State of Kansas

Senate Chamber

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JEFF KING
SENATOR, FIFTEENTH DISTRICT
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Dear Senator McGinn and Members of the Senate Ways & Means Committee,

I appreciate the opportunity to appear before you regarding the bill authored by the KPERS Study Commission. The Study Commission, on which I served as co-chair, spent over sixty hours during a ten-day period studying pension reform efforts across the country. The bill I will describe in my testimony is the product of that hard work. In short, it is an effort to improve the KPERS system and ensure that we will never again find Kansas burdened by the weight of an $8.3 billion unfunded pension liability.

I will address the KPERS reform proposal in four areas (as discussed in bullet-point form below):

1. Employees who will be vested (i.e. have five years of KPERS-eligible service) by January 1, 2014;
2. New Hires and non-vested employees (i.e. those having less than five years of service) as of January 1, 2014;
3. State funding of KPERS
4. Legislative KPERS

<u>Vested Employees</u>

- No recommended changes other than those passed last year in Senate Substitute for HB 2194.
- HB 2194 will not go into effect unless both chambers consider and vote on the bill containing the Study Commission recommendations. One chamber must vote on the Commission's bill in committee and the other chamber must vote on the Commission's bill in the Committee of the Whole.
    - A vote on the Commission's bill will meet this trigger even if the bill is amended in committee or on the Senate floor.

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- HB 2194 requires vested employees to choose between one of two options. These elections would occur starting on July 1, 2013 and would go into effect on January 1, 2014.
    - Pay 2% more of their salary into KPERS for a 6% benefit increase for future years of service; or
    - Accept a 20% reduction in benefits earned for future years of service.

New Hires & Non-Vested Employees

- Establish a new 401(k)-style defined-contribution system:
    - Employees would contribute 6% of their salary to a retirement fund.
        - 6% is the same amount that current Tier II employees pay and that most Tier I employees will pay after HB 2194 takes effect.
    - As in 401(k)-style plans, these retirement savings will grow based on market returns.
        - KPERS-eligible employees can choose from a substantial number of private investment options to manage their retirement accounts.
        - If public employees wish (or if they do not make an investment choice), their money would be invested in an allocation identical to the current KPERS portfolio. This would allow public employees to use KPERS investment expertise at virtually no cost, but would not protect them from market losses.
    - This retirement account is completely portable. Employees can take it with them when they leave KPERS-eligible employment.
- Provides an above-market annuity to public employees
    - The state would also contribute 1% for new employees, increasing annually by ½% to a maximum of 5% after 8 years of service.
    - The state contributions to the new system would be paid into an annuity account
        - This annuity account would be invested in an allocation identical to the current KPERS portfolio and would grow based on market returns
    - When employees retire, they will receive a lifetime annuity payment based on the cash balance in their annuity account
        - The return on this annuity will be based on the distressed termination annuity rate published by the Pension Benefit Guaranty Corporation (which has averaged 6.5% historically over the last 20-30 years).
- Current law provides that non-vested employees who leave KPERS-eligible jobs will receive their retirement contributions plus 4% interest. Similarly, all workers who are not vested by January 1, 2014 will have that amount transferred into the defined contribution system.

- Avoids the transition costs typically associated with switching from a defined benefit to a defined-contribution system
    - By gradually increasing the state's contribution over the first eight years of an employee's service, the Commission's 401(k)-styled plan eases the initial state cost, allowing the state to devote more resources towards reducing the existing unfunded liability.
    - Prevents "closure costs" from eliminating the current defined benefit plan
        - The KPERS actuary estimated that fully closing the current KPERS plan would reduce its investment returns over the next 20-50 years in a way that would cost the state billions of dollars in lost investment returns.
        - Basically, the fewer assets remained in KPERS, the more limited (and less risky) the investment portfolio must be. Narrower and less risky investments equal reduced returns.
        - The annuity plan described above would increase the amount of assets under KPERS investment control, thus allow KPERS to pursue more lucrative investments as it does currently.

State Funding of the KPERS Unfunded Liability

- Over the next 5 years, HB 2194 would double the rate of increase for state KPERS funding.
- The Commission recommended even more aggressive state efforts to reduce the KPERS unfunded liability.
    - The Commission's proposed legislation would require the state, for the first time in decades, to pay the "actuarially required contribution" into KPERS next year.
    - This would require around $150 million in additional KPERS funding in the FY2013 budget.
- **If both HB 2194 and the Commission's recommendations are implemented, the state will save about $4.5 billion over the next 20 years.**

Legislative KPERS Changes

- New legislators and those who have less than five years of service by January 1, 2014 will fall under the new defined contribution plan.
    - Their 6% payment and the state's contribution will be based on the actual (i.e. non-annualized) salary of each legislator
- Legislators who are currently vested in KPERS (or those who will be vested by January 1, 2014) will receive all of the KPERS benefits that they earned through the end of 2013.

- On January 1, 2014, KPERS will compute the present value of each legislator's KPERS plan.
- KPERS would then pay this "lump-sum" amount into the defined contribution plan of each legislator.
- From January 1, 2014 forward, vested legislators would be placed into the same defined contribution plan as other non-vested and new KPERS members where they would pay 6% of their "taxable salary" into their account and receive a roughly 5% contribution from the state.