Approved: March 15, 2007
Date

MINUTES OF THE SELECT COMMITTEE ON KPERS

The meeting was called to order by Chairman Richard Carlson at 5:00 P.M. on March 5, 2007, in Room 234-N of the Capitol.

All members were present.

Committee staff present:
Alan Conroy, Legislative Research Department
J. G. Scott, Legislative Research Department
Julian Efird, Legislative Research Department
Gordon Self, Office of Revisor of Statutes
Mike Corrigan, Office of Revisor of Statutes
Shirley Jepson, Committee Assistant

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

Others attending:
See attached list.

- Attachment 1 Summary of **HB 2558** and **HB 2557**
- Attachment 2 Copy of Report from Joint Committee on Pensions, Investments and Benefits to the 2007 Legislature
- Attachment 3 Testimony by Glenn Deck on Retirement Plan Design - **HB 2558**
- Attachment 4 Testimony by Glenn Deck on Explanation of **HB 2557**

Discussion on HB 2558 - Enacting the Kansas Public Employees Retirement System Act of 2009.

Chairman Carlson recognized Julian Efird, Legislative Research Department, who presented an overview of **HB 2558** and **HB 2557** (Attachment 1). In addition, Dr. Efird distributed a copy of the Report of the Joint Committee on Pensions, Investments, and Benefits to the 2007 Kansas Legislature (Attachment 2).

Dr. Efird reported that the legislation recommends an alternative retirement plan for new, state, school and local public employees who begin work on or after July 1, 2009. Several modifications to the present plan are included for current employees. The legislation is recommended by the Joint Committee on Pensions, Investments and Benefits and supported by the Kansas Public Employees Retirement System (KPERS) Board of Trustees.

Major components of the proposed new plan include:
- First-day membership.
- Five-year vesting.
- 1.75 percent defined benefit multiplier.
- Final average salary based on five highest years
- Normal retirement at age 65 with 5 years or age 60 with 30 years of service.
- Early retirement at age 55 with 10 years of service.
- Automatic 2.0 percent cost-of-living adjustment at age 65.
- Employee contribution rate of 6.0 percent.
- Employer contribution rate at actuarial level, but not less than employee rate.
- Partial lump sum option of 10.0, 20.0 or 30.0 percent at retirement.

Modifications to the current plan include:
- First day membership for all state, school, and local members.
- Five year vesting, effective July 1, 2009.

Chairman Carlson recognized Glenn Deck, Executive Director, Kansas Public Employees Retirement System (KPERS), who presented background information and a review of changes between the current retirement plan and the proposed changes as addressed by **HB 2558**

(Attachment 3). Mr. Deck stated that **HB 2558** is the result of several years of planning to address the funding shortfall and develop a long-term funding plan. A considerable amount of research and planning by the KPERS Board of Trustees, staff and actuary has gone into producing the retirement plan design as outlined in **HB 2558**. It is felt that the new plan establishes financial soundness to the KPERS retirement plan, retirement benefit adequacy and workforce incentives.

Mr. Deck noted that the new plan would cover:
- KPERS-covered employees first employed on or after July 1, 2009.
- Former members who withdraw their contribution accounts before July 1, 2009, and again commence membership after that date.
- Former, non-vested members who left KPERS-covered positions with less than 10 years of service but have not withdrawn contributions.

Mr. Deck stated that **HB 2558** will not affect retirement eligibility and rules for current members; however, will provide two benefit enhancements for those members:
- First-day membership for State and local workers employed between July 1, 2008 and June 30, 2009.
- Five-year vesting for members employed before July 1, 2009.

Mr. Deck stated that it is anticipated that the new plan will significantly reduce liabilities and employer contributions beginning in 15 to 20 years and save the State approximately $2.6 billion through 2033. However, the benefit enhancements for existing members will have a cost impact of approximately $1.3 million to the State General Fund (SGF) and approximately $1.3 million from other funds.

Responding to a question from the Committee, Mr. Deck indicated that an individual must be actively employed to become vested under the enhancement feature.

Discussion on HB 2557 - Permanent COLA for certain KPERS retirants and increase in employee and employer contributions related thereto.

Julian Efird, Legislative Research Department, explained that **HB 2557** is a trailer bill recommending a Cost-of-Living Adjustment (COLA) for active employees. The legislation would have no impact on current retired employees.

Mr. Deck continued his testimony with an explanation of **HB 2557**, stating that the legislation provides that the KPERS employee contribution rate would increase from 4 percent to 6 percent on July 1, 2009, and provide funding for an automatic, annual 2 percent cost-of-living adjustment (COLA) in benefits beginning at age 65 for employees in the new plan (Attachment 4). The retired employee would need to be retired for one year before becoming eligible for the COLA. Mr. Deck stated that the funding for the COLA would be derived from the employee rate increase as well as an increase in the employer rate.

The meeting was adjourned at 6:00 p.m. The next meeting of the Committee will be held at 5:00 p.m. on March 8, 2007.

Richard Carlson, Chairman

Select Committee on KPERS
March 5, 2007
5:00 p.m.

