Approved: January 28, 2011

MINUTES OF THE HOUSE PENSIONS & BENEFITS COMMITTEE

The meeting was called to order by Chairman Mitch Holmes at 9:03 a.m. on January 12, 2011, in Room 142-S of the Capitol.

All members were present except:
Representative Louis Ruiz - Excused

Committee staff present:
Gordon Self, Office of the Revisor of Statutes
David Wiese, Office of the Revisor of Statutes
Julian Efird, Kansas Legislative Research Department
Michael Steiner, Kansas Legislative Research Department
Darla Conner, Committee Assistant

Conferees appearing before the Committee:
Glenn Deck, Executive Director of KPERS

Others attending:
See attached list.

Chairman Holmes asked the members of the committee to introduce themselves. He introduced the staff.

Julian Efird, Kansas Legislative Research Department, (Attachment 1), gave an overview and brief history of KPERS.

Glenn Deck, Executive Director of KPERS, (Attachment 2), gave a presentation on KPERS Long-Term Funding.

The next meeting is scheduled for January 19, 2011.

The meeting was adjourned at 10:33 a.m.

HOUSE PENSIONS & BENEFITS COMMITTEE GUEST LIST

DATE: January 12, 2011

NAME	REPRESENTING
Paje Routhier	Hein Law Firm
Tom Krah	KASB
Glenn Deck	KPERS
Faith Loretto	"
Dennis Phillips	KSCFF
Ed Redmon	KSCFF
TERRY FORSYTH	KNEA
Diane Gjerstad	Wichita Public Schools

Julian Efird

Kansas Legislator Briefing Book 2011

Kansas Legislative Research Department

Retirement

Julian Efird,
Principal Analyst
785-296-3181
Julian.Efird@klrd.ks.gov

Retirement

U-1 Kansas Public Employees Retirement System

KPERS Overview and Brief History

The Kansas Public Employees Retirement System (known as KPERS and referenced in this document as the Retirement System) administers three statewide plans. The largest plan, usually referred to as the regular KPERS plan, or just as KPERS, has two tiers that include state, school and local groups composed of regular state and local public employees; school district, vocational school and community college employees; Regents classified employees and certain Regents unclassified staff with pre-1962 service; and state correctional officers. A second plan is known as the Kansas Police and Firemen's (KP&F) Retirement System for certain designated state and local public safety employees. A third plan is known as the Kansas Retirement System for Judges that includes the state's judicial system judges and justices. All coverage groups are defined benefit, contributory retirement plans and have as members most public employees in Kansas.

The primary purpose of the Retirement System is to accumulate sufficient resources in order to pay benefits. Retirement and death benefits paid by the Retirement System are considered off-budget expenses. In FY 2000, the Governor recommended and the Legislature approved making retirement benefit payments non-reportable expenditures. Since the retirement benefit payments represent a substantial amount of money distributed annually to retirees and their beneficiaries, the historical accounting of assistance paid is presented for informational purposes. Total benefits paid in FY 2000 exceeded $500.0 million for the first time. Today more than $1.0 billion is paid in annual retirement and death benefits.

The number of Retirement System members increased from 156,073 in 2008 to 160,831 in 2009. The market value of assets increased from $9.9 billion on December 31, 2008, to $11.8 billion the end of the next year. There were $747 million in employer and member contributions, $1.1 billion in benefit payments and expenses, and $2.2 billion of investment income.

House Pensions & Benefits
Date: 1/12/2011
Attachment # 1

In order to pay the future retirement benefits, the Retirement System will be required to provide total funding of $21.1 billion in order to meet the accrued actuarial liability, based on the December 31, 2009, actuarial valuation. Total actuarially-valued assets available to pay future benefits totaled $13.5 billion, according to the actuarial valuation. The gap between assets and funding available is known as the unfunded actuarial liability, which amounts to $7.7 billion in the most recent actuarial valuation report.

The Retirement System also administers several other employee benefit and retirement programs: a public employee death and long-term disability benefits plan; an optional term life insurance program; and a legislative session-only employees retirement program. The Legislature has assigned other duties to the agency in managing investments of moneys from three state funds: the Kansas Endowment for Youth Fund, the Senior Services Trust Fund, and the Treasurer's Unclaimed Property Fund.

A nine-member Board of Trustees is the governing body for the Retirement System. Four members are appointed by the Governor and confirmed by the Senate. One member is appointed by the President of the Senate. One member is appointed by the Speaker of the House. Two members are elected by System members. One member is the State Treasurer. The Board appoints the Executive Director who administers the agency operations for the Board.

The Retirement System manages assets in excess of $11.8 billion. Annually, the Retirement System pays out more in retirement benefits than it collects in employer and employee contributions. The gap between current expenditures and current revenues is made up with funding from investments and earnings. The financial health of the Retirement System may be measured by its funded ratio, or the relationship between the promised benefits and the resources available to pay those promised benefits. In the most recent actuarial valuation, the funded ratio for the Retirement System was 64.0 percent. Using market value for assets, the funded ratio is 56.0 percent. Using market-based data, the unfunded liability was $9.4 billion on December 31, 2009. This is the amount of financing shortfall when comparing the Retirement System assets with promised retirement benefits. The actuarial unfunded liability of $7.7 billion, did not reflect all of the investment losses.

Brief History of KPERS

The Kansas Public Employees Retirement System (KPERS) was created by the 1961 Legislature, with an effective date of January 1, 1962. Membership in the original KPERS retirement plan (now referred to as KPERS Tier I) was offered to state and local public employees qualified under the new law and whose participating employers chose to affiliate with KPERS. Another KPERS tier was created in 2007 for future state, school and local public employees. The new KPERS Tier II has many characteristics of the original plan, but with certain modifications to ensure that employees and employers will share in the total cost of providing benefits. The new KPERS tier is described in the last section of this document. Most of this document focuses on the original first tier of KPERS and the history of that plan for state, school and local public employees. Information about other public plans for the judicial branch and public safety personnel is presented in another background document in this publication. A separate document on defined contribution plans discusses the retirement offering for some Regents state employees. The 1961 Legislature, in addition to establishing KPERS, also created the Board of Regents Annuity Assistance Program for another smaller group of state employees, originally administrators and faculty members who are unclassified staff at state universities and colleges.

After the 1961 Legislature established the two retirement plans for state employees, membership in KPERS was granted to all state employees on January 1, 1962, who participated in Social Security and who were not eligible to participate in any other state retirement plan (namely, the Regents annuity program, the state retirement plan for district court judges and Supreme Court justices, a court reporter retirement plan, and two different state law enforcement plans at the Kansas Highway Patrol and Kansas Bureau of Investigation). In addition, local public employees were eligible for original KPERS membership on January 1, 1962, if they participated in Social Security and if the local governing body passed a resolution for affiliation with KPERS. Local governing bodies were defined to include any city, county or township, or any special district and instrumentality of the State of Kansas and of any city, county or township.

KPERS was established as a defined benefit plan in which membership was extended to most state employees at state agencies and classified employees at Regents institutions, and to many local public employees at entities whose governing body chose to affiliate. Regents unclassified staff could participate in the separate defined contribution (annuity) plan. During the first year, 39 counties, 52 cities, 64 county boards of social welfare, and 28 special districts and other local entities initially affiliated with KPERS on January 1, 1962. The focus of this history of KPERS will trace the developments relative to the state, local and school groups that affiliated and with the changes in the KPERS retirement law as a defined contribution plan. A separate document on state defined contribution plans also is available for information about the Regents plan and another defined contribution plan that subsequently were offered to a limited number of statutorily designated state employees as an alternative to the KPERS plan.

Membership in KPERS totaled 24,278 members on June 30, 1962, after the plan opened on January 1, 1962. State government employees who became KPERS members totaled 16,552 and local government employees whose employers affiliated with KPERS totaled 7,726. A total of 2,437 state and local government employees attained retirement age by June 30, 1962. A 1962 KPERS Annual Report indicated that 1,098 applications for retirement benefits were processed prior to June 30, 1962, since July 1, 1962, was the first date that anyone could retire under the new KPERS plan, and that those retirees received the first retirement benefits the next month.

In 1963, affiliation with KPERS increased by 61 additional entities that were determined by the Board of Trustees as eligible to affiliate. Among the additional entities joining the original group, which consisted of the State of Kansas and 183 units of local government, there were another 16 cities, nine counties, four boards of social welfare, nine library boards, six townships, three school districts, five agricultural extension councils, two cemetery districts, one board of health, and the Kansas League of Municipalities. Provision also was made in 1963 for the Kansas Turnpike Authority to affiliate with KPERS as a local government unit.

