

Bill number: HB 2653 Due date: February 13, 2016Responding agency: Kansas Public Employees Retirement SystemPrepared by: Faith Loretto & Jarod Waltner DOB Analyst: Brendan Yorkey**Fiscal Impact**State—Would this bill have a fiscal effect on your agency? Yes ☒ No ☐Local—Would this bill have a fiscal effect on local government? Yes ☒ No ☐Tax Revenue—Would this bill affect State General Fund revenues? Yes ☐ No ☒Fee or Other Revenue—Would this bill affect revenues to other state funds? Yes ☒ No ☐

	<u>FY 2016</u>	<u>FY 2017</u>
Expenditures		
State General Fund	0	0
Fee Fund(s)	0	0
Federal Fund	0	0
Total Expenditures	0	0
Revenues		
State General Fund	0	0
Fee Fund(s)	0	Cannot be estimated
Federal Fund	0	0
Total Revenues	0	0
FTE Positions	0.0	0.0

* Revenue to the KPERS Trust represents increased expenditures for participating employers. Therefore, expenditures will increase for those participating employers funded by the State General Fund or other state fee funds, including state agencies, school group employers, state agencies with KP&F members, and the Judicial System.

Bill Description

Briefly describe what the legislation does. Describe the change(s) from current law that would drive an increase or decrease in expenditures or revenues. If federal funds are affected by the bill in some way, explain that relationship as well. Note any technical or mechanical defects with the bill (bill drafting errors only, do not include commentary as to whether the bill should be enacted or not).

HB 2653 makes several amendments relating to working after retirement rules for KPERS retirees. These amendments revise rules enacted in 2015 Senate Substitute for HB 2095 with respect to returning to work for a different employer, the process for extending certain exemptions to the basic working after retirement rules, and removing the expiration of special rules for certain school retirees.

Returning to work for a different employer

Prior to passage of 2015 Senate Substitute for HB 2095 (2015 HB 2095), KPERS retirees returning to work for a KPERS-affiliated employer other than the employer for which they worked during their last two years before retirement (different employer) have not had a limit on their earnings. The employers have been required to pay the actuarially required rate, plus the employee contribution rate of 6% on the retirees' compensation. However, for KPERS retirees who returned to work for the employer from which they retired (same employer), the general rule has been that, if their annual compensation exceeds \$20,000, their KPERS benefits are suspended for the remainder of the year, unless they discontinue working. No employer contribution on their compensation has been required.

Effective July 1, 2016, 2015 HB 2095 establishes a new basic working after retirement rule that increases the earnings limit to \$25,000, and extends it to KPERS retirees working for any KPERS employer, eliminating the difference between the "same employer" and "different employer." The employer contribution on the compensation of these retirees is to be set at the statutorily prescribed employer contribution rate for active members.

Under HB 2653, the distinction between same and different employer would be reinstated. KPERS retirees returning to work for a different employer would not be subject to an earnings limit, and an employer contribution rate of 30% would be applied to their compensation.

Assurance protocol

2015 HB 2095 established several exemptions from the basic working after retirement rule, including three that were time-limited: a one-year exemption for "hardship" positions and exemptions of up to three years (or three school years, whichever is less) for retirees employed in special education or "hard-to-fill" positions (as identified by the Kansas Board of Education). The 2015 legislation also permitted a one-year extension for these exemptions if approved by the Joint Committee on Pensions and Benefits (Joint Committee).

HB 2653 would remove the requirement that the Joint Committee approve extension applications. Instead, it establishes provisions for a written assurance protocol, which is to be submitted to KPERS. The assurance protocol is to be signed by the superintendent and board president for school districts, or for municipalities, the governing body or a designee. The assurance protocol must state that the position was advertised on multiple platforms for at least 30 calendar days and must identify one of three conditions listed in HB 2653 – (1) no applications were submitted for the position for which an extension of an exemption is sought; (2) none of the applicants met the reference screening criteria of the employer; or (3) no applicant possessed the appropriate licensure, certification or other necessary credentials.

Provisions in 2015 HB 2095 authorizing the Joint Committee to request and review documentation of employers' attempts to fill positions covered by an exemption with a permanent, active employee are retained under HB 2653. Authority is also maintained for the Joint Committee to revoke a special education or hard-to-fill position exemption if it determines the position was filled by prearrangement or the employer has not made sufficient efforts to hire a non-retirant for the position.

Extension of certain grandfathered provisions

Since 2009, KPERS retirees who are employed by in a licensed school professional position

have been exempt from any earnings limitation, whether employed by the same or a different employer than the one from which they retired. The employer has been required to pay the actuarial contribution rate, plus 8%.

