

MEMORANDUM

To: Senate Financial Institutions and Insurance Committee

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

Date: February 4, 2020

Subject: FY 2021 and FY 2022 KPERS Budget

Thank you for the opportunity to discuss the Kansas Public Employees' Retirement System (KPERS) budget with you today. After reviewing the Governor's budget proposal, we respectfully request that you support the Governor's recommendation as it pertains to agency operations for FY 2021 and FY 2022.

KPERS' Mission and Operations

The Kansas Public Employees Retirement System, in its fiduciary capacity, exists to deliver retirement, disability and survivor benefits to its members and their beneficiaries.

- KPERS Administers three statewide defined benefit plans for public employees:
 - Kansas Public Employees Retirement System (KPERS);
 - Kansas Police and Firemen's Retirement System (KP&F); and
 - Kansas Retirement System for Judges.
- KPERS serves approximately 318,000 members, including more than:
 - 156,000 active members;
 - 106,000 retired members and beneficiaries; and
 - 63,000 inactive members with contributions remaining in the Trust Fund.
- KPERS partners with over 1,500 employers, including the State of Kansas, all 286 school districts, all 105 counties, 425 cities and townships, and many other governmental units.

KPERS provides responsive, quality services to its 325,000 active, inactive, and retired members through a balance of technological efficiencies and assistance by KPERS staff. For example, member services responded to approximately 90,000 phone and 20,500 e-mail inquiries, enrolled about 34,500 new or transferring members, and processed more than 5,300 new retirees during FY 2020. KPERS made about 1.3 million retirement benefit payments totaling over \$1.8 billion in FY 2020.

According to research completed by international benchmarking organization, CEM Benchmarking, KPERS provides services on par with peer pension plans at a cost of \$49 per member, well below the peer median average of \$83 per member.

Funding Sources

Benefit payments and operating expenditures for the three defined benefit plans are funded from the KPERS Trust Fund. The Trust Fund is comprised of employee and employer contributions and investment earnings. The Internal Revenue Service (IRS) has strict requirements for the use of Trust Fund assets. Once funds have been deposited in the Trust Fund they must be used exclusively for the benefit of members. The KPERS Trust Fund is used to pay for administration of the defined benefit plans and investment fees related to the KPERS Trust Fund.



The Kansas Deferred Compensation Program (KPERS 457) is a voluntary, tax-deferred retirement savings program for state employees and for employees of local governmental units that have adopted the Plan as their own. The Plan's assets are held in its own Trust Fund. The enabling statute provides for State administrative expenses for the Plan to be recovered through participant service charges or reimbursements through service provider contracts, which are deposited to the Deferred Compensation Fees Fund. About one percent of operating expenses are funded from the Kansas Public Employee Deferred Compensation Fees Fund.

KPERS does not receive a direct State General Fund appropriation for operating expenditures.

Revenues

Revenue to the KPERS Trust Fund is made up of three sources: employee contributions, employer contributions, and investment income. Over the past 20 years, more than 47% of revenue to the Trust Fund has come from investments, 36% from employer contributions and 17% from employee contributions. KPERS has a diverse investment portfolio and has maintained an average rate of return above the 7.75% investment return assumption over the last 25 years. The 25-year time weighted total return as of November 30, 2020 was 7.9%. The rate of return in CY 2019 was 17.1% and the preliminary rate of return for calendar year 2020 is 11.5%

FY 2021 and FY 2022 Budgets

KPERS' ultimate goal is to manage state and member resources prudently and effectively. The Governor's recommendation for operating expenditures in FY 2021 and FY 2022 will allow KPERS to meet that goal. The Governor's recommendations include:

- The Public Employee Retirement Benefits Program provides benefit payments to members and their beneficiaries. Payments include regular monthly benefits, partial lump sum payments, death benefits and death and disability insurance. The recommendation includes \$2.0 billion for FY 2021, \$2.1 billion for FY 2022. The recommendation would cover the estimated benefit payments necessary for those fiscal years.
- Investment-Related Expenses are utilized for the investment and management of the KPERS Trust Funds. Investment expenses are calculated based on a percentage of the total assets being managed. For FY 2021 total fees are estimated to be 0.150% of total assets. The percentage is estimated to be 0.153% for FY 2022. The low fee rates are achievable due to more than \$23 billion in fund assets. The Governor's recommendation of \$36.2 million for FY 2021 and \$37.7 million in FY 2022 matches the estimates for investment-related expenditures in both fiscal years. The increase reflects the assumed growth in the assets of the Trust Fund, which is calculated using the investment return assumption (currently 7.75%).
- The Administration Program provides oversight and management for both the retirement and non-retirement programs administered by KPERS. The Governor recommends \$16.1 million for FY 2021 and \$22.6 million for FY 2022.

