

Examination of Certain Policies, Procedures, Controls, and Transparency Compliance Activities of Retirement Systems in Kentucky

**Public Pension Oversight Board
September 23, 2019**



Office of Auditor Mike Harmon

Retirement Systems in Kentucky

Special Examination

- ▶ Report released August 28, 2019.
- ▶ The special examination looked at all three Kentucky retirement systems: KRS, TRS and JFRS.
- ▶ In 2017, the General Assembly unanimously passed Senate Bill 2 to bring more transparency to pensions.



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State Auditor

Retirement Systems Special Exam

Scope & Timeframe

- ▶ Primary focus of examination was evaluating compliance with increased transparency requirements in Senate Bill 2.
 - ▶ This report is not a financial statement audit.
- ▶ Looked at Retirement Systems' operations between July 1, 2017 and June 30, 2018.



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Senate Bill 2 of 2017

Transparency

- ▶ Specifically, we examined whether each of the systems disclosed information in accordance with Kentucky Revised Statutes 21.540(4), 161.250(4), 61.645(19).
- ▶ Full report available at auditor.ky.gov.



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Senate Bill 2

Failure to Post Contracts

- ▶ Both KRS and TRS have failed to comply with the basic requirement to post all contracts.
- ▶ More than 80% of each systems' investment contracts are not posted online.



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Senate Bill 2

Requirement to Post Contracts

- ▶ SB2 requires the posting of all contracts.
- ▶ Since the law applies equally to contracts signed before 2017, we included those in our review.



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KRS has Abdicated its Responsibility to Abide by the Open Records Act

- ▶ KRS has delegated its responsibility to redact confidential and proprietary information from those contracts to external investment managers.
 - ▶ “If any public record contains material which is not excepted under this section, *the systems shall* separate the excepted material by removal, segregation, or *redaction*, and make the nonexcepted material available for examination.”

-Kentucky Revised Statute 61.645(20)



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Image of Redactions

confidential from one or more Limited Partners for such period of time as the General Partner deems reasonable, any Confidential Information which the General Partner reasonably believes to be in the nature of trade secrets or other information the disclosure of which the General Partner in good faith believes is not in the best interests of the Partnership, its Portfolio Companies or Investments, or the General Partner or its Affiliates or any of their respective businesses or could have an adverse effect on any of the foregoing or which the Partnership or the General Partner is required by law or by agreement with a third party to keep confidential. If any Partner or any Authorized Representative of such Partner is required to disclose any of the Confidential Information, such Partner will use commercially reasonable efforts to provide the Partnership with prompt written notice so that the Partnership, the Partner or any issuer with respect to any Investment may seek a protective order or other appropriate remedy and/or waive compliance with the provisions of this Agreement, and such Partner will use commercially reasonable efforts to cooperate with the Partnership, the Partner or any issuer with respect to any Investment in any effort any such Person undertakes to obtain a protective order or other remedy. If such protective order or other remedy is not obtained or the Partnership or the Partner waives compliance with the provisions of this Section 13.2, such Partner and its Authorized Representatives will furnish only that portion of the Confidential Information that is required and will exercise all reasonable efforts to obtain reasonably reliable assurance that the Confidential Information will be accorded confidential treatment.

