Approved: March 4, 2011

MINUTES OF THE HOUSE PENSIONS & BENEFITS COMMITTEE

The meeting was called to order by Chairman Mitch Holmes at 9:01 a.m. on February 9, 2011, in Room 142-S of the Capitol.

All members were present.

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
- Tom Krebs, Governmental Relations Specialist Kansas Association of School Boards

Others attending:
- See attached list.

Chairman Holmes introduced Glenn Deck, Executive Director of KPERS, (Attachment 1), and he gave his presentation on Defined Contribution Plan Overview.

Tom Krebs, Governmental Relations Specialist, Kansas Association of School Boards, (Attachment 2), appeared before the committee to present the Kansas Association of School Boards policy oversight of KPERS.

The next meeting is scheduled for February 14, 2011.

The meeting was adjourned at 10:30 a.m.

HOUSE PENSIONS & BENEFITS COMMITTEE GUEST LIST
DATE: February 9, 2011

NAME	REPRESENTING
EDMOND LEBOEUF	KDOT
Colin Curtis	Santstone Group
TERRY FORSYTH	KNEA
Doug McKinney	N.C. Reg. Planning Commission
Pepper Roberg	NCRPC
Donna Schmitt	LMC
Phyllis Shurts	LMC
Jeri Kelley	LMC
Travis Couture-Lovelady	KS St Treasurer
Brian R Thompson	PEAK
Dennis Phillips	KSCFF
[illegible]	
Nicole Proulx Aiken	LKM
Gene Meyer	Kansas Reporter
Jane Carter	KOSE
RON BROWN	FOP
Ron Gardner	KCPR

House Pensions & Benefi
Date: 2/9/2011
Attachment # 1

Kansas Public Employees Retirement System

Defined Contribution Plans Overview

House Committee on Pensions and Benefits ▪ *February 9, 2011*

Defined Contribution Introduction

Types of Retirement Plans:

- **Defined Benefit (DB) Plans**—DB plans specify the retirement benefit payable for the employee's remaining lifetime, based on a formula set out in the legal plan document. A common basic formula is:

  Final Average Salary x Years of Service x Multiplier = Annual Benefit

- **Defined Contribution (DC) Plans**—DC plans specify the contribution rate the employer and employee pay into the plan each year. The employee usually directs the investment of the contributions in a range of investment options. There is no guaranteed benefit for life. Instead, the amount employees receive during retirement depends on the value of the account at retirement, investment earnings following retirement, and the timing and amount of distributions during retirement.

- **Hybrid Plans**—Hybrid plans combine both DB and DC elements. For example, a plan might have a base DB plan with a low multiplier (e.g. 1%) and a supplemental DC account. Another example is a cash balance plan in which the employer promises both the contribution to an account (e.g. 5% of pay) and a guaranteed investment return (e.g. 6%).

DB Vs. DC Comparison Chart

1-3

	DEFINED BENEFIT PLAN	DEFINED CONTRIBUTION PLAN
Risk Attributes		
Investment Risk	Employer*	Employee
Liability Estimate Risk	Employer*	Not applicable without guaranteed benefit.
Inflation Risk (After Retirement)	Employer, if an indexed COLA is provided* Employee, if COLA inadequate	Employee
Longevity Risk (Risk of Outliving Assets)	Employer*	Employee
* Some degree of risk may be shared with employee, depending on member contribution structure.		
Investment Attributes		
Asset Allocation and Investment Management	Professional management and expertise.	Dependent on individual expertise, judgment, and attention to active monitoring and managing of the account.
Investment Opportunities	Access to wide range of asset classes and strategies, including private equity and real estate.	Generally access only to equity and fixed income investments through mutual funds.
Time Horizon	Consistent, long-term, pooled horizon.	Shifts depending on individual participant's age.
Investment Fees	Lower institutional fees	Higher fees depending on size of DC plan and mutual fund options provided.
Plan Management Attributes		
Employer Contribution Volatility	Potential for significant increases in employer contribution rates depending on investment and demographic experience and consistency in paying the full actuarial rate.	None
Portability (Member leaves employment prior to retirement)	If non-vested, member can only withdraw or roll over employee contributions, plus interest. If vested, must wait until retirement eligibility to receive benefit earned to that point or, generally, must forfeit the earned benefit to withdraw or roll over employee contributions plus interest.	Can withdraw or roll over employee contributions and all vested employer contributions, plus investment earnings.

