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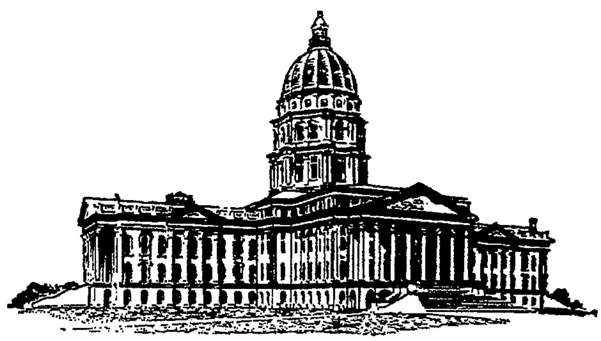
KANSAS LEGISLATURE

2011 Summary of Legislation



Legislative Research Department
June 2011

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RETIREMENT

KPERS Study Commission and Other KPERS Changes

Senate Sub. for HB 2194 modifies the Kansas Public Employees Retirement System (KPERS) plan for public employees who are current KPERS members in the state, school, and local groups, and for future public employees in the same groups. The bill also establishes a new study commission effective July 1, 2011.

In addition, the bill makes a number of modifications, with some of the changes in plan benefits and funding being contingent upon specific triggers, including certain actions that would have be taken by the 2012 Legislature, before becoming effective. Other new plan options for benefits and funding are contingent upon a favorable ruling from the Internal Revenue Service (IRS) regarding elections for KPERS Tier 1 and Tier 2 members to choose from other plan alternatives for retirement contributions and benefits.

The plan modifications and funding changes (without elections) will bring the employer contributions for KPERS state, school, and local groups into actuarial balance. Employer contributions for both the state and local groups will reach the actuarial required contribution (ARC) in 2014, specifically FY 2014 for the state and CY 2014 for local units of government. The ARC for the school group will occur in FY 2019.

The general fiscal note (without factoring an election of other options) through FY 2033 forecasts a net savings of $2.9 billion for the employer contributions for the KPERS state and school groups, and a net savings of $636 million for the KPERS local group. The KPERS plan modifications (without elections) will increase the employee contributions by $932.0 million for the state and school groups, and by $365.4 million for the local group.

A subsequent fiscal impact assessment will be prepared by the KPERS actuary for the effect of elections and will be made available to the study commission. In addition, the impact of plan changes on retirement benefits will be prepared by the KPERS actuary and will be made available to the Study Commission.

Summary of Key Points

First, the bill establishes a 13-member KPERS Study Commission to consider alternative retirement plans, including defined contribution plans, hybrid plans that could include a defined contribution component, and other possible plans. The Commission must report no later than January 6, 2012, on its recommendations, which then would be introduced as two identical bills in each chamber of the Legislature.

The KPERS Study Commission will be comprised of 13 members appointed as follows: four legislative members (one each appointed by the President of the Senate, Speaker of the House, and minority leaders of each chamber); four at-large members (one each appointed by the President of the Senate, Speaker of the House, and minority leaders of each chamber); five private sector members including at least one an attorney (appointed by the Governor); and four ex-officio non-voting members (Executive Director of KPERS, Director of the Budget, Revisor of Statutes, and Director of Legislative Research).

Second, for the other provisions in the bill to become effective, the 2012 Legislature must vote on each of the House and Senate bills containing the study commission's recommendations, with one required vote to occur in the Committee of the Whole of one chamber and another required vote to occur in a Committee of the other chamber. The dual voting is the trigger of the effective date for other provisions in the bill that implement those items noted below, which will bring KPERS into actuarial balance by FY 2019 when all KPERS groups (state, school and local) will reach the actuarial required contribution (ARC).

Third, the statutory annual state, school, and local KPERS increase in employer contribution rate caps will phase into new annual limits from the current 0.6 percent, provided that the dual vote occurs during the 2012 Legislative Session:

- 0.9 percent in FY 2014 (January 1, 2014 for local employers);
- 1.0 percent in FY 2015 (January 1, 2015 for local employers);
- 1.1 percent in FY 2016 (January 1, 2016 for local employers); and
- 1.2 percent in FY 2017 (January 1, 2017 for local employers).

