

February 19, 2014

The Honorable Steven Johnson, Chairperson
House Committee on Pensions and Benefits
Statehouse, Room 286-N
Topeka, Kansas 66612

Dear Representative Johnson:

SUBJECT: Fiscal Note for HB 2519 by House Committee on Pensions and Benefits

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2519 is respectfully submitted to your committee.

HB 2519 would create the Kansas Public Employees Retirement System (KPERs) Defined Contribution (DC) Act, which would go into effect January 1, 2016. The act would apply to employees who are first employed by a participating employer on that same date. The act would not apply to Kansas Police and Firemen's Retirement system (KP&F) or the Judges Retirement System. The cash balance plan would be repealed as of the effective date of the bill. The KPERs Board of Trustees would be required to establish within the retirement system a separate defined contribution plan. An account may be established for paying the plan's administrative expenses, which may be funded by fees assessed on DC plan member accounts.

Active members of the defined benefit plan on January 1, 2016 may choose to become members of the defined contribution plan by making an election within a 90-day period established by the Board. A defined benefit plan member failing to make an election would remain a member of the defined benefit plan. The election would be one-time and irrevocable. An election to become a defined contribution plan member would terminate active membership in the defined benefit plan. Membership in the defined contribution plan would be effective for all service on and after January 1, 2016. A defined benefit plan member who elects to become a defined contribution plan member would retain all credited service earned under the defined benefit plan. Members who become inactive in either the defined benefit plan or defined contribution plan after an election has been made and return to active service would remain in the plan previously elected. However, if the member returns to active membership with a different participating employer, the member would become a member of the defined contribution plan. The bill includes procedures for defined benefit members who purchase service credits.

The DC plan would include a member’s mandatory contribution account, a member’s employer contribution account, and a member’s rollover account. Members may rollover other eligible retirement accounts to the members DC plan rollover account. Active DC plan members must contribute 6.0 percent of compensation to the plan. DC plan members may not make voluntary contributions. Employers must contribute 3.0 percent of the member’s compensation, a percentage of compensation to the defined benefit plan to address unfunded liabilities, a percentage for plan administrative expenses, and a percentage of compensation for the death and long-term disability plan.

The Board must establish appropriate investment options for DC plan members. A DC plan retiree or a retiree’s beneficiary may terminate plan membership and receive a payout through a direct rollover to another retirement plan, a regular rollover to another retirement plan, or a lump-sum distribution of the vested account balance, or some other distribution option offered by the Board.

Estimated State Fiscal Effect				
	FY 2014 SGF	FY 2014 All Funds	FY 2015 SGF	FY 2015 All Funds
Revenue	--	--	--	--
Expenditure	--	--	--	\$1,780,162
FTE Pos.	--	--	--	9.00

KPERS’ consulting actuary completed an actuarial cost study on the provisions of HB 2519. If it is assumed that all actuarial and investment assumptions are met, there would be no fiscal effect in FY 2014 or FY 2015 related to the State/School Group employer contribution rates. However, it is possible that over the long term the bill could increase contribution rates which could result in increased employer contributions of approximately \$12.8 billion or \$2.5 billion on a present value basis. Based on the percentage of State General Fund resources budgeted for statewide salaries and wages in FY 2015, approximately \$5.8 billion from the State General Fund could be required (\$1.1 billion present value). HB 2519 could increase Local Group total employer contributions over the long term by approximately \$3.3 billion. While the Local Group CY 2014 contribution rates would not change, CY 2015 rates could increase from 9.48 percent to 9.84 percent requiring additional contributions from local governments of \$6.2 million.

According to KPERS, establishing a defined contribution plan will entail a range of administrative costs and will require establishing additional internal controls and accounting mechanisms to ensure that the assets of the defined benefit trust and the defined contribution trust are used exclusively for the benefit of the members of each trust. It is expected that KPERS’ administrative start-up and on-going costs would include actuarial services; defined contribution plan, investment, and audit consultant services; legal services; communications and education; third-party recordkeeping, trust, and investment services; ongoing contract

monitoring, audits and reporting; and one-time costs for changes to KPERS' information technology system.

KPERS estimates additional expenditures of \$1,780,162 and 9.00 FTE positions for FY 2015. Expenditures for implementing the bill would grow to \$3,313,825 plus another 3.00 FTE positions in FY 2016. By FY 2017, expenditures are anticipated to moderate to \$2,690,514. These costs would be above current expenses for system operations and would require increases to the expenditure limitation set by the Legislature. In the Governor's budget, the FY 2015 limitation for KPERS administrative expenses is \$11,643,066 and does not include funding from the State General Fund. Of the projected costs, \$1.1 million are related to implementation of the one-time election in which active KPERS 1 and 2 members could choose to transfer to the defined contribution plan (\$163,540 in FY 2015, \$505,916 in FY 2016, and \$394,960 in FY 2017). Although the election is subject to IRS approval, some election implementation costs would need to be expended before receiving approval in order to be prepared to implement the election on a timely basis such as for IT system changes that have a lengthy development timeline.

It is likely that employers will also incur administrative costs in association with implementing and maintaining the defined contribution plan. For example, employers would be required to remit contributions for DC plan members to both the third-party record keepers and KPERS, which would require them to differentiate between those members and KPERS 1 and 2 members. However, no estimate of employer administrative costs is available.

HB 2519 provides the following sources of funding for the administrative costs associated with the defined contribution plan:

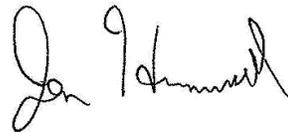
1. Employers are to pay a percentage of compensation on the defined contribution plan payroll to be allocated to the administrative expenses account;
2. The Board of Trustees may assess fees on defined contribution plan members to pay "reasonable" administrative costs of the plan; and
3. All forfeited employer contributions are to be allocated for administrative expenses, including start-up costs.

While these provisions provide some flexibility in funding once the plan is in effect, the last two would not be available until after its implementation, and would not generate significant revenue until there are a sizeable number of members in the plan. Given the obligation to use the defined benefit trust assets exclusively for its members, start-up costs for the defined contribution plan in FY 2015 and the first half of FY 2016 cannot be funded from the defined benefit trust. HB 2519 does not specify a funding source for defined contribution plan costs incurred by KPERS prior to its inception in January 2016 (other than forfeited employer contributions, which would not be available prior to plan inception). Options for funding include an appropriation from the State General Fund or another fund or an administrative fee assessed

on all KPERS employers in addition to the KPERS employer contribution, beginning in FY 2015.

No offsetting reductions in administrative costs are expected from freezing the defined benefit plan. Current membership levels in KPERS 1 and KPERS 2 would not decrease meaningfully for decades, and current service requirements would remain along with additional member support and communication needs that would be involved in the transition to a new plan. Any fiscal effect associated with HB 2519 is not reflected in *The FY 2015 Governor's Budget Report*.

Sincerely,

A handwritten signature in black ink, appearing to read "Jon Hummell". The signature is written in a cursive style with a large initial "J".

Jon Hummell,
Interim Director of the Budget

cc: Faith Loretto, KPERS