MINUTES

JOINT COMMITTEE ON PENSIONS, INVESTMENTS, AND BENEFITS

August 27-28, 2003
Room 519-S—Statehouse

Members Present

Senator Dave Kerr, Vice Chairperson
Senator Jim Barone
Senator Anthony Hensley
Senator Steve Morris
Senator Ruth Teichman (August 28 only)
Representative Ray Cox
Representative Vaughn Flora
Representative Margaret Long
Representative Bill McCreary
Representative Melvin Neufeld
Representative Clark Shultz (August 28 only)

Staff Present

Alan Conroy, Kansas Legislative Research Department
Julian Efird, Kansas Legislative Research Department
J.G. Scott, Kansas Legislative Research Department
Mike Corrigan, Office of the Revisor of Statutes
Gordon Self, Office of the Revisor of Statutes
Carol Doel, Committee Secretary

Committee Conferees

Glen Deck, Executive Director, Kansas Public Employees Retirement System (KPERS)
Rob Woodard, Chief Investment Officer, KPERS
Pat Beckham, KPERS Actuary, Milliman U.S.A.
Stephen R. Weatherford, President, Kansas Development Finance Authority (KDFA)

Wednesday, August 27, 2003
Morning Session

In the absence of Chairperson Edmonds, Vice Chairperson Kerr opened the meeting. He introduced the Ranking Minority Member of the Committee, Representative Flora, who was designated for this meeting in the absence of Representative Flaharty. Senator Kerr explained that the Legislative Coordinating Council has given the Committee a charge to come up with a plan to address the substantial shortfall in the long-term funding for the Kansas Public Employees Retirement System (KPERS).

Information regarding KPERS matters was distributed by legislative staff, including a summary of the 2002 actuarial valuation, legislation passed by the 2003 Session, and a comparison of the different retirement plans under KPERS (Attachment 1).

Glen Deck, KPERS Executive Director, introduced Michael Braude, Chairperson of the KPERS Board of Trustees, and Marjorie Webb, a trustee on the KPERS board, who were present. Mr. Deck first focused on operational areas, addressing the Strategic Business Plan for Fiscal Years 2002-2005 (Attachment 2). He next explained the scope of KPERS operations (Attachment 3). Continuing with his presentation, Mr. Deck covered external conditions and demands that impact KPERS (Attachment 4). On September 1, 2003, KPERS will launch a new website (Attachment 5). A proposed information systems replacement project was presented, with a total estimated cost of $8.0 million over three or more years (Attachment 6). Also covered by Mr. Deck was a summary of KPERS investment litigation (Attachment 7). Senator Kerr and Senator Barone requested an expanded litigation status report with an accounting summary to include monetary gains that were in addition to legal recoveries.

Rob Woodard, KPERS Chief Investment Officer, presented an investment performance report for the period ending June 30, 2003 (Attachment 8). The total portfolio gained 4.0 percent over the 12 months ending June 30, reversing the negative returns of the previous several years. The three-year average was negative (2.8) percent, while the five-year average was a 3.1 percent gain in total portfolio value.

A report on the death and disability fund status was presented by Glen Deck. This fund provides death and disability benefits for active KPERS members (Attachment 9). Recent contribution moratoriums have reduced revenue by an estimated $100.3 million through FY 2004 and investment losses have reduced assets by an additional $19.9 million. As of June 30, 2003, the assets were valued at approximately $73.1 million and the fund had outstanding actuarial liabilities of $163.6 million. The fund balance is estimated at the end of FY 2004 to be $27.3 million. An independent review of the death and disability program is underway, and a report is expected prior to the 2004 Legislature in order to present recommendations about the future financing of the program.

Afternoon Session

Pat Beckham, the KPERS actuary under contract from Milliman U.S.A., presented an executive summary of the KPERS actuarial valuation for the period ending December 31, 2002. She said that the main purpose of this valuation is to value the assets, calculate liabilities, and compare the difference between those assets and liabilities in order to determinate the actuarial contribution rate (Attachment 10). Factored into the report are the impacts of 2003 HB 2014, including the future employer contribution rate increases. No assessment of a potential $500 million bond issue is factored into the report, although the bonds were authorized by HB 2014, pending affirmative actions in a series of subsequent approval steps. Ms. Beckham noted that the System is not in actuarial balance, despite the employer contribution cap increase authorized by the 2003 Legislature. She noted an additional deferred investment loss of $1.5 billion not recognized in the valuation due to the smoothing methodology. She expressed continued concern for both state/school and local employer contribution rates. The state/school unfunded liability is $2.239 billion, with a funded ratio of 75.6 percent; while the local unfunded liability is $340 million, with a funded ratio of 81.7 percent. Ms. Beckham suggested reviewing the increased employer contribution rate increases approved for state government, and consider raising the caps for local governments as well.

Ms. Beckham also submitted a portion of the valuation report for the period ending December 31, 2002 (Attachment 11). One of the new features in the report is a table portraying the split between state and school groups for informational purposes. The unfunded actuarial liability for the state group is $105.5 million, while the school liability is $2,133.3 billion. Chairperson Edmonds had requested this split be shown in the valuation report.

Glen Deck returned to address the need for developing a long-term funding plan. The potential issues to address in a funding plan are employer contribution rates for KPERS state/school and local groups; pension obligation bond options; reamortization for KPERS state/school and local groups; changes in actuarial cost methods for the KPERS, KP&F, and Judges plans; plus benefit enhancements and employee contribution alternatives (Attachment 12).

