PUBLIC PENSION OVERSIGHT BOARD

Minutes of the 3rd Meeting
of the 2021 Interim

May 24, 2021

Call to Order and Roll Call

The 3rd meeting of the Public Pension Oversight Board was held on Monday, May 24, 2021, at 1:00 PM, in Room 154 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, Robby Mills, Gerald A. Neal, Dennis Parrett, and Mike Wilson; Representatives Derrick Graham, Jerry T. Miller, Jason Petrie, James Tipton, Russell Webber, and Buddy Wheatley; John Chilton, Mike Harmon, John Hicks, James M. "Mac" Jefferson, and Sharon Mattingly.

Guests: Bo Cracraft, Executive Director, Judicial Form Retirement System; Beau Barnes, Deputy Executive Secretary and General Counsel, Teachers' Retirement System; and David Eager, Executive Director, Kentucky Public Pensions Authority; Rebecca Adkins, Executive Director, Office of Operations, Kentucky Public Pensions Authority; Laura Owens, Community Mental Health Centers; Joe Dan Beaver, CEO, Life Skills.

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

Approval of Minutes

Representative Tipton moved that the minutes of the April 26, 2021, meeting be approved. Representative Wheatley seconded the motion, and the minutes were approved without objection.

Investment Update – Judicial Form Retirement System

Bo Cracraft, Judicial Form Retirement System (JFRS), started his presentation with investment performance as of March 31, 2021. He reviewed the trailing performance for the fiscal-year-to-date, 1-, 3-, 5-, 10-, 20-year, and inception-to-date for defined benefit and cash balance plans for each of the judicial and legislative plans as compared to benchmarks.

Next, Mr. Cracraft discussed asset allocation. He discussed investment policy targets and defined benefit portfolios rebalanced in April 2021. The cash balance and defined benefit plans are targeting at 70 percent equity and at 30 percent fixed income. The investment manager has discretion within the +/- 10 percent range. Historically, over the short term, JFRS has been overweight on equity and, in January, they rebalanced due to being close to 80 percent equity and rebalanced again in April to about 72 percent.

Lastly, Mr. Cracraft discussed cash flow. He discussed cash inflows, cash outflows, net cash flow before asset gain/losses, realized/unrealized asset gains/losses, and change in net position for the judicial and legislative retirement plans as of March 31, 2021.

In response to a question from Representative Tipton regarding the cash balance plan, where members are guaranteed a 4 percent return investment with any returns over the 4 percent the member is credited at 75 percent with 25 percent held in a reserve in case the 4 percent needs to be balanced out in the future, Mr. Cracraft stated the reserve is not accounted for in a separate pool of assets. When the cash balance plan was created, the board made the decision to invest in a separate pool, and there was not any reserve credited until there were vested members. So, during the first five years, members earned a flat 4 percent. Since then, the plan has earned in excess of 4 percent, so there have been gains from an actuarial standpoint. Last year, the interest credited around 7.5 percent, which JFRS was able to capture some of the 25 percent for reserve. In response to a follow up, Mr. Cracraft stated that, as to the LRP where the General Assembly has not provided funding, if there were prolonged periods of negative experience, the surplus could be impacted due to having to use some of its surplus assets on the defined benefit plan.

Investment Update – Teachers' Retirement System

Beau Barnes, Teachers' Retirement System (TRS), began his presentation with investment performance for the quarter as of March 31, 2021, which was 3.36 percent net, and discussed the gross and net performance for fiscal-year-to-date, 1-, 3-, 5-, 10-, 20-year trailing time periods, and the 30-year compounded gross return of 8.45 percent. Mr. Barnes added that from 2008 to March 2021, TRS investment returns totaled a net $19.3 billion, compared to the average plan's $14 billion. This outperformance generated $5.3 billion to the benefit of Kentucky's teachers.

Mr. Barnes reviewed cash flow for the pension fund FYTD 2021 compared to FYTD 2020. He pointed out the cash inflows, including member contributions, employer contributions/appropriations, and investment income. He explained that the investment income declined over the comparative period due in part to a lower interest rate from 2 percent to nearly 0 percent and less dividends compared to gains as to investments.

