MINUTES OF MEETING
BOARD OF TRUSTEES KENTUCKY RETIREMENT SYSTEMS
QUARTERLY MEETING NOVEMBER 16, 2021 AT 10:00 AM
VIA LIVE VIDEO TELECONFERENCE

At the meeting of the Kentucky Retirement Systems Board of Trustees held on November 16, 2021 the following members were present: Keith Peercy (Chair), John Cheshire, Raymond Connell, Joseph Grossman, Lynn Hampton, Prewitt Lane, Pamela Thompson and Larry Totten. Staff members present were David Eager, Rebecca Adkins, Erin Surratt, Michael Board, Steven Herbert, John Chilton KRS CEO, Ed Owens, III, CERS CEO, Victoria Hale, Ann Case, Connie Pettyjohn, Connie Davis, D'Juan Surratt, Jared Crawford, Kristen Coffey, Elizabeth Smith, Steve Willer, Ashley Gabbard, Shaun Case, Phillip Cook, Glenna Frasher and Sherry Rankin. Others in attendance included Danny White and Janie Shaw with GRS Consulting, and Tracy Garrison, Larry Loew, Carrie Lovell and Carla Whaley with Humana.

Mr. Peercy called the meeting to order.

Mr. Michael Board read the Legal Public Statement.

Ms. Sherry Rankin called roll.

There being no public comment, Mr. Peercy introduced agenda item *Approval of Minutes – September 9, 2021*. Ms. Hampton made a motion and Mr. Grossman seconded to approve the minutes as presented. The motion passed unanimously.

Mr. Peercy introduced agenda item *Draft of 2021 Actuarial Valuations.* Mr. Eager began by providing an overview of the process in an attempt to assist the newer Trustees. He stated that GRS Consulting does a valuation each year based on the June 30 data. They present it to the Public Pension Oversight Board as well as the committees and both of the Boards in November. In December, the Boards approve them and they take effect in July. Therefore, we are currently in fiscal year 2022, using the valuation that is based on the 2020 data, which was approved in December of last year and took effect this past July. He agreed that it is confusing, but wanted to remind the Trustee that the contribution rate you approve in December will come into effect in July 2022 which will actually be Fiscal Year 2023.

Mr. Danny White with GRS Consulting presented the Draft 2021 Actuarial Valuation Results for the Kentucky Retirement Systems. He explained that this presentation is given as information only today and will be brought up again in the December Board meeting at which time the Board will adopt or approve the valuations. Mr. White began by providing an overview of legislation that passed in 2021. The first major legislation was House Bill 8, which was a huge, ground-breaking moment that was the beginning of the financial security of the KERS Non-Hazardous Fund. He explained that normal employer contribution is paid as a percentage of payroll, and with the decline in the number of KERS Non-Hazardous employees, it was causing the contribution rate to spiral upwards at an alarming rate. What House Bill 8 accomplished is that the amortization cost are going to be collected from each participating employer and then each participating employer will then pay a normal cost rate as a percentage of payroll. He explained that there is no longer an incentive for employers to reduce their covered payroll in order to reduce their pension costs. Mr. Grossman asked the question does the liability for each entity stay the same until it is a zero balance. Mr. White answered the allocation is fixed but the amortization cost that each employer pays floats up or down. Mr. Eager clarified that the entity is assigned a percentage of the total. The percentage stays the same but the amount changes year to year. Mr. White then spoke about Senate Bill 169 which provided some disability benefits improvements.

