SESSION OF 2012

CONFERENCE COMMITTEE REPORT BRIEF
SENATE SUB. FOR SUB. FOR HOUSE BILL NO. 2333

As Agreed to May 15, 2012

Brief*

Senate Sub. for Sub. for HB 2333 would amend the current Kansas Public Employees Retirement System (KPERS) plan design (Tiers 1 & 2), including provisions for the correctional subclass of the state group. The bill also would add a new plan design (Tier 3—Cash Balance plan) for future members of the state, school, and local public employee groups. Both employer and employee KPERS contributions for Tier 1 and Tier 2 would be increased to help address the unfunded actuarial liability. The bill generally does not address the Kansas Police and Firemen's (KP&F) Retirement System or the Retirement System for Judges (Judges) that are other plans also administered by KPERS. The bill would implement the following major changes:

- Add a Cash Balance (CB) plan established as a new Tier 3 within the existing KPERS defined benefit plans, effective January 1, 2015;
- Provide for death and long-term disability insurance that would continue coverage as long as the active Tier 3 member is working for a participating employer;
- Retain most revenue enhancing provisions from HB 2194 to be implemented beginning July 1,

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2014, to address the Tier 1 and Tier 2 unfunded actuarial liability;

- Use a single actuarially-determined employer contribution rate covering all three KPERS tiers calculated for each KPERS group, subject to new, higher statutory annual caps on increased contributions;

- Extend for three years to July 1, 2015, a salary cap exemption for school professionals who go back to work after retiring from KPERS and are employed full time by the same KPERS participating employer who will continue to pay a special contribution rate for retired members;

- Change the basis of calculation for legislator KPERS retirement benefits and contributions based on reducing the current period from 372 days to 365 days; and

- Provide for a fourth quarter moratorium in FY 2012 for KPERS participating employers' contributions to the death and long-term disability program.

Conference Committee Action

The Conference Committee agreed on establishing a Cash Balance plan as Tier 3 within the existing KPERS structure, and did not recommend establishing a Defined Contribution (DC) plan as part of the new retirement plan design for future KPERS members. The Cash Balance plan is a type of Defined Benefit (DB) plan design under federal law.

The Conference Committee also agreed on other components of KPERS legislation to be included:

- Credit 50.0 percent annually to the KPERS Trust Fund, commencing quarterly transfers in FY 2014, from the Expanded Lottery Act Reserve Fund (ELARF) after other obligations totaling $10.5 million have been met;

- Transfer 80.0 percent from the sale of certain specified state property to the KPERS Trust Fund beginning July 1, 2012;

- Establish Tier 3 in KPERS as a Cash Balance plan with the following design characteristics:
    - Tier 3 start date - January 1, 2015;
    - Normal retirement age - age 65 and 5 years of service, or age 60 and 30 years of service;
    - Minimum interest crediting rate during active years - 5.25 percent;
    - Discretionary Tier 3 dividends - 4.0 percent maximum; modified formula based on KPERS funded ratio for awarding discretionary credits, unless all plans reach an 80 percent funded ratio, and then Board must pay dividends;
    - Employee contribution - 6.0 percent;
    - Employer service credit - 3.0 percent for less than 5 years of service; 4.0 percent for at least 5 but less than 12 yers of service; 5.0 percent year for at least 12 but less than 24 years of service; and 6.0 percent for 24 or more years of service;
    - Vesting - five years;
    - Termination before vesting - interest would be paid for the first two years if employee contributions are not withdrawn;
    - Termination after vesting - option to leave contributions and draw retirement benefits when eligible, or withdraw employee contributions and interest but forfeit all employer credits and service;

- Death prior to retirement - five-year service requirement and if spouse had been named primary beneficiary, provide retirement benefit for spouse when eligible;
- Tier 3 early retirement - age 55 and 10 years of service;
- Default form of retirement distribution - single life with ten-year certain;
- Annuity conversion factor - 6.0 percent;
- Benefits option - partial lump sum paid in any percentage or dollar amount up to 30.0 percent maximum;
- Post retirement benefit - COLA may be self-funded for cost-of-living adjustments;
- Electronic and written statements - KPERS Board shall provide information specified. Certain quarterly reporting would be required;
- Powers reserved to adjust plan design - The Legislature may prospectively change interest credits, employer credits, and annuity interest rates. The Board may prospectively change mortality rates;
- Actuarial cost of any legislation - fiscal impact assessment by KPERS Actuary required before and after any legislative enactments;
- Divorce after retirement - allow a retirant, if divorced after retirement, and if the retirant had named the retirant's ex-spouse as a joint annuitant, to cancel the join annuitant's benefit option in accordance with a court order;
- If a member becomes disabled while actively working, such member shall be given participating service credit for the entire period of the member's disability. Such member's account shall be credited with both the employee contribution and the employer

credit until the earliest of (i) death; (ii) attainment of normal retirement age; or (iii) the date the member is no longer entitled to receive disability benefits;

  - A benefit of $4,000 is payable upon a retired member's death; and
  - Require employer credits and the guaranteed interest crediting to be reported quarterly.

