Approved: February 8, 2011

MINUTES OF THE HOUSE PENSIONS & BENEFITS COMMITTEE

The meeting was called to order by Chairman Mitch Holmes at 9:02 a.m. on January 24, 2011, in Room 142-S of the Capitol.

All members were present except:
Representative Don Hill - 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
Darla Conner, Committee Assistant

Conferees appearing before the Committee:
Patricia Beckham, Cavanaugh Macdonald Consulting, LLC
Glenn Deck, Executive Director of KPERS

Others attending:
See attached list.

Chairman Holmes introduced Patricia Beckham with Cavanaugh Macdonald Consulting, LLC; (Attachment 1) the firm contracted by KPERS to set contribution rates. Glenn Deck, Executive Director of KPERS, (Attachment 2) presentations included "When Would KPERS Run Out of Money?" and the cost of lifting statutory cap. Julian Efird of the Kansas Legislative Research Department (Attachment 3) gave an overview on Statutory Budget Caps on Annual KPERS Contributions.

The next meeting is scheduled for January 26, 2011.

The meeting was adjourned at 10:46 a.m.

HOUSE PENSIONS & BENEFITS COMMITTEE GUEST LIST
DATE: January 24, 2011

NAME	REPRESENTING
Pat Beckham	Cavanaugh Macdonald
Tom Kuhn	KASB
Ron Gardner	KCPR
TERRY FORSYTH	KNEA
Dennis Phillips	KSCFF
Ed Redmon	KSCFF
Levi Henry	Sandstone Group LLC
Jane Carter	KOSE
Michelle Butler	Cap. Strategies
Glenn Deck	KPERS
Faith Lunette	"
Travis Couture-Lovelady	State Treasurer's office
D. Rupert	Kearney & Assoc.
Paje Routhier	Hein Law Firm
Nicole Proulx Aiken	League of Kansas Municipalities
Jim Miller	NARFE
Brian R Thompson	PEAK
Dave Kingsley	Gray Panthers

House Pensions & Benefits
Date: 1/24/2011
Attachment # 1

Cavanaugh Macdonald
CONSULTING, LLC
The experience and dedication you deserve

Presentation to the House Pensions and Benefits Committee

Actuarial Principles and Funding

Patrice A. Beckham, FSA, FCA, EA, MAAA
Consulting Actuary
Cavanaugh Macdonald Consulting, LLC

Kansas
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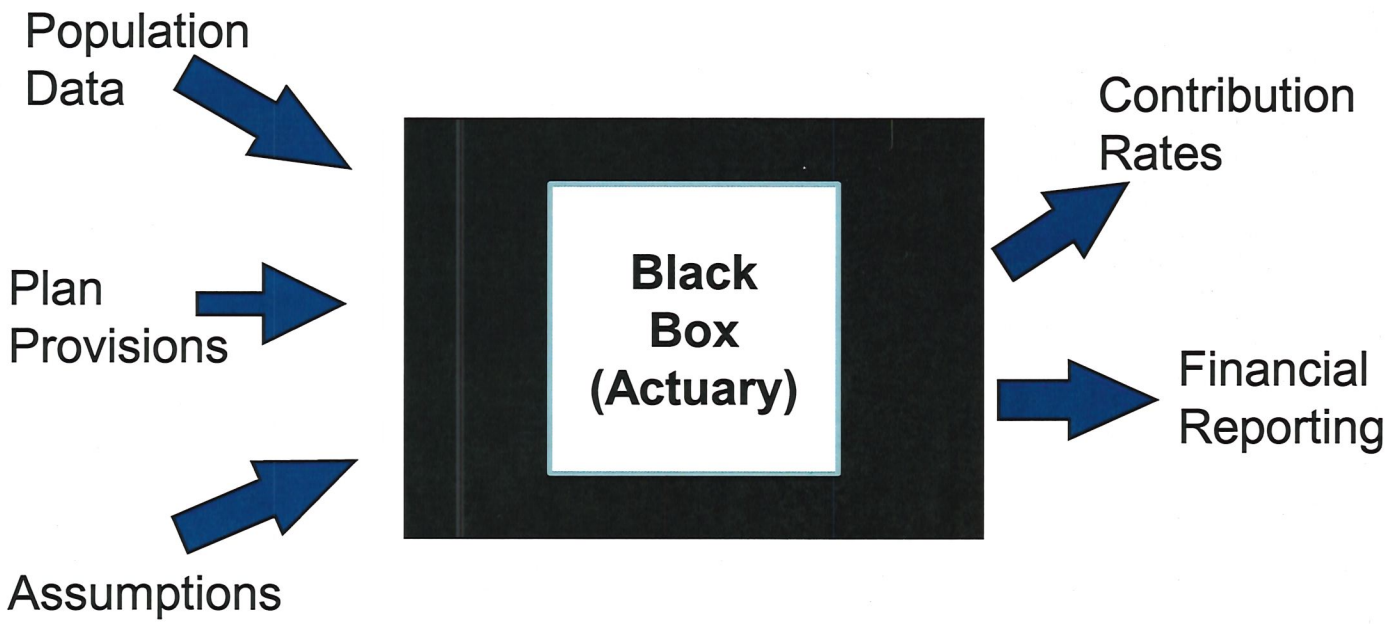
Retirement System

Public Perception of the Actuarial Valuation



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Retirement System

Pension Plan Policies

- Benefit Policy
  - How much, when and to whom are benefits paid?
- Investment Policy
  - What asset classes to invest in and in what proportion?
- Funding Policy
  - How much and when to contribute?

1-4

Cash Flow Characteristics and Need for Actuarial Valuations

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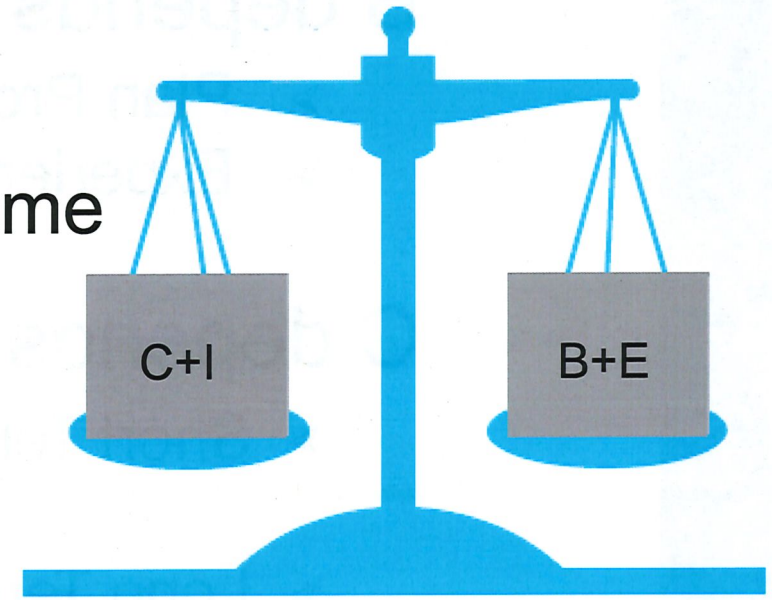
Basic Retirement Funding Equation

$$C + I = B + E$$

C = contributions
I = investment income
B = benefits paid
E = expenses



Basic Retirement Funding Equation

C + I = B + E

B depends on

- Plan Provisions
- Experience

C depends on

- Short Term: Actuarial Assumptions
  Actuarial Cost Method
- Long Term: I, B, E

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Two fundamentally different methods of financing retirement benefits

Social Security:	"Pay as you go" Current generation pays benefits of prior generation.
Most Public Retirement Systems:	"Save as you go" (prefunded) Current generation saves money for its own retirement; prior generation did the same.

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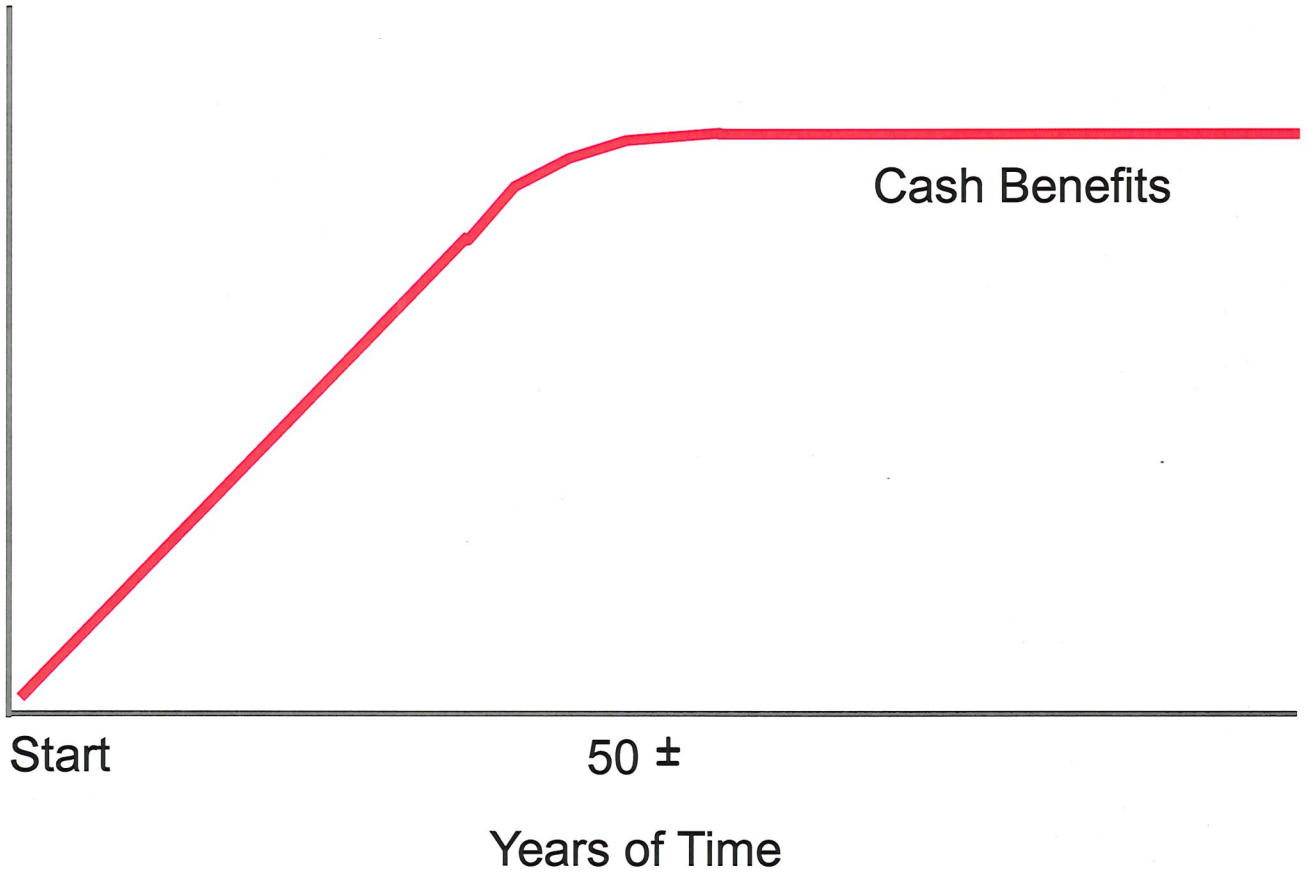
1-8



