

**MINUTES
KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
BOARD OF TRUSTEES**

April 22, 2022

The meeting of the Board of Trustees was called to order by Chairperson James Zakoura at 10:04 a.m. on April 22, 2022, in the Retirement System Board Room, Topeka, Kansas.

Board members present: James Zakoura, Chairperson
 Ernie Claudel
 Ron Johnson
 Emily Hill
 Lynn Rogers
 Brad Stratton
 Ryan Trader
 Jo Yun

Board members absent: Sam Williams

Chairperson James Zakoura welcomed guests in attendance: Melissa Renick and Steven Wu, both of the Kansas Legislative Research Department. Chairperson Zakoura also welcomed virtual guests: Adam Profit, Budget Director, Budget Division, Jeff Arpin, Budget Division; David Weise and Eileen Ma, both of the Revisor of Statutes Office, and all other participants.

Public Comments

There were no public comments.

Continued Review and Discussion of the Actuarial Investment Assumed Rate of Return

Chairperson James Zakoura began the meeting with an explanation of the bylaws that allowed them to call the Special Board of Trustees meeting. Chairperson Zakoura explained that he received a request and presentation from Trustee Ryan Trader for a Special Board Meeting regarding the Retirement System’s current investment rate of return assumption. Chairperson Zakoura elected to honor the request and called the meeting for April 22, 2022. He stated that the purpose of the meeting was to give the Board members another opportunity for review and discussion of the investment rate of return assumption. Chairperson Zakoura stated that all Trustees will have an opportunity to present their position on the issue. Trustees would then have an opportunity to make a motion at that time, and to proclaim the year the motion would take effect.

Chairperson Zakoura stated that the Board passed a motion regarding the investment rate of return assumption at its March 25, 2022, Board Meeting.

Chairperson Zakoura also reminded the Board that he made a motion to continue utilizing the current return assumption until 2023, to allow for studies of the assumed rate of return, reamortization, and the effect on employer contribution rates.

Chairperson Zakoura recognized Alan Conroy, Executive Director. Mr. Conroy stated that copies of materials from the March 25, 2022, meeting relating to the investment assumed rate of returns, were available on the Board members' desks and can be viewed in Diligent.

Chairperson Zakoura recognized Trustee Ryan Trader. Trustee Trader reviewed his presentation, which included a request for an additional option for analysis of phasing in a step-down approach for the investment rate of return assumption. He stated the requested analysis on the phasing in the step-down approach on the investment rate of return assumption is 7.5% for the 2021 actuarial valuation; 7.25% for the 2022 actuarial valuation; and 7.0% for the 2023 actuarial valuation. Below are supporting key points for the proposal:

- The reamortization period is seven years less than that of the 7.0% change.
- The phased-in approach will have less of an impact on the funded ratio in the next five years, which was 74.7% in 2021, compared to the 7.0% in 2021, which will be 70.8%.
- It allows the Board to continue to evaluate the assumption's effect over the next three years and could give the Board the ability to make changes; without a large one-year drop in the funded ratio.
- The employer contribution rates will remain steady over the next five years. The phased-in option does not have the reduction that the 22-year reamortization does, but because it is phased-in, it only rises 0.13% from the 2020 employer contribution rate with a 15-year reamortization.
- The employer contribution rate drops significantly in 2036 to 2.5% from 9.36%, where the 7.0 % return will remain in the 7% range until 2043.
- The option is not as aggressive which is an advantage of this proposed change.
- The phased-in approach would make progress towards lowering the rate, but in a balanced manner.
- This represents a compromise that is required for KPERS' stability for the future.

Trustee Trader responded to questions.

Chairperson Zakoura recognized Trustee Ernie Claudel. Trustee Claudel presented a .25% reduction that would increase the unfunded actuarial liability (UAL) by \$600 million and reduce the funded ratio by 2.0%. It would also increase KP&F employer contributions by 2.0% and does not include a reamortization. He also stated he would favor waiting to proceed with adjusting the investment rate of return assumption. Trustee Claudel responded to questions.

Chairperson Zakoura recognized Trustee Brad Stratton. Trustee Stratton noted that the investment rate of return study has occurred over the last several years, and he put together a motion to continue the conversation of the rate of return assumption under a 7.0% and 6.75% rate of return with a final and definitive conversation at the May 20, 2022, Board meeting for FY 2021. Trustee Stratton complimented Trustee Trader on his presentation and proposal. He concurred that he would like to see a motion that considers a phased-in step-down approach, with concerns on exactly when to implement the step-down, phased-

in method for the assumed rate of return. Trustee Stratton stated that in his experience with investment management, the capital market assumptions do not indicate support for an assumed rate of return as high as 7.75%. Trustee Stratton responded to questions.

