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Laura Kelly, Governor

March 27, 2024

The Honorable Jeff Longbine, Chairperson
Senate Committee on Financial Institutions and Insurance
300 SW 10th Avenue, Room 546-S
Topeka, Kansas 66612

Dear Senator Longbine:

SUBJECT: Fiscal Note for SB 502 by Senate Committee on Federal and State Affairs

In accordance with KSA 75-3715a, the following fiscal note concerning SB 502 is respectfully submitted to your committee.

KPERS currently has three plans of membership, depending on when an employee was hired in the respective tier: Tier 1 (members hired before July 1, 2009); Tier 2 (members hired between July 1, 2009, and December 31, 2014); and Tier 3 (member hired after January 1, 2015). Each KPERS group has a different plan design. KPERS Tier 1 and Tier 2 are traditional defined benefit plans, where benefits are calculated using a benefit formula (Years of Service X Final Average Salary X Multiplier = Annual Retirement Benefit). Members contribute 6.0 percent of pay and employers contribute an amount calculated by the actuary to fund the normal cost and the amortization cost of the unfunded actuarial liability (UAL).

KPERS Tier 3 is a cash balance plan, where a member's lifetime benefit is based on contributions and interest earned throughout the career. Tier 3 members contribute 6.0 percent of pay to a notional account that earns a guaranteed 4.0 percent interest each year and a possible dividend interest credit based on statutory formula that is coupled to the five-year net average rate of return. Tier 3 members also have an employer pay credit account that is credited 3.0 percent to 6.0 percent of pay each year based on the number of years of service. This account also earns the guaranteed 4.0 percent interest plus a possible dividend. However, a participating employer contributes the same actuarial contribution rate for Tier 3 members as for Tier 1 and Tier 2 members. At retirement, the member's account balances are converted to a lifetime annuity.

SB 502 would reopen the Tier 2 plan to new members on July 1, 2024. The Tier 3 plan would be abolished on January 1, 2025. All active and inactive KPERS 3 members would be converted to Tier 2 members by January 1, 2025. If a current Tier 3 member would receive a higher benefit under Tier 3 than under Tier 2, the member would keep their KPERS 3 benefit.

KPERS reports that closing the Tier 3 plan and reopening the Tier 2 plan would have an effect on the agency's administrative costs. Approximately 73,500 active and 44,000 inactive Tier

3 members would be converted to Tier 2 membership. This would require both technical changes to KPERS pension administration system, as well as extensive education and communication efforts for the impacted members.

While the technical structure for Tier 2 currently remains in place in the pension administration system, the conversion of members from Tier 3 to Tier 2 would require coding changes to remove the existing Tier 3 rules built into the pension administration system. The system would have to calculate the proper salary and service time information that would be required for Tier 2 benefit calculations. KPERS estimates the cost for the technical work on the pension administration system and testing would be approximately $1.0 million from the KPERS Fund and would take approximately six months to complete. For the educational and plan administration changes, KPERS would require an additional 4.00 temporary FTE positions with total salary and benefits costs of $284,000 in FY 2025 and $296,000 in FY 2026. The additional staffing would include 2.00 temporary benefits analysts and 2.00 temporary benefits representatives.

The KPERS actuary reports that moving Tier 3 members to the Tier 2 plan would increase the UAL for the State/School members by $298.0 million based on the difference in the benefit plan design. The proposed changes would alter the benefit amounts for future retirees. For these changes, the actuary utilized an amortization period of 20 years for the increase in the UAL. The amortization payments are estimated using the same methodology as is used in the actuarial valuation (level-percent of payroll). The Division of the Budget notes that instead of paying the UAL cost over time, a one-time $298.0 million payment to KPERS from the State General Fund could be made by the state. However, with amortizing this amount over time, usual sources of payroll funds could be utilized to pay the increased employer contribution costs instead of a lump-sum from the State General Fund.

If SB 502 were enacted, the increase in the UAL, normal cost rate, and total actuarial contribution rate for the State/School Group (which includes both the increase in the normal cost rate and the UAL rate), are summarized in the following table:

State/School Group
(Dollars in millions)

	Baseline	SB 502	Change
Actuarial Liability	$24,840	$25,138	$ 299
Actuarial Value of Assets	18,536	18,536	--
UAL	$ 6,303	$ 6,602	$ 299
Funded Ratio	74.60 %	73.70 %	-0.90 %
Normal Cost Rate	8.89 %	9.75 %	0.86 %
UAL Contribution Rate	8.53 %	8.93 %	0.40 %
Actuarial Contribution Rate	17.42 %	18.68 %	1.26 %
Member Rate	6.00 %	6.00 %	--
Employer Contribution Rate	11.42 %	12.68 %	1.26 %

As shown in the above table, the proposed changes under SB 502 would increase the normal cost rate by 0.86 percent of pay for the State/School Group. In addition, there would be a 0.40 percent contribution rate increase to fund the increase in the UAL over 20 years for the State/School Group. The additional payment on the UAL would be over a fixed period and would end after 20 years. The increase of 1.26 percent in the State/School Group employer contribution rate in FY 2025 would be approximately $68.6 million on the current State/School Group payroll. Of this amount, the Division of the Budget estimates that $58.3 million would be from the State General Fund, with the assumption that approximately 85.0 percent of the State/School Group is funded from the State General Fund.

KPERS notes that the Tier 2 plan design has a higher normal cost than the Tier 3 cash balance plan. The long-term cost of reopening the Tier 2 plan design is the difference in normal cost. In the December 31, 2022, actuarial valuation, the Tier 2 normal cost was 9.20 percent compared to 7.67 percent for Tier 3. This difference of 1.53 percent, or about $84.0 million on current payroll, would be an ongoing increase in the cost of benefits. Of this amount, the Division of the Budget estimates that $71.4 million would be from the State General Fund, with the assumption that approximately 85.0 percent of the State/School Group is funded from the State General Fund. Any fiscal effect associated with SB 502 is not reflected in *The FY 2025 Governor's Budget Report*.

The KPERS actuary reports that the actuarial effect would be similar for local government employers, or the Local Group. The increase in the UAL, normal cost rate, and total actuarial contribution rate (which would include both the increase in the normal cost rate and the UAL rate), are summarized in the following table:

Local Group
(Dollars in millions)

	Baseline	SB 502	Change
Actuarial Liability	$7,216	$7,332	$ 117
Actuarial Value of Assets	5,218	5,218	--
UAL	$1,997	$2,114	$ 117
Funded Ratio	72.30 %	71.20 %	-1.10 %
Normal Cost Rate	8.07 %	8.99 %	0.92 %
UAL Contribution Rate	7.53 %	8.00 %	0.47 %
Actuarial Contribution Rate	15.60 %	16.99 %	1.39 %
Member Rate	6.00 %	6.00 %	--
Employer Contribution Rate	9.60 %	10.99 %	1.39 %

As shown in the above table, SB 502 would increase the normal cost rate by 0.92 percent of pay for the Local Group. In addition, there would also be a contribution rate increase to fund the increase in the UAL over 20 years of 0.47 percent for local employers. The increase of 1.39 percent in the Local Group rate is approximately $28.1 million on the current Local Group payroll.

Sincerely,

Adam C. Proffitt
Director of the Budget

cc: Jarod Waltner, KPERS