

MINUTES OF THE SENATE KPERS SELECT COMMITTEE

The meeting was called to order by Chairman Stephen Morris at 4:15 p.m. on February 3, 2011, in Room 548-S of the Capitol.

All members were present.

Committee staff present:

Alan Conroy, Kansas Legislative Research Department
Julian Efird, Kansas Legislative Research Department
Michael Steiner, Kansas Legislative Research Department
Gordon Self, Office of the Revisor of Statutes
Daniel Yoza, Office of the Revisor of Statutes
Linda Reed, Committee Assistant

Others attending:

See attached list.

Chairman Morris welcomed everyone to the meeting. The Chairman stated that it is the intention of the committee to make sure KPERS (Kansas Public Employees Retirement System) stays on track. The Chairman presented an overview of the history and changes to KPERS since its inception.

Chairman Morris welcomed Glenn Deck, Executive Director of KPERS to the Committee. Mr. Deck provided an overview of the long term funding of the Kansas Public Employees Retirement System. (Attachment 1 pg. 1-19)

Julian Efird, from the Kansas Legislative Research Department, addressed issues moved forward from the Joint Committee 2010 Interim Study and Recommendations. Mr. Efird stated that recommendations were reintroduced at beginning of session as **SB 49** and **HB 2086**.

Gordon Self, from the Office of the Revisor of Statutes answered questions from committee members regarding the bills.

Glenn Deck discussed legislation introduced by the Joint Committee. The Joint Committee on Pensions, Investments, and Benefits introduced the two bills focused on steps to address KPERS' long-term funding shortfall. Mr. Deck stated that bills **SB 49** and **HB 2086** are updated versions of bills considered last Session. (Attachment 1 pg. 21-29).

The Committee presented questions and a request for additional information from Mr. Deck.

Chair Morris thanked Mr. Deck, Mr. Self, and Mr. Efird, for the time involved in preparing and presenting the information to the committee.

The next meeting is scheduled for Monday, February 14, 2011.

The meeting was adjourned at 5:20 p.m.

PLEASE CONTINUE TO ROUTE TO NEXT GUEST

KPERS SELECT COMMITTEE GUEST LIST

DATE: 2/3/11

NAME	REPRESENTING
Levi Henry	Sandstone Corp LLC
Jane Carter	KOSE
Terry Forsythe	KINETA
Dodie Wellshear	USA/Kansas
Nicole Proulx Aiken	LKM
Steven Johnson	KS House
Tom Kurb	KNSB
Colin's Mysler	Kansas Reporter
DEREK HEIN	HEIN LAU FIRM
Cheryl Semmel	USA/Kansas
Kari Prestey	Kearney & Associates Inc.
John Faler	KAPE
Brian Thompson	KAPE
Wigh Keck	Capitol Strategies

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KPER'S SELECT COMMITTEE GUEST LIST

DATE: 2/3/11

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Kansas Public Employees Retirement System

KPERS Long-Term Funding

Senate Select Committee on KPERS

• *February 3, 2011*

KPERS' LONG-TERM FUNDING STATUS

KPERS OVERVIEW

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

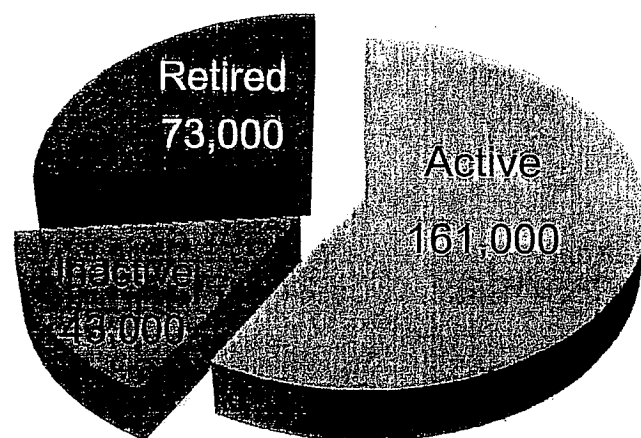
Contributions + Investments - Expenses = Benefits

→ Employees = Statutory rate of 4% (Tier I) or 6% (Tier II)
 → Employers = Changes annually based on actuarial calculations
 → Assumed actuarial rate = 8%