Mr. White spoke about the demographics and stated that the active membership declined across all of the funds. This resulted in the decrease in covered payroll for both KERS Hazardous and State Police Retirement Systems. Again, he stated that for KERS Non-Hazardous, the employer contribution is no longer tied to payroll. Mr. White then spoke about the Fiscal Year 2021 Investment Experience where there was between 21% and 25% return on market value and how this was a monumental year for our investments. He then reviewed the liability experience in both the retirement and insurance funds. He indicated that it is imperative to maintain or increase contribution effort for the KERS Non-Hazardous Retirement Fund. He reviewed the required employer contributions in percentage and dollar amounts for the KERS Non-Hazardous, KRS Hazardous and State Police, as well as, the amortization costs for the KERS Non-Hazardous fund. Mr. Chilton stated in terms of what the money is being used for, it's being used to provide money to cover the normal costs for active employees, and there is an add-on for the amortization under House Bill 8 for the unfunded liability. He asked where the administrative expenses for KPPA are imbedded in these contributions. Mr. White responded that the administrative expenses are imbedded in the normal costs. Mr. Connell asked a question about the statement about with having the investment gains we realized that amortization costs to the agencies can go down. He asked if that is also the case that if the investments are not that great that the amortization costs go up. Mr. White answered that yes that is correct, they can go up. He stated it is in the Funding Policy that is put in Statute, so the Board has control over certain actuarial assumptions but it is the Funding Policy that is driving the amortization costs. Mr. Connell indicated that his concern is that we could experience and economic downturn occur in investment gains, can it be assumed that this 20 year amortization assumption would decrease somewhat the spike and costs to the agencies. He is concerned about a situation in which the economy goes down and our investment gains are hurt, but the costs to the agencies increase. It seems it will put pressure on the whole amortization schedule. Mr. White indicated that it could. This is a prime example of why we use a five-year smoothing in investment gains and losses. Understand that while we have 20 year amortizations and you have an investment event like you experience this past year, it actually gets recognized over more like a 25-year period. This is because you don't recognize all of that immediate gain this year, due to the amortization it is spread out over five years and then it is fully realized. Ms. Hampton asked for clarification on her understanding that there are two pools of money, one amortized over a 30 year period and one over a 20 year period. Mr. White stated that there are two bases that are recognized and we do track and maintain those pools separately, but it is just one net effect that the employers see and pay. Ms. Hampton then asked are these blended annually. Mr. White indicated that yes they are combined. Ms. Thompson then asked if this just goes on in perpetuity. Mr. White responded yes, it does. He stated that the only one that shouldn't go on in perpetuity is the 30 year base that is down to 28. That is your large funding base, the existing unfunded liability. Ms. Thompson then asked if there was a thought about having just a single 20 year period because, in theory, by the time you get 20 years out we are in a much healthier position and it is not going to be as serious of an impact. Mr. White stated that there was some thought about it, but we felt this was the more preferred approach because you are able to track and maintain to show how you are paying down each tranche or base. Mr. Totten stated that back on November 4, 2021, at the Joint Audit Committee meeting, it appeared that a draft of the AFCR and on page 71, there is a list of a schedule of employers' net pension liability and they are all the same. He indicated that he is focusing on the KERS Non-Hazardous and on the line of ratio of plan fiduciary net position the total pension liability gives a percentage amount of 18.48% and that is the figure that was picked up by the Lexington Herald Leader and broadcast all over. Mr. Totten went on to say that here it seems we are saying our funded ratio is 16.8%. He questions if one of these figures is more real than the other, or which one are we going to rely upon and go forward with and he is looking for the difference in these two figures. Mr. White indicated that the most significant difference is the asset amount. The actuarial value of assets is a calculated asset value where investment gains and losses are factored in at 20% a year for the next five years, so that we are not overreacting either way when we get a great return in one year or a return that is less than expected, in terms of developing the contribution rate. So, this actuarial value of assets reflects the terms of calculating contribution rates. The figures used in the Annual Report are reflecting the GASB 67 accounting standards and those are the differences in the percentages you have pointed out. Both are correct but are used for different purposes. Mr. Totten then asked which one with we be using to determine the contribution rates. Mr. Eager indicated that while both figures are published, one in the Annual Report and one here in the valuation, we use the valuation figure in determining the contribution rates.

Mr. White continued to review the change in required employer contributions and amortization cost, the unfunded actuarial accrued liability, active membership count chart, covered payroll chart, retired membership count chart, pension benefit distribution chart, and the funding results chart. Ms. Hampton asked for clarification that this does not include the tier 3 employees who do not have a liability. Mr. White answered that the tier 3 is built in there, there is a liability and everything is pooled together, for all members, including active, retired, tier 1, tier 2 and tier 3. It is just that their benefits are structured different as a cash balance, but it is all weighted in there. We can see a decrease every year in the normal cost rate, and as your tier 1 employees retire, you will continue to see that number decrease. They will be replaced with tier 3 employees and their benefit is relatively less expensive compared to the tier 1 employees.

Mr. White reviewed the projection assumption charts that reviewed the unfunded liability and funded ratio for both pension and insurance and charts showing the employer contributions and costs for the KERS Non-Hazardous, KERS Hazardous and State Police Retirement Systems. Mr. Totten questioned what attributes to the difference in the KERS Non-Hazardous chart showing the pension unfunded liability and the other two plans for the same chart. Mr. White explained that it all about your starting point. The KERS Hazardous plan, for instance, had a better starting point, and when you have an investment gain like we experience this past year, you are going to get a bigger effect. The steep curve you see on this chart for the next four to five years is that investment gain being fully recognized in the funding calculations. Mr. White gave his closing comments on the 2021 valuation results and stated that the favorable investment experience improved the funded status and lowered the required contribution effort across all of the funds. He stated that it is imperative that the State and participating employers continue contributing the actuarially determined contributions in each future year to improve the Systems' financial security.

