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LOCALLY ADMINISTERED CITY PENSION SYSTEMS

, prepared by William Wiley.

Research Report No. 143

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Prepared by
William Wiley

Research Report No. 143

Legislative Research Commission
Frankfort, Kentucky
December, 1977

This report has been prepared by the Legislative Research Commission and paid for from state funds.

FOREWORD

The 1976 General Assembly directed through House Resolution 104 that a comprehensive study of all existing locally administered retirement plans for city employees be conducted. The passage of this resolution was motivated by a growing awareness that many city pension funds were in serious financial condition and that the financial status of others was undetermined because the cities failed to procure periodic actuarial services. This knowledge led to concern that many city employees would face retirement without their expected pension benefits unless corrective action were taken. For these reasons the study resolution requested analysis of the basic provisions of each service retirement program, analysis of death benefits, disability and survivor benefits, evaluation of cost of living adjustments, consideration of the need for periodic actuarial studies, review of the financial status of each program, evaluation of fund management practices and recommendations for additional retirement benefits. The requirements of this resolution were fulfilled through analysis of existing statutes relating to city pension systems and a field survey of the condition and operation of each of the city pension systems located during the preparation of this report. A list of suggested improvements in Kentucky law relating to city pension systems is included as a part of this study. The reader should also refer to 78 HB 74, prefiled by the Interim Joint Committee on Cities, which incorporates many of these recommendations.

The 1976 General Assembly also passed Senate Resolution 77 calling for a study of retirement plans for elected city officials and directing that this study be conducted in conjunction with the House Resolution 104 study. Information and recommendations concerning retirement options for elected city officials are included as a part of this report.

This report was prepared by Bill Wiley in conjunction with the City Employees Pensions Subcommittee of the Interim Joint Committee on Cities. The firm of Meidinger, Actuaries and Employee Benefit Consultants was retained to provide actuarial assistance and professional advice on study design and implementation. Their analysis of certain of the data gathered and processed by Mr. Wiley is included as an appendix to this report. Mr. George Arvin, General Manager of Kentucky Retirement Systems, offered valuable comments at various points during the conduct of the study. The cities of the Commonwealth and their respective pension administrators were most helpful and cooperative during the data gathering phase of the study. Their assistance is most appreciated.

Vic Hellard, Jr.
Director

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SUMMARY OF FINDINGS AND RECOMMENDATIONS

A survey of locally administered city employee retirement systems in Kentucky revealed 52 such systems, created under the provisions of 10 separate governing statutes. Thirty-three of these systems cover police and firemen or police only. Two are for all employees including police and firemen, and the remainder serve non-uniformed employees. Eight are essentially managed for the cities by insurance companies and funded through insurance plans. The others are managed by local pension boards, some with the advice of professional investment counsel. Forty-two Kentucky cities have joined the state administered County Employees Retirement System. These cities range in size from cities of the first class to cities of the sixth class. Some cities cover their uniformed employees under locally administered retirement systems and their non-uniformed employees under the County Employees Retirement System. Five cities have in recent years closed their locally administered retirement systems to new employees in favor of joining the County Employees Retirement System.

There are six different statutes for police and firemen in the various classes of cities and in urban county governments, and pension systems have been established pursuant to each of these statutes. Most are mandatory and all are explicit in the retirement criteria and benefit formulas they require. The cities are given the task of implementing these statutes, managing the systems and paying for the benefits.

There are also six different statutes for non-uniformed employees. Two of these would also allow coverage for uniformed employees in fourth and fifth class cities. Pension systems have been established under the provisions of four of these statutes. These statutes are permissive in nature and do not provide detailed criteria for retirement or specify benefit formulas. The cities are at liberty to design their pension systems according to their own preference within the framework of the few guidelines which are provided.

While periodic actuarial evaluations are essential to determining the financial soundness of pension systems, they are required only in second class cities and urban county governments. The required evaluations must be performed at least once every five years. In practice, Louisville and certain third class cities also purchase actuarial evaluations, but evaluations in most third class cities are not conducted on a regular basis.

The results of actuarial evaluations are not encouraging. Unfunded liabilities are high, and the percentage of payroll necessary to keep these liabilities from growing is very high in most cities. For example, the Louisville Firemens Pension System requires an annual payment of 37.7% of payroll. The city of Covington must contribute 40% of payroll to the non-uniformed employee pension system. Several cities are failing to make contributions to their pension funds which are required by law. This means that their unfunded liabilities will grow. If this practice continues, the cities will one day be unable to meet their pension obligations. While the funding requirements for police and firemen benefits levied by the state are burdensome to many cities, the funding requirements which cities have imposed upon themselves for non-uniformed employee benefits can be just as great. Three second class cities created pension plans for non-uniformed employees featuring very low retirement ages with generous benefits. Each of these systems has approached the point of inability to fund benefits. Two closed their doors to new members, but their unfunded liabilities remain to be paid.

While actuarial evaluations in first and second class cities and urban county governments reveal financial difficulties, the absence of such evaluations in smaller cities leaves potential financial problems undetermined. Only six of 21 police and firemen pension plans in third and fourth class cities have had evaluations performed. Only one of these systems is adequately funded.

There are weaknessess in the statutes which could be corrected to prevent at least some of the difficulties which locally administered pension plans have encountered. First among needed corrections is the requirement that all pension systems, whether for uniformed or non-uniformed employees, have periodic actuarial evaluations performed. These evaluations should occur at least once every three years, and funding requirements should be based upon actuarial evaluation results.

Nearly all the statutes need to provide for a disability determination procedure, and all lack a disability review provision. All pension statutes should also provide for offset of Workmen's Compensation Benefits against pension disability benefits to prevent double payments by cities.

Some statutes allow or require return of employee contributions to the non-vested employee who terminates. None allow interest, and some do not permit the return of contributions at all. For the sake of equity, terminating employees should receive their contributions with interest, as is required in state administered pension systems. Employees should also receive annual statements of their accumulated contributions and their progress toward earning pension benefits. They should receive summaries of annual reports, and copies of actuarial evaluations upon request.

There are certain problems limited to statutes governing non-uniformed employees which ought to be corrected. Foremost among these is the need to establish a minimum retirement age, below which a city cannot offer a normal retirement benefit except on a reduced basis. This retirement age should be no less than age 62. Cities should also be required to base retirement upon some average of the employee's highest years of compensation, rather than the final year of compensation. Failure to implement this restriction can lead to a pension elevated by a final year promotion or an excessive amount of overtime. Cities should also be required to vest the employee after a given number of years to protect the long-term employee who must terminate. Ten year vesting is suggested.

The statutes governing police and firemen also suffer from problems which should be corrected. Those applicable to cities of the third and fourth classes are variable and obsolete with respect to benefits for spouse or children in the event of disability or death. For example, children in fourth class cities can receive as little as $6 per month, and only to the age of fourteen, in the event of the father's occupational death. Another serious deficiency in one statute applicable to police and firemen in cities of the third class and another applicable in cities of the fourth class is the absence of pension benefits for service over 20 years. In cases where there is a minimum retirement age, some employees work longer than others for the same pension benefit.

These statutes now suffer from patchwork amendment which has led to inconsistencies and inequities both within and among the various police and firemen pension systems. Revision of retirement formulas and survivor and death benefits should be accomplished with uniformity in mind and through formulas which adapt to inflation.

Finally, there is a possibility that Congress will impose Social Security coverage on all public employees. If this occurs, the benefit formulas for police and firemen which the state mandates must be amended to integrate them with Social Security benefits. Otherwise the cities will be burdened with additional costs on top of already expensive pension costs.

CHAPTER I

INTRODUCTION

The subject of public sector pension plans has become one of intense interest in recent years for a variety of reasons, including concerns specific to public pensions themselves and a spillover of Congressional interest in private sector pensions which led to the passage in 1974 of the Employee Retirement Income Security Act. In the private sector concern was based primarily on the fear, buttressed by ample evidence, that many corporate pension plans were inadequately financed and managed or were designed in such a way that employees could dedicate long years of service to a firm and receive little or no pension benefits. The Employee Retirement Income Security Act was designed to protect private sector employees through federal regulation of investment, funding, administration and reporting aspects of private sector pension plans. Spillover from this federal action included Congressional committee study of public pension systems and the introduction of two bills which would extend federal regulation to state and local public pension plans. House Resolution 9155, the Public Service Employee Retirement Income Security Act of 1975, would extend many of the controls of the 1974 Act to public sector plans. House Resolution 13040, the Public Employee Retirement Security Act of 1976, would extend to public plans modified versions of the reporting and disclosure and fiduciary provisions of the 1974 Act.

Reaction to possible federal regulation of state and local public pensions plans has not been favorable among state governments. The National Conference of State Legislatures has formed a Pension Task Force to deal with pension plans at the state government level and to prevent federal intervention in this area. While the states desire to avoid federal controls, there is an awareness of the problems with state and local pension plans which invite federal intervention. There is thus motivation to correct those problems through the action of the individual state legislatures.

One of the greatest problems with private sector pension plans, inadequate funding, is also characteristic of state and local plans. The causes of this common problem are in many cases dissimilar. Whereas the private sector might often have been characterized in the past by inadequate funding of benefits which were themselves very low, the public plans are in many cases characterized by inadequate funding of excessive benefits. This problem has resulted from the granting of pension benefits to public employees over the years in an atmosphere of public disinterest and without proper consideration of costs by the legislatures and city councils involved. As these resulting pension systems mature and benefits come due, the public is becoming increasingly aware and resentful of the public sector pension benefits which generally exceed those in the private sector. (Gordon, 1976, p. 3) Legislatures and city councils are faced with the problem of paying benefits which were promised but for which funds are increasingly difficult to provide.

In Kentucky pension problems are not so extreme as in some other states. State administered pension systems generally provide adequate but not unjustifiable benefits. With the exception of funding problems with the Teachers Retirement System, care generally has been taken to adequately fund these pension systems. Funds are available to pay benefits, and the actuarial positions of the systems tend to improve rather than deteriorate. Still, the members of the Kentucky General Assembly are aware of the difficulties they might face in the area of pensions. There is, for several reasons, a special concern in the case of locally administered city pension systems in Kentucky. First, there is evidence available that many cities are having difficulty paying for their pension systems. This awareness comes from knowledge of actuarial reports which warn of serious future problems. Second, the funding status of many Kentucky city pension systems is an unknown factor because the statutes in many cases do not require the cities to have their systems actuarially evaluated. There could be many potential financial problems to be faced by various city councils around the state; but the number, seriousness and timing of these potential financial disasters is undetermined. Third, there is evidence that many cities, in the absence of statutory restrictions, have designed pension systems which provide benefits not justified by good pension theory.

The members of the Kentucky General Assembly, by passing House Resolution 104 calling for a study of Kentucky's city pension systems, evidenced concern both that pension systems be properly designed and that they be adequately funded to insure payment of promised benefits. These concerns cannot be dealt with in the absence of information on the provisions of the systems levied by both the legislature and the respective city councils and knowledge of the financial condition of the systems. This report is designed to provide answers, to the extent possible, to those questions.

The data and information required to complete this report were derived from an analysis of the existing statutes on city pension systems and a field survey conducted with representatives of each of the city pension systems. Review of the statutes took the form of a comparative analysis. A list of important pension system characteristics, such as coverage, administration, funding, and actuarial practices, was prepared. The provisions of each pension system with respect to each of the characteristics were examined. Appropriateness and adequacy of various pension provisions, similarities and differences among systems, internal consistency within each pension system, and detail and scope of each statute were the criteria by which the statutes were analyzed singly and as a group.

Prior to the field work an attempt was made to locate each of the locally administered city pension systems in the state. Data from previous pension reports were used to establish a preliminary list. This list was supplemented through federal sources; the experience of the Meidinger firm with Kentucky city pension funds; and a letter survey of third, fourth and fifth class cities in Kentucky. After locating the various city pension systems, a questionnaire was administered to a knowledgeable person in each city. Usually this person was the city treasurer, finance director, clerk, or the city manager. This questionnaire, which is reproduced as Appendix 4, dealt with supplementary coverage provided by cities, background data on each system, plan benefits, plan administration, investment policies, and actuarial soundness. The bulk of the interviews were conducted in person; a smaller number were completed by telephone; and a few were conducted by mail. After the questionnaires were completed, the data which they contained were categorized for entry onto computer cards and were subsequently reproduced in table form on computer printout, using the SAS program available through the Department for Human Resources. A copy of this printout was provided to Meidinger, Actuaries and Employee Benefit Consultants of Louisville, for their analysis. These data were also used in the preparation of this report.

Chapter II of this report will serve as a discussion of criteria which might be used to evaluate city pension systems. Chapters III and IV examine the results of analysis of existing statutes and the field data gathered in various cities of the Commonwealth. Chapter V presents a discussion of the feasibility of pension systems for elected city officials. Chapter VI consists of a summary of findings and recommendations, many of which were incorporated in 78 HB 74, an act relating to city pension systems which was prefiled by the Interim Joint Committee on Cities.

CHAPTER II

STANDARDS FOR CITY PENSION PLANS

Before undertaking a critical study of the existing conditions of city employee pension systems in Kentucky, it is necessary to have a basic understanding of what the purposes of pension systems are and what criteria will be used to judge their adequacy. The purposes of employee pension systems, the pension and disability protection levels they ideally should achieve, the funding of pension systems and some cautions in planning for local pension systems are discussed in this chapter.

Scope of Employee Pension Plans

An employee and his dependents, whether in the private or public sphere, are subject to at least five separate risks which can result in economic harm to them: unemployment, retirement, disability, medical expenses, and death. Most employee benefit plans are designed to provide protection for one or more of these contingencies, partially on the theory that it is less expensive to provide protection of this nature on a group basis than it is on an individual basis, and partially on the basis that many employees might not accumulate sufficient funds in order to protect against these contingencies. In most instances retirement plans are not designed to provide protection against temporary unemployment, nor are they designed to provide for reimbursement of medical expenses. However, in many instances retirement plans provide not only pension benefits but also death and disability benefits. Death and disability benefits are an option or requirement in all of Kentucky's municipal pension statutes.

Benefit Levels

The first problem to be considered is the level of retirement benefit which should be provided. As people are differentially compensated in our society because of varying levels of training, skill, productivity and responsibility, it is also customary to base pension levels on compensation received during the working years. A convenient way to discuss levels of retirement income is in terms of net replacement ratios, or the percentage of net income received by the retiree as compared to net income prior to retirement. Net figures arrive at a closer approximation of real purchasing power than gross figures because there are tax advantages and reduced expenses which accompany retirement which are not available prior to retirement. For example, the retiree pays no taxes on his Social Security benefits or on his pension plan benefits to the extent that they result from his own previously taxed contributions; and he is usually in a lower tax bracket than before he entered retirement. In addition, the retiree does not pay for job related transportation, wardrobe and meal expenses. Contemporary thought holds that retirement income for the employee in the $15,000 salary range, should, after a full work career, replace between 80% and 100% of the average net income of some number of the worker's final employment years. (Jump, 1976, p. 5) Anything under the 80% figure indicates hardships for the retiree, and anything in excess of 100% is considered too generous and a burden upon members of the working generation.

The question of how to generate this ideal retirement income can be complicated by several factors. Benefits from a public employee retirement system are often combined with benefits from other employee benefit programs to arrive at a total retirement package. For example, many city employees, including many policemen and firemen in third class cities in Kentucky, are covered by Social Security as well as by city pension programs; and all employees in Kentucky cities are covered by Workmen's Compensation in the case of injury. Each of these programs requires a financial contribution by the city as employer. It would seem equitable to determine the employee's total retirement package through integration of benefits from these three sources as applicable. Although this would seem to be an ideal way to plan total retirement benefits, complications arise because Social Security benefits are the province of the federal government and rise in isolation of any planning for retirement benefit levels at the state or local level. Unless a formula is adopted which automatically adjusts to changes in Social Security benefits or Workmen's Compensation benefits, as applicable, the combination of Social Security, city pension, and Workmen's Compensation, as applicable, can easily exceed desired levels. The states of Utah and Virginia are presently studying the possibility of integrating pension benefits with Social Security. (Pension Newsletter, September, 1977, p. 1)

As stated above, pension benefits should be related to compensation during the final few years of employment. The wage to be replaced at retirement is best measured by what was received by the employee relatively near to retirement. However, there are a number of possible abuses of a salary-related program. Perhaps the most evident of these is the program that utilizes overtime in computation of pension benefits. Unless sound administrative procedures are followed, an employee can attempt to work as much overtime as possible during his last few years of employment, since pension benefits will be substantially increased by the amount of overtime actually paid. The second, although less frequent, problem is the possibility of an individual's compensation being artificially inflated during his last year or two prior to retirement in order to provide him with an overly large pension. This problem can be solved by basing pensions on something other than the final year's compensation. The most common solutions are to base the pension on the income of an average of five years in private industry and three years in many public plans. Overtime compensation can also be excluded from pension consideration. An unusual and unfair situation would occur in many Kentucky cities if this approach were used for firemen. As a result of HB 477 of 1974, (KRS 337.285) which requires that firemen be paid overtime for working more than 40 hours in a week, many cities reduced firemen's hourly wages to equate salaries paid after HB 477 to those paid prior to HB 477. Thus, excluding overtime hours from pension consideration would result in unusually low pensions for firemen.

Length of Service and Retirement Age

Pension benefits should also be related to length of service. Ideally, an individual should earn pension benefits during his entire working lifetime, which ordinarily consists of 40 or more years of service. However, in practice many individuals spend their first 5 or 10 years of employment in non-permanent jobs which provide little if any pension benefits at time of retirement. It is frequently assumed that an individual with approximately 30 years of employment should receive full pension benefits.

The specific age at which retirement should occur is difficult to establish with any degree of finality. This question seems to be unresolved in our society. The normal retirement age which is most commonly chosen is age 65, when the retired person can draw full retirement benefits under the Social Security system. The age of 65 is also used by most pension plans in the private sector of our economy. Recently the suggestion has been reported in various news media that the age for retirement under Social Security should be raised to 68 to alleviate financial difficulties with that program. There is a tendency in public sector pension plans to offer normal retirement benefits at an earlier age. Robert Tilove, in Public Employee Pension Funds, reports on the basis of a nationwide survey that the average age for normal retirement in public employment is approaching age 60. (Tilove, 1976, pp. 12-16) Unless we are to assume that public employees age faster than do employees in the private sector or that public sector work is more difficult than work found in the private sector, then early retirement must be resulting from considerations other than how long an employee is productive. Perhaps our society will come to accept the normal retirement age at some point earlier than that at which men and women begin to decline in their vigor and productivity. If people retire earlier, then a way must be found to pay for this earlier retirement. This report assumes that normal retirement should be granted at the age of 65 except in those cases where unusual physical vigor is required, that most men and women can be efficient and productive to that age, and that work beyond the age of 60 does not place an undue burden on the employee.

Any discussion of retirement age for public employees must deal with the fact that policemen and firemen, because of the frequently strenuous nature of their duties, must retire at an earlier age than civil servants in non-hazardous positions. It is generally accepted that policemen and firemen should be allowed to retire at least by the age of 55 and commonly retirement is allowed at earlier ages. Granting early retirement is a costly proposition, however, and costs increase dramatically as retirement ages are lowered.

A substantial number of police and firefighters, including some in the state of Kentucky, have been successful in negotiating retirement plans which provide for immediate commencement of benefits after only 20 years of service, regardless of age. Quite literally this means an individual can retire in his early 40s and receive substantial retirement benefits for as much as 30 to 40 years. The need for so generous a retirement provision is questionable.

While similar "20 year and out" programs have not yet been adopted for non-uniformed employees, there is a clear pattern, as evidenced by some municipalities in Kentucky, to permit non-uniformed employees to retire at an age much younger than the 65 assumed for Social Security purposes and most private plans. In some Kentucky cities normal retirement is granted to non-uniformed employees at the age of 50. This retirement age stands in sharp contrast to normal retirement ages permitted in private industry.

It would not be unreasonable to require most employees to work to age 65 and hazardous duty personnel to age 55 for normal retirement. However, it is becoming customary to allow individuals to elect retirement, regardless of age, without reduction in benefits if a substantial period of service, such as 30 years, has been completed. Early retirement on a reduced basis, such as one-half percent reduction for each month prior to normal retirement date, is commonly permitted for an individual who has reached age 55 (or for hazardous duty positions, age 50) and completed at least 15 years of service. An individual who does wish to retire before age 65 (or 55) should be permitted to do so, but the benefits provided should be substantially reduced in order to reflect the additional cost involved.

Disability

Perhaps the most difficult provisions to include in a retirement plan are appropriate disability benefits. Disability retirement should ideally relate to the degree of disability involved and resultant loss in earning power which can be expected. If earning capacity is totally destroyed, disability payments should be at a maximum, while if earning capacity is only partially impaired, disability payments should compensate only for the percentage of income which is lost. Kentucky statutes generally disregard the possibility of partial disability and deal only with the full disability situation.

Another question which must be considered is whether or not the disability is work-related. If it is work-related, then the city's responsibility to provide adequate coverage is clear. If it is unrelated to work, perhaps the city should not be responsible. While the employee need is the same in either case, ideally disabilities unrelated to work should be covered by a level of government with greater fiscal capabilities than a city. Use of Social Security is one manner in which this can be accomplished. Making group disability insurance coverage available to employees is another way to supplement meagre pension system non-occupational disability benefits, especially until the employee is vested in the Social Security system.

Assuming that relatively stringent disability tests are applied and disability is severe, a substantial disability benefit is desirable and the city should provide the coverage for occupational disability. At the same time care should be taken to see that the various disability benefits toward which the city might contribute--pension, Workmen's Compensation and Social Security--do not accumulate to create a disability bonanza of benefits in excess of previous compensation. Appropriate offsets of various benefits against one another can be built into pension statutes to prevent excessive compensation.

While both occupational and non-occupational disability benefits should be adequate to meet the needs of the employee and his dependents, the possibility of recovery from injury or illness should always be anticipated by permitting the city to re-examine disability retirees on a periodic basis. If a genuinely impartial disability determination and review process is provided, employees have nothing to fear from the process; and the true purposes of disability retirement can be served. Those who continue in a disabled condition can continue to receive benefits, and those who recover can return to work.

Death Benefits

Death benefits are generally designed to serve one of two functions. First, a minimal amount of insurance is generally considered desirable in order to handle final expenses, including burial of an individual. Thus, if the municipality does not maintain a separate life insurance policy, it may be appropriate to provide a death benefit of $1,000 and $2,000 under the plan for both active and retired employees.

The second and substantially more costly need for death benefit coverage is meaningful monthly income to spouses and dependents. Many of Kentucky's city retirement systems provide dependent benefits, some inadequate in amount and others quite substantial.

In certain cases these provisions incorporate two drawbacks. First, in order to qualify for the death benefit protection, lengthy service requirements may be stipulated. Since the needs of an employee with a brief period of service may be just as substantial or greater than those of an employee with the required service, a long service requirement is undesirable. There should be no service requirement for occupational death and in the case of non-occupational death, a service requirement of five years is customary.

Secondly, larger benefits are almost invariably provided when death is due to occupationally related causes. As in the case of disability, the needs of the employee's spouse and dependents will not vary by cause of death. It could be argued, however, that the needs of survivors after non-occupational death must be met by some level of government with greater taxing power than the city. While this is a valid argument, frequently the employee is not covered by, or vested in, the Social Security system, which is the obvious alternative to pension system death benefits.

Perhaps the best a city can do in such cases is to provide some minimum level of benefit to the spouse prior to remarriage, while providing additional benefits at a meaningful level if there are dependent children. By utilizing this method, the city would not be unduly burdened by benefit requirements for adults who could be self-supporting; but larger families with greater financial needs would be protected.

Vesting, Portability, Deferred Benefits

One of the major drawbacks of city retirement system options in Kentucky, CERS being a notable exception, is that an individual must work as much as 20 years before being entitled to any immediate or deferred benefits. The typical employee may not stay with a single employer long enough to receive credit for the substantial number of years required. He may experiment with various sorts of employment, he may move from city to city, or his employment may terminate through the actions of his employer. Under any of these possibilities, he would lose his pension credit. While at one time it was common under private pension plans to require a substantial number of years of service before any pension benefit was granted, passage of the Employee Retirement Income Security Act of 1974 has led to the general requirement that an individual covered by a private plan who terminates with at least ten years of service be entitled to receive a deferred benefit upon reaching normal retirement age. It would also be desirable for municipal plans to provide a non-forfeitable right to deferred benefits payable at normal retirement age if an individual has completed at least ten years of service at the time of termination.

While earlier vesting would be to the benefit of the employees, it is still true that the employee who changes jobs in early or mid-career will never receive a substantial pension for those years, due to the practice of basing pension benefit levels on the final years of compensation in the system. The employee under Social Security is not penalized for such employment transfers. He can move from employer to employer and carry his accumulated credit with him. Under CERS an employee can move to any employer who subscribes to that system or to the Kentucky Employees Retirement System, Teachers Retirement System, or State Police Retirement System and carry his benefits with him. While the earlier vesting recommended above is clearly desirable in itself, it would be ideal if this vesting were combined with some degree of portability of pension benefits among Kentucky cities. Under such a plan the employee would achieve a greater degree of job mobility while maintaining his capacity to build a substantial pension benefit. This suggestion would require some degree of administrative centralization among city pension systems and would be easier to accomplish if all the municipal pension systems were more nearly alike. Caution must always be taken when designing pension portability to insure that the benefit a retiree gets from each system where he earned credit is based upon the formula for that system alone. Otherwise, sophisticated employees might try to end their careers under the provisions of a pension system with the most generous formula, thereby increasing benefits earned earlier under pension systems with less generous formulas. CERS guards against this possibility in its portability provisions, KRS 61.680(2)(a).