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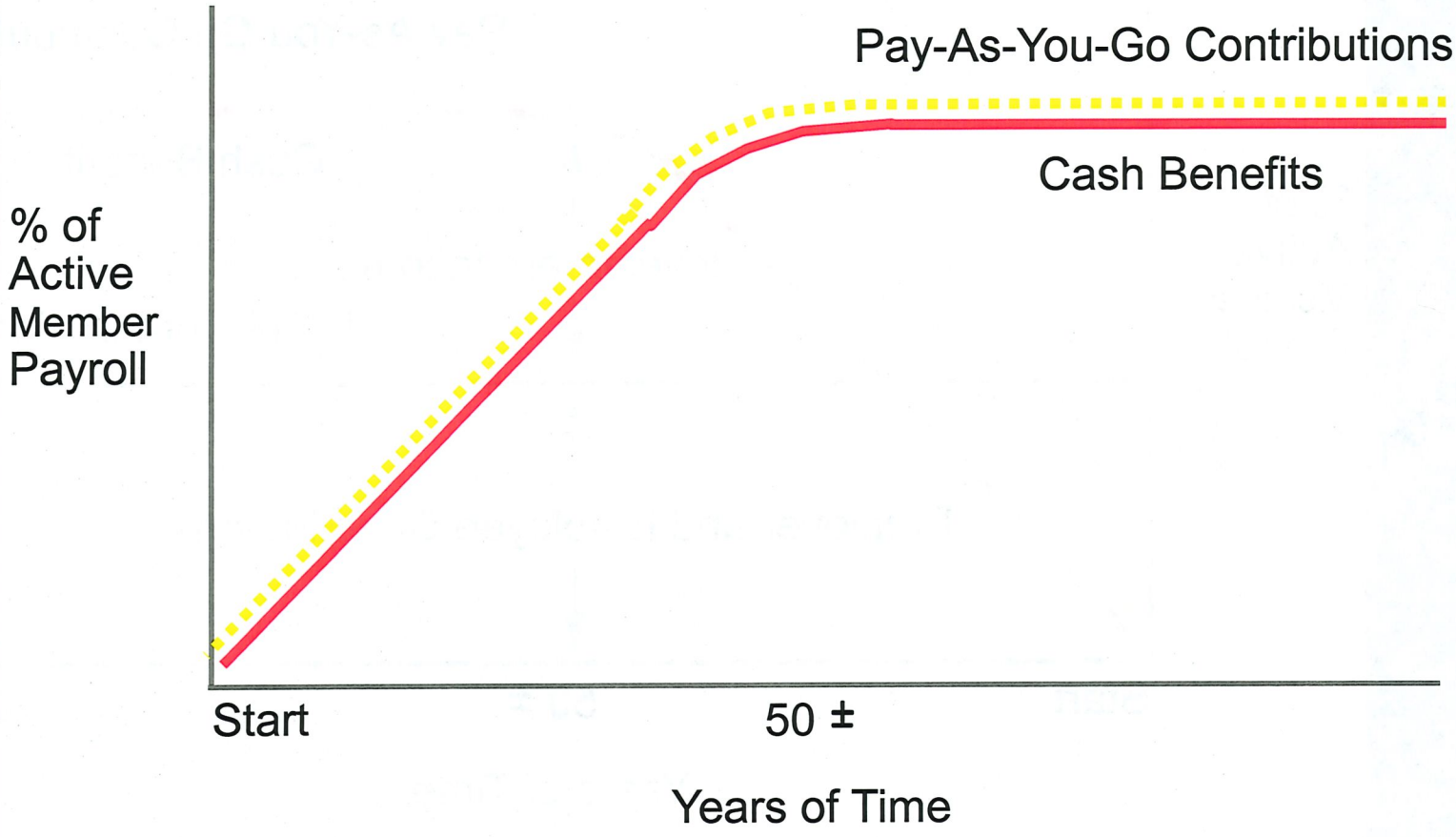
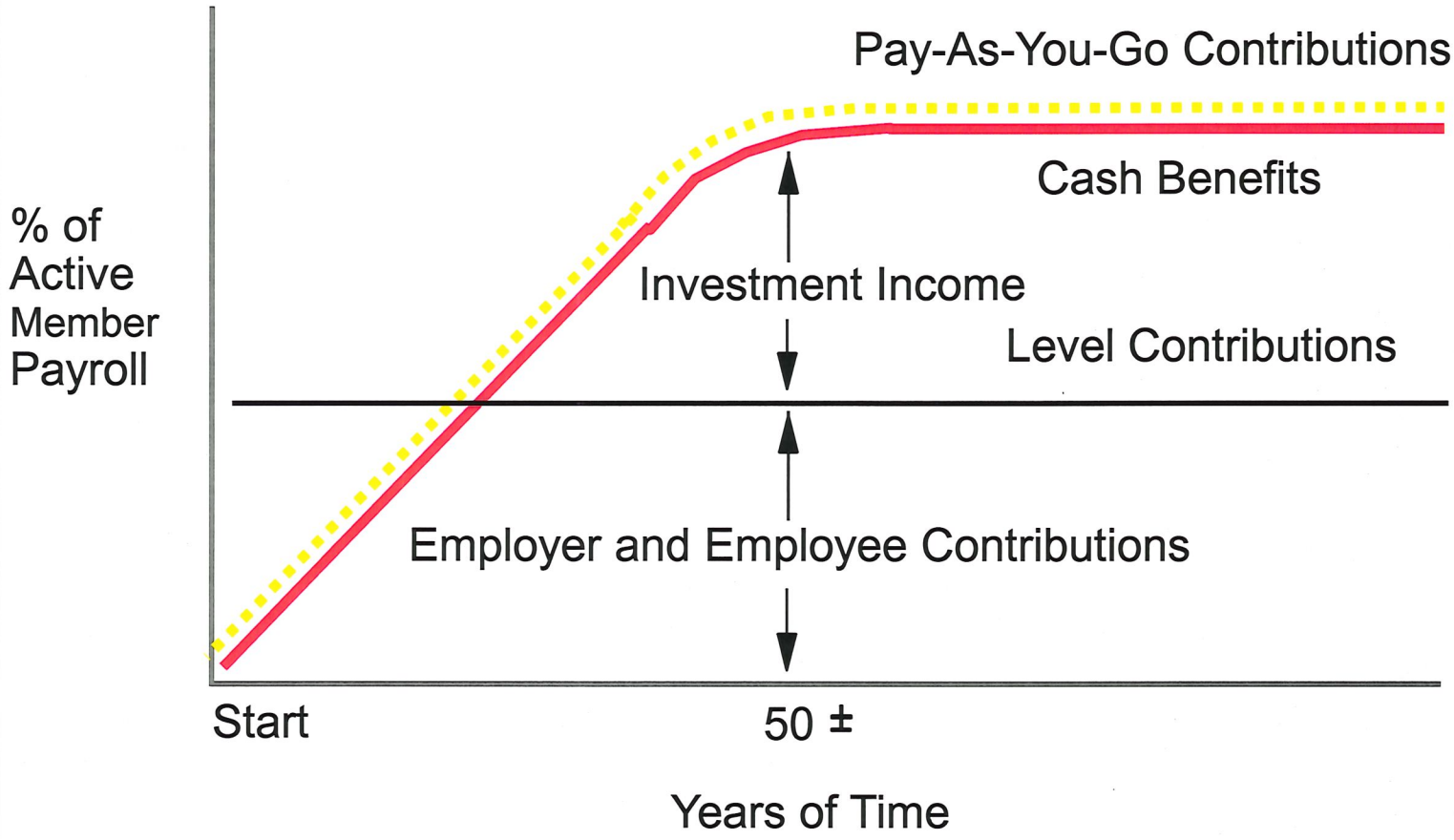
System




Pay-As-You-Go Contributions
Cash Benefits
% of
Active
Member
Payroll
Investment Income
Level Contributions
Employer and Employee Contributions
Start
50 ±
Years of Time

Selecting Assumptions About Future Events

Things That Happen to People

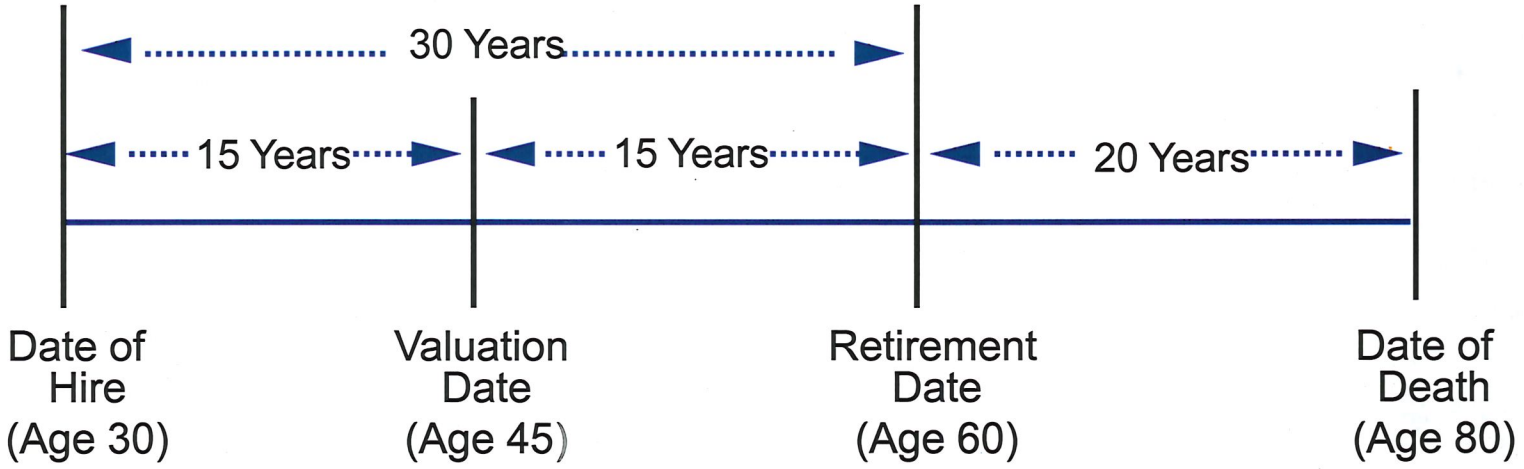
(Demographics)

KNOWN at valuation date:

1. age
2. salary
3. sex
4. service to date
5. occupation

ASSUMED at valuation date:

1. future salary increases
2. retirement date(s)
3. death rates before and after retirement
4. disability rates
5. other termination rates



Things That Happen to Money

(Economic Assumptions)

KNOWN at valuation date:

1. Market value of Investment Fund
2. Composition of Investment Fund
   - Stocks
   - Bonds
   - Alternatives
   - Real Estate
   - International
3. Value of $1

ASSUMED at valuation date:

1. Future rates of investment return
2. Future rates of inflation return
   (Future value of $1)

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Changes in Major Assumptions
Effect on Liabilities and Contributions

1-14

Assumption	Action	Usual Effect
Interest Rate	Increase	Decrease
Salary Scale	Increase	Increase
Retirement Rate	Retire Younger	Increase
Turnover Rate	More Quits	Decrease

1-14

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Fundamentals of Actuarial Valuations & Plan Liabilities

Present Value

The present value of an amount of money payable in the future is the amount of money that, if we had it today, would accumulate to the amount that will be payable considering –

- Investment Return
- Probability that money will be paid

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Present Value

Example 1: You owe $1,000 to a financial institution payable one year from now. You estimate that you can invest money for a 7% return. What is the present value of the debt?

$$\frac{\$1,000}{1.07} = \$934.58$$

Observation: What if you're mistaken about the 7%?