Additional employer rate increases by raising the statutory cap for the state/school group could bring the plan into actuarial balance as early as FY 2017. In order to achieve that goal, the present cap on annual rate increases would need to be raised from 0.6 percent in FY 2008 to 1.0 percent in FY 2008 and subsequent years. A 1.0 percent increase would cost the state approximately $56 million in FY 2008, an increase of $22 million more than the current approved rate increase would yield that fiscal year. Senator Morris requested that a scenario be run using a 1.5 percent increase rather than the new statutory rate increases to see how much that would change the ultimate ending cap.

For the local group, for which no increase in contribution rates has been approved by the Legislature, the present annual statutory cap of 0.15 percent would need to be raised to 0.4 percent in 2006, 0.5 percent in 2007, and 0.6 percent in 2008 and subsequent years in order to achieve equilibrium in 2015 at 8.69 percent.

A change in the amortization period of the unfunded actuarial liability, for instance, could have a positive effect in limiting the increase of employer contributions. Reamortization in 2015 and no other changes in assumptions would result in a projected equilibrium occurring in 2021 for the state/school group. A change could be part of the comprehensive long-term finance plan. Reamortization in 2015 would bring the state/school group into actuarial balance by 2021, with an employer contribution rate of 13.69 percent under current law governing annual rate cap increases.

A similar change in amortization could benefit the local group and cap employer contributions for that group, Mr. Deck pointed out. No projections for the local group were provided.

Changing actuarial cost methods also might be considered. KPERS currently is based on the projected unit credit method. Approximately 13 percent of state retirement systems use this method. Most states use the entry age normal method. It assumes annual costs are equal to level premiums, rather than increasing the contributions for each member over time as the projected unit credit method does. Changing methods will not materially impact long-term funding, but the entry age normal method would slightly lower employer contribution rates for about 10 years. After that, rates would be somewhat higher than projected unit credit rates for the remainder of the amortization. If the KPERS method were to be changed, then conforming the KP&F and Judges plans also should be considered. It would make comparing the plans and contribution rates more meaningful.

Regarding benefit issues and employee contribution alternatives, Mr. Deck reported that asking employees to increase their contributions would require some form of benefit enhancement to offset the higher costs borne by employees. Among the benefit topics recently discussed were providing cost-of-living adjustments for future retirees and paid by the employees themselves by raising their contribution rate; lowering the period for vesting from 10 to five years for state and local groups; giving first-day coverage to state and local employees who currently must wait one year for KPERS memberships (school employees already have first-day coverage); adjusting the work after retirement earnings limit; and certain issues for members of KP&F retirement. It was pointed out that any employee contribution increase must be in conjunction with benefit enhancements.

Thursday, August 28, 2003
Morning Session

Glen Deck provided information regarding the 13th check and pension obligation bonds authorized by the 2003 Legislature to finance a permanent payment each year (Attachment 13). The 13th check group is comprised of individuals who retired before July 2, 1987, and historically have received an annual 13th" month benefit payment. The Legislature passed 2003 HB 2014 to make this payment a guaranteed annual benefit. The legislation had a fiscal note that increases the estimated unfunded actuarial liability by $35.9 million. A portion of the bond issue will finance the state portion of the liability. Local units of government will pay an increased annual amount rather than be included in the bond issue. The state portion using bonds also will be repaid by an increase in the employer contribution rate.

Mr. Deck also addressed the Regents group which is comprised of certain Board of Regents unclassified employees and KU Hospital Authority employees who have prior service credit under KPERS (Attachment 13). The 2003 Legislature provided for bonds to finance this group to be incorporated in the KPERS unfunded liability and to allow the Regents and KU Hospital Authority to amortize the costs over 10 years.

Next, Stephen Weatherford, President, Kansas Development Finance Authority, made a presentation on pension obligation bonds, reporting on KDFA series 2003H for the purpose of paying off the outstanding unfunded liabilities of the 13th check group and the Regents group. The bonds were authorized under HB 2014 for up to $40.4 million plus the costs of issuance, capitalized interest, and any other reserve fund deposits (Attachment 14). The bonds were priced on August 26-27, with an issue of $40.25 million, of which $38.9 million will be transferred to KPERS for prepayment of the unfunded liabilities of the two groups. The true interest cost was 4.60 percent. KPERS and the Board of Regents will request an annual appropriation to repay the principal and interest of the bonds, with KPERS repaying the State General Fund with increased contributions for these costs relative to the 13th check group. The present value savings are estimated at $6.33 million.

Glen Deck next presented an overview of a section of HB 2014 which authorized up to $500 million in pension obligation bonds for the purpose of financing a portion of the unfunded actuarial liability of the KPERS state/school group (Attachment 15).

Rob Woodard provided information regarding the key risks of investments and the impact of refinancing. He also highlighted the investment impact of a pension obligation bond issue and investment strategy considerations (Attachment 16).

Mr. Weatherford presented information regarding issues and options for a proposed taxable pension obligation bond issue which would be intended to refinance a portion of the KPERS unfunded actuarial liability (Attachment 17). The example presented assumed a 30-year final maturity for a $500 million bond issue, with capitalized interest driving up the total bond issue to between $600 and $625 million to fit the projected increase in employer contributions that will begin in FY 2006. Legislators objected to the added costs of capitalized interest, and indicated that a $500 million cap on bonds, except for the costs of issuance, was the intent when the House of Representatives approved HB 2014. In conclusion, Mr. Deck presented information on projected savings and funding impact of a $500 million transaction (Attachment 18).

Following Committee discussion, it was requested that alternative options be submitted and another Committee meeting be scheduled after options were prepared to address the $500 million cap. Several dates in September were chosen to be suggested to Chairperson Edmonds.

Prepared by Carol Doel
Edited by Julian Efird

Approved by Committee on:

October 29, 2003