

PUBLIC PENSION OVERSIGHT BOARD

Kentucky Retirement Systems Administrative Subcommittee

Minutes

March 25, 2019

Call to Order and Roll Call

The 1st meeting of the Kentucky Retirement Systems Administrative Subcommittee of the Public Pension Oversight Board was held on Monday, March 25, 2019, at 10:00 AM, in Room 154 of the Capitol Annex. Senator Wil Schroder, 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; and John Chilton.

Guests: Bryanna Carroll, Kentucky League of Cities; Eric Kennedy, Kentucky School Boards Association; Joe Baer, Kentucky Professional Firefighters; and David Eager, Executive Director, Kentucky Retirement Systems.

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

Costs and Pros/Cons of an Alternative to County Employees Retirement System Separation

Bryanna Carroll, Eric Kennedy, and Joe Baer collectively affirming their organizations' position that a full separation of the County Employees Retirement System (CERS) from the Kentucky Retirement Systems (KRS) is the best path forward. However, Ms. Carroll noted the employer groups had held an initial meeting with KRS staff to discuss the option of CERS having a separate board from Kentucky Employees Retirement System (KERS) and State Police Retirement System (SPRS) but retaining common administration under KRS. She indicated the discussion was positive, but stated that the process of discussions would take some time. Ms. Carroll stated the employer groups would not want a board in just name only, but would seek a board with full authority to govern and make all CERS-related decisions regarding investments, actuaries, managers, and other administrative decisions.

Ms. Carroll discussed how the proposed new CERS board might be structured and referenced the board structure proposed in SB 226 during the 2017 regular session. She stated the bill created a nine member board, consisting of three elected members, three members that have retirement management experience, and three members that have

investment experience. The employer groups are willing to explore the idea of having a KRS board, which would serve as an administrative board for the two underlying boards, but that CERS would want to ensure the composition aligned with CERS interests.

Eric Kennedy stated the initial discussions with KRS staff were productive, but noted that further discussion and planning is needed. He emphasized that this alternative model, which would fall somewhere between full separation and the current operating model, would need clear and explicit details regarding how the two underlying boards would operate, make decisions, and relate to a single KRS administrative board.

Joe Baer stated that the Kentucky Firefighters Association continues to support the full separation of CERS, but was encouraged by the discussions with KRS staff.

In response to a question from Mr. Chilton, Ms. Carroll and Mr. Kennedy both stated the coalition of employer groups still support a full separation of CERS, but are willing to discuss alternatives such as having a separate board.

In response to a question from Senator Schroder with regards to a separate board model, Ms. Carroll stated the discussion could go in several directions, but the recent discussion with KRS focused on a model with three boards; one for CERS, one for KERS and SPRS, and then an overarching KRS board for administrative purposes. In this scenario, staff would be shared across all three governance boards. She stated that more planning was needed regarding the overarching KRS board and expressed a desire from CERS employer groups that any such board better represent the plan.

In response to a question from Mr. Chilton, Mr. Carroll stated that CERS separation had been on KLC's agenda dating back to 2014. She referenced past concerns with how investments were administered, assumptions were set or changed, and administrative functions that were difficult for CERS employers. She noted that CERS represents 63 percent of the KRS membership and 73 percent of the assets, and this is the core basis for why employers were seeking a model that gave them more of a voice.

Representative Webber requested that the groups submit questions and concerns to the KRS Administrative Subcommittee.

Senator Higdon commented that he believes the most logical approach would be for boards to be established for CERS and KERS/SPRS to oversee actuarial, investment, and related issues while the KRS board continues to be responsible for all other aspects of KRS and to keep one administrative operation intact.

David Eager, KRS, began his opening remarks by noting that the topic of CERS separation dated back to 2008. Mr. Eager noted that KRS' position is to not separate CERS from KRS, and he expressed the belief that the current governance and structure worked

effectively and efficiently. He stated that separation would be destructive from a member's standpoint and would cost taxpayers approximately \$7 million more per year. He pointed out how the size of KRS has enabled the system to better serve the underlying membership and also noted that the KRS consolidated model of administration is the most common model utilized in the industry.

Mr. Eager discussed three options regarding CERS separation. The first option would be to continue with the current model and with KRS having one board and one administrative operation. The second option would be to establish separate boards for CERS and KERS/SPRS to oversee actuarial, investment, and related issues. The KRS board would continue to be responsible for all other aspects of KRS and there would only be one administrative operation intact. And the third option would result in KRS and CERS completely separated over time.

