

## **2018 Election Guide: 10 Questions to Ask Candidates for State Office**

While the Kentucky Retired Teachers Association (KTRA) does not specifically endorse candidates, we do take legislative positions designed to protect the interests of our current and future members. We offer our members a list of 10 questions to ask candidates for state to determine if these candidates are aligned with the interests of KTRA and its members.

Remember that this isn't a partisan issue. Both political parties -- along with factors outside of government -- are responsible for our current pension woes.

### **ISSUE 1:**

**Full funding of the Kentucky Teachers' Retirement System (KTRS).**

#### **QUESTION 1:**

**Do you commit to fully funding the actuarial required contributions (ARC) for Kentucky Teachers' Retirement System during your tenure as an elected official?**

#### ***Background***

Many legislators are quick to highlight that for the first time in more than a decade the Commonwealth of Kentucky has fully funded the pension system. This is a fiscally responsible practice and the KTRA appreciates full funding commitment over the next two years.

The reality is that the state's credit-rating agencies lowered Kentucky's credit ratings in both 2015 and 2017, citing the chronic underfunding of its pension obligations. To avoid further rating reductions in the future, Frankfort had little choice but to fully fund all pension obligations over the next two years. Failure to do so would have resulted in much higher interest rates on the debt issued to the Commonwealth of Kentucky, resulting in millions of dollars in higher interest rates and fees.

#### ***Why is this important?***

Gov. Matt Bevin's original pension proposal called for solving decades of pension underfunding on the backs of retired teachers. Despite being pre-funded by teachers, approximately \$4 billion of savings set forth in the original proposal would have come from the future reductions and a retroactive claw back of the annual 1.5 percent cost-of-living adjustment (COLA) for thousands of retired teachers. This would amount to a "bailout" of Frankfort's debt obligations to KTRS.

Regardless of what pension changes may be made for future members of KTRS, existing pension debt must be paid to avoid further costly credit rating downgrades and to ensure that retired teachers continue to receive their earned retirement benefits.

**ISSUE 2:  
Future Pension Changes**

**QUESTION 2:  
If the Kentucky Supreme Court overturns SB151, which the Franklin Circuit Court has ruled is unconstitutional, will you support or oppose similar legislation in the future? If you support additional changes to state's public pensions, what are those changes?**

***Background***

SB151 was a hastily crafted bill enacted without public input and was inserted and passed as an amendment to a sewer bill in the waning hours of the 2018 General Assembly without proper consideration, including an economic scoring or analysis of this legislation. KRTA believes SB151 is harmful to the solvency of KTRS by starving it of future contributions and withdrawals and that it will negatively impact Kentucky's ability to recruit and retain teachers.

***Why is this important?***

SB151 is significantly different than the Gov. Bevin's original pension reform proposal. Some elected officials voted against SB 151, not because they oppose what it does, but because they don't believe it goes far enough in solving the state's pension issues. KRTA believes the implementation of SB 151 is only the first step in a greater effort to eliminate the defined benefit-pension system, as we know it, for *all* Kentucky Teachers. It's important that we understand where our elected officials stand regarding the future of the KTRS' defined-benefit plan, regardless of the legal outcome on SB 151.

**ISSUE 3:  
Tax Reform**

**QUESTION 3:  
If you're elected, how will you try to modernize Kentucky's tax system to ensure that any revenue collected is commensurate with our economic prosperity?**

***Background***

Today's tax systems are not only marred by the bewildering complexities and loopholes that have always afflicted taxation legislation, they are also outdated. That makes them less efficient, unfair, and more likely to conflict with government priorities.

KRTA believes that legislators must examine ways to restore fiscal responsibility in our state by revisiting our outdated tax system. Politicians continue to tout Kentucky's low unemployment rate and record economic investment, yet Kentucky still struggles to invest in education, pay for basic services, and properly fund its public pension systems.

***Why is this important?***

Gov. Bevin's original pension reform package essentially relied on reductions in retired teachers' pre-funded COLAs for a bulk of its savings without modernizing our current tax system. The average teacher earns a \$33,000 pension annually with no Social Security safety net, which is just \$8,000 more than the federal poverty line for a family of four. Asking our retired teachers to bear the brunt of pension reform through reductions in COLAs, payouts, and healthcare benefits without modernizing our tax system and looking for new sources of revenue is simply wrong.

## **ISSUE 4:**

### **Evaluation and assessment of the different state retirement systems**

#### **QUESTION 4:**

**As a member of the General Assembly, do you commit to evaluating the merits of each of the state's public pension system separately?**

#### ***Background***

KRTA believes it is important to look at the big picture, but KTRS must not be "lumped together" with other retirement systems because each system is unique and each has unique issues.

