UPDATED
SESSION OF 2012

SUPPLEMENTAL NOTE ON HOUSE SUBSTITUTE FOR SENATE BILL NO. 259

As Recommended by House Committee on Pensions and Benefits

Brief*

House Sub. for SB 259 would amend the current Kansas Public Employees Retirement System (KPERS) plan design, including provisions for the correctional subclass of the state group. The bill also would add a new plan design 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, except in the instance of requiring actuarial cost studies for proposed legislation that includes changes in benefits for all plans. The bill would implement the following changes:

- Extend a 3-year 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 (original SB 259 provisions passed by the Senate);

- Require an actuarial cost study to be performed before legislative consideration of proposals when pre-retirement or post-retirement benefit adjustments are introduced as legislation (provisions of 2012 HB 2732);

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*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

- Remove the implementation trigger requirement mandated for the 2012 Legislature, would eliminate certain elections, and would revise the terms of future participation for active KPERS members in Tier 1 and Tier 2 (amendments to 2011 HB 2194, the 2011 KPERS Omnibus Bill);

- Retain most of the other revenue enhancing provisions in 2011 HB 2194 that would be implemented beginning July 1, 2012, the effective date of the bill; and

- Add a new Cash Balance Plan that would establish a new Tier 3 within the existing KPERS defined benefit plan.

Provisions of 2012 SB 259 Included

The provisions of SB 259 included in the substitute bill would delete a July 1, 2012, expiration date and would extend an exemption for certain professional school retirees from the statutory $20,000 annual earnings limitation from July 1, 2012, to July 1, 2015. The exemption would apply to teachers and other licensed professional school retirees who retire with KPERS benefits and choose to return to work for the same participating employer from which they retired. The bill also would extend the special KPERS employer contribution rate that applies to compensation earned by retirees on which an assessment is paid to KPERS at an actuarially determined employer contribution rate plus an additional 8.0 percent.

Provisions of 2012 HB 2732 Included

The provisions from HB 2732 included in the substitute bill would amend current law to require an actuarial cost study by the KPERS actuary for any legislation providing a new benefit, an increase in existing benefits, or any other type of benefit enhancement for all plans under KPERS. The actuarial cost assessment would have to be provided prior to any legislative consideration of a bill that proposes a change in KPERS retirement benefits.

Modifications to 2011 HB 2194 Added

The bill would modify last year's KPERS legislation that would have instituted reforms to improve the financing of the KPERS state, school and local groups covered by KPERS Tier 1 and Tier 2. The first changes would eliminate the statutory triggers requiring certain actions by the 2012 Legislature on legislation proposed by the 2011 KPERS Study Commission to have been certified by the Revisor of Statutes and Director of Legislative Research before most other provisions in 2011 HB 2194 would become effective on July 1, 2012.

Other changes would eliminate the elections for Tier 1 and Tier 2 members to decide which options they would choose from a choice of two in each tier, contingent upon approval by the Internal Revenue Service (IRS) to authorize such elections. The new provisions for members would be as follows:

- The default option for Tier 1 members would become mandatory, raising Tier 1 employee contribution rates from 4.0 to 6.0 percent and providing Tier 1 members with a multiplier increase from 1.75 percent to 1.85 percent; and

- The Tier 2 options would be modified in order to eliminate the automatic cost-of-living adjustment (COLA), while maintaining the Tier 2 members' current 6.0 percent employee contribution rate. The bill also would raise the Tier 2 multiplier from 1.75 percent to 1.85 percent, making it retroactive to July 1, 2009, when Tier 2 originally was established.

The increases in the employer contribution rate caps approved in 2011 HB 2194 would be maintained as adopted last Session. The statutory annual state, school, and local KPERS rates would increase as the employer contribution rate caps will phase into new annual limits from the current 0.6 percent:

- 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).

The disposition from the sale proceeds of state public property also would remain unchanged from last year's provision that would use a portion of the money (80 percent) to pay down the KPERS unfunded liability.

Establish a New Cash Balance Plan

The bill would establish a new Tier 3 within the existing KPERS defined benefits plan that would be a Cash Balance Plan and as such would become part of the same Trust as the existing KPERS defined benefit plan. Tier 1 and Tier 2 would remain open to active members but generally closed to any new members, except for correctional officers under a special provision. All funding would be determined on an aggregate basis, and a single actuarial contribution rate would be calculated to be applied across KPERS payrolls of the state, school and local groups' participating employers for Tier 1, Tier 2, and Tier 3. A special employer contribution rate would be required for the correctional officer subgroup members who become new members of Tier 2 on and after January 1, 2014.

