

MEMORANDUM

To: Senate Financial Institutions and Insurance Committee

From: Alan D. Conroy, Executive Director

Date: March 6, 2025

Subject: Informational Testimony on House Bill 2086

House Bill 2086 makes changes to the KPERS 3 cash balance plan design by increasing the dividend interest formula in K.S.A. 74-49,306.

The KPERS 3 plan design is the retirement plan for new State, School and Local employees or nonvested members who return on and after January 1, 2015.

KPERS 3 Cash Balance Plan Design

A cash balance plan is a risk-sharing defined benefit plan that combines features of a traditional pension with elements of a defined contribution plan.

Throughout a KPERS 3 member's career they make 6% employee contributions. Those contributions are still pooled in the KPERS Trust Fund and invested by KPERS, but KPERS is accounting each member's contributions in a notional account.

The KPERS 3 member also earns employer pay credits that increase as a member accrues years of service. KPERS is also tracking these pay credits for each member. These pay credits are not related to the employer contribution rate, which is calculated each year on an actuarial basis.

Every year the member is guaranteed to receive 4% interest on both of their KPERS 3 accounts. In addition, each calendar year a dividend interest credit may be applied if the 5-year average return on the KPERS Trust Fund exceeds 6%.

When a member reaches retirement eligibility, their lifetime benefit is calculated on their total KPERS 3 account balances.

KPERS 3 members:

- Never lose what they contribute
- Are guaranteed a minimum 4% interest every year
- Receive a guaranteed benefit for life when they retire

| KPERS 3 Employer Pay Credits | |
|------------------------------|-------------|
| Years of Service | Annual Rate |
| 1-4 | 3% |
| 5-11 | 4% |
| 12-23 | 5% |
| 24+ | 6% |



KPERS 3 Dividend Interest Credit (K.S.A. 74-49,306)

The dividend interest credit formula is set in statute. The current dividend formula is:

- 75% of the 5-year average return above 6%.

Each calendar year the KPERS Board of Trustees reviews the 5-year average return on investments. If the average return is higher than 6%, KPERS 3 members are eligible for a dividend credit.

The difference between the 5-year average return and 6% is multiplied by 75% to calculate the dividend amount.

For example, if the 5-year average return is 8%, the dividend credit would be:

$$(8\% - 6\%) \times 75\% = 1.5\%$$

Over the first 9 years of the cash balance plan (2015-2023), the dividend has applied 5 times. While investment returns for CY 2024 are not yet final, it appears that the dividend will apply in CY 2024 as well.

| KPERS 3 Dividend interest Credits | | |
|-----------------------------------|-------------------------------------|-----------------|
| Calendar Year | Average Net Compound Rate of Return | Dividend Credit |
| 2015 | 0.2% | No Dividend |
| 2016 | 4.3% | No Dividend |
| 2017 | 7.4% | 1.1% |
| 2018 | 4.7% | No Dividend |
| 2019 | 7.1% | 0.825% |
| 2020 | 9.3% | 2.475% |
| 2021 | 10.7% | 3.525% |
| 2022 | 5.7% | No Dividend |
| 2023 | 8.5% | 1.875% |

House Bill 2086

House Bill 2086 adjusts the dividend interest formula in K.S.A. 74-49,306 by:

1. Increasing the dividend share from 75% to 80%
2. Lowering the threshold from 6% to 5%.

The new dividend formula would be

- 80% of the 5-year average return above 5%

Using the same 8% average return example as above, under HB 2086 the dividend credit would be:

$$(8\% - 5\%) \times 80\% = 2.4\%$$

Higher dividend credits will result in higher KPERS 3 account balances, leading to higher retirement benefits for KPERS 3 members. The actuary estimates that a 30-year career member would see their replacement ratio increase from 33.2% to 36.5% under HB 2086, a 3.3% improvement.

For a career-member retiring with a final salary of \$60,000:

- Current plan: Estimated annual benefit of \$19,920
- HB 2086: Estimated annual benefit of \$21,900
- Increase: \$1,980 per year, or approximately 10%

Additional replacement ratio scenarios are included in Attachment A.

Actuarial Cost Considerations

Increasing the dividend share and lowering the dividend threshold increases the expected future retirement benefits for KPERS 3 members. Some of this increase is for service already earned and increases the unfunded actuarial liability and some is for future service which increases the normal cost (the cost of benefits allocated to each year by the actuary).

For the State/School group the unfunded actuarial liability is estimated to increase by \$102.05 million. This can be funded through a one-time payment or amortized over 20 years. If amortized, the employer contribution rate would increase by 0.13% (about \$7.3 million based on current payroll).

The normal cost contribution rate for the State/School group would increase by 0.35% (approximately \$19.7 million). If the Legislature chooses a one-time payment to cover the unfunded liability increase, only the normal cost increase would apply.

If HB 2086 is enacted in the 2025 session, the State/School employer contribution rate for FY 2026 would increase from 11.68% to 12.16% (0.48% total increase), representing approximately \$27.0 million in additional costs.

The Local group would see a similar impact:

- The unfunded actuarial liability would increase by \$43.7 million.
- The normal cost increase is 0.41%, and the 20-year amortization rate increase is 0.17%.
- The total employer contribution rate increase of 0.58% represents about \$12.9 million across 1,400 Local employers.

House Action

The House approved HB 2086, as it was introduced, 115-6 on February 20.

I would be pleased to respond to any questions the Committee has regarding HB 2086.

Attachment

KPERS 3 Estimated Replacement Ratio Comparison

Current Plan Design vs. HB 2086
Guaranteed Interest Plus Dividend

