PUBLIC PENSION OVERSIGHT BOARD

Kentucky Retirement Systems Administrative Subcommittee

Minutes

February 24, 2020

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, February 24, 2020, at 10:00 AM, in Room 154 of the Capitol Annex. Representative Russell Webber, 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 Jimmy Higdon; Representative Phillip Pratt; John Chilton, and James M. "Mac" Jefferson.

Guests: Bryanna Carroll, Director of Governmental Affairs, Kentucky League of Cities; Tommy Turner, Judge/Executive, LaRue County; Eric Kennedy, Director of Governmental Relations, Kentucky School Board Association; Joe Baer, President, Kentucky Professional Fire Firefighters; David Livingston, Scott County Magistrate and First Vice President of Kentucky Magistrates and Commissioners Association; David Eager, Executive Director, Kentucky Retirement System; and Doug Price, Retiree.

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

Approval of Minutes

Mr. Jefferson moved that the minutes of the October 28, 2019 meeting be approved. Senator Higdon seconded the motion, and the minutes were approved without objection.

Proposal for New KRS Governance Model

Bryanna Carroll, Tommy Turner, Eric Kennedy, Joe Baer, and David Livingston collectively presented a legislative proposal to separate the governance of the County Employees Retirement System (CERS) from Kentucky Retirement Systems (KRS) board of trustees, while maintaining joint administrative functions with the other systems.

Ms. Carroll began with a review of the current CERS status as it relates to the board of KRS. She noted that CERS accounted for 76 percent of total assets and 64 percent of total membership, however, only accounted for 35 percent of representation on the KRS Board of Trustees. She also stated that CERS trustees only represented 11 percent of the

Investment Committee and 14 percent of the Actuarial Subcommittee. Ms. Carroll added that CERS membership had grown by an additional 6,000 members during 2019, while the Kentucky Employees Retirement Systems (KERS) had a drop of 4 percent in membership. She stated that the KRS board had moved towards low-risk and more conservative investments since 2017, which was a result of the poor funding level of KERS nonhazardous, which is 13.4 percent compared to the 49.1 percent funding for CERS nonhazardous. Prior to the change in investing, CERS had earned an average investment return of 8.68 percent per year since FY 2001 and a 30-year return of 8.9 percent, which was above the assumed rate of 6.25 percent the board adopted in 2017. In FY 2019, CERS had a one-year investment return of 5.8 percent, which was below peer group returns of 6.4 to 6.8 percent.

As a result of these concerns, along with others, the proponents sought the drafting of a bill that would reorganize KRS. The bill would create a CERS Board of Trustees that is free of political influence, while protecting the state's pension system and avoiding the duplication of services. The bill maintains the KRS Board of Trustees and creates a joint Kentucky Public Pensions Authority (KPPA). The CERS Board of Trustees would be responsible for governing CERS, while the KRS board would handle KERS and the State Police Retirement System (SPRS). The KPPA would provide personnel needs, day-to-day administrative needs, and other duties specified by the CERS or KRS Board of Trustees.

Both the CERS and KRS Boards of trustees would consist of nine trustees, three of which would be elected by the respective memberships. For the CERS board, two trustees would be elected by nonhazardous members, while one would be elected by hazardous members. The KRS elected membership would include one SPRS member and two KERS members.

In addition to the elected members, both boards would have six trustees appointed by the governor, of whom three must have at least 10 years of retirement experience and three must have at least 10 years of investment experience. Each board would hire a chief executive officer who will function as legislative, legal, and executive advisor to the board. Each board would be responsible for its own investment decisions, actuarial data, auditing, asset allocations, medical, and other professional, or technical services, and each board would hold quarterly meetings and publish an annual financial report.

The KPPA would also consist of nine members, consisting of four trustees from both the CERS and KRS Board of Trustees, along with one gubernatorial appointee chosen from a list submitted by the Legislative Research Commission, who would only vote in the event of a tie. The KPPA would provide benefit counseling and administration, information technology and services, legal services, employer reporting and compliance, processing, distribution of benefit payments and other financial/accounting duties, and completing and compiling of financial data and reports.

In conclusion, Ms. Carroll discussed several other provisions of the draft KRS reorganization bill. She stated that all three boards would report to the Public Pension Oversight Board (PPOB) and noted the legislation would not impact benefits or the inviolable contract. She also pointed out that the governor would not have ability to reorganize, replace, amend, or abolish any of the boards, and that additional language had been added to restrict a municipality from filing for bankruptcy protection if it is in default or delinquent in the payment of pension contributions. Lastly, Ms. Carroll noted the three boards would assume their new roles starting on April 1, 2021.

Mr. Turner added that the County Fiscal Courts and Kentucky League of Cities (KLC) are in total unison with the proposal of this bill.