NAME	REPRESENTING
Katie Quibarge	Kearney & Associates
TERRY FORSYTH	KNEA
Glenn Deck	KPERS

MARY ANN TORRENCE, ATTORNEY
REVISOR OF STATUTES
JAMES A. WILSON III, ATTORNEY
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KANSAS LEGISLATURE

Legal Consultation—
Legislative Committees and Legislators
Legislative Bill Drafting
Legislative Committee Staff
Secretary—
Legislative Coordinating Council
Kansas Commission on
Interstate Cooperation
Kansas Statutes Annotated
Editing and Publication
Legislative Information System

MEMORANDUM

TO: House Select Committee on KPERS
FR: Office of Revisor of Statutes
RE: Bill summary of House Bill No. 2558 and 2557
DA: March 5, 2007

SUMMARY

House Bill No. 2558 provides the implementing legislation to carry out the recommendations of the Joint Committee on Pensions, Investments and Benefits from the 2006 interim with regard to an alternative retirement plan for state, school and local public employees. The Joint Committee requested a bill be introduced to enact a plan developed by the Board of Trustees of the Kansas Public Employees Retirement System with suggested changes as directed by the Joint Committee. The resulting bill enacts the Kansas Public Employees Retirement System Act of 2009. In addition, the Joint Committee recommended that a second bill be introduced that would provide for a permanent COLA for current KPERS members along with an increase in employee contributions to help pay for the COLA. This recommendation is contained in House Bill No. 2557.

This memorandum provides a summary of the two bills, brief comments on the structure of the two bills and a section by section summary of the two bills.

In drafting the new alternative KPERS plan, in consultation with KPERS, the decision was made to not amend existing statutes but rather to set out the provisions for the new plan in separate, new sections. The new plan would incorporate by reference parts of the existing KPERS law when necessary. In addition, it is made clear that all provisions of the existing KPERS law would apply to those employees of the new plan unless specifically provided in the new act that the existing provisions did not apply. With regard to employees who are covered by the new act, when a conflict existed between the provisions of the new act and the provisions of the existing KPERS law, it is stated that the new act will control. It was deemed unnecessary to repeat the myriad of provisions of the existing KPERS law that would continue to apply to the employees covered under the new act that would not be changed by the implementation of this new act. The new act does not apply to members of the system who are employed by a participating employer prior to July 1, 2009.

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House Select Committee on KPERS
Attachment 1
Date 3-05-2007

There are benefit enhancements to existing members of KPERS in House Bill No. 2558, and the permanent COLA provision is contained in House Bill No. 2557.

House Bill No. 2558:

Section 1--General provisions.

This section provides the title of the act as the Kansas Public Employees Retirement System Act of 2009.

The act is effective on and after July 1, 2009.

The KPERS board is charged with administering the new act and should do so in the same manner that the board administers the existing KPERS law unless otherwise required to do so by the new act.

The existing KPERS law will apply to the new act unless specifically provided otherwise in the new act. In fact, the new act is made part of and supplemental to the existing law subject to certain specified differentiations. With regard to those employees covered under the new act, when a conflict exists between the provisions of the existing law and the new act, the new act shall control and no legal or contractual rights shall inure to the benefit of those employees under the existing KPERS law. In that circumstance, the new act provides those employees with their legal and contractual rights.

The new act does not apply to members of KPERS employed by a participating employer prior to July 1, 2009.

Section 2--Definitions.

This section provides definitions of key terms for the new act and specifies that other terms not specifically defined in the new act shall have the same meanings as provided in the existing KPERS law.

Subsection (a)(2) defines compensation and provides a compensation cap to be set at 7.5% before participating employers are billed for high final average salaries that jump in the final two years of service which results in higher retirement benefits.

Subsection (a)(3) defines employee to mean employees first employed by a participating employer on or after July 1, 2009. The term includes school employees. All employees of a new participating employer who affiliates on or after July 1, 2009, are defined as employees and subject to the new act.

Subsection (a)(5) provides that the final average salary of a member of the new plan shall be the average highest annual salary paid to such member for any five years of participating service.

Subsection (a)(6) defines first employed to mean:
(1) An employee who has not been an employee of any state, school or local participating employer prior to July 1, 2009;

(2) an employee who is a former member of the system and who withdrew contribution accounts before July 1, 2009, and who is employed by a participating employer on or after July 1, 2009; and (3) an employee who was an inactive, non-vested member and who is again employed by a participating employer on or after July 1, 2009.

Section 3--Employee membership.

This section provides first day of employment membership for all employees of a participating employer who are first employed on and after July 1, 2009, and for employees of participating employers who first affiliates on and after July 1, 2009. Elected officials who are first elected on or after July 1, 2009, may elect to be a member of the new system.

Section 4--Normal retirement date.

The normal retirement date of members under the new plan whereby they may retire without any reduction in benefits shall be age 65 or age 60 with the completion of 30 years of credited service.

Section 5--Participating service multiplier.

For a member under the new plan who retires after their normal retirement date, the amount for participating service shall be equal to the total of 1.75% of the member's final average salary multiplied by the number of years of participating service to be used in calculating such member's annual retirement benefit.

Section 6--Reduction for early retirement.

A member who retires before their normal retirement date but has attained age 55 with the completion of 10 years of participating service shall receive a retirement benefit which has been actuarially reduced for such early retirement. Such actuarial reduction shall be set by the KPERS board.

A member who retires before their normal retirement date but has attained age 55 with the completion of 30 years of participating service shall receive a retirement benefit which is equal to the average of the normal retirement benefit calculated under the new plan and the early retirement benefit calculated in this section.

Section 7--Security officers.

This section provides normal retirement dates for security officers that are different from those for other members of the new plan. A similar difference in retirement dates exists as well under the existing KPERS retirement plan.

Section 8--Vesting.

Members of the new plan shall be granted a vested retirement benefit in the system when they have completed five years of credited service at the time of termination.

Section 9--Retirement benefit options.

Members of the new plan may elect any of the options available to members of the existing plan, except that if a lump-sum payment is chosen, the member is limited to a payment that is equal to 10%, 20% or 30% of the actuarial present value of their benefit; and if the member elects any joint and survivor option, they shall have their annual retirement benefit determined and reduced by an amount recommended by the KPERS actuary.

Section 10-- Employee contributions.

Employee contributions for members under the new plan shall be an amount equal to 6% of such member's compensation.

