

KPERS.03 - Compensation Changes

Recommendation #3 – Consider Modest Changes In Compensation Which Can Be Considered In Pension Calculations

Generally, KPERS benefits are below average compared to peers. However, certain individuals are able to increase their benefits based on sick leave, annual leave or deferred compensation.

The A&M team encourages a more thorough analysis of the sick and annual leave provisions, including an estimate of administrative costs. This might include a phase-out of the inclusion of leave after a certain date. Although the anticipated cost savings are modest, such an effort may be worthwhile.

KPERS estimated maximum annual cost savings of \$3.2 million for the State/School group once statutory contributions catch up to the actuarially required contribution.

A reasonable estimate for the net cost savings after consideration of administrative costs, phase-ins of the change, and delay until the statutory contribution exceeds the actuarial contribution, is \$2 million per year.

The A&M team also encourages at least a closing of the door on future 457(f) deferrals being included in pensionable compensation. Although the cost savings would be small—\$100,000 per year, the “headline risk” of high paid individuals being able to “spike” their salary as well as the inequity compared between rank and file public employees, may be enough reason to close this loophole.

If executives understand this before making the compensation deferral decision, they will be properly informed and can make the best, most tax-efficient, compensation decision for their individual circumstances.

The state is not currently funding the full ARC and is not scheduled to do so until FY21. Consequently, these changes would not result in any short-term cost savings until FY21.

Recommendation #3 - (dollars in 000's)				
FY17	FY18	FY19	FY20	FY21
\$0	\$0	\$0	\$0	\$2,300

Actuarial Statement

This analysis was performed for Alvarez and Marsal (A&M) by William Fornia, FSA of Pension Trustee Advisors, Inc. as part of the A&M team. The analysis was based on publicly available data, including that provided by KPERS. Mr. Fornia is a Member of the American Academy of Actuaries and meets their qualification standards to render this actuarial opinion.

KPERS.02 - Maximize Investment Income

final average salary calculations reduces the plan's normal cost, albeit very marginally (0.01%-0.03%). Totally eliminating vacation and sick leave from final average salaries results in a reduction in contribution rates of 0.18% for the State Group, 0.04% for the School Group, and 0.07% for the Local Group." This would result in an estimated annual reduction of \$3.2 million for the State and School Group and \$1.2 million for the Local Group.

The memo went on to note that "a reduction in actuarial required contribution rates would ultimately result in fewer contributions entering the KPERS Trust Fund. However, because the State/School Group statutory employer contribution rate is below the actuarial required contribution rate, only the Local Group reduction would result in reduced contributions, totaling approximately \$1.2 million.

In both cases, the reduced revenue reflects lower employer contributions required to fund benefits for pre-1993 members. However, HB 2426 would not be expected to result in savings of the amount projected by the cost study, and therefore, the contribution rates would not decline to the extent above."

It is important to note that KPERS also cautioned that administrative costs to implement this could be considerable. This is partially due to the difficulty in collecting the data of permissible leave and non-permissible leave.

Deferred Compensation

Certain employees, typically key employees, enter into a contract with their employer to defer compensation under Section 457(f) of the tax code. This provides tax deferral. Currently, such amounts may enter into the pension calculation. KPERS identified several reasons that this is not a substantial cost.

- Only three times in the past twenty years have such amounts entered into the calculation
- The IRS imposes a limit on compensation which can be considered for pension purposes:
 - » \$265,000 for those hired after July 1, 1996
 - » \$395,000 for those hired prior to July 1, 1996
- There may be contract rights or legal issues which could preclude a change in the program

Based on this, the A&M team estimates that a total elimination of this benefit would save the system less than \$200,000 per year. A prospective elimination might save \$100,000 per year in the long run.

SUMMARY

The A&M team performed a review of KPERS while keeping in mind their mission "...to deliver [in its fiduciary capacity] retirement, disability and survivor benefits to its members and their beneficiaries."

Many of the recommendations developed align with these goals, including program delivery, organization improvement, workforce and external partnerships.

RECOMMENDATIONS

Recommendation #1 – Make Required Contributions to KPERS as Specified under Current Law

Specifically, all KPERS employers, including the State, should make the required contributions contemplated under current law. Deferral of contributions would result in higher long term costs and put the burden of past public service costs on future Kansans.

Recommendation #2 – Encourage KPERS to Carry out its Strategic Plan with Emphasis on Maximizing Investment Income Consistent with Fiduciary Responsibility

Investment return is the most important driver of long-term costs for the KPERS system. The A&M team reviewed the KPERS strategic plan—which covers investment return—and believe that the plan is reasonable and that KPERS has a strong focus on investment return. The State should support that emphasis and encourage KPERS initiatives, which improve investment performance.

KPERS.01 - KPERS Contributions

final average salary calculations reduces the plan's normal cost, albeit very marginally (0.01%-0.03%). Totally eliminating vacation and sick leave from final average salaries results in a reduction in contribution rates of 0.18% for the State Group, 0.04% for the School Group, and 0.07% for the Local Group." This would result in an estimated annual reduction of \$3.2 million for the State and School Group and \$1.2 million for the Local Group.

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Kansas Summary Recommendations - By Legislative Committee DRAFT
 Prepared on 02/11/2016

House Budget Committee	Action Type	Unique Identifier	Recommendation Name	Recommendation Description	Total Savings and Revenue Estimates		
					FY 2016	FY 2017	FY 2018
House Pensions and Benefits	Legislative Action	KPERS.03	Compensation Changes	Consider Modest Changes In Compensation Which Can Be Considered In Pension Calculations.	-	-	-
	Total Legislative Action						
	Immediate Action	KPERS.02	Maximize Investment Income	Encourage KPERS to Carry out its Strategic Plan with Emphasis on Maximizing Investment Income Consistent with Fiduciary Responsibility	-	-	-
		KPERS.01	KPERS Contributions	Make Required Contributions to KPERS as Specified under Current Law	-	-	-
	Total Immediate Action						
Total House Pensions and Benefits					-	-	-