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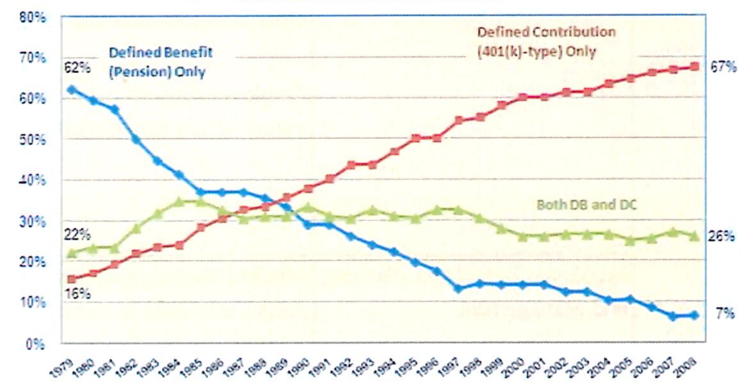
DB Vs. DC Comparison Chart

	DEFINED BENEFIT PLAN	DEFINED CONTRIBUTION PLAN
Plan Management Attributes		
Employer Administrative Complexity	Extensive statutory provisions on eligibility, vesting, final average salary, multiplier, working after retirement, and other elements affecting retirement benefit amounts.	Minimal number of terms and conditions to administer, such as percent of employer and employee contributions, vesting of employer contributions, and options for distribution.
	Employer responsible for developing and maintaining infrastructure for administering these provisions.	Much of the infrastructure for day-to-day account management typically contracted out to third-party service provider. However, timeliness and accuracy of payroll and deferral processing is of particular significance.
Employee Retirement Planning and Management	Minimal ongoing responsibility for active planning, particularly early in career. No responsibility for managing account.	Continuous, primary responsibility for understanding, planning, monitoring, and actively managing retirement account.
	Complex rules and value of benefits not readily understood by all members.	Relationship between savings rate, returns, and ultimate benefit not readily understood by all members.
Workforce Impacts		
Attraction/recruitment	Tends to be preferred by older employees or employees seeking a long-term career.	Tends to be preferred by younger employees and employees who are more mobile.
Retention	Tends to encourage retention of employees with greater length of service (career employees).	Only provides a retention incentive to the extent the employer contribution is higher than provided by employers competing for the same workers.
Relationship Between Plan and Other Conditions of Employment	Other terms and conditions of employment and personnel actions can directly impact both benefits and employer contribution obligations, including pay raises and promotions, overtime, and early retirement incentives in or outside of the plan. This is particularly true for changes in conditions of employment during the years leading up to retirement.	Other terms and conditions of employment and personnel actions have a direct impact on employer contributions only to the extent that the payroll base rises.

Private Sector Trend To DC Plans

- Since the 1980's, pension coverage in the private sector has been shifting significantly from Defined Benefit (DB) to Defined Contribution (DC) plans.
- As the graph to the right shows, of private sector employees with pension coverage, the percent of employees with only a DB plan fell to 7% by 2008, while those with only DC rose to 67%.

Figure 2
Private-Sector *Participants* in an Employment-Based Retirement Plan, by Plan Type, 1979–2008
(Among *those who have* a retirement plan)



Source: U.S. Department of Labor Form 5500 Summaries for 1979-1998; PBGC, Current Population Survey data for 1999–2008; Employee Benefit Research Institute estimates for 1999–2008.

