MINUTES

JOINT COMMITTEE ON PENSIONS, INVESTMENTS, AND BENEFITS

September 6-7, 2007
Room 519-S—Statehouse

Members Present

Representative Richard Carlson, Chairperson
Senator Stephen Morris, Vice-Chairperson
Senator Laura Kelly (September 6 Only)
Senator Ruth Teichman
Representative Geraldine Flaharty, Ranking Minority Member
Representative Vaughn Flora (September 7 Only)
Representative Margaret Long
Representative Robert Olson
Representative Sharon Schwartz

Staff present

Alan Conroy, Legislative Research Department (September 6 Only)
J. G. Scott, Legislative Research Department (September 6 Only)
Julian Efird, Legislative Research Department
Gordon Self, Revisor of Statutes Office
Shirley Jepson, Committee Secretary

Conferees

Glenn Deck, Executive Director, Kansas Public Employees Retirement System
Vince Smith, Chief Investment Officer, Kansas Public Employees Retirement System
Pat Beckham, Kansas Public Employees Retirement System Actuary, Milliman, Inc.
Carol Foreman, Deputy Secretary, Department of Administration

September 6, 2007
Morning Session

Glenn Deck, Kansas Public Employees Retirement System (KPERS) Executive Director, presented an overview of operations (Attachment 1). Mr. Deck noted that KPERS has a total of 258,000 active, inactive, and retired members. The State of Kansas is the largest participating employer. More than half of active members are employed by school districts. It is expected that the number of KPERS retirees will increase to approximately 80,000 by the year 2015. This 22.0 percent increase will impact the System's workload. Responding to a question, Mr. Deck stated that approximately 85 to 90 percent of retirement benefits are paid to persons located in Kansas. The Committee requested additional information showing residence locations of those receiving KPERS retirement benefits.

Mr. Deck reported that KPERS pays out more in benefits each year than contributions received from members and employers, and that the difference is made up from investment earnings. At the present time, KPERS manages total assets of approximately $13.9 billion in market value.

Mr. Deck provided information about key challenges and strategic initiatives identified in a five-year KPERS Strategic Plan which serves as a blueprint for managing the system.

- **Retirement System Long-Term Funding.** Sufficient progress on the long-term funding plan has been made in the last six years, with legislation to increase employer contribution rates; the issuance of $500 million in pension obligation bonds in 2004; and legislation adopting a new plan design for future employees hired on or after July 1, 2009.

- **Investment Management.** Positive earnings have been realized during the past four fiscal years. Market volatility, lower capital market return expectations, and global risks continue to pose a challenge.

- **Services Improvements and Increasing Workload.** In order to provide members and employers with responsive, accurate, and accessible services, an increase in staff will be necessary. Group presentations are held across the state to educate, applications and benefit payments are processed in a timely manner, and a new annual statement has been created.

- **Technology Initiatives.** In 2003, KPERS began a multiyear $8.0 million project to replace and enhance the core information systems. The phased project will be completed in March of 2009. Additional technology initiatives of disaster recovery, security enhancement, and platform consolidation are expected to be completed in 2009, with additional total funding of $2.9 million from the FY 2008 and FY 2009 budgets.

Mr. Deck continued with a presentation on 2007 KPERS legislation implementation (Attachment 2) specifically related to the following:

- **SB 362**—KPERS staff and outside tax counsel are reviewing the new KPERS plan design for IRS compliance. Any possible technical amendments will be presented at the Committee's November meeting. Employer and member communications and training for the new plan design will be developed and implemented during FY 2008 and FY 2009.

- **HB 2457**—KPERS does not have any direct holdings in Sudan or any direct investments in Sudanese companies. However, KPERS has approximately 0.11 percent, or $15.2 million, of the investment portfolio in Sudan-related business operations. KPERS is in the process of developing internal procedures for identifying these companies, sending engagement letters to investment managers and companies, and monitoring company responses and actions.

- **HB 2385**—Transfer of Kansas Public Employees Deferred Compensation Plan oversight and administration from the Department of Administration to KPERS will be effective January 1, 2008.

