PUBLIC PENSION OVERSIGHT BOARD

Minutes of the 5th Meeting of the 2020 Interim

September 22, 2020

Call to Order and Roll Call

The 5th meeting of the Public Pension Oversight Board was held on Tuesday, September 22, 2020, at 1:00 PM, in Room 171 of the Capitol Annex. Representative Jim DuPlessis, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Jimmy Higdon, Co-Chair; Representative Jim DuPlessis, Co-Chair; Senators Christian McDaniel, Dennis Parrett, Wil Schroder, and Mike Wilson; Representatives Joe Graviss, Jerry T. Miller, Phillip Pratt, Steven Rudy, and Buddy Wheatley; John Chilton, Mike Harmon, John Hicks, James M. "Mac" Jefferson, Sharon Mattingly, and Joseph Fawns.

Guests: Steven Shannon, Executive Director, Kentucky Association of Regional Programs, Inc.; Beau Barnes, Deputy Executive Secretary and General Counsel, Teachers' Retirement System; and David Eager, Executive Director, and Rebecca Adkins, Executive Director of Operations, Kentucky Retirement System.

LRC Staff: Brad Gross, Bo Cracraft, Jennifer Black Hans, and Angela Rhodes.

Approval of Minutes

Representative Miller moved that the minutes of the August 24, 2020 meeting be approved. Representative Rudy seconded the motion, and the minutes were approved without objection.

Representative DuPlessis announced Joseph Fawns as the newest member for the Public Pension Oversight Board as the appointee for the Attorney General's Office.

Community Mental Health Centers – Pension Strategy 2021

Steve Shannon, Executive Director, Kentucky Association of Regional Programs, Inc. (KARP), began with an overview of community mental health centers (CMHC). He stated that CMHCs have been in service since 1964, currently serve about 180,000 people annually, and provide a behavioral health public safety net for all Kentuckians. Mr. Shannon stated that KARP is a membership organization of 11 centers, and 9 of those 11 centers participate in Kentucky Employee Retirement System's (KERS) nonhazardous pension plan.

Mr. Shannon thanked the General Assembly for the 49.47 percent frozen employer contribution rate, along with the $23 million appropriation, which has allowed the CMHCs to continue providing the behavioral health public safety net. He stated that, if either of those were to be taken away, the centers would have problems. He emphasized a need for both the freeze on the employer contribution rate and the appropriation to remain in the upcoming budget proposals.

Mr. Shannon stated his purpose for presenting was to discuss a potential compromise solution that would meet the needs of the Kentucky Retirement Systems (KRS), while being affordable for the CMHCs, and also maintaining current employees in KERS Tier 1, Tier 2, and Tier 3 plans.

Mr. Shannon stated that the unfunded liability calculated for CMHCs during the 2020 Regular Session was $1,154,821,405. KARP would propose that this unfunded liability amount be paid off over a 30-year period, contingent upon zero interest accrued, and CMHCs continuing to receive the $23 million appropriation. He emphasized that KARP was not proposing cessations but did reference prior cessation legislation, HB 362 from the 2018 Regular Session passed with bipartisan support and required no interest payments.

In response to a question from Representative Wheatley regarding funds that would be required to make the annual unfunded liability payment, Mr. Shannon stated that the annual amount would be about $38 million. The $23 million currently provided would be supplemented by the CMHCs along with the normal cost for active employees.

Mr. Shannon discussed a couple of graphs that included the KERS nonhazardous employer contribution rate and a comparison graph of the rising KERS nonhazardous employer rate compared to a declining number of CMHC employees. Mr. Shannon also discussed the three biggest expenses for the centers: payroll, KERS nonhazardous employer cost, and other benefits.

Mr. Shannon then discussed a handful of requests that have been made with regards to total contributions paid over time, estimated investment earnings and retirement payments made to current and former employees of the CMHCs. He expressed belief that CMHCs' pension liability should not include any portion of the unfunded liability attributed to individuals hired by CMHCs on behalf of state agencies, including the Cabinet of Health and Family Services. Lastly, he re-iterated that CMHCs' annual payment should be based on a 30-year payment with zero interest.

In response to a question from Representative Graviss regarding what a zero percent interest rate would cost KRS or other employers, Mr. Shannon stated he did not think that KARP's proposal would increase costs to other KERS employers. He did state that the recent actuarial analysis (from SB 249 in 2020 Regular Session) indicated a zero percent rate would result in KRS receiving about $26 million less a year.

In response to a question from Mr. Chilton regarding a remedy where some of the agencies have taken action to reduce their cost by outsourcing their employees, Mr. Shannon stated that KARP is not saying they are going to add more people to the system but intends to keep Tier 1, Tier 2, and Tier 3 employees in the system.

