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MEMORANDUM

To: House Pensions and Benefits Committee

From: Alan D. Conroy, Executive Director *ASC*
Faith Loretto, KPERS 457 Plan Manager *FJL*

Date: January 27, 2016

Subject: HB 2541; KPERS 457 Plan

The KPERS 457 Plan, which was first established in 1980, is available to all state employees. In addition, local government employers that have affiliated or are eligible to affiliate with KPERS may choose to adopt the Plan as their own. Currently, 282 local government employers have chosen to offer the Plan to their employees. As of September 30, 2015, the KPERS 457 Plan held \$891 million in assets (\$626 million in State assets and \$265 million in local assets) on behalf of 23,298 participants (14,394 State participants and 8,904 local participants).

At its November meeting, the KPERS Board of Trustees directed staff to request introduction of legislation to provide clarifying amendments to the KPERS 457(b) deferred compensation plan. These changes relate to (1) state tax treatment of a Roth 457 option; (2) extension of the option to provide a companion 401(a) plan to local employers; (3) provision of data to facilitate participant retirement income planning.

Roth 457

Although Roth individual retirement accounts (IRA's) and 401(k) plans have been available for a number of years, Congress first authorized 457 plans to include a Roth component in 2011. KPERS periodically receives requests from both participants and employers for a Roth option as a way for employees to control the taxation of their deferred wages when they are disbursed in the future. While traditional 457(b) deferrals are pre-tax (with distributions from the Plan subject to taxation), Roth 457 contributions are taxable in the year contributed, and qualifying distributions are not taxed.

Although KPERS has authority to adopt a Roth component to the KPERS 457 plan, a technical amendment is needed to clarify the status of Roth contributions and distributions for state tax purposes, so that they are treated in the same manner as for federal taxes.

Local Employer Contributions to 401(a)

In 2002, the Legislature provided statutory authority for the State to make contributions to a 401(a) defined contribution plan to complement state employees' personal savings through the KPERS 457 plan. Although employer contributions can be made to a 457 plan, it often is preferable to do so through a 401(a) plan in order to provide greater flexibility in plan design and contribution limits. In addition, a 401(a) plan maximizes the funds available for employer contributions as the employer is not obligated to pay Social Security taxes on contributions to a 401(a) plan. However, due to lack of funding for employer contributions, the existing statutory authority has never been used to establish a 401(a) plan for state employees.

HB 2541 would clarify that KPERS also may establish an optional 401(a) plan for local employers that adopt the KPERS 457 plan. This amendment is in response to requests from local employers who, for a



range of reasons, would benefit from having the option of making employer contributions in coordination with the KPERS 457 plan.

- KPERS received inquiries from a fire district that could not afford KP&F membership, but wished to provide some additional retirement benefit beyond KPERS for its firefighters.
- Some local employers who are eligible to affiliate with KPERS have not done so, in which case the combination of the 401(a)/457(b) plans serves as the primary retirement plan for their employees.

There would be several advantages to employers and their participants if a 401(a) option was available in conjunction with the KPERS 457 plan, including –

- Plan design flexibility, including vesting and match structures
- A single, consolidated participant account statement for employer and employee contributions
- One retirement plan counselor, website, and provider
- In most instances, overlapping investment options
- Potential for improved pricing
- Shared fiduciary responsibility between KPERS and the employer

Enhanced Retirement Income Planning Data

For many years, KPERS has emphasized that personal savings, along with KPERS pension benefits and Social Security, are needed for a sound retirement income. In establishing the KPERS 3 cash balance plan, the Legislature underscored personal savings as a priority by directing KPERS to –

- Include members' anticipated monthly benefit, income replacement ratio, and projected account balance in all electronic and written account statements provided to KPERS 3 members
- Clearly state in these account statements that additional personal savings in programs like a 457 plan or a 403(b) plan will likely be needed to ensure adequate retirement savings and to help address cost-of-living increases.

KPERS continues to explore effective means for communicating these messages to KPERS members and to participants in the KPERS 457 plan. Recognizing that many of the latter are KPERS members, HB 2541 allows KPERS to share individual member pension data for KPERS 457 participants with the Plan's record keeper to provide consolidated pension and personal savings benefit estimates, including –

- Online, real-time snapshots of projected monthly retirement income needs, plus gaps between income needed and income accrued so far, taking into account pension and Social Security benefits and personal savings
- Online recommendations for changes in contributions and retirement age, based on income gap, plus immediate feedback on the likely impact of those changes to future income and current take-home pay.

By providing these tools, KPERS 457 participants will have timely feedback to help them assess how financially ready they are for retirement and what they can do to better prepare. All KPERS 457 expenses are paid through participant fees, and therefore, no fiscal impact on KPERS is anticipated.

The Committee's support of HB 2541 is respectfully requested. We would be pleased to answer any questions or provide additional information that the Committee may need in considering this legislation.