Approved March 2, 1989
Date

MINUTES OF THE HOUSE COMMITTEE ON PENSIONS, INVESTMENT AND BENEFITS.

The meeting was called to order by Representative Vernon L. Williams at
Chairperson

9:10 a.m./p.m. on January 26, 1989 in room 313-S of the Capitol.

All members were present except:

Representative Dorothy Flottman (Excused)

Committee staff present:

Alan Conroy, Legislative Research Department
Richard Ryan, Legislative Research Department
Gordon Self, Revisor of Statutes Office
Nedra Spingler, Secretary Pro Tem

Conferees appearing before the committee:

John P. Mackin,, Ph.D., Sr. Vice President, Martin E. Segal Company, New York

The Chairman introduced John P. Mackin, representing Martin E. Segal Company, consultants and actuaries to the Kansas Public Employees Retirement System (KPERS), who presented a statement (Attachment No. 1) regarding the three Kansas retirements systems administered by KPERS - Kansas Public Employees Retirement System, Kansas Police and Firemen's Retirement System (KP&F), and Kansas Retirement System for Judges which cover 152,000 individuals. He listed the purposes and objectives of the three systems and noted that the Kansas system has been doing an impressive job in total benefits paid which have tripled in the last ten years. Dr. Mackin said the Legislature should periodically evaluate the State's retirement objectives, and it needs a set of policy guidelines to evaluate the reasonableness and long-term implications of proposed changes in the system.

In reviewing the state's basic retirement formulas, Dr. Mackin called attention to the sizeable increase in retirement benefits for the 35th year of service (page 8 of statement) with 10 - 34 years service receiving 47.6% of final average salary, and with 35 years, 52.5% of final average salary. This formula would not be allowed by the federal government or in the private sector.

Dr. Mackin noted the disadvantages of the one-time, ad hoc post-retirement increase where only present conditions are considered and pointed out the present favorable KPERS investment experience cannot be anticipated in the future.

In additional comments, Dr. Mackin said the Kansas retirement system has been meeting broad objectives, but questioned if the present higher employer contribution rate versus the lower employee rate should be continued. He said the disability pay plan met needs for most of the system, but the KP&F disability provisions were inadequate and should be considered during an interim study. He suggested the KP&F vesting period be reduced from 20 to 10 years.

Dr. Mackin pointed out the discrepancy in action taken by the 1987 Legislature for the Board of Regents faculty members to raise the state's contribution from 7% to 8%. Dr. Mackin also pointed out the discrepancy in action taken by the 1988 Legislature for certain state appointed officials, including cabinet level officers by allowing the group to be non-KPERS and non-contributing members with an employer contribution rate of 8 percent. At the same time, the employer contribution rate in KPERS went down to 3%.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON PENSIONS, INVESTMENTS AND BENEFITS,

room 313-S, Statehouse, at 9:10 a.m./p.m. on January 26, 1989

In regard to the 2% of final average salary retirement benefit for legislators' retirement also enacted in 1988, he expressed surprise that this caused so much concern, noting that this and Kansas legislative salaries are modest compared with other states. He believed the concern arose from the manner in which the legislation was enacted. He suggested the Legislature wait for a couple of sessions to determine the KPERS cost before enacting legislation that would modify the special class for legislators.

In response to questions regarding special one-time, ad hoc post-retirement increases for older employees, Dr. Mackin said there would be special occasions such as those increases needed to meet costs resulting from federal catastrophic insurance. However, he suggested the Legislature consider in the future the granting of a post-retirement increase to current active employees through a graduated, automatic increase. If a precedent is set with a one-time increase, an increase will be requested every year. He pointed out that legislators do not know what amount retirees on "fixed income" receive in Social Security, and Social Security is automatically raised with the rise of the consumer price index.

A member questioned if a 20-year retirement eligibility which some other states have is better than Kansas' 30-year, 38-41% of final average salary provision. Dr. Mackin said there is nothing magic about 30 years, that this could be lowered to 20 years with a change in percentage in final average salary. Most states have a 1.4% of final average salary formula with an employee non-contributing plan which allows more take home pay.

