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TO: PUBLIC PENSION OVERSIGHT BOARD
FROM: LRC STAFF
DATE: MARCH 25, 2019
RE: CASH FLOW FOLLOW-UP

Background

In response to testimony provided during the February 25, 2019, meeting of the Public Pension Oversight Board (PPOB), LRC staff were asked to provide consistent information regarding the cash flow updates provided by the TRS, KERS Non-hazardous, and CERS non-hazardous systems. Specifically, staff were asked to clarify how each system treated investment income as part of the cash flow data since investment income reported on the system's financial statements can include 3 components: (1) investment income that is received by the system and requires no sale of system assets (i.e. dividends, coupon payments, rental income), (2) realized investment gains/losses (where system assets are sold), and (3) unrealized investment gains/losses (the market value of an asset increases/decreases but that asset has not been sold).

Findings

Two key questions in evaluating cash flows are: (1) is an individual system having to sell assets in an untimely manner to meet benefit payments or in favorable market conditions but having to use part of those asset sales to meet benefit payments instead of reinvesting those assets back into the system's trust fund; and (2) ultimately the level of assets being sold in order to meet benefit payments. This has been an issue that both KRS and TRS have testified as a significant point of concern in past meetings of the PPOB and in other legislative committee meetings.

In 2017, the co-chairs of the PPOB requested that the retirement systems begin presenting cash flow data when providing any quarterly or annual investment updates to the PPOB and directed staff to develop a template so that each system would present data in the same format and to help shed light on the level of assets that were sold in order to meet benefit payments. The template has been

designed to segregate investment income that doesn't require the sale of assets (i.e. dividends, coupon payments, rental income) from realized/unrealized investment gains/losses.

Recently TRS has adjusted their reporting to the PPOB on this cash flow data. At the February 2019 PPOB meeting, TRS reported a positive cash flow during the meeting of \$334 million for the first six months of FY 2018-2019. However, this positive cash flow value included the sale of assets (realized investment gains) and was a point of discussion at the meeting. Based upon additional data provided by TRS after the meeting, if realized investment gains from the sale of assets are excluded, the TRS Net Cash Flow Without Asset Gains/Losses resulted in a negative cash flow of approximately \$156 million for the first six months of FY 2018-2019 (as compared to the reported \$334 million positive cash flow for the first six months of FY 2018-2019).

Similar information provided by KRS staff, with regards to CERS and KERS, reported all realized or unrealized investment gains/losses separately from cash based investment income, such as dividends, bond coupons, and rental income to calculate cash flow for each of the plans.

Below, staff has utilized the Statement of changes in Net Plan assets, as provided by both systems, to report cash flow information for each plan dating back to 2015. In general, cash flow data has been improving in recent years for TRS, KERS, and CERS.

Teacher Retirement System (TRS):

The table below is a summary of the cash flow and changes in TRS plan assets dating back to the 2015 fiscal year. In each period, any unrealized or realized asset gain or losses has been excluded from investment income and reported separately in an attempt to report consistently with other state administered plans as it relates to cash flow.

TRS Pension Fund (in millions)					
	FY2015	FY2016	FY2017	FY2018	YTD19*
Employee Contributions	\$308.1	\$313.0	\$313.6	\$319.1	\$134.9
Employer Contributions	559.6	565.5	1,060.7	1,048.7	517.5
Investment Income	<u>433.1</u>	<u>339.1</u>	<u>308.7</u>	<u>379.1</u>	<u>263.4</u>
Total Inflows	\$1,300.8	\$1,217.6	\$1,683.1	\$1,746.9	\$915.7
Total Payouts	(1,773.4)	(\$1,869.6)	(\$1,955.2)	(\$2,047.1)	(\$1,071.6)
Cash Flow (WITHOUT Asset Gains/Losses)	(\$442.6)	(\$652.0)	(\$272.2)	(\$300.2)	(\$155.9)
Asset Gains/(Losses)	\$429.1	(\$584.3)	\$2,167.0	\$1,574.1	(\$1,554.6)
Net Change in Assets (including Asset Gains/Losses)	(\$13.5)	(\$1,236.3)	\$1,894.9	\$1,273.9	(\$1,710.5)
Net Plan Assets, Beg. of period	\$18,092.6	\$18,049.1	\$16,812.8	\$18,707.7	\$19,981.6
Net Plan Assets, End of period	\$18,049.1	\$16,812.8	\$18,707.7	\$19,981.6	\$18,271.2

* First 6 months of 2019 fiscal year

For the first six months of the current 2019 fiscal year, when realized investment gains are excluded, TRS's stated Net Cash Flow Without Asset Gains results in a negative cash flow of approximately \$155 (as compared to the reported positive cash flow of \$333 million at the February 2019 PPOB meeting).