The recommended level of funding for FY 2022 represents 1.1% percent of the benefits paid to members and less than 0.1% of total assets managed by the System.

KPERS operates with 98.4 FTE positions. KPERS' Board of Trustees has the statutory authority to create positions as needed in either the classified or unclassified service depending on the requirements of the System.

A table summarizing the Governor's Budget recommendations is included in Attachment A.

KPERS Pension Administration System Modernization

The increase in the FY 2022 budget is due to the continuation of the pensions administration system modernization. KPERS first requested funding for this multiyear effort during the 2020 legislative session. The modernization effort will last for 4-5 years with a total cost of about \$20 million over that period.

The current pension administration system was implemented in 2005 when KPERS partnered with Sagitec Solutions to implement their new software. This "NeoSpin" framework allows KPERS and other customers to customize their systems to meet business requirements. Today NeoSpin is one of only a handful of pension solutions available in the marketplace. KPERS has continuously used this system since 2005 and has partnered with Sagitec for maintenance and enhancements.

Over the past 15 years many plan design changes have required additional system customization. These changes are both internal (i.e. implementing solutions for business processes) and external (i.e. legislative changes). The most significant plan design changes include creating KPERS 2 in 2007 and KPERS 3 in 2012. As part of adding the KPERS 3 cash balance plan, the Retirement System also needed to move to pay period reporting for employee and employer contributions (instead of annual reporting).

The existing pension administration system is still capable of executing KPERS' mission-critical processes, namely collecting contributions and paying benefits. However, due to the required customizations over the years, the existing system has become less efficient and more unstable over time. Maintaining the codebase for existing functions is becoming more of a struggle, let alone keeping pace with current best practices among pension administration systems.

The KPERS Board of Trustees and administration made the decision to begin the multi-year effort to modernize the pension administration system starting with the Fiscal Year 2021 budget. The first steps of the modernization effort were included in a budget enhancement to complete a business assessment of KPERS and the current pension administration system. The Governor and the Legislature approved the FY 2021 budget enhancement and the beginning of the modernization effort. KPERS selected The Segal Group for this assessment, which was completed in September 2020. KPERS will work with the Joint Committee on Information Technology at the appropriate time for their oversight on this project.

This modernization effort is KPERS top priority for the 2021 Session of the Legislature.

KPERS is committed to managing our resources in a responsible manner, upholding our responsibility as a fiduciary to guide our management of assets. We will continue to mitigate risk to the Trust Fund whenever possible while also maximizing returns for our members. I would be pleased to answer any questions the Committee has for me.

KPERS FY 2021 and FY 2022 Budget Summary

	Governor's Recommendation	
	FY 2021	FY 2022
Expenditures		
Administration	\$ 16,442,636	\$ 22,904,382
Non-KPERS Investments	533,390	562,035
KPERS Investments	35,711,503	37,088,739
Subtotal Reportable Expenditures	\$ 52,687,529	\$ 60,555,156
Benefit Payments (Non-reportable)	\$ 1,987,254,134	\$ 2,084,563,493
Total Expenditures	\$ 2,039,941,663	\$ 2,145,118,649
Funding Sources		
State General Fund	\$ -	\$ -
All Other Funds	2,039,941,663	2,145,118,649
Total Funding	\$ 2,039,941,663	\$ 2,145,118,649
FTE	98.35	98.35
Non-FTE Unclassified Permanent	-	-
Total Positions	98.35	98.35



KPERS ROADMAP TO OUR FUTURE

Modernizing Technology and Business Processes to Better Serve Our Members

We Need to Modernize

KPERS provides retirement, disability and death benefits for Kansas' state, school and local government public employees. The Retirement System has nearly 320,000 members and manages over \$20 billion in Trust Fund assets for our members.

Having an efficient, dependable and secure pension administration system is critical to accomplishing our mission.