In response to a question regarding a cost of living increase for retired employees, Dr. Mackin said 32 states have some type of automatic adjustment provision not to exceed 3% a year based on the consumer price index. It is applied across the board to all retirees. He cautioned that a one-time increase does not cost much but will get more expensive with more retirees which might require supplemental funds from the budget if KPERS investment experience is not favorable.

In regard to the increased life expectancy and if the Legislature should consider this when enacting pension laws, Dr. Mackin said, based on actuary experience, life expectancy is healthy in Kansas which might affect long-term retirement funds.

In response to a question concerning the establishment of an advisory commission on pensions and benefits, Dr. Mackin believed creating a separate entity that spends all its time studying retirement was a debatable expenditure of funds. By asking people to give their views through interim studies, legislators get the same views a commission would give. He stated if a commission is created to handle a big, specific issue, then after which it should be dissolved, that might serve a useful purpose.

The Chairman stated nine proposals outlined in Attachment No. 2 and several others would be drafted as bills for introduction purposes only. Representative Long moved that all proposals the Chairman was requesting be drafted and introduced, seconded by Representative Shallenburger. Motion carried.

The meeting was adjourned at 10:20 a.m.

Vernon L. Williams

Representative Vernon L. Williams
Chairman

House Pensions, Investments & Benefits Committee
January 26, 1989

Please PRINT Name, Address, the organization you represent, and the Number of the Bill in which you are interested. Thank you.

NAME	ADDRESS	ORGANIZATION	BILL NO.
HAROLD PITTS	TopekA	KCOA	
Basil Covey	Topeka	KRTA	
Glenn O Burnette	Topeka	KRTA	
Jack Hawn	Topeka	KPERS	
Marshall Crowther	Lawrence	KPERS	
John Mackin	New York	Segals	
Kay Coles	Topeka	K-NEA	
Bill Curtis	Topeka	KASB	
TED D AYRES	TOPEKA	KANSAS BD OF REGENTS	
Nancy Echols	Topeka	SRS	
Jerry Sloan	"	OJA	
Matt Truell	Topeka	AP	
Craig Grant	Topeka	K-NEA	

KANSAS RETIREMENT SYSTEMS - OVERVIEW OF
PURPOSES, OBJECTIVES AND PRESENT PROVISIONS

Comments prepared for discussion by:
John P. Mackin, Ph.D.
Senior Vice President
Martin E. Segal Company
Consultants and Actuaries to KPERS
January, 1989

The three retirement systems administered by KPERS - Kansas Public Employees Retirement System (KPERS), Kansas Police and Firemen's Retirement System (KP&F), and Kansas Retirement System for Judges - cover substantially all public employees in Kansas. All three systems are contributory defined benefit retirement plans, administered and funded in accordance with the provisions of Kansas Statutes.

As of June 30, 1988, the three Kansas Retirement Systems had a total membership of approximately 152,300 individuals (116,100 active and inactive members, and 36,200 retirants), more than 1,100 participating employers, and total assets of almost $3.2 billion. KPERS is by far the largest system, with 96% of the total membership and 88% of the total assets of the three systems combined.

Actuarial valuations of Kansas Retirement Systems are prepared annually to determine the employer contribution rates required to fund the systems in accordance with the statutory actuarial reserve funding provisions. The most recent actuarial valuations as of January 1, 1988 included a total of almost 144,500 members:

	KPERS*	KP&F	Judges	Total
Active Employees	93,919	4,312	158	98,389
Inactive Members	10,374	69	5	10,448
Retirees and Beneficiaries	34,077	1,503	69	35,649
Total Membership	138,370	5,884	232	144,486

* Includes KPERS-TIAA members.

House Pensions, Investments + Benefits Comm.
1-29-89
Attachment 1

The number and average characteristics of active employees included in the 1988 actuarial valuations are shown below:

	KPERS*	KP&F	Judges
Number of active employees	93,379	4,312	158
Average age	42	36	52
Average years of service	10	10	10
Average entry age	32	26	42
Average annual salary	$ 22,157	$27,130	$55,478
Total payroll (millions)	$2,069.0	$ 117.0	$ 8.8

* Excludes KPERS-TIAA members.

