

MINUTES OF THE HOUSE COMMITTEE ON APPROPRIATIONS.

The meeting was called to order by Chairperson Representative Kenny Wilk at 9:00 a.m. on January 23, 2002, in Room 514-S of the Capitol.

All members were present except: Representative Brenda Landwehr, Excused
Representative Doug Spangler, Excused
Representative Jeff Peterson, Excused

Committee staff present: Alan Conroy, Legislative Research
Amy Kramer, Legislative Research
Julian Efrid, Legislative Research
Jim Wilson, Revisor of Statutes
Mike Corrigan, Revisor of Statutes
Nikki Feuerborn, Committee Secretary

Conferees appearing before the committee: Glenn Deck, Executive Director, Kansas Public Employees Retirement System (KPERS)
Judy Lambert, KPERS

Others attending: See attached list

Representative Neufeld moved for the introduction of legislation which would increase the number to eight for Home Plus individuals. Motion was seconded by Representative Bethell. Motion carried.

Representative Ballard moved that the minutes of January 15 and 16 be approved as presented. Motion was seconded by Representative Bethell. Motion carried.

Glenn Deck, Executive Director of the Kansas Public Employees Retirement System (KPERS), presented the KPERS Annual Report to the Committee (Attachment 1). It explained the membership, organizational system, different pension plans, investment standards, and plans for the future.

Mr. Deck then explained the KPERS death and disability program funding for active members of the system (Attachment 2). It is anticipated that in order to remain solvent, the contribution rate by the employer will have to be increased to keep pace with the numbers who are drawing benefits.

Judy Lambert, KPERS, used as an example the death of a 45 year old earning \$30,000 per annum with 15 years experience. The employee would have insured death benefits in the amount of \$45,000 which is non-taxable. The spouse has the option of rolling over the amount in the death and disability fund or leaving it in the fund until the deceased would have been 55 before drawing benefits. If the employee is killed on the job, the death benefits increase to another \$50,000.

The meeting was adjourned at 10:30 a.m. The next meeting is scheduled for January 24, 2002.

APPROPRIATIONS COMMITTEE GUEST LIST

DATE: 1/23/02

NAME	REPRESENTING
John Peterson	Security Benefit Group
Mike Huttles	Ks. Governmental Consulting
Sharon Bolvard	SRS
Glenn Deck	KPERs
Marjorie Webb	KPERs Board

KPERS

1962–2002 • 40 years of serving Kansas public servants

Service

Integrity

Respect

Accountability

Innovation

Teamwork

Our Mission: KPERS, in its fiduciary capacity, exists to deliver retirement, disability and survivor benefits to its members and their beneficiaries.

KPERS in Action

- KPERS distributes \$551 million in retirement benefits each year with over 87 percent remaining in Kansas
- 1 in every 12 Kansans is a KPERS member
- KPERS serves over 215,000 people with a full-time staff of 84 people
- KPERS has \$9.2 billion invested in the United States and 15 international markets
- KPERS partners with 1,450 employers across the state of Kansas

HOUSE APPROPRIATIONS

DATE 1/23/02
ATTACHMENT 1

KPERS

1962–2002 • 40 years of serving Kansas public servants

The Kansas Legislature created the Kansas Public Employees Retirement System to build a financial retirement foundation for those spending their careers in Kansas public service. The dedicated staff at KPERS has spent the last 40 years working to provide the means for public servants to retire after a lifetime of service and contribution, knowing they can depend on KPERS to help secure their financial future.

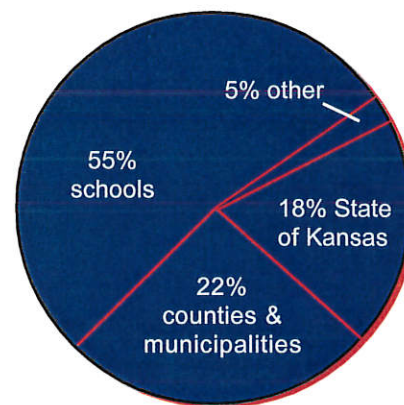
Who We Serve

Our membership includes people from all walks of life in a variety of jobs with one thing in common — serving Kansas in one capacity or another.

The State of Kansas provides KPERS benefits for all state employees, but most municipalities and counties across Kansas do as well. Your child's teacher and principal, local police officers and firefighters, and health care providers in a nearby hospital are all probably members, too.

In all, KPERS active membership totals almost 159,000, plus nearly 56,000 members who are already retired and receiving benefits. That is nearly one in every 12 Kansans. The estimated economic impact on the state is approximately \$540 million every year.

KPERS Membership



How We Are Organized

The System is designed as an umbrella organization with three statewide defined benefit retirement plans:

1. Kansas Public Employees Retirement System
2. Kansas Police and Firemen's Retirement System
3. Kansas Retirement System for Judges

We are governed by a nine-member board of trustees. Four board members are appointed by the governor, one is appointed by the president of the Senate, one is appointed by the speaker of the House of Representatives, two are elected by the members, and one is the elected state treasurer. The board in turn appoints staff and various consultants to assist in managing the System.

Who We Are

People are a vital resource in any organization and KPERS is no exception. Every person, from the chairman of the board to the application processors, brings unique talents and skills to create an effective team, striving to provide members with quality services and maintain financial stability throughout the System.

Members of our board span the state geographically and bring with them different employment experiences including agriculture, government, education, banking and finance, and private industry. The board also has a healthy balance of new and experienced members.

Through the executive director, the board empowers a staff, currently numbering 84, to carry out the daily operations of the System. Staff tenure averages around ten years, demonstrating expertise in the retirement field after years of experience and commitment to the organization. Staff functions include member services, investments, information resources and fiscal services.

Although they are not direct members of the staff, KPERS could not work effectively without the designated agents from participating employers. Designated agents provide a vital link in communication between the System and our active members. They are responsible for distributing KPERS information to members and helping them enroll and retire, as well as reporting a variety of information back to the System. KPERS partners with approximately 1,450 employers across the state.

Mission, Values, Goals

Our qualified and diverse team works together to complete our mission: KPERS, in its fiduciary capacity, exists to deliver retirement, disability and survivor benefits to its members and their beneficiaries.

In all that we do to complete our mission, six core values guide the Retirement System:

- service
- integrity
- respect
- accountability
- innovation
- teamwork

KPERS currently has three major goals within our mission, each a critical factor for our overall success:

Fiduciary Responsibility: Invest the System's assets according to the prudent expert standard of care for the sole purpose of providing benefits to our members and their beneficiaries.

Service: Provide professional, accurate, timely and cost-effective services to our members and participating employers.

Communication: Communicate effectively with our members, employers, public officials and other interested parties.

Service • Integrity • Respect • Accountability • Innovation • Teamwork

ATABOOK: SPONSORS

Per

LARGEST PENSION FUNDS (continued)

and data as of March 31; all other fund data as of Dec. 31. Assets are in U.S.

Assets	Sponsor	Country
151	Midland Bank	U.K.
152	Hewlett-Packard	U.S.
153	Deere	U.S.
154	Delphi Automotive	U.S.
155	Local Government Pension Institution	Finland
156	ICI	U.K.
157	National Electric	U.S.
158	Chicago Public School Teachers	U.S.
159	Kansas Public Employees	U.S.
160	Motorola	U.S.
161	Indiana Public Employees	U.S.
162	Arsten	Netherlands

KPERS is the 159th largest pension plan in the world.

Fiduciary Responsibility

The Retirement System's first goal is to invest assets according to the prudent expert standard of care to provide benefits for our members and their beneficiaries. This goal emphasizes our fiduciary responsibility. A fiduciary is someone who holds assets in trust for another—our trustees and staff are fiduciaries because they manage the System's assets for our members.

