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Jon Hummell, Interim Director

Division of the Budget

Sam Brownback, Governor

March 11, 2014

The Honorable Steven Johnson, Chairperson
House Committee on Pensions and Benefits
Statehouse, Room 286-N
Topeka, Kansas 66612

Dear Representative Johnson:

SUBJECT: Fiscal Note for HB 2743 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2743 is respectfully submitted to your committee.

Under current law, members of the KPERS Tier 1 plan of the Kansas Public Employee Retirements System (KPERS), the Kansas Police and Firemen's Retirement System (KP&F), and the Judges Retirement System (Judges) can elect a lump sum option in 10.0 percent increments up to 50.0 percent. Those members under KPERS Tier 2 can elect a lump sum option in 10.0 percent increments up to 30.0 percent while KPERS Tier 3 members can elect a lump sum option in any dollar amount or percentage up to 30.0 percent. HB 2743 would allow lump sum options of 10.0 percent, 20.0 percent, 30.0 percent, 40.0 percent, 50.0 percent, 75.0 percent or 100.0 percent for all retirement plans.

According to KPERS and the agency's consulting actuary, HB 2743 would have no fiscal effect in FY 2014 or FY 2015. However, the bill could increase long-term retirement system costs for the State/School Group by approximately $2.5 billion or $287.5 million on a present value basis. Based on the percentage of State General Fund resources budgeted for statewide salaries and wages in FY 2015, approximately $1.15 billion ($130.6 million present value) from the State General Fund could be required over the long run. Employer contribution rates for the State/School Group would peak at 16.18 percent in FY 2022. Most of the costs from HB 2743 come from the KPERS Tier 3 plan (cash balance plan). For purposes of the actuarial cost study on the bill, it was assumed that all KPERS Tier 3 members would take a 100.0 percent lump sum option, which represents the highest cost scenario.

If a member elects a partial lump sum option at retirement, the actuarial value of the member's benefits is calculated by converting the monthly benefit amount over the member's anticipated lifetime (based on mortality assumptions) to its present value at the time of retirement, using the actuarial investment return assumption (currently 8.0 percent). Therefore, the calculations of both the liability for the member's benefits and the present value calculation for the partial lump sum option at retirement use the same investment return assumption.

Generally, a lump sum option of any size should be largely cost neutral to most KPERS plans. However, higher lump sum options, including a 100.0 percent lump sum, may have an adverse impact on the retirement system's funding from gender or mortality risk factors. For example, those members who choose to take larger lump sum payouts may include higher proportions of males or those who have reason to anticipate a shorter life span.

Additionally, under current actuarial assumptions and plan provisions, 12.0 percent of benefits are expected to be paid in a lump sum. If there was a major change in cash flow due to large lump sum payouts, additional costs to the retirement system could result from corresponding changes in the portfolio's asset allocation and its investment return assumption.

Unlike the final average pay plans, increasing the maximum lump sum payout for KPERS Tier 3 is not actuarially neutral and, therefore, has a direct cost to the cash balance plan. For the cash balance plan, the lump sum option amount first is netted out from the KPERS Tier 3 account balances, and then the remaining balance is converted to a monthly benefit. This conversion is based on a mortality rate assumption and a discount rate (an investment return assumption). By statute, the discount rate is 6.0 percent and the retirement system's actuarial investment return assumption is 8.0 percent. Due to the difference between the discount and return assumption rates, there is a cost to the system when a member withdraws account balances at retirement, rather than annuitizing the balances and receiving the benefits over time. Because KPERS Tier 3 cash balance plan members would first be reflected in the December 31, 2015 valuation, the higher employer contribution rates associated with the lump sum payouts would first be reflected in FY 2019 State/School Group rates. Therefore, there is no fiscal effect in the short-term.

It is estimated that HB 2743 would also increase employer contributions for the Local Group by $973.2 million (present value of $116.3 million) over the long-term. There would be no fiscal effect for local governments in calendar year 2014 or calendar year 2015.

KPERS estimates that there would be administrative costs to implement the provisions of HB 2743 for information technology changes, publication changes, and printing. However, KPERS estimates that the increased costs can be managed within existing resources. Any fiscal effect associated with HB 2743 is not reflected in *The FY 2015 Governor's Budget Report*.

Sincerely,

Jon Hummell,
Interim Director of the Budget

cc: Faith Loretto, KPERS
Mary Rinehart, Judiciary