Most future new employees hired for KPERS eligible positions as of January 1, 2014, would become members of Tier 3. The only exceptions would be statutorily defined. This bill would allow future state correctional officers to continue to enter Tier 2. (Other exceptions not addressed in the bill include certain statutorily designated state officers and employees who may choose either not to participate in KPERS, or those who are not eligible to choose KPERS, but may elect to participate in the state's deferred compensation plan that pays an 8.0 percent employer contribution with no employee match required. Certain elected public officials would continue to be able to choose whether they wish to participate in KPERS, or if they would decline to join any retirement plan.)

Contribution rates would be set at 6.0 percent for employee members and up to 4.0 percent for participating employers. A sliding scale would increase employer rates, starting at 1.0 percent for the first year, increasing 1.0 percent each year, until reaching a maximum of 4.0 percent and continuing at 4.0 percent during continuous employment.

Vesting in the employer contributions would occur after seven years of covered employment with a KPERS participating employer. Vesting in the member's contributions is from the date that the employee becomes a member of the Tier 3 plan.

A former employee who would return to an eligible KPERS position within two years immediately following termination, if membership had not been forfeited, would be granted previously earned service credits during prior employment and would become an active member again.

After seven years when vested, if a member would terminate employment with a KPERS participating employer, that member would be able to leave contributions in the Trust Fund where it would earn interest (and be eligible for dividends, if credited) until retirement age.

If death of an employee member would occur prior to retirement, but after the member vests, then as an option to paying the spouse a 100 percent annuitized benefit, the bill also would add new authority for payment of a lump sum to an estate, if there were no surviving spouse.

Normal retirement age would be 65 with five years of service or would be 60 with 30 years of service after becoming vested with seven years of service credit and not withdrawing contributions and forfeiting that service. Correctional officers in Tier 2 would be eligible, if in group A, for retirement at 55 with 10 years of service (current law) and if in group B for retirement at 60 with 10 years of service. Early retirement would require at least 10 years of service at age 55 to qualify. Only an annuitized benefit would be awarded to early retirees (and no option of a lump sum payment).

There would be a guaranteed minimum crediting rate of 5.0 percent annually on the employer and employee contributions for the individual member.

There would be an annuity offered at normal retirement with 15 years life certain and 100 percent annuitization. Other options would be offered with 50 percent, 75 percent or 100 percent joint and survivor choices, and 5-year, 10-year and 15-year life certain choices. A partial lump sum would be available after normal retirement with the retiree able to take a dollar amount up to a maximum of 30 percent of the member's account balance.

A self-funded cost-of-living adjustment (COLA) would be offered only at time of retirement.

A death benefit after retirement would be paid in the amount of $4,000 (current law).

The KPERS Board of Trustees would be authorized to provide for an additional interest credit in addition to the 5.0 percent guaranteed annual rate, subject to the following necessary and required conditions:

- The additional interest credit may not exceed the lesser of 2.0 percent or 50.0 percent of the rate of return on the system's assets that is above 8.0 percent for a fiscal year; and

- The additional interest rate for a fiscal year shall not be granted unless the rate of return on the system's assets is at least 10.0 percent for that fiscal year.

The KPERS Board of Trustees or the KPERS actuary would be able to cause a review to be undertaken to modify Tier 3 if the guaranteed fixed rate of 5.0 percent return made the maximum participating employer contribution rate rise or projected to rise to 6.0 percent or higher in order to fund the normal cost of Tier 3. The Board would be able to ask the Legislature for changes in benefits and the Legislature could alter the Tier 3 plan as follows:

- Adjust benefits and the formula used to calculate benefits for employee members;

- Consider changing from the Cash Balance Plan to a different retirement plan; or

- Close the Cash Balance Plan.

The effective date of the bill would be July 1, 2012, with other provisions taking effect after that date as provided in the bill regarding implementation of the new Tier 3.

Background

Note: This revised version of the Supp. Note for House Sub. for SB 259 was updated to include the actuarial cost study information provided on March 19, 2012, by Cavanaugh Macdonald Consulting, LLC, in a letter and attached exhibits.