Cost of Living Adjustments

Cost of living adjustment after time of retirement is one of the most discussed subjects in the area of pensions today. Although cost of living adjustments are still extremely rare in private industry, there are a substantial number of state and municipal plans utilizing such adjustment factors. The most prominent program utilizing post-retirement adjustment to reflect cost of living is Social Security.

The major difficulty with post-retirement adjustments is that they can be extremely expensive. An average annual increase in cost of living of only 3% may result in cost increases under a plan of as much as 30%. It is virtually impossible to predict the amount of future inflationary increases, so there is no appropriate manner to determine the ultimate cost of an automatic post-retirement adjustment feature.

For individuals who are covered by Social Security, the automatic adjustor included in that program may be sufficient to provide meaningful protection against post-retirement inflation. Ideally, all municipal employees should be covered by Social Security; and their pension benefits should be integrated with Social Security coverage. For individuals not covered under Social Security, the alternative of periodic examination of benefit levels for retired individuals is preferable to automatic cost of living raises. This procedure allows the appropriate governing body to examine actual levels of inflation as they occur and to make equitable adjustments based upon the level of benefits currently provided and the capacity of the system to pay increased benefits. It also permits more accurate budgeting, since the cost of adjustment is controlled by the city, rather than by unpredictable levels of inflation.

The Funding of Pension Systems

Paying personnel costs in the form of pension benefits is essentially different from meeting normal payroll costs. The pension obligation is paid to the employee many years after it is incurred, while the normal payroll cost is met at the time the services are rendered. When a city with a pension plan employs a worker and covers him under that pension plan, it immediately begins to incur a financial obligation toward the worker for that time when he retires. Most contemporary writers on pensions recommend that the city begin accumulating assets to pay pension benefits from the initial day of employment. This type of plan is referred to as a funded system. The alternative is to use a "pay as you go" system when the pension becomes payable. If the "pay as you go" approach is used, the city must meet pension obligations 20 or 30 years later with no accumulated assets to draw upon. Costs can become unsupportable.

An example drawn from "Performance Audit of Public Employee Retirement Systems in Indiana, 1976" may serve to illustrate this point. Consider a male employee who starts work at age 35 and retires at age 65. Given the life expectancy of a male who is already 65, he will die at age 80. Thus, he will draw a pension for 15 years. Throughout the 15 years of this employee's retirement, the government will pay an annual pension. Under a "pay as you go" system, this would require a cash outlay during the time of retirement, but no contribution during the employee's 30 working years. In comparison, under a funded system the government would pay a steady 6% of the employee's salary into the fund during his working years but would appropriate no funds during the employee's retirement. Under the "pay as you go" system, the government would pay 4.7 times more during the employee's 15 retirement years than it would contribute to a funded system during his 30 working years. While some of this additional cost must be discounted to inflation, the basic value of prior funding of pension systems is still illustrated. (1976, p. 7)

Many city officials may not understand funding requirements and the potential financial difficulties of city pension plans because determining future pension obligations requires the application of complex actuarial techniques. These techniques involve elements of financial analysis outside the scope of ordinary auditing techniques with which they are familiar. Because retirement systems originally start out with no retired employees, assets generally accumulate quite quickly and after some years may reach deceivingly large proportions in relation to the overall city budget. However, the vast majority of the liabilities under most new retirement systems are for benefits earned for still active employees and are not revealed by simple audits. Thus, a simple analysis of the size of the retirement fund or of the relationship between income and outgo is not sufficient.

The purpose of an actuarial evaluation is to recognize not only current benefits but also benefits which are accruing and which have accumulated for prior service. When pension plans are established, almost always there are workers employed who have worked a number of years without a pension plan and have reached or are nearing the age when pension benefits are very important. It is customary to grant such employees credit for their prior service, even though neither they nor their employer made any pension fund contributions during those years. When this is done, a liability for prior service is created; and that liability must be paid, along with pension liabilities created in the future.

It is possible to actuarially determine the amount of this prior service liability, just as it is possible to determine financial requirements for future service. Each year that a prior service liability remains unpaid, it will grow in size unless interest payments are made on it--much as a mortgage liability will grow unless interest payments are made. As a mortgage is paid over a specified number of years through a combination of principal and interest payments, so it is customary to pay a prior service liability over a number of years through a combination of principal and interest payments. Some actuaries counsel that an unpaid prior service liability is unimportant as long as interest payments on the liability are met and the work force and pension funds continue to expand as the city grows. If the city fails to pay at least for current service and interest on prior service, then the unfunded liabilities will grow and require a larger contribution in the future. Allowing an unfunded liability to grow can lead to a situation where contributions in excess of 50% of payroll are required to slowly restore pension funds to a sound condition.

Unfunded liabilities can grow for reasons other than simple failure to make the necessary contributions. If the benefits of the pension system are made more liberal without accounting for the cost involved, the city's liability to each employee affected by the change will grow, both for future service and for all the service which the employee has rendered in the past. Then the city must pay increased contributions for each employee who has been covered by the pension plan for each year since his initial date of coverage. This result will occur whether pension benefits are increased by the city or by the legislature.

It becomes evident, then, that financial planning for pension funding is complex, simple balance-on-hand accounting can be deceiving, and failure to employ and heed competent actuarial advice can lead to disastrous financial consequences. For these reasons it is imperative that any municipal pension statute require professional actuarial valuation at least every three years.

Number of Participants in a Viable System

An important question that must be examined in an analysis of retirement programs is the number of participants necessary in order for a separate plan to be viable. Small programs suffer from a number of difficulties. First, expenses may be much larger on a percentage basis under a smaller plan than under a larger plan, primarily because certain requirements (such as actuarial evaluation, auditing standards, legal assistance, and other matters of this nature) generate a fixed cost regardless of the number of participants covered under a plan. Second, small plans tend to utilize less sophisticated investment techniques and thus earn smaller yields, primarily because there are not enough funds available to interest most investment firms. Finally, a small plan is subject to much more abuse through lack of understanding by both the participants and the individuals administering the plan. It is relatively uncommon for an outside consultant or actuary to be involved in the operation of a small program, thus depriving the participants and beneficiaries of the assistance of professionals in the employee benefit field.

Any attempt, however, to place an absolute arbitrary limit on the number of employees necessary in order to establish a plan or to administer a plan separately from other programs in the state will encounter difficulty. Some small communities have a much greater capability in this area than others. As a general rule, however, a program that will cover more than 100 participants should be able to support its own administrative expenses and operate in an efficient manner, while those with fewer than 100 participants will have difficulty. If there are between 25 and 100 participants, the decision should probably be made both on the basis of the sophistication of the individuals involved in establishing the plan and on the probability that the program will be fiscally stable. It would be a relatively rare situation where a plan of less than 25 participants should be separately established. The cost of administering a plan of this size usually renders it economically unfeasible.

An alternative for small communities to the use of professional investment counsel and the purchase of actuarial services is investment in insurance funded pension plans. Insurance companies offer certainty of financial stability and careful management, but any insurance plan sold may be more desirable from the agency viewpoint than from the participants' viewpoint. A more attractive alternative might be for smaller municipalities to gain professional management services by joining the County Employees Retirement System (CERS), established under KRS Chapter 78. This system is open to any city or county in Kentucky. While it does not provide ideal benefits in all circumstances, it is a program that will meet valid retirement needs for most employees. Since CERS is organized solely for the purpose of public pension system management, it does not sacrifice a portion of its fund investment returns to private sector profits as do the insurance plans. CERS is not limited to, or designed only for, small cities. Both Louisville and Lexington have placed their civil service employees under CERS.

Some Cautions in Pension Planning

An analysis of the goals retirement benefits should serve and when retirement should occur should also include the goals retirement planning should not serve. Retirement benefits provide for economic security during old age or for disability or death and should be related to the level of compensation earned by the retiree during his or her working years. Sometimes the view is expressed that retirement benefits for public employees are a reward for a low level of compensation during the working years, and therefore retirement benefits should be inflated, or retirement ages reduced, or both. If certain public pensions are inflated because of low salaries, then there is false economic reasoning, because pensions are paid in dollars, the same as wages. If a public sector employer has difficulty raising revenue to pay adequate wages, it follows that it will also have difficulty raising revenue to pay inflated pension benefits. If it is not truly the case that the public employee is under-compensated, then it would seem that in the final analysis that the employee is over-compensated at taxpayer expense.

Perhaps there is a tendency to grant pension benefits in lieu of current compensation because the payout for pensions is delayed for many years and does not seem like a real expense. This tendency involves faulty reasoning. Pension dollars are real dollars, whether paid today or 20 years in the future. They should not be granted unless they are related to rational retirement goals and can be paid for by the public treasury.

Another tendency which should be avoided is granting the same pension benefits to groups of employees who perform vastly different types of services under dissimilar sorts of working conditions. This is most likely to occur when pension benefits for public safety or hazardous duty personnel are compared with pension benefits for general category employees. The pension benefits of public safety employees are greater than ordinary pension benefits because the physical requirements of public safety work require earlier retirement. While early retirement means that pension costs will be great, there would appear to be no way that cities can avoid such costs today and still make police and firemen employment attractive enough to employ a sufficient number of qualified personnel. Non-uniformed employees are not subject to the same dangers and physical stresses as police and firemen. There is no reason or physical requirement for them to interrupt their employment at age 50 or 55 and go into retirement. If cities wish to grant such benefits to non-uniformed employees, it should be with an understanding of the costs involved and consideration of whether such benefits are really justifiable.

CHAPTER III

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

Any analysis of city pension systems must begin with an analysis of the state statutes which authorize and govern them. Table 1 lists statutory requirements for all of the various city pension systems and CERS. In Table 1 statutes are indicated by the first section number of the applicable KRS sections. For example, KRS 95.520-.620 is designated simply as KRS 95.520. In most cases the governing statutes contain more than one section. The statutes described in Table 1, and the number of systems presently operating under each, are as follows:

Statutory Citation	Adoption Mandatory	Adoption Permissive	Number of Systems
KRS 95.290, 1st Class Class City Police and/or Fire		X	2
KRS 95.851, 2nd Class City Police and Fire	X		7
KRS 67A.360, Urban County Govt. Police and Fire	X		1
KRS 95.520, 3rd Class* (or 4th or 5th) Police and Fire	X		8
KRS 95.621, 3rd Class* Police and Fire	X		7
KRS 95.767, 4th or** 5th Class Police & Fire		X	5
KRS 90.400, 2nd Class Civil Service		X	7
KRS 90.410, 3rd Class Civil Service		X	2
KRS 96.180, 3rd Class Electric and Water Plant Board		X	1
KRS 67A.320, Urban County Civil Service		X	
KRS 79.080, All Local Governments, General		X	1
KRS 78.510, County Employees Retirement System (CERS)***		X	42

* Third class cities must adopt either KRS 95.520, 95.621 or the CERS.

** Fourth and fifth class cities may adopt KRS 95.767, 95.520 or 90.300 to 90.420.

*** Any city may adopt CERS except for police and firemen in second class cities and urban county governments.

TABLE 1

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

	KRS 95.290 1st Class Police & Fire	KRS 95.851 2nd Class Police & Fire	KRS 90.400 2nd Class Civil Service	KRS 95.520 3rd Class Police & Fire	KRS 95.621 3rd Class Police & Fire	KRS 90.410 3rd Class Civil Service
Number of Cities	2	7	7	8	7	2
Criteria for Normal Retirement						
Age		Age 50		None	None	
Service		20 years		20 years consecutive	20 years consecutive	
Criteria for Early Retirement						
Age / Service		NA		NA	NA	
Formula for Normal Retirement		(2.5%)X(Average of highest 3 yrs.) X(No. of years) 75% Maximum		50% of final salary	50% of final salary for 20 years, 2% for each year 21 through 25, 3% for each year 26 through 30. 75% Maximum	No more than 50% of final salary
Guaranteed or Petition		Guaranteed		Petition	Petition	
Minimum		$100/Month, rising with Social Security				
Formula for Early Retirement		NA		NA	NA	
Cost of Living Increases		2% annually over base index year after age 60 if actuarially supportable		None	None	
Vesting		20 years		20 years consecutive	20 years consecutive	
Age for Deferred Pension		Age 50		NA	NA	

TABLE 1

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

KRS 96.180 3rd Class Elec & Water	KRS 95.767 4th & 5th Police & Fire	KRS 67A.320 Urban Co. Civil Serv.	KRS 67A.340 Urban Co. General	KRS 67A.360 Urban Co. Police & Fire	KRS 79.080 All Govts. General	KRS 78.510 - County Employees Retirement System	
						Hazardous	Ordinary
1	5	0	0	1	1	1	42
	Age 51 20 years			Age 50 20 years		Age 55 5 yrs. (No age requirement with 30 years service)	Age 65 5 yrs. (Age 55 with 30 yrs. service)
	NA			NA		Age 50 20 years	Age 55 5 years
No more than 50% of final salary	50% of final salary			(2.5%)X(Average of highest 3 yrs.) X(No. of years) 75% Maximum		(2.25%)X(Average of highest 5 yrs.)X (No. of years)	(1.6%)X(Average of highest 5 yrs.) X(No. of years)
	Petition			Guaranteed $100/Month, rising with Social Security		Guaranteed	Guaranteed
	NA			NA		Normal retirement reduced to reflect early commencement. No reduction if 30 yrs., 15 current.	Normal retirement reduced to reflect early commencement. No reduction if age 55 with 30 yrs., 15 current.
	None			2% annually over base index year after age 60		As granted by the legislature. Recent actions are 2% for each year, up to 20%, effective 7/1/76; and 2%, effective 7/1/77.	
	20 years			20 years		5 years	5 years (4 yrs. under certain conditions)
	NA			Age 50		May defer past age 55 (or 50, early retirement) and have pension increased	55 (Early retirement)

TABLE 1

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

	KRS 95.290 1st Class Police & Fire	KRS 95.851 2nd Class Police & Fire	KRS 90.400 2nd Class Civil Service	KRS 95.520 3rd Class Police & Fire	KRS 95.621 3rd Class Police & Fire	KRS 90.410 3rd Class Civil Service
<u>Disability Determination</u>		2 physicians selected by board (5 years service and heart or lung disease creates presumption of occupational disability)		Unspecified	Unspecified	
Review of Disability		No		Unspecified	Unspecified	
<u>Occupational Disability</u>						
Service Required		None		One day to ten years, set by the board.	None	
Formula		70% of final salary		50% of final salary	50% of final salary	
Minimum/Maximum						
Social Security Offset		No		No	No	
Workmens Compensation Offset		Yes		No	No	
<u>Non-Occupational Disability</u>				No provisions		
Service Required		10 years			None	
Formula		(2.5%)(Average of highest 3 years)(Years of service)			50% of final salary	
Minimum/Maximum		25%, 50%				
Social Security Offset		No		NA	No	
Workmens Compensation Offset (Employment other than city)		Yes		NA	No	

TABLE 1

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

KRS 96.180 3rd Class Elec & Water	KRS 95.767 4th & 5th Police & Fire	KRS 67A.320 Urban Co. Civil Serv.	KRS 67A.340 Urban Co. General	KRS 67A.360 Urban Co. Police & Fire	KRS 79.080 All Govts. General	KRS 78.510 - County Employees Retirement System Hazardous	Ordinary
	Unspecified			2 physicians selected by board (5 yrs. service and heart or lung disease creates presumption of occupational disability)	5 yrs. service and heart or lung disease creates presumption of occupational disability for paid police or firemen	Medical examiner selected by the board.	Medical examiner selected by the board.
	Unspecified					Annual until normal retirement date.	
	12 years continuous			None		None	Five years
	50% of final salary with 12 yrs. continuous service. Up to 50% if less than 12 yrs.			75% of final salary		(2.25%)(final comp)(yrs. of service) Double service credit to 20 yrs. total. Dependent children, 10% to 40% of final rate. Minimum 25% final rate of pay	(1.6%)(Final comp)(yrs. of service) Double service credit to 25 years.
						Maximum with S. S. and W.C., 100% of final rate or final compensation, whichever is higher.	
	No			No		S. S. plus W. C. plus disability retirement shall not exceed 100% of final rate of final compensation, whichever is higher.	
	No			No			
	No provisions						
				5 years		5 years	5 years
				(2.5%)(Average of highest 3 years)(Years of service)		(2.25%)(final comp) (yrs.) Double service credit to 20 yrs. total.	(1.6%)(final comp)(years) Double service credit to 25 years total.
				25%, 60%		Maximum with S. S. and W. C., 100% of final rate or final compensation, whichever is higher.	
	NA			No		S. S. plus W. C. plus disability retirement shall not exceed 100% of final rate of final compensation, whichever is higher.	
	NA			No			

TABLE 1

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

	KRS 95.290 1st Class Police & Fire	KRS 95.851 2nd Class Police & Fire	KRS 90.400 2nd Class Civil Service	KRS 95.520 3rd Class Police & Fire	KRS 95.621 3rd Class Police & Fire	KRS 90.410 3rd Class Civil Service
Survivor Death Benefits, Active Employees						
Occupational						
Service Required		None		None	None	
Spouse		Spouse, 50% of final salary		Spouse, $30 to 50% of final salary	Widow, 50% of final salary	
Children		10% of final salary with spouse or 15% without spouse, to age 18		$6 per month to 10% of final salary, to age 18	$24 per month, to age 18	
Other Dependent Beneficiary		Parents, 25% of final salary for each parent (If no spouse or children)		Parents, $30 per month to 20% of final salary, all to one parent or half to each (If no widow or children)	Parents, 25% of final salary, whether one or two parents (If no widow or children)	
Maximum		50% children or spouse alone, 75%, children with spouse				
Social Security Offset		No		No	No	
Workmen's Compensation Offset		Yes		No	No	
Non-Occupational						
Service Required		3 years		15 years consecutive	1 year	
Spouse		Spouse:(1.5%) (Average of highest 3 years) (No. of years)		Spouse:$30 per month to 50% of final salary	Widow:50% of final salary	
Children		With spouse increases by ½ for first, ¼ for 2nd and thereafter. No spouse, 50, 65, 75%. To age 18, 23 if full-time student		$6 per month to 10% of final salary, to age 18	$24 per month to age 18	
Dependent Parents		None		$30 per month to 20% of final salary, all to one parent or half to each. (If no widow or children)	25% of final salary, whether one or two parents (If no widow or children)	
Maximum		75%, children and spouse or children alone				
Social Security Offset		No		No	No	
Workmen's Compensation Offset (Employment other than City)		Yes		No	No	

TABLE 1

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

KRS 96.180 3rd Class Elec & Water	KRS 95.767 4th & 5th Police & Fire	KRS 67A.320 Urban Co. Civil Serv.	KRS 67A.340 Urban Co. General	KRS 67A.360 Urban Co. Police & Fire	KRS 79.080 All Govts. General	KRS 78.510 - County Employees Retirement System	
						Hazardous	Ordinary
	None			None		None	5 years
	Widow, 50% of final salary			Spouse, 60% of final salary		Spouse, lump sum $5,000, then 25% of final rate	Designated beneficiary may select a decreased retirement allowance for life, or the actuarial equivalent for 120 months certain.
	$6 per month to age 14			10% of final salary with spouse or 15% without spouse, to age 18, 23 if full-time student		10% to 40% of final rate, until age 18, or 22 if unmarried full-time student	
	Parents, $30 per month, all to one parent or half to each (In addition to widow and children payments)			25% of final salary for each parent (If no spouse or children)		Lump sum $10,000	
				50%, Children alone, 75%, children with spouse			
	No			No		No	No
	No			No		No	No
	12 years consecutive			5 years		5 years	5 years
	Widow: 50% of final salary			Spouse: (1.5%)(Average of highest 3 years)(No. of years) 15% minimum		The designated beneficiary may select a reduced retirement allowance for life, or the actuarial equivalent for 120 months certain.	
	$6 per month, to age 14			With spouse increases by ½ for first, ¼ for 2nd and thereafter. No spouse, 50, 65, 75%. To age 18, 23 if full-time student			
	$30 per month, all to one parent or half to each. (In addition to widow & children payments)			None			
				60%, children and spouse, or 75% children alone			
	No			No		No	No
	No			No		No	No

TABLE 1

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

	KRS 95.290 1st Class Police & Fire	KRS 95.851 2nd Class Police & Fire	KRS 90.400 2nd Class Civil Service	KRS 95.520 3rd Class Police & Fire	KRS 95.621 3rd Class Police & Fire	KRS 90.410 3rd Class Civil Service
<u>Survivor Death Benefits, Retired Employees</u>						
<u>Occupational</u>						
Service Required		None		15 years, consecutive	1 year	
Spouse		Spouse, 50% of final salary		Spouse: $30/month to 50% of final salary	Widow: 50% of final salary	
Children		10% of final salary with spouse or 15% without spouse, to age 18		$6 per month to 10% of final salary, to age 18	$24 per month to age 18	
Dependent Parents		None		$30 per month to 20% of final salary. All to one parent or half to each. (If no spouse or children)	25% of final salary, whether one or two parents. (If no spouse or children)	
Maximum		50% children or spouse alone, 75%, children with spouse				
Social Security Offset		No		No	No	
Workmen's Compensation Offset		Yes		No	No	
<u>Non-Occupational</u>						
Service Required		3 years		15 years, consecutive	1 year	
Spouse		Spouse:(1.5%) (Average of highest 3 years) (No. of years)		Spouse: $30 per month to 50% of final salary	Widow: 50% of final salary	
Children		With spouse increases by ½ for first, ¼ for 2nd and thereafter. No spouse, 50, 65, 75%. To age 18, 23 if full-time student		$6 per month to 10% of final salary, to age 18.	$24 per month, to age 18.	
Dependent Parents		None		$30 per month to 20% of final salary. All to one parent or half to each. (If no spouse or children)	25% of final salary, whether one or two parents. (If no spouse or children)	
Maximum		75%, children and spouse or children alone				
Social Security Offset		No		No	No	
Workmen's Compensation Offset (Employment other than city)		Yes		No	No	

TABLE 1

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

KRS 96.180 3rd Class Elec & Water	KRS 95.767 4th & 5th Police & Fire	KRS 67A.320 Urban Co. Civil Serv.	KRS 67A.340 Urban Co. General	KRS 67A.360 Urban Co. Police & Fire	KRS 79.080 All Govts. General	KRS 78.510 - County Employees Retirement System Hazardous	Ordinary
	12 years, consecutive			None		None	None
	Widow: 50% of final salary			Spouse, 60% of final salary		Retirement options may be selected by the member which will give the designated beneficiary benefits after the member's death, and the member a reduced benefit during life. If the member is disabled, 10 years are added to age to determine actuarial equivalents.	
	$6 per month to age 14			10% of final salary with spouse or 15% without spouse, to age 18, 23 if full-time student			
	$30 per month, all to one parent or half to each. (In addition to widow and children payments)			25% of final salary for each parent (If no spouse or children)			
				50%, Children alone, 75%, children with spouse			
	No			No		No	No
	No			No		No	No
	12 years, consecutive			5 years			
	Widow: 50% of final salary			Spouse: (1.5%) (Average of highest 3 years)(No. of years) 15% minimum		Retirement options may be selected by the member which will give the designated beneficiary benefits after the member's death, and the member a reduced benefit during life. If the member is disabled, 10 years are added to age to determine actuarial equivalents.	
	$6 per month, to age 14			With spouse increases by ½ for first, ¼ for 2nd and thereafter. No spouse, 50, 65, 75%. To age 18, 23 if full-time student			
	$30 per month, all to one parent or half to each. (In addition to widow and children payments)			None			
				60%, children and spouse, or 75% children alone, widow			
	No			No		No	No
	No			No		No	No

TABLE 1

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

	KRS 95.290 1st Class Police & Fire	KRS 95.851 2nd Class Police & Fire	KRS 90.400 2nd Class Civil Service	KRS 95.520 3rd Class Police & Fire	KRS 95.621 3rd Class Police & Fire	KRS 90.410 3rd Class Civil Service
Board Composition		Mayor, City Treasurer, Fire Chief, Police Chief, 1 policeman 1 fireman		Mayor, City Treasurer, Fire Chief, Police Chief, 1 policeman, 1 fireman	Mayor, City Treasurer, Police Chief, Fire Chief, 1 policeman, 1 fireman	
Expense Payments						
Bond		Fund				
Medical Exam						
Actuary		Board				
Administration		City				
Investment		Board				
Investment						
Who		Board (may employ counsel)		Board, in the name of the board	Board	
Guidelines		Bonds of county, urban county, 1st, 2nd, or 3rd class cities, securities allowed to trustees by Ky. law		Bonds of any county, city of 1st, 2nd, or 3rd class, and securities allowed to trustees by Ky. law	None	
Custodian		City Treasurer		City Treasurer	City Treasurer	
Audit Requirement		Annual				
Reporting Requirement		Annual to city by board. Synopsis to members.	Annual to city by board. Synopsis to members.	Board annually to city	Board annually to city	

TABLE 1

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

KRS 96.180 3rd Class Elec & Water	KRS 95.767 4th & 5th Police & Fire	KRS 67A.320 Urban Co. Civil Serv.	KRS 67A.340 Urban Co. General	KRS 67A.360 Urban Co. Police & Fire	KRS 79.080 All Govts. General	KRS 78.510 - County Employees Retirement System	
						Hazardous	Ordinary
3 members having qualifications of member of electric and water plant board, called commission	Mayor, City Treasurer, Police Chief, Fire Chief, one member of city council	Mayor, 4 councilmen, Comm. of Finance, Director of Personnel, 3 employees		Mayor, Director of Finance, Director of Personnel, Police Chief, Fire Chief, 2 policemen, 2 firemen		Board of Kentucky Employees Retirement System	
Fund	Fund						
						Employee pays for initial determination of disability by physician, system pays for medical examiner to evaluate cases. System pays employee physician to file report.	
		City		Board			
				City		Retirement Allowance Account	
				City			
	Board, Exclusive control and management			Board (may employ counsel)		Board	Board
	Bonds of Ky., 1st, 2nd, 3rd, or 4th class cities, securities allowed to trustees by Ky. law			Bonds of counties, urban counties, cities of 1st - 3rd class, securities allowed to trustees by Ky. law		Investments allowed fiduciaries by Kentucky law, except investments may be made in common stocks with no record of dividend payments.	
	City Treasurer			Director of Finance		For funds, State Treasurer; for securities, chosen by board.	
				Annual			
Trustees to board annually	Board annually to city	Quarterly, trustees to mayor. Post where employees frequent and report		Annually, board to government. Synopsis to members.		Annual financial report prepared by the board, made public.	

