Joint Committee on
Pensions, Investments and Benefits

December 2, 2022

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Joint Committee on Pensions Investments, and Benefits

12/31/2021 Actuarial Valuation

PRESENTED BY:

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December 2, 2022

KPERS

Dependable Benefits. Trusted Partner

KPERS is a fiduciary providing retirement, disability and survivor benefits to our members and their beneficiaries with a 98-member staff.

KPERS administers three statewide, defined benefit plans for public employees.

- Kansas Public Employees Retirement System
- Kansas Police and Firemen's Retirement System
- Kansas Retirement System for Judges

KPERS partners with more than 1,500 state and local government employers.

- State of Kansas
- 286 school districts
- 105 counties
- 426 cities and townships
- Other employers include libraries, hospitals, community colleges and conservation districts

KPERS Board of Trustees

Covering Today

Purpose of the Annual Actuarial Valuation

System Statistics

Current Funded Status and Funding Projections

Impact of Legislative Actions

Employer Contributions

Purpose of the Annual Actuarial Valuation

Measurement of assets and liabilities

Best estimate of ultimate costs

- Project future benefits using actuarial assumptions
- Calculate present value of future benefits (their cost in today's dollars)
- Apply cost method to allocate benefit costs to periods of service

Calculate employer contribution rates

- The 12/31/2021 valuation sets the contribution rates for FY 2025 for State and School employers and CY 2024 for Local employers.

Baseline for any cost studies in 2023 legislative session

Key Findings

All groups remain at the full Actuarial Required Contribution rate.

Net investment returns on a calendar year basis were 15.7% on market value of assets. Due to smoothing, the return on actuarial assets was 10.9%.

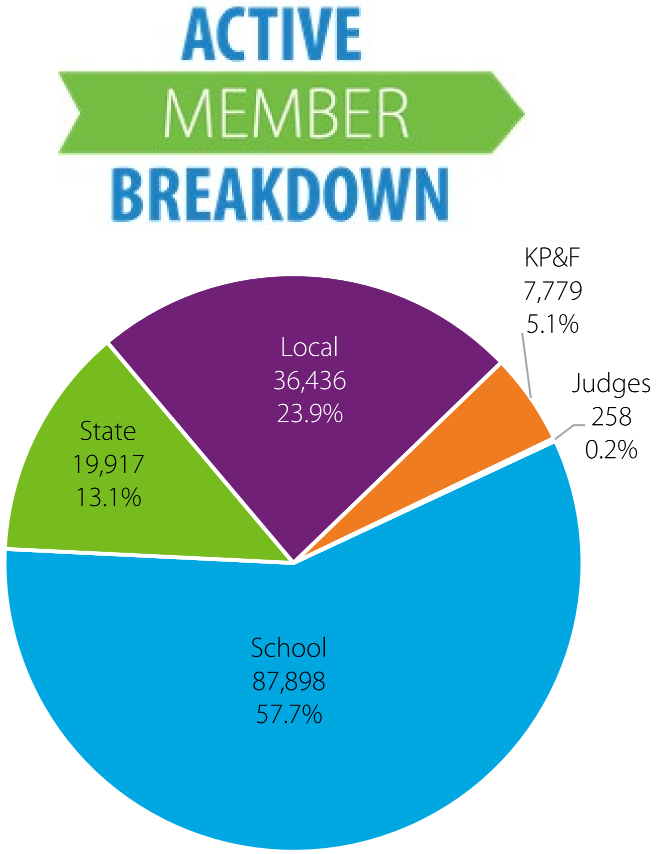
The investment return assumption was changed from 7.75% to 7.0%, which increased the calculated actuarial liabilities by $2.7 billion.

Overall, the unfunded actuarial liability increased from $8.5 billion last year to $9.8 billion this year.

Overall, the funded ratio declined slightly to 71.6% (from 72.5% on 12/31/2020).

The additional funding of $1.125 billion approved in 2022 SB 421 is not included in the 12/31/2021 assets but is reflected in the funding projections.

Active Membership on 12/31/2021



Total Active Members – 152,288

KPERS has about 152,000 active members.

- Active members range in age from 16 to 90.

KPERS 3 is the largest group of active members.

- 50,953 active KPERS 1 members
- 25,348 active KPERS 2 members
- 67,950 active KPERS 3 members

The average KPERS members has 10.9 years of service and a salary of about $49,000.

The average KP&F member has 10.9 years of service and a salary of about $74,000.

The average Judges member has 10.1 years of service and a salary of about $117,000.

Retired Membership on 12/31/2021

KPERS has almost 111,000 retirees and beneficiaries.

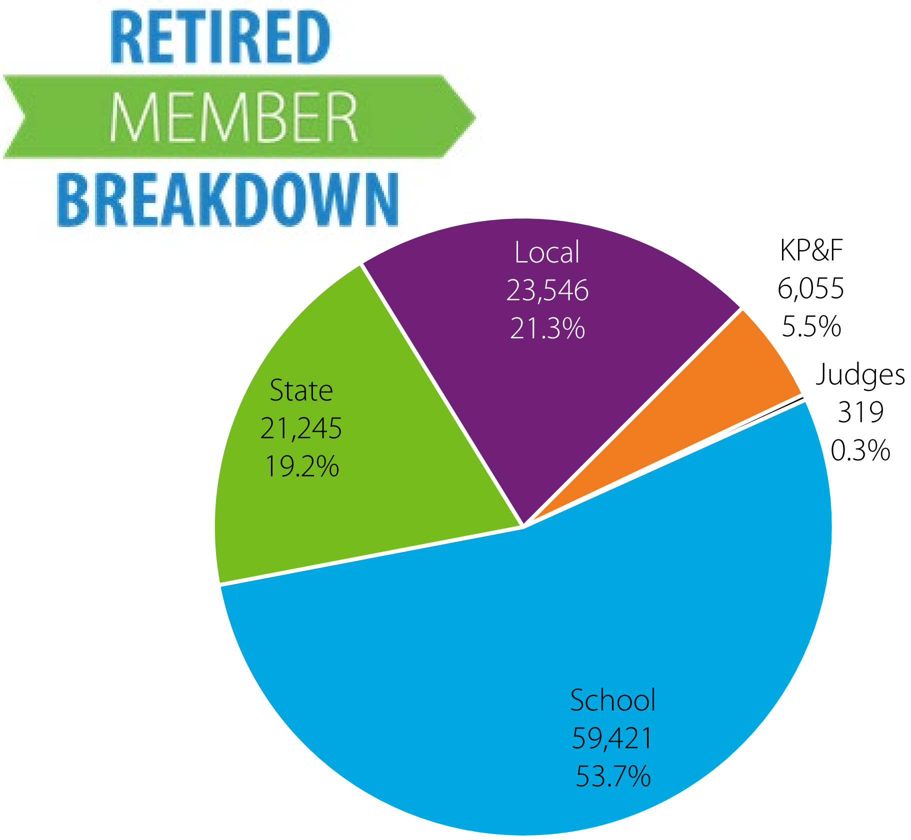
- Retirees range in age from 50 to 111.
- Beneficiaries range in age from 15 to 110.

The average KPERS retiree benefit is about $16,800 per year ($1,403 per month).

The average KP&F retiree benefit is about $40,200 per year ($3,350 per month).

The average Judges retiree benefit is about $47,500 per year ($3,958 per month).

About 88% of retirement benefits are paid to a Kansas address.



Total Retirees – 110,586

Investments

Most revenue to the KPERS Trust Fund comes from investment returns.

KPERS annual actuarial valuation is measured on a calendar year basis.

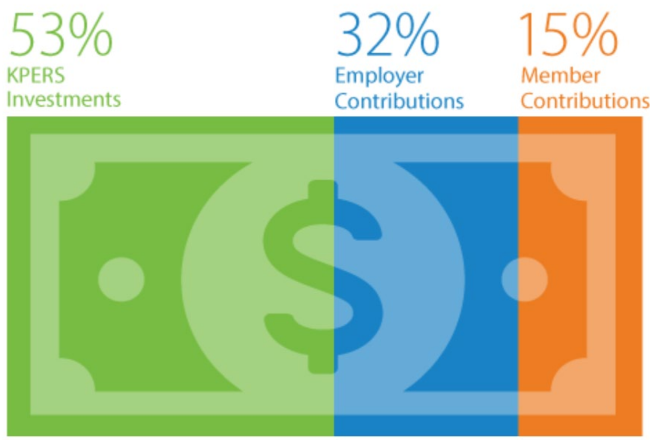
- The CY 2021 total return was 16.1%.

KPERS annual comprehensive financial report (ACFR) is reported on the fiscal year ending June 30.

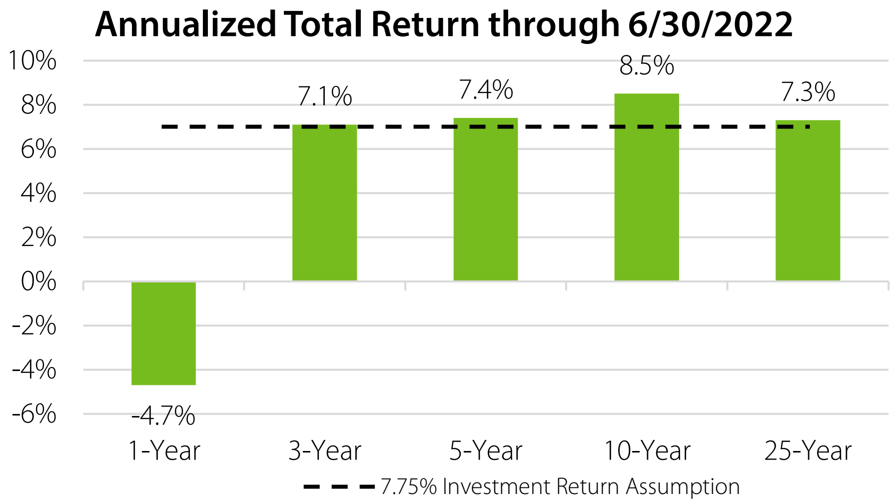
- The FY 2022 total return was -4.7%.

KPERS long-term return assumption changed from 7.75% to 7.0% in in May 2022.

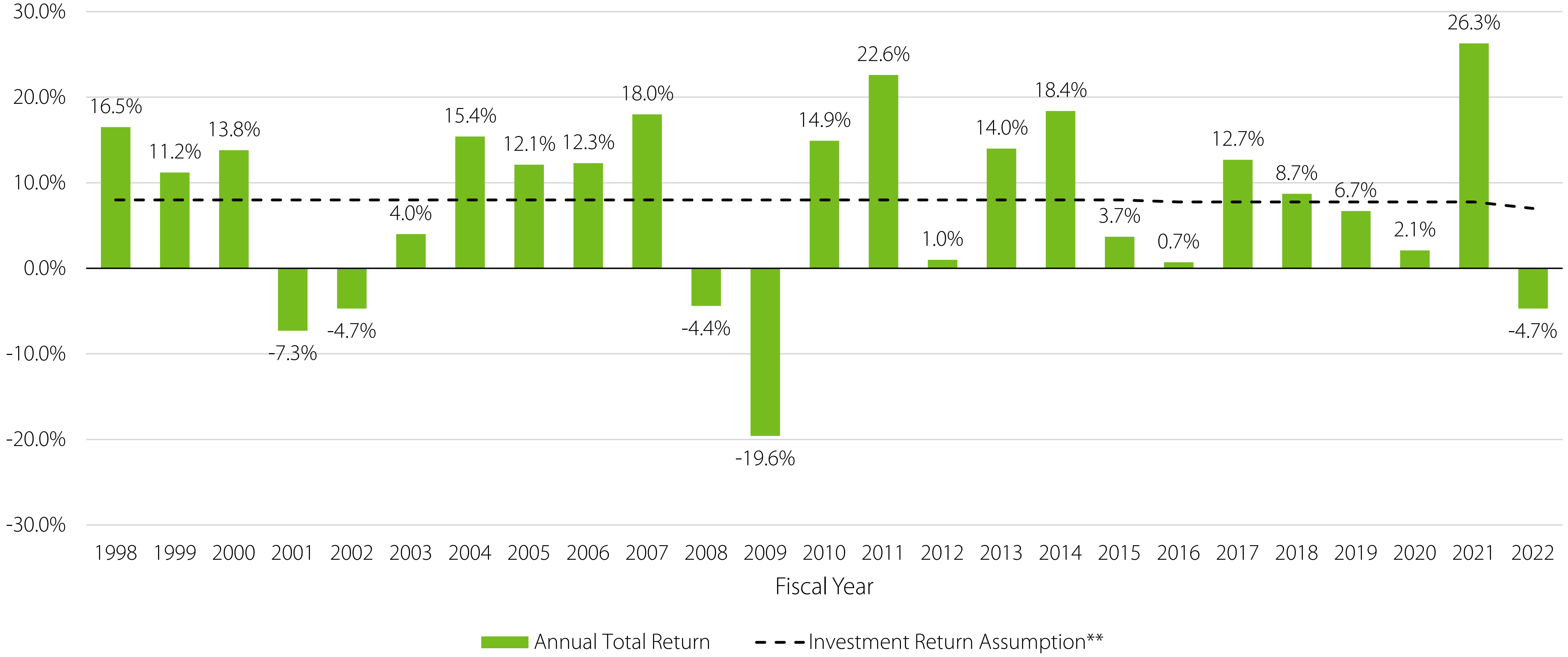
KPERS Funding Sources



Percent of total revenues over the past 20 years



Historical Fiscal-Year Returns*



* Time weighted total return, gross of fees

** The investment return assumption was changed to 7.75% and to 7.0% in 2021.

Development of the Unfunded Actuarial Liability

Actuarial Liabilities – Actuarial Assets = Unfunded Actuarial Liability (UAL)