Present Value

Example 2: You owe $1,000 to a person payable one year from now. The person is 70 years old. The person has no heirs. You estimate that you can invest money for a 7% return. You estimate that the chance that the person will be alive to collect the debt is 98%. What is the present value of the debt?

$$\frac{\$1{,}000}{1.07} \times 98\% = \$915.89$$

Observation: If the person dies, you'll have money left over. If the person lives, you won't have enough to pay the debt.

Present Value

Example 3: You owe $1,000 to 100 people one year from now. Each person is 70 years old. You expect the same return (7%) and chance each person will be alive in one year (98%). What is the present value of the debt?

$$100 \times \frac{\$1{,}000}{1.07} \times 98\% = \$91{,}589$$

Observation: Under what circumstances will you have exactly enough money to pay the debt?

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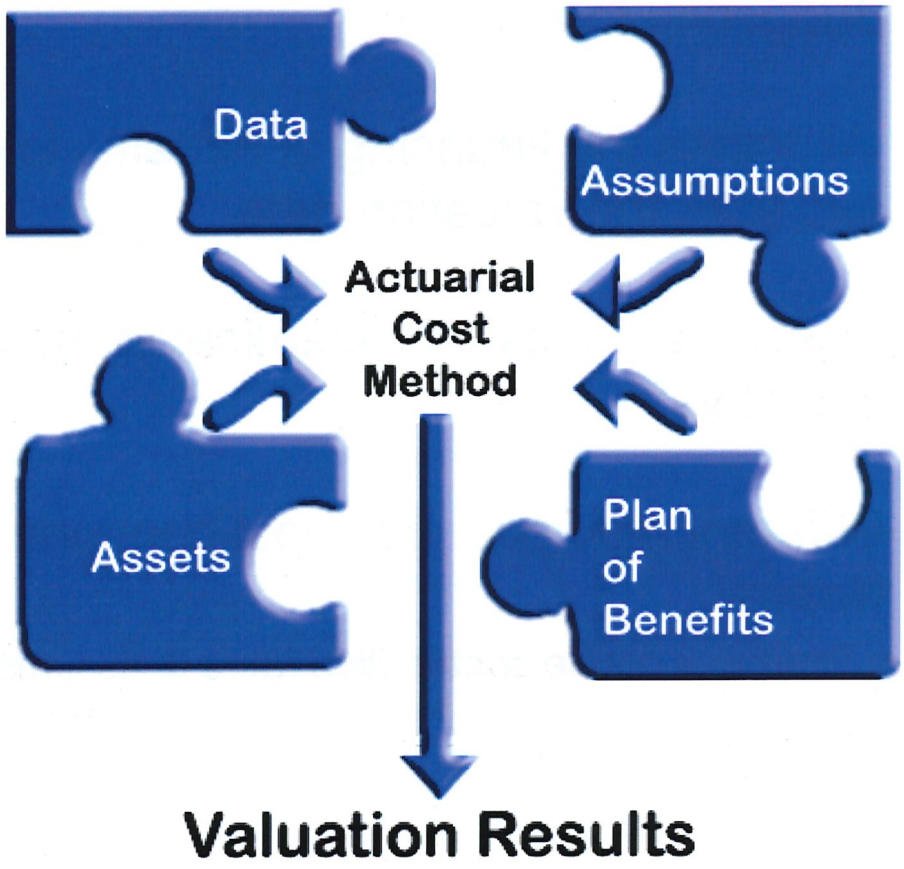
What is an Actuarial Valuation?

1-20

It is a measurement at a point in time - the valuation date - of the cash flows that have occurred, to date, versus those that are expected to come in the future.

Where Does the Actuary Get These Numbers?



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Actuarial Cost Method

- Budgeting tool
- Allocates the financing of benefits to periods before and after the valuation date
- Costs are not usually identical to the benefits earned in that year
- Different methods, but most common is Entry Age Normal
  - Produces stable contribution rates (if assumptions are met)

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Actuarial Valuation Process

Present Value
at Expected Retirement Date
of Future Benefits

Discounted for:

1. assumed rate(s) of investment earnings
2. assumed rates of non-death terminations
3. assumed death rates before retirement

↓

Present Value at Valuation Date
of Future Benefits

Allocated Using Actuarial Cost Method

Actuarial Liability	Present Value of Future Normal Cost

Actuarial Liability
- Valuation Assets

= Unfunded Actuarial Liability

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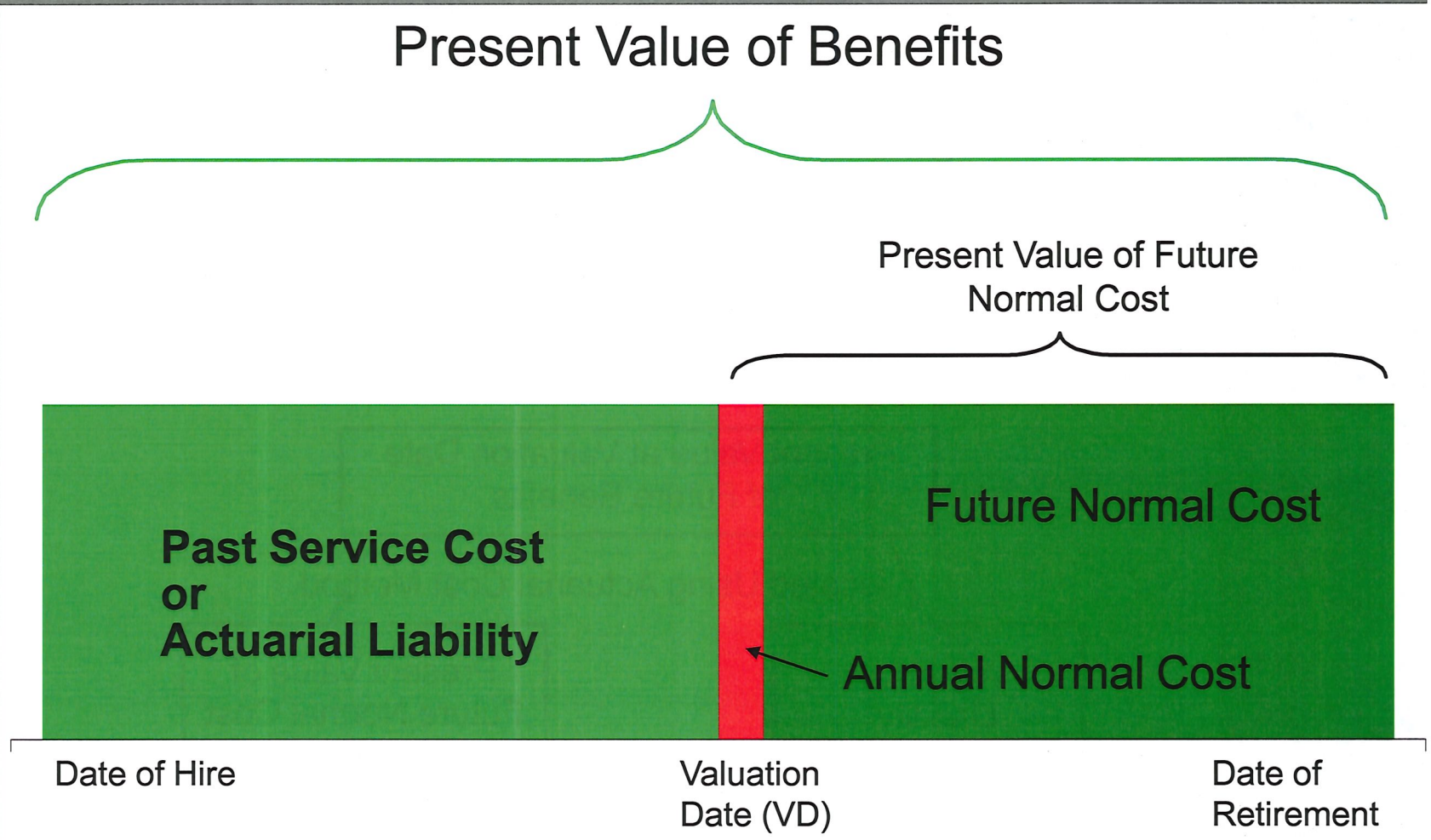
Funding Process—Entry Age Normal

1-24

Contribution as % of Pay



Actuarial Liability - Assets = Unfunded Liability

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Unfunded Actuarial Liability

- Unfunded actuarial liability (UAL) is a natural part of retirement system funding.
- The existence of an UAL does not necessarily mean the system is "underfunded."
- Comparable to a mortgage on a home.
- Must be financed in addition to ongoing cost for actives (normal cost).

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Causes of Unfunded Actuarial Liabilities

1-26

1. Granting initial benefits or granting benefit increases for service already rendered.
2. Actual experience which is less favorable than assumed:
   a. Higher salary increases
   b. Earlier retirement
   c. Lower death rates (people living longer)
   d. Lower rates of investment earnings
   e. Lower rates of non-death terminations
3. Contributing less than the actuarial rate.
4. Changes in actuarial assumptions and methods.

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Amortization of Unfunded Actuarial Liability

- Level $
- Level % of payroll
- Closed period
- Open or rolling period
- Maximum 30 years (GASB requirement)

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Level $ Amortization

1-18

- Same as paying a home mortgage on a fixed interest rate. Part of payment is principal and reduces the debt.
- Payments remain constant in dollar amount over the amortization period, but decline as a percent of a, presumably, growing payroll.
- UAL declines in nominal (total dollar) value every year.

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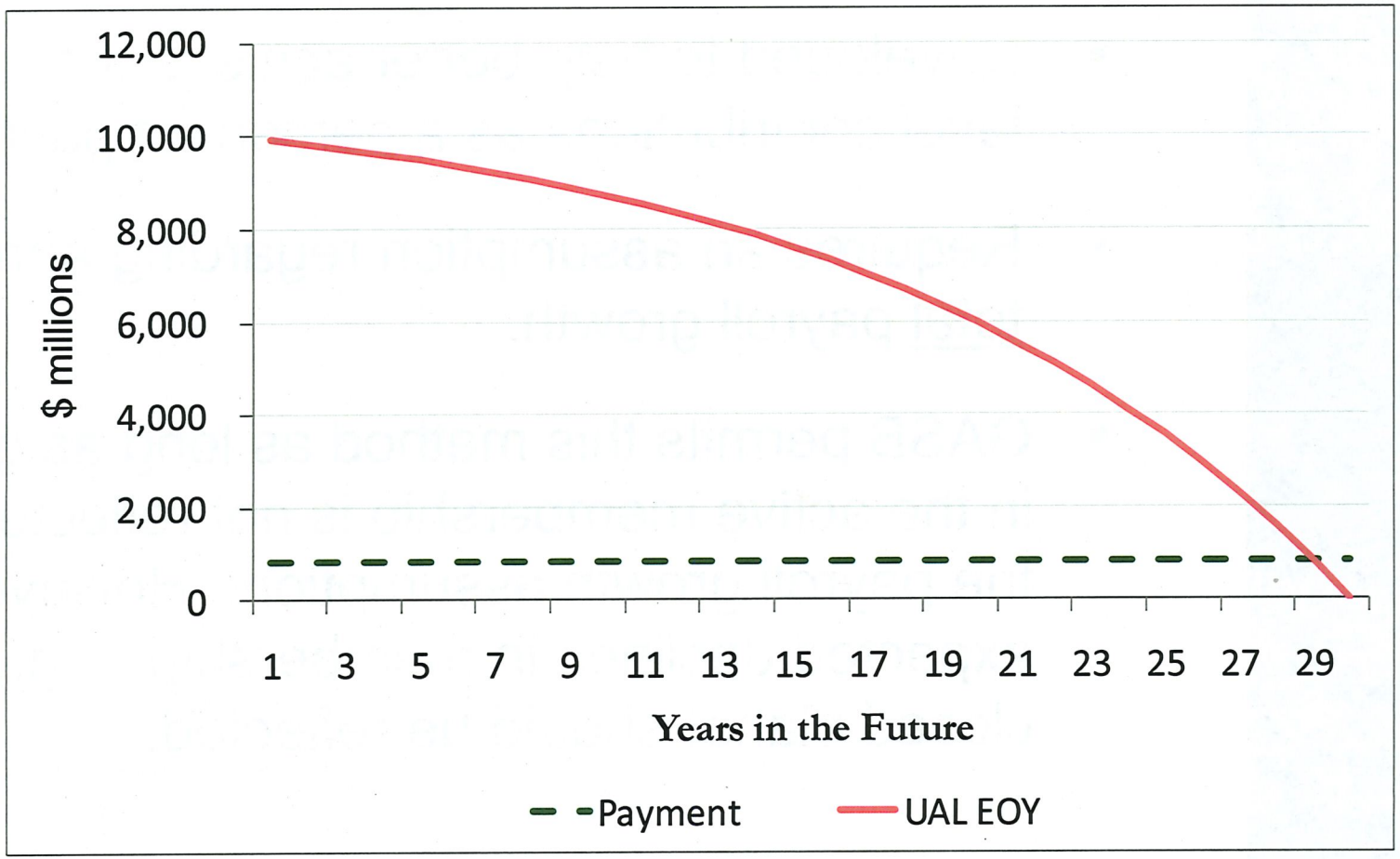
Level $ Amortization



