KENTUCKY TEACHERS' RETIREMENT SYSTEM FUNDING WORK GROUP
Notes of Meeting
Sept. 25, 2015

A meeting of the Kentucky Teachers' Retirement System Funding Work Group was held on Friday, Sept. 25, 2015, at 10:03 a.m., in Room 169 of the Capitol Annex, Frankfort, Ky.

Members present: Chair David Karem; David Adkisson; Mike Armstrong; Mary Ann Blankenship; Sen. Joe Bowen; Jane Driskell; Amanda Ellis; Rep. Derrick Graham; Gary Harbin; Secretary Timothy Longmeyer; Roger Marcum; Brent McKim; Sen. Morgan McGarvey; Brigitte Blom Ramsey; Dr. Tom Shelton; Sen. Damon Thayer; Dr. Robert Wagoner; and Wayne Young

Also Attending: Tom Bennett (on behalf of Auditor Adam Edelen); Ed Ross (on behalf of Secretary Lori Flanery); Kelly Dudley (on behalf of Speaker Greg Stumbo); Shannon Tivitt (on behalf of Secretary Mary Lassiter); Anna Baumann (on behalf of Jason Bailey); Tom Scally (on behalf of Treasurer Hollenbach); Rep. Brad Montell (on behalf of Rep. Jeff Hoover); and Sen. Jimmy Higdon

Guests: William B. "Flick" Fornia and Linda Bournival, Pension Trustee Advisors; and Ben Pasley, executive assistant for Gov. Steve Beshear

1. Call to Order: Chair David Karem called the fifth Kentucky Teachers' Retirement System Funding Work Group meeting to order and asked Mary Ann Blankenship to discuss student loan forgiveness programs. Blankenship said some federal student loans up to $17,500 can be forgiven under certain circumstances, including five consecutive years of teaching at a school that primarily serves students from low-income backgrounds.

2. Recap of Sept. 11 meeting: Chair Karem introduced work group consultant William "Flick" Fornia to recap the previous meeting. Fornia said his main takeaways from the Sept. 11 meeting that featured constituents' testimony were:

    a. Teachers rely on pensions. Their compensation is limited and stretched, particularly for new teachers with student loan debt. Weaker pensions could jeopardize recruiting, retention and education quality.
    b. Kentucky's pension situation is a serious problem. Benefits can be fairly high, with longer serving teachers able to receive nearly as much as before retirement. Unfunded liabilities place Kentucky's economy, budget and schools at risk.
    c. All options need to be considered to solve the problem.

3. Broad solution alternatives: Fornia said the broad solutions are putting more money into the pension plan or reducing benefits to see that less money is spent on benefits. The increased contributions could be by the state (with or without bonding), by teachers or involve other assets. On the reduction side, future teachers could be part of a greatly different pension program, with labor implications, while current teachers' benefits could be reduced only as the Inviolable

Contract would allow. The broad alternatives also could involve a combination of contribution increases and benefit cuts. Fornia urged that the work group develop a long-term solution. “You’re in pretty dire straits right now,” he said. Fornia presented funding ratio projections based on current funding, the bonding of 2015 RS House Bill 4 and on making the full contribution. Fornia briefly discussed pension obligation bonds, reiterating points made at previous meetings and suggesting that they might be helpful for the state and outside bond raters in showing that promises of increased contributions in the future “are genuine.” He said a fuller discussion of them might be made after an agreement on increased contributions is reached.

a. Fornia discussed the implications of phasing into the full annual required contribution (ARC). He said the pension is short about 14 percent of pay or the equivalent of about $500 million a year. A 10-year phase-in could require an increased employer contribution of 1.4 percent of pay.
b. Gary Harbin asked how a 10-year phase-in could ever catch up when liabilities grow at $3 million a day. “That doesn’t look like a viable solution,” Harbin said. Fornia agreed, saying it was an attempt to simplify matters and that a more realistic number might be 1.6 percent. Harbin then asked whether the biggest impact on the solution would be taking away benefits or meeting the current debt? Fornia said it can’t be solved only by eliminating benefits for new hires. Harbin said the point of his questions is that the problem can’t be solved on the backs of new teachers. Harbin said the costs of a new benefit tier and phasing-into the ARC need to be considered in terms of what they will cost to taxpayers compared to the cost of simply paying the ARC.
c. Sen. Damon Thayer said he believes it’s early to be declaring any option as not viable. The purpose of the task force is to consider all options.
d. Sen. Joe Bowen said Social Security maxes out at $2,600 a month and noted the cost is split between the employee and employer.
e. Brent McKim asked whether, given talk that the pension program isn’t sustainable, any pension would be sustainable if it wasn’t properly funded? Continuing, he asked if the scenario were just looking at one year of future hires without pre-existing liabilities, what would the cost of the pension be versus the cost of Social Security, and is that an unreasonable expense? Regardless, the unfunded liability must be paid, he said. “Before we start looking at plan design changes and so forth, it would be good to see what does the current plan actually cost, say compared to Social Security …”
f. Chair Karem said members can make their cases at future meetings.
g. Resuming, Fornia outlined the reasons to find a long-term fix and recommended a funding ratio target of 100 percent in 30 years. He outlined various possibilities, such as, doing nothing, changing contributions and reducing benefits.
h. In response to Rep. Montell, Fornia said that the current situation is the result of a combination of underfunding, investment performance not reaching the 7.5 percent return

and methodology changes that mean the fund wasn't as well funded years ago as previously thought.

i. In response to McKim, Fornia said normal cost means the amount required per year to cover the cost, on average, of that person's eventual retirement.