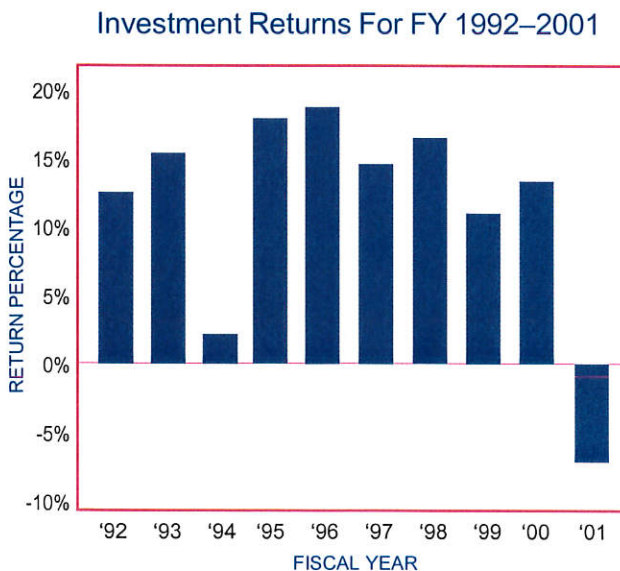
To fulfill our responsibility, we manage a carefully diversified and monitored portfolio designed for long-term gains. We invest that portfolio in a variety of assets to maximize returns while limiting risk. As a result, the System's investments have performed well over the last ten years.

Investment Strategy

The System's investment plan, reviewed by the board annually, outlines a long-term investment strategy with the ideal blend of risk and expected return. It involves investing in a variety of assets that react differently in specific economic situations. This allows us to navigate short-term uncertainty, withstand periods of negative return, and profit from longer-term returns. Over time, asset allocation has significant impact on investment returns and the health of the System.

Size and Impact

KPERS assets total approximately \$9.2 billion. This includes contributions from members and employers, as well as income and appreciation from the investments. The System invests in stocks and bonds of companies in the United States and 15 foreign countries or markets. We also invest in real estate and some alternative investments such as venture capital limited partnerships.



We manage more than \$2 billion internally, and have 14 outside investment managers who manage the rest. Our managers are headquartered around the globe in the United States, London and Tokyo. The System's investments receive constant care and monitoring, 24 hours each day, seven days a week.

Strong 10-Year Performance

In spite of the worst investment return in our history last year (-7.3 percent), KPERS' average annual return for the past decade is approximately 11 percent. For fiscal years 1995 through 2000, the System averaged an annual return of 15.4 percent. KPERS earned an average of more than \$1.1 billion per year during that period!

Because KPERS is a defined benefit plan, benefits are guaranteed by the State of Kansas. Investment gains and losses do not directly affect member benefits. However, long-term returns are important. Historically, investment returns have provided about 70 percent of the benefits paid to members and beneficiaries.

Service

Everyone on the KPERS team strives to provide excellent customer service. Often, members need our help when they are experiencing a significant event like retirement, a new job, divorce or a death. Our goal is to respond to those needs promptly and professionally, with personal service and care.

Benefits and Programs

The KPERS staff of 84 serves over 215,000 people with a variety of programs and services:

- retirement benefits
- disability benefits
- withdrawal payments
- retiree death benefits
- survivor benefits
- life insurance benefits

Our goal for these programs is to provide accurate, timely and cost-effective service. In fiscal year 2001, for example, we distributed more than 650,000 monthly retirement payments totaling \$551 million. Over the year, 99.9 percent of them were made on time.

Reaching Outward

The complex nature of retirement planning makes it essential for us to talk with, and listen to, our members. Each spring, our field representatives conduct pre-retirement seminars for members who plan to retire soon. In 2002, we plan to hold 37 seminars across the state. We also offer individual counseling sessions in our Topeka office. Although we encourage members to make appointments whenever possible, we consult with members who simply walk through our front door.

Another key component of reaching outward is in our vital relationship with Kansas employers. KPERS emphasizes education and assistance to make our partnership more effective. Each fall, we have workshops for employers' designated agents about upcoming changes. To gain valuable feedback, KPERS established the Employer Council, an advisory group with employer representatives who meet with KPERS staff. Also, we recently established a help desk dedicated only to helping employers.

Meeting Needs and Exceeding Expectations

To provide excellent service, KPERS is constantly expanding its services and features. For example, in 2001 after new legislation, we implemented a partial lump-sum option. This allows retiring members to receive up to 50 percent of their benefits at retirement in a lump-sum rather than just receiving monthly payments. In the first six months of this program, we have paid out nearly \$7 million to new retirees.

We are currently implementing a document imaging project so our customer service representatives can retrieve documents more quickly. When working with members, staff will have nearly instant access to all the member's forms and letters.

Customer Service Facts

FACTS

Each year, KPERS staff:

- Distributes lump-sum death benefits totaling \$7.8 million.
- Answers nearly 80,000 calls from members and beneficiaries.
- Distributes \$40 million to 9,000 withdrawing members.
- Responds to more than 4,000 e-mail inquiries from members and others.
- Reconciles 1,450 employer contribution reports involving approximately \$400 million in order to prepare 184,000 annual statements.

Communication

While good customer service helps us take care of our members, providing open and clear communication is just as important. People can't take advantage of a program they don't know anything about. The KPERS board and management staff recognize this importance and have recently included communications as another distinct organizational goal. With this effort, we are hoping to create a consistency in our communications that will in turn make it easier for members and employers to get what they need.

In Black and White

Currently, printed publications provide the basis for most communication. We publish booklets and brochures on various topics at the System, as well as applications and forms for specific circumstances. Each year, we process employer contribution information and generate 184,000 annual statements for our active and inactive members. These statements provide a snapshot of their KPERS contributions to help with retirement planning.

Two times a year, members receive KPERS Papers. This informative newsletter has different editions specially tailored for retired members and for those who are still employed by a participating employer. KPERS also distributes communication pieces for designated agents at participating employers on an on-going basis.

Using Technology

We complement most printed communications with an electronic version on our web site, www.kpers.org. Members can download forms and applications or use the online benefit estimate calculator. In this next year we will unveil an updated version of the web site. Also, staff are working on an e-mail database of designated agents, so we can use the Internet to quickly and efficiently communicate without generating more paper. In addition, our long-range plan is to create a mailing address database so members can receive direct mailings at home instead of depending on their employers.

Since 1998 nearly
15,000 people have
attended a KPERS
pre-retirement seminar.

Each year KPERS
prints over 435,000
KPERS Papers for
distribution.

Up Close and Personal

No amount of technology can replace old-fashioned personal communication. KPERS staff spend time across the state giving presentations to retirement groups, employers and members, and other stakeholders, all in an effort to share the KPERS message and help people get what they need from the Retirement System.

At our Topeka office, if you walk in off the street, you can expect to visit with a member services counselor on a one-on-one basis. We also have a toll-free phone line, called the InfoLine, available during office hours if you can get the information you need over the phone. Designated agents have their own help desk line, too.

However members and employers like to communicate, it is our goal at KPERS to meet them where they are. We want to be an accessible resource, here to help them get the most from their benefits.

