PUBLIC PENSION OVERSIGHT BOARD

Minutes of the 9th Meeting of the 2022 Interim

November 15, 2022

Call to Order and Roll Call

The 9th meeting of the Public Pension Oversight Board was held on Tuesday, November 15, 2022, at 3:00 PM, in Room 154 of the Capitol Annex. Representative James Tipton, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Jimmy Higdon, Co-Chair; Representative James Tipton, Co-Chair; Senators Christian McDaniel, Robby Mills, Michael J. Nemes, Dennis Parrett, Damon Thayer, and Mike Wilson; Representatives Ken Fleming, Derrick Graham, Jerry T. Miller, Jason Petrie, Phillip Pratt, and Buddy Wheatley; Sara Beth Gregory, Proxy for Mike Harmon, John Hicks, and Sharon Mattingly.

Guests: Bo Cracraft, Executive Director, Judicial Form Retirement System; David Eager, Executive Director, 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, Michael Clancy, and Angela Rhodes.

Approval of Minutes

Representative Fleming moved that the minutes of the October 25, 2022, meeting be approved. Senator Parrett seconded the motion, and the minutes were approved without objection.

2022 Actuarial Valuation Update – Judicial Form Retirement System

Bo Cracraft, Executive Director, Judicial Form Retirement System (JFRS) discussed that public pension funds have been required to report since 2013 two sets of actuarial valuation data—one used for funding purposes that determines budget needs and one used for accounting/financial reporting purposes that are calculated in accordance with standards established by the Governmental Accounting Standards Board (GASB). He noted that JFRS is different from the other state systems in that JFRS is required to perform a funding valuation only once every two years to coincide with the biennial budgeting process but are required by GASB standards to annually perform a GASB based valuation. Both a funding and accounting valuation is conducted annually for each of the other state systems. Consequently, only GASB accounting values are available in the 2022 JFRS valuations which will not have an impact on plan funding.

Mr. Cracraft discussed the GASB results. All pension and health plans remain fully funded with a slight decline on the liability. However, the market value assets declined 12 percent. Mr. Cracraft stated the JFRS will do a funding valuation at the end of FY 2023 to determine budget needs in the next biennium.

Mr. Cracraft mentioned to the board that about 15 percent of JFRS' active membership is retiring, which is significant.

In response to a question from Representative Tipton, Mr. Cracraft stated it depends on the current year situation whether the JFRS funds will remain at 100 percent. In response to a follow-up, Mr. Cracraft stated that 2018 or 2019 was the last time the General Assembly fully funded Legislators Retirement Plan.

In response to a question from Senator Higdon, Mr. Cracraft stated that JFRS' proxy voting manager and investment manager is Baird Trust.

2022 Actuarial Valuation Update – Kentucky Public Pensions Authority

David Eager, Executive Director, Kentucky Public Pensions Authority (KPPA), began the presentation with good news. KPPA, despite the poor investment markets in 2022, experienced an increase in funded status for all pension funds due to the impact of asset smoothing and a dramatic increase in the funded status of the retiree health plans due to reductions in Medicare eligible retiree premium costs.

Danny White, GRS Consulting (GRS), stated the results of the valuation are as of June 30, 2022. He began with an overview of the 2022 passed legislation. SB 209 increased health insurance benefits to members hired after July 1, 2003; HB 259 provides for the conversion of excess unused sick leave to employer pay credits for cash balance plan members in the State Police Retirement System (SPRS); HB 1 and HB 604 collectively provides $250 million in additional appropriations above required amounts to the Kentucky Employees Retirement System (KERS) non-hazardous pension fund in both FY 2023 and FY 2024; and HB 1 provided $215 million in additional appropriations above required amounts to the SPRS pension fund in FY 2022.

Mr. White discussed the FY 2022 investment experience. There was a -5 to -6 percent return on market value (varies by fund). Fund assets compared to the expected return resulted about $2.6 to $2.7 billion less than expected for all funds combined in FY 22. For comparison purposes, FY 2021 returns resulted in about $3.4 billion more than expected from all funds. In FY 22, there was an unexpected liability experience loss of $880 million for all retirement funds combined. The liability is approximately 2 percent higher than expected. The insurance fund liability experience resulted in a $2.6 billion gain on all insurance funds combined due to the reduction in Medicare eligible premiums as previously noted by Mr. Eager.

In response to a question from Representative Tipton regarding medical inflation trends in the valuation, Mr. White stated that GRS anticipates Medicare eligible plan costs will go up in future years and the assumption, which is called medical trend, has been adjusted to reflect this anticipated increase.

Mr. White discussed the change in covered payroll. Since the KERS non-hazardous fund no longer collects contributions for the amortization cost on payroll based upon a percentage of payroll, the change in covered payroll does not influence the level of contributions paid into the systems for the unfunded liability. Across the other funds, covered payroll increased by 1.7 percent for KERS hazardous, 5.6 percent for SPRS, 6.4 percent for County Employees Retirement System (CERS) nonhazardous, and 7.4 percent for CERS hazardous.