Mr. Peercy introduced agenda item *Ratification of Investment Policy Statement.* Mr. Lane began by stating changes were needed to the Investment Policy Statement essentially due to the separation, to correct terminology, and to do some fine tuning. He indicated that no significant policy shifts were made in this document this time. However, he did state that at some point we will be including some language about ESG (Environmental, Social and Governance). The Department of Labor has issued a directive to include this language and our legal and investment staffs are conducting research in how other organizations are dealing with this statement. We will have to make changes to keep in conformity with the Department of Labor at some point in the future. Mr. Lane introduced Mr. Herbert to give an overview of the policy statement and to answer any questions. Mr. Herbert reiterated that the changes made were very minor and reviewed a few of those changes throughout the policy. Mr. Chilton stated that because there is much discussion in the media and attention from the regulators on the ESG issue, can you provide an explanation of what that is so that we can understand it when we hear about it. Mr. Lane stated that he really doesn't think it is coming from the regulators, but rather the whole sensitivity of today's society. He stated that it is going to be rather difficult to incorporate this within our investment policy and feels that we just need to follow the Department of Labor's regulations and to insure that our managers are being sensitive to these and are in conformance. Mr. Grossman made a motion and Mr. Cheshire seconded to ratify the Investment Policy Statement. The motion passed unanimously.

Mr. Peercy introduced agenda item *Ratification of Retiree Health Plan Committee Reports and Recommendations.* Ms. Pettyjohn stated that the Joint CERS and KRS Retiree Health Plan Committee met on November 9, 2021. At this meeting, Mr. Larry Totten was elected by the committee to the office of Vice-Chair. The Committee does not have anything for the Board to ratify at this time and the material provided is for informational purposes only. Ms. Pettyjohn reviewed the highlights of the information provided during the committee meeting. Mr. Totten stated that it was nice to see that the retirees are really taking advantage of their benefits. He feels that it is a big deal for Kentucky public retirees and it is good to see them take advantage of the benefits that are offered.

Mr. Peercy introduced agenda item *Ratification of Joint Audit Committee Reports and Recommendations.* Ms. Lynn Hampton began by stating that the Joint Audit Committee met on November 4, 2021 where we met with the external auditors and we are meeting again on November 30, 2021 where we expect to see the final report, including the management letter and replies to the management letter. We also approved the Charter for the Joint Audit Committee. She formally thanked Ms. Coffey who always provides several articles that are on appropriate subjects for our committee and the Boards. Ms. Hampton introduced Ms. Coffey who indicated that the committee is requesting that the Board ratify a few actions taken by the Joint Audit Committee. She stated that the Committee approved the purchase of infrastructure and application security assessment. This is something that is done every year. Ms. Coffey stated that the committee also approved the Charter for the Joint Audit Committee and the Committee meeting dates and time for the next calendar year of 2022, as well as the Special Called meeting scheduled for November 30, 2021. Mr. Lane made a motion and Mr. Totten seconded to ratify the Joint Audit Committee reports and recommendations. The motion passed unanimously.

Mr. Peercy introduced agenda item *Quarterly Financial Reports.* Ms. Adkins reviewed the following Financial Reports for the KERS and SPRS Funds: Combining Statement of Fiduciary Net Position for the Pension and Insurance Funds for the Fiscal Year ending September 30, 2021; Combining Statement of Changes in Fiduciary Net Position for the Pension and Insurance Funds for the Fiscal Year ending September 30, 2021; First Quarter Fiscal Year 2022 Budget to Actual Analysis; Contribution Reports for Pension and Insurance Funds; Outstanding Invoices; and Penalty Waivers. Mr. Chilton asked a question concerning the Outstanding Invoices and wanted an explanation of the credit shown on the line item Refund to Employer. Ms. Adkins indicated that invoices can be credit or debit for the employer so this is just how we exchange funds back and forth with the employer. She provided an example where an employer miss keys an employee's salary and enters $5000.00 instead of $500.00 and they pay contributions on the

$5000.00 amount. When they come back and correct it, then they are given a refund of the contributions that they incorrectly paid and they take it in credit that they can apply to existing invoices or simply take it back. Ms. Hampton asked for an explanation of the pension spiking line item that is listed on this report. Ms. Adkins explained that pension spiking as a concept where an employer increases one of their employee's salary who is getting close to retirement, and high five is in their retirement calculation and the employer gives them a raise for no other purpose than to say they want them to get more in retirement as a reward for being a great employee. The legislature attempts to stop that practice by placing a 10% cap on it. Therefore, a salary that increases more than 10% during a fiscal year is considered a spike. For a while, they were charging the employer for it, so we would calculate the actuarial amount and charge it back to the employer. This practice ended in 2018 and the figures included in the reports are the invoices of those employers who are either struggling to pay or that are included in litigation. Ms. Surratt added that when it shifted to the member pension spiking where they don't get the benefit of the salary above the 10%, any member contributions that were withheld out of that amount above 10% are refunded back to the employer to return to the member, which is the line item entitled member pension spiking refund you see in this report.