Challenges We Face

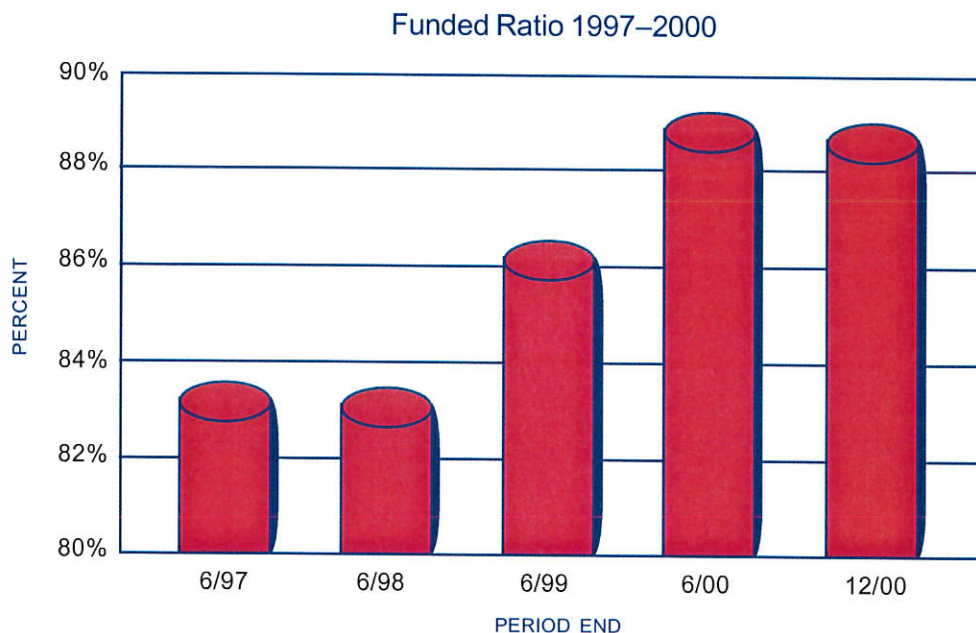
KPERS is financially sound. Current and future benefit payments enjoy the strength of member and employer contributions, a significant asset base, as well as the guarantee of the State of Kansas. As with any large financial undertaking, however, significant challenges exist. Those include navigating current economic conditions, improving our long-term funding, serving our growing membership and replacing obsolete information systems.

Economic Conditions

At this time, we are facing a difficult economic market and the first recession in a decade. The sagging United States economy and worldwide uncertainty after the September 11 attacks continue to create weaknesses in financial markets. Although the System's long-term health and stability do not depend on any single year or single decade of investment returns, current conditions do create volatility and uncertainty. KPERS will continue to rely on a disciplined, long-term investment strategy. As always, this approach will emphasize prudent diversification and long-term market returns.

Long-Term Funding

The funding goal of any retirement system is to accumulate enough assets to pay all promised benefits as they become due. Using the most recent figures available, the System's assets were sufficient to pay 88.3 percent of future benefits as of December 31, 2000. This percentage is called the "funded ratio."



At this time, we expect that our funded ratios for 2001 and beyond will decline. Ideally, the ratios should increase rather than decrease and move closer to 100 percent. Many premier public pension plans have reached at least 100 percent.

The primary reason for our declining ratio is because employer contributions, particularly those from the State/School group of KPERS, are not sufficient. The actuarial recommended rate for employer contributions is 7.05 percent. The current statutory rate is 4.18 percent. This difference has significant financial implications. If KPERS received the full 7.05 percent, annual contributions would need to increase at a cost of approximately \$90 million to the State.

Challenges We Face

Since 1993, the Legislature has gradually increased employer contributions to KPERS, but the annual increases are limited by law to .2 percent of salaries. Consequently, the planned increases will not make up the shortfall. KPERS' staff members are working proactively with the Legislature's Joint Committee on Pensions, Investments and Benefits to identify and discuss funding alternatives. We are committed to developing a long-term funding plan and resolving these issues.

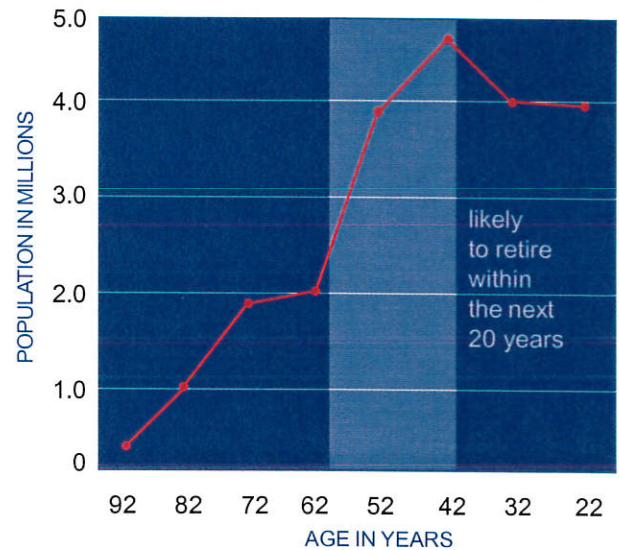
Membership Growth

Nationwide, the aging workforce is reshaping retirement systems. Employees are considering retirement at earlier ages and more workers are getting ready to retire. As the "baby boom generation" in Kansas begins retiring, we expect our number of retired members to skyrocket, reaching approximately 74,000 by 2010. This would be a 36 percent increase in an eight-year period. For the State of Kansas alone, about 6,500 employees will be eligible to retire by December 2005.

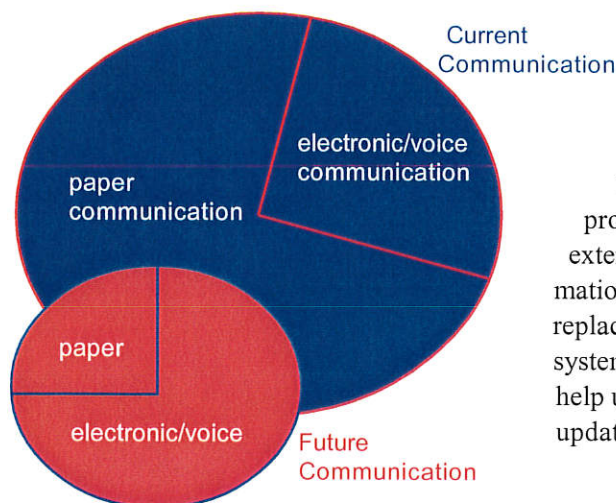
More retired members means more work for KPERS' staff. We will calculate more retirement estimates, process more retirement applications, pay more retirement benefits, answer more phone calls, and so on. With a greater exposure to technology, these future retirees also will expect better and faster service.

At the same time, we anticipate that nearly one-third of our own staff will be eligible to retire during this period. Many of these staff members have years of experience. We are busy preparing for both the increased workload and internal staffing changes.

United States Population by Age



KPERS Information Exchange



Information Systems

Today, the Retirement System relies on a variety of information systems. Some processes run on the State of Kansas' mainframe computer while others run on a mid-range computer at KPERS. We also use many personal computer applications to fill the gaps.

To further complicate the situation, many of our software programs were originally written in the 1960s and modified extensively over the last two decades. To support the information needs of our members and employers, we need to replace these obsolete systems with a current, integrated system. We are in the process of hiring a consultant to help us evaluate the alternatives and finalize plans to update our systems.

An Eye for the Future

In spite of the challenges we face, KPERS stands strong in effectively completing our mission of providing a safe and secure retirement foundation for Kansas public servants. The last 40 years have provided successes and opportunities for improvement. Both have broadened our experience.

The System continues to partner with the Legislature to overcome our challenges with the ultimate goal of providing quality service to our members and their beneficiaries.

We are ready to face our challenges with a vision for the future, working together to help say thank you to Kansas public servants for their years of dedication.



Service • Integrity • Respect • Accountability • Innovation • Teamwork

Board of Trustees

JAROLD W. BOETTCHER, Chairperson

Beloit, President and CEO of Boettcher Enterprises, Inc., and Boettcher Supply, Inc.

