FUTURE SHOCK SOLUTIONS

16 steps to treat Kentucky's public pension ailment

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Why do today what can be put off until tomorrow? Why not take the easy political road and ram through ineffective, watered-down legislation to temporarily bandage a gaping wound?

Unfortunately this seems to be the Kentucky General Assembly's policy when it comes to fixing the state's woefully underfunded and unsustainable public pension system.

This do-nothing policy has driven the state's pension system into a $33.7 billion dollar unfunded liability that will, if not addressed with meaningful solutions, break the financial well-being of the commonwealth.

Contained in this brief is a concise and effective method for setting Kentucky's public pension system back on solid ground. Any effective strategy toward pension reform should include three parts:

- an honest diagnosis of the problem as it exists,
- a vision or goal to be accomplished, and
- a specific set of actions that can be taken to achieve this goal.

Diagnosis

What is the problem?

Kentucky's public pension system is in debt and is not sustainable as it is currently structured. The Kentucky Employees Retirement System, which is one of the commonwealth's six public pension plans, is in danger of going bankrupt in just a few years which puts the retirements of state workers – as well as the standard of living for all Kentuckians – at risk.

This unfunded liability has become an excuse to call for tax increases and expanded gambling to make up the pension-funding shortfall, which is now crowding out essential services like education and public safety.

How did we get here?

The cause for this problem boils down to nothing but a culture of greed and secrecy in Frankfort. This culture led to part-time legislators voting to pad their own pensions, enacting legislation that kept taxpayers from knowing how their money was being spent and, enabled through the legislature's inactions, the use of unrealistic actuarial assumptions to quell any concern about the health of the pension system.

Who caused it?

The blame lies with the Kentucky General Assembly and the state's governors for causing the health of the pension system to deteriorate by passing legislation that continually enhances benefits for state legislators and their constituents. The additional cost of this benefit creep continue to outpace available revenues.

Vision for Kentucky's public pension system

The goal is to enact systemic change and create a climate for long-term solvency. This requires changing the very structure of the system while providing the minimum amount of one-time immediate funding to stave off bankruptcy in the state employees' fund. Steps also must be taken to set in place policies that will enable the commonwealth to avoid such pension crises in the future.

Actions to be taken

There are 16 specific actions that should be taken for a return to sound practices and solvency. Each of these actions must be assigned a party who will be held accountable for its oversight and completion.

These action items are crucial to the repair of Kentucky's public pensions. State lawmakers need to be aware that if they do not repair the damage they have done, they risk a public outcry to ban pensions for legislators as nine states have already done.

1. **Transparency:** The first step toward accountability is transparency. Before anything else is done, the books need to be opened on individual pension records with the information made available through a taxpayer-accessible website. The only information not disclosed would be that which is protected by federal law such Social Security numbers.

2. **Move state employees to a defined contribution plan**: Under the current defined benefit plan, taxpayers assume the overwhelming majority of the risk for the state-administered pension plan. A defined contribution system would act as a 401(k)-type savings plan that splits the risk between taxpayers and state employees. The defined benefit component of the pension should be reduced so that taxpayers assume a more reasonable amount of risk. This hybrid plan should be professionally managed to reduce the risk of employee investment losses. A goal might be that this plan would provide payments of an annual pension benefit that replaces 75 precent of an employee's salary, based on a full career of 30 years for hazardous duty employees and 35 years for non-hazardous duty employees. The University of Kentucky pension system is a full, 100 percent, defined contribution plan.

3. **Rollback HB 299**: In 2005, lawmakers passed HB 299. This became known as the "greed bill" as it greatly enhanced pension benefits for legislators. One of those enhancements is called "reciprocity." This allows legislators to calculate their legislative pension -- not on their part-time lawmaker salary but on their full-time salary in another state or local government job. This practice allows part-time legislators to convert their normal pension to super-sized pensions.

4. **Change COLA formula**: Change the cost-of-living adjustment formula from a simple to a complex COLA.

5. **Lower the legislators' overall retirement benefits** (health and pension) to the level of other public workers.

6. **End "spiking"**: The practice of giving workers pre-retirement raises (reciprocity for legislators) to boost their pensions is referred to as "spiking." This must be banned along with using compensatory time (overtime), unused vacation time and sick leave time to spike pensions. It is abundantly clear that public employees are grossly manipulating the commonwealth's public employee pension systems under the authority granted to them to do so by law. Padding a worker's final compensation as a way to manipulate the benefit formula has gone beyond being common. It's just the way it's done in Kentucky -- supplement salaries with bonuses and raises, and payout unused vacation time, sick leave time and overtime. Padding one's compensation with perks should be stopped and compensation should be defined as one's normal rate of base pay.

7. **Create an independent third-party organization**, the "Kentucky Research Council," to review pension bills and conduct independent actuarial studies of proposed benefit changes -- modeled after a program in Ohio -- and provide those findings to the General Assembly, the governor and the public before any

action can be taken on changes in benefits.

8. **Create a statutory oversight subcommittee on pensions**, the "Legislative Review & Oversight Subcommittee on Pensions," which would sign-off on any future pension benefit enhancements.

9. **Remove all private, non-government entities** -- such as KEA, KACo, KLC and Commonwealth Credit Union -- f**rom the state-run pension plan.**

10. **Employees should contribute more** as a percent of payroll toward their pension and health care benefits; a target could be 8 percent of payroll on the pension side, and pay a portion of annual medical inflation much like the private sector.

11. **Eliminate second pensions** for legislators in Kentucky Employee Retirement System.

12. **Reconfigure the pension boards** to increase independence and financial expertise and to remove control out of the hands of the beneficiaries. As a starting point, add two "independent" members with financial expertise to both the board of Kentucky Retirement Systems and Kentucky Teachers Retirement System. "Independence" should mean that neither the board members nor any of his or her family is eligible to receive a pension from any of the state's public employee pension systems; and further, no board member can have a financial interest in any entity that has a contract with any of the pension systems. The aim is to bring greater independence and sophistication to the boards and shift the balance of power in decision making to a fair and balanced system, instead of the existing beneficiary-controlled boards. Finally, no one who is double dipping should be allowed to serve on a governing board.

13. **Remove the hiring of actuaries by the governing boards** and place that authority in the Office of the Governor. The actuaries should report to the governor, not the beneficiary-controlled boards.

14. **The "air time" perk should be stopped immediately**. Public employees are allowed to buy "air time" to pad their years of service credit, one of the three factors (years of service) in the pension calculation formula. Like the words suggest, up to five years not actually worked can be pulled out of thin air. When the employee buys "air time," taxpayers assume the full risk of delivering retirement income on those years not worked. Pensions are intended to provide retirement stability for time actually worked.

15. **Raise the retirement age** in all public pension systems.

16. **Require that any proposed benefit** enhancement be considered by no less than two sessions of the General Assembly before it can be enacted and signed into law.

If the Kentucky lawmakers and the state's governor are serious about pursuing meaningful pension reform, the above 16 steps should be considered. These actions will set Kentucky's public pension systems on the track toward recovery.

If not, the commonwealth is destined to fall further into debt and the standard of living for all Kentuckians will decline.

The information for this report was compiled by Lowell Reese. Reese is owner of Kentucky Roll Call, a public affairs publishing company in Frankfort, and a former state Chamber of Commerce executive.

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