

SB 2 Transparency Compliance

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PUBLIC PENSION OVERSIGHT BOARD

June 25, 2018

LRC Staff

Board Recommendations

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- As recommended by the PPOB, the General Assembly passed SB 2 (RS 2017) to provide transparency and accountability measures for the state-administered retirement systems.
- On December 18, 2017, the PPOB adopted a new recommendation directing staff to:
 - Research and review the effectiveness of the 2017 pension transparency reforms instituted under SB 2; and
 - Report findings to the board to determine if additional transparency or accountability measures should be recommended.

Overview of SB 2

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Relevant Provisions of SB 2/EN, 2017 Acts ch. 12:

❖ **GOVERNANCE (All systems)**

- ✦ Senate confirmation of gubernatorial appointees.
- ✦ Investment Experience defined and required for all gubernatorial appointees.
- ✦ Board composition:
 - **KRS Board** added four new gubernatorial members with investment experience, expanding from 13 to 17.
 - **JFRS Board's** existing two gubernatorial appointees must have investment experience. No expansion
 - **TRS Board** added two new gubernatorial members with investment experience, expanding from 9 to 11.

❖ **FIDUCIARY DUTY & CONFLICT OF INTEREST (All systems)**

- ✦ Reconfirmed fiduciary duties imposed under HB 300 (2012 RS), refining ban on placement agents.
- ✦ Required CFA Institute's Code of Conduct for staff, trustees, and contracted investment advisors.

❖ **STATE CODES**

- ✦ Model Procurement Code (All systems but investment contracts subject to policy; see below)
- ✦ State Personnel System, KRS Ch. 18A (Kentucky Retirement Systems only)

Overview of SB 2 (cont.)

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❖ **TRANSPARENCY (All systems)**

✦ **Investment Performance, Fees, and Commissions:**

- Quarterly reporting of
- Net of fee performance, asset allocations, and asset class performance relative to benchmarks;
- Investment holdings in aggregate, fees, and commissions for each fund administered; and
- Disclosure of dollar value of profit sharing, carried interest, and other performance related fees by asset class.
 - Each system shall request from all mgrs., partnerships and any other available sources all information regarding fees and commissions, and
 - From the information received, disclose dollar values down to manager or partnership level using the International Limited Partner's Assoc. (ILPA) standards.

✦ **Contracts and Offering Documents** disclosure for services, goods, or property purchased or utilized. Confidentiality provision retained, except that investment contracts to be disclosed to the board, Auditor, and the GCRC in their entirety or subject to redaction.

✦ **Procurement Policy for Investment Contracts** adopted by board and approved by Sec'y of Finance.

❖ **EMERGENCY** – Effective March 10, 2017 (except where otherwise provided in the Act).

Compliance Questionnaire

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- ❖ Staff review of systems' compliance is the **1st Step** of the PPOB's evaluation of SB 2.
- ❖ Staff sent each state-administered retirement system a compliance questionnaire.
 - *(Appendix A in folders)*
- ❖ Responses were due on or before June 15, 2018.
- ❖ The topics addressed in the questionnaire were the categories addressed by SB 2:

- ✦ **Governance**

- Senate Confirmation
- Investment Experience

- ✦ **Fiduciary Duty and Code of Conduct**

- ✦ **State Codes:**

- Model Procurement Code
- State Personnel System (KRS Chapter 18A, if applicable)

- ✦ **Transparency:**

- Investment Performance, Fees, and Commissions
- Contracts
- Procurement Policy for Investment Services

Judicial Form Retirement System

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❖ Governance: *Pending*

- Terms for the current gubernatorial board members expire on June 30, 2020, and subsequent appointees will require investment experience and Senate confirmation.

❖ Fiduciary Duty and Code of Conduct: *In Compliance* (CFA Inst. Codes N/A)

- Under KRS 21.450(2), trustees and investment advisors are required to discharge their duties “solely in the interest of the members and beneficiaries.” Additionally, the board complies with conflict of interest provisions and the Code of Professional Conduct (KRS 21.540(5); 4 KAR 1:050). All FDRs are current.

❖ State Codes: *In Compliance*

- Model Procurement Code:
 - ✓ RFPs for auditing and actuarial services have been issued and are pending. RFPs are publicly available on JFRS website. An evaluation committee has been appointed.
 - ✓ JFRS is utilizing at least two vendors with contracts issued under the authority of and with the permission of the Finance Cabinet’s Office of Procurement Services (Master Agreements) in accordance with KRS Chapter 45A.
- State Personnel System (18A): *Not Applicable*. JFRS has two non-merit employees.

