

**KENTUCKY TEACHERS' RETIREMENT SYSTEM
FUNDING WORK GROUP**

NOTES OF MEETING

JULY 17, 2015

Steven Beshear, Governor

Crit Luallen, Lieutenant Governor

David Karem, Chair

David Adkisson, CEO, Kentucky Chamber of Commerce

Mike Armstrong, Executive Director, Kentucky School Boards Association

Jason Bailey, Executive Director, Kentucky Center for Economic Policy

Mary Ann Blankenship, Executive Director, Kentucky Education Association

Senator Joe Bowen

Jane Driskell, State Budget Director

Adam Edelen, State Auditor of Public Accounts

Amanda Ellis, Associate Commissioner, Kentucky Department of Education

Lori Flanery, Secretary, Finance and Administration Cabinet

Representative Derrick Graham

Gary Harbin, Executive Secretary, Kentucky Teachers' Retirement System

Todd Hollenbach, Kentucky State Treasurer

Representative Jeff Hoover

Mary Lassiter, Secretary, Governor's Cabinet

Timothy Longmeyer, Secretary, Personnel Cabinet

Roger Marcum, Chairman, Kentucky Board of Education

Senator Morgan McGarvey

Brent McKim, President, Jefferson County Teachers Association

Brigitte Blom Ramsey, Executive Director, Prichard Committee for Academic Excellence

Dr. Tom Shelton, Executive Director, Kentucky Association of School Superintendents

Representative Greg Stumbo

Senator Damon Thayer

Dr. Bob Wagoner, Executive Director, Kentucky Retired Teachers Association

Wayne Young, Executive Director, Kentucky Association of School Administrators

Staff

Robin Morley, Deputy Director

Office of Legislative Services, Office of Governor Steven Beshear

KENTUCKY TEACHERS' RETIREMENT SYSTEM FUNDING WORK GROUP

Notes of Meeting

July 17, 2015

A meeting of the Kentucky Teachers' Retirement System Funding Work Group was held on Friday, July 17, 2015, at 10:00 a.m., in Room 169 of the Capitol Annex, Frankfort, Kentucky.

Present were:

Members: David Karem, Chair; David Adkisson; Mike Armstrong; Jason Bailey; Mary Ann Blankenship; Senator Joe Bowen; Jane Driskell; Adam Edelen (non-voting member); Lori Flanery; Representative Derrick Graham; Gary Harbin; Todd Hollenbach; Representative Jeff Hoover; Mary Lassiter; Timothy Longmeyer; Roger Marcum; Senator Morgan McGarvey; Brent McKim; Brigitte Blom Ramsey; Dr. Tom Shelton; Senator Damon Thayer; Dr. Bob Wagoner; Wayne Young

Kelly Dudley attended the meeting on behalf of Representative Greg Stumbo; and Tracy Herman attended on behalf of Amanda Ellis.

Roger Marcum entered the meeting at 11:10 a.m. Mr. Marcum stated that he was delayed in arriving at the meeting because he was presenting a service award to Dr. Terry Holliday, Commissioner of Education, at the Annual Leadership Institute of KASA.

Guests:

Honorable Crit Luallen, Lt. Governor; Representative Brad Montell; Beau Barnes, KTRS; Jane Gilbert, KTRS; PJ Kelly, AON Hewitt; Robin Morley, Governor's Office for Legislative Services.

1. Call to Order: David Karem, Chair, called the meeting to order and called upon Lt. Governor Luallen to address the KTRS Funding Work Group.
2. Charge to the Work Group: Honorable Crit Luallen, Lt. Governor, delivered the charge to the KTRS Funding Work Group as follows:

Thank you, Mr. Chairman. It's an honor to be here with this group today. We want to thank David Karem for stepping forward and agreeing to chair this work group. All of you know David Karem, former state senator but also recently the chairman of the State Board of Education, and he brings great skills and leadership to this effort, and we appreciate that very much. I'll leave it to Senator Karem to say what he said when the Governor asked him to do this.

We do want to thank everyone for agreeing to be an important part of this group and this effort to find a solution to a crisis that if it is left unsolved could have dire

consequences for tens of thousands of current and retired teachers throughout Kentucky as well as the financial stability and reputation of the Commonwealth.