Fourth, Tier 1 employee adjustments, triggered by the 2012 Session dual votes, include adding two options commencing January 1, 2014, that apply to active KPERS members:

- Tier 1 members will have as the default option an employee contribution rate increase from 4.0 to 6.0 percent and also will have for future years of service an increase in multiplier from 1.75 to 1.85 percent; or

- If an election is permitted by the IRS, then Tier 1 members may elect freezing the employee contribution rate at 4.0 percent and reducing their future service multiplier from 1.75 to 1.4 percent.

Fifth, Tier 2 employee adjustments, triggered by the 2012 Session dual votes, include adding two options commencing January 1, 2014, that apply to active KPERS members:

- Tier 2 members will have as the default option an employee contribution rate frozen at 6.0 percent and the cost-of-living adjustment (COLA) eliminated; or

- If an election is permitted by the IRS, then Tier 2 members may elect freezing the employee contribution rate at 6.0 percent and reducing their multiplier from 1.75 to 1.4 percent in order to retain their COLA.

KPERS will determine when an election will be held over a 90-day period. The election will be held only after a favorable IRS ruling that an in-service election may be held for active Tier I and Tier 2 members. The default options will apply if the IRS ruling does not allow an election for active members.

Sixth, inactive KPERS members, if returning to covered employment, will have an election for alternative options in their respective tier prior to July 1, 2013. After that date, or if no election is approved by the IRS, then inactive members will have the default option in their tier upon returning to active, covered KPERS employment.

Seventh, a provision directs that after the sale of surplus state real property, 80 percent of the proceeds will be transferred to KPERS for reducing the unfunded actuarial liability.

Eighth, the bill includes an appropriation of $60,000 in FY 2012 that increases the special revenue fund expenditure authority of KPERS in order to pay for actuarial services in support of the KPERS Study Commission's work during the 2011 Interim. As the Commission is an interim study group, the Legislative Coordinating Council (LCC) will have to authorize the number of meeting days in order for the members to receive pay for the commission when it meets prior to January 6, 2012. Discussions during the conference committee assumed 18 meeting days for the commission during the 2011 Interim period.

KPERS Employer Contributions 2011 to 2033
(In Millions)

KPERS Participants	Baseline Contributions	New Contributions	Change
State & School Groups	$ 30,644.9	$ 28,663.8	$ (1,981.1)
Local Group	7,740.5	7,469.7	(270.8)
Totals	$ 38,385.4	$ 36,133.5	$ (2,251.9)

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Fiscal Note for Conference Committee Bill

The fiscal note is a three-part report to correspond with the different provisions in the bill. The multiyear fiscal impact for the bill (excluding the options offered in an election and using the default options for Tier 1 and Tier 2) is to adjust the net KPERS employer and employee contributions by almost an estimated $2.3 billion as a result of the changes in statutorily required contributions and retirement benefits.

First, the bill establishes a KPERS Study Commission on July 1, 2011. The administrative fiscal note for that provision is presented below under a separate heading.

Second, most other provisions in the bill become effective after dual votes during the 2012 Legislature. KPERS staff worked with the actuary to develop an estimated impact for employer and employee contributions based on the default options (no elections) for Tier 1 and Tier 2. The information for the second part of the fiscal impact is included below as the general fiscal note without elections.

Third, other options become effective if the IRS rules that elections may be held. The KPERS actuary is working to develop an estimated impact if the alternative options are elected by KPERS employees. The third part of the fiscal impact will be available to the KPERS Study Commission. In addition, the KPERS actuary is preparing an estimated impact on retirement benefits of the changes, comparing the assessment with the baseline benefits before the legislation. That assessments also will be provided to the commission.

Administrative Fiscal Note

KPERS estimates professional services for actuarial work and consultants to support the work of the KPERS Study Commission should not exceed $60,000, all from fee funds. In addition, Legislative Administrative Services estimates costs of $55,218, all from the State General Fund, for the travel, subsistence, and per diem compensation associated with the KPERS Study Commission, based on a total of 18 meeting days. The LCC must approve meeting days for 2011 Interim study groups, including the Commission.

General Fiscal Note Without Elections

According to the KPERS actuary, with enactment of Senate Sub. for HB 2194 and the 2012 triggers being fulfilled, the KPERS employee contribution rate for certain members will rise by 2.0 percent. In addition, the annual KPERS employer contribution rate cap will rise yearly from 0.6 percent to 1.2 percent, and the higher annual cap for increases will continue to be applied until each KPERS group reaches the ARC rate.