Section 11--Employer contributions.

Employer contributions under the new plan shall be the same as under the existing plan. This section provides that employer contributions under the new plan shall not be less than the 6% employee contribution rate.

Section 12--Future adjustments of employee and employer contribution rates.

Once the employer rate of contribution equals the actuarially-determined rate of contribution, if the KPERS board upon the basis of the annual actuarial valuation recommends an increase in the actuarially-determined estimate of the rate of contribution, the legislature reserves the right to increase the employer rate of contribution to allow state, school and local employers and employees to share equally in any additional contribution rate of contribution actuarially required to fund the system.

Section 13-- COLA

Provides for a permanent 2% COLA for members of the new plan. The COLA would commence July 1, 2010, and would be paid on that date and each July 1 thereafter.

Section 14-- First day membership for employees under the existing KPERS plan.

Eliminates the one-year waiting period for membership for current employees of participating employers of the existing plan and provides for first day membership for such employees.

Section 15-- Vesting for employees under the existing KPERS plan.

Provides that commencing July 1, 2009, members of the existing plan shall be granted a vested retirement benefit in the system when they have completed five years of credited service at the time of termination.

House Bill No. 2557:

This bill is a companion bill to House Bill No. 2558 that provides a permanent 2% COLA for members of the existing KPERS plan. The COLA would commence July 1, 2010, and would be paid on that date and each July 1 thereafter. It would be applicable to any member who retired after July 1, 2009.

The bill would also require the employee contribution rate to be 6% of the member's compensation for all payroll periods commencing after July 1, 2009.

Report of the Joint Committee on Pensions, Investments, and Benefits to the 2007 Kansas Legislature

CHAIRPERSON: Senator Stephen Morris

VICE-CHAIRPERSON: Representative John Edmonds

OTHER MEMBERS: Senators Anthony Hensley, Laura Kelly, Ruth Teichman, and Dwayne Umbarger; and Representatives Richard Carlson, Ray Cox (replaced by Robert Olson in December), Geraldine Flaharty, Vaughn Flora, Margaret Long, Bill McCreary, and Melvin Neufeld

STUDY TOPICS

The Committee is directed to monitor the operations of KPERS, to review public retirement benefits, and to consider Governor's nominees to the KPERS Board of Trustees, with a recommendation to the Senate regarding confirmation.

LCC Referred Topics:

- **Proposed Alternative Retirement Plan.** Review a plan being developed by the KPERS Board of Trustees to address a long-term funding issue for the KPERS plan that covers state, school and local public employees. The KPERS Board has undertaken a study of the funding status, changing demographics and plan design options for future members and will report on development of alternative plans during the 2006 Interim period.

- **State's Deferred Compensation Plan.** Review the current status of the State's deferred compensation plan. Review if any changes need to be made in the plan.

December 2006

House Select Committee on KPERS
Attachment 2
Date 3-05-2007

Joint Committee on Pensions, Investments, and Benefits

PROPOSED ALTERNATIVE RETIREMENT PLAN

CONCLUSIONS AND RECOMMENDATIONS

The Committee recommends legislation to implement an alternative retirement plan for new state, school, and local public employees who begin work on or after July 1, 2009. In addition, the Committee recommends revisions to the present Kansas Public Employees Retirement System (KPERS) plan for current public employees who work for state, school, or local government employers.

Proposed New Plan

- First-day membership.
- Five-year vesting.
- 1.75 percent defined benefit multiplier.
- Final average salary based on five highest years.
- Normal retirement at age 65 with five years or age 60 with 30 years of service.
- Early retirement at age 55 with 10 years of service.
- Automatic 2.0 percent cost-of-living adjustment at age 65.
- Employee contribution rate of 6.0 percent.
- Employer contribution rate at actuarial level, but not less than employee rate.
- Partial lump sum option of 10.0, 20.0 or 30.0 percent at retirement.

Modifications to Current Plan

- First day membership for all state, school, and local members.
- Five year vesting, effective July 1, 2009.

In addition, the Committee recommends separate consideration of an automatic cost-of-living adjustment for active public employees who work for state, school, or local government employers covered by KPERS. This item would not impact retired public employees. The proposal would provide:

- An automatic 2.0 percent cost-of-living adjustment at age 65 financed by a 2.0 percent additional employee contribution and by an actuarially determined employer contribution of 0.66 to 0.81 percent.

Proposed Legislation: The Committee recommends introduction of two bills.

BACKGROUND

The Joint Committee on Pensions, Investments, and Benefits was assigned this study topic by the Legislative Coordinating Council with direction to review alternative plans being developed by the KPERS Board of Trustees to address a long-term funding issue for the current KPERS plan that covers state, school, and local public employees.

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The KPERS Board undertook a study of the funding status, changing demographics, and plan design options for future members.

Committee Activities

The Committee met on July 24, September 26, November 15, and December 15, 2006. The minutes and attachments for all meetings are available from the Division of Legislative Administrative Services. KPERS staff presented periodic reports to the Committee during these meetings about the study and recommendations from the KPERS Board of Trustees.

For the last several years, the highest priority for KPERS has been developing a comprehensive plan to address the long-term funding shortfall that impacts state, school, and local public employees. Funding improvements made in recent years represented important steps toward improving the System's financial condition and securing funds for all future benefit payments for retired state, school, and local public employees and their beneficiaries.

The 1993 Kansas Legislature provided enhanced KPERS retirement benefits and adopted a 40-year payment plan that gradually would increase employer contributions to pay for the enhancements. Several years after implementing the graduated employer contribution increases, the KPERS consulting actuary advised that the planned rate increases were insufficient to fund future promised benefits, creating a long-term funding problem. Over the last five years, the KPERS Board, staff, and consulting actuary worked closely with the Legislature and the Governor's Office to develop and implement a comprehensive funding plan that covers state, school, and local public employees.

