PUBLIC PENSION OVERSIGHT BOARD

Kentucky Retirement Systems Administrative Subcommittee

Minutes

September 24, 2018

Call to Order and Roll Call

The 2nd meeting of the Kentucky Retirement Systems Administrative Subcommittee of the Public Pension Oversight Board was held on Monday, September 24, 2018, at 10:00 AM, in Room 154 of the Capitol Annex. Representative Russell Webber, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Wil Schroder, Co-Chair; Representative Russell Webber, Co-Chair; Senators Jimmy Higdon and Dennis Parrett; Representatives DJ Johnson and Arnold Simpson; John Chilton, and James M. "Mac" Jefferson.

Guests: Larry Totten, Kentucky Public Retirees; Jim Carroll, Kentucky Government Retirees; Bryanna Carroll, Kentucky League of Cities; Shellie Hampton, Kentucky Association of Counties; Eric Kennedy, Kentucky School Boards Association; Dr. Tom Shelton, Kentucky Association of School Superintendents; and Joe Baer, Kentucky Professional Fire Fighters.

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

Approval of Minutes

Representative Fleming moved that the minutes of the August 27, 2018 meeting be approved. Representative Johnson seconded the motion, and the minutes were approved without objection.

Kentucky Public Retirees

Larry Totten, on behalf of Kentucky Public Retirees (KPR), discussed the issues KPR believes need to be addressed before an opinion is made to separate the County Employees Retirement System (CERS) pension and insurance trust funds from the Kentucky Retirement System (KRS). Someone without a vested interest should conduct a complete analysis on the actuarial, administrative, and financial impacts of separating CERS. KPR encourages the Public Pension Oversight Board (PPOB) to re-establish the Subcommittee under its own authority if the Supreme Court decision were to negate SB 151. KPR expressed concerns about potential conflicts of interest and the effect they may have on the pension plan on which CERS employees and retirees rely. In a Senate Bill 226

(SB 226) model, six of nine board members would be appointed by the three advocacy groups pushing the hardest for the CERS separation. Such a model could create unique situations where employees, employers, and the trustees have conflicted duties or interests.

Kentucky Government Retirees

Jim Carroll, on behalf of Kentucky Government Retirees (KGR), commented that the discussion of stabilizing retirement plans within the state is being sidetracked by this issue of separation, which was resolved decades ago when KRS was consolidated. Separation of CERS would create no tangible gain or benefit to taxpayers, would not save taxpayer money, would create a new redundant bureaucracy, and would result in higher fees for the remaining KRS funds. The administration of CERS would be a large new unfunded mandate that would burden an already understaffed KRS organization. Mr. Carroll expressed concern over the length, cost, and administration of any transition. The transition should be limited to one year in length, all costs should be borne by CERS, and that a mediator should be appointed to manage the transition. A provision should be included that would limit CERS from poaching top KRS employees, who are saddled under the personnel system and receiving limited raises, during the transition. KPR believes separation is a bad idea at exactly the wrong time.

Senator Higdon commented on his concern that two different and separately administered systems could lead to increased administrative costs. He encouraged a thorough examination of any impact before anything is done.

In response to a question from Mr. Chilton regarding their organizations' ultimate position on separation, Mr. Totten said KPR would like to see a full review conducted before taking a position. Mr. Carroll stated that KGR would be adamantly opposed if the decision for separation was similar to the model created by SB 226, but would possibly consider its position if a proposal was based on another organizational scheme.

Kentucky League of Cities

Bryanna Carroll presented on behalf of the Kentucky League of Cities (KLC). She said that separation of CERS had been a top legislative priority of the KLC Board and KLC membership since 2015. KLC firmly believes that separation is the best path forward to deal with management and administration concerns and to ensure CERS sees continued growth. The state does not directly appropriate money to CERS, which is funded with local tax dollars. CERS is the largest system within KRS based on membership and assets with 236,000 members and $13.9 billion in assets. Although CERS accounts for 75 percent of the total assets of KRS, it only holds 6 of 17 board seats, which represents only 35 percent, and only holds one seat on the investment and actuarial subcommittees.

