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Laura Kelly, Governor

March 16, 2022

The Honorable Caryn Tyson, Chairperson
Senate Committee on Assessment and Taxation
Statehouse, Room 548-S
Topeka, Kansas 66612

Dear Senator Tyson:

SUBJECT: Fiscal Note for SB 553 by Senate Committee on Assessment and Taxation

In accordance with KSA 75-3715a, the following fiscal note concerning SB 553 is respectfully submitted to your committee.

SB 553 would enact the Kansas Thrift Savings Plan (KTSP) Act, which would create a defined contribution plan effective on and after July 1, 2024. The bill would require the Kansas Public Employee Retirement System (KPERS) Board of Trustees to establish a separate Thrift Savings Plan under sections 401(a) and 414(d) of the Federal Internal Revenue Code. Members of the Kansas Police and Firemen's Retirement System and the Judges Retirement System would not be included in the KTSP. The plan would be required to have a Roth contribution option for members. KPERS would be allowed to enter into contracts with insurers, investment managers, private firms or other parties for investment and administrative services for the plan. The bill would allow costs for administration of the plan to be recovered through service charges to participants or credit allowances or reimbursements from contracted firms.

The bill would make the KTSP mandatory for new members after July 1, 2024 and would close the existing KPERS defined benefit (DB) plan to new members. Each member that would participate in the KTSP would have four separate accounts:

1. Member Mandatory Contribution Account—the employee would be required to contribute a minimum of 6.0 percent of compensation. Contributions could be pre-tax or post-tax and the member would be immediately vested in this account, including any interest earned on the account;
2. Member Deferred Compensation Account (457 Account)—the employee would be auto-enrolled in this account would have an initial contribution of 1.0 percent of compensation. The contribution would automatically increase 1.0 percent per year up to a maximum contribution of 10.0 percent. The member could elect to change the contribution; however,

without action, the member would automatically make additional contributions to this account and is immediately vested;

3. Employer Contribution Account—the employer would contribute 4.0 percent of the employee's compensation that can be higher, depending on the member contribution. If the member contributes 1.0 percent to the 457 Account, the employer would contribute 4.5 percent and 5.0 percent if the member contributes 2.0 percent or more to the 457 Account. The member would vest after five years of participation in the KTSP;

4. Rollover Account—the bill requires the KTSP to accept assets from another eligible retirement plans and these assets would be deposited into this account. The member would be immediately vested in this account.

Each member would be responsible for choosing the investment of the total balance of the accounts. The bill would require six investment options for members to select from: government securities fund; fixed income index fund; common stock index fund; small cap index fund; international stock index fund; and target date fund. The KPERS Board of Trustees would be responsible for selecting the specific investments for these categories. SB 553 would allow the Board to offer additional investment options, but these six options would be required.

KTSP members would be able to file application for distribution of vested account balances at any time after they terminate employment. Distributions could be made by direct rollover, "regular" rollover, lump-sum distribution, or some combination of those options. In addition, the Board would be given the authority to offer additional distributions options. If a member who leaves employment is not vested in the employer contribution account, the balance of the account would be forfeited and would be used to pay the administrative expenses of the KTSP.

The bill would allow for a one-time irrevocable election for all existing KPERS members to move to the KTSP, if approved by the Internal Revenue Service (IRS). Members who elect to switch would have a calculation of the present value of their future benefits and an equivalent amount would be transferred from the DB plan to their rollover account in the thrift plan. A calculation of the present value of future benefits would require the use of certain actuarial assumptions to determine the amount of the present value. The irrevocable election provisions of SB 553 would be severable from the rest of the bill if the IRS does not approve of the election.

Finally, the bill would require that the total payroll base of the members that enroll in the KTSP would be included in the calculation of employer contributions to the KPERS DB plan.

The enactment of SB 553 would have administrative costs to implement the bill and actuarial costs for the current KPERS DB plan.

Administrative Costs

KPERS indicates that establishing a defined contribution plan would require establishing additional internal controls and accounting mechanisms to ensure that the assets of the DB trust and the defined contribution trust are used exclusively for the benefit of the members of each trust. Ongoing costs would include actuarial services; defined contribution plan, investment, and audit consultant services; legal services; communication and education costs; a request for proposal for third-party recordkeeping, trust, and investment services; contract monitoring, audits, and reporting; and changes to KPERS' information technology system.

KPERS notes that the following cost estimates assume that KTSP would be administered by a third-party administrator and that the election for current members to elect to switch from the DB plan to the KTSP would be allowed by the IRS.

