SESSION OF 2012

SUPPLEMENTAL NOTE ON SENATE SUBSTITUTE FOR SUBSTITUTE FOR HOUSE BILL NO. 2333

As Amended by Senate Committee of the Whole

Brief*

Senate Sub. for Sub. for HB 2333 would amend the current Kansas Public Employees Retirement System (KPERS) plan design (Tier 1 & 2), including provisions for the correctional subclass of the state group. The bill also would add a new plan design (Tier 3) for future members of the state, school and local public employee groups. The bill generally does not address the Kansas Police and Firemen's (KP&F) Retirement System or the Retirement System for Judges (Judges) that are other plans also administered by KPERS. The bill would implement the following major changes:

- Add a Cash Balance Plan that would be established as a new Tier 3 within the existing KPERS defined benefit plan;
- Extend for three years to July 1, 2015, a salary cap exemption for school professionals who go back to work after retiring from KPERS and are employed full time by the same KPERS participating employer who will continue to pay a special contribution rate for retired members;
- Remove the implementation triggers for Tier 1 and Tier 2 revisions that was mandated for the 2012 Legislature in 2011 HB 2194, the 2011 KPERS Omnibus Bill;

*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

- Retain most revenue enhancing provisions from 2011 HB 2194 that would be implemented beginning July 1, 2012;

- Use a single actuarially-determined employer contribution rate covering all three KPERS tiers that would be calculated for each KPERS group, subject to the statutory annual caps on increased contributions;

- Provide for a fourth quarter moratorium in FY 2012 for KPERS participating employers' contributions to the death and long-term disability program; and

- Amend the period of time on which legislators' retirement benefits and contributions are based, reducing the annual number of days from 372 to 365.

Background

Substitute for HB 2333, as passed by the House during the 2011 Session, included a Defined Contribution Plan as a new KPERS retirement plan design.

The Senate Select Committee on KPERS deleted the contents of 2011 Sub. for HB 2333, and inserted into Senate Sub. for Sub. for HB 2333 a number of KPERS provisions on which hearings were conducted during the 2012 Session. This action followed Committee review and deliberations on KPERS plan design alternatives and other KPERS matters that continued most of the 2012 Session.

The Senate Select Committee initially reviewed the KPERS Study Commission's recommendations in 2012 SB 338 and heard testimony from members of the Commission, representatives of organizations and groups which supported the bill, other representatives of organizations and groups which opposed the bill, and consultants from several national organizations who described changes taking place in other states' retirement plan designs. The Senate Committee failed to achieve a majority vote on a motion to recommend the bill favorable for passage, and 2012 SB 338 remains in the Committee.

The Senate Select Committee then introduced 2012 SB 429 from which certain provisions originally included in SB 338 were changed or removed, including allowing legislators to remain in Tier 1 & 2, placing new hires effective January 1, 2014, under Tier 3, leaving nonvested KPERS members in Tier 1 & 2, and adding back the increasing higher statutory caps on KPERS participating employer contribution rate increases to reflect the same changes in 2011 HB 2194.

After hearings on that bill were held and the actuarial cost study presented, the Senate Select Committee began to review general information about cash balance plans and other modifications made to retirement systems in other states. Throughout March, the Committee discussed different options for making changes in the current retirement plan design and the adequacy of retirement benefits provided under different options.

Staff of the Office of the Revisor of Statutes were asked by Senator Morris and Senator Kelly to prepare a new bill draft for a Cash Balance Plan. Amendments requested by Senator King also were prepared to add a defined contribution component to the proposed bill that, if the amendment were adopted, would provide for a hybrid plan design, with a cash balance component for employer contributions plus earnings, and a defined contribution component for employee contributions plus earnings.

