

MINUTES OF THE HOUSE COMMITTEE ON APPROPRIATIONS.

The meeting was called to order by Chairman Melvin Neufeld at 9:00 a.m. on January 23, 2003, in Room 514-S of the Capitol.

All members were present except: Representative Bethell - Excused
Representative Campbell - Excused
Representative Feuerborn - Excused
Representative Light - Excused
Representative Merrick - Excused
Representative Minor - Excused

Committee staff present: Alan Conroy, Legislative Research Department
J.G. Scott, Legislative Research Department
Becky Krahl, Legislative Research Department
Julian Efird, Legislative Research Department
Jim Wilson, Revisor of Statutes
Mike Corrigan, Revisor of Statutes
Nikki Feuerborn, Administrative Analyst
Sue Fowler, Committee Secretary

Conferees appearing before the committee: Glenn Deck, Executive Director of Kansas Public Employees Retirement System (KPERS)
Rob Woodard, Chief Investment Officer, KPERS
Jack Hahn, Deputy Executive Director, KPERS
Bruce Burditt, Chairman of Board, KPERS
Leland Breedlove, Chief Fiscal Officer, KPERS

Others attending: See Attached

Chairman Neufeld introduced Lucas Bell, Legislative Intern from the University of Kansas.

Glenn Deck, Executive Director of the Kansas Public Employees Retirement System (KPERS) presented an overview of the agency (Attachment 1). His presentation outlined membership, the mission and goals, benefit services, communication, finances, investments, market environment, long-term funding, death and disability fund and the 13th check issue.

Mr. Deck gave an historical account of why the two entities of schools (54%) and State of Kansas employees (18%) as shown on the Active Membership Components pie chart are kept separate. In 1971, the old Kansas School Retirement system was merged into KPERS. At that time the School group, State and Local Government groups were all merged together. In the mid to late 1980's, Local Governments were split out separately. The School liability is higher than the other State liability due the large amount of unfunded liabilities that were brought in with that old pay-as-you-go system. It was not pre-funded.

Each year, KPERS staff issue more than 670,000 retirement benefit payments via electronic transfer and postal mail. Direct deposit is more cost effective and more dependable for retirees. In a recent survey of new retirees, more than 94 percent of the respondents rated KPERS service during the retirement process as excellent or good. There was a 47 percent response from the service surveys. KPERS will benchmark similar services to see how service goals can be met in the future.

KPERS is continuing to improve the distribution of Annual Member Statements. An ultimate goal is to have this kind of information on an internet web site through a secure mechanism, where members can actually go in and look it up themselves. Mr. Deck reported the statements are distributed through the designated agents. Once e-mail addresses are available, this mode would be considered for distribution.

Mr. Deck reported that the funded ratio (the ratio of assets to liabilities) is one of the most important measures of the financial health of the retirement system. The funded ratio of all KPERS systems was

CONTINUATION SHEET

MINUTES OF THE HOUSE APPROPRIATIONS COMMITTEE at 9:00 a.m. on January 23, 2003, in Room 514-S of the Capitol

approximately 85 percent as of December 31, 2001. It was pointed out that the retirement system unfunded liabilities ratio does not include the Death and Disability Fund.

Rob Woodard, Chief Investment Officer, presented the KPERS investment goals and results of their investment performance:

- Invest as a "Prudent Expert," emphasizing consistency of principal and diversification
- Manage the assets for the sole and exclusive purpose of paying benefits as provided
- Develop portfolio strategies that will, on average, satisfy the actuarial expectation for investment returns (8 percent)

Mr. Deck informed the Committee of the situation with long-term funding and that retirement benefits are not in any danger of not being paid. These are guaranteed benefits for current retirees at this point but more contributions are not injected into the system, the system's financial health will deteriorate.

At some point KPERS investment strategy will have to begin to shift to provide more liquidity to pay benefits, and the downward spiral begins. The eight percent projected return will not be possible because of investing in more liquid assets rather than in a more fixed income. It is highly unlikely that KPERS will experience another decade with double digit returns. The primary action that needs to take place is increased employer contributions for the system's long-term financial health. Right now KPERS is trying to communicate this issue to the Legislature and other state and local officials. KPERS real objective is to develop a consensus with the Board, the Legislature, the Governor and other state and local officials on a responsible long-term funding plan to restore and ensure the system's financial health.

Mr. Deck reported that KPERS is attempting to develop a satisfactory action plan with the Legislature and the Budget Division for the Death and Disability Fund. If the resulting plan is to continue with a pay-as-you-go fund then preparations must begin as KPERS would need to begin extracting those investments. Mr. Deck recommended that the funds be invested in shorter term fixed income instruments that are much more liquid.

