MINUTES

JOINT COMMITTEE ON PENSIONS, INVESTMENTS AND BENEFITS

November 4, 2019
Room 546-S—Statehouse

Members Present

Representative Steven Johnson, Chairperson
Senator Jeff Longbine, Vice-chairperson
Senator Rick Billinger
Senator Vic Miller
Senator Pat Pettey
Senator Mary Jo Taylor
Representative Brenda Dietrich
Representative Jim Kelly
Representative Annie Kuether

Members Absent

Representative Doug Blex
Representative Broderick Henderson
Representative Brett Parker
Representative Sean Tarwater

Staff Present

Reed Holwegner, Kansas Legislative Research Department
Amit Patel, Kansas Legislative Research Department
Melissa Renick, Kansas Legislative Research Department
J.G. Scott, Kansas Legislative Research Department
Gordon Self, Office of Revisor of Statutes
David Wiese, Office of Revisor of Statutes
Lea Gerard, Committee Assistant

Conferees

Justin Stowe, Legislative Post Auditor
Alan Conroy, Executive Director, Kansas Public Employees Retirement System (KPERS)
Katie Whisman, Executive Officer, Kansas Bureau of Investigation
Elizabeth B.A. Miller, CFA, Chief Investment Officer, KPERS
Randy Bowman, Executive Director of Public Affairs, Kansas Department of Corrections
Ed Klumpp, Legislative Liaison, Kansas Sheriffs' Association
Brad Loveless, Secretary of Wildlife, Parks and Tourism

Others Attending

See Attached List.

MORNING SESSION

Chairperson Johnson called the meeting to order at 10:06 a.m.

Communication to the Legislative Post Audit Committee

Justin Stowe, Legislative Post Auditor, explained a performance audit of the Kansas Public Employees Retirement System (KPERS or the Retirement System) is required by state law at least once every three years. In 2015, an audit was completed on KPERS to determine whether there were sufficient controls to detect and prevent fraud abuse. The audit identified KPERS had suspended field audits for almost two years. The Legislative Division of Post Audit (LPA) recommended KPERS resume its field audits. Mr. Stowe stated the Legislative Post Audit Committee will ask, in April 2020, to approve an audit of the Retirement System. By law, this Joint Committee may communicate its audit suggestions to the Legislative Post Audit Committee (Attachment 1).

Representative Kelly suggested an audit be conducted on the Deferred Retirement Option Program (DROP).

2018 Valuation of KPERS; Update on Performance of Bond Proceeds, 2004 and 2015 Series; Update on DROP

Alan Conroy, Executive Director, KPERS, provided an overview of the 2018 actuarial valuation of KPERS (Attachment 2). KPERS exists to pay for promised benefits to members and their beneficiaries. The agency administers three statewide retirement systems: “regular” KPERS, Kansas Police and Firemen’s Retirement System (KP&F), and the Kansas Retirement for Judges (Judges). KPERS serves more than 1,500 state and local government employers.

Mr. Conroy said the annual actuarial valuation, which measures assets and liabilities, provides the basis for calculating future employer contribution rates. The 2018 valuation is used to set the fiscal year (FY) 2022 contribution rates for state and school employers and calendar year 2021 rates for local employers. As of December 31, 2018, there is a combined total of 154,055 active members for KPERS, KP&F, and Judges, and a combined total of 102,733 retirees. The Retirement System’s funded ratio of assets to liabilities is 68.4 percent. The unfunded actuarial liability increased from $8.9 billion in FY 2018 to $9.2 billion for FY 2019. The Actuarially Required Contribution (ARC) rates decreased for KPERS State/School employers from 14.23 percent in FY 2021 to 14.09 percent in FY 2022. The statutory employer contribution for the State/School group is 14.41 percent in FY 2020 and 14.23 percent for FY 2021. Mr. Conroy acknowledged the State/School group’s employer contribution rate, for the first time in 25 years, will equal the ARC rate in FY 2021. The total actuarial liability is $29.1 billion, minus $19.9 billion in assets, leaving an unfunded actuarial liability of $9.2 billion as of December 31, 2018. The delayed payment of $64.1 million in FY 2017 and $194.1 million in FY 2019 are scheduled to be paid over a 20-year amortization schedule, including interest paid at the rate of

7.75 percent. Mr. Conroy stated the funding projections show continued improvement. The Trust Fund remains strong with $20.0 billion in assets and a well-diversified portfolio.

