MINUTES

JOINT COMMITTEE ON PENSIONS, INVESTMENTS, AND BENEFITS

October 4-5, 2005
Room 519-S—Statehouse

Members Present

Representative John Edmonds, Chairperson
Senator Steve Morris, Vice Chairperson
Senator Anthony Hensley
Senator Laura Kelly
Senator Ruth Teichman
Senator Dwayne Umbarger
Representative Richard Carlson
Representative Geraldine Flaharty
Representative Vaughn Flora
Representative Margaret Long
Representative Bill McCreary
Representative Melvin Neufeld

Staff Present

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

Conferees

Glenn Deck, Executive Director, Kansas Public Employees Retirement System
Rob Woodard, Chief Investment Officer, Kansas Public Employees Retirement System
Patrice Beckham, Milliman Consultants and Actuaries
Richard Cram, Department of Revenue

Tuesday, October 4
Morning Session

Glenn Deck, Executive Director, Kansas Public Employees Retirement System (KPERS), presented an overview of KPERS activities. Mr. Deck related that KPERS' mission is to provide retirement, disability, and survivor benefits to members and their beneficiaries. KPERS administers three statewide, defined benefit plans for most state and local public employees:

- Kansas Public Employees Retirement System for state, school and local workers;
- Kansas Police & Firemen's Retirement System for state and local workers; and
- Kansas Retirement System for Judges for state judges and justices.

KPERS is governed by a nine-member Board of Trustees, with four appointed by the Governor, one by the President of the Senate, one by the Speaker of the House of Representatives, two elected by members, and the State Treasurer who serves *ex officio*. KPERS has 250,000 members, with over half in public school employment.

KPERS manages the investment of $11.5 billion in assets, making KPERS the 104th largest pension fund in the United States. Mr. Deck reviewed the major challenges which are retirement system long-term funding and death and disability program funding.

Mr. Deck discussed the technology improvements recently completed and other projects in process or planned (Attachment 1). In July of 2003, KPERS began a three-phased project to replace and enhance core business information systems with emphasis on risk management and cost containment. Chairperson Edmonds asked that more comprehensive information be presented to the Committee at the November 2005 meeting.

KPERS Investments

Mr. Deck announced that Rob Woodard, Chief Investment Officer of KPERS, who has been on the staff for nine years, has resigned to take a position in the private sector effective October 21, 2005. He will work for Westgate Horizons, a major investment firm in Los Angeles. Mr. Deck announced that Scott Peppard will serve as acting Chief Investment Officer of KPERS and that a nationwide search would be undertaken for a permanent replacement.

Mr. Woodard addressed the Committee regarding KPERS investment performance for the period ending August 31, 2005, pointing out a pie chart which compared the target asset allocation and the actual allocation for a total portfolio of $11.525 billion. Also, Mr. Woodard provided additional charts and information for the various asset allocation components (Attachment 2).

Mr. Woodard noted that the KPERS Board of Trustees adopted a number of changes in the portfolio, including a new category of Global Equity for investments and new target allocations for categories as of March 1, 2005. The asset allocation targets include:

Domestic Equity 31.0 percent
International Equity 18.0 percent
Global Equity 8.0 percent
Fixed Income 19.0 percent
Treasury Inflation Protected Securities (TIPS) 10.0 percent
Real Estate 8.0 percent
Alternative Investments 5.0 percent
Cash Equivalents 1.0 percent

In addition, changes in the managers engaged to assist with KPERS investments were made in conjunction with realigning the portfolio during 2005. New contracts were awarded to Quantitative Management Associates, Payden and Regel, Capital Guardian Global, and Wellington Global. Investment managers not retained included Lazard Freres Asset Management and Alliance Capital Management. The KPERS Board of Trustees contracts with 14 management firms to manage 20 different sectors of the KPERS portfolio.

Mr. Woodard also presented the Committee with an estimated and unaudited interim investment report as of September 30, 2005 showing a total portfolio value of $11,638,103,577 and calendar year-to-date earnings of 6.9 percent (Attachment 3).

