



Member Newsletter

Focused on Your Future

Budget Update

by William P. Hanes

Over the past few months, many of you have contacted the Governor's office and your local legislators to request full funding of Kentucky Retirement Systems' employer contribution rates in the upcoming biennial budget. I want to thank each of you for taking the time to express your concerns on this very important issue affecting your retirement benefits.

As I write this article, I wish I could tell you that your hard work has paid off. I wish I could say the employer rates requested by the Board to adequately fund your retirement benefits were included in the budget proposal Governor Fletcher recently delivered to the Legislature or that meaningful progress had been made towards that end. Unfortunately, this is simply not the case. I am once again in the position of writing to you to request your help in contacting your local legislators in the House of Representatives where the budget currently resides and in the Senate, the next stopping point for the budget. I also ask that you take a few moments to read this article to prepare yourself for the phone calls, e-mails, and letters you may make in the coming days.

How Much Did the Governor's Budget Proposal Provide?

On January 17th, the Governor presented his budget proposal to the Legislature. In that proposal, the Governor did provide a slight increase in the employer contribution rates that help fund the Kentucky Employees Retirement System (KERS) and the State Police Retirement System (SPRS) benefits. However, the rates budgeted for KERS and SPRS are woefully short of the amount recommended by the KRS Board and its' consulting actuary to maintain the financial stability of these plans (please see table below). Based upon our projections, the rates budgeted by the Governor will result in a shortfall of more than \$393 million over the next two years. If enacted, this budget will produce a shortfall

larger than all previous budget reductions combined and will bring the cumulative shortfall to date to more than \$760 million.

Dependent Subsidy

In recent sessions of the General Assembly, legislators have appropriated General Fund monies to KRS to subsidize the cost of couple, family, and parent plus coverage for non-Medicare eligible retirees. These past appropriations have been separate from the employer contribution rate and have been passed on to retirees in the form of lower premiums for dependent coverage. As such, they do not improve the financial stability of the plans but rather provide retirees with the same cost for dependent coverage afforded to active employees.

The Governor's budget proposal does not provide appropriations or a statutory directive to provide for the dependent subsidy. Instead, the budget proposal allows the KRS Board of Trustees the option to pay the dependent subsidy out of the relatively small increase in the budgeted employer contribution rate. Given the current financial condition of the Systems, paying for additional benefits beyond what has already been promised to you is simply not feasible. As a result, the cost of health insurance for Non-Medicare eligible retirees who cover a dependent will increase July 1, 2006 if the Governor's budget proposal is enacted. The amount of the increase will vary from \$70 per month for a member who has Parent Plus coverage to more than \$304 for a member carrying family coverage.

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| System | Rate Currently Being Paid | Rate Requested for Upcoming Biennium | | Rate Budgeted by Governor for Upcoming Biennium | |
|--------------------|---------------------------|--------------------------------------|-----------|---|-----------|
| | 2004-2006 | 2006-2007 | 2007-2008 | 2006-2007 | 2007-2008 |
| KERS Non-Hazardous | 5.89% | 17.13% | 20.15% | 7.30% | 8.10% |
| KERS Hazardous | 18.84% | 23.32% | 25.34% | 21.67% | 23.83% |
| SPRS | 21.58% | 42.30% | 47.06% | 24.82% | 27.30% |

Proposed Study of the Systems

The Governor's budget proposal also provides funding for a comprehensive review of the Retirement Systems. Neither the KRS Board nor I take issue with a legitimate actuarial review of the Systems with a serious intent to develop a long term strategy for funding your benefits. However, the actual financial condition of the plans should not be in dispute. Each year, an audit and actuarial valuation of the plans is conducted by an independent Certified Public Accounting firm and consulting actuary respectively. Copies of these reports are delivered each year to the Governor's Office of the State Budget Director and the Legislative Research Commission and are also available on our web site.

I also can't help but note that the comprehensive review proposed would likely be conducted by the Governor's budget office. It is this same office, under both past and present Governors, that have recommended reductions in the employer contribution rate in prior budgets that have contributed to the current shortfall. I'm concerned that this may be intended as a delay tactic by those who wish to leave this session without addressing the issue and defer the problem until January of 2008 when the next budget will be proposed. KRS cannot wait until 2008 to deal with this very significant funding problem.