In response to questions, Mr. Conroy stated the funded ratio was at 59.0 percent in FY 2008 for State/School funding. He noted the funded ratio should be between 80.0 to 100.0 percent prior to a downturn in the market.

Pension Obligation Bonds

Mr. Conroy provided information on the pension obligation bonds, explaining the bonds are a form of arbitrage intended to reduce future employer contributions and improve the solvency of KPERS (Attachment 3). The State of Kansas issued the bonds. As a contractual obligation, the repayment of the bonds is a high budgeting priority for the State. The first series of bonds was issued in 2004 (2004C) for a total of $500.0 million, gross of fees and included $60.0 million of capitalized interest. These bonds, over a 30-year maturity, pay interest at 5.39 percent. Annual debt service is approximately $33.0 million from the Expanded Lottery Act Revenues Fund. KPERS received $440.165 million in net proceeds after all fees and expenses were paid. The second series of bonds was issued in 2015 (2015H) in the amount of $1.0 billion, net of fees. These bonds, over a 30-year maturity, pay interest at 4.68 percent. Annual debt service is approximately $65.0 million from the State General Fund (SGF).

The average annualized total return for the 2004C series is 7.28 percent, adding over $318.0 million in value to the Retirement System after the annual debt service is considered. The average annualized total return for the 2015H series is 7.3 percent, adding over $128.0 million in value to the Retirement System after the annual debt service is considered.

Mr. Conroy said he would have to respond later to members' questions about refinancing the bonds should interest rates drop.

DROP

Mr. Conroy provided information on the DROP for KP&F members in the Kansas Highway Patrol (KHP) and the Kansas Bureau of Investigation (KBI) (Attachment 4). In DROP, a member initiates retirement benefits, but opts to defer the receipt of the benefits for a three- to five-year period. The member does not earn additional service credits, but continues to contribute 7.15 percent of compensation into DROP. The KHP continues to make employer contributions to KP&F. Retirement benefits are held in a separate account, and at the end of the period the member receives the lump sum with interest. Mr. Conroy acknowledged a member may enter DROP when eligible for normal retirement. Currently, there are 600 KP&F members eligible to participate in DROP, approximately 9.0 percent of KP&F members. Mr. Conroy cautioned if DROP was extended to additional employers, KPERS would need to make information technology updates and hire additional staff for administration.

In response to questions, Mr. Conroy stated he would provide information on the dollar amount of lump sums for the two individuals who have completed DROP and whether the lump sum is taxable or may be rolled over to a qualified plan.

Chairperson Johnson asked about DROP's cost and whether it is neutral actuarially. He asked whether the benefit option has kept troopers on the road longer than what they would have done absent DROP. While there are good things about the program for the employee, the

Chairperson questioned whether it was harmful to KP&F, especially if the DROP program is expanded.

Ms. Katie Whisman, Executive Officer, KBI, stated the agency suggested to the Joint Committee last year the KBI be added to DROP. She explained the KBI had been experiencing critical staffing issues for the last five years. In 2017, the KBI implemented a salary progression matrix for classified personnel of special agents who were operational and working in the field. The group maxes out at 19 years of service, and afterward those agents do not get additional compensation benefits for staying with the agency. KBI was interested in DROP because it would encourage the retention of experienced field agents. Ms. Whisman said three agents have joined DROP since July 1, 2019, when the agency started participation in the program. From the KBI's perspective, she noted, DROP will be beneficial for the employees and the agency. (No written testimony was submitted.)

Chairperson Johnson recessed the meeting at 12:05 p.m.

AFTERNOON SESSION

Chairperson Johnson reconvened the meeting at 1:30 p.m.

Overview of 2019 Enacted Legislation

David Wiese, Assistant Revisor, Office of Revisor of Statutes, provided an overview of KPERS legislation enacted in 2019, stating there was one major KPERS bill last year—HB 2031 (Attachment 5). He noted the bill's provisions as follows:

- Added "contraction of a bloodborne pathogen" to the definition of "service connected" in the KP&F plan;
- Amended the powers and duties of the KPERS Board of Trustees;
- Established a two-year KPERS waiting period for certain membership;
- Created a working-after-retirement exemption for certain KPERS retirees;
- Exempted individuals who retired on or after July 1, 2016, and before July 1, 2019, from working after retirement penalties;
- Added language allowing the Executive Director of KPERS to waive working-after-retirement penalties beginning on and after July 1, 2019; and
- Added KBI agents to the eligible membership in DROP and extended the sunset of the program to January 1, 2025.

