who die in office, including in the line of duty disability and death benefits. After retirement, the benefits left to the retiree's surviving spouse or dependent child vary based on the payment option selected at the commencement of benefits.

Cost Of Living Adjustments On Monthly Retirement Benefits

After the passage of Senate Bill 2 in the 2013 Regular Session of the General Assembly, members of the plans will no longer receive automatic annual increases of 1.5 percent on their monthly retirement benefits. Language in SB 2 did provide that a 1.5 percent cost of living adjustment could be granted if an individual plan is 100 percent funded, and subsequent legislation authorizes the use of surplus funds to provide the 1.5 percent COLA, or the General Assembly may appropriate or direct payment of funds to prefund the COLA in the year it is provided.

Service Purchases And Transfers

Members participating in the plans can choose to transfer service for other public employment or purchase service credit as established by law, such as military service, federal service, and nonqualified service, provided certain requirements established by state statute are met. However, legislative changes in 2013 eliminated service purchases for new participants entering the plans on or after January 1, 2014, with the exception of recontributions of refunds.

Reciprocity

Members who have service in more than one retirement plan administered by the Commonwealth of Kentucky can combine service in the plans to determine eligibility for retirement. LRP members who began contributing on or after June 20, 2005, but prior to January 1, 2014, may also combine salary in other state retirement plans for purposes of determining final compensation (years of highest salary). Each system will pay a benefit based on the amount of service in that system or plan.

Taxation Of Benefits

Monthly benefits from all systems are subject to federal income tax. If a member made contributions with after-tax dollars (usually service purchases), then a portion of the monthly benefit at retirement will not be subject to federal income tax.

All benefits attributable to service earned on or before December 31, 1997, are exempt from Kentucky income tax. The portion of the member's benefits earned January 1, 1998, and after is

subject to Kentucky income tax. However, an annual pension exclusion of \$41,110 applies to this portion and to other retirement income sources.

2015 Legislative Changes

During the 2015 Regular Session, House Bill 47 added JFRS to the systems under the purview of the Public Pension Oversight Board.

Chapter 4

Funding And Investments

System And Plan Funding

Funding for benefits and expenses for each of the state-administered retirement systems and plans is provided through three sources: employee contributions, employer contributions, and return on investment. Employee contributions are set by state statute and do not vary. Employer contribution rates vary based on the results of actuarial valuations completed by the systems.

Employee and employer contributions include funding for retirement benefits, which is managed and invested in separate pension funds for each of the systems and plans, and funding for retiree health benefits, which is managed and often invested in funds separate from the pension funds for each of the systems and plans, except for JRP and LRP. However, JRP and LRP each have separate funds for management and investment purposes for members in the traditional defined benefit plan and for members in the hybrid cash balance plan who began participating on or after January 1, 2014. KTRS also manages a separate life insurance fund, which receives a minimal employer contribution.

Employee Contribution Rates

The employee contribution rates are set by state statute for each of the systems and plans. Legislative changes in 2008 increased the employee contribution rate for future members of all state-administered retirement systems, while legislative changes in 2010 increased employee contribution rate for current and future members of KTRS. The employee contribution rate, as a percentage of the employee's pay, is listed for each system or plan in Table 4.1.

Table 4.1
Employee Contribution Rates By State-Administered Retirement System/Plan

System/Plan	Participation Date/Structure	Employee Contribution Rate (As A Percentage Of Pay)		
		Pension	Health	Total
KERS/CERS nonhazardous	• Participating prior to Sept. 1, 2008	5%	0%	5%
	• Participating on or after Sept. 1, 2008	5	1	6
KERS/CERS hazardous and SPRS	• Participating prior to Sept. 1, 2008	8	0	8
	• Participating on or after Sept. 1, 2008	8	1	9
KTRS	• Nonuniversity employees	9.105	3.750	12.855
	• University employees*	5.410	2.775	8.185
	• Participating prior to Sept. 1, 2008	5	0	5
JRP/LRP	• Participating on or after Sept. 1, 2008, but prior to January 1, 2014	6	0	6
	• Participating on or after January 1, 2014	5	1	6

*University employers have elected to pay 2.215 percent of the employee contribution rate as authorized by Kentucky Revised Statute 161.565. The amount listed is the adjusted employee contribution rate.

Source: Kentucky Retirement Systems, Kentucky Teachers' Retirement System, Judicial Form Retirement System.

The Actuarial Valuation Process

All systems conduct an annual actuarial valuation of the systems they administer. The purpose of the valuation, which is completed by an actuary hired by the systems, is to determine three main items:

- The amount of benefits (liabilities) to be paid out in the future.** To determine the employer contribution rates and to evaluate the financial health of each system or plan, the actuary must first project the amount of benefits, or system liabilities, to be paid out in the future. These benefits are prescribed by law and regulation and, in some cases, the board of trustees. To calculate the amount of benefits that will be paid out in the future, the actuary must make assumptions about factors that affect the system's or plan's money (the rate of return on investments, salary growth of employees, retiree medical inflation rates, etc.) and its people (when will people retire, how long will they live after retirement, etc.). Key actuarial assumptions include investment return, mortality rates, future medical inflation rates, and payroll growth. Statute requires KRS and KTRS to periodically perform an actuarial experience study to review the funding methods and assumptions used in the actuarial valuation, and they typically do so once every 5 years.
- The financial health of the systems/plans.** In the valuation, the actuary reports several statistics useful in evaluating the financial health of the systems or plans as of the valuation date. The two most common actuarial statistics are the unfunded liability and the funding level, which compares the actuarially accrued liability (liability for benefits earned to date) against system assets. The unfunded liability is the dollar amount of the actuarially accrued liabilities that are not covered by system or plan assets. The funding level is the percentage of the actuarially accrued liability covered by system or plan assets. In calculating the unfunded liabilities and funding level as of the valuation date, the actuary uses a smoothed market value known as the actuarial value of assets that smooths actual investment gains or losses over a 5-year period. Both of these statistics are affected by four main factors: the level of benefits payable in the future, the assumptions used by the systems' actuary, the systems' actual experience against those assumptions, and the level of funding made by the employer.

$$\begin{aligned} &\text{Actuarial value of assets} \\ &- \text{actuarially accrued liability} \\ &= \text{unfunded liabilities} \end{aligned}$$

$$\begin{aligned} &\text{actuarial value of assets} \\ &\div \text{actuarially accrued liability} \\ &= \text{funding level} \end{aligned}$$
- The level of employer contributions:** The employer contribution for each of the systems and plans includes two contributions: one to fund pension benefits and one to fund retiree health benefits. KTRS also has a contribution to fund life insurance benefits. Each of these individual contributions comprises two components: a payment for normal cost (the estimated cost of the upcoming year of service for active employees/members) and a payment to finance the unfunded liability over a specific time period or using a specific method. Employer contributions vary based on the level of unfunded liabilities and financial health of the individual system or plan. As unfunded liabilities increase (or decrease), there is

an increase (or decrease) in the level of employer contribution rates needed to adequately fund the system or plan. Employer rates can also vary based on funding policies established by statute, by the biennial state budget, and in some cases by the board of trustees of the systems or plans. Actuarial valuation results are applicable to employer contributions payable in the budgeting period that follows the valuation. For example, the FY 2017 CERS employer rates were determined by the 2015 actuarial valuation.

Amortization Periods And Methods

The various systems and plans use differing amortization periods and methods for paying off unfunded liabilities in their actuarial valuations.

As required by statute, KRS amortizes unfunded liabilities over a 30-year closed period using the level percentage of payroll method and the 2013 valuation as the start of the 30-year period. The level percentage of payroll method sets amortization payments as a set percentage of projected payroll over the 30-year period, with payroll assumed to grow at a set rate each year. For all KRS pension and health funds, a 4 percent payroll growth assumption is used to project payroll. The amortization period was reset to a new 30-year period by Senate Bill 2, which was passed during the 2013 Regular Session.