Why the Additional Increases Are Needed

Although Kentucky Retirement Systems has requested additional funding in the employer contribution rate this biennium, it is important to remember some key points:

Current Rate is at a Historically Low Level:

Exceptional returns from the Systems' investment portfolios during the 1990's



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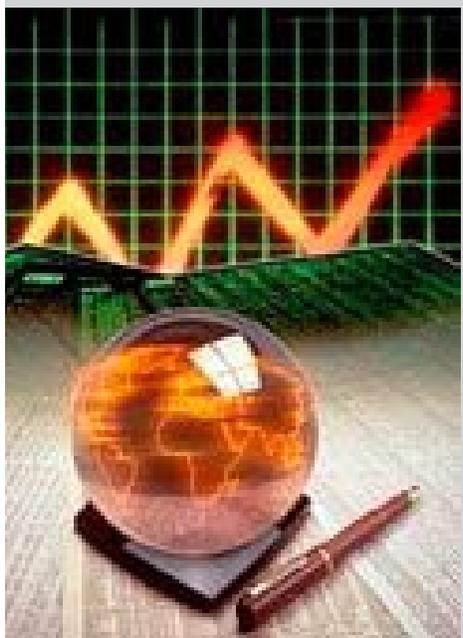


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produced savings that were passed along to the state in the form of lower employer contributions. Five years ago, the actuarially recommended rate fell to 5.89% for KERS non-hazardous employers—the lowest level in more than 40 years. Since that time, past and present Governors and legislators have continued to pay this reduced rate despite changing market conditions, increased benefit payments, and recommendations by KRS to increase the rates in order to maintain the financial stability of the plans.

In terms of dollars, the state is paying less today for your retirement than it did in 1999-2000 when the financial conditions of the Systems were much better. For the KERS non-hazardous fund, the largest fund affected by the budget, the state contributed more than \$191 million in that year. However, in fiscal year 2004-2005, despite eroding funding levels and the need for additional employer contributions, the state's budgeted rate resulted in contributions of less than \$102 million.

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In 2000, the combined funding level for the KERS non-hazardous pension and insurance funds was 113.8%. As of June 2005, the funding level for the KERS non-hazardous pension and insurance funds had fallen to 60.3%.

Benefit Payments Have Increased Significantly: Over the last five years, benefit payments have more than doubled and are continuing to grow due to the increasing number of employees retiring. For the KERS non-hazardous system, annual pension and insurance benefit payments have increased from \$283 million in 1999-2000 to almost \$600 million in the most recent fiscal year.

2005 Insurance Premium Growth: Insurance premiums for Non-Medicare eligible retirees participating in the same plan as active state employees grew at unprecedented levels in 2005—nearly 40% to 60% depending upon the level of coverage chosen and the region of coverage. Since KRS is responsible for payment of premiums retirees have earned under state law, these increases are and will continue to require additional funding.

Key Indicators of Plan Health Show Significant Erosion: As I've mentioned before, a key indicator of the Retirement Systems' financial health is the funding level. The funding level is the percentage of assets available to fund the benefits you and other members have earned to date and measures the Systems' ability to pay out benefits both now and in the future. In 2000, the combined funding level for the KERS non-hazardous pension and insurance funds was 113.8%. As of June 2005, the funding level for the KERS non-hazardous pension and insurance funds had fallen to 60.3%.

This measure is 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 \$212 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 only 47.9%. According to a 2005 study by the National Association of State

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Retirement Administrators (NASRA), the average funding level among public pension plans is around 90%.

Investment Returns: Despite several inaccurate reports, the Systems' investment earnings have been very good over the long term. Returns have exceeded their 8.25% benchmark on average for the past 10 and 20-year periods, which include the worst market decline since World War II. In the last two years, returns have significantly exceeded their 8.25% benchmark. Unfortunately, rate reductions have substantially limited the positive effect of these returns by requiring further depletion of Systems' assets to pay benefits. The depletion of assets will also mean lost investment opportunities in the future.