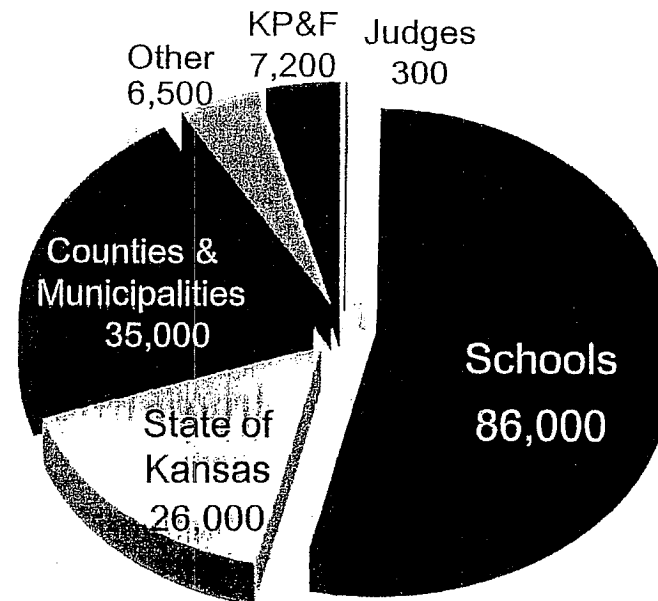
Membership

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

Total Membership



Active Membership

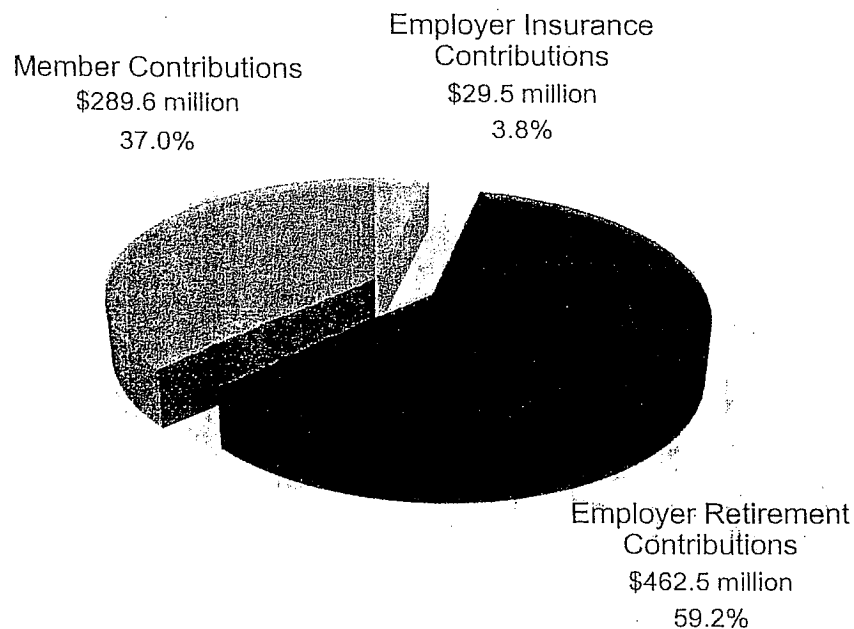


Contributions and Benefits

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

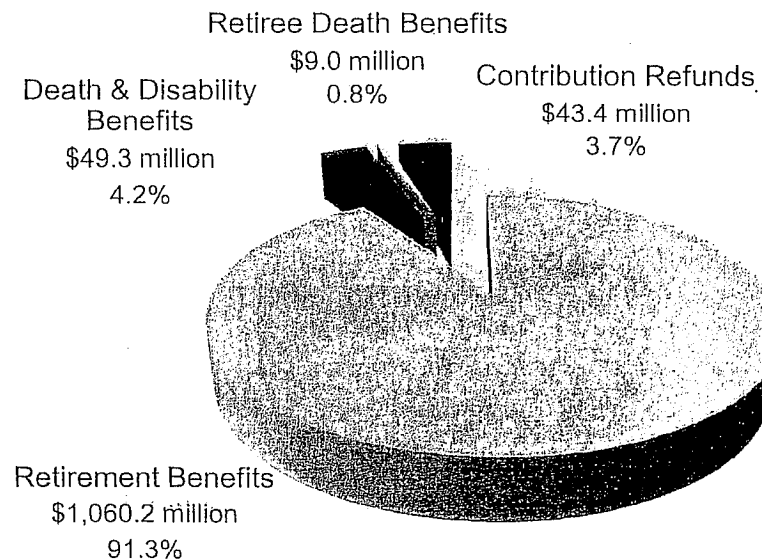
- The State pays employer contributions for state and school employees.
- Approximately 85% to 90% of benefits remain in Kansas.

