MINUTES

KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM STUDY COMMISSION

December 7-8, 2011
Room 346-S—Statehouse

Members Present

Senator Jeff King, Co-chairperson
Representative Mitch Holmes, Co-chairperson
Senator Laura Kelly
Representative Steven Johnson
Representative Ed Trimmer
William Buchanan
Edward Condon
Fredrick Poccia
Rebecca Proctor
Michael Ryan
Paul Seyferth
Richard Stumpf
Brian Winter

***Ex Officio* Members**

Elizabeth Miller, Acting Executive Director, Kansas Public Employees Retirement System
Alan Conroy, Director, Legislative Research Department
Mary Torrence, Revisor of Statutes

Staff Present

Julian Efird, Kansas Legislative Research Department
Michael Steiner, Kansas Legislative Research Department
J.G. Scott, Kansas Legislative Research Department
Gordon Self, Office of the Revisor of Statutes
David Wiese, Office of theRevisor of Statutes
Connie Burns, Committee Assistant

Conferees

Patrice Beckham, Cavanaugh Macdonald Consulting, LLC
Brent Banister, Cavanaugh Macdonald Consulting, LLC
Mary Beth Green, Kansas Public Employees Retirement System

Wednesday, December 7
Morning Session

The meeting was opened by Co-chairperson Holmes. Gordon Self, Office of the Revisor of Statutes, was welcomed back to the staff table.

Approval of Minutes

Co-chairperson King moved to approve the minutes for the October 25-26, 2011, meeting and the minutes for November 7-8, 2011, as distributed. Senator Kelly seconded the motion. The motion carried.

Information Requested by Commission

Elizabeth Miller, Acting Executive Director, Kansas Public Employees Retirement System (KPERS), presented the Core Fiduciary Guidelines (Attachment 1) to summarize the responsibilities of the KPERS Board of Trustees in this matter of changing retirement plans. Ms. Miller stated the KPERS Board of Trustees supports responsible legislation that will result in substantial improvement to KPERS' long-term funding status. The guidelines were summarized, as follows:

Funded Status

- Contribution rates – Employer contributions reach actuarially-required rates at a level sustainable over the long-term;
- Funded Ratio – All KPERS groups are funded at a minimum funded ratio of 80 percent and rising within a reasonable time period that does not leave KPERS exposed to market downturns for an extended period of time; and
- Funding period – Benefits are pre-funded within the amortization period established by the Board (currently just over 20 years).

Plan Design

- Impact of plan design on member behavior – The short-term and long-term incentives of plan design changes do not motivate member behavior and decisions adversely affecting the Plan and its sustainability; and
- Complexity of administration and education – The plan design can be effectively administered and communicated in a cost effective manner.

Core Plan Design Policy Issues

- Funding Policy – Does the plan establish an actuarial funding with an affordable mix of employer and employee contribution rates that ensures the financial soundness of the plan over the long term;

- Workforce Incentives – As part of the total compensation and benefits package, would the plan design provide sufficient incentives to attract and retain high quality employees;

- Retirement Readiness – Does the plan design provide for sufficient benefits to sustain the retiree's standard of living in retirement, in combination with social security and personal savings; and

- Allocation of Risk – How should the responsibility for bearing risk be allocated between employers (taxpayers) and members?

Ms. Miller provided a document on "KPERS Preliminary Plan Design and Administrative Issues" which responds to the request to address administrative issues associated with adopting a new retirement plan (Attachment 2). Administrative issues include the fact KPERS is a multi-employer defined benefit plan, with 1,500 participating employers, and 279,000 participating employees. KPERS currently is set up for annual employer reporting. In order to move to a defined contribution (DC) plan, KPERS would have to move to payroll period reporting.

