PUBLIC PENSION OVERSIGHT BOARD

Minutes

August 22, 2023

Call to Order and Roll Call
The 5th meeting of the Public Pension Oversight Board was held on August 22, 2023, at 3:00 PM in Room 154 of the Capitol Annex. Representative DJ Johnson, Chair, called the meeting to order, and the secretary called the roll.

Present were:
Members: Representative DJ Johnson, Co-Chair; Senator Karen Berg, Senator Robby Mills, Senator Michael J. Nemes, Senator Mike Wilson, Representative Ken Fleming, Representative Derrick Graham, Representative Jason Petrie, Representative Phillip Pratt, Representative James Tipton, Representative Russell Webber, Mike Harmon, John Hicks, and Victor Maddox.

Guests: Bo Cracraft, Executive Director, Judicial Form Retirement System; David Eager, Executive Director, Kentucky Public Pensions Authority; and Beau Barnes, Deputy Executive Secretary and General Counsel, Teachers' Retirement System.

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

Approval of Minutes
Senator Mills moved that the minutes of the May 22, 2023, meeting be approved. Representative Pratt seconded the motion, and the minutes were approved without objection.

FY Ended Investment Returns/Cash Flows & Budget Projections for 2024-2026 Biennium
Bo Cracraft, Executive Director, Judicial Form Retirement System (JFRS), provided a quarterly update for the Judicial Retirement Plan (JRP) and the Legislators' Retirement Plan (LRP). He discussed the fiscal year ending investment performance for the defined-benefit and hybrid cash balance plans. He provided the 1-, 3-, 5-, 10-, 20-, and 30-year rates of return.

Mr. Cracraft discussed the asset allocation for both plans. He reviewed the equity, fixed income, and cash allocations, and stated that JFRS is close to their target range.

Mr. Cracraft discussed cash flow for both plans for FYTD 2023 compared to FYTD 2022. He reviewed the cash inflows, outflows, investment gains or losses, and the total net plan assets across both time periods.

Lastly, Mr. Cracraft provided the current JFRS budget and projected employer costs and employer fund trends. In FY 2024, JFRS received $5.3 million for JRP with no projected funds needed for FY 25 and FY 26 based off projections produced in 2021. The JFRS actuary is currently sorting through data for future projections. LRP has not received employer funds since FY 2018 but did receive appropriations in FY 2019 and FY 2020 for administrative expenses. Those administrative expenses are now incorporated in the valuation and included in the employer contribution. He stated that, along with JRP, LRP should have no funding requests for the upcoming biennium.

In response to a question from Representative Tipton, Mr. Cracraft confirmed a misprint on the slide presenting the cash flow, stating that the investment income for LRP FY 2023 inflows should show 4.0 percent.

In response to a question from Representative Johnson, Mr. Cracraft confirmed JFRS should not be requesting funds for FY 2024 and FY 2025, but that preliminary information will be available October 1, 2023. In response to a follow-up regarding the target allocation for cash on hand, Mr. Cracraft stated JFRS tries to stay fully invested and that most of the cash making up the 1.1 percent cash allocation was due to maturities right at the end of the quarter. So, any cash held was more of a timing issue.

David Eager, Executive Director, Kentucky Public Pensions Authority (KPPA), began his presentation with fiscal year 2023 highlights. He stated there was a wide variance in returns by asset class. KPPA met or exceeded its performances benchmarks in all ten plans. KPPA is still working to get asset allocations into compliance within IPS ranges. Cash flows were positive in all five pension plans. Kentucky Employees Retirement System (KERS) nonhazardous required contributions will decline by $193.2 million in both FY 2025 and FY 2026.

Steve Willer, Chief Investment Officer, KPPA, discussed the market asset class returns for the fiscal year ending June 30, 2023. He commented that the dispersion of asset class returns in FY 2023 were one of the most unusual seen in years. Large cap growth dominated the investment landscape, but was also very narrow. There were a number of asset classes that traditionally serve as ballast that produced negative performance for the fiscal year.

Mr. Willer discussed the pension and insurance investment fund returns for the fiscal year ending June 30, 2023. He provided the 1-, 3-, 5-, 10-, 20, and 30-year net of fees rates of return. He noted that all the plans under pension and insurance exceeded their assumed rates of return and benchmarks. Mr. Eager reminded the board that the insurance trust has $6 billion.

Mr. Willer discussed the asset allocation for all plans. He reviewed equity, fixed income, and cash allocations, stating that the progress has been slow, but they are progressing.

Mr. Eager discussed cash flow for all plans for FYTD 2023 compared to FYTD 2022. He reviewed the cash inflows, outflows, investment gains and losses, and the total net plan assets across both time periods.

In response to a question from Representative Johnson, Mr. Eager stated that the State Police Retirement System has a $1 million negative cash flow.

Mr. Eager discussed the 10-year (2017–2026) projected employer costs. He provided estimates on salaries, total employer contributions, including the normal cost and actuarial accrued liability contribution for the KERS nonhazardous plan, and assumption rates by year.

In response to a question from Senator Berg, Mr. Eager stated there have been no asset reallocations as a result of Senate Bill 250.

