

**REPORT ON THE MERGER  
OF CITY RETIREMENT SYSTEMS**

**RESEARCH MEMORANDUM NO. 453**

**LEGISLATIVE RESEARCH COMMISSION**

**December, 1991**



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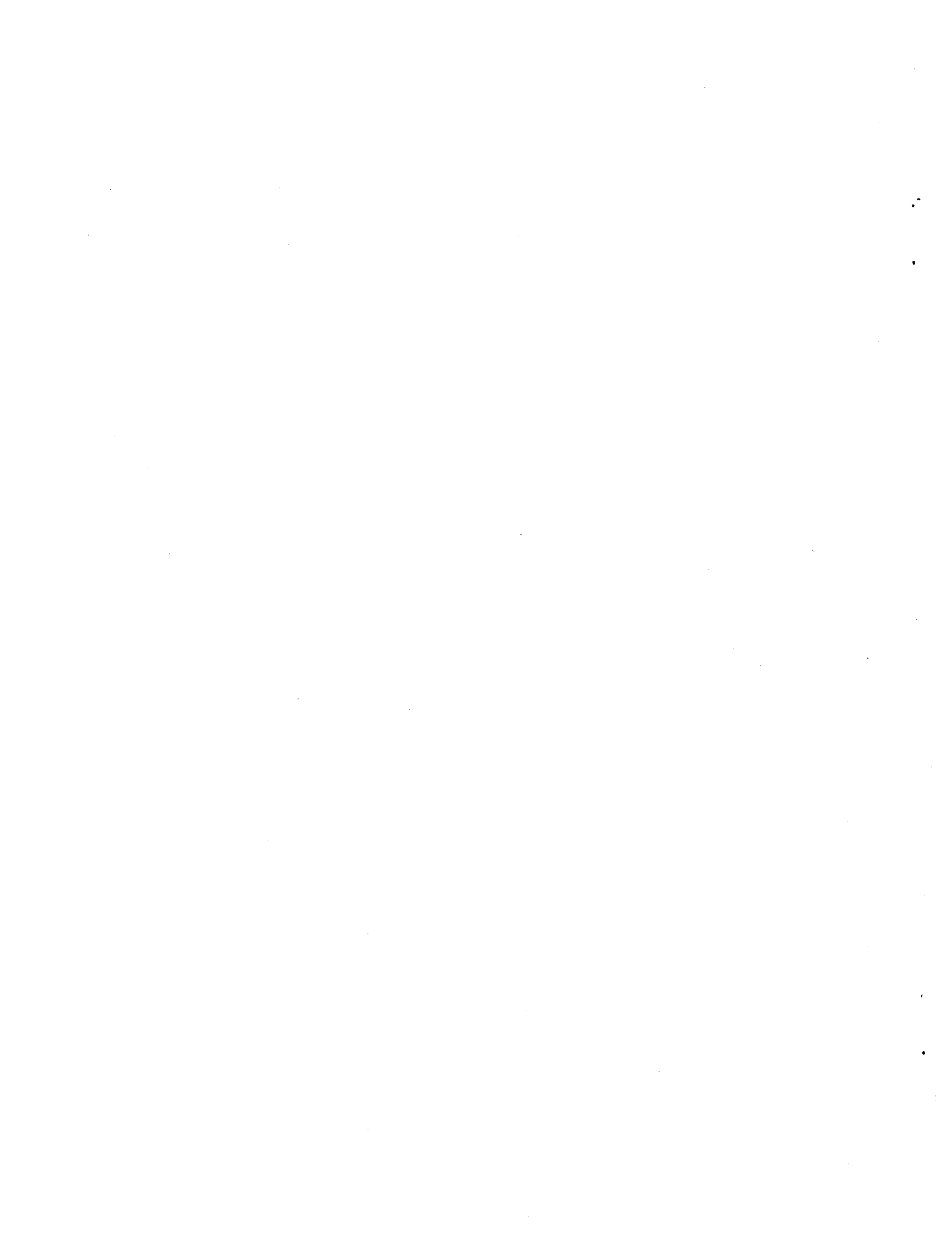
**LRC Staff:**

**Bill Wiley**

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**Legislative Research Commission  
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**TO:** Legislative Research Commission

**FROM:** William Wiley

**SUBJECT:** Report On The Merger Of City Retirement  
Systems With CERS (SCR 20)

**DATE:** December 13, 1991

Senate Concurrent Resolution 20 of the 1990 General Assembly directed that a study be conducted of the impact of merging local government retirement systems with the County Employees Retirement System (CERS). This memo reports the results of that study. It includes three staff recommendations.

1. The merger of city pension systems with CERS was intended to eliminate locally-administered defined benefit pension systems. This study reveals that fire districts, created under KRS Chapter 75, are creating defined benefit retirement systems without any apparent legislative mandate. If this practice is to be terminated, explicit language prohibiting local government defined benefit pension plans should be enacted. This language should be universal in its application and not tied to any particular sections of the statutes.
2. Existing statutes which mandate the procedures whereby cities close their defined benefit pension plans and join CERS require the city to pay the costs of transferring local system retirement credit to CERS. But local pension boards, not city councils, control the pension funds created by past city contributions. If the pension boards refuse to transfer funds, cities might be forced to pay twice for retirement credit earned in a single time period. Disputes have arisen in several cities over the control of local pension funds, and the City of Ashland is in litigation over this matter. The most prudent course would be to await the outcome of this litigation, and then determine whether legislative action is warranted.
3. Legislation in 1990 increased the cost-of-living increments which pension board trustees could grant their police and firefighter retirees. Disability retirees were inadvertently left out of this legislation. In the interest of equitable treatment for all retirees in cities of the second class, the members of the General Assembly may want to consider an amendment which will make disability retirees in cities of the second class eligible for cost-of-living increases.