- In recent years, there has been a significant trend for large companies to freeze DB plans and shift to DC plans. This shift has been driven by a number of factors including: increased regulation of DB plans, financial distress in certain industries, global competitive financial pressures, volatility on company financial statements, and shifting cost and risk to employees.
- In 2009, 42% of the companies in the Fortune 1000 sponsored active DB plans compared to 59% in 2004.

6-1

Other States' Defined Contribution Plans

- The DB plan is the primary retirement plan for most state, local and school employees who are covered by a state-sponsored retirement plan. In the last 10 to 15 years, there have been about a dozen states who have adopted DC plans as either a mandatory plan, voluntary option, or hybrid plan.
- **Mandatory DC Plans**
  - **Michigan**—Adopted a mandatory DC plan for new state employees in 1997. Local employees are still covered by a DB plan.
  - **Alaska**—Adopted mandatory DC plan for new state, local and school employees in 2005.
  - **Utah** — In 2010, adopted a plan structure for new employees with a choice between a straight defined contribution plan or a hybrid pension/defined compensation plan with the employer contributions capped by law at 10% of pay.
- **Optional DC Plans**—States with optional DC plans include: Florida, Colorado, Montana, North Dakota, Ohio, and South Carolina.
- **Hybrid Plans**—States with features combining both DB and DC elements include: Florida, Georgia, Indiana, Nebraska, Ohio, Oregon, and Washington. In 2010, Michigan established a hybrid plan for its public school employees.

Other States' Defined Contribution Plans

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- **States Switching from DC to DB or Hybrid**
  - **Nebraska**—Primary plan was DC from 1967 to 2002. Closed to new employees in 2003 and replaced with cash balance plan.
  - **West Virginia**—DB plan for teachers was closed to new members in 1991, and a DC plan was created. In 2005, DC plan was closed to new enrollment. In 2006, DC members voted to merge with DB plan. After legal challenges, legislation passed in 2008 to allow DC members to transfer to DB plan.

Kansas Defined Contribution Plans

In addition to the three state DB plans (KPERS, KP&F and Judges), there are three types of DC plans for certain State of Kansas employees. Also, Kansas school and local governments sponsor voluntary, supplemental DC plans for their employees.

- **Regents Retirement Plan—**Established in 1961 for unclassified faculty and administrators. Mandatory employer contribution of 8.5%, and employee contribution of 5.5%. Members become vested immediately in all employee and employer contributions and self-direct investments. Currently, two service providers offer a wide range of investment options—TIAA-CREF and ING. The Regents also offer a voluntary plan to which an employee can make additional contributions.
- **Voluntary Deferred Compensation Plan (457 Plan)—**Established in 1976 for state employees. In 1982, local governments were allowed to adopt the state plan. Employees can make voluntary pre-tax contributions to a deferred compensation account and self-direct investments. Current service provider is ING, and the plan was transferred under the administration of KPERS in 2008.

Kansas Defined Contribution Plans (Continued)

1-9

- **Deferred Compensation Plan for State Officials**—Established in 1988 for certain state officials, legislative session employees, and legislative leadership staff. Most members are offered one-time option of joining KPERS or this plan. Employer contribution is 8%, and there is no mandatory employee contribution. These accounts are managed as part of the State's voluntary 457 plan.

- **School District and Local Government Voluntary DC Plans**—Nearly all the school districts in the State have for many years provided a voluntary supplemental "403(b)" DC plan to their employees. Employees make voluntary pre-tax contributions. Most cities and counties that do not adopt the State Deferred Compensation Plan have a separate voluntary deferred compensation plan (457 Plan).

