OTHER PEOPLE'S MONEY AND HOW THE HEDGE FUNDS USE IT

Brandon Girdley[*]

"The goose that lays golden eggs has been considered a most valuable possession. But even more profitable is the privilege of taking the golden eggs laid by somebody else's goose. . . . The fetters which bind the people are forged from the people's own gold."

— Louis D. Brandeis[1]

". . . everything that succeeds creates the conditions for its own demise."

— Tom Drury[2]

INTRODUCTION

"A pension is a promise."[3] It is against that backdrop that, over the past several years, members of the Kentucky Public Pensions Authority (KPPA)[4] have rallied to oppose changes to the system that would cut or alter pension benefits.[5] Their enthusiasm is not misplaced given the stakes: Kentucky's pension system is among the worst funded in the nation at about 33%,[6] which equates to at least $25.8 billion in unfunded liabilities.[7] And because the Commonwealth is statutorily obligated to pay those

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[*] J.D. Candidate, May 2022, University of Louisville Brandeis School of Law.

[1] LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 17–19 (1914).

[2] TOM DRURY, THE DRIFTLESS AREA 27 (2012).

[3] Darcy Costello, *'A pension is a promise': Hundreds rally against proposed pension reform plan*, COURIER-JOURNAL (Nov. 1, 2017, 8:56 PM), https://www.courier-journal.com/story/news /politics/2017 /11/01/pension-reform-plan-hundreds-rally/818762001/ [https://perma.cc/MV3P-QHDG]; John Cheves, *Plan to raise $600 million a year for pension debt appears dead on arrival in House*, LEXINGTON HERALD-LEADER (Feb. 13, 2018, 5:55 PM), https://www.kentucky.com/news/politics-government/ article199676599.html.

[4] During the 2020 legislative session, state lawmakers passed a bill establishing a new governance structure for the Kentucky Retirement System (KRS) and renaming the agency the Kentucky Public Pensions Authority (KPPA). *About Us,* KY. PUB. PENSIONS AUTH., https://kyret.ky.gov/About/Pages/ default.aspx [https://perma.cc/5UPN-NZAY]. Any references in this Note or any of its sources to the Kentucky Retirement System (KRS) are to the KPPA, using its old name.

[5] *See* Costello, *supra* note 3; *see also* Cheves, *supra* note 3.

[6] Elizabeth Bauer, *Public Pensions Update: How Are the Bottom Four Responding to the Covid Recession?*, FORBES (July 9, 2020, 4:30 PM), https://www.forbes.com/sites/ebauer/2020/07/09/public pensions-update-how-are-the-bottom-four-responding-to-the-corona-cession/?sh=5bfae87d78ae [https://perma.cc/2KQF-N4Z2].

[7] John Cheves, *The stock market is up: Why did the KY state pension system only earn a 1.2% return?*, LEXINGTON HERALD-LEADER (Aug. 20, 2020, 2:08 PM), kentucky.com/news/politics-government/article245106980.html.

benefits, someone will be on the hook for the shortfalls.[8]

Public pension shortfalls—not just in Kentucky, but nationwide—are largely the fault of hedge funds that aggressively pursued public pension dollars in the wake of the Great Recession.[9] Struggling public pension systems were playing "catch up" and trying to invest their way out of the hole left by floundering markets.[10] Hedge funds were an alluring option. Hedge funds embraced the opportunity, promising to take the people's money, invest it, and produce high returns that would help replenish the public coffers.[11] It failed. Instead of high returns, public pensions continued losing money.[12] Meanwhile, the hedge funds cashed in on the pension systems' desperation, pocketing 57 to 72 cents in fees for every dollar earned in investments.[13] And they did so without worrying what the consequences might be for the pension systems, because they knew that, in the end, taxpayers were the ultimate insurance policy if things went wrong. But because hedge funds are largely responsible for the dismal state of public pension systems in Kentucky and other states, fairness dictates that they, not the taxpayers, bear the cost in the event that public pension funds become insolvent.

This Note proposes the creation of a new state agency—the Kentucky Pension Assurance Agency (KYPAA)—that would insure Kentucky's public pension plans, allowing for uninterrupted benefit payments in the event that a pension fund is insolvent. The agency could serve as a model for other states seeking to strengthen and protect their struggling pension funds. KYPAA would be modeled on the federal Pension Benefit Guaranty Corporation (PBGC), an agency within the Department of Labor that insures private pensions. KYPAA would be funded by contributions from Investment Managers (third-party financial intermediaries, like hedge funds, who manage and invest state pension assets) as a condition of doing business with the Commonwealth. The first section of this Note provides a background of public pensions, the Employee Retirement Income Security Act (ERISA), and the PBGC. It also places these items in context by

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[8] See discussion of defined-benefit pension plans, *infra* section I.B.

[9] *See generally* Elizabeth Parisian & Saqib Bhatti, *All That Glitters Is Not Gold: An Analysis of US Public Pension Investments in Hedge Funds*, ROOSEVELT INST. 3, https://rooseveltinstitute.org/wp-content/uploads/2015/11/RI-All-That-Glitters-Is-Not-Gold-201511.pdf [https://perma.cc/AT43-ZLKG].

[10] Gary Rivlin, *A Giant Pile of Money: How Wall Street Drove Public Pensions Into Crisis and Pocketed Billions in Fees*, INTERCEPT (Oct. 20, 2018, 9:00 AM), https://theintercept.com/2018/10/20/public-pensions-crisis-wall-street-fees/ [https://perma.cc/J42D-DMA6].

[11] *Id.*

[12] Parisian & Bhatti, *supra* note 9.

[13] *Id.* at 1, 28.

discussing hedge funds and the pension crisis, and by examining two examples of litigation that arose from the pension crisis. The second section surveys the scholarship that has arisen out of the pension crisis, discussing the benefits and drawbacks of various reform proposals. The third section proposes the creation of KYPAA, explaining how the agency would work and why it is a better alternative than other proposals. Finally, the Note's conclusion reaffirms fairness as the guiding principle behind any proposed pension reform, emphasizing that taxpayers are not a piggybank to cover pension shortfalls caused by risky gambling and mismanagement.

I. BACKGROUND

A. Historical Overview of Pensions

The importance of pensions is evident from their age. They can be traced back to the Roman Empire, and pension plans in the United States predate the nation's founding.[14] The PBGC defines a pension as "a retirement arrangement in which your employer promises you a regular payment from the day you retire, for as long as you live."[15] It is meant to be "the cornerstone that supports retirement security, financial well-being, and peace of mind."[16]

Public pensions predated private ones.[17] The American colonies and the Continental Congress provided pensions to militiamen and colonists, and these plans later developed into Army and Navy pensions.[18] Public pensions for civilian employees followed.[19] Throughout the late nineteenth and early twentieth centuries, public pensions grew to cover more and more civilian employees.[20] Police officers and firefighters were among the first to be covered, followed by teachers and other public employees.[21] The Kentucky Retirement System and accompanying asset funds were created in 1956, and cover employees of Kentucky state agencies, county governments, and the state police.[22]

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[14] ROBERT L. CLARK ET AL., A HISTORY OF PUBLIC SECTOR PENSIONS IN THE UNITED STATES 1–2 (2003).

[15] *What Is A Pension?*, PENSION BENEFIT GUAR. CORP. (Feb. 26, 2021), pbgc.gov/about/who-we-are/retirement-matters/post/2013/04/17/What-is-a-Pension [https://perma.cc/3Y37-X7W8].

[16] *Id.*

[17] CLARK ET AL., *supra* note 14, at 5.

[18] *Id.* at 2–3.

[19] *Id.* at 4.

[20] *Id.*

[21] *Id.*

[22] KY. REV. STAT. § 61.515.

Private pensions began toward the end of the nineteenth century, nearly a century after the first military pensions.[23] The first private pension plan in the U.S. was established in 1875 by the American Express Corporation.[24] Private plans continued to grow throughout the twentieth century, and companies like Standard Oil, U.S. Steel, AT&T, Eastman Kodak, Goodyear, and General Electric all offered pension plans by 1930.[25] It was the failure of one of these private pension plans that set the stage for ERISA.[26] In 1963, automaker Studebaker closed its South Bend, Indiana production plant.[27] Studebaker's pension plan was too underfunded to pay all of its employees, the vast majority of whom received 15% or less of what they were owed.[28] The Studebaker failure, combined with the 1972 Peabody award-winning documentary "Pensions: The Broken Promise," put the pension issue into the public eye and helped usher in the passage of ERISA in 1974.[29]

B. ERISA and the Pension Benefit Guaranty Corporation

ERISA "sets minimum standards for most voluntarily established retirement and health plans in private industry to provide protection for individuals in these plans."[30] In announcing its declaration of policy, Congress was clear that it saw pensions as a necessary and important aspect of the developing industrial economy:

> The Congress finds that the growth in size, scope, and numbers of employee benefit plans in recent years has been rapid and substantial; that the operational scope and economic impact of such plans is increasingly interstate; that the continued well-being and security of millions of employees and their dependents are directly affected by these plans; that they are affected with a national public interest; that they have become an

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[23] CLARK ET AL., *supra* note 14, at 5.

[24] *Id.*; Melissa Phipps, *The History of the Pension Plan*, THE BALANCE (Jan. 16, 2021), https://www.thebalance.com/the-history-of-the-pension-plan-2894374 [https://perma.cc/LU8F-JTLY].

[25] *Id.*

[26] *ERISA 40 Timeline Alternate*, U.S. DEP'T OF LAB., https://www.dol.gov/featured/erisa40/timeline/alternative [https://perma.cc/NPX2-PA43]; *see also* H.R. Rep. No. 93-779 (1974); Israel Goldowitz, *Funding of Public Sector Pension Plans: What Can Be Learned From the Private Sector?*, 23 CONN. INS. L. J. 143, 155 (2016).

[27] *ERISA 40 Timeline Alternate*, *supra* note 26.