❖ Transparency: *In Compliance*

- ✓ JFRS is posting quarterly reports for both JRP and LRP, including:
 - Net of fee performance, asset allocations, and asset class performance relative to benchmarks; and
 - Aggregate investment holdings, fees, and commissions for each fund.
 - JFRS does not utilize any managers with “incentive-based” contracts, thus no performance fees, carried-interest, etc. result.
- ✓ Contract and extensions with investment manager are available to the public on the JFRS website.
- ✓ The Investment Procurement Policy has been adopted by the board, approved by the Sec’y of Finance and Administration, and is available to the public on the JFRS website.

Kentucky Retirement System

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❖ Governance: *In Compliance*

- ✓ Senate Confirmation: All gubernatorial members' appointments have been confirmed.
- ✓ Investment Experience: Six of the ten appointees meet required investment experience.

❖ Fiduciary Duty and Code of Conduct: *Partial Compliance*

- ✓ Fiduciary Duty:
 - Employees, trustees, and external investment managers have acknowledged their fiduciary duty.
- ✓ CFA Institute Codes of Conduct:
 - Staff, trustees, and managers hired directly via investment management contract (primarily public equity and fixed income) have been provided respective CFA Institute's code of conduct, notified of change in law, and advised of duty to comply. KRS has incorporated SB 2 requirements into all new investment management contracts.
 - For investments under which KRS is a limited partner in a commingled fund (private equity, real estate, and majority of absolute return), the general partners have not been contacted regarding SB 2 requirements. These investments are subject to contractual terms and conditions that are governed by preexisting Limited Partnership Agreements. KRS has incorporated SB 2 requirements into its "gating items" list and has ceased vetting new opportunities if the general partner cannot comply with SB 2 requirements.

Kentucky Retirement System

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❖ State Codes: *In Compliance*

✓ Model Procurement Code (MPC):

- KRS is following MPC and provided a list of all procurements made since the effective date of SB 2.
- KRS is utilizing 13 vendors with contracts issued under the authority of and with the permission of the Finance Cabinet's Office of Procurement Services (Master Agreements) in accordance with KRS Chapter 45A.
- KRS has issued four RFPs since the effective date of SB 2. Two have been completed, one did not result in a contract but will be reissued with changes to the scope of work, and one is pending completion. A summary of the process, review committee, and ultimate decision to award the contracts, as applicable, were provided to staff.

✓ State Personnel System:

- KRS has completed transition of all non-exempt employee positions to the merit system (KRS Chapter 18A). Job Classifications have been created for each position. KRS currently has 23 non-merit employees across 4 job classes: Executive Director, Division Director, General Counsel, and Special Assistant.
- KRS retains six hearing officer positions not under KRS Ch. 18A. These positions were originally hired under board authority (KRS 61.545(2)(d)) but will be rehired effective July 1, 2018, under personal service contracts consistent with KRS Ch. 45A.

Kentucky Retirement System

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❖ Transparency: *Partial Compliance*

- ✓ Investment Performance, Fees, and Commissions: KRS is posting quarterly reports on their website, including:
 - Net of fee performance, asset allocations, and asset class performance relative to benchmarks for the quarter ending on March 31, 2018;
 - Aggregate investment holdings, fees, and commissions; and
 - Disclosure of dollar value of profit sharing, carried interest, and other performance related fees by asset class.
- ✓ Contracts:
 - Investment Management Agreements/Contracts (i.e. public equity, fixed income) are available to the public on the website.
 - The majority of Limited Partnership Agreements (92) are not currently available on the KRS website. These LPAs (i.e. private equity, real estate, majority of absolute return) contain language that prohibits KRS from making the documents public or would likely subject KRS to litigation from general partners if made public.
 - **NOTE:** Under KRS 61.645(20), as amended by SB 2, the board, the GCRC, and/or Auditor have the authority to seek disclosure and review of agreements; permits redaction. Also, under KRS 7A.255(2), the systems are required to report to “the percentage of system assets and managers for which fees and commissions are being reported.”
- ✓ Procurement Policy for Investment Services:
 - KRS has created an Investment Procurement Policy, which was adopted by the board on Sept 14, 2017 and was approved by the Sec’y of Finance and Administration on October 10, 2017. The policy is available to the public on the KRS website.