j. In response to Harbin, Fornia said most public pension plans since 2000 have raised contribution rates. Harbin said Kentucky has not increased contributions for teacher pensions despite increasing contributions for all other state employees.

k. In response to Harbin, Fornia said it's cheaper to pay the pension debt now because of the time value of money.

l. Sen. Bowen asked whether the prior answer – that bonding is cheaper for the state – only works if the retirement system's investments hit 7.5 percent, something he said wouldn't have happened had HB4 passed because of the market downturn. Fornia said beating the bond rating over 30 years is the bar to trigger the savings.

m. Fornia outlined levers for reducing the normal cost for current members, which are changing sick leave, the 3 percent multiplier of years of service beyond 30 and removing the carrot of the highest average salary being based on three years instead of five years for those 55 with 27 years of service.

n. Fornia said, regarding current members, removing the high-three versus high-five average salary for those 55 with 27 years of service would result in a 0.65 percent of pay savings; removing the 3 percent multiplier would result in a 0.25 percent of pay savings; the sick leave treatment would result in a 0.66 percent of pay savings; and no savings would result from changes to the return-to-work rules or from pension changes for part-timers and substitutes.

o. Levers for future members could be altering early retirement eligibility, reducing the multiplier, make the final average pay based on a period longer than five years or reducing the cost-of-living adjustment, Fornia said.

p. Fornia said, for future members, requiring a minimum retirement age of 60 for full retirement would result in a 1.55 percent of pay savings to the normal cost; requiring a rule of 90 for full retirement would save 1.1 percent of pay; a rule of 85 would mean 0.53 percent of pay saved; requiring a minimum age of 55 for full retirement would save 0.48 percent of pay; and some other type of benefit reduction by 10 percent of full value would result in a 1.58 percent of pay savings to the normal cost. Other options were presented as well, the largest of which was reducing the multiplier to 2 for all service, which would mean a savings in normal cost of 2.9 percent to 3.7 percent.

q. Harbin said the proposed changes being discussed could result in a mass retirement by existing teachers, which also would impact the medical trust fund.

r. Rep. Graham, saying he was speaking as a retired teacher, added he is concerned about the cost of the health care implications and whether it's realistic to make teachers stay in the classroom 40 years. Fornia acknowledged the point, saying society doesn't want police and fire fighters working 40 years, although that is the standard work life for most people.

s. Rep. Montell questioned if a deferred retirement option plan, where a vested teacher could stop making pension contributions and create their own retirement account, had been examined and whether that would violate the Inviolable Contract. Fornia said the concept is possible, but would be tricky to create.
t. Blankenship asked whether there is a financial drawback for a teacher working beyond retirement age and whether changes that would result in members stopping their contributions would hurt the viability of the pension plan. Fornia said that's true but there would be a savings of keeping them working. (There is no cap on years of service in the pension benefit determination, so each year worked adds to the pension benefit.)
u. Fornia also discussed potential major changes, such as entering Social Security, creating a defined contribution plan, creating a hybrid plan or pension obligation bonds. Social Security would result in a small savings for the state, but would not provide much money for investing in another retirement benefit and would give teachers a smaller benefit. "To us, it's a non-starter," Fornia said. A defined contribution plan (without Social Security) would result in a comparable benefit for a person hired later in life (compared to the benefit they'd get in the existing pension program), but long-term employees and particularly those who retired young would receive much less in a defined contribution plan. "We don't see how the math works" for teachers in defined contribution plans, Fornia said. In sum, Fornia said a hybrid cash balance plan would have higher benefits and costs if the crediting rate is higher on average, and benefits would be lower and costs would be lower if the crediting rate is lower on average. He said no features automatically result in higher benefits at a lower cost; they merely create winners and losers by the one method or the other, moving the risk from the government to the teacher. Tom Shelton asked, and Fornia agreed, that the defined contribution plan could drastically reduce a teacher's benefit to poverty level.
v. Paying off the existing unfunded liability is essential regardless of the changes made to benefits, Fornia said. That cost of unfunded liabilities is about 21 percent of pay "and you're not paying that much," and that cost cannot be reduced or eliminated by different benefits for new members, he said.
w. McKim asked whether closing the pension to new hires would cost the General Fund more because of the payments those new hires wouldn't be putting in the pension plan. Fornia said making other changes could avoid that impact, including paying the unfunded liability; the cost is largely the same, at least initially, regardless of whether new hires are added to the plan.
x. Blankenship asked whether pension obligation bonds could help come up with the 14 percent needed. Fornia said they give cash flow relief and makes it cheaper for the state, "but not a ton" and at some risk – but the risk is a liability as well.
y. Fornia said more actuarial calculations are being developed.

4. Adjournment: The meeting adjourned at 1:13 p.m. until the next meeting on Oct. 16.

Kentucky Teachers' Retirement System Funding Work Group Requests

List of Follow-up Information requested at the meeting on Sept. 25, 2015

- Mary Ann Blankenship suggested finding some alternatives that would incentivize teachers who are considering retirement to work longer and, thereby, also help address the shortfall.
- Sen. Joe Bowen requested more information about how people reach the maximum Social Security benefit.
- Brent McKim asked if KTRS's HB4 actuarial tables, which show bonding would result in a $4 billion savings over 20-years for the state, could be reviewed for accuracy.
- McKim also asked that the bonding plan's $4 billion savings, if validated, be compared to the savings from possible benefit changes.
- Rep. Brad Montell requested that the additional ARC costs be represented if the assumed rate of return isn't met and structural changes aren't made and the state is fully leveraged.