Appointed by the Governor

MICHAEL BRAUDE

Mission Woods, Past President and CEO of the Kansas City Board of Trade

Appointed by the Governor

BRUCE BURDITT

Auburn, Financial Reporting and Investments Manager for the Kansas Department of Transportation

Elected member - nonschool

VERN R. CHESBRO

Ottawa, President of Vern R. Chesbro Consulting, Inc.

Appointed by the Governor

LIZ MILLER

Lawrence, Senior Vice President of UMB Bank

Appointed by the Governor

LON PISHNY

Garden City, Pishny Financial Services

Appointed by the Speaker of the House

TIM SHALLENBURGER

Topeka, Kansas State Treasurer

Statutory member

DON STEFFES

McPherson, Retired Banker

Appointed by President of the Senate

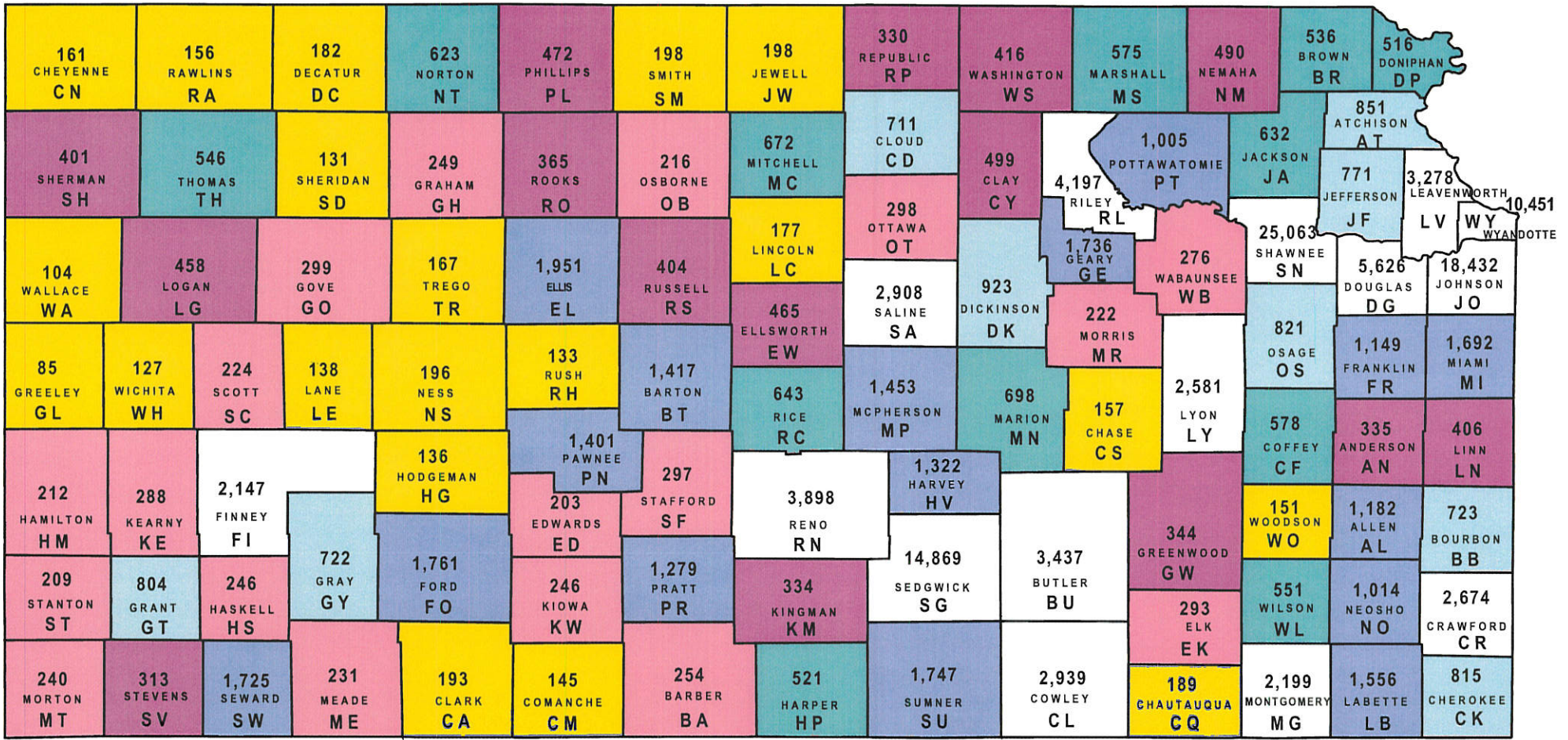
MARJORIE LEE WEBB

Shawnee Mission, Retired teacher - currently teaching part-time in Shawnee Mission

Elected member - school

Active Members by Employer's Location

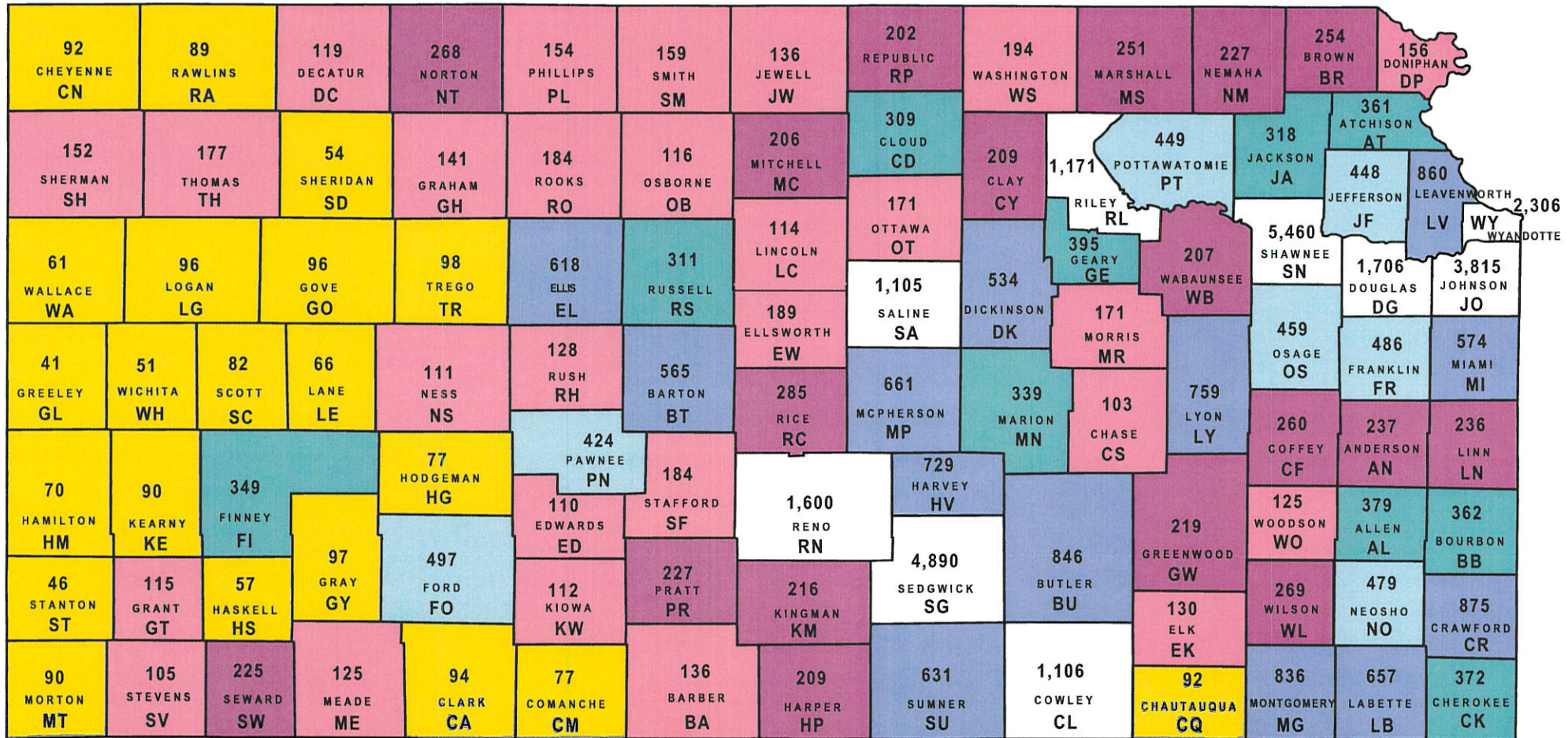
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Total Active Members = 155,980