Mr. Wiese added that SB 9 transferred $115.0 million from the SGF to KPERS during FY 2019. House Sub. for SB 25 (Section 55(b)) repealed the FY 2019 transfer of up to $56.0 million, which would have been contingent upon actual revenues exceeding the most recent

joint estimate. However, Section 56(e) transferred an unconditional $51.0 million from the SGF to KPERS in FY 2020.

Investment Performance

Elizabeth Miller, Chief Investment Officer, KPERS, presented an overview of investment performance as of June 2019 (Attachment 6). In terms of investment performance for FY 2019, there was a 6.7 percent total return with a relative policy performance return of +0.2 percent. The best performing asset classes for FY 2019 were private equity, domestic equity, and fixed income. The growth of $100 invested over time shows the Retirement System's assets are outperforming both inflation and the return assumption. Ms. Miller noted the portfolio has been able to outperform its benchmark with less risk.

Responding to questions, Ms. Miller stated when selecting a new manager to manage assets, the job will be posted online and KPERS may reach out to consultants or investment managers to assist in the selection of a manager to manage assets for each asset class. Once the proposals from interested applicants are received, there are initial and lengthy interviews. When a candidate is to be selected, KPERS staff bring the recommendation to the Board of Trustees for its final decision on hiring the investment manager. Compensation is not performance-based, but on the percentage of assets under management. Ms. Miller said there is a statutory definition of alternative investment and the infrastructure investments and bank loans fall into that category. In terms of capital market assumptions, based upon a liability study, there is an expected return from private equity of 12.25 percent and an expected annual standard deviation of 27.0 percent. The global equity capital market assumption return expectation is 8.5 percent and the standard deviation assumption is 18.5 percent. Ms. Miller said the yield-driven portfolio is a risk class and not an asset class, noting most assets are invested in high-yield income with exposure to bank loans, real estate trust, and small yield investments.

Correctional KPERS, KP&F

Chairperson Johnson yielded the chair to Representative Kelly to preside over the meeting regarding the agenda topic Correctional KPERS and KP&F.

Survey of Previous Interim Reports

Reed Holwegner, Principal Research Analyst, Kansas Legislative Research Department (KLRD), briefed the Committee on the various interim committees over the decades that have discussed transferring personnel, whether state or local government employees, into either Correctional KPERS or into KP&F (Attachment 7 and Attachment 8). He stated KPERS Correctional Group A is for corrections officers and supervisors and Correctional Group B is for correctional institution employees. Groups A and B may retire at the ages of 55 and 60, respectively. KPERS Tier 2 is closed to nearly all new members, except for correctional employees who may retire with ten years of service. Relying upon interim records starting in the 1930s, KLRD staff identified nine interim committee reports that discuss the transfer of employees into different retirement plans. In six out of the nine, the interim committee either took no action or recommended further study. In three years, there were recommendations that groups be added, but only in one instance, found in 1981, did the Special Committee on Pensions and Investments introduce legislation to allow employees who were instructional staff

at the Law Enforcement Training Center, personnel trainers with fire service programs, or campuses' patrol officers into KP&F. Mr. Holwegner also noted for purposes of larger policy context, in the 1970s, there appeared to be a transition point in Kansas public pension policy where actuarial analyses became the primary means of assessing retirement systems.

In response to questions, Mr. Holwegner stated the reports summarized in the attachments use direct quotations from the various interim committees when possible. When comparing the various years, the definition of law enforcement officer or fire fighter seemed to be a central point of discussion. Cost was referenced few times. Emergency Medical Technicians were added later and were placed under the firefighter classification. The definitions are set and have not been revised over the years. A few interim committee reports observed stress and a job situation should not be across-the-board determinations for movement from KPERS to KP&F.

Status and Contents of Pending Legislation

Mr. Wiese provided an overview of bills introduced during the 2019 Session involving changes to KP&F membership and the current status of each bill (Attachment 9).

HB 2165 would require adult corrections officers, juvenile correctional officers, and security officers to move from the KPERS Correctional Groups to KP&F. The bill also would include support staff within any correctional institution or juvenile correctional facility that have regular contact with inmates or juvenile offenders. KP&F benefits would be for service commencing on and after January 1, 2020. Benefits earned prior to that date would be calculated under KPERS statutes. The bill was referred to the House Committee on Financial Institutions and Pensions, which held a hearing on February 25, 2019. The Committee has not acted on the bill and it remains in the Committee for possible action during the 2020 Session.