Purposes and Objectives

The fundamental objective of Kansas Retirement Systems is to provide covered employees with a measure of economic security in retirement. If the extent to which this objective has been met is measured by total benefit payments, Kansas Retirement Systems have been doing an impressive job. Total retirement benefits have tripled during the past decade, rising from about $43 million in fiscal 1979 to $129 million in fiscal 1988.

Other important purposes and objectives of Kansas Retirement Systems include: (1) provide a tax-efficient means for meeting economic needs in retirement; (2) establish an orderly institutional arrangement for preventing the public service from having a disproportionate number of aged employees; (3) assist in the recruitment and retention of competent and qualified public employees; (4) reward public employees for a career of public service; and (5) provide a financial incentive for certain employees to retire so as to maintain efficiency and upward mobility in the public service. In the case of KP&F, the retirement system also is intended to assist in achieving other personnel objectives, including the maintenance of a relatively young and physically capable force of law enforcement officers and firefighters.

The general purposes and objectives of Kansas Retirement Systems should be examined and evaluated periodically, to determine the extent to which the present provisions accomplish the intended objectives within the applicable cost constraints. The separate provisions of each of the three systems should work together in an integrated way to assist in accomplishing the intended objectives. Benefit and financing provisions should reflect long-term rather than short-term objectives.

An evaluation of objectives needs to take account of the differing viewpoints and interests of the various parties involved (including covered employees and retirees, participating public employers, representatives of particular groups of covered employees and retirees, legislators and elected officials, the board of trustees, and all Kansas taxpayers). Wide variance in viewpoints may emerge from an evaluation of almost any major retirement issue, such as the adequacy of KPERS benefits or the appropriate role of KP&F in helping to maintain a young and vigorous force of law enforcement officers. Retirement legislation is an area in which the intense and constant interests of a particular group often contend with the more diffuse interests of broader groups or of the public generally.

There is a need for a coherent and rational overall retirement policy - a framework or set of public policy guidelines that the Kansas Legislature can use to evaluate the reasonableness and long-term implications of proposed changes to Kansas Retirement Systems. The lack of such an overall retirement policy (along with other factors) may contribute to the politicization of Kansas Retirement Systems, because the Legislature will not have a set of basic objectives or principles to refer to when it considers proposed retirement legislation.

A coherent and rational retirement policy does not necessarily mean uniformity. It does mean, however, that differences in the provisions of Kansas Retirement Systems - KPERS, KP&F and Judges - are not arbitrary but are capable of being explained and justified. Each system should comprise a rational structure designed to meet the intended objectives within the applicable cost constraints. A coherent retirement policy is also important over time. Although legislative sessions will undoubtedly reflect different values, an overall policy that incorporates the knowledge and understanding accumulated in the past can at least serve as a guide or starting point for considering proposed retirement legislation.

The Kansas Legislature is faced with numerous retirement bills, and with the expressed desires and dissatisfactions of individual members and groups of covered employees and retirees. Retirement bills can be difficult to deal with because each Retirement Act comprises a complex and technical statute with interrelated provisions. At times, a proposed retirement bill that seems to have a relatively minor effect is actually more far-reaching than is apparent, either because it creates a precedent for other groups of employees or because the ultimate consequences of the bill are not readily understood. In some instances, adequate consideration is not given to the long-term cost and other implications of proposed retirement bills.

The Kansas Legislature has considered and evaluated major questions of retirement policy, both during regular sessions and in interim retirement studies. To a certain extent, an implied overall retirement policy is reflected in the present provisions of Kansas Retirement Systems.

Objectives Reflected in Present Provisions

What are the basic objectives of Kansas Retirement Systems? Do the present provisions generally accomplish the intended objectives within the prevailing cost constraints?

KPERS Benefit Formula. The basic objective of KPERS is to provide a typical career employee who retires at the normal retirement age with combined retirement benefits (KPERS plus Social Security) that approximate full continuance of net income before retirement. Does the present KPERS benefit formula produce retirement benefits that generally meet this widely accepted goal or standard?

The acceptance of full continuance of net income as a goal for a typical career employee inevitably leads to other questions. How do you measure net income? What period of service represents a full career? How do you treat employee contributions, personal savings, and retiree health benefit costs? What assumptions do you make to compute Social Security replacement ratios? Do you evaluate benefit adequacy for a career employee who retires at age 65 or at age 62?