Actuarial liability:

- Project future benefits using actuarial assumptions
- Calculate present value of future benefits (their cost in today's dollars)
- Apply cost method to allocate benefit costs to periods of service

Actuarial value of assets

- Average or "smoothed" value
- Not market value

Development of the Unfunded Actuarial Liability

Actuarial Liabilities – Actuarial Assets = Unfunded Actuarial Liability (UAL)

Total Actuarial Liability on 12/31/2021	$34.63 billion
Total Actuarial Assets on 12/31/2021	$24.80 billion
Total Unfunded Actuarial Liability on 12/31/2021	**$9.87 billion**

Market Value of Assets vs. Actuarial Value of Assets

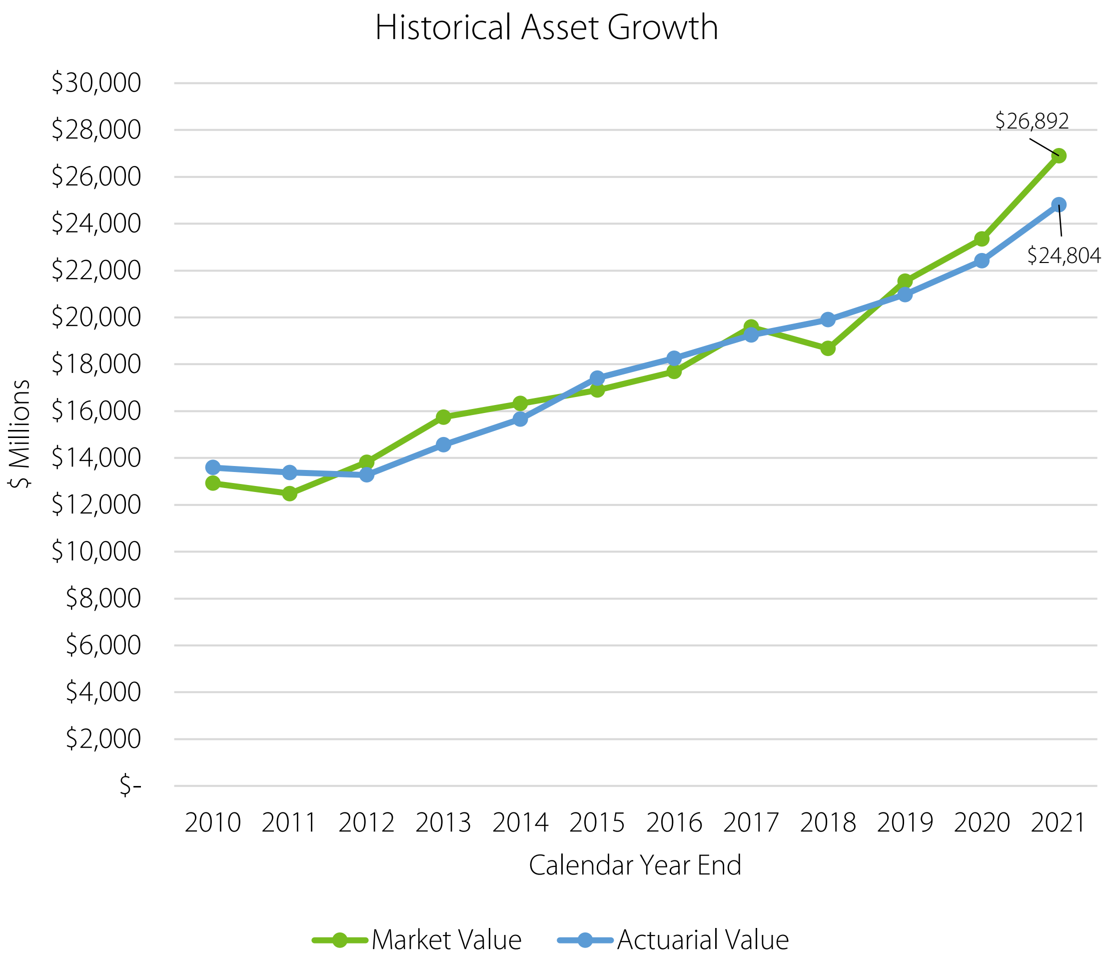
Market value of assets is not used directly in valuation

Asset valuation method is used to smooth the effect of market fluctuations

- Smoothed value is called actuarial value of assets
- Goal is to provide more stability in employer contribution rates

Actuarial value recognizes the difference in actual investment return compared to expected return (7.0%) evenly over 5 years.

There are $2.1 billion in deferred investment gains to be recognized over the next 4 years.



Market Value of Assets vs. Actuarial Value of Assets

Investment return on market value basis in CY 2020 (net) was 15.7%.

Due to asset smoothing method, return on actuarial assets was 10.9%.

Deferred investment experience yet to be recognized due to asset smoothing.

- Deferred gain will flow through smoothing method over the next four years (20% per year).
- Expected to decrease the unfunded actuarial liability and improved the funded ratio in future years absent negative experience.

Actuarial value of assets on 12/31/2021 totaled $24.8 billion.

Deferred Investment Income	
CY 2021 (20% recognized/80% remaining)	$1,431.2 million
CY 2020 (40% recognized/60% remaining)	$389.2 million
CY 2019 (60% recognized/40% remaining)	$678.9 million
CY 2018 (80% recognized/20% remaining)	$(411.2) million
Total Deferred Investment Experience	$2,088.0 million

Asset Smoothing	
Market Value of Assets on 12/31/2021	$26.9 billion
Deferred Investment Experience	$2.1 billion
Actuarial Value of Assets on 12/31/2019 (Market value – Deferred experience)	$24.8 billion

Funded Status on 12/31/2021

As a system, KPERS' funded ratio decreased, and the unfunded actuarial liability increased in the 12/31/2021 valuation.

	12/31/2020	12/31/2021
Funded Ratio	72.5%	71.6%
Unfunded Actuarial Liability	$8.49 billion	$9.83 billion

The change in the funded status is primarily due to an increase in the calculated liabilities due to using a lower investment return assumption (7.0% vs 7.75%). This alone increased the System unfunded actuarial liabilities (UAL) by $2.7 billion.

- State/School UAL increased $1.8 billion
- Local UAL increased $533.8 million
- KP&F UAL increased $327.8 million
- Judges UAL increased $13.7 million

KPERS had a positive actuarial investment return in CY 2021 and additional assets from the $500 million pension funding bond that offset a portion of the increase in the unfunded actuarial liability.

Valuation Results

12/31/2021 Unfunded Actuarial Liability (UAL) by group:

	Actuarial Liability (in millions)	Actuarial Assets (in millions)	Unfunded Actuarial Liability (in millions)	Funded Ratio
State	$ 5,081	$ 3,992	$ 1,088	78.6%
School	18,458	12,655	5,804	68.6%
State/School*	23,540	16,647	6,892	70.7%
Local	6,684	4,900	1,784	73.3%
KP&F	4,190	3,050	1,141	72.8%
Judges	217	207	10	95.3%
Total*	$ 34,631	$ 24,804	$ 9,827	71.6%

*Amounts may not add due to rounding.

Valuation Results

Factors affecting the Unfunded Actuarial Liability (UAL)

System Unfunded Actuarial Liability: 12/31/2020	**$ 8,488M**
Statutory contribution cap/time lag*	0M
Amortization (11 years remaining, paying more principal)	(283)M
Experience	
– Investment	(703)M
– Demographics (e.g., number of retirements, wage growth, number of retiree deaths)	107M
– Bond proceeds	(500)M
Assumption changes (7.0% investment return assumption)	2,718M
System Unfunded Actuarial Liability: 12/31/ 2021	**$9,827M**

All employer groups paid the full actuarial contribution in CY 2021 and are projected to stay at the actuarial required amount. The statutory contribution cap is no longer adding to the unfunded actuarial liability.

Note: Amounts may not add due to rounding

*Time lag is the period from the valuation date (12/31/2021) to the date the new contribution rate takes effect – (e.g., 7/1/2024 (FY 2025) for State and School Groups, 1/1/2024 for Local Group) as provided by law.

Employer Contributions

Rates effective for years beginning in 2024 (FY 2025 for State/School; CY 2024 for Local).

State/School combined statutory rate in FY 2025 is equal to the actuarial required contribution rate 11.42%, for the fifth consecutive valuation.

- The State/School statutory employer contribution rate reached the actuarial required contribution rate for the first time in the 12/31/2017 valuation (FY 2021), the first time the rates were the same in 24 years.
- The Local group reached the actuarial required contribution rate in CY 2015.

Employer contribution rates for State and Local continue to be at the full actuarial rate.

- State actuarial rate went from 9.38% for FY 2024 to 10.66% for FY 2025
- Local actuarial rate went from 8.43% for CY 2023 to 9.26% for CY 2024

Employer Contributions

	December 31, 2020		
	Actuarial	Statutory	Shortfall
State	10.66%	11.42%	(0.76%)*
School	11.60%	11.42%	0.18%
State/School	11.42%	11.42%	0.00%
Local	9.26%	9.26%	0.00%
KP&F	23.10%	23.10%	0.00%
Judges	21.35%	21.35%	0.00%

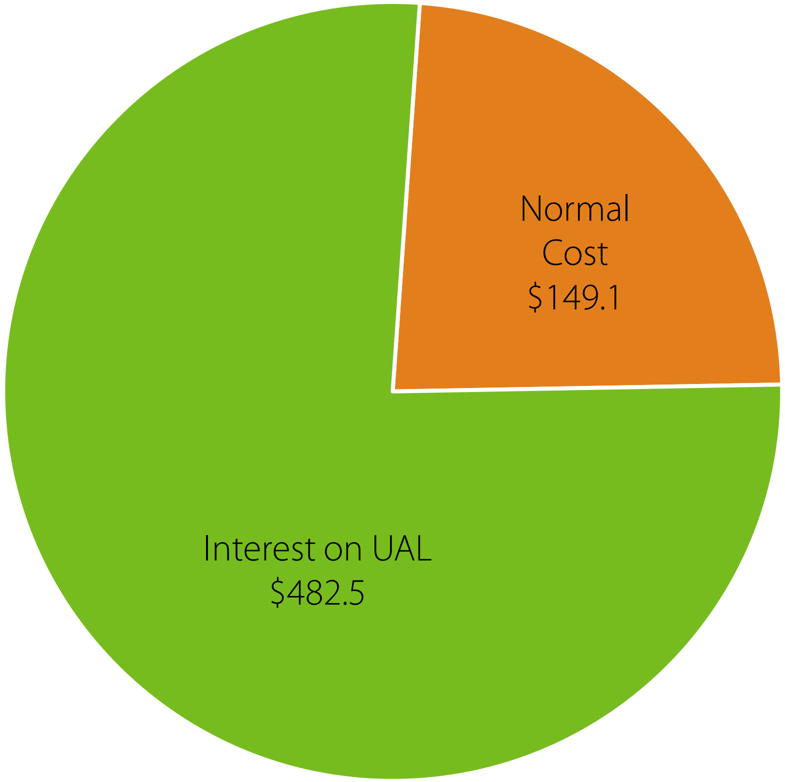
*As provided in statute, the contribution above the State Actuarial Required Contribution (ARC) rate is applied to fund the School Group.

The State/School statutory employer contribution rate continues to be at the full actuarial required contribution rate for FY 25 the fifth consecutive year the statutory and actuarial rates have been equal.

The School only actuarial rate totals 11.60%, higher than the statutory State/School rate of 11.42% for FY 2025.