KPERS estimates that it would require 15.00 FTE additional staff positions during the transition period from FY 2023 through FY 2025. After the transition period, 7.00 FTE positions would be required for the ongoing administration of the KTSP. The positions would include a plan manager, benefits staff for education and transition assistance, and corporate accountants in the fiscal services division. However, only 3.00 FTE positions are estimated to start during FY 2023—a transition coordinator and the plan manager, and an administrator. Those positions are estimated to be filled for six months of FY 2023 at a cost of $182,000.

The staffing costs would ramp up starting in FY 2024 for the start date of the Kansas Thrift Savings Plan of July 1, 2024. The annual salaries and wages estimate for the transitional years is approximately $971,000 annually for 15.00 FTE positions, including those related to plan startup, employer support, benefits representatives, and plan management. Of the 15.00 FTE positions, 8.00 would be temporary positions and 7.00 would be permanent. Permanent staffing salaries and wages beginning in FY 2026 are estimated to be about $705,000 per year for 7.00 FTE positions associated with plan management, fiscal monitoring, and member education and support.

In addition, information technology costs would be required and would fall into two categories: (1) upgrades to KPERS' information technology system; and (2) additional information technology hardware and software for the new employees. Assuming that a third-party administrator would be responsible for tracking member data, changes to the KPERS information technology system would be necessary to ensure that the system can properly interface with the third-party administrator to share data, when necessary. The total cost estimate for changes to the existing information technology system is approximately $200,000 and would have to be completed prior to the implementation of the Kansas Thrift Savings Plan and would likely occur in FY 2024.

<u>Actuarial Costs</u>

KPERS indicates that the two main actuarial cost drivers are the long-term cost of the KSTP (when compared to the current KPERS DB plan), as well as the current KPERS Trust Fund cash flow (including subsequent changes to the Fund investments).

After the KPERS unfunded actuarial liability is paid off in calendar year 2023, the normal cost of the current KPERS DB plan is estimated to be 1.0 percent of payroll. However, with SB 553, the minimum employer contribution is 4.0 percent, and could be as high as 5.0 percent for certain employees, depending on employee contributions to the 457 Account. As a result, KPERS indicates that the ongoing cost of the KTSP is approximately 3.0 percent to 4.0 percent higher than the existing KPERS DB plan.

For KPERS Trust Fund cash flow, the agency states that there could be a potentially significant one-time transfer of assets from the KPERS Trust Fund to the KSTP, if active members elect to take the future present value of their DB plan benefit to the KSTP. This transfer could be significant and require the shift of assets to more liquid investments to fund the transfer. This shift would likely reduce the investment returns of the Trust Fund, which would increase costs long-term to the state. However, the magnitude of this transfer of KPERS Trust Fund assets to the KSTP would be dependent on the number of current members that would elect to participate in the KSTP and cannot be estimated. Because the existing KPERS DB Plan would continue to be funded on the combined DB and KTSP payroll, the unfunded actuarial liability is not expected to change dramatically and the KPERS plan is projected to reach 80.0 percent funded and 100.0 percent funded on the same schedule as the current amortization schedule.

SB 553 would close the current KPERS DB plan, which would change the expected demographic makeup in the future, as new members (typically younger) would no longer be enrolled in the DB plan. This would "mature" the DB plan and would cause the plan to be more "cashflow negative" as members continue to age and reach retirement without being replaced. As cashflow needs increase, future investment allocations may need to be adjusted to more liquid investments, which tend to have lower expected returns. However, the fiscal effect for this change cannot be estimated. The provisions that fund the DB over the combined payroll of the DB and TSP does alleviate this a certain amount but does not eliminate this risk.

The KPERS actuary completed an analysis, looking at the total employer contributions under two scenarios: (1) 10.0 percent of existing KPERS members would elect into the KTSP; and (2) 50.0 percent of existing KPERS members would elect into the KTSP. Under Scenario 1, the total employer contributions over the 30-year project period would be $17.4 billion, compared to the $10.7 billion under the current KPERS plan, or a net increase of $6.7 billion. Under Scenario 2, the total employer contributions over the 30-year project period would total $19.8 billion, compared to the $10.7 billion under the current KPERS plan, or a net increase of $9.1 billion. However, the fiscal effect for the actual number of current KPERS members who would elect into the KTSP cannot be estimated. Any fiscal effect associated with SB 553 is not reflected in *The FY 2023 Governor's Budget Report*.

Sincerely,

Adam Proffitt
Director of the Budget

cc: Jarod Waltner, KPERS
Lynn Robinson, Department of Revenue