MEMORANDUM

To: Senate Ways and Means Committee

From: Alan D. Conroy, Executive Director

Date: March 12, 2013

Subject: HB 2213 – Technical Amendments to 2012 HB 2333

HB 2213 contains several clarifying and technical amendments to 2012 Senate Substitute for House Substitute for HB 2333. The following information regarding HB 2213 and its fiscal impact is provided for your consideration.

Following passage of 2012 HB 2333, KPERS staff and the Revisor's Office have been reviewing its provisions. As is the case with many complex, substantive pieces of legislation, several areas were identified for which clarifying or technical amendments are advisable to ensure internal consistency and to better reflect the bill's intent. The four that are most notable are summarized below.

Tier 2 benefit structure. As originally designed, Tier 2 included an annual cost of living adjustment (COLA) for retirees equal to 2.0% of the Tier 2 retiree's benefit. HB 2333 eliminated the COLA for any Tier 2 member retiring on or after July 1, 2012. 2012 HB 2333 also provides Tier 2 members with a 1.85% multiplier for all years of service, beginning with retirements on and after January 1, 2014. Therefore, any Tier 2 member retiring in the 18-month period between July 1, 2012, and January 1, 2014, would receive neither a COLA nor the higher 1.85% multiplier.

In order to prevent this result, HB 2213 would amend K.S.A 2012 Sup. 74-49,205 to retroactively extend the application of the higher 1.85% multiplier to retirements on and after July 1, 2012. In addition, it directs the Kansas Public Employees Retirement System (KPERS) to re-determine the annual retirement benefit of any Tier 2 member who retired on or after July 1, 2012, but prior to the effective date of the act, by applying the 1.85% multiplier to all periods of the member's service. Any resulting underpayment of benefits to the point the benefit is recalculated are to be paid to the member as a one-time redetermination benefit payment, in a form and manner prescribed by the KPERS Board of Trustees.

Tier 1 member contribution increases. Under 2012 HB 2333, Tier 1 members are to be provided with a one-time, irrevocable election between two options. The first is an increase in the benefit formula multiplier from 1.75% to 1.85% for all future service, beginning January 1, 2014, plus an increase in the member contribution rate from 4.0% to 5.0% on the same date and

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from 5.0% to 6.0% on and after January 1, 2015. The second option would be to retain the 4.0% member contribution rate, in which case the benefit formula multiplier would be reduced from 1.75% to 1.40% for future service, beginning January 1, 2014. This election is subject to approval of the IRS, and 2012 HB 2333 specifies that, if the IRS does not approve the election, or the member does not make an election, the default would the 1.85% multiplier and higher contribution rates.

Language setting out this default option was necessary in more than one section of 2012 HB 2333. One such section, K.S.A. 2012 Supp. 74-49,135, did not reflect the phased-in increase in member contributions from 4.0% to 5.0% and subsequently to 6.0%. HB 2213 amends this section to conform with other provisions setting out this phased increase in contributions.

Tier 3 "grace period" rule. 2012 HB 2333 applies the new Tier 3 cash balance plan to members who are "first employed" by a participating employer on or after January 1, 2015. The term "first employed" is defined to include any employees who become inactive, nonvested members and, on or after January 1, 2015, are again employed by a participating employer in a covered position.

There are circumstance in which a nonvested member would technically be considered inactive for a brief period of time, such as termination with one affiliated KPERS employer followed almost immediately by employment with another KPERS employer. If that were the case upon implementation of Tier 3, the nonvested member could forfeit the member's Tier 1 or Tier 2 status and be required to begin membership in Tier 3 upon his or her return. HB 2213 clarifies the application of the definition of "first employed" by providing a modest period of time during which non-vested members who leave Tier 1 or 2 covered employment may return to covered employment without forfeiting Tier 1 or 2 status. For KPERS members other than school employees, HB 2213 provides a 30-day window in which they may return to employment and retain membership in Tier 1 or 2. For school employees, the grace period preserves a teacher's Tier 1 or 2 membership when transferring from one school district to another between school years, in particular, during the summer months.

Early retirement for Tier 3 inactive, vested members. At the request of KPERS, the House Committee amended language in section 6(b) of HB 2213 to reflect that an inactive, vested Tier 3 member of KPERS would not be eligible for early retirement until attainment of age 55. HB 2213 as introduced would have allowed inactive, vested Tier 3 members to apply for retirement benefits at any age as long as they had at least 10 years of service.

