# MINUTES

## JOINT COMMITTEE ON PENSIONS, INVESTMENTS, AND BENEFITS

October 28-29, 2003
Room 526-S—Statehouse

### Members Present

Representative John Edmonds, Chairperson
Senator David Kerr, Vice Chairperson
Senator Jim Barone
Senator Steve Morris
Senator Ruth Teichman (October 28 only)
Representative Ray Cox
Representative Geraldine Flaharty
Representative Margaret Long
Representative Bill McCreary
Representative Clark Shultz

### Staff

Julian Efird, Kansas Legislative Research Department
Alan Conroy, Kansas Legislative Research Department
J. G. Scott, Legislative Research Department
Gordon Self, Office of the Revisor of Statutes
Mike Corrigan, Office of the Revisor of Statutes
Gary Deeter, Committee Secretary

### Conferees

Glenn Deck, Executive Director, Kansas Public Employees Retirement System
Rob Woodard, Chief Investment Officer, Kansas Public Employees Retirement System
Pat Beckham, KPERS Actuary, Milliman U.S.A.
Steven Weatherford, President, Kansas Development Finance Authority
Andy Sanchez, Kansas Association of Public Employees
Don Rezac, State Employees Association of Kansas
Jeff Bottenberg, Kansas Peace Officers' Association and Kansas Sheriffs' Association
Sam Breshears, Kansas City Kansas Police Department
Dennis Phillips, Topeka Fire Department
Terry Maple, Kansas Highway Patrol
Representative Tom Burroughs
Donald Ash, Kansas City Kansas Police Department

**Written Testimony Only**

David Schauner, General Counsel, Kansas National Education Association
Emmett Lockridge, President, KCK Black Police Officers' Association
Brian Trzok, President, Kansas City Fraternal Order of Police
Stephen Crumpler, Capitol Police
Roger Werholtz, Secretary, Kansas Department of Corrections
Kansas Department of Wildlife and Parks
Steve Wassom, Kansas Office of the Securities Commissioner

**Tuesday, October 28**
**Morning Session**

Julian Efird, Kansas Legislative Research Department, reviewed pending legislation that pertains to retirement and other benefits and that will carry over to the 2004 Legislature, noting that eight bills were included in 2003 HB 2014, the Kansas Public Employees Retirement System (KPERS) omnibus bill as passed and signed by the Governor (Attachment 1). Active bills that were not included in the 2003 KPERS omnibus bill include:

- SB 60 and a similar bill, HB 2127, exempt retirees from the $15,000 earnings limitation if they return to work for the same agency from which they retired. SB 60 addresses teachers if they return to teach in the district from which they retired and if they return to a hard-to-fill position as defined by the State Board of Education. Answering questions, he said the fiscal impact would be greater with HB 2127 than with SB 60 since the Senate bill reduces the number from all retirees covered by HB 2127 to a limited group of retirees who would be eligible.

- HB 2012 allows Tier I members of the Kansas Police and Fireman Retirement (KP&F) System to retire with unreduced benefits after 32 years of service regardless of age.

- HB 2124 expands those eligible in specific law enforcement positions at certain state agencies who would be able to participate in KP&F rather than KPERS.

- HB 2225 reduces vesting under KPERS from 10 years to five years.

- HB 2410 increases the employer-paid death benefit for retirees from $4,000 to $5,000.

Next, Rob Woodard, KPERS Chief Investment Officer, reviewed two KPERS legislative proposals. The first proposal recommends the elimination of the statutory 5.0 percent limitation on alternative investments. He defined alternative investments as any non-real estate investment not traded on a public exchange (Attachment 2). Mr. Woodard said the cap hampers time diversification over a business cycle and, because returns are irregular, causes misalignment of the investments, both of which require KPERS to withdraw from the market periodically, with negative consequences. Answering questions, Mr. Woodard said KPERS' alternative investments include 54 partnerships with over 900 investments in venture capital, business start-ups, media roll-ups, and new technology.

Mr. Woodard said the second proposal recommends a statutory change that will allow the KPERS Board of Trustees to make decisions on real estate investments without the present requirement that the Board receive final due diligence information and specifically approves or disapproves each transaction (Attachment 3). He said the Board needs to be more responsive to the rapidly changing opportunities in the national real estate market, noting that the Board follows a due-diligence negotiation process before approving a transaction and that another due-diligence requirement process is not only redundant, but hampers timely investment activity. Answering questions, Mr. Woodard agreed that changing the current wording to “Executive Director” rather than “System” would be satisfactory.

