UPDATED
SESSION OF 2012

SUPPLEMENTAL NOTE ON HOUSE SUBSTITUTE FOR SENATE BILL NO. 259

As Amended by House Committee of the Whole

Brief*

House Sub. for SB 259 would amend the current Kansas Public Employees Retirement System (KPERS) plan, including provisions for the correctional subclass of the state group. The bill also would add two new plan designs for future qualified members of the state, school and local public employee groups who work for a KPERS participating employer. One of the new plans would be a Cash Balance Plan and the other would be a Defined Contribution Plan. New, qualified public employees of KPERS participating employers would have to elect to participate in one of the new plans after a six-month waiting period. 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 would change benefits in one or more of the plans. The major provisions in the bill would:

- Include the original SB 259 provisions passed by the Senate that would 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;
- Add provisions of 2012 HB 2732 that would require an actuarial cost study to be performed before

*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 legislative consideration of proposals when pre-retirement or post-retirement benefit adjustments are introduced as legislation;

- Include amendments to 2011 HB 2194 (the KPERS Omnibus Bill last Session) that would remove the implementation trigger requirement for the 2012 Legislature to consider the KPERS Study Commission recommendations and legislation, would eliminate certain elections, and would revise the terms of future participation for active KPERS members in Tier 1 and Tier 2;
- Retain most of the other revenue enhancing provisions in 2011 HB 2194 that would be implemented beginning on July 1, 2012, the effective date of the bill;
- Add a new Cash Balance Plan for new employees that would be established as Tier 3 within the existing KPERS defined benefit plan;
- Add a new Defined Contribution Plan that would allow an alternative retirement plan for new employees;
- Establish a six-month waiting period for new employees hired on or after January 1, 2014, that would allow employees to become informed about the two different retirement plan choices before electing either the Cash Balance Plan or the Defined Contribution Plan;
- Provide for death and long-term disability insurance during the first six months that would continue coverage as long as the active member is working for a participating employer;
- Add a mandatory savings plan during the six-month waiting period in which new employees hired on or after January 1, 2014, would contribute 6.0 percent, with a 1.0 percent match by the

participating employer. The contributions would be made to a deferred compensation plan for employee contributions and to a qualified government plan for employer contributions. After becoming a member of the Cash Balance Plan or the Defined Contribution Plan, all assets from the savings plan would be transferred to the new plan that the employee elects (or if no election is made, the default option of the Cash Balance Plan);

- Provide for transfers beginning in FY 2014 of 75.0 percent of moneys deposited in the Expanded Lottery Act Revenues Fund to the KPERS Trust Fund for reducing the actuarial liability of the combined KPERS state and school groups; and

- Reserve for the Legislature the right to make changes in the retirement benefits for the Cash Balance Plan members.

Provisions of 2012 SB 259 Included

The provisions of SB 259 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 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 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.

New Cash Balance Plan Included

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 returns 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 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 be projected to rise to 5.0 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.

Defined Contribution Plan Added

The bill would create the Kansas Public Employees Retirement System Defined Contribution Act that would provide a choice for eligible new public employees of two different retirement plan designs, either the Cash Balance Plan or the Defined Contribution Plan. The default option would be the Cash Balance Plan if an employee failed to make an election of a retirement plan.

Six-Month Waiting Period Added

The bill would establish a six-month waiting period for new employees hired on or after January 1, 2014, that would allow employees to become informed about the two different retirement plan choices before electing either the Cash Balance Plan or the Defined Contribution Plan. The default option if no choice were made would be the Cash Balance Plan for those employees who might not elect a plan.

New Savings Plan Added

The bill would add a mandatory savings plan during the six-month waiting period in which new employees hired on or after January 1, 2014, would contribute 6.0 percent, with a 1.0 percent match by the participating employer. The contributions would be made to a deferred compensation plan for employee contributions and to a qualified government plan for employer contributions. After becoming a member of the Cash Balance Plan or the Defined Contribution Plan, all assets from the savings plan would be transferred to the new plan that the employee elects (or if no election is made, the default option would be the Cash Balance Plan);

ELARF Transfers Authorized

One provision would provide, beginning FY 2014 and after other prior statutory obligations would be met, transfers of 75.0 percent annually would be made from the Expanded Lottery Act Revenues Fund (EFARF) to the KPERS Trust Fund for the purpose of reducing the unfunded actuarial liability for the combined KPERS state and school group. Such transfers would occur quarterly, and would continue until the overall KPERS funding attained an 80.0 percent funded ratio.

