

INTERIM JOINT COMMITTEE ON STATE GOVERNMENT

Minutes of the 1st Meeting of the 2023 Interim

June 20, 2023

Call to Order and Roll Call

The first meeting of the Interim Joint Committee on State Government was held on June 20, 2023, at 11:00 AM in Room 149 of the Capitol Annex. Representative David Hale, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative David Hale, Co-Chair; Senator Robby Mills, Co-Chair; Representative Kevin D. Bratcher, Co-Chair; Senator Karen Berg, Senator Greg Elkins, Senator Denise Harper Angel, Senator Christian McDaniel, Senator Michael J. Nemes, Senator Damon Thayer, Senator Phillip Wheeler, Senator Gex Williams, Representative Chad Aull, Representative Tina Bojanowski, Representative Adam Bowling, Representative Beverly Chester-Burton, Representative Robert Duvall, Representative Jim Gooch Jr., Representative Derrick Graham, Representative Richard Heath, Representative Samara Heavrin, Representative Keturah Herron, Representative John Hodgson, Representative Thomas Huff, Representative Mary Beth Imes, Representative DJ Johnson, Representative Savannah Maddox, Representative Steve Rawlings, Representative Josie Raymond, Representative Russell Webber, Representative Wade Williams, and Representative Susan Witten. Representative Jason Nemes also attended.

Guests: David Eager, Executive Director, Kentucky Public Pensions Authority (KPPA); Beau Barnes, Deputy Executive Secretary of Operations and General Counsel, Teachers' Retirement System (TRS)

LRC Staff: Alisha Miller, Daniel Carter, Christina Gordley, Jennifer Hans, Alaina Spence, Shannon Tubbs, and Peggy Sciantarelli.

Member and Guest Recognition

Representative Hale and Senator Mills recognized new members of the interim committee. A moment of silence was observed in memory of deceased Representative Lamin Swann, who served on the House Elections, Constitutional Amendments & Intergovernmental Affairs Committee during the 2023 Regular Session.

Senator Thayer recognized Ms. Sydney Zakic, a high school student who is participating in the Elkhorn Crossings Law and Justice Program in Scott County.

Overview of State-Administered Retirement Systems: Administration, System Membership, Funding, and Investments

David Eager, Executive Director, Kentucky Public Pensions Authority (KPPA), discussed the three retirement systems operated by KPPA: the County Employees Retirement System (CERS), the Kentucky Employees Retirement System (KERS), and the State Police Retirement System (SPRS). His testimony included a slide presentation.

The systems have a total membership of 410,082, with pension and insurance assets totaling

\$23.1 billion as of March 31, 2023. CERS has 268,788 members (65.5 percent), KERS has 138,486 members (33.8 percent), and SPRS has 2,808 members (0.7 percent), as of June 30, 2022. KPPA's administration of the systems is governed by the KPPA board, in conjunction with the CERS board and the Kentucky Retirement Systems board that oversees KERS and SPRS.

KERS has 33,231 participating employees. The employers include P-1 state agencies, health departments, regional mental health units, universities, and Non-P1 state agencies, with a total of 325 participating employers. CERS has 89,768 participating employees and 1,122 agency employers that include boards of education, fiscal courts, cities, urban and metro government, and utility boards.

The overview charted KERS-nonhazardous and CERS-nonhazardous membership at Tier 1, Tier 2, and Tier 3 levels. KERS-nonhazardous total membership is 124,550, with 29,069 active members and 44,952 retired members—a ratio of approximately 3:5—with KERS-nonhazardous retirees being funded by a smaller number of actively employed members who are making contributions.

The overview delineated retiree pension and health benefits for KERS-nonhazardous and CERS-nonhazardous members; funded status and assets; and employer pension contribution history and special appropriations for the KERS, CERS and SPRS plans from 2015 to 2022. Tier 1 and Tier 2 are defined benefit plans. Tier 3, the hybrid cash balance plan that resulted from passage of SB 2 in 2013, applies to members participating after January 1, 2014. As of June 30, 2022, KERS-nonhazardous pension benefits are only 18.5 percent funded; health insurance benefits are funded at 79.1 percent. Pension benefits for CERS-nonhazardous are 52.0 percent funded, and health insurance is funded at 132.1 percent.