FY 2010 Contributions



FY 2010 Contributions = \$782 million

FY 2010 Benefits

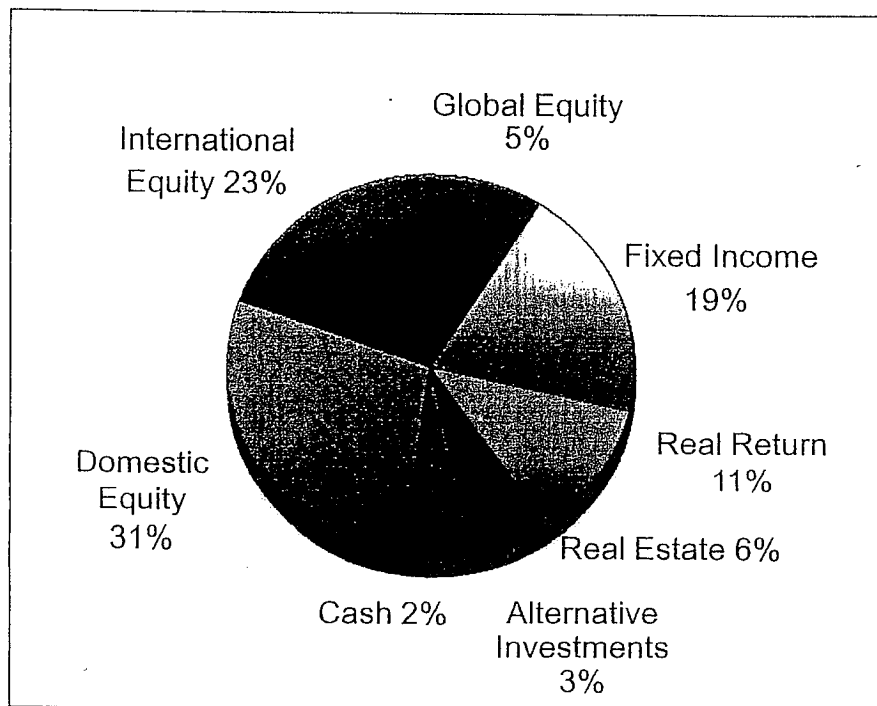


FY 2010 Benefits = \$1,162 million

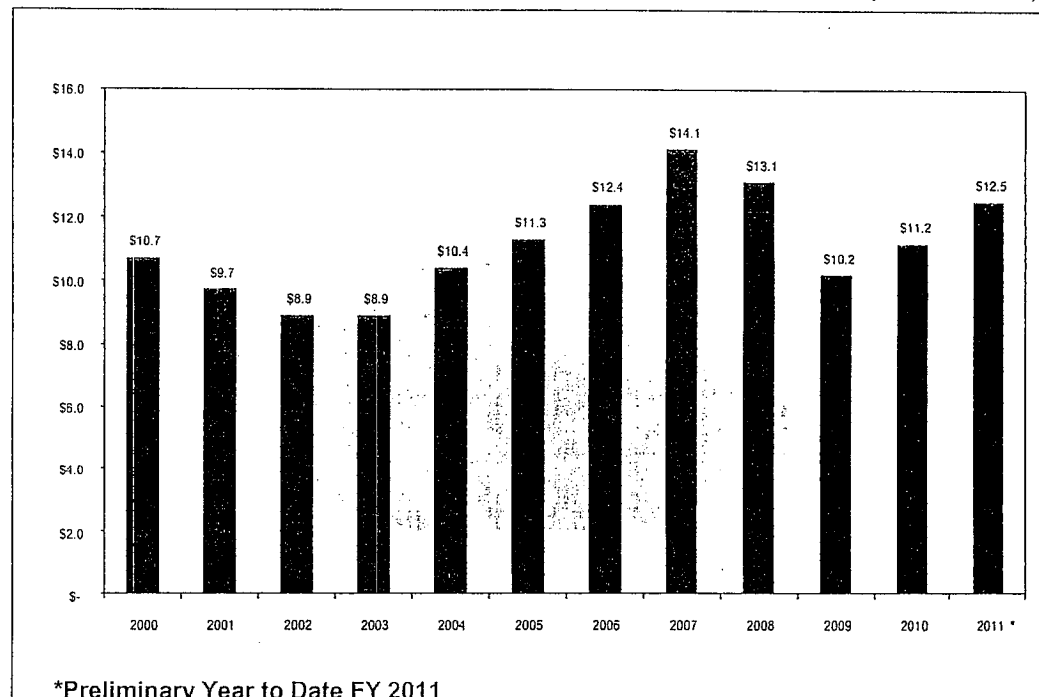
Assets

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



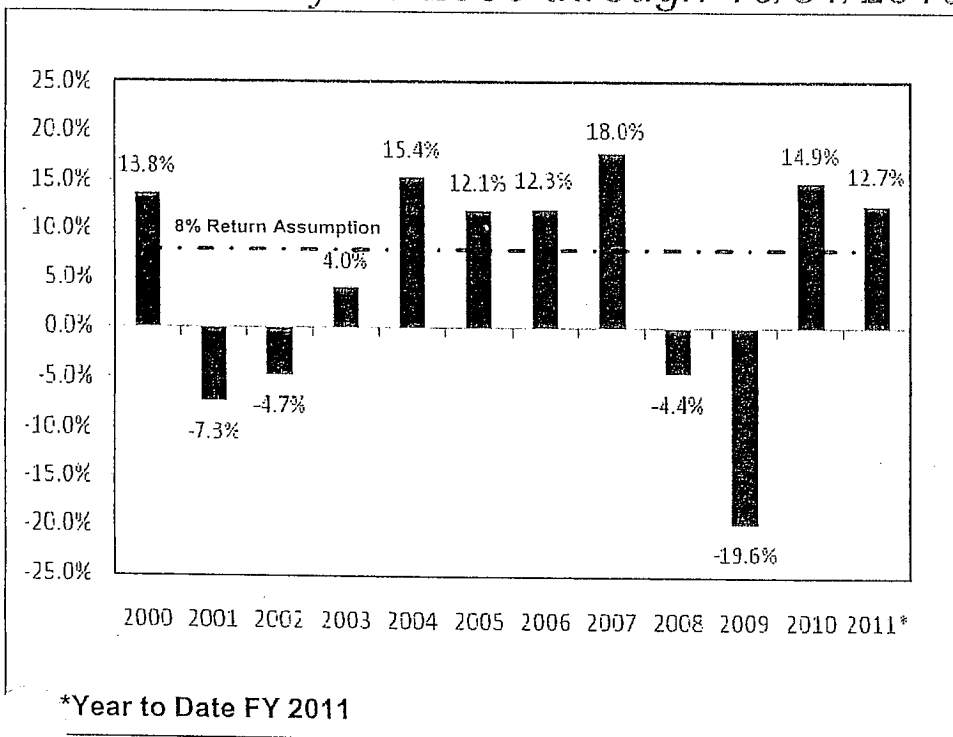
Fund Growth FY 2000 – 10/31/2010 (in billions)



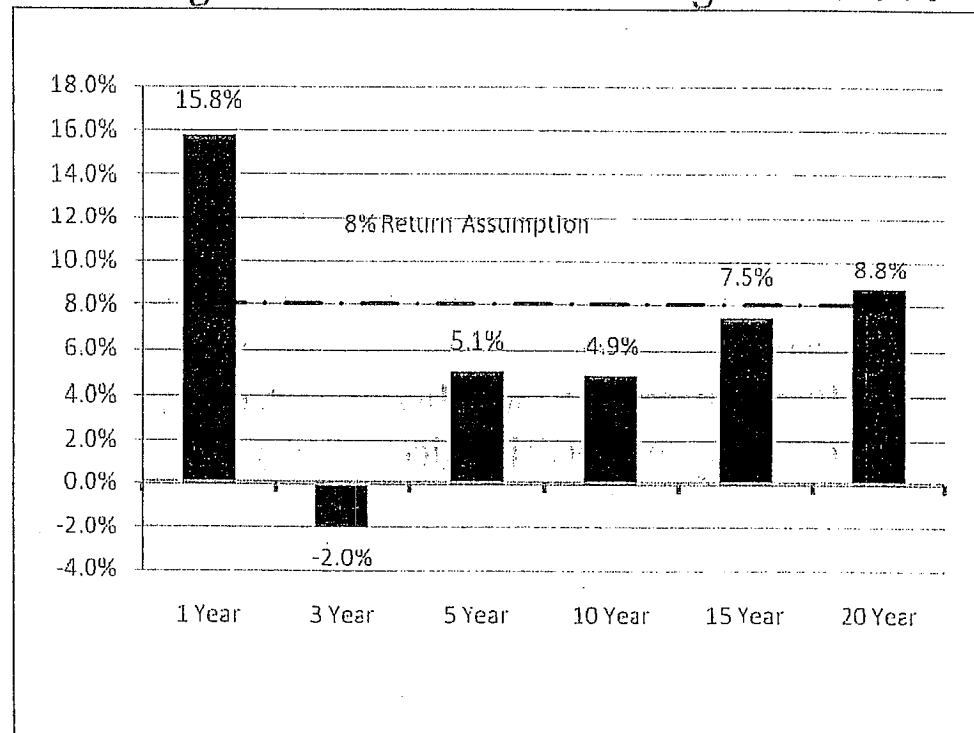
Investment Returns

- 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%
 - Return for FY 2011 through October 31, 2010 = 12.7%

Return History FY 2000 through 10/31/2010



Average Annual Return through 10/31/10



Historical Perspective on Long-Term Funding

- 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

- 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.

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

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.)

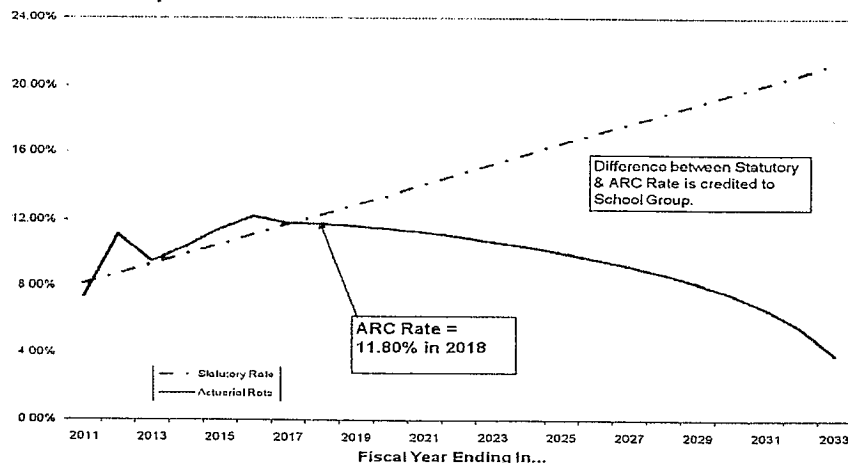
Projections of Long-Term Funded Status

- 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.

