

PUBLIC PENSION OVERSIGHT BOARD

Kentucky Retirement Systems Administrative Subcommittee

Minutes of the 1st Meeting of the 2018 Interim

August 27, 2018

Call to Order and Roll Call

The 1st meeting of the Kentucky Retirement Systems Administrative Subcommittee of the Public Pension Oversight Board was held on Monday, August 27, 2018, at 3:00 PM, in Room 154 of the Capitol Annex. Senator Wil Schroder, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Wil Schroder, Co-Chair; Representative Russell Webber, Co-Chair; Senator Dennis Parrett; Representatives DJ Johnson and Arnold Simpson; and John Chilton.

Guests: Brad Gross and Bo Cracraft.

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

Past and Present City/County Retirement Plans in Kentucky – LRC Staff

Mr. Gross provided a general overview of the current structure of the Kentucky Retirement Systems (KRS), highlighting three separate state-administered retirement systems, including the Kentucky Employees Retirement System (KERS), State Police Retirement System (SPRS), and the County Employee Retirement System (CERS). KERS has 354 agencies, with approximately 75 percent of its membership consisting of general state employees. The CERS plan has 1,138 agencies and a bit more variety of employers, but just over half of the employees in CERS are classified school board employees.

Mr. Gross discussed the history of the local government pension plans within the state. In 1935, before any pension plans had been created in Kentucky, the federal government enacted Social Security, however public employees were not eligible to participate. Mr. Gross noted that from this point, until 1950 when Congress allowed states to opt into Social Security, pension plans were being created. In 1938, the Teachers' Retirement System (TRS) was created, thus it was created as Social Security replacement plan. In addition, in 1942, the General Assembly first authorized the establishment of locally-administered city plans. A lot of the local plans were created as Social Security replacement plans, like TRS, and a 1978 study reported that of the 52 local plans in the

state, 41 plans had been established pursuant to statute. In 1950, Congress allowed states to enter into voluntary agreements to provide Social Security coverage to state and local government employees who were not in a retirement system. Kentucky entered into agreement in 1951. KERS was created in 1956 and in 1958 SPRS was created from the membership of KERS. In 1958, the General Assembly created CERS, and at that time it had a completely separate structure from KERS and was an optional plan in which counties could participate. In 1960, CERS was merged under the umbrella that is known as the Kentucky Retirement Systems today. In 1988, the General Assembly decided to close all open local government plans to new members and required participation in CERS. The only exception was the Lexington Policemen's and Firefighters' Pension Fund (Urban County Government).

Mr. Gross provided a review of the board structures for the Kentucky Retirement Systems and how it has changed over time. When created, both KERS and CERS were governed by five board members, all of whom were appointed. In 1960, when the plans were merged, the board increased to a total of nine members, which included five appointed members and two ex-officio members. In 1962, the board size remained at nine members, but consisted of four elected members, three appointed, and two ex-officio. In 1974, an additional CERS elected member was added, while the attorney general (ex-officio) was removed from the board. In 2010, an additional requirement of investment expertise was required for appointed members. In 2013, the board increased in size from 9 to 13, which included an additional CERS elected member and three additional appointees of the governor selected from lists provided by the Kentucky League of Cities, the Kentucky School Board Association, and the Kentucky Association of Counties. Lastly, in 2017, the board was expanded to 17, adding additional appointees who all were required to have investment expertise.

In response to questions from Mr. Chilton regarding the state of Kentucky opting into Social Security, Mr. Gross explained why teachers were not included. In 1950, the federal government decided that state public employees could be in Social Security, unless those employees already participated in a public retirement system. In 1954, the federal government changed this exception and provided a process for public employees participating in an existing retirement system to opt-in to Social Security by referendum. However, a Kentucky statute prohibits a referendum from occurring for TRS membership.

In response to a question from Representative Simpson, Mr. Gross stated local governments and cities generally govern whether firefighters and other local government entities participate in Social Security.