## DISCUSSION

The merger of city pension systems into CERS was required by 1988 HB 398, which required cities of the second class and lower to close their defined benefit pension plans to new members, and to offer CERS membership to current employees. Pension systems in cities of the first class and in urban-county governments were exempted from the provisions of HB 398, as were local government pension systems which did not provide a defined benefit. (A defined benefit pension plan provides a guaranteed retirement benefit determined by a retirement formula. Because of this guarantee, a defined benefit plan can accumulate an unfunded liability. The accumulation of unfunded liabilities by a number of cities was an important factor motivating the passage of HB 398.)

SCR 20 required consideration of four basic questions:

- (1) The number of employees who transferred to CERS and the effects of the transfers on dates of retirement;
- (2) The financial condition of the local pension systems which remain to service retirees and employees who did not transfer to CERS;
- (3) To what use any surplus funds remaining in local pension systems should be put;
- (4) Whether any local government pension funds which accept new members still exist in Kentucky.

The process of gathering information for this study led to the discovery of other questions or considerations which deserve discussion. Among these are:

- (1) The statutes providing for local government entry into CERS direct that cities transfer funds to CERS, but pension boards, not city councils, control pension funds. This problem led to the issuance of OAG 90-89;
- (2) Legislation passed in 1990 relating to the composition of pension boards and authority to grant retirement cost-of-living increases made the question of pension fund surpluses academic. Surpluses quickly disappear when cost-of-living adjustments are calculated. The relevant consideration becomes the impact of cost-of-living increases on pension fund balances.
- (3) Cost-of-living legislation passed in 1990 inadvertently omitted coverage for disability retirees in cities of the second class.

### Transfer Of Active Members

In terms of inducing active members of city pension systems to transfer to the County Employees' Retirement System, HB 398 was very successful. Two

thousand and fifty-five employees (87.5%) transferred and only 292 declined CERS membership (Table 1). Acceptance was widespread among all classes of cities, but there were individual cities where the majority of employees chose not to transfer. All of Hazard's police and firefighters chose to stay with the local plan, as did all of the employees of the Ashland Department of Utilities. In cities of the second class, the greatest number of rejections was in Paducah, where 29 (18%) chose to stay with the local plan. In cities of the third class, aside from Hazard, the most rejections were in Mayfield, with 45 (68%). In Madisonville, a city of the fourth class, 22 of the police and firefighters (27%) and 77 of the nonuniformed employees (42%) stayed with the local plan.

### **Immediate Retirements**

Some concern was expressed that many police and firefighters in cities of the second class would transfer to CERS and retire immediately, placing the system under financial stress. This might occur because hazardous duty personnel under CERS can retire at any age, with 20 years of service, while the minimum retirement criteria under statutes governing cities of the second class is age 50 and 20 years of service.

In fact, fewer than 10% of police and firefighters in cities of the second class who transferred to CERS chose to retire within the first year after transfer. One thousand and thirty-one employees transferred and one hundred retired (Table 2). Of these 100, 51 were younger than age 50. Their average age was 46.07, but their average service, 24.23 years, exceeded the 20 year requirement for police and firefighters in cities of the second class. The surge in retirements, then, was not as great as was feared, and, according to CERS personnel, did not strain the capacity of the system.

### **Financial Condition Of Local Systems After HB 398**

Any discussion of the financial condition of city pension systems after HB 398 must take account of several factors.

First is that HB 398 contained a provision requiring each city to maintain the cash flow in its local system until the last retiree and beneficiary received the last mandated payment (KRS 65.156(3)). Thus retirees are afforded legal protection which must be supported by the financial commitment, and perhaps sacrifice, of the cities affected.

A second factor is that CERS requires its participating agencies to make the annual payments which the consulting actuary says are necessary to meet current costs and amortize any unfunded liability which might exist. While all cities have been required since 1978 to have periodic actuarial



TABLE 1

TRANSFER OF ACTIVES TO CERS - HB 398

<u>CITIES OF THE SECOND CLASS, P &amp; F</u>	<u>ACCEPTED</u>	<u>REJECTED</u>
ASHLAND	103	2
BOWLING GREEN	152	2
COVINGTON	188	2
FRANKFORT	101	0
NEWPORT	80	0
OWENSBORO	189	6
PADUCAH	130	29
RICHMOND	87	1

<u>CITIES OF THE THIRD CLASS P &amp; F</u>	<u>ACCEPTED</u>	<u>REJECTED</u>
DANVILLE	47	7
ERLANGER (7/1/88)	21	0
FLORENCE	53	1
GLASGOW (3/1/88)	58	0
HAZARD	0	38
HOPKINSVILLE	97	4
MAYFIELD	21	45
MIDDLESBORO	43	0
MURRAY	44	0
SHIVELY	38	0
WINCHESTER	59	8