2012 SB 259 was recommended for introduction by the Legislative Educational Planning Committee during the 2011 Interim. The original legislation was passed by the 2008 Legislature. Hearings were held in the Senate Ways and Means Committee. Representatives from the Dodge City Public Schools, the Doniphan County Education Cooperative, Turner Unified School District 202, Smokey Valley Public Schools, and Unified School District 490 spoke in favor of the bill. A conferee from the Kansas Association of School Boards was neutral. No conferees appeared in opposition to the legislation. The House Committee on Pensions and Benefits also heard the bill. Proponents included representatives from the Wichita Public Schools (USD 259) and the Kansas Association of School Boards which changed its position from neutral to a proponent of SB 259.

The fiscal note on the original SB 259, as introduced, stated passage would have no direct effect on state expenditures.

2012 HB 2732 was introduced at the request of Chairperson Mitch Holmes by the House Committee on Pensions and Benefits. There was no hearing on the bill and there is no fiscal note from the Director of the Budget.

2011 HB 2194 was enacted by the 2011 Legislature, with implementation delayed until July 1, 2012, for most items in the bill. The KPERS Study Commission was created July 1, 2011, and required to file its final report by January 6, 2012, along with legislative recommendations for consideration by the 2012 Legislature. Two triggers were included in the legislation in order for the remaining sections of the 2011 legislation to be implemented on July 1, 2012. First, either the House or the Senate was required to have a vote in a first committee on the KPERS Study Commission's bill with recommended changes in KPERS. The other chamber, either the Senate or the House, was required to have a vote in both a first committee and the committee of the whole on the KPERS Study Commission's bill with recommended changes in KPERS. After the voting in the two bodies, the Revisor of Statutes and the Director of Legislative

Research would have been required to certify that such voting had taken place in order for the other 2011 legislation to go into effect on July 1, 2012. Only a first committee in the Senate (the Senate Select Committee on KPERS) voted in 2012 on the KPERS Study Commission's bill (SB 338 was not advanced out of the Senate Committee for further consideration by the Senate Committee of the Whole). No votes have taken place in the House or its Committee on Pensions and Benefits which was assigned the KPERS Study Commission's bill (HB 2545).

The House Committee on Pensions and Benefits held multiple hearings on various retirement proposals and, while revising certain provisions of 2011 HB 2194, the Committee chose not to modify other provisions in the 2011 legislation. An updated version of 2011 HB 2194 was amended into SB 259 with both modified provisions and original provisions from last year's legislation. Testimony throughout the 2012 hearing process on revisions to KPERS tended to support many of the original provisions in HB 2194 as enacted last year.

New Cash Balance Plan. The new plan design was developed by the Committee after hearing negative testimony about 2012 HB 2545 (the KPERS Study Commission's bill) with recommended changes in KPERS plan designs.

The House Committee on Pensions and Benefits heard testimony on HB 2545, as recommended by the KPERS Study Commission. The Office of the Revisor of Statutes presented a summary of HB 2545. KPERS staff presented a briefing on the bill, and the KPERS actuary presented the cost study on the actuarial costs compared to 2011 HB 2194 being implemented at the same time.

During the primary hearing on HB 2545, following a staff briefing on the content of the bill, the Committee heard from the following conferees:

- **Proponents.** Representatives of Security Benefit Life Insurance Companies, the Kansas Association of Insurance Agents, ING, and TIAA-CREF and a member of the KPERS Study Commission who favored the majority report generally supported the bill.

- **Opponents.** Representatives of the State Employees Association of Kansas, the League of Kansas Municipalities, the Fraternal Order of Police, the Kansas Coalition of Public Retirees, and Keeping the Kansas Promise and a member of the KPERS Study Commission who signed a minority report generally opposed the bill.

- **Neutrals.** A representative of the Kansas Association of Chiefs of Police, Kansas Sheriffs' Association, and Kansas Peace Officers Association asked for public safety officers to be considered as a different class that might be related to the special KPERS correctional class of state employees.

Following the public hearing on HB 2545, the Committee asked to review the specific plan component from which the modified cash balance plan in HB 2545 was developed, namely the Cash Balance Plan established in Nebraska. The Executive Director of the Nebraska Public Employees Retirement Systems participated in a conference call presentation about operation of that plan. The KPERS actuary also participated in the conference call and commented on the general provisions of cash balance plans. The Research Director from the National Association of State Retirement Administrators commented, during the conference call, on the two cash balance plans in Texas.

