MINUTES

JOINT COMMITTEE ON PENSIONS, INVESTMENTS & BENEFITS

November 21, 2011
Room 144-S—Statehouse

Members Present

Representative Sharon Schwartz, Chairperson
Senator Anthony Hensley
Senator Laura Kelly
Senator Ruth Teichman
Representative Richard Carlson
Representative Geraldine Flaharty
Representative Mitch Holmes
Representative Steven Johnson
Representative Richard Proehl
Representative Jerry Williams

Staff Present

Julian Efird, Kansas Legislative Research Department
Michael Steiner, Kansas Legislative Research Department
Alan Conroy, Kansas Legislative Research Department
J. G. Scott, Kansas Legislative Research Department
David Wiese, Office of the Revisor of Statutes
Katherine McBride, Office of the Revisor of Statutes
Shirley Jepson, Committee Assistant

Conferees

Elizabeth Miller, Acting Executive Director, Kansas Public Employees Retirement System (KPERS)
Patrice Beckham, KPERS Actuary
Doug Mays, Member, KPERS Board of Trustees
Dennis Taylor, Secretary, Department of Administration
Dale Dennis, Deputy Commissioner, Department of Education
Tim Overman, Highland Park High School Teacher
Representative Mitch Holmes, Co-chairperson, KPERS Study Commission

Morning Session

The meeting was called to order at 10:00 a.m. by Chairperson Schwartz for the purpose of bringing the Committee up-to-date on KPERS activities and funding issues since the end of the 2011 Legislative Session and providing an update on the progress of the KPERS Study Commission.

Overview of Kansas Public Employees Retirement System (KPERS)

Elizabeth Miller, Acting Executive Director, KPERS, presented an update on operations, the financial condition of the KPERS trust fund, and an overview of Senate Sub. for HB 2194 (Attachment 1). The presentation contained the following:

- KPERS manages the investment of $13.5 billion in trust fund assets in U.S. and international markets. Although the fund saw negative returns in FY 2009, returns for FY 2010 and FY 2011 reflected the market's rebound.

- Previous actions to address the funding status included legislation in 2003 to raise statutory caps on employer contribution rates. The state issued $500.0 million in pension obligation bonds in 2004. Legislation in 2007 established a new plan design for employees hired on or after July 1, 2009, which increased retirement eligibility ages and employee contributions.

- The 2011 Legislature created new legislative committees to address the unfunded liability. Senate Sub. for HB 2194 was passed by both chambers and was signed by the Governor. Senate Sub. for HB 2194 provides for several changes to become effective on July 1, 2012, if the 2012 Legislature acts on recommendations of the KPERS Study Commission which also was created by the legislation. The changes include:

    - Raising the statutory cap on employer contribution rates;
    - Providing one-time elections for Tier 1 members (future service) to increase the contribution rate or decrease the benefit rate; and
    - Provide one-time election for Tier 2 members (future service) to decrease benefits or lose cost-of-living-adjustment (COLA).

  The changes to plan design must have an Internal Revenue Service (IRS) review. The KPERS Board believes Senate Sub. for HB 2194 is a meaningful step towards improving the System's long-term funding outlook and reaching actuarial required contribution (ARC) levels.

- KPERS has submitted a request to the IRS for a letter ruling as to the permissibility of conducting election for members regarding changes in the contribution-benefit options. Ms. Miller noted KPERS has been advised it may be a considerable period of time before it receives a response from IRS.

- The KPERS Board continues to evaluate the System's actual experience, as compared to its actuarial assumptions for demographic and economic variables. Because contributions are received and benefits are paid-out over many decades, KPERS continues to use an 8.0 percent assumption and has realized an 8.5 percent average return for the past 25 years. The Board has agreed to retain the System's 8.0 percent actuarial return assumption and revisit the issue again next year.

Ms. Miller responded to questions from the Committee.

Overview of KPERS Actuarial Valuation Report

Patrice Beckham, KPERS Actuary, presented an overview of the KPERS Actuarial Valuation Report as of December 31, 2010, including a copy of an actuarial valuation of KPERS completed by Cavanaugh Macdonald Consulting, LLC as requested by KPERS (Attachment 2). Ms. Beckham stated an actuarial valuation is a measurement at a point in time of the cash flows that have occurred to-date, versus those expected to occur in the future. Her presentation contained the following points:

- The unfunded actuarial liability (UAL) is a natural part of retirement system funding. The existence of an UAL does not automatically mean the system is "underfunded"; however, the UAL must be financed in addition to ongoing cost.

