

MEMORANDUM

To: House Pensions and Benefits Committee

From: ^{QAC.} Alan D. Conroy, Executive Director

Date: February 15, 2016

Subject: HB 2653, Exemption for Retirees Working for a Different Employer

The Pensions and Benefits Committee has been assigned several bills regarding working after retirement. Several questions have been raised regarding the policy decisions contained in the bills and their cost implications. In this memorandum, we have attempted to respond to questions regarding provisions in HB 2653 relating to removal of an earnings limitation for KPERS retirees returning to a different employer.

Effective July 1, 2016, 2015 Senate Sub. for HB 2095 (2015 HB 2095) established 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. Employers hiring retirees make contributions at the statutorily prescribed employer contribution rate. In FY 2017, that rate would be 10.81% for State/School Group employers and 9.18% for Local Group employer.

Before this change, there were different rules for returning to the same employer or a different employer. Under HB 2653, the distinction between same and different employer would be reinstated. KPERS retirees returning to work for a different employer would not have an earnings limit. However, the employer contribution rate would be 30% of the retiree's compensation, rather than the actuarial rate plus employee contribution rate.

Impact of Removing the Earnings Limit on Actuarial Liabilities

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 are based on historical retirement patterns.

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. Attachment A shows the actual experience of retirement rates of retirees who returned to work for a different employer between 2009 and 2014. During this time period there was no earnings limit on retirees returning to work for a different employer, similar to what is included in HB 2653.



Employer Contributions for Rehired Retirees

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.
- 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.

Ultimately, 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.

Adequacy of 30% Contribution Rate

A 30% working after retirement rate would ensure that KPERS 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. 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.

However, two hypothetical examples presented in prior years to this Committee suggested that, at least in those illustrations, an employer contribution rate equal to the actuarial rate plus 8% did not fully offset the increased actuarial liability of an earlier retirement. The examples compared the present value of the actuarial liability for a

member who retired when first eligible for full retirement benefits and then returned to work until age 62 to the actuarial liability for an identical member who worked until age 62 before retiring. The examples also compared the present value of contributions received whether retiring earlier and returning to work or retiring at age 62.

In both examples, employer contribution rates at the actuarial rate plus 8% did not offset the increased liabilities of retiring and returning to work. However, for those two illustrations, a rate of 31% appears to cover the higher liability created by the decision to retire early and return to work rather than remain in covered employment until retirement. Therefore, it appears that 30% may offset increased liabilities in some, but not all instances. However, it is not possible to determine an actuarial rate that would fully recoup all adverse experience as the increased actuarial liability cannot be accurately projected.

Amendment Language

The Working After Retirement Subcommittee discussed potential balloon amendments to this section of HB 2653 that are intended to permit periodic review and adjustment of the 30% employer contribution rate. Given the inability to project increases in actuarial liabilities, the balloon amendment appears to require greater actuarial precision than is possible in reviewing and setting that rate. For that reason, a possible change to the first sentence of the balloon amendment could be:

On or before July 1, 2019, and at least every three years thereafter, the board, in consultation with the system's consulting actuary, shall evaluate the plan's experience with employment of such retirees and the corresponding employer contribution rate to assess whether the employer contribution rate can be expected to fund adverse experience or higher liabilities accruing under the system in connection with employment of such retirants, to the extent that such liability can be ascertained or estimated. Based on this evaluation of the plan's experience, the Board may certify to the division of the budget, in the case of the state, and to the agent for each other participating employer, a new rate if needed to more fully fund such adverse experience or additional liabilities, but such rate shall not be less than 30%.

Finally, as introduced HB 2653 does not directly address pre-arrangement for retirees returning to different employers. For consistency within the statutes, the Committee may want to consider adding language prohibiting pre-arranged return to work that parallels other portions of the working after retirement statute.

Administrative Costs

Modifications to the KPERS information technology system and database in order to implement HB 2095 are underway and will be ready for testing shortly. At this point in the implementation process, removing the earnings limit for KPERS retirees returning to

work for a different employer would reprogramming of changes made to implement HB 2095 within a tight time frame before the effective date of HB 2095 and HB 2653. However, KPERS anticipates that the costs could be absorbed within its existing expenditure limit.