Patrice Beckham, KPERS Actuary, Cavanaugh Macdonald Consulting, LLC, responded to several requests for information:

- Information in Attachment 3 provided new employee summary statistics;

- A request for the amount needed to pay off the KPERS Unfunded Actuarial Liability (UAL) in 30 years revealed an annual level payment of $628 million would be required (Attachment 4). Another projection revealed paying $500 million annually would not pay off the UAL after 31 years. A third projection showed a 30-year level percentage of payroll payment could pay off the UAL;

- A request to model HB 2194 with a 12 percent cap on employer contributions, and the employer contribution rate capped at a maximum of 12 percent of payroll, with the UAL re-amortized in 2022 is included in Attachment 5. Two other breakouts of the master table were distributed;

- A comparison of State/School Group employer contribution for retirement benefits (Attachment 6) provided information breaking down the dollar amount of contributions for the two components—normal cost and the UAL;

- Information regarding the KPERS estimated employer contribution from FY 2012 to FY 2058, under Sub. HB 2194 with re-amortization in 2025, showed the statutory rate for the state/school group reaches the actuarially-required contribution rate in FY 2018 at 14.46 percent (Attachment 7); and

- A request for the cost of closing the current defined benefit (DB) plan and the employer contribution for a new defined contribution plan was shown (Attachment 8).

New Plan Proposal

Senator King presented a proposed new retirement plan design (Attachment 9). He stated a new system was needed going forward, and, under the current system, a teacher or other public employee who starts work at age 22, then works 25 years and leaves at age 47, rather than working until age 65 or retirement age, is disadvantaged in the final retirement benefit calculation. The results are dramatic in how much worse off the employee in that situation would be when compared with being under a DC system. He proposed a service based annuity and employee directed contribution plan. The plan would require the following:

- The employee would contribute 6 percent of salary to the self-directed component of the plan. He noted the 6 percent contribution is the same amount the Tier 2 employees currently are making in the current KPERS System; and

- The employer would contribute into the annuity component of the plan in the initial year at the rate of 1 percent. This amount would ratchet up by 0.5 percent every year for eight years, until the employer's contribution became 5 percent of the employee's salary. The employer contribution rate would remain at 5 percent for the duration of the person's employment in a KPERS eligible job.

Two important distinctions are associated with a service-based plan:

- It creates an added incentive for retention of employees, which is the main goal; and

- The retirement system benefits by increasing the employers' contribution level as the employee continues in years-of-service, thereby allowing more payments to the closed KPERS plan as the new plan ramps up.

By starting the contribution at 1 percent and increasing that contribution, it would give employees the chance to earn a higher contribution and allow the employer greater time to ramp up its contribution, as well as more time to devote more resources to addressing the unfunded liability problems in this transition period.

The 6 percent employee directed accounts into which the employee invests, would be set up in a system similar to the Oregon and Washington systems presented. The employee would be able to choose how the money would be invested. However, if the employee makes no choice, the default assumption would apply (like Oregon and Washington) to invest in a portfolio mirroring the KPERS portfolio. The employee gets all the rewards of high investment returns and assumes the risk of the investments, but has available the expertise and very low administrative costs the KPERS investments bring to an investment portfolio as the default option.

One large issue remaining when converting from a DB plan to a DC plan is the cost associated with the closure of the DB plan. There must be an element of the DB plan remaining open, so the investment stream can be fairly consistent with what it would have been otherwise, and the investment returns can remain at the levels that would have been if the DB plan had been continued for all employees. In order to do that, the last part of the proposal would be for an annuitization requirement to be taking the amount the employer is contributing to this service-based component of the new plan to provide a guaranteed annuity. Senator King stated he would propose the annuity pay out based on the percentage rate the Pension Benefit Guarantee Corporation has as its annuity rate for certain annuity plans. This figure has ranged from 4 percent to 8 percent over the last five years, and the annuity would be paid out over the lifetime of the member, or the survivor, if survivor benefits were selected.

The non-vested employees would be moved into the new KPERS plan. There are about $225 million in the system for non-vested employees, as computed under current law if non-vested employees would leave employment. Senator King suggested moving the employees' money into the service-based annuity component to minimize the cash flow impact on the KPERS investments.