TABLE 1

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

	KRS 95.290 1st Class Police & Fire	KRS 95.851 2nd Class Police & Fire	KRS 90.400 2nd Class Civil Service	KRS 95.520 3rd Class Police & Fire	KRS 95.621 3rd Class Police & Fire	KRS 90.410 3rd Class Civil Service
Actuarial Evaluation Requirements		Every 5 years	Every 5 years	Not Required	Not Required	Mentioned
Funding Requirements		Must pay interest on unfunded liability for prior service	Must pay interest on unfunded liability for prior service	None	None	
Employer Contribution		Actuarially determined, 12% minimum	No less than employee	1 to 4¢ on the $100	Amount to be determined by commissioners or council	Up to 5¢ on the $100
Employee Contribution		8% of salary, required	Actuarially determined, optional	1 to 4% of salary, required	Same as Social Security, required	No more than 5% of salary, optional
Employee Withdrawal						
Contributions Returned		Yes		Yes(permissive)	Yes(permissive)	
Interest Rate		No interest		No interest	No interest	
Employee Re-entry		After 5 years pay back refund with 6% interest, have credited service reinstated		After 5 years pay back refund with 6% interest, have credited service reinstated (not meaningful since retirement requires 20 years of continuous service, and no credit for service over 20)	After 5 years pay back refund with refund with 6% interest, have credited service reinstated	

TABLE 1

ANALYSIS OF STATE STATUTES GOVERNING CITY PENSION SYSTEMS

KRS 96.180 3rd Class Elec & Water	KRS 95.767 4th & 5th Police & Fire	KRS 67A.320 Urban Co. Civil Serv.	KRS 67A.340 Urban Co. General	KRS 67A.360 Urban Co. Police & Fire	KRS 79.080 All Govts. General	KRS 78.510 - County Employees Retirement System: Hazardous	Ordinary
Mentioned	Not Required	Every 5 years		Every 5 years		Annual actuarial evaluation, actuarial investigation every 10 years.	
	None	Actuarial soundness within 30 years		Must pay interest on unfunded liability for prior service		Normal costs plus 1% of unfunded past service liability annually, plus annual interest on unfunded past service liability.	
No more than .5% of utility property and assets	Not more than 3¢ on the $100	No less than employee		Actuarially determined, 12% minimum		Entry age normal plus 1% of unfunded past service liability, plus interest on unfunded past service liability.	
No more than 5% of salary, optional	No more than 3½% of salary, required	Up to 6% of salary, optional		8% of salary, required		7% of salary, required	4% of salary, required
	No			Yes		Yes.	Yes
	No interest			No interest		Currently 3%	Currently 3%
	Unspecified			After 5 years continuous reemployment pay back refund with 6% interest, have credited service reinstated		After 6 months pay back refund with interest as determined by Board (now 6%). Have credited service reinstated.	

The requirements levied by state law upon police and firemen pension systems are for the most part much more explicit and detailed than are the requirements levied upon civil service pension systems. For this reason the columns in Table 1 devoted to the police and firemen pension systems contain more information. In some cases where neither a police and firemen statute nor a civil service statute treats a particular subject such as "Disability Determination", the column for the police and firemen statute has an entry such as "unspecified", while the column for the civil service statute has no entry at all. This is because the police and firemen statute specifies a disability retirement formula and so logically should have a disability determination procedure. The civil service statute, on the other hand, does not specify a disability retirement formula; thus the need for the determination procedure is not so evident.

There are virtually no state requirements for general pension laws applying to the non-uniformed civil servant and for police and firemen systems in first class cities. Cities are given nearly complete freedom to design pension systems as they desire. The opposite is true for pension law covering policemen and firemen in urban county governments and cities of the second through fifth classes. The requirements of state law are detailed and explicit.

Given that there is no entity of state government which advises local governments in the highly complex area of pension system design, it may not be wise to allow such latitude with respect to city non-uniformed employee pensions. State government, which can more easily obtain the expertise necessary to design pension systems than can the cities, should provide more guidance in order to insure equity and to prevent costly mistakes and duplication of effort.

Since police and firemen pension systems are so tightly controlled by the state legislature, analysis of design problems in this area must be accompanied by an analysis of the legislative process by which these pension systems were established. To the extent that decisions have been made without professional advice, greater use should be made of professional expertise in the future to correct deficiencies and avoid undesirable financial consequences for covered personnel and the employer cities.

Initially it is of interest that survey results reveal a total of 52 locally administered city pension systems in Kentucky. Only 41 of these are indicated in the first row, "Number of Cities", in Table 1 because for 11 of the systems it was impossible to determine what state statute was intended to govern them. Data in this same row indicate that 42 cities have chosen to operate under the state administered CERS. Many of these cities have adopted CERS for their non-uniformed employees while leaving their police and firemen under locally administered pension plans. Louisville, Lexington, Ashland, Bowling Green, Corbin, Covington, Frankfort, Newport, and Paducah fall within this category. Of the 42 cities involved, 1 is of the first class, 6 are second class, 9 are third class, 17 are fourth class, 7 are fifth class, 1 is sixth class and 1 is an urban county government. These figures indicate that CERS is an acceptable substitute to many cities for locally administered systems. These cities are distributed sufficiently among the various classes to conclude that CERS can be satisfactory for both the large and small urban centers.

The Benefit Package

Criteria for Normal Retirement

The first analytical category in Table 1 is "Criteria for Normal Retirement", which includes both age and service requirements. There are gaps in statutory guidance. There are no statutory requirements for any of the civil service systems or for the policemen and firemen in cities of the first class. (KRS 95.290) The other police and fire systems, however, uniformly require 20 years of service for retirement. Employees may receive a pension after 20 years of total service in cities of the second class as provided in KRS 95.851, in cities of the fourth and fifth class as provided in KRS 95.767, and in urban county governments as provided in KRS 67A.360. In third class cities operating under either the basic plan, KRS 95.520, or the alternate plan, KRS 95.621, the requirement is for 20 years of consecutive service. CERS provides a retirement allowance after only five years of service.

There is also an inconsistency in age requirements among the various statutory systems. Under KRS 95.520, KRS 95.621, and 95.290, there are no age requirements for retirement. In Louisville as well as in most third class cities, the local policy is to allow both police and firemen to retire after 20 years of service, regardless of age. The employee must be 50 years old to retire in second class cities as provided by KRS 95.851, and in urban county governments as provided by KRS 67A.360. There is a provision, however, for the younger employee to complete 20 years of service, withdraw from service before age 50, and receive a deferred pension at age 50. In fourth and fifth class cities under KRS 95.967, the age requirement is 51 and there is no deferred pension option.

CERS has two sets of age requirements. For the hazardous category the age requirement is 55, but there is no age requirement with 30 years of service. There is also a provision for early reduced retirement at age 50 with 20 years of service. Retirement may be deferred past either the normal or early retirement age, and the pension thereby increased. For the ordinary category, non-uniformed civil service primarily, the retirement age is 65, with no age requirement after 30 years of service. Early reduced retirement may be taken at age 55. The employee may terminate at any time after five years of service, and begin drawing a pension at age 55 or any time thereafter.

Formula for Normal Retirement

As in the case of age and service requirements, the statutes provide guidelines primarily for police and fire pension systems. There is, however, a restriction in KRS 90.410 for third class city civil service and in KRS 96.180 for third class city electric and water plant board employees, that retirement benefits shall not exceed 50% of final salary. Many police and firemen are granted 50% of pay at the completion of 20 years of service and 75% at the completion of 30 years of service. These provisions are established for second class cities in KRS 95.851, for third class cities in KRS 95.621, and for urban county governments in KRS 67A.360. In second class cities and urban county governments, the percentage is applied to the average salary for the employee's highest three consecutive years, while under KRS 95.621 it is based upon final salary of the employee. Final salary will most likely also be the highest salary ever earned by the employee. In the third class cities operating under KRS 95.520 and in fourth and fifth class cities under 95.767, 50% of final salary is granted after 20 years of service, with no increment for additional service. Under CERS, where pension benefits are vested after only five years of service, there are two formulas for determining the pension benefit. Under the hazardous category, 2.25% of the average salary of the highest five years is granted for each year of service, while for non-hazardous service, 1.6% of the average salary is granted for each year of service.

Guaranteed Retirement or Board Discretion

Table 1 indicates for the category, "Guaranteed or petition", that employees under KRS 95.520, 95.621, and 95.767 must petition for retirement upon completing age and service requirements, as applicable. The granting of retirement is at the discretion of the retirement board. Under KRS 95.851, 67A.360 and CERS, retirement is guaranteed upon fulfilling minimum age and service requirements. This is also a local policy in Louisville, where the police retirement system and the firemen's retirement system are both established pursuant to KRS 95.290.

Comments on the Benefit Package

The requirement for consecutive service in third class cities under either KRS 95.520 or 95.621 is a stringent one and penalizes the long-term employee who temporarily terminates his employment before fulfilling the 20-year requirement.

The lack of any age requirement under KRS 95.520, 95.621, and 95.290 is extremely generous. If an employee is only 40 years old when he completes 20 years of service, he can retire and draw his full retirement benefit for the rest of his life. This generosity is not extended to policemen and firemen under KRS 95.851, 67A.360, 95.767 or CERS; they must reach the age of 50, 51 or 55 to retire. There is no apparent pattern to these varying age requirements. It could not be argued that police and fire duty is more strenuous in third class cities than in second class cities or urban county governments. Neither has it been demonstrated that a person approaching age 50 or 51 is too old for police or fire duty in a third class Kentucky city. CERS, which covers many policemen and firemen in smaller Kentucky cities, has set the normal retirement age at 55. The effect of having no age requirement in third class cities is to allow men who are fully capable of continuing their work to retire, while the real purpose of a pension should be to provide for retirement when the employee's capability to perform begins to decline.

There may be reason to provide different age requirements for normal retirement in different classes of cities. Some would argue that police and fire duty is more strenuous in large urban centers than in small cities. Regardless of the possible merits of differing age requirements among classes of cities, it is difficult to justify the present lack of age requirements in some cities and their presence in others.

While KRS 95.851, 95.621, and 67A.360 provide generous benefits for 20 years of service, there is incentive for the employee to remain for 30 years, since he can thereby increase his pension by 50% and still retire at a relatively young age and find employment elsewhere. There is no such incentive under KRS 95.520 or KRS 95.767 for policemen and firemen in third, fourth, and fifth class cities. Since only 20 years are required for retirement and the pension cannot be increased by remaining longer except through salary increases, there is no reason to remain on the force if employment opportunities exist elsewhere. The employees' logical alternative under the provisions of KRS 95.520 would be to terminate immediately upon serving 20 years. For those employees in pension plans established under KRS 95.767, the logical step would be to terminate immediately upon reaching the age of 51.

It does not seem to be in the best interest of cities operating under KRS 95.520 and KRS 95.767 to provide an arbitrary 50% retirement benefit with no option to increase the pension through continued work. The effect of this design should be to swell retirement rolls and drain the force of experienced personnel.

A potential inequity is designed into the system established by KRS 95.767. Some employees may complete 20 years of service prior to the age of 51, while others will not complete 20 years until they are 51 years or older. Since there is no provision for a deferred pension under KRS 95.767, the young employee must continue to work until he is 51, yet he cannot increase his pension by so doing. The effect is that employees under the same pension system are granted equal pensions for unequal amounts of work.

This same problem exists for another reason under KRS 95.767 and under KRS 95.520. Employees under these statutes must petition for retirement upon completing age and service requirements, as applicable. The granting of retirement is at the discretion of the retirement board. Since under KRS 95.520 and KRS 95.767 the employee cannot increase his pension by staying more than 20 years, some employees can be required to work longer than others for the same 50% retirement. In addition to creating a potential for partial individual judgments on the part of the retirement board, the petition mechanism allows the board, implicitly or explicitly, to set a retirement age requirement which is not a part of the governing statute. As a result several cities have established differing age requirements. One third class city under KRS 95.520 has established a retirement age of 55 for its policemen. This seems to be a reasonable requirement given the nature of the work performed. Another third class city and a fourth class city have established a retirement age of 65 for policemen and firemen under KRS 95.520 and 95.767, respectively. This requirement will most probably result in a high percentage of disability applications as the work force matures and the employees find it increasingly difficult to perform their responsibilities. An additional consequence of such local policies may be litigation. An attorney general's opinion relating to KRS 95.520, OAG 76-706, suggests that litigation may be required to determine the legality of establishing an age requirement locally in the absence of such a requirement in the statute. If the General Assembly intends that cities have this power, the language of the statute should explicitly state that fact.

As a correction for these inequities, the General Assembly could require first that personnel covered under KRS 95.520 and 95.767 be granted additional pension compensation for service over 20 years. Guidance should also be given with respect to retirement age. If the General Assembly does not choose to set a uniform retirement age at which a pension is guaranteed and wishes to grant cities latitude in this area, a maximum age should be established, under which cities can establish a retirement age. Whether a guaranteed retirement age is established by the General Assembly or by local policy, there should be a provision in KRS 95.520, 95.621 and 95.767, for terminating employment after completion of minimum service requirements and award of a deferred pension upon reaching retirement age.

There can be significant variation in the pension benefit level depending on whether the pension is based upon final salary (KRS 95.520, 95.621, 95.767), the average of the highest three consecutive years (KRS 95.851, 67A.360), or the average of the highest five years (CERS). A pension based upon final salary will in almost all cases exceed one based upon some average number of years, because most employees receive an annual cost of living increase and perhaps a merit or longevity increase. Therefore, the greater the number of years averaged to arrive at the pension, the smaller the pension will be. Basing the pension upon final salary can lead to abuse, particularly if overtime is considered in the pension calculation. A worker can work an accelerated overtime schedule in his final year of employment and significantly inflate his pension benefit. It is possible for a favored employee to be granted a promotion and salary increase during his final year of employment and thereby benefit in terms of his pension for the rest of his life. In order to prevent such abuse and to establish a pension level which is reasonable, the ideal pension is pegged to an average of the highest years of compensation, much as are KRS 95.851, 67A.360 and CERS. Whether a three-year average or a five-year average is best is a matter for judgment, and certainly the probability of cost-of-living increments in pension compensation should bear on that judgment. It seems unwise to continue to base pensions under KRS 95.520, 95.621 and 95.767 upon final salary. While the language of KRS 90.410 and 96.180 does not require that pensions be based upon final salary, it would be better to phrase the limitations in these statutes in terms of an average salary.

The statutes on civil service retirement, KRS 90.400, 90.410, 96.180, 67A.320, 67A.340 and 79.080, fail to establish a normal retirement age. Common practice in private industry is to set normal retirement age at 65, while in the public sector a retirement age of 60 or 62 is common. While it could be argued that cities should be allowed self-determination in this area, it is established in a later chapter of this report that several cities have set extremely low normal retirement ages for civil service employees and subsequently encountered serious financial problems. For this reason it would be wise to set a reasonable minimum normal retirement age in each of these state statutes.

The same statutes discussed above also fail to set a period of service after which the employee earns a vested pension benefit, payable upon reaching retirement age. The Employee Retirement Income Security Act of 1974, which governs pensions in the private sector, permits several vesting provisions, one of which requires that the employee be entitled to a vested benefit after ten years of service. It would be appropriate, in the interest of fairness to city employees, to levy a similar requirement in each of these statutes covering civil service employees.

Disability Retirement

Formulas for Disability Retirement

Disability benefits show wide variation among the various police and fire systems. In a second class city operating pursuant to KRS 95.851, an employee would receive 70% of final salary for an occupational disability, while in an urban county government, pursuant to KRS 67A.360 he would receive 75% of final salary. If the employee were in a third class city operating pursuant to either KRS 95.520 or 95.621, he would receive only 50% of final salary for an occupational disability. In a fourth or fifth class city operating pursuant to KRS 95.767, the employee would receive 50% of final salary only if he had served continuously for 12 years. If he had served less than 12 years continuously, the amount of his pension would be at the discretion of the board but could not exceed 50% of final salary.

A similar employee covered by CERS under the hazardous category would receive 2.25% of his average salary earned during the five fiscal years of his highest compensation, multiplied by his years of service. His service credit would be doubled, up to a maximum of 20 years of service. If his actual service were in excess of 20 years, the actual figure would be used. As a minimum he would receive 25% of his final monthly rate of pay. As a maximum he would receive 100% of his five year average or final salary, whichever is higher, from a combination of disability pension, Social Security and Workmen's Compensation. Each dependent child would also receive 10% of his final salary, up to a maximum of 40% for children; and each child's allowance would continue until the child reached age 18, or age 22 in the case of an unmarried full-time student. If the CERS employee were under ordinary coverage, he would receive 1.6% of average salary for the highest 5 years for each year of service, and service credit would be doubled to a maximum of 25 years. There would be no children's benefit or minimum payment, but the same maximum found under hazardous coverage would apply.

In the case of non-occupational disability, employees under KRS 95.851 or 67A.360 would receive 2.5% times the average of the highest three consecutive years of salary times years of service. The minimum benefit in either case would be 25% of the average salary. Under KRS 95.621 there is no difference between occupational and non-occupational benefits, while under KRS 95.520 and 95.767, there are no non-occupational disability benefits. Both hazardous and ordinary CERS use the same formulas for non-occupational disability as for occupational disability, except that in the hazardous non-occupational category there are no children's benefits and no minimum pension as found in the hazardous occupational category.

Service Required for Disability Pension

There is no service requirement for an occupational disability pension under KRS 95.851 for second class city police and firemen, KRS 67A.360 for urban county government police and firemen, or the CERS hazardous category. This is also the case for third class city police and firemen under KRS 95.621. For third class city police and fire systems pursuant to 95.520, however, the statute permits the city to establish a service requirement of one day to ten years. In fourth or fifth class cities operating pursuant to KRS 95.767, the service requirement is 12 years of continuous service for a full occupational disability pension. If less than 12 years of service have been completed, the cities may decide individually the amount of occupational disability pension to grant--up to and including a full benefit. The CERS ordinary category requires five years of service.

For non-occupational disability there is a ten year service requirement under KRS 95.851, while under KRS 67A.360 the requirement is five years. KRS 95.621, as in the provisions of occupational disability, levies no service requirement for non-occupational disability. CERS requires five years of service in both the hazardous and ordinary categories.

Disability Determination

Two physicians selected by the retirement board make disability determinations for police and firemen in second class cities and urban county governments operating pursuant to KRS 95.851 and 67A.360. There is a presumption in both of these statutes and in KRS 79.080 that after five years of service any heart disease or lung or respiratory disease is a result of occupational causes. Although KRS 95.520, 95.621 and 95.767 for police and firemen in third, fourth, and fifth class cities specify disability retirement formulas, they do not specify a method for determining disability. CERS requires a medical examiner selected by the retirement board to make disability determinations. All the other statutes governing city pension systems are silent in the area of disability.

Review of Disability

None of the Kentucky statutes permitting or requiring locally administered pension systems make any reference to review of disability once established. In Louisville, operating pursuant to KRS 95.290, local ordinance requires a review of disability by both the police and firemen pension systems. CERS law permits an annual review of disability until normal retirement age is attained, and disability cases are being reviewed annually.

Comments on Disability Retirement

Disability provisions are a very important consideration in pension system design for both the employee who needs protection and the employer who must meet the cost. Disability retirements, as a class, are very expensive for several reasons. Normally they occur earlier than normal retirements and must therefore be paid longer. In addition, employee and employer do not contribute to the pension fund, nor do earnings accumlate on their contributions to the extent that they would have for a normal retirement. An analysis of disability retirements among safety officers in the California Public Employees Retirement System and in San Diego City and County reveal that the average excess cost per occupational disability claim, as opposed to ordinary retirement, was $31,957. (Through The Roof, A Report on Escalating Compensation Costs, p. 97) The similiar figure for non-safety personnel was $22,960.

Disability retirements can be very expensive and should be granted only in the case where there is true long-range impairment of earning capability.

Thus, all city pension systems should specify a standard procedure for determining disability. This procedure should assure impartial judgments based solely on medical evidence. Failure to specify such a procedure by law can lead to a system of biased judgments by doctors selected by the employee. The lack of adequate statutory support leaves pension board members at the local level subject to pressure from employees to grant disability pensions when they are not justified. KRS 95.520, 95.621, and 95.767 are all remiss in this respect, as are all the statutes which do not specify a procedure.

While there is a need for each statute to provide a rational procedure whereby disability is medically determined, the heart-lung requirement found in KRS 95.851, 67A.360 and 79.080 nearly forecloses the consideration of medical evidence. As outlined above, the heart-lung provision creates a presumption of occupational disability if a policeman or fireman is unable to perform his duties by reason of heart disease or any disease of the lungs or respiratory tract after five years of service. It is reasonable to assume that not all disease of the heart or lungs in police or firemen with five years of service could be due to occupational causes. Yet medical evidence has been provided to indicate that firemen are subject to unusual stresses which affect the heart and respiratory tract and that once injury has occurred it is difficult to pinpoint the time and cause of the injury. Firemen can suffer heart damage by going very quickly from a restful state to a state of high activity and excitement. (Barnard, 1975, p. 248) They can also suffer heart damage from repeated exposure to carbon monoxide at levels lower than usually considered detrimental to health. (Sammons, 1974, p. 545) Firemen are also frequently exposed to various noxious gases which can damage their respiratory tracts. Given these conditions, it may be reasonable to grant firemen the presumption of occupational disability for heart or respiratory tract disease after five years of service. If this is reasonable, it should apply to all firemen, not just those covered by the provisions of KRS 95.851, 79.080 and 67A.360.

The case for policemen is more tenuous, however. While policemen do frequently go from a restful state to a state of high activity and excitement and are thus subject to one possible cause of stress on the heart, they are not routinely subjected to the high levels of carbon monoxide or other noxious gases which firemen encounter. Therefore, while there might be justification for granting policemen a presumption of occupational disability for heart disease after five years of service, there seems to be little or no evidence to justify such a presumption in the case of disease of the respiratory tract. If policemen under KRS 95.851, 79.080 and 67A.360 are to retain the presumption for heart disease, then those policemen presently not covered should be granted the same protection. Removing the presumption of occupational disability for respiratory tract disease does not preclude the possibility of occupational disability retirement. It simply shifts the burden of proof from the pension board to the potential retiree.

If disability pensions compensate for inability to continue in one's work, pensions should cease if the retiree regains his capability to work. Yet none of Kentucky's statutes governing locally administered systems permit any review of disability once it is established. A procedure for periodic disability review similar to that employed by CERS and the police and fire pension systems in Louisville is definitely needed.

Also ignored by the local government statutes is the possibility that disability, though permanent, may be only partial. The employee may be able to find some satisfactory employment other than that which he previously performed for the city. If this is the case, there should be a procedure for determining partial disability and granting a pension proportional to the degree of disability and impaired earning capability. CERS covers the possibility that disability retirees may be able to work in some other capacity by allowing the retirement board to reduce a disability pension if the retiree is engaged in gainful occupation.

There is no logical pattern in the service requirements for disability pensions among the various classes of cities and pension systems. While it is possible that occupational disability is more likely to strike a policeman or fireman in a large city than a small one, it would seem that the occupational disability will have the same impact on any employee or his family regardless of the size of the city involved. Yet employees in the larger cities are protected fully and immediately against the possibility, while many of those in smaller cities are not. For example, there is a permissible variation of service requirements from one day to ten years in third class cities under KRS 95.520. While most cities in this class in practice have the one day requirement, the potential for variation should be eliminated, as should the requirement of 12 years of continuous service in fourth and fifth class cities under KRS 95.767. Certain cities under KRS 95.767 have decided to evenly prorate the occupational disability pension granted those with less than 12 years continuous service. An employee with 1 year of service would get 1/6 the amount that an employee with 6 years would receive, and 1/12 the amount that an employee with 12 years of service would receive. This might seem equitable in the context in which the statute is written but inequitable when considering the types of disability which might occur. As a hypothetical example, a policeman shot in the line of duty and paralyzed from the waist down would receive only 4.16% of final salary if he had been employed one year, but 50% if he had been employed 12 years. The grievousness of the injury is not reduced by the lesser term of service, nor is the future earning capacity increased. It appears that this statute is not written to properly deal with the disabling situations which might occur.