<u>CITIES OF THE FOURTH CLASS P &amp; F</u>	<u>ACCEPTED</u>	<u>REJECTED</u>
CATLETTSBURG	9	0
FT. THOMAS (2/1/88)	37	0
LUDLOW	6	0
MADISONVILLE (3/1/88)	58	22
PRESTONSBURG (UNIFORMED AND NONUNIFORMED)	49	3

TABLE 1

TRANSFER OF ACTIVES TO CERS - HB 398  
(CONTINUED)

<u>CITY UTILITY SYSTEMS</u>	<u>ACCEPTED</u>	<u>REJECTED</u>
ASHLAND WATER	0	25
BENTON ELECTRIC	9	0
BOWLING GREEN UTILITIES	138	3
FRANKFORT ELECTRIC & WATER (7/1/88)	103	0
FRANKLIN ELECTRIC	0	14
HOPKINSVILLE ELECTRIC	34	0
HOPKINSVILLE WATER	50	0
MONTICELLO ELECTRIC	11	0
MURRAY ELECTRIC	20	0
PRESTONSBURG UTILITIES	20	0
<u>CITY NONUNIFORMED</u>	<u>ACCEPTED</u>	<u>REJECTED</u>
GLASGOW (3/1/88)	52	2
MADISONVILLE (3/1/88)	105	77
TOTAL	2055	292

TABLE 2

FIRST YEAR RETIREMENTS - CITIES OF THE SECOND CLASS  
POLICE AND FIREFIGHTER PENSION SYSTEMS

	<u>Electing Employees</u>	<u>Total Retirees</u>	<u>Pre Age 50 Retirees</u>	<u>Av. Age, Pre Age 50</u>	<u>Av. Service, Pre Age 50</u>	<u>Disability Retirees</u>
Ashland	103	12	3	48.33	28.63	3
Bowling Green	152	8	6	44.50	22.31	0
Covington	188	22	14	44.92	22.65	0
Frankfort	101	18	12	47.08	26.42	0
Newport	80	10	7	46.42	22.51	1
Owensboro	189	13	4	47.25	26.22	0
Paducah	131	12	2	47.0	25.83	0
Richmond	87	5	3	45.33	22.61	1
<b>TOTALS</b>	<b>1031</b>	<b>100</b>	<b>51</b>	<b>46.07</b> (weighted average)	<b>24.23</b> (weighted average)	<b>5</b>

evaluations of their systems, no authority required them to make the recommended annual payments. Those cities which remained current on their recommended payments incurred less debt for unfunded liability coming into CERS, and consequently were not impacted as heavily as cities which had lagged on annual payments.

A third factor is that HB 398 permits cities to pay their debt to CERS for past service liabilities over a thirty-year period. Meanwhile, they can retain local pension fund assets that might have been transferred to CERS, in order to invest for the highest return. Several cities with substantial assets chose this option because of their intent to earn a higher yield on investments than the 8% required by CERS to finance their obligation there.

An examination of the financial condition of a city pension system after HB 398 would not, in itself, tell us much about the impact of HB 398 on the city, because the city has obligations to CERS also. The total pension costs of a city before and after HB 398, including CERS and local obligations, give us a more useful picture of the bill's impact. Unfortunately, data for before and after comparisons are not available for all cities, and when the data is available there are variables which make clear comparisons very difficult. For example, the number of years between actuarial reports varies. The salary increases will vary from city to city. The statutes which governed the cities before HB 398 vary by class of city. The amortization periods which cities choose to retire their lump sum debts vary, and the actuarial firms which perform the valuations sometimes vary in their methods and recommendations. Nevertheless, before and after data on 14 cities is presented in Table 3.

In Table 3, the second class cities are those governed by KRS 95.861. Two of these cities, Bowling Green and Paducah, have lower costs after HB 398 than before. Neither of these cities must amortize a lump sum past service debt to CERS. Their only costs are CERS annual costs, plus the costs for their local plan.

An increase of 121% is indicated for Frankfort, but Frankfort has a local surplus of \$5,326,540, and a lump sum debt to CERS of only \$3,883,361. Frankfort is holding assets for high investment return, and its true pension costs are costs as reported in Table 3 minus its earnings of its local surplus of over \$5 million dollars. When this is taken into account, Frankfort's costs may actually be less after HB 398 than before.

Other cities of the second class, Ashland, Covington, and Owensboro, show increases of 53% to 65%, but the periods between actuarial reports range from 4.5 years to 6.5 years. Some of these increased costs must be attributed to inflationary pressures unrelated to the CERS transfer.