Employer Contributions

FY 2023 "Steady State" Contribution
(in Millions)



Total State/School employer contributions needed to maintain "steady state"
$631.6 million

12/31/2021 State/School unfunded actuarial liability	X	KPERS Investment Return Assumption	=	Interest on 12/31/2021 State/School unfunded actuarial liability
$6.892 billion	X	7.0%	=	**$482.5 million**

Actuarial payroll projection for FY 2023	X	Employer Normal Cost Rate	=	FY 2023 normal cost
$5.158 billion	X	2.89%	=	**$149.1 million**

Funding Projections

Not precise predictions but general estimates

Projections based on many assumptions

- 7.0% return on market value in 2022 and all future years
- All actuarial assumptions met
- Current plan provisions
- Contributions are paid per current statutes
- New entrants in future years are similar to recent history

State/School Funding Projections

December 31, 2021 Valuation

- State/School Funded Ratio: 70.7% (Total System is 71.6%)
- Actuarial required rate: 11.42%
- Statutory rate: 11.42%

Actuarial Required Contribution (ARC) Date/Rate (actuarial and statutory contribution rates are equal) occurred in 12/31/2017 valuation at 14.23% for FY 2021.

Continues to be at full actuarial contribution rate in 12/31/2021 valuation.

Actuarial contribution rate declined to 11.42% for FY 2025, primarily due to positive investment returns.

Bond proceeds were received in 2021 and are reflected in funded status.

Funding Projections

If all assumptions were met in future years:

- The State/School group employer contribution rate is projected to slowly decline from 12.57% in FY 2024 to around 8.84% over the next 10 years.
- The State/School group unfunded actuarial liability would steadily decline until the unfunded actuarial liability is paid off in 2039.
- The State/School group funded ratio would reach 80% in the 2023 valuation, 90% in the 2031 valuation and 100% in the 2039 valuation.

We know that not all assumptions will be met exactly each year, but the goal is that the assumptions are accurate over time.

- CY 2022 returns through October are -11.2%.

KPERS Funding

Strong investment performance in CY 2021 increased the assets in the Trust Fund.

Changing the investment return assumption from 7.75% to 7.0% increased the calculated liabilities of the System.

Overall, the funded ratio decreased from 72.5% to 71.6%, however the funding projections show continued improvement of the funded status until the unfunded actuarial liability is scheduled to be extinguished in 2039.

Continued full funding of the employer contribution rate is one of the keys to keeping KPERS on a path to full, sustainable funding.

KPERS benefits are not in jeopardy, with $24 billion in assets today and a well diversified investment portfolio, KPERS will pay all promised benefits.

Questions?

Joint Committee on Pensions, Investments, and Benefits

Pension Funding Bonds

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December 2, 2022

Covering Today

Purpose of pension funding bonds

History of approved pension funding bonds

Investment performance

Pension Funding Bonds

Pension funding bond proceeds immediately improve funded status of the Retirement System.

Bond debt is considered "hard debt" and is one of the highest budgeting priorities for the State.

The expectation is that, over time, KPERS' investment returns will exceed interest rate paid on the pension funding bonds for the State, which in turn will reduce required future employer contributions for the State.

History of Pension Funding Bonds

The State of Kansas has issued pension funding bonds to improve the funded status of the System on three occasions.

In 2004 the Legislature approved the sale of $500 million, gross of fees and capitalized interest. These bonds (2004C) were sold at a 5.39% interest rate and KPERS received about $440 million.

In 2015 the Legislature approved the sale of $1.0 billion, net of fees. These bonds (2015H) sold at a 4.69% interest rate. KPERS received the funding August 2015.

In 2021 the Legislature approved the sale of $500 million, net of fees. These bonds (2021K) sold at a 2.65% interest rate. KPERS received the funding in August 2021.

2004C Bond Issue

In 2004, the Legislature approved a $500 million bond issue to be deposited in the KPERS Trust Fund.

The bonds are 30-year maturity bonds with a total interest cost of 5.39%.

The structure of the bonds included capitalized interest totaling about $60 million.

KPERS ultimately received $440,165,000 in net proceeds.

Approximate annual debt service is $33 million. Funding source is the Expanded Lottery Act Revenues Fund.

The remaining principal balance at the end of FY 2022 was $311 million

2015H Bond Issue

In 2015, the Legislature approved a $1.0 billion bond issue, net of fees, with proceeds to be deposited in the KPERS Trust Fund.

The bonds are 30-year maturity bonds with a total interest cost of 4.68%.

The 2015H bonds sold in August 2015 and KPERS received the full $1.0 billion in proceeds.

Approximate annual debt service is $65 million. Funding source is the State General Fund.

The remaining principal balance at the end of FY 2022 was $881 million

2021K Bond Issue

In 2021, the Legislature approved a $500 million bond issue, net of fees, with proceeds to be deposited in the KPERS Trust Fund.

The bonds are 30-year maturity bonds with a total interest cost of 2.65%.

The 2021K bonds sold in August 2021 and KPERS received the full $500 million in proceeds.

Approximate annual debt service is $24 million. Funding source is presumed to be the State General Fund when payments begin in FY 2022.

Investment Performance as of October 31, 2022

As of October 31, 2021, investment returns on the System's investment portfolio have exceeded the interest cost of both bond issues.

The System's average annualized total return for the time period since the **2004C** bond issue is **7.09%**, compared to the bond interest cost of 5.39%. The value added since issuance, after payment of the debt service, is almost **$408 million**.

The System's average annualized total return for the time period since the **2015H** bond issue is **6.80%**, compared to the bond interest cost of 4.69%. The value added since issuance, after payment of the debt service, is about **$216 million**.

The System's total return for the two months since receiving the **2021K** bond proceeds is a positive **-7.78%**. This is approximately **$60 million** below the interest cost at 2.65%.

Considerations

All three pension funding bond issues are 30-year maturity bonds.

The value to the State of issuing the bonds will not be fully known for many years, particularly on the 2021K bond, which was sold just over one year ago.

The expectation is that KPERS will be able to invest the proceeds and realize an investment return that exceeds the bond rate. KPERS has earned 7.7% over the past 20 years.

As of October 31, 2022 the combined investment experience over the time periods since the sale of the three pension funding bond issues is a net positive to the State with **$564 million in value added**. This position is expected to vary over time, depending on market conditions.

MEMORANDUM

To: Joint Committee on Pensions, Investments, and Benefits

From: Jarod Waltner, Planning and Research Officer

Date: December 2, 2022

Subject: KPERS 3 Dividend Credits

KPERS 3 Cash Balance plan was created in 2012 and has been the primary retirement plan for new KPERS members since 2015 (some corrections positions continue to be enrolled in KPERS 2). A cash balance plan is a defined benefit plan (like KPERS 1 and KPERS 2) that has features like defined contribution plans (like 401k plans).

KPERS 3 retirement benefits are based on notional account balances accrued throughout a member's career based on employee contributions, employer credits and interest earnings. This structure of benefit calculation makes the accrual of interest more important for KPERS 3 members and their ultimate retirement benefits.

The KPERS 3 plan design includes two ways that interest is applied to member account balances:

1. A guaranteed 4% annual interest rate credited quarterly.
2. An optional dividend credit determined by statutory formula.

Dividend Credit Statutory Formula

The dividend credit for KPERS 3 is contained in K.S.A. 74-49,306 and is set at 75% of the five-year average net compound rate of return above 6%.

Dividend Calculation Example	
Five-year average net compound rate of return	8%
Amount of average return above 6%	2%
75% of return above 6%	1.5%
Dividend credit equals 1.5%	

KPERS

Dividend Experience
Each year in the March the KPERS Board of Trustees reviews the previous calendar year returns and whether a dividend is to be paid based on the statutory formula.

Over the first six years of KPERS 3, the formulaic dividend interest credit has applied in three years. A summary of the dividends paid is included in the following table.

KPERS 3 Dividend Credit Calculations

Calendar Year	Average Net Compound Rate of Return*	Dividend Credit
2015	0.2%	None
2016	4.3%	None
2017	7.4%	1.1%
2018	4.7%	None
2019	7.1%	0.825%
2020	9.3%	2.475%
2021	10.7%	3.525%

*The compound rate of return in the first four years was based on the number of years since the plan took effect (the first year was based on the one-year average, the second year was based on the two-year average, etc.). Starting in 2019 and going forward the formula uses a five-year rolling average.

The total interest credited for each member will depend on their service time. If a member started on the first date of KPERS 3 (1/1/2015) and continued employment through the end of CY 2021, the effective interest credit earned at the end of CY 2021 totals 5.124%.

Future Dividend Credits
KPERS net investment return through October 2022 totaled -11.5%. The total net return for the trailing 5-year period at the end of October totaled 5.5%, which is below the statutory threshold for the dividend credit. While still preliminary, November has had positive investment returns, which may improve the 5-year average.

The change in the investment return assumption from 7.75% to 7.0% reduced the actuarial assumption for future KPERS 3 dividends from 2.25% to 2.0%. If we expect future returns to be lower, it is consistent to assume that the 5-year average will reach the 6% statutory threshold less often. However, the actuarial assumption is used only for actuarial projections (e.g., future benefits, funding). The actual dividends credited to KPERS 3 members in the future will be based on actual investment returns.

I would be pleased to answer any questions the Committee has regarding the KPERS 3 dividend interest credit.

Joint Committee on Pensions, Investments and Benefits

Retirement Experience and Working After Retirement

PRESENTED BY:

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December 2, 2022

KPERS

Today's Topics

Recent Retirement Experience

Working After Retirement History

Current Working After Retirement Rules

Legal and Actuarial Implications of Working After Retirement

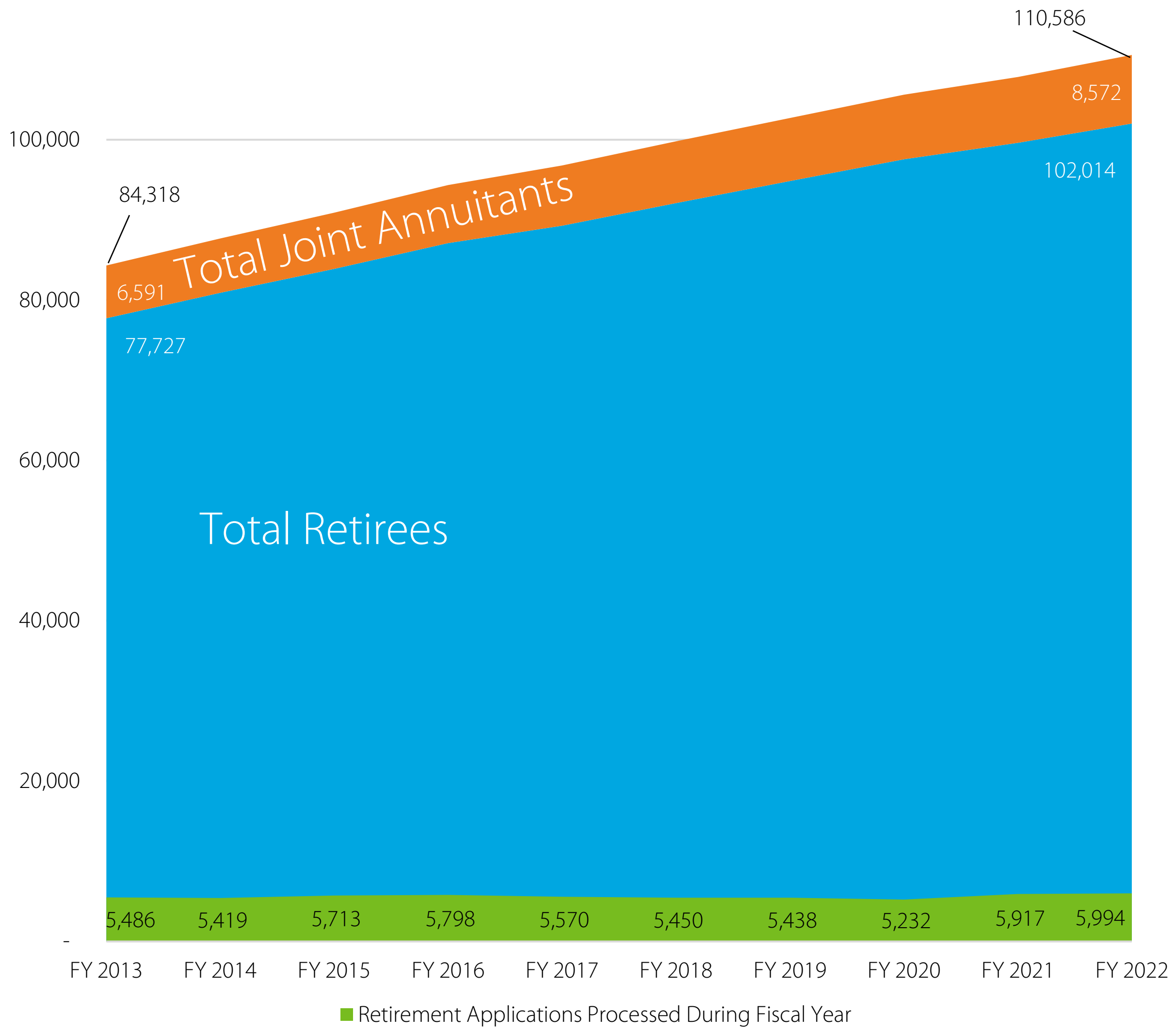
Recent Working After Retirement Experience

Retirement Rates

Retirement applications have consistently been in the 5,500 to 6,000 per year.

