Approved February 16, 1988
Date

MINUTES OF THE SENATE COMMITTEE ON WAYS AND MEANS.

The meeting was called to order by SENATOR AUGUST "GUS" BOGINA at
Chairperson

11:10 a.m./~~p.m.~~ on January 22, 1988 in room 123-S of the Capitol.

All members were present except:
Senator Harder was excused

Committee staff present:
Research Department: Scott Rothe, Alan Conroy
Revisor's Office: Norman Furse
Committee Staff: Judy Bromich, Pam Parker

Conferees appearing before the committee:
Marshall Crowther, Executive Director, Kansas Public Employee Retirement System (KPERS)

Mr. Crowther presented an annual overview of KPERS and distributed copies of the 1987 Comprehensive Annual Financial Report. Each Committee member was also provided a copy of the December, 1987 issue of KPERS PAPERS. (Attachment 1) Mr. Crowther reviewed the structure of KPERS, the Board of Trustees, the stock market's "Black Monday", "junk" bonds, the fund allocated to direct investments, the real estate program, the issue of the Kr[illegible] Brothers, employer contribution rates, funding and the determination of rat[illegible] and the impact on benefit changes.

Mr. Crowther made the observation that a situation has arisen with the Board of Trustees of KPERS that has never occurred in the 26 year history of the System. By the end of this year, due to resignations, the Board will have had five positions vacant. One remains vacant at this point.

Mr. Crowther called attention to pages ten and eleven and page sixty-one which contain highlights from the last ten years and information regarding rates of return for the last ten fiscal years. On page sixty-one he defined the accounting rate as the total fund valued at cost until it is sold. To that is added interest and dividends and the net of any realized gains over any realized losses. The accounting rate is utilized by the actuary in its calculations to determine the employers' rates of contribution. The weighted rate of return is taking the market value of the fund at the start of the period and the market value at the end, both of which factor in the contribution additions and reflect the change. This is the market value of the fund.

As to the picture of the KPERS fund at this point in time, Mr. Crowther stated that if we were to have the same rates as of January 1, 1988 for the calendar year rather than the fiscal year, the accounting rate of yield would be around 11.5 percent, about the same rate as has been returned in the previous year. The total fund rate would probably be in the five to six percent positive range. Throughout the entire year KPERS has never been at a point in time where the market value of the fund was less than the cost value. Nothing has happened since October, 1987, the large turndown in the stock market, that has reflected any great change in the monthly totals of realized income. The actuarial analysis of the fund is that it is going to continue on the same course.

Mr. Crowther noted that the rates of contribution have been certified through FY 1990. For several years the completion of the calculation of future rates of contribution has been midway or later in the session. This year they were able to function on a much earlier schedule. The rates that are in effect now for all employers are 3.04 percent of covered payroll for the employer for FY 1989.

Mr. Crowther reminded the Committee that through action last year rates are now combined for all employers. They have asked their actuaries to calculate the rates for FY 1990 using the provisions prior to the merging of the rates. This information will provide a clear understanding of what the rates are and what they would have been had there been no action to merge. As soon as these figures are available they will supply them to the legislature and other interested parties.

Mr. Crowther reported that following investigations by the Public Disclosure Commission and Attorney General's Office the findings were determined that no violations had been made by the Chairman of the Board of Trustees of KPERS a year ago under the ethics and conflicts laws applicable to the Board. For reasons other than this investigation, this person is no longer a member of the Board.

In regard to "junk bonds", Mr. Crowther stated reviewed the process by which investments are made. He stated that one of the new Board members suggested that there seemed to be a school of thought that large portfolios might have some appropriate allocation of a portion of the funds to what are called, "high yield" or "junk bonds". Public attention seemed to make the assumption that a decision had been made and that a large portion of the fund was being moved into some new area of asset allocation. The Board looks at many new ideas and this option was one that seemed appropriate to have the investment consultant suggest some issues and have a couple of firms that do that come in for information. Information in a chart on page sixty-two shows the quality breakdown for the last ten years. This indicates that nothing new was being suggested. The ultimate conclusion was that the expertise that was being utilized still seemed appropriate and it was not timely to make specific allocations, add another manager or anything else. Mr. Crowther stated that the new Board of Trustees has reviewed all of the investment policies and guideline practices of previous Boards and has made no major alterations at this point in time.