Mr. Deck presented an update on legislation proposed by the Joint Committee to the 2007 Legislature which did not become law, and carried over to the 2008 Session (Attachment 3):

- **HB 2076**—Increases the KP&F Tier II earnings limitation from the $10,000 level established in 1989 to $20,000 for working when disabled.

- **HB 2077**—Makes technical amendments to improve the statutory language regarding improper withdrawals and portability of service between systems.

- **HB 2078**—Authorizes KPERS to implement certain tax-free distributions for health insurance premiums of retired public safety officers, as provided by the federal Pension Protection Act of 2006.

Hearings were held during the 2007 Session on these three bills by the House Appropriations Committee. **HB 2076** and **HB 2078** were combined into **HB 2077** and recommended for passage by the House Appropriations Committee. However, the amended bill remains on House General Orders for the 2008 Session.

With regard to IRS compliance legislation, the KPERS outside tax counsel is reviewing the revisions to the KPERS plan design in **SB 362** and checking against current IRS-qualified plan guidelines in order to determine that the new legislation complies with IRS rules and regulations. Some technical amendments may be necessary during the 2008 Legislative Session.

The proposed FY 2009 KPERS budget request will include:

- Additional staff in FY 2009 because of the increase in the number of retirees by the year 2015.

- $250,000 for programming changes to implement the new KPERS Plan Design as signed into law in **SB 362**.

Vince Smith, KPERS Chief Investment Officer, presented an overview of KPERS investments and market volatility (Attachment 4). Mr. Smith stated that financial markets have been somewhat volatile during recent weeks, affected mainly by changes in the housing market financing. It was noted that the housing market has not been affected as severely in Kansas as in other parts of the country. Responding to a question, Mr. Smith reported that when the economy is doing well, investments are doing well.

Mr. Smith stated that the KPERS portfolio is invested for the long term, is managed by staff and 15 managers, and is well diversified, enabling KPERS to weather periodic bouts of volatility without undue exposure to any particular factor driving the markets. With reference to present financial market conditions, Mr. Smith reported the following.

- KPERS expects occasional periods of volatility; long-term investing keeps them prepared for these periods.
- Portfolio is invested across seven asset classes and divided into eight distinct sub-portfolios managed by 15 managers using 27 mandates.
- KPERS looks at low-risk opportunities during times of excess volatility.

Afternoon Session

Pat Beckham, KPERS Actuary, Milliman, Inc., presented the KPERS Actuarial Valuation and Long-Term Projections Report, as well as a copy of a part of the Valuation Report as of December 31, 2006 (Attachment 5). Ms. Beckham noted that the actuarial valuation is a snapshot picture of KPERS on December 31 of each year that is used to monitor the financial health of the system, including its assets, benefits, and future contributions. An investment income earnings rate of 8.0 percent is used in the actuarial projections and a “smoothing” method is employed to cushion sudden changes to account for some years exceeding the rate and some years falling under the rate. Ms. Beckham stated that investment return has a significant impact on the health of the whole system. The market value of KPERS investments was more than $1.0 billion greater than the actuarial value on December 31, 2005, allowing for a reserve in the smoothing method to help offset any adverse future experience.

Ms. Beckham noted that in FY 2010, the state’s actuarial contribution rate will be 0.23 percent less than the maximum statutory rate since the actuarially required rate will be reached that year. Current law requires the “excess” or amount of difference between the statutory and actuarial rate to be shifted to pay for the school’s unfunded actuarial liability in FY 2010.

Responding to a question, Alan Conroy, Legislative Research Department, stated that the state’s employer contribution for the school districts to KPERS is funded entirely from the State General Fund (SGF).

Carol Foreman, Deputy Secretary, Department of Administration, presented a report on the state’s Deferred Compensation Program pertaining to recent developments in the administration of the 457 Plan and the ING management contract, audits of plan, and the new contract for services with ING (Attachment 6). Ms. Foreman stated that the state’s Deferred Compensation Program was implemented with legislation in 1976 and has grown to include $480 million in assets and 15,300 participants for the state. In addition, approximately 240 local units of government participate in the plan with ING and those local units have $243 million in assets with 11,000 local employee participants. The state’s current contract with ING will expire in December 2007.

