

# **PUBLIC PENSION OVERSIGHT BOARD**

## **Minutes of the 5th Meeting of the 2021 Interim**

**July 20, 2021**

### **Call to Order and Roll Call**

The 5th meeting of the Public Pension Oversight Board was held on Tuesday, July 20, 2021, at 3:00 PM, in Room 154 of the Capitol Annex. Representative Jim DuPlessis, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Jimmy Higdon, Co-Chair; Representative Jim DuPlessis, Co-Chair; Senators Robby Mills, Gerald A. Neal, Dennis Parrett, and Mike Wilson; Representatives Derrick Graham, Jerry T. Miller, James Tipton, Russell Webber, and Buddy Wheatley; Joseph Fawns, Mike Harmon, John Hicks, and James M. "Mac" Jefferson.

Guests: David Eager, Executive Director, and Erin Surratt, Executive Director, Office of Benefits, Kentucky Public Pensions Authority; and Beau Barnes, Deputy Executive Secretary and General Counsel, Teachers' Retirement System.

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

### **Approval of Minutes**

Senator Wilson moved that the minutes of the June 24, 2021, meeting be approved. Senator Mills seconded the motion, and the minutes were approved without objection.

Representative DuPlessis had the committee observe a moment of silence for the passing of Representative Bam Carney.

### **Overview of Sick Leave Programs and Impact of Bonuses on Pension Payments – Kentucky Public Pensions Authority**

Erin Surratt, Kentucky Public Pensions Authority (KPPA), began the presentation by giving an overview of how sick leave and bonus payments are used to determine pension benefits for all systems under KPPA. She started with sick leave and discussed how the use of sick leave is different based on a member's participation date or tier. Tier 1 members with a participation date prior to September 1, 2008, who are participating in the Kentucky Employees Retirement System (KERS) or the State Police Retirement System (SPRS), have an unlimited amount of sick leave that may be converted into service credit for benefit purposes and that service can be used toward determining retirement and health insurance

eligibility. Tier 2 KERS and SPRS members with a participation date on or after September 1, 2008, but prior to January 1, 2014, are limited to 12 months of sick leave service credit and that service cannot be used toward determining retirement and health insurance eligibility. Tier 3 KERS and SPRS members, along with Tier 3 County Employees Retirement System (CERS) members, with a participation date on or after January 1, 2014, are not eligible for sick leave service credit. For Tier 1 and 2 CERS members, sick leave service credit/benefits are optional with the employer, with Tier 2 CERS members subject to the same limitations noted for KERS and SPRS members.

In response to a question from Representative DuPlessis regarding costs to employers, Ms. Surratt offered an example of how sick leave would work. In Tier 1, for a person age 55 with 27 years of service, 12 months of sick leave, and a final compensation of \$50,000, the cost to the KERS employer to fund the 12 additional months of service credit would be \$12,000.

Ms. Surratt continued with sick leave for Tier 2 members with a participation date on or after September 1, 2008, but prior to January 1, 2014, stating that sick leave is limited to 12 months between KERS, CERS, and SPRS for purposes of determining monthly benefits. It does not count towards retirement eligibility or health insurance benefits, and the last participating employer pays total cost. Under Tier 3, for members participating on or after January 1, 2014, there is no sick leave credit toward retirement benefits.

In response to questions from Representative Graham, Ms. Surratt stated KPPA would follow-up with member participant data and the breakdown by number of employees and cost for each tier.

Ms. Surratt discussed bonus payments. State statutes governing the KPPA systems provide that lump sum bonuses, severance pay, or employer-provided payments for purchase of service credit must be averaged over the employee's total service with the system in which it is recorded if it is equal to or greater than one thousand dollars (\$1,000). So, for example, a \$5,000 bonus in FY 2022 to a school board employee who has 120 months of service credit would be prorated over all 10 years of service by adding \$500 to each fiscal year salary. Further, bonus payments are not exempt from pension spiking.

In response to a question from Representative Graham, Ms. Surratt stated that a one year bonus would likely not cause a spike to occur, but bonuses over several years could do so.