Mr. Eager described how employer contribution rates for KERS and SPRS increased dramatically in 2018 and 2019 as a result of actuarial assumption changes in 2017. This inhibited hiring and salary increases for state employees. He reviewed KERS and CERS projected employer contributions for 2032, 2042, and 2049; asset allocation for KERS-nonhazardous and CERS-nonhazardous as of June 30, 2022; and investment performance as of June 30, 2022. If assumptions are met and full funding continues, the retirement systems will be “out of the woods” by year 2049.

He concluded his presentation with a review of recent pension milestones and fiscal year highlights. In FY 2014, Tier 3 and the Public Pension Oversight Board were introduced. Full funding was reinstated by the legislature in FY 2015. The KRS board revised economic assumptions for all pension and insurance plans in FY 2017, which resulted in pension contribution rates rising 50-80 percent. In FY 2021, passage of HB 8 allocated the unfunded liability to all KERS-nonhazardous employers, and HB 484 created the separate CERS system and the Kentucky Public Pension Authority. In FY 2022, SPRS received a \$215 million additional supplemental appropriation, and funded status grew from 31 percent to 53 percent. For FY 2023 and 2024, the legislature has approved additional supplemental appropriations of \$480 million over the biennium.

Senator Thayer briefed the committee on the significance and positives that resulted from passage of SB 2, which he sponsored during the 2013 regular session. The bill created the new Tier 3 Hybrid Cash Balance Plan, which has elements of both a defined benefit plan and a defined contribution plan; it became law to require the General Assembly to fully fund the

actuarially required contribution to the retirement systems; and it created the Public Pension Oversight Board. Senator Thayer also complimented former Governor Steve Beshear for his role in developing and securing passage of the legislation. He stated that SB 2 was a major accomplishment. The retirement systems are now on a good trajectory that reflects the General Assembly's commitment to secure the retirement of state employees, and because the legislation is fiscally responsible, it was also a positive for the taxpayers.

Senator McDaniel questioned whether it might be beneficial during the budget process to strive to apply all new dollars toward the payroll side, since insurance funding is on a positive trajectory. In response, Mr. Eager stated that would be a good question to discuss with KPPA's actuary, Gabriel, Roeder, Smith & Co. (GRS).

In response to questions from Representative Bratcher, Mr. Eager stated that newly hired employees of the systems' seven university employers—which do not include the University of Kentucky and the University of Louisville—would participate in Tier 3. The tier status of system participants currently in Tier 1 and Tier 2 will not change over the years. Funded status of KERS-nonhazardous, which is currently 18.5 percent, was at its lowest in 2019 at 12.9 percent.

When asked by Representative Graham, Mr. Eager stated that the impact of early retirements on system funding is actuarially neutral. Representative Graham stated that when employees retire early, there is an accompanying loss of institutional knowledge. In his opinion, taking steps to encourage employees to work longer would have an overall positive impact. Mr. Eager added his opinion that employees being offered the flexibility of working from home is a benefit and also an incentive for them to stay on the job longer.

In response to questions from Senator Berg, Mr. Eager explained that the overall rate of investment return is currently in the 7-8 percent range, and it is the desired goal—and the statutory obligation—to fund the systems at 100 percent.

Senator Williams, noting that employees in the current generation often change jobs mid-career, questioned how employees leaving the retirement systems early might impact solvency. Mr. Eager said that a portability factor is accounted for in Tier 3 and that solvency of the systems would not be affected.

Beau Barnes, TRS Deputy Executive Secretary and General Counsel, Teachers' Retirement System (TRS), was next to speak. His testimony included a slide presentation.

The 2022-24 biennial budget marks eight straight years of nearly full funding for the TRS annuity trust for pensions. In years 2008-2017, TRS was not receiving full funding. The biennial budget provides additional funding of over \$1.28 billion to meet actuarially required contributions to the annuity trust and to pay off the legacy unfunded liability.

The biennial budget also provides \$149 million, the full amount for the state's share for health insurance for retired teachers under the shared responsibility plan. Before 2010, retired teachers' health insurance was funded on a pay-as-you-go basis, and the Commonwealth had been voluntarily paying for almost all the cost of retired teachers' health insurance prior to 2010. The biennial budget also provides \$479.2 million to pay off liabilities for certain previously awarded benefits that had been amortized over several years.

