PUBLIC PENSION OVERSIGHT BOARD

Minutes of the 5th Meeting
of the 2022 Interim

July 19, 2022

Call to Order and Roll Call

The 5th meeting of the Public Pension Oversight Board was held on Tuesday, July 19, 2022, at 3:00 PM, in Room 149 of the Capitol Annex. Representative James Tipton, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Jimmy Higdon, Co-Chair; Representative James Tipton, Co-Chair; Senators Robby Mills, Gerald A. Neal, Michael J. Nemes, Damon Thayer, and Mike Wilson; Representatives Ken Fleming, Derrick Graham, Jerry T. Miller, Jason Petrie, Phillip Pratt, Russell Webber, and Buddy Wheatley; Mike Harmon, John Hicks, and Victor Maddox.

Guests: Jim Carroll, President, Kentucky Government Retirees, Larry Totten, President, Kentucky Public Retirees; David Eager, Executive Director, Erin Surratt, Executive Director of Benefits, Kentucky Public Pensions Authority.

LRC Staff: Brad Gross, Jennifer Black Hans, and Angela Rhodes.

Approval of Minutes

Representative Pratt moved that the minutes of the May 23, 2022, meeting be approved. Senator Neal seconded the motion, and the minutes were approved without objection.

Representative Tipton informed the members that a memorandum confirming the approval of a contract for the actuarial audit of all the systems was in their folders. Milliman Solutions, LLC, will be conducting a Level 1, full-scope audit of the actuarial work performed by the plan actuaries for the fiscal year 2021 valuation for each of the systems, over a six-month term at a total fixed rate of $190,000.

Kentucky Public Pensions Authority Cost of Living Adjustments Discussion

Jim Carroll, President, Kentucky Government Retirees (KGR), an organization representing nearly 16,000 members of the Kentucky Public Pensions Authority (KPPA) discussed retiree cost of living adjustments (COLA). KPPA retirees are facing sky-high costs for essential goods and services, and the most recent COLA adjustment was granted a decade ago on July 1, 2011.

Mr. Carroll read messages from retirees who are struggling without any COLAs.

Mr. Carroll stated that as the Public Pension Oversight Board (PPOB or Board) reviews recommendations for the 2023 legislative session, KGR hopes that it will recommend a prefunded COLA for KPPA retirees with a goal to provide an amount that would help defray some portion of the loss of real income over the past decade. KGR calls this a "catch-up COLA."

KGR believes that the most impactful way of providing this benefit would be a one-time lump sum amount to each retiree, which KGR believes is the simpler, less expensive, and more impactful approach. A couple of ideas that have been discussed are one extra monthly or "13th" pension check or a lump sum payment determined or stratified by benefit level.

Mr. Carroll closed by stating that a General Fund investment in a COLA is an investment in Kentucky's economy and hopes the Board will consider this critical need.

Larry Totten, President, Kentucky Public Retirees, discussed that the retiree COLA should be the number one recommendation by the PPOB to the 2023 General Assembly. Two-thirds of KPPA pension recipients receive less than $20,000 a year and need relief from the consumer price index and the effects of inflation over the past decade.

Mr. Totten mentioned two possible benefit increase scenarios that were presented at a PPOB meeting in October 2021, for which the costs ranged from $171 million to just over $6 billion. Included were a one-time permanent 1.5 percent increase with an estimated cost of $352 million and a single lump sum payment of a retiree's current monthly benefit or so-called "13th check" with an estimated cost of $188 million.

Mr. Totten closed by stating retirees are relying on the realization of the General Assembly that a decade is far too long and that the time is right to help mitigate this situation.

Representative Tipton wanted to remind everyone that the Teachers' Retirement System has an automatic COLA that is prefunded in the contributions, which is not the case in the KPPA system.

Representative Miller commented that Mr. Carroll's statement regarding prefunding a COLA is exactly right and that the General Assembly cannot afford to be generous without prefunding a COLA in order to maintain the funding improvement it has been achieving with Kentucky Employers Retirement System (KERS) and County Employee Retirement System (CERS).

Representative Wheatley recommended that the General Assembly find a way to increase the opportunities for COLAs without putting the retirement system at risk.