Cities of the third class are those governed by KRS 95.621 or KRS 95.520. Three of these cities, Florence, Murray, and Winchester, show dramatic cost

TABLE 3

**CITY PENSION COSTS - BEFORE AND AFTER CERS ENTRY**

City	New Costs +	Old Costs	Difference	Period Between Reports	% Increase	Local Unfunded Liability	Statute
Ashtand P & F	\$ 913,538 (7/1/90)	\$572,192 (1/1/86)	+\$341,346	4.5 yrs.	59%	\$2,950,328	95.861
Bowling Green P & F	\$ 589,225 (7/1/90)	\$684,212 (1/1/85)	-\$ 94,987	5.5 yrs.	- 13%	(\$2,362,662)	95.861
Covington P & F	\$1,427,589 (1/1/91)	\$930,306 (7/1/86)	+\$497,283	4.5 yrs.	53%	\$1,270,279	95.861
Frankfort P & F	\$ 678,227 (1/1/89)	\$306,391 (1/1/86)	+\$371,836	3.0 yrs.	121%	(\$5,326,540)	95.861
Newport P & F	\$ 446,721 (7/1/90)	\$454,902 (7/1/85)	+\$ 11,819	5.0 yrs.	2%	\$ 197,225	95.861
Owensboro P & F	\$1,024,947 (1/1/91)	\$618,157 (7/1/84)	+\$406,790	6.5 yrs.	65%	(\$3,320,980)	95.861
Paducah P & F	\$ 669,958 (5/1/91)	\$804,043 (7/1/84)	-\$134,085	6.75 yrs.	- 17%	\$1,924,564	95.861
Richmond P & F	\$ 440,479 (6/30/91)	\$427,398 (1/1/87)	+\$ 13,081	4.5 yrs.	3%	\$ 56,903	95.861
Danville P & F	\$ 328,207 (7/1/90)	\$338,160 (7/1/88)	-\$ 9,953	2.0 yrs.	- 2%	\$1,196,295	95.520
Florence P & F	\$ 326,292 (7/1/89)	\$108,989 (6/30/84)	+\$217,303	5.0 yrs.	199%	(\$ 165,822)	95.621
Hazard P & F *	\$ 81,000 (6/30/91)	\$ 75,400 (6/30/88)	+ 5,600	3.0 yrs.	7%	\$1,137,115	95.621
Hopkinsville P & F	\$ 911,349 (1/1/91)	\$971,318 (1/1/88)	-\$ 59,969	3.0 yrs.	- 6%	\$3,211,003	95.621
Murray P & F	\$ 320,381 (6/30/90)	\$110,050 (7/1/87)	+\$210,331	3.0 yrs.	191%	\$ 473,909	95.621
Winchester P & F	\$ 392,605 (7/1/90)	\$178,187 (1/1/86)	+\$214,418	4.5 yrs.	120%	\$ 568,038	95.520

\* No employees transferred to CERS  
 + '89-'90 employers CERS annual costs, plus amortization of CERS lump sum, plus costs of the local system. The date in parentheses is the date of the most recent valuation of the local system.

increases of 199%, 191% and 120%. Two of the other three cities show small decreases in total pension costs. Hazard shows an increase of 7%, but in Hazard no current employees transferred to CERS.

It is not clear why there is such difference among the five third class cities in which the majority of the employees transferred. An examination was made of the size of their local unfunded liabilities, and another of the size of their lump debts to CERS. Their annual payments to CERS were divided by their respective lump sum debts, and the resulting percentages were compared. None of these exercises offered an answer to the question of cost increase differences. Since no opinion can be offered that would be any more than speculation, the question remains unanswered.

It is useful, however, to note the case of Covington, a second class city, and compare the actuarial evaluations of 1991 and 1989. In 1991 the actuary reported an unfunded liability of \$1,270,279. This was a substantial increase from the \$151,823 liability reported in 1989, and occurred in spite of the fact that over the two-year period, the city had contributed more to the system than the actuary had recommended. The actuary attributed this unexpected result to two factors. First, the yield on investments had been less than projected. Second, the assumptions on marital status and number of dependents used in the '89 report were inaccurate. The '91 report relied on survey information to accurately state potential spouse and dependent costs, which were higher than had been assumed. The point is that there can be variations in actuarial cost estimates which result from inaccurate assumptions relating to various cost factors. When this happens, significant changes in cost estimates can occur. These changes are not predictable, and may run counter to expectations based on otherwise sound reasoning.

### **The Use Of Surplus Funds**

After the passage of 1988 HB 398, each affected city pension system was subjected to an actuarial valuation to determine the costs of CERS entry. These valuations revealed pension surpluses in several cities of the second class. Some of these surpluses were erased when cities, such as Paducah, decided to pay on their lump sum debt to CERS. But two cities, Frankfort and Bowling Green, still have local surpluses which exceed their lump sum debt to CERS. The existence of surpluses led to the introduction, in 1990, of HB 625, which would have defined these surpluses and provided for their distribution to retirees on a twice-yearly basis until they were exhausted. HB 625 did not pass.

Two legislative enactments occurred during the 1990 session which rendered the concept in HB 625 obsolete by encouraging the use of cost-of-living increases for retirees instead of twice-yearly distribution of surpluses. The first was HB 59, which increased the cost-of-living award that could be granted by pension trustees in cities of the second class, and provided for the first time a cost of living option in cities of the third class. Before

1990, the maximum allowable increase in cities of the second class was 2% of the base index year, payable after age 60 or three years of retirement, whichever was later. As a result of HB 59, the maximum amount was pegged to the increase in the Consumer Price Index, to a maximum of 5%, compounded annually, and payable after three years of retirement. Both before and after 1990 increases in cities of the second class were subject to the qualification that they could "be supported on an actuarially sound basis by the fund" (KRS 95.859(3)).

In cities of the third class, the trustee-granted increase was also pegged to the consumer price index, with a maximum of 5%, but without the three-year waiting period and without the qualification of actuarial soundness.

