House Pensions & Benefits
Date: 1/28/2013
Attachment # 5

KPERS OVERVIEW

ACTUARIAL VALUATION

2012 HB 2333

KPERS' Long-Term Funding

- Over KPERS' 51-year history, the Legislature provided various benefit enhancements
- Made significant plan design changes in 1993
  - Common plan design features in most state defined benefit plans
    - Provided unreduced retirement under "Rule of 85"
    - Increased benefit formula multiplier to 1.75% for all service (from 1.4%)
  - Costs of the plan enhancements borne by employers
- Added statutory cap on employer contribution increases
  - Intended to make enhancements more affordable over short term
  - Statutory rate was expected to converge with actuarial rate within a short period
  - However, employer contributions remained below the actuarially required rate from that point forward
- Also adopted actuarial methods that lowered employer contributions in initial years, shifting cost of enhancements into the future.

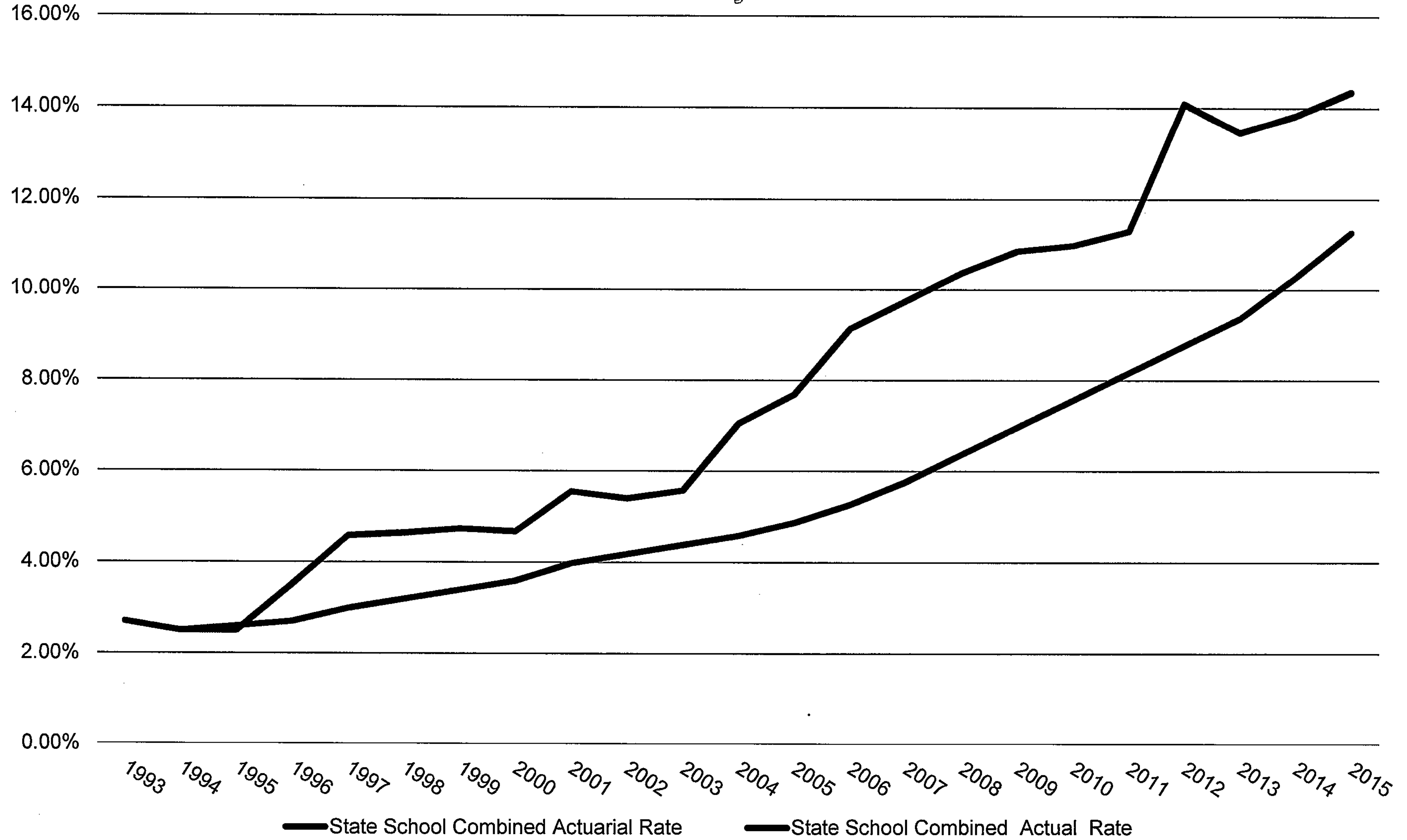
Long-Term Funding

- These changes, along with later experience losses and other factors adversely affecting liabilities contributed to long-term funding issues that emerged in 2001-2002.
- By 2001 and 2002, actuarial projections indicated
  - The statutory rate would not reach the actuarial rate before the end of the amortization period in 2033.
  - The UAL had reached $2.6 billion.
- KPERS began working with the Legislature to develop a plan to address the shortfall and bring the Plan into actuarial balance.

