

**MINUTES OF THE SENATE COMMITTEE ON WAYS AND MEANS.**

The meeting was called to order by Senator August "Gus" Bogina, Chairperson, at 11:08 a.m. on January 29, 1992 in Room 123-S of the Capitol.

All members were present except:  
No one was absent

Conferees appearing before the committee:  
Craig Grant, Kansas National Education Association  
Bill Graves, Secretary of State

Continuation of the hearing on SB 526 - Prescribing certain investment practices and standards for KPERS investments

Craig Grant, Kansas NEA, testified in support of SB 526 and reviewed Attachment 1. In answer to a concern regarding the suggestion that the Legislature designate that one participating member on the board be a school member, Mr. Grant stated that this suggestion might avert the problem of both elected members coming from the school sector.

Senator Gaines questioned whether it would be advisable to appoint only KPERS members to the Board of Trustees as the Governor suggested. Mr. Grant stated that he believed there would be problems because the background of most members does not include expertise in investments.

In answer to Senator Rock's question, Mr. Grant stated that he did not foresee any problems in allowing current members of the Board of Trustees to complete their terms.

The Chairman closed the hearing on SB 526 and directed the Committee's attention to SB 505 - Appropriations for FY93, secretary of state

Secretary of State, Bill Graves, distributed and reviewed Attachment 2. In response to Secretary Graves' testimony, Chairman Bogina stated that the appropriation for the presidential primary was made for FY93 in accordance with the Governor's recommendation.

Senator Harder expressed doubt regarding the financial benefits the state might receive at this late date, and asked what would happen if the state did not fund the primary. Sec. Graves explained that because, by law, there is to be an election on April 7, 1992, the counties will bill the Secretary for expenses caused by the election and will sue when those bills are not paid.

Chairman Bogina noted that he believed the real issue was whether the presidential primary would merit voter turnout.

Senator Salisbury expressed her preference to postpone the primary rather than to give the financial obligation to either the state or the counties.

In answer to Senator Brady's question, Sec. Graves stated that the \$1.5 million cost of the primary was determined from costs submitted by the counties minus some cost-savings techniques. He said that the cost of the 1980 presidential primary was \$1,053,000.

The Chairman submitted written testimony (Attachment 3) from Senator Oleen who was unable to appear before the Committee.

Senator Winter moved, Senator Feleciano seconded, that SB 505 be recommended favorable for passage. The motion carried on a roll call vote.

The Chairman called members' attention to SB 526 and asked Senator Winter for suggestions in response to requests for amendments to the bill.

In accordance with Meredith Williams suggestions (Attachment 4-3), Subsection (5)(b)(1), Senator Winter moved, Senator Kerr seconded, to

conceptually amend SB 526 so that the System would not be in violation if market forces act to arbitrarily increase the value of "alternative" investments above the 10% cap. The motion carried on a voice vote.

As suggested in Subsection (5)(b)(6) of Attachment 4-3, Senator Winter moved, Senator Kerr seconded to conceptually amend SB 526 by exempting the System from the 2.5% alternative investments limitation when participating in multi-investor pools, but provide a 20% cap of money available for alternative investments on such pool investments. The motion carried on a voice vote.

It was moved by Senator Kerr, seconded by Senator Winter, that SB 526 be amended by deleting the words "stop-loss" from line 43, page 15. The motion carried on a voice vote.

There was lengthy discussion regarding errors and omission insurance (Subsection 7 of Attachment 4-4). It was the consensus of the Committee that the amount of coverage provided in SB 526 should not be altered.

Senator Winter moved, Senator Doyen seconded, that technical amendments to SB 526 be allowed. The motion carried on a voice vote.

In answer to a question, staff explained that current statute provides for an investment advisory committee made up of Board members; subsection 6 of section 2 provides for an investment advisory committee made up of non-trustees. Senator Winter moved, Senator Gaines seconded, that SB 526 be amended by striking and repealing the old investment advisory committee in current statute. The motion carried on a voice vote.

It was moved by Senator Kerr, seconded by Senator Winter, that lines 34-37 on page 2 of SB 526 be conceptually amended so as to exempt employment with publicly traded companies that are insulated from the KPERS Board by an investment manager. The motion carried on a voice vote.