As provided by board policy, KTRS amortizes pension unfunded liabilities accrued as of the 2014 actuarial valuation over a 30-year closed period using the level percentage of payroll method and the 2014 valuation as the start of the 30-year period. Any new source of unfunded liability occurring after the 2014 valuation for the pension fund is amortized over a 20-year closed period. However, the policy requires the pension fund to be 100 percent funded in 30 years. Unfunded liabilities of the KTRS retiree health and life insurance funds are amortized over a 30-year open period using the level percentage of payroll method. For all KTRS funds, a 4 percent payroll growth assumption is used to project payroll.

JRP and LRP amortize unfunded liabilities by a formula set in state statute. The formula provides an amortization payment for these plans equal to the investment return assumption plus 1 percent (total of 8 percent) of the dollar value of the plan's unfunded liability.

Investment Return Assumptions

The investment return assumption, which is also the rate used to discount future liabilities in the actuarial valuation, is a key assumption in the actuarial valuation. For KRS, a 7.5 percent investment return assumption is used in the 2015 actuarial valuation for all pension and insurance funds it administers (prior to the 2015 valuation, a 7.75 percent assumption was used). However, the KRS board recently reduced the investment return assumption for the KERS and SPRS pension funds to 6.75 percent, which will be used in future actuarial valuations. KTRS uses a 7.5 percent investment return assumption for the pension fund and an 8 percent investment return assumption for the retiree health fund. JFRS uses a 7 percent investment return assumption for both JRP and LRP.

Financial Health Of The Systems

The 8-year historical funding levels and unfunded liabilities for each system's or plan's pension and health insurance funds, as reported in or determined from the annual actuarial valuations, are provided in Tables 4.2 through 4.5. This period begins with the downturn in investment markets that occurred in FY 2008 and 2009.

Funding levels for each of the system or plan pension funds have generally fallen over the 8-year period, and the total unfunded liabilities for the combined pension funds have grown from \$14.6 billion to \$30.7 billion over the same period. However, some system and plan pension funds have experienced improvement in recent years. In 2015, the KTRS, LRP, and JRP pension funds experienced improving funding levels and reduced unfunded liabilities. Over the same period, funding levels for each of the retiree health funds have generally improved, and unfunded liabilities for the combined retiree health funds have fallen from \$15.2 billion to \$5.9 billion.

Table 4.2
Pension Fund Funding Levels (% Actuarial Assets To Actuarial Liabilities)

Valuation Year	KERS NH	KERS H	CERS NH	CERS H	SPRS	KTRS	JRP	LRP
2008	52.5%	81.3%	78.5%	72.9%	59.8%	68.2%	88.9%	104.1%
2009	45.0	74.5	71.4	67.9	54.8	63.6	72.8	71.4
2010	38.3	73.1	65.6	65.5	49.7	61.0	65.8	64.1
2011	33.3	70.8	63.1	62.2	45.0	57.4	57.0	58.4
2012	27.3	66.1	60.7	58.1	40.1	54.5	55.7	57.2
2013	23.2	64.5	60.1	57.7	37.1	51.9	55.7	57.0
2014	21.0	64.6	62.6	59.8	35.6	53.6	61.8	62.1
2015	19.0	62.2	60.3	58.0	33.8	55.3	67.2	71.4

Note: NH means nonhazardous duty; H means hazardous duty. Values for JRP and LRP do not include hybrid cash balance plan participants, which are reported in a separate actuarial valuation.

Source: KRS, KTRS, and LRP, and JRP actuarial valuations.

Table 4.3
Pension Fund Unfunded Liabilities (In Billions)

Valuation Year	KERS NH	KERS H	CERS NH	CERS H	SPRS	KTRS	JRP	LRP
2008	\$4.81	\$0.12	\$1.57	\$0.65	\$0.24	\$7.14	\$0.03	(\$0.00)
2009	5.86	0.17	2.26	0.83	0.27	8.51	0.08	0.02
2010	6.79	0.19	2.91	0.92	0.31	9.49	0.10	0.02
2011	7.46	0.21	3.29	1.08	0.35	11.06	0.13	0.03
2012	8.26	0.26	3.59	1.26	0.39	12.28	0.14	0.03
2013	8.75	0.28	3.74	1.32	0.41	13.85	0.15	0.03
2014	9.13	0.29	3.66	1.32	0.44	14.01	0.13	0.03
2015	10.01	0.34	4.27	1.52	0.49	13.93	0.11	0.02

Note: NH means nonhazardous duty; H means hazardous duty. Values for JRP and LRP do not include hybrid cash balance plan participants, which are reported in a separate actuarial valuation.

Source: KRS, KTRS, and LRP, and JRP actuarial valuations.

Table 4.4
Retiree Health Fund Funding Levels (% Actuarial Assets To Actuarial Liabilities)

Valuation Year	KERS NH	KERS H	CERS NH	CERS H	SPRS	KTRS	JRP	LRP
2008	11.1%	53.2%	32.6%	34.7%	27.9%	2.9%	92.7%	106.1%
2009	11.9	61.4	39.6	40.9	33.9	3.5	110.0	132.1
2010	10.6	63.7	40.9	41.4	27.9	7.5	103.2	123.0
2011	10.6	65.1	46.6	46.8	28.2	8.6	95.8	113.7
2012	14.3	89.9	63.8	60.7	37.2	9.4	95.6	112.3
2013	23.4	96.2	66.6	62.1	61.3	11.7	86.6	110.9
2014	27.9	105.6	70.0	66.8	66.4	15.9	95.0	119.9
2015	28.8	120.4	68.7	72.3	65.8	18.1	99.8	123.1

Note: NH means nonhazardous duty; H means hazardous duty. Values for JRP and LRP do not include hybrid cash balance plan participants, which are reported in a separate actuarial valuation.

Source: KRS, KTRS, and LRP, and JRP actuarial valuations.

Table 4.5
Retiree Health Fund Unfunded Liabilities (In Billions)

Valuation Year	KERS NH	KERS H	CERS NH	CERS H	SPRS	KTRS	JRP	LRP
2008	\$4.83	\$0.25	\$2.41	\$1.16	\$0.32	\$6.25	\$0.004	(\$0.001)
2009	3.97	0.19	1.85	0.94	0.24	6.23	(0.004)	(0.006)
2010	3.99	0.18	1.87	0.98	0.31	2.97	(0.001)	(0.004)
2011	3.83	0.18	1.64	0.88	0.31	3.13	0.002	(0.003)
2012	2.68	0.04	0.86	0.54	0.21	3.26	0.002	(0.003)
2013	1.63	0.02	0.82	0.54	0.09	3.11	0.007	(0.003)
2014	1.61	(0.02)	0.79	0.50	0.08	2.69	0.003	(0.005)
2015	1.72	(0.08)	0.91	0.42	0.09	2.89	0.000	(0.006)

Note: NH means nonhazardous duty; H means hazardous duty. Values for JRP and LRP do not include hybrid cash balance plan participants, which are reported in a separate actuarial valuation.

Source: KRS, KTRS, and LRP, and JRP actuarial valuations.

GASB 67 Reporting Requirements

In 2012, the Governmental Accounting Standards Board (GASB) issued two new statements that change the way public retirement systems like KRS, KTRS, and JFRS, and its participating employers report pension information. One of these statements, GASB 67, effectively divorces pension plan reporting standards from funding standards. The result is that two values may often be discussed relative to the health of a system’s pension fund—one for funding purposes and one for GASB 67 reporting purposes.