Mr. Kennedy added that the Kentucky School Board Association (KSBA) has been a strong supporter of the overall movement to examine how the systems function. He stated that KSBA is looking forward to the passage of this bill.

Mr. Baer added that the proposed separation has been the top priority for the Kentucky Professional Fire Fighters for a number of years.

Mr. Livingston added that the passage of this bill is important to the Kentucky Magistrates and Commissioners Association.

In response to a question from Representation Pratt regarding liability in the event a municipality declares bankruptcy, Ms. Carroll stated the hybrid approach, as proposed in the bill, would continue to function just as it does currently. In the event that a county were to dissolve, then its liability would be the responsibility of the state to fund, however, if a municipality declared bankruptcy, the remaining employers in the system would absorb payment. In addition, new language had been added in the bill so that no municipality could declare bankruptcy solely based on their pension liability.

In response to a question from Mr. Jefferson regarding how investment and retirement experience would be defined, Ms. Carroll stated that current statutory language already defines the terms, and the CERS board would adopt the same requirements. In response to a follow up question regarding what specific items, outside of board inequity, led to the hybrid approach versus reorganizing the current board, Ms. Carroll stated KLC could not support increasing the number of CERS trustees on the current board due to concerns regarding liability, fiduciary conflict of interests, and politics. She stated that CERS trustees do not want to have input in or and fiduciary responsibility for other state systems, and there are times when making decisions in the best interest of CERS, while considering the other systems, could lead to a fiduciary conflict. Lastly, she advised that another important component of the hybrid approach was to remove politics from the process.

In response to a question from Mr. Jefferson with regards to added costs of the proposal, Mr. Eager stated that staff had estimated the cost would roughly include $225,000 of one-time implementation costs, with ongoing annual costs ranging from a low end of $3.6 million and a high end of $6.7 million.

Senator Higdon commented that he was in support of the separation but had concerns regarding some of the details. First, he expressed some concern over administrative costs, which he believes were already high. Ms. Carroll responded that KLC is very sensitive to the administrative costs of KRS and noted that 64 percent of those expenses are being paid by CERS. Secondly, Sen. Higdon expressed some concern over further separating the investment management process and removing staff from KRS 18A personnel standards. Ms. Carroll stated that the KPPA was created in a manner that would allow both systems to invest together, however, it would be a joint decision by each. With regards to removing staff from KRS 18A, Ms. Carroll stated that decision was based on removing the political aspects of staffing, however, she noted the bill included requirements of the KPPA to report number of staff, salaries, as well as any raises provided on an annual basis.

Mr. Turner added that he has examined the retirement situation from top to bottom over his extended work life and believes the plan being presented is one of the best and most workable.

Mr. Livingston added that sometimes the similar focus needs to be placed on the revenue aspect and not just a cost aspect. While additional costs may be incurred, if a CERS board could maximize returns or create additional income, less pressure will be placed on employers, such as school boards, who represent half of CERS.

Senator Higdon agreed that returns need to be maximized, however, was not certain it was necessary to have their own investment board in house. He stated that he continues to be concerned about the administrative costs. In response, Ms. Carroll stated the proposal would not result in additional staff hired other than the one employee that would be their representative for CERS on the KPPA board. She noted both boards would share investment staff.

Mr. Chilton added his comments. First, he stated that there was some confusion with regards to the term "joint investment." He clarified that CERS and KERS had never made joint investments but rather had invested assets in the same security. Secondly, he noted that a statement had been made indicating that KRS was in support of the proposal. As a member of the KRS board, Mr. Chilton stated that he did not believe an opinion had been made. Third, he noted that he had participated in this discussion, which dated back to 2015, and asked if the major motivation for separation dealt with managing the budgets of the employers and the investment return that is being assumed. In response to comments and questions from Mr. Chilton, Ms. Carroll stated that the ability for CERS and KRS to unitize or invest in the same security would still be available. In addition, she clarified that the statement of KRS' support was regarding the decision to remove CERS from under KRS 18A due to political aspects, and that KRS agreed to language requiring the KPPA to report salaries and the number of employees. With regards to motivation, Ms. Carroll stated concerns over political pressure, inequitable membership on the KRS board, along with serious concerns with the liability of having to manage KERS, are additional to the motivations of budget and investment return.

Mr. Kennedy added that part of the reason why employer groups are wanting a separation is the desire to have a stronger focus on CERS. Given meetings are live streamed, more and more constituents are watching, and there have been times where KERS or CERS might not always get the adequate focus to each of their respective needs. In addition, he noted a concern from potential CERS trustee candidates who do not want to carry the responsibility for oversight of the KERS or SPRS plans.

Mr. Price, a retiree, spoke in opposition to separation and proposed that a CERS subcommittee be created with the express purpose of allowing input on setting assumptions and investments.

With no further business, the meeting was adjourned.