KPERS retirees who retired prior to July 2, 1987, are eligible to receive an additional annual payment up to a maximum of one month's benefit if there is sufficient funding. The Kansas Legislature created the 13th check as an alternative to a cost-of-living increase for that group in 1985. Members who retired and started receiving a benefit after July 2, 1987, had their retirement benefits calculated at a higher rate than previous retirees and are not eligible for the additional payment.

The Committee discussed with Mr. Deck the fund which provides moneys for this 13th check. The fund statutorily has a cap which allows one year's payment carried over, thus it has been impossible to build up the fund through the years to avoid the current problem. It was designed to cushion against one year of poor returns from the market not the triple hit the fund has suffered recently. KPERS was requested to provide additional information and the annual reports regarding the funding of the 13th check for the past ten to fifteen years.

Representative Ballard moved the minutes of January 15 and 16, 2003, be approved as presented. Motion was seconded by Representative Gatewood. Motion carried.

The meeting was adjourned at 10:35 a.m.. The next meeting is scheduled for January 24, 2003.



Melvin Neufeld, Chair

APPROPRIATIONS COMMITTEE GUEST LIST

DATE: 1-23-03

NAME	REPRESENTING
Jack Hawn	KPERS
Glenn Deck	KPERS
Rob Woodward	KPERS
BRUCE BURDITT	KPERS
Kim Rollenhagen	DPS
Lelana Breedlove	KPERS
Ed Redmon	Ks. State Council of Fire Fighters
RANDY TONGLER	PAST AUDIT
Mike Kuttles	Ks. Governmental Consulting
Joshua Cassatt	Rep. McLeland intern
Lucas Bell	Rep. Neufeld's office
OPP Appin	T Division of the Budget
Teresa Schwab	KCSL
Robert Blaufuss	KNEA
Chris Carucci	Rep Bob Bothell
Mark Tomb	LKM

KPERS

House Appropriations Committee
January 23, 2003

HOUSE APPROPRIATIONS *of*

DATE 1/23/03

ATTACHMENT 1

1-2

Presentation Outline

KPERS Overview

Benefit Services

Communications

Finances

Investments

Long-Term Funding

Death and Disability Fund

13th Check

About KPERS

KPERS is an umbrella organization that administers three statewide, defined-benefit retirement systems:

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

KPERS is governed by a nine-member Board of Trustees.

Daily operations are carried out by 85 full-time staff members.

KPERS Membership

Membership Highlights

1 in every 12 Kansans is a KPERS member.

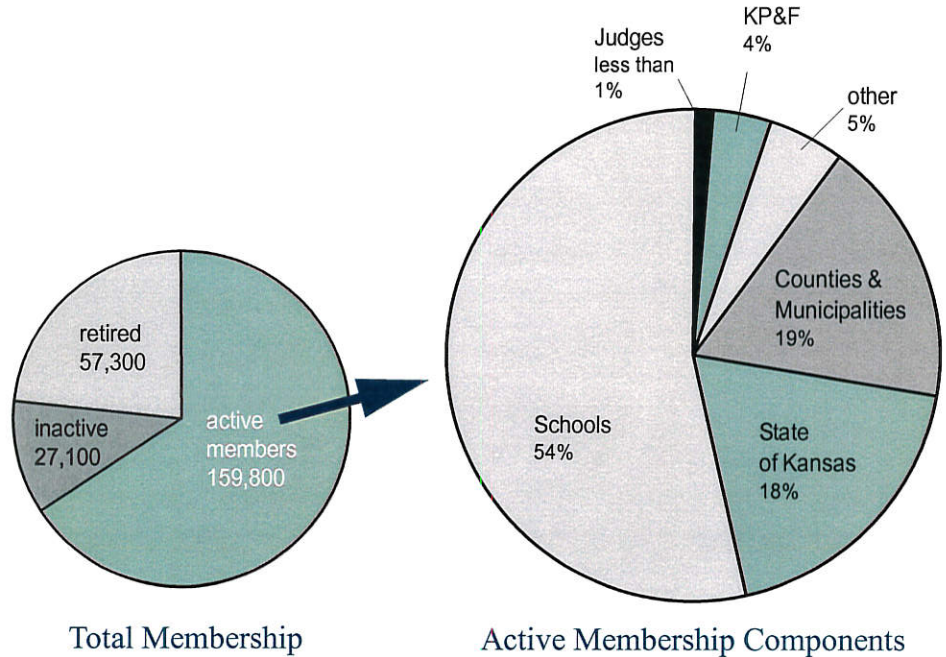
244,200 members

More than half our active members are employed by school districts.