In 1981, the President's Commission on Pension Policy provided information regarding levels of total retirement income needed to maintain preretirement disposable or net income. Although preretirement net income is difficult to quantify precisely, the Commission's report indicated that full replacement ratios for a single employee range from 75%-85% for lower salary levels, 60%-70% for middle salary levels, and 45%-55% for higher salary levels. Based on the Commission's report and the findings of more recent studies, a replacement ratio of roughly 70%-75% of gross preretirement income would be required to fully maintain the preretirement standard of living of a typical KPERS career employee.

Social Security benefits replace a higher percentage of income for lower-paid than for higher-paid employees. This weighting of the benefit formula in favor of the lower-paid reflects the "social objectives" of the Social Security system. For a career employee who retires at age 65, current Social Security replacement ratios as a percentage of final salary are about 40% for an employee with a $20,000 final salary, 33% at $30,000, 26% at $40,000, and 22% at $50,000. (The current age 62 Social Security replacement ratios are about 32% for a $20,000 final salary, 26% at $30,000, 21% at $40,000, and 18% at $50,000.) If the Social Security replacement ratio for a typical KPERS career employee who retires at age 65 approximates 30%-35%, a KPERS benefit of about 40% of final salary would produce combined retirement benefits that meet the objective of full continuance of preretirement net income.

In general, the current KPERS benefit formula meets the objective of providing a typical career employee with combined benefits that approximate full continuance of preretirement net income. Certain KPERS members (for example, those with relatively low salaries and long periods of service who retire at or after age 65) will receive combined benefits that exceed 100% of preretirement net income, but this is primarily due to the weighting of the Social Security benefit formula in favor of employees with lower salaries.

KPERS retirement benefits are based on the member's final average salary (FAS = average of highest 4 years), and years of prior and participating service. The formula for normal retirement benefits is currently:

> For prior service - 1% FAS per year.
>
> For participating service - 1.25% FAS per year to July 1, 1982 plus 1.4% FAS per year after June 30, 1982; with 10 or more years of participating service, 1.4% FAS for all years of participating service; with 35 or more years of total credited service, 1.5% FAS for all years of participating service.

As a percentage of final average salary, the KPERS benefit for each year of participating service is higher than the benefit for each year of prior service. The difference in benefit percentages recognizes several factors, including the fact that employees have contributed 4% of salary to KPERS during years of participating service. For career employees retiring this year, the KPERS benefit as a percentage of final average salary will vary depending on the portion of total service represented by participating service.

KPERS normal retirement benefits as a percentage of final average salary are illustrated below for State employees and School employees who retire in 1989 with 30 and 35 years of continuous service.

Years of Service: Prior	Years of Service: Participating	Years of Service: Total	KPERS Benefit (% of FAS)	Average KPERS Benefit per Year of Service (% of FAS)
		STATE EMPLOYEE		
3	27	30	40.8%	1.36%
8	27	35	48.5%	1.39%
		SCHOOL EMPLOYEE		
12	18	30	37.2%	1.24%
17	18	35	44.0%	1.26%

Note: State employees can have 30 years of participating service beginning in 1992 and 35 years beginning in 1997. School employees can have 30 years of participating service beginning in 2001 and 35 years beginning in 2006.

For a career employee with 30 or 35 years of service, the KPERS benefit as a percentage of final average salary is currently higher for State employees than for School employees (because participating service is for years after 1961 for State employees and for years after 1970 for School employees). Nevertheless, during the past five fiscal years the average monthly benefit for new KPERS School retirees has consistently been higher than for new KPERS Non-School retirees (which reflects differences in average salary levels and average periods of service).

Fiscal Year Ended June 30	Average Monthly Benefit For New Retirees: KPERS Non-School	Average Monthly Benefit For New Retirees: KPERS School
1984	$306	$345
1985	309	407
1986	334	384
1987	381	422
1988	533	626

Looking to the future, when many KPERS members will be retiring with participating service credit for all years of service, the KPERS benefit is expected to continue to meet the combined benefit goal for a typical 30-year career employee. When all service is participating service, the KPERS benefit will be 42% of final average salary for a 30-year employee (and 52.5% for a 35-year employee). Recent changes in Social Security and lower federal income tax rates require a slightly higher level of KPERS retirement benefits to meet the objective of full continuance of preretirement net income. Moreover, KPERS members who retire in the future with participating service credit for all years of service will have also contributed to KPERS for all years of service.