Kentucky Retirement Systems (KERS/CERS):

Investment income reported by KRS staff during the February meeting did not include any realized or unrealized gains as investment income. Similar to the information reported above for TRS, staff has provided a summary of the cash flow and changes in KERS and CERS assets dating back to the 2015 fiscal year. In each period, any unrealized or realized asset gain or losses has been excluded from investment income and reported separately in an attempt to report cash flow data as requested by the co-chairs in 2017.

KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)

As shown in the chart below, as a result of a significant increase in employer contributions, the current 2019 fiscal year is projected to result in a positive cash flow for the KERS plan. This would represent the first fiscal year a combination of contributions and traditional investment income (dividends, coupons, etc) exceeded payouts since the 2001 fiscal year.

For the first half of the fiscal year, the plan experienced a positive \$74.0 Net Cash Flow Without Asset Gains/Losses.

KERS NH Pension Fund (in millions)					
	FY2015	FY2016	FY2017	FY2018	YTD19*
Employee Contributions	\$104.9	\$106.5	\$105.7	\$110.8	\$50.2
Employer Contributions	521.7	513.1	757.1	689.1	512.7
Investment Income	<u>57.8</u>	<u>24.5</u>	<u>50.9</u>	<u>34.9</u>	14.3
Total Inflows	\$684.1	\$644.1	\$913.7	\$834.8	577.2
Total Payouts	(\$929.8)	(\$946.4)	(\$971.3)	(\$991.7)	503.2
Cash Flow <i>(WITHOUT Asset Gains/Losses)</i>	(\$245.7)	(\$302.3)	(\$57.6)	(\$156.9)	\$74.0
Asset Gains/(Losses)	(\$4.8)	(\$45.2)	\$170.1	\$113.0	(\$53.3)
Net Change in Assets <i>(including Asset Gains/Losses)</i>	(\$250.5)	(\$347.5)	\$112.5	(\$43.9)	\$20.7
Net Plan Assets, Beg. of period	\$2,578.3	\$2,327.8	\$1,980.3	\$2,092.8	\$2,048.9
Net Plan Assets, End of period	\$2,327.8	\$1,980.3	\$2,092.8	\$2,048.9	\$2,069.6

* First 6 months of 2019 fiscal year

COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS)

As shown in the table below, for the first six months of the current 2019 fiscal year, without any asset gains (or losses), total inflows for CERS have fallen short of total payouts by approximately \$69.0 million dollars.

CERS NH Pension Fund (in millions)					
	FY2015	FY2016	FY2017	FY2018	YTD19*
Employee Contributions	\$140.3	\$141.7	\$159.9	\$171.2	\$80.3
Employer Contributions	298.6	284.1	333.5	358.0	187.4
Investment Income	<u>128.1</u>	<u>70.5</u>	<u>137.7</u>	<u>101.6</u>	<u>58.8</u>
Total Inflows	\$567.0	\$496.3	\$631.1	\$630.8	\$326.5
Total Payouts	(\$647.1)	(\$684.4)	(\$721.6)	(\$760.8)	(\$395.5)
Cash Flow <i>(WITHOUT Asset Gains/Losses)</i>	(\$80.1)	(\$188.1)	(\$90.5)	(\$130.0)	(\$69.0)
Asset Gains/(Losses)	(\$7.2)	(\$111.3)	\$688.2	\$477.2	(\$284.1)
Net Change in Assets <i>(including Asset Gains/Losses)</i>	(\$87.3)	(\$299.4)	\$597.7	\$347.2	(\$353.1)
Net Plan Assets, Beg. of period	\$6,528.1	\$6,440.8	\$6,141.4	\$6,739.1	\$7,086.3
Net Plan Assets, End of period	\$6,440.8	\$6,141.4	\$6,739.1	\$7,086.3	\$6,733.2

* First 6 months of 2019 fiscal year