



# KRS MEMBER NEWS

Kentucky Employees Retirement System • County Employees Retirement System • State Police Retirement System

VOLUME 23, ISSUE 2

SEPTEMBER 2005

## KRS News Briefs

### 04-05 Fiscal Year Investment Return

The KRS Pension and Insurance Funds finished Fiscal Year 2005 strong. For the 12 months ending June 30, 2005, the pension funds yielded a return of 9.3% while the insurance funds yielded a return of 9.5%. The strong performance was generated by returns in excess of 12% for non-U.S. equities and alternative asset classes.

### New KRS Phone System

Over the past year, many of you may have experienced problems contacting the Retirement Systems by phone. These problems have often occurred during peak call times such as open enrollment for health insurance. To deal with this problem, KRS will be installing a new phone system to better serve you and other members. The new phone system will go "live" on September 12<sup>th</sup>, 2005. The new phone system will have many new features but will also require some changes to the current structure you have become accustomed to in recent years. If you call the Retirement Systems on or after this date, please be advised of the following:

- Same Phone Number:** The phone number to contact the Retirement Systems **will not be changing when the new phone system is installed** (please see phone numbers below).  

**(502) 564-4646**                      **1-800-928-4646**  
 (if inside local calling area)    **-OR-**    (if outside the local calling area)
- New Options:** In order to more appropriately respond to your needs, you will have additional options to select from when you phone the Retirement Systems.
- New Direct Lines & Extensions:** Although the phone numbers listed above for the Retirement Systems will not be changing, phone numbers and extensions assigned to specific employees will not remain the same. If you have contacted a specific KRS employee in the past by dialing their direct line or extension, please note that these numbers and extensions will no longer be valid September 12<sup>th</sup> and your call will be directed to the KRS Phone Center.

### Annual Statements Mailed In August

Annual statements for the fiscal year ending June 30, 2005 were mailed in August to employees and inactive members of the Retirement Systems.

## Doing Your Part

*By Bill Hanes, Executive Director of Kentucky Retirement Systems*

In the last issue of the Member Newsletter, I discussed with you the continued budget reductions to the employer contributions that help fund your retirement benefits and how these reductions are affecting the financial health of the Kentucky Employees Retirement System (KERS) and the State Police Retirement System (SPRS). I want to thank those of you who took the time to contact the Governor's office and your local legislators to help address this problem. I also want to encourage each of you to continue making your voices heard on this very important issue as it develops in the coming months.

If you were one of the individuals who contacted the Governor's office or the legislature, you may have likely been told that the funding issues facing your retirement plan were complicated and the solutions to address the problem were even more complicated and could only be solved at some point in the future. Unfortunately, the problem and solution to funding your benefits are not as difficult as some would lead you to believe. Instead, both are rather simple.

### What's the Problem?

Kentucky Retirement Systems' funding is similar to the three-legged stool that many of us are familiar with and were once accustomed to seeing in homes and on farms throughout Kentucky. Just like the legs of the stool, there are three sources of revenue that provide stability to fund your benefits. The first leg of the funding stool is the employee contribution. From every check you receive during your working career there is an amount that has been withheld, or set aside, to help pay for future retirement benefits. Currently, each non-hazardous employee contributes five percent (5%) of total earnings while each employee participating in a hazardous duty position contributes eight percent (8%) of total earnings. The second leg of the funding stool is the employer contribution. This is the amount that your employer sets aside to help pay for your future retirement benefits. The third leg of our funding stool is the interest, or investment return, on the funds that have been set aside by the employee and employer.

Unfortunately, it becomes much more complicated when one of the three funding sources, or legs on our stool, is broken or missing. Instead of having a very stable stool that requires little or no effort to use, it becomes a never ending

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battle to stay on the stool. That is exactly what has happened to the Retirement Systems. Two of the three legs are just fine. The second leg, however, has been cut off or shortened to the point where the financial health of the Retirement Systems has become unstable.

Since the Retirement Systems were first started some 50 years ago, current and former employees have dutifully made their contributions, on time, in full and without fail. The investment return, or earnings on the funds that have been contributed, has been more than adequate. Even accounting for the significant market decline in 2000 through 2002, the Retirement Systems' earnings have averaged more than 9.5% for the past 10 years; and remarkably, the earnings have averaged more than 10% for the past 20 years. It's the second funding source, or employer contribution, that is the problem. In 7 out of the last 13 fiscal years and for the fourth year in a row,

current and former Governors and legislators have reduced the employer contribution rates for the Kentucky Employees Retirement System (KERS) and the State Police Retirement System (SPRS) from the amounts recommended by the Board of Trustees and its consulting actuary. The cumulative effect of all reductions in today's dollars amounts to \$349.6 million in lost contributions and investment opportunities. The largest portion of these reductions, more than \$213 million over the current biennium, was made in the last session of the General Assembly by both the Governor and current legislators.