Kentucky has three main retirement systems:

- Legislative and Judicial Retirement System (This system is fully funded)
- Teachers Retirement System of KY (TRS)
- Kentucky Retirement System (KRS)

The Kentucky Retirement System is made up of five subsystems, one of which -- KERS non-hazardous -- is near collapse despite recent imposition of a retirement plan for new hires similar to what SB 151 proposed for new teachers.

#### ***Why is this important?***

Gov. Bevin's initial reform package called for consolidation of Kentucky's three retirement systems, with each system reporting up through the governor.

TRS, which is overseen by under an independent board of directors, is nationally recognized as one of the top managed retirement systems in the United States. TRS has averaged an eight percent return over a 30-year timeframe and ranks in the top five percent in investment performance for U.S. retirement systems over the past couple of years. Given the chronic underfunding in the past, it is important for TRS to retain its management and investment independence so it can continue to remain as one of the best-run retirement systems in the United States.

## **ISSUE 5:**

**Upholding the 2010 Shared Responsibility Plan for retired teachers' healthcare.**

## **QUESTION 5:**

**Will you commit to supporting full funding of the Shared Responsibility Plan?**

### ***Background***

Legislation critically important to Kentucky's teachers, which is called commonly called "Shared Responsibility Plan," was enacted in 2010. Prior to this legislation, there was a \$5 billion in the unfunded liability portion of the retired teachers' medical insurance fund.

Under shared responsibility law, teachers, school boards, retired teachers under the age of 65, and the state all agreed to invest more money to prefund health insurance for retired teachers over the age of 65.

Teachers agreed to pay three percent more of their salary along with additional commitments from school boards to fund the over-65 health insurance program. The state agreed to fund the cost of health insurance for teachers under the age of 65.

The law was a success, quickly erasing the \$5-billion deficit and this program is current funded at about 27 percent after just eight years.

The Shared Responsibility Plan was on a sustained path to full funding until this past legislative session, when the legislature decided to only fund one year of payment (\$60,000 in 2019) and forgo its agreed upon contribution in 2020. This forces KTRS to fund the state's share out of its Medical Trust Fund in fiscal year 2020.

### ***Why is this important?***

The state's failure to live up to the 2010 Shared Responsibility commitment in 2020 sets the medical trust fund on the same path toward insolvency as Kentucky's public retirement systems. This would substantially impair the over-65 health insurance program and the overall ability to provide health benefits to retired teachers.

This would be financially devastating to retired teachers, whose average annual retirement benefit is \$33,000 with no Social-Security benefits.

## **ISSUE 6: Understanding the pension Issue**

### **QUESTION 6: Do you believe the underfunding KTRS by the Kentucky Legislature is the main culprit for the retirement system's shortfall?**

#### ***Background:***

KRTA believes that the failure of policymakers to provide the actuarially required contributions is the main cause of underfunding the KTRS pension.

We keep hearing political "spin" that only 15 percent of pension's unfunded liability is due to not paying the full ARC. This 15 percent figure comes from the Gov. Bevin's "PFM Report," based on this consultant's analysis of all of the state's pension systems, where it lumped the very troubled KERS nonhazardous plan in with other plans like KTRS, which are in much better shape and improving now that credit-rating agencies are mandating full funding. Furthermore, the other factors the PFM Report tied to the causes of unfunded liability are all ultimately tied to funding.

According to the PFM Report, 25 percent of underfunding was caused by using the percentage of payroll method to calculate the state's share of funding. If level-dollar funding had been in place over the last decade, unfunded liability may have been less, but the state wouldn't even fund the full ARC during this period, let alone the much higher amounts required by level-dollar funding.

According to the PFM Report, 23 percent was assigned to underperforming investments relative to the assumed rate of return. Obviously pension systems failed to earn their assumed rate of returns during the recession – but the state knew this and that not appropriating extra funds to the public pension systems to meet the full ARC was making the problem increasingly worse every year. For the last ten years, KTRS has had to sell income-producing assets to make benefit payments, further exacerbating investment income. The inviolable contract guarantees under Kentucky law provides KTRS members with a previously agreed-upon retirement benefit and the state should have provided the extra funding needed to ensure these retirement benefits are paid as promised.

According to the PFM Report, 22 percent was assigned to lowering actuarial assumptions. First, actuarial assumptions were only lowered for the KRS systems – not KTRS -- and furthermore, KTRS has always met its 7.5 percent assumed rate of return over every 30-year period.