[28] *Id.*

[29] *Id.*

[30] *Employee Retirement Income Security Act (ERISA)*, U.S. DEP'T OF LAB., https://www.dol.gov/general/topic/retirement/erisa#:~:text=The%20Employee%20Retirement%20Income%20Security,for%20individuals%20in%20these%20plans [https://perma.cc/NT9Z-8WV9].

important factor affecting the stability of employment and the successful development of industrial relations . . .[31]

Recognizing the American worker's growing dependence on pensions, Congress decided "to provide a financially self-sufficient program for the guarantee of employee benefits."[32] That protection came in the form of the Pension Benefit Guaranty Corporation, a body corporate within the Department of Labor whose purpose is to maintain the viability of private pension plans, ensure timely and uninterrupted payments, and keep premiums low.[33] The PBGC acts as an insurer to private pension plans.[34] It is not funded by general tax revenues, but by insurance premiums paid by sponsors of defined-benefit plans and by investment income.[35] When a private pension plan fails, the PBGC takes over the plan and maintains uninterrupted payouts to the plan beneficiaries.[36] The amounts received by plan beneficiaries depend on their pension plan's provisions and are subject to federal limits.[37]

Premium calculations are straightforward. PBGC coverage is split between single-employer plans and multiemployer plans.[38] Multiemployer plans are those created between multiple employers in the same industry or sector, and a union.[39] Multiemployer plan premiums are calculated using a per participant rate.[40] The multiemployer premium rate for 2022 is $32 per employee.[41] Single employer plans are divided into two categories for premium calculation purposes.[42] Single employer plans that are fully funded have their premiums calculated on a per participant basis, just like multiemployer plans.[43] The single employer premium rate for these plans in

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[31] 29 U.S.C. § 1001.

[32] 29 U.S.C. § 1001a.

[33] 29 U.S.C. § 1302.

[34] *How PBGC Operates*, PENSION BENEFIT GUAR. CORP., https://www.pbgc.gov/about/how-pbgc-operates [https://perma.cc/U66S-HN4B].

[35] *Id.*

[36] *Id.*

[37] *Id.*

[38] *Multiemployer Insurance Program Facts*, PENSION BENEFIT GUAR. CORP., https://www.pbgc.gov/about/factsheets/page/multi-facts [https://perma.cc/M5FY-YQF8].

[39] *Id.*

[40] *Premium Rates*, PENSION BENEFIT GUAR. CORP., https://www.pbgc.gov/prac/prem/premium-rates (last visited Feb. 23, 2021) [https://perma.cc/X4UQ-9CND].

[41] *Id.*

[42] *Id.*

[43] *Id.*; PENSION BENEFIT GUAR. CORP., Opinion Letter (Aug. 9, 1994), https://www.pbgc.gov/sites/default/files/legacy/docs/oplet/94-4.pdf [https://perma.cc/V2ZU-5D8P] (explaining that fully funded plans are exempt from the variable-rate premium that is applied to underfunded plans).

2022 is $88 per employee.[44] Single employer plans that are not fully funded are subject to a different premium calculation rate called a variable-rate premium.[45] This method assesses a dollar amount for every $1,000 of unfunded vested benefits (UVBs) and is subject to a per participant cap.[46] The 2022 variable-rate premium is $48 per $1,000 of UVBs, and the per participant cap is $598.[47]

Importantly, the PBGC does not cover every private pension plan.[48] Only defined-benefit pension plans (DBPs) are eligible for coverage, because DBPs guarantee a specific payout amount regardless of the pension plan's investment performance.[49] In other words, DBP beneficiaries are legally entitled to their pension payouts, even if the pension plan lacks the funds to make those payments. In contrast, defined-contribution pension plans (DCPs), such as 401(k)s, are not covered by the PBGC because there is no guaranteed payout amount.[50] With a DCP, the payout amount fluctuates with the performance of the pension fund.[51] When the fund performs well, payouts increase; when the fund performs poorly, payouts decrease. DCP beneficiaries are not legally entitled to a specific amount of benefits.[52] And because there is no guaranteed payout amount, there is no need for insurance coverage in the event that payouts fall below a certain threshold.

The PBGC also does not apply to public pension plans.[53] Congress has considered expanding protections to public plans several times, but has never done so.[54] Several reasons have been offered for Congress's refusal to include public pensions in the regulatory scheme, all of which stem from federalism concerns.[55] First, Congress felt that private plans were more

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[44] *Premium Rates*, *supra* note 40.

[45] *Id.*

[46] *Id.*; *How to Determine Unfunded Vested Benefits*, PENSION BENEFIT GUAR. CORP., https://www.pbgc.gov/prac/prem/help/instructions/2012/HowToDetermineUVB.htm [https://perma.cc/3A2P-JBDM].

[47] *Premium Rates*, *supra* note 40.

[48] *Your Guaranteed Pension: Single-Employer Plans*, PENSION BENEFIT GUAR. CORP., https://www.pbgc.gov//wr/benefits/guaranteed-benefits/your-guaranteed-pension [https://perma.cc/83AH-R7CJ].

[49] *Types of Retirement Plans*, U.S. DEP'T OF LAB., https://www.dol.gov/general/topic/retirement/typesofplans [https://perma.cc/53Z4-ADDQ]; Julie Kagan, *Pension Plan*, INVESTOPEDIA (Oct. 3, 2020), https://www.investopedia.com/terms/p/pensionplan.asp [https://perma.cc/8CMJ-MBQ8].

[50] *Types of Retirement Plans*, *supra* note 49; *Your Guaranteed Pension: Single-Employer Plans*, *supra* note 48.

[51] Kagan, *supra* note 49.

[52] *Types of Retirement Plans*, *supra* note 49.

[53] *Employee Retirement Income Security Act (ERISA)*, *supra* note 30.

[54] Amy B. Monahan & Renita K. Thukral, *Federal Regulation of State Pension Plans: The Governmental Plan Exemption Revisited*, 28 ABA J. LAB. & EMP. L. 291, 292, 297 (2013).

[55] *Id.* at 297; Goldowitz, *supra* note 26, at 158–59.

likely than public ones to be subjected to unreasonable restrictions that would prevent employees from vesting.[56] Second, "Congress believed 'the ability of the governmental entities to fulfill their obligations to employees through their taxing power' eliminated much of the need to regulate how pension plans were funded."[57] And third, Congress was concerned that imposing regulations on public pension plans would be too costly to government entities.[58]

C. Growing Pension Assets Attract the Attention of Hedge Funds

Thanks to the bullish equities markets of the 1990s, by the mid- to late-2000s public pension plans had trillions of dollars in assets.[59] In 2004, there were fourteen million workers and six million retirees participating in 2,670 public pension plans.[60] These pension plans accounted for over 10% of the domestic equities market and held over two trillion dollars in assets.[61] That same year, nine of the country's ten largest pension funds were public pension funds.[62]

As the years passed, public pensions continued to grow. Robert Novy-Marx and Joshua D. Rauh, in a 2008 study of 116 state government pensions, concluded that these plans held approximately $1.94 trillion in assets.[63] Local government pensions held an additional $560 billion in assets.[64] In 2009, 126 state and local pension plans (accounting for 85% of the nation's public pension funds) held $2.6 trillion in assets.[65] And by

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[56] Monahan & Thukral, *supra* note 54, at 297.

[57] *Id.* (quoting S. Rep. No. 93-383 (1974); H.R. Rep. No. 93-779 (1974)); *but see* Paul Secunda, *Litigating for the Future of Public Pensions*, 2014 MICH. ST. L. REV. 1353, 1402 (" . . . Congress mistakenly believed in the 1970s that underfunded public pension plans would be bailed out by taxpayers if they encountered financial problems. But with the recent spate of municipal bankruptcies and the significant underfunding of federal, state, and local pension funds, history has shown that the federal government and states are either unwilling or incapable of raising tax revenue to bail out failing pension plans.").

[58] *See* Monahan & Thukral, *supra* note 54, at 297 (quoting H.R. Rep. No. 93-807 (1974)).

[59] David Hess, *Protecting and Politicizing Public Pension Fund Assets: Empirical Evidence on the Effects of Governance Structures and Practices*, 39 U.C. DAVIS L. REV. 187, 188 (2005).

[60] *Id.*

[61] *Id.*

[62] *Id.* at 188 n.2.

[63] Robert Novy-Marx & Joshua D. Rauh, *Public Pension Promises: How Big Are They and What Are They Worth?*, 66 J. FIN. 1211, 1213 (2011).

[64] *Id.* at 1215.

[65] *The Underfunding of State and Local Pensions*, CONG. BUDGET OFF. 1, https://www.cbo.gov/sites/default/files/112th-congress-2011-2012/reports/05-04-pensions.pdf [https://perma.cc/JY6J-HHQ4].

2014, public pensions held over $3.7 trillion in assets.[66]

Given the seemingly limitless amounts of money held by public pension funds, it was only a matter of time before they began attracting the attention of hedge funds. As public pension fund assets increased throughout the 2000s, so too did the share of those funds invested in hedge funds. In 2008, about $380 billion of public pension assets were invested in hedge funds.[67] Over the next six and half years, those funds invested another $70 billion in hedge funds.[68] "As of mid-2014, $450 billion in U.S. public pension assets was invested in hedge funds, and one-fifth of institutional investor capital invested in hedge funds came from public pension plans."[69] The hedge funds "aggressively pursued U.S. public pension dollars," "[a]nd many public pension systems, with encouragement from their investment consultants, have made significant allocations to hedge funds, chasing the promise of superior returns and downside protection."[70]

The hedge funds' pursuit of public pension dollars coincided with and arguably was caused by the Great Recession.[71] As the economic downturn took its toll on tax revenues, states pursued "an unprecedented amount of reform measures to shore up pensions by boosting contributions and cutting benefits."[72] But "'the plan sponsors were less able to pay those higher

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[66] Phillip Vidal, *Annual Survey of Public Pensions: State- and Locally-Administered Defined Benefit Data Summary Report: 2014*, U.S. DEP'T. OF COM., ECON. AND STAT. ADMIN. 2 (July 2015), https://www.census.gov/content/dam/Census/library/publications/2015/econ/g14-aspp-sl.pdf [https://perma.cc/CK8F-R6V6]; *see also* T. Leigh Anenson, *Public Pensions and Fiduciary Law: A View from Equity*, 50 U. MICH. J. L. 251, 252 (2017) (noting that public pension plans held over three trillion dollars in assets).