HB 2139 and SB 121 would permit detention deputies, corrections officers, detention officers, or jailers employed by local units of government to be covered by KP&F. HB 2139 was referred to the House Committee on Financial Institutions and Pensions, which held a hearing on February 20, 2019. The bill remains in that Committee for possible action during the 2020 Session. SB 121 was referred to the Senate Committee on Financial Institutions and Insurance, which held a hearing on February 19, 2019; that Committee recommended the bill be passed as amended by making affiliation with KP&F be for future service only. The Senate has taken no action.

HB 2099 provides that the Kansas Department of Wildlife, Parks and Tourism (KDWPT) would affiliate with KP&F commencing on July 1, 2019, for those certified, full-time officers and employees who have successfully completed law enforcement course work approved by the Kansas Law Enforcement Training Center. Starting on July 1, 2020, members would be required to make the KP&F employee contribution of 7.15 percent of compensation. The bill was referred to the House Committee on Financial Institutions and Pensions, which held a hearing on February 6, 2019. The Committee recommended the bill be passed on February 12, 2019. On February 28, 2019, the bill was stricken from the House Calendar pursuant to House Rule 1507.

Estimated Costs to Transition Certain Employees to KP&F

Mr. Conroy gave an overview of KP&F, which consists of approximately 5.0 percent of the Retirement System's total active membership (Attachment 10). He provided a breakdown of

the active members of "regular" KPERS (144,071 members), KPERS-Correctional (2,033 members), and KP&F (7,695 members) and the associated employer and employee contribution rates. He noted if KPERS correctional officers contribute to Social Security, these officers will remain in the federal program even though the member moves to KP&F. This also applies to the employers that make Social Security contributions.

Mr. Conroy stated 2019 HB 2099 would have a total cost estimate increase of $600,000, including a $700,000 increase for KDWPT and a decrease of $100,000 spread across all other State KP&F employers. Regarding 2019 HB 2139 and SB 121, he noted with additional KP&F employees it could impact the KP&F employer contribution rate; it is not possible to estimate the impact of those bills without more information. He stated the cost estimate for 2019 HB 2165 would be approximately $5.2 million net. This would include a $6.1 million cost increase for the Kansas Department of Corrections (KDOC), but a decrease of $900,000 in savings spread across all other KP&F employers.

Responding to questions, Mr. Conroy noted since the KPERS employer group is so large, the impact on the actuarial estimate would be minimal. He noted when the number of participating employers decreases, the remaining unfunded liability must be spread over the smaller group. The vesting difference is 11 years of service for KP&F versus 9 years for KPERS-Correctional. If an employee goes from one plan to another with 9 years of service in KPERS-Correctional, the employee would have to work 6 more years in KP&F to be vested. If the employee quits or retires early, that person would get regular KPERS benefits plus the employee's contributions made to KP&F, with interest, with no service benefit. Mr. Conroy will provide information about whether non-vested contributions can be rolled into another qualified plan. He noted none of the retirement groups allow a member to purchase service years.

Randy Bowman, Executive Director of Public Affairs, KDOC, provided an overview of workforce challenges with correctional employees (Attachment 11). He stated the employees' main concern is their compensation, including pay rates, health insurance costs, and retirement. Through a recent survey, 66.0 percent of the employees would like to complete their public service career in KDOC. The employees have regular contact with offenders, juveniles, and adults within an institution and in the community, exposing them to risk of injury or death. This is comparable to employees currently provided KP&F retirement benefits. The KDOC employees should be included with KP&F.

In response to questions, Mr. Bowman stated parole officers and correctional officers do not have the complete law enforcement training. The amount of money needed for KDOC employees to be included in KP&F would cost $6.1 million. Currently, KDOC has a stress-filled system with insufficient space.

Ed Klumpp, representing the Kansas Sheriffs' Association, provided answers to questions regarding the KP&F proposal for local corrections officers who are not state-certified law enforcement officers (Attachment 12). He explained of the 96 jails in operation, 2 are unique in management positions. Shawnee County has a corrections agency that is not operated by the sheriff's office. All of those employees are KPERS members. Riley County operates a county-wide police department that is led by an appointed director who has all the duties and obligations of a sheriff. He explained within those jails there is a large variation of using certified correction officers, who are KP&F members, and non-certified correction officers, who are KPERS members. Mr. Klumpp noted many sheriffs' offices are finding it difficult to hire officers due to lower wages than fully commissioned deputies.