After a slow down from FY 2017-FY 2020, retirement applications increased to near 6,000 in both FY 2021 and FY 2022.

Some amount of increase is expected over time, especially as the "baby boomer" cohort reaches retirement.



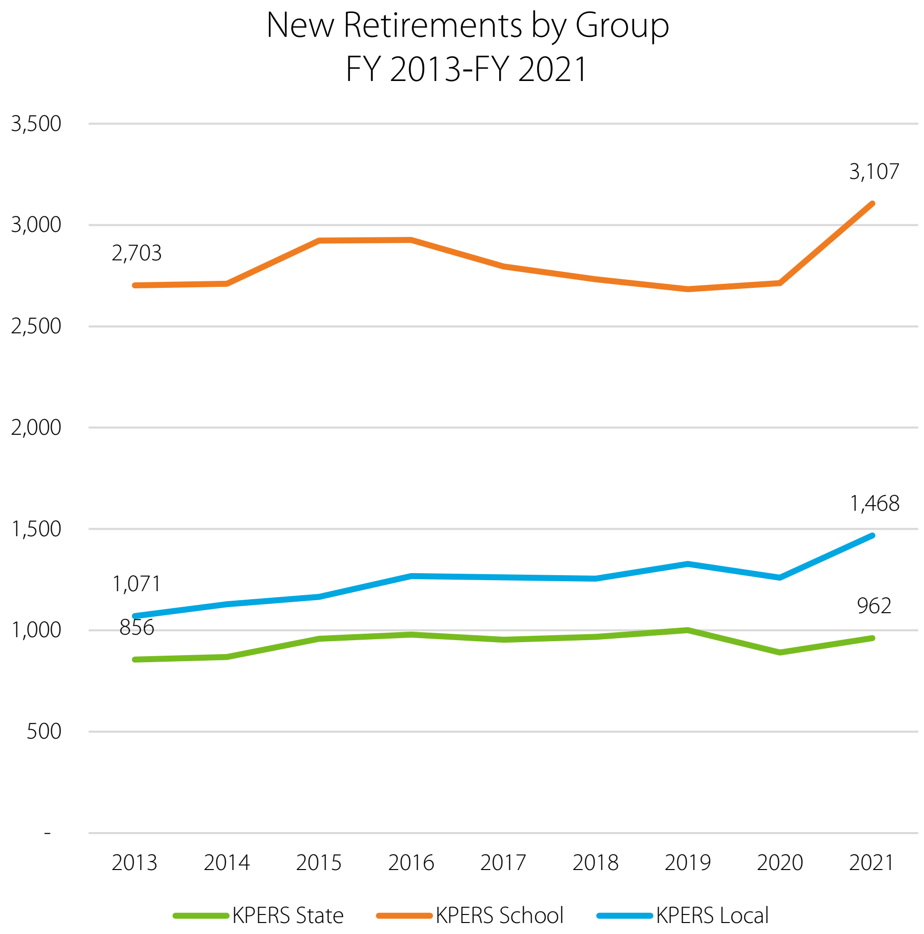
School Group Retirements

Retirements from the School group followed a similar pattern as other groups, slowing in the recent past and ramping back up in FY 2021.

The average age and service time for School retirees has changed by less than 6 months over the past five years, indicating that members are not delaying retirement or retiring early.

It will take several years for any change in retirement trends to be identifiable, but for now retirements are relatively steady.

KPERS does not collect position level data, so it is not possible to tell what percent of the retirements are teachers.



Working After Retirement History

The changes made in 2015 and 2016 added new working rules starting July 1, 2016 and grandfathered in old working after retirement rules.

- School employers had 13 different working after retirement categories for retirees, depending on position types, with different requirements and contribution rates.

The changes proved to be very difficult for employers and retirees to navigate.

The 2017 Legislature made another attempt at working after retirement reform and established a single set of rules for retirees and employers, with some minimal exemptions (including substitute teachers without a contract).

The focus in 2017 was to make a more uniform set of rules that was easier to understand and administer while still addressing the legal and actuarial implications.

Current Working After Retirement Rules

The working after retirement rules, in place since January 1, 2018, are:

1. Retirees have a 180-day waiting period if they retire before age 62 and a 60-day waiting period if they retire at age 62 or later, but only if they return to work for a KPERS employer. No waiting period for a KPERS retiree to work in the private sector.
2. No prearranged agreement to return to work.
3. <u>No retiree who returns to work has an earnings limitation</u>.
4. <u>Employers contribute</u> the statutory rate (13.11% for State/School in FY 2023) on the first $25,000 in earnings and 30% on all earnings above $25,000 for retirees in covered positions, but no contributions on non-covered positions.

Covered Positions	**Non-covered position**
Not seasonal or temporary *and* 630 or more hours of work per year for school employers 1,000 or more hours of work per year for non-school employers	Seasonal or temporary *or* Fewer than 630 hours of work per year for school employers Fewer than 1,000 hours of work per year for non-school employers

Employer Contributions

Employer contributions were included in working after retirement to help offset the actuarial cost to the System.

The actuarial cost is difficult to estimate because working after retirement affects member behavior, but the 30% contribution rate was selected the Legislature was intended to be the best guess to make working after retirement actuarially neutral.

Employer contributions are only required on retirees filling covered positions. Non-covered positions are not subject to employer contributions, but the waiting period still applies.

Legal and Actuarial Implications

The IRS requires a bona fide retirement take place before distributions can occur for qualified 401(a) plans like KPERS.

The waiting period and prohibition on prearrangements are in place as tests to satisfy this IRS requirement.

Earlier retirements have an actuarial cost to the system.

- **Shorter period for contributions**. Contributions are received for a shorter period than actuarially expected, so the retirement benefit may not be fully funded during the working career.
- **Longer period of benefit payouts**. In general, there is a higher actuarial liability for retirements at or soon after initial eligibility (even when considering potential for benefit increases with additional years of service.)

Since working after retirement decisions are behavioral in nature, the actual cost cannot be calculated.

The employer contribution was put in place to offset as much of the actuarial impact as possible.

Recent Working After Retirement Experience

Since 2018, the working after retirement rules have been much easier for employers and retirees to understand.

There were about 5,300 retirees reported as returned to work in the last actuarial valuation (December 31, 2021), however certain positions (e.g., daily call substitutes) are no longer being reported.

Schools reported about 3,750 retirees as returned to work in the last actuarial valuation.

KPERS does not collect position specific information, so we do not know how many of those positions are teachers.

Policy Considerations

There were about 11,500 retirements from the School group between 1/1/2018 and 12/31/2021. All of these retirees, regardless of whether they retired before or after age 62, have completed their statutory waiting period and are eligible to return to work.

Reducing the waiting period to allow retirees to return to work sooner could increase the pool of retirees available, but it could also increase the number of members retiring.

Reducing the employer contribution for working after retirement may help incentivize retirees to return to work. Any change in the actuarial liability due to lowering the employer contribution would impact future employer contributions.

Questions?

Joint Committee on Pensions, Investments, and Benefits

Deferred Retirement Option Program (DROP)

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December 2, 2022

KPERS

Covering Today

What is a Deferred Retirement Option Program

History of the Deferred Retirement Option Program (DROP)

Deferred Retirement Option Program Provisions

Deferred Retirement Option Program Experience

What is a Deferred Retirement Option Program

A Deferred Retirement Option Plan (DROP) is a plan design feature where a member initiates the calculation of a retirement benefit but opts to defer actual receipt of the benefit for a specified period.

During this DROP period, the member continues working.

The member's benefit is credited to a notional account during the DROP period.

At the end of the DROP period, the member receives a lump sum payment of the DROP account balance.

History of the Deferred Retirement Option Program

The 2015 Legislature passed a pilot deferred retirement option program (DROP) for KP&F members starting January 1, 2016.

- The DROP only applied to troopers, examiners or officers of the Kansas Highway Patrol.
- The DROP was given a sunset date of January 1, 2020.

The 2019 Legislature amended the law to extend the sunset to January 1, 2025.

- The DROP was expanded to include agents of the Kansas Bureau of Investigation as eligible participants.

Deferred Retirement Option Program Provisions

Entering the DROP means a member's retirement benefit is established and begins accumulating and earning interest in a DROP account while the member continues to work.

A member can enter the DROP plan when eligible for normal (unreduced) retirement.

Tier 1 members:	55 years old with 20 years of service
Tier 2 members:	50 years old with 25 years of service
	55 years old with 20 years of service
	60 years old with 15 years of service

The member elects to continue working for a 3, 4 or 5-year DROP period.

- The member has an opportunity to extend their initial election to a maximum of 5 years, but in no case can the DROP period be longer than 5 years in total.

Deferred Retirement Option Program Provisions

Members and their employer continue making contributions to KPERS during the DROP period. Those contributions are not added to the DROP account.

No additional benefits are earned by the member upon entering DROP.

At the end of the DROP period, the member receives a lump sum of the accumulated balance in the DROP account, which includes the accrued benefit payments and interest.

Deferred Retirement Option Program Experience

Participation in the DROP is limited to less than 550 of the 7,800 KP&F member, approximately 7% of the total KP&F active membership.

- Kansas Highway Patrol has about 450 KP&F members.
- Kansas Bureau of Investigation has about 90 KP&F members.

Participation was slow in the early years of the new DROP.

To date, there have been 67 members enrolled in the DROP.

- 61 Kansas Highway Patrol members.
- 6 Kansas Bureau of Investigation members.

18 members have completed their DROP period and received their lump sum payment.

Deferred Retirement Option Program Experience

From July 1, 2015 – December 31, 2021, there were 70 KHP and KBI members that retired from KP&F.

Over the same period, 61 members elected into the DROP.

The most common DROP election is for the maximum, 5-year period.

61 members elected or extending to the 5-year DROP period.

2 members elected the 4-year DROP period.

4 members elected the 3-year DROP period.

Deferred Retirement Option Program Experience

The average age of DROP participants is lower than the retirees who did not elect DROP, indicating that DROP participants enter the DROP earlier than when they would be expected to retire without the DROP.

DROP participants average service time is higher than the KP&F retirees who did not elect DROP.

Group	Average Age at Retirement	Average Service at Retirement
DROP Participants	54.5	26.9 years
Retired Members	55.5	23.8 years

Potential Costs of a DROP

Individual decisions to participate in a DROP plan are largely behavioral and therefore require several assumptions to complete a cost estimate. The initial cost estimate included two different scenarios:

- Members enter DROP when they planned to retire and work additional years.
- Members enter DROP 3-5 years before their planned retirement date.

When members were assumed to enter the DROP at their planned retirement and work additional years there was very little change in the expected costs for the plan.

However, if members decided to enter the DROP 3-5 years before they planned to there was an expected increase in the plan costs, which would require an increase in annual KP&F employer contributions.

The experience so far appears to be somewhere in the middle. DROP members are entering the DROP about one year younger than members who retire, but most are electing the 5-year DROP period.

Potential Costs of a DROP

Because of the behavioral nature of DROP decisions, we will never know the true cost or savings to KP&F.

The actuary is assuming 75% of eligible members will utilize the DROP in the long-term, but we have not seen that level of participation during pilot phase.

The pilot group is less than 10% of the total KP&F population. If the DROP was expanded, the actuarial impact would be more noticeable.

Any costs caused by the DROP would impact future employer contributions rates.

If DROP is expanded, KPERS will need additional staffing and upgrades to the pension administration system to implement the new benefit structure.

MEMORANDUM

To: Joint Committee on Pensions, Investments, and Benefits

From: Alan D. Conroy, Executive Director

Date: December 2, 2022

Subject: KPERS Pensions Administration System Modernization and Budget Request

KPERS maintains a pension administration databased that provides the functionality needed to collect critical data, collect contributions and pay benefits. The current system was implemented in 2005.