According to the PFM Report, nine percent was assigned to unfunded COLAs. Again, unfunded COLAs were a KRS problem; the KTRS COLA of 1.5 percent, paid over the last decade, was prefunded.

## **ISSUE 7:**

**Maintaining the independence of KTRS as an independent board that is not dominated by political appointees**

## **QUESTION 7:**

**Will you commit to keeping an independent board to oversee KTRS and to ensure political appointees do not dominate this board?**

### ***Background***

KRTA believes that the KTRS must keep its independence and not be dominated by political appointees with political agendas.

While no pension systems performed well during the recession, KTRS has always been in the top 20 percent of public pension systems in the nation in terms of investment performance, including ranking in the top five percent in recent years. TRS has always had low administrative expenses relative to other systems. This is due, in large part, to the independent nature of the KTRS Board that only has a fiduciary responsibility to its members.

Conversely, the KRS board resisted a decision to lower its assumed actuarial returns until gubernatorial appointees overtook it. Now that KRS has adopted a historic low assumed rate of return, its unfunded liability has significantly increased and local governments are facing much higher pension costs than would otherwise have been the case. The situation at KRS is clearly a board-created problem by members who have loyalties to persons or entities other than the KRS members themselves. This board looked at short-term investment returns and more immediate political concerns rather than a taking long-term view on returns and the interests of its members.

## **ISSUE 8: Relying on independent expertise**

### **QUESTION 8:**

**Will you commit to supporting state payments the Annual Required Contribution (ARC) as determined by actuaries each budget cycle? Will you support independent pension boards with institutional knowledge of the pension systems to help avoid KTRS falling back into the same issues caused by state's chronic pension underfunding?**

### ***Background***

Much debate has surrounded how to calculate payments towards the unfunded liability of our pension systems. Two methods of payment calculations exist:

1. **Percentage of payroll method** takes into consideration a percentage of gross payroll and factors in assumptions, such as future payroll growth, in calculating proper "catch-up" payments.
2. **Level-dollar funding** simply takes the unfunded liability and divides the payment equally over 30 years to determine proper catch-up payments.

At the end of 30 years, both methods produce the same result of paying off the unfunded liability. However, level-dollar funding results in much higher payments up front whereas the percentage-of-payroll method results in more manageable payments up front and higher payments in years 15 to 30.

Presently, Kentucky uses the percentage-of-payroll method -- an actuarially accepted practice for funding pension debt used by the pension systems in 41 of 50 states. While we would like to see our pension debt paid off as quickly as possible, we question how sustainable it is for the state adopt level-dollar funding as the method of payment given that it almost doubles the state's annual pension payments at a time when we are struggling to fund the basic needs of our current educational system.

### ***Why is this important?***

Doubling the state's pension payments under level-dollar funding could place a tremendous strain on municipalities and school districts, forcing them to make further cuts, consolidate, or declare bankruptcy. Having Kentucky pay its pension obligations as soon as possible through consistent, disciplined funding (not the method upon which our payments are currently calculated) is the true key to solving our current crisis.

**ISSUE 9:  
Retired teachers' COLA**

**QUESTION 9:  
Will you support the continuation of the 1.5 percent COLA for retired teachers and oppose any further attacks of this important benefit?**

***Background***

The 1.5 percent COLA that has been legislated for retired teachers is the only hedge they have against inflation. This statutorily required COLA has always been prefunded. On a few occasions in the 1980s, the Legislature found funds to increase the amount of this COLA, but otherwise, this benefit has not been responsible for any of the unfunded liability of the KTRS pension.

**Why this is important?**

Retired teachers cannot draw federal Social Security benefits and our country is entering a period when many economists are predicting higher inflation. The 1.5 percent COLA is the only thing that helps retired teachers offset the impact of rising prices.

**ISSUE 10:  
Cash-hybrid balance plan**

**QUESTION 10:  
Do you support the cash-hybrid balance plan outlined in SB 151?**

***Background***

The cash-hybrid balance plan outlined in SB 151 could *possibly* provide better retirement security for teachers than the current plan if the market performs satisfactorily throughout the years teachers are paying into the plan. However, a sustained recession during the teachers' working years could decimate their retirement security, which would be especially devastating for teachers because they do not receive Social Security benefits.

***Why is this important?***

Under the changes set forth in SB 151, the state could very well be replacing current pension problems with much worse problems down the road. Another recession could cause retired teachers to become destitute in their old age and have to depend on public assistance and social-welfare programs to survive. More importantly, under SB 151, future teachers have no inviolable contract protections to safeguard them. Any retirement benefits these teachers are counting on in the future could be, at some point in the future, changed by the whim by a future General Assembly.