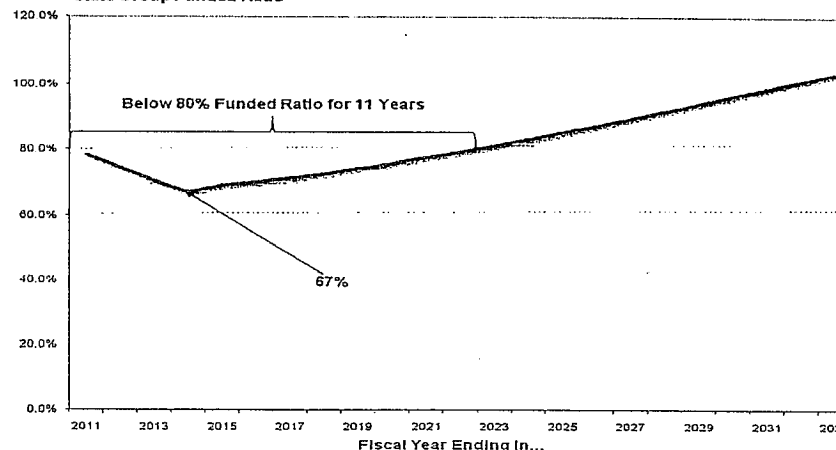
State Group: Baseline Projections

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

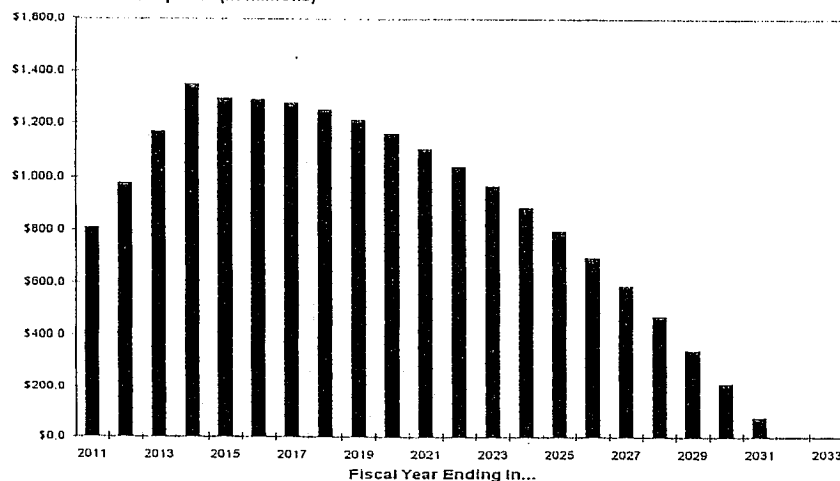
State Group ARC Rate & Date



State Group Funded Ratio



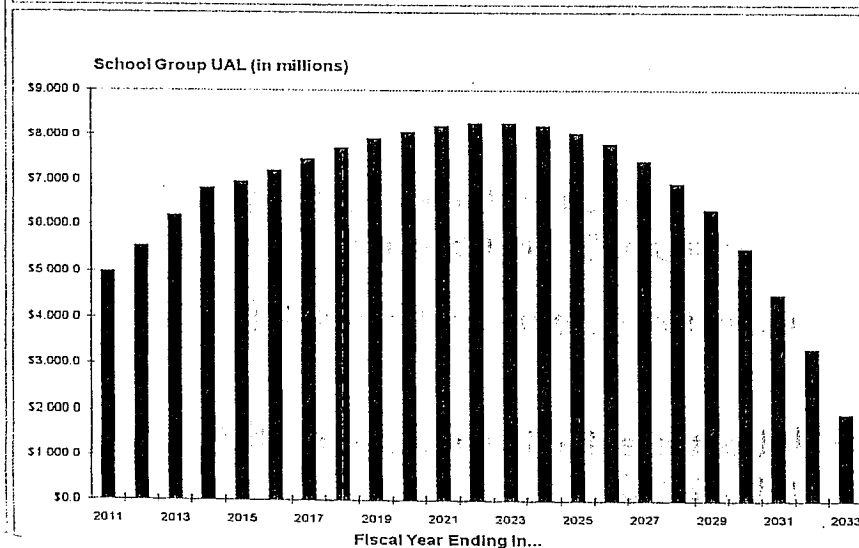
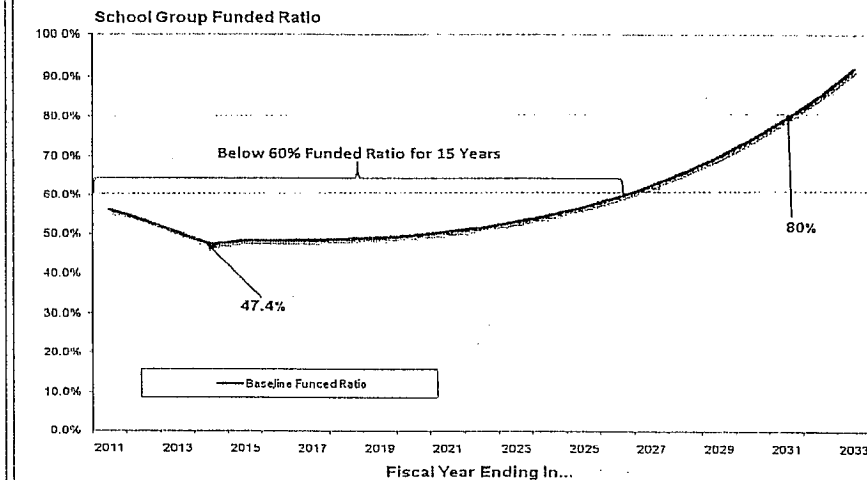
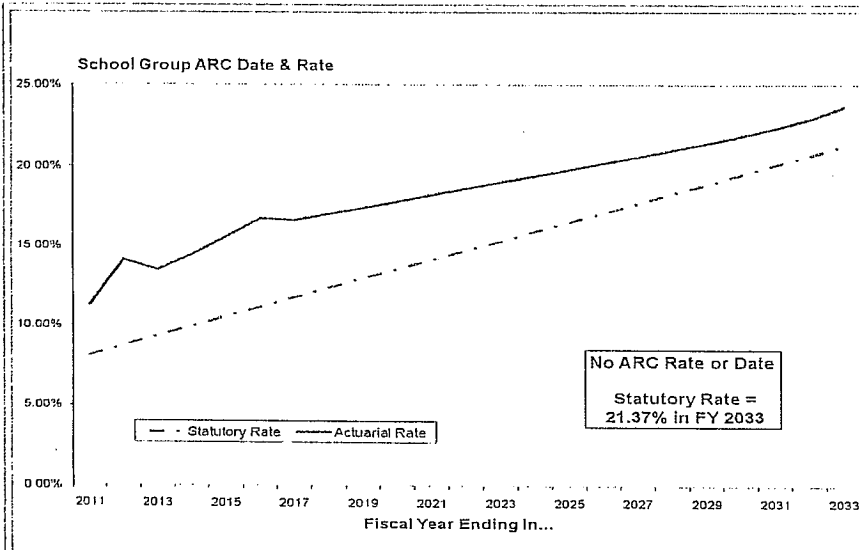
State Group UAL (in millions)



- 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.

