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Contact: **John E. Chilton**
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To: All CERS Employers
Attn: Chief Executive Officer
From: John Chilton, State Budget Director
Subject: CERS pension plans
Delivered via email by KRS

I am writing to provide an update on the status of pension reform as it relates to the County Employees' Retirement System (CERS) of which your organization is a participant.

The current situation

Required pension contributions will continue as a percent of your organization's actual payroll, assuming no legislative changes occur. The rates that will apply for FY 2018-2019 are substantially higher than the previous year. The increase arises primarily from revised actuarial assumptions that the KRS Board believes are realistic and which will result in immediate decreases in the unfunded liability. The most significant revised assumptions include the long-term average investment rate of return (6.25%, previously 7.5%) and the payroll growth rate (2%, previously 4.0%). The preliminary rates for FY 2018-2019 are shown below. For reference, I have included rates that apply to KERS and State Police plans.

Percent of payroll	CERS plans		Other KRS plans		
	CERS – NH	CERS – H	KERS – NH	KERS – H	SPRS
Old assumptions	19.18%	31.55%	50.39%	21.82%	80.67%
Revised Assumptions	28.86%	50.67%	84.06%	41.12%	154.10%
FY 2019 increase	50.47%	60.62%	66.68%	88.45%	71.85%

You can determine the projected increase in the impact on your budget by referring to the schedule that accompanies this memorandum. Note that Non-hazardous and Hazardous amounts are on separate lines.

Reform efforts

As you know, discussions about changes to the pension system have become more intense since PFM Group Consulting LCC presented their "Report #3 – Recommended Options." That report presented options that Governor Bevin and legislative leadership are evaluating and considering. The recommendations provide a framework for legislation to be proposed in an upcoming special session of the General Assembly.



Addressing the crisis

It is well known that the Commonwealth's pension plans are in a crisis. While the CERS plans are in better shape than other Kentucky plans, the funding level is below 60%. This is in spite of the fact that the assessment of funding levels is based on the old actuarial assumptions that were used in the FY 2016 calculations. Applying realistic assumptions, CERS plans' funding levels are actually much lower. In addition, using the same investment rates of return that corporate plans are required to use – the Corporate Bond Index rate – the CERS unfunded liability goes from \$5 billion to \$9 billion. Across all Commonwealth plans, using the Corporate Bond Index rate, the aggregate underfunding for all of Kentucky's eight plans goes from \$33 billion to \$64 billion.

Furthermore, if Kentucky plans were subject to federal standards for single-employer private plans, the CERS plans would be designated as having severe funding shortfalls because their funded status is less than 60%. As such, federal law would require that all benefits be frozen and the plans terminated. This is true even using the old 2016 actuarial assumptions, not the more realistic discount rates and other assumptions required of private plans.

The need for significant reform is evident to anyone looking at the health of the CERS plans within that larger context, not simply benchmarking it against the health of the KERS plans.

Budget impact

While changes can be made to moderate the cost of pensions, each of the plans will need more money in order to avoid future insolvency and to safeguard future pension benefits. Implementing the appropriate changes will require a long-term commitment by employers to reforms that are necessary to rebuild the financial foundations and that allow a path to fully sustainable fiscal health.

The obvious problem is most employers cannot afford the additional pension contributions associated with the higher rates indicated above. The pension plans are in a crisis but so are employer budgets.

In order to address this predicament, the Governor and legislators believe it is appropriate to do two things:

1. Assess the status of all of the plans, not just the CERS plans, using conservative and realistic actuarial assumptions. No more pretending that everything is just fine. Everyone needs to understand the severity of the situation. To do otherwise will lead to solutions that fall short of solving the problem.
2. Examine the benefit structures with a view to lowering future costs without jeopardizing employee and retiree retirement security.

To address budgetary implications to the Commonwealth and to all employers, priorities must be set and choices must be made. Unfortunately, the choices are not happy choices – make structural changes to the pension plans and/or reduce other spending. Governor Bevin and the members of the General Assembly are considering, but have not decided upon, changes to KERS, CERS and the other state plans.

The PFM report identified changes to CERS benefit structures that would reduce the cost of each of the eight plans. These need to be considered and some of the suggested options should be implemented. I urge you to work with the Kentucky League of Cities, Kentucky Association of Counties, Kentucky School Boards Association, and other organizations to address the pension crisis and to consider ways to put the financial condition of the plans and the employer organizations on a sustainable path forward.

We look forward to working with these groups to find a solution that strengthens the Commonwealth's fiscal foundation and fulfills Kentucky's commitments to its public servants and teachers.