SESSION OF 2011

SUPPLEMENTAL NOTE ON SUBSTITUTE FOR HOUSE BILL NO. 2333

As Amended by House Committee of the Whole

Brief*

Sub. for HB 2333, as amended, would revise the retirement plans administered by the Kansas Public Employees Retirement System (KPERS) for most current state, school, and local government employees. The bill also would add a new retirement plan.

First, the bill would reduce the annual KPERS benefit multiplier from 1.75 percent to 1.4 percent for future service credit, beginning July 1, 2012, for all current and some future public employees working for state, school, and local public employers.

Second, the bill would increase the cap on annual KPERS employer contributions from 0.6 percent to 0.8 percent on July 1, 2012, for the state, school, and local public employers.

Third, the bill would direct that any net proceeds from the sale of state real property be transferred to KPERS for the purpose of reducing the unfunded actuarial liability of the state and school groups.

Fourth, the bill would create a new mandatory defined contribution (DC) plan for all future members of KPERS, effective July 1, 2013, for all new state, school, and local public employees who work for participating KPERS employers. The KPERS Board of Trustees would be required

*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at http://www.kslegislature.org to establish a separate DC plan within KPERS. The DC plan would be a qualified governmental plan as provided by Sections 401(a) and 414(d) of the Internal Revenue Code and related regulations. As such, all assets of the plan would be held in trust for the exclusive benefit of its members.

The new DC plan would become the primary KPERS retirement plan, which would be known as "Tier 3," and would include as members any KPERS State, School, and Local Group employees, defined as anyone first employed in an eligible position on or after July 1, 2013, and anyone who is an inactive, non-vested KPERS member who returns to work in an eligible position on or after July 1, 2013.

In addition, subject to an Internal Revenue Service (IRS) ruling, any member of Tier 1 or Tier 2 KPERS member may choose in a one-time, irrevocable election to transfer to the Tier 3 DC plan within a 90-day window to be established by the Board. Those who do not elect or do not participate in an election to transfer will be considered to have made an irrevocable election to remain in Tier 1 or Tier 2. The member's KPERS account balance (only cumulative employee contributions plus accrued interest) as of the date of transfer would be credited to the member's DC plan account. The Tier 1 and Tier 2 transfer option would not be implemented unless the election is first approved by the IRS.

The bill would not apply to members of the Kansas Police and Firemen's Retirement System or the Retirement System for Judges with respect to the DC plan election.

Employee DC Contributions. The bill would require active DC members to contribute 6.0 percent of compensation, to be deposited in their mandatory contribution account. These contributions and the income earned on them would be vested immediately. The contributions would be made prior to tax calculations for federal income tax purposes. Members would not be permitted to make additional, voluntary contributions to their DC account. Tier 3 members could continue using any alternative supplemental retirement plans provided by their employer, such as the Kansas Public Employees Deferred Compensation Plan, the State's Section 457(b) plan, and Section 403(b) plans offered by school districts. However, the DC Plan would accept rollover of contributions and income from other eligible retirement plans, within the limits of applicable federal law. Rollover contributions would be deposited in a separate rollover account, and the contributions and income earned would be vested immediately.

Employer DC Contributions. Participating employers would be responsible for making an "Employer DC Account Contribution," which would be an amount equal to 3.0 percent of the active member's compensation. This contribution would be credited to the employer contribution account of each active member and would be vested only when the member has three years of participating service in the DC plan.

In addition, there would be a "plan funding rate," which would be defined as a percentage of active members' compensation determined by the KPERS Board. The plan funding rate would be paid to the KPERS defined benefit (DB) plan's Tier 1 and Tier 2. The KPERS Board would set a rate as necessary to fund the DB plan's unfunded liabilities on an actuarial basis, plus the change in the normal cost contribution rate that would result from establishing the new DC plan for future members and closing the existing DB plan.

Also, there would be a "Death and Long-Term Disability Plan Rate," which would be a percentage of active members' compensation determined by the Board to fund coverage of Tier 3 members under the insured death benefit and insured disability benefit provided by KSA 74-4927. Tier I and Tier 2 members would continue to be covered. Finally, an "Administrative Expense Rate," would be funded as a percentage of active members' compensation determined by the Board to pay for costs incurred by the Board in administering the Plan.

DC Investments. The Board would be responsible for selecting and reviewing the investment alternatives offered through the DC plan. Individual members are to direct the investment of their employee contribution account, their employer contribution account, if vested, and any rollover account. The Board is required to designate a default investment option for the employer contribution account of non-vested members and for the employee contribution account and rollover account of any member who does not select one or more investment alternative. The default investment alternative may be a balanced fund.

DC Distributions. The bill would prohibit distribution or refund of any portion of a member's vested account balance before termination of service. Upon termination, the member can choose to terminate membership and receive a distribution of the member's vested account balance or to leave the vested account balance in the DC plan until a later date, subject to minimum distribution requirements under federal and state law. Distributions are to be made through one or more authorized payout options: a direct or regular rollover to an eligible retirement plan, a lump-sum distribution, or any other distribution option provided by the Plan Document to be adopted by the Board.