Senator Rock expressed concern over reporting the cost or lower market value for individual alternative investments, page 6, Sect. 4, ln 16-19 of SB 526. There was discussion involving the advisability of public disclosure versus the negative impact on investments that public disclosure might cause. Senator Kerr moved, Senator Rock seconded, that SB 526 be conceptually amended to allow aggregate reporting of the cost and the lower of cost or market value for alternative investments through the establishment of a loss reserve, and report on an individual basis when the loss is recognized. The motion failed on a voice vote.

Senator Rock stated that SB 526 will be vetoed, noting what he termed the substance of the bill in Sect. 2 and the politics of the bill in Sect. 1. In order to avoid the Governor's veto, Senator Rock moved, Senator Parrish seconded, that SB 526 be amended by removing Sect 1 and making it a separate bill.

Senator Gaines expressed his objection to the motion, stating that because of the large amount of money involved, there needs to representation from all segments on the Board.

Senator Winter, noting his objection, stated that Sect. 1 is the most fundamental and necessary reform in SB 526 and has nothing to do with politics.

The motion failed on a voice vote.

Senator Gaines moved, Senator Winter seconded, that SB 526 as amended be recommended favorable for passage. The motion carried on a roll call vote.

The Chairman announced that regular Committee time would be reserved for subcommittee work on January 30 and 31 and February 5, 6, and 7, 1992. The meeting was adjourned at 12:30 p.m.





KANSAS NATIONAL EDUCATION ASSOCIATION / 715 W. 10TH STREET / TOPEKA, KANSAS 66612-1686

Craig Grant Testimony Before  
Senate Ways & Means Committee  
Tuesday, January 28, 1992

Thank you, Mr. Chairman. I am Craig Grant and I represent Kansas-NEA. I appreciate this opportunity to visit with the committee about SB 526.

I probably followed the proceedings of the Joint Committee on KPERS Investment Practices as closely as any other organization lobbyist. For those of you who did not serve, I can assure you that these legislators worked extremely hard this past year. The hours were long, the topic was sensitive, yet it was obvious that the legislators were willing to do the job they were assigned--to get as much as possible to the root cause of the KPERS investment problem. I might go so far as to say that if an equal amount of "due diligence" had been exercised by the people charged with the responsibility of handling our retirement moneys as the joint committee exercised, there probably would have been no problem.

But there was a problem. Members of KPERS lost over \$200 million of moneys which could have helped us improve what is some of the lowest benefits in the nation. I know from my calls all last year that my members--and we represent about 24,000 members of the fund plus a number of retired members--were worried and angry about what had happened to "their" retirement money.

Our members wanted something done to guarantee that this situation did not happen again. SB 526 places some logical and reasonable restrictions on investments and also changes the structure of operation. We support these changes.

We don't support the change in the KPERS Board because we are unhappy with the present trustees. On the contrary, we believe there are very good

members on the Board presently who are doing good things. But we must remember that the close scrutiny will eventually fade. We must not relax our guard once again and not keep the proper oversight on the board. Participating members on the board will help insure that the oversight continues.

We would ask that you designate that one participating member on the board be a school member and one a nonschool member. It is fine in subsection (12) of KSA 74-4909 that the board adopt the rules and regulations for the election of members; however, we would appreciate it if you amended KSA 74-4905 (A) (2) to make one member from both systems. I realize that other fund participants would not be eligible, but these two groups comprise the vast majority of participants.

Kansas-NEA supports the changes proposed in SB <sup>526</sup>275. We want the safeguards and the structural changes in statute. Those changes will, hopefully, guarantee that even a slight hint of a warning will not be ignored in the future.

We thank those of you who served on the joint committee for your hard work and would ask that the committee pass SB <sup>526</sup>276 favorably. Thank you for listening to our concerns.

Bill Graves  
Secretary of State



2nd Floor, State Capitol  
Topeka, KS 66612-1594  
(913) 296-2236

## STATE OF KANSAS

### SENATE WAYS AND MEANS COMMITTEE January 29, 1992

#### Testimony of Secretary of State **BILL GRAVES**

Mr. Chairman, Members of the Committee:

The deadline for candidates to file for Kansas' presidential preference primary is two weeks from today. As of this morning, a dozen candidates have filed, with the exception of Bob Kerrey and, unfortunately, Pat Paulsen none are nationally known.