Key steps taken to implement the long-range funding plan include:

- Approving a series of scheduled employer contribution rate increases;
- Issuing pension obligation bonds;
- Making actuarial changes; and
- Reviewing possible plan design changes for *future* employees.

The first three steps have been completed and the final step was the subject of Interim study this year. The focus is the plan that covers state, school, and local public employees. Other plans under KPERS, including the Kansas Police and Firemen's Retirement System and the Retirement System for Judges are not included in this study since both are funded on an actuarial basis.

Funding Status. In the most recent KPERS actuarial valuation dated December 31, 2005, the consulting actuary reported that the plan's funding condition continues to show improvement. The plan remains in actuarial balance and the unfunded actuarial liability increased from $4.74 billion as of December 31, 2004, to $5.15 billion as of December 31, 2005. With this increase, the plan's overall funding ratio fell from 70 percent to 69 percent.

The unfunded actuarial liability will continue to increase until statutory employer contribution rates catch up with the actuarially required contribution rates. Employer contribution rates are projected to meet the actuarially required rates in the next 15 years, if there is continued positive investment experience.

Alternative Plans. Consideration of alternative plan designs for future members represents the remaining component of the long-term funding plan. KPERS funding is leveraged for approximately 15 years until the incremental employer rate increases allow actual employer contributions to reach the actuarially-required rates. Although

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implementation of an alternative plan design for future members will not significantly impact the projected cost and timing of reaching actuarially-required levels, an alternative plan design would significantly reduce liabilities and employer contributions beginning in approximately 20 years.

Following discussion and analysis of plan design alternatives over the 2002, 2003, and 2004 Interims, the Committee introduced an alternative retirement plan during the 2005 Legislature. SB 281 incorporated a basic defined benefit plan along with a defined contribution component for future KPERS members. After 2005 subcommittee hearings on behalf of the Senate Ways and Means Committee, SB 281 was carried over to the 2006 Session. At that time, KPERS recommended that action be deferred until a comprehensive review and analysis of alternative plan designs could be completed during the 2006 Interim.

In January 2006, KPERS staff and the consulting actuary began developing the framework and timetable for completing a plan design review, culminating with an in-depth series of six presentations to the KPERS Board. The Board's discussion and analysis of plan design options included detailed examinations of KPERS funding status and outlook, demographic projections, key plan design objectives and features, and cost estimates.

The Board, recognizing the tenuous nature of the funding projections, coupled with revised demographic predictions that members will live longer in retirement, decided to recommend plan design objectives and general features to be considered before establishing an alternative plan design. The Board believed that such factors should be thoughtfully considered and systematically addressed in order to establish appropriate and affordable retirement benefits for future public employees. Throughout the process, the Board stressed that tradeoffs will need to be made and compromises reached to balance competing objectives such as benefit levels for career employees versus those for non-career employees and acceptable levels of additional complexity created by an alternative plan's administrative and educational components.

The Board recommended that the following objectives and features should be incorporated into any plan design changes for future members.

Financial Soundness

Establish an actuarial funding plan with an affordable mix of employer and employee contribution rates that ensures the financial soundness of the plan over the long-term.

Retirement Benefit Adequacy

Provide benefits that, when combined with Social Security benefits and personal savings, sustains the retiree's standard of living in retirement.

Workforce Incentives

Provide sufficient incentives to attract and retain high quality employees as part of the total compensation and benefits package.

The Board recommended the following general plan design changes for future members.

- Adopt retirement planning framework of 40-year working life and 30-year career.
- Establish minimum retirement income replacement ratio goal of 80 percent.
- Adopt basic financial planning principle that retirement income should come from three main sources: Social Security, KPERS benefits and personal savings.
- Place greater emphasis and direct resources toward encouraging personal

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savings and educating members about retirement planning.

- Increase normal retirement age above current levels.
- Reduce early retirement subsidies.
- Eliminate year of service requirement for state and local members.
- Reduce vesting period to five years.
- Provide automatic cost-of-living adjustments funded by increased employee contributions.

Based on the recommended objectives and general design features, the Board examined a range of design alternatives. Using the SB 281 plan design as a framework, the Board selected two preferred plan design alternatives.

Modified Current Plan

Traditional defined benefit plan with higher retirement eligibility, reduced early retirement subsidies, and automatic cost-of-living adjustments funded by increased employee contributions.

Retirement Savings Plan

Reduced defined benefit component including higher retirement eligibility, reduced early retirement subsidies, and automatic cost-of-living adjustments funded by increased employee contributions along with separate, interest-bearing accounts for each member.

The KPERS Board recommended legislative consideration of the modified current plan design. The Board's recommendation is based on the following key evaluation factors for the modified current plan.

- Continuation of guaranteed lifetime benefit payments for future public employees which are designed to complement retirement income from Social Security and personal savings.
- Higher normal retirement age and lower early retirement subsidies provide incentives for future members to work until they reach Social Security eligibility.
- Projected income replacement ratio at retirement from KPERS and Social Security of 81 percent for career employees retiring under normal retirement provisions (age 65 with 30 years of service) which is the same as the projected ratio under the current plan.
- Employee-funded cost-of-living adjustments that help maintain the purchasing power of KPERS benefits during retirement as demonstrated by projected income replacement ratios 10 years after retirement from KPERS and Social Security of:
  - 76 percent for career employees retiring at age 65 with 30 years of service versus 68 percent under the current plan.
  - 64 percent for career employees retiring at age 62 with 30 years of service versus 60 percent under the current plan.
- Higher levels of employee contributions and interest returned to non-career employees who terminate membership versus amounts returned under the current plan.
- Improvements in the long-term financial soundness of the plan as demonstrated by:
  - Projected actuarially-required employer contribution rate of 11.75 percent in FY 2017 for the State and School Groups under the modified

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current plan versus 12.82 percent in FY 2019 under the current plan.