In response to questions from Representative Miller, Mr. Barnes stated the first quarter of the calendar year, TRS rebalanced its portfolio, pulling $2 billion out of the stock market and moving it to cash and treasuries. In response to a second question regarding the decreased amount of investment income for the FYTD 2021 compared to FYTD 2020, Mr. Barnes further explained that over the last 9 months the interest was at 0 percent compared to 2 percent in the previous 9 months. Representative Miller requested more data with prior years included.

In response to a question from Representative Wheatley, Mr. Barnes stated AON is one of the largest consultants in the world that provides investment and medical insurance consulting for pensions. The AON Rank compares pension plans of $1 billion of assets or greater. TRS ranks in the top 49 percent out of a probable 150 to 170 public pension funds. In response to a follow up question, Mr. Barnes confirmed that TRS outperformed an average pension plan by over $5 billion between 2008 to March 2021.

In response to a question from Representative Tipton, Mr. Barnes affirmed that the TRS experience study is based on the previous five years ending June 30, 2020. In response to a follow up, Mr. Barnes stated that the actuaries also look at capital market assumptions going forward, what other investors are looking at, and consider what they see going into the future.

Mr. Barnes continued with an update of outflows, investment gains or losses, and the total net plan assets across FYTD for 2021 and FYTD 2020. The actuaries agree that the $435 million negative cash flow is still manageable, and the asset base has grown. Mr. Barnes went on to discuss the investment gains or losses and net plan assets, which stood at over $24.7 million by the end of the period.

Lastly, Mr. Barnes continued with a review of cash flow for the health insurance fund through FYTD 2021 compared to FYTD 2020. He pointed out cash inflows, outflows, investment gains or losses, and the total net plan assets across both time periods. Cash flow remained positive.

In response to a question from Auditor Harmon, Mr. Barnes stated that the funding level percentage is 58.4 percent as of June 30, 2020, and the unfunded liability stood at $14.8 billion in the pension trust.

In response to a question from Representative Miller, Mr. Barnes stated the experience study will be presented to the TRS Board on June 21, 2021. He added that assumptions can change depending on the outcome of the experience study.

In response to questions from Mr. Jefferson, Mr. Barnes stated that the net returns, within the presentation, do not include carried interest and stated that it is included in the comprehensive financial report as a separate item. He added that TRS does not consider carried interest an expense. In response to a follow up, Mr. Barnes stated that as of June 30, 2020, the pension trust's funded status was 58.4 percent and the health insurance trust's funded status was 61.7 percent. Further, TRS is comfortable with the cash flow numbers in both pension and health.

In response to a question from Representative DuPlessis, Mr. Barnes stated that there is certainly a lot of talk about inflation moving upward.

Investment Update – Kentucky Public Pension Authority

David Eager, Kentucky Public Pension Authority (KPPA), began by responding to a question from Representative Tipton from the last Public Pension Oversight Board (PPOB) meeting in April. He stated that KPPA cannot project the liability of June 30, 2021, and did not know the market value of the assets. KPPA may have an estimate by late July from GRS.

Mr. Eager began his presentation discussing performance and cash flow highlights stating that all pension year-to-date performance was 18.44 percent resulting in a net increase of $2.3 billion in assets. The insurance performance was 18.74 percent resulting in a net increase of $1.0 billion in assets. Performance above the benchmark was 106 basis points for pension, which is equal to $134.9 million and 102 basis points for insurance, which is equal to $55.9 million. Mr. Eager provided cash flow highlights, stating that Kentucky Employees Retirement System (KERS) nonhazardous is cash positive and County Employees Retirement System (CERS) is not cash positive.

Mr. Eager discussed the pension and health investment updates as of March 31, 2021. He discussed the net of fees rates of return for the FYTD, 1-, 3-, 5-, 10-, 20-, and 30-year periods for all plan systems along with their plan index.

Mr. Eager discussed the cash flow for the pension funds. He discussed the cash inflows, cash outflows, net contributions, and change in net position for the period of ending on March 31, 2021, compared to the prior year ending on March 31, 2020.

In response to a question from Representative DuPlessis regarding the funding ratio, Mr. Eager stated that he would have to get back with an answer.

Mr. Eager continued to discuss cash flow for the health insurance funds. He discussed the cash inflows, cash outflows, net contributions, and change in net position for the period of March 31, 2021, compared to March 31, 2020.