1,450 participating employers

The State of Kansas is our single largest participating employer.

More than 87 percent of retired members live in Kansas.



KPERS Mission and Goals

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

Our three major goals are:

- Provide professional, accurate, timely and cost-effective **services** to our members and participating employers.
- **Communicate** effectively with our members, employers, public officials and other interested parties.
- **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.

KPERS Benefit Services

	Fiscal Year 2002 Recipients	Fiscal Year 2002 Payments
<p>Monthly Retirement Benefits</p> <p>All retired members and their survivors receive monthly benefit payments based on options selected upon retirement.</p>	56,000	\$565.9 million
<p>Lump-Sum Retirement Benefits</p> <p>Upon retiring, members may take up to 50 percent of their retirement benefit in a lump-sum.</p>	1,200	\$61.8 million
<p>Retired Member Death Benefits</p> <p>A \$4,000 lump-sum death benefit is paid to designated beneficiaries when a retired member dies.</p>	1,922	\$7.8 million
<p>Disability Benefits for Active Members</p> <p>Under certain conditions, active members who are unable to continue working receive monthly benefit payments.</p>	2,683	\$24.6 million
<p>Life Insurance</p> <p>Active members are covered by basic group life insurance equal to 150 percent of annual compensation, with an option to purchase additional insurance coverage.</p>	325	\$14.1 million

KS gives police have a lower

KPERS Service Highlights

Each year, KPERS staff:

- Issues more than 670,000 retirement benefit payments via electronic transfer and postal mail
- Answers nearly 80,000 incoming telephone calls
- Responds to about 9,500 e-mail inquiries
- Reconciles 1,450 employer contribution reports involving more than \$400 million to prepare 189,000 annual member statements

*- encourage direct deposit!
more cost effective - more dependable for retirees*

In a recent survey of new retirees, more than 94 percent of the respondents rated KPERS service during the retirement process as excellent or good.

*(Service (survey) 47% response
Will benchmark all service options forward*

KPERS Communication

Retired Member Communication

57,300 members

Provide clear, concise information and forms for new retirees, publish *KPERS Papers* newsletter twice each year, distribute tax forms, and provide information on topics of interest to retirees.

Active Member Communication

159,800 members

Provide individualized member benefit statements, publish *KPERS Papers* newsletter twice each year, keep active members informed on current topics and respond to member inquiries.

Employer Education and Communication

1,450 employers

Conduct annual workshops across the state for employer (25-30 across the state) representatives responsible for KPERS transactions, encourage two-way communication about current issues, assist with forms and procedures, and respond to questions.

Stakeholder Communication

various

Provide accurate and complete information to the Legislature, other state and local officials, and membership groups regarding significant issues and current topics.

KPERS Communication Highlights

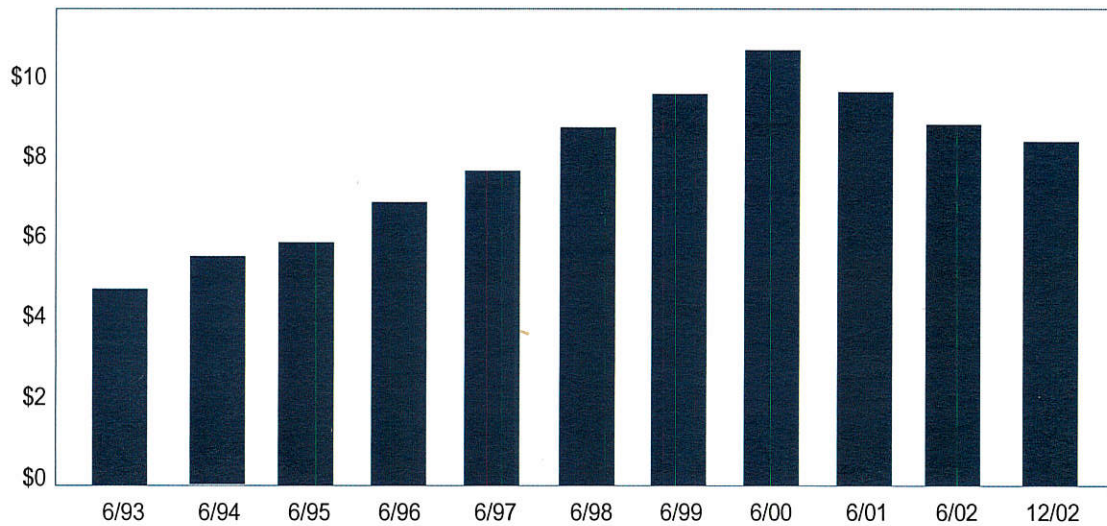
Each year, KPERS staff:

- Prepares and distributes more than 189,000 Annual Member Statements - *continuing to improve earlier dates for*
- Informs and educates active and retired members with *KPERS Papers* newsletters twice a year (*McClelland?*) - *email, website??*
- Holds pre-retirement seminars across the state for members who are planning to retire (more than 20,000 members have attended since 1998)
- Conducts group counseling across the state and individual counseling in our Topeka office - *to build a retirement pkg for indiv. savings*
- Maintains a comprehensive web site, *www.kpers.org*, that had more than 95,000 visitors in December 2002 - *calculators for retirement - most used*

KPERS Total Assets

As of December 31, 2002, KPERS had total assets of \$8.3 billion. The total asset value increased steadily during the 1990s, peaking at nearly \$11 billion during the spring and summer of 2000. With negative investment returns during recent years, the asset value has declined to the current level.

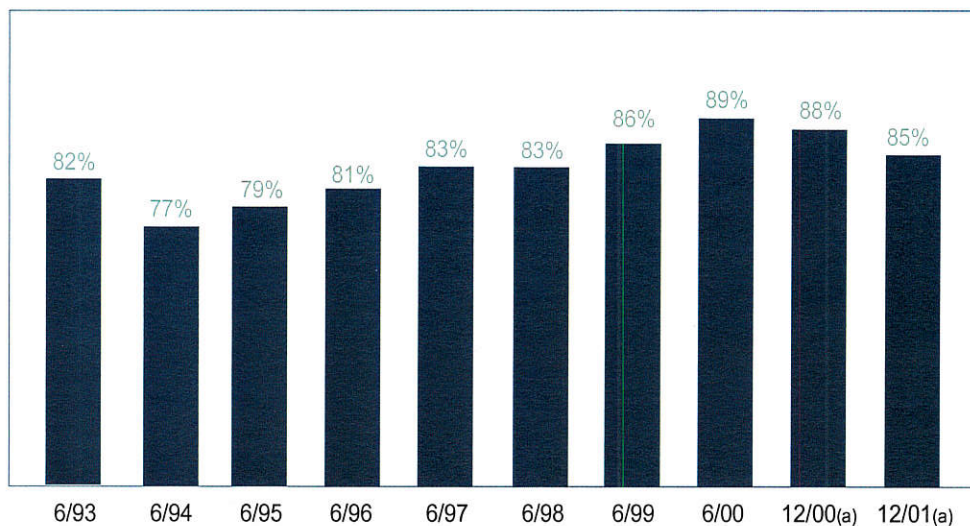
Total System Assets (in billions)



KPERS Funded Ratio - "most important..."

The funded ratio for all KPERS systems was 85 percent as of December 31, 2001. The funded ratio is the ratio of the actuarial value of assets to actuarial liabilities. A funded ratio of less than 100 percent indicates that the System has unfunded actuarial liabilities.

KPERS Funded Ratio by Fiscal Year



(a) Valuation date changed to December 31 as of fiscal year 2001.

KPERS Operating Budget

Fiscal Year 2004 Budget Request

General Operations	\$ 6,819,098
Investment Management	18,510,296
Imaging/Workflow Project	1,158,115
Total Operating Budget	\$26,487,509

Budget Highlights

Expenditures paid from the Retirement Fund—no General Fund appropriations

Fiscal Year 2004 budget request at current service level only—no enhancements

2004 budget request does not include any increase in FTE

Financial Accountability

KPERS received an unqualified opinion on its fiscal year 2002 financial statements with:

- No internal control weaknesses or findings
- No compliance exceptions

KPERS' annual financial report awarded the Government Finance Officers Association's Certificate of Achievement for Excellence in Financial Reporting for the last eight years - *available soon, @ Printers*

Independent actuarial audit in January 2002 found KPERS actuary's methods and assumptions to be reasonable and performed in accordance with generally accepted actuarial principles and practices

Legislative Post Audit currently conducting performance audit to review the reasonableness of funding projections by the System regarding its long-term funding outlook