I have every reason to believe that the primary is going forward. I also believe that this body needs to send a clear message of its intent to the people of this state and to every potential candidate. You can do that by recommending the favorable passage of a \$1.5 million appropriations bill to finance the primary.

If we are to have a primary, and it seems that we are, then we want to have a successful primary with every bonafide national candidate represented. The legislature's failure to provide funding has generated uncertainty about the primary's future among voters and candidates alike.

Ironically, it appears that the state is already obligated to pay for this primary. A close reading of the language carried over from the 1980 primary (25-4508 which is attached) clearly directs the state to reimburse counties for their costs. Although I wish I could offer the funding from my FY '93 general fund appropriations, the \$1,479,500 I may get for all agency operations, won't quite pay the bill.

The primary is going forward and the state is clearly obligated to pay for it. I urge you to ensure the success of the primary by recommending favorable, timely, passage of this appropriations measure.

Thank you.

*SWAM  
January 29, 1992  
Attachment 2*

**25-4508.** Payment of election expenses; reimbursement and payment for certain expenses; audit of amounts. Not later than sixty (60) days following a presidential preference primary election held pursuant to this act, the board of county commissioners of each county shall certify to the secretary of state the amount of all necessary direct expenses incurred by the county in conducting the presidential preference primary election. In the event any election is held on the same day as the presidential preference primary election the direct costs solely attributable thereto shall be paid by the county and the subdivision of government responsible therefor shall reimburse the county. Payment for such expenses shall be made to the county treasurer of the county upon warrants of the director of accounts and reports pursuant to vouchers approved by the secretary of state. Upon receipt of such payment and reimbursements, the county treasurer shall deposit the entire amount thereof in the county election fund, if there is one and if there is not then the county general fund.

The secretary of state, with the advice of the director of accounts and reports, shall determine the correctness of each amount certified under this section and adjust any discrepancies discovered before approving vouchers for payment to any county.



LANA OLEEN  
SENATOR, 22ND DISTRICT  
RILEY AND GEARY COUNTIES



TOPEKA

SENATE CHAMBER

COMMITTEE ASSIGNMENTS

CHAIRMAN: GOVERNMENTAL ORGANIZATION  
VICE-CHAIRMAN: CONFIRMATIONS  
LABOR, INDUSTRY AND SMALL  
BUSINESS  
MEMBER: ASSESSMENT AND TAXATION  
ECONOMIC DEVELOPMENT  
JUDICIARY  
LEGISLATIVE EDUCATIONAL PLANNING  
CHILDREN AND YOUTH ADVISORY COMMITTEE  
JOINT COMMITTEE ON ARTS AND  
CULTURAL RESOURCES  
WASTE REDUCTION, RECYCLING COMMISSION

LEGISLATIVE HOTLINE  
1-800-432-3924

Chairman Bogina & Members of the Committee:

There are a number of reasons why I am in opposition to the Presidential Preferential Primary. I have attached a copy of testimony I presented to the Senate Elections Committee for your reference.

For your Committee's consideration, I would note that a departure from funding practices occurs in this bill. The Primary was passed in one session and now wants to be funded out of this year's tight budget.

There has not been a public outcry from the people for return of a primary which last occurred in 1980. The public has had twelve years to demand its return - there has not been a groundswell to do so. A recent WIBW survey last week showed 62% of their "voters" were against spending 1.5 - 1.8 million dollars, with 34% in favor. The hype for support comes from media, who can sell ads; state officials of the Republican and the Democrat party whose jobs would be easier and allow them more power of selection of delegates to their state conventions, and the Secretary of State who is faced with a legislative mandate without funding.

We have a current system in the CAUCUS method which allows registered Republicans, Democrats, and Unaffiliated voters to do the same thing - - - elect delegates to a national convention. That system doesn't cost our state taxpayers.

I urge you to keep those funds available for services and legislative measures in this fiscal year, not break precedence by funding past actions.