Retirees and Joint Annuitants by Location

1-12



1 - 99
 200 - 299
 400 - 499
 1,000 +

100 - 199
 300 - 399
 500 - 999

Retirees and Joint Annuitants in Kansas = 48,681
 Outside of Kansas = 6,925
 Total Retirees and Joint Annuitants = 55,606

KPERS DEATH AND DISABILITY PROGRAM FUNDING

The Kansas Public Employees Retirement System (KPERS or the System) administers a death and disability program (the program) for active members of the System. Because of State budgetary pressures, the 2000 Legislature enacted a five-quarter moratorium on employer contributions to the Group Insurance Reserve Fund (the Fund) and the 2001 Legislature extended this moratorium for two additional quarters. During the consideration of these contribution moratoriums, legislators, budget officials, and other interested parties raised questions about the program's benefits, administration, and funding status. The State's budgetary problems are predicted to continue into FY 2003 therefore, it is likely that there will be further discussion of extending the contribution moratorium in the upcoming legislative session. This report is intended to improve policymakers' understanding of the program and assist them in making decisions on the appropriate funding level for the program. This report is divided into the following sections:

- Program History
- Current Benefits
- Program Administration
- Funding Method and Status
- Funding Options

Program History

In 1965 the KPERS Board of Trustees (the Board) submitted a proposal to the Legislature to establish a group life and long-term disability program for active members of the System. The Legislature established this program effective January 1, 1966. The legislation, in part, gave the Board the authority to provide "... within funds available therefore, the broadest possible coverage for members who are in active employment...". The program consists of a basic group life and long-term disability plan and an optional group life insurance plan.

From its inception the benefits of the basic life and disability plan have improved considerably. Based on its statutory mandate of providing the broadest possible coverage within funds available the Board has periodically recommended enhancements to the Legislature when the Fund developed a surplus. Since the beginning of the program, the death benefit has increased from 50% of final average salary to 150% of annual compensation and the disability benefit has increased from 42% of final average salary to 66 2/3% of annual compensation. In 1975 the employer contribution rate of the program was increased from 0.5% to 0.6% of members' annual compensation.

In 1978 legislation was enacted establishing the optional group life insurance plan. Under this plan members may purchase additional term life insurance through payroll deductions. Over the years, the statutes have been amended to provide coverage to additional employer groups under the basic life and disability plan and the employee funded optional life insurance plan.

HOUSE APPROPRIATIONS

DATE 1/23/02
ATTACHMENT 2

Current Benefits

The current benefits for active members under the program are as follows:

Life Insurance Benefits

- Insured death benefit (basic group life insurance) for active members equal to 150% of the member's annual compensation rate on the date of death.
- Optional group life term insurance available of up to \$200,000 for members to purchase at their cost through payroll deductions.

Disability Benefits

- Long-term disability benefit equal to 66 2/3% of the member's annual compensation rate on the date disability commences, reduced by Social Security disability and retirement benefits, workers' compensation benefits, and any other disability benefits by reason of employment.
- Benefit payments start after 180 days of continuous and total disability provided the member has left the payroll. Paid until the earlier of a) recovery, b) death, c) retirement or withdrawal from KPERS, or d) age 65 (or older if disability begins after age 60).
- Disabled members continue to receive service credit under KPERS and basic group life insurance coverage at no cost, and, depending on age, waiver of premium on optional group life coverage.
- Long-term disabled members (5 years) have their salaries indexed for retirement benefit calculation purposes.

Table 1 summarizes the coverage under the basic life and disability plan and optional group life insurance plan for the various types of employee groups. Currently, there are approximately 150,000 participants in the basic life and disability plan and 44,000 in the optional group life insurance plan.

TABLE 1		
Program Eligibility		
(Estimated Participants) as of June 30, 2001		
Group	Basic Life and	Optional Group Life
KPERS		
State	26,706	14,875
Schools	82,176	11,409
Local	35,608	13,090
Board of	6,700	5,140
State		
Deferred Compensation	77	N/A
JUDGES	260 *	168
KANSAS POLICE AND FIRE	**	1,734
Total	151,527	44,682
*Judges are covered under the basic life benefit but have a separate statutory disability under the Judges Retirement		
** Kansas Police and Fire have separate statutory disability and death benefits under Retirement		

Program Administration

By statute KPERS has been responsible for the administration of the program (with discretion to contract with a third-party provider for all or any part of the program services) since its inception in 1966. KPERS has 2.5 full time equivalent employees in the Member Services Division devoted to this function. In addition, other employees throughout the agency provide additional supervisory and support functions such as fiscal, legal and administration. The primary administrative functions of the program include:

- Communicating with designated agents and active members on program eligibility, enrollment, and claims questions.
- Processing enrollment forms.

- Maintaining a database of eligible KPERS members and death and disability claims.
- Collecting employer contributions (which fund the basic group life and long-term disability benefits) and the employee premiums for optional group life coverage.
- Accounting for employer contributions and employee premiums, and making appropriate remittances and transfer to insurance company/third-party administrator
- Initial processing of and eligibility determinations on death and disability claims.
- Managing the contractual relationship with third-party provider of life insurance benefit and administrative services on disability claims.

KPERS contracts with Security Benefit Life Insurance Company for a group term life insurance policy for the basic death benefits, a group term life insurance policy for the optional employee life insurance benefits and an administrative services agreement to process disability claims. KPERS staff work closely with Security Benefit Life to review claims, make determinations of eligibility, and pay claims. Table 2 summarizes the death and disability claims for FY 2001

