MINUTES

JOINT COMMITTEE ON PENSIONS, INVESTMENTS, AND BENEFITS

July 24, 2006
Room 123-S—Statehouse

Members Present

Senator Steve Morris, Chairperson
Senator Laura Kelly
Senator Ruth Teichman
Senator Dwayne Umbarger
Representative Ray Cox
Representative Geraldine Flaharty
Representative Margaret Long
Representative Bill McCreary
Representative Melvin Neufeld

Staff Present

Alan Conroy, Director, Kansas Legislative Research Department
J.G. Scott, Chief Fiscal Analyst, Kansas Legislative Research Department
Julian Efird, Principal Analyst, Kansas Legislative Research Department
Gordon Self, Office of the Revisor of Statutes
Carol Doel, Committee Secretary

Committee Conferees

Glenn Deck, Executive Director, Kansas Public Employees Retirement System
Pat Beckham, Actuary, Kansas Public Employees Retirement System, Milliman, Inc.
Vince Smith, Chief Investment Officer, Kansas Public Employees Retirement System
Carol Foreman, Deputy Director, Department of Administration
Chris Biggs, Kansas Securities Commissioner

Morning Session

Senator Morris recognized Glenn Deck, Executive Director, Kansas Public Employees Retirement System (KPERS), who described the agency's recent accomplishments, as well as the strategic plan for 2006 to 2010. Mr. Deck explained that the core values adopted by the Board of Trustees are service, integrity, respect, accountability, innovation, and teamwork. KPERS has three primary goals:

- Invest the System's assets according to the "prudent expert" standard for the sole purpose of providing benefits to members and their beneficiaries;
- Serve members and employers in a professional, timely, accurate, and cost-effective way; and
- Communicate effectively with members, employers, public officials, and other stakeholders.

Mr. Deck noted that an increase of 30.0 percent in the number of retirees was expected over the next ten years, and a 50.0 percent increase over the next 15 years. A modest increase in KPERS staff in order to maintain service levels was predicted.

Mr. Deck introduced Vince Smith, the new KPERS Chief Investment Officer. Mr. Smith has 19 years of experience in public pension investments. Prior to his appointment to KPERS, he served as the Director of International Equity Investments for the Employees Retirement System of Texas (Attachment 1).

Mr. Smith presented the May 31, 2006 performance report that shows the fiscal year-to-date performance was 11.6 percent, with a total portfolio market value of $12.238 billion. Detailed charts for the different investment sectors were provided by Mr. Smith (Attachment 2). A preliminary, unaudited estimate as of June 30, 2006 showed the total assets at market value to be $12.276 billion, with a fiscal year investment return of 12.3 percent (Attachment 3). Other charts were provided showing the investment outlook relative to energy prices, monetary and financial conditions, and the U.S. housing market (Attachment 4).

Pat Beckham, KPERS actuary, Milliman, Inc. presented the annual KPERS actuarial valuation report. Ms. Beckham stated that the valuation results held no surprises and continued the trends from the previous valuation. The unfunded actuarial liability increased $409.0 million in the past year and will continue to grow in the next few years, Ms. Beckham cautioned. A summary of her presentation was distributed (Attachment 5).

Ms. Beckham reported that the most recent actuarial valuation, dated December 31, 2005, found that the Retirement System's long-term funded status has improved significantly, and was considered to be in actuarial balance. For example, the state group is projected to reach "equilibrium" in FY 2010. "Equilibrium" represents the point in time when the statutory employer contribution rate equals the required actuarial contribution rate. Also, given the higher statutory rate caps, the statutory and actuarial contribution rates are projected to converge in 2014 for the local group and in 2019 for the school group.

Ms. Beckham noted that as of December 31, 2005, the Retirement System's funded ratio was less than 70 percent and the unfunded actuarial liability was $5.2 billion for all groups (state, school, and local; KP&F; and judges). As anticipated, the unfunded actuarial liability increased $0.409 billion between 2004 and 2005, primarily because the full actuarial contribution rate is not paid for the state, school, and local groups due to statutory caps; changes due to experience; and deferred losses from investment returns in past years. The increase in unfunded actuarial liability totals $4.184 billion from 1994 to 2005, with the largest component of increased cost—$1.348 billion—attributed to not paying the full actuarial contribution amount.

Ms. Beckham concluded that even with recent funding improvements approved by the Legislature, the dollar amount of the unfunded actuarial liability is projected to increase for a number of years before it begins to decline. This is due to the funding methodology selected in 1993, the gap between statutory and actuarial contribution rates for the school and local groups, and the time lag between the calculation and implementation of contribution rates. In addition, because of the asset-smoothing methodology, investment losses deferred from 2001 and 2002 have yet to be fully recognized in future actuarial valuations. Ms. Beckham stressed that any future unfunded actuarial liability increases will be less substantial than they would have been absent the increased caps for annual employer rate increases and issuance of $440 million in pension obligation bonds.

The executive summary of the KPERS actuarial valuation report as of December 31, 2005 was provided for the members of the Committee to review (Attachment 6).

Next, Mr. Deck reported on the retirement plan design review project. He noted that in 2001 and 2002, the actuarial projections indicated the KPERS retirement plan was not in actuarial balance. Following the release of those results, KPERS began working with the Joint Committee and the Governor's Office to develop a long-term funding plan to address the problem. Actuarial changes were made and revisions in the plan design were adopted. Mr. Deck also reported on the historic and projected membership, retirement eligibility trends, and changes in assumptions about general life expectancy (Attachment 7).

The issue of mortality assumptions was addressed by Pat Beckham, Milliman, Inc., who indicated that continued mortality improvements would have a significant impact on KPERS long-term costs (Attachment 8). There have been three revisions since 1993 in the assumptions about mortality to reflect newer retirees living longer and drawing benefits longer.

The plan design project was described by Mr. Deck, with the design objectives to seek financial soundness, retirement benefit adequacy, and workforce retention incentives. Current plan design issues include first year of service, vesting, retirement eligibility, early retirement subsidies, and cost-of-living adjustments (Attachment 9). The Board of Trustees will consider alternatives and make recommendations for consideration at a later meeting.

Chairperson Morris recommended that an employee longevity booster rate for staff with 30 or more years of service be explored as an option to help retain qualified public employees longer in the work force.

Afternoon Session

Carol Foreman, Deputy Secretary of Administration, described the State Deferred Compensation Plan and the Oversight Committee which supervises the plan's operation. Ms. Foreman stated that all state employees are eligible to participate in the Deferred Compensation Plan on a voluntary basis. The goal of the plan is to provide supplemental retirement savings by offering quality investments and professional services at low cost for participants. Ms. Foreman provided information about the operation of the plan (Attachment 10).

Ms. Foreman noted that the contract with the current service provider, ING, expires on December 31, 2007, and that planning was underway to rebid the contract. The last time the contract was placed out for bids was 2002, she reported. In addition, a contract with Segal and Company to provide evaluation services will expire on December 31, 2006. That firm has provided twice-yearly assessments of the investment options included in the State Deferred Compensation Plan. That contract also will be rebid, Ms. Foreman reported.

Chris Biggs, Kansas Securities Commissioner, was asked to appear because of regulatory actions in New Hampshire regarding ING, the firm that is under contract to provide services for the

Kansas plan. Mr. Biggs related that there were serious allegations in New Hampshire. However, after initial review of the ING contract and operation in Kansas, there was no cause for concern at this time, Mr. Biggs noted.

Chairperson Morris noted the dates of September 25-26 for the next meeting.

Prepared by Carol Doel
Edited by Julian Efird

Approved by Committee on:

September 26, 2006
(Date)