Ms. Carroll discussed recent CERS returns and asset growth, saying that total investments had increased an average of 8.68 percent per year since FY 2001 and the 30-year average return for the system was 8.9 percent, both of which exceeded the assumed rate of return. In comparison, the Kentucky Employees Retirement System (KERS) had seen its total investments decline 1.5 percent per year and was the only plan within KRS that saw total assets decline during the 2018 fiscal year.

Ms. Carroll discussed the history timeline of CERS under KRS and stated that, since 2000, KRS' administrative costs have increased 247 percent, 63 percent of which CERS is responsible for paying. Using FY 2018, CERS administrative expenses totaled $20 million of the $32 million total reported by KRS. In comparison, a report from October 3rd conducted by an outside actuarial firm hired by KLC reported that administrative expenses for a separated CERS system would cost approximately $8 to $10 million per year. Ms. Carroll discussed recent changes to the KRS Board, saying legislation in 2013 and 2017 increased the majority of unelected trustees, all of whom are appointed by the Governor.

Ms. Carroll discussed the proposed CERS separation, which is supported by a coalition of 25 employer and employee groups. Separation would create a new CERS Board, which would be free of political influence and solely focused on making decisions to ensure continued growth of the plan. Details of the proposal included the creation of a nine member board, which would include the three currently elected CERS representatives from the KRS Board, three appointed members with 10 years of investment experience, and three appointed members with 10 years of retirement management experience. The PPOB would still have oversight of the separated CERS Board.

Ms. Carroll said that SB 226 initially provided for a one-year transition period, but KRS staff requested a longer separation period. As a result, the proposed bill calls for an immediate separation of CERS, thus creating a board, but then allowing for a transition period of up to five years during which CERS could contract with KRS for services.

Kentucky Association of Counties

Shellie Hampton noted that Kentucky Association of Counties (KACo) had supported the separation of CERS from KRS for the past five years. KACo believes that a separate board can employ a laser focus on CERS, based on the singular performance of CERS, something which cannot occur today with CERS holding only 35 percent of the KRS Board. KACo had intentionally included specific requirements in SB 226 regarding who could be included on the new CERS Board and highlighted a few of those trustee requirements.

Ms. Hampton said that KACo has members who are impacted by both KERS and CERS. All of the members have an equal desire for the funded status of every public pension system in the state to continue to improve in order for the payment of retiree benefits to continue as expected and under the terms of the inviolable contract.

Kentucky School Boards Association

Eric Kennedy discussed some of the unique characteristics of the Kentucky School Board Association (KSBA) members included in the CERS plan. Approximately 52 percent of the active members in the CERS nonhazardous fund are non-teacher school district employees who are represented by KSBA. Locally elected school boards and superintendents have a vested interest in the health of the CERS system and are bound by state law to pay the full contribution rates on behalf of their employees.

Mr. Kennedy discussed how the plans are becoming more divergent and noted that, while attending KRS Board meetings, one could get a sense of how difficult, diverse, and unique the plans are and how difficult of a charge the KRS Board of Trustees has to administer them. As the plans become more divergent, particularly in their funding status, the more difficult it becomes for one board of trustees to give adequate due diligence, care, and focus to all of the plans as there is a limited bandwidth within the board and for the staff at KRS. KSBA has an interest in the separation proposal. KSBA believes that a separated CERS plan can provide a laser focus to their plan, can provide investment decisions for CERS that make sense for that plan, and also that the other plans, like KERS, have a proper focus provided to them as well.

Kentucky Association of School Superintendents

Dr. Tom Shelton noted there are roughly 47,000 classified employees across the 173 public school districts who are performing needed tasks daily for the benefit of the children of the Commonwealth. The Kentucky Association of School Superintendents (KASS) believes there are many compelling reasons shared that would indicate reasons for a CERS separation and noted that CERS separation is one of KASS' strongest legislative priorities.

Kentucky Professional Fire Fighters

Joe Baer noted that with the reform packages from 2003, 2008, 2013, and with SB 151 this past year, there has been a continual reduction of retirement benefits, which is causing problems with the retention and recruitment of fire fighters. He highlighted that most firefighters do not participate in Social Security, so CERS represents their sole retirement option. Given these characteristics, along with several other reasons expressed during the meeting, the Kentucky Professional Fire Fighters are in favor of separating CERS.

