

PUBLIC PENSION OVERSIGHT BOARD

Minutes

February 27, 2023

Call to Order and Roll Call

The meeting of the Public Pension Oversight Board was held on February 27, 2023, at 1:00 PM in Room 154 of the Capitol Annex. Representative DJ Johnson, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative DJ Johnson, Co-Chair; Senator Jimmy Higdon, Co-Chair; Senator Karen Berg, Senator Danny Carroll, Senator Robby Mills, Senator Michael J. Nemes, Senator Mike Wilson, Representative Tina Bojanowski, Representative Ken Fleming, Representative Derrick Graham, Representative Jason Petrie, Representative Phillip Pratt, Representative James Tipton, Representative Russell Webber, Mike Harmon, John Hicks, Victor Maddox, and Sharon Mattingly.

Guests: Scott Porter, FSA, EA, and Daniel Wade, FSA, EA, Milliman; Bo Cracraft, Executive Director, Judicial Form Retirement System; Rebecca Adkins, Deputy Executive Director, Kentucky Public Pensions Authority; Beau Barnes, Deputy Executive Secretary and General Counsel, Teachers' Retirement System; Allison Ball, Kentucky State Treasurer, and Brittany Warford, General Counsel for Treasury; and Bryanna Carroll, Director of Public Affairs, Kentucky League of Cities.

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

Approval of Minutes

Senator Wilson moved that the minutes of the January 30, 2022 meeting be approved. Senator Mills seconded the motion, and the minutes were approved without objection.

Actuarial Valuation Audit Results

Scott Porter and Daniel Wade, Milliman, Inc. ("Milliman"), discussed the results of the actuarial audit performed on Kentucky's state-administered retirement systems. An independent full scope actuarial audit of the fiscal year ending June 30, 2021, actuarial valuations and related experience studies was performed to provide an opinion regarding the reasonableness and accuracy of the actuarial assumptions, actuarial cost methods, valuation results, and contribution rates for retirement and insurance benefits.

The overall findings for all state-administered retirement systems found that: the actuarial methods, procedures, and policies comply with all major aspects of the applicable actuarial standards of practice and guidance; member data is reasonable, appropriate, and complete; and actuarial assumptions are reasonable and in compliance with actuarial standards or practice. Milliman suggested promoting consistency in setting certain actuarial assumptions across all the systems, while still maintaining each system's unique demographics and funding situation.

Milliman offered further evaluation for each of the following systems: for the Judicial Form Retirement System (JFRS) to reduce the inflation assumption, which may also apply in setting

the investment return assumption; for the Kentucky Public Pensions Authority (KPPA) to review how the timing of member retirements in the final fiscal year can impact final compensation, particularly for Tier 1 State Police Retirement System members subject to the high-3 provision, and how the interest credit on the cash balance plan is calculated; and for the Teachers' Retirement System (TRS) to provide more information regarding the five-year phase-in of employer contribution rates, including the full actuarially determined contribution rate without the TRS board's five-year phase-in of the employer contribution rate, and how the phase-in impacts future rates.

Milliman stated that certain recommendations that have already been adopted by the systems include the correction of how nonhazardous and hazardous service is split and applied at retirement for members having both kinds of service in the Kentucky Employees Retirement System (KERS) and County Employee Retirement System (CERS), and the application of a mortality table in JFRS. Each adjustment had a minimal impact on liabilities and has been corrected by the affected system in its 2022 valuation.

In response to a question from Senator Higdon regarding setting assumptions, Mr. Wade stated that several states, including Florida and Washington State, use mostly one set of assumptions for certain assumptions, like inflation and mortality improvement. In response to a follow-up, Mr. Porter said that the systems were using appropriate payroll assumptions based on an inflation assumption of between 2.3 to 2.5 percent.

Senator Higdon asked Milliman to elaborate on the reciprocity issues between KPPA and TRS. Mr. Porter discussed how the systems use reciprocity to incorporate member service and compensation between systems in developing a member's final benefit amount. For TRS, Milliman identified an actuarial impact that may not be fully reflected in the valuation. Milliman is recommending an actuarial review of the impact of reciprocity service from the KPPA systems when that service is incorporated at the time of retirement and how prevalent that impact is occurring.

In response to a question from Mr. Hicks regarding the mortality improvement scale, Mr. Wade confirmed that the Society of Actuaries has updated the mortality improvement scale since KPPA's last experience study. In response to a follow-up regarding TRS' use of tables with specific rates for teachers, Mr. Wade explained that KPPA applied the ultimate table to all groups, and Milliman suggests using separate tables by employee type. Mr. Porter added that by aligning the timing of all experience studies to the same year, the systems would likely reach more conformity.

In response to a question from Representative Tipton regarding Milliman's table showing TRS' total contribution rate without the phase-in, Mr. Wade agreed that the weighted-average statutory rate of 21.68 percent is a blend of the different rates, and that the \$1.78 billion actuarially determined contribution is the actual cost needed to fund TRS per year as of the fiscal year ending June 30, 2021. In response to a follow-up question, Mr. Wade stated that most public retirement systems use some type of smoothing, and the five-year smoothing is the most common. He stated that balancing the pros and cons comes down to consistency of contribution rate stability. In response to another follow-up question, Mr. Porter stated that, in the Legislative Retirement Plan, Milliman's primary concern is that the actuarial impact of the 40 percent non-legislative salary load, which could be significant, is not fully known. He added that the non-legislative salary load is applied to the entire active liability as well as to terminated

vested members.