School Group: Baseline Projections

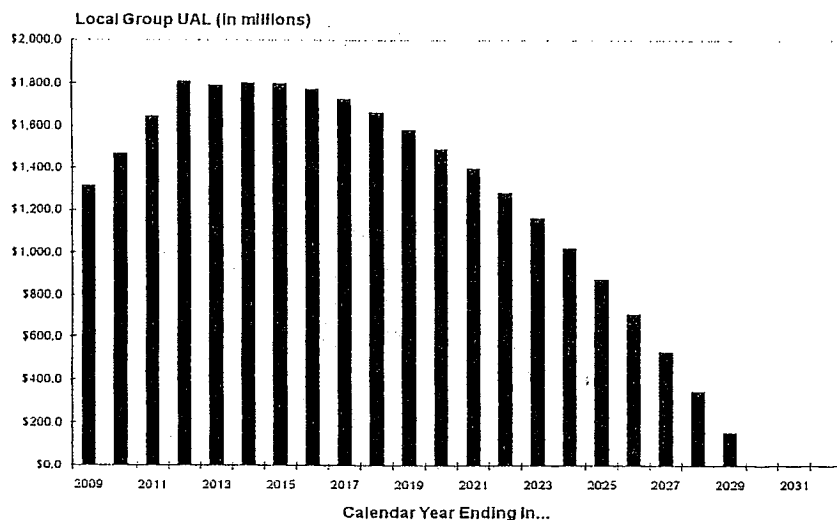
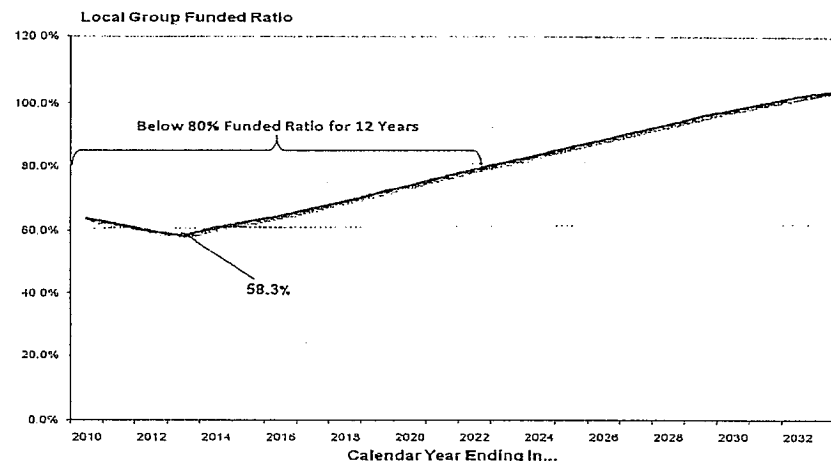
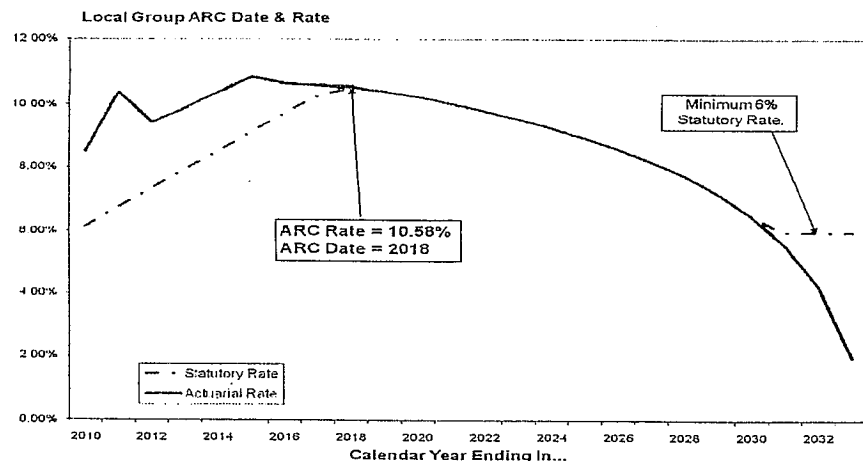
- No change in the .6% employer rate increase cap. Assumes average annual investment return of 8%.



- 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%.



- 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.

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.

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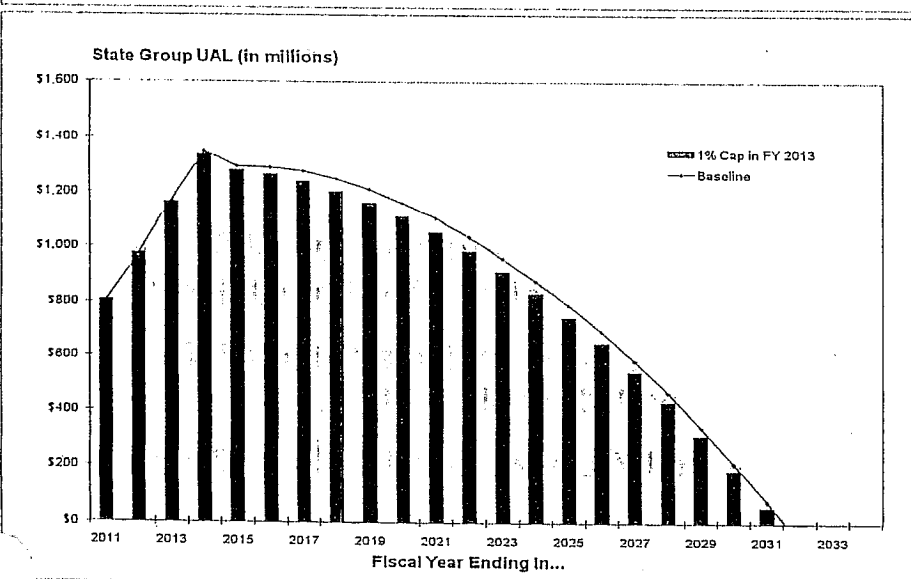
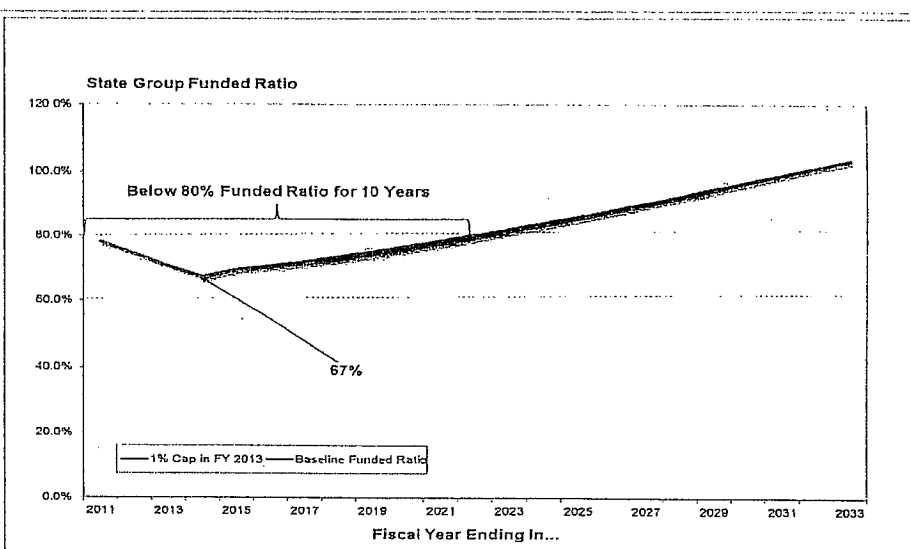
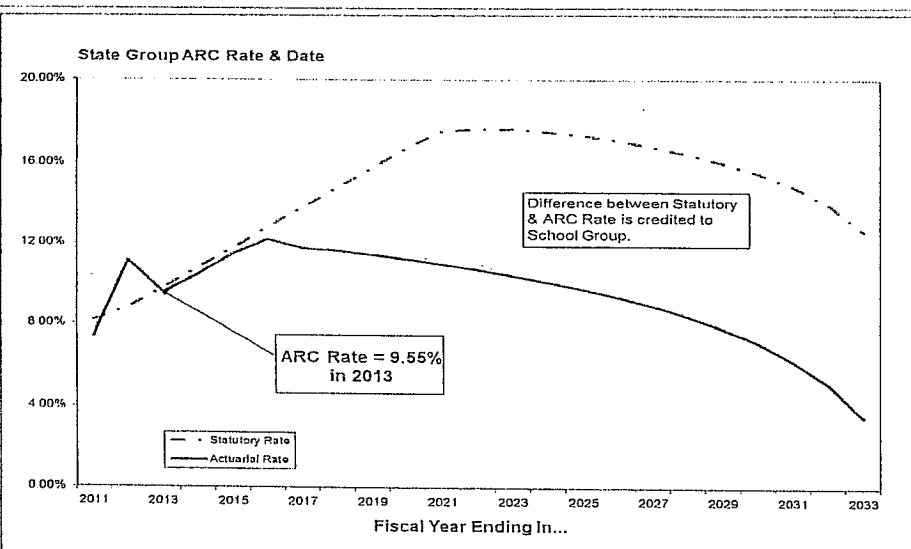
HB 2086 AND SB 49