Another 1990 enactment, HB 9, changed the composition of police and firefighter pension boards in cities of the second and third class. The old boards had six members, comprised of city officials, police and fire chiefs, and active employees. The new boards have either four or six members. If there are fewer than six active members remaining in the local pension system, the board of trustees consists of the mayor, the city treasurer, and two retirees. If there are six or more active members of the local pension fund, then two active members are elected to the board.

HB 9 and HB 59 were introduced and enacted not as a package, but as separate acts. When they both became law, some predicted that the effect would be that both four- and six-member boards would be conservative in granting cost-of-living increases. The six-member boards would be conservative because the two active members would vote in concert with the two city officials, in order to preserve the pension fund for their own retirement. The four-member boards would be conservative because the two city officials would vote together to prevent an increase.

In fact, neither type of board has been conservative. Five of seven six-member boards granted increases in both 1990 and 1991. The other two did not grant an increase in either year. Five of fourteen four-member boards granted increases in both years. Eight granted an increase in either 1990 or 1991, and only one did not offer an increase in either year (Table 4).

The criterion that cost-of-living increases "be supported on an actuarially sound basis by the fund" in cities of the second class does not consistently deter cities from granting increases. Actuaries do not often directly state in a valuation that a board should not grant an increase. Instead they present financial analyses that indicate how debt levels will increase if increases are granted. A reading of actuarial valuations for the eight cities of the second class indicates that four of them granted increases in 1991 which would increase unfunded liabilities if city contribution rates were not increased. Three of these cities have four-member boards which enable the city administration to veto cost-of-living increases. Apparently

TABLE 4

COST-OF-LIVING INCREASES  
CITY PENSION SYSTEMS 1990-1991

<u>CITIES OF THE SECOND CLASS</u>	<u>1990</u>	<u>1991</u>
ASHLAND POLICE AND FIRE (4 member board)	0	5%
BOWLING GREEN P & F (4 member board)	5%	3%
COVINGTON P & F (4 member board)	0	5%
FRANKFORT P & F (4 member board)	5%	5%
NEWPORT (4 member board)	0	5%
OWENSBORO (6 member board)	2%	5%
PADUCAH (6 member board)	4.4%	5%
RICHMOND (4 member board)	\$100/mo. across the board	0

<u>CITIES OF THE THIRD CLASS</u>	<u>1990</u>	<u>1991</u>
CORBIN P & F (4 member board)	0	0
DANVILLE P & F (6 member board)	3%	5%
ERLANGER POLICE (4 member board)	5%	5%
FLORENCE P & F (4 member board)	5%	0
FLORENCE NON-UNIFORMED	5%	0
GLASGOW P & F (4 member board)	0	5%
GLASGOW NON-UNIFORMED	0	5%
HAZARD P & F (6 member board)	0	0
HENDERSON P & F (4 member board)	4.62%	5%
HENDERSON NON-UNIFORMED	4.62%	5%
HOPKINSVILLE P & F (4 member board)	0	5%
MAYFIELD P & F (6 member board)	0	0
MAYSVILLE P & F (6 member board)	3.77%	5%
MIDDLESBORO P & F (4 member board)	5%	0
MURRAY P & F (4 member board)	5%	5%
WINCHESTER P & F (6 member board)	4.6%	5%



TABLE 5

IMPACT OF COST OF LIVING RAISES ON SURPLUSES AND LIABILITIES

<u>SYSTEM</u>	<u>SURPLUS (+) OR LIABILITY (-)</u>	<u>LIABILITY WITH ANNUAL 3% COLA</u>	<u>LIABILITY WITH ANNUAL 5% COLA</u>
ASHLAND P & F	- \$2,950,328	- \$4,491,869	- \$6,085,287
BOWLING GREEN P & F	+ \$2,418,726	- \$ 197,200	- \$2,959,701
NEWPORT P & F	- \$ 197,225	- \$2,019,431	- \$3,880,896
PADUCAH P & F	- \$1,924,564	-----	- \$9,832,414
RICHMOND P & F	- \$ 56,903	-----	- \$ 424,011
DANVILLE P & F	- \$1,196,295	-----	- \$2,270,119
MADISONVILLE P & F	+ \$ 590,678	- \$ 185,082	- \$ 963,087
MIDDLESBORO P & F	- \$1,387,716	-----	- \$2,559,542
MURRAY P & F	- \$ 473,909	- \$1,069,504	- \$1,737,814

it has been determined that protecting the purchasing power of retirees is important, and the cities are willing to shoulder the expense.

Since the enactment of HB 59, actuaries have routinely included in their valuations the effect of granting cost-of-living increases to retirees on an annual basis. These effects are illustrated in Table 5, and the cost increases are dramatic. In Bowling Green, for example, a \$2,418,726 surplus becomes an unfunded liability of \$197,200 if three percent increases are granted on an annual basis, and an unfunded liability of \$2,959,701 if five percent increases are granted. In Madisonville, a surplus of \$590,678 would become a deficit of \$185,082 or \$963,087, if three or five percent annual increases, respectively, were granted. The results can be even more dramatic. Paducah would incur an addition to its unfunded liability of \$7,907,850 by granting 5% increases each year.

Since so many cities have chosen to give their retirees cost-of-living increases, it is obvious that there will be no large surpluses in city pension funds, and no need to ponder what to do with them.