School districts generally were not authorized to affiliate with KPERS until the 1970s, but there were three affiliating in 1963 as the first exceptions to the general rule: the Corning Joint Rural High School 6 NP, Corning Joint School District 44 NP, and L'Dora School District 55. Two more school districts affiliated in 1966, the Frontenac Board of Education School District #47 and Frontenac USD #249. Later in 1966, four of the five school districts which had affiliated with KPERS were dissolved by the Legislature effective on July 1, 1966, and only the Frontenac USD #249 maintained KPERS affiliation until the general merger into KPERS of the principal school retirement group in 1971. No other school districts became affiliated with KPERS until January 1, 1971, when a general law became effective that brought the old State School Retirement System (SSRS) and its individual members into KPERS.

The 1970 Legislature authorized affiliation with KPERS on January 1, 1971, for any public school district, area vocational-technical school, community college, and state agency which employed teachers, provided the entity had employees who were members in the SSRS that originally had been created in

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1941. The 1970 legislation also provided for a transfer of all assets from the SSRS to KPERS, and for control of SSRS to be vested in the KPERS Board of Trustees. After September 1, 1971, no school employee was able to participate in SSRS, although the SSRS enabling legislation (KSA 72-5501 *et seq.*) was preserved in order for promised benefits to be paid as annuities. However, a number of individual school districts maintained their own retirement systems in 1971, but gradually they, too, were merged into KPERS in subsequent years.

In 1973 legislation, members of the Legislature were authorized to join KPERS. Other public officials and officers not addressed in the original 1961 legislation had been authorized, beginning in 1963, to participate in KPERS as the result of a series of statutory amendments to KSA 74-4910 *et seq.* that broaden participation to include groups defined as public rather than governmental exclusively. Amendments to KSA 74-4901 also broadened the definition of which governmental officials and officers were eligible for KPERS membership.

In other statutory changes, certain state officials, beginning in 1988, as defined in KSA 74-4911f, were allowed to opt out of KPERS and to participate in a defined contribution plan (the plan originally allowed voluntary participation by all state employees and was known as the Kansas Deferred Compensation Program). The special state officer retirement plan, in which the state pays an 8.0 percent contribution on behalf of the eligible members, allows participants to have individual, self-directed retirement savings accounts. The member may contribute to the account, but no one is required to pay a matching amount after the state pays an 8.0 percent contribution to the account.

Calculation of Retirement Benefits and Eligibility for KPERS

KPERS retirement benefits are calculated by a formula based on years of credited service multiplied by a statutory percentage for the type of service credit multiplied by final average salary. The original legislation distinguished between different types of credited service with different values to be used in calculating retirement benefits. For credited service, two categories were defined in the 1961 KPERS legislation: participating service which was equal to 1.0 percent of defined salary for each year, and prior service which was equal to 0.5 percent of defined salary for each year. In 1965 legislation, the prior service multiplier was raised to 0.75 percent. In 1968 legislation, the prior service multiplier was raised to 1.0 percent, and the participating service multiplier was increased that year to 1.25 percent for all years of service. Participating service was further defined as future continuous employment with a participating employer after affiliation with KPERS and prior service with previous continuous service with a participating employer before affiliation with KPERS. In 1970 legislation, participating service for school employees was set as the same as for other regular KPERS members which was1.25 percent at that time. The prior service multiplier for education employees was set at 1.0 percent for years under the SSRS and 0.75 percent for years of school service which were not credited under the SSRS.

In 1982 legislation, the participating service credit for state, school and local KPERS members was increased from 1.25 percent to 1.4 percent of final average salary for all participating service credited after July 1, 1982. An actuarial reduction for early retirement of 0.3 percent was extended to July 1, 1987. In 1984 legislation, the 0.3 percent actuarial reduction factor was made permanent. Also in 1984 legislation, KPERS members who retired on or after July 1, 1989, with at least 25 years of participating service would have all participating service based on the 1.4 multiplier, while other members would have their benefit based on a 1.25 percent multiplier for participating service through June 30, 1982. In 1985 legislation, the 1.4 percent multiplier for participating service was allowed for all who retired on and after July 1, 1988, with 10 or more years of service, and for prior service, benefits would be based on final average salary effective January 1, 1986.

In 1987 legislation, the Legislature increased the multiplier to 1.5 percent of final average salary for all individuals who retired on or after August 1, 1987, with at least 35 years of service. In 1989 legislation, a 1988 provision was made permanent that allowed normal retirement with 40 years of service or completion of 35 years of service and attainment of age 60.

In 1993 legislation, the multiplier was raised to 1.75 percent for all years participating service for members who retired on or after July 1, 1993. Three different qualifications for normal retirement were established: age 65; age 62 with 10 years of service; and 85 points (any combination of age plus years of service).

Other Factors Determining Retirement Benefits

In 1961 KPERS legislation, participating service defined salary was capped at a maximum of $10,000 for final average salary during those credited years and prior service defined salary would be capped at $6,000 for prior service average salary during those credited years. Employee contributions also were based on the original 1961 $10,000 cap. In 1967 legislation, the statutory caps for computing employee contributions and final average salary were eliminated. In 1981 legislation, the use of prior service average salary in calculating benefits was eliminated, and final average salary was cited in the new law. In addition, the actuarial reduction of 0.6 percent used to calculated early retirement benefits was replaced with 0.3 percent between July 1, 1981, and July 1, 1984.

In 1961 KPERS legislation, determining the number of years of credited service, whether participating or prior service, a fractional year of six months or more would be counted as one year, and a fractional year of less than six months of credited service would be disregarded. Normal retirement date was defined as the first day of the month coinciding with or following attainment of age 65, and at least six months after the entry date of the employer. Early retirement with actuarial reduction was defined as either the first day of the month following attainment of age 60, or completion of 10 years of credited service, whichever occurred later.

Over the years, the Legislature authorized various purchases of other types of service credit to be treated as prior or participating service credit for calculating KPERS retirement benefits. The different types of service credit purchases would augment the years of service calculation in determining monthly benefits.

Contribution Rates for KPERS

KPERS is a participatory plan in which both the employee and employer make contributions. In 1961 KPERS legislation, employee contributions were statutorily set at 4.0 percent of the first $10,000 in total annual compensation. The $10,000 cap was eliminated by 1967 legislation.

In 1961 KPERS legislation, initial employer contributions were statutorily set at 4.35 percent (3.75 percent for retirement benefits and 0.6 percent for death and disability benefits) of total compensation of employees for the first year, with future employer contribution rates to be set by the KPERS Board of Trustees, assisted by an actuary and following statutory guidelines. The KPERS Board of Trustees engaged Martin E. Segal & Company as actuarial consultants.

In 1970, the employer contribution rate for public education employers was set at 5.05 percent from January 1, 1971 to June 30, 1972, with subsequent employer contribution rates to be set by the

KPERS Board of Trustees. In 1981 legislation, the Legislature reset the 40-year amortization period for KPERS until December 31, 2022, and accelerated a reduction in the employer contribution rates in FY 1982 to 4.3 percent for state and local units of government (KPERS nonschool), and to 3.3 percent for education units of government (KPERS school).

During the 1980s, the Legislature reset the actuarial contribution rates for employers on numerous occasions in statutory provisions. In 1988 legislation, the Legislature established two employer contribution rates, one for the state and schools and one for the local units of government. Previously, the state and local employer rate had been combined as the KPERS nonschool group. The amortization period for the combined state and school group was extended from 15 to 24 years, with employer contribution rates set at 3.1 percent for the state and 2.0 percent for the local employers in FY 1990.

The 1993 legislation introduced the statutory budget caps that would limit the amount of annual increase for employer contributions. The 1993 legislation provided a 25.0 percent increase in retirement benefits for those who retired on and after July 1, 1993, and an average 15.0 percent increase in retirement benefits for those who retired before July 1, 1993. In order to finance the increased benefits, the Legislature anticipated phasing-in higher employer contributions by originally setting a 0.1 percent annual cap on budget increases. It was anticipated that the budget caps would allow the employer contributions to reach the actuarial rates in about seven years. The gap between the statutory rates and the actuarial rates that began in the FY 1995 budget year has never been closed, and the Legislature has modified the annual cap to its present level of 0.6 percent in an effort to close the gap.