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Level % of Pay Amortization

1-30

- Developed to help better achieve the goal of level contributions as a percent of payroll.
- Requires an assumption regarding annual total payroll growth.
- GASB permits this method as long as growth in the active membership is not reflected in the payroll growth assumption. However expected declines in membership (e.g., closed plans) should be reflected.

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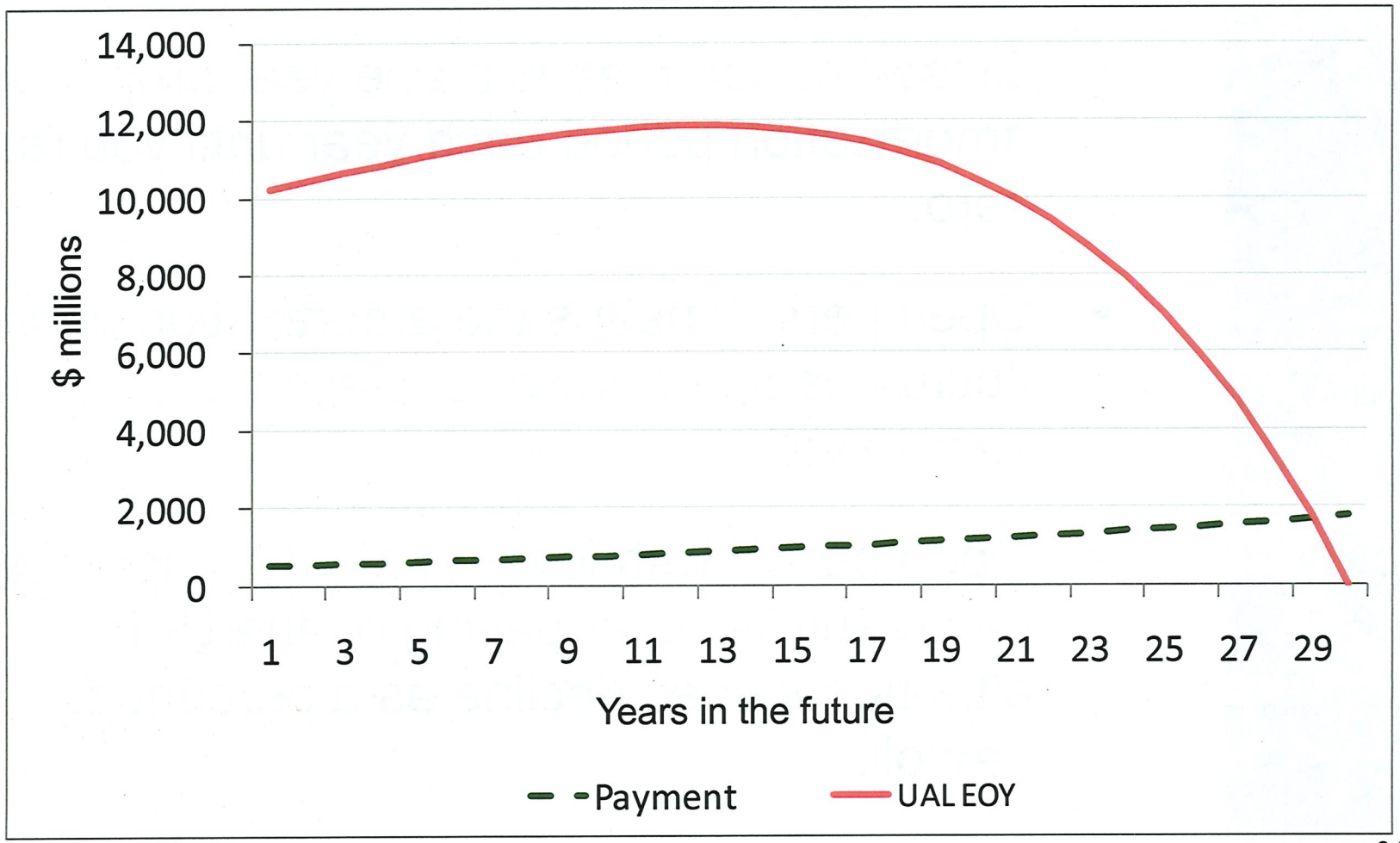
Level % Amortization



Closed vs. Open Periods

1-32

- Closed period means a one year drop in the amortization period each year until you reach zero.
- Open period means the amortization period fluctuates up or down, or stays the same from year to year.
- Open period with level % of pay amortization can result in never paying off the UAL, although it does decline as a percent of payroll.

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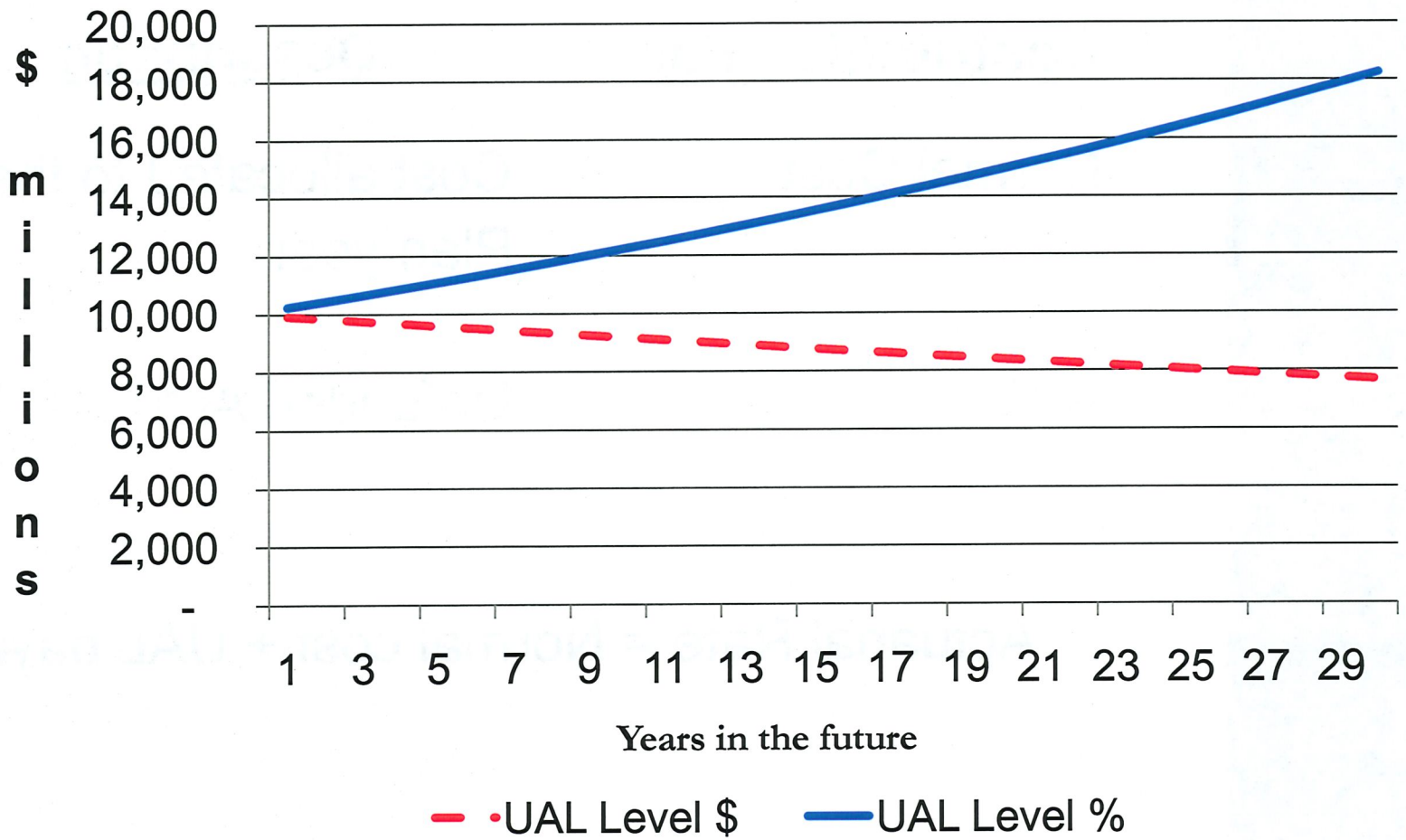
Open Period
UAL Dollar Amount



Valuation Results

Contribution For	Description
Normal Cost	Cost allocated to the current Plan year
UAL	Unfunded Actuarial Liability

Actuarial Rate = Normal cost + UAL payment

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Asset Valuation Methods for Public Employee Retirement Systems

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Asset Valuation Methods

1-36

- Purpose of advance funding is to build up an asset pool.
- Actuary needs to value the current asset pool.
- Options include:
  - Cost or Book
  - Market
  - Smoothed Market

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COST BASIS

Uses out-of-date values.

Results affected by timing of sales.

MARKET BASIS

Short-term factors obscure long-term values
Sharp ups and downs misleading.

