PUBLIC PENSION OVERSIGHT BOARD

Minutes of the 9th Meeting of the 2021 Interim

November 22, 2021

Call to Order and Roll Call

The 9th meeting of the Public Pension Oversight Board was held on Monday, November 22, 2021, at 3:00 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 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 Hicks, and Sharon Mattingly.

Guests: Bo Cracraft, Executive Director, Judicial Form Retirement System; David Eager, Executive Director, Erin Surratt, Executive Director of Benefits, Kentucky Public Pensions Authority; Danny White and Janie Shaw, GRS Consulting; and Beau Barnes, Deputy Executive Secretary and General Counsel, Teachers' Retirement System.

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

Representative DuPlessis recognized and welcomed Sarah Beth Gregory, Chief of Staff for the Auditor of Public Accounts, who was attending for Auditor Mike Harmon.

Approval of Minutes

Representative Tipton moved that the minutes of the October 19, 2021, meeting be approved. Senator Mills seconded the motion, and the minutes were approved without objection.

2021 Actuarial Valuation Update – Judicial Form Retirement System

Bo Cracraft, Judicial Form Retirement System, started his presentation with investment performance as of June 30, 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 Retirement Plan (JRP) and Legislators' Retirement Plan (LRP) as compared to benchmarks.

Mr. Cracraft discussed cash flow for the plans. He discussed cash inflows, cash outflows, net cash flow before asset gain/losses, realized/unrealized asset gains/losses, and change in net position for each plan as of June 30, 2021.

Next, Mr. Cracraft discussed the funding valuation results that were completed July 1, 2021. New assumptions were adopted as a result of an experience study conducted in October 2020, and approved in April 2021. Specifically, the mortality assumptions were changed; the investment return assumption for the hybrid cash balance tier of benefits was updated to 6.5 percent, which is the same as what is utilized for the legacy tier; and the two tiers of benefits were consolidated for actuarial purposes. Mr. Cracraft noted that half of the active membership in the LRP is now participating in the hybrid cash balance tier. He also discussed the pension and retiree health funding statistics and contribution levels for JRP and LRP. Funding levels for the JRP and LRP pension and retiree health funds improved, and the actuarially determined employer contribution (ADEC) declined, due to the positive asset gains. With the exception of the pension fund for the JRP, which is 95 percent funded, the other three funds are fully funded.

In response to a question from Representative Tipton, Mr. Cracraft stated it is accurate to say that, even though the General Assembly has chosen not to add funding to the LRP during the last two budget cycles, it has not negatively impacted the plan's situation due to the outsized investment returns over the last five years.

In response to a question from Representative DuPlessis, Mr. Cracraft stated that both retiree health funds have a zero ADEC request as a result of the current funding level. In response to a follow-up question regarding whether employee members should continue to pay the same rate into those funds, Mr. Cracraft stated the board's actuary had recently noted the overpayment issue in regards to the hybrid cash balance members. The issue is under active discussion by the board.

Lastly, Mr. Cracraft discussed JFRS housekeeping requests, which included: amending KRS 21.525 to revise the UAL amortization policy; amending KRS 21.540 to clarify the budget request process for administrative expenses; and providing technical cleanup for KRS Chapter 6 and 21.

2021 Actuarial Valuation Update – Kentucky Public Pensions Authority

David Eager, Kentucky Public Pensions Authority (KPPA), began his presentation by discussing the 2021 actuarial valuation results. For the fiscal year ending June 30, 2021, the investment returns were 21 to 25 percent on market value on the various funds. Additionally, there was $902 million more than expected for Kentucky Employees Retirement System (KERS) and State Police Retirement System (SPRS) funds, with $191 million in asset gains recognized this year via the asset smoothing method.

Mr. Eager stated that it is imperative to maintain or increase the contribution effort for the KERS non-hazardous retirement fund. As of June 30, 2021, the plan assets were $3,019 million with $1,030 million in benefit payments and administrative expenses in fiscal year 2021 and an actuarially determined employer contribution (ADEC) of $1,129 million for fiscal year end 2023.

Mr. Eager discussed the active membership count for KERS non-hazardous. The count is down 4.8 percent with an average decrease of 4.3 percent over the last 10 years.

In response to a question from Representative DuPlessis, Mr. Eager agreed that, as a result of HB 8, there is now an incentive to hire and not outsource.

Mr. Eager discussed the pension and retiree health updated contribution rates for KERS and SPRS. The positive effects of HB 8 are, in part, demonstrated in the resulting modest reduction in rates.