- Modify Tier 1 and Tier 2 provisions in the current plan design for each, as follows:
  - Allow Tier 1 election (if IRS approves) in choosing changes in plan design - either continue employee contribution of 4.0 percent and have the multiplier reduced from 1.75 percent to 1.4 percent for future service, or increase the employee contribution from 4.0 percent to 6.0 percent and have the multiplier increased to 1.85 percent for future service;
  - Eliminate Tier 2 COLA and provide an increase in the multiplier from 1.75 percent to 1.85 percent retroactive to July 1, 2009 (if eligible), as well as future service years; and
  - Increase caps on all participating KPERS employer contributions for the state, school and local groups, with the cap increasing to 0.9 percent in FY 2014, 1.0 percent in FY 2015, 1.1 percent in FY 2016, and 1.2 percent in FY 2016.

- Add $2.75 million from KPERS Fund and 11.0 FTE positions to implement new provisions in FY 2013.

Background

The Senate Select Committee on KPERS and the House Committee on Pensions and Benefits each passed bills establishing a Cash Balance plan as Tier 3 in KPERS.

Each plan had differences in basic plan design, as well as similarities in plan design characteristics.

Sub. for HB 2333, as passed by the House during the 2011 Session, included a Defined Contribution (DC) plan as a new KPERS retirement plan design.

Senate Committee Deliberations

The Senate Select Committee on KPERS deleted the contents of 2011 Sub. for HB 2333, and inserted into Senate Sub. for Sub. for HB 2333 a number of KPERS provisions on which hearings were conducted during the 2012 Session. This action followed Committee review and deliberations on new KPERS plan design alternatives and other KPERS matters that continued most of the 2012 Session.

The Senate Select Committee reviewed the actuarial cost study for the proposed Cash Balance plan bill, and also reviewed the actuarial comparisons of that proposal with three other options: HB 2194, the proposed Defined Contribution (DC) amendment, and SB 429. The Senate Committee rejected the DC amendment, and recommended adding provisions for the Cash Balance plan to Senate Sub. for Sub. for HB 2333 after removing all of its original provisions. The new provisions included the following.

Senate Cash Balance Plan. The proposed Tier 3 retirement plan design for a Cash Balance plan would apply to new employees beginning July 1, 2014, including most state, school and local public employees who would be eligible for KPERS and not eligible to choose another retirement plan. Future state corrections officers would continue to be eligible for Tier 2 when becoming KPERS members as new hires.

- The normal retirement age would be age 65 with five years of service credit, or age 60 with 30 years of service credit. For state corrections officers, Group A would be eligible for normal retirement at age 55 with ten years of service and Group B would be eligible for normal retirement at age 60 with ten years of service.

- The interest crediting rate for both the employee account and employer account would be a fixed amount of 6.0 percent annually as defined in statute; after 20 years of service the rate would increase to 6.25 percent; and after 30 years of service the rate would increase to 6.5 percent. The Legislature would reserve the right to prospectively adjust the interest credits.

- The KPERS Board of Trustees, at its discretion, may add interest credits if the following conditions apply to active members of Tier 3 who are eligible for dividends: minimum of ten years service credit; maximum dividend of 4.0 percent; and Board consideration of overall KPERS funding, market conditions, investments returns, and other related factors determined by the Board.

- Tier 3 employees would contribute a fixed rate of 6.0 percent of compensation to the member's annuity saving account.

- The KPERS participating employers would certify quarterly a fixed employer credit at a rate of 4.0 percent of compensation that would be recorded in the member's retirement annuity account.

- Vesting would occur after five years of service for the KPERS participating employer(s).

- If termination of employment would occur before vesting, then KPERS membership could be maintained for up to five years. If the former member would return to an eligible position within five years, and had not withdrawn the member's contributions plus interest, then membership may be reestablished and prior service credits would be retained. If the former member would not become reemployed by an eligible employer after five years, the member's contributions plus interest would be refunded and KPERS membership would be forfeited along with any funds in the retirement annuity account where employer contribution were deposited.

- If termination of employment would occur after vesting, then KPERS membership could be retained until retirement age in order to draw a KPERS benefit and interest credits would continue to accrue.

- If a terminated member, whether vested or not, would choose to withdraw the employee contributions plus interest, then all employer credits and interest would be forfeited in the employer retirement annuity account, along with service credits.