Desire for better basis of recognizing investment activity

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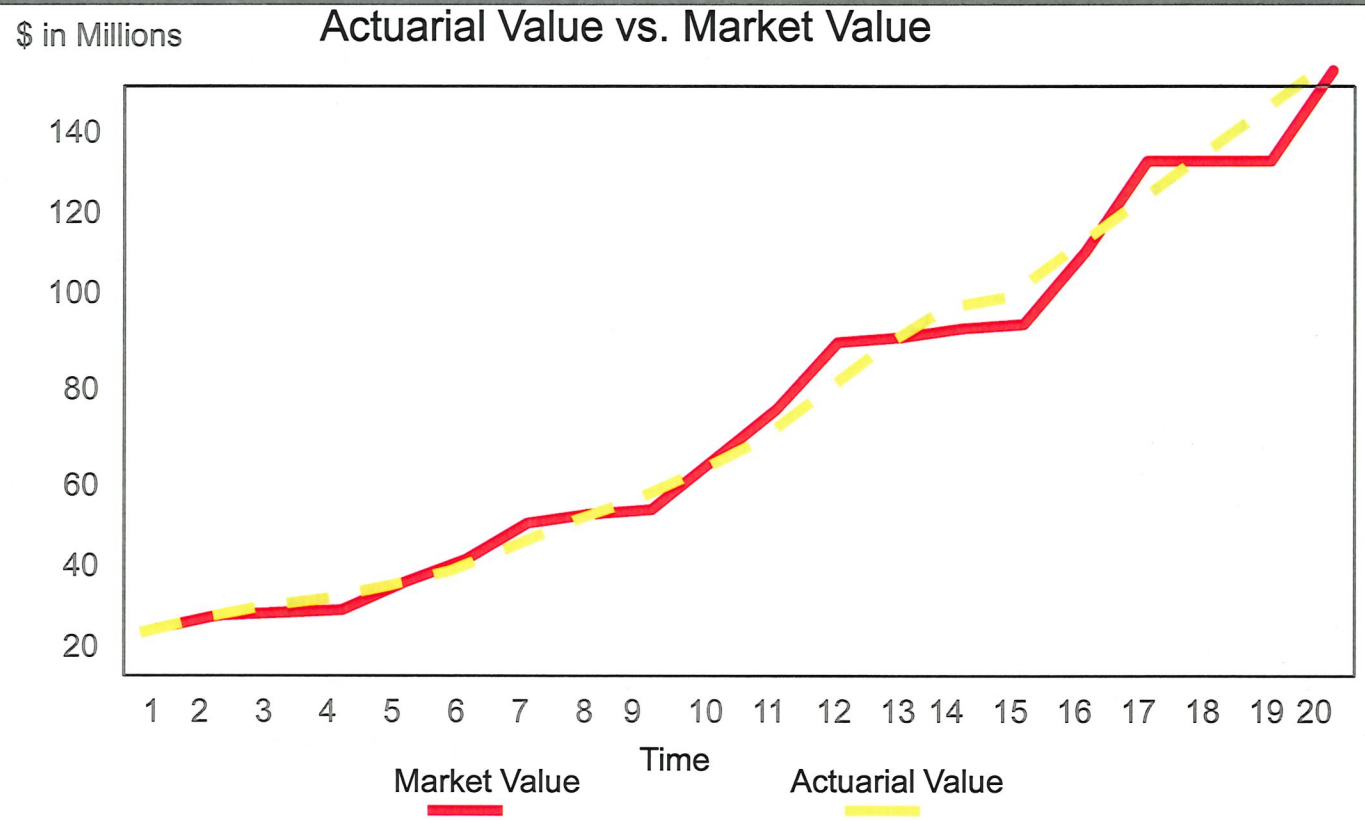
Funding Value of Assets



Actuarial (Smoothed) Value is expected to be:

- Below Market when market is doing well
- Above Market when market is doing poorly

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Private Defined Benefit Plans

- Benefits are insured by a governmental agency called the Pension Benefit Guaranty Corporation (PBGC).
  - Plans can be terminated voluntarily by employer if sufficiently funded or involuntarily (bankruptcy).
  - Outside forces may impact plan (mergers, acquisitions).
  - Only accrued (earned) benefits are guaranteed.
  - Funding rules are designed to protect the PBGC.
- Heavily regulated due to the favorable tax treatment for both contributions by employers and benefits to employees.

Public vs. Private Plans

- Actuarial Cost Method
  - Public plans: Board decides with input from Actuary or sometimes in statute.
    - ✓ Typically use entry age normal or another method that funds the ultimate, projected benefit.
    - ✓ Experience studies are performed to set assumptions, based on best estimate.
  - Private plans use methods and assumptions mandated by IRS (since 2008).
    - ✓ Unit credit: liability is the value of accrued benefits earned to date.
    - ✓ Interest rates are based on corporate bond rates.

Public vs. Private Plans

Asset Valuation Methods

- **Public plans**
  - Various options exist.
  - No requirement to use a corridor for the actuarial value of assets.
- **Private plans**
  - Used to be more like public sector.
  - Since 2008, only 1 smoothing method can be used. Pure market value can also be used.
  - Corridor is now 90 – 110% of market value. Prior to 2008 corridor was 80-120% of market value.

Public vs. Private Plans

➢ Minimum Funding Requirements

- **Public plans**
  - No federal rules. Some states impose funding requirements.
- **Private plans**
  - Federal requirements in the Internal Revenue Code set the minimum required contribution. Hefty excise taxes apply if not made.
  - Min = cost of benefit earned in current year + amortization of unfunded actuarial liability over 7 years.

➢ Benefit Restrictions: Private plans only

- Lump sums are restricted if < 80% funded.
- Benefit accruals are frozen if < 60% funded.

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Review of KPERS 12/31/09 Valuation

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Retirement System

Key 2009 Valuation Results

44-1

- Due to strong investment performance in 2009, the 12/31/09 valuation results showed a modest improvement in the System's funded status. The UAL decreased $602 million to $7.7 billion, and the funded ratio rose to 64%.
- Despite the short term improvement in the funded status, the fundamental, long term shortfall remains and will continue to grow.
  - KPERS will absorb the remaining $1.7 billion in deferred loss from 2008 over the next 3 years.
    - The actuarial value of assets is significantly greater than the market value. The funded ratio on market value is 56%, and the UAL is $9.4 billion.
    - Even assuming a yearly 8% return, the funded ratio will continue to fall, and the UAL will rise.

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Key 12/31/09 Valuation Measurements

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.)

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Key 2009 Valuation Results

1-40

- A key measurement of KPERS' long term funding status and financial health is its funded ratio (actuarial assets divided by actuarial liability).
- A funded ratio of 80% and rising is generally considered to indicate adequate funding.
- A funded ratio of 60% or below can be considered at significant risk and in need of prompt remedial action to stabilize funding.
- At 56% funded, the School group's funded status is the weakest of the three KPERS groups and is the major cause of concern.

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Change in UAL ($M)

UAL 12/31/08	$8,279
Contribution Cap/Timing Lag/Method	480
Experience	
– Investment	(1,011)
– Other	(71)
Assumption Change	0
Benefit Change	0
UAL 12/31/09	$7,677

Appendix

Kansas
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Projections of Long-Term Funded Status

64-7

In addition to the snapshot of KPERS' current funded status provided by the valuation, we model future trends in the System's long-term funding status, using the valuation data and certain assumptions.

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 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.

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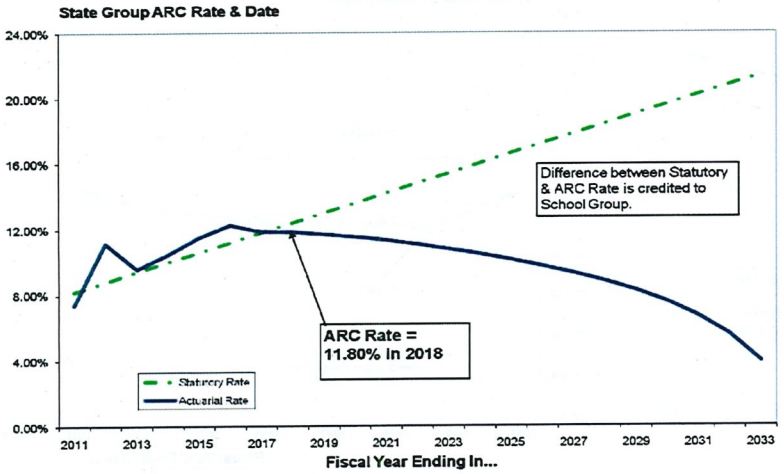
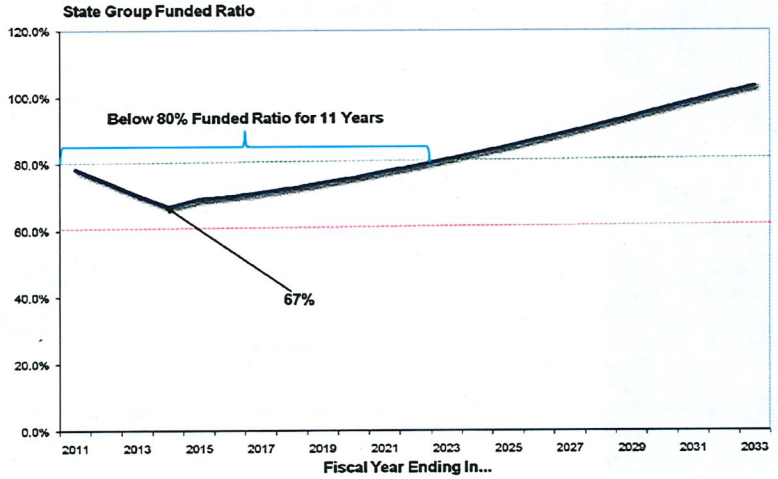
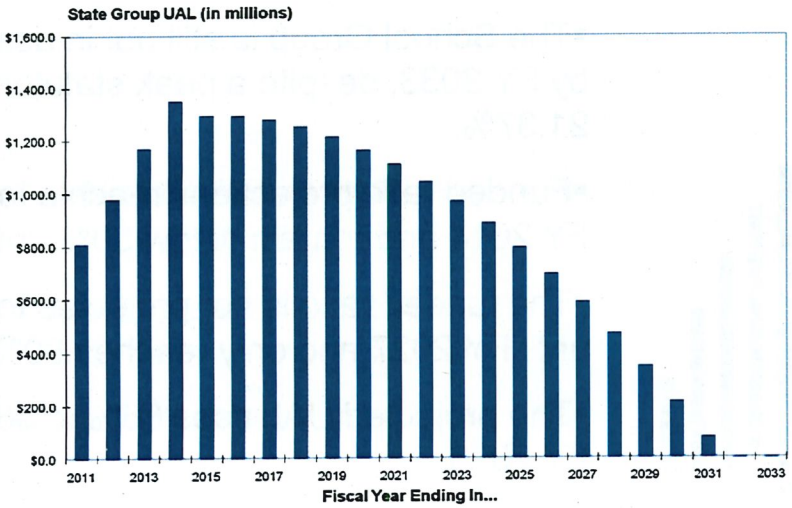
State Group Projections

- 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.