- The experiences contributing to a UAL include granting initial benefits or granting benefit increases, higher salary increases, earlier retirement age, lower death rates, lower rate of investment earnings, lower rates of non-death terminations, contributing less than the actuarial rate and changes in actuarial assumptions or methods.

- The actuarial valuation is a measurement of assets and liabilities and provides a best estimate of future costs. It also provides a baseline for legislative changes.

- Due to investment performance in 2010, up 13.0 percent, the System's funded status held steady in the December 31, 2010, valuation.

- The amount of deferred investment loss from 2008 declined from $1.7 billion in the 12/31/09 valuation to $672 million in the December 31, 2010, valuation.

- The projections of the impact of 2011 Senate Sub. for HB 2194 assumes everyone elects the default provision in both Tier 1 and Tier 2. There should not be a significant impact if elections vary from default. The projections anticipate assumptions are the same as baseline projections and the focus will be on long term trends.

Ms. Beckham responded to questions from the Committee.

Search for KPERS Executive Director

Doug Mays, KPERS Board of Trustees Member, reported on the retirement of Glenn Deck, former Executive Director, KPERS, indicating a search is underway to hire a new executive director. The Board received 26 applications through state and national publications. The Board narrowed the applicants to six and, presently, are considering three applicants. Mr.

Mays said the Board hopefully will make a final decision on a new executive director in the near future.

Afternoon Session

State Voluntary Early Retirement Incentive Program

Dennis Taylor, Secretary, Department of Administration, presented an update on the State's Revised 2011 Voluntary Early Retirement Incentive Program (Attachment 3). Mr. Taylor indicated the purpose of the program was to provide incentives for state employees to retire early in order to generate salary and benefit savings, and to effect budget reductions. The Voluntary Early Retirement Incentive Program was available to eligible employees from August 2, 2011, through October 31, 2011. The program was not available to employees covered under the Correctional KPERS plan or the Kansas Police and Firemen (KP&F) plan, employees from the Kansas Department of Labor whose positions are not funded by the State General Fund (SGF) or fee funds, and employees who have previously retired from the State of Kansas. Mr. Taylor reported that 1,027 state employees took advantage of the early retirement program at an annual salary cost of $42,751,251. Savings from the program will be realized after it is determined how many of these positions will be re-filled with new employees and the cost of one-time payments and health insurance is deducted.

Responding to questions from the Committee, Mr. Taylor reported approximately 4,000 state employees were eligible for the program. Mr. Taylor indicated it is anticipated approximately 25.0 percent of the positions will be refilled.

The Committee requested a report on the average age of retirees who took advantage of the program and the amount of savings realized by the program.

Unified School District Early Retirement and Working after Retirement

Dale Dennis, Deputy Commissioner, Department of Education, presented an update on the School District Early Retirements Incentive Program (Attachment 4). Early retirement for school districts was established by statute; however, the law allows each school district to establish and fund its own incentive program. Of the 286 Kansas school districts, 170 have an early retirement incentive program. Mr. Dennis' testimony included a summary of responses received from the 286 Kansas school districts with regard to the early retirement incentive program. The information was broken down by cost of early retirement benefits, number of administrators, number of other certified employees and number of non-certified employees receiving the benefits. Benefits included with the retirement are negotiated by each individual school district and could include health insurance payments or a cash payment. Mr. Dennis indicated the program allows an employee to retire from one school district and to return to work at another school district. Because of the cost of the program, a retirement surcharge is applied to those employees who return to work after retiring from KPERS, and presently is approximately 22.0 percent.

Tim Overman, Highland Park High School Teacher, appeared before the Committee to voice his displeasure with the surcharge applied by the school district to early retirement employees who return to active work. Mr. Overman provided information copied from the internet on a lawsuit brought by working retirees in South Carolina and other states (Attachment

5). Responding to a question from the Committee, Mr. Overman indicated he would prefer to have an option to relinquish his present retirement status, be able to return to full salary and to pay into KPERS at the applicable rate to earn future retirement benefits.

Senator Hensley stated he was aware of Mr. Overman's concerns and encouraged him to appear before the Committee.