Mr. Gross discussed the underlying membership of KRS and noted a change in membership dynamic over time. In the beginning, KERS was the predominant portion of the membership, with 85 percent in 1960. However, over the course of time, CERS has

grown in membership and, as of 2018, represents the predominant share of the KRS membership.

Mr. Gross highlighted several historical studies and past legislation over time. Mr. Gross stated there were several studies, the largest being in 1977. The 1976 General Assembly passed a resolution “motivated by a growing awareness that many city pension funds were in serious financial condition and that the financial status of others was undetermined because the cities failed to procure periodic actuarial services.” In 1978, there was a LRC study on pooled pension investments for city pension systems, evaluating a way to invest the smaller plans to get better rates and lower fees. In 1982, another study was done, and there was some discussion on transitioning certain police and fire pension funds to CERS. In 1988, HB 398 closed the remaining locally-administered pension funds and required participation in CERS with exception of Urban County Government police and fire plans. In 2008, HB 600 SCS would have established a new retirement system with a separate board under KRS umbrella known as the Local Government Employees Retirement System (LGERS) for non-school board employees. The bill did not pass. In 2017, SB 226 would have separated CERS from KRS, with a separate board and separate statutory structure. Lastly, Mr. Gross mentioned that the 2017 PFM report did include a recommendation to consolidate the investment functions of all state systems, while retaining retirement boards for benefit administration. Also, PFM noted that consideration should be given to a centralized committee to set actuarial assumptions.

Review of Industry Administration, Governance, and Board Structures

Mr. Cracraft discussed the structures across the industry and stated there are three primary structures of administration and governance. The consolidated model is the most common and similar to what Kentucky is currently using. Under this model there is a single entity, such as KRS, that is responsible for administration of multiple plans, like CERS and KERS. Mr. Cracraft highlighted a few states, including Tennessee and Kansas, utilizing the model and noted that in many states, local non-hazardous employees are included in the same plan as general state employees, while other states have separated police and fire members in a separate plan.

Mr. Cracraft discussed a consolidated administration but separate governance model. This model is similar to a fully consolidated model, like KRS, where a single entity is responsible for administration, but a few states have separate boards that are responsible for governance of multiple systems. This structure is very similar to HB 600, which was introduced in 2008. Mr. Cracraft highlighted a couple states utilizing the model, including Vermont and North Carolina.

In response to a question from Representative Simpson with regards to who would be responsible for setting assumptions and plan details, Mr. Cracraft stated that the party addressing assumptions would be established by statute. Mr. Gross added that in most cases

each individual board would be responsible, but one consistent actuarial consultant would likely be used.

Mr. Cracraft continued with a separated administration and governance model, which is similar to the model that would have been created by SB 226. A handful of states have standalone local government plans that are administered and governed by a separate entity and board. He reviewed a couple of states that are utilizing this model, specifically Georgia and Missouri. Mr. Cracraft noted that while local employees are not handled this way in Kentucky, TRS and the Judicial Form Retirement System do operate in this manner.

Mr. Cracraft also discussed a few other states that utilize unique models where the plans are administered under a consolidated entity, such as KRS, but an advisory committee or subordinate board has been created to assist in governance or make recommendations regarding a specific plan.

In response to questions from Senator Schroder, Mr. Cracraft stated that SB 226 would have created a completely separated administration and governance model. In response to a follow up question regarding the investment of plans under a separate governance, Mr. Cracraft states he believed plans could handle situations where underlying boards choose different investment strategies. Mr. Gross added that generally the bigger the level of assets, the lower fees will be, but investments return may be more or less based upon various factors like asset allocation.

Mr. Chilton commented that he believes that it was the recommendation of PFM that each fund might make the same investment under an investment board, but there would be no mixing of money.

In response to a question from Representative Simpson, Mr. Gross stated that there was no data that indicated that the state would be liable if a locally administered city plan (not in CERS) faltered.

With no further business, the meeting was adjourned. The next regularly scheduled meeting is Monday, September 24, 2018.