In response to a question from Mr. Jefferson, Mr. Eager stated that he believes that the member contributions have been negative for the last ten years. Representative DuPlessis stated that he hopes that HB 8 stops the negative decline in member contributions.

In response to a question from Representative Miller regarding de-emphasizing national equities, Mr. Eager stated that he believes there would be some reduction due to KPPA lowering risk. It is anticipated that the value is going to be added more in active managers versus the index funds.

In response to a question from Representative Tipton regarding the KPPA plans' investments in hedge funds, Mr. Eager stated KPPA had about $1.5 billion at one point and are down to about $300 million at present.

House Bill 8 Appeal Process Discussion

Representative DuPlessis explained that he, Mr. Eager, and representatives from regional/community mental health centers (CMHCs) have had several conversations regarding how KPPA would calculate the actuarially accrued liability contribution (unfunded liability) of CHMCs for payment on or after July 1, 2021. The CHMCs had asked for particular data, and KPPA was, at that time, not willing to share some of the data.

Laura Owens, Partner JYB3 Group, stated that she was here as a legislative agent for Life Skills and Pennyrile and that many of the CHMCs have reached out asking for the information.

Joe Dan Beaver, CEO, Life Skills and the Pennyrile Center, discussed the importance of this issue and appreciates the help from the legislators. HB 8 has provided the ability to move forward with the challenges of paying the employer costs of pensions, particularly with the appeal process. The data that the CMHCs, specifically Life Skills and the Pennyrile Center, are seeking relate to employee information and will be a material component in determining the unfunded liability. Under the appeal process, it will also allow fraud-based analytical reviews. He added that transparency is the hallmark of good governance and a good aspect to have in order to pay their fair share.

Representative DuPlessis stated that the whole point of HB 8 was to pay what is owed and trust what is being paid.

Mr. Eager discussed the HB 8 appeals process. He stated that HB 8 is going to cause a lot of employers' rates to go down and others to go up. The KPPA's concern is that for those employers that also have the option to cease participating, the additional data requested could be used adversely against employee members. Rebecca Adkins, Director of Operations, KPPA, explained that such employee liability data has never been provided to agencies that had the option to voluntarily cease participation. While CHMCs can no longer cease under the terms of HB 1 (19 SS), they can still voluntarily cease participation under KRS 61.522.

Representative DuPlessis commented that HB 8 provides that you can no longer cease employment to save money. In response to a question from Representative DuPlessis regarding why KPPA is unwilling to give the data information, Mr. Eager stated that these agencies can also cease participation. In response to a question from Representative DuPlessis, Ms. Adkins clarified that the cessation liability is a different calculation than the HB 8 liability.

Representative Tipton commented that Mr. Eager is correct. In 2015, legislation was enacted that would allow certain quasi-governmental employers to cease participation, either voluntarily or involuntarily, under a formula specific to cessation. He added there may need to be more research and discussion.

Representative DuPlessis added that there might need to be a legislative change relative to data availability to employers.

Members of the PPOB asked if a concern was that the agency receiving the data would then determine which individuals make up a larger share of the unfunded liability and then terminate an individual's employment prior to ceasing participation in the system. Mr. Eager responded yes. Mr. Beaver stated that he believes that is illegal.

Representative DuPlessis commented that KPPA's purpose is not hiring and employment decisions of participating employers, but to manage money and the data associated. Mr. Eager stated that in order to get an accurate number an actuary would need to verify the liability. Mr. Beaver added that they are not asking to recalculate the number, but reasonableness. Ms. Owens added this is information is something that quasis should have the right to have for their employees.

In response to a question from Senator Higdon regarding KPPA having a hold harmless type contract, Mr. Eager stated that he would need to consult with his legal department.

In response to a question from Representative Wheatley, Mr. Beaver stated that there could be an audit required regarding the data received for an accurate confirmation.

Representative Miller commented that he believes there could be a hold harmless agreement to be able to move forward. Mr. Beaver, agreed.

Representative Tipton commented that the appeal has to take place on or before July 1.

Senator Parrett commented that the process needs to be done quick and very thorough.

Representative DuPlessis commented that KPPA needs to have a better answer as to why they are not sharing the data information.

With no further business, the meeting was adjourned.