- Lower employer contributions for the modified current plan compared with the current plan, resulting in projected savings of approximately $2.7 billion through 2033 and $6.2 billion through 2050 for the State and School Groups. The Committee met on July 24, September 26, November 15, and December 15, 2006. The minutes and attachments for all meetings are available from the Division of Legislative Administrative Services. KPERS staff presented periodic reports to the Committee during these meetings about the study and recommendations from the KPERS Board.

Conclusions and Recommendations

The Committee makes the following recommendations regarding a new plan and modifications to the current plan:

Proposed New Plan

- First day membership for state, school and local KPERS members. Under the current plan, some members, such as school district employees, have first day coverage and others, such as state employees, must wait one year.

- Five-year vesting. Under the current plan, members have a 10-year vesting period.

- 1.75 percent defined benefit multiplier. The current plan also uses a 1.75 percent multiplier.

- Final average salary based on five highest years. The current plan, depending on whether sick and annual leave payments are added, uses either three or four years.

- Normal retirement at age 65 with five years or age 60 with 30 years of service. Under the current plan, normal retirement may be at age 65, age 62 with 10 years, or with 85 points (age plus years of service).

- Early retirement at age 55 with 10 years of service. The current plan has the same provision.

- Automatic 2.0 percent cost-of-living adjustment at age 65. New provision partially funded by additional 2.0 percent employee contribution.

- Employee contribution rate of 6.0 percent. Under the current plan, members contribute 4.0 percent.

- Employer contribution rate at actuarial level, but not less than employee rate. No floor on employer contributions under the current plan.

- Partial lump sum option of 10.0, 20.0 or 30.0 percent at retirement. The current plan allows up to 50.0 percent in 10.0 percent increments for this option.

Modifications to Current Plan

- First-day membership for all state, school, and local members. Some local units and all state government members covered by KPERS have a one-year waiting period under the current plan.

- Five-year vesting, effective July 1, 2009. Vesting period is 10 years under the current plan.

In addition, the Committee recommends separate consideration of an automatic cost-of-living adjustment for current public employees who work for state, school, or local government employers covered by KPERS. Retired public employees would receive no adjustments in benefits.

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- Automatic 2.0 percent cost-of-living adjustment (COLA) at age 65 financed by 2.0 percent additional employee contribution and an actuarially determined employer contribution of 0.66 to 0.81 percent. No automatic COLAs are provided under the current plan. The Committee expressed concern about the increases in unfunded actuarial liability: $182 million for local governments, and $762 million for the state and school group. The employer contribution rate increases that would address the unfunded actuarial liability would be 0.38 percent of local governments and 0.76 percent for the state in paying for the state and school groups' combined cost.

The Committee also agreed to other details of the proposed new plan generally as recommended by the KPERS Board.

For correctional officers, early retirement for corrections officers and supervisors would be age 50 with 10 years of service and early retirement for support personnel who have regular contact with inmates would be age 55 with 10 years of service.

If the new plan begins on July 1, 2009, then the following individuals would be members of new plan: all members first employed on, or after, July 1, 2009; former members who withdrew contributions before July 1, 2009, and commenced new membership on or after July 1, 2009; and inactive, non-vested members who commence active membership on, or after, July 1, 2009.

Employers and employees shall share future rate increases on a 50/50 basis if required in the future.

Compensation caps are set at 7.5 percent before participating employers are billed for inflated final average salaries that increase the retirement benefits.

The KPERS Board will be given more flexibility in adjusting joint survivor factors and in setting them to actuarially determined standards.

The Committee also asked for further KPERS review of rollovers as related to the partial lump sum option. Information was requested about the possibility of allowing rollovers up to 100.0 percent of the KPERS benefit, provided such transfers were to qualified plans and not used for other purposes.

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House Select Committee on
KPERS
Attachment 3
Date 3-05-2007

Kansas Public Employees
Retirement System

Retirement Plan Design – House Bill 2558

House Select Committee on KPERS ▪ *March 5, 2007*

Background

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Since 2001 and 2002 when actuarial projections indicated KPERS was not in actuarial balance, KPERS' Board and staff have worked closely with the Joint Committee on Pensions, Investments and Benefits to address the funding shortfall and develop a long-term funding plan.

- Plan has been comprehensive, multi-year, incremental approach involving **funding** increases, **actuarial changes**, and **plan design** review.

Key steps that have been implemented as part of the plan include:

- Scheduled series of **employer rate increases** which began in FY 2006.
- **Pension obligation bonds** of $500 million issued in February 2004 with $440.2 million in net proceeds to KPERS and debt service paid through State General Fund.
- **Actuarial components** implemented by adopting Entry Age Normal cost method and modifying mortality assumptions.

Background

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Although employer rate increases and issuance of pension obligation bonds have improved KPERS' funding projections, significant challenges remain.

- KPERS funding leveraged for the next 10-15 years until employer contributions reach actuarially-required levels (ARC).
  - State Group ARC = 7.38% in 2010
  - Local Group ARC = 8.42% in 2015
  - School Group ARC = 12.82% in 2019
- Any future investment returns below the 8 percent assumed investment target will negatively impact funding projections.
- State's employer contributions for the State and School Groups are expected to increase from 1.5 percent to 2.0 to 3.5 percent of State budget.
- Demographic projections indicate:
  - Current retirement rules create incentives for most experienced and marketable employees to leave in their early- to mid-50s.
  - KPERS members retiring in 2036 expected to live (and collect benefits) about two years longer than those who retire in 2006.
  - Ratio of active, contributing members to retired members expected to decline from current level of 2.4 active members for each retiree to about 1.67 in 2020.