The current KPERS benefit formula produces a sizeable increase in the normal retirement benefit for the 35th year of service, and the benefit for the 35th year of service will be even higher in the future. Consider, for example, two KPERS members who retire in the future with 35 and 34 years of participating service credit. The normal retirement benefit for the 35-year member is 52.5% of final average salary and the benefit for the 34-year member is 47.6% of final average salary. In other words, the current formula will ultimately provide a benefit of 4.9% of final average salary for the 35th year of service.

Is it good public policy and good benefit design to provide a relatively much larger benefit for a particular year of service? Should that particular year of service be the 35th year, the 30th year, or the 25th year? Should the present benefit formula be modified to reduce the "benefit jump" for the 35th year of service?

If the intended objective is to recognize long service and avoid a sizeable benefit jump for a particular year of service, the KPERS formula for participating service could be modified to produce a benefit that increases more gradually with years of service. An example of such a formula is: 1.4% FAS for each of the first 10 years of participating service, plus 1.5% FAS for each year over 10 up to 20, plus 1.6% FAS for each year over 20. Under this formula, the benefit as a percentage of final average salary for KPERS members with all years of participating service would be 45.0% for a 30-year member, 51.4% for a 34-year member and 53.0% for a 35-year member.

Proposals have been made to increase the KPERS benefit formula to 2% of final average salary for each year of service. Proponents of such an amendment may not realize that a 2% formula would produce combined retirement benefits for a typical KPERS career employee that substantially exceed preretirement net income. Or they may disagree with the widely accepted standard that a career employee's combined retirement benefits should not exceed preretirement net income. Although many reasons can be advanced to support this widely accepted standard, the essential reason is: there is no rational justification for providing a person who retires and stops working with a higher net income than he or she ever received as a full-time employee.

<u>KPERS Eligibility Requirements</u>. Eligibility requirements for normal and early retirement benefits are an important determinant of the long-term actuarial cost of KPERS. In addition, eligibility requirements may also affect personnel and retention policies, productivity, the need for and cost of periodic post-retirement benefit increases, the cost of retiree health care benefits, and other aspects of total compensation costs.

Retirement patterns are influenced by numerous factors, including: KPERS benefits and eligibility requirements, anticipated changes in KPERS provisions, early retirement incentives, recent and expected rates of inflation and salary increases, economic conditions in Kansas, and Social Security benefits and eligibility requirements.

The present eligibility requirements for KPERS members are as follows:

> Normal retirement - Age 65. From July 1, 1986 to July 1, 1989, requirements for full benefits are (a) age 65, or (b) age 60 and 35 years of service, or (c) any age and 40 years of service.
>
> Early retirement - Age 55 and 10 years of service. Effective August 1, 1989, normal retirement benefit is reduced 0.2% per month under age 65 to age 60, plus 0.6% per month under age 60 to age 55.

Social Security currently provides full benefits at age 65 and reduced benefits beginning at age 62. For a person who starts to receive Social Security benefits before age 65, the reduction is 5/9% - or 0.555% - for each month under age 65 (i.e., the reduction is approximately 6.7% at age 64, 13.3% at age 63, and 20.0% at age 62).

In part because age 62 is the earliest age at which reduced Social Security benefits are payable, a relatively small percentage of KPERS members retire before age 62. During calendar year 1987, for example, 370 or approximately 16% of the 2,350 KPERS members who retired were under age 62. Although only 16% of the 1987 KPERS retirees were under age 62, almost 53% (1,237 of the 2,350) were under age 65 at retirement.

The percentage of pre-65 KPERS retirees may increase slightly as a result of such factors as the temporary 60/35 and any/40 requirements for normal retirement, as well as the new 55/10 requirements for early retirement and the smaller reduction for early retirements between ages 60 and 65 beginning August 1, 1989. Although the percentage of pre-65 KPERS retirees may eventually decrease, that percentage is likely to remain relatively stable for at least the next decade.