For the pension funds administered by KRS, the values used for funding purposes and for reporting purposes under GASB 67 are similar. For the pension funds administered by JFRS, the values used for reporting purposes under GASB 67 are slightly higher than the values used for funding purposes. However, the KTRS pension fund values for funding and reporting purposes are significantly different. For funding purposes, the KTRS pension fund is 55.3 percent funded and has an unfunded liability of \$13.93 billion as of the 2015 actuarial valuation. Under the

GASB 67 reporting requirements, the KTRS pension fund would be 42.5 percent funded and would have a net pension liability of \$24.4 billion. The primary difference is the discount rate used to value pension liabilities, with 7.50 percent being used for funding purposes and 4.88 percent being used for GASB 67 reporting purposes. The lower discount rate used in the GASB 67 computation is due to the pension plan assets being anticipated to be depleted in the future, which requires an adjustment to the discount rate under these reporting standards. Currently, the KTRS pension fund is anticipated to deplete all assets by FY 2039. If a funding plan is developed for the KTRS pension plan so that plan assets are not anticipated to deplete in the future, then the reported values under GASB 67 will more closely resemble the values used for funding purposes.

KERS, CERS, And SPRS Employer Rates

Employer contribution rates paid by participating KRS agencies differ by retirement system and fluctuate based on the financial health of the individual system as determined by the actuarial valuation and the funding policies established by statute and by the board of trustees.

For KERS and SPRS, employer contribution rates established by the KRS Board of Trustees vary every 2 years to coincide with the state's biennial budgeting process.² The current state biennial budget provided the employer contribution rate established by the KRS Board of Trustees for FY 2015 and FY 2016 for KERS and SPRS in accordance with state statute and as recommended by the 2013 actuarial valuation. However, the prior six biennial budgets provided an employer contribution rate less than the amount established by the KRS Board of Trustees. Tables 4.6 to 4.10 show the KERS and SPRS employer contribution rates established by the board and the amount provided in the biennial state budget from FY 2009 to FY 2016.

Table 4.6
KERS Nonhazardous Employer Contribution Rates
Since FY 2009 As A Percentage Of Payroll

Fiscal Year	Rate Established By KRS Board			Total Budgeted	
	Ended	Pension	Retiree Health		Total
2009		16.54%	12.06%	28.60%	10.01%
2010		18.96	12.33	31.29	11.61
2011		21.77	16.81	38.58	16.98
2012		24.30	16.41	40.71	19.82
2013		28.03	16.52	44.55	23.61
2014		32.57	12.71	45.28	26.79
2015		30.84	7.93	38.77	38.77
2016		30.84	7.93	38.77	38.77

Source: Kentucky Retirement Systems.

² Senate Bill 2 provided that the Kentucky Retirement Systems Board of Trustees could only amend the KERS and SPRS employer contribution rates every 2 years to coincide with the biennial state budget. This change was effective with KERS and SPRS employer contribution rates payable on or after July 1, 2014. If the KRS board could have changed the recommended rate in the second year of the current biennium, the KERS nonhazardous employer rate would have been 41.31 percent of pay instead of 38.77 percent of pay. Actuarial valuation results are applicable to employer contributions payable in the budgeting period that follows. For KERS and SPRS, the FY 2015 and FY 2016 employer rates were determined by the 2013 actuarial valuation.

For FY 2015, the dollar value of the employer contributions for KERS nonhazardous totaled \$657.6 million. For FY 2017 and 2018, the KERS nonhazardous employer rate established by the KRS board is 47.28 percent of payroll. However, the KRS board also decided to lower the investment return assumption for the KERS nonhazardous pension fund from 7.50 percent to 6.75 percent per annum in future actuarial valuations. The KRS board has indicated that if the 6.75 percent assumption were implemented in the 2015 valuation, the recommended employer contribution rate for this system would increase to 48.59 percent of pay.

Table 4.7
KERS Hazardous Employer Contribution Rates
Since FY 2009 As A Percentage Of Payroll

Fiscal Year Ended	Rate Established By KRS Board			Total Budgeted Rate
	Pension	Retiree Health	Total	
2009	10.84%	23.94%	34.78%	24.35%
2010	11.98	23.56	35.54	24.69
2011	14.11	20.26	34.37	26.12
2012	14.11	19.73	33.84	28.98
2013	16.16	19.73	35.89	29.79
2014	17.00	11.84	28.84	32.21
2015	16.37	9.97	26.34	26.34
2016	16.37	9.97	26.34	26.34

Source: Kentucky Retirement Systems.

For FY 2015, the dollar value of the employer contributions for KERS hazardous totaled \$43.4 million. For FY 2017 and 2018, the KERS hazardous employer rate established by the KRS board, in accordance with the 2015 actuarial valuation results, is 23.82 percent of payroll.

Table 4.8
SPRS Employer Contribution Rates Since FY 2009 As A Percentage Of Payroll

Fiscal Year Ended	Rate Established By KRS Board			Total Budgeted Rate
	Pension	Retiree Health	Total	
2009	32.39%	27.75%	60.14%	30.07%
2010	35.23	26.64	61.87	33.08
2011	35.74	49.89	85.63	45.54
2012	39.80	54.83	94.63	52.13
2013	47.48	55.93	103.41	63.67
2014	53.35	43.17	96.52	71.15
2015	53.90	21.86	75.76	75.76
2016	53.90	21.86	75.76	75.76

Source: Kentucky Retirement Systems.

For FY 2015, the dollar value of the employer contributions for SPRS totaled \$42.4 million. For FY 2017 and 2018, the SPRS employer rate established by the KRS board, in accordance with the 2015 actuarial valuation results, is 85.34 percent of payroll. However, the KRS board also decided to lower the investment return assumption for the SPRS pension fund from 7.50 percent

to 6.75 percent per annum in future actuarial valuations. The KRS board has indicated that if the 6.75 percent assumption were implemented in the 2015 valuation, the recommended employer contribution rate for this system would increase to 89.21 percent of pay.

As shown in Tables 4.9 and 4.10, the CERS employer contribution rates established by the KRS Board of Trustees vary annually based on the results of the most recently completed actuarial valuation. Of the total employer contribution rate, the pension contribution is paid at the full actuarially determined rate, but the retiree health contribution is being phased in to the full actuarially determined rate through FY 2018 based on the 10-year schedule established by House Bill 117 passed in 2009. For FY 2015, the dollar value of the employer contributions to CERS totaled \$418.0 million for nonhazardous employers and \$179.9 million for hazardous employers.

Table 4.9
CERS Nonhazardous Employer Contribution Rates
Since FY 2009 As A Percentage Of Payroll

Fiscal Year Ended	Pension	Retiree Health	Total
2009	7.76%	5.74%	13.50%
2010	8.62	7.54	16.16
2011	10.03	6.90	16.93
2012	11.70	7.26	18.96
2013	12.62	6.93	19.55
2014	13.74	5.15	18.89
2015	12.75	4.92	17.67
2016	12.42	4.64	17.06
2017	13.95	4.73	18.68

Source: Kentucky Retirement Systems.

Table 4.10
CERS Hazardous Employer Contribution Rates
Since FY 2009 As A Percentage Of Payroll

Fiscal Year Ended	Pension	Retiree Health	Total
2009	15.04%	14.46%	29.50%
2010	16.11	16.86	32.97
2011	16.79	16.46	33.25
2012	17.91	17.85	35.76
2013	20.10	17.50	37.60
2014	21.77	13.93	35.70
2015	20.73	13.58	34.31
2016	20.26	12.69	32.95
2017	21.71	9.35	31.06

Source: Kentucky Retirement Systems.

