MEMORANDUM

To: Senate Education Committee

From: Alan D. Conroy, Executive Director

Date: March 5, 2024

Subject: Senate Bill 479; KPERS 2 coverage for teachers

Senate Bill 479 makes changes to the retirement plan design for teachers at local school districts and community and technical colleges. The proposed change impacts plan funding and will require additional resources to administer.

Current Plan Design

Within the KPERS plan, there are three groups:

1. KPERS 1 – Members started before July 1, 2009.
2. KPERS 2 – Members started from July 1, 2009, to December 31, 2014.
3. KPERS 3 – Members started after January 1, 2015.

Each group has a different plan design. KPERS 1 and KPERS 2 are traditional defined benefit plans, where benefits are calculated using a benefit formula (Years of Service x Final Average Salary x Multiplier). Members contribute 6% of pay and employers contribute an amount calculated by the actuary to fund the normal cost and amortize the unfunded actuarial liability (11.42% in FY 2025 for State/School employers).

KPERS 3 is a cash balance plan, where members' lifetime benefits are based on contributions and interest earned throughout their careers. Members contribute 6% to notional accounts that earn guaranteed 4% interest each year and a possible dividend interest credit based on statutory formula coupled to the 5-year net average rate of return. Members also have employer pay credit accounts that are credited 3% - 6% of pay based on the number of years of service they have. These accounts also earn the guaranteed 4% interest plus possible dividends. At retirement, the members' account balances are converted to lifetime annuities.

Employers contribute at the same actuarial contribution rate for KPERS 3 members as they contribute for KPERS 1 and KPERS 2 members.

SB 479 would reopen the KPERS 2 plan to teachers on July 1, 2024. Teachers are defined in the bill as:

- Any certified professional employee who is required to hold a certificate to teach in any school district.
- Any teacher or instructor in any technical college, community college or the institute of technology at Washburn university.

KPERS

Members who meet the definition of teacher and are already enrolled in the KPERS 3 plan would convert to KPERS 2 members by January 1, 2025. If a current KPERS 3 member would receive a higher benefit under KPERS 3 than under KPERS 2, they would keep their KPERS 3 benefit.

KPERS 2 and KPERS 3 Benefit Comparison

The KPERS 2 and KPERS 3 plan designs are not expected to provide the same level of benefits for each member. The ultimate benefit a member earns is highly dependent on individual circumstances (e.g., starting salary, salary progression, years of service), so it is not possible to provide a single comparison that can be applied to every scenario.

Using a simplified set of assumptions and calculations, we estimated the benefit for a 30-year teacher who retires at age 60 under KPERS 2 and KPERS 3. The results are summarized in the following table:

KPERS 2 and KPERS 3 Benefit Comparison 30-year Teacher, Retiring at Age 60			
	KPERS 2	KPERS 3 4% guarantee only	KPERS 3 4% guarantee + 2% dividend
Retirement Benefit 10-Year Life Certain Benefit Option	$45,015	$26,978	$36,866
Difference from KPERS 2 Benefit	$ -	$(18,037)	$(8,149)

As you can see in this career member example, the KPERS 2 plan design is expected to provide a higher benefit than under the KPERS 3 plan design. Another set of assumptions would yield different results. While most scenarios are expected to provide higher benefits under the KPERS 2 plan design, there are scenarios where the KPERS 3 benefit would be greater than KPERS 2.

Another way to compare benefits is to use an expected replacement ratio. A replacement ratio compares the expected benefit a member will receive, expressed as a percent of the wages earned in their final year before retirement.

KPERS actuary provided a replacement ratio comparison using four different scenarios:

- Career employee (30 years of service, age 35-65)
- Early career employee (10 years of service, age 25-35)
- Mid-career employee (20 years of service, age 30-50)
- Late career employee (20 years of service, age 45-65)

These 4 scenarios all have the same set of underlying assumptions, except for the period worked as a public employee.

Like the example above, most of the scenarios expect the KPERS 2 plan design to provide a higher benefit than the KPERS 3 plan design. However, for members who join KPERS early in their career and then leave KPERS-covered service, the KPERS 3 benefit may provide a higher benefit. Although in this scenario, the KPERS benefit would presumably be a smaller portion of the member's retirement planning than it would for a career public servant.

A graph with the results of the replacement ratio comparison is attached to this memorandum.