The employer contribution rate for the combined KPERS state and school groups will rise to an ARC rate of 15.75 percent in FY 2019. The state group will reach an ARC rate of 9.46 percent in FY 2014, but will continue rising until the combined state and school groups reach an ARC five years later. The bill reduces long-term aggregate KPERS employer contributions for the state and school groups through FY 2033 by a net of $2.913 billion from all funding sources when compared to current law. The estimated first-year cost increase compared to current law is an additional $14.5 million in FY 2014 for the state and school groups employer contributions from all funding sources. The estimated State General Fund cost is approximately $12.3 million in additional FY 2014 payments.

The increasing annual cap for the KPERS local group will raise the employer contribution rate to an ARC of 8.74 percent in CY 2014 (beginning January 1, 2014). The bill reduces the long-term aggregate KPERS employer contributions for the local group through CY 2033 by a net of $636.1 million when compared to current law. The estimated first-year cost increase compared to current law is $3.8 million in CY 2014 for local units of government.

The bill also increases some KPERS employee contributions by 1.0 percent beginning January 1, 2014, and by another 1.0 percent the next year beginning January 1, 2015, unless an employee elects an option to freeze the contribution rate. The total KPERS employee contribution rate rises from the current 4.0 percent to 6.0 percent over this period for one Tier 1 option, while Tier 2 will remain at 6.0 percent under both options. The KPERS actuary estimates the impact on the state and school group of employees will increase their aggregate employee contributions by $932.0 million over the period through FY 2033 based on the default options. The impact for the local group of employees will add $366.0 million of employee contributions over the period through CY 2033 based on the default option.

General Fiscal Note With Elections

The general fiscal note for the election of options and its impact will be provided by the KPERS actuary for the KPERS Study Commission.

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Retirement

V-4 Long-Term Funding of KPERS

The Kansas Public Employees Retirement System (known as KPERS and referenced in this document as the Retirement System) administers three statewide plans. One plan includes state, school, and local groups composed of regular state and local public employees, school district and community college employees, Regents classified employees and certain Regents unclassified staff with pre-1962 service, and state correctional officers. A second plan known as the Kansas Police and Firemen's (KP&F) Retirement System includes certain designated state and local public safety employees. A third plan known as the Kansas Retirement System for Judges includes the state's judicial system judges and justices. All coverage groups are defined benefit, contributory retirement plans and have as members most public employees in Kansas.

The primary purpose of the Retirement System is to accumulate sufficient resources in order to pay benefits. Today more than $1.0 billion is paid in annual retirement and death benefits. Payments exceed the contributions from employees and employers, leaving the balance in benefit payments to come from investment earnings. Long-term disability benefit payments also are paid to disabled members. Of the three plans, only the regular KPERS plan is experiencing a long-term funding problem. The other two plans are funded on an actuarial basis, and employer contributions are adjusted annually in order to provide adequate funding on an actuarial reserve basis. The regular KPERS plan, however, is limited in the amount of annual budget increases by statutory caps on the state, school, and local participating employers. Therefore, the participating employer contributions for regular KPERS are not paid at the actuarial amounts, but rather are paid at the statutorily capped amounts. The employee contributions also are capped by a statutory maximum amount that currently is being paid annually.

The Retirement System faces two challenges in terms of long-term funding. The first challenge involves the regular KPERS program's long-term funding of all three groups (state, school, and local), and the second challenge specifically involves the KPERS School Group which is no longer in actuarial balance to achieve full-funding for promised benefits under provisions of current law. Both challenges are impacted by two situations. First, there is an annual gap between current revenue (contributions) and expenditure (benefits) that must be funded from investment income. Second, there is a shortfall in annual employer contributions computed as the difference between the actuarial rate (which indicates how much should be paid by employers) versus the statutory rate (which determines how much is paid by employers). The resulting reduced funding increases the unfunded actuarial liability, which is the difference between assets and promised benefits. The Legislature focused its attention on the long-term retirement funding issue during recent sessions. As recently as two years ago, all plans, including the KPERS School Group, were in actuarial balance and were expected to reach full-funding by FY 2033. However, in the last two actuarial valuations, the KPERS School Group was determined to be "out of balance" and in danger of not having enough resources to pay all promised benefits by the end of its amortization period in 2033.