KTRS Employer Rates

KTRS employer contribution rates differ for nonuniversity and university employers. The KTRS employer rates for FY 2017 and 2018 include the following:

- A fixed statutory rate payable by participating employers: Prior to the passage of HB 540 in 2010, nonuniversity employers paid a fixed statutory rate of 13.105 percent, which was and is financed primarily by state appropriations. Due to the passage of House Bill 540³ in 2010, nonuniversity employers must also contribute up to 3.0 percent of pay toward retiree health funding, resulting in a total fixed statutory rate to 16.105 percent of pay. For university employers, the equivalent statutory rate is 13.650 percent of pay.
- A state special contribution for both nonuniversity and university employers that consists of state appropriations to KTRS to pay amortized payments for specific benefits such as ad hoc COLAs awarded in prior years, minimum benefit provisions, and the costs of additional pension benefits for accumulated sick leave payments made by local school districts for retiring employees: The amount of this contribution changes annually as additional sick leave costs are added and as amortized payments for prior ad hoc COLAs and minimum benefit provisions are paid off. As a percentage of payroll, the values for FY 2017 and 2018 equals 2.70 percent and 2.94 percent of pay respectively.
- A required increase in the employer contribution rate that KTRS is requesting be paid by state appropriations for all nonuniversity and university employers equal to 13.800 percent of pay and 13.490 percent in FY 2017 and 2018 respectively, to help fund the pension fund on an actuarially sound basis. KTRS began requesting this additional contribution, in addition to the statutory contribution rates and the state special contribution, beginning in FY 2007. The additional required increases in employer contributions were funded in FY 2007 and FY 2008. However, funding for the required increase has not been provided since 2009. A breakdown of this contribution increase request since 2009 is provided in Table 4.12.

Table 4.11
KTRS Employer Contribution Rates As A Percentage Of Payroll

Item	Employer Rates			
	Nonuniversity		University	
	FY 2017	FY 2018	FY 2017	FY 2018
Statutory Rate	16.105%	16.105%	13.650%	13.650%
State Special	2.700	2.940	2.700	2.940
Required Increase	13.800	13.490	13.800	13.490
Total	32.605%	32.535%	30.150%	30.080%

Source: June 30, 2015, KTRS actuarial valuations.

In addition to these contributions, the state is also required as part of HB 540 to pay the cost of coverage of members who retire on or after July 1, 2010, who are not eligible for Medicare. For FY 2015, the additional appropriation for the premium payment totaled \$50.2 million. In total, the

³ Under HB 540, nonuniversity employers phased into a 3.0 percent employer contribution rate over a 6-year period to help fund retiree health benefits and university employers phased into a 2.775 percent employer contribution rate over a 6-year period to help fund retiree health benefits.

dollar value of all KTRS employer contributions, which included the statutory rate, the state special contribution, and the health cost payments made by the state, totaled \$705.9 million.

Table 4.12
KTRS Requests For The Required Increase In Employer Contribution Rates Since 2009

Fiscal Year Ended	% Of Payroll	Dollar Value
2009	1.88%	\$60,499,800
2010	2.46	82,331,200
2011	3.59	121,457,000
2012	5.81	208,649,000
2013	7.27	260,980,000
2014	8.02	299,420,000
2015	10.42	386,400,000
2016	12.97	487,400,000
2017	13.80	520,372,000
2018	13.49	512,883,000

Source: June 30, 2015, KTRS actuarial valuations.

JRP And LRP Employer Rates

Employer contribution rates, which are paid by state appropriations, to JRP and LRP differ based on the financial health of each individual plan as determined by the actuarial valuation and the funding policies established by statute and by the board of trustees.

For JRP and LRP, employer contribution rates established by the JFRS Board of Trustees vary every 2 years to coincide with the state's biennial budgeting process. The current state biennial budget provided the employer contribution rate established by the JFRS Board of Trustees for FY 2015 and FY 2016 for JRP and LRP in accordance with state statute and as recommended by the 2013 actuarial valuation. However, the prior two biennial budgets provided for an employer contribution rate less than the amount established by the JFRS Board of Trustees. Table 4.13 shows the JRP and LRP employer contribution rates, as a percentage of payroll, established by the JFRS Board of Trustees and the amount provided in the biennial state budget from FY 2009 to FY 2016⁴.

⁴ Budgeted rates have been calculated by multiplying the actuarially required contribution rate by the percent funded in the budget.

Table 4.13
JRP And LRP Employer Contribution Rates
Since FY 2009 As A Percentage Of Payroll

Fiscal Year Ended	JRP Employer Rates		LRP Employer Rates	
	Rate Established By Board	Budgeted Rate	Rate Established By Board	Budgeted Rate
2009	16.57%	16.57%	8.00%	8.00%
2010	16.57	16.57	8.00	8.00
2011	36.80	16.19	43.50	19.14
2012	36.80	17.66	43.50	20.88
2013	48.57	25.74	61.91	32.81
2014	48.57	27.68	61.91	35.29
2015	49.77	49.77	67.49	67.49
2016	49.77	49.77	67.49	67.49

Source: Judicial Form Retirement System

For FY 2015, the dollar value of the employer contributions paid to JRP and LRP totaled \$16.7 million and \$3.4 million respectively. For FY 2017 and 2018, the JRP and LRP employer rates established by the JFRS board are separated for traditional defined benefit plan participants and for those participating in the hybrid cash balance plan. For JRP, the employer contribution rate established by the board is 43.66 percent of pay for traditional defined benefit plan and 3.58 percent of pay for the hybrid cash balance plan. For LRP, the employer contribution rate established by the board is 53.38 percent of pay for traditional defined benefit plan and 4.99 percent of pay for the hybrid cash balance plan.

2015 Actuarial Audits

Purpose Of An Actuarial Audit

The state-administered retirement systems are not required by statute to conduct an actuarial audit, but such an audit can be performed to enhance the valuation process by providing an independent assurance that it was performed in accordance with actuarial standards of practice and to increase public trust of how the systems are governed. An actuarial audit also can determine whether the systems are meeting funding objectives, identify errors, and make recommendations to improve the process.

Kentucky Retirement Systems Actuarial Audit

In 2014, the Public Pension Oversight Board recommended that KRS engage an independent actuarial firm to perform an actuarial audit of the systems they administer. KRS hired Segal Consulting (Segal) to conduct an actuarial audit, and actuaries from Segal provided testimony to the board twice in 2015. In June, representatives provided an overview of the process, the purpose and objectives, and Segal's approach to the upcoming audit. Segal recommended performing a level two or limited scope audit of KRS, which involved a similar review as a level one audit but which reviews a sample of actual data rather than fully replicating all liabilities.

The objective is to provide an opinion and evaluation regarding the reasonableness and accuracy of the actuarial valuation results, including accrued liability, normal cost and employer contribution rates, and any improvements that can be made.

In October, actuaries from Segal presented results of the audit performed on KRS. The audit was limited in scope with Segal building a sample of “test life” data. Test lives were actual members and highlighted the scope of the systems and benefits, including members from all tiers and each retirement system administered by KRS. Overall, the data appeared complete and the assumptions and methods were reasonable and complied with actuarial standards of practice. Some suggestions were made to improve the usefulness of reports and to fine-tune the actuarial liabilities.

Kentucky Teachers’ Retirement Systems Actuarial Audit

KTRS also hired Segal to perform an actuarial audit. Actuaries from Segal presented results of the audit during the November 2015 meeting. Segal performed a full scope audit, or level one audit, which fully replicates the pension, retiree medical, and life insurance actuarial valuations. The audit also evaluated the data, assumptions, and methods used in the valuation and provided an assessment of valuation conclusions. Segal also reviewed the GASB 67 and 68 reports and the 2005-2010 actuarial experience study for KTRS. Segal reported that all three valuations matched within a tolerable range. Overall, Segal found that the valuation reports comply with Actuarial Standards of Practice and that the assumptions and methods were found to be reasonable.

2015 Audited Financial Statements

For the fiscal year ended June 30, 2015, the combined net plan assets of all system or plan pension funds fell by \$387 million, to a combined total market value of \$30.02 billion. Individually, the two JFRS funds experienced slight gains, while the KRS and KTRS systems experienced a decline in assets. Pension net plan assets at the beginning of year and end of year for the fiscal year ended June 30, 2015, and the additions and deductions that resulted in the net plan asset change over the year are provided in Table 4.14.