Senator Lana Oleen

January 29, 1992

*SWAM*  
*January 29, 1992*  
*Attachment 3*  
STATE CAPITOL, ROOM 143N  
TOPEKA, KANSAS 66612  
(913) 296-7360



LANA OLEEN  
 SENATOR, 22ND DISTRICT  
 RILEY AND GEARY COUNTIES



TOPEKA

SENATE CHAMBER

LEGISLATIVE HOTLINE  
 1-800-432-3924

## COMMITTEE ASSIGNMENTS

CHAIRMAN: GOVERNMENTAL ORGANIZATION  
 VICE-CHAIRMAN: CONFIRMATIONS  
 LABOR, INDUSTRY AND SMALL  
 BUSINESS  
 MEMBER: ASSESSMENT AND TAXATION  
 ECONOMIC DEVELOPMENT  
 JUDICIARY  
 LEGISLATIVE EDUCATIONAL PLANNING  
 CHILDREN AND YOUTH ADVISORY COMMITTEE  
 JOINT COMMITTEE ON ARTS AND  
 CULTURAL RESOURCES  
 WASTE REDUCTION, RECYCLING COMMISSION

Chairman Sallee and Members of the Committee:

Today we revisit the issue of the Presidential Primary. The bill before you today, which has be-partisan sponsorship, postpones the primary until 1996. The enactmnet of this bill would allow the Legislature to revisit and to plan for funding of a presidential primary, if there is public interest and dollars to do it. I oppose the primary on grounds of two major impacts: fiscally and politically.

First, it is deficit spending. The Secretary of States' office contacted each of our 105 counties to see what this special election would cost our tax payers the amount - 1.8 million dollars. We knew the fiscal note last year, and what did we do about it - nothing - it was ignored. By passage of the bill and not the buck, we sent yet another mandate to our counties to pick up the tab at the local level which is primarily funded by property taxes.

Currently, Kansas plans to join 38 other states in holding a primary election. However, 20 of those states hold their primary in conjunction with their regularly scheduled spring primaries, not a special \$1.8 million event. Of the remaining 19 states, one - only one - Kansas - has scheduled a special primary without funding it. The answer? Take it out of next year's budget, after the fact? I think not. The \$1.5 million could better be used for people, not paper ballots. The \$1.5 million could fund all the at-risk student grants currently administered throughout the state; the \$1.5 million could restore funding to the arts which has been recommended to cut from this year's budget.

We set a dangerous precedent of funding one year's actions with the dollars from another year's budget. If we allow this \$1.5 million to slip by, what's next? Do we pass on other mandates to the counties, promising to reimburse them later? I urge you not to let this way of "charging for services occur in Kansas.

Secondly, our form of government has a strong two party system. The caucus system works well for our type of democracy. Any registered voter in the State of Kansas can participate in a caucus. If the voter is Republican, participation and vote at the Republican caucus in resident county. If Democrat, participation and vote is at the Democrat county caucus. If unaffiliated, the person merely declares her/his affiliation at either the Republican or Democratic county caucus.. the participation and voting rights are available.

In the caucus system 10 of the Republican delegates are locally elected; 20 are elected at the state meeting. Those 30 delegates are the Kansas delegation which compose a fractional part of the 2,209 delegates to the national convention. Democrats select 23 individuals at their local caucuses and 19 statewide to join 4, 318 national delegates. Our impact in numbers is not great. A presidential primary - where voters select delegates for candidates - not elect presidential contenders -- occurs 39th in the nation. Our proud presidential primary voice rings after all the large states have had their primaries (which they paid for?) and committed delegates may have already been determined on the Democrat and Republican tickets.

To date we have 10 candidates who have filed for office. I'm certain we will get a few more, but the \$1.5 - \$1.8 million pricetag is not money well spent. I ask, have vast numbers of your constituents called for the Presidential primary? Have they questioned why we haven't had one in 12 years and demanded its return? Have they asked to have the bill sent to their counties to pay?

We have an opportunity today to rethink the issue of spending \$1.5 million on a one-day event which has a viable, proven alternative already in place. I urge your favorable consideration of SB 487.