In response to a comment from Representative Tipton, Ms. Surratt confirmed that, in the case of a classified employee participating in CERS who receives a bonus from the school board, the initial cost of the retirement benefit associated with that bonus would be paid by the county school board in the employer's contribution.

David Eager, KPPA, discussed and answered a question from the April meeting regarding the favorable impact of the markets on the pension systems. Between June 24 and June 30, 2021, the change of assets was about one tenth of 1 percent favorable. He provided charts to demonstrate the estimated impact of the FY 2021 investment returns on the unfunded accrued actuarial liability/funded ratio and the employer contribution dollar amount/percentage for KERS nonhazardous plan. He advised caution when relying on the FY 2021 returns, as they represent a one-time windfall and will be averaged by 5-year smoothing.

In response to a question from Mr. Jefferson regarding whether there is a method the actuaries use to estimate the future value of bonuses and sick pay relative to how that compensation will be reflected in the funded ratio, Mr. Eager stated the actuaries have not made such a calculation at this time, but that they can isolate that cost. In response to a follow up question regarding sick pay and bonus rules, Ms. Surratt stated that for sick leave the actuarial value is calculated upon retirement, and the last employer pays the full actuarial cost within a month.

In response to Senator Higdon's comment that some of the budget surplus should be used to pay off the SPRS' unfunded liability, which is currently \$757 million, Mr. Eager stated that the idea is something KPPA has reviewed.

Representative DuPlessis stated that the discussion of sick leave and bonuses and their impact on retirement costs was prompted by news that the Jefferson County School Board was using some of its federal stimulus funding to award teachers a \$5,000 bonus.

### **Overview of Sick Leave Programs and Impact of Bonuses on Pension Payments – Teachers' Retirement System**

Beau Barnes, Teachers' Retirement System (TRS), began his presentation by updating the Public Pension Oversight Board that the investment returns are now at 30 percent with about \$5 billion added to the pension fund, whereas in March they were at 22 percent with about \$4 billion in assets added to the pension fund.

As background, Mr. Barnes discussed member and state contributions. The member contributes 12.855 percent of salary with 9.105 percent going to pension and 3.75 percent going to retiree health care. The state contributions depend on a member's participation date: 13.105 percent of salary for participation before 7/1/2008 (12.355 pension/life; 0.75 retiree healthcare) and 14.105 percent of salary for participation after 7/1/2008 (13.355 pension/life; 0.75 retiree health care).

Mr. Barnes described the basic retirement formula to help explain how bonuses and sick leave work. A member's annual benefit is calculated based on the total service credit times the statutory retirement multiplier times the final average salary. The final average

salary is one element of the annuity calculation formula, which creates an average using the high five or three salaries.

Mr. Barnes discussed the formula for the sick day calculations for school district teachers. Only school districts can use unused sick leave as salary credit and may compensate retiring employees for up to 30 percent of their accumulated sick leave, which is then included in the member's final average salary. Universities and other employers are not permitted to do so. Starting January 1, 2022, sick leave will not be used for purposes of defined benefit retirement calculations for new teachers. He also discussed how sick leave impacts retirement by comparing an example of a member who has sick leave and a member with no sick leave.

In response to a question from Representative DuPlessis, Mr. Barnes stated that in his calculation example, he used the high five salary. Mr. Barnes stated he would follow up with an example using a high three salary.

Mr. Barnes discussed how sick leave is funded. When used as salary credit for retirement calculation purposes, sick leave is funded from 3 sources: (1) member contributions at 9.105 percent on the amount of sick leave included in final average salary; (2) employer contributions at 12.305 percent on the amount of sick leave included; and (3) the remaining cost is paid by state (amortized since fiscal 1999), which is about \$32.5 million, with a total cost of \$36 million from all funding sources for retirees who retired in 2020.