2010 HB 2751

- Late in the 2010 Legislative Session, a bill was introduced establishing a mandatory defined contribution plan for new members.
- Key elements of HB 2751 included –
  - A new Tier 3 consisting of members first employed on and after 7/1/2012, as well as inactive, non-vested members returning to employment on or after that date.
  - An employer contribution to each employee defined contribution accounts equal to 5% of pay. The employer contributions would be vested with 3 years of service.
  - A mandatory, pre-tax employee contribution of 7% of pay, vesting immediately.
  - Additional employer contributions in amounts to be established by the Board for –
    - A "plan funding rate," which would be paid to the KPERS DB plan (Tiers 1 and 2) to fund the plan's unfunded actuarial liabilities and to offset any other adverse effect of the DC plan on the closed DB plan.
    - An employer contribution for coverage by the KPERS death and disability plan.
    - An administrative expense rate to pay for the Board's administration costs.
  - Investment options selected by the Board, including a default option. Investments may be the same as those for the State's 457 plan.
  - Option to negotiate contract with the 457 Plan's current third-party administrator (ING) for a period not to exceed five years.

Plan Design Evaluation Factors

1-11

- The State of Kansas is ultimately the plan sponsor for KPERS, and the Legislature establishes its plan design.
- If the Legislature was to consider changes to KPERS, what might be key plan design goals?
  - **Financial Soundness/Cost—**Does it ensure the financial soundness of the System over the long-term? Are the short-term and long-term costs to employers and employees affordable and sustainable?
  - **Retirement Benefit Adequacy—**Does it provide benefits that, when combined with Social Security and personal savings, will sustain the retiree's standard of living in retirement?
  - **Workforce Incentives—**Does it provide sufficient incentives to attract and retain high quality employees? Does the benefit level provide incentives for premature or belated retirement? Or for orderly retirements and succession planning?
- After addressing basic policy issues relating to financial soundness and retirement benefit adequacy, there is a range of supplemental plan design and administration issues to be considered, such as vesting and availability of member options and choices, recordkeeping, and member communications.
- Each type of retirement plan design has characteristics with a different mixture of strengths, weaknesses, and tradeoffs that need to be weighed.

Financial Soundness and Cost

- If the Legislature chose to redesign KPERS by establishing a mandatory DC plan for a third tier of future members, two preliminary funding goals should be considered.
  - **Amortize the existing unfunded actuarial liability (UAL) over approximately the same time period**, paying at least the same amount each year as currently scheduled with the existing plan.
    - The School Group is currently out of actuarial balance, and there is a significant portion of the actuarially required contribution rate's UAL cost component that is not being paid.
    - In order to pay off the current UAL by the end of its existing amortization period, additional contributions would be required whether or not the current DB plan is closed to new members and replaced with a mandatory DC plan.
  - **Avoid significantly increasing total employer costs due to the new plan design** when compared to the existing plan design.
- A review of some of the key concepts involved in KPERS' actuarial funding formula is helpful in thinking about what would be required to accomplish those goals.

DB Plan Actuarial Funding Formula

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- Actuarially based funding for the DB plan is illustrated by this formula:

  Contributions + Investment Earnings = Benefits + Expenses

- Contributions consist of employee and employer contributions.
- KPERS employee contributions are set by statute.
  - Tier 1 – 4% of pay.
  - Tier 2 – 6% of pay.
- Today's primary focus is on employer contributions.
  - KPERS actuarial employer contributions are paid as a percent of the payroll -- the actuarially required contribution (ARC) rate.
  - KPERS actuarial employer contributions consist of two components:

DB Normal Cost + DB UAL Cost = Actuarial Employer Contribution

- **DB Normal Cost (DB NC)**—The employer portion of the cost of projected benefits allocated to that year. Employee contributions are applied first to the normal cost, and the remainder is paid by the employer.
- **DB UAL Amortization Payment (DB UAL)** —The annual payment on the cost of funding the unfunded actuarial liability.