Legislation Introduced by the Joint Committee

- The Joint Committee on Pensions, Investments, and Benefits has introduced two bills focused on steps to address KPERS' long-term funding shortfall.
- Both bills are updated versions of bills considered last Session.
 - **HB 2086.** This bill would raise the .6% statutory cap on employer rate increases to 1.0% per year, effective FY 2013.
 - Unlike its predecessor, HB 2400, it applies to all three KPERS groups – State, School, and Local.
 - **SB 49.** This bill contains the same three elements as 2010 SB 564.
 - A 1.0% cap on increases in the employer contribution rate, effective FY 2013.
 - A 2.0% increase in employee contributions, phased in with a .5% increase in each of four years, beginning January 1, 2013.
 - An increase in the benefit formula multiplier to 1.85% for future service only, effective January 1, 2013.

State Group: HB 2086 Projections

- Raise employer rate increase cap to 1.0%, effective FY 2013. Assumes average annual investment return of 8%.



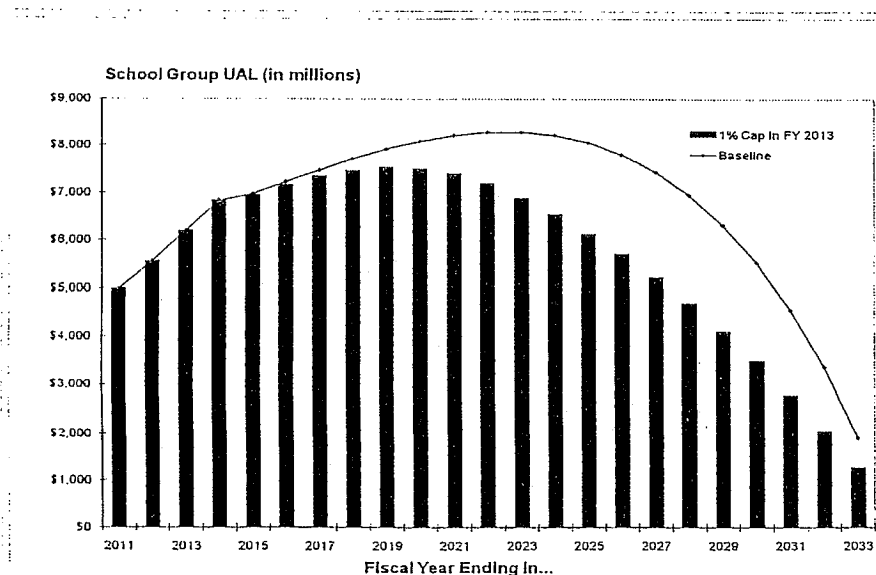
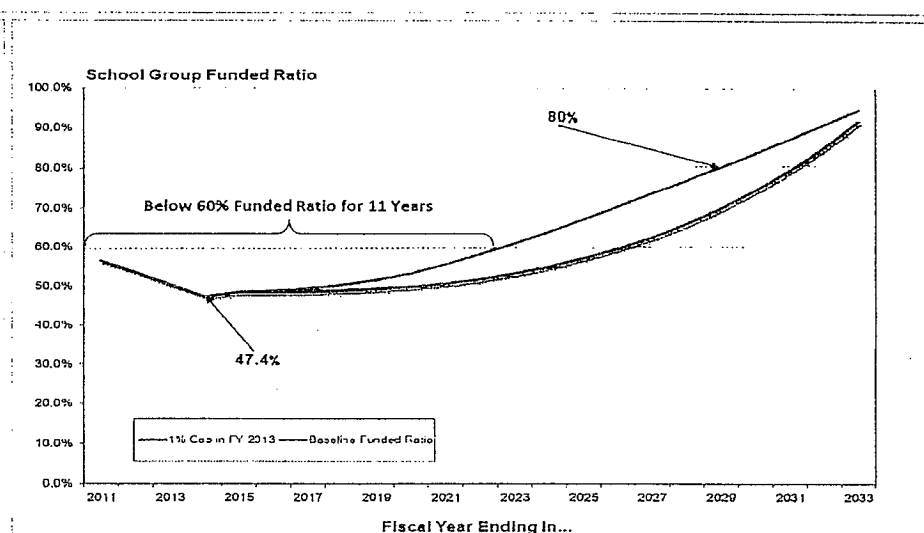
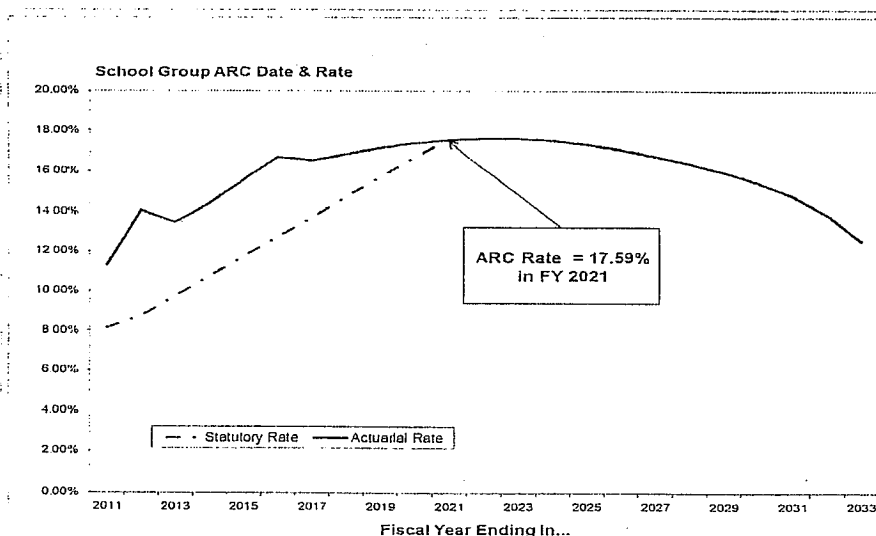
- The projected ARC rate of 9.55% is 2.25% less than the Baseline ARC rate of 11.8%. The ARC date moves up 5 years to FY 2013.