Plan Design Review History

3-4

As the final piece of the long-term funding plan for KPERS, the Joint Committee on Pensions, Investments and Benefits has been considering plan design changes for **future** members during the last five years.

- In 2002 and 2003 interims, the Joint Committee on Pensions, Investments and Benefits reviewed employees' contractual rights and options for changing plan design.
- In 2004 interim, the Joint Committee reviewed various plan design alternatives that would reduce long-term costs. The Joint Committee endorsed alternative retirement plan for **future members only** designed to provide a basic defined benefit plan along with an optional defined contribution component.
- This alternative was introduced in the 2005 Session as Senate Bill 281. Senate Ways and Means Subcommittee and full Committee held hearings on the bill and KPERS proposed a number of amendments to the bill.
- SB 281 carried over to 2006 Session, and KPERS recommended that action be deferred pending completion and consideration of a comprehensive analysis of plan design.

2006 Plan Design Review

3-5

Beginning in January 2006, the KPERS Board of Trustees, staff and actuary began developing an analytical framework and timetable for completing a comprehensive and systematic review of retirement plan design.

- During the spring and summer of 2006, the Board of Trustees examined KPERS' funding status and outlook, demographic projections, key plan design objectives and features, cost projections and a range of plan design alternatives (including defined benefit and defined contribution components).
- The Board's plan design recommendations to 2006 Joint Committee included recommendations on general objectives and features and a modification of the current plan design for future employees.

During the 2006 interim, the Joint Committee reviewed and discussed extensive information about KPERS' funding, demographic, plan design and cost projections.

- The Joint Committee recommended the retirement plan design outlined in SB 362 and HB 2558 for state, school and local employees who begin work on or after July 1, 2009.

Plan Design Recommendations

3-6

Recommended Plan Design Objectives

- **Financial Soundness** - Establish actuarial funding plan with an affordable mix of employer & employee contribution rates that ensures financial soundness of the plan over the long term.
- **Retirement Benefit Adequacy** - Provide benefits that, when combined with Social Security and personal savings, sustain the retiree's standard of living in retirement.
- **Workforce Incentives** - Provide sufficient incentives to attract and retain high quality employees as part of the total compensation and benefits package.

Recommended Plan Design Features

- Direct greater emphasis and resources toward encouraging personal savings.
- Increase the normal retirement age above current levels.
- Reduce incentives for members to retire early.
- Provide earlier membership and vesting for all employees.
- Protect the purchasing power of KPERS retirement benefits over time.

Tradeoffs and compromises required to balance competing objectives and develop benefits for members of different ages, salaries and years of service.

Plan Design Bill - HB 2558

3-7

Following the 2006 interim study, the Joint Committee on Pensions, Investments and Benefits approved the introduction of a bill providing modified benefits for future KPERS members.

- HB 2558 and SB 362 incorporate the KPERS Board of Trustees recommendations as modified by the Joint Committee.

The new plan design will apply to:

- KPERS-covered employees first employed on or after July 1, 2009.
- Former members who withdraw their contribution accounts before July 1, 2009, and again commence membership after that date.
- Former, non-vested members who left KPERS-covered positions with less than 10 years of service but have not withdrawn contributions.

HB 2558/SB 362 also include two enhancements for current employees, first-day membership for those hired between July 1, 2008, and June 30, 2009, and five-year vesting effective July 1, 2009.

Plan Design - Future Members

8-30

	Current Plan	HB 2558/SB 362 Plan
▪ Membership	Employed before 7-1-09	Employed on or after 7-1-09
▪ First-Day Membership	School members only	State, school & local members
▪ Vesting	10 years	5 years
▪ Retirement Multiplier	1.75%	1.75%
▪ Normal Retirement Eligibility	Age 65 Age 62 with 10 years 85 Point Rule	Age 65 with 5 years Age 60 with 30 years
▪ Early Retirement Eligibility	Age 55 with 10 years	Age 55 with 10 years
▪ Early Retirement Reductions	Subsidized for ages 55-64	Subsidized with 30 years only
▪ Final Average Salary Definition	Average of 3 or 4 highest yrs (depending on hire date)	Average of 5 highest yrs

Plan Design - Future Members

3-9

	Current Plan	HB 2558/SB 362 Plan
▪ Compensation Caps	15%	7.5%
▪ Partial-Lump Sum Option	10, 20, 30, 40, or 50%	10, 20, or 30%
▪ Joint Survivor Factors	Specified in statute	Set actuarially by KPERS Board
▪ Cost-of-living adjustments	Ad hoc only	Automatic, annual 2% at age 65
▪ Employee Contributions	4%	6%
▪ Employer Contributions	Based on actuarial valuation subject to statutory caps	Based on actuarial valuation subject to statutory caps May not be less than 6%
▪ Future Cost Increases	Employer-paid	May be shared equally by employers and employees once actuarially-required rates are reached

Plan Design - Existing Members

3-10

The HB 2558/SB 362 plan design will not affect retirement eligibility and rules for current members.

- Current members may continue to retire at age 65, age 62 with 10 years of service, and with 85 "points."
- These retirement benefits and eligibility considered contractual in nature and cannot be changed.

HB 2558/SB 362 does provide two benefit enhancements for current members:

- first-day (immediate) membership for State and local workers employed between July 1, 2008, and June 30, 2009, and
- five-year vesting for members employed before July 1, 2009.

These changes are intended to provide current employees with membership and vesting provisions similar to the HB 2558/SB 362 provisions for future employees.