Table 4.14
Pension Fund Net Plan Assets And Changes In Net Plan Assets (In Millions)

	KERS NH	KERS H	CERS NH	CERS H	SPRS	KTRS	LRP	JRP
Net plan assets (BOY)	\$2,578	\$561	\$6,528	\$2,087	\$261	\$18,093	\$55	\$244
<u>Additions</u>								
Employee contributions	\$100	\$13	\$134	\$47	\$5	\$308	<\$1	\$2
Health insurance contributions	4	1	7	1	<1			
Employer contributions	522	29	299	108	32	560	3	15
Net investment income	53	9	121	40	3	862	6	25
Total additions	\$679	\$51	\$560	\$196	\$41	\$1,730	\$9	\$43
<u>Deductions</u>								
Benefit payments	\$906	\$57	\$615	\$200	\$55	\$1,742	\$4	\$22
Refunds	14	3	14	3	<1	23	<1	<1
Administrative expenses	10	1	18	1	<1	9	<1	<1
Total deductions	\$930	\$60	\$647	\$204	\$55	\$1,774	\$4	\$22
Net plan assets (EOY)	\$2,328	\$552	\$6,441	\$2,078	\$247	\$18,049	\$60	\$265

Note: Employee contributions for health insurance, while required to be part of the pension trust assets, are used to fund retiree health benefits. Health insurance contributions are the 1 percent of pay contributions made by employees who began participating in the KRS systems on or after September 1, 2008, as provided in 2008 HB 1. KERS, CERS, and SPRS employer contributions include pension spiking charges. The Bank of America Settlement proceeds for KRS are not listed separately above but are included in the net investment income. NH means nonhazardous duty; H means hazardous duty; BOY means beginning of year; EOY means end of year. Source: June 30, 2015, KRS Annual Report, KTRS Audit Report, and JFRS Audit Report.

For the fiscal year ended June 30, 2015, the combined net plan assets of all state-administered retiree health funds increased by \$193 million to \$5.0 billion. Individually, each of the eight funds experienced asset growth over the year. Retiree health net plan assets at the beginning of year and end of year for the fiscal year ended June 30, 2015, and the additions and deductions that resulted in the net plan asset change over the year, are provided in Table 4.15 for each system and plan.

Table 4.15
Retiree Health Fund Net Plan Assets And Changes In Net Plan Assets (In Millions)

	KERS NH	KERS H	CERS NH	CERS H	SPRS	KTRS	LRP	JRP
Net plan assets (BOY)	\$647	\$434	\$1,879	\$1,030	\$165	\$536	\$34	\$62
<u>Additions</u>								
Employee contributions	<\$1	<\$1	\$1	<\$1	<\$1	\$157	<\$1	<\$1
Employer contributions	136	15	120	72	10	146	0	1
Net investment income	9	8	37	20	3	30	3	7
Total additions	\$145	\$23	\$157	\$92	\$13	\$333	\$4	\$8
<u>Deductions</u>								
Health care subsidies	\$123	\$17	\$110	\$65	\$13	\$240	\$1	\$2
Other deductions	2	<1	4	<1	<1		<1	<1
Administrative expenses	1	<1	1	<1	<1	2	<1	<1
Total deductions	\$126	\$17	\$115	\$66	\$14	\$242	\$1	\$2
Net plan assets (EOY)	\$666	\$439	\$1,921	\$1,056	\$165	\$627	\$37	\$68

Note: NH means nonhazardous duty; H means hazardous duty; BOY means beginning of year; EOY means end of year. KERS, CERS, and SPRS employer contributions include retired reemployed health care contributions by employers. KERS, CERS, and SPRS employee contributions include health premiums paid by retirees.

Source: June 30, 2015, KRS Annual Report, KTRS Audit Report, and JFRS Audit Report.

KERS Nonhazardous Cash Flow Issues

In 2015 the Public Pension Oversight Board heard testimony and discussed cash flow issues facing the KERS nonhazardous pension fund. For FY 2015, employee and employer contributions to the pension fund were approximately \$100 million and \$522 million, respectively. Investment returns of 2.38 percent in FY 2015 resulted in net investment income of \$45 million to the fund. Combined, the KERS nonhazardous pension fund received contributions and net investment income of \$679 million in FY 2015. However, benefit payments and expenses totaled \$930 million in fiscal 2015, resulting in a net decrease of \$251 million. The assets from the beginning of the fiscal year dropped from \$2.6 billion to \$2.3 billion, despite the full actuarially required employer contribution rate being paid in FY 2015. Funding projections provided by KRS in 2015 indicated that the actuarial funding level will continue to fall, reaching 14.9 percent before improving with projected asset values also expected to fall to approximately \$1.9 billion before improving.

Key factors for improving cash flow are paying the full actuarially required contribution rate (which is growing in the upcoming budget), payroll growth occurring at levels assumed by the systems, and favorable investment returns. Additional funding options were also discussed including bonding, supplementing the funds through legislative proposals, and setting the employer contribution rate above the rate recommended by the KRS board.

2015 Investments And Investment Performance

As outlined in KRS 7A.250, the Public Pension Oversight Board conducted a review of the state-administered retirement systems investment program. The review covered an analysis of asset allocation, performance and volatility, policies, fees and expenses, and securities litigation. In addition to this review, members also heard testimony from outside investment consultants, R.V. Kuhns and CEM Benchmarking Inc.

State-Administered Retirement Systems Funds

KRS manages two separate pension and retiree health funds for each of the five separate systems it administers. Assets are managed both internally by KRS investment staff and externally by investment managers. The KRS Board of Trustees has authorized and directed a five member Investment Committee required by statute to manage the investment portfolios in accordance with approved policies.

KTRS manages separate pension and retiree health funds for the system it administers. Assets are managed both internally by investment staff and externally by investment managers. The KTRS Board of Trustees has authorized and directed a five-member Investment Committee to manage the investment portfolios in accordance with approved policies and statutes. Two additional nonvoting members added by the KTRS board with investment experience also serve on the committee.

JFRS is responsible for managing separate funds for the JRP and LRP, with each plan having a fund for the traditional defined benefit plan and the hybrid cash balance plan. Assets are managed by a single external investment manager. Statute provides for a five-member Investment Committee for each plan to manage and oversee the investment portfolios in accordance with approved policies and statutes.

Asset Allocation

Assets are diversified across various assets classes as determined by the investment committees and board of trustees of each fund. For KRS and KTRS, target asset allocations are driven by Asset Liability Studies, which are conducted typically every 5 years by a third-party consultant. Assets classes currently used by all systems include traditional public markets such as equities and fixed income, while KRS and KTRS also invest in alternative assets, which include absolute return, real return, and private equity.

Actual and targeted asset allocations for all pension funds as reported in the system or plans financial statements, along with two available peer groups, are shown in Table 4.16.

Figure 4.16
Pension Fund Asset Allocation As Of June 30, 2015

	KRS		KTRS		JFRS		Peer Groups	
	Actual	Target	Actual	Target	Actual	Target	LRC	Cliff-water
Public Markets	62.5%	62.7%	80.2%	78.0%	100.0%	100.0%	71.4%	72.0%
• US equity	20.7	20.5	43.6	42.0	74.4	70.0		
• Non-US equity	23.1	22.9	19.2	20.0	0.0	0.0		
• Fixed income	18.7	19.3	17.4	16.0	25.6	30.0		
Alternative markets	35.3	34.5	9.3	11.0	0.0	0.0	27.0	24.0
• Real estate	5.3	4.5	4.6	5.0	0.0	0.0		
• Absolute return	10.7	10.0	0.0	0.0	0.0	0.0		
• Real return	9.7	10.0	0.0	0.0	0.0	0.0		
• Private assets	9.6	10.0	4.7	6.0	0.0	0.0		
Additional categories	0.0	0.0	7.9	9.0	0.0	0.0		
Cash	2.1	2.8	2.6	2.0	0.1	0.0	1.6	3.0

Note: The values provided are based upon reported values in the system or plans annual financial reports.