Background

Component Parts of the Bill

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 was 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 HB 2194, the Committee chose not to modify other provisions in the 2011 legislation. An updated version of 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 2011 HB 2545, as recommended by the KPERS Study Commission. The Office of the Revisor of Statutes presented a summary of 2011 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 2011 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 2011 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. The actuarial cost study information was provided on March 19, 2012, by Cavanaugh Macdonald Consulting, LLC, in a letter and attached exhibits. There would be a uniform employer contribution rate set for all participating employers in each group -- state, school, and local -- with the actuarial calculations applied to all tiers within each group to have a uniform group rate, except for the state group where the correctional subgroup will have a different rate. As shown below, the state and school groups uniform rate should remain under 15.0 percent of compensation until 2033, while the local groups uniform rate should remain under 10.0 percent until 2033.

For the state and school groups, 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, 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 $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.

The estimated costs for the period in the current amortization period that ends in FY 2033 also were calculated by the KPERS actuary in addition to the long-term projections through FY 2060 previously presented.

For the period through FY 2033, the state and school group's cost would be $723 million 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 $18.4 billion, which would be less than the original provisions of 2011 HB 2194 estimated to cost $19.1 billion.

The net present value difference would be a reduction of $206 million attributed to the House Committee's bill compared with the original version of 2011 HB 2194.

For the period through CY 2033, the local group's cost would be $245 million 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 $4.1 billion, which would be less than the original provisions of 2011 HB 2194, estimated to cost $4.4 billion. The net present value difference would be a reduction of $73 million attributed to the House Committee's bill compared with the original version of 2011 HB 2194.

Cash Balance Plan Design

A 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 1.0 percent and grading up to 4.0 percent after the member attains four years of service;
- The guaranteed interest credit is 5.0 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 2.0 percent or 50 percent of the rate of return on the system's assets that is above 8.0 percent. The additional interest credit shall not be granted unless the rate of return on KPERS assets is at least 10.0 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 the 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 30.0 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.

Modifications by House Committee of the Whole

Six floor amendments were adopted in the following order by the House Committee of the Whole:

- The first amendment would make two technical changes. The first technical change would add the same language in New. Sec. 6(e) regarding a member's annuity savings account as the language found in New Sec. 8(c) regarding a member's retirement annuity account and the necessary conditions for a Tier 3 member to be eligible for an additional interest credit in both accounts. The second technical change would replace a reference to subsection "(b)" with "(a)" in correcting an internal error in New. Sec 11.

- A second amendment was adopted regarding the period from April 1, 2012 to June 30, 2012, for which participating employers would make no payments to KPERS during a moratorium for contributions to the death and long term disability insurance program.

- The number of days used for legislative actualization would be reduced from 372 to 365 in a third amendment.

- Beginning FY 2014 and after other prior statutory obligations end, a fourth amendment would add language to begin transferring 75.0 percent annually from the Expanded Lottery Act Revenues Fund (ELARF) to the KPERS Trust Fund for the purpose of reducing the unfunded actuarial liability for the combined KPERS state and school group. Such transfers would occur quarterly, and would continue until the overall KPERS funding attained an 80.0 percent funded ratio. Current statutory obligations for money in ELARF would have to be met before the 75.0 percent transfer could take place.

- A fifth amendment would change the trigger rate for determining when the Legislature would consider making changes in Tier 3 benefits. The trigger rate would be lowered from 6.0 percent to 5.0 percent. If the participating employer's normal cost would increase to 5.0 percent or greater, then the Legislature may make adjustments to the benefits of Tier 3 members, contingent upon either one of the two following conditions:
  - The KPERS Board of Trustees would have to recommend specific adjustments in benefits for legislative consideration; or
  - An actuarial study requested or commissioned by either the KPERS Board or the Legislature would find that contributions will continue to rise above the 5.0 percent trigger rate.
- The sixth amendment would add the optional Kansas Public Employees Retirement System Defined Contribution Act that would provide for a choice between the Cash Balance Plan or a new Defined Contribution (DC) Plan.

Defined Contribution Plan Design

The House Committee of the Whole added most of the DC provisions from 2011 HB 2311 (that also was amended into 2011 HB 2333 last Session and then passed by the House during the 2011 Session) which would have established a defined contribution (DC) plan.