(b) Notwithstanding Section 13.2.1(a), the Partnership hereby acknowledges that KRS is a public agency subject to (i) Kentucky's public records law (the "Open Records Act," Kentucky Revised Statutes sections 61.870 to 61.884), which provide generally that all records relating to a public agency's business are open to public inspection and copying unless exempted under the Open Records Act, (ii) Kentucky Revised Statutes section 61.645(19)(i) (the "Fee Disclosure Law"), and (iii) Kentucky Revised Statutes sections 61.645 (19)(I) and (20) (the "Document Disclosure Law"), which provide generally that all contracts or offering documents for services, goods, or property purchased or utilized by KRS shall be made available to the public unless exempted under the Document Disclosure Law. Notwithstanding any provision in this Agreement or the Subscription Agreements to the contrary, the Partnership hereby agrees that (x) KRS will generally treat all information received from the General Partner or the Partnership as open to public inspection under the Open Records Act, the Fee Disclosure Law or the Document Disclosure Law, unless such information falls within an exemption under the Open Records Act, the Fee Disclosure Law or the Document Disclosure Law, and (y) KRS will not be deemed to be in violation of any provision of this Agreement or the Subscription Agreements relating to confidentiality if KRS discloses or makes available to the public (e.g., via KRS' website) any information regarding the Partnership to the extent required pursuant to or under the Open Records Act, the Fee Disclosure Law or the Document Disclosure Law, including the Fund-Level Information described in paragraph (c) below (even if a court or the Attorney General later determines that certain information disclosed by KRS falls within an exemption under the Open Records Act, the Fee Disclosure Law, or the Document Disclosure Law). Notwithstanding the foregoing, such Limited Partner hereby agrees that, in addition to compliance with the notice requirements set forth in this Section 13.2, such Limited Partner (x) shall take reasonable steps to oppose and prevent the requested disclosure unless (i) such Limited Partner is advised by counsel that there exists no reasonable basis on which to oppose such disclosure, (ii) the General Partner does not object in writing to such disclosure within ten days (or such lesser time period as stipulated by the applicable law) of such notice or (iii) such disclosure solely relates to fund level,

53

(b) Notwithstanding Section 13.2.1(a), the Partnership hereby acknowledges that KRS is a public agency subject to (i) Kentucky's public records law (the "Open Records Act," Kentucky Revised Statutes sections 61.870 to 61.884), which provide generally that all records relating to a public agency's business are open to public inspection and copying unless exempted under the Open Records Act, (ii) Kentucky Revised Statutes section 61.645(19)(i) (the "Fee Disclosure Law"), and (iii) Kentucky Revised Statutes sections 61.645 (19)(I) and (20) (the "Document Disclosure Law").

53



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Image of Redactions

Table of Contents (continued)

	Page
5.2 <u>Admission of Limited Partners</u>	21
5.3 <u>Admission of Additional General Partners</u>	21
5.4 <u>Limited Partner Withdrawals</u>	21
5.5 <u>Mandatory General Partner Withdrawal</u>	22
5.6 <u>Conditions and Restrictions</u>	23
ARTICLE 6 EXPENSES AND REIMBURSEMENT; FEES	24
6.1 <u>Expenses and Reimbursements</u>	24
6.2 <u>Management Fee</u>	27
6.3 <u>Placement Fees</u>	27
ARTICLE 7 RIGHTS AND OBLIGATIONS OF THE GENERAL PARTNER	28
7.1 <u>General Authority and Power</u>	28
7.2 <u>Right of Others to Rely on Authority of General Partner</u>	30
7.3 <u>Custody and Brokerage</u>	31
7.4 <u>[Reserved]</u>	31
7.5 <u>Conflicts of Interest</u>	31
7.6 <u>Investment Opportunities</u>	32
7.7 <u>Transactions and Business Activities with Affiliates</u>	33
7.8 <u>Soft Dollars</u>	34
7.9 <u>Insurance</u>	34
7.10 <u>Non-U.S. Investments</u>	34
7.11 <u>Indebtedness</u>	35
ARTICLE 8 EXCULPATION, INDEMNIFICATION AND LIABILITY OF PARTNERS	36
8.1 <u>Exculpation and Indemnification</u>	36
8.2 <u>Limited Partner Limited Liability</u>	39
8.3 <u>No Participation in Management</u>	40
8.4 <u>Limitations on Limited Partner Rights</u>	40
ARTICLE 9 TRANSFERS OF PARTNERSHIP INTERESTS	40
9.1 <u>Restrictions</u>	40

Table of Contents (continued)