[67] Miles Johnson, *Profits at a price in the world of hedge funds*, FIN. TIMES (May 26, 2015), https://www.ft.com/content/6252febe-b150-11e4-831b-00144feab7de#axzz3r70lPxrN [https://perma.cc/ZL3U-C9RW].

[68] *Id.*

[69] Parisian & Bhatti, *supra* note 9, at 3.

[70] *Id.* at 1.

[71] *See* Douglas A. McIntyre, *The Sixteen States That Are Killing Their Pensions*, 24/7 WALL ST. (Mar. 9, 2011, 1:16 PM), https://247wallst.com/jobs/2011/03/04/the-sixteen-states-that-are-killing-their-pensions/ ("During a period like the market collapse of 2008, the value of many large pension funds plunged."); *see also* Matt Taibbi, *Looting the Pension Funds*, ROLLING STONE (Sept. 26, 2013, 11:00 AM), https://www.rollingstone.com/politics/politics-news/looting-the-pension-funds-172774/ [https://perma.cc/D8TX-7A3G] ("Five years ago this fall, an epidemic of fraud and thievery in the financial-services industry triggered the collapse of our economy. The resultant loss of tax revenue plunged states everywhere into spiraling fiscal crises, and local governments suffered huge losses in their retirement portfolios . . . .").

[72] Karen Pierog & Daniel Bases, *Battered by Great Recession, underfunded public pensions to persist*, REUTERS (Mar. 26, 2018, 1:16 AM), https://www.reuters.com/article/us-financial-crisis2008-municipals-pensi/battered-by-great-recession-underfunded-public-pensions-to-persist-idUSKBN1H20EG [https://perma.cc/4EU9-2HKY]; *see also NASRA Issue Brief: State and Local*

contributions,'" which "prompted retirement systems to turn to riskier alternative investments such as hedge funds, private equity, real estate and commodities to pad returns. U.S. public pension funds became the biggest risk-takers among pension funds internationally . . ."[73] Sensing blood in the water, the hedge funds swooped in and presented themselves as a solution to state pensions' underfunding woes. State pension funds turned to these "desperate investments" as a means of "'shooting for the moon because they're trying to catch up.'"[74] Scholar Dana Muir presented the issue in plain terms: "[T]he trillions of dollars held in pension plans are an enticing target for intermediaries and service providers who are opportunistic, desperate or just plain greedy."[75] "Wall Street marketers" were given marching orders "'to do anything necessary to win over these government pension officials who control trillions[] . . .'"[76] The plan worked. "[A]s pension funds sought desperately to make up for funding shortfalls, more and more of those trillions of dollars made their way to the country's hedge funds and private equity managers."[77]

Kentucky was no exception. A 2008 report by the Kentucky Public Pension Working Group indicated that Kentucky's public pension system lost an estimated $5 billion over the course of ten years.[78] Desperate for a turnaround, Kentucky turned to hedge funds, committing over a billion

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Government Spending on Public Employee Retirement Systems, NAT'L ASS'N STATE RET. ADM'RS 1 (Dec. 2020), https://www.nasra.org/files/Issue%20Briefs/NASRACostsBrief.pdf [https://perma.cc/5A4F-THZR].

[73] Pierog & Bases, *supra* note 72 (citing Aleksandar Andonov, Rob Bauer & Martijn Cremers, *Pension Fund Asset Allocation and Liability Discount Rates*, REV. FIN. STUD. 35 (Feb. 2017)).

[74] Rivlin, *supra* note 10; *see also* Stephen Fehr, *Market Slide Batters State Pension Funds*, PEW CHARITABLE TR. (Oct. 20, 2008), https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2008/10/20/market-slide-batters-state-pension-funds [https://perma.cc/YD9A-43BK] ("To produce higher yields in their underfunded plans, states gradually have been putting their money into somewhat riskier nongovernmental securities such as stocks, corporate bonds and foreign investments. Some states also have invested in hedge funds, and venture capital funds, or seed money to start a business."); Brian Keeley & Patrick Love, *From Crisis to Recovery: The Causes, Course and Consequences of the Great Recession*, ORG. FOR ECON. CO-OPERATION AND DEV. 78 (2010), https://www.oecd-ilibrary.org/economics/oecd-insights_19936753 (click "From Crisis to Recovery" from the list; then click "READ") [https://perma.cc/L8GE-7HHL] ("Funds could react by looking for alternative investments with better returns (for example, hedge funds or speculating on future commodity prices.")).

[75] Dana M. Muir, *Decentralized Enforcement to Combat Financial Wrongdoing in Pensions: What Type of Watchdogs Are Necessary to Keep the Foxes Out of the Henhouse?*, 53 AM. BUS. L.J. 33, 34 (2016).

[76] Rivlin, *supra* note 10.

[77] *Id.*

[78] *Investments*, KY. PUB. PENSION WORKING GRP. (Oct. 23, 2008), https://finance.ky.gov/initiatives/Documents/pensionref/PublicPensionWorkingGroupDocumentsCompiled.pdf; *see also State pensions have lost $5 billion in 10 years*, ASSOCIATED PRESS (Oct. 19, 2008, 1:05 AM), https://www.kentucky.com/latest-news/article43980546.html [("By relying too heavily on U.S. stocks, Kentucky's public pension systems have lost an estimated $5 billion over the last 10 years, according to a study by a Missouri consulting firm.").

dollars of public pension money to the care of hedge fund managers.[79]

For Kentucky's pension system and other public pension systems all over the country, the hedge fund gamble failed spectacularly. A Roosevelt Institute study of eleven public pension plans' investments in hedge funds concluded that "hedge funds failed to deliver significant benefits to any of the pension funds . . . ."[80] Instead, the hedge funds "collected billions in disproportionately high fees that do not appear to be justified by performance, while costing public pension funds—and the public employees and taxpayers who fund them—additional billions in lost investment revenue."[81] The eleven pension plans suffered "an estimated $8 billion in lost investment revenue" while paying "an estimated $7.1 billion in fees to hedge fund managers over the life of their hedge fund investments; on average, each pension fund paid an estimated $81 million per year in fees to hedge fund managers."[82] "For every dollar of net returns to the pension fund, the average pension fund analyzed paid an estimated 57 cents in fees to hedge fund managers—compared with 5 cents in management fees per dollar of net return for a same-sized total fund portfolio."[83] For one of the studied pension plans, that figure was even worse—the plan paid 72 cents in fees for every dollar of net returns to the fund.[84] The study ultimately concluded that "all 11 pension funds included in our analysis would have performed better having never invested in hedge funds in the first place."[85]

The Roosevelt Institute study was not an outlier. A 2010 study from the Pew Center on the States opened with a sobering look at the issue: "A $1 trillion gap. That is what exists between the $3.35 trillion in pension, health care and other retirement benefits states have promised their current and retired workers as of fiscal year 2008 and the $2.35 trillion they have on hand to pay for them . . . ."[86] Two years later, an updated version of that

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[79] *See* Timothy Inklebarger, *Kentucky hires 3 hedge funds of funds to run $1.2 billion*, PENSIONS & INVS. (Aug. 19, 2011, 1:00 AM), https://www.pionline.com/article/20110819/ONLINE/110819892/kentucky-hires-3-hedge-funds-of-funds-to-run-1-2-billion [https://perma.cc/LQW9-M6JM]; Christine Williamson, *Institutions drop funds of hedge funds for direct hedge fund investments*, PENSIONS & INVS. (Sept. 19, 2011, 1:00 AM), https://www.pionline.com/article/20110919/PRINT/309199978/institutions-drop-funds-of-funds-for-direct-hedge-fund-investments [https://perma.cc/2TS3-HRQP].

[80] Parisian & Bhatti, *supra* note 9, at 1.

[81] *Id.* at 4.

[82] *Id.*

[83] *Id.*

[84] *Id.* at 28.

[85] *Id.* at 4.

[86] *The trillion dollar gap: underfunded state retirement systems and the roads to reform*, PEW CTR. ON THE STATES 1, 15 (Feb. 2010), https://www.pewtrusts.org/-/media/legacy/uploadedfiles/pcs_assets/2010/trilliondollargapunderfundedstateretirementsystemsandtheroadstoreformpdf.pdf

report revealed that the pension gap had grown to $1.38 trillion.[87] A 2017 Pew study found that "the funds with recent and rapid entries into alternative markets—including significant allocations to hedge funds—reported the weakest 10-year returns."[88] A 2018 report by the Maryland Public Policy Institute found that if the state had invested only in stocks and bonds instead of in hedge funds, it would have earned an additional $5 billion over ten years.[89] And a 2020 Pew study found that by 2018, the gap between public pension assets and liabilities had shrunk, but was still an incredible $1.24 trillion.[90]

Again, Kentucky was no exception. A 2015 study of the Kentucky pension system concluded that overexposure to hedge funds, which the study considered to be "among the poorer performing asset classes," led to losses of $1 billion over five years, partly due to high management fees.[91] And the gap between the Kentucky pension system's assets and liabilities only continued to grow. Annual financial reports published by the Kentucky Retirement System over the next decade plus showed unfunded liabilities ranging from $18 billion in 2012[92] to $28 billion in 2020.[93]

As it became more and more clear that hedge funds and other alternative investments were no panacea for failing public pensions, states and pension beneficiaries turned to another avenue for relief: litigation. In a 2014 article, Paul Secunda noted that "there has been a large swath of litigation involving state and local pensions over the last few years, with diverse outcomes."[94] The focus here will be on two cases: *Thole v. U.S. Bank*, decided by the United States Supreme Court, and *Overstreet v.*

[https://perma.cc/5TPL-4YK2].