TABLE 2

**BENEFIT PAYMENT STATISTICS
FISCAL YEAR 2001**

LIFE

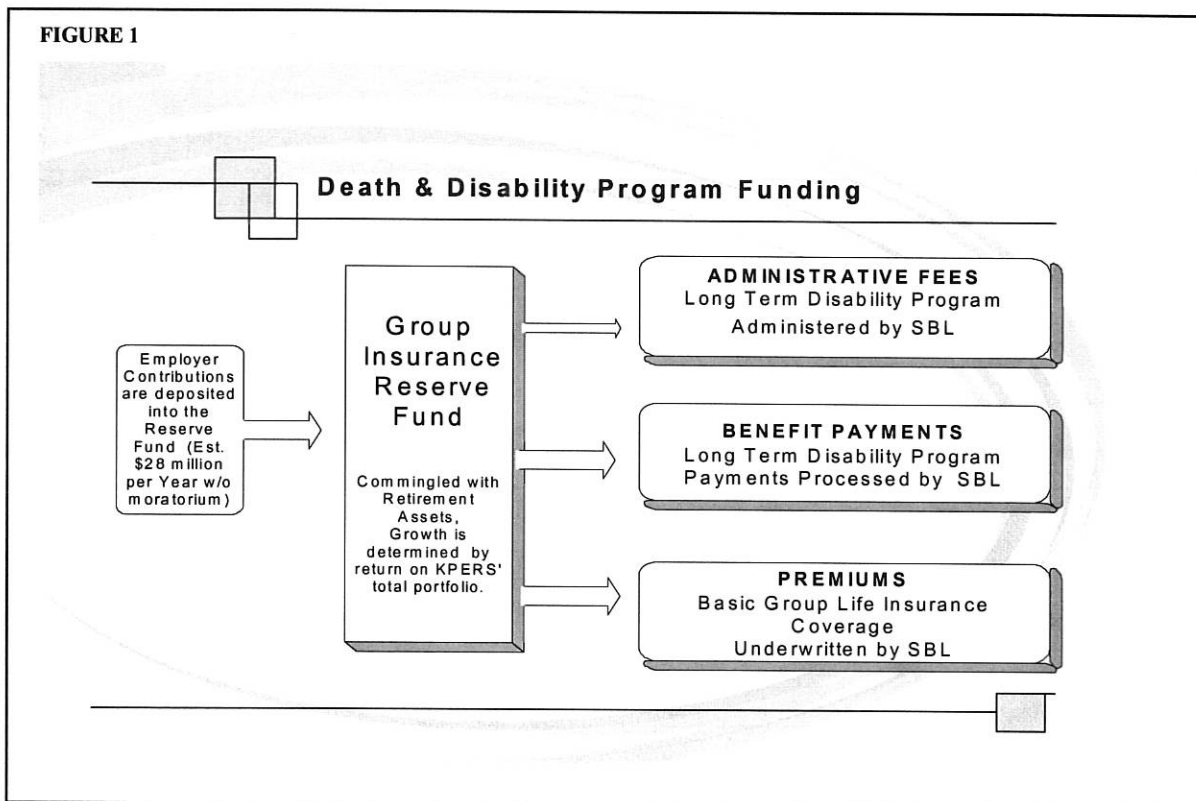
Total Death Benefit	\$	14,101,889
Number of Claims		316
Average Benefit	\$	43,684

DISABILITY

Total Disability Benefits	\$	23,168,824
Number of Claims Outstanding		2,632
Average Monthly Benefit of FY 2000 Claims Approved	\$	1,556
Average Monthly Benefit paid by KPERS Disability Program	\$	774
Percentage of Total paid by KPERS Disability Program		50%

Funding Method and Status

Employers remit to KPERS a statutory rate of 0.6% of covered payroll to pay for the basic group life insurance and the long-term disability protection for covered employees. For Judges, the contribution rate is 0.4% since they only participate in the basic group life insurance portion. The premiums are accounted for in the Retirement System's Group Insurance Reserve Fund. Using these funds, KPERS contracts with a third party provider for the life insurance coverage, and pays the same contractor under an Administrative Services Only agreement for handling the disability claims, which KPERS self-insures. Employees who purchase additional coverage under the optional group life insurance program pay additional payroll-deducted premiums, which KPERS collects from the employer and remits to the insurance company. Figure 1 illustrates the flow of funds for the program.



In the 2000 and 2001 legislative sessions, legislation was passed which, together, placed a seven-quarter moratorium (April 1, 2000 through December 31, 2001) on employer contributions into the Fund. The employer contributions are remitted from the various participating agencies as follows:

- **State employees and Board of Regents employees** – Contributions are transferred one business day after the payroll date.
- **School employees** – Contributions are transferred by the State on a quarterly basis in arrears.
- **Local employees** – Contributions are remitted via electronic fund transfer within three days after the payroll date.

Although accounted for separately, contributions for basic group life and disability benefits after being deposited in the Fund at the State Treasury are then wired to the KPERS custodian bank and commingled with retirement fund assets for investment. From the assets credited to the Fund, KPERS remits to the third-party provider the employer premiums for the basic group life insurance, the employee premiums for the optional group life insurance, the administrative services fees for the disability program, and the funds with which to pay the self-insured disability claims. Table 3 provides a five-year cash flow analysis for the Fund. This cash flow analysis shows that the assets of the Fund grew from \$163 million in FY 1998 to 193.7 million in FY 2000. This growth was primarily a result of investment income. The balance in the Fund declined to \$140 million at year-end FY 2001 due to the moratorium on employer contributions and investment losses. For FY 2002 the Fund is projected to end the year with assets of \$115 million.

	Fiscal Year 1998	Fiscal Year 1999	Fiscal Year 2000	Fiscal Year 2001	Fiscal Year 2002 (Estimated)
Group Insurance Reserve Beg. of Year	\$ 162,997,919	\$ 181,065,034	\$ 189,586,717	\$ 193,741,927	\$ 140,075,741
Additions:					
Employer Contributions	\$ 24,173,871	\$ 26,071,503	\$ 17,164,419	\$ -	\$ 13,791,243
Investment Income	\$ 27,045,986	\$ 19,486,583	\$ 24,266,283	\$ (14,541,389)	\$ 2,526,529
Total Additions	<u>\$ 51,219,857</u>	<u>\$ 45,558,086</u>	<u>\$ 41,430,702</u>	<u>\$ (14,541,389)</u>	<u>\$ 16,317,772</u>
Deductions:					
Disability	\$ (25,847,934)	\$ (28,065,398)	\$ (28,652,822)	\$ (30,170,330)	\$ (32,282,253)
Basic Group Life Insurance	\$ (7,304,808)	\$ (8,971,005)	\$ (8,622,670)	\$ (8,954,467)	\$ (9,133,556)
Total Deductions	<u>\$ (33,152,742)</u>	<u>\$ (37,036,403)</u>	<u>\$ (37,275,492)</u>	<u>\$ (39,124,797)</u>	<u>\$ (41,415,809)</u>
Group Insurance Reserve End of Year	<u>\$ 181,065,034</u>	<u>\$ 189,586,717</u>	<u>\$ 193,741,927</u>	<u>\$ 140,075,741</u>	<u>\$ 114,977,704</u>

Each year KPERS' actuary, Milliman USA, conducts an actuarial valuation for the program. This valuation report calculates the unfunded liability for the KPERS disability benefits. There is no liability for death benefits since these benefits are fully insured and the insurance company is responsible for their payment. In addition, the report determines an actuarial long-term employer contribution rate for the basic death and disability benefit provided by KPERS and compares it with the statutory contribution rate to determine funding adequacy.

Assets – For valuation purposes, the assets of the Fund are valued using a smoothing technique that smoothes returns that are higher or lower than the expected return. This method is identical to what is done for the KPERS retirement plan actuarial valuation. The investment rate of return assumption is 8%, which is also the same as the retirement plan assumption.

Liabilities – A liability “reserve” is calculated for disability benefits for the actuarial valuation. This reserve is intended to represent the present value of future benefits to members who have already become disabled by the valuation date. No reserves are calculated for the basic death benefits, since they are fully insured and the insurance company is responsible for any needed reserve. There are four sets of assumptions that the actuary uses to determine the disability benefits reserve:

- **The discount rate.** This is the interest rate used to discount future benefit payment to a current present value. This rate should represent the expected rate of investment return on the funds set aside to pay off these future benefits.
- **The length of time the disability benefits are expected to last.** Disability benefits are paid until the earlier of a) recovery, b) death, c) retirement, or d) age 65 (or older if disability begins after age 60).
- **The number of members who are currently disabled, but have not yet begun receiving payments** (defined as “Incurred by not Reported” (IBNR)).
- **The mortality rate for disabled members.** This is needed to determine the value of the waiver of premium benefits.

Contribution Rate – The actuarial contribution rates for the death and disability benefits have been calculated using a “term cost” methodology. This means the annual contribution is intended to be equal to the value of benefits incurred by members who die or become disabled during the year. There is no additional contribution to develop additional funds for those who die or become disabled in future years.