In the area of real estate, Mr. Crowther stated that within that portfolio of the KPERS fund, which is managed by a discretionary manager at the present time, is about $135 million. He briefly reviewed the involvement of the Kroh brothers with three real estate investments. One was the Kansas Commerce Center in Lenexa, the second was the Medical Plaza in Topeka and the Ward Parkway Shopping Center in Kansas City. The first two were both investments that, at the time they were made, the Kroh brothers were the general partner of the investments. As a result of negotiations the Kroh brothers relinquished their role as general partner and were retained on a management only contract. The Kroh brothers have been terminated under the terms of the management contract and no longer have any interest in either of those properties. Neither of those properties have been part of any litigation or bankruptcy proceedings. He stated that the Kroh brothers no longer have any ownership or management involvement with the Ward Parkway Shopping Center investment.

Mr. Crowther concluded his remarks by briefly outlining and discussing the issues which may arise during the 1988 Session in regard to KPERS.

The meeting was adjourned.

GUEST LIST

COMMITTEE: SENATE WAYS AND MEANS DATE: 1/22/88

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
Jack Hawn	Topeka	KPERS
Ron Bleidissel	Topeka	KPERS
Marshall Crowther	Lawrence	KPERS
Craig Grant	Topeka	K-NEA
Richard S Funk	"	KASB
Basil Covey	Topeka	KRTA
Linda McGill	"	KSTA
Jeri Reece	"	KSTA
Terry Stevens	"	city of Topeka
Kay Coles	"	K-NEA
Dick Koerth	Topeka	DOB
G A Mosher	"	League of Ks Municipalities
Jan Johnson	Topeka	Budget Division

SWAM 1-22-88

KPERS PAPERS

KPERS PAPERS is published by the Kansas Public Employees Retirement System,
Capitol Tower, 2nd Floor, 400 W. 8th, Topeka, Kansas 66603-3911

December 1987 Topeka, Kansas

BLACK MONDAY . . .

HOW SAFE ARE KPERS BENEFITS?

On Monday, October 19, 1987, the New York Stock Exchange suffered a decline of over 500 points. This has been referred to "Black Monday" and has caused some to ask questions regarding KPERS.

How safe are KPERS benefits? Will benefits be reduced? Will benefits be paid on time? Will the employers and/or employees have to contribute more?

The above are samples of some questions which have been directed to the KPERS office. It may be worth noting that over three times as many questions came from members of the news media as came from members and beneficiaries of KPERS. However, they are all questions which should be addressed.

KPERS is a defined benefit plan. A defined benefit plan means that a formula defines how the benefit is calculated. In the case of KPERS, it is a percent of salary times years of service. The value of the fund or investment performance have no effect whatsoever on the determination of an individual's benefits. The sole test is the amount of service and the level of salary. This differs greatly from a defined contribution plan in which the amount the employer and/or employee contribute and the benefit is determined by the amount of a member's account. Participants in defined contribution plans (unlike participants in KPERS) are directly affected by the investments and earnings of the fund.

At one time, there was a belief that retirement benefits were some type of gratuity and could be changed or stopped for any reason or for no reason at all. The courts have repeatedly held that retirement benefits are now considered a part of every employee's contract of employment. These contractual rights are constitutionally protected and cannot be reduced or stopped. As a matter of law, members of the retirement system would have rights which are enforceable in a court of law should there be any attempt to reduce or stop payment of any benefits.

KPERS pays over $120 million each year in benefits to members and beneficiaries of KPERS members. The employer and employee contributions to KPERS are nearly $200 million annually. Without regard to any money which is already invested, there is positive cash flow into KPERS each year which far exceeds the benefit payment requirements.

The contribution rates for KPERS have already been determined through 1990. Rates are determined each year by the actuary, taking into account all of the experience of the retirement system. This includes investment experience for the entire year and is related only to gains or losses in the situation where securities were actually sold. Large "paper profits", which KPERS system has experienced in past years, have no more effect on the required rates of contribution than any "paper losses" which might result from a present downturn in the stock market.

The KPERS investment portfolio is over $3 billion and is well diversified. The actions of the KPERS Board of Trustees, such as participating in real estate, direct placements, and the international market have proved to be a strategy which has helped them be better positioned to absorb the downturn in the one part of the investment environment. They have carefully avoided "putting all their eggs in one basket" and as a result, while there was a great deal of publicity about loss of value in common stocks, there was very little publicity about increase in value of many of the bonds.