#### **Are Local Government Pension Funds Accepting New Members?**

In drafting HB 398, a systematic review was made of the statutes to determine all of the sections which either enabled or mandated the creation of local government defined benefit pension plans. These sections were then amended to prevent the creation of new plans, and to close the existing ones to new members. The authority of local governments to create or continue money purchase, defined contribution, or deferred contribution plans, which by their nature cannot have an unfunded liability, was maintained and made explicit in HB 398.

The intent of the General Assembly to end the creation of local government defined benefit pension plans has not been entirely successful. Despite the lack of language in KRS Chapter 75 authorizing fire taxing districts to create any sort of locally administered pension plan, at least seven fire districts in Jefferson County have enrolled in defined benefit plans, called length of service award programs, administered by VFIS, Inc. (Volunteer Firefighters Insurance Services). These plans provide death benefits and retirement benefits tailored to the specifications of the district. One plan pays \$600 per month at age 63 for 20 years or more of service.

These VFIS, Inc. plans are audited annually and subject to actuarial analysis every third year. The problem is not that they are potentially unsound. Because of their administration by VFIS, Inc., they are probably well funded. The point is that local governments, in this case fire districts, are still incurring obligations to local defined benefit pension

plans. If this practice is to be terminated, explicit language prohibiting defined benefit plans should be enacted. This prohibition should not be tied to particular sections of the statutes, but should be universal in its application.

### Control Of City Pension Funds And Fund Transfers To CERS

There are basically two methods under which a city can join CERS. Under the first method, pension benefits begin to accrue only after the city participates in the system, and any city service prior to that date is uncredited. The other method is called alternate participation, and under this mode, prior city service is also credited to CERS. Contributions which participating employees have made to the local plan are transferred to CERS. The city is then required to purchase "on behalf of each employee electing coverage,...service credit for employment...between July 1, 1958 and the participation date of the (city)."

HB 398 amended this provision to require the purchase of only as much service credit as the employee had accumulated in the city plan. (The plan may have been created after July 1, 1958). But no change was made in the requirement that the city purchase prior service credit in CERS. The fact is, however, that pension boards of trustees, not the cities, control the pension funds to which the cities had contributed for their employees over the life of the plan. No problem had occurred with this language prior to the passage of HB 398. When cities joined CERS, the pension boards, as a matter of course, transferred both employer and employee contributions to CERS.

With the passage of HB 398, however, the question of whether pension boards would transfer employer contributions became a point of dispute. Some boards of trustees were reluctant to transfer funds, choosing instead to keep the funds at home for the benefit of remaining active employees and those already receiving annuities. This approach would put cities which had faithfully funded their pension plans in the position of having to contribute to CERS, for transferring employees, for a period of service they had already funded in the local plan. The problem led the Chairman of the Paducah Police and Firefighters Retirement Fund to query the Attorney General on the control of the pension funds. The Attorney General responded, in OAG 90-49, that the funds were indeed under the control of the pension board, not the city. But he also pointed out the anomaly of the city having to pay twice for the same period of service. He therefore advised that the pension board "transfer funds related to the city's previous contributions...so long as such does not affect the actuarial soundness of the Local Fund."

Paducah made a transfer of employer contributions with the consent of the pension board. In Ashland, however, a transfer was made without the consent of the pension board. As a result, the city of Ashland is currently in litigation with a group of retirees who filed suit.

One might speculate that it does not matter whether funds related to employer contributions are transferred to CERS, since the city is legally obligated to pay its contributions to CERS and to maintain adequate cash flow in the local fund (KRS 65.156(3)). But two important factors must be considered. First is the understandable anxiety of local plan retirees who want actual money as well as legal obligations backing up their retirement annuities. The second is that local plan retirees want to receive cost-of-living increases just as CERS retirees have received consistently in the past. The local retirees cannot reasonably expect to receive these increases if the funds are not on hand to pay the costs.

Since the local pension plans which are affected by this mismatch of statutory language to fiscal realities are already in CERS, and the problem will not recur, it is unclear what the General Assembly should do. The most prudent course would be to await the outcome of the litigation in Ashland, and then to determine a legislative solution, if warranted.

#### **Cost-Of-Living Increases For Disability Retirees In Cities Of The Second Class**

1990 HB 59 enabled trustees in cities of the third class to grant cost-of-living increases to retired police and firefighters. In addition, it increased the raises that trustees in cities of the second class were authorized to grant. HB 59 as originally drafted applied only to cities of the third class, and covered explicitly both disability and service retirees. The act was amended during the Legislative Session to apply also to cities of the second class, but the amendment applied only to KRS 95.859, relating to service annuities. KRS 95.862 and 95.863, relating to disability retirements, were not amended. The Attorney General advised in a January 14, 1991 letter (not a formal opinion) that the cost-of-living provisions of KRS 95.859 did not apply to disability retirees. This letter has led the trustees in at least one city to withhold increases from disability retirees. In the interest of equitable treatment for all retirees in cities of the second class, the members of the General Assembly may want to consider an amendment which will make disability retirees in cities of the second class eligible for cost-of-living increases.