As of June 30, 2001 the actuarial contribution rate calculation was as follows:

	<u>Percent of payroll</u>
Life Insurance	0.25%
Disability Benefit	<u>0.36</u>
Total Normal Cost	0.61
Less 40 year Amortization of Overfunded Reserve	<u>0.01</u>
Actuarial Contribution Rate	<u>0.62%</u>

Figure 2 and Table 4 show the trend of the fund's funded ratio (assets to liabilities) since 1995. Due to strong investment performance the funded ratio was over 100% from FY 1995 through 2000. Because of the seven-quarter moratorium on contributions into the Fund and investment losses in FY 2001 the funded ratio dropped to 92.5% at June 30, 2001 and is estimated to decline to 75.9% by the end of FY 2002.

FIGURE 2

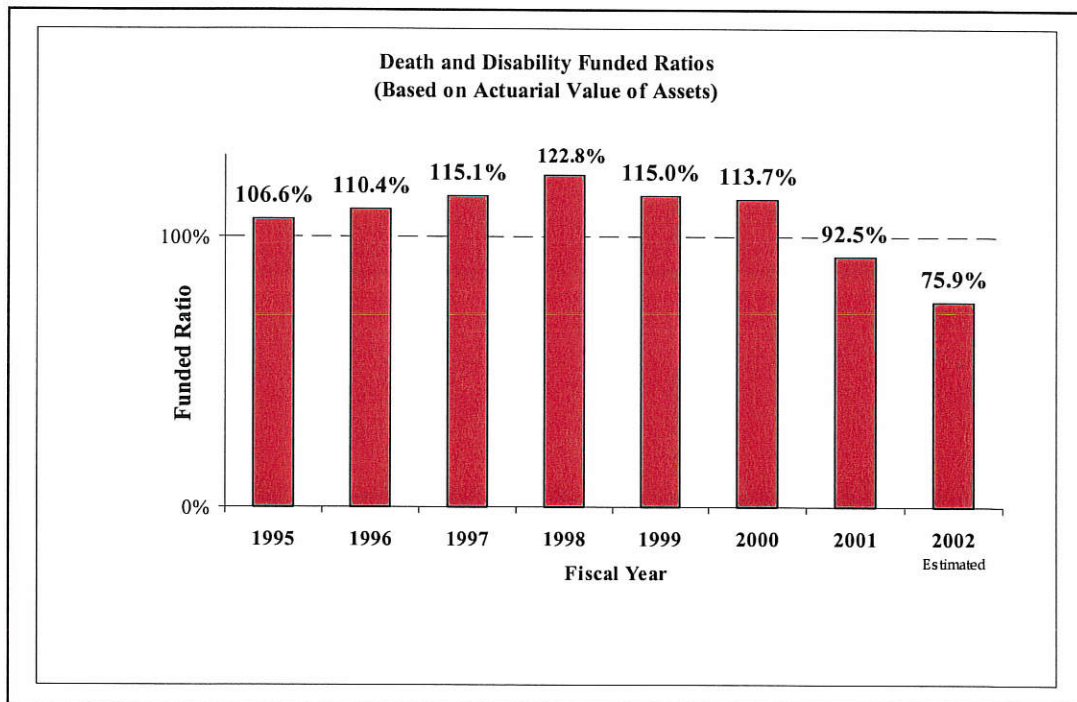


TABLE 4

Death and Disability Fund Schedule of Assets and Liabilities Fiscal Year 1995 - 2002					
Fiscal Year	Market Value of Assets	Actuarial Value of Assets	Reserve for Liabilities	Funded Ratio (Using Actuarial Value)	Funded Ratio (Using Market Value)
1995	\$129.7	\$124.0	\$116.3	107%	112%
1996	\$148.7	\$134.6	\$121.9	110%	122%
1997	\$163.0	\$146.7	\$127.4	115%	128%
1998	\$181.1	\$159.7	\$130.1	123%	139%
1999	\$189.6	\$170.6	\$148.4	115%	128%
2000	\$193.7	\$172.6	\$151.8	114%	128%
2001	\$140.1	\$143.9	\$155.5	93%	90%
2002	* \$115.0	\$122.8	\$161.72	76%	71%

* Estimated

Funding Options

Several funding options exist along a spectrum that ranges from complete outsourcing (a fully insured, third-party disability benefit program) to operating as fully self-insured for both basic group life and disability and paying for benefits annually as incurred (pay-as-you-go). The benefits of pre-funding existing and expected claims are primarily related to lowering ultimate costs (due to accrued earnings on reserves) and improving the ability to sustain consistent contributions for budgeting purposes. KPERS' research indicates that there does not appear to be a funding standard by which programs like this are measured. A privately insured program would demand reserve standards in excess of 100% whereas a pay-as-you-go program would require no reserves. Most other state pension plans that administer a self-insured disability program appear to do so as an integrated element of the overall retirement system. As such, funded ratios and funding mechanisms are varied but typically reflect the fully funded or nearly fully funded status of the average state retirement system.

The State has self-insured the disability program since 1981. As described earlier, an actuarial term method of financing benefits has been employed. This method involves the actuarial estimation of present and pending claims, their probable tenure and the offsetting investment earnings available from pre-funded reserves. As a consequence of this funding methodology, the program enjoyed above expected investment returns throughout much of the decade of the 1990's and through fiscal year 2000, which led to a surplus of assets.

Due to the excess investment earnings, the actuarial estimates of cost and resulting contributions have been sufficient to sustain benefits and reserves without changes in the funding rate. Annual funding from the State had been a constant 0.6% of payroll, generating an annual contribution in current general fund dollars of \$28 million per year. In contrast, if managed on a pure pay-as-you-go basis, current annual expenditures would be approximately \$40 million. Given the effects of the contribution moratorium, and the impact of recent negative investment performance, the reserves have been substantially reduced.

Conclusion

All estimations of the future economic elements of the program are predicated on actuarial and investment assumptions. If contributions to the program were stopped entirely the reserves would be depleted and the program would become pay-as-you-go (with considerably higher annual outlays) sometime in the next three to five years. A return to historical contributions (0.6% of payroll for all four quarters) will reduce the erosion of reserves, but will not return the program to full funding. Pre-funding future obligations is the most attractive economic solution to a self-insured program, but requires the usage of scarce budget resources. These dynamic and conflicting objectives represent the tradeoff that must be considered by the Legislature in determining the optimal funding strategy for the program.

