PUBLIC PENSION OVERSIGHT BOARD

Minutes

January 30, 2023

Call to Order and Roll Call
The 1st meeting of the Public Pension Oversight Board was held on January 30, 2023, at 1:00 PM in Room 154 of the Capitol Annex. Senator Jimmy Higdon, Chair, called the meeting to order, and the secretary called the roll.

Present were:
Members: Senator Jimmy Higdon, Co-Chair; Representative DJ Johnson, Co-Chair; Senator Karen Berg, Senator Danny Carroll, Senator Christian McDaniel, Senator Robby Mills, Senator Gerald A. Neal, 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, and Sharon Mattingly.

Guests: Representative Thomas, Chair of Veteran, Military Affairs, and Public Protection; Brian O'Neil, Legislative Director and Kevin Pletzke, Secretary of Treasurer, Kentucky Professional Firefighters; Bryanna Carroll, Director of Public Affairs, Kentucky League of Cities; and Shawn Butler, Executive Director, Kentucky Police Chiefs Association.

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

Discussion of Proposed Legislation

Judicial Form Retirement System Transfer of New Hires/Cash Balance Members to Kentucky Employees Retirement System
Representative Tipton announced that the Legislative Retirement Plan (LRP) bill he discussed at the Public Pension Oversight Board (PPOB) December meeting has been filed as House Bill 114. The proposed legislation states that LRP would be closed to new members. Additionally, current legislative members in the LRP Hybrid Cash Balance Plan would transfer into the Kentucky Employees Retirement System (KERS) nonhazardous plan with no change in benefits.

Representative Tipton asked for input regarding a similar proposal for Judicial Retirement Plan members. With these proposals of transferring future and current cash balance plan members, the Judicial Form Retirement System would no longer be needed except to pay out benefits to existing Defined Benefit Plan members.

In response to a question from Senator Higdon, Representative Tipton stated that there are 43 legislators in the legacy plan. He thinks the number is low because he suspects there are current members who qualify for the legacy plan that have not retired yet.

Senator Higdon welcomed the newest members of the PPOB. This included Senator Berg, Senator Carroll, Representative Bojanowski, and Co-Chair Johnson. Representative Johnson commented that it is a pleasure being back with PPOB and that he appreciates the work that has been done getting the pension plans on the road of financial health and looks forward to continuing that focus.

Deferred Retirement Option Plan for County Employees Retirement System
Representative Thomas commented that it is his hope that the Deferred Retirement Option Plan (DROP) will extend employment of key staff eligible to retire from County Employees Retirement System (CERS). Bryanna Carroll, Director of Public Affairs, Kentucky League of Cities, stated that the proposed DROP draft is cost neutral, has limited risk, and serves as a means for possible retention of key staff. The DROP program will provide a lump sum payment to those who choose to participate. An employee who wishes to participate will notify their employer of their retirement plans; the employee will then continue to work 1 to 5 years being paid their regular salary while their retirement proceeds will be placed into the DROP program. Upon contract completion, the employee will finalize their retirement and receive their lump sum DROP proceeds.

Shawn Butler, Executive Director, Kentucky Police Chiefs Association, stated that looking from a retention perspective, there is a struggle to get qualified new applicants while losing qualified applicants to retirement. He stated that options are being sought to enhance retention and encourage present employees to stay in the field.

Brian O'Neil, Legislative Director, Kentucky Professional Firefighters, stated that the DROP program has been recognized by the organization's members for many years, and that other states have similar plans that were successful and some that were not successful.

In response to a question from Senator Higdon, Ms. Carroll and Mr. Butler stated that an unsuccessful DROP program would offer a high guaranteed rate of return or would cost the pension system money. In response to a follow-up, Ms. Carroll stated that a meeting has been scheduled among interest groups and the retirement plans to discuss who the administrator of the plan will be. The draft legislation details that employee contributions and pension payments would be deposited into the DROP account and the employer contribution would continue to be paid into CERS to pay down the unfunded liability.

In response to a question from Senator Berg, Mr. O'Neil explained that the DROP program offers the retirement eligible employee the option to stay in their current position with the same salary and provides that their retirement payment is deposited into a savings type account. Upon completion of the contract terms, the employee would receive a lump sum payment of the retirement payments during the contract and also a lifetime monthly benefit. In response to a follow-up, Mr. Butler stated that it is a good plan for the employee to continue receiving their salary through their contract period.