Source: Kentucky Retirement Systems, Kentucky Teachers' Retirement System, and Judicial Form Retirement System.

As shown in the table, the KRS funds have a higher allocation to less traditional alternative asset classes, while the KTRS and JFRS funds have above average exposure to public equity and fixed income. According to the *Cliffwater 2015 Report on State Pension Asset Allocation and Performance* conducted by Cliffwater LLC, a state plan's average exposure to alternative assets was 24 percent, while publicly listed assets accounted for 72 percent of assets. In addition, a Legislative Research Commission staff review of public pension plan asset allocations, which included 35 of 50 state employee plans, indicated similar results.

Investment Performance

Pension and retiree health fund performance for each retirement system over the 1-, 3-, 5-, and 10-year periods for the fiscal year ended June 30, 2015, is provided in Table 4.17.

The KRS pension and retiree health funds provided positive, albeit low, single-digit returns during the fiscal year ending June 30, 2015. In addition, both the pension and retiree health funds fell short of their policy benchmark, posting a return of 2.0 percent and 1.9 percent, respectively. Over the most recent 3- and 5-year periods, both funds have fallen short of policy benchmarks but exceeded the 7.75 percent actuarially assumed rate of return.⁵ Over a longer 10-year time frame, the funds have fallen short of the 7.75 percent actuarially assumed rate of return.

⁵ The assumed rate of return beginning July 1, 2015, for the KRS pension funds was reduced to 7.50 percent for all funds and will be reduced to 6.75 percent beginning July 1, 2016, for the KERS nonhazardous and SPRS pension funds.

The KTRS pension and retiree health funds provided positive results during the fiscal year. The pension fund, which earned 5.1 percent, also posted a result above its policy benchmark. Over the most recent 3- and 5-year periods, the pension fund has exceeded the policy benchmark return and 7.5 percent actuarially assumed rate of return. Over a longer 10-year period, the funds have fallen short of the 7.5 percent actuarially assumed rate of return. The KTRS retiree health fund was established by HB 540 in April of 2010. Given its limited size and cash flow position, strategic asset allocation targets were not established until the 2015 fiscal year and performance was not benchmarked. For the fiscal year, the retiree health care fund posted a gross return of 1.5 percent.

The two underlying JFRS systems posted positive absolute returns during the fiscal year ending June 30, 2015. The two plans manage all pension and retiree health care assets in aggregate; thus returns between the two funds are identical. Over the most recent 3-, 5-, and 10-year periods, both funds have exceeded the return of policy benchmarks and the 7.0 percent actuarially assumed rate of return.

Figure 4.17
Pension Fund Investment Returns, June 30, 2015

	Pension Funds				Retiree Health Funds			
	1 Year	3 Year	5 Year	10 Year	1 Year	3 Year	5 Year	10 Year
KRS Total Fund (N)	2.0%	9.3%	9.2%	6.1%	1.9%	8.8%	9.3%	5.5%
Benchmark	3.1	9.6	9.9	6.3	3.8	9.9	11.1	6.0
KTRS Total Fund (G)	5.1	12.3	12.0	7.0	1.5	8.9	N/A	N/A
Benchmark	3.4	11.1	11.3	N/A	N/A	N/A	N/A	N/A
LRP Total Fund (G)	10.9	15.5	14.9	8.1	10.9	15.5	14.9	8.1
Benchmark	4.7	10.0	10.4	5.8	4.7	10.0	10.4	5.8
JRP Total Fund (G)	10.5	15.3	14.9	8.0	10.5	15.3	14.9	8.0
Benchmark	4.7	9.4	9.9	5.7	4.7	9.4	9.9	5.7

Note: The KTRS medical trust was established by HB 540 in April 2010. Due to its size and cash flow position, FY 2015 was the first year strategic targets and ranges were established for the fund. FY 2016 is the first year a policy benchmark will be measured for the fund. (G) means returns are reported gross of (or before) fees; (N) means returns are reported after all fees are paid.

Source: Kentucky Retirement Systems, Kentucky Teachers' Retirement System, and Judicial Form Retirement System.

In addition to evaluating each system relative to stated policy benchmarks, the Public Pension Oversight Board also reviewed investment results against other public fund peer groups: RV Kuhns, Wilshire TUCS, and BNY Mellon. Table 4.18 includes median results from three publicly available peer groups, as well as an LRC staff-generated peer group consisting of only US state employee plans. The results reflect a volatile decade that included a significant market downturn.

Figure 4.18
Peer Group Median Investment Returns As Of June 30, 2015

	1 Year	3 Year	5 Year	10 Year
LRC Calculated	3.3%	10.8%	10.6%	6.8%
RV Kuhns	3.0%	10.5%	10.7%	6.4%
Wilshire TUCS	3.4%	10.7%	11.0%	6.9%
BNY Mellon	3.0%	N/A	11.0%	6.9%

Note: For all peer groups shown, returns are reported gross of (or before) fees are applied. "LRC Calculated" includes 35 plans.

Source: LRC Annual Investment Review.

2015 KRS Asset Liability Modeling Study

The Public Pension Oversight Board heard testimony from R.V. Kuhns, a third-party investment consultant conducting the 2015 Asset Liability Modeling (ALM) Study of KRS. ALM studies are generally conducted approximately every 5 years and are a tool to gauge the financial health of a plan and its direction over time. The purpose of the study is to evaluate both plan assets (current investment portfolio) and future liabilities (benefits). Asset liability studies are comprehensive, considering multiple factors such as funded status, contribution requirements, and various time horizons. A policy portfolio, or target asset allocation, is the final output of the study. The board of KRS approved new target asset allocations for each of the plans during its December 2015 meeting, and they have been adopted for the 2016 calendar year.

Kentucky Retirement Systems Change In Investment Fee Reporting

The Public Pension Oversight Board heard testimony from KRS investment staff regarding a recent change in how the systems were reporting fees and expenses. Reported fees had increased 75 percent from the prior year; however, the fees actually paid did not increase, and a change in reporting method was cause of the increase.

The new reporting method provides greater transparency and more information to the public and to the KRS board. In previous years, investment fees for private equity were reported using an equity method of reporting, which, while the industry norm for public pension plans, does not report private investment fees as a separate line item. KRS decided to report these fees using an investment shared method, which chooses to report fees as a separate line item instead of netting against investment activity and income. KRS staff reported that fees from the prior year would have been very similar if both time periods had been reported using the same method. KRS staff noted that the choice of method does not affect net returns but merely provides a different view of the systems' investments and expenses.

Investment Cost Effectiveness Analysis

The Public Pension Oversight Board heard testimony from CEM Benchmarking, a third-party global benchmarking company that conducted an investment cost effectiveness analysis of KRS. The analysis included an independent multiyear review of KRS' overall investment performance, risk, and costs compared to a custom peer group and a larger US pension universe. The analysis found that KRS' 5-year return was below that of both peer groups, while total investment cost was slightly above the benchmark costs. The above average cost was driven largely by higher implementation costs, specifically aligned with the allocation to fund of funds within the Absolute Return allocation. KRS' performance placed the fund in CEM's negative value added, high-cost quadrant for calendar year 2014.

Chapter 5

2015 Public Pension Oversight Board Meetings

Testimony Before The Board

During 2015, the Public Pension Oversight Board met 10 times. Board members received testimony regarding benefits, funding, and investments at multiple meetings. Benefits, funding, and investment summaries are included in Chapters 1 to 4 of this report. The board also reviewed issues relative to KRS personnel and compensation system, Federal Insurance Contributions Act (FICA) taxes, and received testimony and recommendations from various outside interest groups. A summary of these additional issues and testimony is provided below.

KRS Personnel And Compensation System

The board discussed KRS' personnel and compensation system during the April 27, 2015, meeting, focusing on the number of employees, the work they perform, and the personnel system applicable to KRS.