In 1983 the Social Security Act was amended to provide that the age at which unreduced benefits are payable will eventually be raised to 67. The increase in the Social Security "normal retirement age" will be phased in gradually, and does not affect persons born in 1937 or earlier. Early retirement with reduced benefits will still be permitted at age 62, but the percentage reduction for early retirement will increase gradually beginning in the year 2000. In the year 2022 or later, when the normal retirement age is 67, an individual who retires at 64 will receive 80% of the full benefit and an individual who retires at 62 will receive 70% (rather than the 80% currently provided for an age 62 retirant).

To encourage employees to delay retirement after the normal retirement age, the 1983 Social Security Amendments also increased the credit or bonus for delayed retirement. The late retirement bonus, which is currently 3% per year after 65 to age 70, will increase gradually beginning in 1990 and reach 8% per year in 2009. Persons born in 1943 or later will receive an 8% bonus for each year of delayed retirement (i.e., for each year after the then-existing normal retirement age to age 70).

Even though the Social Security normal retirement age will gradually be raised from 65 to 67 during the period from 2000 to 2022, the 1989 Kansas Legislature may decide to consider the long-term cost and other implications of reducing the KPERS normal retirement age. If finances permit, legislation could be considered to reduce the KPERS normal retirement age from 65 to 62. Such legislation could also provide that the reduction for early retirement under KPERS will be computed from age 62 rather than from age 65. For KPERS members who retire at age 62, reduced Social Security benefits are available to help meet economic needs in retirement.

<u>KP&F</u>. An important objective of KP&F is to assist in maintaining a relatively young and physically more capable force of law enforcement officers and firefighters. One indication that this objective is being met is that the average retirement age of KP&F members is approximately age 55.

The present retirement benefit provisions of KP&F are as follows:

> Normal retirement benefit - 2% of member's final average salary (FAS = average of highest 3 in last 5 years) for each year of service, up to a maximum of 70% FAS.
>
> Normal retirement eligibility - age 55 and 20 years of service.
>
> Early retirement - age 50 and 20 years of service. Normal retirement benefit is reduced 0.4% per month under age 55.

Does the Legislature view the present KP&F provisions as serving the general public interest? Does Kansas want law enforcement officers and firefighters to remain on the force after age 55? Would the public's need for efficient law enforcement and fire protection services be met as effectively if the normal retirement age for KP&F members was higher than age 55?

Law enforcement officers and firefighters are usually covered by more liberal retirement plans than other groups of public employees. The special early retirement provisions for policemen and firemen are the result of a long historical development, which reflects numerous factors including the objective of keeping public safety forces youthful by providing full retirement benefits at comparatively early ages.

Proponents of earlier retirement for public safety employees contend that such provisions are desirable for various reasons, including:

- The ability to perform vital law enforcement and firefighting services would be severely hampered by an older workforce.

- Special retirement provisions are important for recruiting and retaining public safety employees, and help to maintain a high level of employee morale.

- Because criminals are becoming increasingly younger and more aggressive, it is necessary to maintain a young and vigorous force of law enforcement personnel.

- Public safety employees are subjected to protracted periods of physical and emotional stress, as well as the more readily recognized exposure to physical violence and danger. Law enforcement officers and firefighters accept employment understanding that the stresses and hazards of their jobs will be compensated for by special early retirement benefits.

- Other forms of compensation, such as additional pay, will not reduce retirement ages and result in a young and vigorous workforce.

- For both the welfare of law enforcement officers and firefighters, and the safety of the public which counts on their ability to perform their duties, it is in the public interest to have such employees retire before vigor and physical ability begin to ebb.

- Because special early retirement plans for law enforcement and firefighter personnel are prevalent in State and municipal governments, the elimination of such provisions could have a significant adverse effect on recruitment and retention.

The present provisions of KP&F also recognize that:

- KP&F members contribute 7% of salary (compared to the 4% employee contribution rate for KPERS members).
- KP&F members have an average entry age of approximately 26 (compared to average entry ages of 32 for KPERS members and 42 for Judges).
- Approximately 64% of the 4,312 employees covered by KP&F as of January 1, 1988 were not also covered by Social Security as public employees.

