

PUBLIC PENSION OVERSIGHT BOARD

Minutes of the 2nd Meeting of the 2021 Interim

April 26, 2021

Call to Order and Roll Call

The 2nd meeting of the Public Pension Oversight Board was held on Monday, April 26, 2021, at 1:00 PM, in Room 154 of the Capitol Annex. Senator Jimmy Higdon, 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, Dennis Parrett, and Mike Wilson; Representatives Derrick Graham, Jerry T. Miller, Jason Petrie, James Tipton, Russell Webber, and Buddy Wheatley; John Chilton, Joseph Fawns, Mike Harmon, John Hicks, James M. "Mac" Jefferson, and Sharon Mattingly.

Guests: David Eager, Executive Director, Kentucky Public Pensions Authority; Kathy Rupinen, Executive Director, Office of Legal Services, Kentucky Retirement Systems; Beau Barnes, Deputy Executive Secretary and General Counsel, Teachers' Retirement System.

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

Approval of Minutes

Senator Parrett moved that the minutes of the February 22, 2021, meeting be approved. Representative Wheatley seconded the motion, and the minutes were approved without objection.

Update on HB 484 (2020 RS) Implementation

David Eager, Executive Director, Kentucky Public Pensions Authority (KPPA), began his presentation with some good news. Since June 30, 2020, investments are up around 20 percent, and assets grew from \$18.3 billion to \$22.1 billion. This gives the investment team the opportunity to de-risk and make some changes in the investment allocation in the coming year.

Mr. Eager discussed the implementation of HB 484, and stated that KPPA staff has worked diligently and over extended hours to address the transition to two new boards as well as addressing all other duties, including those relating to the 2021 General Assembly. For the reorganization, there are two common objectives: 1) To vest governance control of

the County Employees Retirement System (CERS) pension and health care systems with a board of CERS elected members and gubernatorial appointed trustees; and 2) To establish and maintain the new structure with the least amount of disruption and added expense. KPPA staff has made a lot of progress in keeping the complexity and duplication low.

Mr. Eager provided more detail regarding the implementation of HB 484 and HB 9 (2021 RS). There are two new governance boards: the CERS board and the Kentucky Retirement Systems (KRS) board, which governs the Kentucky Employees Retirement System (KERS) and State Police Retirement System plans. Under HB 9, there was no need to establish new pension and health trusts just for CERS. Rather, the statutes have been amended to reflect the appropriate governance for the trust assets (C-assets and K-assets), while the KRS Trust remains intact, thereby saving money and avoiding a wholesale rewriting of contracts

Mr. Eager discussed the new KPPA, stating that it has 250 employees with himself being the Executive Director. KPPA is responsible for benefit administration, employer reporting, investments, legal, actuarial, legislative liaison for KPPA issues, accounting and audit, communications, and CERS and KRS board and committee support. KPPA will select the actuary, investment consultant, custodian, outside legal counsel, accountant, and other service providers, which will avoid duplicative responsibilities and expenses.

Mr. Eager discussed tasks and issues. Planning for the CERS separation began in earnest following the passage of HB 484 (2020 RS). At that time, there were 104 separate tasks/issues originally identified that needed to be resolved for a successful transition, 74 of which have been completed, 30 which are still in process, including the investment procurement, which is 80 percent complete. Additional tasks/issues include the election of trustees, finalizing bylaws and numerous policies, form revisions, establishing new contracts, deciding on fiduciary insurance, retaining CEOs and legal counsel, and changing literature. Further, staff is beginning a list for a housekeeping bill in 2022.

Next, Mr. Eager discussed the board membership structure for KPPA, CERS and KRS, including elected and appointed board members and current vacancies. The current chairs are Betty Pendergrass for the CERS board and Keith Percy for the KRS board. Mr. Percy will chair and Ms. Pendergrass will serve as vice-chair for the KPPA board. Mr. Eager also provided the names and short bios for the other members of the respective boards.

In response to a question from Representative Wheatley regarding whether the legal office has expressed any concerns regarding the fiduciary duties of trustees serving on multiple boards, Ms. Kathy Rupinen, Executive Director, Office of Legal Services, KPPA, stated KRS 61.505 specifically provides that while the trustees are serving on the KPPA board or on joint committees, the trustees are to act in the best interest of both systems.

In response to questions from Representative Miller, Mr. Eager stated that there are two actuarial committees, but one actuary that is selected by KPPA. In response to a follow up question, Mr. Eager stated that each board will draft its own investment policies.

Lastly, Mr. Eager provided an update on HB 8 (RS 2021) regarding agency cessation of participation. As it relates to this bill, both Northern Kentucky University and the Kentucky Housing Corporation (tentative) are leaving KERS nonhazardous, 47 quasi-governmental employers have requested HB 8 liability data for comparison purposes, 19 quasi-governmental employers have completed their comparisons, none have yet appealed, and training has been conducted for agencies.

In response to a question from Mr. Chilton, Mr. Eager stated that the trust that holds the assets for the KRS and CERS plans maintains the assets in separate accounts.