At the suggestion of the Chairperson, the Committee recommended that a Cash Balance Plan bill be drafted, using the Nebraska model as a guide. Because the drafting process occurred late in the Session, the Chairperson, with assistance from the KPERS staff, prepared a decision tree list that outlined parts for inclusion in a bill to implement a Cash

Balance Plan for review by the Committee. After considerable Committee discussion and modification of the initial proposal, the Committee recommended introduction of legislation based on the outline for a Cash Balance Plan.

The House Committee on Pensions and Benefits voted to amend SB 259 by adding the cash balance plan design and other items of agreement for inclusion in the amendment bill previously noted.

Fiscal Note of March 19, 2012

The fiscal note for ***House Sub. for SB 259, as recommended by the House Committee***, was submitted by the KPERS actuary after conducting a cost study for the bill recommended by the House Committee on Pensions and Benefits.

For the state and school group, the total long-term cost would be $3.237 billion less for the House Committee's Cash Balance Plan, together with amendments to provisions from 2011 HB 2194. The change in plan design and amendments to last year's provisions of HB 2194 will cost less than the original provisions of 2011 HB 2194. The net present value difference would be a reduction of $368.1 million attributed to the House Committee's bill compared with the original version of 2011 HB 2194. The maximum employer contribution rates for the state and school group under the House Committee's bill would be less than 15.0 percent from FY 2014 to FY 2032.

For the local group, the total long-term cost would be $1.505 billion less for the House Committee's Cash Balance Plan, The change in plan design and amendments to last year's provisions of HB 2194 will cost less than the original provisions of 2011 HB 2194. The net present value difference would be a reduction of $156.7 million attributed to the House Committee's bill compared with the original version of 2011 HB 2194. The maximum employer contribution rates for the local group under the House Committee's bill would be less than 9.2 percent from FY 2014 to FY 2032.

All three KPERS groups—the state, the school and the local—would reach equilibrium by FY 2021 and the unfunded actuarial liability would be reduced significantly by FY 2033, with the system funded at greater than an 80.0 percent ratio at that time.

Cash Balance Plan Design

The summary of basic plan provisions upon which the actuarial cost projections are based include:

- The employer credit to the cash balance account is a service-based credit, beginning at 1 percent and grading up to 4 percent after the member attains four years of service;
- The guaranteed interest credit is 5 percent per year with interest credited quarterly. Additional interest credits may be granted at the discretion of the KPERS Board of Directors subject to certain conditions. The additional interest credit cannot exceed the lesser of 2 percent or 50 percent of the rate of return on the system's assets that is above 8 percent. The additional interest credit shall not be granted unless the rate of return on KPERS assets is at least 10 percent for that fiscal year;
- Employee contribution rate is 6.0 percent of pay;
- 100 percent vesting after seven years of service;
- Normal retirement date is earlier of age 60 with 30 years of service or age 65 with five years of service;
- Early retirement is age 55 with ten years of service;
- Upon termination of employment, a vested member may elect to withdraw the member's employee account balance, but will forfeit any future benefit

payable from the system. If the member leaves employee contributions in the System, the member may retire upon reaching normal retirement age with benefits based on the total account value (employer plus employee);

- When the member retires at normal retirement age, the member can elect to receive up to 30 percent of the total account balance as a lump sum. The remaining balance must be converted to a monthly benefit, based on the form of payment selected by the member. No partial lump sum option is available if the member retires at early retirement age. The annuity amount is determined by the annuity conversion factors which are based on a 5.0 percent interest rate and a mortality table selected by the Board;

- If a member dies prior to reaching the normal retirement age of 65, no benefit is payable and the account balance is forfeited unless (i) the member is vested; (ii) the member has at least ten years of service at death; and (iii) the member's spouse at the time of death is designated as the sole primary beneficiary. In that case, the spouse shall receive a benefit when the member would have reached normal retirement age;

- If a member becomes disabled while actively working, such member shall be given participating service credit for the entire period of the member's disability. Such member's account shall be credited with both the employee contribution and the employer credit until the earliest of (i) death; (ii) attainment of normal retirement age; or (iii) the date the member is no longer entitled to receive disability benefits; and

- A benefit of $4,000 is payable upon a retired member's death.