Chairperson Zakoura recognized Trustee Emily Hill. Trustee Hill complimented Trustee Trader for his efforts to put together the phased-in, step-down approach presentation. Trustee Hill concurred with this approach and would like to see this implemented in FY 2021. Trustee Hill stated that in her investment marketing experience, she has not seen a capital market assumption that would anticipate a return as high as 7.75%. She stated that as fiduciaries, the Board must look out for the best interests of the System and its members. Trustee Hill was in favor of the phased-in, step-down approach because the employer contribution rate stays relatively level and we do not see a funded ratio that drops below 70%. Trustee Hill responded to questions.

Chairperson Zakoura recognized Trustee Johnson. Trustee Johnson agreed with lowering the investment rate of return assumption and was open for a discussion of how this will be implemented. Trustee Johnson expressed concern for how the changes will affect the employer contribution rate, and he would like to see the contribution rate remain the same. Trustee Johnson would prefer the State be allowed to close this fiscal year before implementing a change in the investment rate of return assumption. He suggested reviewing the investment rate of return assumption on an annual basis. Trustee Johnson commented on the letter presented by Senate President Ty Masterson and Senator Rick Billinger, Chair, Senate Ways and Means, noting the last paragraph, where the sentence stated, *"to present a comprehensive and compelling plan as to why this is deemed as a necessity."* Trustee Johnson stated the Board should consider educating the Legislature on this issue. Trustee Johnson responded to questions.

Chairperson Zakoura recognized Trustee Yun. Trustee Yun complimented Trustee Trader for his efforts and stated that she agreed with the proposal of the phased-in, step-down approach to lowering the investment rate of return. Trustee Yun stated that the accounting evaluation is 7.25% and the rate we use for our actuarial rate of return is 7.75%. She stated that although these are two separate measurements, she would like to see both rates be aligned in the future as we are a pooled investment fund. Trustee Yun would like for the proposal that Trustee Trader presented to change the rate of return in this fiscal year. Trustee Yun responded to questions.

Chairperson Zakoura commented that his position is the same as it was last month, that he would not agree to making a change in the investment rate of return in this fiscal year. He stated that the obligation of what the Board is trying to accomplish as Trustees is to make sure that it is currently funding the obligations that the System has on behalf of the beneficiaries. He stated that 2021 was a rather extraordinary year, in that full contribution were made, there was \$500 million of bonded indebtedness, and there could be an additional \$1 billion that will be coming to KPERS. The current funding decisions that were made for 2021 by trustees, legislators, and all concerned, produced an extraordinary year. The current year has been funded beyond any assumed rate of return that the Board was discussing, whether it be 7.0% or 7.5%. There are two other factors that go into the assumed rate of return, which is the reamortization and the employer contribution rate. Another factor is the current interest rates and inflation. Chairperson Zakoura agreed with the step-down approach that was introduced by Trustee Trader; however, he did not favor implementing the change in this fiscal year, and he suggested the Board examine the step-

down approach in FY 2022 instead of FY 2021. Because of the extraordinary support from the Legislature with the support of \$800 million in 2022, this will allow the Board to take more time to reach a definitive resolution post year 2021. Trustee Zakoura responded to questions.

Chairperson Zakoura recognized Trustee Brad Stratton. Trustee Stratton stated that this conversation was very helpful as he was considering the timing of implementing the step-down approach that Trustee Trader proposed with more examination of the reamortization and was comfortable as the Board was preparing a multi-year step-down plan in the next fiscal year. Trustee Stratton stated that he is open for the consideration with the 7.5% in the year 2022, but he was looking forward to the proposal in the future that may include the amortization.

Chairperson Zakoura recognized Ernie Claudel. Trustee Claudel stated that it was important provide more education for better understanding to receive the continued support from the Legislature.

Chairperson Zakoura recognized Trustee Trader. Trustee Trader responded to the letter from Senate President Ty Masterson and Senator Rick Billinger, specifically, the second to last paragraph, last sentence, *"this is what some other states and pensions are also doing in this financial climate with no context of their past performance."* Trustee Trader stated he shares the concerns that Trustee Claudel stated the Legislature on the process of how the Board has studied the investment rate of return for years including simulations provided by our expert consultants, and how it will affect our System. Trustee Trader commented that the timing of making the change in May is that the Board will not be ready to decide for this year.

Chairperson Zakoura recognized Trustee Rogers. Trustee Rogers stated that the UAL has been a historical issue for decades. While the legislature has provided additional contributions in the form of bonds in recent years, they also have delayed or eliminated payments at least 15 times since 2010. That is part of our problem with the UAL issue. Our key role is that we are serving as fiduciaries for the beneficiaries. Trustee Rogers stated that our historical investments cannot be continued, and expert consultants and investment advisors have cautioned that it is at risk. Trustee Rogers stated that originally, he was uncomfortable with the step-down approach, but after reviewing it, he agreed with the phased-in approach. Trustee Rogers responded to questions.