Because of the diversity of the investments in the KPERS fund, this system remains solid. The Board of Trustees met with their investment consultant the week after "Black Monday". The consultant noted that because of the variety of investments in the KPERS fund we were in a much better position than other funds which had heavily concentrated their investments in one or two areas. The fundamentals remain strong; the board is carefully watching the situation and remains committed to the basic investment philosophy which has stood them well in past years and was tested by recent events. Your account and your benefits under KPERS are not changed one penny by any of the activities in the stock market. Whether you are an active or retired member of KPERS, you are assured that the benefit defined for you under KPERS will be paid to you in a timely manner.

Marshall Crowther
Executive Secretary

BOARD INCREASES DISABILITY BENEFITS

At its meeting of October 23, 1987, the Board of Trustees of the Kansas Public Employees Retirement System increased benefits for disabled members. The board received a review of the past year's insurance experience and was able to make the increase effective January 1, 1988.

Effective that date, the disability benefit will be based on 65% of the member's annual rate of compensation at the date of disability. Formerly, the disability benefit was based on 60% of the member's annual salary. In addition, the minimum insured disability benefit was increased from $50 per month to $100 per month also effective January 1, 1988. Both of these enhancements were provided without a corresponding increase in the employer contribution rate for group insurance purposes. The enhancements affect all existing disabilities as well as those that occur in the future.

This insurance program was first established on January 1, 1966, and

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ATTACHMENT 1
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over the years, the board was able to make significant improvements.

This Group Life and Long-Term Disability insurance is provided to all active members and state employees in their year of waiting for membership. Employees of local employers also have coverage in their year of waiting if their employer has elected to affiliate for this coverage. The entire cost of this insurance program is paid by the employers and presently amounts to .6% of covered payroll. The KPERS board is charged with providing the broadest possible coverage with the funds generated through this statutory employer contribution rate.

The life insurance provides for an insured death benefit which is currently 100% of the member's annual rate of compensation. Upon termination of employment or retirement, a member may convert the life insurance to an individual policy. This conversion must be made within 31 days of terminating employment or retirement, whichever occurs first. This individual policy is sold by Security Benefit Life Insurance Company and is not available at group rates. While the cost of this insurance is competitive with other carriers, the primary advantage is that issuance of the policy does not require proof of good health of the former member.

As stated above, the disability income benefits provide a monthly benefit based on 65% of the member's annual rate of compensation effective January 1, 1988. To qualify for a disability benefit, a member must be totally disabled for 180 continuous days. Disability income benefits are subject to reduction for benefits received from primary social security, one-half worker's compensation, or any other employer provided disability benefit. In no event will the disability income benefit be less than $100 after January 1, 1988. Members who qualify for disability income benefits receive continued life insurance coverage, waiver of premium for optional insurance if under age 60, and participating service credit for the period of disability. Withdrawal of contributions from KPERS forfeits entitlement to disability benefits under this insured program. Qualifying members between the ages of 60 and 70 will receive benefits until the earlier: (1) recovery from the disability; (2) retirement; (3) attainment of age 70 (maximum five year benefit). For disability occurring between ages 70 and 75, the maximum benefit period is 12 months and at age 75, benefits are payable for a six month period.

The member's annual rate of compensation for life insurance, or final average salary used for calculation of retirement benefits, will be adjusted based on actuarial salary assumptions in effect during the period of disability if the member was disabled at least five years prior to death or retirement.

During the Fiscal Year ended June 30, 1987, KPERS members and their beneficiaries were paid a total of $11.9 million in death and disability benefits. During the first twenty-two and one-half years of the program's operation, death and disability benefits paid to KPERS members and their beneficiaries have exceeded $89.5 million.

WITHHOLDING FOR FEDERAL INCOME TAX

Annual Benefit *Less* than $7,560

If your annual benefit from the retirement system is less than $7,560, no federal income tax will be withheld unless you choose to have withholding apply by filing a form W-4P, Withholding Certificate for Pension or Annuity Payments, with the retirement system.

Although your KPERS benefit is *NOT* subject to mandatory withholding, your benefit is reportable and may be taxable.

Any election for withholding will be effective on the first of the month provided it is received at least 30 days before that date. You may make or revoke withholding elections at any time. Your request must be in writing and you must include your social security number. The completed forms should be returned to the address below.

Please keep in mind, that since the annual benefit you are receiving is less than $7,560, NO FEDERAL INCOME TAX WITHHOLDING IS REQUIRED UNLESS YOU SPECIFICALLY REQUEST THAT THE WITHHOLDING PROVISIONS APPLY TO YOUR MONTHLY BENEFIT.