What You Can Do to Help

The budget is currently being reviewed by legislators in both the House of Representatives, where the budget currently resides, and in the Senate. Once the House of Representatives passes their version of the budget, the Senate will then have the opportunity to make adjustments and adopt their version of the budget. Several legislators, including many in leadership positions, have expressed their desire to make a meaningful increase in the employer contribution rates for the Kentucky Employees Retirement System (KERS) and the State Police

Retirement System (SPRS) in the upcoming budget. Many have also committed to work with Retirement Systems staff towards developing a long term plan to improve the Systems' financial stability.

Significant decisions will be made regarding this matter by those serving in leadership positions in both the House of Representatives and the Senate. My request is that you contact not only your local legislators but also those in key leadership positions in the coming days before the House and Senate adopt their versions of the budget. Tell them that you support their efforts to increase the employer contribution rates to Kentucky Retirement Systems. Ask them to honor the contractual commitments they have made to you in state law before appropriating funds for new projects and programs. Ask them to commit towards working with the Retirement Systems in developing a long term strategic plan to deal with the funding problems facing your retirement plans.

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 your local legislator is provided below. In order to keep you up to speed on the budget as it progresses, I will also be posting a weekly update to our website, www.kyret.com.

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>.

KRS Benefits...Good for You, Good for Kentucky

By investing in your future through employer contributions, the Commonwealth is also making a significant investment in state and local economies. In fiscal year 2004-05, Kentucky Retirement Systems distributed more than \$1 billion in benefit payments to retirees and beneficiaries. With 96% of these benefits being paid to individuals who reside in Kentucky, our economies are the beneficiaries of these payments.

KRS benefits are also good for Kentucky taxpayers. Over the long-term, defined benefit plans, such as those administered by Kentucky Retirement Systems, have proven to be efficient in providing benefits. In fact, for every 26 cents the state contributes, \$1.00 in benefits is realized. See the following table for individual county totals.

| | | | | | | | |
|--------------|--------------|-----------|---------------|------------|--------------|------------|--------------|
| Adair | \$3,375,303 | Edmonson | \$1,137,800 | Knox | \$3,820,391 | Nicholas | \$1,391,780 |
| Allen | \$2,299,639 | Elliott | \$982,033 | Larue | \$2,505,624 | Ohio | \$2,784,900 |
| Anderson | \$14,247,229 | Estill | \$2,282,356 | Laurel | \$8,835,929 | Oldham | \$11,338,760 |
| Ballard | \$1,183,653 | Fayette | \$54,702,182 | Lawrence | \$1,710,634 | Owen | \$6,060,527 |
| Barren | \$7,293,276 | Fleming | \$3,911,874 | Lee | \$1,756,755 | Owsley | \$1,718,674 |
| Bath | \$2,537,544 | Floyd | \$7,019,198 | Leslie | \$1,682,283 | Pendleton | \$2,664,100 |
| Bell | \$5,199,166 | Franklin | \$118,105,285 | Letcher | \$3,179,001 | Perry | \$3,790,055 |
| Boone | \$12,182,556 | Fulton | \$1,453,189 | Lewis | \$1,823,176 | Pike | \$8,143,723 |
| Bourbon | \$4,525,267 | Gallatin | \$791,039 | Lincoln | \$3,269,384 | Powell | \$2,335,200 |
| Boyd | \$8,010,572 | Garrard | \$2,544,474 | Livingston | \$1,938,776 | Pulaski | \$17,526,847 |
| Boyle | \$7,524,236 | Grant | \$4,832,943 | Logan | \$4,041,338 | Robertson | \$734,344 |
| Bracken | \$1,250,905 | Graves | \$5,892,652 | Lyon | \$2,813,209 | Rockcastle | \$2,383,078 |
| Breathitt | \$4,466,287 | Grayson | \$4,092,790 | McCracken | \$14,031,498 | Rowan | \$6,320,751 |
| Breckinridge | \$3,191,125 | Green | \$1,812,950 | McCreary | \$1,689,115 | Russell | \$3,369,037 |
| Bullitt | \$9,526,144 | Greenup | \$3,310,820 | McClellan | \$1,857,755 | Scott | \$9,004,368 |
| Butler | \$1,859,294 | Hancock | \$1,141,774 | Madison | \$15,258,268 | Shelby | \$19,421,121 |
| Caldwell | \$3,736,034 | Hardin | \$14,458,565 | Magoffin | \$1,862,288 | Simpson | \$1,339,832 |
| Calloway | \$7,526,844 | Harlan | \$4,659,322 | Marion | \$3,061,600 | Spencer | \$3,780,959 |
| Campbell | \$11,195,634 | Harrison | \$2,950,738 | Marshall | \$5,890,082 | Taylor | \$3,824,861 |
| Carlisle | \$1,179,309 | Hart | \$2,340,025 | Martin | \$1,062,525 | Todd | \$1,736,983 |
| Carroll | \$2,623,876 | Henderson | \$7,797,601 | Mason | \$2,462,887 | Trigg | \$3,869,534 |
| Carter | \$5,000,637 | Henry | \$9,566,291 | Meade | \$2,923,634 | Trimble | \$1,887,950 |
| Casey | \$2,369,054 | Hickman | \$555,145 | Menifee | \$1,338,068 | Union | \$1,837,273 |
| Christian | \$15,309,362 | Hopkins | \$7,840,252 | Mercer | \$5,920,013 | Warren | \$21,334,929 |
| Clark | \$5,673,742 | Jackson | \$1,830,705 | Metcalfe | \$1,994,106 | Washington | \$2,440,981 |
| Clay | \$6,854,058 | Jefferson | \$165,383,958 | Monroe | \$1,414,903 | Wayne | \$3,316,846 |
| Clinton | \$1,432,343 | Jessamine | \$7,131,705 | Montgomery | \$3,859,227 | Webster | \$2,029,276 |
| Crittenden | \$1,311,459 | Johnson | \$4,334,492 | Morgan | \$3,411,572 | Whitley | \$6,806,098 |
| Cumberland | \$1,589,395 | Kenton | \$18,687,374 | Muhlenberg | \$3,158,557 | Wolfe | \$2,290,207 |
| Daviess | \$19,501,203 | Knott | \$4,242,475 | Nelson | \$6,500,284 | Woodford | \$10,150,496 |