KPERS Investment Objectives

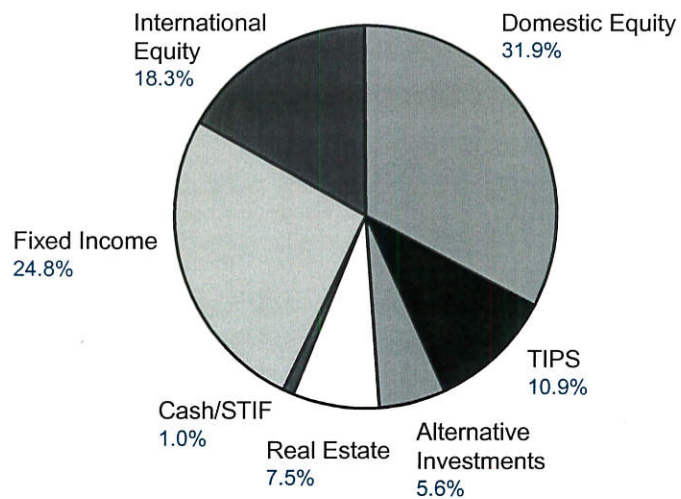
Our major investment goals are:

- Invest as a “**Prudent Expert**,” emphasizing consistency of principal and diversification
- Manage the assets for the sole and exclusive purpose of **paying benefits** as provided
- Develop **portfolio strategies** that will, on average, satisfy the actuarial expectation for investment returns (8 percent)

KPERS Asset Allocation

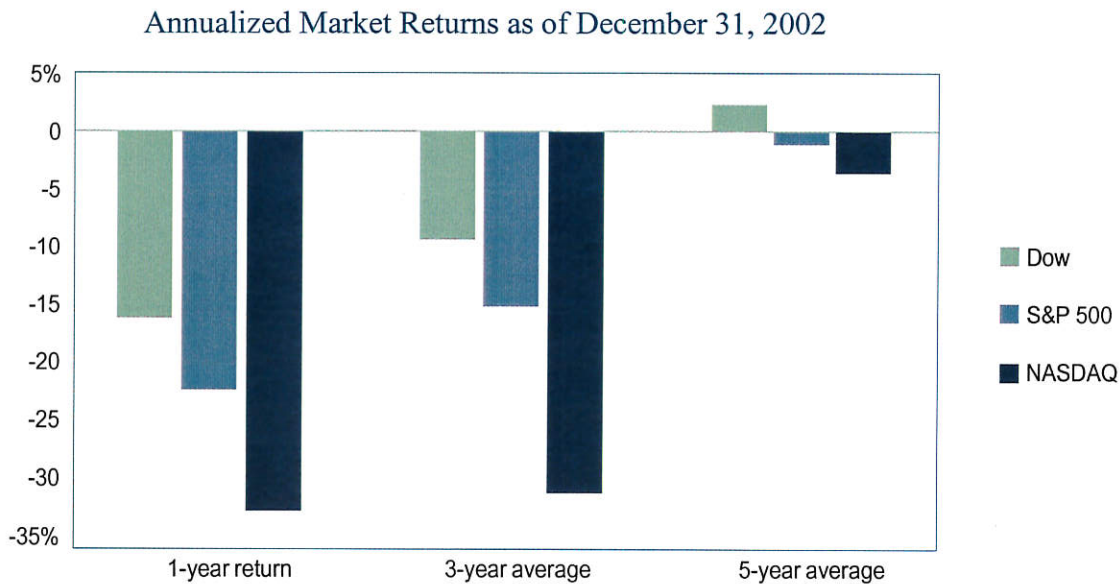
KPERS' portfolio is invested in a variety of assets to maximize returns while mitigating risk, following a strategic asset allocation policy. Diversification among investments, which individually may be volatile in the short run, provides the framework for our asset allocation strategy.

