INTERIM JOINT COMMITTEE ON STATE GOVERNMENT

Minutes of the Fourth Meeting of the 2024 Interim

September 24, 2024

Call to Order and Roll Call
The fourth meeting of the Interim Joint Committee on State Government was held on September 24, 2024, at 11:00 AM in Room 149 of the Capitol Annex. Senator Robby Mills, Chair, called the meeting to order, and the secretary called the roll.

Present were:
Members: Representatives Kevin D. Bratcher Co-Chair; David Hale Co-Chair; Senator Robby Mills Co-Chair; Senators Cassie Chambers Armstrong, Greg Elkins, Amanda Mays Bledsoe, Christian McDaniel, Michael J. Nemes, Damon Thayer, Phillip Wheeler, and Gex Williams; Representatives Adam Bowling, Adrielle Camuel, Beverly Chester-Burton, Jennifer Decker, Derrick Graham, Richard Heath, Samara Heavrin, Keturah Herron, John Hodgson, Thomas Huff, Mary Beth Imes, DJ Johnson, Matthew Koch, Scott Lewis, Matt Lockett, Kimberly Poore Moser, Steve Rawlings, Nancy Tate, and Susan Witten.

Guests: Chris Chamness, Department of Employee Insurance, Personnel Cabinet; Ryan Barrow and Erin Surratt, Kentucky Public Pensions Authority; Bo Cracraft, Judicial Form Retirement System; and Robert "Beau" Barnes, Teachers' Retirement System.

LRC Staff: Daniel Carter, Jesse Farler, Brad Gross, Alaina Spence, and Peggy Sciantarelli.

Approval of Minutes
A motion by Representative Hale to approve the minutes of the August 22, 2024, meeting was seconded and passed without objection by voice vote.

2025 Kentucky Employees' Health Plan (KEHP)
Chris Chamness, Commissioner of the Personnel Cabinet's Department of Employee Insurance, discussed the 2025 Kentucky Employees' Health Plan.

KEHP is a $2 billion self-funded health plan that administers health and flexible spending benefits. Planholder enrollments decreased to 137,998 in 2022 but increased in 2023 to 138,515, representing 257,953 covered lives. Average net payments per claim has continued to grow—from $208.12 in 2020 to $240.95 in 2023. Both Kentucky and the U.S. population tend to use benefits more frequently, and the services provided have become more expensive.

KEHP's goal is to provide robust benefits in a fiscally responsible manner. Plan experience for medical and pharmacy costs follows national trends. Costs are increasing due to price inflation and increased utilization. Medical spend is increasing for chronic conditions, outpatient procedures, and behavioral health care. The increase in drug spending is partially offset by increases in rebates that pass to the plan.

For both the 2024 and 2025 plan years, there is no increase to employee premium contributions and no changes to copays, co-insurance, deductibles, or maximum out-of-pocket amounts. A fourth plan option is being offered in 2025—a qualified high-deductible health plan (LivingWell HDHP) that offers lower premiums than the Basic Consumer Driven Health Plan (CDHP).

Mr. Chamness discussed the Hinge Health, Clinical Management, and SmartShopper programs, which focus on cost prevention and better health outcomes. He noted that careful use of cost controls and cost sharing helps the plan avoid increasing premiums. The current budget year plan costs are on track, with no changes anticipated in the near term.

Senator McDaniel commented on the dramatic increase in pharmacy cost in 2023 and suggested that KEHP consider a review of outcomes in the patient population that utilizes GLP-1 and certain other categories of drugs in order to determine effectiveness and potential cost savings. Mr. Chamness said the department has begun to prepare the groundwork for that analysis.

Responding to questions from Representative Camuel, Mr. Chamness said the average age of plan members is 38 years. He confirmed that there will be no premium increases in plan year 2025.

Kentucky Public Pensions Authority (KPPA) - Overview and Status Update
Ryan Barrow, Executive Director of KPPA, and Erin Surratt, Executive Director of the Office of Benefits, reviewed investment returns for Fiscal Year (FY) 2024, plan cash flows, actuarial statistics, possible proposed legislation for the 2025 Regular Session, and federal legislation/changes that could affect KPPA.

Investment return for all pension and insurance plans exceeded their actuarial assumed rates of return for FY 2024. CERS adopted new asset allocation targets effective July 1, 2024. KRS adopted new asset allocation targets effective February 1, 2024.

With respect to cash flow, pension plans are expected to be fully funded in 2049. All pension plans had positive cash flow for FY 2024. Four of five insurance plans are fully funded, but three of five plans had negative cash flow for FY 2024.

The pension funding ratio for KERS Nonhazardous as of June 30, 2023, was 21.79 percent. Funding ratio for the other plans ranged from 51.42 to 65.4 percent. When actuarial statistics are calculated for the period ending June 30, 2024, the positive investment return should lead to a higher funding ratio on all plans. The insurance funding ratio for KERS Nonhazardous as of June 30, 2023, was 81.66 percent. Funding ratio for the other plans ranged from 100.46-170.43 percent.

KPPA may propose legislation in the 2025 Regular Session to create a new Office of Financial Management and to split the current Division of Accounting into two divisions. In response to a Kentucky Court of Appeals opinion, KPPA may also propose pension spiking legislation that will address across-the-board raises and increase in creditable compensation for all employees in a specified class.

New federal laws affecting insurance plans will improve pharmacy benefits for beneficiaries of retired members but will increase the 2025 premiums for KPPA and exert downward pressure on funding levels.