- If the death of a member would occur prior to retirement, but after serving five years to become vested, then the spouse, if the sole beneficiary, would receive the benefit accrued prior to death of a member when the member would have reached normal retirement age.

- If a member would become disabled, the member would receive participating service credit for the entire period of disability. The member's account would be credited with both the employee contribution and the employer credit until the member is no longer determined to be disabled, attains normal retirement age and is retired, or dies. The program would be funded by the employer.

- A $4,000 benefit would be paid upon a retired member's death.

- There would be no early retirement provisions for KPERS Tier 3 members.

- Retirement benefits would be paid as a single life annuity with five years certain as the default option. The annuity conversion rate would be a fixed rate of 6.0 percent established in the plan design.

- Partial lump sum distributions at normal retirement would be available in increments of 10.0 percent, up to a maximum of 30.0 percent of the member's account balance.

Reenact Certain Provision of HB 2194. KPERS participating employer contribution caps would increase from 0.6 percent to 0.9 percent in FY 2014, 1.0 percent in FY 2015, 1.1 percent in FY 2016 and 1.2 percent for FY 2017 and subsequent fiscal years.

The bill would offer elections for both Tier 1 and Tier 2 members as originally established in 2011 HB 2194, subject to approval by the Internal Revenue Service.

Tier 1 members would be able to choose:

- To continue the current 4.0 percent employee contribution and receive a reduced multiplier of 1.4 percent for future service (rather than the current 1.75 percent); or

- To increase the employee contribution to 5.0 percent in 2012 and 6.0 percent thereafter, and be eligible for a higher multiplier of 1.85 percent for future service.

- The default option, if the IRS does not rule favorably on elections or if the member does not make a choice, would be the 6.0 percent employee contribution and the 1.85 percent multiplier.

Tier 2 members' contributions would remain at 6.0 percent, but they would have an election to choose one of two options:

- If the cost-of-living adjustment (COLA) were retained, then the multiplier would be reduced to 1.4 percent for future service; or

- If the Tier 2 member would give up the COLA, then the multiplier would remain at 1.75 percent.

- The default option, if the IRS does not rule favorably on elections or if the member does not make a choice, would be the 6.0 percent contribution, no COLA, and the 1.75 percent multiplier.

Working After Retirement. The contents of 2012 SB 259, as passed by the Senate, were added to the bill.

- The provisions would remove a June 30, 2012, sunset date and extend an exemption for certain retirees from the statutory $20,000 earnings limitation from July 1, 2012, to July 1, 2015. The exemption applies to teachers and other licensed school professionals who retire with KPERS benefits and choose to return to work without an earnings cap. The bill also would extend the special employer contribution rate that applies to compensation earned by retirees.

Death and Disability Moratorium. The contents of 2012 SB 259 that pertained to a moratorium on contributions by participating employers were added to the substitute bill.

- The provisions would suspend all participating employer contributions to the Kansas Public

Employees Retirement System (KPERS) Group Insurance Reserve Fund for a three-month period, beginning on April 1, 2012, and ending on June 30, 2012. Under current law, each KPERS participating state, school, and local employer must pay an amount equal to 1.0 percent of the amount of compensation on which KPERS members' contributions to the System are based. The participating employer contributions are deposited in the Group Insurance Reserve Fund, from which the death and long-term disability benefits are paid.

The provision would be effective upon publication in the *Kansas Register.*

Legislators' Retirement Calculations. The contents of 2012 House Sub. for SB 259 that pertained to Legislators' rate of compensation and calculation of retirement contributions and benefits were included in the substitute bill.

- Current language pertaining to how the period of compensation for legislators is computed for determining retirement benefits and contributions would be stricken and new language added that would use 30 calendar days as the basis of computation multiplied by 12, with five more days added, for a total of 365 days. The current method produces a total of 372 days.

Modifications Due to Divorce. The Senate Committee of the Whole amended the bill to modify current law concerning divorce after a member would retire and the status of the ex-spouse. The amendment would allow an exception to the statutory provision that under no circumstance may a retirement option elected be changed or canceled nor the named joint annuitant changed after the member's actual retirement.

- The exception would be to allow a retirant, if divorced after retirement, and if the retirant had named the retirant's ex-spouse as a joint annuitant, to cancel the join annuitant option.

House Committee Deliberations

The House Committee on Pensions and Benefits held multiple hearings on various retirement proposals and, while revising certain provisions of HB 2194, the Committee chose not to modify other provisions in the 2011 legislation. An updated version of HB 2194 was amended into SB 259 with both modified provisions and original provisions from last year's legislation. Testimony throughout the 2012 hearing process on revisions to KPERS tended to support many of the original provisions in HB 2194 as enacted last year.