For vested KPERS employees, nothing would change; they would remain under the old KPERS plan. Senator King would like the vested employees to be given the option of entering the new plan, but those details would be discussed at a later time.

A memorandum was provided by Ms. Miller, KPERS, that sought guidance from tax counsel (Attachment 9). Ice Miller LLP, and the Kansas Development Finance Authority (KDFA), and its bond counsel, Gilmore and Bell, P.C., responded in order to provide the Commission with the most accurate information possible.

A chart was provided reflecting the elements of the existing KPERS DB plan and the proposed elements of the new KPERS plan (Attachment 10).

The Commissioners further discussed the proposed new plan. The Commissioners asked about any potential savings. Senator King said, for the new plan, there were no short term savings, but still included savings of HB 2194. Longer term savings would occur by reducing risk to the state.

Co-chairperson Holmes recessed the meeting until 1:20 p.m.

Afternoon Session

Co-chairperson King called the meeting to order. The Co-chairperson opened the floor for discussion on the new plan design, and how the new plan design would be applied to new hires, vested KPERS members, and non-vested KPERS members.

Discussion and Questions on New Plan Design

Several Commissioners stated HB 2194 should be allowed to run its course and the funding problem would be fixed. Senator King stated HB 2194 created the Commission with the task to come back to the Legislature with a recommendation for change. The charge also included funding the UAL, making sure future state employees and Kansas taxpayers are not put in the same place as now, and to provide the best affordable benefits for KPERS-eligible employees.

The Commissioners asked if the portable moneys were only the employees' contributions and earnings. Senator King stated employees' 6 percent contribution was portable and employers' contribution was not portable.

Senator Kelly requested information on the percent of the State General Fund (SGF) being spent for the KPERS state/school group under current law and under HB 2194, if implemented. That information was distributed (Attachment 11).

Representative Holmes presented a proposed variation in the new King plan design. Representative Holmes stated this was just one version and everything is amendable**.** Several models and scenarios were run by the actuaries using the parameters suggested by Representative Holmes, who changed the match to a salary-based contribution. After discussion, the Commission returned to consideration of Senator King's proposal and its three parts addressing new hires, non-vested KPERS members, and vested KPERS members.

Senator King moved that part of the legislation the Commission recommends for adoption by the Legislature pursuant to the charge in HB 2194 is the new KPERS plan design that was set forth (by Senator King) in the morning session of the meeting, and only pertains to new hires for this motion. Representative Holmes seconded the motion.

The floor was opened for discussion.

Commissioner Condon made a substitute motion that following July 1, 2013, the Defined Benefit plan would admit no new members and KPERS beneficiaries would participate in a Defined Contribution plan with the goals to optimize the benefits to KPERS beneficiaries and employer costs. Commissioner Stumpf seconded the motion. Commissioner Condon asked to change the motion "to beginning July 1, 2013, no new persons will be admitted to the KPERS DB plan." The second was not in favor of the change proposed in the motion. Motion failed for lack of a second.

Back on the original motion by Senator King, the floor still was open for discussion.

The Commissioners questioned whether Senator King's proposal addressed the unfunded liability, and if there would be no guarantee on the rate of return under his proposed new plan that would include an employer paid annuity contribution. Senator King indicated continued and increasing funding of the old KPERS plan would need to happen, and a minimum guaranteed zero rate of return would be required for the employer paid annuity contribution in the new KPERS plan.

Representative Johnson requested a model run on the employer normal cost rate if the rate of return was less than 8 percent assumed earnings, and since the lowest rate the model can project is a 7 percent assumed rate of return, that result was shown (Attachment 12).

The Commissioners asked if there was a way to force annuitization if it was critical to the proposed new KPERS plan. Senator King stated annuitization options have consequences on DB plan closures and the Commission can address or amend it.

Ms. Beckham stated the model's projections are for new hires only. Senator King stated the current proposal is for new hires only. It does not address non-vested or vested members at this time.