Also difficult to rationalize is the variation in occupational disability benefit formulas among the various systems. It would seem logical to treat disabled employees in a uniform fashion and provide a single formula rationally calculated to provide for the actual needs of the employee rather than to pay 75% of final salary in an urban county government, 70% in a second class city, and 50% in a third, fourth or fifth class city for an occupational disability. Possibly a large benefit, uniformly applied, should be paid to the employee who suffers catastrophic disability or total inability to work, and a lesser benefit should be designed for those who can find some type of work other than their previous city employment.

The payments for non-occupational disability in a third class city operating pursuant to KRS 95.621 are the same as for a non-occupational disability, and there is no service requirement. While the impact of the disability on the employee may be the same regardless of its orgins, from the standpoint of the city, it seems unreasonable that it should immediately obligate itself to pay a lifetime pension if an employee permanently disables himself while water-skiing. Perhaps the burden of such support payments should be put on a level of government with greater taxing power than the city.

Another important consideration concerning disability benefits is the integration, or present lack of integration, of disability benefits from various sources, especially since a city could be contributing simultaneously to a pension fund, Workmen's Compensation and Social Security for the employee. For example, all city employees in Kentucky are covered by Workmen's Compensation; but, with the exception of KRS 95.851, there is no deduction of Workmen's Compensation benefits from the disability pension which may be payable. KRS 95.851 requires deductions of any Workmen's Compensation benfits, from both occupational and non-occupational disability pensions. The deduction in non-occupational disability cases is unusual, and could only occur if the employee were working on a second job also covered by Workmen's Compensation.

While it is certainly rational to deduct these Workmen's Compensation benefits in second class cities it is unfair by comparison to allow policemen and firemen in other cities to collect both benefits. Many policemen and firemen in third class cities are further covered in the event of disability by Social Security. Thus, it would be possible for them to combine pension, Social Security and Workmen's Compensation benefits to arrive at a retirement benefit exceeding 100% of their final salary. It was this possibility that led to the provision under CERS that the maximum benefit under such triple coverage be 100% of final salary or final average compensation, whichever is higher. If the benefit exceeds 100%, the pension is reduced. All statutes mandating retirement formulas for city administered systems need a similar provision.

As serious as is the possibility for overpayment of disability benefits in some cities, is the possibility of no benefits in others. This possibility can occur under both KRS 95.520 and 95.767, which provide no non-occupational disability benefit. Certain cities using these systems also do not provide Social Security coverage. Thus, the employee who does not vest in the Social Security system through outside employment and who disables himself off the job receives nothing. As George Arvin, General Manager of Kentucky Retirement Systems has noted in a report, such an employee would be better off with no pension system at all but Social Security coverage instead. (Arvin, 1973, p. 6)

The apparently similar non-occupational disability benefits under KRS 95.851 and 67A.360 are not really the same. The formula is the same: (2.5%) (highest three consecutive year average salary) (years of service), but only KRS 67A.360 requires a minimum benefit of 25% of average salary. Thus, with only a five-year service requirement, a benefit under KRS 67A.360 after five years of service would actually equal 5% times the average salary times years of service. Only after ten years of service do the KRS 95.851 and 67A.360 formulas become identical. If identical disability benefit formulas are sought by the General Assembly, this technicality should be corrected.

Survivor Death Benefits

Widow or Spouse

The question of survivor death benefits is addressed only in the CERS and in the statutes dealing with police and firemen. Under KRS 95.851, the spouse, and under 95.621 and 95.767, the widow, receives 50% of final salary after occupational death. In urban county governments under KRS 67A.360, the spouse's occupational death benefit is 60% of final salary. In third class cities under KRS 95.520, the benefit goes to the spouse and ranges from $30 per month to 50% of final salary, at the option of the city. There are separate provisions under CERS for occupational death depending on whether coverage is for hazardous or ordinary duty. For hazardous coverage the spouse receives a lump sum $5,000, and 25% of the employee's final rate of pay. Under ordinary coverage the designated beneficiary receives a retirement allowance based upon the earned credit of the employee.

Surviving spouses in third, fourth and fifth class cities (KRS 95.520, 95.621, 95.767) receive the same benefits in the case of non-occupational death as they receive for death in the line of duty. In second class cities (KRS 95.851) and urban county governments (KRS 67A.360) there is a different formula for non-occupational death. [1.5% (average of the highest three consecutive years compensation) (years of service)] KRS 95.851 sets a 50% maximum while KRS 67A.360 sets a 15% minimum. For both hazardous and ordinary coverage under CERS, the designated beneficiary receives a retirement allowance following non-occupational death based on the earned credit of the employee.

Service Requirements

While CERS ordinary coverage imposes a five-year service requirement for occupational death benefits, the locally administered police and fire systems and the CERS hazardous category do not impose a service requirement. In the case of non-occupational death, there are service requirements in all cases, though they vary considerably in length. Under KRS 95.520, which applies to third class cities, there must be 15 years of consecutive service, while KRS 95.621, also applicable to third class cities, requires only one year of service. KRS 95.767 requires 12 years of consecutive service, while service required under KRS 95.851 (3 years) or 67A.360 (5 years) need not be consecutive. Five years of service are also required under CERS hazardous and ordinary coverage.

Children

There is considerably more variance in benefits for dependent children than for widows or spouses. A child whose father dies from any cause in a fourth class city operating under KRS 95.767 receives $6 per month until age 14. In a third class city under KRS 95.520, he would receive from $6 per month up to 10% of final salary until the age of 18. In a third class city under KRS 95.621, he would receive $24 per month to the age of 18.

In second class cities and urban county governments under KRS 95.851 and 67A.360, respectively, the child whose parent died, from occupational causes only, would receive 10% of final salary if the spouse were living, and 15% if the spouse did not survive. While benefits continue only to age 18 in second class cities, they continue to age 23 for full-time students in an urban county government. If the parent died from non-occupational causes, the presence of a child would increase the pension benefit of the surviving spouse by one-half. If a parent did not survive, the first child would receive 50% of the employee's salary, the second an additional 15%, and so on to a maximum of 75%. In both second class cities and urban county governments, the benefit would continue until age 23 for a full-time student.

Under CERS children's benefits are specifically provided for only in the case of occupational death under hazardous coverage. In such cases, each child receives 10% of the final rate of pay, up to a 40% maximum for more than one child, until the age of 18, or 22 in the case of unmarried full-time students. In the case of occupational death under ordinary coverage, or non-occupational death under either hazardous or ordinary coverage, the child would receive no benefit unless he were a designated beneficiary.

Dependent Parents

Dependent parents also receive certain survivor benefits under Kentucky's laws, but in most cases only if there is no surviving spouse or children. In the case of occupational death under KRS 95.851 or 67A.360, each parent receives 25% of final salary, for a combined 50%. In third class cities under KRS 95.621, there is a limit of 25% of final salary, payable to one or both parents. In third class cities under KRS 95.520, the limit is a total of $30 a month to 20% of final salary payable to one or both parents, while in fourth or fifth class cities under KRS 95.767, $15 a month is paid to each parent if both live, and $30 to the survivor if the other dies. The payments under KRS 95.767 are in addition to payments to the widow and children, while in the other cases the parents receive benefits only if the spouse, widow or children do not survive. Under the CERS hazardous category, a parent could be an "other dependent beneficiary" and receive a lump sum $10,000 payment.

Under KRS 95.520, 95.621, and 95.767, the same dependent parent benefits apply to non-occupational death as apply to occupational death, while under KRS 95.851, 67A.360 and CERS, there are no benefits to dependent parents after non-occupational death.

Comments on Survivor Death Benefits

The widow's or spouse's benefits for occupational death are, for the most part, consistent and adequate among the various police and firemen pension statutes, with the exception of KRS 95.520. Under KRS 95.520, the surviving spouse can be given as little as $30 a month or as much as 50% of final salary, depending upon the decision of the pension board. Until the 1976 General Assembly regular session, the figure was simply $30 per month. While this figure was obviously obsolete, raising the pension amount was made discretionary rather than mandatory for cities due to growing concern among members of the General Assembly about the significant costs of pension benefits.

In the case of non-occupational death, the widow's or spouse's benefits under KRS 95.520, 95.621 and 95.767 are identical in amount to the occupational death benefit. This may be proper under KRS 95.520 and 95.767, given the respective service requirements of 15 and 12 consecutive years. Under KRS 95.621 where only one year of service is required, a pension to the widow of 50% of final salary following non-occupational death seems excessive.

Under KRS 95.851 and 67A.360 the non-occupational death benefit formula might result in particular hardship for the spouse with children. If the formula of (1.5%) (average wage) (number of years) were applied to a situation where the member had worked for five years, under KRS 95.851 the pension would then be 7.5% of the average wage. (Under KRS 67A.360 there is a 15% minimum.)

If the spouse has a child, the pension benefit increases by one-half. The pension for spouse and child would be 11.25% of the average wage, which would hardly seem adequate. If the surviving spouse died, the child would receive 50% of the member's average salary. Perhaps the gross differential is based upon the assumption that the spouse will work to support herself or himself and the child. If the child or children were young, work outside the home would be difficult and present a hardship to many women.

It is generally in the area of children's benefits that inconsistencies among the statutes are greatest. The $6 a month benefit which KRS 95.767 provides a child whose father dies from any cause is by any measure inadequate, as is the $6 a month the child might receive under KRS 95.520. As in the case of the spouse's benefit, the 1976 General Assembly gave the cities operating under KRS 95.520 the option of increasing this to 10% of final salary. While $6 a month is almost without value to a dependent child, the $24 a month provided under KRS 95.621 is also too low and is continually subject to inflationary pressure which reduces its value.

The occupational death benefit of 10% of final salary provided under KRS 95.851 or 67A.360, or 15% if the spouse does not survive, is a more rational benefit. Both these statutes can provide an even greater benefit to the surviving child, especially an orphan, in the case of non-occupational death. If the spouse survives, the pension is increased by one-half for the first child. Thus if the pension were of adequate amount, the increase would be meaningful. As noted above, if the pension is small, the increase would not be meaningful. If the spouse does not survive, the child receives 50% of the member's average salary. It might seem unfair to give the child whose parent died from non-occupational causes more than the child whose father died in the line of duty, but Workmen's Compensation is payable for an occupational death. Workmen's Compensation would pay the first orphaned child 50% of the average weekly wage established pursuant to KRS 342.740, or $86.66 per week.

The statutes are obsolete with respect to occupational death survivor benefits for more reasons than the inconsistencies discussed above. Since under KRS 95.851 any Workmen's Compensation benefit payable to a spouse or children is subtracted from the pension benefit, the child or spouse might not receive any occupational death benefit from the pension plan. Workmen's Compensation benefits received through employment, other than with the city, are also deducted from the non-occupational death benefit under KRS 95.851. Under KRS 67A.360, 95.520, 95.621 and 95.767, the pension occupational death benefit would be in addition to the Workmen's Compensation benefit. In all these cases, except non-occupational death under KRS 95.851, the city pays for both the pension benefit and the Workmen's Compensation benefit. It would seem logical to integrate both benefits to arrive at a benefit schedule which is fair to both survivors and the cities as employers. The only attempt to do this is found in KRS 95.851.

An analysis of dependent financial needs resulting from situations which might exist following occupational and non-occupational death is desirable. After a needs analysis has been completed the responsibility that the city, as employer, should assume can be determined. Based on such determination, agreeable and consistent formulas should be written into the statutes; and such formulas should in all cases consider possible benefits from the pension, Workmen's Compensation, and Social Security. Such a procedure would avoid the inconsistencies which exist today. Part of this analysis should include determining how long a dependent child needs support and what service requirements should be levied before benefits are earned. Under existing statutes benefits can be terminated to a child at the age 14 in one city while they can continue to age 23 in another. Only 1 year of service is required for non-occupational death benefits in one city, as under KRS 95.621, while 15 consecutive years are required in another, as under KRS 95.520. Common figures are needed which could rationally be applied to all pension systems.

Actuarial Studies and Funding Requirements

Actuarial Requirements

Of the 12 statutes under which locally administered city pension systems are required or permitted to operate, 4 set explicit requirements for periodic actuarial evaluation, 2 implicity require actuarial evaluation, and the remaining 6 do not mention the subject. Explicit requirements for actuarial evaluation are limited to second class cities and urban county governments. KRS 95.851, 90.400, 67A.320, and 67A.360 each require actuarial evaluation every five years. While KRS 90.410 (third class city civil service) and KRS 96.180 (third class city electric and water boards) do not explicitly require periodic actuarial evaluation, language in these statutes dealing with funding does speak to the actuarial function. Contribution levels are to be determined on a "fair actuarial basis." The state administered CERS levies the most stringent requirements in this area. An actuarial evaluation is to be performed annually, and an actuarial investigation is required every 10 years.

Funding Requirements

The statutes which explicitly require actuarial evaluation also base funding requirements on the actuarial determinations. KRS 95.851, 90.400, and 67A.360 require funding to the extent of normal costs and interest on the unfunded liability for prior service. This procedure will prevent the growth of any unfunded liability. KRS 67A.320 would seem to levy a more stringent requirement. After the first evaluation the legislative body is required to determine a period, not to exceed 30 years, over which the fund shall be brought to an actuarially sound position. Actuarially sound position is not defined; it could be interpreted to mean full funding, or something less than that. KRS 67A.320 probably would require that any unfunded prior service liability be reduced on an annual basis, whereas KRS 95.851, 90.400, and 67A.360 require only that normal costs and the interest on prior service liability be paid on an annual basis. KRS 90.410 and 96.180 do not set funding requirements, nor do any of the remaining statutes. Once again, CERS explicitly sets the most stringent requirement. All normal costs plus interest on the unfunded past service liability are to be met on an annual basis. In addition, 1% of the unfunded past service liability is to be paid annually.

Contribution Rates

Following from the actuarial and funding requirements, KRS 95.851, 90.400 and 67A.360 tie city contribution rates to the results of the actuarial evaluation. Under both KRS 95.851 and 67A.360, the city contribution is to be actuarially determined, but it is initially to be no less than 12% of payroll.

KRS 90.400, in indirect language requires the employee contribution to be actuarially determined and the employer contribution to be no less than that of the employee. This in effect requires all contribution rates to be actuarially determined. Since the employee contribution is optional at the discretion of the city, the city may choose to pay the entire actuarially determined contribution. The employee contribution under KRS 95.851 and 67A.360 is explicitly set at 8% of salary.

KRS 67A.320 does not levy a requirement that contributions be related to the actuarial study. The city may require the employee to contribute up to 6% of salary, and the city is to contribute no less than the employee. CERS sets two contribution rates for employees, depending upon whether coverage is for hazardous or ordinary duty. Hazardous coverage requires a contribution of 7% of salary, while ordinary coverage requires 4%. In both cases, the employer contribution must be sufficient to meet all of the funding requirements, including amortization of unfunded past service liability, as determined by the annual actuarial evaluation.

There is variation among, and flexibility within, the contribution rates of those remaining systems which do not levy actuarial or funding requirements. Of the remaining police and fire systems, KRS 95.520 and 95.767 provide for employee contributions of 1% to 4% of salary and no more than 3 1/2% of salary, respectively. The employer rates are $.01 to $.04 per $100 of property valuation and not more than $.03 tax per $100 property valuation, respectively. KRS 95.621 requires employee contributions at the same rate as Social Security, and employer contributions "as determined by the commissioners or council." Both KRS 90.410 (third class city civil service) and KRS 96.180 (third class city electric and water boards) permit the employer to require an employee contribution of up to 5% of salary. Employer contributions of up to $.05 on the $100 property valuation and no more than .5% of utility property and assets are allowed, respectively. The other statutes are silent in the area of employee contributions.

Comments on Actuarial Studies and Funding Requirements

There is no concern in the design of pension statutes which is more important than actuarial and funding requirements. Failure to assure adequate performance in these areas can lead to failure of basic purpose, the ability to make pension payments as promised. Four of the statutes are relatively strong in this area; KRS 95.851, 90.400, and 67A.320, and 67A.360 require actuarial evaluations at five-year intervals and funding at least to the degree of interest on the unfunded prior service liability. KRS 90.410, and 96.180 are somewhat weaker since they do not explicitly require actuarial evaluations at regular intervals and do not specify minimum funding criteria. They do, however, require contributions to be actuarially determined, so that administrators of these systems should be periodically alerted to funding problems. The remaining statutes are notable for their failure to speak to actuarial and funding requirements.

While a five-year actuarial evaluation is sufficient to allow corrective action in pension systems before deficiencies become critical, it would be much wiser to require a more frequent evaluation, perhaps every two to three years. Actuarial costs might be raised by this proposal; but the potential costs associated with growing unfunded liabilities would be avoided, and cities would be better off in all but short run.

This actuarial evaluation requirement should be levied on all locally administered pension systems. It is especially crucial to those systems, such as KRS 95.520, 95.621 and 95.767, which dictate liberal pension benefit levels but do not now require city officials to actuarially determine whether they are contributing at a rate sufficient to pay those benefits.

It appears that certain of the city pension statutes were enacted without consideration of relating contribution levels to potential costs. For example, under KRS 95.520 and 95.767, quite liberal and specific police and fire pension benefits are granted; but employers are limited in their contribution to $.01 to $.04 and not more than $.03 per $100 of property valuation, respectively. Cities may have enough real property value to raise adequate pension contributions within these limitations, but the converse might also be true. If such were the case, the cities could be caught in a situation where, if they complied with the law, they would necessarily underfund their pension systems. No city pension administrator should be put in this situation by law. Employer contribution levels should be governed by actual need rather than within arbitrary limits.

KRS 90.410 and 96.180 also limit both employer and employee contributions in isolation of actuarial considerations, but neither of these systems mandates pension benefit levels. The cities are free, therefore, to maintain actuarial soundness by determining the benefit package which can be financed within the defined limits.

Regardless of the rate or by whom contributions are set, there should be sufficient flexibility in all the statutes to ensure that total pension contributions and accumulated earnings can be sufficient in amount to adequately fund the various pension systems. Furthermore, there should be established in all statutes a minimum funding standard which is expressed in precise, unambiguous language understandable to both professional actuaries and pension system administrators. The language found in KRS 61.565 which applies to CERS is stated in unambiguous terms, while the language of KRS 67A.320, by way of contrast, is susceptible to differing interpretations. This standard should at a minimum require that all current service costs and interest charges on unfunded prior service liability be met on an annual basis, as is the present requirement for KRS 95.851 and 67A.360. Ideally the standard would also require gradual amortization of the prior service liability. A funding standard such as this, coupled with requirements for frequent actuarial evaluation and legal avenues to enforce compliance, would insure that no pension system would in the future face the potential bankruptcy which exists in several cities today.

A Note on the Value of Employee Contributions

There is considerable variation in the level of employee contributions required by the various statutes. Some statutes provide that employee contributions are a matter of local policy and vary within limits set by the state. Other statutes provide that a specific contribution level is set by the state, presumably, in relation to the cost of pension benefit involved. Employee contributions are sometimes a small component of total pension fund costs. Particularly for police and fire systems, the employer usually makes a far greater contribution than does the employee. Increasing the employee contribution significantly would not make an appreciable difference in total pension costs where the employee has the right to a return of contributions upon termination. So while variations in employee contribution levels are of considerable importance to the employee, they are usually of secondary importance to the funding of pension benefits. Some argue that employee contributions, as a small component of total pension fund costs, are a nuisance and should be eliminated. Others would counter that they are necessary to justify the generous pension benefits often found in the public sector and have value in alleviating strained city budgets where every dollar can find alternative uses. As long as maximum limits are set by the state on the amount of employee contribution, it is probably best to allow those cities which have flexibility in determining their employees' contribution rates to continue the practice. This procedure enables the city to consider pension contributions in the light of local pension costs and the total city budget.

In one case, however, the statute places the employee contribution rate in the hands of neither state nor local government. Under KRS 95.621 the employee rate is set at the same level as Social Security contributions. This process vests the decision on employee contributions in the federal government, which is oblivious to the performance of pension systems pursuant to KRS 95.621 or to the ability of the employee to pay. When Social Security rates rise, employee contribution rates will also rise; and the employee will pay more for a constant pension benefit. It would seem that the contribution formula should be related to pension system needs or to local government labor-management relations, rather than to an extraneous factor such as the current needs of the federal Social Security system.

Investment Procedures

With the exception of KRS 95.290, which applies to cities of the first class, each of the statutes governing police and firemen pension systems places responsibility for investing pension fund assets in the hands of the board of trustees. This is also the case with CERS. The statutes governing the various city civil service pension plans fail to speak to this issue.

In the case of KRS 95.851 and 67A.360, specific mention is made of the fact that the board may employ professional investment counsel. No such mention is made in the other statutes. In the case of KRS 95.520 and 95.767, an uncommon restriction is placed upon the board of trustees that the board must maintain exclusive control and management of the funds.

Investments are limited by the language of KRS 95.851, 95.520, 95.767 and 67A.360 to bonds of local governments in Kentucky and securities allowed to trustees by Kentucky law. CERS is limited to investments allowed to fiduciaries by Kentucky law, with the exception that investment may be made in common stocks with no record of dividend payments. The remaining statutes governing city pension systems in Kentucky fail to place any restrictions on, or provide any guidelines to, the investors of city pension funds.

Comments on Investment Procedures

Investment procedures and practices of the various pension boards of Kentucky city pension systems are extremely important because of the financial gains which follow good investment practices and the losses which follow poor ones. For example, if an employee works for 20 years and lives for 20 years following retirement, increasing annual investment yield by 1% can reduce required annual contributions by approximately 8 1/2%. (Bleakney, 1972, p. 133) These savings occur in the case of defined benefit plans, or plans which guarantee a given level of retirement benefit regardless of pension fund investment performance. All of Kentucky's police and firemen pension systems and most of the civil service systems fall within the defined benefit category. Because investments are so important for both decreasing pension system costs and assuring ultimate payment of benefits, it is unwise to omit, as eight of Kentucky's local government pension statutes do, any restrictions or guidelines for pension fund investment. Seven of these statutes also fail to specify who is responsible for investments. While there have been no scandals or widely publicized investment failures associated with Kentucky's city pension systems, the law should be written so as to limit as nearly as possible the likelihood that anything of this nature will ever occur. The eight statutes which omit investment standards should be amended to include the same basic standards found in the remaining statutes, to specify in all cases who is responsible for the pension fund, and to require that all trustees adhere to the "prudent man rule."

Even when investment guidelines are provided, unless a city has personnel on its own payroll who are skilled in investment practices, it is advisable to hire professional investment counsel in order to benefit from high investment yield. Unfortunately, many of Kentucky's city pension funds are so small that they are unattractive as clients for professional investment counselors. For some of the smaller cities, an alternative to independent management of funds might be to place their assets in the hands of an insurance company for purposes of investment and administration. Although it is not the purpose of this report to endorse such a practice, it might be preferable to the possibility of inexperienced local management and consequent loss of potential earnings or losses on principal amounts. It is important that on at least two occasions (OAG 71-154, 71-202) the Attorney General has advised that cities operating police and fire pension systems pursuant to KRS 95.767 cannot contract with an insurance company for fund management because of the requirement for exclusive control and management of funds by the board. Cities of the fourth and fifth classes can circumvent this restriction by placing their police and firemen under the provisions of KRS 90.400. There are at least three cities of the fourth class which have established pension systems pursuant to other statutes, which include coverage for police and firemen and which have given over fund management to insurance companies. If cities can accomplish this purpose by simply organizing under an alternative statute, it is not consistent to prohibit insurance contracts, or possibly other forms of investment counsel, under KRS 95.520 and 95.767. It would be advisable to amend these particular statutes so that any form of responsible and professional investment counsel could be used.

Treatment of Employee Contributions

Amounts

Mandatory employee contributions are established at 8% under KRS 95.851, existing Social Security rate under KRS 95.621, not more than 3 1/2% under KRS 95.767 and 8% under KRS 67A.360. Under KRS 90.400, 95.290, 95.520, 90.410, 96.180 and 67A.320, employee contributions are at the option of the employer.

In these cases the amount contributed is variable, the upper limit being from 4% to 6% of salary except in the case of KRS 95.290, where limits are not specified. Under KRS 90.400 the amount is actuarially determined. For the remaining systems, KRS 67A.340 and 79.080, the statutes are silent on the issue; so it must be assumed that contributions under these statutes would also be at the option of the employer. In practice most cities in Kentucky require an employee contribution. CERS levies two required contribution rates. Hazardous coverage requires a 7% contribution, and ordinary coverage requires 4%.

Return of Contributions

Two statutes, KRS 95.851 and 67A.360, require the city to return contributions to the employee if he terminates employment; but no interest is permitted. Under KRS 95.520 and 95.621, return of contributions is at the option of the pension board; again, no interest is returned. Under KRS 95.767 no mention of return of contributions is made, and an Attorney General's opinion (OAG 68-98) advised that a departing employee is not entitled to his accumulated contributions. The other statutes do not speak about return of employee contributions. Under the state administered CERS, contributions are returned with interest, which is currently 3%.

The Case of Employee Re-entry

Four of the statutes, KRS 95.851, 95.520, 95.621 and 67A.360, contain an identical provision concerning employees who terminate employment, collect a refund, and subsequently are re-employed and wish to regain credit for their previous service. This provision is that after five years of re-employment, the employee can return his refund with 6% interest and have his credited service reinstated. CERS has a similar provision, but with only a six month waiting period. The other statutes do not speak to this issue.