SENATOR LANA OLEEN

January 22, 1992



# Kansas Public Employees Retirement System

January 28, 1992

Senator August "Gus" Bogina, Jr., P.E., Chairman  
Senate Ways and Means Committee  
Room 120-S, Statehouse  
Topeka, Kansas 66612

Dear Senator Bogina:

I appreciate the opportunity to comment on the provisions of Senate Bill No. 526 as recommended by the Joint Committee on KPERS Investment Practices. Outlined below are my preliminary comments on the proposed legislation. In the days ahead I would hope to provide the Committee with additional information concerning the fiscal ramifications of the legislation.

## Section 1

**Subsection (a)** calls for the expansion of the Board of Trustees from its current seven members to nine. This enlarged Board would have a fiscal impact, although not significant. The election of two Trustees by active and retired members of the Retirement System would also entail some new expenditures. The Retirement System will provide the Committee with a fiscal estimate as soon as possible.

**Subsection (e)** calls for certain members of the Board of Trustees to have experience in one of several specified areas. One of those areas is listed as "investment making." This particular term, which also appears in several later sections, is unclear. Members may wish to consider alternate language, perhaps "investment management."

**Subsections (f) and (g)** both contain restrictions on the investment and employment activities of members and former members of the Board of Trustees. These restrictions may be too broad. Given the wide-ranging Retirement System portfolio, including, over time, substantial portions of publicly traded stock universe, Board membership could be severely limited. The Committee may wish to consider a similar restriction relating to the System's non-publicly traded investments.

## Section 2

**Subsection (6)** calls for the creation of a five-member investment advisory committee. As no provisions are included for compensating or reimbursing the members of this advisory committee, no measurable fiscal impact is anticipated.

## Section 3

**Subsection (3)** establishes a new, higher level of compensation for Trustees. The Retirement System will provide the Committee with a fiscal estimate as soon as possible.

#### **Section 4**

**Subsection (2)** contains new language calling for the Retirement System to prepare its *Annual Report* in accordance with generally accepted accounting principles. This commendable addition should provide great assurance to System members and Kansas citizens that the annual results of the System's operations are fairly and consistently presented.

Additional language in the same subsection calls for the Retirement System to annually report for every individual alternative investment the cost and the lower of cost or market value for each such alternative investment. This additional language raises a significant public policy issue for the Committee's consideration. The requirement that the market value of individual alternative investments be publicly disclosed can come into conflict with the Retirement System's statutory and fiduciary responsibility to maximize the value, income, and safety of the System's assets. The problem with the public disclosure of such information relate solely to those direct placement and real estate investments in the System's current portfolio where the System currently holds the controlling interest in a non-publicly traded investment. I trust that the problem is of a temporary and declining nature as the Board of Trustees has placed a moratorium on future investments of this nature, the direct placement portfolio is being restructured and liquidated to eliminate such controlling interests, and legislation seems likely to prohibit such investments in the future. During this period of adjustment, the Committee may wish to consider language that would allow the Retirement System to report the lower market values on an aggregate basis through the establishment of a loss reserve, reporting on individual investments when the loss is actually recognized and a writedown is charged against the previously established loss reserve.

#### **Section 5**

**Subsection (3)(a)** contains new language stating that employer contribution rates will be based only on the needs of the System. Similiar language is contained in following sections of the proposed legislation. This language is most welcome as it serves to preserve and strengthen the actuarial funding basis of the Retirement System.

#### **Section 6**

**Subsection (11)** calls for the Board of Trustees to develop a plan to manage a portion of the System's assets using Retirement System staff. Such a move will have a fiscal impact and that impact may well be a positive one. As you know, the Board of Trustees has already initiated actions in this arena, beginning with the August hiring of the System's first Investment Officer. The State Finance Council has provided additional resources to facilitate the same goals.

#### **Section 9**

**Subsections (2) and (3)** discuss the investment purposes of the Board of Trustees. Subsection (3) in particular specifies that "economic development" and

"social purposes or objectives" are not sufficient stand-alone investment objectives. The Committee may wish to consider the advisability of adding additional language to cover related situations such as the current prohibition on South Africa related investments.

**Subsection (4)** adds new language containing the prudent expert standard. The Board has already initiated actions to incorporate the prudent expert standard in its contractual relationships with managers and consultants.