Ms. Foreman reported that the Department of Administration and the Deferred Compensation Oversight Committee began a comprehensive review of the plan in 2006. Legislation was proposed and enacted during the 2007 Session to transfer administration of the Deferred Compensation Program from the Department of Administration to KPERS.

Proposals for a service provider were solicited and seven qualified service providers responded to a request for proposals. As a result, a new five-year contract has been negotiated, with ING being selected. The new contract will allow for new investment options to be added and for fees to be reduced. One new option will offer a Vanguard index fund with a fee of five basis points, and two other new Vanguard index funds will charge eight basis points. Some of the current investment options will be continued and fund mapping will be provided to participants during September of 2007 about the transition to be effected on December 10, 2007, with some of the other current investment funds being replaced by new fund options.

The audit firm of Allen, Gibbs & Houlik, L.C. was selected through a negotiated procurement to perform a financial audit for plan years 2003, 2004, and 2005, as well as a contract compliance audit. No exceptions were found by the financial audits. Several minor exceptions were found with regard to the contract compliance audit. ING has reviewed these exceptions and is taking steps to address the exceptions.

With the enactment of **2007 HB 2385**, Ms. Foreman reported that the Department of Administration and KPERS entered into an interagency agreement to facilitate transition of administration of the program from the Department of Administration to KPERS prior to January 1, 2008.

In response to a question regarding how employees receive information about the Deferred Compensation Program, Ms. Foreman noted that information is provided for new employees at the time of initial employment and that ING works with employers to educate employees. By moving the plan to KPERS, information about deferred compensation may be integrated into its educational program. Glenn Deck stated that KPERS will work with ING to schedule seminars to educate employees on deferred compensation, as well as the KPERS retirement program. Mr. Deck felt that combining these programs under one entity will improve employees' understanding of the relationship between savings and retirement. An online program also gives employees another avenue to track investments and make adjustments.

Mr. Deck suggested that the state might be interested in researching automatic enrollment for all state employees, with matching state dollars.

September 7, 2008
Morning Session

Julian Efird, Legislative Research Department, presented a review of interim study topics (<u>Attachment 7</u>). Mr. Efird noted that statutes direct monitoring, reviewing, and making recommendations relative to investment policies and objectives formulated by KPERS; reviewing KPERS benefits; and considering and making recommendations on the confirmation of members nominated by the Governor to serve on the KPERS Board of Trustees. Other interim topics may be directed by legislation or by committees of the Legislature. The Legislative Coordinating Council (LCC) has assigned two topics for 2007 interim study.

- Topic No. 1—Allow local units of government to elect coverage under KPERS similar to the State Correctional Officer Group. Study allowing local units of government the option of electing coverage under KPERS that would be similar to the state correctional officer group.

Mr. Efird explained that **SB 339** was introduced during the 2007 Session and would provide local detention officers and support personnel with some limited enhanced benefits regarding earlier retirement benefits when compared to regular KPERS benefits. The bill would allow counties to elect coverage for such officers, provided that at least 500 local detention officers would be participating after elections are held. Provision would allow for enhanced benefits for retirees. Mr. Efird said that the 85-point normal retirement provision would be continued for this group. It was noted that the counties would need to be willing to buy into the program and pay the additional cost as an increased employer contribution. This group of employees are currently members of KPERS. However, the change would enhance benefits but not require additional employee contributions. Any additional costs would be paid by the local units of government.

Glenn Deck stated the legislation was proposed as a result of approximately 12 counties that had an interest in an enhanced program. Mr. Deck provided information on the effects of **SB 339** and copies of the bill brief (Attachment 8).

Gordon Self, Revisor of Statutes Office, noted that the legislation is written to allow all counties to participate. Mr. Self noted that this group of employees are currently members of KPERS and the only changed benefit is a change in the normal retirement date from the KPERS plan.