The failure of employers to contribute at the actuarial rate since 1993 has contributed to the long-term funding problem. Other problems, such as investment losses, also have contributed to the shortfall in funding.

Retirement Benefits and Adjustments

The original 1961 KPERS legislation provided for the nonalienation of benefits. The KPERS act stated that: "No alteration, amendment, or repeal of this act shall affect the then existing rights of members and beneficiaries, but shall be effective only as to rights which would otherwise accrue hereunder as a result of services rendered by an employee after such alteration, amendment, or repeal." This provision is found in KSA 74-4923 and further clarified in that statute by the following statement: "This subsection shall not apply to any alteration or amendment of this act which provides greater benefits to members or beneficiaries, but any increase of benefits shall only be applicable to benefits payable on the first day of the month coinciding with or following the effective date of the alteration or amendment."

The KPERS retirement benefits were exempted in 1961 legislation from all state and local taxation. The original enacting legislation, found in KSA 74-4923, also declared that "No alteration, amendment, or repeal of this act shall affect the then existing rights of members and beneficiaries, but shall be effective only as to rights which would otherwise accrue hereunder as a result of services rendered by an employee after such alteration, amendment, or repeal." In other words, no taxes shall be assessed and no retroactive reduction of promised benefits may be enacted. Any change in benefits must be prospective, unless it involves a benefit increase which may be retroactive in application, as in the case of increasing the multiplier for all years of service credit.

In 1972 legislation, the Legislature provided for the first cost-of-living adjustment (COLA) to KPERS retirees by increasing benefits by 5.0 percent for anyone who had retired on or before June 30,

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1971. The cost of providing such funding was to be included in the next annual actuarial valuation, as provided in the 1972 legislation. Over the years the Legislature provide additional ad hoc post-retirement benefit adjustments for retirees and their beneficiaries. No automatic COLA was authorized until the new KPERS Tier II was established in 2007 for future KPERS members as described in the last section of this document.

Special and Shared Funding for KPERS

Special funding was authorized by the Legislature after the school group that had membership in the SSRS was merged into KPERS. In 1972 legislation, the Legislature authorized a transfer of $5.0 million on July 1, 1972, from the State General Fund to KPERS for payment of school annuities, noting in the legislation that authorized subsequent transfers for school service annuities would be amortized over 11 years through annual payments for the SSRS annuities authorized by KSA 72-5501 *et seq.* In 1973 legislation, the annual transfer was increased to $10.22 million on July 1, 1973, and $10.0 million for subsequent fiscal years. In 1984 legislation, the transfers were cancelled and the remaining obligation for SSRS annuities was added to the KPERS unfunded actuarial liability and that obligation was to be amortized over 27 years through state employer payments.

In 1977 legislation, the Legislature included a preamble to HB 2041 that stated: "Whereas, It is the intent of the Legislature of the State of Kansas that the participating service costs of the Kansas Public Employees Retirement System shall be shared equally by employers and employees; and Whereas, It is also the intent of the Legislature of the State of Kansas that the costs of all benefit increases and other changes in the Kansas Public Employees Retirement System affecting active members shall be shared equally by employers and employees."

Section 1 of HB 2041(Chapter 276 of the 1977 Sessions Laws of Kansas) became KSA 74-4920 without the preamble being included in the statute. The new section addressed only the setting of employer contributions and the amortization period of not to exceed 40 years. The employee contribution rate of 4.0 percent established in the 1961 legislation was never changed by the Legislature until 2007 when Tier II members were increased to a 6.0 percent rate to help pay for an automatic COLA. KPERS Tier I members remained at the original 4.0 percent level, and even when significant benefit enhancements were approved in 1993, no change was contemplated in the employer contribution rate.

In order to partially address the long-term funding issue, the 2003 Legislature authorized the issuance of up to $500 million in pension obligation bonds for the reduction of the KPERS unfunded actuarial liability. The State of Kansas assumed the responsibility of repaying the principal and interest on the 30-year bonds that were issued in 2004. Annual payments average $36 million per year from the State General Fund for the debt service on the bonds. KPERS invested most of the net bond proceeds totaling approximately $440 million and the balance of the $500 million was used for bond issuance costs and debt service in the first three years of repayments (in order to avoid paying the costs out of the State General Fund).

New KPERS Tier for Future Members

In 2007 legislation, a new tier for KPERS state, school and local employees was established, effective July 1, 2009, and with the existing KPERS members becoming a "frozen" tier that no new members could join. The employee contribution rate for the "frozen" KPERS Tier I remained set at 4.0 percent.

The new KPERS Tier II for employees hired on or after July 1, 2009, continued the 1.75 percent multiplier; allowed normal retirement at age 65 with five years of service, or at age 60 with at least 30 years of service; provided for early retirement at age 55 with at least 10 years of service and an actuarial reduction in benefits; included an automatic, annual 2.0 percent cost-of-living adjustment at age 65 and older; and required an employee contribution rate of 6.0 percent.

The 2007 legislation in KSA 74-49,212 stated that "the legislature reserves the right to adjust the employee rate of contribution prescribed in KSA 74-49,210, and amendments thereto, to allow participating employers and employees to share equally any additional contribution rate actuarially required to fund the system."

Sources: Summary of Legislation, Kansas Legislative Research Department, 1961-2010.
Annual Reports, Kansas Public Employees Retirement System, 1962-2009.

For more information, please contact:

Julian Efird, Principal Analyst
Julian.Efird@klrd.ks.gov

Alan Conroy, Director
Alan.Conroy@klrd.ks.gov

Michael Steiner, Senior Fiscal Analyst
Michael.Steiner@klrd.ks.gov

Kansas Legislative Research Department
300 SW 10th Ave., Room 68-West, Statehouse
Topeka, Kansas 66612
Phone: (785) 296-3181
Fax: (785) 296-3824

House Pensions & Benefits
Date: 1/12/2011
Attachment # 2

Kansas Public Employees
Retirement System

KPERS Long-Term Funding

House Pensions and Benefits Committee January 12, 2011

KPERS OVERVIEW

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KPERS' mission is to provide retirement, disability and survivor benefits to our members and their beneficiaries.

Administer three statewide, defined benefit plans for public employees.

- Kansas Public Employees Retirement System
- Kansas Police & Firemen's Retirement System
- Kansas Retirement System for Judges

Partner with 1,499 state and local government employers.

- State of Kansas
- 293 school districts
- 105 counties
- 474 cities & townships
- Other employers include libraries, hospitals, community colleges & conservation districts

Governed by a nine-member Board of Trustees.

- 88-member staff.

Plan Basics

Kansas Legislature enacts KPERS' retirement plan design in State statutes, providing for:

- membership eligibility
- employee and employer contributions
- service credit
- vesting
- benefit formula
- retirement eligibility

Defined Benefit Formula

- Final Average Salary X Years of Service X Statutory Multiplier = Annual Benefit

Example: $40,000 x 30 years x 1.75% = $21,000

Retirement Funding

- Contributions + Investments - Expenses = Benefits

Investments → *Assumed actuarial rate = 8%*

Contributions → *Employees = Statutory rate of 4% (Tier I) or 6% (Tier II)*

Contributions → *Employers = Changes annually based on actuarial calculations*

Membership

- Serves 277,000 members.
- State of Kansas is largest participating employer.
- More than half of active members employed by school districts.

