

MEMORANDUM

To: Senate Financial Institutions and Insurance Committee

From: Alan D. Conroy, Executive Director

Date: March 2, 2023

Subject: SB 256; KPERS 3 Dividend Credit

KPERS 3 Cash Balance plan was created in 2012 and has been the primary retirement plan for new KPERS members since 2015 (some corrections positions continue to be enrolled in KPERS 2). A cash balance plan is a defined benefit plan (like KPERS 1 and KPERS 2) that has features like defined contribution plans (like 401k plans).

KPERS 3 retirement benefits are based on notional account balances accrued throughout a member's career based on employee contributions, employer credits and interest earnings. This structure of benefit calculation makes the accrual of interest more important for KPERS 3 members and their ultimate retirement benefits.

The KPERS 3 plan design includes two ways that interest is applied to member account balances:

1. A guaranteed 4% annual interest rate credited quarterly.
2. An optional dividend credit determined by statutory formula.

SB 256, as introduced, sets a 1% dividend credit for account balances as of 12/31/2023 and then reestablishes the statutory formula for 12/31/2024 and future years.

Dividend Credit Statutory Formula

The dividend credit for KPERS 3 is contained in K.S.A. 74-49,306 and is set at 75% of the five-year average net compound rate of return above 6%.

Dividend Calculation Example	
Five-year average net compound rate of return	8%
Amount of average return above 6%	2%
75% of return above 6%	1.5%
Dividend credit equals 1.5%	



Dividend Experience

Each year in the March the KPERS Board of Trustees reviews the previous calendar year returns and whether a dividend is to be paid based on the statutory formula.

Over the first six years of KPERS 3, the formulaic dividend interest credit has applied in three years. A summary of the dividends paid is included in the following table.

KPERS 3 Dividend Credit Calculations		
Calendar Year	Average Net Compound Rate of Return*	Dividend Credit
2015	0.2%	None
2016	4.3%	None
2017	7.4%	1.1%
2018	4.7%	None
2019	7.1%	0.825%
2020	9.3%	2.475%
2021	10.7%	3.525%
2022	5.7%	None

*The compound rate of return in the first four years was based on the number of years since the plan took effect (the first year was based on the one-year average, the second year was based on the two-year average, etc.). Starting in 2019 and going forward the formula uses a five-year rolling average.

Actuarial Cost Estimate

As introduced, SB 256 provides a 1% interest credit for 12/31/2023. In order for the statutory formula to provide a 1% interest credit on 12/31/2023, KPERS investment return would need to be approximately 4.9% for CY 2023. Until we have a better idea of the actual investment returns in CY 2023, an actuarial cost estimate is not possible.

If an additional 1% interest credit to KPERS 3 was applied as of 12/31/2022 it would be more than currently expected, since there is no dividend provided by the statutory formula on 12/31/2022. A 1% dividend credit on 12/31/2022 increases each KPERS 3 member's notional account balances and therefore increases their expected benefits at retirement. Since the KPERS 3 cash balance plan is still relatively new, only about half the active membership is covered by KPERS 3 and KPERS 3 account balances have not accrued large balances. As a result, the expected increase in the unfunded actuarial liability is about \$3.4 million. Amortized over 20 years, this would increase State/School and Local employer contribution rates by 0.01%, or about \$250,000.

Policy Question

As introduced, SB 256 applies a 1% dividend to account balances on 12/31/2023. However, at this time the statutory dividend formula will provide a 1% dividend if the System has a 4.9% investment return in CY 2023. If the CY 2023 investment return meets or exceeds 4.9%, SB 256 would disadvantage KPERS 3 members.

If the 1% dividend credit was applied to account balances on 12/31/2022, this would advantage KPERS 3 members since the statutory dividend does not provide any dividend on 12/31/2022.

If the intent of SB 256 is to provide a benefit on 12/31/2022, the date for the statutory dividend to restart should also be updated to 12/31/2023.

I would be pleased to answer any questions the Committee has regarding the KPERS 3 dividend interest credit and SB 256.