In response to questions from Representative DuPlessis regarding centers who have reduced payroll to avoid pension contributions, Mr. Shannon stated that the CMHCs would be responsible for paying their specific liability, but with no added interest and using some of the general fund appropriation they are receiving now. Representative DuPlessis added that one of the reasons he liked HB 171 was that it incentivized facilities who had shed employees out of the system to reemploy, since it was cheaper to pay normal costs. Mr. Shannon responded that he is not sure if centers would necessarily see it as an incentive to put people back into the system.

In response to a question from Senator Higdon regarding the employees who remain at NorthKey, Mr. Shannon stated that NorthKey offered an opportunity for an early retirement plan, and all three current employees are non-management people who opted to stay.

In response to questions from Representative Graviss, Mr. Shannon stated that the $23 million is an annual appropriation. In response to a follow up question, Mr. Shannon stated that KARP's proposal would result in $26 million less than the actuarial analysis from SB 249 required. In response to a second follow up from Representative Graviss, Mr. Shannon stated, based on the $1.154 billion divided by 30 years, which is $38 million, the actuarial analysis had the CMHCs paying $62 million. Representative Graviss commented that if KRS does not get the full payment, someone is going to have to make it up. Mr. Shannon stated that this is a compromise, a way for the CMHCs to pay the actual unfunded liability of $1.154 billion over 30 years, modeled after legislation passed in 2018, and be able to continue to operate.

Representative Tipton commented that the 30-year, zero interest proposal in HB 362 from 2018 was predicated on employers that agreed to the proposal no longer participating in the system so that no additional unfunded liabilities would occur. In response to a question from Representative Tipton, Mr. Shannon agreed that it is a fair assessment that at some point in the future, other employers of KERS would have an incrementally higher rate that would have to be paid.

In response to a question from Auditor Harmon, Mr. Shannon agreed that new employees will go into Tier 3. In response to a question regarding whether or not KARP would be willing to pay beyond the 30 years, if additional obligations were to occur, Mr. Shannon stated keeping KARP at the 49.47 percent going forward along with the $23 million, it would be plausible.

In response to a question from Representative DuPlessis, Mr. Shannon stated that KARP has not discussed these proposals with KRS.

Quarterly Investment/Cash Flow Update & Fund Stress Testing – Teachers' Retirement System Continuation

Beau Barnes, Teachers' Retirement System (TRS), joined the meeting to continue a presentation about stress testing that was not finished during the August 2020 meeting. Mr. Barnes stated that TRS does a lot of stress testing with continual monitoring and evaluation of actual experience and potential fluctuations in experience versus what its assumptions are, while making adjustments in short and long terms based on those outcomes. Some of those adjustments are produced from a sensitivity analysis on the TRS investment return assumption and actuary studies and reports on the actual experience compared to what was assumed. The results of this sensitivity analysis are published annually as required by statute. An outside investment consultant periodically conducts asset liability modeling studies, which reassess assumptions, risks, asset allocation, and the likelihood of meeting assumptions to ensure benefits will be paid. Every five years an experience study compares actuarial experience projected five years ago to the actual experience of those years.

In response to a question from Representative DuPlessis, Mr. Barnes stated that the next experience study should be released mid-year of 2021. In response to a follow up, Mr. Barnes stated he does not know what the experience study will predict for the assumed rate.

Mr. Barnes discussed TRS's 2019 sensitivity analysis for the retirement annuity trust for investment return assumption and payroll growth assumption, which included funding level, unfunded liability, and Actuarial Determined Employer Contribution (ADEC) change. The investment return assumption scenario was for a decline of 1 percent, the current assumption of 7.5 percent, and an increase of 1 percent, and the payroll growth assumption scenario was for the current assumption of 3.5 percent, a decline of 1.5 percent to 2 percent, and no growth.

In response to a question from Representative DuPlessis regarding who pays any extra funding required, Mr. Barnes stated that any extra funding comes from the general fund (taxpayer). In response to a follow up regarding historical data, Mr. Barnes stated that he does not know the five-year average for payroll growth, but recently it has been around 1 to 2 percent.

In response to questions from Representative Miller regarding the assumptions considered in the upcoming experience study, Mr. Barnes stated that several assumptions, in addition to payroll growth and investment return, include individual salaries, retirement rates, life expectancy, etc. would be evaluated.

In response to a question from Representative Pratt, Mr. Barnes stated that the unfunded liability represents the total amount of liability that is unfunded, and a change in the investment return assumption is going to increase or decrease the unfunded liability. In response to a follow up question regarding the change in the ADEC as a result of an assumption change, Mr. Barnes stated that the ADEC balance would be a budget request to the General Assembly.

In response to questions from Representative Graviss regarding how investment gains or losses are considered, Mr. Barnes stated that any gain or loss from year to year is considered when setting the assumption rate.

In response to a comment from Representative DuPlessis regarding TRS's returns being below 7.5 percent more recently, Mr. Barnes stated that the returns have been below 7.5 percent within a 20 year period, but have exceeded the benchmark in the shorter time frame of 10-years.