- 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: HB 2086 Projections

▪Raise employer rate increase cap to 1.0%, effective FY 2013. Assumes average annual investment return of 8%.



▪The School Group is in actuarial balance with an ARC rate of 17.59% in FY 2021. Under the Baseline, the statutory rate reaches 21.37% by FY 2033.

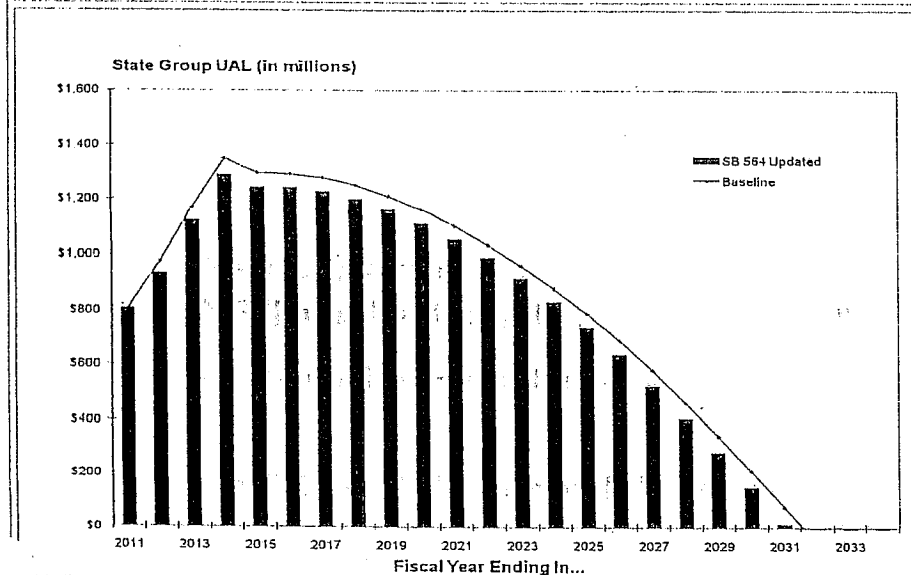
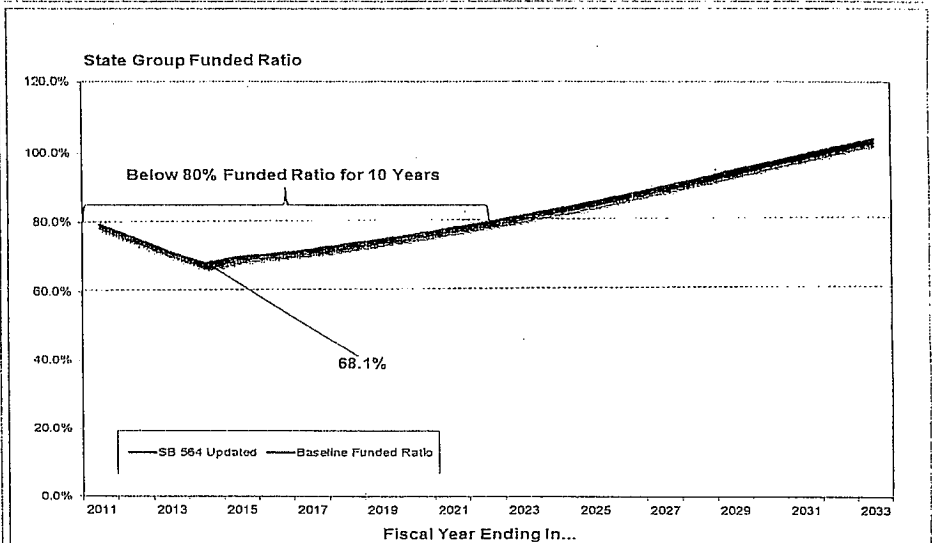
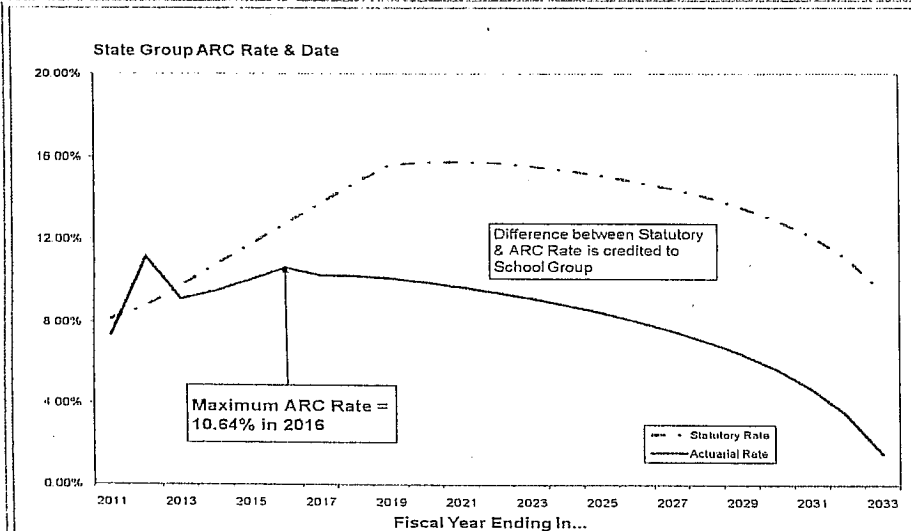
▪Funded ratio projections reach a low of 47.1% in FY 2014 and remain below 50% through FY 2017.

▪The funded ratio is not projected to reach 60% until FY 2023 or 80% until FY 2029.

▪The projected UAL rises 57% to \$7.53 billion in FY 2019.