The impact of these rate reductions will be significantly greater in the long run, considering the compounding effect over the years ahead. Much like a home mortgage where the payments over the life of the loan are significantly greater than the original price of the home, rate reductions today will require even greater taxpayer dollars tomorrow to make up for unpaid contributions and lost investment returns.

### **How Significant is the Problem?**

Regardless of what you may have been told by elected policy makers, it is important that you understand the funding problem is real and that the reductions are adversely affecting the financial stability of your retirement plan today. Uninformed comments to the contrary are only meant to pacify you and pass the problem off to another day. Let me give you a few examples of why the funding problem should be addressed today.

❑ **Eroding Financial Stability:** A key indicator of the Retirement Systems' financial health is the funding level, which is the percentage of assets available to fund the benefits you and other members have earned to date. This value provides a measure of the Systems' ability to pay out benefits both now and in the future.

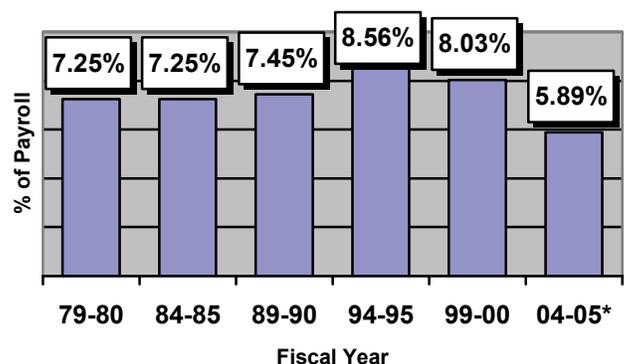
In the mid to late 1990's, funding levels began increasing rapidly due to above average investment returns. By 2000, funding levels had increased to record amounts. In the KERS non-hazardous plan, the pension and

insurance funds **had a combined funding level of 113.8%**. These increases helped to push KERS non-hazardous employer contribution rates to the lowest level in 40 years. Increasing funding levels also prompted legislation to create additional benefits including the 2.2% benefit factor and final compensation based upon a member's three highest years of salary. Unfortunately, the stock market collapsed and less than favorable returns from 2000-2003 began pushing funding levels back down. By 2004, the KERS non-hazardous pension and insurance funds **had a combined funding level of 70.33%**.

This becomes a greater concern when you consider two additional factors that can make these values fall even further. First, funding levels are based upon the actuarial value of assets which smooth fluctuations in investment returns over a 5 year period. Currently, the KERS non-hazardous plan still has \$750 million in investment losses from previous years to recognize in the funding equation. Secondly, the legislature passed a measure in 1996 that effectively defers funding for retiree Cost of Living Adjustments (COLAs) until after they are awarded. Consequently, COLAs that should be pre-funded during an employee's career are instead paid for after he or she retires and is no longer contributing to the plans. If these two additional factors are incorporated into the funding equation today then the KERS non-hazardous pension and insurance funds would **have a combined funding level of 50.84%**.

In order to balance out the decreases in funding levels mentioned above, the KRS Board and its consulting actuary have recommended increases in the employer contribution rates to maintain the financial stability of the Retirement Systems. However, instead of increasing the budgeted employer contributions as needed, both current and former Governors and legislatures have opted to keep the employer contribution rate at historically low levels (please see chart below). If elected policy makers continue with this trend, funding levels will deteriorate even further, and the State will go deeper in debt to the active and retired employees of Kentucky.

**KERS Non-Hazardous Employer Contribution Rate**  
*as a percentage of payroll*



\*Budgeted Contribution Rate

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❑ **Creating Cash Flow Problems:** For several years now, KERS and SPRS have been in a negative cash flow environment. Simply stated, the Systems take in less money from employee contributions, employer contributions, and interest and dividend payments from the investment portfolio than they are paying out in benefits and operating expenses. The shortfall for the two systems is roughly \$16.6 million per month or about \$200 million per year. Consequently, KRS has been required to sell investments in order to meet the monthly beneficiary payroll when employee contributions, employer contributions and investment income are insufficient to meet the KERS and SPRS obligations.

❑ **Passing the Burden:** Since the burden of paying for today's benefits cannot be removed, it will simply be passed onto future generations of taxpayers in the form of increased employer contributions.

### **What about Other Budget Needs?**

The benefits promised to you and the other members of Kentucky Retirement Systems by the legislature are no less important and in many cases, we believe, more important than other commitments made in past sessions and that are currently being discussed. During the 2005 session, debt service was increased to unparalleled levels to fund new projects and new programs at the expense of not adequately funding the employer contribution rates. The consequence of these new programs will be even more competition for General Fund dollars in future sessions, as the new debt service will require greater commitments in the long run. Currently, the Governor has reported a \$214 million surplus to the budget for the fiscal year ending June 30, 2005. Already discussions are being made on how to spend the surplus, including new projects and programs. These uncommitted funds should be considered as a source to pay employer contributions for benefits the state promised to you when you began your working career.