Representative Johnson stated that although pension funding is trending upward compared to previous years, the numbers are not yet where they need to be. He cautioned the committee that they need to “stay the course.”

In response to questions from Representative Lockett, Mr. Barrow stated funding ratios are anticipated to increase on the pension side due to investment performance and other factors. On the insurance side, the ratios are expected to increase because of the federal Inflation Reduction Act. However, insurance funding can be volatile and is subject to the impact of federal legislation and regulations.

Senator McDaniel stated that it has taken years of hard work and the honoring of commitments that have been made to get pension funding to its current level, with expectation of full funding by 2049. He commended Senator Thayer for his leadership in getting necessary reforms enacted. He also complimented the hard work of LRC staff.

Representative Hodgson commented on the dramatic improvement in unfunded liability and the progress that has been made during the past three years.

In response to a question from Representative Bratcher, Mr. Barrow commented that the assumed rate of return has been exceeded but that it is understood that investments are not going to be as strong during the next 30-year period.

Senator Mills announced that at a future meeting the committee will consider KPPA's proposed amendment to administrative regulation 105 KAR 1:411.

Judicial Form Retirement System - Overview and Status Update
Bo Cracraft, Executive Director of the Judicial Form Retirement System (JFRS), provided a quarterly investment and cash flow update for the system.

Mr. Craycraft discussed JFRS' investment strategy. Baird Trust is the sole investment provider and only invests in the United States. Historically, JFRS has had a good cash flow position and employs a long-term approach toward investment, taking the position that over a 15 to 20 year period the US market is going to outperform other markets.

Investment performance has been successful. Both the JRP and LRP plans outperformed their 3-year, 5-year, 10-year, 20-year, and 30-year, and FY 2024 benchmarks.

JFRS does a full funding valuation every other year. As of 2023, all plans reached full funding status, with actuarial asset value exceeding total liability. Cash balance plans were introduced in 2014 and are continuing to grow. Nearly all of the liability is driven by the legacy tier of benefits.

JFRS experienced negative cash flow for FYs 2023 and 2024—paying out more in benefits than receiving in contributions. Mr. Craycraft said this is not necessarily a sign of unhealth. The discussion becomes more about management of cash flow and whether JFRS' can continue its long-term approach to investing in the US equity market.

Mr. Cracraft acknowledged that the federal Inflation Reduction Act is having a significant impact. JFRS expects retiree health insurance premiums may increase as much as 35 percent. Projected estimates hopefully will be available soon.

When asked by Representative Johnson, Mr. Cracraft clarified that JFR membership is limited to the Supreme Court, the Court of Appeals, and trial court judges.

Teachers' Retirement System - Overview and Status Update
Robert "Beau" Barnes, Deputy Executive Secretary and General Counsel, represented the Teachers' Retirement System (TRS). He reviewed data relating to investment performance, cash flow, and asset allocation for the retirement annuity and health

insurance trusts; current and projected actuarial status; cost sharing for retiree health care; and funded status and premium levels of TRS health insurance.

The biennial budget enacted in the 2024 Regular Session provided TRS with 10 straight years of full, or nearly full, pension annuity funding. For the quarter ending June 30, 2024, investment return for the retirement annuity trust was 0.88 percent, which placed TRS in the top 55 percent nationally, compared to other large public pension plans with assets of $1 billion or more. The one-year return of 11.93 percent placed TRS in the top 10 percent nationally.

Cash flow information was provided for FY 2024 and FY 2023, showing member contributions, employer contributions and appropriations, investment income, and recovery income. Cash outflow includes benefit payments and refunds and administrative expense.

Asset allocation for both the retirement annuity and the health insurance trusts was well within the target range set by the investment committee. Thirty-year actuarial projections indicate that, at full funding, TRS required contributions and unfunded liabilities will decrease through year 2053, funded ratio will reach 100 percent, and the legacy unfunded liability will be paid off. Mr. Barnes said that the new actuarial valuations for FY 2024 are not yet available.

Mr. Barnes discussed the health insurance program, formation of the 2010 “shared responsibility" legislation and how it works, and TRS’ participation in the Medicare prescription drug Employer Group Waiver Plan (EGWP). Mr. Barnes stated that as a result of the shared responsibility legislation, the Commonwealth’s cost began dropping dramatically. Depending on medical and health insurance inflation and continued access to federal funding and rebates, the health insurance trust should be fully funded in 2026.

Responding to Senator Nemes, Mr. Barnes explained how the TRS health insurance plan is able to pass savings from prescription drug company rebates directly to retired teachers through participation in EGWP.

In response to questions from Representative Bratcher, Mr. Barnes discussed shared responsibility contribution levels; the new TRS-4 benefit tier for individuals who become members on or after January 1, 2022; and TRS’ 1.5 percent cost-of-living adjustment.

In response to Representative Witten, Mr. Barnes discussed factors affecting past and future funding levels of the retirement annuity trust, which is currently funded at 58.6 percent. He explained that it is still very early in the amortization process, but TRS expects to eventually be fully funded. Actuarial assumptions and mortality table were changed a few years ago following an experience study for the five-year period ending June 30, 2020, and the actuary changed the investment assumed rate of return from 7.5 to 7.1 percent. TRS uses conservative actuarial assumptions and is a long-term investor. If full funding continues as it has under previous budgets, the unfunded liability will be paid off, TRS will be 100-percent funded, and the Commonwealth's cost will be slashed by more than half.

Adjournment
There was no further business, and the meeting was adjourned at 12:39 PM. The next meeting of the Committee is scheduled for October 22, 2024.