In response to questions from Representative DuPlessis regarding provisions for a member that commits a felony in their line of work and how KPPA receives notification of the felony, Ms. Rupinen stated that KRS 61.535, which now has parallel legislation for CERS, provides that, for individuals hired before August 2000, termination as a result of a felony related to some kind of malfeasance or theft from their employment results in loss of retirement benefits; for individuals hired after August 1, 2000, the forfeiture of retirement benefits occurs if the individual is convicted of felony “related to their employment” in a court competent jurisdiction. Since February 2019, KPPA (formerly KRS) has had 8 individuals who have had their membership terminated as a result of a conviction under the statute. Ms. Rupinen described the process conducted by the retirement system in these cases. Although employers have a duty to report a felony conviction, a felony conviction of a member is mostly discovered through the media or via law enforcement or sometimes from co-workers. KPPA has an investigator on staff who is building relationships with several federal prosecutors and law enforcement agencies who have started to report back to KPPA.

In response to a question from Senator Higdon regarding if new legislation needs to be passed, Ms. Rupinen stated that the legislation is clear that an employer shall notify the retirement systems when an employee is convicted of a felony related to their employment, but possibly a regulation clarifying how the notification is given could be helpful.

In response to a question from Representative Tipton requesting an update on the 2018 assumption rate changes that were capped at no more than a 12 percent increase per year for CERS, Mr. Eager stated that he would have to report back. In response to a follow up regarding an update of the adjusted percentage of funding level with the increase in asset allocation, Mr. Eager stated he would have to report back.

In response to a question from Representative Tipton regarding the judge’s ruling in the *Mayberry et al v. KKR et al* case as reported in the Lexington Herald, Ms. Rupinen

stated that KPPA has retained a law firm that is based in New York City to conduct the investigation. The contract is broad in that it requests that the firm look at investment actions but with an emphasis on the matters before the court. The board's intention is to have a report available pursuant to and in compliance with Judge Shepherd's orders, which require the investigative report be provided to the Attorney General.

Update on HB 258 (2021 RS) Implementation and Actuarial Experience Study Progress

Beau Barnes, Deputy Executive Secretary and General Counsel, Teachers' Retirement System (TRS) began his presentation with good news on investment returns as of March 31, 2021. The fiscal-year-to-date returns are at 23 percent with the 1-, 3-, 5-, 10- and 30- year returns above the 7.5 percent assumed rate at 8.54 percent. The 20-year period, which includes the Tech.com bubble and the 2008 great recession, are still below the 7.5 percent assumed rate at 7.4 percent.

Mr. Barnes discussed the updates on HB 258 (RS 2021). HB 258 provides a new retirement tier for new members joining TRS on or after January 1, 2022. The new tier is a social security replacement plan and creates a new hybrid plan. The new tier will increase the minimum retirement age to 57 and it shifts risk of any developing unfunded liability from the Commonwealth to the members. The new tier is established as a 100 percent funded plan with excess contributions going to a stabilization reserve account. If funding goes below 90 percent, the board is required to take action to maintain the funding level by using reserve funds and/or reducing benefits.

Mr. Barnes stated that TRS started implementing HB 258 before the General Assembly adjourned by preparing summaries with questions and answers to educate and prepare staff for inquiries from members. TRS staff is having daily meetings to ensure that HB 258 will be implemented by January 1, 2022. The summary plan description for the new tier, law books, and related publications for all members are being updated. TRS is creating training content, including a video for members, to be posted on the website.

In response to a question from Senator Higdon, Mr. Barnes stated that an actuarial analysis was performed, filed, and updated for HB 258. The analysis shows the cost and savings projections and is available on the LRC website.

In response to a question from Representative Wheatley, Mr. Barnes stated that the five-year vesting requirement is still in place for the new tier. If someone leaves employment prior to the five year period, they would be entitled a refund of their contributions with interest only. In response to a follow up question regarding there being anything less than 100 percent funding until five years after January 1, 2022, Mr. Barnes stated that anything is possible, but a member with less than five years vested in the system would still be entitled to their contributions with interest upon leaving employment. Mr.

Barnes explained how the structure of the new tier would maintain 100 percent funding under such a scenario.

Mr. Barnes discussed the experience study that will be concluded June 2021. He stated that TRS does a five year experience study, which is a look back over the last five year period of assumptions compared to what actually happened. In response to a question from Senator Higdon, Mr. Barnes stated that the TRS board will make decisions regarding assumptions based on the experience study in June 2021.

In response to a question from Senator Higdon regarding the provisions for a member that commits a felony in their line of work and how TRS receives notification of the felony, Mr. Barnes stated TRS has a similar statute as KPPA, under which members or any individuals who become members of TRS on or after August 1, 2000, who are convicted of a felony related to their employment, forfeit all rights to pension benefits except for the return of their contributions plus interest. It is rare that a member has a felony conviction related to their employment, and Mr. Barnes could only recall a handful of members whose retirement benefits had been forfeited under such circumstances. As far as reporting methods, when a teacher or school administrator is convicted of a felony that is usually big news with the media. TRS monitors state and local media.

In response to a question from Representative DuPlessis regarding the interest received despite the forfeiture of pension benefits, Mr. Barnes stated that a member is entitled to a set amount of interest accrued on the member's own contributions. If an individual became a member before July 1, 2008, the interest is a fixed rate of 3 percent; for individuals who became a member on or after July 1, 2008, the interest is 2.5 percent. In response to follow up questions, Mr. Barnes stated that TRS will look into a way to have better reporting of these felony convictions and will provide that change as part of a housekeeping bill.

In response to a question from Senator Higdon, Mr. Barnes stated that the returns presented were combined returns, and returns on the health care trusts were slightly lower than the pension side but still strong.

With no further business, the meeting was adjourned.