The current system is still capable of paying member benefits and collecting member and employer contributions and information from our employers. But the current system is over 15 years old and has accommodated many legislative plan design changes over the years.

- Adding KPERS 2 and KPERS 3.
- Changing working-after-retirement rules.
- Moving to pay period reporting (instead of annual) to support the needs of the KPERS 3 cash balance plan.

It is time to modernize. The existing system has become less efficient and more unstable. Maintaining it is becoming more of a struggle with each passing year. We cannot leave our foundational pension administration system frozen in the past.

The risk for some future difficulty with the existing pension administration system is just too great to delay a major upgrade.

Begin With the End in Mind

In 2020, KPERS partnered with Segal to complete a comprehensive pension administration system assessment and review of existing business processes.

Segal provides administration and technology consulting for both private and public sector organizations, with significant experience in the public retirement industry.

Based on the three-month assessment, Segal helped KPERS develop a roadmap to our future – an improved retirement administration system with efficient business processes, tools for increased organization productivity, and the highest quality interactions with our members and employers. Much more than just a software application.

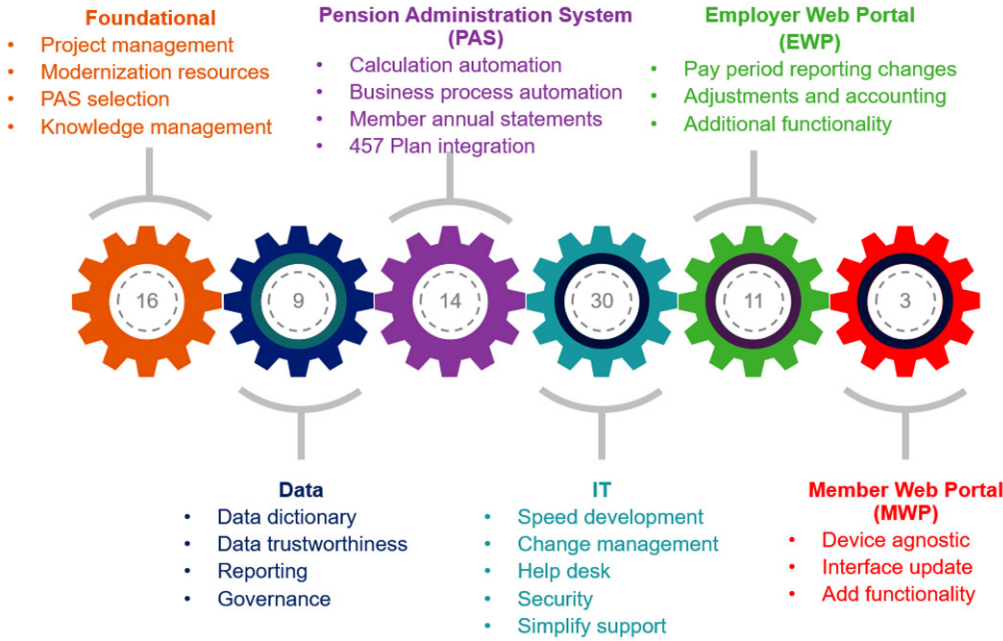
How Do We Get There?

Segal's assessment identified six areas for investment over the next four years. KPERS plans to begin with "foundational" projects and data improvement during the first year, laying the groundwork for the pension administration system modernization and business process improvements to follow.

KPERS will also focus on the business of information technology and how it supports the rest of the organization.

To reflect the importance of our members and employers, during the later phase of the initiative we will also invest in both the member and employer portals. Employers are our partners, equipping us with timely and accurate information to help deliver promised benefits. We also seek to be a valued partner for members, providing the tools and information they need to truly be ready for retirement.

Key Areas for Modernization



How Much Will It Cost?

KPERS expects a total cost of about \$20 million over five years to modernize our current technology and business processes.

The first step in the modernization effort was approved by the Governor and 2020 Legislature, beginning with the comprehensive assessment in 2020. Based on the assessment, the KPERS Board has approved the five- year modernization project. We have built the coming Fiscal Year 2022 budget request to reflect the estimated costs associated with implementing the roadmap initiative.

FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	Total
\$1.5 M	\$6.6 M	\$5.3 M	\$4.6 M	\$2.5 M	\$20.5 M

KPERS' Vision for Modernization