*On the original motion by Senator King, seconded by Representative Holmes, the **King** motion carried to adopt a new KPERS plan for new hires.*

Senator King moved that employees who are non-vested in the system by July 1, 2013, would participate in the new KPERS plan in exactly the same way as new hires in the previous motion. Commissioner Seyferth seconded the motion.

The Chairperson opened the floor for discussion on the motion.

Ms. Miller stated KPERS staff had not modeled any impact of employee movement from the current DB plan to the new DC/DB plan in terms of its impact on the funding status of the DB plan, but she stated she knew it would have an adverse impact. Senator King stated the motion only dealt with non-vested employees.

There would be approximately 53,000 employees who are in the non-vested pool, according to Ms. Miller. Commissioners asked if this has any effect on the UAL. Ms. Beckham stated the modeling that has been done cannot isolate a change for non-vested employees and the impact is not available at this time.

When asked by Commissioners about what dollar amount is associated with the non-vested employees that might be moved to the new KPERS plan, Ms. Miller stated approximately $225 million.

Commissioner Poccia moved to amend the motion to allow employees who are not vested but have employee contributions currently in KPERS to move those dollars to either the employee directed part of the plan or to the annuity contribution part of the plan at their option. This would be a one-time election. Commissioner Proctor seconded the motion.

The Co-chairperson opened the floor for discussion on the amendment to the motion. Ms. Miller stated, according to the Ice Miller memorandum, this proposal would require IRS approval.

*The **Poccia** amendment to the motion carried.*

Back on the amended motion:

*The amended **King** motion carried to include non-vested KPERS members in the new DC/DB plan and to allow employee contributions to be transferred to each part of the new KPERS plan at the option of the employee to choose the allocation going into each account.*

The meeting was adjourned until Thursday, December 8, at 9:00 a.m.

Thursday, December 8
Morning Session

The meeting was opened by Co-chairperson King, who stated the agenda would include discussion of plan designs for vested employees; review of the list of seven items dealing mainly with existing KPERS eligible employees; and any other items that the Commission would like to discuss.

Senator King moved the Study Commission recommend the Legislature consider adopting a mechanism to allow current vested KPERS members to opt into the new KPERS plan if they choose to do so. Commissioner Seyferth seconded the motion.

The Co-chairperson opened the floor for discussion.

The Commissioners asked about buying-down the unfunded liability. Senator King stated there were several ways the Legislature could approach this option, but in this case he was asking the Commissioners whether they believe it is worthy to consider giving this option to vested employees and for the Legislature to consider it.

Commissioner Stumpf proposed an alternative new plan design (Attachment 13). The proposal would freeze the current DB plan and replace the current tier 1 and tier 2 with a tier 3 option of a stacked hybrid DC/DB plan.

Commissioner Stumpf made a substitute motion to freeze the current KPERS plan and replace the current Tier 1 and Tier 2 plans with a Tier 3 stacked hybrid defined benefit/defined contribution plan. Motion failed for lack of a second.

Back to the original motion:

Senator Kelly moved to table indefinitely Senator King's motion on vested employees. Commissioner Poccia seconded the motion. The Kelly motion carried.

The Co-chairperson opened the floor for discussion.

Ms. Miller provided requested information on KPERS retirement options (Attachment 14).

Ms. Beckham provided a chart on the impact of a service freeze on final benefits (Attachment 15).

The Commissioners asked if double dipping is a negative on the unfunded liability. Ms. Beckham stated the big concern is, if people are retiring sooner because of that provision, then the liability increases as benefits must be paid out longer.

Commissioner Stumpf made a motion on the previous Stumpf proposal to remove the double dipping and pay off of the UAL, and replace the plan design was approved in the December 7, 2011, meeting. Commissioner Buchanan seconded the motion.

The Co-chairperson opened the floor for discussion on the Stumpf second proposal.

The Commissioners asked to see the number on the Stacked Hybrid Plan.

Ms. Beckham presented a memorandum on Stacked Hybrid Plan with $25,000 as the covered pay cap (Attachment 16). She indicated the pertinent measurement when analyzing this plan design for new hires is the normal cost rate (the ongoing cost of the benefit structure for active members).