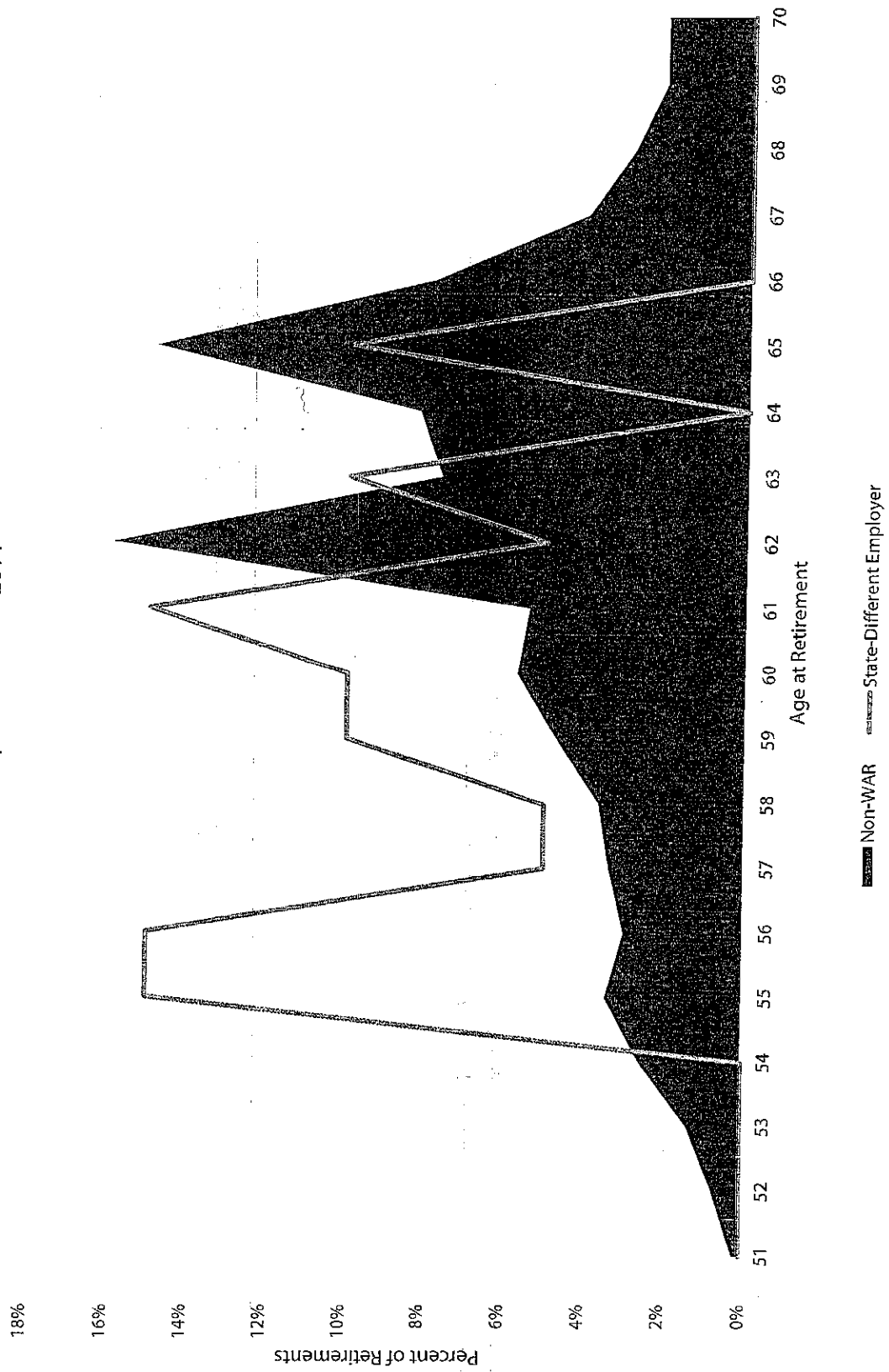
On its own, removal of the earnings limit for retirees returning to work for a different employer does not create any staffing issues that would require a request for increased staffing. However, with implementation of 2015 HB 2095 and the potential passage of some combination of the additional amendments to working after retirement rules, the administration of these 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.

I hope this information is helpful, I would be happy to answer any questions the Committee may have.