Actuarial Costs
There are two primary funding impacts to the KPERS plan due to changing the benefit plan design for teachers:

1. An increase in the unfunded actuarial liability.
2. An increase in the normal cost of benefits, which is the cost of benefits allocated to each fiscal year.

Unfunded Actuarial Liability
Moving the KPERS 3 teacher members to KPERS 2 increases the unfunded actuarial liability for those members by $134 million. It reflects an increase in the total liability expected for this group based on the change in the benefit plan design. This increase can be funded through a one-time payment of $134 million or the cost can be amortized over a number of years. If the $134 million is paid up front, there is no ongoing cost applied to future employer contribution rates.

If the increase in the unfunded actuarial liability is amortized, there will be a yearly cost applied to the State/School employer contribution for the length of the amortization period. For the cost analysis, KPERS' consulting actuary calculated the cost of a 20-year amortization period. The estimated increase in the employer contribution rate to amortize the $134 million increase in the unfunded actuarial liability over 20 years is 0.20%, or about $11 million based on the current State/School payroll.

Normal Cost
The normal cost is also expected to increase based on the provisions of SB 479. KPERS 2 has a higher normal cost rate than KPERS 3, so moving a large group of members to the KPERS 2 plan design increases the normal cost. The expected increase in the normal cost rate is 0.26%, or about $14.2 million on the current State/School payroll. This increase would be permanent and not affected by the funding of the increase in the unfunded actuarial liability discussed above.

The following table summarizes the expected impact on State/School funding and State/School employer contribution rates based on the provisions of SB 479:

SB 479 Actuarial Impact - State/School Group ($ millions)	Baseline	SB 479	Change	Additional Contributions
Actuarial Liability (AL)	$24,290	$24,424	$134	
Actuarial Value of Assets	18,029	18,029	0	
Unfunded AL (UAL)	$ 6,261	$ 6,395	$134	
Funded Ratio	74.2%	73.8%	(0.4%)	
Employer Normal Cost Rate	2.89%	3.15%	0.26%	$14.2
UAL Contribution Rate	8.53%	8.73%	0.20%	$10.9
Actuarial Contribution Rate	11.42%	11.88%	0.46%	$25.1

SB 479 does not include a funding mechanism for the plan design changes in the bill, so under current law the FY 2025 employer contribution rates would be increased by the amount in the above table to begin funding the changes in SB 479.

Administrative Costs

Reopening the KPERS 2 plan for teachers will have a large impact on plan administration. Looking at CY 2022 valuation data and cross-referencing Kansas State Department of Education data, KPERS estimates there are about 35,000 to 40,000 teacher positions in total at the Unified School Districts in Kansas, with about 15,500 being KPERS 3 members. This does not include the positions that would be considered teachers under SB 479 at the community and technical colleges, nor does it include inactive teacher members who will be converted to KPERS 2.

SB 479 will require both technical changes to KPERS' pension administration system as well as extensive work to collect additional data on "teachers" that KPERS does not currently have or collect. In addition, there will need to be education and communication efforts for the impacted members.

KPERS 2 is a fundamentally different plan than the KPERS 3 cash balance plan. While the technical structure for KPERS 2 remains in place in the pension administration system, the conversion of members from KPERS 3 to KPERS 2 would require substantial coding changes to calculate the proper salary and service time information that will be required for KPERS 2 benefit calculations. In addition, modifications also are needed to allow the ongoing calculation/comparison of KPERS 2 and KPERS 3 benefits to ensure that no member is disadvantaged by this change.

KPERS estimates the cost for the technical work on the pension administration system and testing to total $950,000 and take six months to complete. Additional staffing would be required for the identification of teacher members and for providing education and resources to members to include 5.0 temporary FTE with total salary and benefits costs of $362,111 in FY 2025, and $377,528 in FY 2026. This includes 3.0 temporary benefits analysts and 2.0 temporary benefits representatives in the Benefits and Member Services Division.