In response to a question from Representative Tipton, Mr. Butler stated that the current retired reemployed laws would not apply to the DROP program since the employee is not leaving employment and is not allowed to have access to the pension payment. In response to a follow-up question regarding taxable obligations, Mr. Butler stated that there would not be taxes while in the DROP program, however, upon contract completion, the employee would have to make tax decisions. In response to an additional follow-up question, Mr. Butler agreed that once the employee has enrolled in the DROP program, the calculated retirement payment will not change.

In response to a question from Senator Carroll, Mr. Butler stated that some police departments offer a type of 401K to members who return after separation, but it is not the norm. In response to a follow-up regarding whether the DROP program is the same as a 401K program, Ms. Carroll stated that the retirement plans would have to answer that question. Senator Carroll stated that there is concern on how much the DROP program would help because the officers that are likely to reemploy or continue employment are currently doing so.

Representative Johnson cautioned the sponsors that if there are claims of a guaranteed benefit to make sure that it works financially for the pension plans.

In response to a question from Representative Bojanowski, Representative Thomas stated that if the DROP program can succeed at this level, then it could be considered for other pension plans. In response to a follow-up question, Mr. O'Neil stated that the DROP program can offer a nest egg for people that are almost ready to retire, while continuing to draw their salary.

In response to a question from Senator Higdon, Mr. O'Neil discussed reemployment after retirement provisions.

Senator Berg commented that if the revenue is kept neutral, how can the DROP program offer a higher rate of return than what the market offers and thereby provide a financial incentive. Mr. Butler stated that he does not believe the program will offer any guaranteed return and the incentive is the person can stay in their job drawing their same salary and setting aside a nest egg to go along with their monthly pension. Ms. Carroll added that the employee contribution also goes in the DROP program account.

In response to a question from Senator Higdon, Mr. Butler stated that the DROP program will be offered to anyone that wants to join.

In response to a question from Mr. Harmon, Ms. Carroll stated that all employee benefits will remain the same while under the DROP program, such as, health insurance. In response to a follow-up, Ms. Carroll stated the program offers options of lump sum and roll over.

Fiduciary Duties and ESG/Proxy Voting Issues
Senator Mills commented that it is a concern to make sure all pension funds are being invested with the best financial interest of the members in mind with no mixed issues that come into the investment process. Senator Mills' bill proposal will amend statutory language to ensure all necessary parties in the investment process are fiduciaries to the systems' members and beneficiaries. Included as fiduciaries are: trustees or board members, investment committee of the board, investment managers, advisors, consultants, and any other person who is a fiduciary defined throughout this bill. It will apply to all systems and require that fiduciaries act in accordance with federal and state laws, to acknowledge their fiduciary duties in writing, and prohibit any waiver, restriction, or limitation of their fiduciary liability by contract or agreement. The bill proposal will define what a fiduciary is for each system and will specifically prohibit the consideration of ESG factors in the fiduciary duty owed to a system and its beneficiaries.

The bill will also address proxy voting by requiring the board to adopt written proxy voting guidelines consistent with the fiduciary guidelines. It will require a proxy advisor to acknowledge in writing its fiduciary duty and commit to following the board's adopted proxy voting guidelines, require all shares owned by the system to be voted according to the boards adopted proxy voting guidelines, and require transparent reporting of proxy votes to the board of trustees and public.

In response to questions from Senator Berg, Senator Mills stated that ESG is Environmental, Social, and Governance investing. Senator Berg commented that she believes there should be an individual right to tell the fiduciaries where to invest. Senator Mills stated that as a group pension fund, it needs to be the right of the pensioners.

Mr. Harmon commented that for those needing more information, he encourages them to search "Our Money Our Values". He continued that the United States President is changing administrative rules on the federal level to allow for ESG investments. State law already requires to invest as fiduciary and he appreciates the clarity of the bill proposal. In response to a question, Senator Mills stated that it is the goal of the bill to make sure state laws prevail in regard to fiduciary duty.

In response to a question from Representative Bojanowski, Senator Mills stated that the bill provides policy for the boards to follow. Almost any stock that is invested in petroleum, fossil fuels, wind, and solar are all ESG type investments that may or may not give the best return for the pensioners. He stated that the desire is that the investment be evaluated by the return that it gives, not by social or environmental score.

Representative Tipton read a portion from the existing language of statute regarding proxy voting and stated that the language in the proposed bill is for the ones taking proxy votes on behalf of the retirement systems that must follow the fiduciary responsibilities, which are in the best interest of the members and beneficiaries of the retirement system. He stated that with the billions of dollars of unfunded liability, he believes this is an excellent idea of what a fiduciary responsibility should be. Senator Mills commented that this proposed legislation makes sure the fiduciary responsibility is consistent across all funds.

Adjournment
With no further business, the meeting was adjourned.