In response to a question from Representative Tipton, Mr. Eager stated that the impending assumption rate changes are calculated into the contribution rates for FY 2025 and FY 2026 for the CERS nonhazardous plan.

In response to a question from Representative Johnson, Mr. Willer stated that they are not closer to the 4.4 percent cash allocation target because while the capital has been committed to private equity investments, the fund manager has not yet called the capital or drawn down the funds, so it has not transferred out of cash. When the manager calls, the capital will be taken directly out of cash and should bring the 15.5 percent current cash holdings down closer to the target allocation. In response to a follow-up question, Mr. Willer stated that if they carved out all the calls for cash, they were looking at around 8 percent of the portfolio invested in cash.

In response to a question from Senator Mills, Mr. Willer stated that commercial real estate and real estate generally is a very broad asset class and KPPA has a small amount of exposure, but it is limited across the entire exposure.

In response to a question from Representative Johnson regarding the funded status versus the desired lower contribution rates, Mr. Eager stated that the funding status will continue to improve, but any additional appropriations would contribute to the overall funded status.

Beau Barnes, Deputy Executive Secretary, General Counsel, Teachers' Retirement System (TRS), began his presentation with the investment performance. He discussed the preliminary and unaudited gross and net performance for the retirement and health insurance plans for the fiscal year ending June 30, 2023. He provided net returns for the 1-, 3-, 5-, 10-, and 20-year time periods. The retirement plan's 30-year compounded gross return was 7.7 percent.

Mr. Barnes discussed cash flow for both plans for FYTD 2023 compared to FYTD 2022. He reviewed the retirement and health insurance cash inflows, outflows, investment gains or losses, and the total net plan assets across both time periods.

Mr. Barnes discussed asset allocation. He reviewed the equity, fixed income, and cash allocations, stating the only change for FY 2024 is the lower end of domestic large cap, but overall range for domestic equity was unchanged. The Additional Categories target increased three percent for reclassification of timber; and equity targets reduced to offset the change. FY 2023 percentages are unaudited.

Mr. Barnes discussed funding sources and the contribution details for retirement and health insurance trends. He provided a chart for the insurance contributions that showed FY 2009 to 2023, state contributions, other employer contributions, and member/retiree contributions. Mr. Barnes also provided a chart for the retirement trust that showed FY 2017 to 2026, state unfunded liability payments, state employer fixed contributions, other employers fixed contributions, and members fixed contributions. He noted that FY 2023 figures are unadjusted and unaudited.

Mr. Barnes discussed the actuarial 30-year retirement cost projections based on an assumed 7.1 percent investment return. He provided a chart that shows funded ratios, unfunded liabilities, and required contributions, which are sometimes called the actuarially determined employer contributions. He noted that, at full funding once the amortization period has ended, the required contributions from the Commonwealth of Kentucky will decrease dramatically.

Mr. Barnes discussed the 10-year state and other employer contribution trends. He provided information for FY 2017 to FY 2026 for the retirement trust. He noted that FY 2023 is unadjusted and unaudited and FY 2024 through 2026 are based on budget and estimates.

In response to a question from Representative Johnson, Mr. Barnes agreed that after the next five-year period, the increases in contributions will not be as steep. Over the next five years, the annual increases in the state/other employer contributions are estimated at over $100 million. After the five-year period, the annual increases in the state/other employer contributions will be closer to $15 million per year. In response to a follow-up request, Mr. Barnes agreed to provide a 10-year projection.

In response to a question from Senator Berg, Mr. Barnes stated that there are certainly more international investments other than what is shown in the chart of 16 to 27 percent non-U.S. equities. He stated some of the other international or non-domestic investments fall under the alternative investments. In response to a follow-up question regarding the actual percentage of investments outside of the United States, Mr. Barnes stated he would have to research the data and follow up with a response.

In response to a question from Representative Johnson, Mr. Barnes stated that within the asset allocation class of alternative investments is private equity. The additional categories class are the private credit and timberland.

Regarding state and other employer contribution projections, Representative Petrie commented that he would like to have 30-year projections, and Mr. Barnes agreed to produce those numbers.

Mr. Barnes continued discussing the 10-year state and other employer contribution trends. He provided information for FY 2017 to FY 2026 for the insurance trust.

Lastly, Mr. Barnes presented the 2024-2026 budget request for TRS. For the pension trust, the Actual FY 2024 budget is $650,706,000; the Preliminary FY 2025 request is $809,940,000; and preliminary FY 2026 request is $907,250,000. The state's shared responsibility portion towards health insurance in Actual FY 2024 is $77,700,000; preliminary FY 2025 is $76,900,000; and preliminary FY 2026 is $84,200,000. These numbers do not include the SEEK formula numbers. He noted that FY 2025 begins the assumed return reduction to 7.1 from 7.5 percent.

In response to a question from Mr. Hicks, Mr. Barnes stated he would have to confirm, at a later time, that FY 2027 is year five of the five-year phase-in of the 7.1 percent assumed rate of return. In response to a follow-up question, Mr. Barnes confirmed that the rate of return is the only assumption or element of the most recent experience study remaining to be continuously phased-in.

Adjournment