**Subsection (5)(a)** increases the common stock limitation to 60 percent of the total book value of the fund. This additional discretionary authority will serve the Retirement System well in future years.

**Subsection (5)(b)(1)** caps the System's total "alternative" investments at ten percent of the total. The System's current size would place this cap at approximately \$440 million. Language is provided to cover the contingency that such investments exceed the cap at the effective date of the cap. However, the Committee may wish to consider additional language to cover the potential contingency where the System is fully invested at the ten percent level in "alternative" investments and market forces act to arbitrarily increase the value of such investments relative to the rest of the System's portfolio.

**Subsection (5)(b)(2)** would require at least two other "sophisticated investors" involvement in any "alternative" investment. The requirement for institutional coinvestors provides additional safeguards against the abuses that have taken place in the past by ensuring that each potential investment is subjected to a minimum of three independent due diligence reviews.

**Subsection (5)(b)(3)** places a 20 percent limit on the System's interest in any one investment. This restriction should ensure that the Retirement System would not have a majority interest in a particular "alternative" investment.

**Subsections (5)(b)(4), (5), (7) and (8)** require that "alternative" investments be preceded by several determinations, all in keeping with the prudent expert standard of care.

**Subsection (5)(b)(6)** restricts the Retirement System from investing more than 2.5 percent of its "alternative" investments in any one "alternative" investment. While this restriction is certainly appropriate to actual individual investments, it may arbitrarily restrict the System's ability to participate in multi-investor pools such as venture capital funds if the restriction is placed on the investment in the pool itself and not on the underlying individual assets of the pool or fund.

**Subsection (5)(b)(8)** also contains language defining "alternative" investments. This is a most important definition given the many confusing definitions in this area. For the Committee's consideration we would also offer this definition provided by Carol Proffer, FSA, Managing Director of William M. Mercer Asset Planning, Inc.: "Alternative investments are defined by what they are not. Alternative Investments are defined as forms of investments not including marketable stocks, bonds, or typical real estate properties; usually involving private equity investing and limited partnerships, and are illiquid." The Mercer firm was recently selected as the Retirement System's investment consultant.

Senator August "Gus" Bogina, Jr., P.E.  
January 28, 1992  
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**Subsection (6)** requires the Board of Trustees to develop specified policies and objectives to govern the System's investment practices. Generally, these requirements seem quite reasonable. However, I would direct the Committee's attention to the language in Subsection (6)(c) concerning the "investment committee." Members may wish to consider whether this should be the "investment advisory committee" referred to in Section 2, Subsection (6) and elsewhere. Additionally, the Committee may wish to revisit the language in Subsection (6)(e) of Section 9 concerning "stop-loss criteria." The Retirement System does not believe that this concept can be practically applied in the "alternative" investment arena due to the illiquid nature of these types of investments.

**Subsection (7)** requires the Retirement System to compensate its investment managers and others subject to legislative appropriations. This provision would only present a problem in the hypothetical instance where appropriations were made on an historical basis and the System was subsequently confronted with market shifts that called for dramatic portfolio restructurings and the resulting unpredictably high levels of brokerage expenses. I expect that this contingency could be effectively addressed through the annual appropriation process.


The same subsection calls for the System's managers and others to obtain errors and omissions coverage in an amount equal to the funds entrusted to the manager. Retirement System staff are currently obtaining cost estimates of the fiscal impact of such a requirement. Likewise, staff will develop a range of cost estimates for the mandated fidelity bond.

Finally, the Retirement System supports the addition of language specifying the principal-agent relationship that has always existed between the Retirement System and its managers and others.

**Subsection (12)** specifies annual audit coverage for the Retirement System. I would only comment on the provision calling for the Retirement System to reimburse the Legislative Division of Post Audit for the expenses associated with the annual financial-compliance audit. Traditionally, that expense has been borne by the State General Fund. This legislation would shift the expense to the Retirement System, increasing the System's administrative costs and reducing the investment earnings available to cover current and future benefit payments.

I again appreciate the opportunity to comment on Senate Bill No. 526. In the event I have overlooked some element of this legislation, please let me know. All of us on the Retirement System staff are available at your convenience.

Sincerely,

  
Meredith Williams  
Executive Secretary

cc: Members, Board of Trustees