

## MEMORANDUM

To: House Financial Institutions and Pensions Committee

From: Alan D. Conroy, Executive Director  
Bruce Fink, Chief Investment Officer

Date: January 22, 2024

Subject: Proponent Testimony on HB 2103; KPERS Alternative Investments

I appear before the Committee on behalf of the KPERS Board of Trustees to request your support for HB 2103.

As part of the long-term investment strategy, KPERS utilizes an alternative investment strategy. Alternative investments, as defined in the current statute, include the private equity and infrastructure investments within KPERS investment portfolio. House Bill 2103 changes the existing requirements for alternative investments by delegating the selection of the cap on alternative investments to the KPERS Board of Trustees but leaving the other statutory requirements in place.

### KPERS Alternative Investment History

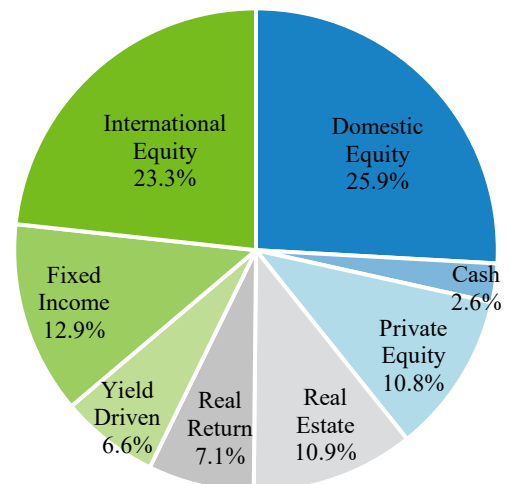
Alternative investments include two investment strategies utilized by the KPERS Board of Trustees in the asset allocation of the KPERS Trust Fund.

The two strategies currently used are:

- **Private Equity** which are investments in funds that provide capital to companies that typically have not gone public, (i.e., are not publicly traded on an exchange.)
- **Infrastructure** (included in the Real Return asset class) which are investment in funds that provide financing for the physical assets that are used in society such as roads, bridges, power generation, or telecommunications.

With recent investment market volatility, KPERS alternative investment portfolio recently reached 13.8% and is currently at 12.9%.

KPERS Asset Allocation  
as of 12/31/2023



Alternative investments were first defined in statute in 1992 with a cap of 10% of the total investment assets of the Trust Fund. That cap was revised to 5% by the 1993 Legislature.

After working for almost a decade on building out an alternative investment strategy, the allocation to alternative investments reached 4.5% at the end of CY 2000. From 2000 to 2002 there were steep declines in the public equity markets (dot-com bubble) causing the alternative investments to exceed the statutory 5% cap. KPERS stopped allocations to alternative investments as was required by statute.

The KPERS Board of Trustees requested the alternative investment cap be changed from a 5% total cap to a 1% cap on annual commitments to alternative investments. The 2004 Legislature approved this change and KPERS began the process of restarting the alternative investment program.

In 2012, the System requested a change in the statutory language that would allow annual net new investments in the alternative investment portfolio of up to 5% of the total market value of the System's assets, as measured from the end of the preceding calendar year. The 2012 Legislature passed HB 2461 in the 2012 Legislative Session to enact this change, keeping the other statutory restrictions on alternative assets were left in place. The Legislature also added the current overall cap of 15% on total alternative investments as a percentage of the System's total investments.

If KPERS were to reach the 15% alternatives cap under current statute, new investments in private equity and infrastructure would stop and could not be resumed until exposure fell below the cap. This would restrict KPERS' ability to diversify these investments across economic cycles, increasing risk, and may result in KPERS losing access to top tier investment managers, potentially reducing return.

### **Current Statutory Restrictions on Alternative Investments**

Current statute (K.S.A. 74-4921) sets an overall cap on alternative investments of 15% of the total investment assets of the KPERS Trust Fund. K.S.A. 74-4921 also includes other requirements for alternative investments, including:

- The system must receive a favorable recommendation from a qualified independent expert in investment management.
- KPERS staff must complete due diligence and report findings to the Board of Trustees.
- The alternative investments must be consistent with the Board's investment policies.
- KPERS must have procedures and systems to monitor and accurately measure the investment performance.
- Annual net commitments to alternative investments cannot exceed 5% of the total investment assets.

- There must be two other qualified institutional buyers for the alternative investment.
- KPERS share of any individual investment cannot represent more than 20% of such individual investment.
- Any single investment cannot exceed 2.5% of the total alternative investments of the Trust Fund.
- The total alternative investments in any one individual multi-investor pool cannot exceed more than 20% of the System's total alternative investments.

### **Alternative Investments in Other Public Plans**

Alternative investment allocations are common among public pension plans. The definition of alternative investments may vary slightly from one plan to another, but most plans have an investment allocation to alternative investments.