Ms. Carroll discussed that changes made in 2013, which created the hybrid cash balance plan, has put the CERS plans on an upward trajectory. While there continues to be much discussion regarding the health of other plans and the need for systemic changes, this is not the case for CERS. To better evaluate CERS, KLC hired its own actuary and has produced data that shows CERS will be fully funded by the end of the period. She emphasized the timely matter of this topic due to KRS undergoing an experience study soon and referenced that, during the presentation of the last experience study to the KRS Board, the CERS data was not presented, yet decisions and recommendations were made for all plans based only on the KERS data.

In response to questions from Senator Higdon, Ms. Carroll stated a separated CERS would be a creature of statute, so the General Assembly would still have oversight and be subject to PPOB oversight. She referenced the Lexington Police and Firefighters Retirement Plan and indicated that a separated CERS plan would operate in a similar fashion. In addition, Ms. Carroll confirmed that the current unfunded liability of CERS would move with the CERS plan upon separation. Regarding Senator Higdon's follow up question concerning the state's liability for the debt of the new system, Mr. Kennedy and Ms. Carroll noted that due to the inviolable contract with the Commonwealth the ultimate answer is difficult to ascertain. Given the limited history of cities and counties failing, this is a question of first impression. KLC was hiring outside attorneys to help with this topic and going forward hope to have more clarity. In response to a follow up question regarding outsourcing, Ms. Carroll noted that a separated CERS Board would likely consider outsourcing. Senator Higdon commented on the trend toward consolidation in other states, including Tennessee.

In response to questions from Senator Schroder, Ms. Carroll stated that CERS would pay their obligations for any administrative costs associated with CERS during the transition. CERS would be separated immediately so a new board could be created, but services could be contracted with KRS for up to five years. Employers of CERS, as a shared retirement plan, would share in the cost resulting from the unlikely event a city failed to meet their liabilities. The inviolable contract is listed as an agreement between the CERS members and the Commonwealth.

Representative Simpson asked about the state liability and whether CERS would be opposed to indemnifying the state if separation occurs. In response, Ms. Hampton indicated that she could not take a position and would have to consult with her board, and Ms. Carroll stated that KLC could not agree to it at this time. In a follow up regarding administrative costs, Ms. Carroll stated that she would be happy to share the KLC actuary's administrative cost analysis. The actuary has reviewed other state plans and that outsourcing is approximately $8 to $10 million per year. In response to an additional question regarding board representation, Ms. Carroll indicated she did not believe additional seats on the KRS Board or a reorganization would provide long term security for CERS.

In response to questions from Mr. Chilton regarding what a separated CERS might look like, Ms. Carroll indicated the model would be up to the new CERS Board and executive director. One option could be very similar to what KRS looks like, but during the transition period, the board could figure out what is the best approach, whether it would be outsourcing, keeping it in house, or contracting with others. Ms. Hampton stated there has been no concerns about the handling of calls or the ability of KRS to counsel retirees or employees. In a response to a follow up question regarding the investment of CERS funds, Ms. Carroll stated KRS has indicated they combine funds from each of the plans for investment purposes, but each is accounted for separately. Some would say that this combination of funds is commingling even though they are accounted for separately. In response to a follow up question regarding any drawbacks or risk to separation, Ms. Hampton stated that the only down side of separating at this point is it will be a new system with obvious growing pains.

In response to a question from Senator Higdon proposing a statutory cap on administrative costs, Ms. Carroll indicated KLC would have to look at the matter further, but she did not see a problem with statutory language that would cap CERS at an industrial standard percentage for administrative costs.

Senator Schroder gave Mr. Carroll and Mr. Totten the opportunity to respond with regards to the question of board representation and asked both representatives if their organizations would be in favor of or opposed to CERS having more representation. Mr. Carroll stated that he believed KRS was no longer an independent agency and that KERS, CERS, and the State Police Retirement System are all under represented. Mr. Carroll agreed that he had no problem with proportional representation of the elected representatives on the basis of the holdings of assets. Mr. Totten stated he felt the board membership should be legislatively mandated.

In response to a question from Representative Johnson, Mr. Totten stated that KRS should be asked how there was a 247 percent increase in administrative costs.

With no further business, the meeting was adjourned. The next regularly scheduled meeting is Monday, October 22, 2018.