Long-Term Retirement Funding

For a number of years, the Legislature, the Governor, and the Retirement System's Board of Trustees engaged in the development of a comprehensive plan to address the long-term retirement financing problem. Funding improvements that were made during the 2003 and 2004 Legislative Sessions represented important steps toward improving the Retirement System's financial condition and securing sufficient funds for future benefit payments. The 2005 Legislature clarified the calculation and contributions for the state and school groups in future years. The 2006 Legislature, in approving a modest benefit adjustment for former members of the Kansas School Retirement System, paid the entire actuarial contribution to prepay the lifelong enhancement, thus having a neutral impact on the unfunded actuarial liability. The 2007 and 2008 Legislatures followed the same practice when $7.0 million from the State General Fund was appropriated to pay the state's share of a $300 bonus payment in FY 2008 and in FY 2009. No benefit enhancements were passed by the 2009, 2010, or 2011 Sessions of the Legislature.

However, in spite of the various funding measures adopted by the Legislature, the KPERS long-term problems have grown worse. There was modest improvement in 2009 compared with 2010 and 2011, but the long-term projections are negative.

In the December 31, 2010, actuarial valuation, the actuary states that: "...KPERS continues to face a significant long-term funding challenge, particularly with the School Group."

Background of the Funding Shortfall

The 1993 Legislature authorized enhanced Retirement System benefits and adopted a 40-year payment plan running until 2033 that gradually increased employer contribution rates to pay for the enhancements. The incremental rate increases were designed so that the statutory contribution rates would converge with the actuarial rates required to fund the enhanced benefits. By 2000 and 2001, it became apparent that the incremental rate increases were insufficient. The Retirement System's 2001 actuarial valuation showed that the unfunded actuarial liability (difference between the actuarial liabilities and the actuarial value of assets) had increased significantly, and future contribution rates were not projected to converge with actuarially required rates. At that time, the Retirement System actuary recommended that "action be taken to increase future contributions to a level which would restore the System to actuarial balance."

Prior Funding Improvements

Following review of the 2001 valuation results, the Retirement System Board of Trustees, staff, and actuary began working closely with the Legislature's Joint Committee on Pensions, Investments and Benefits and the Governor's Office to develop a long-term funding plan. The following improvements were adopted as part of that comprehensive plan.

- The 2003 and 2004 Legislatures raised the statutory cap on annual employer contribution rate increases from 0.2 percent for the state and from 0.15 percent for local employers to 0.4 percent in 2006, 0.5 percent in 2007, and 0.6 percent in 2008.
- The 2003 Legislature authorized issuance of $500.0 million in pension obligation bonds, and the Retirement System received net proceeds of $440.2 million in March 2004.
- The 2003 Legislature divided the Retirement System state and school group into two separate groups (the state employees group and the school employees group) for actuarial calculations and determination of employer contribution rates.
- After the 2003 Session, the Retirement System Board of Trustees revised the actuarial components of the new funding plan by adopting the traditional Entry Age Normal actuarial cost method and a five-year asset valuation smoothing method.
- The 2005 Legislature clarified the determination of the State group and School group employer contributions, and reestablished calculation of a combined rate for the two groups. In any year that the combined rate would be greater than the individual rate for the State group, the difference in contributions amounts for the state group payment calculated under the two methods shall be applied to the School group's payment.
- The 2007 Legislature established a new KPERS tier for future employees with estimated savings of $3.6 billion in future employer contributions. For the new Tier II KPERS members, the plan includes state, school, and local employees first hired on or after July 1, 2009. Many characteristics of the current KPERS plan are retained, but modifications included addition of a 2.0 percent cost-of-living adjustment after retirement with a 2.0 percent employee contribution to help finance the cost, elimination of the 85-point rule for early retirement, first day membership, and five-year vesting. The fiscal note for employer contributions estimates $2.6 billion in state employer contribution savings and $1.0 billion of local savings over 25 years after implementation of the new tier.

Latest Actuarial Projections

The most recent actuarial valuation, dated December 31, 2010, found that the Retirement System's long-term funding status remains challenged. The unprecedented negative investment experience in 2008 was a significant setback in the Retirement System's long-term funding. Despite the 2008 investment losses, the State and Local groups remain in actuarial balance. For the School group, the statutory and actuarial contribution rates are not projected to converge before 2033 if all assumptions are met in future years.

As of December 31, 2010, the Retirement System's actuarial funded ratio decreased from 64.0 percent the previous year to 62.0 percent and the unfunded actuarial liability increased from $7.7 billion the previous year to $8.3 billion for all groups (state, school, and local; KP&F; and judges). Even with recent funding improvements approved by the Legislature, the dollar amount of the unfunded actuarial liability is projected to increase for a number of years before it begins to decline. However, the KPERS School group may never close the gap and its unfunded liability may not be brought into balance with assets sufficient to pay all promised benefits within the 40-year amortization period that ends in 2033.