Since 2002, KRS has operated a personnel system separate from the state's personnel system. Prior to the change, a comprehensive review with cost benefit analysis was performed, which identified problems with the personnel and pay system. Some of the problems included inaccurate placement and classification of KRS employees in the state's personnel system, compensation that did not take into consideration comparisons to other public retirement systems, and excessive overtime hours and staff turnover. The recommendations to address the problems were to move KRS from the state merit system and recreate a new classification and compensation system. KRS 61.645 was amended by legislation in 2002, establishing a separate personnel system for KRS.

The KRS Board of Trustees has adopted personnel policies and established a personnel and pay system to attract, hire, and retain qualified individuals. KRS has a goal-oriented performance management system. The executive staff and division managers establish division goals and meet with employees to establish specific employee goals. Pay is based on available revenue and the employee's performance and uses the state's budgeted increases as the base for salary increases. The number of total employees increased from 225 in December 2003 to 252 as of December 31, 2014. Salary increases for the same period decreased from 3.55 percent in 2004 to 2.29 percent in 2014, with employees receiving no increases in some of those years. The percentage increases were those received by all state employees and also included an amount above the state level that was granted by the KRS board.

FICA Withholding On Employee Pension Contributions

The board heard an update from the state Social Security administrator regarding FICA withholding on employee pension contributions. Currently, FICA withholdings, which are federal Social Security and Medicare taxes, are paid on the residual employee salaries after employee pension contributions have been made. A recent Internal Revenue Service (IRS) ruling determined that the method used by the Commonwealth of Kentucky to calculate FICA withholdings was incorrect, and the IRS was requiring a reasonable plan to begin withholding FICA on employee salaries (including pension contributions) to bring the state into compliance. An agreement was reached via contract negotiations, and a new calculation will go into effect on January 1, 2017, giving agencies adequate time to plan, implement payroll systems, and communicate with affected employers and employees. All governmental employers (including the executive, legislative, and judicial branches of state government), eight universities and the Kentucky Community and Technical College System, and 1,471 county, city, and local school districts are affected. The estimated cost of the determination was \$5.7 million in additional payroll taxes, but employees who participate in Social Security will also receive increased Social Security benefits upon retirement as a result of the additional contributions and reported income.

KRS Housekeeping Legislation

The board heard a summary of KRS housekeeping legislation proposed for the upcoming legislative session. The legislation is designed to bring the system into compliance with federal law changes, provide authority that will allow the system to increase efficiency, and resolve ambiguity in existing statutes. Highly controversial language from the last legislative session regarding a requirement to issue benefits through electronic funds transfer or debit card has been removed.

KTRS Housekeeping Legislation

The board heard a summary of KTRS housekeeping legislation proposed for the upcoming legislative session. The proposed legislation makes technical amendments to the plan to ensure continued compliance with federal tax law, to take advantage of efficiencies from a recent overhaul of the information technology used by the system, and to make a couple of other technical changes that will not change current practice or procedure. Additionally, there are a few substantive cost-saving changes, specifically recommendations to tighten provisions that allow retired members to return to work and provisions relating to disability.

JFRS Housekeeping Legislation

The board heard a summary of JFRS housekeeping legislation proposed for the upcoming legislative session. The legislation primarily consists of technical corrections resulting from SB 2, which was passed during the 2013 Regular Session. As the new hybrid plan has been implemented, the system has discovered the need for more direction and some ambiguities that

need clarification. Additionally, there are some items that deal with legislative intent and federal law compliance.

KTRS Funding Work Group

The actuary for the KTRS Funding Work Group, a group established by Governor Beshear, to study and formulate recommendations to address KTRS pension funding issues, also testified before the Public Pension Oversight Board in November. The actuary testified on the proceedings of the work group to date, which include evaluating the issues facing the KTRS pension fund, potential options to address the additional funding needs, and evaluating KTRS benefits to other public pension plans.

The actuary testified that several problems facing KTRS had previously been addressed, including recent changes resolving retiree health funding issues. However, the KTRS pension fund needs an additional \$500 million annually beyond historical statutory contribution rates, and without action through funding, benefit reductions, or a combination of both, the pension fund will be unable to pay current benefit levels in the future. He testified that most of the pension benefit provisions are covered by an “inviolable contract,” with notable exceptions including the high-three final average salary, the 3.0 percent benefit factor, and sick leave payments at retirement. He also testified that an adequate funding plan where the additional contributions needed are phased in over time is a preferable option. The actuary also provided various comparisons, options, and packages for addressing the KTRS pension fund issues.

Testimony And Recommendations From Outside Groups

The Public Pension Oversight Board heard testimony from employee, employer, teacher, and retiree groups during its November 23, 2015, meeting. The testimony included the following recommendations and comments from these groups.

- The Kentucky School Boards Association (KSBA) noted that healthy pension systems for all school district employees were a top priority. KSBA indicated that it was working with constituent groups and KRS to address pension spiking and that finding a solution would be a priority for the upcoming legislative session. KSBA also addressed the issues facing KTRS and expressed concerns that potential changes could affect the quality of teacher recruitment and retention. Lastly, KSBA recognized that the budget was currently strained but requested adequate funding of the actuarially required contribution (ARC) for KRS and KTRS.
- The Kentucky League of Cities (KLC) highlighted the retirement crisis from the perspective of city governments and employers that participate in CERS. KLC expressed satisfaction from its members that SB 2 from the 2013 Regular Session was working to reduce contribution rates, while percentage of funding increased. As a result, KLC was not seeking any structural changes in regard to CERS. KLC did note a recent vote by its board of directors to explore the option of separating CERS from KRS in order to seek greater distinction between the two systems from the legislature in the future.

KLC indicated continued interest in pension spiking and the desire to seek a solution to the inadvertent effects of SB 2. Lastly, KLC drew attention to BR 63, which had been prefiled for the 2016 Regular Session. The legislation would allow cities to operate the way sheriffs' offices do in regard to hiring retired law enforcement officials without making an employer contribution for pension or retiree health insurance. KLC believes this is extremely important for smaller cities that are having difficulty entering new hires into the Department of Criminal Justice training program.

- The Kentucky Association of Counties (KACo) noted the vested interest of its membership, which includes members in both KERS and CERS, as well as retired school professionals and former legislators. KACo encouraged the legislature to remain committed to the schedule established by SB 2 to fully fund the ARC and suggested that the legislature explore options for a dedicated revenue stream to meet the ARC payment.
- The Kentucky Chamber of Commerce testified on behalf of its member employers, expressing concern about the systems as well as the repeated downgrading of Kentucky's bonds. The chamber requested a full independent performance audit of KRS and suggested that the funding for the audit come from existing LRC funds. Second, the chamber suggested that board members look more deeply into the use of placement agents by the pension systems. Third, the chamber recommended a shared responsibility strategy for the KTRS pension fund, much like that used for KTRS in 2010 regarding retiree health benefits, which would include structural changes in benefits to help ensure that the system can be sustained and ensure the additional funding necessary to meet current obligations. Lastly, with regard to bonding, the chamber suggested that any bonding capacity the state can use to rescue KTRS should be considered for KERS, given its precarious financial state and lack of assets.
- The Kentucky Government Retirees (KGR) emphasized a need for additional resources to stabilize the KERS nonhazardous and SPRS pension funds. KGR highlighted the plan's negative cash flow and decline in plan assets during a 4-year period in which the plan exceeded the assumed rate of investment return. As a solution, KGR advocated an ARC-plus strategy, where the full employer contribution is made "plus" an additional amount to provide a cushion. KGR noted that funding the ARC-plus strategy would have to come from a separate revenue stream, such as incremental bond issues.
- The Kentucky Public Retirees (KPR) urged the board to consider several recommendations. KPR asked for continued commitment to fully funding the ARC in the upcoming budget, and it asked for improvement in the condition of the most vulnerable fund, the KERS nonhazardous pension fund, by exploring additional options such as a dedicated funding source to supplement, but not replace, the fully funded ARC. KPR also asks legislators to resist attempts to reduce benefits to current retirees who rely on their benefits. KPR strongly recommended that the General Assembly pass the KRS housekeeping legislation in the upcoming session, specifically the provision to make the investment committee voting membership more reflective of the full board. Finally, KPR requested some consideration of a COLA for existing retirees, whose benefits have been eroded by 6 years of inflation.