House Sub. for SB 259, as amended, would require the KPERS Board of Trustees 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.

Retirement accounts would be established for each DC plan member. All assets of the plan would be held in trust for the exclusive benefit of its members. The KPERS Board of Trustees would contract for plan administration using a competitive proposal process to secure various service providers. The Board would be required to adopt a DC plan document and shall negotiate a contract with a third party for administering the DC plan.

The statutory provisions governing the DC plan would be subject to amendment by the Legislature. The KPERS Board of Trustees would have the power to amend the DC plan document, consistent with the statutory provisions governing the DC plan at the time of amendment.

Employee DC Contributions. The bill would require active DC plan members to contribute 6.0 percent of compensation, to be deposited in their members' mandatory contribution accounts. 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 accounts.

Employer DC Contributions. Participating employers would be responsible for making graduated contributions to the member's employer contribution account. The KPERS participating employer would contribute 1.0 percent for 6 months to one year of service; 2.0 percent for one year but less than 2 years; 3.0 percent for two years but less than three years; and the maximum rate of 4.0 percent for three or more years of service. This contribution and any income earned would be credited to the member's employer contribution account of each active member and would be vested only when the member has seven years of participating service in the DC plan. The employer contributions and and income would be forfeited if the member terminates plan participation and has not become vested.

The KPERS Board of Trustees would review periodically the sufficiency of the plan funding rate and would adjust the amount of contributions as necessary. The DC plan funding rate must be adjusted as provided by this legislation and by the plan document to actuarially fund the defined benefit plan's unfunded liabilities and the change in the normal cost contribution rate that is the result of the DC plan members' participation 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 the DC plan 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 KPERS Board of Trustees would be responsible for selecting and reviewing the investment alternatives offered through the DC plan. The Board would designate a default investment option for any member who did not select one or more investment alternatives. Individual members would direct the investment in all member accounts after becoming vested in the member's employer contribution account. The non-vested portion of the DC plan member's employer contribution account must be invested for the first seven years in the Board's default investment fund. The Board may utilize a balanced fund as the default investment 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 would 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 DC plan document.

Death and Disability Benefits. The bill would provide coverage for active DC plan members with the same death and long-term disability benefits as current KPERS members. In addition, if a DC plan member receiving the insured disability benefit would become permanently and totally disabled, the member's employer would contribute the appropriate graduated employer contribution depending upon years of service and the 6.0 percent for the employee contribution until the member would no longer be 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 current KPERS 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.

Fiscal Note

The KPERS Actuary completed an analysis of the hybrid Cash Balance (CB) component and the Defined Contribution (DC) component, reporting 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 House Sub. for SB 259. 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 House Sub. for SB 259 is estimated generally to increase for KPERS participating employer contributions. However, because of the choice that new employee must make in selecting one of the two retirement plans (CB or DC), the KPERS Actuary modeled several decision-alternatives because making projections under such circumstances with no experience presented numerous problems regarding assumptions. The default option if no choice were made is the CB alternative. The KPERS Actuary decided to make multiple projections that are based on a fixed percentage of employees choosing the DC alternative: 0.0 percent, 25.0 percent, 50.0 percent, or 75.0 percent.

The estimated participating employer contributions through FY 2060 for the four different projections would be as follows:

- No DC participation: $18.244 billion for state and school groups; $4.279 billion for the local group.
- 25.0 percent DC participation: $22.281 billion for state and school groups; $5.708 billion for the local group.
- 50.0 percent DC participation: $29.936 billion for state and school groups; $8.6798 billion for the local group.
- 75.0 percent DC participation: $40.084 billion for state and school groups; $11.730 billion for the local group.

The CB Plan would yield an average annual benefit for a 30-year KPERS member of Tier 3 of $15,255 when retiring at age 65. This amount represents a replacement ratio of 34.0 percent of pre-retirement income for the KPERS member.

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

No information about average annual benefit was available for the DC Plan when this fiscal note was prepared on May 4, 2012.

Administrative Fiscal Note

For implementing the Cash Balance (CB) plan component 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 administrative cost associated with the DC component also will have an impact, and the assessment of that cost was provided on May 4, 2012. In addition to the CB plan administrative costs, KPERS staff estimates additional resources in FY 2013 would be required, including $949,277 from the 401(a) Defined Contribution Fund and 9.0 FTE positions.

Total administrative costs would be $3.5 million and 20.0 FTE positions to implement the CB and DC plan components.