2015 HB 2095 does not continue this particular exemption, except that, through July 1, 2017, it grandfathered all KPERS retirees employed in a licensed school position who had retired on or before May 1, 2015. After July 1, 2017, those grandfathered retirees will then be subject to a \$25,000 annual earnings limit while working after retirement for a KPERS employer (unless they are employed in a position qualifying for a hardship, special education, or hard-to-fill exemption).

As introduced, HB 2653 would eliminate the July 1, 2017, sunset and indefinitely extend the grandfathered status for these retirees.

Assumptions for Fiscal Effect Estimate

Expenditures: Detail the assumptions made in preparing the cost estimate. Describe agency expenditures that would become necessary with passage of the bill and how workload assumptions translate into the cost estimates. The estimate for any new position should be detailed to show the salary, benefits and associated other operating costs (such as a computer or other equipment). Distinguish between one-time and ongoing costs.

Revenues: Describe the assumptions and methods used in estimating the bill's effect on revenues. Detail the source of the revenue—is it a tax, agency earning, fee income or a federal reimbursement—and the fund that would receive the revenue. Distinguish between one-time and ongoing revenue changes estimated to result from passage of the bill.

Administrative Costs:

HB 2653 would entail expenses related to modifications to the KPERS' information technology system and database to track employment by same and different employment separately, to receive and maintain assurance protocols, and to track grandfathered retirees in licensed school professionals indefinitely. However, it is anticipated that these costs can be funded within existing resources.

Additional staff responsibilities for communications and services to retirees and employers subject to working after retirement provisions, reporting and payment functions, and other administrative duties are expected with HB 2653. In combination with 2015 HB 2095, the administration of working after retirement rules is growing in complexity. While KPERS anticipates absorbing the additional workload, further consideration of appropriate staffing levels may be required in the future as KPERS' gains experience with the administrative impact of the new rules.

Contribution Costs:

HB 2653 would, in some instances, increase employer working after retirement contribution rates as outlined below:

Rate if returning to work for a different employer

Under 2015 HB 2095, employers who hire a KPERS retiree who retired from a different employer would pay the statutory employer contribution rate for active members. In FY 2017, that rate would be 10.81% for State/School Group employers and 9.18% for Local Group employers. Under HB 2653, the rate would be fixed at 30%.

Rate for grandfathered licensed school professionals:

Currently, school employers that hire KPERS retirees in licensed school professional positions pay the actuarial employer contribution rate, plus 8%. (24.03% in FY 2017 and 24.38% in FY 2018) That rate structure would continue indefinitely for grandfathered retirees in licensed positions (retirees with retirement dates before May 1, 2015). If the grandfathering provisions were to sunset after June 30, 2017, as currently provided under 2015 HB 2095, and the retirees continued working (under the new \$25,000 earnings limit), the employer contribution rate for those retirees would drop to the statutory employer contribution rate (12.01% in FY 2018).

KPERS is not able to anticipate how these new rules would impact working after retirement patterns, and therefore cannot estimate how the rate changes may impact expected revenues into the KPERS trust fund.

Long-Term Fiscal Considerations

If the bill affects future years, beyond those shown in the table above, explain the long-term fiscal effect—are the revenues stable over the long term or would there be a phase-in of costs or revenues; if the bill ends at a specific future date, indicate this as well.

The fiscal impact of changes in working after retirement rules cannot be readily projected in advance, but trends may unfold over time as any resulting changes in retirement patterns become evident.

Two changes in HB 2653 relate to exemptions from the \$25,000 earnings limit. Exemptions from the earnings limitation for retirees returning to work can impact the cost of retirement benefits, with the degree of the impact dependent on the number of retirees affected and the demographic characteristics of the employees (e.g., age, earnings, gender, years of service). The potential for an impact results primarily from two factors:

(1) Changes in retirement patterns and behavior stemming from incentives for members to retire earlier than they would have absent the exemption. Members who can continue receiving pension benefits while earning all or a significant portion of their pre-retirement salary through employment with a KPERS-affiliated employer are incented to retire earlier than they might otherwise, due the material increase in their income. This, in turn, increases the actuarial liability for their benefits above that anticipated under current actuarial assumptions, which reflect historical retirement patterns where an earnings limit applies to working after retirement.

(2) Reductions in employee and employer contributions that occur when positions historically filled by active, contributing members are instead filled by noncontributing retirees.

The application of these two factors to the two changes in HB 2653 is summarized below:

Returning to work for a different employer

Changes in retirement patterns. Historically, there has not been an earnings limitation on retirees returning to work for a different employer. Data regarding the retirement patterns of retirees returning to work for different employers from 2006 through 2014 (whether state, school or local) suggests that the ability to receive both benefits and unlimited compensation working for a KPERS employer may have incented earlier retirement dates, with associated higher actuarial liabilities for these employees.