It is especially a positive sign that the legislative leadership has appointed such strong members representing different viewpoints to this group because these legislative members will be so important to the ultimate passage of any solutions that are brought forward in the General Assembly, and we appreciate the legislative involvement.

To ensure that we are able to put our teachers' retirement fund on solid footing, Governor Beshear issued an executive order that created this work group and in that executive order, he charged this group with first reviewing the best practices in other states regarding pension benefits as part of total compensation; secondly, conducting a comprehensive review of funding options; and making recommendations for improving the fiscal solvency of KTRS, the Kentucky Teachers' Retirement System.

As you know from press accounts, this system's 2014 actuarial evaluation showed a \$14 billion unfunded liability and a 53.6% funding status. That's compared with the funding status in 2000 of a \$571 million unfunded liability and a 95.7% funding status.

If Kentucky is to compete successfully for 21st century jobs, we must have a world class education system and the success of such a system is dependent upon the recruitment and retention of outstanding education professionals. If we do not have a stable secure retirement system for our teachers, Kentucky will never be able to compete in education at the highest levels. We've made too many recent strides in job creation, health care access and education rankings to risk losing those gains now if we aren't able to fulfill our commitment to teachers and continue attracting the best and brightest educators.

In addition, recent bond rating warnings issued by a national credit rating agency regarding the KTRS situation are further evidence that this fiscal crisis has financial implications beyond the KTRS and beyond the impact on individuals' retirements. With this fiscal crisis facing the KTRS and therefore the entire Commonwealth, Governor Beshear has asked this work group to complete its work and submit its report to him on or before December 1, 2015 in advance of the legislative session so that there will be time for adequate review and discussion and consideration leading into that session.

Obviously this administration will change. The first week of December we will be transitioning to a new governor and a new administration, and we want to wrap this work up and complete this work and be sure that it is at a point where it is ready for full debate and discussion in the legislative process. While this is a difficult and challenging issue, the Governor's confident that as has been

demonstrated numerous times, we can put aside partisan politics and work collaboratively to find reasonable solutions to this issue.

I have no illusions about how complicated this is. I have served as Secretary of the Governor's Cabinet for seven years. I have served as State Budget Director. There will be no good options. There will be no easy options. It will be a matter of trying to decide what is the best path forward that is the most fair and equitable approach to solving this crisis over time while ensuring the stability of the fund but also our ability to fulfill our promises to Kentucky's retired teachers, those who are teaching today, and ensuring our ability to continue to recruit and retain good teachers.

The administration is offering the resources of the Executive Branch to support your work, the Governor's Budget Office, Secretary Lassiter's office. Robin Morley has been assigned to the group, and it is also our understanding that legislative leadership will make available expertise from the LRC staff who also have broad background in dealing with these issues of both pension systems. The breadth of experience in this room gives us confidence of leaders with education, business, legislative, budget and fiduciary expertise.

With that combined leadership and with everyone, I know having the similar goal of trying to reach stability and long term solvency for this fund and for the teachers of Kentucky, with those goals in mind we have confidence that this group will arrive at solutions that can move us forward.

Thank you again on behalf Governor Beshear and myself for applying your expertise to help solve this crisis but also being willing to give your time and your attention and your diligence to one of the most pressing financial issues facing Kentucky today. Thank you very much.

3. Instructions and Announcements: Chair Karem introduced Ms. Robin Morley, who will serve as staff for the KTRS Funding Work Group. Ms. Morley is the Deputy Director, Office of Legislative Services, Office of Governor Steven Beshear.

Ms. Morley reported to members that they may contact her with any questions concerning the business operations of the KTRS Funding Work Group. Ms. Morley also reported that a link was established on the Governor's web page where all KTRS Funding Work Group information will be posted. Public comments on the Governor's web page related to the KTRS Funding Work Group will be reported at future meetings.

4. KTRS Overview: Chair Karem introduced Gary L. Harbin, CPA, KTRS Executive Secretary, and Beau Barnes, JD, KTRS Deputy Executive Secretary and General Counsel.

