PUBLIC PENSION OVERSIGHT BOARD

Minutes

August 27, 2024

Call to Order and Roll Call

The fifth meeting of the Public Pension Oversight Board was held on August 27, 2024, at 2:30 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: Representative DJ Johnson Co-Chair; Senator Jimmy Higdon Co-Chair; Senators Karen Berg, Robby Mills, Gerald A. Neal, Michael J. Nemes, and Mike Wilson; Representatives Robert Duvall, Derrick Graham, Jason Petrie, Phillip Pratt, and James Tipton; Auditor Allison Ball by proxy, Matt Frey; Victor Maddox.

Guests: Bo Cracraft, Executive Director, Judicial Form Retirement System; Ryan Barrow, Executive Director, Kentucky Public Pensions Authority; Erin Surratt, Executive Director, Office of Benefits, Kentucky Public Pensions Authority; Gary Harbin, CPA, Executive Secretary, Teachers' Retirement System; 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

Representative Johnson moved that the minutes of the May 20, 2024, meeting be approved. Senator Wilson seconded the motion, and the minutes were approved by voice vote without objection.

FY Ended Investment Returns and Cash Flow Update – Judicial Form Retirement System

Bo Cracraft, Executive Director, Judicial Form Retirement System (JFRS), provided a quarterly investment update for the Judicial Retirement Plan and the Legislators' Retirement Plan. 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 further discussed the asset allocation for both plans; the equity, fixed income, and cash allocations; and cash flow for both plans for FYTD 2024 compared to FYTD 2023.

In response to a question from Senator Higdon, Mr. Cracraft stated that the significant cost increases expected for the Medicare-eligible retiree insurance premiums are due to the Inflation Reduction Act that applies to the Medicare Part D prescription drug plans. Significant changes in Medicare will be in effect starting January 1, 2025, including the maximum out of pocket cap for prescription drugs dropping from $8,000 to $2,000 to the benefit of member/policy holders. Plan sponsors will be responsible for the difference, which could increase the premiums between 35 to 50 percent for the plans offered by JFRS.

Mr. Cracraft announced that JFRS has changed actuaries from USI to Gabriel, Roeder, Smith and Company.

FY Ended Investment Returns and Cash Flow Update – Kentucky Public Pensions Authority

Ryan Barrow, introduced himself as the new Executive Director of the Kentucky Public Pensions Authority (KPPA).

Erin Surratt, Executive Director, Office of Benefits, KPPA, discussed the cost increases for the Medicare-eligible retiree insurance plan as a result of the Inflation Reduction Act. She noted that the $2,000 maximum cap is not an out-of-pocket amount but an incurred cost amount. There are adjustments to the coverage gap at the catastrophic phase of drug coverage under Medicare Part D where the plans will be responsible for a much higher percentage of those costs. As a result of these combined changes at the federal level, KPPA's Medicare eligible plan premiums will increase about 55 percent in 2025. Additional information will be shared at the joint retiree health plan committee meeting.

In response to a question from Senator Higdon regarding the increase in cost, Ms. Surratt stated that she did not currently have exact data at hand, but the preliminary assessment is somewhere between a 5 percent to 10 percent decrease in funding levels of the health insurance trusts as a result of the premium increase.

Mr. Barrow discussed the FYTD 2024 highlights and stated that all plans exceeded their actuarial assumed rates of return, produced top decile risk adjusted performance, met or exceeded pension policy performance benchmarks, and were within policy asset allocation ranges.

Mr. Barrow discussed the pension and insurance investment returns for the quarter ending June 30, 2024. He provided the 1-, 3-, 5-, 10-, 20, and 30-year net of fees rates of return and noted that there was strong equity performance, strong overall returns, and the benchmarks were exceeded for both pension and insurance. Mr. Barrow presented asset allocation for all plans; reviewed the equity, fixed income, and cash allocations; and discussed cash flow for all plans for FYTD 2024 compared to FYTD 2023. He concluded with a review of the cash inflows, outflows, investment gains or losses, and the total net plan assets across both time periods.

Senator Higdon commented that reducing contribution rates while having a negative cash flow is not necessarily good for the plans. Mr. Barrow responded by stating the Kentucky Employees Retirement System contribution rate remained the same, but the County Employees Retirement System did decrease the contribution rate. He stated that within certain ranges he does not have a major concern. If investment income is taken out, cash flow is negative, but if coupon payments and disbursements are included cash flow is positive.