Chairperson Zakoura recognized Trustee Yun. Trustee Yun agreed with both Trustee Rogers and Trustee Trader. We do not know what the ideal end point is, and for that reason, she has grown more comfortable with the step-down approach as the Board is taking a small step in the right direction, and then to revisit and evaluate it methodically and thoroughly. By implementing this in 2021 we will begin the process of moving a small step in the right direction. Trustee Yun responded to questions.

Chairperson Zakoura recognized Trustee Hill. Trustee Hill stated that one of the reasons to delay the change from 2021 to 2022 is to take the time to educate the legislators. What is the process to educate the legislators? Do we need to have a forum, do we need to write a letter, or perhaps meet with them one on one?

Chairperson Zakoura recognized Alan Conroy, Executive Director. Mr. Conroy stated the Board would give direction, and then staff would provide the outreach to policy makers. There is a Joint Pensions Committee, and the House will be standing for election this summer (primary election) and fall (general election) and some have decided not to run again, so there will be new members in the House of Representatives next January. The Senate will remain in office to fulfill their term, as they are not up for re-election. A letter from the Board is certainly a start and could be written to the Joint Pensions Committee, the Legislative Budget Committee, House, and Senate members who monitor the funding process, and the funding process for the entire state budget. The mechanics is to rely on staff for the outreach.

Chairperson Zakoura recognized Trustee Ron Johnson. Trustee Johnson stated that next week the 2022 Legislature will be approving the budget bill for FY 2023, which starts July 1, 2022. Already embedded in that budget are the contributions to KPERS, based on the actuarial assumption that are in place right now. Trustee Johnson commented that at this point, the budget is in place, and it's not fair to the Legislature to make them go back and readdress the budget due to making a change to the investment rate of return for 2021.

Mr. Conroy confirmed that the 2022 Legislature has already built-in the current rates to the budget bill. The Census Revenue Estimates group and the final Omnibus Budget bill will be considered next week. They could decide to adjust employer contribution rates should the \$1.25 billion contribution to KPERS pass the Senate, as there has been discussion to adjust the contribution rates to capture those employer savings. That would be reflected in the Omnibus Appropriations bill.

Chairperson Zakoura recognized Trustee Johnson. Trustee Johnson stated that the Board must balance its fiduciary responsibilities with recommendations from consultant advisors, along with contribution rates at the state and local level. We do need to act and move forward. Although the calendar year performance was 21% the fiscal year shows performance is less than 3%. This needs to be one of the considerations.

Chairperson Zakoura recognized Alan Conroy, Executive Director. Mr. Conroy stated the 2021 Valuation will set the rates for FY 2025. The valuation rates have already been set for FY 2023 and FY 2024.

Chairperson Zakoura recognized Kristen Basso, Communications Director. Ms. Basso stated that over 20 years ago, the Executive Director at that time sent the Legislature a 50-page document announcing that KPERS was underfunded. Most of the communication that we have had with the Legislature since then has been convincing them that we have a funding shortfall and communicating to all concerned how we got to that point. Part of the regular conversation that is published media started here at KPERS, in reference to investment performance and underfunding through contributions. The point we have not spent a lot of time on is explaining the mechanism of how KPERS is funded. The Legislature knows there are three sources, but they may not understand the assumptions, and how all the pieces fit together. That is a really hard thing to explain, but it's not impossible. It's a matter of us helping them understand how the pieces work, and why we would make the change, what are the benefits, other than to just have a better funded ratio. I do believe we have additional messages to teach. In addition, when we prepare an educational communications plan, we need to include members, employers, our stakeholder groups,

Troopers Association, Kansas School Board Association, etc., to make sure they all understand what we are doing and why.

Discussion by the Board continued.

Chairperson Zakoura made a motion that the Board receive information at the May Board Meeting on the current assumed rate of return to a lower-level dependent upon the review of the Board and based on such analysis. Trustee Johnson seconded the motion. Motion was withdrawn.

Chairperson Zakoura made a motion that the assumed investment rate of return to not change from 7.75% for calendar year 2021, but that the assumed investment rate of return for calendar year 2022 would be 7.5%. Motion was withdrawn.

Trustee Trader moved that the Board approve an additional analysis of the actuarial assumed investment rate of return be approved for review that would include a step-down approach of 7.5% for the 2021 valuation; 7.25% for the 2022 valuation; and 7.0% for the 2023 valuation. Trustee Yun seconded the motion. Motion carried.

Trustee Trader moved that the Board direct the actuary not to complete the actuarial analysis at this time on the assumed investment rate of return of 6.75% that was requested by Board action at the March 25, 2022, meeting. Trustee Yun seconded the motion. Motion carried.

Other Business

No other business was discussed.

Board Self Evaluation

There was no further discussion.

Trustee Claudel moved that the meeting be adjourned. Trustee Johnson seconded the motion. The meeting adjourned at 11:40 a.m.