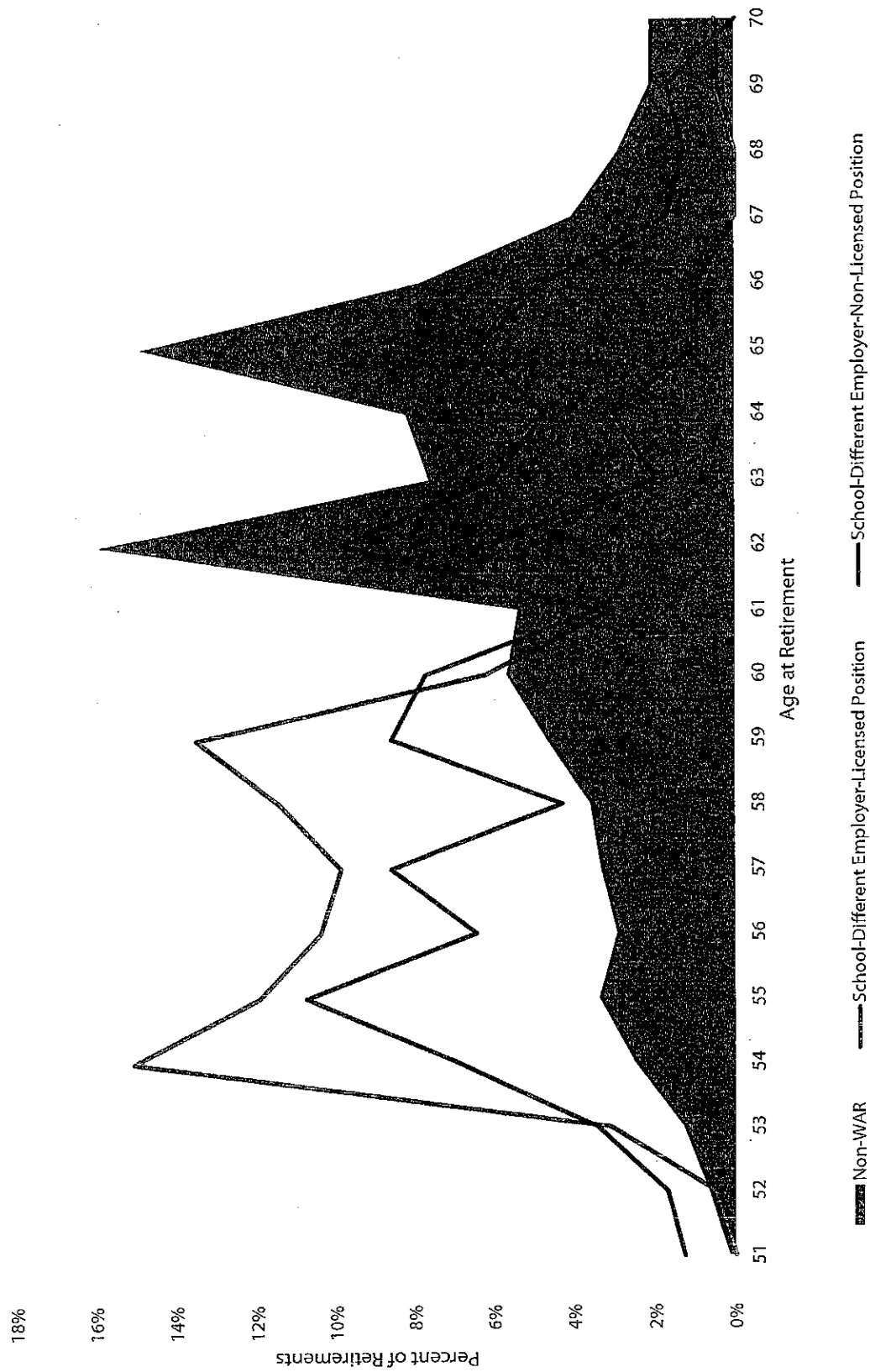
Attachment

Attachment A

Percent of Retirements by Retirement Age (age 50-70)
Age at retirement of retirees working for a different employer compared to non-WAR retirees
State Group - CY 2009 - CY 2014



Percent of Retirements by Retirement Age (age 50-70)
 Age at retirement of retirees working for a different employer compared to non-WAR retirees
 School Group - CY 2009 - CY 2014



Percent of Retirements by Retirement Age (age 50-70)
 Age at retirement of retirees working for a different employer compared to non-WAR retirees
 Local Group - CY 2009 - CY 2014