	Page
5.2 <u>Admission of Limited Partners</u>	21
5.3 <u>Admission of Additional General Partners</u>	21
5.4 <u>Limited Partner Withdrawals</u>	21
5.5 <u>[Redacted]</u>	22
5.6 <u>Conditions and Restrictions</u>	23
ARTICLE 6 EXPENSES AND REIMBURSEMENT; FEES	24
6.1 <u>Expenses and Reimbursements</u>	24
6.2 <u>Management Fee</u>	27
6.3 <u>Placement Fees</u>	27
ARTICLE 7 RIGHTS AND OBLIGATIONS OF THE GENERAL PARTNER	28
7.1 <u>General Authority and Power</u>	28
7.2 <u>Right of Others to Rely on Authority of General Partner</u>	30
7.3 <u>Custody and Brokerage</u>	31
7.4 <u>[Reserved]</u>	31
7.5 <u>[Redacted]</u>	31
7.6 <u>[Redacted]</u>	32
7.7 <u>[Redacted]</u>	33
7.8 <u>[Redacted]</u>	34
7.9 <u>[Redacted]</u>	34
7.10 <u>Non-U.S. Investments</u>	34
7.11 <u>[Redacted]</u>	35
ARTICLE 8 EXCULPATION, INDEMNIFICATION AND LIABILITY OF PARTNERS	36
8.1 <u>Exculpation and Indemnification</u>	36
8.2 <u>Limited Partner Limited Liability</u>	39
8.3 <u>No Participation in Management</u>	40
8.4 <u>Limitations on Limited Partner Rights</u>	40
ARTICLE 9 TRANSFERS OF PARTNERSHIP INTERESTS	40
9.1 <u>Restrictions</u>	40



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KRS is Not Monitoring Investment Managers Consistent with its Policy

- ▶ KRS staff have not met annually with investment managers as required by KRS investment policy.
- ▶ As of June 30, 2018, KRS had 110 investment managers, and TRS had 41 investment managers. JFRS only has one investment manager.
- ▶ While SB2 does not limit the number of investment managers, having so many may impact KRS's ability to properly manage its investments and contracts.



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TRS Redaction Process

- ▶ TRS has a process in place to redact confidential & proprietary information.
- ▶ TRS makes some redactions to contracts even without a request from the investment manager if TRS believes the information would compromise its ability to competitively invest.



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TRS Does Not Report Carried Interest in a Transparent Manner as Required by Senate Bill 2

- ▶ Carried interest is the amount of a private equity or a hedge fund's profits that the general partner or investment manager receives as compensation.
- ▶ “[d]isclose the dollar value of any profit sharing, carried interest, or any other partnership incentive arrangements, partnership agreements, or any other partnership expenses received by or paid to each manager or partnership.”

- Kentucky Revised Statute 161.250(4)(i)(2)



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Kentucky Retirement Systems

Summary of Findings

▶ Kentucky Retirement Systems:

- ▶ KRS has Abdicated its Responsibility to Abide by the Open Records Act.
- ▶ KRS Does Not Post Contracts as Required by Senate Bill 2.
- ▶ KRS is Not Monitoring its Investment Managers Consistent with its Investment Policy.
- ▶ KRS Was Unable to Recalculate One Investment Manager's Fees During FY 2018 Due to a Lack of Information and Understanding of the Fee Calculation.
- ▶ TRS Uses Fee Caps in Some Contracts; KRS Does Not.
- ▶ KRS has \$16.1 Million in Delinquent Balances.
- ▶ KRS Paid \$12,611 to Deceased Individuals in FY 2018.



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Teachers' Retirement System

Summary of Findings

- ▶ **Teachers' Retirement System of Kentucky:**
 - ▶ TRS Does Not Post Contracts and Does Not Disclose Contact Information for Fund of Funds as Required by Senate Bill 2.
 - ▶ TRS Does Not Report Carried Interest in a Transparent Manner as Required by Senate Bill 2.



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Judicial Form Retirement System

Summary of Findings

▶ Judicial Form Retirement System:

- ▶ JFRS Chose Not to Recover Over \$1,300 in Overpayments Made Subsequent to Retirees' Death.



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Retirement Systems in Kentucky

Recommendations

- ▶ Each of our findings is accompanied by specific recommendations for KRS, TRS, and JFRS to improve its internal controls and oversight, as well as its overall transparency and accountability.
- ▶ PPOB should work with other stakeholders to develop an enforcement mechanism for full compliance with transparency requirements.



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