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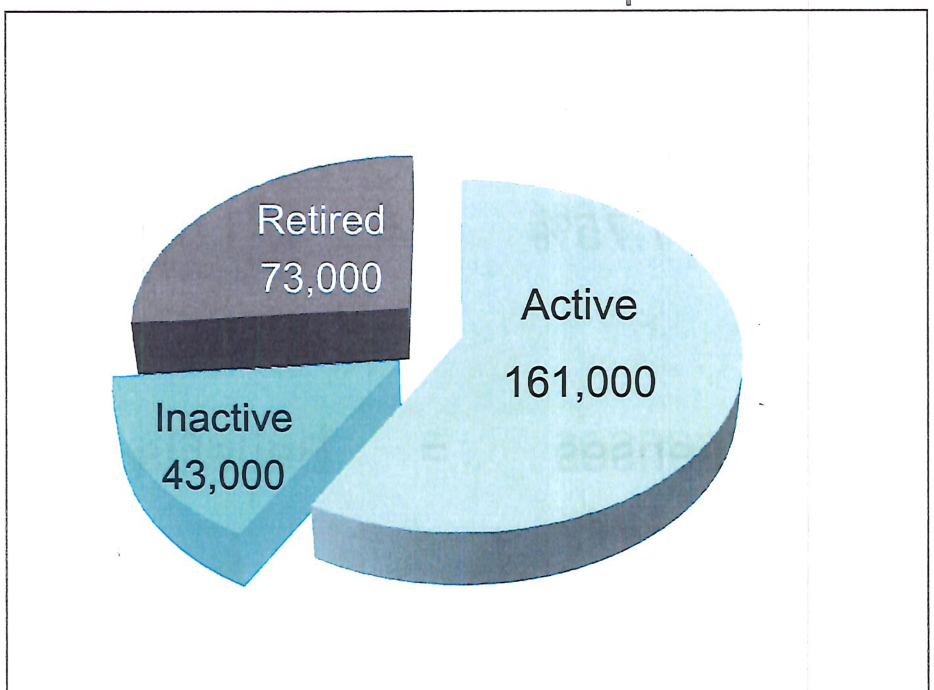
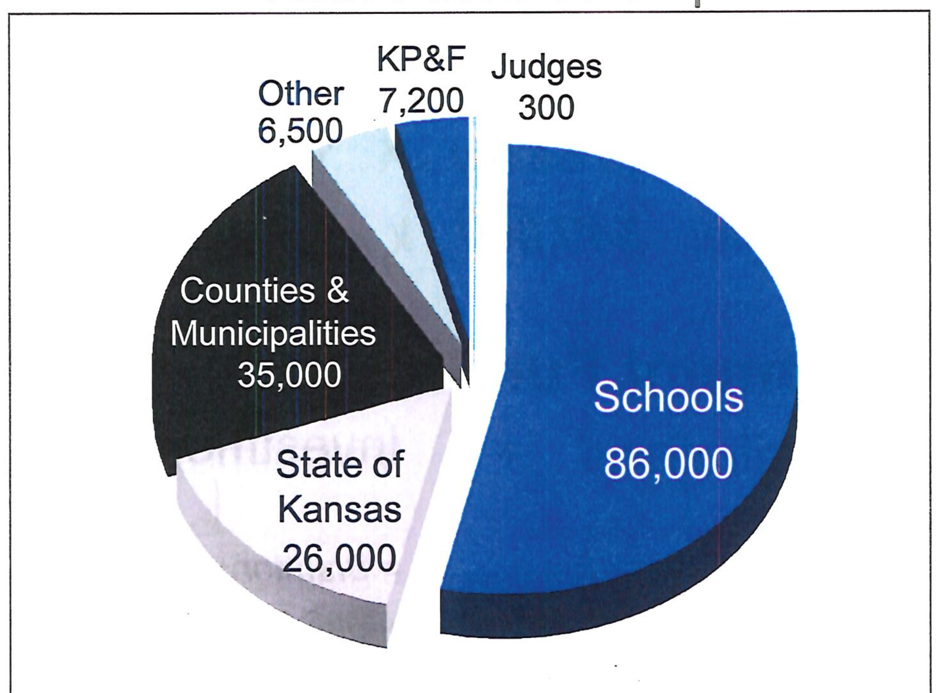
Total Membership



Active Membership

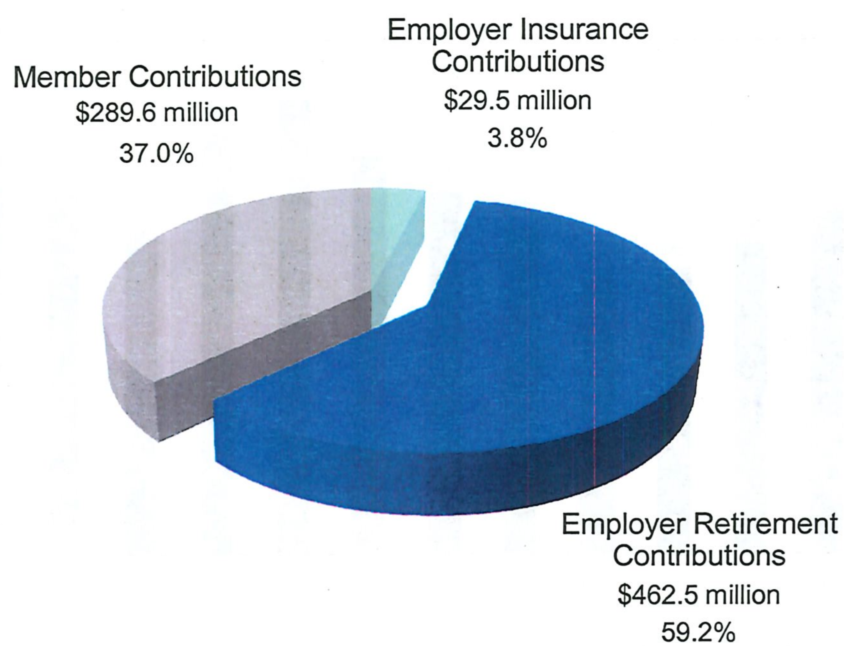


Contributions and Benefits

KPERS' total contributions for FY 2010 were over **$782 million** with benefit payments over **$1.16 billion**.

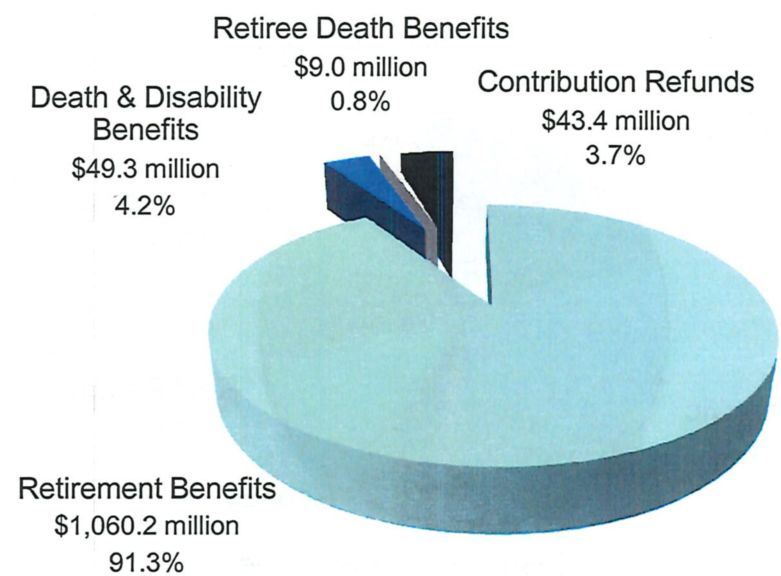
- The State pays employer contributions for state and school employees.
- Approximately 85% to 90% of benefits remain in Kansas.

FY 2010 Contributions



FY 2010 Contributions = $782 million

FY 2010 Benefits



FY 2010 Benefits = $1,162 million

Assets

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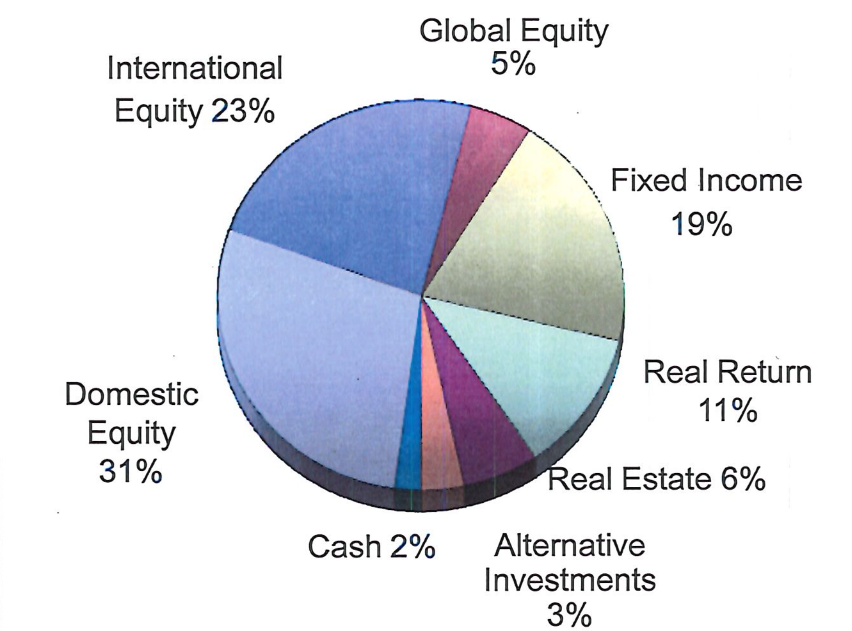
KPERS manages the investment of $12.5 billion in trust fund assets in the U.S. and international markets.