Employer Contribution Components

- For example, the State/School Group's FY 2013 employer contribution rate or ARC rate is:

DB Normal Cost + DB UAL Cost = Total Employer Contribution*

4.47% + 8.99% = 13.46%

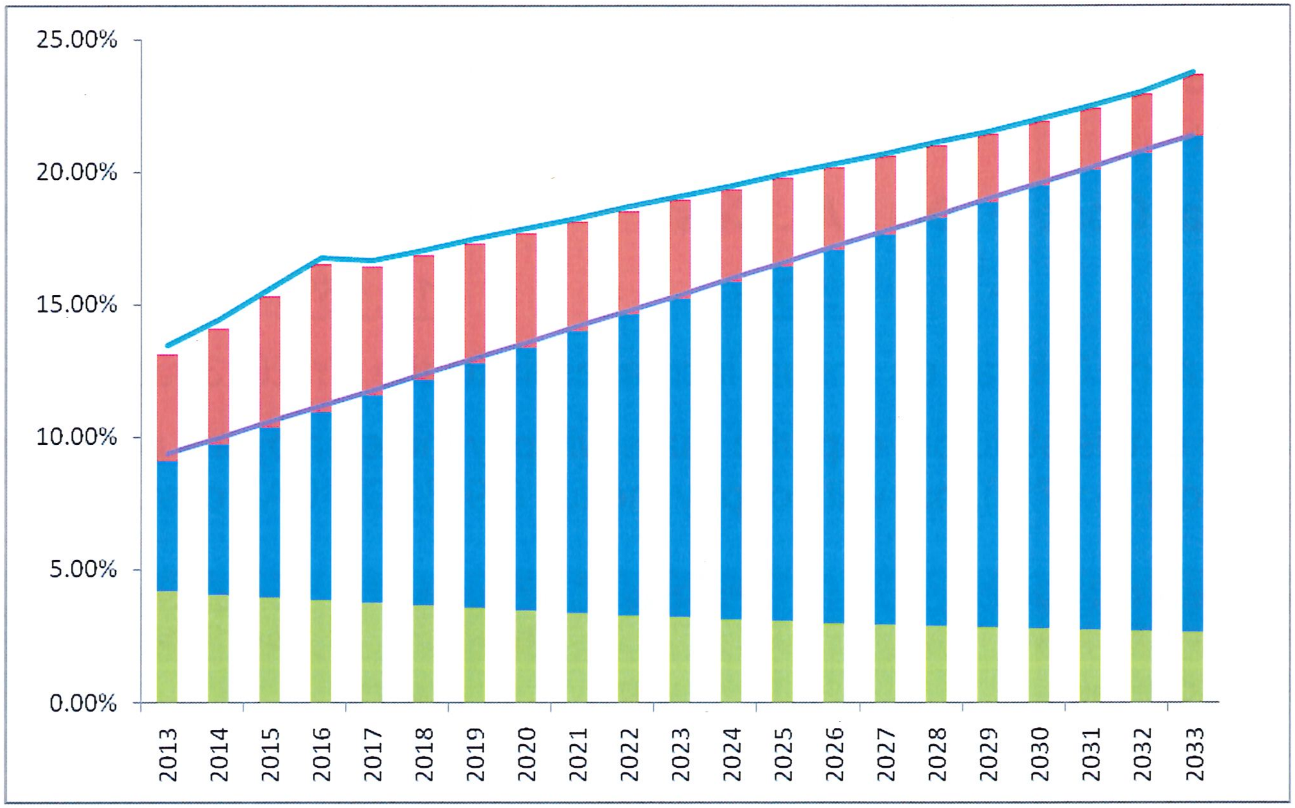
  - The statutory .6% cap on annual increases limits the FY 2013 rate to 9.37%.
  - Because of this statutory cap, the State will pay the employer's portion of the normal cost (4.47%), but will not pay the full 8.99% DB UAL cost.

Components Of FY 2013 State/School Employer Rates*	ARC Rate	Statutory Rate	Portion of ARC Not Contributed
DB Normal Cost Rate	4.47%	4.47%	0.0%
DB UAL Rate	8.99%	4.90%	4.09%
Total Rate	13.46%	9.37%	4.09%

- Graphic representations of the components of KPERS employer contribution rates over time follow.

* Rates based on 12/31/09 Valuation, which become effective in FY 2013 for State and School Groups and CY 2012 for Local Groups. Assumes the current .6% cap on employer contribution increases remains in place.