Factors Affecting the System's UAL

Historical Changes to System's UAL (1993-2011)		
Effect of Employer Contribution Cap/Lag	$3,095	37.5%
Actuarial Methodology (Includes changes to fund benefit liabilities more rapidly)	$2,405	29.1%
Changes in Assumptions/Demographic Experience	$1,500	18.2%
Actual vs. Assumed Investment Returns	$1,477	17.9%
Benefit Changes (after 1993)	$264	3.2%
Bond Issue	($481)	-5.9%
Total	$8,260	100.00%

- Changes to actuarial methodology –
  - Provided greater stability in the System's ongoing cost
  - Funded benefit liabilities more rapidly, which is more a conservative approach.
- Changes in demographic assumptions (such as mortality and retirement rates) were made to better reflect actual experience over time
- Differences between actuarial assumptions and actual experience also may affect the UAL.


State/School Group
Actuarial Versus Statutory Rates: FY 1993-2015
16.00%
14.00%
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
State School Combined Actuarial Rate
State School Combined Actual Rate

Long-Term Funding Response

The Legislature took action to address long-term funding issues

- Gradually raised statutory cap of 0.2% on employer rate increases (2003)
  - Reached 0.6% in FY 2008
- Issued $500 million in pension obligation bonds (2004)
- Created new plan design for future employees (2007)

	Tier 1	Tier 2 (Effective 7/1/2009)
Employee contributions	4%	6%
Full retirement age	• 85 “points” (age + service) • 65 with 1 year service • 62 with 10 years service	• 65 with 5 years service • 60 with 30 years service
Final average salary	3 years No final payouts (e.g., vacation or sick leave) if hired 7/1/93 or later	5 years No final payouts

- These actions, plus strong investment returns from 2004-2007, improved projected funded status significantly
- Plan remained vulnerable to market downturns

Impact of 2008 Crisis

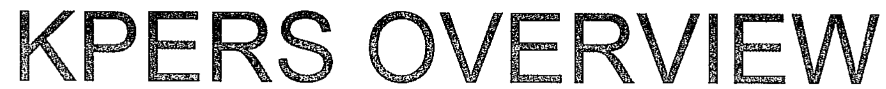
- Unprecedented investment market declines in 2008
- Substantial negative impact on KPERS' long-term funded status
- In the 12/31/08 actuarial valuation report for the entire System
  - 12% decline in funded ratio to 59%
  - $2.7 billion increase in UAL to $8.3 billion
  - Actuarial value of assets significantly greater than the market value
    - About $2 billion in deferred losses (averaged in over next four years)
    - On a current market value basis, a funded ratio of 49% and a UAL of $10.3 billion
- Statutory and actuarial contribution rates for school employers no longer projected to converge

Legislative Response: 2008-2011

- Multiple legislative committees requested options for a KPERS funding solution over the following three years
- During 2011 Session, both chambers passed bills with additional employer contributions and changes for active members
  - House also voted to establish a defined contribution (DC) plan for future employees
- Compromise in conference committee resulted passage of HB 2194
  - Delayed employer and current employee changes until an interim KPERS Study Commission could make recommendations
- Study Commission met throughout summer/fall 2011

Legislative Response: 2011-2012

- Study Commission recommended a hybrid cash balance/ defined contribution plan
  - Employer contributions funded a cash balance plan with pay credits based on years of service
  - Employee contributions funded a defined contribution plan
  - Required employer contributions to rise to actuarially required rate immediately
  - Included increases in current member contributions or reductions in future benefits
- When the Study Commission bills did not receive favorable action, the Legislature renewed review of multiple options
  - Increased focus on a cash balance element as new plan design foundation for future members
    - Cash balance plan only (House Committee bill)
    - Member election of cash balance or defined contribution plan (House floor)
    - Variation on Study Commission hybrid plan (Senate floor)
- Compromise
  - Raise cap on employer contribution increases (1.2% annually by FY '17)
  - Higher contributions or lower benefits for active members
  - Cash balance plan for new members (effective 1/1/2015)



KPERS OVERVIEW

ACTUARIAL VALUATION

LONG-TERM FUNDING HISTORY

2012 HB 2333

HB 2333: Employer Contributions

- Raises statutory cap on employer contribution increases:

		State/School Group	
Fiscal Year	Cap	Statutory rate	Actuarial rate
2013	0.60%	9.37%	13.46%
2014	0.90%	10.27%	13.83%
2015	1.00%	11.27%	14.34%
2016	1.10%	12.37%	15.34%
2017 and later	1.20%	13.57%	16.59%
FY 2020: Statutory/actuarial rates converge		16.87%	16.87%