Mr. Eager discussed the funding results for KERS nonhazardous pension fund from fiscal years 2020 to 2021. He stated that the actuarially accrued liability has declined from $16,349 million to $16,321 million with a corresponding rise in the actuarial value of assets. The unfunded liability has declined from $14,026 million to $13,585 million, and the funded ratio has increased from 14.2 percent to 16.8 percent. Mr. Eager distinguished the actuarial funded ratio from the GASB number of 18.5 percent, which reflects the market value. The funding results for SPRS unfunded pension liability went from $757 million to $730 million with the funding ratio going from 28.1 percent to 30.1 percent.

Mr. Eager discussed the projections for KERS non-hazardous pension and insurance funds from 2021 through 2048, contingent on meeting assumptions for unfunded liability, funded ratio, amortization cost, and normal cost.

Mr. Eager presented a sensitivity analysis for the discount rate and inflation rate for the KERS non-hazardous members. The results provided retirement, retiree health, and combined figures.

Mr. Eager discussed the County Employees Retirement System (CERS) valuation results. The fund experienced a 25 percent return on market value and produced an additional $2,504 million in assets, with $511 million in asset gains recognized this year via the asset smoothing method. Mr. Eager also presented the contribution rates and funded ratios for the CERS non-hazardous and hazardous plans.

In response to a comment from Representative DuPlessis regarding that it would be easier on the budget if the assumed rate of return was at 6.25 percent and not 5.25 percent, Mr. Eager stated more of a funded status would help before taking such a step.

Senator Higdon commented that, while the question of raising the assumed rate of return is certainly worth asking, he believes the current contributions are suitable and that the pensions are in a much better state than they were previously.

Mr. Eager discussed the contributions for all plans as of June 30, 2021. He said that all systems are positive, except CERS, which is still phasing in to the full contribution rate. He discussed contribution inflows, outflows, net contributions, and realized and unrealized gains.

Lastly, Mr. Eager discussed the investment performance and cash flow highlights for September 30, 2021. He stated that all 10 funds had positive returns, nine of which beat their plan index modestly, which is worth over $44 million in additional assets. There was positive cash flow for most plans even before investment gains.

In response to a question from Representative Wheatley, Mr. Eager stated that the median trend for assumed rates of return is below 7 percent. Janie Shaw, GRS Consulting (GRS), stated that there is no doubt that the investment return assumption is certainly below the median of peers, but KERS non-hazardous is certainly in a unique situation. The trend associated with the investment return assumptions across the nation is definitely downward consistent with the advice of other consultants such as GRS. For KERS non-hazardous, it is important to continue to maintain the current contributions to keep positive cash flow and to help maintain the increase in the funded ratio.

In response to a question from Representative DuPlessis regarding a change to the assumed rate of return as discussed, GRS reported that the amortization costs would decrease from $994 million to $921 million. However, changes to the assumption would carry increased risk in not meeting the assumptions.

Representative DuPlessis commented that he believes it is worth having a conversation concerning assumption rates. Mr. Eager added that GRS agrees.

Representative Miller cautioned the body against overly optimistic actions.

Erin Surratt, KPPA, stated that they have several housekeeping items, particularly relating to bills that passed last session that will need general clean up.

2021 Actuarial Valuation Update – Teachers' Retirement System

Beau Barnes, Teachers' Retirement System (TRS), began his presentation with investment performance for the retirement annuity trust as of June 30, 2021, reporting a fiscal year return of 29.59 percent. He reviewed the gross and net performance for fiscal-year-to-date, 1-, 3-, 5-, 10-, 20-year, and the 30-year returns for the fiscal year ending June 30, 2021 and the quarter ending September 30, 2021, respectively. He also reviewed the investment performance for the retiree health insurance trust on the quarter, 1-, 3-, 5-, and 10-year returns for the same periods.

Mr. Barnes reviewed cash flow for the pension funds comparing fiscal year 2021 to fiscal year 2020. He discussed the cash inflows, cash outflows, investment gains or losses, and the total net plan assets across both time periods. He explained that the investment income declined over the comparative period due in part to low interest rates and less dividends compared to gains as to investments.

Senator Higdon commented that he is always concerned about the negative cash flow.

In response to a question from Representative Miller, Mr. Barnes stated that investment income dropped $100 million due mostly to fixed income bonds and interest rates, which were very low.

In response to a question from Representative DuPlessis, Mr. Barnes stated that TRS has lower administrative expenses than most other state pension plans. Mr. Barnes will update the board at a later date regarding investment expenses.

Mr. Barnes continued with the cash flow for the retiree health insurance fund comparing fiscal year 2021 to fiscal year 2020. He reviewed the cash inflows, cash outflows, investment gains or losses, and total net plan assets.

In response to a question from Senator Higdon, Mr. Barnes stated that with the structured shared responsibility under the retiree health insurance trust, TRS is getting healthy contributions coming in to the net cash flow.