Comments on Treatment of Employee Contributions

Employee contributions are taken from current after-tax income and cause a reduction in disposable income. They cannot be characterized as deferred compensation, as one might characterize the employer contribution which is not available to the employee until he vests and retires. As the employer's obligation to pay a pension ceases to exist when the nonvested employee terminates, so does his need to retain and invest the employee's contributions for that purpose. It is therefore difficult to justify the employer's retention of an unvested employee's contributions when the employee leaves the employer. Since by this reasoning the contributions are the property of the employee, he should also receive some measure of the accumulated earnings on those contributions. But return of interest is a right either denied or unaddressed by all the statutes providing for city administered systems. It is important to note both that CERS returns contributions with interest and that certain locally administered systems are now in litigation initiated by employees seeking the return of their contributions.

Finally, there is a technical problem with KRS 95.520 which needs correction. This statute allows a returning employee to purchase prior credit after five years re-employment by returning refunded contributions with 6% interest; but the formula for retirement under KRS 95.520 is 50% of final pay after 20 years of continuous service. If an employee served two years, terminated, and then returned, he would have to serve 20 additional years with no further unauthorized breaks in service to qualify for a pension. Then he could receive only 50% of final pay, no more. The purchase of prior credit by returning a refund is of no value, since the two years of initial service cannot be credited toward earning a pension. If the requirement that service be continuous were dropped, or if additional pension credit were given for service over 20 years, then this provision of KRS 95.520 would be of value to employees.

Reporting and Information Requirements

Reports required of police and fire pension boards in second class cities by KRS 95.851 and urban county governments by KRS 67A.360 are identical. Each statute requires that an annual report by the board to the city must include a statement of financial and actuarial condition; a statement of income and expenditures; a statement of changes in asset, liability and reserve accounts; a statement of investments owned; detailed statements of investments acquired and disposed of during the year; and other necessary financial or statistical data. A synopsis of this report is to be prepared and distributed among the members of the pension system.

With the exception of KRS 95.290, which levies no reporting requirements, the boards of the other police and fire pension systems established pursuant to KRS 95.520, 95.621 and 95.767, must report annually to the city. Guidelines for the report are limited, however, to the condition of the pension fund. There is no requirement for reporting to the members of the system.

KRS 90.400 and 67A.320 require second class cities and urban county government civil service systems, respectively, to report quarterly to the mayor. The report must include data or receipts, expenditures and financial status, places of deposit, and the character of investments made. There is no requirement that the report be given to members, but it must be posted where employees frequent and report. The only other reporting requirement in the statutes is for third class city electric and water plant boards, KRS 96.180, where the trustee must annually file with the electric and water plant board a record of his actions and accounts. No reporting to the membership is required.

Comments on Reporting and Information Requirements

Ideally, a pension board should report to two constituencies: the city which is financially responsible for the condition of the fund and the employees who will depend upon the fund for retirement income security. The city should be primarily interested in the financial health of the pension fund and in determining that satisfactory procedures are being followed in the management of the assets of the fund. The employee's interest should fall into two categories: first are the same financial and administrative matters which are of interest to the city, and second are the benefit characteristics of the plan and his particular status with respect to those benefits during the reporting period.

There are four systems for cities governed by KRS 95.290, 90.410, 67A.340, and 79.080 which do not specify any report to the city or the employee. Neither do any of these systems require an audit. With the exception of KRS 90.410, there is no mention of an actuarial requirement. It seems unwise for the legislature to authorize local governments to undertake programs of such potential complexity and with such financial implications without some procedural requirements to insure that interested parties will be well informed.

In terms of providing information to the city, KRS 95.851, 67A.360, 90.400 and 67A.320 require the most detail and would seem to best satisfy the needs of the cities for information. Each of these systems further meets the cities' need for information through a requirement for periodic actuarial evaluation. Two of them, KRS 95.851 and 67A.360, also require an annual audit. While these four systems provide adequate information for the cities to satisfactorily monitor fund performance, the same cannot be said with much assurance about the other four systems which require reports. KRS 95.520, 95.621, 95.767 and 96.180 do not detail any specifics for the report; and none of these systems require an audit. Only KRS 96.180 makes mention of actuarial requirements. While it might be possible for the cities using these systems to gain satisfactory information on the condition of their respective pension funds, disregarding of course the question of actuarial soundness, it would only occur because of local policy or conscientious accounting and reporting by the pension administrators on their own volition. The law makes no such demands.

While there are definite shortcomings in requirements for reporting to cities, it is in reporting to employees that the most serious inadequacies appear. Two statutes, KRS 95.851 and 67A.360, require that a synopsis of the report sent to the city be also provided to the employees. KRS 90.400 and 67A.320 require that such reports to the city be posted where employees frequent and report. This is the sum of statutory requirements on reporting to employees. As mentioned previously, employees should be entitled both to information on fund financial condition and administrative practice which is of interest to the cities, and information on benefit provisions and the individuals' status with respect to those benefits. It is in the area of reporting and disclosure to employees that the 1974 Employees Retirement Income Security Act levied stringent requirements on the private sector. While the public sector is not at this time governed by the provisions of this Act, such legislation relating to the public sector is now under consideration by Congress. Whether or not such legislation is ever passed, there should be improvement in Kentucky's statutes regarding reports to employees. These statutes should require that new employees be briefed on the retirement benefits which may be obtained through the pension system, how much service is required to obtain a given level of benefits, what effect breaks in service will have on benefits, what dependents can expect in the event of disability or death, and how much the employees must contribute toward their own retirement benefits. The employees should be given an easily read booklet or pamphlet on the system at the time of this briefing. On an annual basis thereafter, the employees should be given a written report on what progress they have made toward qualifying for retirement benefits, the value of accumulated employee contributions, and any changes which have occurred in the provisions of the pension system which would affect their status in any way. All this information should be provided in addition to a written summary of a financial and administrative report made by the pension system to the city government.

Were many small city pension systems faced today with such reporting and disclosure requirements, they would probably initially be unable to comply. The technical expertise to prepare such reports to city and employee and to update the employee on his pension system status simply may not be available. While such service can be obtained from the private sector if it cannot be developed locally, there is an expense involved which may be burden to small local governments. Discussion of the administrative and financial costs of adequate reporting and disclosure, as with other pension system costs, inevitably leads to the conclusions that adequate pension system management is more easily provided and costs are proportionately less in a large pension system than in a small one. It would perhaps be arbitrary and in certain cases unfair to determine that pension systems below a certain size are too small to perform efficiently and effectively. It would not be unfair to set performance criteria for city pension systems in the reporting area as well as in other areas of pension system performance which are of significant concern. Cities whose pension systems are unable to meet such performance criteria might better serve their employees and themselves by consolidating management with other cities or by joining a state administered pension system.

CHAPTER IV

SURVEY RESULTS

Civil Service Pension Systems

As has been pointed out in the previous chapter on analysis of the provisions of the various city pension statutes, the General Assembly has given the cities great latitude in designing their civil service pension systems. The purpose of this chapter is to catalog some of the more pertinent information derived from the survey of city pension systems and to discover whether the cities have used their discretion wisely. The 21 systems discussed here have been separated into 3 categories according to the number of active participants in each system. The first category contains systems with 95 or more members, the second contains those with 26 to 94 members, and the third is limited to those with 25 or fewer members. At times the report centers on all systems rather than systems by categories if the point of interest is common to systems in more than one category. Appendix 3, prepared by Meidinger Actuaries and Employee Benefit Consultants, is an analysis of the survey data on Civil Service pension systems, and should be consulted for information in detail.

Retirement Age and Benefit Formulas

Table 2 indicates that a normal retirement age below age 65 is common to all but one of the retirement systems with 95 or more members. The exception is in Elizabethtown, a relatively new system established in 1976. In two of the cities, Covington and Newport, the normal retirement age is 50. An early retirement age is a costly provision to fund because each extra year of retirement granted is an extra year that must be paid for out of a declining period in which to accumulate assets. If it is estimated that retirees will live to an average age of 75, then dropping the retirement age from 65 to 60 could increase pension costs by at least 50%. Dropping the age to 50 would more than double costs. Aside from the cost factor, the practice of retiring civil servants with full benefits at age 50 must be questioned. Although certainly more defensible, a normal retirement age of 60 is also open to question.

Tables 3 and 4 indicate that the next smaller categories, 26 to 94 members, and 25 or fewer members, are characterized by a retirement age of 65, with some exceptions. Ashland, a second class city, gives its water department employees a retirement age of 50; and Paducah, another second class city, sets it at age 60. While Shively has set its retirement age age 62, the covered employees are policemen and firemen, and age 62 may therefore be too high. The retirement age of 65 for policemen and firemen in Dayton and Prestonsburg would, by the same criterion, also be too high.

It is when these retirement ages are paired with benefit formulas that problems become most evident. Covington and Newport in Table 2 and Ashland in Table 3 have granted a retirement formula for the first 20 years of service which is extremely generous and nearly duplicates what is given to policemen and firemen in second class cities for the first 20 years of service. This amounts to 50% of salary for 20 years of service at age 50, a benefit which must be extremely costly to the city. Covington supplements this pension coverage with Social Security benefits. Net take home pay under this combination of benefits could easily be greater after retirement than prior to retirement.

While the formula is generous for the first 20 years, it drops precipitously from 2.5% of average, or final, salary for each year of employment to 1% of salary for each year over the first 20. Therefore, the most logical thing for the employee to do is to work until he has reached age 50 and completed 20 years of service, and then take a handsome retirement and seek a new job elsewhere. A formula which heavily rewards later rather than earlier years of service would tend to retain employees and make more financial sense for these cities.

The city of Lexington, Table 2, also grants the same generous retirement formula. Since retirement occurs there at age 60 and is not supplemented with Social Security coverage, it is much less costly. Owensboro and Henderson (Table 2) and Paducah (Table 4) grant 50% of average or final salary at age 60 for 20 years of service. This is a very generous formula for the 20 year employee who, in each city, also receives Social Security coverage. There appears to be no provision for extra benefits for the employee who works longer than 20 years. In other words, different employees can work unequal lengths of time for the same pension benefit under this system. Henderson is limited by KRS 90.410 which allows no more than 50% of final salary.

There are certain other isolated difficulties. Bellevue, for example, while operating by a formula which is certainly fiscally within its means, may be offering its employees too little protection against inflation. There is no factor in its formula (Table 4) which adjusts in any way to the rising cost of living. Without adjustment, this formula may rapidly become obsolete. Ft. Thomas Public Works (Table 4) demonstrates the same problem, as does Shively Police and Fire (Table 3). Fortunately, in each of these cases, Social Security coverage is also provided by the city, offering some protection from inflation. Still it must be understood that these three systems suffer from inflationary erosion of benefits in two ways. Ordinary pension plans, which base benefits on final salary or final average salary, are subject to erosion of benefit values after retirement unless cost-of-living raises are given. Pension plans such as these three which base benefits on a constant factor and are not pegged to final or average salary, are subject to inflationary erosion in value prior to, as well as after, retirement.

Another apparent difficulty exists in Prestonsburg, where the retiree gets 26% of his average salary for the last five years, whether he has worked 5 years or 20. This means that the employee who has completed five years of service cannot improve his pension through continued service.

Finally, it was impossible to determine from the interviews conducted or the documents available precisely what the benefit formulas were for certain of the insurance funded plans. (See Table 4.) Thus, some of the problems discussed may exist in these cities also. But more importantly it reveals that in some cases only the insurance agent who sold the retirement plan may be really knowledgeable as to its provisions. Adequate pension plan management demands greater knowledge of benefits for both employer and employee.

Costs and Funding

This section discusses cost and funding problems of these plans which result in great measure from the factors discussed above. Table 2 indicates that each of the cities with pension plans with 95 or more members has recently had its pension system actuarily evaluated. With the exception of Elizabethtown, which is a money purchase plan and which employs professional investment counsel, the results are not encouraging. A column in Table 2 labeled "Funding Ratio" indicates ratio of funding for the system. This statistic is derived by substracting the present value of future contributions from the present value of future pension fund liabilities. This gives the accrued liabilities of the fund. If the accrued liabilities are divided into the assets on hand, the "Funding Ratio" is the result. If the present assets equal the accrued liabilities; or, more simply if the system is fully funded, the ratio will be 1.0 or 100% funded.

The most important factor in measuring pension system fiscal soundness is to determine the direction in which the ratio is moving. If it increases, the system is sound or becoming more sound. If it declines, or if the unfunded liabilities of the system increase, the system is headed for eventual inability to meet its pension obligations. None of the systems in Table 2 is funded to even the .30 or 30% level, and in most cases liabilities are growing. One of the systems had nearly reached a pay-as-you-go condition when this study's survey was conducted. What that city will do to meet its obligations is unclear at this time. Examination of current employer contributions to the funds reveals that one city has allocated an extremely high sum, 40% of payroll, to keep its fund in a stable condition. The other cities are not contributing anywhere near this percentage, but their liabilities are growing. Some are in a more serious position than others, as would be indicated by the respective actuarial evaluations, but none can survive in the long term if unfunded liabilities continue to grow. While the unfunded liability of the Lexington fund is now increasing, the Urban County Council has dedicated a percentage of the property tax base to the fund. It is estimated that the growth of the tax base will eventually provide sufficient money to meet all pension obligations.

Tables 3 and 4 indicate that nine of the pension plans are of the insurance variety. Though an actuarial evaluation is not available to demonstrate it, it must be assumed that any unfunded liabilities which they might have would be declining and their ratios of funding increasing. Otherwise, the respective insurance companies would not continue the insurance contracts. Two of the remaining systems, Radcliff and Maysville, are money purchase systems; so discussion of funding ratios is not relevant. Two systems, Frankfort Electric and Water Plant Board and Bellevue Retirement System, have had recent actuarial evaluations and have high funding ratios with declining unfunded liabilities. Basically, each of these systems is designed to complement Social Security coverage; and both benefit from professional management and actuarial assistance. Two of the systems, both in second class cities, are estimated to have increasing unfunded liabilities and declining funding ratios. One of these, Ashland Water Department, offers the same generous retirement provisions as Covington and Newport. The second, Paducah Appointive Employees, is an example of a trend among these civil service retirement systems: the closing of membership to new members and the selection of CERS as an alternative. Paducah closed its system to new members in 1975. At that time old members were allowed to choose CERS, and nearly all took the option.

TABLE 2

SELECTED CHARACTERISTICS, CIVIL SERVICE PENSION SYSTEMS WITH 95 OR MORE MEMBERS

CITY	SIZE	S.S.	AGE AND SERVICE REQUIRED	BENEFIT FORMULA	ACTUARIAL EVALUATION	FUNDING RATIO	ACTUAL CITY CONTRIBUTION	DIRECTION, UNFUNDED LIABILITY
Covington (KRS 90.400)	141	Yes	Age 50/20 yrs.	First 20 yrs., (2.5%) (high 5) (yrs.) After 20 yrs., (1%) (high 5) (yrs.)	1976	.05	40%	Constant or Decreasing
Lexington (KRS 90.400)	454	No	Age 60/20 yrs.	See above	1976	.17	14%	Increasing
Owensboro (KRS 90.400)	227	Yes	Age 60/20 yrs.	50% of average of last 10 yrs.	1974	.27	6%	Increasing
Elizabethtown (KRS 90.410)	121	Yes	Age 65	Money purchase	1976	NA	5%	NA
Henderson (KRS 90.410)	199	Yes	Age 60/20 yrs.	50% of average of last 10 yrs.	1974	.12	5%	Increasing
Newport (KRS 90.400)	95	No	Age 50/20 yrs.	First 20 yrs., (2.5%) (high 5) (yrs.) After 20 yrs., (1%) (high 5) (yrs.)	1976	Nearly bankrupt	6% (?)	City response to 1976 actuarial evaluation unknown

TABLE 3

SELECTED CHARACTERISTICS, CIVIL SERVICE PENSIONS SYSTEMS WITH 26 TO 94 MEMBERS

CITY	SIZE	S.S.	AGE AND SERVICE REQUIRED	BENEFIT FORMULA	ACTUARIAL EVALUATION	FUNDING RATIO	ACTUAL CITY CONTRIBUTION	DIRECTION, UNFUNDED LIABILITY
Ashland Water (KRS 90.400)	32	No	Age 50/20 yrs.	First 20 yrs., (2.5%) (final salary) (yrs.) After 20 yrs., (1%) (final salary) (yrs.)	1975	.20	11%	Increasing
Frankfort Electric (KRS 96.180)	60	Yes	Age 65, 9 yrs.	(.75 X $ to 400 mo.) (yrs.) plus (1.3 X $ over 400/mo.) (yrs.)	1975	.42	8.5%	Decreasing
Glasgow (Statute unknown)	40	Yes	Age 65/20 yrs.	(1.5%) (average of last 5) (yrs.)	--	--	7%	Unknown
Paris (Insurance) (Statute unknown)	85	Yes	Age 65/10 yrs.	$50/mo. plus (.5) ($ to 300/mo.) plus (.9) ($ over $300/mo.) (yrs.)	1975	--	7.5%	Decreasing
Prestonsburg Police, Fire & Other (Insurance)	26	Yes	Age 65 or 5 yrs.	26% (average of last 5)	1976	--	4%	Decreasing
Radcliff (Insurance) (Statute unknown)	26	Yes	Age 65	Money purchase, 8% of salary contributed	--	--	5%	NA
Shively Police & Fire (Insurance) (KRS 90.400)	36	Yes	Age 62	Rate for income class Years in income class	--	--	3%	Decreasing

TABLE 4

SELECTED CHARACTERISTICS, CIVIL SERVICE PENSION SYSTEMS WITH FEWER THAN 26 MEMBERS

CITY	SIZE	S.S.	AGE AND SERVICE REQUIRED	BENEFIT FORMULA	ACTUARIAL EVALUATION	FUNDING RATIO	ACTUAL CITY CONTRIBUTION	DIRECTION, UNFUNDED LIABILITY
Bellevue (KRS 79.080)	9	Yes	Age 65/10 yrs.	$6.50/mo./yr. for future service, $2.50 /mo./yr. for past service	1976	.63	Level deposit	Decreasing
Carrollton (Insurance) (Statute unknown)	12	Yes	Age 65/10 yrs.	Undetermined	--	--	3%	
Dayton Police & Fire (Insurance) (Statute unknown)	14	No	Age 65	Undetermined- $140/mo. (illustration only, 24 years service)	--	--	4%	
Ft. Thomas Adm. (Insurance) (Statute unknown)	11	Yes	Age 65	Undetermined- Rate for income class · Years in income class	--	--	--	
Ft. Thomas Public Works (Insurance) (Statute unknown)	25	Yes	Age 65	($3.25/mo.) (yrs.)	1973	--	--	
Maysville (Statute unknown)	5	Yes	10 yrs.	Money purchase, $50/mo. at 5% interest	--	--	$30/mo.	NA
Paducah (KRS 90.400)	5	Yes	Age 60/20 yrs.	50% of final salary	1973	.20	15%	Probably increasing
St. Matthews (Insurance)(Statute unknown)	20	Yes	Age 65/10 yrs.	20% of salary subject to S.S. tax, 50% of salary in excess	1976	--	6%	Decreasing

In 1973 Lexington closed its system to new members. Maysville also took this path for both its civil servants and its police and firemen in 1976. In 1977 both Covington and Newport closed their programs to new members in favor of CERS. Currently Paris is transferring its insurance funded plan to CERS.

Closing pension plans to new members when it is determined that existing coverage is too expensive for the city to bear is a logical alternative and certainly preferable to possible pension system bankruptcy. When this path is taken and CERS is chosen as an alternative, both city and employee benefit because an adequate pension is then guaranteed to the employee at a price the city can afford. At least 42 cities in Kentucky have placed employees under CERS coverage, twice as many as have created independently administered pension plans for non-uniformed employees. Closing a pension plan to new members does not, however, erase any pension liabilities which have already been created. To the contrary, such action may accelerate the pace at which pension liabilities become difficult to finance. This is because in a pension system which receives no new members the proportion of retired to active members increases and the contributions of active members can no longer be relied upon to pay the pensions of those already retired. Pension reserves can be quickly depleted, and unfunded liabilities must be met at an earlier date.

Disability Coverage Under Civil Service Plans

As with retirement ages and basic benefit formulas, the General Assembly has given the cities free rein to design their own pension disability benefits. Table 5 indicates that the cities with 95 or more members have once again been quite generous in what they have granted their employees. The non-occupational disability benefits, for example, closely resemble those benefits which are commonly offered to policemen and firemen. This is not to say, however, that the benefits are excessive. In the case of non-occupational disability, the distinction between hazardous duty personnel and other civil servants breaks down. We would expect both to face the same probability of disability, and the city would not have a greater responsibility to either party. Comparsion with CERS is also instructive. While the CERS formula, (1.6%) (final compensation) (years of service) is apparently much less than the city formulas, CERS requires only five years of service for the non-occupational disability benefit; and that service credit is doubled to the point where 25 years of service are obtained. (See Table 1) A criticism which might be made of the city systems in this regard is that they require ten years of service before the employee is eligible for any benefit. In no case is group disability insurance offered to cover the employee until he has completed ten years of service. Four of the cities in Table 5 offer their employees Social Security coverage, which is also a source of non-occupational disability benefits. While the Social Security service requirements for persons of various age groups are not excessive, the worker must also vest in the Social Security system before he is eligible for benefits. It is possible for the worker to be injured, therefore, in a period when he has no coverage. For this reason, an interim group disability coverage option would be desirable, or service requirements could be reduced.

The occupational disability benefits which are granted are also quite generous, allowing the employee to receive between 50% and 65% of average salary, depending upon the city. An exception is the Eliazabethtown money purchase plan. One weakness in three of these plans is that the benefits increase at a yearly rate; and while they might be quite adequate after ten years of service, they are hardly adequate after one year of service. It would be appropriate to set a minimum benefit of perhaps 25% of average salary for occupational disabilities regardless of years of service.

While it is important to adequately protect employees from the hazards of disability, it is also important to prevent the payment of excessive disability benefits in these days of disability coverage from multiple sources. Although all cities in Kentucky protect their employees through Workmen's Compensation, two of the cities in Table 5 which offer substantial disability benefits do not offset Workmen's Compensation benefits against the pension disability benefit. In no case is a possible Social Security disability benefit offset against a pension benefit. CERS, by way of contrast, has a provision whereby the combination of pension disability benefits, Workmen's Compensation benefits and the Social Security benefits cannot exceed 100% of final compensation. If benefits exceed 100%, the pension is accordingly reduced.

Another safeguard which should be built into all disability programs is a periodic medical review of disability at the option of the pension board. The recovered employee should return to the payroll. Two of the cities listed in Table 5 have failed to institute such a procedure.

Tables 6 and 7 indicate that quite commonly the smaller plans do not offer non-occupational disability benefits at all. Of the eight cities which fall in this category, all offer Social Security coverage, which can provide adequately for disability once the employee is vested. None of these eight cities offers any interim group disability insurance coverage. Of the remaining seven systems only two, Ashland Water Department and Paducah Appointive Employees, offer a substantial benefit. Paducah also offers Social Security coverage; Ashland does not. The Ashland system does not grant eligibility for the non-occupational disability benefits until seven years of service have been completed. For this reason, interim group disability insurance coverage would be desirable, but it is not provided.

The remaining five systems offer what appear to be minimal benefits. Of these, Frankfort Electric and Water Plant Board and Dayton Police and Fire offer group disability insurance. All but Dayton provide Social Security coverage. While the Social Security coverage can be quite adequate, it would be desirable for all the systems to provide an interim group disability insurance option for those employees not vested in the Social Security system.

Occupational disability coverage is not strong in any of the systems found in Tables 6 and 7 except for Paducah and Ashland. In Ashland the employee must accumulate 15 years of service before he has earned the occupational disability benefit. At the time this survey was conducted, it took longer to vest for occupational disability than for non-occupational disability in Ashland. Seven of the systems do not provide occupational disability benefits. This is probably not a serious problem, however, because of the universal coverage by Workmen's Compensation in these systems and the near universal coverage under Social Security. Relying on Workmen's Compensation and Social Security would seem to be logical occupational disability alternatives for a city and would eliminate the need to be concerned with offsets against the city disability pension and with disability determination and review procedures. For smaller cities as well as larger ones, the avoidance of these administrative and accounting tasks is desirable.