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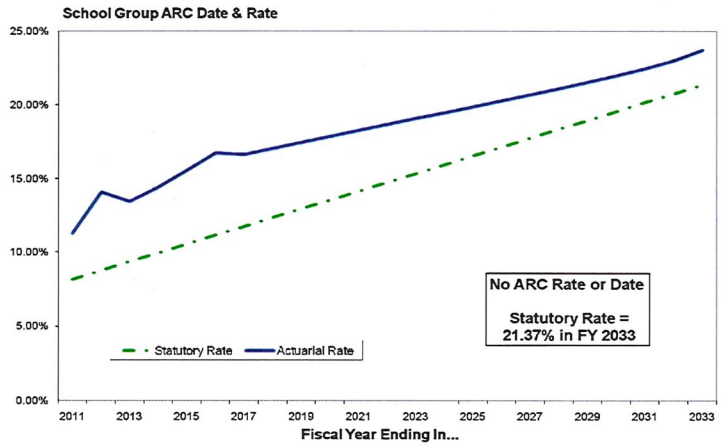
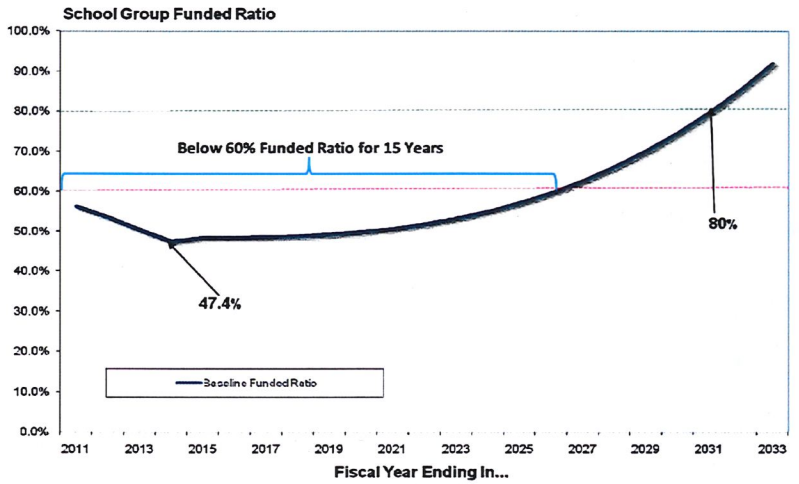
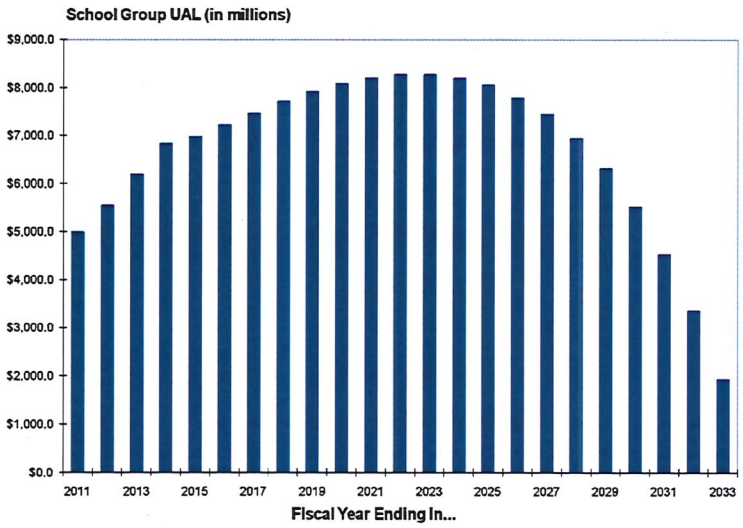
School Group Projections

- 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.

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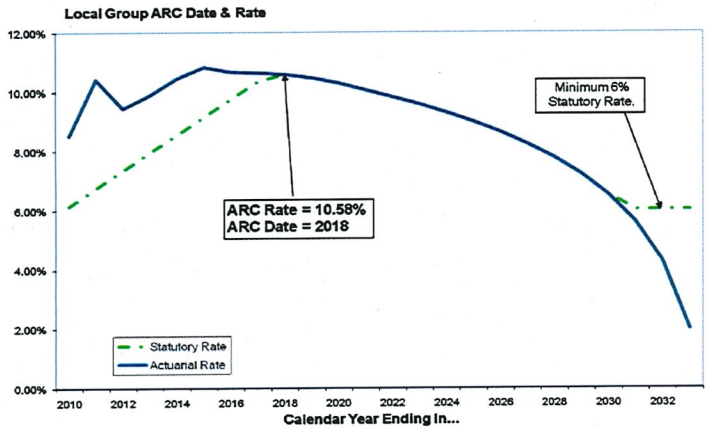
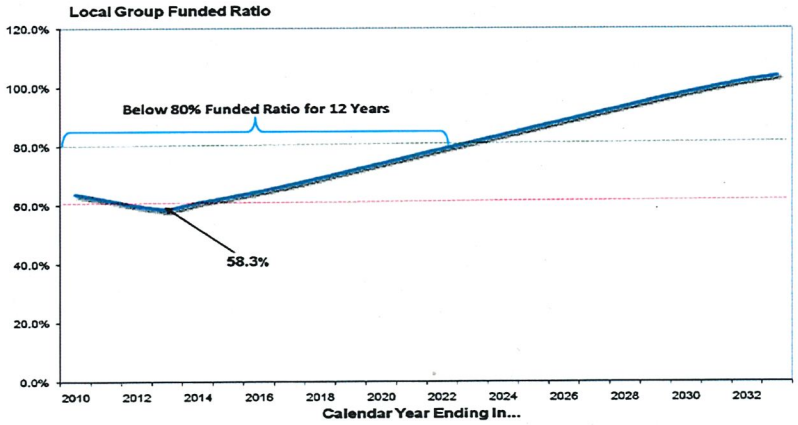
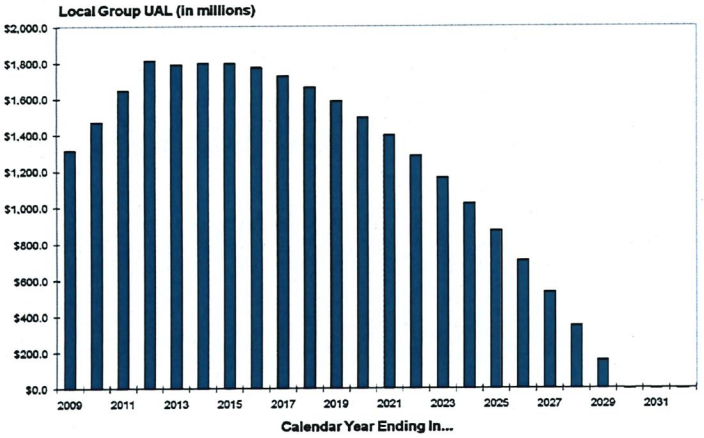
Local Group Projections

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







- 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.

European Buyout Comparison

LP Capital[SM] ADVISORS

	Montagu	EQT Partners[1]	Barclays	BC Partners
Firm & Investment Professionals				
Firm Inception	1968	1994	1979	1986
Number of Partners	22	15	7	15
Total Investment Professionals	34	75	33	49
Background	Originally a subsidiary of Midland Bank, Montagu became part of HSBC in 1992. In 2003 Montagu spun out from HSBC.	Global firm with offices in Copenhagen, Frankfurt, Helsinki, Hong Kong, London, Munich, New York, Oslo, Shanghai, Stockholm and Zurich.	Originally founded to make balance sheet investments for Barclays, the Firm raised its first 3rd-party capital investment vehicle in 1997. Currently in the process of spinning out of Barclays.	BC Partners is a European buyout firm with approx. $10 billion of AUM. The Firm has offices throughout Europe and North America.
Fund Size and Strategy				
Expected Fund Size	€2.0 billion (€2.5 billion hard cap)	€4.3 billion	€1.5 billion	€6.0 billion
First Close	Q4 2010	Q2 2011 (fee discount in first close)	TBD	EOY 2010 (Estimate)
Final Close	1H 2011	TBD	TBD	TBD
Strategy	Targets buyout investments in non-cyclical markets with inelastic pricing (e.g. Manufacturing, healthcare, waste management).	The Fund will make equity investments in companies across a diversified range of industries in Europe, with a particular focus on industries that are consolidating, growing or undergoing structural change.	The Fund will make equity investments in lower-mid market companies with strategic assets in defensive markets, strong growth opportunities or companies undergoing a change in control.	The Fund will make 10 to 15 equity investments of $200 million to $800 million in upper middle market companies, with particular focus on defensive industries and operational improvements.
Sector	Diversified	Diversified	Diversified	Diversified
Geography	Northern Europe (UK, France, Germany, Poland and Nordic region)	Particular focus on Germany and the Nordic region.	Pan European with particular focus on the UK, France, Germany and Switzerland.	Europe
Target Enterprise Value	€100 million to €1 billon	TBD	€50 to €300 million	TBD
Target Investment Size	Est. €100 to €200 million	€75 to €400 million	€25 to €125 million	€200 to €800 million
Target Number of Investments	Approx. 10	10 to 15	Approx. 30	10 to 15
Notes	The Firm's preference is to back existing CEOs in their focus areas.	The Firm places particular focus on corporate governance and operational improvements.		
Overview of Terms				
Mgmt Fee - Investment Period	1.75% of commitments	1.5% of commitments	1.75% of commitments	1.5% of commitments
Mgmt Fee - Realization Period	1.75% of invested capital; steps down to 1.25% upon subsequent fund.	0.75% of cost	TBD	1.5% of invested capital; steps down to 1.25% upon subsequent fund.
Carried Interest	20%	20%	20%	20%
Preferred Return	8%	8%	8%	8%
GP Commitment	3% of commitments, up to €60 million	TBD	TBD	TBD
Track Record	**As of 6/30/10**	**As of 12/31/10**	**As of 9/30/10**	**As of 12/31/10**
Number of Prior Funds	3	5	3	8
Prior Fund Size Range	€1.0 billion to €2.3 billion	$348 million to $4.3 billion	$1.25 billion to $2.4 billion	€61 million to €5.9 billion
Number of Investments	>80	>80	>100	>70
Invested Capital	€3.5 billion	€8.2 billion	€2.2 billion	€9.5 billion
Realized Value	€4.9 billion	€10.1 billion	€6.5 billion	€13.7 billion
Unrealized Value	€1.4 billion	€6.8 billion	€2.7 billion	€7.7 billion
Total Value	€6.3 billion	€16.9 billion	€9.2 billion	€21.4 billion
Previous Funds				
Vintage Year / Net IRR / Net Mult.	2005 / 8.2% / 1.2x	2006 / 8.4% / 1.2x	2007 / NM% / 1.0x (gross)	2005 / 5.6% / 1.1x
Vintage Year / Net IRR / Net Mult.	2002 / 23.5 / 1.8x	2004 / 17.9% / 1.5x	2005 / 16% (net) / 1.7x (gross)	2000 / 23.9% / 2.5x
Vintage Year / Net IRR / Net Mult.	1994 / 22.3% / 1.5x	2001 / 15.4% / 1.6x	2002 / 29% (net) / 2.8x (gross)	1997 / 21.0% / 2.3x
Vintage Year / Net IRR / Net Mult.	NA	1998 / 15.5% / 2.1x	NA	1994 / 58.0% / 5.2x
Vintage Year / Net IRR / Net Mult.	NA	1995 / 65.4% / 4.2x	NA	1991 / 26.0% / 2.2x

Source: Firm provided marketing materials, Preqin and Thomson. Other relevant competitors may exist that are not included above.