Mr. Harbin reported to the Funding Work Group an overview of KTRS's 75 year history of operations, professional staff, the low cost of benefits (low administrative costs, low investment costs, solid investment performance, and positive impact on Kentucky's economy), recent board

accomplishments, membership facts, and the importance of funding a defined benefit pension plan.

Mr. Harbin introduced KTRS's investment consultant P.J. Kelly, a partner with AON Hewitt, to report on KTRS's investment program. Mr. Kelly reported on KTRS's investment performance, the implications of underfunding, and liquidity stress testing analysis.

Mr. Kelly reported that KTRS's investment program receives an "A+" or "A" in every category.

- KTRS outperformed the Policy Benchmark for each period shown by meaningful margins—A+
- KTRS exceeded the return of the Public Policy Index for each period shown—A+
- KTRS ranks near the top of the Public Fund Universe for each period shown except for the 10-year period where the return ranks in the top third of results—A
- KTRS exceeds the actuarial assumed rate of return of 7.5% for each period shown with the exception of the 10-year period which includes the 2008 financial crisis—A

Mr. Kelly noted that KTRS's investment program is producing exceptional performance at very low costs; however, when a plan is underfunded, investment assets need to return more than the assumed rate of return to maintain pace with the growth of liabilities. For example, a plan that is 60% funded must return 12.5% to match liabilities. This high level of return exceeds any historical or projected standard. Even KTRS's excellent investment program cannot overcome underfunding.

Mr. Harbin introduced Jane Gilbert, KTRS Director of Retiree Health Insurance. Ms. Gilbert reported that the "Shared Responsibility Solution" for prefunding retiree health insurance was working as planned and eliminated more than \$5 billion in liability. Ms. Gilbert thanked members of the education community for their hard work related to the Shared Responsibility Solution.

The PowerPoint and audio, video presentations of Mr. Harbin, Mr. Barnes, Mr. Kelly, and Ms. Gilbert are incorporated by reference.

5. General Discussion: Members of the KTRS Funding Work Group asked questions during the presentations and also requested follow-up information. A list of requested follow-up information is attached and incorporated by reference.

Chair Karem announced that a consultant was hired to assist with the analysis of KTRS. The consultant will be attending the next meeting of the Funding Work Group. Chair Karem distributed a "Consultant Scope of Work" to the members of the KTRS Funding Work Group. The "Consultant Scope of Work" is attached and incorporated by reference.

Adjournment: The KTRS Funding Work Group adjourned at 2:00 p.m.

Kentucky Teachers' Retirement System Funding Work Group

List of Follow-up Information requested at the meeting on July 17, 2015

1. KTRS administrative costs since 2009
2. Number of retirees drawing from two retirement accounts
3. Number of people receiving refunds
4. Investment returns for each of the last ten years
5. Schedule of bond payments for \$3.3B in bonds
6. Demographic information about Kentucky teachers
 - when they begin
 - how long they teach
 - how many leave before vesting
7. What is the cost of doing nothing?
8. What would pay-as-you-go look like?
9. Clarification of "green box" dollars and "yellow box" dollars

KY Teachers' Retirement System Funding Work Group

July 17, 2015

Consultant Scope of Work

- Analysis of Actuarial Components: Review of Methods, assumptions and factors that comprise/influence the actuarial and cash flow analyses performed by and for the KY Teachers' Retirement System (KTRS).
- KTRS Plan Design: Compare various components of the KTRS pension benefits package including benefits as part of total teacher compensation to packages offered by other states, including the seven states contiguous to KY as well as other states with comparable size and demographic characteristics where teachers do not participate in the Social Security program; make recommendations for modification to the pension benefits package for future hires.
- System Funding: Review funding options and cash flow requirements and make recommendations for improving the solvency of the KTRS. Options include, but are not limited to, increasing state appropriations for contribution rates, financing or refinancing liabilities including the issuance of pension obligation bonds, and adjusting components of benefits for future members of the KTRS.
- Assessment of Impact: In cooperation and collaboration with KTRS staff and external service providers (such as system actuary), summarize and quantify the impact of recommended changes on the solvency and sustainability of the KTRS.
- Ad hoc analyses: At the request of the KTRS Work Group Chair, perform impact analyses of other plan modifications or adjustments of interest to Work Group members.