The Senate Select Committee reviewed the actuarial cost study on the proposed Cash Balance Plan bill requested by Senator Morris and Senator Kelly, and also reviewed the actuarial comparisons of their proposal with three other options: HB 2194, the proposed King amendment impact on their bill, and SB 429. The Senate Committee rejected the

King amendment, and recommended adding provisions for the Morris-Kelly Cash Balance Plan to Senate Sub. for Sub. for HB 2333 after removing all of its original provisions. The new provisions include the following:

Cash Balance Plan

The proposed Tier 3 plan design for a Cash Balance Plan would apply to new employees beginning July 1, 2014, including most state, school and local public employees who would be eligible for KPERS and not eligible to choose another retirement plan. Future state corrections officers would continue to be eligible for Tier 2 when becoming KPERS members as new hires.

- The normal retirement age would be age 65 with five years of service credit, or age 60 with 30 years of service credit. For state corrections officers, Group A would be eligible for normal retirement at age 55 with ten years of service and Group B would be eligible for normal retirement at age 60 with ten years of service.

- The interest crediting rate for both the employee account and employer account would be a fixed amount of 6.0 percent annually as defined in statute; after 20 years of service the rate would increase to 6.25 percent; and after 30 years of service the rate would increase to 6.5 percent. The Legislature would reserve the right to prospectively adjust the interest credits.

- The KPERS Board of Trustees, at its discretion, may add interest credits if the following conditions apply to active members of Tier 3 who are eligible for dividends: minimum of ten years service credit; maximum dividend of 4.0 percent; and Board consideration of overall KPERS funding, market conditions, investments returns, and other related factors determined by the Board.

- Tier 3 employees would contribute a fixed rate of 6.0 percent of compensation to the member's annuity saving account.
- The KPERS participating employers would certify quarterly a fixed employer credit at a rate of 4.0 percent of compensation that would be recorded in the member's retirement annuity account.
- Vesting would occur after five years of service for the KPERS participating employer(s).
- If termination of employment would occur before vesting, then KPERS membership could be maintained for up to five years. If the former member would return to an eligible position within five years, and had not withdrawn the member's contributions plus interest, then membership may be reestablished and prior service credits would be retained. If the former member would not become reemployed by an eligible employer after five years, the member's contributions plus interest would be refunded and KPERS membership would be forfeited along with any funds in the retirement annuity account where employer contribution were deposited.
- If termination of employment would occur after vesting, then KPERS membership could be retained until retirement age in order to draw a KPERS benefit and interest credits would continue to accrue.
- If a terminated member, whether vested or not, would choose to withdraw the employee contributions plus interest, then all employer credits and interest would be forfeited in the employer

retirement annuity account, along with service credits.

- If the death of a member would occur prior to retirement, but after serving five years to become vested, then the spouse, if the sole beneficiary, would receive the benefit accrued prior to death of a member when the member would have reached normal retirement age.

- If a member would become disabled, the member would receive participating service credit for the entire period of disability. The member's account would be credited with both the employee contribution and the employer credit until the member is no longer determined to be disabled, attains normal retirement age and is retired, or dies. The program would be funded by the employer.

- A $4,000 benefit would be paid upon a retired member's death.

- There would be no early retirement provisions for KPERS Tier 3 members.

- Retirement benefits would be paid as a single life annuity with five years certain as the default option. The annuity conversion rate would be a fixed rate of 6.0 percent established in the plan design.

- Partial lump sum distributions at normal retirement would be available in increments of 10.0 percent, up to a maximum of 30.0 percent of the member's account balance.

Reenact Certain Provision of HB 2194

KPERS participating employer contribution caps would increase from 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 for FY 2017 and subsequent fiscal years.

The bill would offer elections for both Tier 1 and Tier 2 members as originally established in 2011 HB 2194, subject to approval by the Internal Revenue Service.

Tier 1 members would be able to choose:

- To continue the current 4.0 percent employee contribution and receive a reduced multiplier of 1.4 percent for future service (rather than the current 1.75 percent); or
- To increase the employee contribution to 5.0 percent in 2012 and 6.0 percent thereafter, and be eligible for a higher multiplier of 1.85 percent for future service.
- The default option, if the IRS does not rule favorably on elections or if the member does not make a choice, would be the 6.0 percent employee contribution and the 1.85 percent multiplier.