Mr. Eager reviewed the current KRS board structure and composition. The 17 member board consists of 10 gubernatorial appointments, six elected members, and one ex-officio member. He discussed the several underlying committees of the board, such as the investment, audit, and retiree healthcare committees. Mr. Eager discussed the increasing time commitment for members and expressed concern for finding qualified investment professionals to serve on multiple boards.

Mr. Eager reviewed the cost comparisons for each of the three options being considered. For option one, he stated that KRS currently operated on a \$47 million annual budget. Under option two, Mr. Eager stated there would be some additional expenses added to the \$47 million annual budget. Under option 3, or full separation, there would be an estimated \$7 million in additional expenses annual added to the \$47 million budget.

In response to a question from Senator Schroder, Mr. Eager stated that the estimated \$7 million in additional expenses under the third option was an annual expense. Mr. Eager stated there would be one-time costs anywhere from \$2.5 to \$4.5 million under the full separation option.

Mr. Eager discussed the composition and governance of a new CERS board and stated that it should be large enough to get a broad perspective, but not so large to become cumbersome. He also expressed a belief that at least two investment professionals should be included. With regards to governance, Mr. Eager proposed the new board would be responsible for actuarial and investment related decisions. This would include assumptions, experience studies, annual valuations, asset allocations, and the selection of external asset managers.

Mr. Eager discussed how the current KRS board would change under each option. Under the second option, the KRS board would likely continue, but would not be not be

responsible for investments and actuarial decisions. Under complete separation, the six board members related to CERS would leave and likely be replaced.

Next, Mr. Eager discussed the duplication of administrative and consulting services, how to promulgate or amend regulations, and trends for consolidation under two separate boards. He indicated there would be some duplication of services if separate boards were created or if CERS was fully separated. And he indicated that administrative regulations would have to be addressed by the new boards under options 2 or 3.

In closing, Mr. Eager provided a summary of the options from KRS' perspective and outlined reasons why their position was to continue with option 1, which is the current consolidated model. He emphasized that KRS operated efficiently and effectively and noted the current model was the cheapest of the three reviewed. It avoids duplication, can respond to each systems different needs, assumptions, and asset allocations effectively. He stated that option three, or full separation, is problematic and unnecessary. He stated it would result in greater cost to taxpayers and would cause multiple disruptions. Mr. Eager did state that while KRS does not believe it is needed, option two could be an acceptable alternative if properly organized.

In response to a question from Senator Schroder, Mr. Eager clarified that the investment operations department was essentially the accounting team associated with the investment activities of KRS. The group settles transactions and performs monthly reconciliations, so it is likely they could support both the CERS and KERS/SPRS board.

In response to questions from Senator Higdon regarding requested actuarial analysis, Mr. Eager stated that KRS is asked to conduct analysis for each bill that is related to pensions. Some have no fiscal impact, while others are forwarded to the systems' actuary to provide an estimated cost or savings. He indicated KRS had processed approximately 35 requests for actuarial analysis during the 2019 regular session.

In response to a follow up question from Senator Higdon regarding projected administrative costs, Mr. Eager stated that KRS does periodic trainings throughout the state as well as in their Frankfort offices to try and encourage members to use the START online self-serve program. He indicated KRS was trying to improve communications through the use of email and referenced HB 80, which would allow trustee ballots to be sent via email.

Senator Schroder commented and Mr. Eager confirmed that the electronic ballot is optional.

In response to a question from Representative Webber with regards to decisions made by the board for CERS and KERS, Mr. Eager stated that he was not aware of any conflicts when making decisions, including investment decisions.

Senator Schroder invited the CERS employer groups back to the testimony table to add anything further to Mr. Eager's remarks.

As follow up to Representative Webber's question regarding board decisions resulting in conflict, Ms. Carroll noted that currently, with how committee memberships are structured, CERS is only 11 percent of the investment committee. She also stated that CERS members have expressed concern with there only being three elected CERS members, while the remaining three are ultimately appointed by the Governor. Lastly, she referenced the board's decision to lower actuarial assumptions in 2017 and their unwillingness to consider a phase-in period, which forced CERS to rely on legislative intervention.

Mr. Kennedy agreed with Mr. Eager's statement that the overall investment policy and decisions have become more unique and tailored to the CERS fund, but emphasized that had not always been the case. He stated that having a singular focus on CERS, and its investment decisions and funding, was one aspect of why the employer groups supported full separation.

With no further business, the meeting was adjourned.