Gordon Self, Revisor of Statutes staff, briefed members on the contractual rights of KPERS members (Attachment 4). It was explained that the Kansas Supreme Court has found that the relationship of KPERS to its members falls under the contractual guarantees of the *U.S. Constitution*, thus limiting unilateral modification in the agreement to “reasonable changes” to maintain the integrity of the System. It also was noted that any such changes which result in disadvantages to employees must be accompanied by offsetting or counterbalancing advantages. Noting the paucity of case law on the subject, Mr. Self summarized his findings as follows:

- There is a contract for pensions between the State and its employees which creates rights protected from unilateral modification under the *U.S. Constitution*.
- Reasonable modification is allowed based on Supreme Court decisions.
- Reasonable modification may be made if resulting disadvantages to employees are counterbalanced by offsetting advantages.
- Case law clearly states that the State cannot increase employee contributions without providing offsetting benefits.
- To justify an increase in employee contributions to bolster the financial future of the plan, there must be evidence that the employer cannot meet its obligations in the future and the employees’ pensions are in jeopardy.
- The employer may provide a new system for new employees and may provide options for existing employees to keep what they have or opt into new provisions.

## Afternoon Session

Glenn Deck, KPERS Executive Director, outlined the current funding status of KPERS, funding issues and alternatives, and alternative plan designs and benefits (Attachment 5). He pointed out that the present plan is designed to provide benefits that, when combined with Social Security and personal savings, will sustain a retiree’s standard of living in retirement. He also noted that the plan is designed to provide a benefit package to attract and retain high-quality employees. He stated that the cost of the plan includes both the funds needed to finance current service credit accrued each year and the funds needed to reduce the unfunded actuarial liability (UAL). Mr. Deck said the Legislature began to address the issue in 2003 with HB 2014, increasing the statutory cap for employer contributions and authorizing the issuance of up to $500 million in pension obligation bonds. Even so, he said that the funded ratio (presently about 76 percent) will go down and the UAL will go up, requiring further action to adequately protect the plan.

Pat Beckham, KPERS Actuary, Milliman USA, explained two actuarial cost methods: Entry Age Normal (EAN) and Projected Unit Credit (PUC). She said both are sound methods which estimate the costs of future benefits. She recommended changing from PUC (the current KPERS method, used by 14 percent of state plans) to EAN because the latter develops a more stable cost rate and is used by 74 percent of state plans. EAN is considered more conservative than PUC. She noted that KP&F and the Kansas Retirement System for Judges use the frozen initial liability (FIL) method (used by 11 percent of state plans). The FIL method is much less stable during times of market volatility. Ms. Beckham suggested all three plans should use the same EAN method.

Next, Ms. Beckham explained the "smoothing" purpose of the asset valuation method, an approach of recognizing only a portion of annual changes in asset values over time rather than recognizing all changes immediately. She recommended a change to a five-year smoothing method. Ms. Beckham said this approach does not materially impact long-term funding issues.

Addressing the amortization period of the UAL, Ms. Beckham said the 40-year term was established in 1993, noting that reamortization will cost more over time if the period is adjusted. Reamortization should be considered as a part of any long-term funding plan, Ms. Beckham stressed.

Commenting on the UAL, Mr. Deck said Kansas is one of the few states that have not been making contributions at the actuarially required rate, noting that the increases authorized by HB 2014 are not sufficient without additional employer contributions or other increases in funding. He reviewed the impact the proposed $500 million in pension obligation bonds would have on the UAL and how other potential funding adjustments would impact the funded ratio and the UAL. Mr. Deck summarized the Board of Trustees' preliminary recommendations:

- Increase employer contributions rates for the State/School Group beyond the increases in HB 2014.
- Increase employer contributions rates for the KPERS Local Group to at least the cap levels established in HB 2014 for the State/School Group.
- Authorize the Board to adopt changes in the actuarial methods to the Entry Age Normal cost method, implement a five-year asset valuation method, and adopt a plan to reamortize the State/School Group's UAL at some optimal future date.
- Continue to analyze pension obligation bond alternatives.

Steven Weatherford, President, Kansas Development Finance Authority, assessed pension obligation bonds as a means to improve KPERS long-term funding (Attachment 6). He said the present U.S. Treasury Bond yields have reached historic lows, making bonds a viable alternative funding source for KPERS. He critiqued several options:

- A repayment structure of annual interest payments until near the maturity of the bonds, at which time all the principal would be repaid, making the principal repayments as close to the end of the maturity cycle (2033) as would be palatable to the bond insurer (cumulative impact $1.087 billion).
- Capital Appreciation Bonds (CABS), where no interest is paid until maturity in 2033, are uninsurable (cumulative impact $1.099 billion).
- Level debt service with all payments from outside sources by annual appropriations of the Legislature (cumulative impact $4.903 billion).