KERS Trustee Election Update

As mentioned in previous newsletters, 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 this year. Election ballots will be mailed by January 31, 2006 and should arrive by mail by the time this newsletter is in print.

Please remember that all ballots must be postmarked no later than March 1, 2006 and must include your signature in order to be valid. Winners of the KERS election will be announced on or before March 15, 2006 and the two trustees elected will begin their new term in April 2006. Please take care of your ballot, as duplicate ballots will not be provided if yours is misplaced.

Do You Have a PIN?

In recent years many active and retired members have chosen to increase the speed and efficiency of their telephone inquiries by applying for and using a Personal Identification Number (PIN). If you have not yet applied for your PIN, you can do so by completing a Form 1000, Request for a Personal Identification Number and filing it with the Retirement Office. This will authorize our staff to issue your PIN. To take advantage of this service, you may contact our office for more information or you may simply print and complete the Form 1000 provided on our website and mail it to the Retirement Office. Please remember that the Form must be completed in its entirety, acknowledged by a Notary Public and returned to the Retirement Office in order to be valid. Once our office receives your Form, the PIN should arrive at the address on file within 10 days.



COBRA and the 2006 Kentucky Employee Health Plans

Retirees, spouses and dependents of retirees who are enrolled in the Kentucky Employees Health Plans (KEHP) for the 2006 plan year will receive COBRA continuation services from Ceridian COBRA Continuation Services. The names of the KEHP plans are the Commonwealth Essential plan, the Commonwealth Enhanced plan, and the Commonwealth Premier plan. Members enrolled in these plans can receive COBRA customer service support from Ceridian COBRA Continuation Services by calling Ceridian COBRA Continuation Services at 1-800-877-7994. If you need further assistance after contacting Ceridian COBRA Continuation Services with your COBRA questions, please call Kentucky Retirement Systems at 1-800-928-4646 (outside Franklin County) or (502) 696-8800 (inside Franklin County).