[87] *The widening gap update*, PEW CTR. ON THE STATES 1, 4 (June 2012), https://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/PewPensionsUpdatepdf.pdf [https://perma.cc/5SKR-7KDY].

[88] *State Public Pension Funds Increase Use of Complex Investments*, PEW CHARITABLE TR. 2 (Apr. 2017), https://www.pewtrusts.org/-/media/assets/2017/04/psrs_state_public_pension_funds_increase_use_of_complex_investments.pdf [https://perma.cc/G2BS-MF9P].

[89] Carol Park & Jeff Hooke, *2018 State Pension Fund Investment Performance Report*, MD. PUB. POL'Y INST. (Apr. 26, 2018), https://www.mdpolicy.org/library/doclib/2018/04/Policy-Report-2018-02.pdf [https://perma.cc/FH32-M28W].

[90] *The State Pension Funding Gap: 2018*, PEW CHARITABLE TR. 1 (June 2020), https://www.pewtrusts.org/-/media/assets/2020/06/statepensionfundinggap2018.pdf [https://perma.cc/ WCH2-4NBB].

[91] *Investment Cost Effectiveness Analysis – Kentucky Retirement System*, CEM BENCHMARKING 10–18 (Sept. 4, 2015), https://assets.documentcloud.org/documents/2423226/kentucky-retirement-systems-consultants-report.pdf [https://perma.cc/B7NM-Q64V].

[92] *2012 Comprehensive Annual Financial Report*, KY. RET. SYS. 23–26 (2012), https://kyret.ky.gov/Publications/Books/2012%20CAFR%20(Comprehensive%20Annual%20Financial%20Report).pdf [https://perma.cc/2FGL-D7GQ].

[93] *2020 Comprehensive Annual Financial Report*, KY. RET. SYS. 21 (2020), https://kyret.ky.gov/Publications/Books/2020%20Annual%20Report.pdf [https://perma.cc/SL3F-FHLW].

[94] Secunda, *supra* note 57, at 1358.

Mayberry, decided by the Kentucky Supreme Court.

D. The Supreme Court Holds That Defined-Benefit Pension Litigants Lack Standing

In June of 2020, the Supreme Court decided *Thole v. U.S. Bank*.[95] *Thole* involved two retiree participants in U.S. Bank's ERISA-governed defined-benefit retirement plan.[96] The defined-benefit distinction was "[o]f decisive importance" to the case since, under that type of plan, "retirees receive a fixed payment each month, and the payments do not fluctuate with the value of the plan or because of the plan fiduciaries' good or bad investment decisions."[97] The Court found that the plaintiffs had received and would continue to receive the pension payments they were owed.[98] Therefore, regardless of the financial health of the company's retirement fund and regardless of the outcome of their case, the Court concluded they had not suffered any injury and therefore had no standing.[99] The plaintiffs had offered four different theories for standing, each of which the Court rejected.[100]

First, the plaintiffs analogized to trust law and argued that they possessed an equitable or property interest in the pension plan so that an injury to the plan was tantamount to an injury to the plan participants.[101] But the Court found that beneficiaries of a defined-benefit retirement plan are not similarly situated to beneficiaries of a trust.[102] In the trust context, the value of the trust property—and thus the value that eventually inures to the beneficiaries—is predicated on the trustee's management of the trust.[103] By contrast, beneficiaries of a defined-benefit retirement plan receive the same value regardless of how well or how poorly the plan's assets are managed.[104] Beneficiaries might not receive that value from the plan itself; the payout might come, for example, from an insurance fund provided by the PBGC. But regardless, one way or another, the beneficiaries will receive their payments, so there could be no injury to support standing.

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[95] 140 S. Ct. 1615 (2020).
[96] *Id.* at 1618.
[97] *Id.*
[98] *Id.*
[99] *Id.* at 1619.
[100] *Id.*
[101] *Id.*
[102] *Id.* (citing Varity Corp. v. Howe, 516 U.S. 489, 497 (1996)).
[103] *Id.*
[104] *Id.*

Second, the plaintiffs argued that they had standing as representatives of the retirement plan itself.[105] The Court rejected this argument because, for the plaintiffs to represent the interests of another, they "still must have suffered an injury in fact, thus giving' them 'a sufficiently concrete interest in the outcome of the issue in dispute.'"[106] And because the plaintiffs would receive their pension payments no matter what, they had no cognizable injury.

Third, the plaintiffs argued "that ERISA affords the Secretary of Labor, fiduciaries, beneficiaries, and participants—including participants in a defined-benefit plan—a general cause of action to sue for restoration of plan losses and other equitable relief."[107] The Court did not buy this argument either. It "rejected the argument that 'a plaintiff automatically satisfies the injury-in-fact requirement whenever a statute grants a person a statutory right and purports to authorize that person to sue to vindicate that right.'"[108] A statutory right to sue is not in itself sufficient; it must be accompanied by an injury, which the plaintiffs could not show.

Lastly, the plaintiffs argued that if they were not allowed to sue in order to police fiduciary misconduct, then plan fiduciaries would be allowed to escape any meaningful regulation.[109] But the Court pointed out that "defined-benefit plans are regulated and monitored in multiple ways."[110] These include employers' and their shareholders' incentives to eliminate fiduciary misconduct; the Department of Labor's statutory authority to enforce ERISA's fiduciary obligations; and the ability of fiduciaries to sue other fiduciaries.[111] But most importantly, the Court pointed out that, in the event that a private defined-benefit plan fails, the PBGC is required by law to step in and pay the retirees' vested pension benefits.[112]

That the plaintiffs' pensions were insured by the PBGC is arguably the sine qua non of the Court's decision, because it guarantees that the plaintiffs will continue receiving their pension benefits, thus precluding any injury. And without an injury, there was no standing. Indeed, according to the congressional findings and declaration of policy, ERISA's purpose is to protect "the interests of participants in private pension plans and their

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[105] *Id.*
[106] *Id.* (quoting Hollingsworth v. Perry, 570 U.S. 693, 708 (2013)).
[107] *Id.* (citing ERISA §§ 502(a)(2), (3), 29 U.S.C. §§ 1132(a)(2), (3)).
[108] *Id.* (quoting Spokeo, Inc. v. Robins, 136 S. Ct. 1540, 1549 (2016)).
[109] *Id.* at 1621.
[110] *Id.*
[111] *Id.*
[112] *Id.*

beneficiaries by improving the equitable character and the soundness of such plans . . . and by requiring plan termination insurance."[113] Congress later expanded on this policy with the Multiemployer Pension Plan Amendments Act of 1980:

> (1) it is desirable to modify the current multiemployer plan termination insurance provisions in order to increase the likelihood of protecting plan participants against benefit losses; and
>
> (2) it is desirable to replace the termination insurance program for multiemployer pension plans with an insolvency-based benefit protection program that will enhance the financial soundness of such plans, place primary emphasis on plan continuation, and contain program costs within reasonable limits.[114]

Thole is premised on pension beneficiaries continuing to receive their benefits regardless of what happens to the pension fund.[115] For private, defined-benefit plans subject to ERISA, this ensured plan continuance comes from the PBGC. If the Court's reasoning in *Thole* is to be applied in other contexts, there must be some mechanism through which pension beneficiaries continue to receive their defined-benefit payouts, even if that mechanism is not the PBGC.

E. The Kentucky Supreme Court Holds That Defined-Benefit Pension Litigants Lack Standing

A little over a month after the Supreme Court announced its decision in *Thole*, the Kentucky Supreme Court announced its decision in a similar case, *Overstreet v. Mayberry*.[116] *Overstreet* involved a group of plaintiffs who were members of defined-benefit pension plans in the Kentucky Retirement System.[117] The plaintiffs sued hedge fund sellers, actuarial and investment advisors, and officers and trustees of the Kentucky Retirement System alleging that the defendants were aware that the pension plans were at risk of default but chose to hide the truth and play catch up by investing

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[113] 29 U.S.C. § 1001.

[114] 29 U.S.C. § 1001(a).

[115] *Thole*, 140 S. Ct. at 1618–19.

[116] 603 S.W.3d 244 (Ky. 2020).

[117] *Id.* at 250; *see also Kentucky Workers Suing Hedge Funds to Recover Pension Losses*, ASSOCIATED PRESS (Dec. 27, 2017), https://wfpl.org/kentucky-workers-suing-hedge-funds-to-recover-pension-losses/ [https://perma.cc/X48X-66KS].

plan assets in high-risk "Black Box" hedge funds.[118] Thus, the backdrop of the case was similar to *Thole*: a group of plaintiffs whose pension funds had lost significant value and who sought to restore those assets by suing the plans' various fiduciaries.

Analogizing to ERISA and borrowing heavily from *Thole*, the *Overstreet* court reached the same conclusion as the Supreme Court, and for essentially the same reason: "If Plaintiffs here had not received their vested monthly pension benefits, they would certainly have the requisite injury in fact to support standing. But Plaintiffs at this point have received and will continue to receive all their monthly pension benefits."[119] Nevertheless, like the plaintiffs in *Thole*, the *Overstreet* plaintiffs in their briefs and oral argument offered several reasons to support their standing to sue.