Milliman responded to additional questions from Senator Higdon. Mr. Porter explained that reciprocity was discussed for TRS only because a sample was taken at random from individuals who had retired in the past year, and it is important for an actuary to know about prior service in order to accurately determine its actuarial impact. For TRS, he confirmed that the special appropriation for the Green Box dollars was 2.38 percent of payroll, and its application consistent with board policy should have been explained better in the valuation. For the KERS nonhazardous plan, he confirmed that the error in how nonhazardous and hazardous benefits were split resulted in a 1.8 percent increase or \$200-\$260 million in liability. Finally, Mr. Wade provided further information regarding negative amortization.

Actuarial Valuation Audit Responses

Bo Cracraft, Executive Director, JFRS, stated that JFRS is pleased that the assessment was positive and looks forward to finding ways to improve. The report indicated that one of the mortality tables was not applied correctly, JFRS' actuaries have been made aware, and the correction has been implemented in the 2022 valuation. In regards to the inflation and return assumptions, Mr. Cracraft stated JFRS is slated to do biennial reviews of their economic assumptions in July. Lastly, Mr. Cracraft commented on the legislative load of 40 percent, stating that JFRS' actuary would say that it is abnormal but not unrealistic and will consider Milliman's recommendations.

Rebecca Adkins, Deputy Executive Director, KPPA, began by stating that KPPA is thrilled with the report and feels it provides a great level of assurance to their members that the valuations are accurate. One of the recommendations from Milliman was for more uniform assumptions across all systems. In response to this recommendation, Ms. Adkins stated that the needs of each system are varied and, therefore, the assumptions need to be unique. Ms. Adkins also stated that the Kentucky Retirement System (KRS) and CERS boards and their actuary are committed to considering the rest of the minor recommendations.

Beau Barnes, Deputy Executive Secretary and General Counsel, TRS, stated that TRS is pleased that Milliman found that the TRS actuary is projecting the liabilities correctly and using reasonable and appropriate actuarial assumptions. One matter to which TRS took exception was Milliman's suggestion that TRS and the other systems use a similar framework for developing actuarial assumptions. He stated that TRS is a unique retirement system in many ways, including demographics (70 percent female), funding levels, risk tolerance, and approach to investments. Adopting similar or identical assumptions would be consolidating risk for the Commonwealth instead of spreading it out.

Representative Johnson added that he believes the suggestion to use a similar framework for the systems is more food for thought and is something that can be revisited in the future.

Discussion of Bills

Representative Sharp discussed HB 236, which provides in part that fiduciaries consider the sole interest of the members and beneficiaries of the retirement systems using only pecuniary factors and prohibit the consideration of or actions on nonpecuniary interests, including environmental, social, political, and ideological interests. Allison Ball, Kentucky State Treasurer, commented that, in the last few years, the consideration of environmental, social, and governance (ESG) factors over the goal of getting good returns has become a major issue. She

stated that focusing on investments with the highest returns is what all the Kentucky pension systems should be doing.

In response to a question from Representative Tipton as to the definition of pecuniary, Treasurer Ball stated that pecuniary means money, and the bill provides that these returns must be financial and not pushing an ideological agenda.

In response to a question from Senator Berg regarding balancing the short-term return against long term costs, Treasurer Ball stated that society is policy-related, but you want good investments to get good returns. It is about the pecuniary benefit and making sure there are good returns so people can retire. Anything else is introducing problematic areas into investments.

In response to a question from Auditor Harmon, Treasurer Ball stated that the bill offers clarification on ESG, expands the fiduciary duties to asset managers, and addresses proxy voting.

In response to a question from Representative Graham, Treasurer Ball stated she wanted to avoid political areas, and that the bill provides clarity by providing that pecuniary factors must have a direct and material connection to the financial return of an investment and that "material connection" is also defined in the bill.

Representative Johnson discussed HB 328, which adjusts the membership date in CERS for the 2003 participants of the Kentucky Department of Criminal Justice Training's Police Corps program, who subsequently began participating in CERS as sworn officers. Representative Johnson also stated that HB 328 only affects 14 police recruits, and that it will not have a statistical impact to the systems.

Representative Webber discussed HB 587, which requires KPPA to appoint or contract for the services of an independent internal auditor to perform internal audit functions as directed by the Authority.

In response to questions from the Board, Bryanna Carroll, Kentucky League of Cities, stated the bill would remove the current classified position of internal auditor from KRS Chapter 18A and create a non-18A internal audit position that is appointed by and reports directly to the trustees serving on the Authority board.

Representative Johnson commented that a second set of eyes is always beneficial to stay on the right track.

Senator Higdon discussed SB 128 which would require each school district to annually report sick leave balances to TRS, beginning with the fiscal year ending June 30, 2023, and require the TRS actuary to report the total liabilities and costs of the sick leave program in the annual valuation.

Senator Higdon discussed SJR 83, which directs the establishment of the Public Pensions Administration Advisory Committee of the Public Pension Oversight Board (PPOB) to evaluate options for coordinating, aggregating, or consolidating actuarial, investment, or general administrative services among the state-administered retirement systems and examining

additional legislative or administrative action that may be necessary to clearly define the roles of the KRS board of trustees, CERS board of trustees, and the shared administrative entity of the two boards known as the KPPA.

In response to a question from Mr. Hicks regarding the necessity of the resolution since the PPOB already has the statutory authority to do so, Senator Higdon stated he wanted to specify in writing the exact scope of such an advisory committee.

Adjournment