Mr. White commented on the KERS nonhazardous retirement fund. It is imperative to maintain or increase contribution efforts. As of June 30, 2022 plan assets were $3 billion.

Janie Shaw, GRS, discussed the Actuarially Determined Employer Contributions (ADEC) for the KERS, CERS, and SPRS pension and insurance funds. The 2021 valuation established the contribution requirement for FYE 2023 and FYE 2024 for KERS and SPRS. The contributions calculated in the 2022 valuation are for informational purposes only for these systems. She reviewed comparisons for 2021 versus 2022 valuations for KERS non-hazardous, KERS hazardous, and SPRS.

Ms. Shaw discussed the ADEC amounts payable by CERS non-hazardous and CERS hazardous for the 2021 valuation and the 2022 valuation. The 2021 valuation established the contribution requirement for FY 2023. The contributions calculated in the 2022 set the contribution rates for FY 2024 and will go down due to the favorable Medicare eligible premium experience previously noted.

Ms. Shaw provided a comparison of the unfunded liability in the 2021 and 2022 valuations for all funds under the KPPA umbrella. The funded ratios for all pension and retiree health funds improved in 2022.

In response to questions from Representative Tipton regarding trends in investment return assumptions, Mr. White stated that GRS has provided KPPA with a chart that shows the downward trend in this assumption among public pension funds over time. In response to a follow-up, Mr. White stated that with the information from the current valuation, at this time he would not recommend an increase in the investment return assumptions for any of the KPPA systems.

In response to a question from Senator Higdon, Mr. Eager stated that Institutional Shareholder Services (ISS) provides proxy voting services to the systems.

2022 Actuarial Valuation Update – Teachers' Retirement System

Beau Barnes, Deputy Executive Secretary and General Counsel, Teachers' Retirement System (TRS), began his presentation mentioning that TRS recently received their 2022 actuarial valuations and staff have not had time to review in detail. He discussed key points, which included investment returns for the retirement fund and retiree health insurance trusts, how the impact of investment losses from FY 22 were limited due to asset smoothing, and the additional funding of $479 million appropriated to pay off previously awarded benefits. TRS had a new tier (TRS 4) take affect January 1 with about 3,100 members enrolled to date.

Mr. Barnes reviewed a 2021 versus 2022 comparison summary of actuarial valuation for the pension and retiree health insurance funds that included actuarial assets, liabilities, unfunded liabilities, and funded ratio.

Mr. Barnes discussed the cash flow data from the actuarial reports. TRS received 140 percent of actuarially determined employer contribution for the pension fund and that the negative cash flow for 2022 as a percentage of assets improved to (1.19) percent from the prior year value of (3.85), with the main difference being the additional $479 in appropriations previously noted.

Mr. Barnes provided an analysis of the actuarial experience gain/(loss) findings. He discussed investment return, salary increases, turnover and retirement, mortality, new entrants, other (interest and contributions), and assumption changes.

Mr. Barnes discussed the 2024-2026 budget request. He provided comparisons from FY 2022 to FY 2025. The FY 2025 preliminary total request above the fixed employer contribution rate is $805.7 million for pension and $77.7 million for retiree health insurance.

In response to questions from Senator Higdon, Mr. Barnes stated overall there was improvement in the ratio between the unfunded liability and asset due to the increase of assets. In response to a follow-up, Mr. Barnes stated that cash flow would be close to 3.85 percent without the green box dollars. In response to a follow-up regarding the increased budget request of $805.7 million for FY 2025, Mr. Barnes stated that this subject is pending with their actuary.

In response to questions from Representative Miller, Mr. Barnes agreed that the increased budget request is partially due to the decreased assumed rate of return, but also the change in the mortality tables. In response to a follow-up, Mr. Barnes stated that the trend line has been steadfast.

In response to question from Senator Higdon, Mr. Barnes stated that since 2021 was an exceptional year for investments, TRS still has actuarial gains despite the recent negative 10 percent return experienced in FY 2022.

In response to questions from Representative Tipton, Mr. Barnes agreed that the $805.7 million does not include the statutory contribution of about $500 million. In response to a follow-up, Mr. Barnes stated the actuaries have not yet provided future contribution projections. In response to another follow-up, Mr. Barnes agreed that the salary increase is causing an actuarial loss of $285.9 million. Mr. Barnes will provide information on the $243.9 million gain in "Other" category under the gain/(loss) analysis.

In response to a question from Representative Tipton on ESG and proxy voting, Mr. Barnes stated that TRS is not an ESG investor and uses ISS for their proxy voting services.

Representative Tipton announced that all pension legislation be presented for review to the Public Pension Oversight Board (PPOB) during December 2022 and January 2023.

Senator Thayer commented that even through pension legislation would go through the Senate State and Local Government Committee during session, he would like to have it, at the request of the Co-chairs, to go through PPOB first.

With no further business, the meeting was adjourned.