In response to questions from Representative DuPlessis, Mr. Barnes agreed that out of the \$36 million, the members are paying about \$1.5 million and the taxpayers are paying the remainder. In response to a follow up question, Mr. Barnes stated that when the plan was established, they would not have contemplated sick leave. Sick leave was added as a benefit in the mid-90s, and it is a benefit that falls outside the statutory range for the inviolable contract.

In response to questions from Senator Higdon, Mr. Barnes agreed that there are more members that retire with the high three salary average, which requires 27 years of service and being at least 55 years of age. Senator Higdon asked for other examples to include the high three calculations, higher salaries, and more sick leave. In response to a follow up question, Mr. Barnes agreed that the state's cost of \$32.5 million is about 1 percent of payroll.

Mr. Barnes discussed the 10-year historical information going back to 2011, including the year of retirement, percentage and number of members receiving sick leave payments, average sick leave payment, average added to monthly annuity, full actuarial cost, average cost per member, and annual payment.

Mr. Barnes discussed historical sick leave schedules, balances, and the amounts of annual remaining payments for years 2003 to 2022.

Mr. Barnes discussed the estimated future costs based on recent assumption changes. He explained that the future cost is based on the estimated number of retirees receiving sick leave multiplied by the average cost per retiree less the estimated contributions received on the sick leave payout. He gave estimates over a 20 year period. In total, the annual amortization payment for sick leave is about \$60 million.

In response to a question from Representative DuPlessis, Mr. Barnes stated that the estimated future costs are based on the most recent experience study with the new investment rate of return/discount rate of 7.1 percent.

Mr. Barnes discussed bonuses and raises for teachers. This year was different due to the federal funds available to school districts, and a lot of the districts used those funds to pay bonuses ranging from \$300 to the highest of \$5,000 in Jefferson County. Most of the bonuses being paid across the district will not be used for retirement calculation purposes, because most teachers will not be retiring in the near term, so the bonus is less likely to be included in the final average salary. Also, out of those bonuses, TRS will collect 12.855 percent from the member and 13.105 percent from state.

In response to a question from Representative DuPlessis, Mr. Barnes stated that 1,900 members retired last year out of approximately 75,000 full and part-time teachers.

Mr. Barnes continued, explaining that the use of these bonuses could still be limited by the TRS anti-spiking law. If the anti-spiking law does apply, a teacher would have to delay retirement for four years to see a retirement benefit, and there would be no impact or reduced impact if the teacher retires before four years. Also, if the anti-spiking provisions apply, both the member's and the state's contribution is refunded.

In response to a question from Representative Higdon, Mr. Barnes agreed that in 2020, for those members receiving sick leave payments at retirement, an average of \$200 per month or \$2,400 per year was added to the annuities of those members.

In response to a question from Senator Higdon, Mr. Barnes explained that "Green Box" dollars are amortized payments that the Commonwealth has been making over and above the fixed statutory 13.105 percent to pay off prior benefits offered many years ago, including COLAs above 1.5 percent awarded prior to 2008. Green box payments total about \$60 million a year. In response to a follow up question, Mr. Barnes stated that the anti-spiking provision in KRS 161.220(9) limits increases in compensation during the last three years before retirement to no greater than highest percent rank and step increase received for the school district. So, the value of a bonus in a single year would only be included in a member's final average salary if the member worked an additional four years.

In response to a question from Representative Tipton regarding the balance remaining on the Green box dollars, Mr. Barnes stated that the installment payments include interest, and the Commonwealth could save money by paying off the lump sum and not paying the interest. The interest rate is 7.1 percent. The total amortization payment is about \$60 million a year. In response to a follow up question, Mr. Barnes stated that there have always been statutory limitations for retired teachers returning to work. Recently, TRS tightened the language in its statutes (2021 housekeeping bill) and regulations regarding retired reemployed members to ensure compliance with federal tax law.

In response to a question from Representative DuPlessis, Mr. Barnes stated that, before TRS started getting full funding in 2017, TRS would have to avoid certain long term investments due to being in a negative cash flow and could not take full advantage of market opportunities.

With no further business, the meeting was adjourned.