Kansas Public Employees Retirement System

Long-Term Funding Follow Up

House Committee on Pensions and Benefits ▪ *January 24, 2011*

Cost of Lifting Statutory Cap

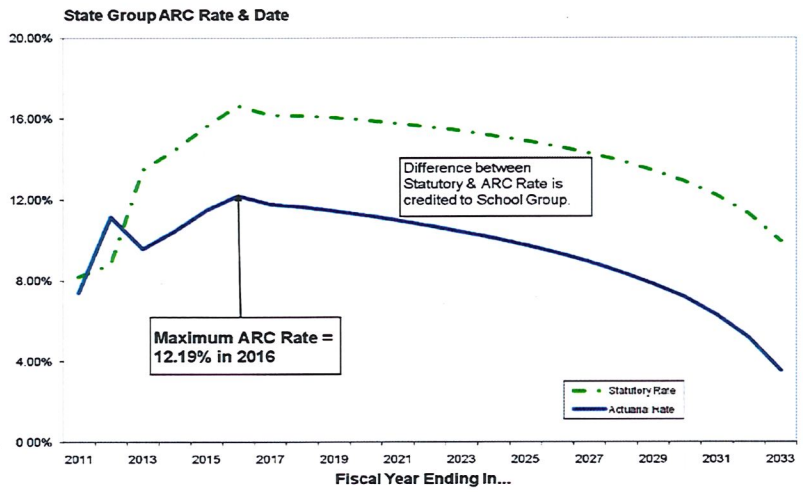
State/School Employer Contributions	State/School Rates		State/School Contributions (In Millions)		
	Baseline Rate*	ARC Rate**	Baseline	ARC Rate	Additional Contributions
FY 2012 State/School Contributions	8.77%		$ 401.6	-	-
FY 2013 Increase over Prior FY			$ 38.7	$ 231.7	$ 193.0
FY 2013 Total Contributions	9.37%	13.48%	$ 440.3	$ 633.3	$ 193.0
FY 2014 Increase over Prior FY			$ 41.1	$ 63.8	$ 22.7
FY 2014 Total Contributions	9.97%	14.44%	$ 481.4	$ 697.1	$ 215.7
FY 2015 Increase over Prior FY			$ 43.5	$ 77.3	$ 33.8
FY 2015 Total Contributions	10.57%	15.59%	$ 524.9	$ 774.4	$ 249.5
FY 2016 Increase over Prior FY			$ 46.1	$ 74.7	$ 28.6
FY 2016 Total Contributions	11.17%	16.61%	$ 571.0	$ 849.1	$ 278.1
Total Employer Contributions: FY 2011-2033			$ 23,048.8	$ 20,379.2	$ (2,669.5)

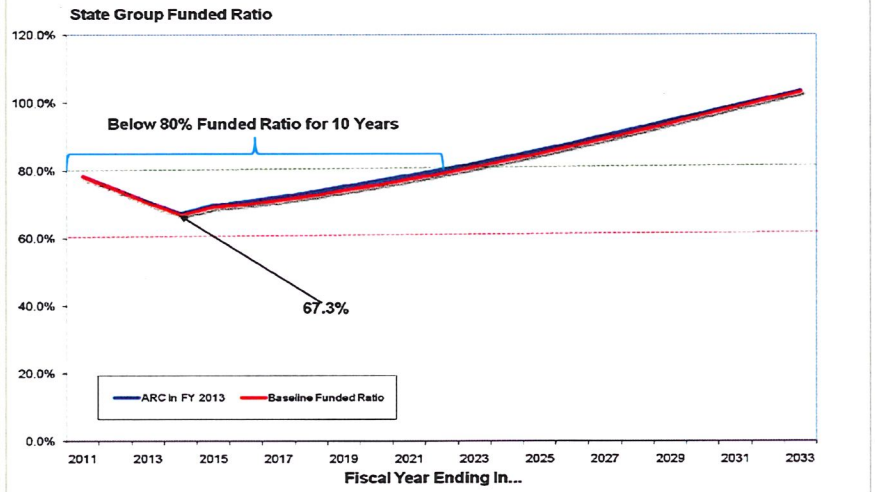
*.6% cap on annual employer contribution increases.
** No cap on employer contribution increases, effective FY 2013. Employer contributions rise to Actuarial Required Contribution Rate (ARC).

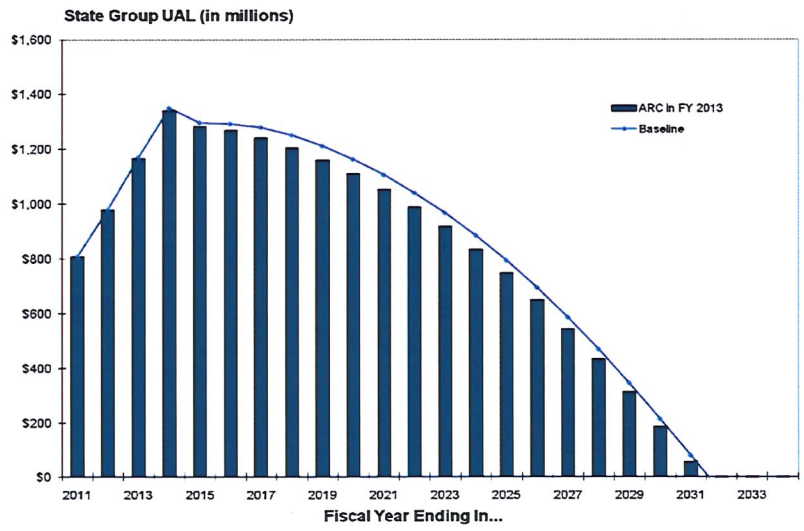
State Group: Effect of Lifting Statutory Cap

2-3

- **Raise employer rate to actuarially required contribution rate, effective FY 2013. Assumes average annual investment return of 8%.**







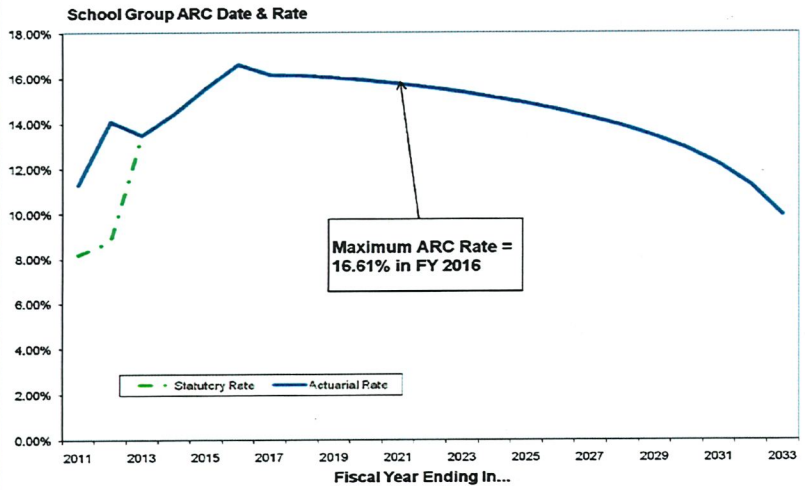
- Without a statutory cap, the State Group reaches ARC at 9.55% in FY 2013. This initial ARC rate is 2.25% less than the Baseline ARC rate of 11.8%, and the ARC date moves up five years from FY 2018.

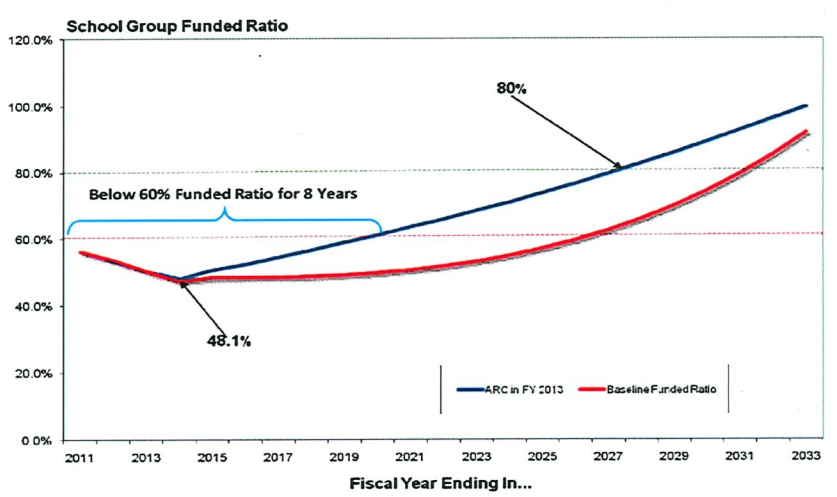
- Funded ratios reach a low of 67% in FY 2014. They are projected to reach 80% in FY 2022.

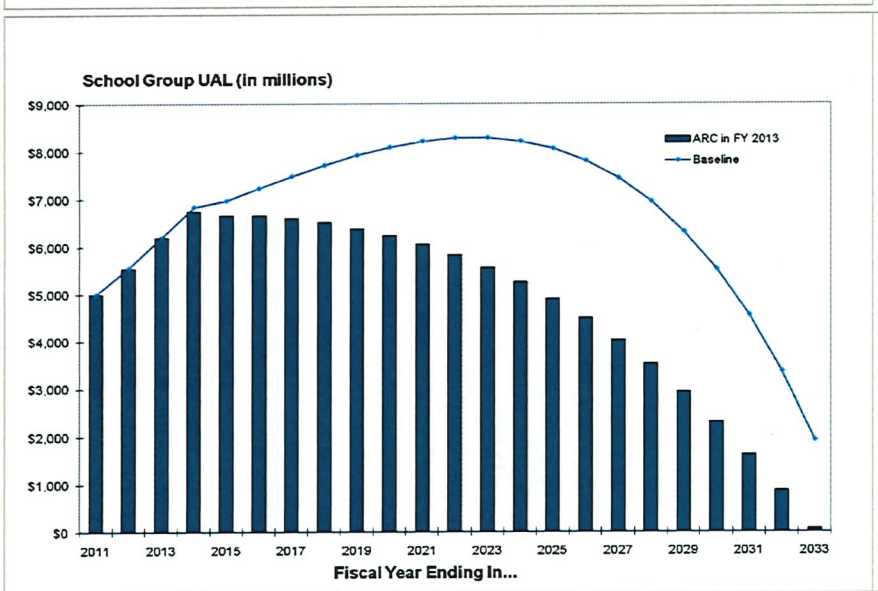
- The projected UAL rises by 66% to $1.34 billion in FY 2014.

School Group: Effect of Lifting Statutory Cap

- **Raise employer rate to actuarially required contribution rate, effective FY 2013. Assumes average annual investment return of 8%.**







- The FY 2013 ARC rate is 13.48%. The maximum ARC rate is 16.61% in FY 2016. Under the Baseline, the statutory rate climbs 21.37% by FY 2033 without reaching the ARC rate.
- Funded ratios reach a low of 48% in FY 2014. They remain below 60% through FY 2019.
- The funded ratio is not projected to reach 80% until FY 2028.
- The projected UAL rises 35% to $6.75 billion in FY 2014. Under the Baseline projection, the UAL climbs 66% to $8.28 billion in FY 2023.

"When Would KPERS Run Out of Money?"