Asset Allocation as of 10/31/2010



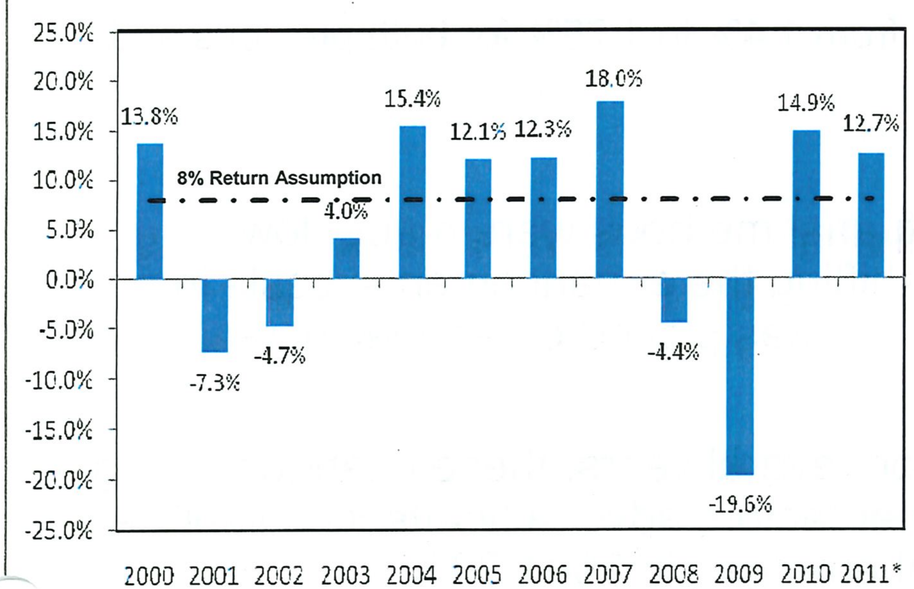
Fund Growth FY 2000 – 10/31/2010 *(in billions)*

***Preliminary Year to Date FY 2011**

Investment Returns

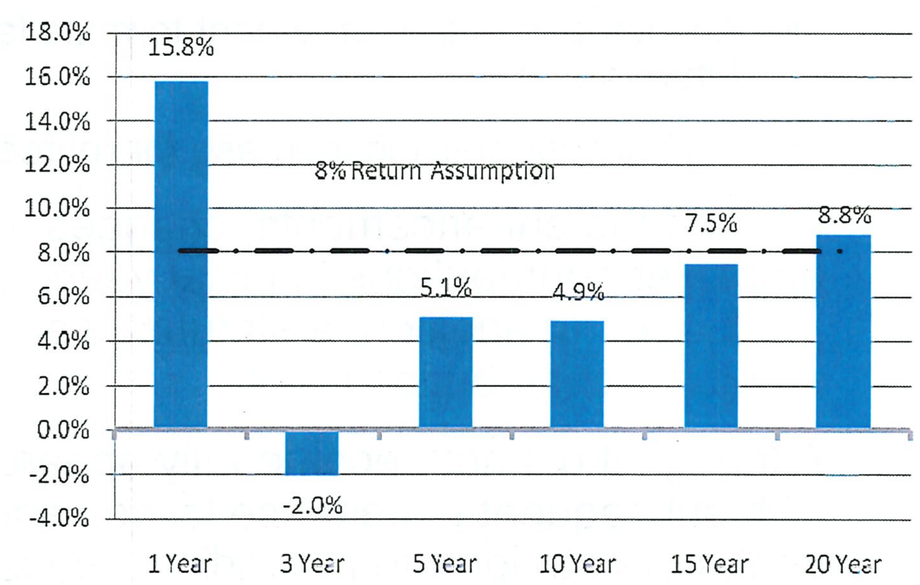
- Due to unprecedented market declines, KPERS' investment returns for FY 2009 were -19.6%.
- KPERS' returns for FY 2010 reflect the market's rebound since March 2009.
  - KPERS' FY 2010 return = 14.9%
  - Preliminary return for FY 2011 through October 31, 2010 = 12.7%.

Return History FY 2000 through 10/31/2010



***Year to Date FY 2011**

Average Annual Return through 10/31/10



Historical Perspective on Long-Term Funding

2-8

- Over KPERS' 49-year history, the Legislature passed laws providing various benefit enhancements to KPERS members.
- The KPERS enhancements were common plan design features in most state defined benefit plans.
- A significant benefit enhancement package passed in 1993, including:
  - Full retirement eligibility under the "85-point rule" (when the sum of a member's age and years of service credit equals 85) or at age 62 with 10 years of service.
  - An increase in the retirement formula factor from 1.4% to 1.75% for both previous and future service.
  - A 15% cost-of-living increase for retirees.
- To fund the enhancements, changes to actuarial methods were made, lowering employer contributions in initial years, but shifting the enhancements' costs into the future. In addition, a statutory cap of 0.1% was placed on annual increases to employer contribution rates.
- Although it did not become fully apparent for several years, these changes, along with subsequent experience losses and other factors adversely affecting liabilities, contributed to long-term funding issues that emerged in 2001-2002.

Previous Actions to Address Funding Status

- By 2001 and 2002, actuarial projections indicated the KPERS retirement plan was not in actuarial balance.
- Following the 2001 actuarial valuation results, KPERS worked with the Legislature to develop a comprehensive, long-term funding plan to address the shortfall and bring the Plan into actuarial balance.
  - 2003 legislation raised statutory caps on employer contribution rate increases from 0.2% annually to 0.4% in FY 2006; 0.5% in FY 2007; and 0.6% in FY 2008 and subsequent years.
  - State issued $500 million in pension obligation bonds in 2004. The debt service payments on these bonds, which are paid from the State General Fund, are approximately $36 million annually.
  - 2007 legislation established a new plan design for employees hired on or after July 1, 2009, which increased retirement eligibility ages and employee contributions.
- These actions, along with strong investment returns in the 2004-2007 period, significantly improved the projected funding status of the System.

Key 2009 Valuation Results

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- The unprecedented investment market declines in 2008 had a substantial negative impact on the funding status of the System, reversing forward progress on long-term funding.
- The 12/31/08 actuarial valuation report reflected a 12% decline in the System's funded ratio to 59% and a $2.7 billion increase in the unfunded actuarial liability (UAL) to $8.3 billion.
- Due to strong investment performance during 2009, the 12/31/09 actuarial valuation report shows modest improvement in the System's funding status. The UAL decreased by $602 million to $7.7 billion, and the funded ratio rose to 64%.
- Despite this year's modest, short-term improvement in its funded status, the System's fundamental, long-term shortfall remains and will continue to grow.
  - KPERS will continue to absorb the remaining $1.7 billion in deferred losses from 2008 over the next three years. For this reason –
    - The actuarial value of assets remains significantly greater than their market value. On a current market value basis, the funded ratio is 56%, and the UAL is $9.4 billion.
    - Even assuming a yearly 8% investment return, the funded ratio of each group will continue to fall, and their UAL's will rise significantly.

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Key 2009 Valuation Results (Continued)

- A key measurement of KPERS' long-term funding status is its funded ratio.
  - A funded ratio of 80% and rising is generally considered to indicate adequate funding for a public sector defined benefit plan.
  - A plan with a funded ratio of 60% or below can be considered at significant risk and in need of prompt remedial action to stabilize its funding.
- At a 56% funded ratio, the School Group's funded status is the weakest of the three KPERS groups.

Key 12/31/09 Valuation Measurements

2-12

Group	Contribution Rates*		Actuarial Funded Status	
	Actuarial Rate	Statutory Rate	Unfunded Actuarial Liability (in Millions)	Funded Ratio
State	9.55%	9.37%	$806.2	78%
School	14.69%	9.37%	$4,998.8	56%
Local	9.44%	7.34%	$1,315.5	64%
KP&F	16.54%	16.54%	$530.3	76%
Judges	23.75%	23.75%	$26.1	82%
System Totals			$7,676.9	64%

*Effective for fiscal year beginning in 2012. (FY 2013 for State and School Groups, State KP&F employers, and Judges. CY 2012 for Local Group and Local KP&F employers.)