Afternoon Session

Patrice A. Beckham, Milliman Consultants and Actuaries, provided the Committee with the results of the December 31, 2004, actuarial valuation results. She explained that the purpose of the actuarial valuation was an “annual check-up” for the retirement system. In that process, the assets and liabilities are compared in the determination of the financial health of the system. Ms. Beckham explained that the steps in the process are to take the current benefit structure and try to estimate future benefit payments, then compare the liabilities with the assets. Actuarial assumptions are used to try to estimate the future benefit payments. Ms. Beckham provided the Committee with summary materials depicting the various aspects of the valuation (Attachment 4). Also Ms. Beckham provided a complete copy of the Kansas Public Employees Retirement System Valuation Report as of December 31, 2004 (Attachment 5).

Ms. Beckham reported that the total unfunded actuarial liability for all KPERS plans increased $1.2 billion, from $3.586 billion on December 31, 2003, to $4.743 billion on December 31, 2004. The funded ratio for all plans, a more meaningful measure of the health of a retirement plan according to the actuary, decreased from 75 percent to 70 percent over the same one-year period.

The KPERS state and school portion of the unfunded actuarial liability, Ms. Beckham explained, was divided into separate components for each group as a result of 2004 legislation that requires a separate actuarial valuation for each group – state, school, and local. The December 31, 2004, unfunded actuarial liability for the state group was $433 million, the amount for the school group was $3.151 billion, and the amount for the local group was $824 million. The funded ratio for the state group was 85 percent, the ratio for the school group was 63 percent, and the ratio for the local group was 67 percent.

In conclusion, Ms. Beckham stressed that the three largest KPERS groups (state, school, and local) should reach actuarial balance before 2033. Projections suggest that as a result of the major steps taken over the past three years to enhance long-range funding, coupled with strong investment returns, the funding outlook has improved dramatically.

State Corrections Officers

Next, Mr. Deck presented a report on employer rate increases for the state correctional officers group. Mr. Deck noted the earlier ages at which correctional officers could retire and noted the Budget Director's concerns about the $1.5 million impact attributed to the correctional officers group rate increase in the state's FY 2007 budget (Attachment 6).

Local Corrections Officers

Chairperson Edmonds requested a briefing on 2005 HB 2293 which is a local corrections officer bill (Attachment 7). Mr. Deck indicated the bill would allow local units of government to affiliate for coverage that would provide the same retirement provisions for local corrections officers to retire at earlier ages with unreduced retirement, and that was modeled after the special benefits of the state correctional officers group. The estimated fiscal impact of 2005 HB 2293 would be an increase in actuarial liability of $1.9 million for local governments.

Long-Term KPERS Funding

The subject of KPERS long-term funding was discussed by Mr. Deck, who gave an overview of the state, school, and local groups' employer contributions, current funding projections, and the impact of investment volatility on the projections (Attachment 8). Mr. Deck stressed that the KPERS actuary concluded the three largest KPERS groups (state, school, and local) should reach actuarial balance before 2033. Projections suggest that as a result of the recent major steps taken in long-range funding, coupled with strong investment returns, the funding outlook has improved dramatically in the past three years.

Alternative Retirement Plan Design

The next subject was alternative retirement plan designs and 2005 SB 281, which was introduced by the Committee after studying the topic during the 2004 Interim. Material was presented by Mr. Deck who explained that the Committee had requested an alternative retirement plan design to help reduce long-term employer costs (Attachment 9). In 2004, various alternatives were presented. An alternative retirement plan bill was recommended for introduction in 2005 as SB 281, which provides a basic defined benefit plan along with an optional defined contribution component. This legislation would only apply to new employees hired after July 1, 2007. A copy of a Senate Subcommittee Report on 2005 SB 281 was provided for Committee review (Attachment 10). Changes recommended in the subcommittee report would make the optional defined contribution component into a mandatory part of the new plan with participants contributing at a level of 2.0 percent, with a 0.5 percent employer match; the 90-point rule would apply to correctional officers; interest earnings for employee contributions would be linked to the one-year Treasury bill rate with a 4.0 percent cap; and early retirement would continue to receive a partial, but reduced subsidy for employees with 20 or more years of service. None of these amendments was adopted during the 2005 Session and the bill as introduced remains in the Senate Ways and Means Committee for the 2006 Session.