HB 2558 Savings Estimates

3-11

The most significant impact of HB 2558/SB 362 will be the projected contribution savings for state and local employers associated with the modified plan design for future employees.

- Plan design changes for future employees will not significantly impact reaching the actuarially-required rates, but will significantly reduce liabilities and employer contributions beginning in 15 to 20 years.
- State savings projected to be $2.6 billion through 2033.
- Local employer savings projected to be $1 billion through 2033.

	KPERS State & School Groups		KPERS Local Group	
	Current Plan	**HB 2558 Plan**	**Current Plan**	**HB 2558 Plan**
Total Employer Contributions (through 2033, estimated)	$ 16.4 billion	$ 13.8 billion	$ 4.4 billion	$ 3.4 billion
Savings versus Current Plan (through 2033, estimated)	n/a	$ 2.6 billion	n/a	$ 1.0 billion

HB 2558 Savings Estimates (cont). 3-12

The State's projected costs, including detailed information for select years, for the KPERS State and School Groups are under the current plan design and the HB 2558/SB 362 plan design are summarized below.

Plan Design Cost Estimates for State & School Groups

		Current Plan	HB 2558/SB 362 Plan
Actuarially-Required Employer Contribution Rate (ARC Rate)		12.82%	11.75%
ARC Date		FY 2019	FY 2017
Employer Contributions	FY 2010	$ 296 million	$ 296 million
	FY 2011	328	328
	FY 2012	361	361
	FY 2013	395	395
	FY 2014	432	432
	FY 2015	470	470
	FY 2020	658	592
	FY 2025	767	639
	FY 2030	846	611
Totals thru 2033		$ 16.4 billion	$ 13.8 billion

Est. Savings = $2.6 billion

3-13

HB 2558 Cost Estimates

The HB 2558/SB 362 enhancements for existing members will have cost impacts for the State and local employers.

First-Day Membership (for those hired during FY 2009)

- One-time increase of $2.6 million for the State in fiscal year 2009.
- Division of Budget estimates $1.3 million from State General Fund and $1.3 million from other funds.
- No impact on KPERS unfunded actuarial liability.

Five-Year Vesting (for existing members effective July 1, 2009)

	Increase in...		
	Unfunded Actuarial Liability (UAL)	**Actuarial Employer Contribution Rate**	**FY 2009 Employer Contributions**
State Group	$2 million	0.14%	$1.4 million
School Group	$7 million	0.09%	$2.8 million
Subtotal, State	$9 million	0.09%	$4.2 million
Local Group	$4 million	0.18%	$2.6 million

Conclusion

3-14

Recognizing the tenuous nature of KPERS' funding coupled with demographic projections, the KPERS Board of Trustees supports the HB 2558/SB 362 plan design for future employees. The HB2558/SB 362 plan would:

- Improve KPERS' long-term financial security by establishing an affordable mix of employer and employee contribution rates that ensure the System's financial soundness over the long term.
- Provide benefits that, when combined with Social Security and personal savings, sustain our retiree's standard of living in retirement.
- Align plan design and benefits for future public employees with demographic projections for longevity and working careers.

3-15

Appendix

- **Early Retirement Reduction Factors**
- **Retirement Income & Replacement Ratio Estimates**
- **Correctional Officer Retirement Eligibility**

Early Retirement Reduction Factors

3-16

Members who do not qualify for normal, or full, retirement benefits may retire early and receive reduced benefits beginning at age 55 (with at least 10 years of service). Assuming a monthly benefit of $1,000 before the early retirement reduction factor is applied, early retirement benefits under the current plan and the SB 362 and HB 2558 plans are summarized below.

	Current Plan[(a)]		SB 362 & HB 2558 Plans[(b)]			
	All early retirements		*Members with < 30 yrs of service*		*Members with > 30 yrs of service*	
Retirement Age	**Factor**	**$1,000 benefit reduced to...**	**Factor**	**$1,000 benefit reduced to...**	**Factor**	**$1,000 benefit reduced to...**
55	59%	$ 590	37%	$ 370	70%	$ 700
56	66%	$ 660	40%	$ 400	73%	$ 730
57	74%	$ 740	44%	$ 440	76%	$ 760
58	81%	$ 810	49%	$ 490	79%	$ 790
59	88%	$ 880	54%	$ 540	82%	$ 820
60	95%	$ 950	59%	$ 590	100%	$ 1,000
61	98%	$ 980	66%	$ 660	100%	$ 1,000
62			73%	$ 730	100%	$ 1,000
63			81%	$ 810	100%	$ 1,000
64			90%	$ 900	100%	$ 1,000

(a) Under current plan, early retirement benefits are reduced 0.2% for each month between ages 60-62 plus 0.6% for each month between ages 55-60. These reductions are "subsidized" meaning the reductions for early retirement are less than the full actuarial reductions.
Under SB 362 and HB 2558 plans, early retirement benefit reductions would be subsidized only for members retiring early with 30 or more years of service. Early retirement benefits would be actuarially reduced for members retiring with less than 30 years of service.

Retirement Income & Replacement Ratios

3-17

At Retirement	Current Plan: KPERS	Current Plan: Social Security	Current Plan: Total	HB 2558 Plan: KPERS	HB 2558 Plan: Social Security	HB 2558 Plan: Total
Age 55 w/ 30 years ▪ Current Plan: 85 Points	$1,684 51%	$0 0%	$1,684 51%	$1,178 35%	$0 0%	$1,178 35%
Age 62 w/ 22 years ▪ Average retiree	$1,235 37%	$746 22%	$1,981 59%	$901 27%	$746 22%	$1,647 49%
Age 65 w/ 30 years ▪ Career employee	$1,684 51%	$1,009 30%	$2,693 81%	$1,684 51%	$1,009 30%	$2,693 81%

(a) Assumes employee retires at listed age and service with a final salary of $40,000 ($3,333 monthly).