The 2% formula and age 55 provisions of KP&F work together to assist in accomplishing the intended objectives. The experience of correctional officers indicates that, by itself, an age 55 normal retirement age may have a minor effect on retirement patterns. Since 1982, when the normal retirement age for correctional officers was reduced to age 55, the average retirement age of correctional officers has decreased by only about one year - from 63 to 62. Although the normal retirement age is 55 for both KP&F members and correctional officers, the average retirement age of KP&F members is substantially lower than the average retirement age of correctional officers, in part because the retirement benefits provided under KP&F are higher than those provided under KPERS.

Judges. The present retirement benefit provisions of the Kansas Retirement System for Judges are:

Normal retirement benefit - For judges who become members on or after July 1, 1987, 3-1/3% of final average salary (FAS = average of highest 4 in last 10 years) for each year of service, up to a maximum of 65% FAS. For judges who became members before July 1, 1987, 5% FAS for each year of service up to 10 years, plus 3-1/3% FAS for each year in excess of 10 years, up to a maximum of 65% FAS.

Normal retirement eligibility - Age 65.

Early retirement - Age 62 and 10 years of service. Normal retirement benefit is reduced 0.3% per month under age 65.

Under present provisions, judges who became members before July 1, 1987 reach the maximum benefit of 65% FAS after approximately 14-1/2 years of judicial service, and new judges who first become members on or after July 1, 1987 reach the maximum benefit of 65% FAS after 19-1/2 years of judicial service.

The retirement benefits provided for members of the Judges System are substantially higher than the benefits provided for members of KPERS or KP&F. The higher benefit formula for judges recognizes that, on the average, judges enter service at later ages and retire with fewer years of credited service than members of KPERS or KP&F. The provisions of the Judges System also reflect historical developments and the levels of retirement benefits typically provided for judges in other states.

Post-Retirement Benefit Increases

Benefit adequacy cannot be judged solely by the level of income replacement at the point of retirement. One needs to consider both the initial benefit at the time of retirement and the benefit payable some years after retirement. The adequacy of the initial benefit measured in terms of purchasing power will be eroded rapidly if it is not adjusted after retirement to reflect rising prices.

The need for post-retirement benefit increases is obvious, particularly in years of high inflation. At the same time, it needs to be recognized that post-retirement benefit increases are as costly as they are desirable.

Retired persons who are receiving Social Security benefits have a portion of their retirement income fully indexed to rising prices. As a result, the purchasing power of total retirement benefits is affected not only by the relationship between inflation and the percentage increases in state retirement system benefits, but also by the portion of total benefits represented by Social Security benefits. For most retired public employees, fully-indexed Social Security benefits increase over time as a percentage of total retirement benefits, because the benefits payable from the state system are generally increased by less than the rate of inflation.

State retirement systems have used a variety of methods to adjust benefits after retirement. The two basic methods are (1) ad hoc or one-time upward adjustment of benefits, and (2) automatic benefit increases based on a specific plan or formula.

A majority of state retirement systems have some type of automatic adjustment plan, and in most of these the maximum annual benefit increase is limited to 3% or 4% per year. The ad hoc approach is followed by 18 states - including Kansas - and many of these have provided ad hoc benefit increases on a regular basis. In addition, several states with automatic adjustment plans have provided one or more ad hoc benefit increases during the past five years.

When benefit increases are provided on an ad hoc basis, retirees are uncertain as to the timing and amount of future post-retirement benefit increases. Paradoxically, however, some of the states that provide periodic ad hoc benefit increases for retirees - including Kansas - have in fact provided considerably larger percentage increases in benefits than those provided by states with automatic post-retirement adjustment provisions.

Post-retirement benefit increases have been provided for retired members of Kansas Retirement Systems almost annually. During the past five years, the percentage increases in retirement benefits for eligible retirees have been as follows: 1984 - 10%, 1985 - 5%, 1986 - 3%, 1987 - 2%, and 1988 - 3%. These post-retirement benefit increases have maintained the purchasing power of retirement benefits, and also helped retirees meet the rising costs of medical care.

For all members of Kansas Retirement Systems (current retirees and active members who will retire in the future), the fundamental shortcoming of the ad hoc approach is uncertainty regarding future post-retirement benefit increases. Will the Kansas Legislature continue to provide ad hoc increases periodically? Because ad hoc increases are by definition not prefunded on an actuarial reserve basis, will the timing and amount of any future increases depend on such factors as the actuarial condition of Kansas Retirement Systems and the finances of the State of Kansas? To what extent will future ad hoc increases maintain the purchasing power of retirement benefits?