The revised fiscal note for 2005 SB 281, with amendments recommended in the subcommittee report, is based on comparing the estimated long-term cost of the existing KPERS plan design with the proposed new plan design, along with the costs of the current KPERS plan that will be closed to new members but remain in effect for those public employees already covered by its provisions as of June 30, 2007.

The proposed new plan, combined with the current KPERS plan, is expected to reduce employer contributions for the state and school groups from $17.012 billion to $15.582 billion and for the local group from $4.529 billion to $4.063 billion over the period to 2033 as new hires participate in the proposed new plan and the other employees covered by the existing plan continue under that plan's provisions until they retire or leave covered employment. The estimated employer savings for the state and school groups is $1.43 billion, and for the local group $466 million by implementing the new plan, compared with continuing the current KPERS plan absent any changes. The present value of savings is estimated to be $525 million for state and local governments.

Members of the Committee discussed the possibility of making 2005 SB 281 apply only to the KPERS school group. The bill carried over from last session in the Senate Ways and Means Committee, available for consideration during the 2006 Legislature.

Wednesday, October 5
Morning Session

Richard Cram, Department of Revenue, reported on the general tax treatment of contributions and distributions of state employees (Attachment 11). Mr. Cram explained information about the tax status of different payments (employee contributions and retiree benefits) associated with two Kansas-based retirement plans, KPERS and the Regents retirement plan. KPERS generally is available for all state employees, both classified and unclassified, unless otherwise provided by statute. In the case of unclassified employees at Regents institutions and other facilities under the State Board of Regents, a separate statutory retirement plan is authorized.

KPERS employees generally make contributions based on 4.0 percent of pay and Regents unclassified employees make contributions based on 5.5 percent of pay. State employees covered by other KPERS plans, including public safety officers, judges, and justices, make contributions based on separate group rates higher than 4.0 percent. KPERS is a defined benefit plan and the Regents retirement plan is a defined contribution plan, with retirement benefits paid to retired members according to plan provisions of each. A summary of the tax status for state employees covered by each plan follows, with the statutory or other citation of authority pertaining to contributions and to benefit payments:

KPERS Plans (including KP&F and Judges)
Contributions Taxed KSA 79-32,117(b)
Benefits Not Taxed KSA 74-4923(b)

Regents Plan
Contributions Not Taxed KSA 74-4925
Benefits Not Taxed Rev. Ruling 12-88-1

Under current state law, KPERS employee contributions are taxed, but Regents unclassified employee contributions are not taxed. Benefits are tax exempt for both KPERS retirees and Regents unclassified retirees. In the case of the Regents retirement plan, Revenue Ruling 12-88-1 cites KSA 74-4923(b) as the nexus for the exemption. The fiscal note for eliminating the KPERS employee contributions add-back to the adjusted federal gross income by state and local employees for computing state income tax liability is estimated at $11 million annually by the Department of Revenue. No fiscal note was available for the amount of taxes associated with requiring Regents unclassified employees' contributions to be treated as an add-back to federally adjusted gross income. Chairperson Edmonds requested the agency provide a fiscal note at the next meeting.

In addition to information about contributions and benefits, Mr. Cram also provided two recent agency notices regarding the tax treatment of other types of payments: namely, distributions in the form of direct one-time payments, monthly payments, and roll-over payments. Basically, the same information is contained in KPERS Notice 05-04 and Regents Retirement Notice 05-05. Generally, the agency indicates that in order to qualify for an exemption from Kansas income tax, payments received by a KPERS or Regents retirement plan participant must be:

- Received directly from KPERS or from companies authorized by the State Board of Regents to be plan sponsors; and

- Included in the member's federally adjusted gross income in the year that it is received.