The majority of the provisions of HB 2213 represent clarifying or technical amendments that are not expected to have any fiscal impact. The changes to the Tier 2 benefit structure would represent a small benefit increase for a limited number of Tier 2 members who would be eligible to retire prior to January 1, 2014. However, the change is not expected to have any material fiscal impact.

- Since July 1, 2012, only two Tier 2 members have retired. Thus far, those two individuals would be the only retirees affected by HB 2213.
- As of December 31, 2011, fewer than 20 Tier 2 members were age 65 years of age or older with five or more years of service. While that number would now be somewhat larger, there would still be a limited number of Tier 2 members eligible to retire during the 18-month window covered by 2012 HB 2213.
- KPERS' consulting actuary has indicated that, in preparing the cost study for 2012 HB 2333, the number of Tier 2 members that could be expected to retire was small enough that the cost study's projections assumed all Tier 2 members would retire with the 1.85% multiplier for all years of service. Therefore, any cost associated with the higher multiplier for those retiring before January 1, 2014, would have already been incorporated in the 2012 HB 2333 cost study.

Under New Section 29 of 2012 HB 2333 (now codified at K.S.A. 2012 Supp. 75-3715b), the fiscal note for bills which provide any type of benefit enhancement for KPERS members are to include an actuarial appraisal of the liability and required contributions necessary to discharge that liability. The fiscal note is to be available to members of the standing committee of the Legislature to which the bill is assigned. Because HB 2213 does provide an increase in benefits for some Tier 2 members, a letter prepared by KPERS' consulting actuary, Cavanaugh MacDonald, is attached, confirming that the bill is not expected to increase KPERS' actuarial liabilities or required contributions beyond the costs anticipated in the original cost study for 2012 HB 2333.

As KPERS continues to work toward implementation of 2012 HB 2333, we will share with this Committee any additional items of this nature identified for future consideration by the Legislature.

Cavanaugh Macdonald
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February 7, 2013

Mr. Alan Conroy
Executive Director
Kansas Public Employees Retirement System
611 S. Kansas Ave., Suite 100
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Re: Cost Study for HB 2213

Dear Alan:

Sub HB 2333, as passed by the 2012 Legislature, changed the benefit structure for Tier 2 members by eliminating the 2% cost of living adjustment (COLA) and increasing the benefit multiplier from 1.75% to 1.85% for all years of service. Under Sub HB 2333 the COLA was eliminated for retirements after July 1, 2012 and the benefit multiplier was increased for retirements effective on and after January 1, 2014. As a result, there is a small window from July 1, 2012 to January 1, 2014 in which Tier 2 members who retire would receive neither the COLA nor the 1.85% benefit multiplier. This was not the intent of the original legislation, and HB 2213 has been introduced in the 2013 session to provide the higher benefit multiplier of 1.85% for all years of service to those Tier 2 members whose retirement date falls within the eighteen month window from July 1, 2012 to January 1, 2014. You have asked Cavanaugh Macdonald to discuss the potential cost implication of HB 2213.

First, it should be noted how the formal cost study prepared for Sub HB 2333 in June 2012 valued the Tier 2 provisions. With the creation of Tier 3 in Sub HB 2333, the Tier 2 group is very small since it represents members hired after July 1, 2009 and before January 1, 2015. In the context of the fifty year projections prepared for Sub HB 2333, the cost impact of the entire Tier 2 group, given its size, is small. Furthermore, the number of Tier 2 members expected to retire during the window from July 1, 2012 to July 1, 2014 has no material impact on the projection results because there are so few who will be eligible to retire during that window. Even those members who are eligible to retire during the window will typically have no more than five years of service, resulting in small benefit amounts. As a result, to simplify the coding for Tier 2 members in the projections, it was assumed that all future Tier 2 retirees would receive the 1.85% multiplier instead of the 2% COLA. Therefore, Tier 2 members who retire between July 1, 2012 and January 1, 2014 were valued with the 1.85% benefit multiplier even though Sub HB 2333 did not make that change until January 1, 2014. As a result, last year's cost study for Sub HB 2333 included the cost of the higher multiplier for the subset of Tier 2 members who retire between July 1, 2012 and January 1, 2014 and HB 2213 does not create any additional costs.

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We are available to answer any questions on the material contained in this study or to provide explanations or further details upon request. We, Patrice A. Beckham F.S.A. and Brent A. Banister, F.S.A., are consulting actuaries with Cavanaugh Macdonald Consulting, LLC. We are also members of the American Academy of Actuaries and Fellows of the Society of Actuaries, and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

If you have questions or need additional analysis, please let us know.

Sincerely,

Patrice Beckham

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Principal and Consulting Actuary

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