In response to a question from Senator Higdon, Mr. Barnes stated that the actuaries include sick days as part of the calculation for budget requests. In response to a follow up question, Mr. Barnes agreed that there is a statutory rate of 13.105 percent that is to be paid by primarily the general fund. Senator Higdon commented that, as the assumed rate of returns are reduced, it increases the unfunded liability which increases the requests for contributions from the General Assembly. Senator Higdon also commented that reducing the payroll assumption does not increase the unfunded liability, but it does increase the requests for contributions from the General Assembly.

Mr. Barnes added that TRS received additional funding in 2016/2018 and almost all the ADEC funding for 2018/2020. In the first year of this budget biennial, TRS received all the funding for the pension fund requested. Mr. Barnes stated that TRS is very appreciative, and it is these budget line items put into the funding plan that will get TRS to 100 percent funded. Mr. Barnes added that once TRS reaches 100 percent funded, its budget request to the General Assembly would be 6.2 percent.

Representative DuPlessis commented that maybe TRS should possibly take a layered approach now to have a gradual decline.

Mr. Barnes discussed the market scenario analysis with actuary projections for the retirement annuity trust, which included current, positive scenario, expected scenario, flat scenario, and negative scenario for FY 2021, FY 2022, FY 2025, FY 2030, FY 2040, and the 20-year total cost.

In response to a question from Representative DuPlessis, Mr. Barnes stated that TRS had a negative year of return in 2016 with a -1 percent. Representative DuPlessis commented that anything that happens in the markets is 100 percent on the backs of the taxpayers.

In response to a question from Representative Graviss, Mr. Barnes stated that he was not sure if TRS's actuary is doing similar smoothing techniques as does KRS' actuary.

In response to a question from Representative DuPlessis, Mr. Barnes stated that TRS has run projections on the health insurance fund and believes it should be fully funded by 2028.

Study Topic from 2019 Annual Report: Allocating Health Premium Subsidy Costs for Retirees with Service in Multiple Retirement Systems

David Eager, Executive Director, Rebecca Adkins, Executive Director of Operations, KRS and Beau Barnes, TRS, came together to talk about KRS' and TRS's health insurance reciprocity. Mr. Eager stated that he is aware that there have been no payments between KRS and TRS for a number of years and states that the issue is KRS and TRS cannot resolve what the amounts are. He stated that he and Beau Barnes are in agreement to meet and determined to resolve this issue by June 30, 2021.

Ms. Adkins gave an overview on reciprocity. She stated that reciprocity is defined such that all state-administered retirement systems allow members across multiple systems, at the time of retirement, to pull service from any system the retiree has service for eligibility of health insurance and retirement. Health insurance reciprocity is defined by KRS 61.680, KRS 61.702(3)(a)4, and KRS 61.702(3)(b)2.

Ms. Adkins then gave a description of how reciprocity works and stated that a member who has retired from multiple state-administered retirement systems at the same time selects the system from which to apply for health insurance during open enrollment. Service from both systems is used to determine how much of the premium is covered by each of the two systems. Each system pays a percentage of the premium based on the percentage of service attributable to each plan, and the amount paid by each system cannot exceed 100 percent of the monthly contribution adopted by the respective boards of trustees.

Ms. Adkins discussed the current reciprocity statistics. Between TRS and KRS, there are approximately 5,500 retirees. She stated that up until FY 2017, the calculated reciprocity reimbursement amounts varied, but generally stayed within a few hundred thousand dollars. Beginning in FY 2017, there has been a major shift to retirees electing to take insurance from KRS, and the reimbursement amounts exceed $2 million annually. For reciprocity between KRS and the Judicial Form Retirement System (JFRS), there are approximately 50 retirees with the Judicial Retirement Plan, where KRS reimburses JFRS less than $80,000 annually, and less than 5 retirees with the Legislators Retirement Plan, where KRS reimburses JFRS less than $8,000 annually. Ms. Adkins added that TRS also has reciprocity with JFRS with very small numbers.

Lastly, Ms. Adkins discussed the reciprocity issues between KRS and TRS. She stated that, until 2005, reciprocity reimbursement calculations were straightforward and were performed annually. In 2012, KRS and TRS agreed upon a one-time payment of $3.9 million from KRS to TRS for reciprocity payments from January 2, 2005, through June 30, 2012. Both parties agreed to reconcile the data and make any adjustments as needed. Since 2012, KRS and TRS staff have reviewed data and eliminated many of the discrepancies in the calculation methodologies. With work still needing to be done, there may be a time that a statutory clarification may be needed, but for now, the systems are continuing to address the issues.

Mr. Barnes added that he believes TRS and KRS will be able to work out the reciprocity issues.

With no further business, the meeting was adjourned.