Mr. Peercy introduced agenda item *Legislative Updates.* Mr. Eager indicated that the General Assembly session is set to begin January 4, 2022 and since it is an even year, it will be a 60 day session as opposed to a 30 day session. Their primary function is to approve the biennium budget, but there will be a multitude of bills, many which will have an effect on Kentucky Public Pensions Authority and Kentucky Retirement Systems and County Employee Retirement System. Shawn Sparks in Communications does a fabulous job in tracking those bills. Mr. Eager stated that for the past six years, we have had a housekeeping bill that has been sponsored by Representative Jerry Miller. Representative Miller is sponsoring a bill that will add an exemption of overtime to the pension spiking issue, due to the excessive amount of overtime that was needed dealing with the State of Emergency declarations enacted by the Governor. This will eliminate a great deal of the current pension spiking issues. Another bill is sponsored by Representative Wheatley that proposes to retroactively move Tier 3 hazardous duty employees into Tier 2. The idea behind that is to make those positions more appealable to potential employees and to help keep the employees that are hired in those positions. As the session progresses, we will be monitoring and tracking the progression of any bill that affects any of the systems.

Mr. Peercy introduced agenda item *CEO Report.* Mr. Chilton began by stating that there is a process in play currently in dealing with expense allocations between the Kentucky plans and the County plans and this will be coming forward sometime in the near future. The actuarial assumptions will be discussed and the contribution rates will be voted on at the December meeting. Also at the next meeting, we will be approving the audit report. We have discussed the ESG issues, so be alert to the media about that issue that is affecting many organizations. Mr. Chilton advised that he recently sent an email out to all of the Trustees reminding them about the IT security awareness and the online training that all Trustees need to complete. Board Smart is another resource for the Trustees to gain more education. He stated that one subject that will be discussed in the upcoming legislative session is the COLA (cost of living adjustments). He indicated that as a Board, we should remain neutral on the subject as it is a legislative issue to change benefits in that manner. In the Statutes, it indicates that any change in benefits must be prefunded, therefore it will be a very costly measure. Nonetheless, it will be discussed during this session on some level. Mr. Chilton stated that other than himself, the Board can hire an outside counsel. The search is ongoing and he will be coming to the Board for approval in the near future.

Mr. Peercy introduced agenda item *New Business.* Mr. Peercy announced that he had no new business and unless anyone had new business, this agenda item would be passed. Since no new business, the meeting continued.

Mr. Peercy introduced agenda item *Closed Session.* A motion was made by Mr. Grossman and Mr. Connell seconded to go in to closed session. The motion passed unanimously.

Mr. Peercy read the following statement and the meeting moved into closed session: A motion having been made in open session to move into a closed session for a specific purpose, and such motion having carried by majority vote in open, public session, the Board shall now enter closed session to consider litigation, pursuant to KRS 61.810(1)(c), because of the necessity of protecting the confidentiality of the Systems' litigation strategy and preserving any available attorney-client privilege. All public attendees exited the meeting.

Mr. Peercy called the meeting back to open session. During the course of the closed session, Mr. Peercy and Mr. Eager removed themselves for a portion of the meeting due to a conflict of interest. Also during the course of the meeting, Ms. Thompson and Mr. Lane left the meeting due to other prior commitments. A quorum was maintained throughout the closed session portion of this meeting.

There being no action taken during the closed session, Mr. Peercy opened the floor for a motion to adjourn. Mr. Connell made a motion and Mr. Totten seconded to adjourn the meeting. The motion passed unanimously.

Copies of all documents presented are incorporated as part of the Minutes of the Board of Trustees held November 16, 2021 except documents provided during a closed session conducted pursuant to theopen meetings act and exempt under the open records act.

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CERTIFICATION

I do certify that I was present at this meeting, and I have recorded the above actions of the Trustees on the various items considered by it at this meeting. Further, I certify that all requirements of KRS 61.805-61.850 were met in conjunction with this meeting.

Recording Secretary

I, the Chair of the Board of Trustees of the Kentucky Retirement Systems, do certify that the Minutes of Meeting held on November 16, 2021 were approved on December 2, 2021.

Chair of the Board of Trustees

I have reviewed the Minutes of the November 16, 2021 Board of Trustees Meeting for content, form, and legality.

Executive Director
Office of Legal
Services