First, like the *Thole* plaintiffs, the *Overstreet* plaintiffs argued that they had standing "in a *representational* or *derivative* capacity on behalf of KRS and the Commonwealth."[120] The court borrowed from ERISA and *Thole* and rejected that argument: ". . . the Supreme Court in *Thole* recently rejected this exact argument in the context of participants in an ERISA defined-benefit plan, who did not themselves have an injury in fact, asserting claims on behalf of the plan."[121] The *Overstreet* plaintiffs also argued that they were statutorily authorized to bring claims on behalf of the Kentucky Retirement System.[122] Again borrowing from ERISA, the court rejected this argument on the basis that, even with statutory authority to sue in a representative capacity, plaintiffs must nevertheless have suffered an injury to themselves: ". . . ERISA participants are unquestionably authorized to bring suits on behalf of the plan for fiduciary misconduct under the ERISA enforcement provision, § 502(a)(2), but courts repeatedly dismiss suits brought under that provision because the participants failed to show an injury particular to themselves."[123]

Second, again like the *Thole* plaintiffs, the *Overstreet* plaintiffs argued

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[118] *Overstreet*, 603 S.W.3d at 250, n.3. The plaintiffs, in their original Complaint, defined "Black Box" hedge funds: "'Black Box' hedge funds are vehicles where the 'investor' knows little if anything about the contents of the vehicle or how the money is being 'invested.' This secrecy is usually based on a claim by the hedge fund seller/manager that the methods, strategies and fees of the fund are sophisticated, secret and successful and thus are claimed to be proprietary and cannot be disclosed for fear of losing claimed competitive advantages." Complaint, *Mayberry v. KKR, et al.*, No. CI-17-1348, at *18, http://wfpl.org/wp-content/uploads/2017/12/367973905-Mayberry-v-KKR-KRS-lawsuit.pdf [https://perma.cc/5DN4-H5YF].

[119] *Overstreet*, 603. S.W.3d at 252–53.

[120] *Id.* at 257.

[121] *Id.* (citing Thole v. U.S. Bank, 140 S. Ct. 1615, 1620 (2020)).

[122] *Id.* at 260.

[123] *Id.* at 260–61.

they had standing as trust beneficiaries.[124] The court again leaned on ERISA jurisprudence and held that the standing-via-trust-beneficiaries argument "has squarely been rejected in the context of ERISA plans by federal circuits and, recently, the Supreme Court, because participants in a defined-benefit plan possess no equitable or property interest in the plan assets."[125] And without an interest in the plan assets, there can be no injury when those assets are mismanaged.[126]

Third, the *Overstreet* plaintiffs argued they had standing as taxpayers of the Commonwealth of Kentucky.[127] Specifically, they argued that billions of taxpayer dollars were wasted when that money was paid into the Kentucky pension system, and that there will be "future costs to the Commonwealth in [the form of] otherwise avoidable taxpayer-funded payments to KRS to make up for the alleged misconduct."[128] The court remained unconvinced. It noted that while taxpayer suits in Kentucky had historically been permitted, such suits were against government bodies or their agents, whereas the *Overstreet* plaintiffs were suing "private third parties and KRS officials in their individual capacities."[129]

Lastly, the plaintiffs argued "that they *themselves* have a direct injury because the Defendants' collective actions substantially increased the risk that their benefits will be denied in the future."[130] The court rebutted that argument by relying on the distinction between defined-benefit and defined-contribution plans, just as the *Thole* court had done.[131] Since the plaintiffs were members of defined-benefit plans, in which "'the payments do not fluctuate with the value of the plan or because of the plan fiduciaries' good or bad investment decisions,'"[132] "any alleged mismanagement of the KRS plan has no direct bearing on whether the KRS-member Plaintiffs in this case will receive their vested monthly retirement payments."[133] Instead, the plaintiffs argued that the injury they suffered was not the loss of their pension payments, but the risk of future loss.[134] The court again turned to ERISA to reject this theory as too speculative:

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[124] *Id.* at 261.
[125] *Id.*
[126] *Id.*
[127] *Id.* at 263.
[128] *Id.*
[129] *Id.* at 264.
[130] *Id.* at 253.
[131] *Id.*
[132] *Id.* (quoting Thole v. U.S. Bank, 140 S. Ct. 1615, 1618 (2020)).
[133] *Id.*
[134] *Id.*

> In the context of private ERISA defined-benefit pension plans, similar increased-risk standing arguments have been rejected as too speculative largely because even mismanagement that results in severe underfunding still requires the realization of several additional risks beyond plan termination before beneficiaries are denied their benefits. . . . And even in the event the employer is unable to cover the underfunding, "the impact on participants is not certain since the PBGC provides statutorily-defined protection of participants' benefits."[135]

The court also referenced *Thole* in rejecting the plaintiffs' risk of future injury theory: "The [*Thole*] Court did, however, suggest in a footnote that the plaintiffs might not even have standing in the event both the plan and employer were to fail because, in that scenario, 'the PGBC would be required to pay these two plaintiffs all of their vested pension benefits in full.'"[136] The implication seems to be that multiple layers of protection are unnecessary as long as some mechanism exists to guarantee uninterrupted pension payouts.[137]

The Kentucky Supreme Court recognized that ERISA and the PBGC had limited application in the context of *Overstreet* because they only apply to private pension plans.[138] Nevertheless, it concluded that the result should be the same as in *Thole* because, in both cases, there is a mechanism to protect defined-benefit plan beneficiaries and ensure continued payment of their benefits. In *Thole*, that mechanism is the PBGC. In *Overstreet*, it is the taxpayers of Kentucky:

> . . . Plaintiffs in this case have not alleged that the Commonwealth will be unable to cover the shortfall by increasing its contribution to the system or that, in the event of plan termination, the Commonwealth would be unable to pick up the tab directly. In sum, Plaintiffs have only alleged that the plan mismanagement increases the relative likelihood that the Commonwealth—*an entity with taxing authority* and the inability to avoid

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[135] *Id.* at 254–55 (quoting Lee v. Verizon Communs., Inc., 837 F.3d 523, 545 (5th Cir. 2016); Clapper v. Amnesty Int'l USA, 568 U.S. 398, 409 (2013)).

[136] *Id.* at 256 (quoting *Thole*, 140 S. Ct. at 1622 n.2).

[137] The Kentucky Supreme Court also pointed to another Supreme Court case, *LaRue v. DeWolff, Boberg & Assocs.*, and its assertion "that the risk of plan default is what 'prompted Congress to require defined benefit plans . . . to make premium payments to the Pension Benefit Guaranty Corporation for plan termination insurance.'"[137] Thus, the *LaRue* court was not convinced that pension plan default constituted an injury to pensioner plaintiffs "because of the effect of the PBGC." *Id.* (quoting LaRue v. DeWolff, Boberg & Assocs., 552 U.S. 248, 255 (2008)).

[138] *Id.* at 263. "Our decision today borrows heavily from the analysis of *Thole* and other federal circuit cases discussing the *constitutional standing* of beneficiaries in defined-benefit plans governed by ERISA . . . We recognize that ERISA does not apply to government plans, including KRS."

> its obligations through bankruptcy—will eventually have to fund the KRS plan's actuarial shortfall or pay Plaintiffs their benefits directly.[139]

But when defined-benefit pension plans are at risk of collapsing because hedge funds have engaged in risky gambling with plan assets, it is unfair to expect taxpayers to step up and insure them. Fairness demands that the burden of insuring those plans falls on those responsible for managing them. Forcing taxpayers to do so has severe and long-lasting consequences on state and local governments' ability to meet the demands of their citizens, because those governments are forced to redirect much needed public funds to cover their pension obligations.

F. An Expanded View of Taxpayers as Insurers

Scholars have long observed that taxpayers are seen as the primary funding mechanism for public pension plans. "While state governments are arguably a good credit risk and may find ways to finance the retirement of their workers from other public resources, taxpayers ultimately suffer the repercussions of poorly performing public pension funds."[140] Indeed, "[t]he demise of public retirement systems will extend beyond the financial deprivation of individual pension plan participants and their families. Failed (and failing) pensions will adversely impact all state citizens. Taxpayers will share the burden of plan insolvency when states raise taxes to cover pensions."[141] Moreover, public pension plans cannot "reduce equity risk by spreading it over a finite number of different taxpayer generations. . . . If one generation bears a lesser share of risk than of risk premiums, another must bear more risk. An intergenerational transfer of risk, and thus of value, must occur."[142] In other words, it is unfair to saddle current taxpayers with the burden of mismanaged public pension plans. But it is even more unfair to extend that burden to future generations of taxpayers.

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[139] *Id.* at 256 (emphasis added).

[140] Karen E. Lahey & T. L. Anenson, *Public Pension Liability: Why Reform Is Necessary to Save the Retirement of State Employees*, 21 NOTRE DAME J.L. ETHICS & PUB. POL'Y 307, 308 n.12 (2007) (citing *The Other Pension Crisis,* WALL ST. J. (Aug. 18, 2006), at A14 ("Public pensions only have one source of money—the taxpayer.")).

[141] T. Leigh Anenson, *supra* note 66, at 270–71 (citing T. Leigh Anenson, Alex Slabaugh & Karen Eilers Lahey, *Reforming Public Pensions*, 33 YALE L. & POL'Y REV. 1, 6 (2014)); *see also* Paul Rose, *Public Wealth Maximization: A New Framework for Fiduciary Duties in Public Funds*, 18 U. ILL. REV. 891, 894 (2018) (explaining that, for public pension plans, "the government and taxpayers . . . bear almost all of the risk should a public fund fail.").

[142] Lawrence N. Bader & Jeremy Gold, *The Case Against Stock in Public Pension Funds*, 63:1 FIN. ANALYSTS J. 58 (Jan./Feb. 2007).

This is particularly true when insolvencies stem from underlying high-risk asset investments.[143] Investing pension fund assets in high-risk securities like hedge funds can potentially lead to increased returns, but those returns "would be obtained by imposing added risk on taxpayers."[144] And "even if those losses would not immediately result in higher taxes or reduced government services, the losses from a reduction in the market value of assets are equivalent to borrowing from the pension plan, and that debt eventually would need to be repaid."[145] The responsibility for those repayments will inevitably fall on current and future taxpayers, despite the fact that they contributed nothing to the mismanagement that led to the pension fund insolvency. That taxpayers are the ones left holding the bag when governments are forced to increase pension fund contributions is largely a consequence of the legal frameworks governing state pension plans:

> The legal framework that governs state pension plans—the constitutional and statutory provisions and the legal precedents that are applicable—suggests that, in most states, increases in contributions to address underfunding will probably be borne by employers, not employees. Larger government contributions, in turn, will need to be financed either by raising taxes or by reducing other spending by state and local governments (including employees' salaries). Alternatively, managers of pension plans can seek faster growth in their assets through higher expected returns by increasing the share of risky assets in their portfolios. Whether that strategy is good public policy has been the subject of debate.[146]

If "trustees make poor investment decisions, the result often is simply that future taxpayers will have to contribute additional amounts to the plan."[147] And while requiring taxpayers to contribute to certain

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[143] *Economic and Budget Issue Brief: The Underfunding of State and Local Pensions*, CONG. BUDGET OFF. 5 (May 2011), http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/ doc12084/ 05-04-pensions.pdf [https://perma.cc/9SNE-5FYL].