(b) Income replacement ratio refers to percent of pre-retirement income provided by retirement benefits. Financial planners generally recommend minimum income replacement ratios of 70% to 80% from all sources (Social Security, employer plans, and personal savings).

Retirement Income & Replacement Ratios

3-18

10 Years After Retirement	Current Plan			HB 2558 Plan		
	KPERS	Social Security	Total	KPERS	Social Security	Total
Age 55 w/ 30 years ▪ Current Plan: 85 Points	$1,684 38%	$951 21%	$2,635 59%	$1,437 32%	$951 21%	$2,388 53%
Age 62 w/ 22 years ▪ Average Retiree	$1,235 28%	$1,003 22%	$2,238 50%	$1,099 25%	$1,003 22%	$2,102 47%
Age 65 w/ 30 years ▪ Career Employee	$1,684 38%	$1,356 30%	$3,040 68%	$2,052 46%	$1,356 30%	$3,408 76%

(a) Assumes employee retires at listed age and service with a final salary of $40,000 ($3,333 monthly).

(b) Income replacement ratio refers to percent of pre-retirement income provided by retirement benefits. Financial planners generally recommend minimum income replacement ratios of 70% to 80% from all sources (Social Security, employer plans, and personal savings).

3-19

Retirement Income & Replacement Ratios

15 Years After Retirement	Current Plan			HB 2558 Plan		
	KPERS	Social Security	Total	KPERS	Social Security	Total
Age 55 w/ 30 years ▪ Retiree w/ 85 Points	$1,684 33%	$1,103 21%	$2,787 54%	$1,586 31%	$1,103 21%	$2,689 52%
Age 62 w/ 22 years ▪ Average retiree	$1,235 24%	$1,162 22%	$2,397 46%	$1,213 24%	$1,162 22%	$2,375 46%
Age 65 w/ 30 years ▪ Career employee	$1,684 33%	$1,572 30%	$3,256 63%	$2,266 44%	$1,572 30%	$3,838 74%

(a) Assumes employee retires at listed age and service with a final salary of $40,000 ($3,333 monthly).

(b) Income replacement ratio refers to percent of pre-retirement income provided by retirement benefits. Financial planners generally recommend minimum income replacement ratios of 70% to 80% from all sources (Social Security, employer plans, and personal savings).

3-20

Retirement – Correctional Officers

Under the current plan, certain State correctional officers may retire with unreduced benefits earlier than other KPERS members.

	Normal Retirement	Early Retirement
C 55 Group (corrections officers and supervisors)	Age 55 with 3 years of service immediately preceding retirement or "85 points"	Age 50 with 10 years of service
C 60 Group (support personnel who have regular contact with inmates)	Age 60 with 3 years of service immediately preceding retirement or "85 points"	Age 55 with 10 years of service

The additional cost of correctional officers' retirement provisions is added to the State employer rate to determine the required employer rates for correctional officers.

Retirement – Correctional Officers (HB 2558)

3-21

Under the HB 2558/SB 362 plan, the "85 point" rule for normal retirement eligibility will be eliminated for all members, including correctional officers.

- The retirement rules for correctional officer retirement eligibility under HB 2558/SB 362 are summarized in the following table.

	Normal Retirement	Early Retirement
C 55 Group (corrections officers and supervisors)	Age 55 with: a) 3 years of service immediately preceding retirement, and b) 10 years of service.	Age 50 with 10 years of service
C 60 Group (support personnel who have regular contact with inmates)	Age 60 with: a) 3 years of service immediately preceding retirement, and b) 10 years of service.	Age 55 with 10 years of service

Under the HB 2558/SB 362 plan, the additional cost of correctional officers' retirement provisions would continue to be added to the State's employer rate to determine the required employer rates for correctional officers.

Kansas Public Employees Retirement System

Legislative Data Sheet

2007 House Bill 2557

Sponsored by Committee on Appropriations.

Effects of Bill

HB 2557 provides that the KPERS **employee** contribution rate would increase from 4 percent to 6 percent on July 1, 2009. KPERS members retiring from active service after July 1, 2009, would receive an automatic, annual 2 percent increase in their benefits beginning at age 65. The annual COLA adjustment would be made each July 1 to eligible retirees. In addition to attaining age 65, retirees would need to be retired for at least one year before becoming eligible for the COLA.

Fiscal Impact

The additional funding required to pay for the HB 2557 COLA would be derived from two sources: the employee rate increase from 4 to 6 percent plus increases in state and local employer contribution rates. As shown in the table below, the employer rate increase and resulting additional employer contributions would vary by KPERS membership group.

Estimated Fiscal Impact of HB 2557
Cost Estimate, 2% COLA for Active Members

	Increase in Unfunded Actuarial Liability (UAL)	Contribution Rate Increase		Estimated First Year Employer Contributions
		Employee	Employer	
KPERS State Group	$ 171 million	2.00%	0.66%	$ 6.6 million
KPERS School Group	591 million	2.00%	0.81%	26.2 million
Subtotal, State & School	**$ 762 million**	**2.00%**	**0.76%**	**$ 32.8 million**
KPERS Local Group	$ 182 million	2.00%	0.38%	$ 5.6 million

These cost estimates are based on membership data and actuarial assumptions used in the Retirement System's December 31, 2005, actuarial valuation. The estimates also assume that future retirement patterns will not change and that the UAL increase will be amortized over the 28 years remaining in KPERS current amortization period.

The Retirement System could implement HB 2557 within currently approved staffing and operating expenditure levels.

Date: March 2, 2007

House Select Committee on KPERS
Attachment 4
Date 3-05-2007