School Group Issue

The KPERS School Group's unfunded actuarial liability increased from $5.0 billion in 2009 to $5.3 billion in the December 31, 2010, valuation report, which is more than one-half of the Retirement System's total unfunded actuarial liability. For this group, the actuarial liability is $11.8 billion and the actuarial value of assets is $6.5 billion. The funded ratio on an actuarial basis decreased slightly from 56.3 percent the previous year to 54.9 percent. Anything below 60 percent funding is considered reason for concern. Rising annual contributions under the current statutory cap of 0.6 percent will not bring the KPERS School Group into actuarial balance even though the state's employer contribution rate would rise to almost 20.0 percent in FY 2033. If all other actuarial assumptions are not met, such as annual earnings of 8.0 percent, then the situation could be worse in terms of the long-term funding shortfall.

Summary

The twin challenges facing the Retirement System both involve funding: all of the retirement plans need more money to address a long-term financing problem, and the School Group needs an even greater share of that new money to solve its funding issue. The KPERS School group is out of actuarial balance, and the State and Local groups are barely in actuarial balance. Both of the latter two groups could move out-of-balance if all actuarial assumptions are not met in the future.

The 2011 Legislature passed Senate Sub. for HB 2194 which would make fundamental changes in the Kansas Public Employees Retirement System (KPERS) plan on July 1, 2012. Implementation of the funding and plan design provisions was delayed in order for the KPERS Study Commission that was created by the bill to makes recommendations to the 2012 Legislature that may modify the funding and other provisions in the 2011 legislation.

Senate Sub. for HB 2194 established a 13-member KPERS Study Commission to review alternative plan designs and to make recommendations for long-term sustainability of the System. A commission report is due to the Legislature by January 6, 2012. The report recommendations must have a vote in each chamber of the 2012 Legislature for the other parts of 2011 Senate Sub. for HB 2194 to become effective, unless amendment or repeal of those provisions are recommended by the KPERS Study Commission.

The provisions scheduled to go into effect on July 1, 2012, (if not modified or repealed during the 2012 Legislature) include the following:

> **Employer Contribution Increases.** Raise incrementally the cap on employer contribution increases from the current 0.6 percent to 0.9 percent in FY 2014, 1.0 percent in FY 2015, 1.1 percent in FY 2016, and 1.2 percent in FY 2017 and subsequently until the actuarial required contribution (ARC) is reached.

Tier 1 Members. Contribution Increase or Benefit Decrease (future service only). 6.0 percent contribution and 1.85 percent multiplier is the default option; or alternatively, 4.0 percent contribution and 1.4 percent multiplier is the other option. There is a 90-day election starting July 1, 2013 to choose between Tier 1 options, pending IRS approval. The change does not affect past service credit and the changes are effective January 1, 2014.

Tier 2 Members. Benefit Decrease or Lose COLA (future service only except COLA). 6.0 percent contribution, 1.75 percent multiplier, and lose cost-of-living adjustment for all service, not just future service, is the default option; or alternatively, 6.0 percent multiplier, 1.4 percent multiplier, and keep the COLA is the other option. There is a 90-day election starting July 1, 2013, to choose between Tier 2 options, pending IRS approval. The multiplier change does not affect past service credit. The COLA loss is for all service credit and the changes are effective January 1, 2014. All new employees automatically have the default option.

Inactive Members. Inactive members returning to work after July 1, 2013, will be given the default tier.

Surplus Property. Proceeds (80.0 percent) from the sale of excess state real estate property will be used to pay down the KPERS' unfunded liability.

Fiscal Note. Plan modifications and funding changes (without elections) will bring the employer contributions for KPERS state, school, and local groups into actuarial balance. Employer contributions for both the state and local groups will reach the actuarial required contribution (ARC) in 2014, specifically FY 2014 for the state and CY 2014 for the local units of government. The ARC for the school group will occur in FY 2019. The general fiscal note (without elections) through FY 2033 forecasts a net savings of $2.9 billion for the employer contributions for the KPERS state and school groups, and a net savings of $636 million for the KPERS local group. The KPERS plan modifications (without elections) will increase the employee contributions by $932.0 million for the state and school groups, and by $365.4 million for the local group.

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