In response to a question from Representative Tipton, Ms. Surratt said she did not have a definitive answer regarding what trends were driving the increase in employer and employee contributions from payroll, but KPPA has seen an increase in the number of employees and in salaries, which are likely responsible. Mr. Barrow added that there is anecdotal information that higher salaries are encouraging continued employment. Representative Tipton asked for updated comparison numbers from the last few years to understand any potential trends.

FY Ended Investment Returns and Cash Flow Update – Teachers' Retirement System

Beau Barnes, Deputy Executive Secretary and General Counsel, Teachers' Retirement System (TRS), began his presentation with investment performance. He discussed the preliminary and unaudited gross and net performance for the retirement and health insurance plans for the quarter ending June 30, 2024, for the 1-, 3-, 5-, 10-, and 20-year time periods. The retirement plans 30-year compounded gross return was 8.1 percent.

Mr. Barnes discussed cash flow for both plans for FYTD 2024 compared to FYTD 2023; reviewed the retirement and health insurance cash inflows, outflows, investment gains or losses; and presented the total net plan assets across both time periods.

In response to questions from Representative Johnson, Mr. Barnes said the additional funding from the General Assembly has stabilized negative cash flow, keeping it consistent and in low ranges. TRS is at a 2 percent negative cash flow and negative 3 to 5 percent is an acceptable range. Mr. Barnes anticipates that the cash flow will remain similar within the next six years.

Mr. Barnes discussed asset allocation as of June 30, 2024, for the retirement and health insurance plans. He reviewed the equity, fixed income, and cash allocations.

In response to a question from Representative Johnson, Mr. Barnes stated the "alternative investments" asset class is private equity and the "additional categories" class is where TRS owns timberland acreage and private credit.

Lastly, Mr. Barnes discussed the 2024-2026 biennial budget, reporting that the end of the current budget (June 30, 2026) will mark 10 consecutive years of full or nearly full pension funding. TRS received more than $1.75 billion above the statutory rates to meet the actuarially required contribution for the pension funds and $161 million for under-65 health insurance costs under shared responsibility. Beyond the requested amounts appropriated in the budget (House Bill 6 of the 2024 Regular Session), House Bill 1 of the 2024 Regular Session provided an additional $80 million.

In response to questions from Senator Higdon, Mr. Barnes stated that TRS is working with federal agencies to receive guidance regarding the Inflation Reduction Act. TRS has an Employer Group Waiver Plan, which is a Medicare Advantage plan. There are 28 systems across the country that are seeking exemptions from the Inflation Reduction Act. He also gave an update of the funding levels on the pension and health plans.

In response to additional questions from Senator Higdon, Gary Harbin, CPA, Executive Secretary, TRS, stated that the teachers are extremely appreciative of the continued full actuarial contributions. When Tier 4 takes over and the old legacy liability is paid, the state will have no more unfunded liabilities with teachers' pensions. He discussed the success of the shared solution for retiree healthcare. Mr. Harbin confirmed that Tier 4 is a defined benefit plan with a supplemental component. He confirmed that the Kentucky General Assembly bonded $800 million to repay in full the funding that had been moved from the health insurance trust, provide transitional funding in shared solution, and pay bonds. Mr. Harbin explained that superintendents agreed to take 3 percent out of their budgets toward the retiree health liability with the understanding that the 3 percent would be reduced once the funding neared 100 percent. The unwind plan would incrementally bring school district and employee funding down to the same level as the state, then all the funding streams will be reduced equally.

In response to questions from Representative Tipton, Mr. Harbin stated TRS' actuary reviews the funding level of the Tier 4 plan every year to make sure it is above 90 percent and agreed to provide additional information about the funding level for the Tier 4 plan. Mr. Harbin said the Inflation Reduction Act could potentially delay the healthcare funding reaching 100 percent, but that it should not affect TRS as much as it will affect KPPA or JFRS. TRS estimates an increased cost of about $20 million per year as a result of the change to the out-of-pocket cap. Mr. Barnes and Mr. Harbin agreed that the statutorily required contribution is around $460 million for FY 2025 and $470 million for FY 2026. The additional funding of just under $1 billion is going toward the unfunded liability, with the funding level anticipated to reach 100 percent by 2047.

In response to questions from Senator Berg, Mr. Barnes stated TRS has a $17.5 billion unfunded liability for the retirement trust for FY 2025, and he discussed the discount rate applicable to the unfunded liability.

Adjournment
With no further business to come before the committee, the meeting adjourned.