The House Standing Committee on Pensions and Benefits
Testimony by the Kansas Coalition of Public Retirees
Mr. Ernie Claudel, Vice-Chair
March 20, 2013

Mr. Chairman and the House Committee on Pensions and Benefits, thank you for allowing us to appear today in opposition to the Pension Plan Design Change Bill. My name is Ernie Claudel, and I represent the Kansas Coalition of Public Retirees, KCPR.

Members of our Coalition represent a total of 39 employee organizations of KPERS retirees. Our group consists of retirees from all levels of State, County, and Municipal Government. The Coalition occupations include retired firefighters, police, municipal safety workers, judges, school personnel, professional and clerical workers. In recent months we have closely followed KPERS developments including formation of the KPERS Study Commission.

<u>The Key to Solving the KPERS Problem</u>
The Coalition believes the extreme complexity of KPERS must be considered when our pension system is evaluated. A limited time to investigate the entire system can be dangerous. This argument over KPERS must not be allowed to become a political and ideological argument. While the KPERS pension system is highly complex with hundreds of moving parts, the focus must center on the problem. From testimony you have heard this session, as well as testimony from previous sessions, the focus must be on the UAL. The pension funding retirement equation which is C + I = B + E. (Reference 2, Page 3.) Simply stated, when contributions are increased, the potential for investment income is compounded. If the investment income is heightened and expenses are retained at a low level, then the UAL is reduced and the health of the system to pay benefits is increased. If contributions, investment income, and expenses are altered in any way, the UAL is affected. The only parts of this equation that can be controlled are the contributions and the expenses. The higher the contributions and the lower the expenses the more stable the KPERS Trust Fund. Thus, by focusing on the UAL, through contributions and keeping expenses as low as possible, the UAL problem will be eventually solved.

To review:

1. The reason for the ugly UAL is under funding. The Trust Fund is not broke or broken. When examined long term and focusing on the problem as indicated by the actuary, the UAL will be reduced to an acceptable level. We submit that controlling contributions and expenses, which are the only things we can control, the KPERS Trust fund will remain healthy.
2. Employee contributions have been increased by 50%. The contribution by the employer has also been increased. This increase in funding must be maintained for the UAL to be reduced.
3. A DC will only contribute to the problem. A DC would stop the influx of employee and employer contribution going into the Trust Fund. The employee share has been the only constant supply of funds over time. (A 401k type plan would require all contributions to be placed in individual accounts. This would dramatically increase the UAL. The increased expenses for investment would be shouldered by the employee as well.)
4. It is our contention that the problem is eventually solved by placing as many funds in the trust fund as possible and keeping the expenses as low as possible.

5. ELARF funds were also designated to the KPERS Trust Fund over and above the employer contribution to reduce the UAL. Now it appears that as a practical matter, while ELARF funds are still purposed for funding KPERS, that they are no longer being added to the contribution, only supplanting general funds monies in order to reduce the proposed State Budget shortfall.

While this committee has more access to information than the Coalition, we are still learning things after 8 years. KPERS involves 281,000 plus (Reference 1, Page 5) Kansas public employees from all different job descriptions. As you have learned, with the exception of the Judges and the legislators, the classification lines are blurred because not all police and fire belong to KP&F, as many are covered by KPERS. We caution making any decisions in haste! The UAL is the primary problem and MUST be appropriately addressed! Once again, the best way to address this is to keep the contributions to the KPERS Trust Fund as high as possible.

<u>Other Complexities</u>

In the interest of time we would provide the following additional points we believe should be considered since no one else is apparently thinking about them. This is based on our long standing belief that this KPERS debate is an ideological and political argument. We believe the lack of the Kansas Retirement System being a priority over the years has led to the large UAL number.

1. Since a majority of the employees covered under KPERS are not highly paid individuals, if the retirement system is not sustained, aren't many likely to end up needing some other type of state assistance?
2. A good pension system provides the ability to hire and retain qualified individuals.
3. How are we going to keep the highly competent public employees we are educating and training from leaving the State once they have reached a high level of skill?
4. A number Kansas Firefighters do not qualify for Social Security.