COMMONWEALTH OF KENTUCKY  
OPINION OF THE ATTORNEY GENERAL

FREDERIC J. COWAN  
ATTORNEY GENERAL

OAG 90-49

STATE CAPITOL  
FRANKFORT 40601

July 12, 1990

John Michael Starks, Chairman  
Paducah Police and Fire Fighters  
Retirement Fund  
Paducah Fire Department  
301 Washington Street  
P.O. Box 2267  
Paducah, Kentucky 42002-2267

Dear Mr. Starks:

This is in response to your letter on behalf of the Paducah Police and Fire Fighters Retirement Fund (hereafter referred to as "Local Fund") concerning the legality of transferring certain funds from the Local Fund to the County Employees' Retirement System (hereafter referred to as "CERS").

In your letter you state that 131 police and firefighters elected to transfer from the Local Fund to the CERS pursuant to House Bill 398, passed by the 1988 General Assembly.

Since Paducah elected the alternate participation plan, as set forth in KRS 78.530(3), employee contributions made by the transferring police and firefighters to the Local Fund were required to be transferred to the CERS and credited to the individual's account. KRS 78.531(2). These employee contributions were transferred in November, 1988.

In addition to this, House Bill 398 required the city to pay for the prior service years of the police and firefighters who transferred to the CERS. You state that the cost to the city, in paying for these prior service years, was \$4,781,270.

The city, through the Mayor and Board of Commissioners, has requested the Board of Trustees of the Local Fund to transmit the \$4,781.270 to the CERS to pay for the prior service years of those transferring.

You ask this office whether the Board of Trustees would be in violation of any statute should it transfer the funds from the Local Fund to the CERS, as requested by the city.

We assume that the Local Fund is established and operating under the provisions of KRS 95.851 and KRS 95.991.

The Board of Trustees of the Local Board is responsible for the direction and operation of the affairs and business of the fund and holds title to all assets of the fund. KRS 95.851(4) and KRS 95.869(1).

The purpose of the Local Fund is to provide for retirement annuities and disability benefits to members of the police and fire departments, as well as their spouses and dependents, and to encourage qualified personnel to enter and remain in the service of such departments. KRS 95.853.

Pursuant to KRS 95.868, the city is required to make contributions to the fund on an actuarially funded basis toward the annuities and benefits of the members of the Local Fund.

Neither House Bill 398 nor other statutes specifically address whether funds contributed by the city to the Local Fund may be transferred to the CERS to follow the employees' contributions transferred to CERS pursuant to KRS 78.531(2). Thus, we must look at other relevant pension statutes pertaining to the Local Fund, CERS and the city to see if an answer is provided.

In construing pension statutes the following guidance is offered:

One line of authority holds that statutes providing for pensions ought to be construed liberally in favor of the persons intended to be benefitted thereby, but the better rule is to construe such statutes in light of the general plan evidenced by the enactment including protection of the

solvency of the fund and protection of the  
municipality and its taxpayers.

Sands and Libonat, Local Government Law, § 1034 (1989).  
(Emphasis added. Footnotes omitted.)

The city's contributions to the Local Fund were made on an actuarially funded basis toward the benefit of the members of the retirement program. KRS 95.868. This included the 131 transferring members.

KRS 78.530(3)(a) requires the city, which elected the alternate participation plan, to purchase, on behalf of the transferring employees, the current service credit for employment years from July 1, 1958 up to the participation date of the city in the CERS.

If the city's contributions to the Local Fund, under KRS 95.868, do not follow the transferring police and firefighters and the City is required to purchase the prior service years, under KRS 78.530(3)(a), then the city will have to contribute public funds twice toward the same employment service to provide pension annuities and benefits to the transferring members.

We believe that the Legislature could not have intended the city to pay for this employment service twice as such would be an inappropriate use of public funds and unfair to the taxpayers.

Because there is no specific statute or court case addressing what may be done with the city's previous contributions to the Local Fund relating to the transferring employees, the question may ultimately have to be resolved by the courts or the legislature.

Despite this absence of legislative or judicial direction, it is the opinion of this office that the Board of Trustees may transfer funds from the Local Fund to the CERS to pay for prior service years of those who transferred. However, such transfer must be made with the approval of the Board of Trustees of the Local Fund, which must determine whether the amount requested to be transferred to the CERS can be done without negatively affecting the actuarial soundness of the Local Fund.

Since the city's contributions to the Local Fund were actuarially calculated to meet annuity and benefit levels of the system, funds should be available to follow the transferring employees without negatively impacting the soundness of the Local Fund. However, this is left to the Board of Trustees to determine.

In addition, regarding the soundness of the Local Fund, KRS 65.156(3) requires the City to contribute annually to the Local Fund, for the benefit of the retirees of the system and the active participants who remain with the system an amount equal to that which would be required pursuant to the funding standards of KRS 95.868, plus so much of the principal amount of any unfunded prior service liability as the actuary states is necessary to maintain cash flow adequate to pay retiree and beneficiary payments until financial obligations to all retirees and beneficiaries are fully satisfied.

Based on the foregoing, this office believes that the Board of Trustees may transfer funds related to the city's previous contributions, to follow the transferring employees' contributions so long as such does not affect the actuarial soundness of the Local Fund.