Over the past 15 years many plan design changes have required customization. These changes are both internal (i.e., implementing solutions for business processes) and external (i.e., legislative changes).

The most significant plan design changes include creating KPERS 2 in 2007 and KPERS 3 in 2012. As part of adding the KPERS 3 cash balance plan, the Retirement System also needed to move to pay period reporting for employee and employer contributions (instead of annual reporting).

The existing pension administration system is still capable of executing KPERS' mission-critical processes, namely collecting contributions, and paying benefits. However, the existing system has become less efficient and more unstable over time. Maintaining the codebase for existing functions is becoming more of a struggle, let alone keeping pace with current best practices among pension administration systems.

It is imperative that a new pension administration system be implemented before the existing system can no longer effectively meet the needs of the organization and our members.

Pensions Administration System Modernization Project

The pension administration modernization project began with a budget request to the 2020 Legislature to begin the process. With the funding, KPERS engaged with a vendor through competitive bid and ultimately selected Segal to complete a full needs assessment in the summer of 2020.

Part of the overall assessment was to determine whether KPERS needed to invest in a completely new pension administration system or whether the existing vendor (Sagitec) could meet the future needs of KPERS. Ultimately Segal recommended a "fork in the road" approach where Sagitec would be asked to first complete a specific project as a gauge for whether they could execute KPERS' vision of the pension administration modernization.

KPERS

Project Status
Between September 2021, and February 2022, KPERS held a series of meetings with business users from the different divisions (member services, fiscal services, information technology, and administration) to establish the requirements for the pension administration system to meet the needs and expectations of our members, and to administer all plans under KPERS (KPERS, KP&F and Judges). This process yielded about 3,000 requirements that will be continued from the existing system or added as new items in the updated system.

After the initial assessment, it was determined that an initial phase of categorizing issues and stabilizing the existing application (KPERS Information Technology System, or KITS), would be required to ensure that it remains viable through the duration of the modernization period (5-6 years).

During this "Analyze and Retool" phase, Sagitec has not fully met KPERS' expectations for a successful project. There have been improvements made in the collaborative work between Sagitec and KPERS, but Sagitec has struggled to meet deadlines and quality goals.

In addition, the estimated total budget for modernization submitted by Sagitec has increased by 20% for the remainder of the project. This increase was not fully itemized to KPERS and puts the total cost of the project almost equal to the expected cost of going to Request for Proposal (RFP) for a new pension administration system. We recognize there are issues across the industry regarding hiring and retaining staff as well as inflationary costs, however, we would not expect the cost of modernization using the existing vendor to equal the cost of modernization with a new vendor.

Next Steps
Based on the performance of Sagitec at this stage and the estimated costs, KPERS has initiated the process of writing a comprehensive RFP. We anticipate publishing the RFP in the spring of 2023 with the expectation that we will have completed the process and selected a pension administration system vendor in the fall of 2023.

KPERS has not entered into a new contract on modernization or purchased any software related to modernization at this stage. All of the work completed so far has been to collect requirements and address deficiencies in the existing system. KPERS will need to continue using the existing system for another 4 years or longer, so the work completed to date was essential and is not time and resources lost if the decision is made to go to RFP for a new system.

We will be reliant on this system for the duration of the modernization, so it is critical that the existing system can continue to function until modernization is complete.

FY 2023 and FY 2024 Budget Request
For FY 2023 and FY 2024, KPERS is maintaining the budget estimates for modernization provided in 2022. The expenditures are budgeted as contractual services as most of the work will be completed by the information technology vendor. There will be staffing positions that are backfilled to allow for internal staff to focus on the modernization project, however those

positions will be contract positions until necessary staffing levels are determined later in the project.

The 2022 Legislature approved FY 2023 budget expenditures totaling $9.2 million for the pension administration modernization and this amount is maintained in this request. In FY 2024, the requested appropriation for the modernization effort is $9.0 million. The expenditures remain in the contractual services portion of the budget. Additional staffing is again included as contract positions in FY 2024, but the primary cost is the contractual costs with Sagitec for development of the new pension administration system.

The expected out-year funding may shift as we engage with a vendor through the RFP process and receive new estimates for implementing a new pension administration system. KPERS will certainly keep the Governor and Legislature informed as we move forward on our improvements to our pensions administration system.

I would be pleased to respond to any questions that you might have.

Overview of Investment Performance and Discussion on Investments Topics

Joint Committee on Pensions, Investments and Benefits

Alan Conroy, Executive Director

Bruce Fink, CFA, Chief Investment Officer

December 2, 2022

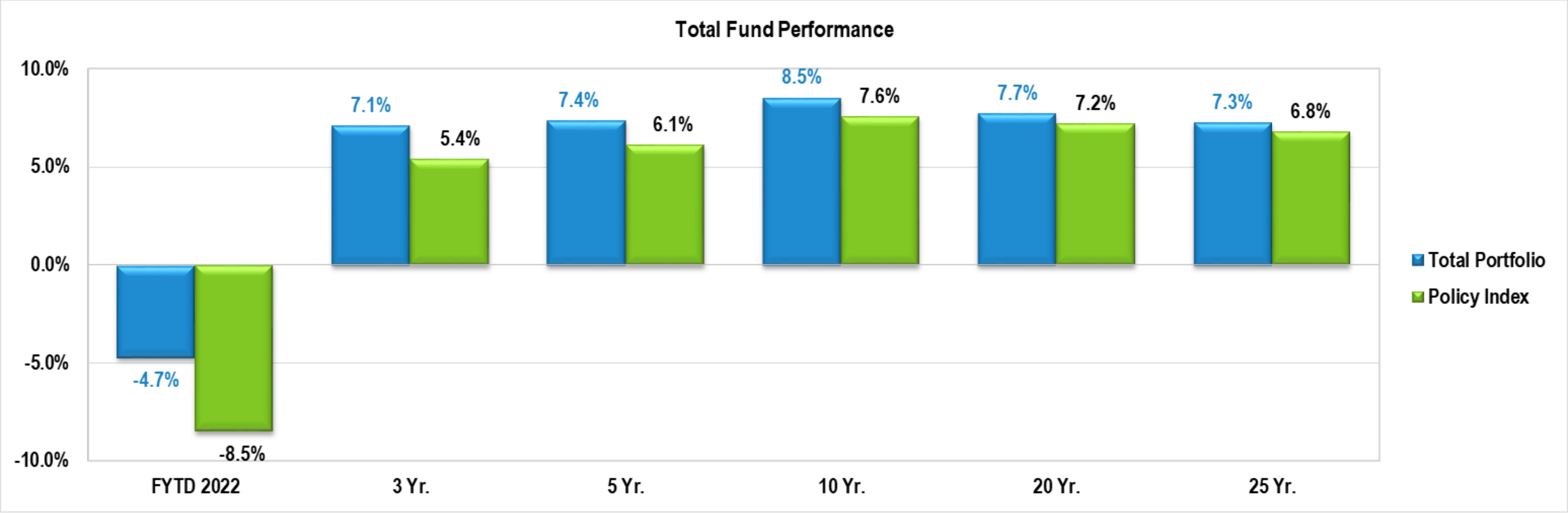
KPERS

Introduction

In today's presentation, we will discuss the following:

- KPERS' investment performance as of fiscal year end June 30, 2022.
- The Board of Trustees' Alternative Investment Request to delegate authority to set the limit on alternative investment in the Trust Fund's portfolio to the Board.
- An overview the System's investments in China and Hong Kong.
- A discussion of Environmental, Social and Governance matters.

Total Fund Performance through June 2022	Total Return	Excess Return
• Fiscal Year 2022	-4.7%	[+3.8%]
• Trailing three years	7.1%	[+1.7%]
• Trailing five years	7.4%	[+1.3%]
• Trailing ten years	8.5%	[+0.9%]
• Trailing twenty years	7.7%	[+0.5%]
• Trailing twenty five years	7.3%	[+0.5%]

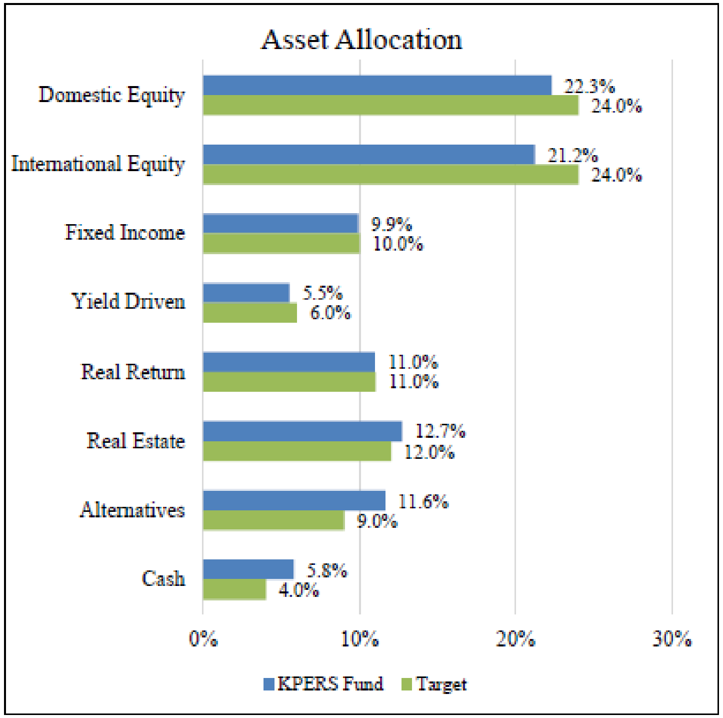


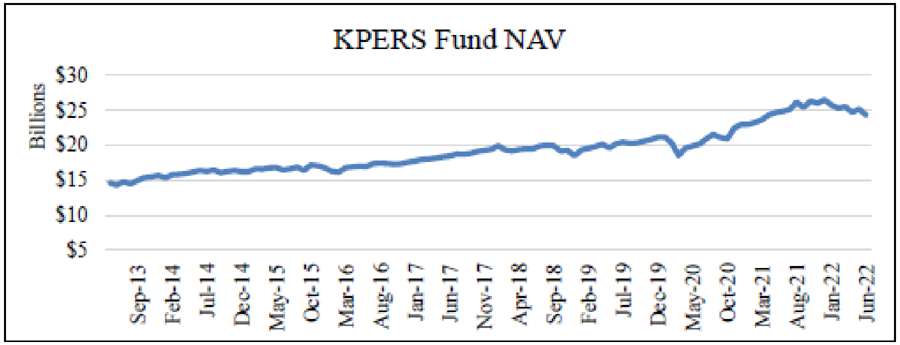
Performance data as of June 30, 2022; Returns are annualized for periods greater than 1 year. Excess Return = performance relative to Policy Index or asset class benchmark.