Projected actuarial rates

- Provides contributions from the Expanded Lottery Act Revenue Fund
  - Beginning in FY 2014, dedicates 50% of ELARF revenue after distributing $10.5 million to higher education programs
  - Continues until KPERS reaches 80.0 percent funding ratio

HB 2333: Tier 1 Members

- Election – Pending IRS approval

Member Contributions	Benefit Formula	
5% effective January 1, 2014 and 6% effective January 1, 2015	Increase multiplier to 1.85% for future service only, effective January 1, 2014	DEFAULT
or		
Remain at 4%	Multiplier is reduced to 1.40% for future service only, effective January 1, 2014	

HB 2333: Tier 2 Members

- For all retirements on or after 7/1/12, cost of living increase is eliminated
- For all retirements on or after 1/1/14, multiplier increases to 1.85% for all service

Current Tier 2	Revised Tier 2
6% contributions	6% contributions
1.75% multiplier	1.85% multiplier for all service, starting with January 1, 2014, retirements
Includes cost of living increase	Eliminate COLA, first effective for July 1, 2012, retirements

What Is a Cash Balance Plan?

Defined benefit plan with defined contribution characteristics

- DC features
  - Value of benefit is expressed during working years as account value
    - However, accounts are "notional" or hypothetical accounts
    - Assets don't precisely match account values as in a DC plan
  - Reflects compensation earned over entire career
  - Investment, inflation and longevity risks may be shared with employee
- DB features
  - Benefit is paid as lifetime income in retirement
    - Lump sum may be optional form of payment
  - Guaranteed interest crediting rate provides definitely determinable benefit
  - Assets are pooled and professionally managed
  - Actuarial valuation determines contributions required to fund the plan
  - Required actuarial contributions vary depending on the actual experience compared to actuarial assumptions

What Is a Cash Balance Plan?

- Cash balance plan design features affecting benefit
  - Total pay credits attributed to employee's cash balance account
  - Interest credit
    - May be fixed or tied to a benchmark
    - May include discretionary dividends
  - Annuitization versus lump sum
    - Availability of employer credits for distribution to members terminating before retirement
    - Must offer an annuity option
    - Annuity factors (interest rate and mortality)
- Plan design features can reduce employer risks and costs
  - Interest crediting rate
    - If lower than investment return assumption, can provide margin and/or reduce employer contributions
  - Annuity factors (e.g., set interest rate below assumed investment return)
  - Distribution options
    - Restrict distribution of employer account balance prior to retirement
    - Minimize lump sum distributions
  - Flexibility to change pay credits, interest credits and annuity factors prospectively

The Kansas Cash Balance Plan

Plan Provision	KPERS Cash Balance Plan
Employee contributions	6%
Employer "pay credit"	• Based on years of service: 1-4 yrs = 3%, 5-11 years = 4%, 12-23 years = 5%, 24 years+ = 6% • May be changed prospectively by the Legislature
Interest credits	• 5.25% guaranteed. Paid quarterly on prior quarter's ending balance • Possible additional interest credits (0-4%) at Board discretion based on statutory criteria, including KPERS' funding, investment returns, market conditions • May be changed prospectively by the Legislature
Vesting	5 years
Normal retirement age	Age 65 with 5 years of service. Age 60 with 30 years of service
Early retirement age	Age 55 with 10 years of service
Retirement benefit	• Account balance converted to monthly benefit at retirement using annuity factors — 6% interest rate assumption — Mortality table selected by Board • Annuity factors may be changed prospectively by the Legislature • Various forms of payment, including survivor options and self-funded COLA • Partial lump-sum option up to 30% (not available at early retirement)
Termination before retirement	• Can withdraw employee contribution balance, but forfeit employer account balance • Vested members can leave contributions in and receive benefit at retirement age • Inactive members earn interest credits on notional account • Non-vested: two years following termination • Vested: Until retirement or forfeiture of membership

What HB 2333 Accomplishes

- Employers and current employees take shared steps toward a funding solution
  - Higher statutory cap on increases in employer contributions, beginning FY 2014
  - Current employees pay additional contributions or accept reduced benefits (future service)
- Future employees in cash balance plan share risk to a greater degree than in a traditional DB plan
- Greater flexibility to change new cash balance plan design to manage future affordability and sustainability issues
- Existing DB plan stays OPEN – no adverse impact on cash flow, asset allocation or investment return assumption
- Guaranteed lifetime benefit as the basic foundation for retirement income
- Reduce total employer contributions over long-term

What HB 2333 Does NOT Affect

- No decrease in benefits already earned by current employees
- The unfunded actuarial liability – it is a “debt” that has already been incurred
  - As structured, does not shorten the UAL’s amortization period