During Committee discussion, in view of the potential for a lawsuit if employee contributions are increased, Senator Kerr urged the Committee to find ways to link all employer funding improvements as a package to create the strongest demonstrable case to the courts to show that any increased employee contributions are being offset and counterbalanced by employer contributions.

**Wednesday, October 29**
**Morning Session**

Representative Cox, addressing a statutory problem, noted that retired school teachers are prohibited from making more than $15,000 annually if they return to teach in the district from which they retired, but there is no salary cap if they return to teaching in a neighboring school district. Staff provided a memo written to Representative Cox (Attachment 7) reviewing what other states have done to modify post-retirement restrictions. Representative Cox, seeking to rectify this inequity, recommended statutory changes in a proposed bill draft (Attachment 8) which would allow retirants to return to work for the employer from which they had retired to teach in hard-to-fill positions as would be defined by the State Board of Education. Staff noted that other provisions in the bill draft include licensed registered nurses working at state institutions, that the returning employees would make no contribution to KPERS nor receive any additional retirement credit, and that the employer would pay both the employee contribution and the employer contribution. Representative Cox said the proposed legislation would sunset on June 30, 2007. During discussion, Mr. Self said the bill has no geographic specificity. Mr. Deck said that deleting the hard-to-fill requirement would not be a problem for KPERS, but would have a negative effect on KPERS if the bill would create an incentive for teachers to retire earlier than normal. Representative Cox noted that under the bill the employer would be paying about 13 percent to cover the combined employee and employer contributions. The Chairperson requested a Post Audit report be mailed to members which reviewed the effect of a school district early retirement incentive program.

The Chairperson opened hearings for a series of bills. HB 2225, which reduces the vesting period for KPERS from ten years to five years, was heard first. Andy Sanchez, Executive Director, Kansas Association of Public Employees, testified in support of the bill (Attachment 9). He said the bill would increase the number of state workers who feel an ownership in KPERS, would improve morale, and would bring Kansas in line with other state retirement systems and the private sector. Don Rezac, speaking for the State Employees Association of Kansas, spoke in favor of the bill, saying that state employees are more likely to stay with the state if vesting occurs earlier in their employment (Attachment 10). The Kansas National Education Association provided written testimony in support of the bill (Attachment 11).

Next was HB 2012, which allows Tier I members of the KP&F to retire with unreduced benefits after 32 years of service regardless of age. Samuel Breshears, Deputy Chief of Police, Kansas City Kansas Police Department, spoke in favor of the bill, saying some Tier I law enforcement officers reach maximum benefits at age 53 and could retire, except that current law requires them to wait until age 55 or take a 4.8 percent penalty for early retirement. He said because of the small number of individuals affected (about 100), the fiscal impact would be minimal (Attachment 12). Dennis Phillips, Topeka Fire Department, testified as a proponent, saying that after 32 years of service, a fire fighter is ready for retirement. Jeffery Bottenberg, Legislative Counsel for the Kansas Peace Officers' Association and the Kansas Sheriffs' Association, testified in favor of the bill and provided written testimony from Emmette Lockridge, President, Kansas City Kansas Black Police Officers' Association, and Brian Trzok, President, Kansas City Kansas Fraternal Order of Police (Attachments 13, 14, and 15). Mr. Bottenberg said that the bill would narrow the gap between Tier

I and Tier II employees, reduce possible work-related injuries, and allow law enforcement officers to retire with dignity. He noted the fiscal impact to be an addition of $2.2 million to the unfunded liability, but said that currently KP&F is funded at 96 percent. Representative Tom Burroughs testified in support of the bill, saying it would recognize the valuable service of law enforcement officers and promote fairness by narrowing the gap between Tier I and Tier II employees. Major Donald Ash, Kansas City Kansas Police Department, testified that the Kansas Peace Officers' Association agreed with the points made by previous speakers. The Chairperson asked that information comparing Tier I and Tier II be mailed to members of the Committee.