Death and Disability Benefits. The bill would provide coverage for active Tier 3 members with the same death and long-term disability benefits as Tier 1 and Tier 2 KPERS members. In addition, if a Tier 3 member receiving the insured disability benefit would become permanently and totally disabled, the member's employer would contribute 3.0 percent for the employer contribution and the 6.0 percent for the employee contribution until the member is no longer entitled to an insured disability benefit, up to a maximum of five years. The contributions would be based on the member's compensation at the time the member became disabled. Beneficiaries would be designated as provided in existing regulations for the DB plan and receive the member's vested account balance after the member's death.

DC Administration. The bill would authorize the KPERS Board to contract for DC plan administration, consulting, investment, educational, record keeping, or other services for the plan. The contracts would be awarded using a competitive proposal process.

A separate account for paying administrative expenses for the plan would be established within the DC plan. Administrative expenses would be funded through a combination of assessments of fees on DC plan member accounts, negotiated vendor reimbursements, the administrative expense rate paid by employers on active member compensation, and forfeited employer contributions from non-vested members and earnings on those contributions. The bill would authorize the expenditure of forfeited employer contributions for the Plan's start up expenses. The Board would be authorized to establish reasonable and necessary policies to administer the plan without the adoption of regulations.

The bill would establish a member DC contribution rate of 6.0 percent, which is credited to the member's mandatory contribution account. Current rates for Tier 1 and Tier 2 members are 4.0 percent and 6.0 percent respectively. Retirement benefits for members of the new Tier 3 would be dependent on the assets accumulated in the members' accounts prior to terminating employment, as well as the investment rate of return and timing of distributions following termination.

Background

HB 2333, as introduced, would have increased the 85 point retirement calculation for normal KPERS retirement to 95 points over a phase-in period between July 1, 2012 and July 1, 2021. No proponents testified in favor of the bill as introduced. Two representatives of educational entities, the Kansas National Education Association, and USD 259 (Wichita Public Schools) opposed the bill as introduced.

The House Committee on Pensions and Benefits amended the bill to include modifications in current KPERS law, but after reconsideration of one of the earlier actions originally approved, the House Committee removed a provision that would have changed KPERS normal retirement age for current and future employees to match the Social Security full-retirement age that ranges from 65 to 67, depending upon birth year. The provisions included in the substitute bill recommended by the House Committee on Pensions and Benefits are:

Future service credit. The 1993 Legislature increased the multiplier from 1.4 percent to 1.75 percent for both prior and future service credit effective July 1, 1993. Prior service credit referred to retroactively increasing the multiplier for previous credited service, and future service credit referred to all credit after July 1, 1993. The 2011 House Committee amendment would address only future service credit that is earned on and after July 1, 2012 in setting the 1.4 percent rate.

Cap on KPERS employer contributions. The current 0.6 percent cap on annual increases was implemented in FY 2008 after the 2003 Legislature passed legislation to gradually raise the rate from 0.2 percent over several years, beginning in FY 2005. The 2011 House Committee amendment would increase the rate to 0.8 percent in FY 2013 for the state and school groups, and January 1, 2012, for the local governments.

Net proceeds from the sale of state real property. This provision, effective July 1, 2012, would direct that 80 percent of net proceeds from the sale of state real property would be used to help pay off the state and school groups' KPERS unfunded, actuarial liability.

The House Committee of the Whole amended provisions from HB 2311 into Sub. for HB 2333 to implement a defined contribution retirement plan.

A revised fiscal note was submitted by KPERS regarding the impact of the changes included in Sub. for HB 2333, as recommended by the House Committee on Pensions and Benefits.

> A reduction in the service credit multiplier from 1.75 percent to 1.4 percent represents a decrease of 20.0 percent in the calculation of retirement benefits for each year the lower rate would be applied. Beginning July 1, 2012, the lower multiplier will be applied for each year of future service credit.
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> The increase in the KPERS employer contribution cap by 0.2 percent is effective in FY 2012; for the state and school groups, the effective date is July 1, 2011; for the local units of government, the effective date is January 1, 2012. The estimated cost for the state and school group increase in employer contributions during FY 2013 by raising the cap to 0.8 percent would be $9.4 million from all funds, including approximately $8.0 million from the State General Fund. The estimated cost for the local governments in FY 2013 for raising the cap on contributions would be $3.7 million.
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> The revised fiscal note indicated that for the state and school groups, the actuarially required contribution rate would be reached in FY 2021 at 15.6 percent. Total savings in state and school employer contributions are estimated at $3.7 billion as a result of the changes in the bill and will accrue through FY 2033.

No fiscal note is available for the bill, as amended by the Committee of the Whole, at the present time.