Portfolio Asset Allocation as of December 31, 2002



Market Environment

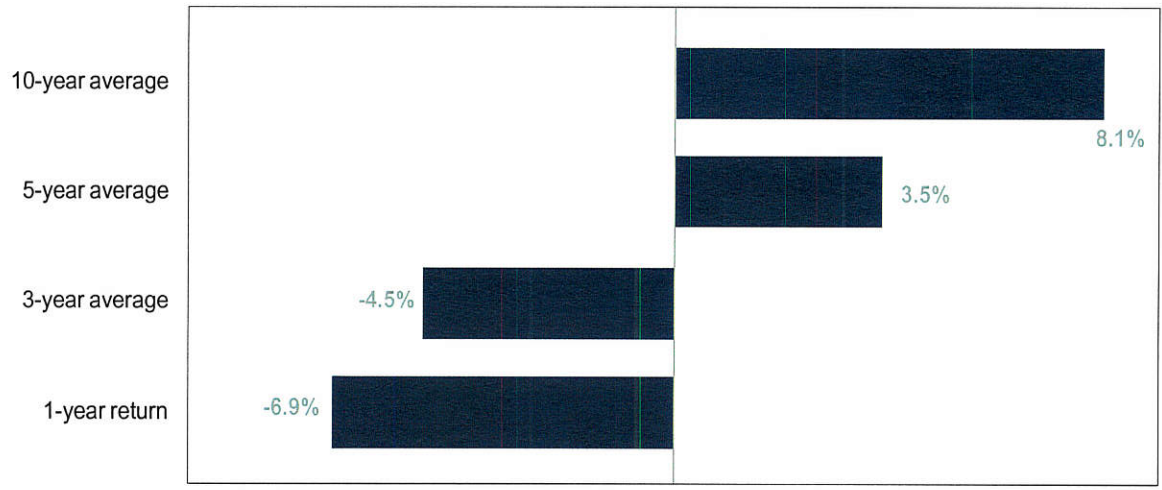
The following chart shows the performance of the three most common domestic equity market indices. It presents information for varying periods during the last five years. Over the last one-, three-, and five-year periods, KPERS has outperformed these indices.



KPERS Investment Returns

Our average annual return for the last ten fiscal years has been 8.1 percent. This means that, during the last decade, the System has matched the 8 percent rate that is assumed in the actuarial models.

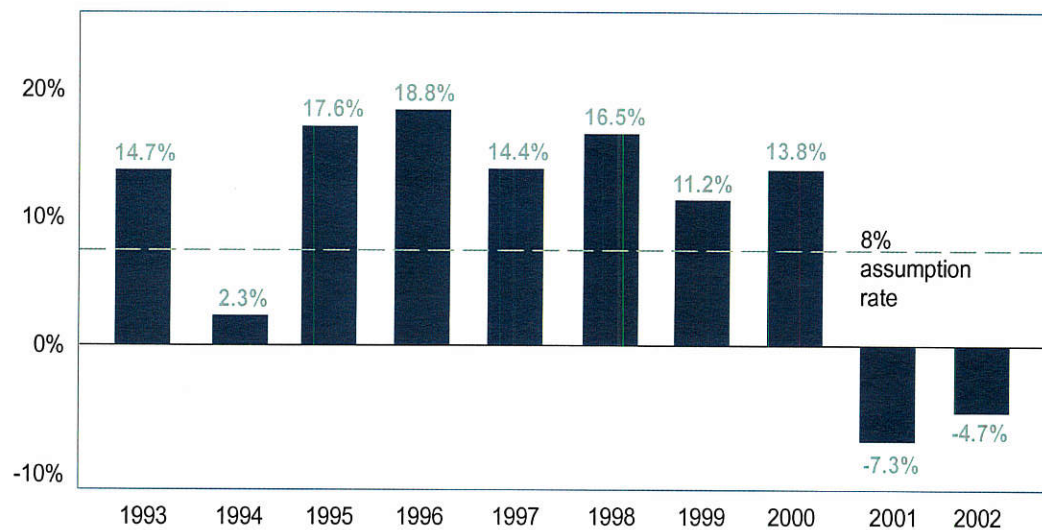
System Investment Performance as of December 31, 2002



KPERS Historical Returns

The System earned more than 11 percent for seven of the eight years between fiscal years 1993 and 2000. Returns for the last two years have been negative. However, the long-term health of the System is not predicated on any single year of performance, be it exceptionally good or exceptionally disappointing.

10-Year Investment Return Rates by Fiscal Year



Long-Term Funding

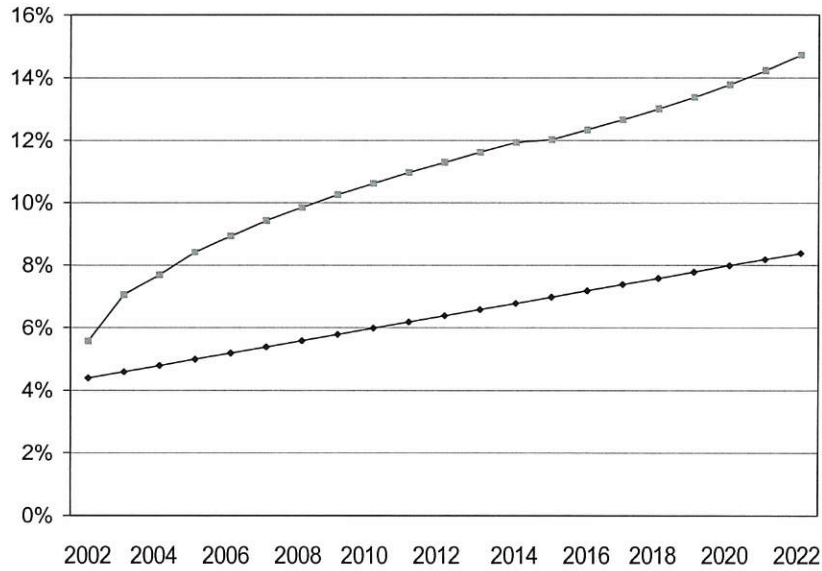
The Retirement System's most recent actuarial valuation, dated December 31, 2001, showed that:

- The unfunded actuarial liability for the KPERS State/School and local groups was \$1.7 billion.
- The State/School group funded ratio was 82 percent and the local group funded ratio was 89 percent.
- Employer contribution rates set by State statute will not converge with rates required to fund existing benefits.

If employer contributions increased to the actuarially-required rates, State contributions would need to increase by \$100 million in fiscal year 2005.

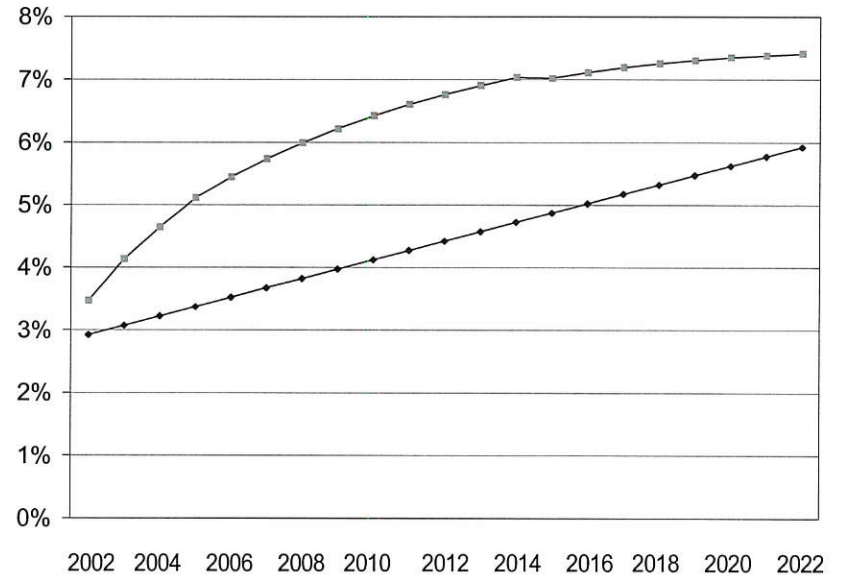
Employer Contribution Rates

KPERS State/School Group Contribution Rates



■ Recommended actuarial rates
◆ Statutorily capped rates

KPERS Local Group Contribution Rates



The Price of Inaction

The unfunded actuarial liability will grow from \$1.7 billion to more than \$4 billion in 2011.

The funded ratio will decline to 72 percent in 2011.

The actuarially-required employer contribution rates will continue to grow, reaching double digits around 2009.

The System's investment strategy must shift to provide liquidity to pay benefits, causing investment returns to decline.

Funding Alternatives

Increased employer contributions are essential to the System's long-term financial health.

Alternatives exist for increasing employer contributions:

- Immediate increase to actuarially-required rates
- Gradual increase to actuarially-required rates
- Employer contribution increases and issuance of pension obligation bonds
- Employer contribution increases coupled with changes in actuarial methods.

Long-Term Funding Issue Objectives

Communicate KPERS long-term funding issue to the Legislature and other state and local officials to build understanding

- Presented *Long-Term Funding Reports, Part I and II*, to the Joint Committee on Pensions, Investments and Benefits in August and November 2002

Explore areas of interest to the Board and Legislature to further refine available alternatives

Develop a consensus on a responsible long-term funding plan to ensure the financial health of the System

Target development of funding plan in the 2003 interim with introduction of authorizing legislation in the 2004 Session

Death and Disability Fund

Death and Disability benefits are funded by employer contributions of 0.6 percent of payroll.

Nine quarter moratorium on contributions—from April 1, 2000 through December 31, 2001, and from July 1 through December 31, 2002 - *employers didn't have hit*

Fund balance declined from \$193.7 million in fiscal year 2000 to \$108.8 million as of June 30, 2002.