The motion on the floor was the Stumpf motion. The Stumpf motion failed.

List of Items for Further Study

The Co-chairperson reviewed the list of seven items for further discussion:

- Address calculation of legislators' retirement benefits;
- Remove statutory cap on annual KPERS participating employer contributions;
- Refund inactive, non-vested members earlier than five years;
- Eliminate buyback service credit purchases;
- Extend vesting from five to ten years;
- Review Pension Obligation Bonds and bonding; and
- Eliminate sick and annual leave from pre-1993 calculations for final average salary (FAS).

Commissioner Seyferth moved to remove from the table the King motion on the recommendation to the Legislature regarding vested employees. Commissioner Winter seconded the motion. The Seyferth motion failed.

Back on the list:

Item 1 – address calculation of legislators' retirement benefits.

The Co-chairperson asked Gordon Self if the approved motions from the previous day's meeting on the new plan design were to have new hires become members of the new KPERS plan and to have non-vested KPERS members transfer into the new KPERS plan. Effectively, any new legislators who come into the system and any non-vested legislators as of July 1, 2013, would become members of the new KPERS plan. The legislators' enhanced benefit calculation would be eliminated for those two groups of new and non-vested legislators who would participate in the new KPERS plan without having their salary annualized. Mr. Self agreed with the clarification of the motions as applied to new and non-vested Legislators. The enhanced benefit calculation would remain for legislators who are already vested and or who will be vested by 2013.

The Co-chairperson opened the floor for discussion of the issue.

The Commissioners requested legislators' retirement benefit be based on only the cash salary component. A handout was presented on KPERS membership choices for legislators who joined KPERS (Attachment 17). KPERS contributions are based on legislative annualized compensation on bi-weekly pay schedule. The compensation and expense payments on an annualized basis are used to determine contributions. The annualized compensation figure also serves as the basis for calculating any retirement benefits.

Ms. Miller stated the final average salary (FAS) is based on the highest years of pay during the member's career. A handout was provided, "Exclusion of Payouts from Final Average Salary" (Attachment 18). The highest years do not have to be continuous or the last years.

Commissioner Proctor made a motion to move all legislators into the new KPERS plan and any employer and employee attributed benefits accrued under KPERS would transfer to the annuity contribution part of the plan beginning on the same date as the other state employees' transition. Legislators will have the same option of joining the new KPERS plan as existing state employees. Participation would be based on actual annual salary on which the legislators are taxed, as suggested by Commissioner Condon. Commissioner Condon seconded the motion.

Discussion followed the motion.

Commissioner Strumpf moved an amendment to the motion that the accrued KPERS benefit be calculated on a no gain/no loss/nothing extra, but gets no accelerated benefit. Senator Kelly seconded the motion. The Strumpf amendment passed.

The Commissioners stated the value of the accrued benefits in KPERS would be calculated and transitioned to the new KPERS plan, so the amount vested Legislators would have earned would be transferred, nothing more, nothing less.

Back on the Proctor motion as amended, *a roll call vote was requested. With 13 voting yes, the Proctor motion, as amended, passed to transfer all legislators and their accrued benefits to the new KPERS plan.*

Co-chairperson King recessed the meeting until 12:50 p.m.

Afternoon Session

The meeting was called to order by Co-chairperson King.

List of Items for Further Study (continued)

Item 2 – Remove statutory cap on annual KPERS participating employer contributions

The Co-chairperson opened the floor to discussion. The Commissioners requested to postpone this item.

Item 3 – Refund inactive, non-vested members earlier than five years

The Commissioners decided the item would be eliminated from the list. There was a KPERS handout explaining the proposed change (Attachment 19).

Item 4 – Eliminate buyback service credit purchases

The proposed change would eliminate all options for members to purchase service credits. A KPERS handout was provided on "Elimination of Service Purchases" (Attachment 20).