Annual Benefit Equal to or Greater Than $7,560

If your annual benefit is at least $7,560, your benefit is subject to *automatic* federal income tax withholding unless you elect not to have withholding apply. This does not mean your benefit is not taxable; it means that you choose *not* to have the retirement system withhold federal income tax for you.

KPERS will send you the necessary election form when your benefit becomes subject to federal income tax.

You may elect not to have withholding by completing and returning the election form sent to you. If you do *not* return this election form, federal income tax will be withheld from your benefit payment as if you were a married individual claiming three withholding allowances.

You may make or revoke elections concerning withholding at any time. Additional election forms may be obtained from the retirement system by contacting us at the address below.

To change your withholding allowances, or change the additional amount being withheld, you may obtain a form W-4P, Withholding Certificate for Pension or Annuity Payments, from the IRS or KPERS. You must include your social security number in your written consent to change your withholding.

*** Your Tax Responsibility**

* Note: Even if you do not have federal income tax withheld, you are liable for payment of federal income tax on the taxable portion of your pension. You also may be subject to tax penalties under the estimated tax payment rules if your payments of estimated tax and withholding, if any, are not adequate.

Mail tax forms to:

Kansas Public Employees Retirement System
ATTN: Post Retirement Unit
Capitol Tower—2nd Floor
400 West 8th St.
Topeka, Kansas 66603-3911

TAXABILITY OF BENEFITS

By law, your benefit is exempt from Kansas state income tax, but for federal income tax, the law is different.

If the effective date of your retirement was on or **BEFORE JULY 1, 1986,** your retirement benefit may be excluded from taxable income until you have received benefits equal to your own contributions made prior to the third quarter, 1984. Contributions made on and after the third quarter of 1984 were not taxed at the time of your employment. Consequently,

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these contributions are not considered in determining when your benefit becomes subject to federal income tax.

If your retirement date was **AFTER JULY 1, 1986,** a portion of your benefit is subject to federal income tax beginning with the first benefit payment you receive. Each payment is made up of two parts: (1) a return of your cost (the tax free part) and (2) a taxable part. The division is based on your cost as calculated using an IRS formula and your expected return (how much you will receive during your lifetime).

KPERS will calculate the taxable amount of your benefit using the formulas and tables provided by the IRS. This information is contained in IRS's Publication 575, Pension and Annuity Income. You will need to contact the IRS to obtain a copy of this publication.

On or before February 1, 1988, you will receive a W-2P form for 1987. This form reports total benefits paid to you in 1987 to the Internal Revenue Service and other relevant information.

Remember, your KPERS contributions beginning with the third quarter of 1984 were not taxed at the time you were employed. Consequently, only contributions made prior to that date are considered in determining the taxability of your benefit. We are required to report to the Internal Revenue Service all benefit payments which may be subject to federal income tax.

Your W-2P form will show the total benefits paid to you in 1987. *Since your December warrant is mailed in December, it is considered part of your total 1987 benefits.* If you were eligible to receive the 2% raise in July, 1987, you received six checks at the old rate and seven checks at the new rate. The additional payment is the retirant dividend payment (... Check). Your W-2P will also show the total benefits you have received since you retired. We recommend you consult a reputable tax consultant or the IRS in the preparation of your tax forms, especially during your early retirement years. You may also find IRS Publication 554, "Tax Benefits for Older Americans", Publication 575, "Pension and Annuity Income" and Publication 505, "Tax Withholding and Estimated Tax" helpful in determining the taxability of your pension. These publications are available from the IRS.

This article is not intended to supply legal advice or to offer solutions to individual tax problems. For specific questions regarding the taxability of your benefits, you should contact the Internal Revenue Service (IRS) or a qualified tax consultant.

SHOULD I WITHDRAW?

When members of the Kansas Public Employees Retirement System terminate employment from a covered position, contributions plus interest may be withdrawn. The decision whether or not to withdraw is an important one because withdrawal forfeits all rights and privileges that may have accrued as a member.

Vested Benefits

What does it mean to have vested benefits? Vesting means that you have been credited with the minimum amount of service under the retirement system so that should you leave covered employment, the benefits you have accrued are protected. So long as you leave your contributions on deposit, they will continue to earn interest. When you reach retirement age, you may make application to receive a monthly retirement benefit based upon this past period of employment. The service requirements for vesting varies among the different retirement systems administered by KPERS. Under KPERS and Judges, vesting accrues after ten years of credited service, while in the KP&F system it requires 20 years before a member is vested.