Next was HB 2124, which expands membership in KF&P to include certain law enforcement personnel of the Kansas Department of Revenue, Department of Wildlife and Parks, Department of Corrections, Highway Patrol, Office of the State Fire Marshal, Securities Commission, and Racing and Gaming Commission. Andy Sanchez spoke as a proponent, saying the bill would strengthen public safety by providing incentives to attract quality employees (Attachment 16). Lt. Colonel Terry Maple, Kansas Highway Patrol, testified in favor of the bill, saying it would embrace two groups of certified law enforcement officers presently denied membership, the Capitol Police and the Motor Carrier Inspection Division of the Kansas Highway Patrol (Attachment 18). Written testimony supporting the bill was also provided by Stephen Crumpler, Capitol Police (Attachment 17), Roger Werholtz, Secretary of Corrections (Attachment 19), Department of Wildlife and Parks (Attachment 20), and Steve Wassom, Office of the Securities Commissioner (Attachment 21). Answering a question, Mr. Deck said that allowing members to move from KPERS to KP&F would have minimal effect on KPERS funding, since the bill applies only to a relatively few state employees.

The Chairperson opened Committee discussion on interim topics covered to date. Senator Kerr distributed Attachment 22, commenting that editorials such as the *Wichita Eagle's* does a disservice to the facts about KPERS. Representative Cox, addressing increased funding for KPERS, spoke in support of pension obligation bonds with the state paying the debt service, but he opposed creation of another tier in KPERS. Senator Morris encouraged members to act with alacrity on the pension obligation bonds. Discussion on the bonds centered on whether to pay for them with KPERS money or to use money outside the KPERS funding stream, the latter requiring annual legislative appropriations. Members noted that after the legislative committee review and recommendation regarding the bonds, the responsibility for issuing of bonds goes to the State Finance Council, which meets only upon call of the Governor.

Further discussion focused on the challenge of balancing advantages and disadvantages to employees if there are changes in the terms of KPERS. The Chairperson requested that Mr. Deck and the Revisor's Office staff collaborate further on establishing legal grounds for changing the contractual benefits and obligations of employee and employer. Senator Kerr expressed concern that employer decisions must be seen to be part of an incremental package that offsets any disadvantages to employees if they are required to increase their contributions. He inquired of Revisor's Office staff whether moving forward on any one of the Joint Committee's tasks delegated in 2003 HB 2014, specifically the one involving a recommendation related to the issuance of pension obligation bonds, before all actions of the Legislature related to KPERS long-term funding efforts have been finalized, would create a difference in time between recommendations and resulting actions, such as to have an adverse effect on the legal position of the Legislature in the circumstance of a lawsuit challenging any legislative changes involving such actions related to the improvement of the long-term funding of the KPERS plan, especially actions that require employee sacrifice.

Mr. Self responded that there is no clear case law with which to answer this question with certainty. However, it is anticipated that it will be necessary for the Legislature to approach the long-term funding issue on a number of levels to adequately address the concerns expressed during the past few years. It is anticipated that consideration of increased employer contributions, pension obligation bonds, increased and decreased benefit changes, actuarial methodology changes, reamortization, increased employee contributions, and other options must be evaluated. The

Legislature began this process in 2003 with enactment of HB 2014, which contained provisions to increase employer contributions and authorized the issuance of pension obligation bonds. This process continues with the work of the Joint Committee during the 2003 interim and will continue into at least the 2004 Session. This will be a difficult task which requires a comprehensive approach. The fact that not all these efforts are contained in the same legislation should not minimize the fact that they are all part of the same effort. It would be counter-productive to hold back on some critical efforts just to package together in one piece of legislation when it is made clear that it is part of the same effort. The consequences of not moving forward on a recommendation related to pension obligation bonds at a time when the market is at this historically attractive moment with low interest rates and other favorable factors would deny everyone the opportunity to benefit from improved long-term funding of the KPERS plan. Mr. Self said that it is his opinion that, if the Legislature makes it clear that any recommendations of this Committee related to pension obligation bonds are connected and part of this overall effort to solve the KPERS long-term funding issue, he believes that a court would make this connection as well and would not dismiss such effort from consideration simply because it is not part of the same legislation.

Regarding the issue of equality, Mr. Self said the court's words "offsetting" and "counterbalancing" denote equality, but how equality is measured has not been set forth by the courts. Representative Flaharty noted that state employees have received minimal pay increases in recent years and that requiring an increase in their contribution rate to KPERS would affect morale and recruitment. Members discussed a cost-of-living adjustment in benefits without reaching a conclusion.

As requested by the Committee, Mr. Deck distributed a national public fund survey giving details on various state retirement systems (Attachment 23).

*By motion of Representative Flaharty and seconded by Representative Long, the minutes for August 27-28, 2003, and September 23, 2003, were approved*.

Prepared by Gary Deeter
Edited by Julian Efird

Approved by Committee on:

December 1, 2003
(date)