- Topic No. 2—Expansion of employee groups into the Kansas Police and Fire Retirement System. Study the possibility of adding selected state agency employee groups who perform public safety duties (fire and law enforcement) into the Kansas Police and Fire (KP&F) Retirement System from regular KPERS. Also, review the Social Security coverage for certain groups in the KP&F Retirement System and any potential implications for other groups.

Mr. Efird noted that three related bills were introduced during the 2007 Legislative Session that address this topic. Copies of the three bill briefs for **SB 388**, **HB 2238** and **HB 2584** were provided by Glenn Deck (Attachment 9).

Mr. Efird explained that the question of which state agency public safety officers should be members of the KP&F Retirement System has been addressed by several previous interim studies. Legislation authorizing sworn officers of the Kansas Highway Patrol (KHP) and Kansas Bureau of Investigation (KBI) was passed in 1968. Subsequently, other state agency public safety officer groups have been added to the KP&F Retirement System. Mr. Efird noted that, because at one time participation in Social Security was elective, KP&F members in the KHP and KBI generally are not covered by Social Security. However, newer KP&F member groups are covered by Social Security. Generally, retirement systems that do not participate in Social Security have higher retirement benefits, Mr. Deck pointed out.

Mr. Efird noted that groups that moved into the KP&F Retirement System have been brought in for future service only. **HB 2584**, pertaining to law enforcement officers in the Department of Wildlife and Parks, would be an exception and require the employer to pay a higher rate than other groups because it calls for both prior and future service. It was noted that any unfunded liability for prior service is the responsibility of the employer.

Mr. Deck indicated that there are three enhanced benefits to the KP&F Retirement System when compared with regular KPERS; allowing employees to retire at an earlier age because of the physical demands of the occupation and a higher multiplier in the determination of retirement benefits. Special disability benefits also are provided under the plan.

Mr. Self stated that the definition of who should be covered by the KP&F Retirement System has been a long-standing issue for the Legislature.

After discussion of possible studies, other study topics selected for the Committee's interim review will include:

- Review the findings of an actuarial audit of the KPERS actuary and work products, which is required every six years, at a December 2007 or January 2008 meeting;

- Review of 2007 **HB 2151**, which concerns increasing the maximum KP&F retirement benefit from 80 percent to 100 percent of final average salary and providing for continued member contributions equal to 7.0 percent of compensation until the benefit maximum is reached;

- Cost-of-living adjustments (COLAs); and

- Working after retirement.

Glenn Deck presented an overview of statutory restrictions on retirees returning to work after retirement for KPERS-affiliated employers (Attachment 10). The overview included recent statutory changes, earnings limitations for working for the same KPERS employer, working for a different KPERS employer, working for a non-KPERS employer, and sunset of exemption for licensed nurses which expires on June 30, 2008.

Mr. Deck noted that recently several companies have begun offering to contract with school districts to provide "contract" teachers who have retired from KPERS, an arrangement that appears to be designed to circumvent the working-after-retirement restrictions. Mr. Deck felt that this issue should be monitored.

With reference to keeping teachers from retiring early and assisting with the teacher shortage problem, Mr. Deck suggested that options may be available to alleviate the situation and keep the teachers employed by offering incentives, such as setting up a 401(a) Money Purchase Plan for the employee, with the school districts providing matching funds.

In regard to a question regarding COLA proposals, Mr. Deck noted that the current KPERS retirement plan and employees' contribution rate do not allow funding for a COLA. Future state employees after July 1, 2009 will contribute an additional 2.0 percent in order to earn an automatic 2.0 percent COLA after retirement under the new plan authorized in 2007 **SB 362.**

Mr. Deck was asked to provide the Committee at a future meeting with the following information:

- Presentation of a report, after submission to the Legislative Educational Planning Committee (LEPC) at its October 15, 2007 meeting, on options for modifying the post-retirement earnings limitation to address the teacher shortage issue.

- Information on the 30-day waiting period in Kansas for teachers between retirement and returning to work, as opposed to 60-90 days in other states.

Prepared by Shirley Jepson, Committee Secretary
Edited by Julian Efird, Principal Analyst

Approved by the Committee on:

December 10, 2007
(Date)