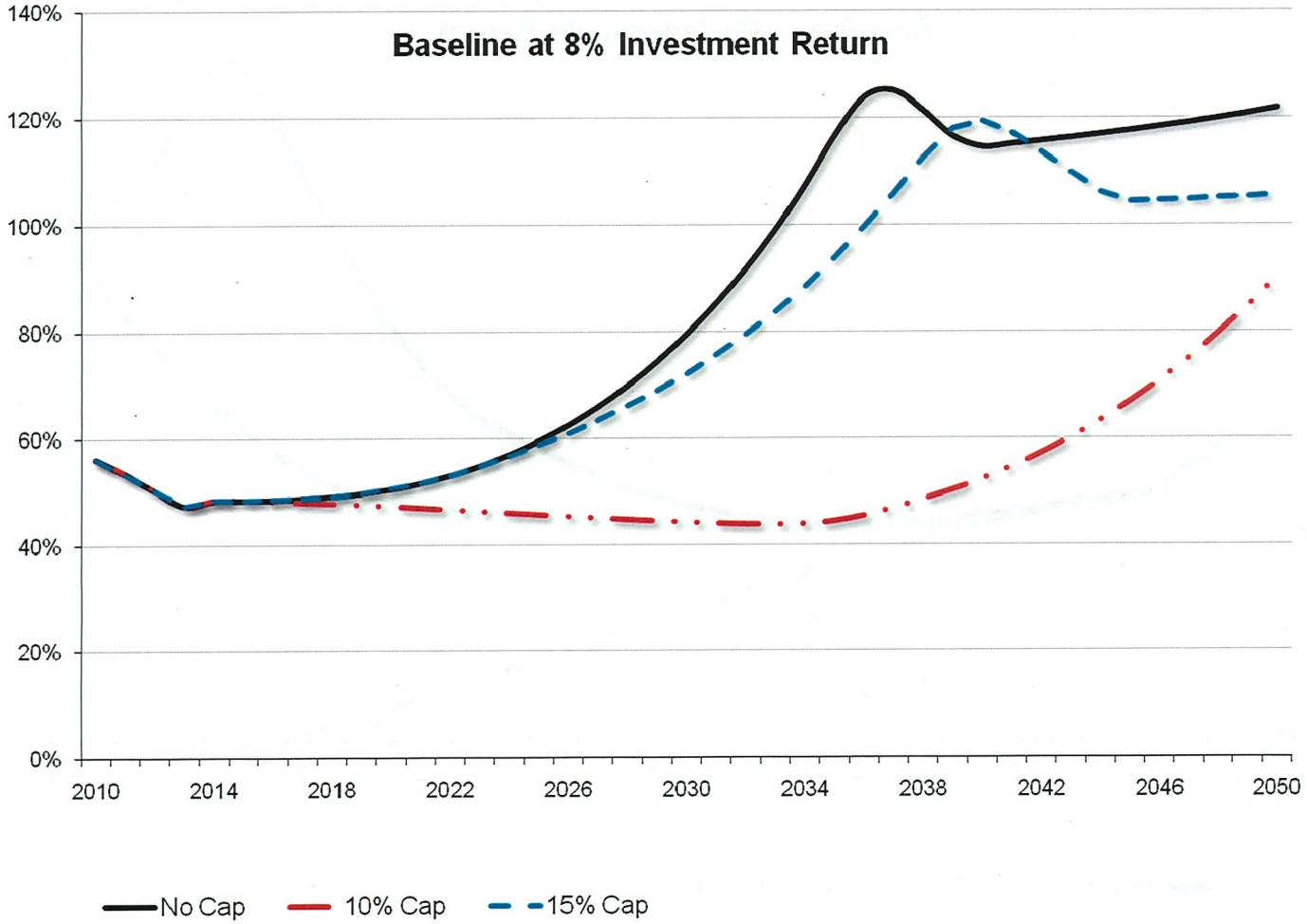
- KPERS currently has sufficient assets to pay benefits for years. However, without changes to address its funded status, KPERS eventually may have insufficient assets to pay all promised benefits.
  - KPERS' funded status is affected by numerous variables, including investment returns, contributions, changes in member demographics and experience. Changes in one or more of these variables can lead to very different results over long periods of time.
  - Therefore, projections as to "when KPERS would run out of money" are dependent on assumptions about variables such as these.
- A key measure of KPERS' long-term funding status is its funded ratio.
  - The funded ratio compares KPERS' liabilities to its assets.
  - A funded ratio of 0% would indicate that KPERS had exhausted all assets.
  - However, very low funded ratios could create sufficient cash flow problems to threaten KPERS' ability to pay full benefits.
    - At very low funded ratios, preservation of sufficient liquidity to pay benefits would be a high priority, reducing investment return potential.
    - Lower average investment returns would place additional downward pressure on funded ratios.

Running Out of Money (Continued)

2-6

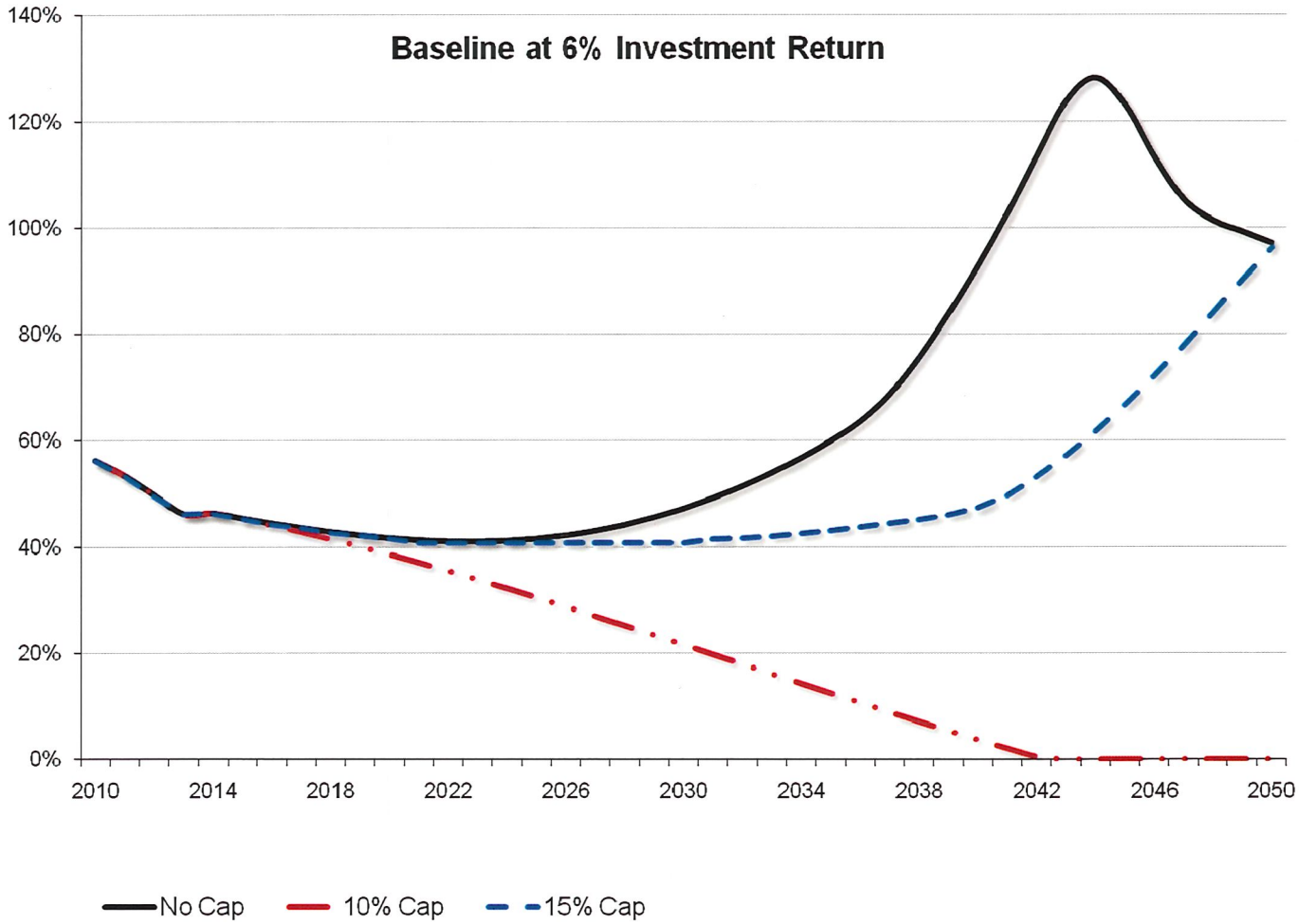
- The following projections of the School Group's funded ratio illustrate the impact of two variables on whether and when KPERS may run out of money.
  - At 56% funded, the School Group funded status is the weakest of the three KPERS groups.
  - For this reason, the projections focus on the School Group.
  - The two variables are --
    - Average investment return (at an 8% average return and a 6% average).
    - Whether employer contributions are capped (employer contributions with no maximum rate, with a 15% maximum rate, and a 10% maximum rate).
      - Statutory contribution rate for FY 2011 is 8.17%.
- For purposes of the projections, it is assumed that –
  - There is no change in the .6% cap on annual increases in employer contributions.
  - There are no changes in employee contributions or in plan design features.

- Assuming an 8% average return, the School Group is not projected to run out of money.
- However, the School Group would remain in a very vulnerable status with a funded ratio below 60% for at least 15 years.
- With a 10% cap, the School Group's funded status remains below 50% for about 28 years.



- Assuming a 6% average return and a 10% cap, the School Group is projected to run out of money around 2042.
- The School Group's funded status would remain near 40% for about 25 years with a 15% cap and around 15 years without a cap.

2-8

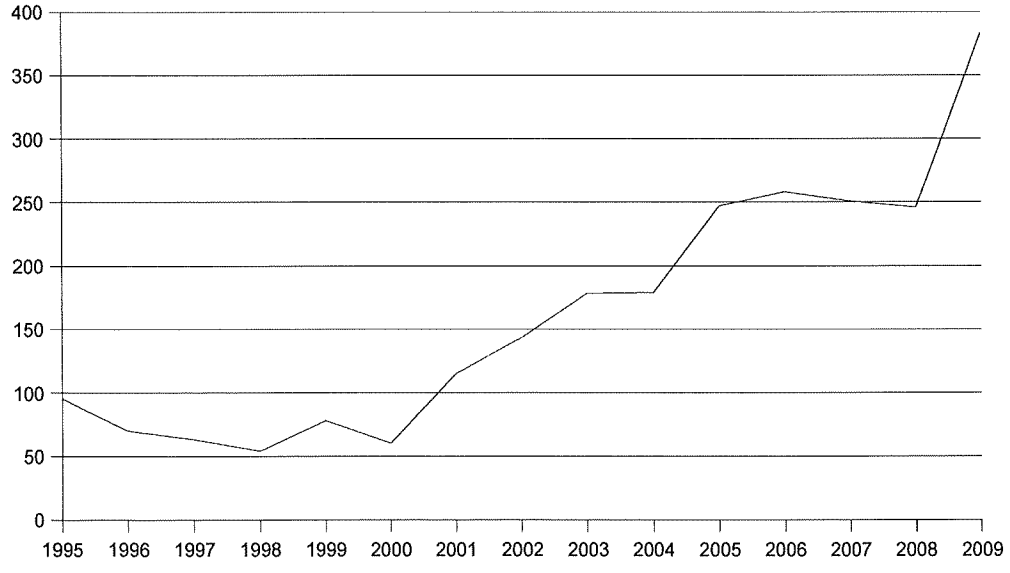


STATUTORY BUDGET CAPS ON ANNUAL KPERS CONTRIBUTIONS

The 1993 Legislature instituted budget caps that were first effective in 1995 and limited the annual increases in retirement contributions paid by certain KPERS (Kansas Public Employees Retirement System) participating employers for specified employee groups. Not all KPERS groups have had the limitation applied. The statutory caps (KSA 74-4920) have been modified several times by the Legislature to increase the annual limitation. The current limitation on annual increases for the KPERS state, school, and local government groups is 0.6 percent, allowing the KPERS participating employer contribution rates to increase no more than 0.6 percent from the previous year's rate.

Because KPERS is funded on an actuarial reserve basis, the results of an annual actuarial valuation are used to determine the annual required contribution (ARC) that should be paid by KPERS participating employers. The ARC has been used to determine the annual rates for two groups, the Kansas Police and Firemen's Retirement System, and the Retirement System for Judges. However, since 1995, the ARC has not been paid by state, school, and local KPERS participating employers due to the statutory budget caps. As a result, there has been a gap between the statutory rate (SR) that has been paid and the ARC that resulted in an underpayment of employer contributions. The KPERS actuary calculated the monetary impact of the statutory caps in limiting contributions and the shortfall amount is included in each annual actuarial valuation. Over the period from 1995 to 2009, the cumulative impact is estimated to total almost $2.5 billion that should have been paid if the ARC had been used, rather than using the SR that limited the amount of payments made annually.

Effect of Statutory KPERS Annual Contribution Caps (Shortfall)
(In Million of Dollars)



House Pensions & Benefits
Date: 1/24/2011
Attachment # 3