- The Kentucky Education Association (KEA) discussed a growing concern among members that pensions they have paid into over many years will not be there when the members retire. KEA reiterated its support for HB 4 from the 2015 Regular session and viewed it as a viable solution that the state could maintain. KEA suggested that bonding and a commitment to fully funding the ARC were needed to create a path to solvency for KTRS.
- The Kentucky Retired Teachers Association (KRTA) discussed the need for a comprehensive and long-term solution for the KTRS pension crisis. KRTA recommended focusing on three primary aspects. First, any solution must ensure that retired teachers receive the benefits that they have earned over their many years of service. Second, the state must provide competitive pension benefits to active and future teachers; otherwise, potential teachers will be lost to other states or professions. Third, the solution must not make mistakes made by other states, such as the hard lessons learned from West Virginia, Michigan, and Alaska when switching from pensions to individual accounts. KRTA supports a defined-benefit group retirement plan.

Chapter 6

Public Pension Oversight Board Recommendations

The Public Pension Oversight Board adopted recommendations at its December 17, 2015, meeting. These recommendations included legislative recommendations for the 2016 Regular Session of the Kentucky General Assembly, administrative recommendations for the state-administered retirement systems, and recommendations to the Governor in development of the 2016-2018 biennial budget.

For the 2016 Regular Session of the Kentucky General Assembly, the board approved the following legislative recommendations:

- The Governor and the General Assembly should include in the 2016-2018 biennial budget the employer contribution rates recommended by the KRS Board of Trustees for KERS and SPRS based on the 6.75 percent investment return assumption adopted for the KERS nonhazardous and SPRS pension funds.
- The Public Pension Oversight Board supports measures that would provide additional funding to improve the financial health of the state-administered retirement systems and in particular measures that would improve the cash flow issues facing the Kentucky Employees Retirement System nonhazardous pension fund or that would improve the overall funding of the Kentucky Teachers' Retirement System pension fund and the State Police Retirement System pension fund.
- The General Assembly should evaluate the KTRS Funding Work Group findings and recommendations and adopt a financially sound approach to address the funding issues facing the KTRS pension fund.
- Currently, KRS and KTRS are exempt from Kentucky Revised Statutes Chapters 45 (Budget and Financial Administration) and 45A (Kentucky Model Procurement Code) relative to contracting. Legislation should be enacted to make KRS and KTRS subject to Kentucky Revised Statutes Chapters 45 and 45A.
- Legislation should be enacted to require Senate confirmation of the KRS and KTRS executive director/executive secretary and all nonelected board members.
- Currently, two trustees appointed by the Governor for the 13-member KRS board of trustees must have 10 years of "investment experience" as broadly defined by KRS 61.645 and must serve on the KRS investment committee and one trustee appointed by the Governor must be "knowledgeable about the impact of pension requirements on local governments." Legislation to address the qualifications of these trustee positions should be enacted, which may include one of the following options:

- Refining the definition of “investment experience” in Kentucky Revised Statute 61.645 to ensure that truly qualified individuals are selected; or
 - Requiring the two appointees with “investment experience” to possess a chartered financial analyst (CFA) designation and to require the Governor to request the CFA Society of Louisville to submit a list of potential applicants for any future appointments/reappointments; or
 - Requiring these three gubernatorial appointees to be selected by the Governor from a list of three applicants submitted by the CFA Society of Louisville (with separate lists required for each appointment) and for these appointees to serve on the KRS investment committee.
- Currently, the KTRS board comprises seven trustees elected by the membership, with the two remaining members being the chief state school officer and the state treasurer. The General Assembly should enact legislation to add additional gubernatorial-appointed members to the KTRS board, and some or all of the additional members should have investment experience.
 - The Kentucky Retirement Systems housekeeping bill, similar to provisions included in House Bill 108 (as passed by the House of Representatives) that did not pass into law during the 2015 Regular Session, should be enacted.
 - The Kentucky Teachers’ Retirement System housekeeping bill, similar to provisions included in House Bill 500 that did not pass into law during the 2015 Regular Session, should be enacted.
 - The Judicial Form Retirement System housekeeping bill, similar to provisions included in House Bill 353 that did not pass into law during the 2015 Regular Session, should be enacted.
 - Legislation similar to the “pension spiking” measures included in Senate Floor Amendment 2 (SFA 2) of HB 306 that was proposed during the 2015 Regular Session should be enacted for KRS. The measure would have added future “pension spiking” charges as a surcharge to the employer contribution rate in each system instead of billing individual employers.
 - Measures to require KRS, KTRS, and JFRS to establish placement agent disclosure policies similar to the measures included in SB 22 from the 2015 Regular Session should be enacted.
 - The General Assembly should require and provide funding for a performance audit of the Kentucky Retirement Systems conducted by the State Auditor of Public Accounts to evaluate administrative expenses, investment fees and expenses, staffing levels, and overall administration of the funds. The performance audit should provide recommendations for any means of reducing administrative and investment related expenses for KRS.

- Legislation similar to HB 306 that was introduced during the 2015 Regular Session relative to actuarial and financial reporting requirements for KRS, KTRS, and JFRS should be enacted.
- Legislation should be enacted to require that an actuarial audit be completed for KRS, KTRS, and JFRS at least once every 10 years by an actuary retained by the Public Pension Oversight Board and paid for by the systems to evaluate the reliability of the actuarial assumptions and methods; to require that the employer contribution rates be reviewed by December 31 in the year prior to each budget biennium by an actuary retained by the Public Pension Oversight Board that is paid for by the systems; and to require that actuarial valuations for KRS, KTRS, and JFRS be completed and submitted no later than November 1 following the close of the fiscal year.
- Legislation to address paid volunteers issues with the Kentucky Retirement Systems, similar to the measures introduced in HB 488 in the 2015 Regular Session and pre-filed in BR 33 for the 2016 Regular Session, should be enacted.

The Public Pension Oversight Board also approved the following administrative recommendations, with an expectation that 2016 legislation can be enacted based upon findings:

- The Kentucky Retirement Systems' board of trustees shall by January 25, 2016, study issues related to agency participation, including but not limited to KRS participating agencies that are using contract employees or that are not offering employees the opportunity to participate in the systems, and shall provide a listing of all agencies that are attempting various means to avoid paying contributions on employees along with the estimated number of employees not being reported as well as the anticipated financial impact to the systems. Based on this information, the General Assembly should enact legislation to address the loss of employer contributions from KRS participating agencies that are using contract employees or that are not offering employees the opportunity to participate in the systems.
- JFRS should develop a website to provide greater access to information to its members and the public. Legislation should be enacted to require specific information to be posted on the JFRS website similar to what is currently required for the KRS/KTRS websites under Kentucky Revised Statutes 61.645(19) and 161.250(4).

The Public Pension Oversight Board also approved the following administrative recommendations for the state-administered retirement systems:

- KRS, KTRS, and JFRS should report investment returns on a net of fees basis on all public documents produced. Currently, KRS reports returns on a net of fees basis, while KTRS and JFRS report returns on a gross of fees basis.
- The Kentucky Retirement Systems' board of trustees shall by January 25, 2016, provide no more than three options for addressing the cash flow issues facing the KERS nonhazardous pension fund. The options shall be detailed with specific research performed for each option which shall include specific savings/costs for each option identified.

- KRS, KTRS, and JFRS shall study and report to the Public Pension Oversight Board by January 25, 2016, on the fees paid directly or indirectly by each system (that is, through incentive or partnership agreements) and shall provide a consensus recommended standard for investment fee reporting to be used by all systems.