Legislative History

- KPERS board submitted a proposal to the 1965 Legislature to establish a group life and long-term disability program for active members of the System
- The Legislature established the program effective January 1, 1966
- The legislation, in part, gave the Board the authority to provide “... within funds available therefor, the broadest possible coverage for members who are in active employment...”
- Numerous amendments over the last 35 years increased the coverage levels and added covered groups

Current Life Benefits

- Insured death benefit (group life insurance) for active members equal to 150% of the member's annual compensation on the date of death
- Optional group life term insurance available for members to purchase at their cost through payroll deductions of \$5,000 to \$200,000

Current Disability Benefits

- Long-term disability benefit equal to 66 2/3% of the member's annual compensation on the date disability commences, reduced by Social Security disability and retirement benefits and 100% of workers' compensation benefits
- Benefit payments start after 180 days of continuous and total disability. Paid until the earlier of a) recovery, b) death, c) retirement or withdrawal from KPERs, or d) age 65 (or older if disability begins after age 60)
- Disabled members continue to receive service credit under KPERs and life insurance coverage at no cost
- Long-term disabled members have their salaries indexed for retirement benefit calculation purposes

TABLE 1

2-14

Program Eligibility

(Estimated Participants)

Group	Basic Life and Disability	Optional Group Life
KPERS		
State	26,706	14,875
Schools	82,176	11,409
Local	35,608	13,090
Board of Regents	6,700	5,140
State Officials		
Deferred Compensation Plan	77	N/A
JUDGES	260 *	168
KANSAS POLICE AND FIRE	**	1,734
Total	151,527	44,682

* Judges are covered under the basic life benefit but have a separate statutory disability benefit under the Judges Retirement System

** Kansas Police and Fire have separate statutory disability and death benefits under the KP&F Retirement System

2-15

TABLE 2

Benefit Payment Statistics Fiscal Year 2001

LIFE

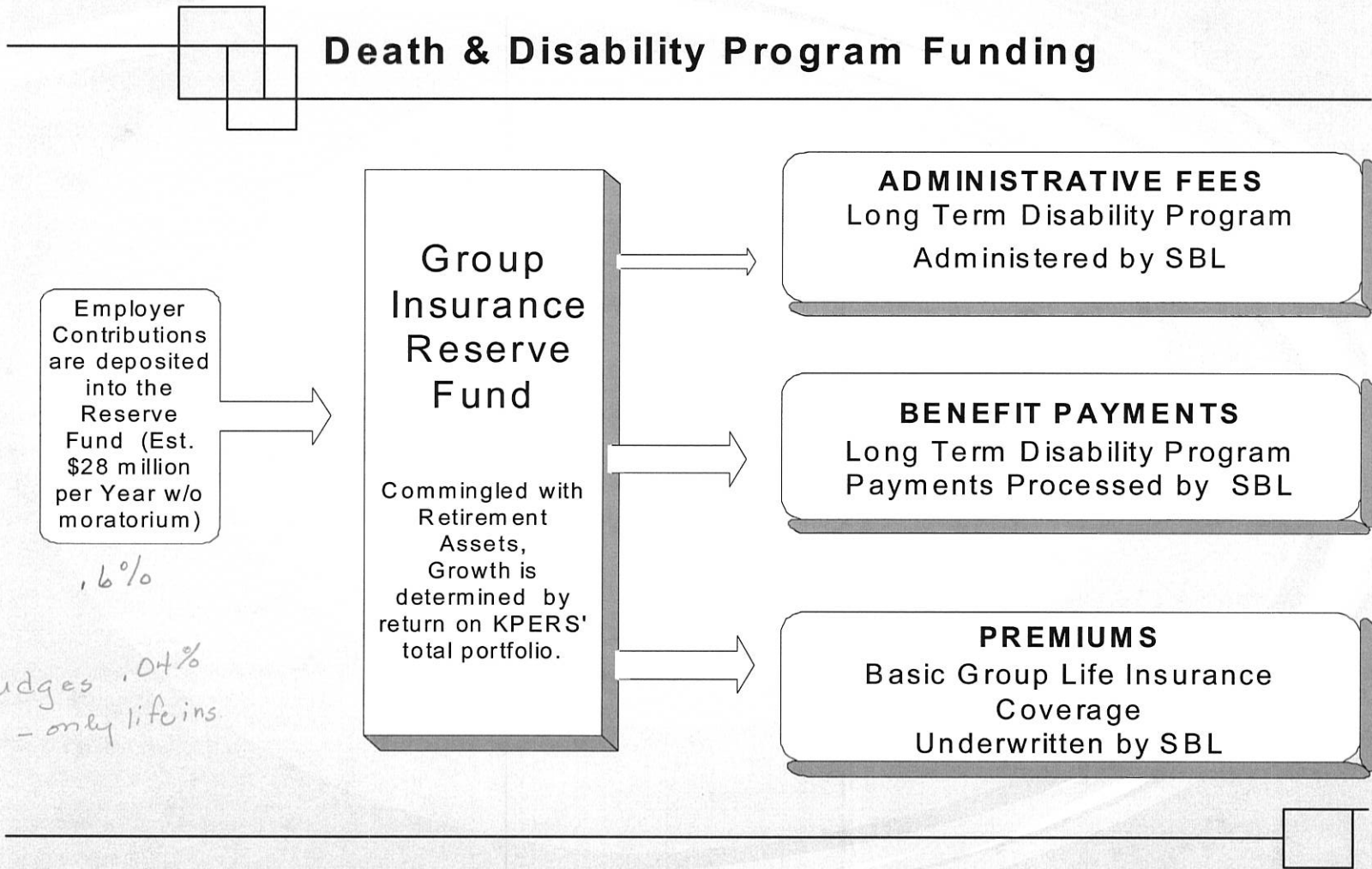
Total Death Benefit	\$14,101,889
Number of Claims	316
Average Benefit	\$44,626

DISABILITY

Total Disability Benefits	\$24,465,400
Number of Claims Outstanding at 6-30-01	2,632
Number of Claims Approved During FY 2001	344
Average of Monthly Benefit of FY 2001	
Claims Approved	\$1,556
Average Monthly Benefit Paid by KPERS	
Disability Program	\$774
Percentage of Total Paid by KPERS Disability	
Program	50%

FIGURE 1

2-16



2-17

TABLE 3

Cash Flow Analysis

Group Insurance Reserve Fund

Five Year Analysis

	Fiscal Year 1998	Fiscal Year 1999	Fiscal Year 2000	Fiscal Year 2001	Fiscal Year 2002 (Estimated)
Group Insurance Reserve Beg. of Year	\$ 162,997,919	\$ 181,065,034	\$ 189,586,717	\$ 193,741,927	\$ 140,075,741
Additions:					
Employer Contributions	\$ 24,173,871	\$ 26,071,503	\$ 17,164,419	\$ -	\$ 13,791,243
Investment Income	\$ 27,045,986	\$ 19,486,583	\$ 24,266,283	\$ (14,541,389)	\$ 2,526,529
Total Additions	<u>\$ 51,219,857</u>	<u>\$ 45,558,086</u>	<u>\$ 41,430,702</u>	<u>\$ (14,541,389)</u>	<u>\$ 16,317,772</u>
Deductions:					
Disability	\$ (25,847,934)	\$ (28,065,398)	\$ (28,652,822)	\$ (30,170,330)	\$ (32,282,253)
Basic Group Life Insurance	\$ (7,304,808)	\$ (8,971,005)	\$ (8,622,670)	\$ (8,954,467)	\$ (9,133,556)
Total Deductions	<u>\$ (33,152,742)</u>	<u>\$ (37,036,403)</u>	<u>\$ (37,275,492)</u>	<u>\$ (39,124,797)</u>	<u>\$ (41,415,809)</u>
Group Insurance Reserve End of Year	<u>\$ 181,065,034</u>	<u>\$ 189,586,717</u>	<u>\$ 193,741,927</u>	<u>\$ 140,075,741</u>	<u>\$ 114,977,704</u>

Funding Status

- Funded Ratio over 100% from 1995-2000
- Seven quarter moratorium on contributions—April 1, 2000 - December 31, 2001
- Impact of negative investment returns in FY 2001 and 1st half of FY 2002
- Fund balance has declined from \$193.7 million in FY 2000 to an estimated \$115.0 million ending FY 2002

Funding Status (Cont.)

- Estimated FY 2001 ending Funded Ratio – 93%
- Estimated FY 2002 ending Funded Ratio – 76%
- Projections of Funded Ratio ending FY 2003
 - No moratorium - 70%
 - 2 quarter moratorium - 62%
- Actuarial required contribution rate will increase unless investment returns exceed 8% assumption for extended period

FIGURE 2

Death and Disability Funded Ratios (Based on Actuarial Value of Assets)