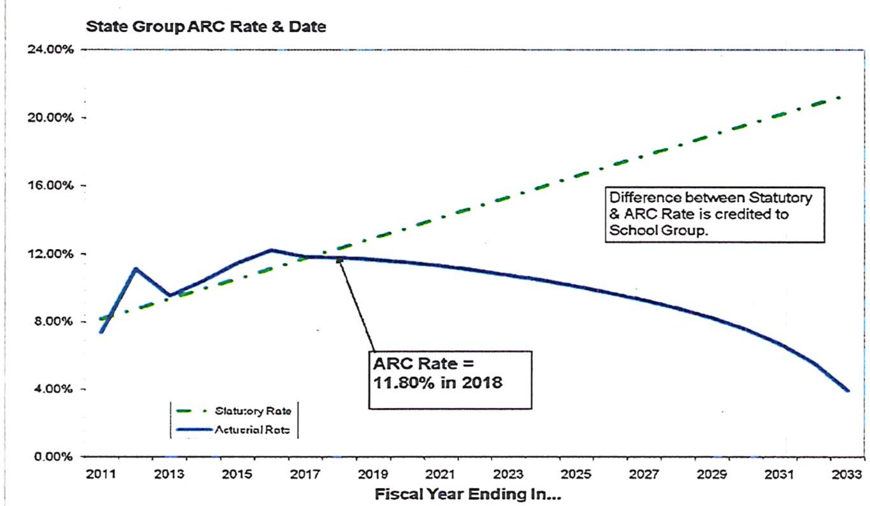
Projections of Long-Term Funded Status

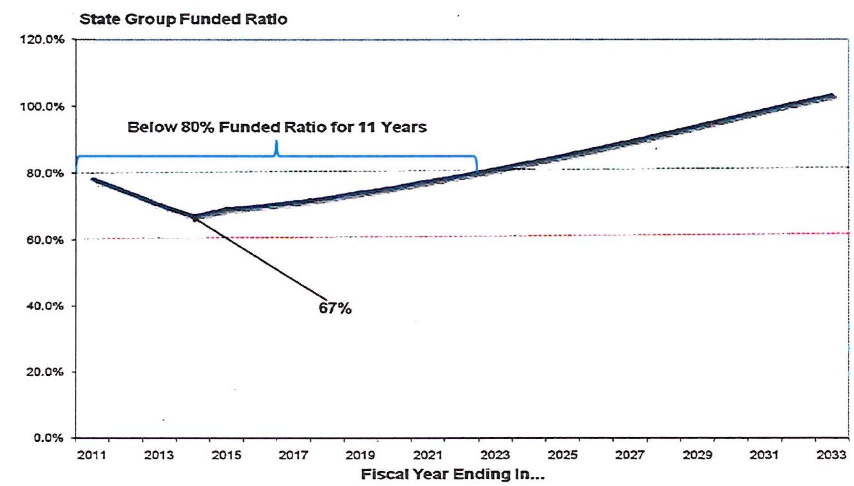
- In addition to the snapshot of KPERS' current status provided by the valuation, KPERS' actuary is able to model future trends in the System's long-term funding status, using the valuation's data.
- Projected actuarially required contribution (ARC) rates, statutory rates, funded ratios, and unfunded liability for each KPERS group through FY 2033 are set out on the following pages.
- These projections indicate that, in the absence of additional funding or plan design changes –
  - The UAL will continue rising significantly for all KPERS groups.
  - The School Group is out of actuarial balance, which means that the statutory rate will not equal the ARC rate before the end of the amortization period in FY 2033.
  - The School Group's funded ratio is projected to remain below 60% funded for 15 years.
- Therefore, without additional steps to address the shortfall, the School Group's funded status, in particular, is highly vulnerable to market downturns for a protracted period of time.

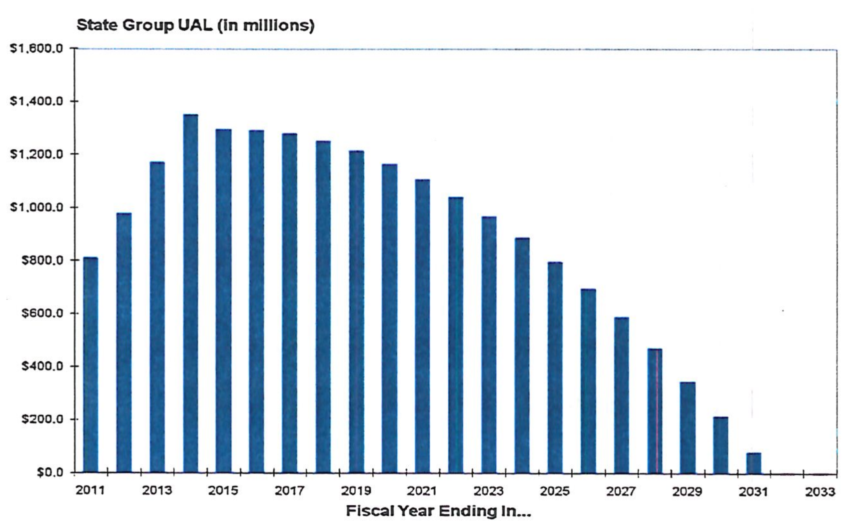
State Group: Baseline Projections

2-14

▪No change in the .6% employer rate increase cap. Assumes average annual investment return of 8%.







▪The projected ARC rate of 11.8% is 44% higher than the State/School rate paid by state agencies in FY 2011 (8.17%).

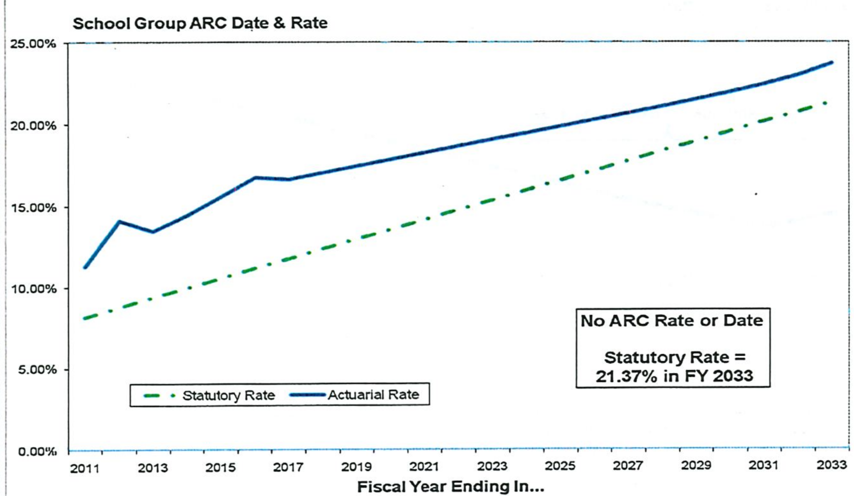
▪Funded ratios reach a low of 67% in FY 2014. They are projected to reach 80% in FY 2023.

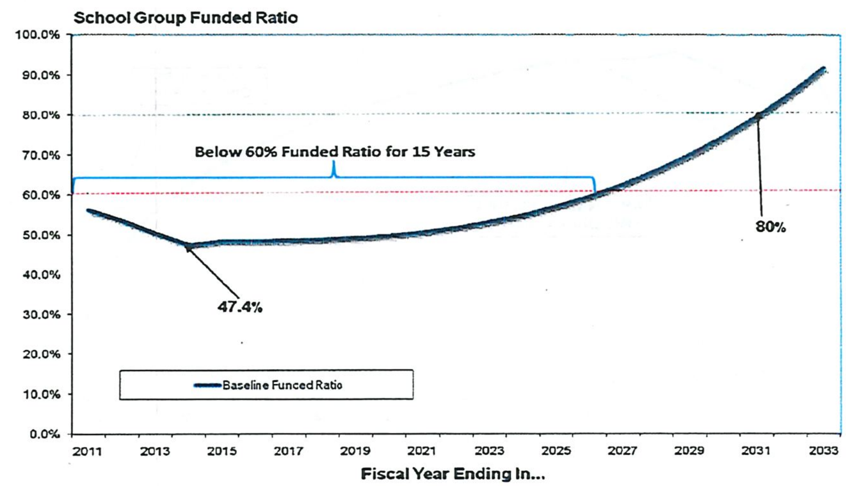
▪The projected UAL rises by 67% to $1.35 billion in FY 2014.