TABLE 5

DISABILITY PROTECTION, CIVIL SERVICE SYSTEMS WITH 95 OR MORE MEMBERS

CITY	SOCIAL SECURITY COVERAGE	GROUP DISABILITY INSURANCE	OCCUPATIONAL DISABILITY	NON-OCCUPATIONAL LIABILITY	DISABILITY REVIEW	SOCIAL SECURITY OFFSET	WORKMENS COMPENSATION OFFSET
Covington (KRS 90.400)	Yes	No	60% of High 3	(2.5%)(AV)(yrs) to 65%,10 yrs.reg.	No	No	No
Lexington (KRS 90.400)	No	No	(5%)(High 3)(yrs) to 65%	(2.5%)(High 3)(yrs) to 65%,10 yrs.reg.	Yes	NA	Yes
Owensboro (KRS 90.400)	Yes	No	(5%)(Last 10)(yrs) to 50%	(2.5%)(Last 10)(yrs) to 50%,10 yrs.reg.	Yes	No	Yes
Elizabethtown (KRS 90.410)	Yes	No	Money Purchase	Money Purchase	S.S. Procedure	No	No
Henderson (KRS 90.410)	Yes	No	(5%)(Last 10)(yrs) to 50%	(2.5%)(Last 10)(yrs) to 50%, 10 yrs.reg.	Yes	No	Yes
Newport (KRS 90.410)	No	No	60% of High 3	(2.5%)(High 3)(yrs) to 65%, 10 yrs.reg.	No	NA	No

TABLE 6

DISABILITY PROTECTION, CIVIL SERVICE SYSTEMS WITH 26 TO 94 MEMBERS

CITY	SOCIAL SECURITY COVERAGE	GROUP DISABILITY INSURANCE	OCCUPATIONAL DISABILITY	NON-OCCUPATIONAL LIABILITY	DISABILITY REVIEW	SOCIAL SECURITY OFFSET	WORK-MENS COMP OFFSET
Ashland Water Department (KRS 90.400)	No	No	50% Final salary 15 yrs. req.	(2.5%) (Final) (yrs.) 7 yrs. req. to 50%	No	NA	No
Frankfort Elec. and Water (KRS 96.180)	Yes	Yes	Deferred or early retirement	Deferred or early retirement	Yes	No	No
Glasgow (Statute unknown)	Yes	No	(1.5% (Final) (yrs.) 10 yrs. req.	None	Yes	No	No
Paris (Insurance)	Yes	No	None	None	NA	NA	NA
Prestonsburg (Insurance)	Yes	No	Vested Benefit	Vested Benefit	NA	NA	NA
Radcliff (Insurance) (Statute unknown)	Yes	No	None	None	NA	NA	NA
Shively (KRS 90.400)	Yes	No	None	None	NA	NA	NA

TABLE 7

DISABILITY PROTECTION, CIVIL SERVICE SYSTEMS WITH LESS THAN 26 MEMBERS

CITY	SOCIAL SECURITY COVERAGE	GROUP DISABILITY INSURANCE	OCCUPATIONAL DISABILITY	NON-OCCUPATIONAL LIABILITY	DISABILITY REVIEW	SOCIAL SECURITY OFFSET	WORK-MENS COMP OFFSET
Bellevue (KRS 79.080)	Yes	No	Full retirement reduced by .5%/mo. for each month prior to normal retirement, 10 yrs. req.	Full retirement reduced by .5%/mo. for each month prior to normal retirement, 10 yrs. req.	Yes	No	No
Carrollton (Insurance)	Yes	No	Insurance Annuity	Insurance Annuity	No	No	No
Dayton (Insurance)	No	Yes	Insurance Annuity	Insurance Annuity	No	No	No
Ft. Thomas Administrative (Insurance)	Yes	No	None	None	NA	NA	NA
Ft. Thomas Public Works (Insurance)	Yes	No	None	None	NA	NA	NA
Maysville (Statute unknown)	Yes	No	Money Purchase 10 yrs. req.	Money Purchase 10 yrs. req.	No	No	No
Paducah (KRS 90.400)	Yes	No	50% final	50% final	Yes	No	No
St. Matthews (Insurance)	Yes	No	None	None	NA	NA	NA

Administration of Disability Benefits

As was indicated in the discussion of disability benefits in the previous chapter, disability retirements tend to cost a pension system more than normal retirement because they characteristically occur earlier than normal retirements. Therefore, they must be paid for a longer period of time and from a decreased time period in which to fund the benefit. For this reason it is important to examine the manner in which the disability provisions of pension systems are administered. Administration which allows liberal use of the disability retirement option can seriously drain the resources of a pension system and will increase funding requirements.

In the questionnaire used for this study, figures on the number of retirees and beneficiaries drawing benefits in each system were gathered. From the figures for the total number retired and the number retired on permanent disability, the percentage of retirees in each system who have received permanent disability retirement was calculated. These percentage figures can be examined to make comparisons among the administrative practices of the various systems and to make some tentative judgments about practices in individual cities. For this purpose the cities which were segregated in the previous analysis into three size groups have been placed in a single table, Table 8. This was done because only those cities with enough retirees to make analysis meaningful were chosen for this discussion.

An examination of Table 8 reveals first that there is wide variation among the cities in the percentage of retirees who are on disability; second, that certain of the cities have a strikingly high percentage of disability retirements. Two cities, for example, are granting disability retirements to 55% of those retired. Two other cities are above the 40% level. Yet another city with disability provisions quite similar to the other cities has granted disability benefits to only 3% of its retirees. These contrasts are so evident and the percentages so high as to invite a separate study of administration of disability benefits by the cities. Because no data is available on the nature of the disability retirements granted or the age at which they tend to occur, it would be inappropriate to draw any strong conclusions in this area. Perhaps disability retirements have been granted in the past to tax advantage of federal income tax exemptions. The data presented do indicate that administation of disability benefits is one problem which the cities must examine closely if they are to achieve professional management of their funds. The General Assembly might do well to provide the cities with some guidelines on disability administration.

Vesting for Deferred Benefits

In Chapter I of this report, it was stated that desirable goals for pension plans from the employee perspective are early vesting for deferred benefits and portability from one job to another. None of the 21 civil service pension systems provide a portable benefit, but it would be worthwhile to examine the vesting provisions. (Table 9)

Six of these 21 systems require 20 years of service before the individual is vested in the pension system, and 2 of these 6 make no provision for a deferred benefit. The employee must continue to work until retirement age or lose his accrued pension benefits. Eight grant a vested benefit at the accumulation of 10 to 15 years of service. Five of these eight provide for full vesting, while another two provide initially for partial vesting and full vesting as time progresses. One fails to provide for a deferred benefit; the employee must continue working until retirement age. Five systems begin the vesting process at between one and five years. Usually the vesting is on a percentage basis and increases with time. Finally, there are two insurance plans which set no time requirement for vesting and provide a cash settlement or annuity when the employee terminates.

An interesting point is that five of the six systems which are requiring 20 years for vesting are in second class cities. This pattern is probably derived through imitation of the police and fire pension systems in those cities. Twenty years seems an excessive priod of time to require before the employee has any right to his pension benefit. There seems to be no pattern to the vesting provisions in the other cities, but the periods required for vesting do seem reasonable.

Treatment of Employee Contributions

Of the 21 civil service pension plans studied, 3 do not require employee contributions. Of the remaining 18 systems, employee contributions of between 2% and 6% of salary are assessed. (Table 10) Usually when the employee leaves his job with the city, his employee contributions are returned to him. There are exceptions to the pattern. In one city contributions of 5% of payroll are not returned, and in two other cities only 50% of employee contributions of 3% and 5% of payroll are returned.

Of the nine pension systems which are insurance plans, eight are contributory and all return contributions. Six of these return contributions with interest when the employee terminates. Of the remaining 12 pension systems, 10 are contributory for the employee, 7 return employee contributions when the employee terminates, and 3 of these return employee contributions with interest.

As was stated in Chapter II of this report, employee contributions to a pension plan are after-tax dollars which belong solely to the employee. By giving the contributions to the pension fund, the employee is purchasing pension benefits which the pension fund is then obligated to pay upon retirement of the employee. If the employee terminates prior to retirement, the city's obligation to pay a pension also terminates. Therefore, there can be no justification for failure to return employee contributions. Fortunately, few cities have chosen to withhold employee refunds. Those which do should be prohibited from this practice in the future.

While the need for returning contributions with interest is not so strong as the need for returning the contributions themselves, the subject deserves attention. The pension systems benefit from investment of their funds for interest. It might be argued that the employee has received some pension system benfits, akin to term insurance, during his employment with the city and so does not deserve full interest upon the return of his contributions. At least part of that interest should be returned to the employee when he terminates. Contributions in the state retirement systems are returned with 3% interest. This practice is recommended for city pension systems. Implementation of this proposal would require change by 9 of the 21 systems.

TABLE 8

DISABILITY RETIREMENTS AS A PERCENTAGE OF TOTAL RETIREMENTS

Civil Service Systems for
Nonuniformed Employees

City	Total Retired	% Retired on Disability
Ashland Water	5	0
Covington	90	42%
Lexington	68	55%
Newport	33	3%
Owensboro	71	55%
Paducah	30	46%
Henderson	36	27%
Frankfort Electric & Water	9	11%
Paris Employees	6	16%

TABLE 9

VESTING AND DEFERRED BENEFITS - CIVIL SERVICE SYSTEMS

CITY	TIME TO VEST	EARLIEST AGE DEFERRED BENEFIT
Covington (KRS 90.400)	20 yrs.	Age 60
Lexington (KRS 90.400)	10 yrs./age 45	Age 55
Owensboro (KRS 90.400)	20 yrs.	Age 60
Elizabethtown (KRS 90.410)	1 yr., 5%/ 10 yrs., 50%/ 15 yrs., 100%	Age 55
Henderson (KRS 90.410)	20 yrs.	No provision
Newport (KRS 90.400)	20 yrs.	Age 50
Ashland Water Department (KRS 90.400)	20 yrs.	No provision
Frankfort Electric & Water (KRS 96.180)	15 yrs./age 55	Age 55
Glasgow (Statute unknown)	11 yrs., 10%/ 15 yrs., 50%/ 20 yrs., 100%	Age 60
Paris (Insurance)	10 yrs.	No provision
Prestonsburg (Insurance)	15 yrs.	Age 65
Radcliff (Insurance)	5 yrs. (50%)	Age 65?
Shively (Insurance) (KRS 90.400)	5 yrs.	Age 62
Bellevue (KRS 79.080)	10 yrs.	Age 55
Carrollton (Insurance)	None, cash settlement or annuity	None, cash settlement or annuity
Dayton (Insurance)	None, cash settlement or annuity	None, cash settlement or annuity
Ft. Thomas Administrative (Insurance)	1 yr.	Age 65
Ft. Thomas Public Works (Insurance)	5 yrs., 25%/ 10 yrs., 50%/ 20 yrs., 100%	Age 55
Maysville (Statute unknown)	10 yrs., lump sum	
Paducah (KRS 90.400)	20 yrs.	Age 60
St. Matthews (Insurance)	10 yrs., age 45,50% 15 yrs., age 50,75% 20 yrs., age 55,100%	?

TABLE 10

LEVEL AND TREATMENT OF EMPLOYEE CONTRIBUTIONS - CIVIL SERVICE SYSTEMS

CITY	EMPLOYEE CONTRIBUTION	RETURN	INTEREST	CITY	EMPLOYEE CONTRIBUTION	RETURN	INTEREST
Covington (KRS 90.400)	6%	Yes	No	Shively (Insurance) (KRS 90.400)	3%	Yes	No
Lexington (KRS 90.400)	6%	Yes	No	Bellevue (KRS 79.080)	None	NA	NA
Owensboro (KRS 90.400)	3%	50% only	No	Carrollton (Insurance)	3%	Yes	Yes
Elizabethtown (KRS 90.410)	4%	Yes	Yes	Dayton (Insurance)	6%	Yes	Yes
Henderson (KRS 90.410)	5%	50% only	No	Ft. Thomas Administrative (Insurance)	2%	Yes	Yes
Newport (KRS 90.400)	6%	Yes	No	Ft. Thomas Public Works (Insurance)	2%	Yes	Yes
Ashland Water Dept. (KRS 90.400)	5%	Yes	No	Maysville (Statute unknown)	$20/mo.	Yes	Yes
Frankfort Elec. & Water (KRS 96.180)	None	NA	NA	Paducah (KRS 90.400)	5%	No	NA
Glasgow (Statute unknown)	2%	Yes	Yes	St. Matthews (Insurance)	None	NA	NA
Paris (Insurance)	2.5%	Yes	No				
Prestonsburg	4%	Yes	Yes				
Radcliff (Insurance)	3%	Yes	Yes				

General Considerations Concerning Civil Service System Design

Apparently the large systems have in many cases designed pension plans with retirement age and benefit formulas which they simply cannot afford. This is primarily a phenomenon of the second class city, with a few exceptions. These retirement age and benefit formulas are not founded in good pension theory but appear to be in many cases closely related to what is provided for policemen and firemen without the logical justification which accompanies such pension plan provisions for safety personnel. Partly as a result of these plan provisions, large unfunded liabilities have been created. In many cases these liabilities are growing rather than decreasing. Fortunately, there is a corrective action for cities to take when this occurs. This is to close the system to new members, put the new members in the centrally administered CERS, and attack the remaining liabilities with the knowledge that someday the financial problem will work out to a satisfactory conclusion. The caution must be added that the financial problems will be worked out only by the contribution to the respective pension systems of sufficient funds to offset all the financial liabilities which have been created. This is a course of action which has been taken by Covington, Lexington, Maysville, Newport, and Paducah.

Many smaller cities have contracted with insurance firms to provide pension coverage for employees. While this course greatly reduces the risk of financial difficulties and possible financial collapse, two questions must be considered. The first is whether such insurance plans are designed primarily for the benefit of the employees covered or whether the financial interests of the insurance company weigh too heavily in plan design. The second question is whether the cities and employees get more benefit per dollar contributed by joining CERS than by purchasing an insurance plan. In either case, CERS or insurance company, the city benefits from professional management. The question thus becomes one of adequate coverage with the best return on investment.

Finally, while many cities have caused themselves serious financial injury by their pension system decisions, other cities have demonstrated the capacity to establish good pension systems for their employees at prices which the cities can afford. Although CERS is a fine alternative to local pension systems, cities should understand their local conditions better than the General Assembly can and should be allowed continued flexibility to work with those local needs and conditions. They should also be protected from possible future legislative action relative to CERS which would make it a more expensive and therefore undesirable option for them. This protection would be in the form of a local option on pension system design rather than mandatory membership in CERS.

Cities should no longer be given the extreme flexibility to design pension systems according to any mold which local pressures may dictate and lack of pension sophistication may permit. In the future the General Assembly should stipulate rational guidelines in the statutes relative to retirement age, method of calculating benefits, disability provisions, vesting, treatment of employee contributions, and actuarial and funding requirements. Imposition of such standards would not prevent cities from designing equitable and affordable pension systems but would prevent the very costly mistakes which have been made in some cities in the past and which must now be painfully corrected.

Police and Firemen Pension Systems

Except in the case of cities of the first class (KRS 95.290), statutory requirements for police and firemen pension systems are much more explicit than those for the civil service systems. A great deal of the commentary on these systems is found in Chapter III of this report. Additionally, the Meidinger study (Appendix 3) contains survey results on actuarial soundness and plan administration. A few items of interest are set forth in this section, however, which are in addition to or supplementary to the information found in Chapter III and in the Meidinger study.

Costs and Funding

Sections III B, C, E, F and H of Appendix 3 contain survey results on the actuarial soundness of pension funds created pursuant to KRS 95.290, 95.851, 95.520, 95.621 and 95.767. There are some important summary observations which can be made by consulting this appendix. First is the fact that the police and firemen pension plans in certain cities are becoming extremely expensive. On the basis of a 1976 actuarial evaluation, one second class city has been advised to contribute 44% of covered payroll annually to the pension fund. Another has been advised to contribute 39.5%. On the basis of earlier evaluations, two third class cities operating pursuant to KRS 95.621 were advised to contribute 23% and 39% of payroll.

A second important observation is that of the 21 third and fourth class cities operating pursuant to KRS 95.520, 95.621 or 95.767, only 6 have ever had an actuarial evaluation performed on their own initiative. In all but one case, the evaluations revealed serious financial problems. Only one city with serious problems at the time information for this report was gathered had allocated sufficient resources to the pension fund to prevent further deterioration. That one city took action sufficient to fund its pension plan based upon a retirement age of 65. Disregarding for the moment any question of whether such a high retirement age is appropriate for uniformed personnel, it is apparent that the unfunded liabilities of the other four systems are increasing. Based upon an examination of the employer and employee contribution rates for the remaining cities, the actuarial consultant concludes that many of them may be in the same serious financial condition as those which have had actuarial evaluations. At the same time, three cities operating pursuant to either KRS 95.851 (second class cities) or KRS 67A.360 (urban county governments) are not contributing funds sufficient to prevent the growth of their unfunded liabilities. If this practice continues for too long, these systems will one day be unable to meet their pension obligations. For each year that contributions fail to meet the minimum required to prevent growth in unfunded liabilities, the subsequent recovery of these systems will become more difficult financially.

Retirement Age

There is additional information revealed by the survey which should be brought to light for possible legislative action. As discussed in Chapter III of this report, after statutory service requirements are met, petitions for retirement are granted at the discretion of the pension board in cities operating pursuant to KRS 95.520, 95.621, or 95.767. This is true regardless of the fact that the statutes set no retirement age under KRS 95.520 or 95.621 and require only that the applicant for retirement be age 51 under KRS 95.767. As a result of this petition mechanism, one city operating under KRS 95.520 has set a retirement age of 55, which is not an unreasonable requirement given the criteria established in Chapter II of this report. Two other cities operating under KRS 95.520 and 95.767 require their policemen and firemen to reach age 65 before retirement. While the cities certainly can save money by this procedure, presuming they are not deluged in the future with disability retirement applications from aging employees, such a high retirement age for public safety personnel is difficult to defend.

Disability Coverage Under Police and Firemen Systems

As noted in Chapter III, employees under KRS 95.520 or 95.767 do not receive non-occupational disability coverage. Of the 13 cities which fall in this category, 5 fail to provide Social Security coverage which would protect the employee in the event of non-occupational disability. Only one of those five cities provides any group disability insurance. This lack of any non-occupational disability coverage is a serious deficiency for the affected employees.

While those employees without either pension non-occupational disability coverage or Social Security suffer a coverage gap, the 12 third or fourth class cities which provide Social Security coverage to their employees as well as state mandated pension benefit levels under KRS 95.520, 95.621 or 95.767 suffer an excessive cost burden. There should be a method whereby they can offset some amount of the double coverage they provide their employees. An offset of a portion of the city financed Social Security benefit against the pension benefit would accomplish this purpose.

Administration of Disability Benefits

As the number of disability retirements as a percentage of total retirements was discussed for non-uniformed employee pension systems earlier in this chapter, an examination of similar figures for the police and firemen pension plans is included in this chapter. Tables 11 and 12 show the percentage of disability retirements in first and second class cities and urban county governments, and in third and fourth class cities respectively. Cities chosen for the tables were limited to those with a sufficient number of cases to make analysis meaningful. Examination of these figures and the drawing of conclusions are subject to the same cautions expressed earlier, with one additional comment. Police and firemen in second class cities and urban county governments must reach age 50 to retire, while those in first and third class cities can retire at any age after completing 20 years of service. This factor might account for generally higher disability rates in second class cities and urban county governments. Yet this possibility cannot be demonstrated conclusively until data is available on the actual ages at which retirements are occurring in first and third class cities. In most cases this information is not readily available because actual retirement age was not an item on the survey questionnaire, and in many cases actuarial evaluations which would contain such information have never been performed.

TABLE 11

DISABILITY RETIREMENTS AS A PERCENTAGE OF TOTAL RETIREMENTS

Police and Firemen in First and Second Class Cities
and Urban County Governments

CITY	TOTAL RETIRED	% RETIRED ON DISABILITY
Ashland	39	38%
Bowling Green	31	48%
Covington	104	47%
Frankfort	16	37%
Newport	50	16%
Owensboro	44	34%
Paducah	71	42%
Lexington	121	53%
Louisville Firemen	232	21%

TABLE 12

DISABILITY RETIREMENTS AS A PERCENTAGE OF TOTAL RETIREMENTS

Police and Firemen in Third and
Fourth Class Cities

CITY	TOTAL RETIRED	% RETIRED ON DISABILITY
Danville	7	0
Glasgow	6	16%
Mayfield	11	18%
Maysville	15	6%
Richmond	7	0
Winchester	5	40%
Corbin	10	0
Henderson	25	8%
Hopkinsville	16	6%
Middlesboro	12	25%
Murray	9	77%
Ft. Thomas	6	50%
Madisonville	10	30%

Tables 11 and 12 indicate that the percentage retired on disability tends to be very high in second class cities and urban county governments and lower in first and third class cities. The city with the lowest rate on Table 11, Newport, also had the lowest rate for non-uniformed employees. (See Table 8.) Exceptions are found in Table 12. In Ft. Thomas, a city of the fourth class, a retirement age of 65 has been set by local policy. This factor alone might account for the higher rate of disability found there. In Murray, where the disability rate is 77%, city officials indicated that most disability retirements are being granted at close to the normal retirement date. This practice would appear to be motivated by federal income tax exemptions which were available until 1976.

Treatment of Employee Contributions

Cities operating under KRS 95.520 or 95.621 are not required, but are permitted, to return employee contributions when an employee terminates prior to qualifying for a pension. All but 2 of 16 cities in this category are returning contributions. The statutes do not permit interest, however, so it is not granted in any case. There is no statutory provision relating to the return of contributions in KRS 95.767. The attorney general has advised that departing employees are not entitled to return of contributions, and indeed no city in this category is returning contributions (OAG 69-98). The suggestion has been made previously in this report that these after-tax dollars should be returned to the employee with 3% annual interest. That suggestion also holds in this case.

Cost-of-Living Adjustments

House Resolution 104 which directed this study requested an analysis of the advisability of cost-of-living retirement benefit increases. KRS 67A.360 now requires a cost-of-living raise for the retiree after age 60, limited to 2% of the original benefit uncompounded. KRS 95.851 permits a similar cost-of-living raise if recommended by an actuary. In no case has an actuary advised a second class city operating pursuant to KRS 95.851 that its pension fund could sustain a cost-of-living raise. Given that actuarial evaluations for cities operating under KRS 95.520, 95.621 or 95.767 either have not been performed or are no more encouraging that those for the KRS 95.851 systems, it is doubtful that an actuary would recommend cost-of-living benefit increases for any police and fire system where it is not required. Using the same actuarial comparisons, there would be a few if any civil service pension plans where a cost-of-living benefit could be sustained or would be recommended. Rather, it is uniformly the case that basic benefits must be adequately funded before any supplements are introduced.

Compliance With the Statutes

Finally, while the statutes clearly require that all third class cities provide their police and firemen a pension benefit under either KRS 95.520, 95.621 or under CERS two cities are not in compliance with the law. One third class city covers its employees under KRS 95.767, a holdover from the time when it was a city of the fourth class. A second city has adopted KRS 95.621. Examination of the provisions of the local pension ordinance reveals that the explicit requirements of this statute are not being met. Neither would this city be in compliance with KRS 95.520 or the requirements of CERS if it chose to designate its current pension plan as pursuant to either of those options.

CHAPTER V

PENSION BENEFITS FOR ELECTED CITY OFFICIALS

Senate Resolution 77, which calls for a study of the pension system options for elected city officials and recommendations for retirement benefits, states in its introduction that elected city officials serve with little or no pay and a pension system would encourage participation in city government. Since the city officials are described as receiving little or no pay, it appears that the resolution was intended to address the needs of mayors and city councilmen, rather than the needs of elected officials such as the treasurer, clerk, or assessor, who would be full-time officials compensated by full salary. Research conducted for this study revealed, however, that the needs of elected officials such as the city treasurer should be included, because these officials are effectively blocked by the statutes from the benefits of a city administered pension system.

Present Options

The existing criteria for pension system membership under KRS 90.400, 90.410, 67A.320, 67A.340 and 79A.080 limit participation to employees and exclude elected officials. Elected officials may become members of CERS if certain conditions are met. First, the official must occupy a regular, full-time position, which is interpreted to mean that he must devote an average of 100 hours to his official duties per month on a fiscal or annual year basis. (KRS 78.510 (6) and (21)). Second, he cannot be a member of some other state, county or local retirement system supportd in whole or in part by public funds. (KRS 78.540)

It would appear that most elected officials, other than clerks, treasurers, or assessors, would be excluded from membership in CERS by the time requirements which are levied in KRS Chapter 78. This is not necessarily the case, however. Many elected county officials are members of CERS, and each such member establishes his eligibility by signing an affidavit that he does devote the required time to his official duties on a fiscal or annual year basis. The fact that CERS membership is open to elected city officials is evidenced by the fact that survey data for the House Resolution 104 study pointed to seven cities which have obtained membership in CERS for their elected officials.

Future Options

As was established in Chapter II, the administrative costs of a pension system are proportionately much greater for a small system than a large one. It would thus seem at the outset that the logical path to pursue in obtaining pension benefits for elected city officials would be to place them in an existing, well managed and adequately funded system. While CERS is presently the only available option, it would be a simple proposition to amend KRS 90.400, 90.410, 67A.320 and 79.080 to provide for coverage of elected officials.

Before taking such a step, however, it would be useful to examine the purposes and characteristics of pension systems to see if they are really suitable for accomplishing the purposes of Senate Resolution 77 as outlined above. It must be determined whether pension benefits for elected city officials are the most effective form of compensation to encourage participation in city government. In Chapter II of this report, the following points were made about pension systems. First, a full pension, or a normal retirement, is usually based upon a working career of 30 years. Second, pension benefits are usually related to the level of compensation which the employee enjoyed during his working years. Customarily, the employee receives a certain percentage of his average wage for each year he was a member of the pension system. Third, the average wage is a device to peg the retirement benefit to the wages earned close to the date of retirement in order to provide some degree of protection from inflation. If these characteristics of pension systems are compared to the conditions commonly associated with service as an elected pubic official, several areas are apparent where needs for meaningful pension benefits are not satisfied.

Elected city officials usually do not devote what would be considered a full career to public service. They are subject to the hazard of defeat at the polls, or they might decide not to seek re-election. The elected city official, especially a mayor or council member, who would spend 30 years, or even half that number, in office would be rare. Commonly officials hold office only one or two terms. From the standpoint of length of service then, a pension is not ideally suited as a reward or incentive for most elected city officials.

Another consideration is salary. Usually, the higher the salary, the greater the pension. If the problem to begin with is one of inadequate compensation for city officials, then pensions will also be inadequate unless they are tied to some factor other than actual salary level. It is possible to design a pension formula with an assumed salary level rather than an actual one. There is a precedent for this found in KRS 61.510 (13), where an assumed salary of $18,000 per year is granted to members of the General Assembly for purposes of calculating pension benefits. Without such an adjustment factor, a pension benefit for elected city officials would really be of little financial value.