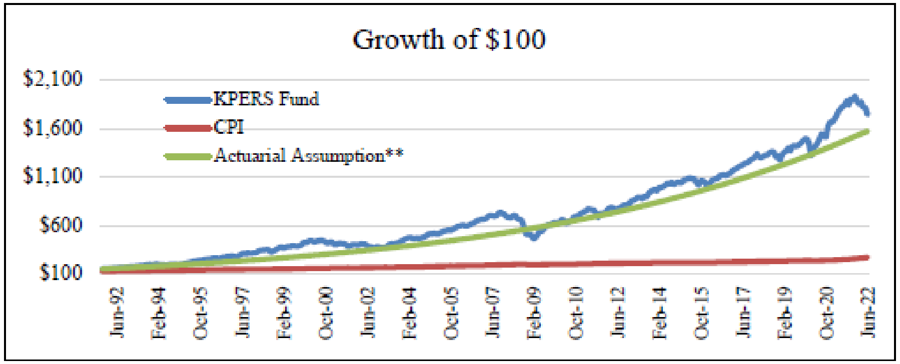
KPERS

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
INVESTMENT PERFORMANCE REPORT
June 30, 2022

Time Weighted Total Return*	June 30, 2022 Net Asset Value (Millions)	Latest Quarter	Fiscal YTD	Calendar YTD	Latest 1 Year	Latest 3 Years	Latest 5 Years	Latest 10 Years	Latest 25 Years
Total Portfolio	$24,316.8	-7.3%	-4.7%	-10.0%	-4.7%	7.1%	7.4%	8.5%	7.3%
Policy Index		-10.2%	-8.5%	-13.2%	-8.5%	5.4%	6.1%	7.6%	6.8%
Excess Return		*2.9%*	*3.8%*	*3.2%*	*3.8%*	*1.7%*	*1.3%*	*0.9%*	*0.5%*





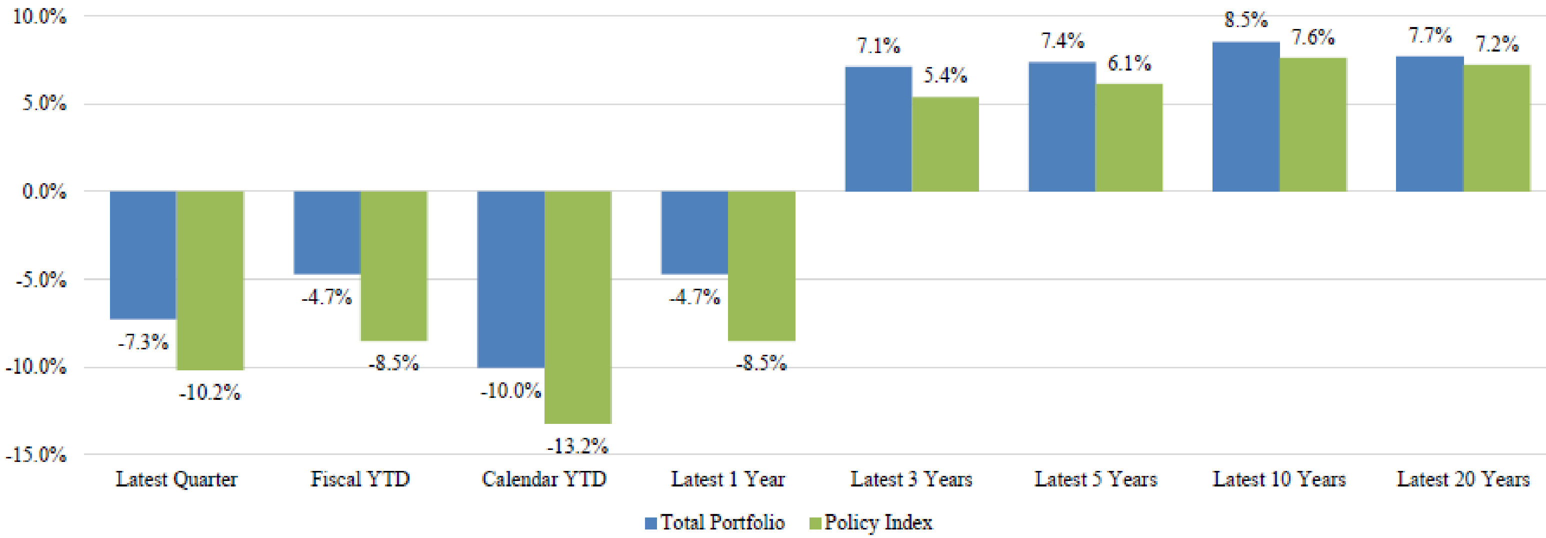


* Returns for time periods less than one year are not annualized.

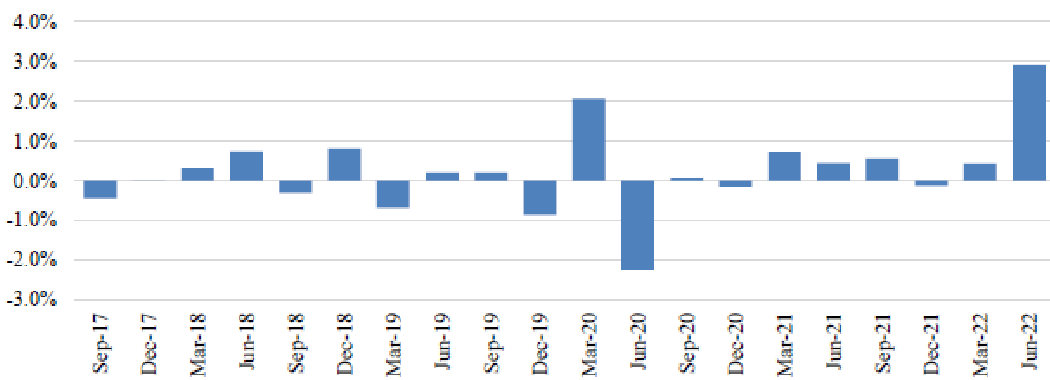
** Actuarial assumption was 8% from 1986 through 2016; 7.75% from 2017 through 2021; 7.00% currently.

Total Plan Performance

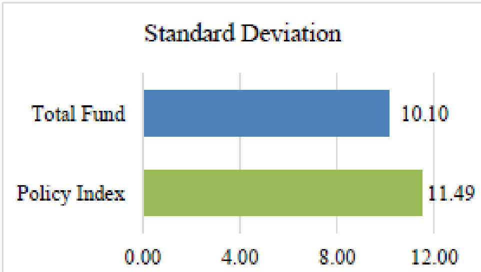
KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
PLAN PERFORMANCE
June 30, 2022



Rolling 3-Month Excess Return

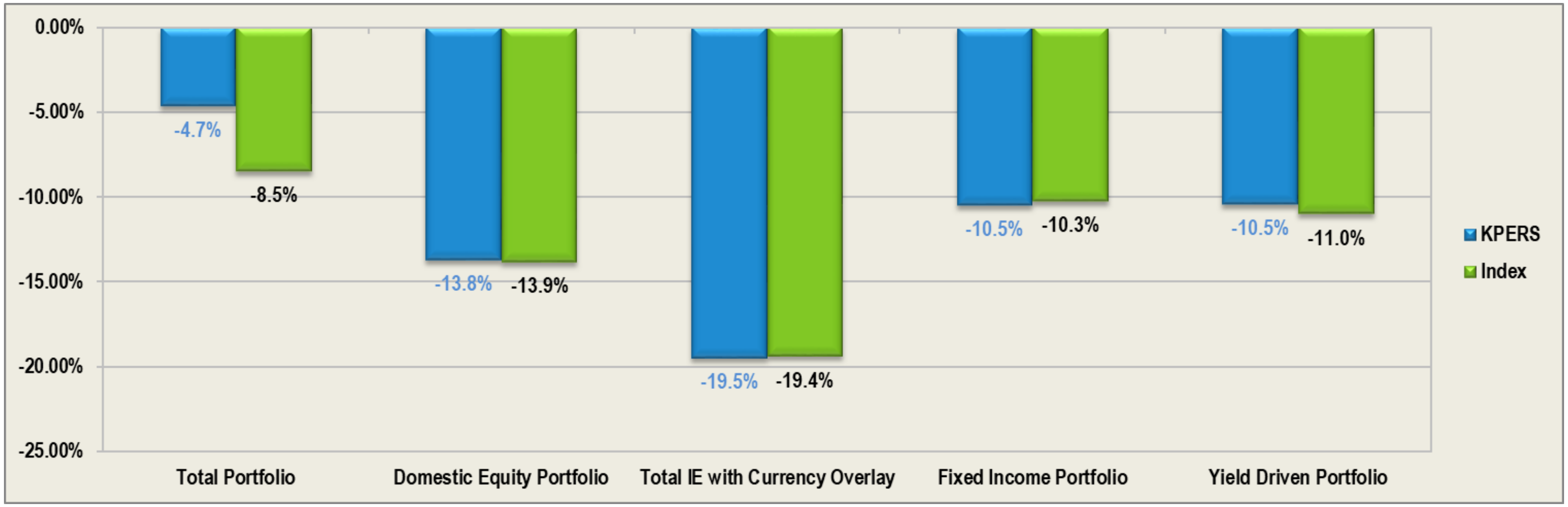


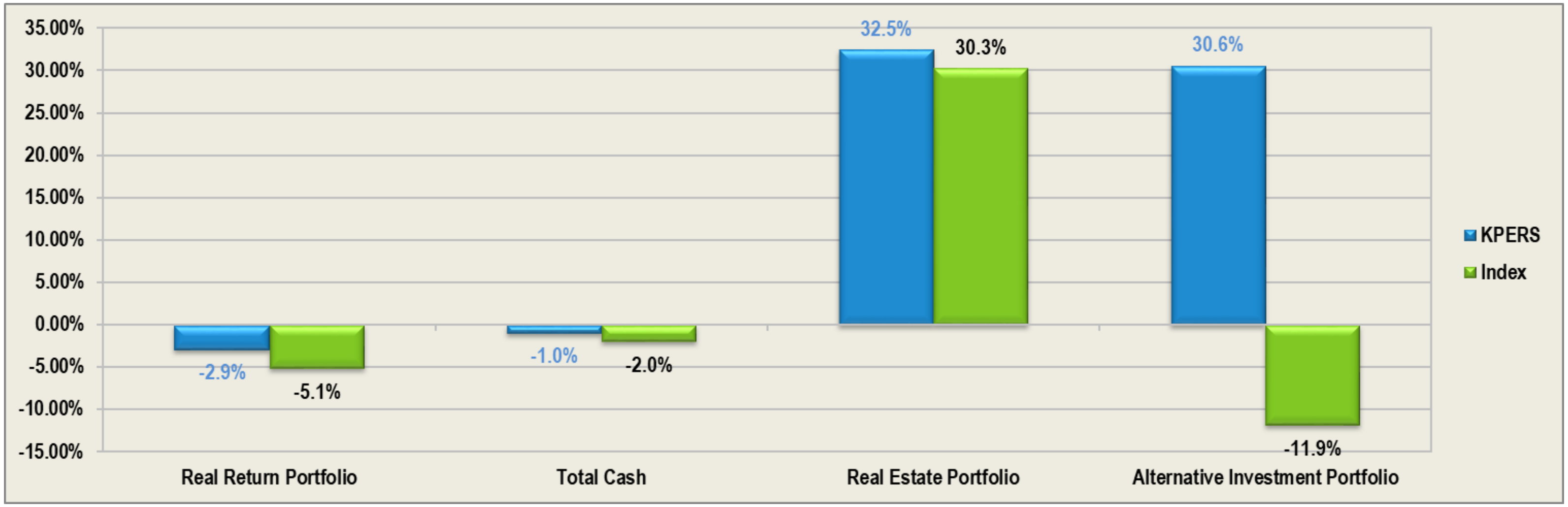
Risk Statistics - Trailing 3 Years



	Fund
Standard Deviation	10.10
Sharpe Ratio	0.64

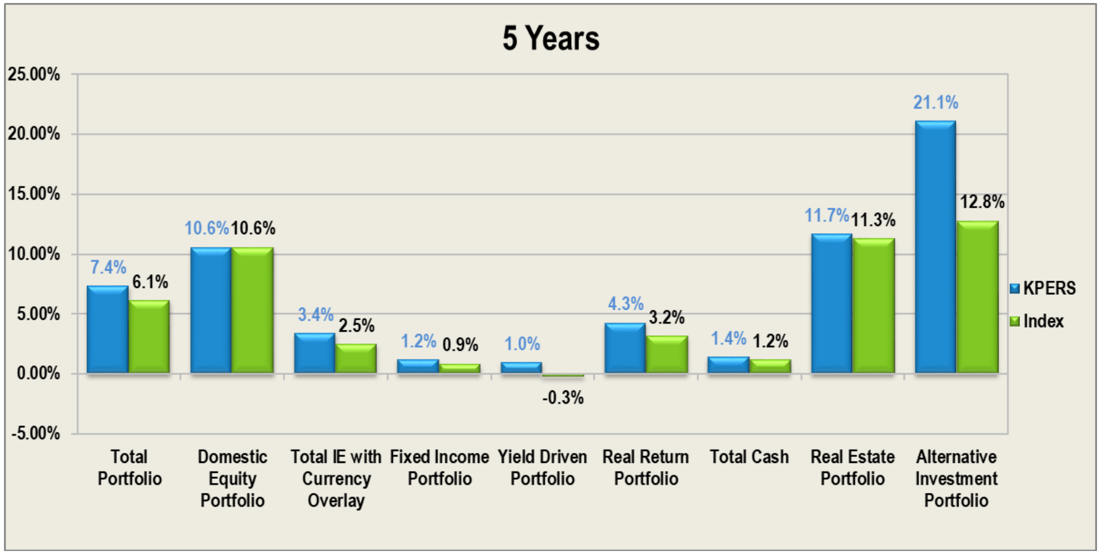
Fiscal Year 2022 Returns

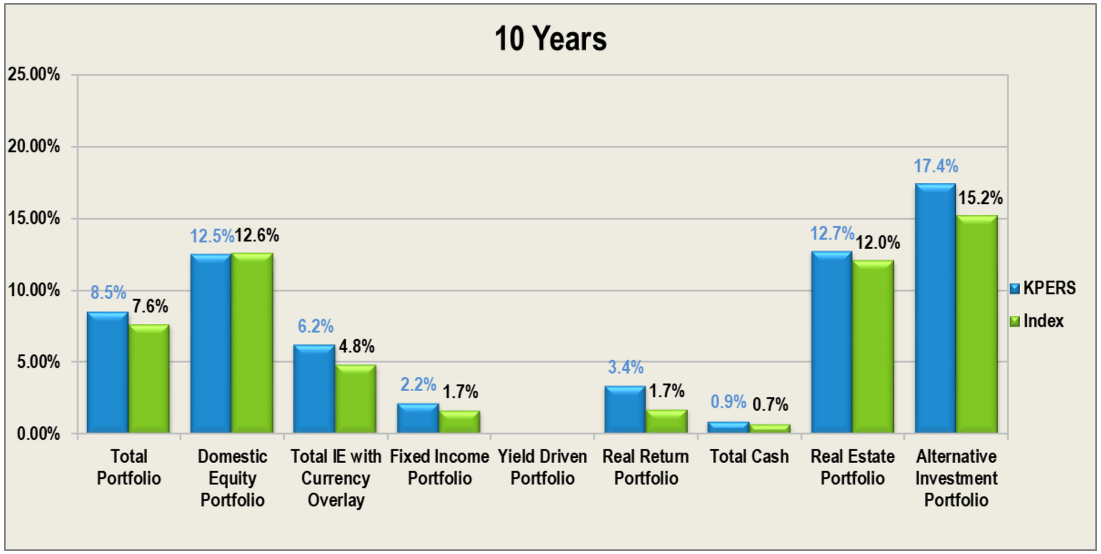




Performance data as of June 30, 2022.
Returns for periods less than 1 Year are not annualized.