In reviewing the allocation to alternative investments (using the statutory definition of alternative investments) among other Midwest public pension plans, KPERS has one of the lowest allocations to alternative investments compared to our geographical neighbors. Of the 33 plans that we were able to collect alternative investment allocation targets, KPERS ranked 30<sup>th</sup> with a target allocation of 14%. Indiana plans were the highest at a 44% allocation. Attached to this memo is a graph of the alternative allocation targets for 33 Midwestern public pension plans.

### **House Bill 2103**

HB 2103 changes the language in K.S.A. 74-4921 that governs the cap on alternative investments for the KPERS Trust Fund by delegating the selection of the overall cap on alternative investments cap to the KPERS Board of Trustees.

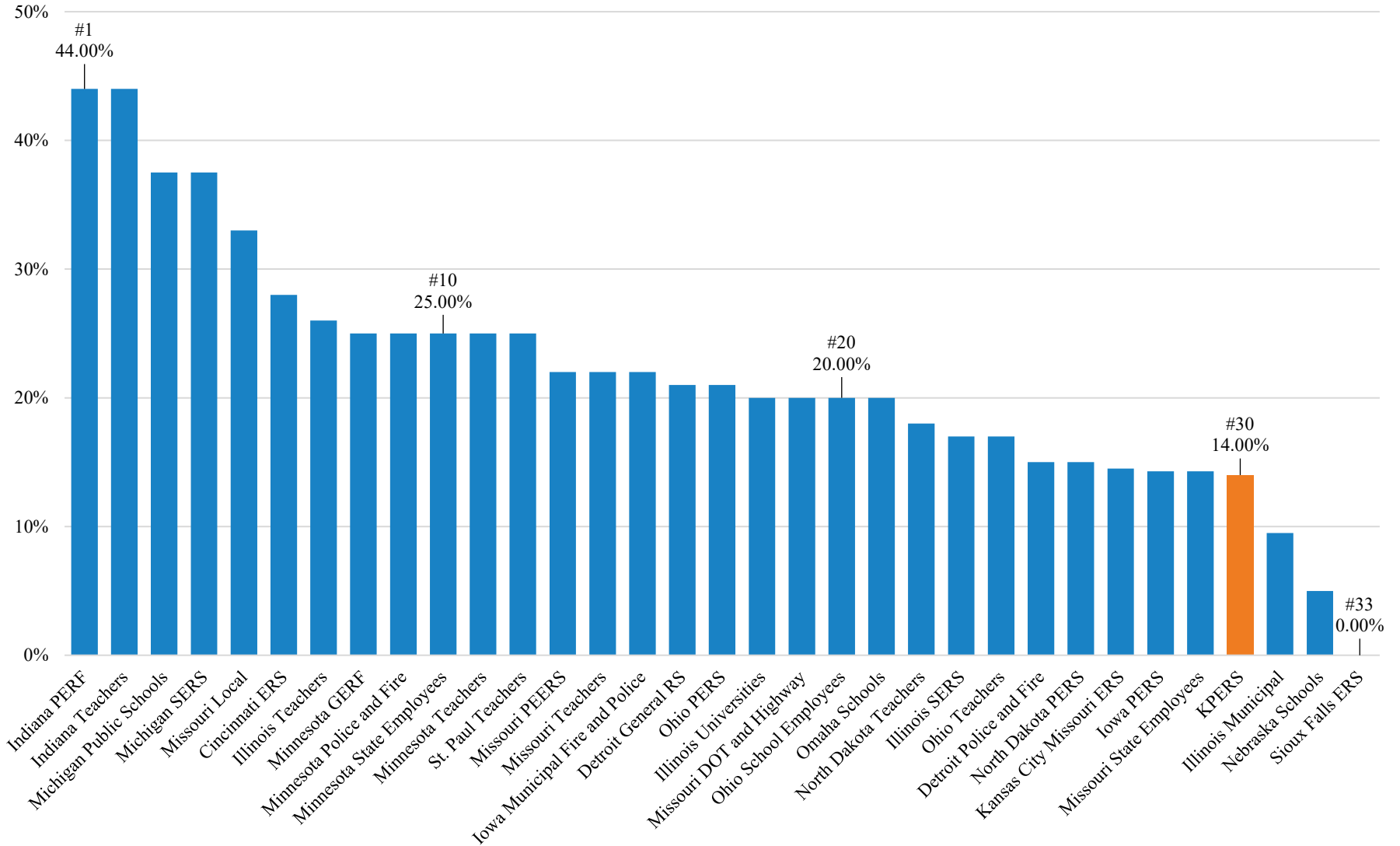
Adding this to the list of delegated authorities of the Board of Trustees will allow the System to be more responsive to market conditions while executing the Board's alternative investment strategy.

All the other statutory requirements discussed above would remain unchanged under HB 2103.

I respectfully request your support for HB 2103. I would be pleased to answer any questions the Committee may have.

Attachment

### Public Funds Alternative Allocations\* All Midwest Public Plans Reporting Assets Class Targets



\*Alternatives as defined by State of Kansas statute.

Source: National Association of State Retirement Administrators (NASRA); Mercer.