KPERS Update on Working after Retirement

Elizabeth Miller, Acting Executive Director, KPERS, provided an update on KPERS working after retirement (Attachment 6). Ms. Miller stated KPERS working after retirement restrictions are provided in Kansas statutes and are subject to IRS regulations, because KPERS is a qualified, tax-exempt retirement plan. Employers are required to submit an annual working-after-retirement report in December, with data regarding the number of retirees, by category, who were rehired during any part of that calendar year. A summary of the data was included with Ms. Miller's testimony.

Additional information, previously requested by the Committee, on KPERS Estimated Employer Contributions for FY 2012 to FY 2034, was provided and distributed to the Committee by KPERS staff (Attachment 7).

KPERS Investment Performance Report as of September 30, 2011

Ms. Miller presented the following update on the Investment Performance Report as of September 30, 2011 (Attachment 8):

- Fiscal Year 2011 total fund return: 22.6 percent;
- FYTD 2012 total fund total return through 9/30/11: (10.3) percent; and
- October estimated total fund total return: 6.2 percent.

Ms. Miller noted a trio of uncertainties have contributed to market concerns:

- European sovereign debt crisis and political uncertainty;
- Concerns about “soft landing” in China (economic growth/inflation); and
- U.S. fiscal policy uncertainty (November 23 deadline for $1.2 trillion cuts).

Update on KPERS Study Commission

Representative Mitch Holmes, Co-chairperson of the KPERS Study Commission, provided an update on the Commission's activities. Representative Holmes reported the Study Commission has met on five occasions to discuss:

- The real-time projections of actuarial assumptions;

- Public testimony from several retirees, including a retired legislator, who was able to provide background on earlier KPERS legislation;

- Plans from other states, including Utah, Nebraska, Colorado, Oregon and Washington; and

- Information from National Conference of State Legislatures (NCSL) and other national organizations and speakers.

At this point, no decisions have been made; however, the five original plans under consideration have been narrowed to two plans. The two plans are “Defined Contribution” and “Stacked Hybrid.” These terms are defined as follows:

- Defined Contribution–allows the employer and employees to pay fixed contributions into an account; and

- Stacked Hybrid–(new concept) allows an employee to pay into the defined benefit plan up to a certain threshold and anything over the threshold goes into a defined contribution plan.

It is anticipated the KPERS Study Commission will make a decision in December 2011 on the plan to recommend to the 2012 Legislature. In addition, the Study Commission has a list of approximately 16 additional items to be reviewed at the December meeting and a decision will be made if legislation will be proposed to the 2012 Legislature to make changes in the current plans.

As determined by the Legislative Coordinating Council, the Study Commission has three remaining days it may meet.

Chairperson Schwartz noted it is her understanding any legislation recommended by the KPERS Study Commission would be introduced by the Joint Committee. Because the KPERS Study Commission will not make its recommendations until some time in December, it is anticipated the Joint Committee will not meet again until the first week of the 2012 Legislature for the purpose of reviewing and introducing the recommended legislation at that time.

The Committee voiced concern as to whether Senate Sub. for SB 2194 is still “on the table” before the Study Commission.

KPERS State and School Comparison

At the request of Representative Johnson, information on KPERS State and School Comparison as prepared by KLRD, was distributed to the Committee (<u>Attachment 9</u>).

Introduction of Legislation

As recommended by the KPERS Board of Trustees, Elizabeth Miller, requested the Committee's introduction of KPERS legislation at the beginning of 2012 Legislative Session.

Representative Flaharty moved to introduce legislation to revise the current statutory limitation on new and alternative investments by raising the current limitation of 1.0 percent per year of the previous year's market value to 5.0 percent per year limit on “net” new investments. The motion was seconded by Representative Johnson. <u>Motion carried</u>.

Senator Kelly moved to introduce technical legislation to (1) remove the provision setting forth a fixed contribution rate for first year employers and clarify that the first year employer pay the appropriate statutory rate; and (2) amend current law to allow KPERS employers with the option of affiliating for either prior and future service or future service only as is currently allowed for KP&F employers. The motion was seconded by Representative Holmes. Motion carried.

Approval of Minutes

Representative Carlson moved to approve the minutes of the June 2, 2011, meeting as written. The motion was seconded by Representative Proehl. Motion carried.

Adjournment

The meeting was adjourned at 3:25 p.m. The next meeting will be "on call of the Chairperson."

Prepared by Shirley Jepson
Edited by Michael Steiner

Approved by the Committee on:

January 20, 2012
(Date)