Finally, there is the question of the average wage upon which the pension is based. Sometimes this is the final salary, other times it is an average of the highest three or five years of compensation. Regardless of the actual formula for the salary level upon which the pension is based, the important point is that the closer a retiree is to normal retirement age at the time he terminates work, the more closely his retirement pay will reflect his financial needs during retirement. If, on the other hand, he terminates employment at an early age, such as 45, the final or average salary upon which his pension is based will have decreased significantly in value due to inflation by the time he retires. Many elected officials will terminate their public service many years in advance of normal retirement age, and any pension benefit they have earned will have suffered this erosion due to inflation.

The factors discussed above tend to reduce the value of a pension to an elected city official, at least one based upon the formulas we typically use to calculate pension benefits. Assuming that an elected official did serve an extended period in office and that he retired close to normal retirement age, a pension might be of value to him. This would be so only if he had a high salary while he was in office, or if such a salary were assumed for pension purposes as in KRS 61.510 (13). Unless such an adjustment were made, there would be little purpose in granting pensions to city officials.

If the goal of a pension system is to adequately compensate public officials in order to encourage public service, perhaps a better way to accomplish this goal is to increase salaries of city officials. Other factors to be considered include the percentage of city officials who already participate in a pension plan attached to their full-time employment. Officials in this category might not attach much value to a city pension. City officials who do not enjoy pension benefits elsewhere may have established an individual retirement account. Such officials could probably satisfy their needs by contributing the maximum permitted by law to their IRA accounts rather than participating in a city pension plan. Income earned as a public official could be contributed to such accounts, and the tax advantages would be the same as those associated with pension plans.

Summary

In summary, the conclusion drawn from this study is that pensions are not an ideal way to compensate elected city officials, other than those such as the treasurers, clerks, or assessors who are full-time officials at full-time salary. Therefore, city pension system laws should be amended to permit participation by full-time officials only. If, however, the members of the General Assembly wish to facilitate participation in pension plans for elected city officials, the following suggestions are offered.

1. New pension systems should not be created for elected city officials. The administrative costs would be too high. City officials should participate in existing systems and, with the exception of 3. below, should be governed by all of the rules of the existing systems.

2. KRS 90.400, 90.410, 67A.320 and 79.080 should be amended to permit participation by elected city officials. KRS 67A.340 has been recommended for repeal in 78 HB 74, an act relating to city pension systems which was prefiled by the Interim Joint Committee on Cities. CERS should also be retained as an option.

3. City legislative bodies should be given the option to determine, within an upper limit, an assumed salary for mayors and council members in the same fashion that a salary level is assumed for members of the General Assembly in KRS 61.510 (13). Contributions to the pension fund should be pegged to the assumed salary.

CHAPTER VI

FINDINGS AND RECOMMENDATIONS

The following is a summary of the findings of this study of locally administered city pension systems. Recommended action accompanies each listed finding. Many of these recommendations have been incorporated in 78 HB 74, an act relating to city pension systems which was prefiled by the Interim Joint Committee on Cities.

Retirement Age

1. Finding. Statutes applicable to non-uniformed city employees do not specify any range for retirement age. Cities, especially of the second class, are allowing retirement at ages too low to justify by commonly accepted pension standards.

Recommendation. Normal Retirement for non-uniformed city employees should be restricted to the ages 62 through 65, unless the employee has accumulated 30 years of service. In this case normal retirement could be permitted at an earlier age.

2. Finding. There are no guidelines for early retirement in statutes applicable to non-uniformed city employees.

Recommendation. Early retirement should be permitted, but retirement benefits should be actuarily reduced to reflect early commencement.

3. Finding. Police and firemen in cities of the first class can retire at any age after completing service requirements of 20 years. In cities of the second class and urban county government, police and firemen can retire upon completing 20 years of service and reaching age 50. Some third class cities allow personnel to retire regardless of age after 20 years of service, while other third and fourth class cities have used the lack of precise language in the statutes to establish a local retirement age as high as 65 for policemen and firemen. Retirement at any age or retirement at age 65 are both extreme and undesirable. Retirement at age 55 would seem to be an acceptable alternative.

Recommendation. Cities should be allowed to establish retirement ages for policemen and firemen at a maximum of age 55. Statutory language on this point should be explicit.

Normal Retirement Benefit Levels

1. Finding. Certain of the statutes applicable to either non-uniformed employees or police and firemen specify or permit retirement to be based upon the employee's final salary. This practice can lead to inflation of pension benefits through high final salary or excessive overtime in the final year.

Recommendation. Pensions should be based upon an average of the highest three consecutive years of compensation.

2. Finding. Retirement formulas which are statutorily required and applicable to police and firemen in certain third and fourth class cities do not reward years of service in excess of those required for normal retirement. Employees who complete required service time prior to reaching normal retirement age must therefore work longer for the same pension benefit than employees who complete their age and service requirements at the same time.

Recommendation. Police and firemen in this category should receive additional pension benefits for service in excess of minimum requirements.

3. Finding. Service requirements mandated by statute for police and firemen in third class cities require 20 consecutive years of service for retirement benefits. The requirement for consecutive service is unduly harsh for employees who take a break in service.

Recommendation. The requirement that years of service be consecutive should be removed from the law.

4. Finding. Statutes applicable to non-uniformed employees do not speak to the issue of vesting in the pension benefit. Cities have adopted a wide range of requirements for vesting.

Recommendation. These statutes should require full vesting after 10 years of service.

5. Finding. There is no provision for a deferred pension benefit in statutes applicable to police and firemen in third and fourth class cities.

Recommendation. The law should require a deferred pension option for police and firemen who have completed service requirements but have not reached retirement age.

6. Finding. Twelve third class cities provide Social Security as well as required pension coverage to their police and firemen. Since the cities cannot drop pension coverage and dropping Social Security coverage would be difficult and perhaps not desirable, they must carry a heavy cost burden for total employee retirement benefits. Federal legislation may in the future require Social Security coverage for all public employees, which would extend this burden to all Kentucky cities with police and firemen pension systems.

Recommendation. Cities providing both Social Security and pension coverage for police and firemen should be allowed to offset that part of the employee's Social Security pension for which they have paid against the employee's city pension when the employee reaches age 62.

7. Finding. Only the statutes governing police and firemen in urban county governments require a cost-of-living adjustment for retirees. Except for Louisville's police pension system, other city pension systems are not granting cost-of-living adjustments. Actuarial evaluations of these other systems generally indicate that they cannot support cost-of-living increases.

Recommendation. No additional requirements for cost-of-living increases in pension benefits should be levied upon city pension systems.

Disability Retirement Benefits

1. Finding. Local ordinances governing non-uniformed employees and pension statutes governing police and firemen in fourth class cities and certain third class cities levy service requirements of up to 12 years for occupational disability benefits. Such service requirements are inappropriate in the case of occupational disability.

Recommendation. Statutes governing either non-uniformed or uniformed employees should not permit or require service requirements for occupational disability benefits.

2. Finding. Statutes governing police and firemen in some third class cities and in fourth class cities do not provide for non-occupational disability benefits. Since police and firemen often are not covered by Social Security, there is a gap in coverage for these personnel. At the same time statutes governing other third class cities provide non-occupational disability benefits identical to occupational disability benefits, which is a costly and perhaps inappropriate benefit for a city to provide.

Recommendation. All police and firemen should receive non-occupational disability coverage after five years' service. The amount of coverage should begin with a minimum figure such as 25% of average salary and should increase with time spent in the service. If non-uniformed employees are granted non-occupational disability coverage by local ordinance, a five-year service requirement should also apply.

3. Finding. No disability determination procedure is provided in statutes governing non-uniformed employees or police and firemen in first, third and fourth class cities. None of the city pension statutes specify a periodic disability review procedure.

Recommendation. All statutes governing city employees should provide for disability determination by two physicians selected by the pension board. Pension boards should have an option to review disability determinations on an annual basis and to require employees who have recovered from disability to return to work.

4. Finding. All Kentucky cities must provide Workmen's Compensation benefits to their employees. Only in the statutes governing second class city police and firemen is there a provision for offsetting Workmen's Compensation benefits against pension disability benefits. Since cities pay for both pensions and Workmen's Compenation, they are in effect required by law to provide double coverage for disability.

Recommendation. All statutes applicable to city pension systems should provide that Workmen's Compensation benefits be offset against occupational disability benefits provided by the pension system.

5. Finding. Police and firemen in second class cities and urban county governments are protected by a provision known as the heart-lung clause. Essentially this clause provides that any heart or respiratory tract disease in a policeman or fireman with five years of service is presumed to be occupationally caused. Policemen and firemen in third and fourth class cities do now have this coverage. Medical research has been conducted which tends to

justify this coverage for firemen. The same research would lend some support to granting "heart" coverage to policemen, but not "lung" coverage.

Recommendation. All paid firemen in Kentucky should be covered by the heart-lung clause. Policemen should be covered only by the "heart" presumption.

Survivor Death Benefits

1. Finding. The spouse occupational death benefit provided by one of the third class city police and firemen statutes is flexible in amount at the option of the city. Benefits under this procedure can be set so low as to be nearly valueless. The children's occupational death benefit provided by all statutes governing police and firemen in third and fourth class cities is generally set at levels too low to be of value.

Recommendation. The spouse occupational death benefit in all third and fourth class city police and firemen statutes should be set at 50% of the final salary. The children's occupational death benefit in all such statutes should be 10% of the final salary if the spouse survives and 15% of the final salary if the child is orphaned.

2. Finding. The service requirements for non-occupational death benefits in statutes governing third and fourth class city police and firemen range from 1 to 15 consecutive years. A uniform and reasonable service requirement should be adopted.

Recommendation. A five-year service requirement should be adopted for each such statute.

3. Finding. The spouse's non-occupational survivor death benefits in statutes governing third and fourth class city police and firemen are not uniform. In most cases such benefits would be too great if a five-year service requirement were adopted as recommended above.

Recommendation. A minimum spouse benefit of 15% of average salary should be adopted for all such statutes, along with a formula by which benefits increase with additional service time.

4. Finding. As with occupational death, in statutes governing third and fourth class city police and firemen, the children's survivor benefit for non-occupational death is generally too low to be of value.

Recommendation. Grant to children 10% of the average salary if the spouse survives and 25% of salary if orphaned. While 25% may seem high, it should be remembered that Workmen's Compensation benefits will probably not be payable in this situation.

5. Finding. The children's survivor death benefit for non-occupational death in statutes governing police and firemen in second class cities and urban county governments is related to the amount of the spouse benefit. If the spouse benefit is low, then the children's benefit will be low. Actual financial needs may not be met by such a formula.

Recommendation. The children's benefit should be uniform in amount and identical to the formula suggested by Recommendation 4.

6. Finding. The statutes governing police and firemen in second, third and fourth class cities and urban county governments provide a survivor benefit to dependent parents, usually only if spouse or children do not survive. This coverage for dependent parents is unusual and survey results do not indicate its actual use.

Recommendation. Dependent parent benefits should be eliminated.

7. Finding. Except in the case of the second class city police and firemen statute, none of the police and firemen statutes require an offset for Workmen's Compensation in the event of occupational death survivor benefits. Thus, the cities are providing double coverage for occupational death.

Recommendation. All of the city pension statutes should require that Workmen's Compensation benefits be offset against occupational death survivor benefits.

Pension Funding

1. Finding. Survey results from this study (See Appendix 3) reveal that few city pension funds are in satisfactory financial condition and several are nearly without assets. Frequent actuarial evaluation is a necessity for measurement of funding status and for satisfactory pension system management. The most stringent requirement for periodic actuarial evaluation, once every five years, is found in statutes governing pension systems in second class cities and urban county governments. Other statutes are not explicit in requiring actuarial evaluations.

Recommendation. Every city pension statute should require actuarial evaluation at least once every three years.

2. Finding. Many cities fail to heed the advice of actuarial consultants and the requirements of the law concerning pension fund contributions. The result of this failure is growth in unfunded pension system liabilities.

Recommendation. Employees who are members of pension programs should receive a copy of actuarial evaluations upon request. A synopsis of pension system financial reports from the pension system to the city should be given to members. Members will then be in a position to monitor funding activities by the cities.

3. Finding. Except in statutes governing pension systems in second class cities and urban county governments, there are no standards for pension system funding.

Recommendation. All pension systems should be funded annually to the extent of normal contributions, interest on prior service liabilities and 1% of the principal amount of any unfunded liabilities.

4. Finding. Statutes governing police and firemen pension systems in third and fourth class cities place property tax limits on the amounts cities

can contribute to their pension funds. These limits are arbitrary and may prevent adequate funding.

Recommendation. Property tax limitations on the amounts which cities can contribute to pension funds should be removed from the statutes.

5. Finding. Only the statutes governing police and firemen pension systems in second class cities and urban county governments require annual audits.

Recommendation. All pension systems should be required to have an annual audit.

6. Finding. The level of employee contributions which the city may require for participation in the pension system varies according to the respective statutes. In the case of police and firemen statutes where the levels of benefit are mandated and basic retirement formulas are nearly equal in value, contribution rates vary in a way unrelated to benefits provided.

Recommendation. Each of the statutes relating to police and firemen should permit an 8% employee contribution as is presently required in second class cities and urban county governments. Cities should retain the flexibility to set contribution rates for non-uniformed employees according to the level of pension benefits adopted for the respective systems.

Communications with Employees

1. Finding. The statutes do not require, and the cities generally do not provide, written information on pension system benefits to new employees. The cities generally do not communicate regularly with employees on pension system operations.

Recommendation.

a. All employees should be given a written summary of pension system benefits upon joining the pension system.

b. Employees should receive a synopsis of annual reports from the pension board to the city.

c. The employee should receive a copy of the system's actuarial evaluation upon request.

d. The employee should receive an annual statement of his accumulated contributions to the pension system.

Employee Contributions

1. Finding. Statutes governing police and firemen in cities of the third class make return of employee contributions upon termination of the employee optional with the city. Statutes governing police and firemen in first and fourth class cities do not speak to this issue, nor do any of the statutes governing non-uniformed city employees. As a result there are cities which do not refund employee contributions upon termination of the employee.

Recommendation. All statutes governing city pension systems should require the return of employee contributions upon request of the terminating employee.

2. <u>Finding.</u> None of the statutes governing city pensions permit return of employee contributions with interest. Cities generally earn 4% to 8% annually on these contributions. The County Employee Retirement System and the state employees retirement system (Kentucky Retirement System) return contributions with 3% interest.

Recommendation. All city pension statutes should provide for the return of employee contributions with interest compounded annually at 3%.

Transition to New Statutory Provisions

1. <u>Finding.</u> Employees governed by existing city pension statutes have made career decisions based upon the provisions of those statutes. To alter their requirements for retirement age or to reduce their future pension benefits in mid-career would be unfair. Police and firemen in third and fourth class cities might wish to accept a higher retirement age in exchange for the increased pension benefits which can be earned under the provisions of 78 BR 61/V4. (Appendix 5)

Recommendation. Changes in retirement age or normal retirement benefit levels should affect only employees who become members of affected pension systems after the effective date of changes in city pension law. Policemen and firemen in third and fourth class cities should be given the option, however, to choose the retirement age and normal retirement benefit provisions of either prior law or law which may exist after consideration of 78 BR 61/V4 by the 1978 General Assembly.

2. <u>Finding.</u> The state administered County Employees Retirement System is a viable option to locally administered pension systems. It provides professional pension fund management and adequate benefits at affordable levels. Forty-two Kentucky cities have placed employees under CERS coverage. One difficulty for cities which wish to join the CERS is that any prior service credit purchased for employees who have served the city prior to the decision to enter CERS must be paid for within ten years. This relatively short time period makes the CERS option expensive to those cities which wish to provide prior service credit for employees.

Recommendation. The statutes governing city entrance to the CERS should be amended to permit 30 years for payment for employees' prior service credit.

3. <u>Finding.</u> If a city closes entry to a local pension system in favor of joining the CERS, except in the law governing second class city non-uniformed employees, there is no provision for employees to withdraw contributions from the local pension system and place them in the CERS. This makes the purchase of prior service credit in the CERS difficult.

Recommendation. The CERS statutes should be amended to allow employees of any city pension system to withdraw their contributions from the city fund and place them in the CERS fund if the city joins the CERS and purchases prior service credit for its employees.

4. Finding. While the CERS is a viable alternative to locally administered pension systems and insures good management and adequate funding, local conditions may make the CERS more expensive to a city than a locally administered system.

Recommendation. Cities presently permitted to create locally administered pension systems should retain that right within rational pension system guidelines embodied in the statutes.

General Criteria for Police and Firemen Pension System

1. Finding. There is too much variation in retiree benefit levels, disability benefits, survivor benefits, required service, employee and employer contributions among the various police and firemen pension systems to be explained on a systematic basis. It appears that pension requirements have been enacted and amended through the years without sufficient attention to uniformity and equity.

Recommendation. There should be one pension statute, rather than three, for third and fourth class city police and firemen. It should closely resemble the statutes governing second class cities and urban county governments, but with a retirement age provision set high enough to avoid excessive costs.

General Assembly Procedures With Respect to Pension Systems

1. Finding. Consideration of legislation relating to pension benefits is a complex undertaking, ideally accompanied by a basic understanding of the purposes of pension systems and the relative costs of decisions on benefit levels. In addition, decisions made on benefit levels for one group of employees often lead to requests by other groups of employees at a later date for similar or improved benefits. If pension system requests of different groups of employees are assigned to various legislative committees, it will be difficult both to generate pension expertise among all such committees and to conduct comparative analyses of various pension benefit requests, one with another and with existing statutory benefit provisions. Many states have tackled this problem by establishing commissions to evaluate pension bills prior to consideration by the legislature. Others require that all pension bills be assigned to either a single joint committee or to sister committees of either house prior to consideration either by other committees or on the floor of either house. (Permanent Legislative Retirement Commissions, 1976, pp. 10-19)

Recommendation. The Kentucky General Assembly should provide, by law or by rules of procedure, that all pension legislation affecting state or local employees be assigned for initial consideration to a joint committee of the House and Senate formed for the purpose of reviewing pension legislation. Funds should be available for the purchase of actuarial services to provide cost projections on pension bills. No pension bill should proceed to the floor of either house prior to the completion of a fiscal note on the bill.

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APPENDIX 1

IN HOUSE

REGULAR SESSION 1976

HOUSE RESOLUTION NO. 104

TUESDAY, MARCH 9, 1976

Representative Norbert Blume introduced the following resolution which was ordered to be printed.

A RESOLUTION on retirement benefits for city employes.

WHEREAS, the employes of Kentucky's municipalities should be permitted fair and reasonable retirement benefits as a reward for their dedicated public service; and

WHEREAS, local public employes retirement plans must balance the retirement needs of employes and the ability of the taxpayers to pay additional taxes to fund increased retirement benefits; and

WHEREAS, a significant number of city pension plans are showing alarming levels of unfunded liability and, further, many other plans have not completed actuarial studies in recent years; and

WHEREAS, the high rate of inflation of the past several years has caused a great financial burden on retired city employes; and

WHEREAS, Congress is presently reviewing public pension plans to evaluate their actuarial soundness and the management practices utilized to manage such plans; and

WHEREAS, the members of the General Assembly, city employes and elected city officials wish to insure that the beneficiaries of public employes retirement plans will not face the tragic experience of nonexistent or reduced pension benefits at the time of retirement due to underfunded pension plans; and

WHEREAS, there is an urgent need to carry out a full and complete study of the existing city public pension plans;

NOW, THEREFORE,

Be it resolved by the House of Representatives of the General Assembly of the Commonwealth of Kentucky:

Section 1. That the staff of the Legislative Research Commission, in conjunction with the Interim Joint Committee on Cities, is authorized and directed to conduct a comprehensive study and evaluation of the existing retirement plans and benefits for all city employes covered by locally administered programs.

Section 2. The study shall include but not be restricted to the following: analysis of the basic provisions of each service retirement program; analysis of death benefits, including group insurance coverage; analysis of disability and survivor benefit provisions; evaluation of a cost-of-living adjustment plan for retired employes, review of the need for periodic actuarial studies for all locally administered programs; review of the present financial condition of local pension programs; evaluation of present fund management practices; and recommendations for additional retirement benefits.

Section 3. The Interim Joint Committee on Cities should conduct a sufficient number of public hearings to allow for full participation by city employes and city officials in the preparation of the study.

Section 4. Employe groups, individual cities and related organizations are requested to offer full cooperation in this study by supplying all pension related information requested by the Committee.

Section 5. To assist in the study, an actuarial firm shall be employed by the Legislative Research Commission.

Section 6. The Committee shall complete the study and report its findings to the Legislative Research Commission at its October, 1977, regular meeting and to the 1978 General Assembly and make recommendations for legislation.

Section 7. Staff services and consulting fees to be utilized in completing this study are estimated to cost $40,000. These staff services shall be provided from the regular commission budget and are subject to the limitations and other research responsibilities of the commission.

IN SENATE

REGULAR SESSION 1976

SENATE RESOLUTION NO. 77

FRIDAY, MARCH 19, 1976

Senator Gene Huff introduced the following resolution which was ordered to be printed.

A RESOLUTION on retirement benefits for elected city officials.

WHEREAS, the cities of Kentucky are administered by dedicated elected public officials; and

WHEREAS, these elected public officials serve with little or no pay; and

WHEREAS, citizens should be encouraged to seek elective offices in our cities; and

WHEREAS, a pension system would encourage participation in city government; and

WHEREAS, the House of Representatives of the General Assembly of the Commonwealth of Kentucky has passed House Resolution No. 104 to study the retirement benefits for city employes; and

WHEREAS, it would be to the best interest of the people of Kentucky that the study called for under House Resolution No. 104 and this resolution be combined;

NOW, THEREFORE,

Be it resolved by the Senate of the General Assembly of the Commonwealth of Kentucky:

Section 1. That the staff of the Legislative Research Commission, in conjunction with the Interim Joint Committee on Cities, is authorized and directed to conduct a comprehensive study and evaluation of the existing retirement plans and benefits for all elected officials.

Section 2. The study shall include but not be restricted to the following: group insurance coverage; disability and survivor benefit provisions; recommendations for retirement benefits and death benefits.

Section 3. The Interim Joint Committee on Cities should conduct a sufficient number of public hearings to allow for full participation by elected city officials in the preparation of the study.

Section 4. Individual cities and related organizations are requested to offer full cooperation in this study by supplying all pension related information requested by the Committee.

Section 5. To assist in the study, an actuarial firm shall be employed by the Legislative Research Commission.

Section 6. The Committee shall complete the study and report its findings to the Legislative Research Commission at its October, 1977, regular meeting and to the 1978 General Assembly and make recommendations for legislation.

Section 7. Staff services and consulting fees to be utilized in completing this study are estimated to cost $5,000. These staff services shall be provided from the regular commission budget and are subject to the limitations and other research responsibilities of the commission.

Section 8. This study shall be conducted in conjunction with and be a part of that study authorized by House Resolution No. 104.

STUDY OF

CITY RETIREMENT SYSTEMS

IN KENTUCKY

Prepared By
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Louisville, Kentucky

August 16, 1977

STUDY OF

CITY RETIREMENT SYSTEMS

IN KENTUCKY

I. INTRODUCTION

Meidinger & Associates, Inc. was retained to assist the Legislative Research Commission in a survey of City Retirement Systems in Kentucky. We were able to identify 52 such systems which have self-administered plans, and also determined that 42 cities were participating in the County Employees Retirement System--a statewide system. There is some overlap here, since some cities which previously had self-administered plans have joined CERS for new employees, but have continued the prior plan for other employees. In some instances, one department of civil service employees will have a self-administered plan (e.g., electric and water plant board), while all other civil service employees are covered under CERS. In most areas, a different plan has been established for policemen and firemen than for civil service employees, so there are often two plans from one city. There are some instances where civil service employees and policemen and firemen are covered in one plan. Of the 52 self-administered plans in our study, 33 cover policemen and firemen, while the remaining 19 cover civil service employees, or a combination of both.

This report will be primarily concerned with the actuarial aspects of self-administered plans, but we shall also discuss the information gathered by the questionnaire in a number of other areas.

In the next section of this report, we shall show the distribution of active and inactive participants of the plans included in the study. This will be followed by sections on actuarial soundness, administration and fund management, plan benefits, other benefits and, finally, some concluding observations.

II. DISTRIBUTION OF PARTICIPANTS

The schedule on the following page shows a breakdown of the self-administered plans by classification, as well as the statute under which the plan was created, and provides information with regard to the number of active and inactive participants.

(See schedule - page 3)

It can be seen from this schedule that the 52 plans cover 5,601 active employees and 2,286 members or beneficiaries either drawing benefits or entitled to deferred benefits.

Approximately 90% of the active members and 70% of the inactive members participate in the 17 plans which cover employees of 1st Class or 2nd Class cities and Urban County employees.