Mr. Cram indicated that the notices conclude that any payments, that are not included in the member's federally adjusted gross income in the year of receipt, and that are not received either from KPERS or a Regents retirement plan sponsor company, are not exempt.

KPERS Technical Amendments

Next, Mr. Deck provided a copy of proposed technical amendments requested by the KPERS Board of Trustees to be introduced for the 2006 Legislature (Attachment 12). The subject matter is largely technical and is not considered to be of a controversial nature. The first change would correct terminology describing certain KP&F members in tier II. The second change would clarify statutory language in naming a beneficiary. The third change would make the cost calculation for service purchases reflect the actual cost of buying years of credit.

Death and Disability Plan Update

Mr. Deck presented a report on death and disability plan funding and plan design changes (Attachment 13). The Legislature passed 2005 Senate Substitute for HB 2037 which included changes in the contribution rate, loan provisions in case of cash flow deficits, and authorized plan design changes. Mr. Deck reported that KPERS is currently in the process of implementing the modified disability plan design that will be effective on January 1, 2006.

The Death and Long-Term Disability Benefits Fund, which is separate from the KPERS Trust Fund, provides death and disability benefits for active KPERS members and unclassified staff at Regents institutions. Recent contribution moratoriums 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, 2005, the fund's assets were valued at $13.9 million. The fund balance is estimated by the end of FY 2006 to decrease to $5.7 million on June 30, 2006, then to begin rising to $8.8 million on June 30, 2007, due to rate increases in employer contributions over two years.

2005 Senate Substitute for HB 2037 was enacted and signed by the Governor, with one section of the bill modifying the KPERS death and disability plan and finances. The legislation increases the statutory employer contribution rate of 0.6 percent to 0.8 percent on July 1, 2005, and to 1.0 percent on July 1, 2006. It also allows borrowing from the Pooled Money Investment Board if the funds are not sufficient to meet a catastrophic event. The rate change increases the participating employer payments for the state, Regents, judges, school, and local groups that participate in the death and long-term disability benefits plan offered by KPERS. Additional authority is delegated to the KPERS Board of Trustees to make changes in plan design to operate the program within available financial resources and statutory guidelines as modified by this bill. The net impact of the legislation is to guarantee no reduction in benefits for eligible employees disabled prior to January 1, 2006. After passage of the bill, it was anticipated that the KPERS Board of Trustees would modify the plan and reduce the disability benefit from 66⅔ percent to 60 percent of compensation. Subsequently, the KPERS Board of Trustees did adopt anticipated changes in plan design and reduced the disability benefit to 60 percent of compensation for persons becoming disabled after January 1, 2006. The legislation also maintains participating employer-provided basic life insurance at 150 percent of annual compensation.

Working After Retirement

A summary of information on the KPERS earnings limitation and the issue of working after retirement was presented by Mr. Deck (Attachment 14). Generally, annual compensation of retired KPERS members returning to work for their previous employer is statutorily limited to $15,000 and they have two options when that limit is reached. They can either stop working and continue receiving retirement benefits, or if they continue working, KPERS will suspend their retirement benefits until the end of the calendar year. There are certain types of employees not subject to limitation, such as teachers and certain legislative staff. A new three-year exemption applies to licensed professional and licensed practical nurses employed by certain state institutions.

Mr. Deck also presented information about the cost impact of changes to the earnings limitation and he stressed the need to accurately estimate the potential impact on KPERS financial condition if changes are made. The largest KPERS group includes school district employees. KPERS was asked how many of those KPERS school members were eligible for retirement, but who had not retired when eligible and who might be motivated to retire if the salary cap were removed. The results of the most recent KPERS Three-Year Actuarial Experience study showed the following aggregate experience for members of the school group who were eligible for unreduced retirement:

- In 2003, 6,213 were eligible for retirement and 1,374, or 22 percent, actually retired;
- In 2002, 5,674 were eligible for retirement and 1,183, or 21 percent, actually retired; and
- In 2001, 4,894 were eligible for retirement and 752, or 15 percent, actually retired.