Longer Period Returns





Performance data as of June 30, 2022. Annualized Returns. Yield Driven Portfolio incepted January 2013.

Economic and Market Observations

- Fiscal year 2022 has been an extraordinarily volatile and difficult period for all investors.
- Inflation remains a top concern.
    - How quickly and to what level will central banks be willing to increase interest rates to bring inflation under control?
    - Will central banks accept a prolonged recession in order to do so?
- Russia's invasion of Ukraine continues without a resolution in sight.
    - Energy prices and energy security concerns are increasing recession risks particularly in Europe and the UK.
- Investors remain cautious.
    - Although there has been some improvement in returns over recent weeks, expectations are that investment returns will remain low and very volatile through 2023.
- The System continues to hold the perspective of a long-term investor during this volatile market environment.
    - Maintaining a level of risk below that of the policy benchmark, protecting capital during market downturns, while achieving positive returns in excess of the benchmark over longer time periods.

15% Statutory Limit on Alternative Investments

- In the 2012 Legislative Session, the Legislature passed HB 2461 which added a cap of 15% on total alternative investments as a percentage of the System's total investments.
- Alternative investments are defined by Kansas statute as:
  - …includ[ing] a broad group of investments that are not one of the traditional asset types of public equities, fixed income, cash or real estate. Alternative investments are generally made through limited partnership or similar structures, [and]…generally include but are not limited to, private equity, private credit, hedge funds, infrastructure, commodities and other investments which have the characteristics described in this paragraph. (K.S.A. 74-4921(5)(b)(ix))
- The System investments in private equity and infrastructure (highways, utility systems, airports, etc.) fall under this definition.
- The System's exposure to alternative investments is ~13.3% of total investments.
- When the current exposure breaches the 15% limit, the System will be unable to make new commitments to alternative assets as defined in the statute.
- Such an event would impact the System's investment program by:
  - Introducing unnecessary risk into the program (by stopping and restarting the investment process),
  - Impairing access to the top tier private market firms that the System has cultivated, and
  - Potentially impacting expected returns.
- Investment staff and the System's consultants believe that delegating the authority to set a limit on alternative investments to the System's Board of Trustees would serve the best interest of the System.
- All other K.S.A. language governing investment in alternative investments would remain in force (next slide).

15% Statutory Limit on Alternative Investments

The following guidelines currently in K.S.A. 74-4921 (5)(b) will remain in effect:

- [T]he system has received a favorable and appropriate recommendation from a qualified independent expert in investment management or analysis in that particular type of alternative investment.
- [T]he board has received and considered the investment manager's due diligence findings submitted to the board as required by subsection (6)(c).
- [T]he alternative investment is consistent with the system's investment policies and objectives as provided in subsection (6).
- [P]rior to the time the alternative investment is made, the system has in place procedures and systems to ensure that the investment is properly monitored and investment performance is accurately measured.
- The total of the annual net commitment to alternative investments does not exceed more than 5% of the total market value of investment assets of the fund as measured from the end of the preceding calendar year.
- …in addition to the system, there are at least two other qualified institutional buyers, as defined by section (a)(1)(i) of rule 144A, securities act of 1933.
- [T]he system's share in any individual alternative investment is limited to an investment representing not more than 20% of any such individual alternative investment.
- [T]he individual alternative investment does not exceed more than 2.5% of the total alternative investments made under this subsection. If the alternative investment is made…in a multi-investor pool, the 2.5% limitation….is applied to the underlying assets of such pool and not to the investment in the pool itself
- [T]he total of such alternative investments made…in any one individual multi-investor pool shall not exceed more than 20% of the total alternative investments made by the system pursuant to this subsection.

Exposure to China and Hong Kong

- As of September 30, 2022, the System's investment in China [1] represented ~1.45% of total assets and investments in Hong Kong ~0.80% of total assets. [2]
  - The market value of publically traded equity investments in China was $299.2 million, which was ~1.28% of total assets. China is considered an "emerging market".
  - The market value of publically traded equity investments in Hong Kong was $187.4 million, which was ~0.80% of total assets. Hong Kong is considered a "developed market".
  - The private equity investment portfolio held approximately $41 million of assets with exposure to China, which represented ~0.17% of total assets. (Private markets valuations are lagged by one quarter.)
- Combined China and Hong Kong public equity holdings had a market value of $486.6 million and comprised 10.44% of the System's international equity portfolio and 2.08% of total assets.
  - Exposure to China and Hong Kong represented approximately 6.42% and 4.02% of the international equity portfolio, respectively.
  - The System's China exposure in the international equity portfolio (in aggregate) is in line with the benchmark weighting of 9.18%
  - The System did not have any exposure to debt issued by China or Hong Kong.

1. Classification as China or Hong Kong is based on the "Issue Country Name" as assigned by the System's master custodian.
2. All market values and exposures on this slide are reported as of September 30, 2022.

Environmental, Social and Governance

- Environmental, Social and Governance (“ESG”) investment mandates seek to advance certain investors’ and investment managers’ environmental and social initiatives in areas such as climate change, workers rights, diversity, equity, etc.
- ESG considerations are most prominent in equity related investment mandates.
- An equity manager’s ESG stance can impact investors in three ways:
  - Decisions to advance ESG initiatives by actively buying or selling specific securities within an investor’s portfolio.
  - Decisions to advance ESG initiatives through corporate policies outside of those expressed through an investor’s portfolio.
  - Decisions to advance ESG initiatives through an investor’s delegation of proxy voting authority. The System has delegated this duty to each equity manager.
    - Each investment manager hired by the System serves as a fiduciary and as such must comply with the KPERS investment policy statement and the State statutes governing these decisions, some of which are detailed on the following slide.
- The System does not invest in any ESG focused mandates, nor does the System impose any ESG consideration(s) on any of its managers.

The decisions made by trustees, staff and the investment firms hired to manage the System's assets are guided by fiduciary standards expressed in policy and Kansas statute which include, though not limited to, the following:

- The Statement of Investment Policy, Objectives and Guidelines:

  SECTION 13: SOCIALLY/POLITICALLY RESPONSIBLE INVESTMENT POLICY

  A. <u>Fiduciary Responsibility</u>: The Board recognizes that its first responsibility as fiduciary for the Kansas Public Employees Retirement System is to prudently invest the assets of the System solely for the benefit of members and beneficiaries.

  B. <u>Standards by which to Judge Investment Opportunities</u>: Investments will be judged on the same basis, that being that the investments are to be prudent, when considered as a part of the Fund and in light of this Statement of Investment Policy, and that they provide the highest expected return commensurate with the lowest expected risk and are appropriately diversified.

  Criteria other than these will <u>not</u> override the above. (emphasis added)

- State of Kanas Statute:

  74-4921 (3) Moneys in the fund shall be invested and reinvested to achieve the investment objective which is preservation of the fund to provide benefits to members and member beneficiaries, as provided by law and accordingly providing that the moneys are as productive as possible, subject to the standards set forth in this act. **No moneys in the fund shall be invested or reinvested if the sole or primary investment objective is for economic development or social purposes or objectives.** (emphasis added).

KPERS

November 30, 2022

Joint Committee on Pensions, Investments and Benefits:

Senator Jeff Longbine, Chairperson
Representative Steven Johnson, Vice-Chairperson
Senator Brenda Dietrich
Senator Michael Fagg
Senator Tom Holland
Senator Mary Ware
Representative Jesse Borjon
Representative Broderick Henderson
Representative Jim Kelly
Representative Cindy Neighbor
Representative Sean Tarwater
Representative Carl Turner
Representative Rui Xu

Dear Members of the Joint Committee:

On behalf of the KPERS Board of Trustees, we respectfully request that the Joint Committee on Pensions, Investments and Benefits consider the introduction of a bill related to KPERS investments.

The Board requests legislation to allow the Board of Trustees to set the percentage of alternative investments within the KPERS Trust Fund. Current law limits the sum of alternative investments to no more than 15 percent of the KPERS Trust Fund.

All other existing limitations on the alternative investments would remain in place, including:

- Total of the annual net commitment to alternative investments will not exceed 5.0 percent of the total market value of the investment assets of the Trust Fund.
- There are at least two other qualified institutional buyers.
- The System's share in any individual alternative investment will not be more than 20% of any such individual alternative investment.
- Any individual alternative investment will not exceed more than 2.5 percent of the total alternative investments.
- Any one individual multi-investor pool shall not exceed more than 20 percent of the total alternative investments made by the System.

Kansas Public Employees Retirement System Alan D. Conroy, Executive Director www.kpers.org
611 S. Kansas Ave., Suite 100, Topeka, KS 66603-3869 • Phone: 785-296-1019 • Fax: 785-296-2422

The current statutory cap has been in place since 2012. Over the past decade we have implemented a strategic investment plan that has increased our allocation to alternative investments to help increase returns while minimizing risk. Today we are nearing the statutory cap and the Board would be limited in its ability to set investment policies because of the cap.

The Board conducts a periodic asset/liability study to map the best distribution of KPERS Trust Fund assets across the investment market. The goal of the study is to maximize investment returns within acceptable risk for the Trust Fund. Allowing the Board to select the limit on alternative investments would assist the Board with this important fiduciary responsibility.

KPERS staff would be pleased to assist the Office of the Revisor of Statutes with proposed language should that be helpful. For consideration, we have attached a draft of the proposed changes.

Please know that we stand at the ready to respond to any questions that you might have regarding this request. Thank you for your consideration of assisting the Board in carrying out our fiduciary responsibilities to the KPERS Trust Fund.

Respectfully,

James P. Zakoura
Chairperson

Alan D. Conroy
Executive Director

cc:
KPERS Board of Trustees
Gordon Self, Revisor of Statutes, Office of Revisor of Statutes
David Wiese, Senior Assistant Revisor of Statutes, Office of Revisor of Statutes
Eileen Ma, Assistant Revisor of Statutes, Office of Revisor of Statutes
J.G. Scott, Director, Kansas Legislative Research Department
Melissa Renick, Assistant Director for Research, Kansas Legislative Research Department
Steven Wu, Senior Fiscal Analyst, Kansas Legislative Research Department

Enclosure

Kansas Public Employees Retirement System
Draft Legislation
November 15, 2022

K.S.A. 74-4921

(1) There is hereby created in the state treasury the Kansas public employees retirement fund. All employee and employer contributions shall be deposited in the state treasury to be credited to the Kansas public employees retirement fund. The fund is a trust fund and shall be used solely for the exclusive purpose of providing benefits to members and member beneficiaries and defraying reasonable expenses of administering the fund. Investment income of the fund shall be added or credited to the fund as provided by law. All benefits payable under the system, refund of contributions and overpayments, purchases or investments under the law and expenses in connection with the system unless otherwise provided by law shall be paid from the fund. The director of accounts and reports is authorized to draw warrants on the state treasurer and against such fund upon the filing in the director's office of proper vouchers executed by the chairperson or the executive director of the board. As an alternative, payments from the fund may be made by credits to the accounts of recipients of payments in banks, savings and loan associations and credit unions. A payment shall be so made only upon the written authorization and direction of the recipient of payment and upon receipt of such authorization such payments shall be made in accordance therewith. Orders for payment of such claims may be contained on (a) a letter, memorandum, telegram, computer printout or similar writing, or (b) any form of communication, other than voice, which is registered upon magnetic tape, disc or any other medium designed to capture and contain in durable form conventional signals used for the electronic communication of messages.