[144] *Id.* at 6.

[145] *Id.* at 16n.22.

[146] *Id.* at 8 (citing Bader & Gold, *supra* note 142, at 55–62); *see also* Deborah J. Lucas & Stephen P. Zeldes, *How Should Public Pension Plans Invest?*, 99:2 AM. ECON. REV. (PAPERS AND PROC.) 527–32 (May 2009).

[147] Thomas J. Fitzpatrick IV & Amy B. Monahan, *Who's Afraid of Good Governance? State Fiscal Crises, Public Pension Underfunding, and the Resistance to Governance Reform*, 66 FLA. L. REV. 1317, 1321 (May 2014) (citing KATELIN P. ISAACS, CONG. RES. SERV., 98-810, FEDERAL EMPLOYEES' RETIREMENT SYSTEM: BENEFITS AND FINANCING 10 (2012), http://www.fas.org/sgp/crs/misc/98-810.pdf [https://perma.cc/K6MZ-J97F]) (explaining that taxpayers "are the 'ultimate guarantors' of public pension funds"); *see also* Mark Daniels, *Pensions in Peril: Single Employer Pension Plan Terminations in the Context of Corporate Bankruptcies*, 9 HOFSTRA LAB. & EMP. L.J. 25, 110 (1991)

governmental expenditures is far from controversial, "[i]t is harder . . . to justify imposing the costs of current state consumption on future taxpayers who will receive no corresponding benefit."[148] This is especially true when a taxpayer bailout was caused by reckless, high-risk investments made by financial intermediaries who used state pension fund assets as free money, and then cut and run when the funds began to fail.

Shifting the burden for unfunded pension liabilities to taxpayers may seem insignificant considering that the cost is spread among the state's entire tax base, but Kentucky's defined-benefit pension funds are so underfunded that the per capita cost of restoring them is substantial. Kentucky ranks 46th out of the 50 U.S. states in fiscal health, and "[l]ong-term liabilities are higher than the national average, at 138 percent of total assets, or $9,960 per capita."[149] Unfunded pension liabilities are estimated to be as high as $32.66 billion.[150] And Kentucky is not alone. According to a 2010 paper by Joshua Rauh, thirty-one states could see their pension funds run dry by 2025.[151]

Preventing insolvencies will require taxpayers to increase contributions, in some states by significant amounts: "state revenues might have to increase by twenty percent in Indiana and by thirty-five percent in Illinois and New Jersey. Colorado, which could see its pension reserves exhausted by 2022, would at that point require potential tax increases of over fifty percent to avoid defaulting on its pension obligations."[152] What does this mean in concrete terms for public employees? To answer, we can view unfunded pension liabilities in terms of how much more money those employees would have to contribute to the plan in order to meet a state's unfunded pension liabilities. As of 2015, Kentucky workers would have had to increase their pension contributions by a whopping 435% in order to

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("In light of [an unfunded pension plan] bailout, it would not take great imagination to envision a public bailout of the pension plan deficit by shifting the burden to taxpayers."); Julia L. Coronado et al., *Public Funds and Private Capital Markets: The Investment Practices and Performance of State and Local Pension Funds*, 56 NAT'L TAX J. 579, 581 (2003) (noting that taxpayers are the ones "ultimately liable for sub-par returns").

[148] Fitzpatrick & Monahan, *supra* note 147, at 1326 (citing Anna Gelpern, *Bankruptcy, Backwards: The Problem of Quasi-Sovereign Debt*, 121 YALE L.J. 888, 907 (2012)).

[149] Eileen Norcross & Olivia Gonzalez, *Ranking the States by Fiscal Condition*, MERCATUS CTR., GEORGE MASON UNIVERSITY 111 (2018), https://www.mercatus.org/system/files/norcross-fiscal-rankings-2018-mercatus-research-v1.pdf [https://perma.cc/8LGW-Q5R4].

[150] *Id.*

[151] Joshua D. Rauh, *Are State Public Pensions Sustainable? Why the Federal Government Should Worry About State Pension Liabilities,* 62 NAT'L TAX J. 585, 586 (2010), http://ntj.tax.org/wwtax/ntjrec.nsf/FB6C0589369AA873852577A8003FB784/$FILE/Article%2008Rauh.pdf.

[152] Terrance O'Reilly, *A Public Pensions Bailout: Economics and Law*, 48 U. MICH. J.L. REFORM 183, 186 (2014) (citing *id.* at 585).

meet the Commonwealth's unfunded liabilities.[153]

In sum, forcing taxpayers to bear the cost of shoring up pensions that are failing because of someone else's risky gambling will leave "states, and tomorrow's taxpayers, in even worse shape, since every dollar needed to feed that growing liability cannot be used for education, health care or other state priorities."[154]

II. ANALYSIS

A. Reform Proposals for Public Pensions

Given the magnitude of the public pension crisis, it is unsurprising that several proposals have been introduced to address the problem. However, a survey of these prior proposals reveals a variety of issues ranging from obstinance to opportunism.

Terrance O'Reilly has suggested a federal bailout of ailing public pensions.[155] O'Reilly urges the federal government to "accept that it may be called upon to provide financial aid to several sizable public pension plans and act to meet the crisis on its own terms."[156] He posits that such a federal rescue is both likely and desirable.[157] But he also recognizes implicit obstacles to such a substantial undertaking.[158] Congress has repeatedly said that the federal government will not bail out public pension plans.[159] A federal bailout would be controversial and distinguishable from past bailouts of banks and auto manufacturers.[160] Moreover, many state and local governments would oppose any federal interference in their pension

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[153] Robert C. Pozen, *New tax law means fighting over unfunded state pension plans is about to get worse*, BROOKINGS INST. (Jan. 11, 2018), https://www.brookings.edu/opinions/new-tax-law-means-fighting-over-unfunded-state-pension-plans-is-about-to-get-worse/ [https://perma.cc/PE72-WLU9].

[154] *The trillion dollar gap*, *supra* note 86, at 7.

[155] *See generally* O'Reilly, *supra* note 152.

[156] *Id.* at 188.

[157] "A federal bailout of public plans will be controversial but, in the end, some sort of federal financial support is likely. . . . Only the federal government has sufficient financial resources and legal authority to assure that the most seriously underfunded pension plans do not default." *Id.* at 187–88.

[158] *Id.* at 186–89.

[159] *See, e.g.*, Press Release, Senator John Thune, Burr, Coburn, Thune Introduce Public Employee Pension Transparency Act (Apr. 22, 2013), https://www.thune.senate.gov/public/index.cfm/2013/4/burr-coburn-thune-introduce-public-employee-pension-transparency-act [https://perma.cc/RA6Y-NHNW] (noting that the proposed bill "prevents a federal bailout of state and local government pension plans . . .").

[160] O'Reilly, *supra* note 152, at 187 (citing David A. Skeel Jr., *States of Bankruptcy*, 79 U. CHI. L. REV. 677, 704–05 (2012)).

systems,[161] and are instead enacting pension reform measures of their own.[162] Thus, state and local governments should not expect the federal government to come to the rescue any time soon.

Other scholars have proposed action at the state level. Richard Mendales has advocated for a uniform model code to govern state public pension plans.[163] The code would provide for common funding, investment, and administration of state plans and would borrow from ERISA "to protect the funds and their beneficiaries."[164] To incentivize states to adhere to the code, it would include "a common emergency fund created as a backup for each state fund, somewhat like the federal PBGC."[165] The fund would be gradually built up with contributions from state and local pension funds.[166] But given the realities of political divisions and parochial interests, it is unlikely that states—especially those with well-funded pension systems—would agree to a uniform code or contribute to a common fund to help underfunded pension systems in other states.

Between these two ends of the spectrum lies a hybrid approach. Paul Secunda has advocated for a more "incremental approach based on informal arrangements between the states, as interstate compacts would require federal involvement, which would complicate state pension plan regulation unnecessarily."[167] Secunda would blend the federal and state models, expanding ERISA to cover federal employees and encouraging states to adopt uniform public pension laws.[168] His hybrid approach also contemplates future creation of a PBGC for public pension plans.[169]

Finally, T. Leigh Anenson et. al. offer a comprehensive set of reforms

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[161] *The Role of Public Employee Pensions in Contributing to State Insolvency and the Possibility of a State Bankruptcy Chapter: Hearing Before the Subcomm. on Courts, Commercial and Administrative Law of the H. Comm. on the Judiciary*, 112th Cong. 6–7 (2011) (testimony of Keith Brainard, Research Director, National Association of State Retirement Administrators), https://www.nasra.org/files/Presentations%20Testimony/Brainard02142011.pdf [https://perma.cc/CG27-GJEW] ("*State and local government retirement systems do not require, nor are they seeking any Federal financial assistance. . . .* '[T]he great strides made in the ability of state and local government retirement systems to ensure that more than 20 million working and retired public employees have financial security in retirement have been achieved without Federal intervention. One-size-fits-all Federal regulation is neither needed nor warranted and would only inhibit recovery efforts already underway at the state and local levels.'").

[162] O'Reilly, *supra* note 152, at 188.

[163] *See generally* Richard Mendales, *Federalism and Fiduciaries: A New Framework for Protecting State Benefit Funds*, 62 DRAKE L. REV. 503 (2014).

[164] *Id.* at 512.

[165] *Id.* at 540.

[166] *Id.* at 541.

[167] Secunda, *supra* note 57, at 1405.

[168] *Id.* at 1360–61.