Mr. Barnes discussed the cash flow update for the retirement annuity trust and retiree health insurance trust for the quarter ending September 30, 2021. He reviewed the cash inflows, cash outflows, investment gains or losses, and total net plan assets for each trust.

Mr. Barnes summarized the 2021 retirement annuity and health insurance valuations for the June 30, 2021 fiscal year, and compared those results to the June 30, 2020 fiscal year. The unfunded liability went from $14.9 billion to $17 billion for the retirement annuity trust and from $1.1 billion to $1.4 billion for the retiree health insurance trust. The funded ratios went from 58.4 percent to 57.2 percent for the retirement annuity trust and from 61.7 percent to 60 percent for the retiree health insurance trust. He noted that this valuation is the first reflection of the assumption changes from the recent 5 year experience study.

In response to a question from Senator Higdon, Mr. Barnes stated the liabilities have increased by $4 billion. The primary assumption changes, reducing the assumed rate of return and changing the mortality tables, were responsible for over $3 billion of the increase. Mr. Barnes noted that the system's assets did increase, but reminded the board members that investment returns are smoothed over a 5-year period. In this manner, smoothing is a good method to flatten the market peaks and valleys and provide consistency in budgets.

Mr. Barnes discussed the actuarial findings. TRS received 100 percent of the ADEC for the retirement annuity, the annuity trust increased by $5.2 billion, and negative cash flow for 2021 as a percentage of assets was negative 3.79 percent. He also reviewed the actuarial experience gains/(loss) analysis.

In response to a question from Representative DuPlessis, Mr. Barnes stated that the assumption changes are recognized immediately, as well as the mortality tables, unlike the 5-year smoothing on returns. The contribution requests are not being recognized immediately, but will be phased in over a 5-year period.

Mr. Barnes discussed the 2022-2024 budget request. He reviewed annual expenditures, additional ADEC requested, the fixed statutory contribution through SEEK in the Kentucky Department of Education's (KDE) budget, and the state's expenditure for debt service. The total TRS budget request for fiscal year 2023 is $843.2 million and for fiscal year 2024 is $852.6 million. With the addition of the SEEK formula funding for school districts requested through the KDE budget, the total state's expenditure requested that would be directed to TRS is $1.299 billion for fiscal year 2023 and $1.301 billion for fiscal year 2024.

In response to a question from Senator Higdon, Mr. Barnes stated that budget requests are based on a fiscal year that has not happened yet, which means there are projections for future expenses that may be higher or lower during the year. In response to a follow-up, Mr. Barnes stated that decreasing amortized payments reflected in the budget include the last remaining payments for the old cost of living adjustments that exceeded the statutory 1.5 percent and sick leave payments. In response to a follow-up, Mr. Barnes stated that the $770 million ARC request has increased due to the green box dollars and the sick leave payments. In response to a follow-up, Mr. Barnes stated that there will continue to be increases with the ARC over the next 5 years as a result of the changes in the assumptions.

Legislative Proposals

Representative Miller discussed his legislative proposals. He began with BR 341, which proposes to: amend KRS 21.440, 61.670, 78.784, and 161.400 to require the LRP, the JRP, the Kentucky Retirement Systems, the CERS, and the TRS to perform an actuarial investigation of economic assumptions once every 2 years, rather than once every 5 years while retaining a review of demographic assumptions once every 5 years; amend KRS 78.784 to require the CERS to provide a projection/analysis over a 30-year period rather than a 20-year period regarding projections in the annual actuarial valuation and as it relates to experience studies, assumption changes, and other changes made by the boards of each system; and require the first actuarial investigation of economic assumptions to occur prior to the 2023 actuarial valuations for the systems. He requested that BR 341 be included in the PPOB's recommendations for 2022.

Secondly, he discussed BR 40, which proposes to amend KRS 61.598 to exempt from the anti-pension spiking provisions any overtime directly attributable to a local government emergency in which the Governor calls in the Kentucky National Guard and to make those amendments retroactive to May 30, 2020, and have the Act declared an EMERGENCY.

In response to a question from Representative Tipton, Representative Miller explained that BR 40 would be retroactive to May 30, 2020, when the Governor sent in the National Guard into Metro Louisville.

In response to comment from Representative DuPlessis, Representative Miller confirmed that, in order for the anti-spiking exception to be triggered, the Governor would have to call in the National Guard.

In response to a question from Representative Graham, Representative Miller stated that for those who have been retired since May 30, 2020, the bill would be retroactively applied to apply the anti-spiking exception and would adjust the benefits of the retirees accordingly.

In response to a question from Representative Wheatley, Representative Miller stated that as a result of BR 40, the Governor would either have to call a state of emergency or send in the National Guard in order for the anti-spiking exception to apply.

With no further business, the meeting was adjourned.