Teachers Retirement System

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❖ Governance: *In Compliance*

- ✓ Senate Confirmation: The two gubernatorial appointees have been confirmed.
- ✓ Investment Experience: The two appointees meet the required investment experience.

❖ Fiduciary Duty and Code of Conduct: *Partial Compliance*

- ✓ Staff and investment committee members adhere to:
 - “Strategy for Implementation of Investment Policies,” (amended June 20, 2018), requiring compliance with all applicable law, including the fiduciary standards and cited in KRS 161.430; and
 - “Code of Ethics and Standards of Professional Conduct” (CFA Institute), which TRS recognizes as a “best practice reference and supplemental resource for executing fiduciary duties.”
- ✓ All trustees are bound by oath to faithfully execute and comply with state law. Trustees adhere to:
 - “Board of Trustees Governance Manual,” which includes the fiduciary standards cited in KRS 161.430; and
 - “Code of Conduct for Members of a Pension Scheme Governing Body” (CFA Institute), which TRS recognizes as a “best practice reference and supplemental resource for executing fiduciary duties.”
- ✓ External Investment Managers affirm contractually to:
 - For investment contracts executed prior to SB 2, fiduciary duties and an investment policy that met or exceeded the “Asset Manager Code of Conduct.” TRS did not specifically notify all current external investment managers of the “Asset Manager Code of Professional Conduct” adopted by SB 2.
 - For all new investment contracts, TRS has developed language acknowledging the specific fiduciary duties mandated by KRS 161.430, including the “Asset Manager Code of Professional Conduct.”

Teachers Retirement System

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❖ State Codes: *Partial Compliance*

✓ Model Procurement Code:

- TRS is following the MPC for nearly all contracts executed on or after July 1, 2017. Contracts used during FY 2018 were adopted prior to this effective date. A pre-SB 2 contract for janitorial services was extended six months to facilitate converting the contract term to the fiscal year.
- Six RFPs for actuarial, auditing, legal, tax, janitorial, and printing services were issued prior to June, 2018. These RFPs are available to the public on the TRS website.
- At its meeting on June 18, 2018, the board approved the recommendations of the Governance and Audit Committee as to the contracts for FY 2019 services. *See above.* The terms are pending negotiation. The contracts will be presented at the next meeting of the GCRC. The evaluation committee members, criteria, and scoring sheets were not produced.
- TRS is utilizing 14 vendors with contracts issued under the authority of and with the permission of the Finance Cabinet's Office of Procurement Services (Master Agreements) in accordance with KRS Chapter 45A.

➤ State Personnel System: *Not Applicable*

Teachers Retirement System

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❖ Transparency: *Partial Compliance*

- ✓ Investment Performance, Fees, and Commissions:
 - Net of fee performance, asset allocations, and asset class performance relative to benchmarks for the quarter ending on March 31, 2018, is posted on TRS' website;
 - Aggregate investment holdings, fees, and commissions were included in the most recent CAFR. *Recent quarterly returns are pending finalization for publication on the website by June 25.*
 - Dollar value of profit sharing, carried interest, and other performance related fees is not available. TRS has contacted each general partner by letter and requested the fee information. However, all managers contacted asserted the confidentiality of the proprietary information under KRS 161.250(5) as it relates to KRS 61.870 *et seq.*
 - **NOTE:** Under KRS 161.250(5), as amended by SB 2, the board, the GCRC, and/or Auditor have the authority to seek disclosure and review of agreements; permits redaction. Also, under KRS 7A.255(2), the systems are required to report to "the percentage of system assets and managers for which fees and commissions are being reported."
- ✓ Contracts:
 - TRS reports posting a portion of its contracts online. At time of review, only one investment manager contract appeared to be available online. All current offering documents have been posted.
 - Per TRS, almost all investment advisors have objected to the release of their proprietary information under KRS 161.250(5) as it relates to KRS 61.870 *et seq.* See note above.
- ✓ Procurement Policy for Investment Services: TRS has created an Investment Procurement Policy, which was adopted by the board on June 19, 2017 and approved by the secretary of Finance and Administration on June 20, 2017. A copy is available to the public on the TRS website.

CONCLUSION

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QUESTIONS?