Automatic post-retirement adjustment plans generally provide for less than full indexation of benefits to increases in the CPI. Alternatives to full indexation which have been used by state retirement systems indicate that there are numerous possibilities for the design of a limited cost-of-living adjustment plan.

> Indexing but with a cap - Annual benefit increases can be limited to a specified percentage such as 3% per year. This is the prevailing pattern among state retirement systems with automatic cost-of-living adjustment plans.
>
> Indexing but with a deductible - The automatic adjustment plan can provide for benefit increases only after the CPI rises by a minimum percentage such as 2% or 3%. For example, benefits could be increased each year by the percentage rise in the CPI above 3%, with the maximum annual increase limited to 3%. This would mean that benefits would be increased by 3% in any year in which the increase in the CPI was 6% or more.

<u>Partial indexing</u> - Benefits can be increased by a portion of the rise in the CPI such as 50% or 60%. Partial indexing can be combined with either a cap or a deductible, or both. For example, a plan might provide that benefits will be increased by half the rise in the CPI above 2%, with the maximum increase limited to 4% in any year in which the CPI rises by 10% or more.

<u>Deferred indexing</u> - Annual benefit increases under any automatic adjustment plan can be deferred for a period of years after retirement or until the retiree attains a specified age such as 65.

The design of a limited automatic post-retirement adjustment plan for Kansas Retirement Systems could be approached from two perspectives: (1) define the objectives to be met by the adjustment plan, and then design a plan intended to meet the stated objectives; or (2) determine the contributions that might be available to finance an adjustment plan, and then design a plan expected to increase costs by approximately the same percentage of salary as the estimated additional contribution rate. Various plans could be evaluated from both these vantage points, with the ultimate purpose being the development of a limited automatic post-retirement adjustment plan that meets desired objectives and also recognizes the prevailing cost constraints.

PROPOSED BILL REQUESTS FOR COMMITTEE INTRODUCTION

(1) Reduce years of credited service required for vesting of benefits from 10 to five years (9 RS 0462).

(2) Provide an increase in the lump-sum death benefit of $500 from $2,500 to $3,000; and provide a 4% postretirement benefit increase for retirants who retired prior to January 1, 1988 (9 RS 0463).

(3) Reduce annuity benefit formula component from 2.0% to 1.75% for elected state officials who elect to become a special member under the provisions of K.S.A. 74-4998b through 74-4998g after February 1, 1989 (9 RS 0464).

(4) Provide for any member who retires on or after July 1, 1989, with 25 or more years of service, the retirement benefit component for prior service shall be equal to 1.25% and the retirement benefit component for participating service shall be equal to 1.5% (9 RS 0486).

(5) Provide for any member who retires on or after July 1, 1989, the retirement benefit component for participating service shall be equal to (a) 1.5% for any member with 25 or more years of service, and (b) 1.75% for any member with 35 or more years of service (9 RS 0487).

(6) Require that any retirant who retired after July 1, 1988, and who is employed, appointed or elected to any position or office for which compensation is paid in an amount exceeding $5,000 by any participating employer that such retirant was employed, appointed or elected during the final two years of such retirant's participation, shall not receive any retirement benefit during any month serving in such position or office. The retirant may revoke retirement and become an active member again. Prohibition shall not apply to officers, employees, appointees or members of the legislature and any other elected officials (9 RS 0488).

(7) Provide a mechanism for active participating members to purchase participating credit for periods of service in the national guard which when added to creditable military service do not exceed six years (9 RS 0492).

(8) Reduce the normal retirement age for members from 65 to 62 years with no reduction to retirement benefit amount (9 RS 0497).

(9) Provide that the final average salary for members who retire after July 1, 1989, shall be the average highest annual compensation for any three years of participating service rather than the present four years, if such member's compensation upon which the final average salary is based does not include any aggregate payments for accumulated sick or annual leave, severance pay or any other similar type employee payment or benefit (9 RS 0503).

House Pensions, Investments
& Benefits Comm.

1-26-89

Attachment 2