You may withdraw your contributions at any time after you terminate your position. You could repurchase this service upon again attaining membership in KPERS, but it would probably cost you more than the original amount that was withdrawn as your salary would no doubt be greater.

Withdrawal

Even if your benefit is not vested, there are other things you should consider before submitting a withdrawal application as a reason for your termination could have a bearing on the length of time your membership is protected under the KPERS program.

(1) Leave of Absence—The retirement system recognizes a leave of absence for not to exceed one year. While on a leave of absence, you are considered to be in the status of employment and may not make application to withdraw. Should the leave expire, or you resign without returning to covered employment, your membership is protected for five years, and you will continue to receive interest on your contributions. You must resign from your leave before you submit an application to withdraw.

(2) Involuntary Leave of Absence—The retirement system recognizes an involuntary leave of absence for up to 92 days. This is primarily used by school employers for their cooks, custodians, and secretarial workers who are off during the summer months. While on an involuntary leave of absence, you are considered to be in the status of employment and are covered by life insurance and disability coverage. Until you resign, or the involuntary leave expires, you may not make application to withdraw. If you do not return from the involuntary leave, or resign, your membership is protected for five years, and you will continue to receive interest on your contributions.

(3) Military Service—If the reason you left employment was to enter the military service, your membership is protected for the period you are in military service, so long as your contributions remain on deposit. Your contributions will continue to earn interest. If you return to a covered retirement position within one year of your discharge or separation, you could receive up to five years of military credit at no cost.

(4) Disability—If you left employment because of a health condition or disability, your membership is protected throughout the period of disability so long as you do not withdraw your contributions. This would apply even if you did not qualify for disability under the KPERS disability program, i.e., alcoholism, self-inflicted disabilities, etc.

(5) Resignation or Dismissal—Members who simply resign or are dismissed have their membership protected for five years if contributions are not withdrawn. Interest will continue to be credited and should the member be employed in a covered position within that five year period, retirement coverage would be immediate. If the individual does not return to covered employment and does not withdraw, the retirement statutes provide that their contributions will revert to the employer's reserve at the end of

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the five year protection of membership; however, a special application can be made to withdraw the contributions, but must be directed to the KPERS Board of Trustees.

If you have not vested, but are within five years of normal retirement, you could leave your contributions on deposit and draw a monthly benefit upon reaching that normal retirement age. Normal retirement under KPERS and Judges is age 65 and under KP&F is 55.

Interest

Interest is credited annually on June 30 based upon accumulated contributions through December 31 of the previous year. If your application is received in the KPERS office on June 29, you would not be entitled to interest even though the application may not be finalized until some time later. Receipt of your application in the KPERS office constitutes irrevocable withdrawal and you would have been considered a withdrawn member one day before the interest crediting date.

As you can see, your membership under the retirement system is protected for various lengths of time depending on your reason for leaving employment and whether or not you are vested. You should consider these matters before hastily making application to withdraw your contributions. If you do decide to withdraw, do so with the understanding that you are forfeiting all the rights and benefits that you have accrued under the retirement system.

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM
Statement of Operations

2 months ended 8/31/87

Account Description	Account Balance	Totals
Revenues		
Contributions		
Member Contributions	$ 3,017,011.19–	
Employer Contributions	1,227,627.10–	
Unallocated Contributions	18,819,186.92	
Optional Life Insurance	123,986.63	
System Recoveries	17,434.15	
Total Contributions		$14,715,969.41
Investments		
Misc Interest Income-Transfers	182,885.43	
Temporary Investment Income	3,365,143.80	
Dividends	3,829,065.27	
Interest: Net of Amortization	17,660,216.40	
International Equities Income	394,450.25	
Rental Income	1,045,830.87	
Gain/(Loss); Sale of Security	26,305,698.30	
Manager/Custodial Fees & Expenses	1,391,421.33–	
Net Income of the Fund		$51,391,868.99
Total Revenues		$66,107,838.40
Expenses		
Withdrawal of Contributions	2,217,048.75–	
Paid to Beneficiary of Deceased Members	539,369.66–	
Retirement Benefits	19,257,794.30–	
Paid to Beneficiary of Deceased Retirants	488,101.40–	
Group Life Insurance Premiums	1,531,988.37–	
Optional Life Insurance Premiums	271,376.18–	
Current Year Administration	427,140.41–	
Deposited with Insurance Carrier	1,400,000.00–	
Other Payments—Insurance Carrier	4,056.62–	
Total Expenses		$26,136,875.69–
Revenues in Excess of Expenses		$39,970,962.71