(2) The board shall have the responsibility for the management of the fund and shall discharge the board's duties with respect to the fund solely in the interests of the members and beneficiaries of the system for the exclusive purpose of providing benefits to members and such member's beneficiaries and defraying reasonable expenses of administering the fund and shall invest and reinvest moneys in the fund and acquire, retain, manage, including the exercise of any voting rights and disposal of investments of the fund within the limitations and according to the powers, duties and purposes as prescribed by this section.

(3) Moneys in the fund shall be invested and reinvested to achieve the investment objective which is preservation of the fund to provide benefits to members and member beneficiaries, as provided by law and accordingly providing that the moneys are as productive as possible, subject to the standards set forth in this act. No moneys in the fund shall be invested or reinvested if the sole or primary investment objective is for economic development or social purposes or objectives.

(4) In investing and reinvesting moneys in the fund and in acquiring, retaining, managing and disposing of investments of the fund, the board shall exercise the judgment, care, skill, prudence and diligence under the circumstances then prevailing, which persons of prudence, discretion and intelligence acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims by diversifying the investments of the fund so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so, and not in regard to speculation but in regard to the permanent disposition of similar funds, considering the probable income as well as the probable safety of their capital.

(5) Notwithstanding subsection (4): (a) Total investments in common stock may be made in the amount of up to 60% of the total book value of the fund;

(b) the board may invest or reinvest moneys of the fund in alternative investments if the following conditions are satisfied:

(i) The total of the annual net commitment to alternative investments does not exceed 5% of the total market value of investment assets of the fund as measured from the end of the preceding calendar year;

(ii) if in addition to the system, there are at least two other qualified institutional buyers, as defined by section (a)(1)(i) of rule 144A, securities act of 1933;

(iii) the system's share in any individual alternative investment is limited to an investment representing not more than 20% of any such individual alternative investment;

(iv) the system has received a favorable and appropriate recommendation from a qualified, independent expert in investment management or analysis in that particular type of alternative investment;

(v) the alternative investment is consistent with the system's investment policies and objectives as provided in subsection (6);

(vi) the individual alternative investment does not exceed more than 2.5% of the total alternative investments made under this subsection. If the alternative investment is made pursuant to participation by the system in a multi-investor pool, the 2.5% limitation contained in this subsection is applied to the underlying individual assets of such pool and not to investment in the pool itself. The total of such alternative investments made pursuant to participation by the system in any one individual multi-investor pool shall not exceed more than 20% of the total of alternative investments made by the system pursuant to this subsection. Nothing in this subsection requires the board to liquidate or sell the system's holdings in any alternative investments made pursuant to participation by the system in any one individual multi-investor pool held by the system on the effective date of this act, unless such liquidation or sale would be in the best interest of the members and beneficiaries of the system and be prudent under the standards contained in this section. The 20% limitation contained in this subsection shall not have been violated if the total of such investment in any one individual multi-investor pool exceeds 20% of the total alternative investments of the fund as a result of market forces acting to increase the value of such a multi-investor pool relative to the rest of the system's alternative investments; however, the board shall not invest or reinvest any moneys of the fund in any such individual multi-investor pool until the value of such individual multi-investor pool is less than 20% of the total alternative investments of the fund;

(vii) the board has received and considered the investment manager's due diligence findings submitted to the board as required by subsection (6)(c);

(viii) prior to the time the alternative investment is made, the system has in place procedures and systems to ensure that the investment is properly monitored and investment performance is accurately measured; and

(ix) ~~the total~~ subject to the provisions set forth in subsections (3), (4) and (5), the board shall adopt a limitation for the investment of alternative investments expressed as a percentage ~~does not exceed 15%~~ of the total investment assets of the fund. The ~~15%~~ limitation contained in this subsection shall not have been violated if the total of such alternative investments exceeds ~~15% of the total investment assets of the fund~~ the percentage set by the board, based on the fund total market value, as a result of market forces acting to increase the value of such alternative investments relative to the rest of the system's investments. However, the board shall not invest or reinvest any moneys of the fund in alternative investments until the total value of such alternative investments is less than ~~15% of the total investment assets of the fund based on the market value~~ <u>the limitation adopted by the board or the board adopts a new limit</u>. ~~If the total value of the alternative investments exceeds 15% of the total investment assets of the fund,~~ <u>T</u>he board shall not be required to liquidate or sell the system's holdings in any alternative investment held by the system, unless such liquidation or sale would be in the best interest of the members and beneficiaries of the system and is prudent under the standards contained in this section.

For purposes of this act, "alternative investment" includes a broad group of investments that are not one of the traditional asset types of public equities, fixed income, cash or real estate. Alternative investments are generally made through limited partnership or similar structures, are not regularly traded on nationally recognized exchanges and thus are relatively illiquid, and exhibit lower correlations with more liquid asset types such as stocks and bonds. Alternative investments generally include, but are not limited to, private equity, private credit, hedge funds, infrastructure, commodities and other investments which have the characteristics described in this paragraph; and

(c) except as otherwise provided, the board may invest or reinvest moneys of the fund in real estate investments if the following conditions are satisfied:

(i) The system has received a favorable and appropriate recommendation from a qualified, independent expert in investment management or analysis in that particular type of real estate investment;

(ii) the real estate investment is consistent with the system's investment policies and objectives as provided in subsection (6); and

(iii) the system has received and considered the investment manager's due diligence findings.

(6) Subject to the objective set forth in subsection (3) and the standards set forth in subsections (4) and (5) the board shall formulate policies and objectives for the investment and reinvestment of moneys in the fund and the acquisition, retention, management and disposition of investments of the fund. Such policies and objectives shall include:

(a) Specific asset allocation standards and objectives;

(b) establishment of criteria for evaluating the risk versus the potential return on a particular investment;

(c) a requirement that all investment managers submit such manager's due diligence findings on each investment to the board or investment advisory committee for approval or rejection prior to making any alternative investment;

(d) a requirement that all investment managers shall immediately report all instances of default on investments to the board and provide the board with recommendations and options, including, but not limited to, curing the default or withdrawal from the investment; and

(e) establishment of criteria that would be used as a guideline for determining when no additional add-on investments or reinvestments would be made and when the investment would be liquidated.

The board shall review such policies and objectives, make changes considered necessary or desirable and readopt such policies and objectives on an annual basis.

(7) The board may enter into contracts with one or more persons whom the board determines to be qualified, whereby the persons undertake to perform the functions specified in subsection (2) to the extent provided in the contract. Performance of functions under contract so entered into shall be paid pursuant to rates fixed by the board subject to provisions of appropriation acts and shall be based on specific contractual fee arrangements. The system shall not pay or reimburse any expenses of persons contracted with pursuant to this subsection, except that after approval of the board, the system may pay approved investment related expenses subject to provisions of appropriation acts. The board shall require that a person contracted with to obtain commercial insurance which provides for errors and omissions coverage for such person in an amount to be specified by the board, provided that such coverage shall be at least the greater of $500,000 or 1% of the funds entrusted to such person up to a maximum of $10,000,000. The board shall require a person contracted with to give a fidelity bond in a penal sum as may be fixed by law or, if not so fixed, as may be fixed by the board, with corporate surety authorized to do business in this state. Such persons contracted with the board pursuant to this subsection and any persons contracted with such persons to perform the functions specified in subsection (2) shall be deemed to be agents of the board and the system in the performance of contractual obligations.

(8)(a) In the acquisition or disposition of securities, the board may rely on the written legal opinion of a reputable bond attorney or attorneys, the written opinion of the attorney of the investment counselor or managers, or the written opinion of the attorney general certifying the legality of the securities.

(b) The board shall employ or retain qualified investment counsel or counselors or may negotiate with a trust company to assist and advise in the judicious investment of funds as herein provided.

(9)(a) Except as provided in subsection (7) and this subsection, the custody of money and securities of the fund shall remain in the custody of the state treasurer, except that the board may arrange for the custody of such money and securities as it considers advisable with one or more member banks or trust companies of the federal reserve system or with one or more banks in the state of Kansas, or both, to be held in safekeeping by the banks or trust companies for the collection of the principal and interest or other income or of the proceeds of sale. The services provided by the banks or trust companies shall be paid pursuant to rates fixed by the board subject to provisions of appropriation acts.

(b) The state treasurer and the board shall collect the principal and interest or other income of investments or the proceeds of sale of securities in the custody of the state treasurer and pay same when so collected into the fund.

(c) The principal and interest or other income or the proceeds of sale of securities as provided in clause (a) of this subsection (9) shall be reported to the state treasurer and the board and credited to the fund.

(10) The board shall with the advice of the director of accounts and reports establish the requirements and procedure for reporting any and all activity relating to investment functions provided for in this act in order to prepare a record monthly of the investment income and changes made during the preceding month. The record will reflect a detailed summary of investment, reinvestment, purchase, sale and exchange transactions and such other information as the board may consider advisable to reflect a true accounting of the investment activity of the fund.

(11) The board shall provide for an examination of the investment program annually. The examination shall include an evaluation of current investment policies and practices and of specific investments of the fund in relation to the objective set forth in subsection (3), the standard set forth in subsection (4) and other criteria as may be appropriate, and recommendations relating to the fund investment policies and practices and to specific investments of the fund as are considered necessary or desirable. The board shall include in its annual report to the governor as provided in K.S.A. 74-4907, and amendments thereto, a report or a summary thereof covering the investments of the fund.

(12)(a) Any internal assessment or examination of alternative investments of the system performed by any person or entity employed or retained by the board which evaluates or monitors the performance of alternative investments shall be reported to the legislative post auditor so that such report may be reviewed in accordance with the annual financial-compliance audits conducted pursuant to section 8, and amendments thereto.

(b) The board shall prepare and submit an alternative investment report to the joint committee on pensions, investments and benefits prior to January 1, 2016. Such report shall include a review of alternative investments of the system with an emphasis on the effects of changes in law pursuant to this act and includes specific investment cost and market value information of each individual alternative investment.

MEMORANDUM

To: Joint Committee on Pensions, Investments, and Benefits

From: Alan D. Conroy, Executive Director

Date: December 2, 2022

Subject: KPERS Performance Audit Topics

Current law (K.S.A. 46-1136) requires the Legislative Post Audit to complete a performance audit on KPERS at least every three years. The Legislative Post Audit Committee will be considering potential topics for that performance audit in the spring or summer of 2023. One source the Legislative Post Audit Committee will use to make their selection is any recommendations made by the Joint Committee on Pensions, Investments, and Benefits.

K.S.A. 46-1136 was created by act of the 2018 Legislature when the Legislature ended the statutory legislative annual financial audit of KPERS. KPERS already has a comprehensive financial audit completed by an outside auditor each year and that is accepted by the Legislature in lieu of requiring the Legislative Post Audit to complete and annual financial audit of KPERS.

The last Legislative Post Audit Committee performance audit of KPERS in 2020 was a review of the Deferred Retirement Option Plan (DROP) for members of the Kansas Highway Patrol and the Kansas Bureau of Investigation. In reviewing topics of Legislative interest since that last performance audit, we have compiled the following list of topics that may be of interest to the Joint Committee:

1. **Working After Retirement.** The current working after retirement rules were passed in 2017. The changes made the working after retirement rules easier for employers and members to understand but also added new restrictions. After 5 years, an audit of the experience since the new rules were implemented may provide direction on any policy adjustments that may be considered. The audit could include an examination of how other selected public pension plans deal with working after retirement for their members.
2. **KP&F Coverage for KPERS Correctional Members.** Legislation has been introduced in the last 3 biennial legislative cycles to move KPERS Correctional members to the KP&F retirement plan. An audit of this policy could help inform the Legislature on a path forward for the KPERS Correctional group.
3. **Cost of Living Adjustments.** Cost of Living Adjustment (COLA) legislation has been introduced or offered as a floor amendment in almost every year since the last COLA was approved in 2008. An audit of COLA options could provide a framework for the Legislature to review as future COLA legislation is considered. The audit could examine how selected other public pension plans deal with the issue of COLA's for their respective retirees.

These topics were selected based on recent legislative focus, but it is certainly not an exhaustive list of topics that may be of interest to this Committee or the Legislature.

I would be pleased to answer any questions the Committee has regarding KPERS performance audit topics.

KPERS