<u>Legal Issues</u>

We believe that there are legal questions and obligations which need to be addressed. Often mentioned here in the Capitol are the IRS considerations. We believe that the following also must be considered: 1) Contract Law. 2) The legally allowed length of time to pay off the UAL. 3) Finally, there is Fiduciary Responsibility. A fiduciary responsibility is a legal responsibility to act in the best interest financially and otherwise for someone else. It is an obligation to act honestly and responsibly in another person's best interest. As was indicated last week, the only group covered under KPERS who has an option in participating in either KPERS School, KPERS or KP&F are legislators. Not only are others required to contribute as a condition of being employed, our contracts indicate that the sponsoring agency will be required to contribute as well. We also know that over the last twenty years, 57% of the KPERS Trust Fund (Reference 1, page 8) has been realized through investment returns. The KPERS Trust Fund was established for the sole use and benefit of its members. This is the point where the question of Fiduciary Responsibility comes into play. The Coalition believes that the obligation of properly funding the KPERS Trust Fund is a legislative obligation that cannot be ignored. The debt is their legal responsibility.

Fair and equable

All KPERS retirees have paid in every dime they were required, and they have all met the requirements necessary to receive KPERS benefits as outlined by the Kansas Legislature!
The state is contributing and has contributed 8.5% as employer to the regency retirement plan (Employees contribute 5.5%) (University faculty & administrators) for years. We have heard the same inferences that Director Conroy testified to regarding this program. It is considered such a good retirement system that rules are being bent to include as many employees as possible under the regency retirement plan rather than KPERS. Also, we have recently discovered there is a DC retirement plan available for certain state officials (hired and elected). We have learned that upon employment a one time offer is made to either choose KPERS or this DC plan. This plan is funded at an 8% level by the state w/no mandatory employee contribution**.**

Comparing other Pension Systems Design

Extreme caution should be used when comparing what other states do with their pension systems. This is often like comparing – "Apples to Dump Trucks". "Not everyone is doing things with their pension systems", many are evaluating and talking about it but little action has been taken. Systems differ greatly.

1. Some states offer Social Security, others don't.
2. States with properly funded pension systems are not in financial trouble. "A fundamental principle of sound funding for a defined benefit plan is to consistently pay the full ARC rate." (Reference 1, page 27)
3. The excuse that every state is making changes in their retirement system is not correct. Much discussion has taken place, little action has been taken.
4. This lack of change is likely due mainly to legal issues, plan complexity and their UAL.
5. The states of which we are most familiar that have changed to a hybrid system, i.e., Utah and Nebraska, were able to begin their plans with what is essentially a UAL of 0.00. Any switch is complicated by the size of the UAL!

Economic Impact

Economic Impact is one area that has never been publicly discussed in committee to our knowledge. Some consider public employees, "tax takers not tax payers". We would disagree. Presently 100% of the current actively working KPERS employees presumably live in Kansas as do 90% of the retirees. They pay Kansas sales tax, property tax, and state income tax on income not derived from KPERS benefits. KPERS employee contributions are taxed when earned, not when benefits are paid out. We might call KPERS retirement benefits a "Kansas Roth IRA". The contribution made by KPERS retirees to the Kansas economy in the way of benefits is significant. We have included two pieces of information which come from KPERS. They are the annual benefits received by the KPERS retirees living in Kansas as well as the monthly benefits by total and by county. You will note that in 2011, benefit payments to Kansas residents equal $1,100,700,246.00 ($1.1 billion). (Reference 3, Page 11) In June, 2011, a total of $77,124,754.00 ($77 Million) was paid to KPERS retirees living in Kansas Counties. (Your county totals are attached. The attachments show an annual as well as a monthly total.) Knowledge we receive from our contacts is that this money is being "recycled" into the local economy monthly to offset living expenses, medical bills and to pay their taxes.