Funded ratio was 78 percent at the end of fiscal year 2002.

Assuming no additional moratoriums on contributions, at the end of fiscal year 2003, the estimated fund balance will be \$80 million with a funded ratio of 58 percent.

Death and Disability Fund

The Governor's budget recommendations for fiscal years 2003-04 include an additional five-quarter moratorium on death and disability contributions:

- The fourth quarter of fiscal year 2003
- All four quarters of fiscal year 2004

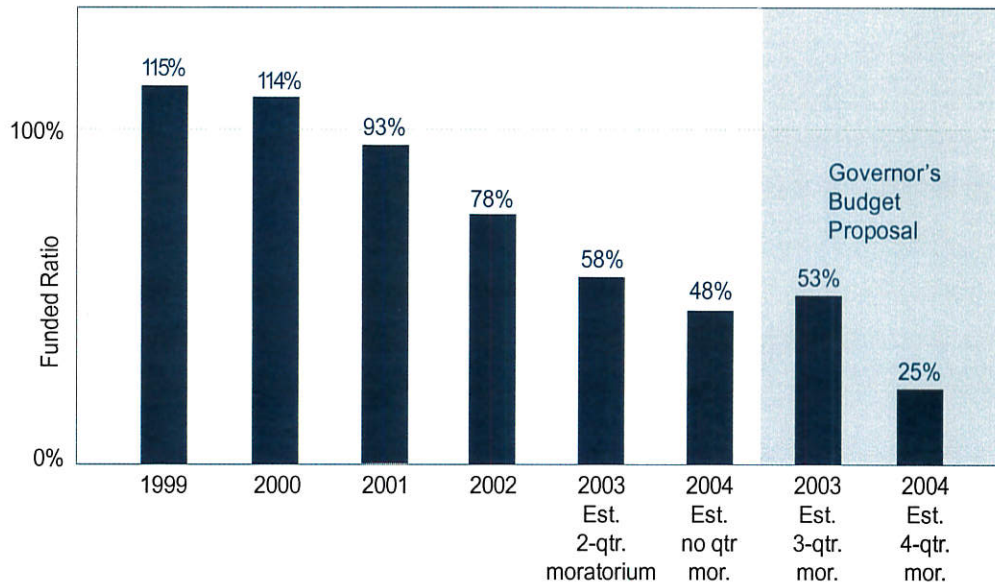
If adopted, this additional moratorium would cause further decline in the Death and Disability Fund's reserves:

- The fund balance would fall to about \$31.5 million with a funded ratio of 25 percent at the end of fiscal year 2004.
- Benefits would need to be funded on a pay-as-you-go basis beginning sometime between fiscal years 2005 and 2007, depending on contribution moratoriums after 2004.
- During the first full year after the reserve is depleted, annual employer contributions would be in the range of \$50 million (versus the current level of \$28 million) and the contribution rate would increase to approximately 1 percent of payroll (versus 0.6 percent).

Death and Disability Fund

- KPERS would need to re-examine the Fund's investment policy and invest in instruments with a lower risk profile and more liquidity.
- KPERS is committed to working with State officials to develop a plan to ensure the financial stability of the Fund.

Death and Disability Funded Ratios 1999-2004



KPERS 13th Check

- KPERS retirees who **retired prior to July 2, 1987**, are eligible to receive an additional annual payment up to a maximum of one month's benefit.
- This payment is **conditional** based on the availability of funds in the Retirant Dividend Reserve
- Funds are credited to the reserve based on a **statutory formula** that involves KPERS annual investment income.
- Due to **negative investment returns** the past two fiscal years the reserve balance is now only \$1 million.
- The estimated cost of a full 13th Check in October 2003 will be **\$6.7 million**.
- There are **15,000 eligible** recipients, their average age is 84 and the average amount of the benefit is \$475.

KPERS 13th Check

- The portion of the statutory formula that will determine the reserve credit this year is: 15% of (Interest + Dividends +/- Realized Gains or Losses)
- The System's realized gains or losses over the remaining six months of the fiscal year will be the determining factor of whether there is a reserve credit

Three Options for the Legislature to consider:

1. Take no action. The October 2003 13th Check would depend on investment performance the rest of the fiscal year.
2. Modify the formula for 2003 only. Retirees would receive a full 13th Check for October 2003 and future checks would depend on performance under the statutory formula.
3. Modify the formula permanently. Members of this group would receive a full 13th Check annually for life.

KPERS has informed retiree groups about this issue and will have an article in the next *KPERS Papers* retiree newsletter.