Sincerely,

FREDERIC J. COWAN  
ATTORNEY GENERAL

*James M. Ringo*

James M. Ringo  
Assistant Attorney General

JMR:sjj





**FREDERIC J. COWAN  
ATTORNEY GENERAL**

COMMONWEALTH OF KENTUCKY

January 14, 1991

CIVIL AND ENVIRONMENTAL LAW DIVISION  
ANN M. SHEADEL, DIRECTOR

THE CAPITOL  
FRANKFORT 40601  
502/564-7600

David C. Fowler, Esq.  
City Attorney, City of Owensboro  
P.O. Box 847  
Owensboro, Kentucky 42302

Dear Mr. Fowler:

While this letter does not represent a formal legal opinion pursuant to KRS 15.025, we trust it will be of some assistance. Our response will be restricted to the applicable law based upon the facts you have presented.

Your letter raises questions about KRS 95.859 relative to retirement annuities and the police and fire fighters' retirement fund in cities of the second class. The section in question was amended during the 1990 session of the General Assembly and the amendments became effective on July 13, 1990.

KRS 95.859 was amended in part by the addition of what has been codified as KRS 95.859(4). It provides that a surviving spouse who does not receive a pension increase pursuant to subsection (2) of that provision shall receive the same increase an annuitant receives pursuant to subsection (3) of the statute. The annual increase authorized by subsection (3) is in an amount determined by the results of an actuarial study to reflect so much of the annual increase in the cost of living as may be supported on an actuarially sound basis by the fund. Thus, while subsection (3) of the statute authorizes an increase, that increase is dependent upon several factors which we know nothing about in your particular situation, specifically the results of the actuarial study. See OAG 80-213, copy enclosed.

KRS 95.859 deals with retirement annuities of retired members and surviving widows of retired members. It does not deal with persons who retired because of a disability. Other

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David C. Fowler, Esq.  
Page Two

statutory provisions deal with disability retirements. In McQuillin Mun. Corp. Vol. 3 (3rd Ed.), §12.149, it is stated that, "There is a clear distinction between pensions and disability benefits." Thus, persons who left the police and fire departments because of work-connected injuries cannot claim benefits set forth in KRS 95.859.

While KRS 446.010(37) defines "year" as meaning a calendar year, KRS 95.859(3) talks in terms of an annual increase. "Annual" generally refers to once a year without signifying what time in the year. See Black's Law Dictionary (4th Ed.), p. 116. Most governmental entities operate on a fiscal year basis which is July 1 through June 30. See Section 169 of the Kentucky Constitution. KRS 95.859 as amended took effect July 13, 1990, and since statutes are not retroactive in operation unless it is expressly so provided [KRS 446.080(3)], the increases authorized by the statute as amended would be for the fiscal year beginning July 1, 1990.

We have not restated, verbatim, the questions you posed nor have we restated all of the factual material you presented but, hopefully, this letter will answer most of the matters with which you are concerned.

Sincerely,

FREDERIC J. COWAN  
ATTORNEY GENERAL



Thomas R. Emerson  
Assistant Attorney General

TRE:reb

Enclosures

# IN SENATE

**REGULAR SESSION 1990**

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**SENATE CONCURRENT RESOLUTION NO. 20**

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**TUESDAY, JANUARY 9, 1990**

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Senator Joseph U. Meyer introduced the following concurrent resolution which was ordered to be printed.

A CONCURRENT RESOLUTION directing a study of the impact of merging local government retirement systems with the County Employees Retirement System.

WHEREAS, in 1988 the General Assembly passed HB 398, which required local government pension systems to be merged with the County Employees Retirement System (CERS); and

WHEREAS, HB 398 was conceived to benefit employees by ensuring their pension benefits, and to benefit local governments by requiring timely funding of pension benefit obligations; and

WHEREAS, all new local government employees were required to join CERS and employees at the time of the merger were given the option to join CERS, and most did join CERS; and

WHEREAS, the cost to a local government of joining CERS was related to the number of employees who transferred to CERS; and

WHEREAS, local government financial obligations to CERS as a result of HB 398 ranged from insignificant to substantial, and funding periods were extended for up to thirty (30) years at the option of local governments; and

WHEREAS, it is the desire of the General Assembly to assess the effects of CERS membership on local government employees who transferred to CERS and to assess the current and long term financial impact on local

governments which joined CERS as a result of HB 398;

NOW, THEREFORE,

Be it resolved by the Senate of the General Assembly of the Commonwealth of Kentucky, the House of Representatives concurring therein:

1           Section 1. That the Legislative Research Commission  
2           conduct a study of the impacts of 1988 HB 398, including  
3           consideration of:

4           (1) The number of employees who transferred to CERS  
5           and the effects of the transfers on dates of retirement;

6           (2) The financial condition of the local pension  
7           systems which remain to service retirees and employees who  
8           did not transfer to CERS;

9           (3) To what use any surplus funds remaining in local  
10          pension systems should be put;

11          (4) Whether any local government pension funds which  
12          accept new members still exist in Kentucky.

13          Section 2. The Legislative Research Commission is  
14          authorized to employ actuarial consultants to assist in  
15          this study, and those consultants shall have the  
16          qualifications for actuarial consultants required by KRS  
17          6.350.

18          Section 3. The results of this study shall be  
19          submitted to the Legislative Research Commission no later

1 than September 1, 1991.

2 Section 4. Staff services to be utilized in  
3 completing this study are estimated to cost twelve  
4 thousand, five hundred dollars (\$12,500).