Tier 2 members' contributions would remain at 6.0 percent, but they would have an election to choose one of two options:

- If the cost-of-living adjustment (COLA) were retained, then the multiplier would be reduced to 1.4 percent for future service; or
- If the Tier 2 member would give up the COLA, then the multiplier would remain at 1.75 percent.
- The default option, if the IRS does not rule favorably on elections or if the member does not make a choice, would be the 6.0 percent contribution, no COLA, and the 1.75 percent multiplier.

Working After Retirement

The contents of 2012 SB 259, as passed by the Senate, were added to the bill.

- The provisions would remove a June 30, 2012, sunset date and extend an exemption for certain retirees from the statutory $20,000 earnings limitation from July 1, 2012, to July 1, 2015. The exemption applies to teachers and other licensed school professionals who retire with KPERS benefits and choose to return to work without an earnings cap. The bill also would extend the special employer contribution rate that applies to compensation earned by retirees.

Death and Disability Moratorium

The contents of 2012 SB 259 that pertained to a moratorium on contributions by participating employers were added to the substitute bill.

- The provisions would suspend all participating employer contributions to the Kansas Public Employees Retirement System (KPERS) Group Insurance Reserve Fund for a three-month period, beginning on April 1, 2012, and ending on June 30, 2012. Under current law, each KPERS participating state, school, and local employer must pay an amount equal to 1.0 percent of the amount of compensation on which KPERS members' contributions to the System are based. The participating employer contributions are deposited in the Group Insurance Reserve Fund, from which the death and long-term disability benefits are paid.

The provision would be effective upon publication in the *Kansas Register.*

Legislators' Retirement Calculations

The contents of 2012 House Sub. for SB 259 that pertained to Legislators' rate of compensation and calculation of retirement contributions and benefits were included in the substitute bill.

- Current language pertaining to how the period of compensation for legislators is computed for determining retirement benefits and contributions would be stricken and new language added that would use 30 calendar days as the basis of computation multiplied by 12, with five more days added, for a total of 365 days. The current method produces a total of 372 days.

Modifications Due to Divorce

The Senate Committee of the Whole amended the bill to modify current law concerning divorce after a member would retire and the status of the ex-spouse. The amendment would allow an exception to the statutory provision that under no circumstance may a retirement option elected be changed or canceled nor the named joint annuitant changed after the member's actual retirement.

- The exception would be to allow a retirant, if divorced after retirement, and if the retirant had named the retirant's ex-spouse as a joint annuitant, to cancel the join annuitant option.

Fiscal Note

The KPERS Actuary completed an analysis of the Cash Balance Plan design and reported the findings in a cost study for estimated employer costs. The analysis took into consideration the provisions from 2011 HB 2194 that were included and the statutory contribution caps from that original legislation that also were included in Senate Sub. for Sub. for

HB 2333. The potential impact on the KPERS participating employers (state, school and local groups) would be an increase in employer contributions for Tier 1, Tier 2, and Tier 3 members.

The fiscal impact for the provisions from 2012 Senate Sub. for Sub. for HB 2333 is estimated to require KPERS participating employer contributions of $30.141 billion through FY 2060 for the state and school groups. For the local group, contributions are estimated to require $8.415 billion through FY 2060 from the KPERS participating employers.

The Cash Balance Plan would yield an average annual benefit for a 30-year KPERS member of Tier 3 of $20,565 when retiring at age 65. This amount represents a replacement ratio of 46.0 percent of pre-retirement income for the KPERS member.

The estimated Social Security benefit for persons retiring at age 65 with a final salary of $45,000 is $13,872 annually, assuming they worked a full career. This represents about a 31.0 percent income replacement ratio.

Administrative Fiscal Note

For implementing a Cash Balance Plan only, KPERS staff estimates additional resources in FY 2013 would be required, including $2.6 million from the KPERS Fund and 11.0 FTE positions for new staff. An additional 3.0 FTE positions would be needed in subsequent fiscal years. A fiscal note is available from KPERS with details of this estimate.