Employer Contribution Rate Components



FY 2013		FY 2033
4.47%	Normal Cost Payment	2.73%
4.90%	Funded UAL Payment	18.64%
9.37%	Statutory Rate	21.37%
4.09%	Portion of UAL Rate Not Contributed	2.35%
13.46%	Actuarial Rate	23.72%

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Funding for Closed DB Plan + New DC Plan

- If the existing DB plan was to be closed and a new, mandatory DC plan established for all new (Tier 3) employees, the formula for employer actuarial contributions would then be –

Closed DB NC + Closed DB UAL Cost + DC Contribution (New Hires)

=

Total Employer Contribution

  - **DB NC**—The employer's portion of the cost of projected benefits allocated to that year for members of the closed Tier 1 and Tier 2.
  - **DB UAL Amortization Payment**—The annual payment on the cost of funding the unfunded actuarial liability for the closed Tier 1 and 2.
  - **DC Employer Contribution**— The contribution paid by the employer into the DC participants' accounts for the new Tier 3 employees.

Funding Goals

1-17

- The following formula helps with evaluating plan design options:

New Plan: Closed DB NC + Closed DB UAL Cost + DC Contribution (New Hires)

– Is less than or equal to –

Existing Plan: Open DB NC + Open DB UAL Cost

- The UAL cost payment is assumed to be at least the same for the open DB plan and a closed DB plan.
- The normal cost for current employees is the same whether the DB plan is open or closed, unless changes can be made to active employees' future benefits.
- Therefore, the primary drivers of total employer costs are the normal costs for new hires in the existing plan compared to the DC employer contributions for new hires.
  - The normal costs for all new members of the DB plan are the lower costs associated with Tier 2.
  - The Tier 2 normal costs are projected to be approximately 3% due to lower benefit levels and higher employee contributions, with the current investment return assumption.

1-18

Funding Observations

- Moving to a DC plan would not, in and of itself, reduce KPERS' long-term funding shortfall.
  - The UAL is a liability that will need to be paid whether the existing DB plan is retained or whether it is closed and replaced by a DC plan for new members.
- The employer contribution to a DC plan would need to be no more than the normal cost for the new members in the existing DB plan in order to avoid either raising total employer costs or paying smaller amounts toward the UAL.
  - For a DC plan to free up resources to make additional contributions toward amortizing the UAL, the employer DC contribution would need to be less than the normal cost for new members of the existing DB plan.
- If the DB plan is closed and replaced with a DC plan for future members, then with respect to those members the employers' future investment and longevity risks are controlled and the risk of new unfunded liabilities is reduced in the future.

Retirement Benefit Adequacy

1-19

- The basic goal of retirement planning is to provide for a level of retirement income that will permit retirees to maintain their preretirement lifestyle throughout retirement.
- The accepted quantitative standard for measuring achievement of this goal is the "replacement ratio."
  - Replacement ratio refers to the percentage of preretirement income that is provided or needed after retirement.
- **Minimum** target replacement ratios of 70 percent to 80 percent are commonly recommended by financial planners.
  - The appropriate replacement ratio for a particular member may need to be modified due to personal factors such as spousal income and retirement benefits.
- KPERS was designed to work in tandem with Social Security benefits and personal savings. All three components are necessary to provide an adequate replacement ratio throughout retirement.
  - The level of KPERS benefits will depend on the member's length of service, age at retirement, and final average salary.
  - The replacement ratio may change over time, depending on whether there is a COLA (as with Tier 2) and inflation rates during retirement.

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Retirement Benefit Adequacy (Continued)

Example: KPERS Tier 2 member retiring at age 65 with 22 years of service (average for KPERS members) with $40,000 salary.

	Annual Benefit	% of Income Replaced
Social Security	$13,800	34%
KPERS	$14,260	36%
Personal Savings	$3,940	10%
Total	**$32,000**	**80%**

- Similarly, any analysis of the level of benefits provided by a defined contribution plan would be affected by a variety of factors, such as length of service, age on entry into the plan, age when benefits are drawn, savings rates (employer and employee contributions), investment returns, inflation, and longevity.
  - Such analyses would also include "snapshots" of benefits at the point of retirement and at different points during retirement.