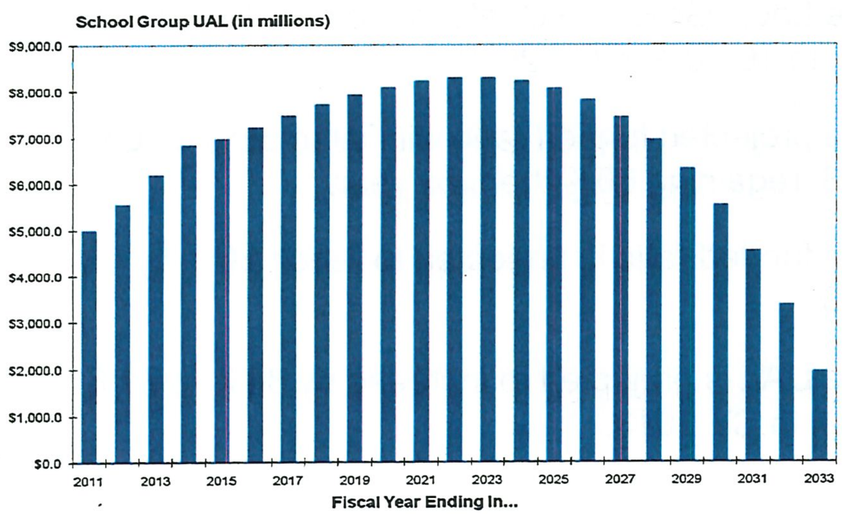
2-15

School Group: Baseline Projections

▪**No change in the .6% employer rate increase cap. Assumes average annual investment return of 8%.**





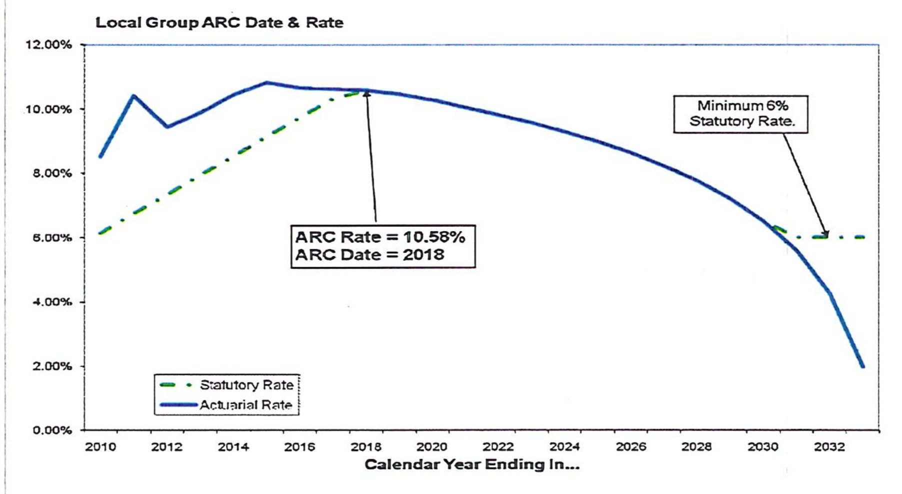


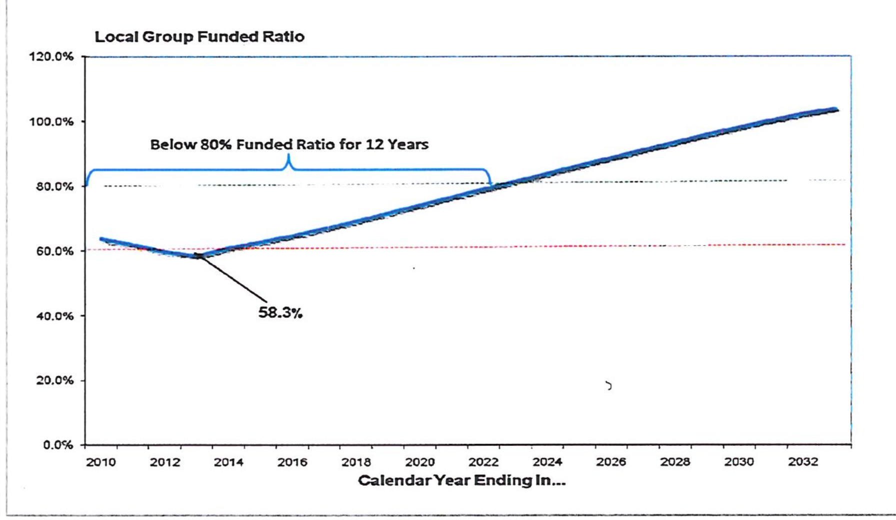
- The School Group is still not in actuarial balance by FY 2033, despite a peak statutory rate of 21.37%.
- Funded ratio projections reach a low of 47% in FY 2014 and remain below 50% until FY 2021.
- The funded ratio is not projected to reach 60% until FY 2027 and only reaches 80% in FY 2032.
- The projected UAL rises 66% to $8.3 billion in FY 2023.

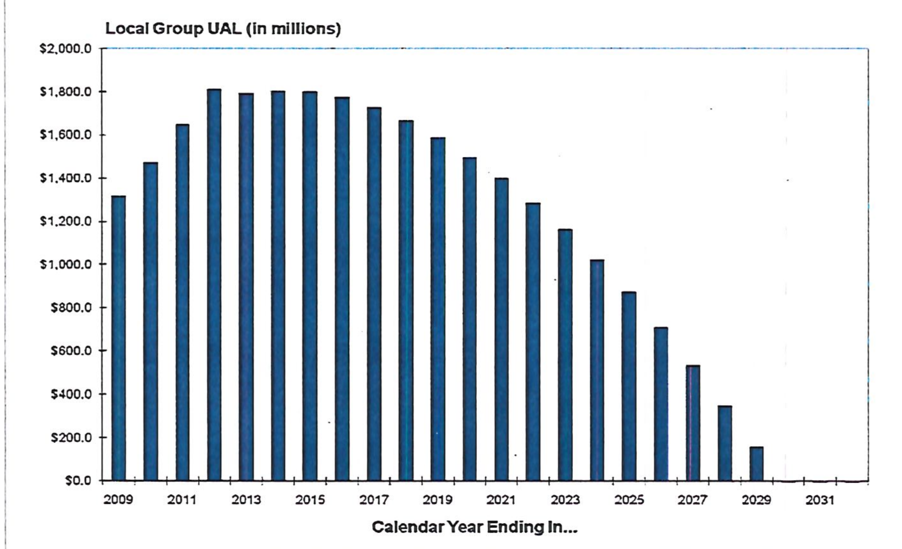
Local Group: Baseline Projections

▪**No change in the .6% employer rate increase cap. Assumes average annual investment return of 8%.**

2-16







▪The Local Group ARC rate is projected to rise by 72% to 10.58% in CY 2018.

▪The projected funded ratio will fall to 58% by CY 2013, regaining 60% the next year.

▪The funded ratio is projected to reach 80% by CY 2023.

▪The UAL is projected to increase by 38% to $1.8 billion in CY 2013.

Employer Contributions

- A fundamental principle of sound funding for a defined benefit plan is to consistently pay the full ARC rate.

- Due to the statutory cap on employer rate increases of .6%, there is a significant gap between the statutory and ARC rates for each of the KPERS Groups.

  - In the current fiscal year, the statutory employer rate for the State/School Group is 72% of its ARC rate (8.17% statutory rate vs. 11.30% actuarial rate).

  - The State/School statutory rate is not projected to reach 100% of ARC before the end of the amortization period in FY 2033.

- Raising the cap on employer contribution rate increases to 1% per year moves KPERS closer to the goal of contributing at the ARC rate.

  - With a 1% cap beginning in FY 2013, the State/School statutory rate is projected to reach 100% of ARC within 9 years.