Mr. Deck indicated that the complete removal of the earnings limit is likely to motivate some number of members to retire and return to work for their current employer after the 30-day waiting period. The KPERS actuary and KPERS staff have had difficulty in estimating how many members might return to work if the annual salary cap were either removed or raised to a higher limit. The $15,000 salary cap does not apply if a school employee retires from one district and goes to work after 30 days for another school district or some other KPERS employer, such as the state or local unit of government.

School District Early Retirement Plans

Kansas Legislative Research Department staff presented a memorandum on school district early retirement incentive plans (ERIPs) for school district employees, including administrative, other certified, and non-certified personnel (Attachment 15).

KSA 72-5395 authorizes school district boards of education to establish early retirement incentive programs, known as ERIPs, for school district employees, including administrative, other certified, and non-certified personnel. Enabling legislation originally was passed in 1980. These plans may be used to supplement the regular KPERS retirement benefits with additional benefits for school district employees. Such plans originally were intended to assist anyone retiring before age 65 eligibility for Social Security and Medicare benefits in providing a financial supplement in addition to KPERS benefits until federal benefits were available. Because of age discrimination issues and Attorney General's Opinion No. 99-14, the 1999 Legislature deleted the statutorily stated purpose of reducing the penalty under the Federal Insurance Contributions Act (FICA) for retiring prior to age 65.

During the 1990s, after the 1993 Legislature passed pension benefits enhancing legislation for KPERS members and retirees, questions confronted the Legislature about the school districts' ERIPs encouraging additional retirements under the newly enacted 85-point KPERS option. After a series of post audit studies, actuarial audits of school district plans, KPERS actuarial valuations and experience studies, and interim legislative studies that concluded a higher number of school district personnel were retiring earlier than anticipated in the fiscal note for the 1993 KPERS benefit enhancements, the 2002 Legislature mandated a budget report for ERIPs every three years to be reviewed by this Committee.

A report for school year 2004-2005 was transmitted from the State Department of Education for review. In the report, there were 172 school districts with ERIPs (and 130 without plans). The reported actual costs for the 2003-2004 school year were almost $25.8 million in FY 2004 for annual benefits paid to 2,746 former employees of the school districts who had retired from KPERS and were eligible for ERIP benefits. The 2004-2005 estimated budget costs were almost $27.8 million in FY 2005, increasing to an FY 2009 estimated $29.8 million during the 2008-2009 school year.

ERIP benefits for participants who have retired include health insurance, cash payments, and other kinds not specified. The 2004-2005 report also notes the number of employees who were eligible for KPERS retirement and the ERIP benefits on July 1, 2004, but who chose not to retire (and were not ERIP participants). There were 2,259 additional eligible employees for whom ERIP benefits could have been paid in school year 2004-2005 if they had retired. Had those eligible employees retired and benefits been paid, the FY 2005 budgeted ERIP costs could have exceeded $45.0 million.

Special Resolution

Staff from the Office of the Revisor of Statutes read a resolution by the Joint Committee on Pensions, Investments, and Benefits commending Robert Woodard, Chief Investment Officer for KPERS for exceptional service to the State of Kansas (Attachment 16).

Senator Morris made a motion to adopt the resolution. Motion was seconded by Representative Flaherty. Resolution adopted.

State Corrections Officers

Senator Morris made a motion for a bill introduction to add an annual statutory cap to apply to the state Correctional Officer Group's rate in the same manner that an annual cap applies to the state group as a whole. Motion was seconded by Representative Flora. Motion adopted.

KPERS Technical Amendments

Senator Hensley made a motion to introduce a bill with three technical amendments requested by the KPERS Board of Trustees. Representative Flora seconded the motion. Motion adopted.

Chairperson Edmonds asked that the two bills be brought back to the Committee's next meeting for further review of the drafts approved for introduction.

The next Committee meeting will be November 28-29, 2005.

Prepared by Carol Doel
Edited by Julian Efird

Approved by Committee on:

November 28, 2005
(date)