In response to a question from Senator Higdon, Mr. Totten stated that the $188 million estimated cost for the single lump sum payment to retirees is for all five KPPA systems.

Representative Graham indicated his support for the single lump sum payment for retirees in the short-term and continuing bi-partisan efforts going forward to build a system capable of future consistent COLAs. He commented on the struggles that retirees face.

Senator Thayer commented that thanks to SB 2 (2013), which he sponsored, the retirement systems are going down the correct path with the new hybrid cash balance plan and the General Assembly paying the ARC every year. The COLAs have to be considered in the broad spectrum of the overall financial stability of the fund.

David Eager, Executive Director, KPPA, began by providing the National Association of State Retirement Administrators' definition of the COLA issue as one of competing elements: benefit adequacy versus plan sustainability and cost. The topic is complex and, nationally, there are many different approaches.

Mr. Eager explained that there are different types of COLAs: ad hoc, automatic, and then simple or compounded. Next, he discussed the Kentucky Statutes, KRS 61.691 and 78.5518, that pertain to COLAs, that provide COLAs will only be granted in the future if: (1) assets of the system(s) are greater than 100 percent of the actuarial liabilities and legislation authorizes the use of surplus funds for the COLA; or (2) the General Assembly fully prefunds the COLA for KERS or State Police Retirement System (SPRS); or (3) in the case of CERS directs payment of employer contributions in the year the COLA is provided. Mr. Eager noted that new COLAs are not a part of the inviolable contract.

Mr. Eager provided a summary of the plan funding status from the actuarial valuation results as of June 30, 2021, for each of the retirement systems under KPPA. The summary included actuarially determined contribution rates and funded status as of the valuation date. Mr. Eager discussed each of the funding ratios on actuarial value of assets for each of the systems.

Mr. Eager provided estimates of the appropriation necessary to fully prefund a 1.5 percent COLA for current retirees of the following systems as of July 1, 2023: $116 million for CERS nonhazardous; $50 million for CERS hazardous; $162 million for KERS nonhazardous; $12 million for KERS hazardous; and $12 million for SPRS.

In response to a question from Representative Tipton, Mr. Eager stated that typically CERS COLAs would come from employer contribution rate increases. For example, the

$116 million cost for the CERS nonhazardous COLA would be a 4.5 percent increase to the employer contribution rate and the $50 million cost for CERS hazardous COLA would be an 8.5 percent increase.

Mr. Eager discussed costs to fully fund benefit increases for all systems. He listed five different increase scenarios with possible costs, including a one-time "13th check" option to all current retirees for all systems at a cost of $188 million. Mr. Eager also provided an example of a one-time COLA costing a total of $25 million for KERS and SPRS retirees adjusted based on the number of years retired.

In response to a question from Representative Tipton, Mr. Eager stated the one-time COLA example is based on number of years retired but could also be based on years of service earned. The scenarios could be run as an iterative process based on criteria submitted.

In response to a question from Auditor Harmon, Mr. Eager stated that the one time COLA example could also be based on benefit level.

In response to a question from Representative Tipton, Mr. Eager stated that it is prohibited by statute to spread a COLA across an amortization period and, if the statute were to change, he believes the actuary would find it an unhealthy financial approach.

Overview of Statutory Pension Spiking Provisions

Erin Surratt, Executive Director, Office of Benefits, KPPA, began her presentation by defining pension spiking. Pension spiking occurs when there is an increase in creditable compensation of more than 10 percent in a fiscal year when compared to the previous fiscal year during the member's last five years of employment. However, exemptions apply.

Ms. Surratt discussed the pension spiking legislation, enacted as part of SB 2 during the 2013 Regular Session and codified as KRS 61.598. When created, it was effective for retirement dates beginning on or after January 1, 2014, and remained applicable for retirements through June 30, 2017, when new legislative amendments took effect. The member could use the full value of the spike in calculating creditable compensation, but the last participating employer was responsible for paying the actuarial cost of the pension spike. The employer has twelve months to pay the invoice without interest and may appeal a bona fide career advancement or promotional determination made by the KPPA.