Our Confusion and Fear

Our trepidation around "tinkering" with the KPERS retirement system is, and will continue to be in the future, around the UAL for the following reasons:

1. Already listed is the fact that the KPERS Board of Trustees does a wonderful job with the investments. One of the reasons these record returns are possible is because of the large investment pool available for them to invest. With huge sums to invest, opportunities are made available to the investor in terms of investment options and guarantees.
2. The concern in many legislators' voices is centered on the cost of the pension system and in some extreme cases; the absolute question of affordability is raised. Taking actions that increase the UAL and reduce the funding ratios are scary and may be illegal because a large percentage of the Trust Fund is our money, and arguably all of it is. Concern for the future of the KPERS retiree is very real!

Income Replacement

We previously opposed a change from the previous KPERS program. The Cash Balance plan is preferable to a DC plan only because in the documented expenses, DC will be more expensive and will also put the potential benefits (income replacement) in question. Income replacement under the current KPERS system works out to be about 50% of the final salary. The projected best case scenario under the CB system which is to take effect in July 1, 2014, is estimated to be 43%, worst case scenario, 34%. (Reference 2, page 42) DC options are available in the way of 457 and 403B options, often referred to by state employees as deferred compensation. With the required contribution of the individual increased from 4% to 6% (a 50% increase), the ability of many of the public employees to invest in one of these in addition to their pension comes into even more question.

The Other Side of the Story

There is, in fact, another side to this DC vs. DB debate. There is an opposite explanation for why the 401k became so popular. We will likely never get to hear these arguments here, so we are recommending some reading material. The good news is that in one evening you could cover the subject from the opposite point of view.

A. The book we recommend is "Retirement Heist" by Ellen Schultz. She is a Pulitzer Prize winning investigative reporter with the Wall Street Journal. The book is a readable 216 pages and has 16 pages of references.

B. The recommended website is the "National Institute of Retirement Security" at www.nirsonline.org. Their latest study we are sure was being quoted by Sen. Bradley. One of the main points to be found here is that in the last few years, attitudes toward retirement has changed dramatically! Today, given the choice of a 401k job or a DB pension plan job, the majority will pick the latter.

C. An additional writer we recommend is Teresa Ghilarducci. She can be Googled for articles & books. She is the Irene and Bernard L. Schwartz Chair of Economic Policy Analysis and director of the Schwartz Center of Economic Policy Analysis in the Department of Economics at The New School's New School of Social Research. She has a Ph.D. in Economics from Berkeley.

All three sources listed above, question the use of the 401k for the reason that they are too unpredictable at retirement, i.e., the market might be down when you want to retire. Further, Ms. Schultz indicates that the 401k was never devised for the common wage earner. Other main problems sighted are that people tend to do the opposite of what they should do with their holdings. You must dollar cost average to lessen investment risk, and you must "buy low and sell high". People panic when times are hard and take the opposite action that they should. They generally either, “sell low and buy high,” or stop investing. When this happens, your investment plan is doomed to failure!

<u>In Conclusion</u>

The KCPR believes that the current system is superior to the Cash Balance System and far superior to a DC Plan. The present system costs less and brings the system into ARC balance more quickly and has superior benefits. “A fundamental principle of sound funding for a defined benefit plan is to consistently pay the full ARC rate.” (Reference 1, page 27) The conversion to Cash Balance increases the employee contribution 50% and represents not only a funding shift but a degree of risk to the employee. DC does not solve the primary KPERS funding problem, which is the UAL, but does reduce the growth of the KPERS Trust Fund and costs the employee much more in individual fees. Total investment risk would be placed on the shoulders of the employee.

Our fear is that mistakes will be made because of misunderstanding of the KPERS system.

We are particularly concerned since the money in the KPERS Trust is either our personal contribution or contributions promised to us upon employment, or investment income made off of the two. It is essential that as large a sum for investment as possible be kept in the Trust Fund. Please act with responsibility and with compassion in our behalf so as not to set the system up for failure, because the retired and near retirees will have no way to recover.

References:

(1) Kansas Public Employees Retirement System report to the House Pensions and Benefits Committee Dated, January 16, 2013
(2) The Basics of a Cash Balance Plan Design Presentation to the KPERS Board, Dated October 18, 2012
(3) Recommendations for the 2013 Legislative Session by the Kansas Coalition of Public Retirees

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