SCHEDULE

DISTRIBUTION OF PARTICIPANTS

Classification	Statute	No. of Plans	No. of Active Part'pnts.	No. of Inactive & Beneficiaries: Age Ret.	Perm. Disab.	Spouse	Children	Deferred
1st Class Police & Fire	95.290	2	1,469	369	108	237	34	4
2nd Class Police & Fire	95.851	7	904	217	138	178	30	6
Urban County Police & Fire	67A.360	1	709	56	65	55	1	2
2nd Class Civil Service	90.400	5	500	137	92	155	21	--
Urban County Civil Service	90.400	1	454	30	38	41	5	--
2nd Class Elec. & W.B.	96.180	1	60	8	1	--	--	--
3rd Class Police & Fire	95.520	8	325	47	7	7	--	--
3rd Class Police & Fire	95.621	8	398	63	2	40	5	--
3rd Class	90.410	1	199	26	10	4	1	--
Civil Service	None	2	45	2	1	--	--	--
4th Class Police & Fire	95.767	5	153	13	6	10	--	--
4th Class	79.080	2	130	--	--	--	--	--
Other	None	9	255	11	1	1	--	1
TOTAL		52	5,601	979	469	728	97	13

III. ACTUARIAL SOUNDNESS

Although actuarial soundness is difficult to define precisely, we believe that, for the purpose of this study, a plan should be considered actuarially sound if the annual contributions are sufficient to pay the current cost for the year plus the interest on the unfunded past service liability. Such a rate of contribution would not be sufficient to meet the minimum funding requirements for corporate plans, where some funding of the past service liability must be made.

On the basis of actuarial valuations we have previously performed for cities covered by the questionnaire and the information provided in the questionnaire itself, we will make some general comments with regard to actuarial soundness and funding, and then we will discuss the plans in more detail in broad classifications.

A. General Comments with Regard to Actuarial Soundness in Self-Administered City Plans

1. Actuarial valuations are not usually performed unless required by statute and, if required, are not made more often than required.

2. With one or two possible exceptions, the plans are not facing immiment bankruptcy, but, in most instances, the present assets are not sufficient to cover the present value of the liabilities of members and beneficiaries currently receiving benefits. In other words, no assets have accumulated for currently active employees.

3. In only rare instances are contributions sufficient to amortize the unfunded past service liability and, in more instances than not, the unfunded past service liability is increasing, rather than decreasing.

4. Generally, the policemen and firemen plans are in better shape than the civil service plans.

5. The larger plans and very small plans are generally in better financial balance than the medium-sized plans.

6. The administrators appear to ignore provisions of the statutes, especially in the area of funding.

7. There seems to be a widely-held belief that, if contributions exceed benefit payments (in other words, the fund has a positive cash flow), the plan is actuarially sound. This is not true, of course, since it completely ignores emerging liabilities and the need to fund for the benefits as they are earned, so that sufficient funds will be available to pay them at some future date.

8. The required contribution rates in many cities are reaching the 30% to 40% range, and are no doubt becoming a substantial burden on the cities.

9. Plan improvements are sometimes approved, even though prior benefits are not being adequately funded.

B. <u>1st Class City - Policemen and Firemen (95.290)</u>

This statute has no requirements with regard to the frequency of actuarial reports or minimum funding. However, the two plans under this statute do have an actuarial valuation performed each year, and fund accordingly. Past service liabilities are scheduled to be funded by the year 2019 for one plan, and 2024 for the other. The employee contribution rates are 6.5% and 7%, while employer contributions were 36% and 37.7% in 1976. The employer contribution rate is quite high but, as long as present funding practices are continued, the plans should remain actuarially sound.

C. <u>2nd Class City - Policemen and Firemen and Urban County - Policemen and Firemen (95.851 and 67A.360)</u>

These statutes require an actuarial valuation at least every five years. They also require an 8% employee contribution and an employer contribution of at least 12%, which is to be actuarially determined. All eight of the plans in this category have had an actuarial valuation fairly recently. The latest was in 1973, five were in 1974 and two were in 1976. All but three of these plans are being funded at the rate required in accordance with the most recent actuarial reports. The required contributions for the two plans derived in the 1976 valuations are significantly higher (39.5% and 44% of covered payroll), both in comparison to previous estimates for these plans (20% and 28.4% of covered payroll) and to contribution requirements established for the other plans in this group several years ago. Two factors that had an important bearing on these increases were the effect of the inflationary economy on covered earnings and the possible over-utilization of the disability provision.

As in the case of 1st Class City Policemen and Firemen plans, there should be no problem of actuarial soundness as long as the plans are funded in accordance with the contribution levels actuarially determined. However, a contribution rate as high as 44% would appear to be very close to, if not already beyond, the breaking point. The large change in the required rate between valuations indicates that it would probably be desirable to have more frequent valuations.

The remaining three plans, which had actuarial valuations in 1973, 1974 and 1975, have been funding at rates below the minimum requirements established by the actuarial valuations. The actual contributions have been 15%, 16.5% and 15%, while the respective required contributions were 29%, 22% and 26%. Since the rate of funding is less than the minimum requirements, the unfunded liabilities will be significantly higher now than they were at the time of the valuations, and this, coupled with inflationary salary increases in recent years, indicates that the required contribution rates at the present time are probably even higher than those developed in the last valuation.

D. 2nd Class City and Urban County Civil Service Plans (90.400)

This statute requires that an actuarial valuation be performed at least once every five years. The amount of employee contribution is optional, and the employer contribution must be at least as great as that of the employee. The total contribution must be actuarially determined and be sufficient to at least pay the interest on the unfunded past service liability.

Although there were six plans in the survey that were formed under this statute, the plans for two cities covered only a small number of their civil service employees--5 and 32--since the largest number of these employees are covered under CERS. Two other cities with plans under this statute currently cover all new employees under CERS, and one of those two also permitted present employees to elect CERS. The required contribution for these two plans was determined in 1976 to be 26% and 40%, significantly higher than the current employer contribution rate of 14% and 20%. The employer contribution rate should be adjusted to the new levels established in the 1976 actuarial reports in order to retain an actuarial balance.

The remaining two plans are funding at a rate which is less than that which is required in accordance with the most recent actuarial report. In the one case, a required contribution rate of 10-1/2% (quite low in comparison with other plans) was developed in 1974, but the employer is only contributing 6%. Since the required contribution rate has probably increased since 1974, the funding condition of this plan is deteriorating. The other plan under this statute is in even worse condition. It is also being funded by a 6% employer contribution, but the required contribution was 20%, based on the 1969 actuarial report, and 39%, based on the 1976 actuarial report. Unless contributions are increased significantly, or benefits are reduced (the level of benefits is not established by statute), funds will not be available to provide the promised benefits.

E. <u>3rd Class City - Policemen and Firemen (95.520)</u>

This statute does not require an actuarial valuation to be made and, as a result, only three of the eight plans covered under it had such a valuation at any time. As a part of our study, we made a valuation of one additional plan. In all instances, the present rate of employer contribution is less than the minimum contribution required, although, in one instance, the difference is only 1% of payroll, and may be adjusted as a result of the actuarial study just recently completed. In the other three cases, the current contributions are approximately 5.75%, 2.5% and 10.6%, while the respective minimum actuarially determined contributions are 12.5%, 8.7% and 18.7%. Although it is impossible to determine the actuarial condition of the other plans from the available information, we would suspect that, based on contribution information provided, they are in similar condition. The statute permits employee contributions of 1% to 4% of compensation. In one city, employees are actually contributing 5.85% (the amount required under 95.621), which is in excess of the 4% maximum. Three others are contributing at the 4% maximum, and the remaining four are contributing less than the permissible maximum. The city contribution is limited to 4¢ per $100 of taxable property. Several cities are currently contributing below this permitted rate. From the information we have available, we believe that all cities should be funding at the maximum rate. However, actuarial valuations would be necessary to determine this for certain. This statute is particularly bothersome from an actuarial point of view, since it establishes required maximum contribution rates which may not be sufficient to fund the benefits required.

F. 3rd Class City - Policemen and Firemen (95.621)

This statute, like 95.520, does not require an actuarial valuation and, as a result, only two of seven cities covered under it have ever had an actuarial study. For those two for whom studies were made, the city contribution rates (9.5%, 4.8%) are significantly below the minimum required rates (23%, 39%). The actual levels of contribution for the other plans range from 4.3% to 12.6% of payroll, which would indicate that contributions are well below the amounts required to meet minimum funding requirements. As indicated earlier, this cannot be determined for certain without an actuarial valuation. The employee contribution under this statute is set equal to the Social Security tax, and is currently 5.85% for all plans. It is our opinion that probably all of these plans are in quite serious financial condition.

There is one other city with an insured plan that is supposedly under this statute, although the information with regard to benefits provided does not bear this out. It appears to be more like a money purchase plan, based on a 3% employee and 12% city contribution.

G. 3rd Class City - Civil Service (90.410 or more)

Of the three cities included in this category, only one has had an actuarial valuation performed. This valuation was performed in 1974, and demonstrated that the city contribution rate of 5% was significantly below the 14% rate required. One of the others is a defined contribution plan, with benefits equal to the participants' accumulated accounts; thus, no actuarial valuation is required. The third, although apparently not insured currently, is planning on insuring the benefits, in which case we assume the contributions will be set at the level required to provide the benefits.

H. <u>4th Class City - Policemen and Firemen (95.761)</u>

Actuarial valuations are not required by this statute, and employer contributions are limited to a tax of 3¢ per $100 of property value. Only one of the five plans covered under this statute has had an actuarial valuation performed. This study showed that the current contribution was sufficient if retirements are not permitted prior to age 65. Any lowering of that age without a reduction in the benefit would require additional city contributions. The levels of both employee and city contributions are lower in the other four plans, which would certainly indicate that they are not being funded at a satisfactory level.

I. <u>4th Class City - Civil Service (no statute indicated)</u>

Eleven plans fall under this category, and all but two are under insured programs. Since the insurance company will require that the contribution be sufficient to provide the promised benefits, these plans should be actuarially sound, although it is quite possible that the benefits will be less than adequate. One other plan is a defined contribution plan which, by its nature, does not require actuarial valuations. The remaining plan in this category had not been valued in the past, but was valued as a part of this study. The results indicated adequate contributions were being made to fund the rather modest benefits.

IV. ADMINISTRATION AND FUND MANAGEMENT

One section of the questionnaire asked a number of questions with regard to administration of the retirement plans, and another covered questions regarding investment policies related to the retirement fund. Although there was some variation in the answers to the questions in these two sections, there was a definite enough pattern to the answers to permit the formation of certain conclusions. Obviously, there will be specific situations where these general conclusions do not apply.

In the case of the policemen and firemen plans, the membership of the Board of Trustees is generally stipulated by statute, and usually includes the Mayor, City Treasurer or Director of Finance, Police Chief, Fire Chief, and one or more policemen and firemen. Usually, the mayor and director of finance or treasurer are members of the Board of Trustees for civil service plans, but the rest of the committee varies from city to city, since membership is normally not stipulated by statute.

It appears, however, that, despite the fact that there are formal committees, the administration of the plan is usually the responsibility of the treasurer or director of finance, especially in the case of the smaller plans.

In almost all instances, administrative expenses are paid from the general fund, although occasionally they are paid from the pension fund. Apparently, very little information is provided to the members concerning the plans, except that they are, on occasion, given information with regard to their own contributions. In many cases, this is only provided as a deduction on their check stub, with no cumulative information.

Twelve of the larger funds do have outside investment assistance. Twelve other plans are funded with insurance contracts; thus, the investment responsibility has been transferred to an insurance company. In most of the other cases, the treasurer or director of finance is responsible for the investment of the assets. Very few funds have established investment objectives, and the portfolio would indicate rather unsophisticated investment management. The total assets are approximately

$66,000,000. However, after excluding the assets of the funds that have utilized outside investment advice, there are only about $3,000,000 of assets remaining, which are spread over quite a large number of plans. The small amount of assets for each plan is probably not enough to warrant the employment of an investment advisor. Perhaps, some method of pooling the assets could result in better overall fund managenent. Only seven of the funds have any investments in common stocks, and all but one of these are funds which do use outside investment advice. All seven are 1st or 2nd Class cities. Most plans have the bulk of their assets invested in government securities or in certificates of deposit, with the certificates of deposit being more prominent in the smaller funds.

The questionnaire asked for the overall yield on investments, but no instructions were given as to how to determine the yield. Therefore, we are sure the results are approximate, at best. The yields provided range from a high of 9% to a low of 4%, with the preponderance of the yields falling in the 5-6% category.

Most of the funds indicated that they had an audit of the fund at least annually, and it was usually performed by an outside accountant. The audit very rarely attempted to relate the assets in the fund to the liabilities of the plan, nor did it make any comments with regard to the adequacy of the contributions, even where the amount being contributed was significantly less than had been determined as a minimum contribution in an actuarial valuation.

Although the replies to the questionnaire seemed to indicate that the fund performance was monitored, the form of the monitoring seemed to be limited to the periodic report of the assets in the fund and the operations of the fund. Since, in most cases, no objectives had been established, it was not possible to monitor the actual investment performance relative to investment objectives.

Although the larger funds seem to have developed good administrative procedures and utlize investment advisors in an attempt to improve investment results, a large number of the plans seem to have very little in the way of administrative procedures with regard to either the operation of the plan or the investment of the funds.

V. BENEFITS UNDER THE PLAN

The benefits provided under the various statutes have been discussed in some detail in a separate report; therefore, we shall not go into such a discussion. We do want to make several comments with regard to benefits, however.

A number of the statutes do not provide specific benefits that must be provided. These are KRS-95.290 for 1st Class policemen and firemen, KRS-90.400 for 2nd Class civil service employees, KRS-67A-320 for Urban County civil service employees, and KRS-79.080 for all governments general. In addition to this, KRS-90.410 for 3rd Class civil service employees and KRS-96.180 for 3rd Class electric and water board employees only specify that the normal retirement benefit be limited to 50% of final salary, and place a maximum on the employer and employee contributions that may be made. The 1st Class policemen and firemen benefits are quite similar to the retirement benefits provided under KRS-95.621 for 3rd Class policemen and firemen, except that the disability benefits are a little more generous. In the case of 2nd Class civil service employees plans, they have been generally patterned after KRS-95.851, except that, in some instances, the normal retirement age is 60, rather than 50. There are also some differences in the supplemental benefits.

The 4th Class civil service employees plans and two of the 3rd Class civil service employees plans are either under no statute at all, or are under KRS-79.080, which does not provide any plan specifications. In most cases, the benefits provided in these plans are less generous than those provided by statute, and the benefits are insured, rather than self-funded, thus eliminating the danger of inadequate funding. There could, however, be problems of inadequate benefits in some instances.

Although a lower retirement age is a generally accepted plan design for plans covering policemen and firemen, a normal retirement age of 50 and 20 years of service, or 20 years of service without any age requirement, seem to be especially generous. This, combined with generous disability benefits and rather liberal administration of disability benefits, results in a need for very high contribution levels. This is alleviated to some extent in some statutes by not permitting retirement automatically after meeting these requirements, but rather only permitting the employee to petition for retirement. Thus, the Board of Trustees can establish a higher age for actual retirement than is provided in the statute.

More disturbing than the low retirement age requirement for policemen and firemen is the fact that a number of cities have adopted similar retirement ages for their civil service employees as well, where it would seem reasonable to expect retirement ages similar to those used in corporate plans, which are generally no lower than age 60, and more usually age 65. For example, the cities of Covington and Newport permit retirement with full benefits after attainment of age 50 and completion of 20 years of service. This provision has increased the required contribution significantly, and has been the major reason for the fact that their funds are inadequate at this time.

We have summarized in the following schedule the age and/or service requirements for normal retirement for the plans in our study:

Requirements for Normal Retirement		Number of Plans		
Age	Service	Police & Fire	Civil Service	Total
-	10	-	1*	1
-	20	15	-	15
50	20	8	3	11
51	20	5	-	5
55	20	1	-	1
60	20	1	4	5
62	-	1	-	1
65	-	1	5	6
65	10	-	5	5
65	20	1	1	2

* Normal retirement requirements not significant, since this is a defined contribution plan.

VI. OTHER BENEFITS

The questionnaire had several questions with regard to other benefits that may be provided to employees. The results indicate that almost all cities included in the study provide group life insurance for their employees. The levels provided participants of the fifty-two plans are summarized below:

Number	Amount of Coverage
12	None
12	$ 2,000
1	3,000
2	4,000
14	5,000
1	6,000
1	8,000
6	10,000
1	1 x Salary
2	Amount not specified

The portion of the cost for group life insurance paid by the city is shown below:

Number	% of Premium by City
28	100%
1	66%
4	50%
3	48%
4	None

Only 7 of the 52 provided Group Disability benefits outside of the retirement plan.

Of the 52 surveyed, 29 provided Social Security benefits in addition to the self-administered retirement plan, and 23 did not provide Social Security benefits. We have summarized the participation in Social Security below:

Classification	No. of Plans	No. Covered by Soc. Sec.
1st Class Police & Fire	2	--
2nd Class Police & Fire	7	--
Urban County Police & Fire	1	--
2nd Class Civil Service	5	3
Urban County Civil Service	1	--
2nd Class Elec. & W. B.	1	1
3rd Class Police & Fire	16	11
3rd Class Civil Service	3	3
4th Class Police & Fire	5	--
4th Class - Other	11	11

It can be seen from the above table that there is no Social Security coverage for five classifications.

All of the 3rd and 4th Class civil service employees are covered by Social Security but, since their retirement plans are generally quite modest, the problem of excessive benefits does not arise. An area of concern, however, is the 3rd Class policemen and firemen, where 11 of the 16 are covered by Social Security. Unless the plan benefits are adjusted to some extent for Social Security benefits, their total retirement benefits could be excessive, especially when compared to other policemen and firemen who are not covered by Social Security.

VII. GENERAL OBSERVATIONS

The plans that have regular valuations are being funded adequately, but the city contribution rate is very high (30% to 40%), and may increase even higher if participants take full advantage of the liberal normal retirement requirements.

The insured plans which normally are not in accordance with any statute are, by their very nature, being adequately funded. Although the benefits are generally less liberal, they may be adequate as a supplement to the Social Security benefits to which all the participants of these plans will be entitled.

The balance of the plans which have not had actuarial valuations, or only have one every five years (as required in some statutes), are generally in an unsound actuarial condition. Many have not been able to fund at the rates required by the periodic actuarial valuation; thus, the results are ignored, and the actuarial condition deteriorates further.

If money is available to fund these programs adequately, then actuarial soundness could be attained by determining the required contribution periodically (at least every three years). If the money is not available or, as is the case in some statutes, the amount of contribution is limited, actuarial valuations are obviously of little help, except possibly to demonstrate the fact that the plan is not actuarially sound. In the latter case, the removal of the limitations on the amount of contributions may resolve the problem but, if money is not available, the only solution would seem to be a reduction in benefits or less liberal requirements for retirement. This solution is not possible in all instances, since the benefits are stipulated by statute.

In addition to the funding problem, there are problems with regard to inconsistencies between statutes, questionable plan design, plan administration and the investment of funds.

The answers to the questionnaire indicated that there was a lack of understanding of the complexities of the retirement systems. This was borne out by the fact that plans established under certain statutes had provisions at variance with those statutes. There also seemed to be a feeling that, as long as the cash flow was positive, the funds were in good condition, which obviously is not the case.

With the passing of the Employees Retirement Income Security Act in 1974, sponsors of corporate plans were required to meet certain minimum funding requirements and report a substantial amount of information concerning these plans to both the government and the participants. From our experience, the need for minimum funding requirements, as well as better communication to the individual participants, is needed even more with regard to government plans. Certain reporting requirements have already been imposed upon government plans under ERISA, and there are rumblings with regard to taxing the fund earnings if the plans are not modified to conform with ERISA. It does seem an opportune time, therefore, to solve the problems that have been brought to light by this survey.

MEIDINGER & ASSOCIATES, INC.

Prepared by Lloyd H. Johnson, F.S.A.

APPENDIX 4

KENTUCKY LEGISLATIVE RESEARCH COMMISSION

QUESTIONNAIRE FOR CITY EMPLOYEE AND ELECTED OFFICIAL

PENSION SYSTEMS - 1976

A) Program Examined

Interviewer ______________________________ Date ______________________

City ______________________________ City Class ______________________

Name of Program ____

Category (ies) of Employees Covered __________________________________

Interviewee ____

Position ____

B) Other Benefits Information

1) Are members covered by Social Security?

All ( ) None ( ) Some ( ) indicate category(ies) covered by Social Security.

2) Is there a separate group life insurance program?

Yes ( ) No ( )

If yes, how much coverage is provided? ___________________________

What percentage of premium is paid by the city? __________________

3) Is there a separate group disability insurance program?

Yes ( ) No ( )

If yes, what are the benefits and period of coverage? ____________

____

____

____

What percentage of premium is paid by the city? __________________

4) Are members covered by Workmen's Compensation?

All ( )   None ( )   Some ( ) indicate category(ies) covered by Workmen's Compensation.

5) Are any employees or elected officials of your city covered by the County Employees Retirement System?

Yes ( )   No ( )

If yes, please describe the criteria for coverage under the CERS.

____

____

____

C) <u>Background of the Pension Plan</u>

1) Number of active members ____________

Number of non-active members entitled to deferred benefits ____________

Number of disability retirees

Temporary ____________

Permanent ____________

Number of age-service retirees ____________

Number of surviving spouses ____________

Number of children receiving benefits ____________

Number of others receiving benefits ____________

2) When was the plan established? ____________

3) When was the plan last amended? ____________

4) Plan is pursuant to what state statute? KRS ____________

5) Is the plan "qualified" under Section 401(a) of the Internal Revenue Code?

Yes ( )   No ( )

D) Benefits Under The Plan

1) What are the age and service requirements for retirement? Include reduced level of benefits for early retirement. ____________________

____

____

____

2) What is the formula used to compute retirement benefits? __________

____

____

3) Is retirement guaranteed upon fulfilling certain requirements, or is it at the discretion of the board?

   Guaranteed ( )   Discretionary ( )

4) Does the wage base include overtime pay? Yes ( )   No ( )

5) Does the wage base include a state supplement? Yes ( )   No ( )

6) What is the formula used to compute disability retirement benefits?

____

____

____

____

7) Who determines disability? ________________________________

____

8) Are there continuing reviews for disability? Yes ( )   No ( )

   If yes, how often? ____

____

9) Is there an offset for Social Security disability payments?

   Yes ( )   No ( )

   If yes, please describe. ____________________________________

____

10) Is there an offset for payments under Workmen's Compensation?

Yes ( )   No ( )

If yes, please describe. ____________________

____

11) If an employee terminates before eligibility for a pension, does he get his own contributions back? Yes ( )   No ( )
With interest? Yes ( )   No ( )

12) Are there provisions for re-entering the system after withdrawing?

Yes ( )   No ( ) If yes, please describe. ____________________

____

____

13) How many years of service must an employee have to be entitled to a deferred pension if he terminates employment? ____________________

14) What age must an employee reach to be entitled to a deferred pension if he terminates employment? ____________________

15) Is there a cost of living adjustment for retirees? Yes ( ) No ( )

If yes, please describe. ____________________

16) Are there survivor death benefits for active employees?

Yes ( )   No ( )

17) Are there survivor death benefits for retired employees?

Yes ( )   No ( )

18) Is there a funeral expense death benefit? Yes ( )   No ( )

E) Administration

1) How is the Board of Trustees composed? ____________________

____

____

____

2) From what source are administrative expenses paid? ______________

____

____

3) Is written information describing the plan provided new members?

Yes ( ) No ( )

4) Is there any regular periodic written communication with members?

Yes ( ) No ( )

If yes, please describe.______________________________________

____

5) Are members given statements of contributions?

Yes ( ) No ( )

If yes, how often?____

F) <u>Investment Policies</u>

1) Who invests the funds? ______________________________________

____

2) Who is custodian of the funds? _____________________________

3) Are there investment guidelines? Yes ( ) No ( )

If yes, please describe. ______________________________________

____

____

4) In what types of assets are funds invested? By percentage:

__________ Stocks

__________ Corporate Bonds

__________ Federal Securities

__________ State bonds

__________ Local government bonds

__________ Bonds of your city

__________ Savings Accounts

__________ Mortgages

__________ Other

5) Are audits required? Yes ( ) No ( )

If yes, how often, and by whom? ______________________________

____

6) How much cash is on hand, uninvested? ______________________

7) What is the overall yield on investments? ____________________

8) Are there reporting requirements on investments? Yes ( ) No ( )

If yes, please describe. ______________________________________

____

9) How are investment results monitored? ______________________

____

G) <u>Actuarial Soundness</u>

1) When was last actuarial evaluation made? ____________________

2) By whom? ____

3) Was any opinion given as to "soundness" of fund? If so, briefly

explain. ____

____

____

____

4) Amount of Unfunded Past Service Liability ____________________

5) Steps taken to fund that liability ___________________________

____

____

6) Present level of employee contributions (as a percent of pay)

____

7) Present level of employer contribution (as a percent of pay)

____

H) GENERAL

1) Is there any judgment now held against the fund or the City arising from the Plan? Yes ( ) No ( ) If yes, please explain.

____

____

____

2) Are there any legal actions pending against the fund or the City arising from the Plan? Yes ( ) No ( ) If yes, please explain.

____

____

____

3) Are there any other facts or opinions which would help LRC better understand the program and its future?

____

____

____

I) ATTACHMENTS

Please attach the following:

1) A copy of the ordinance (including amendments), establishing the program.

2) A copy of any Board of Trustee rules and regulations concerning the program.

3) A copy of any trust agreement or insurance contracts used to fund the plan.

4) A copy of the most recent statement of assets, including both cost and market value. Please include date of statement.

5) A copy of the most recent audit report.

6) A copy of the most recent actuarial report.

7) A copy of the most recent communication to members concerning the plan.

8) A copy of any investment policy.