State Group: SB 49 Projections

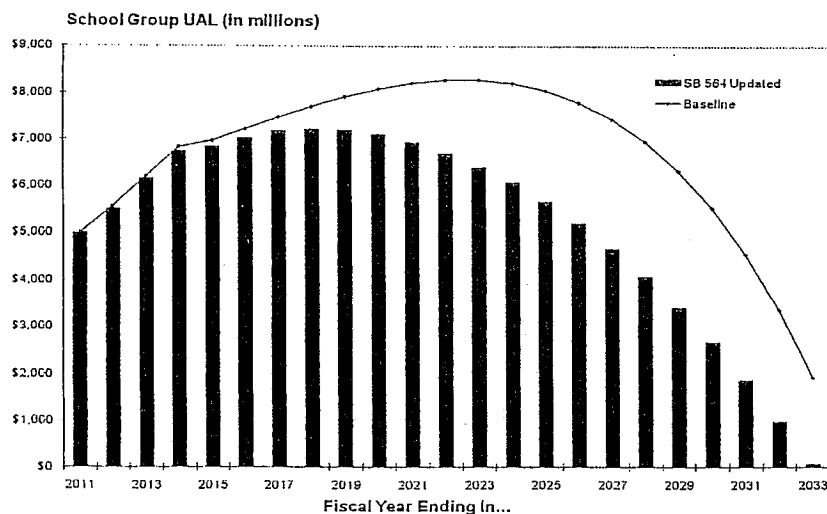
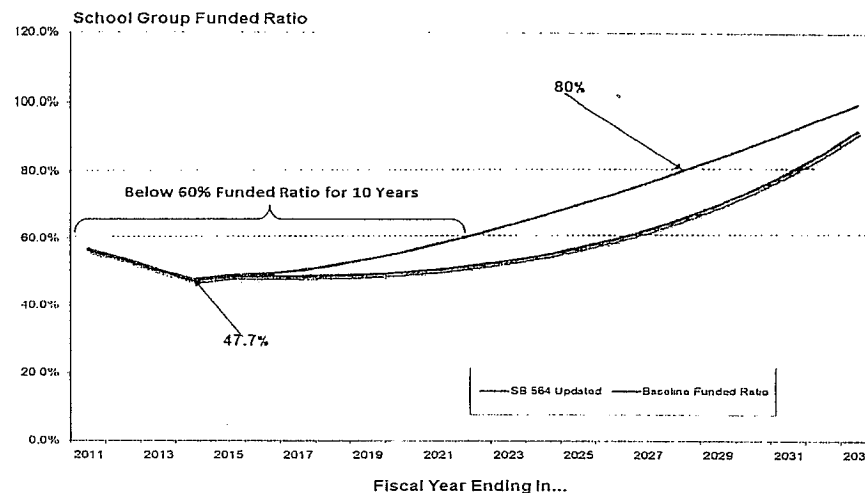
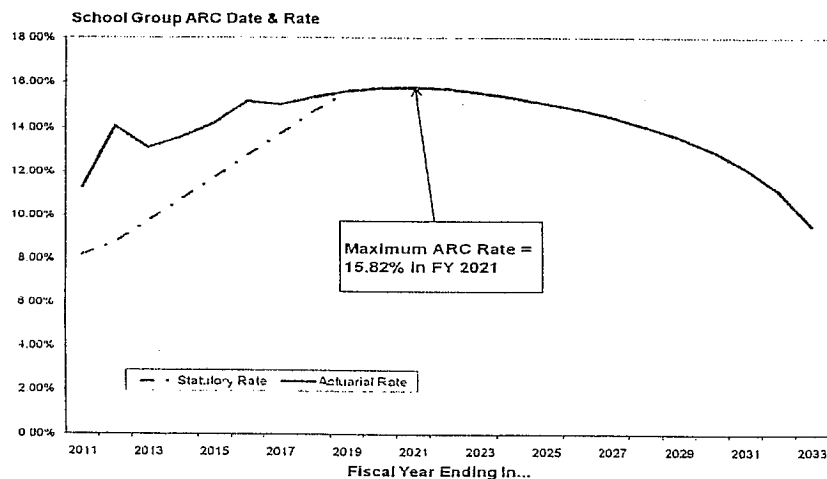
- Raise employer rate increase cap to 1.0%, effective FY 2013. Raise employee contribution rate by 2.0% over 4 years and multiplier to 1.85% for future service, effective January 1, 2013. Assumes average annual investment return of 8%.



- The projected ARC rate of 9.13% in FY 2013 is 2.67% less than the Baseline ARC rate of 11.8%. The ARC rate continues rising through FY 2016 to a high of 10.64%.
- Funded ratios reach a low of 68.1% in FY 2014. They are projected to reach 80% in FY 2022.
- The projected UAL rises by 60% to \$1.29 billion in FY 2013.

School Group: Updated SB 49 Projections

- Raise employer rate increase cap to 1.0%, effective FY 2013. Raise employee contribution rate by 2.0% over 4 years and multiplier to 1.85% for future service, effective January 1, 2013. Assumes average annual investment return of 8%.



- The School Group reaches the ARC rate of 15.66% in FY 2019 – two years earlier than under HB 2086. The maximum ARC rate of 15.82% is reached in FY 2021.
- Funded ratio projections reach a low of 47.7% in FY 2014, remaining below 50% through FY 2016.
- The funded ratio is not projected to reach 80% until FY 2028.
- The projected UAL rises 45% to \$7.23 billion in FY 2018.

Employer Contributions

- A fundamental principle of sound funding for a defined benefit plan is to consistently pay the full ARC rate.
- Raising the cap on employer contribution rate increases to 1% per year moves KPERS toward the goal of contributing at the ARC rate.
- The State/School statutory rate is projected to reach 100% of ARC in FY 2021 and FY 2019 under HB 2086 and SB 49 respectively.
- Under either HB 2086 or SB 49, the pace at which State contributions grow would accelerate substantially, beginning in FY 2013.
 - 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 to \$652.8 million.
- However, from FY 2011 through the remainder of the amortization period in FY 2033, total employer contributions under both options would be less than under the Baseline – by \$1.16 billion with HB 2086 and by \$3.53 billion for SB 49.

Employer Contributions

<u>State/School Employer Contributions*</u>	<u>Baseline</u>	<u>SB 49/HB 2086</u>	<u>Additional Contributions</u>
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			
SB 49	\$ 23,048.75	\$ 19,517.13	\$ (3,531.62)
HB 2086	\$ 23,048.75	\$ 21,887.03	\$ (1,161.72)

*All contributions shown in millions.

Observations

- Increases in contributions, such as a higher cap on employer rate increases alone (HB 2086) or in combination with higher member contributions (SB 49), would –
 - Bring the Plan into actuarial balance.
 - Reduce the maximum employer contribution rate and the total employer contributions paid through FY 2033.
 - Modestly improve the funded ratio after 10 to 20 years.
- However, the long-term funding shortfall is of a magnitude that increases in contributions are not likely to result in substantial improvement in KPERS' funded status in the short to mid-term.
 - Consistently contributing at the ARC rate is a fundamental principle of sound funding.
 - Legislation such as HB 2086 and SB 49 moves funding closer to that goal. However, contributions would not reach the ARC rate for 7 to 9 years.