Please review carefully any COBRA notices and other COBRA-related information that Ceridian COBRA Continuation Services or KEHP may provide to you in the 2006 plan year in order to understand your COBRA rights and obligations. Ceridian's COBRA procedures may be different from the KRS procedures to which you have become accustomed.

Note: For retirees, spouses, and dependents of retirees enrolled on the KEHP plans for 2006, the COBRA provisions contained in the Kentucky Retirement Systems Summary Plan Description do not apply.

One on One Retirement Conference Schedule

For your convenience, we will be providing one-on-one conferences throughout the state. These sessions give members the opportunity to meet individually with a Retirement Counselor to discuss retirement estimates, service purchases, and questions regarding individual retirement accounts.

You must make an appointment for the One-on-One Conferences. To reserve an appointment for a particular conference, please call the Employee Call Center at 1-888-696-8820. Members should consider what retirement dates, purchases, and information they desire for the one-on-one session before making an appointment. You are encouraged to bring your spouse, and a photo ID is required at the session.

| DATE | CITY | LOCATION | CALL FOR APPT. |
|--------------------|----------------|--|---------------------------------|
| Jan. 9-13 | Falls of Rough | Rough River State Resort Park 450 Lodge Road Falls of Rough, KY 40119 | Beginning December 13, 2005 |
| Feb. 13-17 | Pineville | Pine Mountain State Resort Park 1050 State Park Rd. Pineville, KY 40977 | Beginning January 10, 2006 |
| Mar. 20-24 | Louisville | Memorial Auditorium - Ballroom 970 S. 4 th Street (4 th and KY) Louisville, KY 40203 | Beginning February 14, 2006 |
| Apr. 17-21 | Hardin | Kenlake State Resort Park 542 Kenlake Road Hardin, KY 42048 | Beginning March 21, 2006 |
| May 22-26 | Owensboro | OCTC - Southeastern Campus Industry Room 1901 Southeastern Parkway Owensboro, KY 42303 | Beginning April 18, 2006 |
| June 19-23 | Lexington | Paul Laurence Dunbar High School 1600 Man O War Boulevard Lexington, KY 40513 | Beginning May 23, 2006 |
| July 17-21 | Greenup | Greenbo Lake State Resort Park HC 60 Box 562 Greenup, KY 41144 | Beginning June 20, 2006 |
| Aug. 21-25 | Dawson Springs | Pennyrile Forest State Resort Park 20781 Pennyrile Lodge Rd. Dawson Springs, KY 42408 | Beginning July 18, 2006 |
| Sept. 18-22 | Prestonsburg | Jenny Wiley State Resort Park 75 Theatre Court Prestonsburg, KY 41653 | Beginning August 22, 2006 |
| Oct. 16-20 | Bowling Green | Barren River District Health Dept.. Upstairs Conference Room 1100 State Street Bowling Green, KY 42102-1157 | Beginning September 19, 2006 |
| Nov. 13-17 | Burkesville | Dale Hollow State Resort Park 6371 State Park Rd.. Burkesville, KY 42717 | Beginning October 17, 2006 |
| Dec. 11-15 | Florence | City Building - Community Room A 8100 Ewing Boulevard Florence, KY 41042-7511 | Beginning November 7, 2006 |

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SYSTEMS

Kentucky Retirement Systems
Perimeter Park West
1260 Louisville Road
Frankfort, Kentucky 40601



Contacting Kentucky Retirement Systems

By Mail Kentucky Retirement Systems
Perimeter Park West
1260 Louisville Road
Frankfort, KY 40601-6124

All written inquiries should include the member's name, social security number, home mailing address, and signature. If you are requesting an estimate of retirement benefits, please include any retirement dates you are considering. If you are requesting a service purchase calculation, please include the type of purchase and the necessary verification if required.

By Phone 1-800-928-4646 outside Frankfort
502-696-8800 in Frankfort

Telephone inquiries are handled by the Retirement Systems' call center, which assists callers in obtaining services or forms and with answers to questions about the Retirement Systems. You can also make an appointment to see a KRS counselor at the retirement office or submit a request for information by contacting the KRS call center.

Web Page Visit us online at: www.kyret.com

You can generate individual retirement estimates online by going to www.kyret.com and selecting "Online Benefit Estimator." Educational materials and forms are also available on our web page.