Next Steps

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- At the February 7th meeting of the House Committee on Pensions and Benefits, introduction of a bill establishing a mandatory defined contribution plan for future members of KPERS was requested.
- The Chair of the Senate Select Committee on KPERS has asked KPERS and its actuary to prepare models analyzing the cumulative impact on funding of combining –
    - A mandatory defined contribution plan for future members; and
    - SB 49, HB 2086 or similar measures that begin addressing the long-term funding shortfall in the existing KPERS DB plan.
- As this legislation is developed, KPERS will provide analysis of DC plan design and funding issues, such as transition costs and retirement benefit adequacy.

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KPERS Testimony
before the
House Pensions and Benefits
by

Tom Krebs, Governmental Relations Specialist
Kansas Association of School Boards

February 9, 2011

Chair Holmes and members of the committee; thank you for the opportunity to share KASB's impressions of the committee's work to date.

First, a bit of background. KASB is a not-for-profit corporation established to help school boards and their members to better perform their jobs. Of the 289 school districts, 287 are members. Other members include community colleges and regional service centers. We offer a number of services, including legal, board training, policy, and of course, advocacy. We also sponsor several pools that allow our members to buy insurance and commodities at either a reduced rate and/or when they cannot get the service elsewhere.

Each December, our Delegate Assembly meets. It is asked to approve a series of resolutions, which are good for one year. It also has the opportunity to revise or add specific policies, which are, once adopted, in effect until amended or repealed. The current policy language on KPERS reads:

The employers' cost of any retirement program or benefits mandated by the state should be fully and directly funded by the state. KASB opposes making KPERS a non-contributory system. KASB believes the Legislature should consider changes in the KPERS system to reduce the need for state general fund support, providing that benefits remain.

Let me address each specifically.

"The employers' cost of any retirement program or benefits mandated by the state should be fully and directly funded by the state." As a result of this statement, we

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oppose any attempt to shift the costs from the state to districts. But just as we believe the cost of the plan should be borne by the state, we also believe it is the state's purview to establish benefits. We have never lobbied to increase benefits by adding COLAs or other means. Also, we did not oppose changes in the law several years ago when new limitations were put on employees working after retirement.

We are also aware, unfortunately, of what has happened recently when the state has shifted programs to districts with a promise to pay…it hasn't. Special education, LOBs, capital outlay, professional development, and most prominently, base aid per pupil are all below levels established in statute. We are firm in our insistence the state pay for the state retirement program.

"KASB opposes making KPERS a non-contributory system." This sentence is the remnant from a different time when talk of a non-contributory system was discussed, which is not the case now. As a result, we do not have a policy concern with the consideration of defined contribution plans for employees hired at some date certain in the future. As the committee has heard from everyone it's ask, a defined contribution plan does nothing to address the significant unfunded actuarial liability that exists for retirees and those employees currently in the system whether they are Tier I or Tier II.

KASB believes the Legislature should consider changes in the KPERS system to reduce the need for state general fund support, providing that benefits remain. We understand the money used for schools comes from the state's general fund as does the state's contribution to KPERS; therefore our policy statement has other implications. The committee heard from the Utah delegation a system that spends too much for pension will, by definition, be stretched to pay wages…if the size of the pie is static. KASB has expressed an interest in looking at the tax system, as we feel it probably needs reform. A shrinking tax base and expanded exemptions have hurt revenues. Perhaps by making it more fair and broad based, additional revenues might be generated that are perceived to be appropriate to Kansans. By doing so, we created an avenue for both paying off the UAL as well as keeping the Legislature's ability to make good its commitment to raising state pay to market parity.

KASB believes it will take a balanced approach and some sacrifice from all parties to solve the problem and maintain a fair retirement system without damaging the educational interests of Kansas students.

Thank you for the opportunity to come before the committee.