Employer Contributions (Continued)

2-18

- Substantial increases in state funding for KPERS retirement benefits will occur even with the current .6% per year statutory cap on employer rate increases.
  - Because the employer contribution rate is a percent of payroll, contributions automatically increase as the payroll base increases.
  - State funding in FY 2012 will rise by $37.1 million to $401.6 million.
  - From FY 2011 to FY 2016, State funding will have increased by 57% to $571.0 million.
- If the .6% cap on employer rate increases was raised to 1.0% beginning FY 2013, the pace at which State contributions grow would accelerate substantially.
  - State funding in FY 2013 would rise by an additional $18.8 million to $459.1 million.
  - By FY 2016, State funding would increase an additional $81.8 million to $652.8 million.
  - However, from FY 2011 through the remainder of the amortization period in FY 2033, total employer contributions would be less than under the Baseline – by $1.16 billion.

Employer Contributions (Continued)

Employer Contributions	Baseline	1% Cap *	Additional Contributions
FY 2013 Increase over Prior FY	$ 38.76	$ 57.56	$ 18.80
FY 2013 Total Contributions	$ 440.34	$ 459.14	$ 18.80
FY 2014 Increase over Prior FY	$ 41.08	$ 60.91	$ 19.83
FY 2014 Total Contributions	$ 481.42	$ 520.05	$ 38.63
FY 2015 Increase over Prior FY	$ 43.50	$ 64.46	$ 20.96
FY 2015 Total Contributions	$ 524.92	$ 584.51	$ 59.59
FY 2016 Increase over Prior FY	$ 46.08	$ 68.29	$ 22.21
FY 2016 Total Contributions	$ 571.00	$ 652.80	$ 81.80
Total Employer Contributions: FY 2011-2033	$ 23,048.75	$ 21,887.03	$ (1,161.72)

*Effective FY 2013

Legal Issues

2-20

- Kansas state retirement systems are contracts between the State and members that are protected by the Contract Clause of the U.S. Constitution.
- Kansas law states that amendments to the Retirement Act may not affect existing rights of members and beneficiaries, but are effective only as to rights that would otherwise accrue with service performed after the statutory change.
- Kansas courts have found that:
  - Changes in benefits for current members are permitted only in limited circumstances and on a case-by-case basis.
  - Changes that result in disadvantages to employees must be accompanied by comparable new advantages.
  - Unilateral alteration of the employees' contractual interests may be allowed if reasonable to keep the system flexible while maintaining its integrity.
  - In order for the Court to allow changes to improve the actuarial soundness of the plan and consider it an advantage to the members, the Court must find evidence that the employer would not be able to meet its obligations in the future.

Funding Solution Options

KPERS modeled a series of funding solution options that were presented to the Joint Committee on Pensions, Investments and Benefits during the 2009 Interim. These options included:

- Increases to the statutory employer contribution rate cap.
- Increases in employee contribution rates.
- Changes in the statutory multiplier for future service.
- Bond issues in lieu of the statutory employer contribution cap increase.
- Various combinations of employer and employee rate increases and multiplier changes.
- Creating a new mandatory defined contribution plan for future employees.

2010 Legislative Activity

2-22

- **SB 564.** Based on its review of options for improving KPERS' funded status, the Joint Committee recommended introduction of SB 564 as an initial step in addressing the shortfall. This bill would have –
  - **Increased Contributions.** Raised the cap on employer contribution rate increases from .6% per year to 1.0% per year, beginning in FY 2012. Beginning January 1, 2012, increased employee contribution rates for both Tier 1 and Tier 2 by .5% in each of four calendar years, for a total increase of 2%.
  - **Increased Multiplier for Future Service.** Effective January 1, 2012, raised the benefit formula's multiplier to 1.85% for all future years of service credited to members.
- **House Sub for HB 2400.** The House Select Committee on KPERS recommended this substitute bill, which would have raised the maximum increase in employer contributions for the KPERS State and School Groups to 1.0% a year, effective FY 2013.
- While bills such as these provide essential funding increases, they would not substantially improve KPERS' funded ratio for a number of years.
- Addressing KPERS' long-term funding problems will be an ongoing process, even with additional employer and employee contributions.

2-33

2010 Legislative Activity (Continued)

- **HB 2751.** The House Appropriations Committee introduced a bill which would have created a Tier 3 KPERS defined contribution retirement plan for those hired after June 30, 2012.
  - Employees would contribute 7% of compensation to their retirement account.
  - Employers would contribute 5% to each employee account, as well as percentages set by the Board for death and disability plan benefits, a funding rate for the current defined benefit plan and a rate for plan administration expenses.
- Hearings were held for SB 564 and HB 2400, but neither of the bills passed out of its house of origin.
- No hearing was held on HB 2751, as it was introduced a few days before adjournment.
- The Joint Committee has reviewed long-term funding issues during the 2010 Interim.
- At its December 2, 2010, meeting, the Joint Committee recommended that HB 2400 and SB 564 be updated and reintroduced during the 2011 Session.

Other States' Long-Term Funding Responses

2-24

- The majority of other state retirement systems are facing long-term funding issues similar to those confronting Kansas.
- The National Conference of State Legislatures reported that, as of December 2, 2010, a number of states changed contributions, plan design or plan type for one or more of their state-administered pension systems.
- Many of these changes bring benefit levels more in line with plan design changes made in 2007 for Tier 2 KPERS members.
  - **Contribution Increases.**
    - Increased employer contributions: California, Iowa, Minnesota, and Wyoming.
    - Increased employee contributions for one or more state-level plans: California, Colorado (through funds otherwise available for pay increases), Iowa, Louisiana, Minnesota, Mississippi, Missouri, Vermont, Virginia, and Wyoming.
    - There is a wide variation in legal limitations on changes to employee contributions among these and other state-level pension systems.
    - At least one state (Mississippi) explicitly added benefit enhancements to help offset employee contribution increases.

Other States' Responses (Continued)

- **Plan Design Changes.**
  - Narrowed eligibility for membership for future employees: New Jersey.
  - Increased the time required to vest:
    - Future members: Minnesota to five years. Missouri and Pennsylvania to 10.
    - Active members: Iowa (nonvested members as of 7/1/2012 only).
  - Increased normal retirement age (NRA):
    - Future members: Arizona, California, Illinois, Michigan, Mississippi, Missouri, Pennsylvania, Utah, Virginia.
    - Active members: Colorado and Vermont (phased in).
  - Changed the multiplier in their benefit formula:
    - Future members: California, New Jersey, Louisiana, Pennsylvania (two multiplier options, with different employee contribution rates), and Utah.
    - Active members: Vermont (higher multiplier for future service of certain members, based on years of service and number of years before NRA).
  - Increased the amount of time included in calculating the final average salary (FAS):
    - Future members: Arizona, California, Illinois, Louisiana, Michigan, New Jersey, Utah, and Virginia.
    - Active members: Iowa (Phased in).

Other States' Responses (Continued)

2-26

- Placed new limits on "spiking" of the FAS:
  - Future members: Louisiana.
  - Active members: Colorado and Vermont.
- Eliminated, reduced, or added restrictions to cost of living adjustments (COLA's):
  - Future members: Illinois, Michigan, Virginia, and Utah.
  - Active members: Rhode Island.
  - Current retirees: Colorado, Minnesota, and South Dakota. Litigation has been filed in each of these states.

- **Hybrid Plan Designs**
  - Established a hybrid plan for new members with a DB component, plus a defined contribution (DC) component: Michigan (Public School Employees) and Utah.
    - Michigan. The DB component has a higher NRA (age 60 with 10 years of service) and a five-year period for calculating the FAS. The DC Component automatically enrolls members with a 2% contribution and a 1% employer match (with options to negotiate higher employer contributions up to 3%).
    - Utah. Members choose either a hybrid plan or a new DC plan. The hybrid caps combined employer contributions to the DB and DC components at 10% of pay. Members are responsible for any required DB contributions over 10%.

Conclusions

- Current benefits are safe for a period of time. Assets of more than $12 billion are available to pay benefits.
- While the 12/31/09 valuation indicates a modest, short-term improvement in KPERS' funding status, the fundamental, long-term funding shortfall remains and will continue to grow.
- KPERS' ability to withstand future economic downturns is compromised.
- Investment returns alone cannot fix the funding problem. Last year's strong investment returns do not happen every year. Employers are still not contributing at the required actuarial rate.
- Legislative action is necessary to begin the process of addressing the funding shortfall, with additional employer contributions as a basic element.
- Because the 2010 Legislature did not increase KPERS' funding beyond the current 0.6% statutory increase cap, passing long-term funding legislation in the 2011 session is essential.