[169] *Id.* at 1406.

that are also spread between the federal and state levels.[170] They include mandatory pension funding; amending balanced budget requirements; adopting uniform state laws governing public pensions; and barring union activity in certain circumstances.[171] Notably, while they recommend against placing state public pensions under the purview of the PBGC, they do entertain the possibility of "a *state* PBGC-type program," recognizing that "insuring defined benefit pensions against default (albeit at a reduced rate) would provide public employees some retirement security while simultaneously allowing states considerable cost savings in the long-run."[172]

III. RESOLUTION

A state PBGC-like program could help reassure Kentucky pension beneficiaries of their continued payments even in the event of plan insolvency. It would also provide relief to Kentucky taxpayers by eliminating the need for sudden and substantial new tax revenues to fund failing pensions. In other words, because Kentucky defined-benefit pension plan payouts must be satisfied, there must be a mechanism to ensure continued payouts in the event that the pension funds become insolvent.[173] And fairness dictates that the mechanism not simply be the taxpayers' pocketbooks. A state agency modeled on the PBGC—the Kentucky Pension Assurance Agency (KYPAA)—would help insure the various pension funds so that, in the event of insolvency, payouts to Kentucky pension beneficiaries would continue uninterrupted.[174]

A. The Kentucky Pension Assurance Agency (KYPAA)

At the outset, it is important to note that KYPAA would not solve the pension crisis overnight. It takes a long time to dig a $28 billion hole, and it will probably take just as long, if not longer, to replenish Kentucky's

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[170] T. Leigh Anenson, Alex Slabaugh & Karen Eilers Lahey, *supra* note 141, at 35.

[171] *Id.*

[172] *Id.* at 62 (emphasis added).

[173] See discussion of defined-benefit pension plans, *supra* section I.B.

[174] There is already a Kentucky Retirement Systems Insurance Trust Fund, but its name belies its purpose. The fund does not insure the assets of the Kentucky pension plans to ensure uninterrupted payments, it merely serves as a separate trust for health and accident reimbursement payments in accordance with 26 U.S.C. §§ 105–106. There is also a Kentucky pension unfunded liability trust fund (KY. REV. STAT. § 61.706), but this consists of gifts and contributions that go towards eliminating unfunded liabilities. It is not a robust insurance policy; it is a means through which private charity can contribute to alleviating the underfunding.

pension funds to pre-2008 levels. It would be virtually impossible for KYPAA to erase a $28 billion deficit no matter how aggressive its funding mechanism is. But that process must start somewhere, and installing an agency to insure pension funds that are at risk of failing, without putting the onus on taxpayers, is a good place to begin.

A state agency modeled on the PBGC would also avoid many of the pitfalls of other reform proposals discussed above. Placing the agency within the apparatus of state government would circumvent the inevitable issues, both political and administrative, of a federally imposed overhaul. Kentucky taxpayers are more likely to accept an organic solution proposed by their own locally elected officials than a top-down approach from a committee of Washington bureaucrats. And unlike a uniform model code or common insurance fund that is shared among states, an internal state agency like KYPAA would be insulated from charges of outside influence or smash-and-grab politicians.

A new agency may seem a dramatic response to the pension crisis. But other approaches are either demonstrably worse, or politically impractical. For example, in 2017, former Kentucky Governor Matt Bevin proposed a sweeping pension reform bill that would have shifted the state's pension plans from a defined-benefit system to a defined-contribution system more akin to a 401(k).[175] But a financial analysis of that proposal revealed that, over the long term, the reforms "would have cost state taxpayers more money while providing fewer benefits for retirees."[176] This was partly due to the economic incentives created by the plan.[177]

A proposal directly addressing or banning hedge funds is also unlikely. The Kentucky pension system's former Deputy Chief Investment Officer

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[175] Ryland Barton, *Governor Matt Bevin's Pension Proposal Is Out. Here's How It Will Affect Kentuckians*, WFPL (Oct. 29, 2017), https://wfpl.org/gov-matt-bevins-pension-proposal-is-out-heres-how-it-will-affect-kentuckians/ [https://perma.cc/86UW-2Y2S].

[176] Michael Katz, *Kentucky Analysis Dispels Myth of 401Ks as Pension Saviors*, CHIEF INV. OFFICER (Dec. 26, 2019), https://www.ai-cio.com/news/kentucky-analysis-dispels-myth-401ks-pension-saviors/ [https://perma.cc/6MCJ-DNGZ].

[177] Letter from Joseph P. Newton, Janie Shaw & Daniel J. White, Consultants, Gabriel Roeder Smith & Co., to John E. Chilton, Budget Director, Office of State Budget Director 2 (Nov. 14, 2017), https://governor.ky.gov/attachments/GRS-Actuarial-Analysis.pdf [https://perma.cc/E56J-R75B] ("However, it is unlikely that most of the potential savings will be realized as it is likely the System will experience an increase in the number of retirements when a member becomes first eligible for an unreduced retirement benefit as the new provisions provide a large economic incentive for the member to retire at first eligibility and seek other employment.") Former Governor Bevin first commissioned this report in 2017 but then blocked it from being made public. Tom Loftus, *Kentucky Supreme Court rules against Matt Bevin in pension open records case*, COURIER-JOURNAL (June 5, 2019, 6:29 AM), https://www.courier-journal.com/story/news/politics/2019/06/05/kentucky-pension-crisis-bevin-loses-appeal-open-records-case/1340174001/ [https://perma.cc/2GDD-C8SB].

and Director of Absolute Return, Christopher Schelling, published two memos on the Kentucky Retirement System website: "The Role of Hedge Funds,"[178] and "In Defense of Private Equity."[179] As their names suggest, these memos defend the inclusion of hedge funds in public pension portfolios, maintaining that hedge funds' reputation as a high-risk investment vehicle is unfounded and that a healthy hedge fund allocation "actually helps in lowering the total portfolio risk[.]"[180] The Kentucky pension system is thus unlikely to surrender its hedge fund investments any time soon. Therefore, a practical solution will recognize the political reality that hedge funds are here to stay. It should be designed to work in tandem with, rather than against, the investment allocations of a typical public pension portfolio.

Enter KYPAA. To understand how KYPPA will operate, an overview of the Kentucky pension system is necessary. The Kentucky Public Pensions Authority is the umbrella agency that administers three separate systems.[181] First, the County Employees Retirement System (CERS) includes "local governments (county and city), school boards, and eligible local agencies."[182] It is further divided into hazardous and non-hazardous pension plans.[183] Second, the Kentucky Employees Retirement System (KERS) includes "state departments, boards, and employers directed by Executive Order of the Governor to participate in KERS."[184] It too is divided into hazardous and non-hazardous plans.[185] Finally, the State Police Retirement System (SPRS) "covers all full-time Kentucky State Police troopers."[186] Each of these systems has its own set of pension funds with their own asset allocations.[187] Pensioners within each system fall into one of three "benefit tiers," which determines pension and insurance benefits based

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[178] Christopher M. Schelling, Deputy Chief Investment Officer, Director of Absolute Returns, KY. RET. SYS., *The Role of Hedge Funds* (June 4, 2014), https://kyret.ky.gov/Investments/Investment %20Educational%20Resources/TheRoleofHedgeFunds.pdf [https://perma.cc/RM6V-8285].

[179] Christopher M. Schelling, Deputy Chief Investment Officer, Director of Absolute Returns, KY. RET. SYS., *In Defense of Private Equity* (June 17, 2014), https://kyret.ky.gov/Investments/Investment %20Educational%20Resources/InDefenseofPrivateEquityFinal.pdf [https://perma.cc/F8CT-TEYN].

[180] *The Role of Hedge Funds*, *supra* note 178, at 1.

[181] *Summary Annual Financial Report 2020*, *supra* note 93, at 7.

[182] *Id.*

[183] *Id.*

[184] *Id.*

[185] *Id.* at 8.

[186] *Id.* at 7.

[187] Memorandum from Richard Robben, Executive Director of Investments, to KRS Board of Trustees (May 16, 2019), https://kyret.ky.gov/Investments/CIO%20Investment%20Committee %20Summary/Investment%20Committee%20Update%20May%2016th%202019.pdf [https://perma.cc/ 5XBC-CTD6].

on the member's participation date.[188]

Each pension plan is managed and funded separately from the others. The Pension Authority's 2021 Investment Policy Statement "recognizes that each plan and any underlying fund has its own capacity to tolerate investment volatility, or risk."[189] Therefore, assets are allocated on a system-by-system basis.[190] Investment decisions are made by an Investment Committee, but the committee may "employ the services of an external Investment Manager[.]"[191] These Investment Managers are often responsible for steering the plans towards the hedge funds and other high-risk alternative investments that precipitated the pension crisis.[192]

KYPPA will borrow for its structure and operation from both the PBGC and the Pension Authority. The PBGC maintains multiple funds for the various categories of pension benefits it insures (single employer, multiemployer, etc.).[193] KYPAA will adopt the same approach, maintaining a separate fund for each pension plan within the Pension Authority. Thus, there will be an insurance fund for the CERS Hazardous Plan, an insurance fund for the CERS Non-Hazardous Plan, an insurance fund for the KERS Hazardous Plan, etc.

Where KYPAA and the PBGC diverge will be their funding mechanisms. Whereas the PBGC is funded through premiums paid by company sponsors of pension plans, KYPAA will be funded (partly) by the Investment Managers as a condition of their being awarded management contracts with the Commonwealth. Tasking the Investment Managers with funding KYPAA will further the principle of fairness by minimizing the cost to taxpayers of poor management or risk taking. The amount that each Investment Manager pays into a KYPAA fund will be calculated on a per participant basis, like the PBGC. But unlike the PBGC, the per participant rate will vary from Manager to Manager based on the percentage of the assets of the pension fund that the Manager is granted control over. The rate will be calculated by multiplying that percentage number by the total number of participants in the plan. For example, the KERS Non-Hazardous Plan has 123,857 members.[194] If the Pension Authority grants an

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[188] *Summary Annual Financial Report 2020*, *supra* note 93, at 7.