Implementation Timing

SB 479 includes two key dates of implementation:

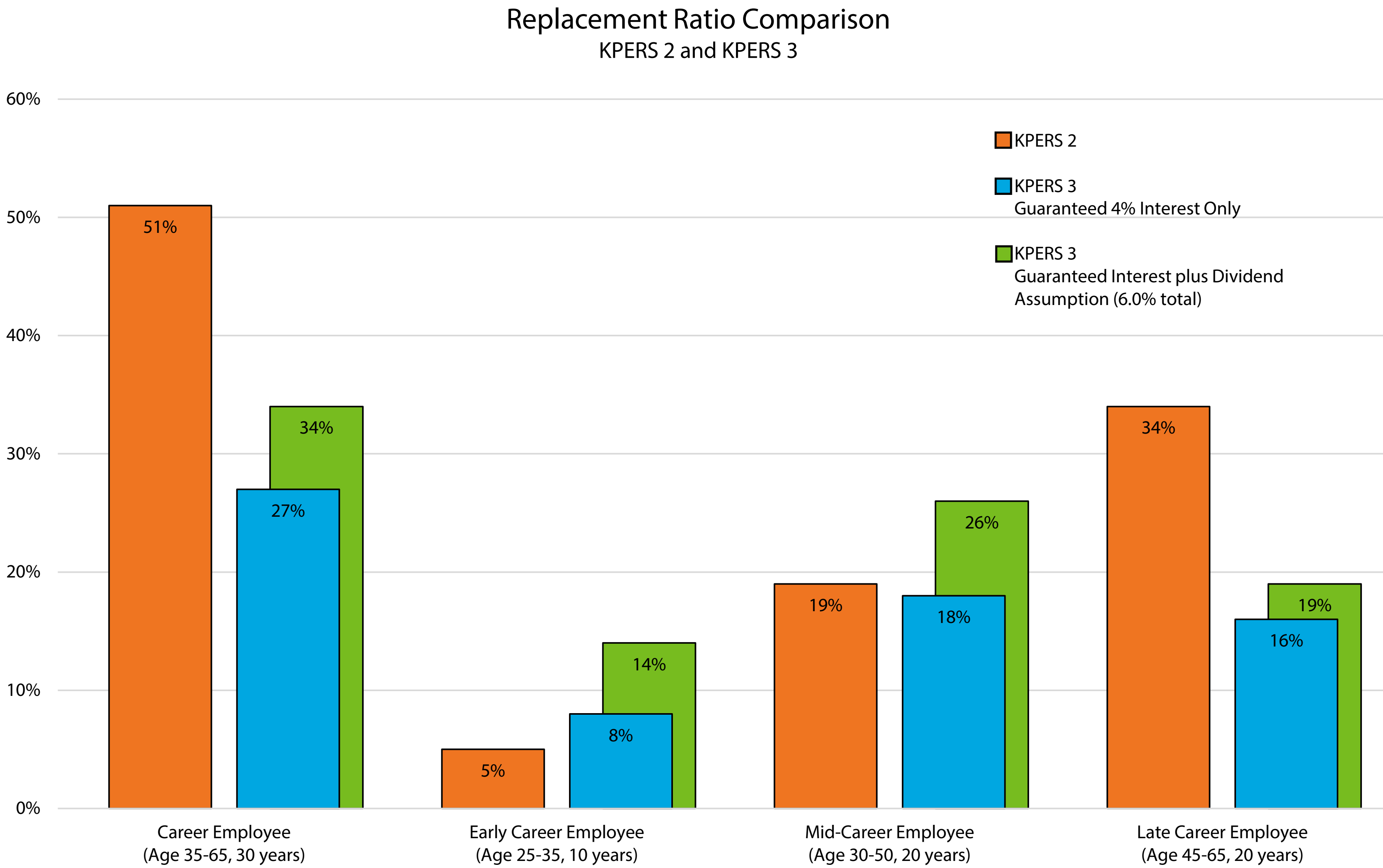
- All new teacher members will be enrolled in KPERS 2 starting July 1, 2024.
- All existing KPERS 3 teacher members will be converted to KPERS 2 on or before January 1, 2025.

Due to number of development and testing hours for the pension administration system and the manual effort that will be required to identify all active and inactive members who are eligible for KPERS 2 coverage, this timeline will be difficult to execute.

If SB 479 moves forward, we would request the date for the conversion of existing members be delayed by six months (to July 1, 2025) to allow the necessary time to complete the administrative work of converting the current KPERS 3 members.

The bill may be amended to include a provision that any teacher member retiring after a date certain (e.g., July 1, 2024 or January 1, 2025) would have their benefit calculated as a KPERS 2 member if that is the will of the Legislature.

I would be pleased to respond to any questions the Committee may have.



All scenarios assume that the member retires at age 65 and reflects the current set of actuarial assumption, including the 7.0% investment return assumption.

KPERS

January 2024