### **What's the Solution?**

Thankfully, the solution to fixing the problem is fairly simple; only one leg of the funding stool is in need of repair. It doesn't take a specially appointed panel to solve the funding issues nor is it a decision that needs to be delayed. What it does take is discipline on the part of the Governor and legislature to make a commitment and appropriate the full employer contribution rates rather than an arbitrarily determined amount. It's only right that the Commonwealth fix the problem. After all, the employees and the Retirement Systems have held up, or supported, their legs of the stool.

### **What Should I Do?**

Preliminary work by the Governor's office is already in progress for the 2006-2008 biennial budget. The decision by the Governor to include or reduce the rates requested by Kentucky Retirement Systems will be presented to the legislature in early 2006. I am asking that you first contact

the Governor's office in the coming months before the budget is presented. I would also ask that you then contact your local legislator on this issue. You should ask for full payment of contribution rates at the level recommended by Kentucky Retirement Systems. You should not ask for payment of the \$349.6 million in contribution reductions that have occurred in the past. These reductions have already been incorporated into the rates requested by Kentucky Retirement Systems. You should also continue to follow-up with the Governor's office and your legislators on this issue. Keep in mind that both the Governor's office and legislature will make decisions based upon the level and persistency of your demands and how these demands impact their overall constituency. I hope you will take the opportunity to voice your concerns and ensure that your retirement benefits are adequately funded now and in the future. Information for contacting the Governor's Office and your local legislator is provided below.

### **Contacting the Governor's Office**

For more information on contacting the Governor and his staff, please review the information below.

#### **By Phone**

You can leave a message for the Governor by dialing 502-564-2611.

#### **By Mail**

Letters should be addressed to:

Governor Ernie Fletcher  
700 Capital Avenue, Suite 100  
Frankfort, KY 40601

#### **Online Information**

Visit the Governor's web site at <http://www.governor.ky.gov/contact.htm> for additional contact information.

### **Contacting the General Assembly**

For more information on contacting your legislator, please review the information below.

#### **By Phone**

You can leave a message for your legislator by dialing 1-800-372-7181.

#### **By Mail**

Mail a letter to a legislator C/O:  
Legislative Research Commission  
700 Capitol Ave.  
Frankfort, KY. 40601

#### **Online Information**

Visit the Legislative Research Commission (LRC) web site at <http://lrc.ky.gov/whoswho/whoswho.htm>.

## KERS Election Update

### Nominations by the Board

In the May 2005 newsletter, you were notified that employees, inactive members and retired members of the Kentucky Employees Retirement System (KERS) will be voting for two individuals to serve on the KRS Board of Trustees in early 2006. In that newsletter, the Board of Trustees also requested names and resumes of individuals interested in running for one of the two trustee positions. At the quarterly meeting of the KRS Board of Trustees on August 18, 2005, the Board nominated 5 individuals to be placed on the 2006 KERS election ballot. The individuals nominated by the KRS Board include:

<b>James Dodrill</b> Louisville, Ky.	<b>Bobby Henson</b> Frankfort, Ky.
<b>Susan Smith Horne</b> Lexington, Ky.	<b>David A. Jackson</b> Frankfort, Ky.
<b>Bruce A. Odle</b> Bowling Green, Ky.	

### Nominations by the Membership

This action by the Board does not preclude another KERS member from being placed on the 2006 election ballot. A KERS member may also be placed on the election ballot

by submitting a petition from the membership. Per Kentucky Revised Statutes 61.645, the petition must contain the name, social security number, and signature of no less than 1/10 of the number of members voting in the last election. Based upon 2002 election results, the petition would require a minimum of 1,305 names, social security numbers, and signatures from the current KERS membership. Petitions may only contain the name of one prospective candidate. Petitions to be included on the KERS election ballot must be delivered to the Retirement Systems no later than November 30, 2005.

### Eligibility Requirements for KERS Trustees

To be eligible to serve as a KERS Trustee, an individual must be an employee, inactive member, or retired member of KERS.

Individuals who are currently serving as elected or appointed city, county, or district officers should also be aware of the constitutional and statutory provisions that may prevent them from simultaneously serving on the Board of Trustees. Kentucky Revised Statute 61.645 and Section 165 of the Constitution of Kentucky establish when a constitutional incompatibility may exist. If you are concerned that a constitutional incompatibility may exist between a position you currently hold and membership on the KRS Board of Trustees, you may wish to contact the Attorney General's office for further guidance.



www.kyret.com

KENTUCKY RETIREMENT SYSTEMS  
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**Enclosed: Important Information About Your Benefits**