[189] *Investment Policy Statement*, KY. RET. SYS. 4 (Nov. 16, 2021), https://kyret.ky.gov/Investments/Investment%20Policies/KRS%20Investment%20Policy%20Statement.pdf [https://perma.cc/P3QE-7U53].

[190] *Id.*

[191] *Id.* at 3.

[192] Inklebarger, *supra* note 79.

[193] 29 U.S.C. § 1305.

[194] *Summary Annual Financial Report 2021*, KY. PUB. PENSIONS AUTHORITY 7, https://kyret.ky.gov/Publications/Books/2021%20SAR%20(Summary%20Annual%20Report).pdf (last

Investment Manager control of 7% of the assets in the KERS Non-Hazardous Plan, that Investment Manager would pay $866,999 (123,857*7) into KYPAA's KERS Non-Hazardous Plan insurance fund.

Thus, each Investment Manager's contribution will be commensurate with the amount of assets it controls and, by extension, with the potential amount of management fees it stands to earn from the Commonwealth. The more pension fund money that an Investment Manager is given control over, the higher its contribution to KYPAA must be. But that same Investment Manager also stands to earn more in fees since it manages more money. Therefore, despite being required to make an initial contribution to KYPAA before gaining access to pension funds, each Investment Manager maintains the incentive to perform well, since the management fees it will earn are tied to the performance of its investment decisions.

It is difficult to use current Investment Managers and asset percentages to formulate examples of this method of calculating contributions because information regarding asset amounts, asset classes, investments, and commitment periods is almost always redacted from the Investment Manager contracts.[195] There are currently 72 Investment Manager contracts listed on the Pension Authority website, but a review of those contracts reveals no information about how much pension money a particular Manager has control over, what the commitment period is, or which pension plan the funds came from.[196]

Again mimicking the PBGC, once initial contributions to KYPAA are made, the money will be invested so that the insurance funds can grow over time. Warren Buffet's investing methodology provides a good starting point: "'Rule Number One: Never Lose Money. Rule Number Two: Never Forget Rule Number One.' Don't be frivolous. Don't gamble. Don't go into an investment with a cavalier attitude that it's okay to lose."[197] In other

visited Jan. 10, 2022) [https://perma.cc/HY84-59YL].

[195] *See Investment Manager Contracts*, KY. PUB. PENSIONS AUTH., https://kyret.ky.gov/Investments/Investments-Library/Pages/Investment-Manager-Contracts.aspx [https://perma.cc/JU9V-CS9F] ("Please note that the contracts may contain redacted sections that are protected under Kentucky Revised Statute 61.661, are exempt under Kentucky Revised Statute 61.878(1)(c), or, if disclosed, could compromise KPPA's ability to competitively invest in Private Equity, Real Estate, or other asset classes."); *see also* Taibbi, *supra* note 71 ("In fact, in recent years more than a dozen states have carved out exemptions for hedge funds to traditional Freedom of Information Act requests, making it impossible in some cases, if not illegal, for workers to find out where their own money has been invested. The way this works, typically, is simple: A hedge fund will refuse to take a state's business unless it first provides legal guarantees that information about its investments won't be disclosed to the public. The ostensible justifications for these outrageous laws are usually that disclosing commercial information about hedge funds would place them at a 'competitive disadvantage.'")

[196] *Investment Manager Contracts*, *supra* note 195.

[197] Stephanie Loiacono, *Rules That Warren Buffett Lives By*, INVESTOPEDIA (Jan. 12, 2021), https://www.investopedia.com/financial-edge/0210/rules-that-warren-buffett-lives-by.aspx

words, since the purpose is not to maximize returns but to conserve funds as a backstop in the event of insolvency, the funds should be invested very conservatively.[198]

Just how conservatively is debatable. The Maryland Public Policy Institute's 2018 pension fund report compared a 60/40 stocks/bonds benchmark to the state's investment portfolio, which included hedge funds and other alternative investments.[199] It found that, over ten years, the 60/40 benchmark would have saved Maryland $5 billion, or enough money "to replace every public school in Baltimore City with a new brand-new facility[.]"[200] On the other hand, a 2009 study by Deborah Lucas and Stephen Zeldes found that the 60% equities benchmark (which was the average for state and local pension plans in 2006) was partly due to the desire for a higher average return.[201] It was also partly due to public pension accounting rules that "create a perverse incentive to invest in stocks" because doing so leads to a higher discount rate for liabilities that, in turn, reduces the amount of money the state has to contribute to pensions.[202] Neither of these justify a 60% equities share for KYPAA funds. KYPAA's purpose is not to pursue higher returns, and since KYPAA funds are insurance for the pension funds, not the pension funds themselves, minimizing state contributions to pensions is irrelevant. While Lucas and Zeldes's findings "do suggest a positive share of stocks in the portfolio, they do not rationalize the clustering of observed equity shares around 60 percent."[203] In other words, the KYPAA funds will invest more conservatively than the actual pension funds. And if a 60% equities share is too risky for the pension funds, then it is certainly too risky for KYPAA funds. A better option would be to concentrate KYPAA assets in low-risk investments like municipal bonds, U.S. Treasury notes and bonds, and U.S. Treasury Inflation-Protected Securities.[204]

[https://perma.cc/S6YF-JAK9].

[198] *See, e.g.*, Mendales, *supra* note 163, at 542 ("Because the emergency fund is a last resort, its funds should be invested more conservatively than the general funds. In this case, conservative investment in liquid securities for an anticipated annual return of 4 percent is not as unreasonable as it is for the general funds.").

[199] Park & Hooke, *supra* note 89.

[200] *Id.*

[201] Lucas & Zeldes, *supra* note 146, at 531–32.

[202] *Id.* at 527.

[203] *Id.* at 532.

[204] Treasury Inflation-Protected Securities, or "TIPS," are U.S. Treasury securities that protect against inflation by tying the principal balance to the inflation rate as measured by the Consumer Price Index. Thus, the principal goes up with inflation, and down with deflation. TIPS are a relatively conservative long-term investment but may present liquidity problems if the KYPAA fund needs to be accessed before the securities mature. James Chen, *Treasury Inflation-Protected Securities*, INVESTOPEDIA (Sept. 22, 2020), https://www.investopedia.com/terms/t/tips.asp [https://perma.cc/BYV2-

Perhaps the biggest drawback of a state agency modeled on the PBGC is that the PBGC itself has undergone financial hardships in recent years.[205] The U.S. Government Accountability Office has designated the PBGC a "high-risk" government program due to the deficits of its multiemployer insurance program.[206] But KYPAA's funding mechanism more closely resembles that of PBGC's single employer program, which currently has billions of dollars in surplus assets.[207] Moreover, because KYPAA would be a newly created agency designed from a blank slate, it could incorporate the recommendations GAO has offered for the PBGC. For example, the GAO recommends "authorizing a redesign of PBGC's premium structure to better align premium rates with risk."[208] KYPAA's proposed premium structure already does so by calculating an Investment Manager's premium rate based on the risk represented by its share of managed assets.[209] Another GAO recommendation—"strengthening funding requirements for plan sponsors, as appropriate given national economic conditions"[210]—could be accomplished by giving the General Assembly flexibility and authority to alter funding requirements according to changing economic conditions. Lastly, the very nature of pension funds means that the fund (and any accompanying insurance programs) need not have the assets on hand to cover all its liabilities at any given time. A pension fund's liabilities are comprised of the money it owes to current beneficiaries and *will owe* to *future* retirees. But those future retirees will not receive their pension distributions until some future date. Thus, despite those obligations appearing as liabilities on the pension fund's ledger, the fund does not actually have to pay those obligations *today*.

287X].

[205] *Pension Insurer Expects to Be Out of Funds By 2022*, COMM. FOR RESPONSIBLE FED. BUDGET (July 3, 2014), https://www.crfb.org/blogs/pension-insurer-expects-be-out-funds-2022 [https://perma.cc/Y4GG-ECPQ].

[206] *High-Risk Series: Dedicated Leadership Needed to Address Limited Progress in Most High-Risk Areas*, U.S. GOV'T ACCOUNTABILITY OFF., GAO-21-119SP, at 276 (Mar. 2021), https://www.gao.gov/assets/720/712647.pdf [https://perma.cc/2H7N-HGMX].

[207] Hazel Bradford, *PBGC program set for reversal of fortune*, PENSIONS & INVS. (Apr. 6, 2020, 12:00 AM), https://www.pionline.com/washington/pbgc-program-set-reversal-fortune [https://perma.cc/3Q4T-2BXZ] (noting "[t]he Pension Benefit Guaranty Corp.'s good news, just six months ago, that its single-employer program enjoyed a healthy surplus . . ."); *but see id.* at 278 (explaining that PBGC's "single employer program has not experienced many large underfunded plan terminations recently, allowing the program to build a surplus, but PBGC's experience shows that the single-employer program's condition can change quickly and precipitously.").

[208] *High-Risk Series*, *supra* note 206, at 279.

[209] *See supra* section III.A.

[210] *High-Risk Series*, *supra* note 206, at 279.

CONCLUSION

There is no silver bullet that will solve the public pension crisis. The reality is that states will probably experiment with a number of different reform measures over the next decade as they attempt to replenish their ailing funds. A state agency like KYPAA is but one small piece of that overall puzzle. It will likely take multiple reform proposals working in conjunction to overcome the trillion dollar deficit that public pensions find themselves in today. But whatever form those proposals take, they should be guided by the principle that taxpayers are not a get out of jail free card. Fundamental principles of fairness preclude states incentivizing risky gambling with public pension assets simply because the resulting deficits can always be covered by the taxpayers. If states want to allow financial intermediaries to play with the people's money, then those entities ought to take responsibility when their risky investments go awry. Allowing hedge funds to gamble with people's money and then, when things go sideways, to wipe their hands and move on to the next public pension fund, is wrong. If Wall Street wants to gamble with the people's money, it ought to have some skin in the game.