TRS is primarily a retirement system for school teachers in 171 local school districts. Membership also includes five universities, state education agencies, and the Kentucky Community and Technical College System (KCTCS). The TRS retirement plan replaces Social Security for non-university members—about 95 percent of TRS membership. It also includes health insurance premium benefits upon retirement. University members pay into and receive Social Security benefits. Since July 1, 1994, universities also have offered optional retirement plans in lieu of TRS.

TRS has an 11-member board of trustees. All funds are held in trust to provide benefits for members. There are four account types (TRS 1, 2, 3, and 4), based on entry date into the system. As of June 30, 2022, TRS has 74,785 active members and 58,438 retirees and beneficiaries.

As of June 30, 2022, the TRS retirement annuity trust has assets of \$24.1 billion, liabilities of \$41 billion, and a funded ratio of 58.8 percent—the highest level within recent years. In 2022, the health insurance trust was funded at 63.7 percent, having grown quickly since shared responsibility became law in 2010. It is anticipated that the health insurance may be 100 percent funded within a few short years, depending on the rate of inflation and available federal subsidies.

State contributions to all funds constituted \$1.57 billion in FY 2022—an anomaly, because that included the previously mentioned one-time \$479.2 million payment for past benefit adjustments. Contributions from FY 2017 to FY 2021 ranged from \$1.06 billion to \$1.14 billion. In FY 2016, TRS was not receiving full funding, and contributions were only \$.56 billion.

Mr. Barnes reviewed actuarial 30-year projections for the retirement annuity trust and the health insurance trust, based on an assumed 7.1 percent investment return. By the end of FY 2047, contributions to the retirement annuity trust are expected to drop to about one-third of the cost. He also discussed investment performance for both trusts (based on unaudited returns as of March 31, 2023) and asset allocation for the trusts. The health insurance trust was established in 2010, when prefunding of retiree health insurance began.

Mr. Barnes provided a chart comparing TRS 3 and TRS 4 plans for local school district teachers. He noted that TRS 1, 2, and 3 plans are very similar. TRS 4 is a hybrid plan that is part pension and part savings account; it requires a minimum retirement age of 57. The most significant difference in TRS 4 is that the Commonwealth of Kentucky bears no responsibility for any unfunded liability that might develop in that tier. However, TRS 4 is well funded, and the actuaries do not anticipate any future unfunded liability. If funding falls below 90 percent, the board of trustees is required by statute to make adjustments to maintain funding for non-university members.

Representative Bojanowski spoke about the current teacher shortage and questioned how returning to the classroom might impact retired teachers. Mr. Barnes advised that retired teachers who are considering returning to teaching should first contact TRS so that they understand applicable federal law and all the pertinent regulations and restrictions. For example, there are earnings limitations and rules relating to breaks in service.

Senator Williams suggested that it would benefit Kentucky to attract trained teachers from other states to teach here. He asked how someone who previously taught in a system that participates in Social Security would be impacted by joining the TRS system. Mr. Barnes stated

that they should reach out to TRS in advance to determine how the transition would affect their individual circumstances and Social Security earnings.

Representative Bratcher spoke about the fiduciary responsibility of the TRS board and questioned past decisions of board members to award annual cost-of-living increases (COLAs) to teachers during the years when the system was not properly funded. Mr. Barnes explained that, because the TRS system is a Social Security replacement plan, the annual 1.5 percent COLA is required by statute, and it is partially prefunded by teachers' contributions. During good budget years TRS would request additional funding to provide COLAs over and above the 1.5 percent in order to keep track with inflation, but once funding no longer became available via the state budget, the board did not provide any unfunded COLAs.

Representative Nemes praised the actions taken by the General Assembly since 2016 to help properly fund the pensions of teachers and state and county employees. He stated that in some years, the state contributions to TRS have been greater than what is spent yearly on the state's entire court system. The General Assembly has made a massive commitment to Kentucky citizens, as well as students and people who are committed to their careers.

Representative Graham stated that policy relating to teacher retirement has been developed in a bipartisan way. Funding of the state budget in recent years has also been bolstered by federal dollars. He expressed hope that the General Assembly will continue to work together in a bipartisan way on behalf of the people of Kentucky.

Date of Next Meeting - Monday, July 24

Adjournment

There was no further business, and the meeting was adjourned at 12:52 p.m.