Effective July 1, 2016, 2015 HB 2095 will, as a general rule, establish a \$25,000 earnings limitation on KPERS retirees returning to either the same employer or a different employer. In

addition to creating a more consistent set of working after retirement limitations, extending the earnings limitation to retirees returning to work for a different employer was expected to minimize or moderate the incentives for members to retire closer to eligibility for full retirement. For the most part, HB 2653 is likely to preserve the existing incentives, and therefore, the current pattern of earlier retirements among retirees returning to work for a different employer could be expected to continue.

Depending on the agreements reached between employers and retirees, the 30% employer contribution rate may to some extent offset the incentive to retire earlier. If employers hire retirees at rates of pay comparable to an active member with similar experience and qualifications while assuming responsibility for the 30% employer contribution rate, fewer employers are likely to hire a retiree who retired from a different employer. However, based on experience since 2009 with the licensed school professional earnings limit exemption, it appears that employers may instead reduce pay offered to retirees in an amount needed to recoup much, if not all, of the employer's working after retirement contribution. In that case, the employer contribution rate may not serve as a disincentive to retiring and returning to work.

- KPERS retirees with 25 years of service receive 44% of their pre-retirement final average salary, while retirees with 30 years of service receive about 53% of their final average salary.
- Retirees do not have to pay the 6% employee contribution rate paid by active members.
- Therefore, even if an employer negotiated pay that is 30% lower than the retiree's pre-retirement income (to fully offset the employer's working after retirement contribution), the retiree could expect an increase in total income (pension plus working after retirement compensation) of 20-30% with 25-30 years of service at retirement.

Members can be expected to act in their own financial interest, and a 20-30% increase in income may well be sufficient to retire and return to work. Therefore, a 30% working after retirement contribution rate is not expected to offset the incentives created by the ability to receive both a pension and unlimited compensation from working after retirement.

Contributions:

A 30% working after retirement rate would ensure that KPRS receives the full actuarial employer and employee contributions for an active member, plus an additional amount that would shift over time as the actuarial rate changes, as illustrated below:

	FY 2017	<u>Difference</u>	FY 2018	<u>Difference</u>
	<u>Actuarial rate + 6%</u>	<u>from 30%</u>	<u>Actuarial rate + 6%</u>	<u>From 30%</u>
State	16.77%	13.23%	15.62%	14.38%
School	22.03%	7.97%	22.38%	7.62%
Local	15.18%	14.82%	14.46%	15.54%

There is a wide range of individual circumstances that can affect retirement decisions and the actuarial liability for a particular member. It is not possible to determine when a member would have retired had the incentives created by working after retirement opportunities been different. For these reasons, it is not possible to project what additional actuarial liabilities may result from changing working after retirement rules or whether a 30% contribution rate would fully fund any additional actuarial liabilities.

Elimination of the sunset on grandfathering for licensed school professionals

Changes in retirement patterns. Since 2009, retirees returning to work in a licensed school position have not had an earnings limit. Grandfathered retirees could continue working without a limit indefinitely under HB 2653. Data regarding the retirement patterns of licensed school professionals since 2009 clearly suggest that the potential for increased income created an

incentive to retire earlier than expected under actuarial assumptions. Therefore, it appears that the exemption is likely to have increased the actuarial liabilities associated with these retirees, although the extent of the increase cannot be accurately determined. However, any increase in actuarial liabilities occurs at the point of retirement, and therefore, no additional increases in actuarial liability for this closed group is expected.

Contributions. Employers of these grandfathered retirees continue paying the actuarial rate plus 8%. At this contribution level, KPERS receives the full actuarial contributions that would be received for an active member, plus an additional 2%, which may serve to at least partially offset increases in the actuarial liability for the retirees. However, it is not possible to determine the extent to which that additional 2% might offset any actuarial liability increases that were connected to this closed group.

In summary, HB 2653 could be expected to affect decisions by KPERS members about when to retire and whether to return to work, with the potential for an unknown increase in KPERS actuarial liabilities.

Local Government Fiscal Effect

If the bill affects local governments, identify which local governments would be affected (e.g., cities, counties, school districts, water districts, etc.). Describe the bill's fiscal effect to the local governments.

Under HB 2653, local employers would have the opportunity to employ KPERS retirees from a different employer without an earnings limit, at the 30% working after retirement rate. Employers have the flexibility to determine whether such an arrangement is an effective means to hire qualified employees at a reasonable rate of compensation.

The proposed assurance protocol also provides local employers with additional flexibility to make timely decisions about retaining a retiree for an additional year in a position covered by a hardship, special education, or hard-to-fill exemption from the earnings limitation, without first obtaining approval from the Joint Committee, if the employer has not been able to fill the position with a permanent, active employee.

References/Sources

If there are supporting documents or spreadsheets explaining calculations or assumptions, please attach them.