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Division of the Budget

Sam Brownback, Governor

March 17, 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 2760 by House Committee on Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2760 is respectfully submitted to your committee.

HB 2760 would increase the waiting period for a KPERS retiree to return to work for an affiliated employer from 60 days to 180 days.

According to KPERS, enactment of HB 2760 could have a fiscal effect but it is difficult to estimate. Plan design modifications that are likely to influence the behavior of members, retirees, or employers may have an effect on the funding of the plan, whether by increasing or decreasing its cost. A number of actuarial assumptions used to project the costs of the KPERS plan reflect member choices and behaviors, including assumptions about the probability that an eligible member will retire in the first year he or she becomes eligible for retirement and in each year thereafter. Working after retirement restrictions and exceptions may shape member decisions about how soon they retire after reaching eligibility for benefits.

Analysis of KPERS working after retirement data from 2006 through 2012 by KPERS' consulting actuary point to some ways in which the current 60-day break in service requirement, in combination with other working after retirement provisions, may impact retirement decisions. This analysis indicated that across all groups (State, School and Local), members appeared to be most likely to return to work for the same employer within three months of retiring. Notably, over half of Local and School Group retirees who return to work for the same employer did so within three months of retiring. The same was true of returning to work for a different Local or School Group employer, although to a smaller degree. Also, KPERS retirees returning to work for the employer from which they retired are subject to an annual $20,000 earnings limit, which would often represent part-time employment. However, beginning in 2009, licensed school professionals have been able to work for the same employer without any limit on their compensation. Moreover, the current 60-day break in service requirement permits these members to retire at the end of a school year and return to work at the beginning of the next school year with no loss of work time or interruption of their normal compensation. In combination, these two provisions appear to be associated with the greatest proportion of retirees who returned to work for the same employer reemployed within three months (56.0 percent). The number of licensed school professionals returning to work for the same employer increased by 43.0 percent from 2009 through 2011.

KPERS indicates that increasing the waiting period for retirees to return to work from 60 to 180 days is likely to affect the behavior of members when considering retirement. In general, the longer the waiting period, the more difficult it may be for an employee to enter into prearranged reemployment agreements with the employer. The difficulty may stem from the employer's ability and willingness to hold the position open until the member's return to work or the employee's ability to have adequate financial resources in place for the period of time before employment income resumes.

In most cases, the present value of retirement benefits is greatest when the member first becomes eligible for full retirement benefits. Therefore, plan design changes that incent members to retire later than expected under current rules could have the effect of reducing plan costs. However, KPERS states that changes in member behavior cannot be predicted with any accuracy, and the causes of subsequent changes in retirement patterns cannot be isolated with any certainty after the fact. To the extent that member retirement behavior shifts due to the provisions of HB 2760, future plan costs can be expected to change, but it is not possible to estimate the overall impact to the plan.

KPERS indicates that HB 2760 may also reduce the potential for costs to the system related to Internal Revenue Service (IRS) requirements. Under current law, KPERS retirees are prohibited from returning to work for any affiliated KPERS employer for 60 days from their date of termination. Such break in service requirements reflect IRS requirements for a genuine separation from service. While the IRS does not stipulate a minimum break in service requirement, such a requirement can serve to reduce incentives or opportunities for employees and employers to enter into prearranged agreements for an employee to retire and return to work for that employer. Raising the KPERS break in service requirement from 60 to 180 days may increase the practical challenges around entering into such inappropriate prearrangements between employees and employers, and thereby reduce the incentive for members to retire under circumstances that may indicate that there was no true separation in service. Therefore, to the extent a 180-day break in service increases the likelihood that KPERS retirements are based on a true separation from service, the bill may minimize the potential for costs to the system associated with noncompliance with IRS requirements.

KPERS notes that the bill would increase administrative costs from changes to member and employer documents, printing, and information systems upgrades. It is estimated that these administrative costs can be managed within existing resources. Any fiscal effect associated with HB 2760 is not reflected in *The FY 2015 Governor's Budget Report*.

Sincerely,

Jon Hummell

Jon Hummell,
Interim Director of the Budget

cc: Faith Loretto, KPERS