Mary Beth Green, Member Services Officer, KPERS, stated employees have to be active to purchase, so they have a salary at that time.

Commissioner Stumpf moved to eliminate the ability for future buyback service-credit purchases going into effect July 1, 2013. Senator Kelly seconded the motion. The Stumpf motion carried.

The Co-Chairperson went back to postponed item 2.

Item 2 – Remove statutory cap on annual KPERS participating employer contributions.

Representative Holmes moved to recommend the Legislature consider removing the statutory cap. Senator Kelly seconded the motion. Discussion followed.

Commissioner Condon made a substitute motion to repeal the statutory cap language and require the payment of the UAL. Commissioner Buchanan seconded the motion. The Condon substitute motion passed.

A chart was provided showing the projections for the state/school group, if the actuarially required contribution rate in FY 2013 rises to 13.46 percent per the substitute motion (Attachment 21).

Representative Holmes moved to recommend in the report the Legislature consider bonding a portion or all of the UAL. Commissioner Seyferth seconded the motion. The Holmes motion carried.

Back on the list of topics:

Item 5 – Extend vesting from five to ten years

A KPERS handout was provided, "Increase Vesting from Five Years to Ten Years" (Attachment 22). The funding impact was determined to not be significant. There was no further interest to address the issue.

Item 6 – Eliminate sick and annual leave from pre-1993 calculations for final average salary (FAS)

Ms. Miller stated Attachment 18 provided information about this issue. For Tier 1 with a membership date on or after July 1, 1993, FAS is three-year salary average excluding additional compensation. For Tier 1 with a membership date before July 1, 1993, FAS is the higher of:

- A three-year salary average excluding additional compensation; or
- A four-year salary average including additional compensation.

KPERS calculates both options and uses whichever result provides the higher benefit.

For Tier 2, FAS is computed on the average of the five highest years of salary, excluding additional compensation.

Representative Johnson moved to recommend in the report excluding payouts for additional compensation going forward. Commissioner Seyferth seconded the motion. The Co-chairperson opened the floor for discussion.

There are approximately 34,000 active Tier 1 members who were hired before July 1, 1993, and would be affected by this change. Mr. Self stated this would raise a legal question on whether it is a contract clause issue.

The Johnson motion failed. Commissioner Buchanan requested to be recorded as abstaining from the vote.

Commissioners asked about employees who suffer an on the job injury and have to retire.

Ms. Miller stated, as a covered KPERS employee, they are entitled to disability benefits, if injured while on duty and only those benefits would apply. The benefits are based on a percentage of salary. They are part of the death and long-term disability plan.

Senator King moved to include a strong recommendation for workers under the new KPERS plan to have death and disability incorporated in the new plan design, so it treats them the same relative way as it does other workers in the existing KPERS plan. Commissioner Ryan seconded the motion. The King motion carried. The Co-chairperson opened the floor to discussion.

Commissioner Buchanan moved to ask the Legislature to consider separating the local group of KPERS and to enter discussion with local government representative about how they believe the retirement system for their employees should be handled. Representative Holmes seconded the motion. The Buchanan motion failed.

The Co-chairperson called on Mr. Self to explain how the rest of the process will work.

Mr. Self stated both agencies, Kansas Legislative Research Department and the Office of the Revisor of Statutes, will plan the drafting of the report and the legislation, working with both KPERS staff, the KPERS actuary, and the KPERS tax counsel. Once the report is completed, it will be sent out to the Commission members to review. There is one meeting date left available to meet, if there would be concerns about the report or legislation, and then the Commission could meet, if necessary. There is a possibility of a minority report. For those members desiring such a minority report, they should contact Julian Efird. There would not be any legislation accompanying the minority report.

The Co-chairpersons thanked Committee staff, Ms. Beckham, Mr. Banister, Ms. Miller, and the KPERS staff for their efforts on this Commission.

The meeting was adjourned.

Prepared by Connie Burns
Edited by Julian Efird

Approved by Committee on:

January 3, 2012
(Date)