Ms. Surratt also discussed SB 104 enacted during the 2017 General Assembly which made significant amendments to KRS 61.598, particularly shifting the cost of the spike from the employer to the member. Effective for retirement dates on or after January 1, 2018, a member's creditable compensation is reduced as a result of the pension spike and will not be used to determine the member's retirement benefit. Creditable compensation earned prior to July 1, 2017, is not considered for reduction. If the member's creditable compensation is reduced, the KPPA refunds the employee contributions and interest attributable to the reduction in compensation, but employer contributions are not refunded and are used to pay down the unfunded liability. Members may appeal the pension spiking determination. Pension spiking provisions do not apply to Tier 3 members.

Ms. Surratt then discussed the multiple exemptions from pension spiking and the year the exemption was enacted, including: a bona fide promotion or career advancement (2013); a lump-sum compensatory payment at termination (2013); a lump-sum payment for alternate sick leave at termination (2017); leave without pay (2017); overtime worked as a result of a state or federal grant (2017); overtime performed during and as a result of a state of emergency declared by the President of the United States or Governor of the Commonwealth of Kentucky (2017); increases in the monthly retirement benefit of less than $25 (2021); the first 100 hours of mandatory overtime worked in a fiscal year (2022); overtime performed during and as a result of a state of emergency declared by a local government in which the Governor authorizes mobilization of the Kentucky National Guard during such time as the National Guard is mobilized (2022, retroactive to May 28, 2020); pay raises for public defender specified attorney and staff positions are exempt. (2022 – HB 1). Ms. Surratt also noted that the 2021 amendment that exempted spikes that increase the monthly benefit by less than $25 reduced the number of spikes by 80 percent while only losing 20 percent of the savings to the retirement systems, and saved a great deal of administrative time.

In response to a question from Representative Tipton, Ms. Surratt agreed that the 2022 RS HB 1 budget provision will only be in effect for two years.

Ms. Surratt discussed how KPPA makes a pension spiking determination. At retirement, the last five fiscal years of employment are evaluated for increases greater than 10 percent. If a spike occurs, notice and a form is sent to the last employer to verify any exemptions that may apply, and, after the form is returned, any applicable exemptions are keyed into the system. A post retirement audit is performed and the last five years are reevaluated to determine if a spike still exists after exemptions have been entered. A letter is sent to the member advising the final determination has been made and that the member has 30 days from the date the letter is mailed to appeal.

Lastly, Ms. Surratt provided member pension spiking statistics for fiscal years 2017 through 2022. Over that period, 3,210 retirees have spiked for an average of nine percent of retirees.

In response to questions from Representative Tipton, Ms. Surratt stated that the SPRS salary increases along with other lump sum salary payments in addition to across-the-board raises in the current budget are not exempted from the pension spiking provision. In response to a follow up question, she advised that the KPPA did not have a calculation of the cost to the systems were those salary increases to be exempted from spiking, but she would supply those figures to the Board once they were available.

In response to a question from Representative Graham, Ms. Surratt reviewed the steps of the appeal process.

In response to questions from Senator Higdon, Ms. Surratt stated that the many pension spiking exemptions has caused administrative issues with the staff, members, and legal staff. Possible legislative changes to satisfy the original intent of the pension spiking law to prevent egregious salary spikes without all of the exemptions is being discussed internally with KPPA staff and the actuaries. As a follow up, Senator Higdon commented that legislative changes that may have “no meaningful cost” concern him. Therefore, any legislation having to do with pensions should be reviewed by the PPOB around October and November.

In response to a question from Mr. Hicks, Ms. Surratt stated that the most common item that has resulted in pension spiking is overtime worked.

Representative Miller commented that he agrees with Senator Higdon that pension legislation should be reviewed by the Board before introduced during the Regular Session. Additionally, he wanted to assure the Board that the overtime subject to emergency National Guard mobilization was reviewed by the Board during the 4th quarter of last year.

In response to a question from Representative Wheatley regarding the cost to the system when there is perceived pension spike, Mr. Eager stated that the actuary could provide comment on the question.

Senator Higdon commented that spiking occurs anytime an employee retires with a higher than anticipated final salary. When spiking occurs, there is a cost to the system.

With no further business, the meeting was adjourned.