Brad Loveless, Secretary of Wildlife, Parks and Tourism, provided an explanation of why natural resource officers, park rangers, and various manager positions who are full-time certified law enforcement officers should be included in KP&F (Attachment 13). He said the employees are the only statewide law enforcement officers who are not included in KP&F. Their specialized job requirements often place them in harm's way. He noted the agency is self-funded. This transition would have no negative impact on the SGF.

In response to questions, Secretary Loveless stated the agency would be asking for fee increases during the 2020 Session. The Secretary said the agency could move forward on transferring its certified law enforcement officers to KP&F without using any money from fee increases.

KPERS Board of Trustees, Planning Assumptions

Representative Kelly yielded the chair to Chairperson Johnson, who presided for the remainder of the meeting.

Mr. Conroy presented an overview on the triennial experience study, which, by law, covers actuarial assumptions, experience studies, and preliminary recommendations to the Board regarding the assumed rate of return (Attachment 14). Assumptions have a significant impact on the calculation of liabilities and actuarial contribution rates. He noted accurate assumptions are important to ensure generational equity. Types of assumptions that are reviewed and possibly revised include economic, demographic, and actuarial methods. The study compares the actual experience of the past three years with the current assumptions. The Board is responsible for the selection of actuarial assumptions that are used for budgeting and planning purposes in the subsequent three years. Preliminary recommendations for actuarial methods and demographic assumptions will be presented at the Board's November and January meetings.

Discussion and Recommendations for the Committee Report to the 2020 Legislature

Mr. Holwegner provided information on the 2018 Report of the Joint Committee on Pensions, Investments and Benefits as an example of what may be communicated from the Joint Committee to the Legislature (Attachment 15). He said it is the Joint Committee's responsibility, as provided by law, to monitor, review and make recommendations regarding the Retirement System for the 2020 Legislature.

Representative Kelly recommended LPA study how DROP has performed and its cost to KHP and other employers in the Retirement System. The policy's intention was to keep troopers on the road. The study should focus on participation in DROP and who has benefited from the program.

Senator Longbine recommended KPERS staff provide information to legislators, either now or at the appropriate time when enough data has been collected, on the trends in public retirement and re-employment. Substantial changes were made to working-after-retirement rules during the 2018 Session. Senator Longbine questioned whether the intended goal to keep people in their present positions longer had been met.

Chairperson Johnson recommended LPA study KPERS' management of contracts, including contracts for actuary and investments services, to discern whether there is sufficient control and oversight.

Chairperson Johnson recommended LPA study the expenses related to net investment performance. While KPERS' investment and management costs appear low, the extent to which all investment-related expenses are included should be determined and whether they are reasonable.

Chairperson Johnson recommended KPERS staff study the legal definition of alternative investments and re-evaluate the extent to which other investments, such as bank loans and other yield-driven assets, should be classified as alternative investments. For purposes of transparency, the Chairperson observed, the Retirement System's alternative investment portfolio should be readily understandable to policymakers, pension administrators, taxpayers, and, perhaps most importantly, KPERS members.

Representative Kelly suggested further discussion and study may be necessary regarding KPERS-Correctional and similar groups, perhaps through a subcommittee of a standing committee; the appointment of a select or special committee, consisting of members knowledgeable about pensions, law enforcement, or corrections; or through the creation of a task force, which could rely on outside expertise. Representative Kelly recommended instead of focusing on pensions benefits, which may not be an immediate draw to younger, recently hired employees, new approaches to compensation, work conditions, and management practices should be considered.

Senator Longbine suggested a cost study be done on what the cost difference is between moving existing employees over to KP&F versus new hires.

Chairperson Johnson would like to include in the study the unintended issues of the transition from KPERS to KP&F.

There was Committee discussion to either support the passage of 2019 HB 2099 or to further study pensions benefits.

Representative Kelly moved, seconded by Senator Longbine, to move forward with the Kelly proposal for considerations and recommendations. Motion passed.

Senator Pettey recommended no new legislation regarding DROP be introduced or considered until the legislative session immediately prior to the sunset date of January 1, 2025.

Chairperson Johnson commented on the methodology planned to be used for the triennial experience study, explaining the assumed rate of return is one of the foundation stones that ensure there is greater generational equity in KPERS. He expressed concern if analyses are too limited in scope, the assumed rate of return may become overly averse to risk taking. He suggested further hearings may be necessary during the 2020 Session so legislators have a better understanding and deeper appreciation of the Board's assumed rate of return and the assumptions behind it.

Adjourn

The Committee adjourned at 4:30 p.m.

Prepared by Lea Gerard

Edited by Reed Holwegner and Amit Patel

Approved by the Committee on:

January 13, 2020
(Date)