House Cash Balance Plan. The new plan design developed by the House Committee after hearing negative testimony about 2012 HB 2545 (the KPERS Study Commission's bill).

At the suggestion of the Chairperson, the House Committee recommended that a Cash Balance plan bill be drafted, using the Nebraska model as a guide. Because the drafting process occurred late in the Session, the Chairperson, with assistance from the KPERS staff, prepared a decision tree list that outlined parts for inclusion in a bill to implement a Cash Balance plan for review by the Committee. After considerable Committee discussion and modification of the initial proposal, the Committee recommended introduction of legislation based on the outline for a Cash Balance plan.

The House Committee on Pensions and Benefits voted to amend SB 259 by adding the Cash Balance plan design and other items of agreement.

A summary of basic House Committee Cash Balance plan provisions upon which actuarial cost study projections are based included:

- The employer credit to the cash balance account is a service based credit, beginning at 1.0 percent and grading up to 4.0 percent after the member attains four years of service;
- The guaranteed interest credit is 5.0 percent per year with interest credited quarterly. Additional interest credits may be granted at the discretion of the KPERS Board of Directors subject to certain conditions. The additional interest credit cannot exceed the lesser of 2.0 percent or 50 percent of the rate of return on the system's assets that is above 8.0 percent. The additional interest credit shall not be granted unless the rate of return on KPERS assets is at least 10.0 percent for that fiscal year;
- Employee contribution rate is 6.0 percent of pay;
- 100 percent vesting after seven years of service;
- Normal retirement date is the earlier of age 60 with 30 years of service or age 65 with five years of service;
- Early retirement is age 55 with ten years of service;
- Upon termination of employment, a vested member may elect to withdraw the member's employee account balance, but will forfeit any future benefit payable from the system. If the member leaves employee contributions in the System, the member may retire upon reaching normal retirement age with benefits based on the total account value (employer plus employee);
- When the member retires at normal retirement age, the member can elect to receive up to 30.0 percent of the total account balance as a lump sum. The remaining balance must be converted to a monthly benefit, based on the form of payment selected by

the member. No partial lump sum option is available if the member retires at early retirement age. The annuity amount is determined by the annuity conversion factors which are based on a 5.0 percent interest rate and a mortality table selected by the Board;

- If a member dies prior to reaching the normal retirement age of 65, no benefit is payable and the account balance is forfeited unless (i) the member is vested; (ii) the member has at least ten years of service at death; and (iii) the member's spouse at the time of death is designated as the sole primary beneficiary. In that case, the spouse shall receive a benefit when the member would have reached normal retirement age;
- If a member becomes disabled while actively working, such member shall be given participating service credit for the entire period of the member's disability. Such member's account shall be credited with both the employee contribution and the employer credit until the earliest of (i) death; (ii) attainment of normal retirement age; or (iii) the date the member is no longer entitled to receive disability benefits; and
- A benefit of $4,000 is payable upon a retired member's death.

Fiscal Note

Provisions of 2011 HB 2194 incorporated into HB 2333 would increase the participating KPERS employer contributions by raising the annual caps to allow higher payments. The increased cost for Tier 1 and Tier 2 under these provisions would be reflected first in FY 2014 payments for state and school KPERS participating employers, and in CY 2014 for local employers. The tables below show the estimate impact during the initial years.

State and School Employers
(In Millions)

FY	Baseline	HB 2194	Difference
2014	$472.90	$487.10	$14.20
2015	516.80	551.10	34.20
2016	563.90	624.50	60.60
2017	614.10	708.00	93.90
2018	667.50	780.70	113.20

The increased cost for Tier 1 and Tier 2 under HB 2194 would be reflected first in CY 2014 for local KPERS participating employers.

Local Employers
(In Millions)

CY	Baseline	HB 2194	Difference
2014	$151.80	$153.80	$2.00
2015	167.60	167.30	(0.04)
2016	184.40	170.50	(14.00)
2017	200.80	176.00	(24.80)
2018	208.90	181.80	(27.10)

The fiscal impact for the Conference Committee's proposed Cash Balance plan has not been determined by the KPERS Actuary. Both a income replacement study and a cost study must be completed before a new fiscal note would be available for the bill as recommended by the Conference Committee in Senate Sub. for Sub. for HB 2333.

The earlier fiscal note for the original version of HB 2194 may be compared with the total cost of SB 259 (House conference position) and HB 2333 (Senate conference position) reported in cost studies by the KPERS Actuary of the proposed House and Senate legislation.

Comparison of Previous Fiscal Notes

(in billions)

	HB 2194	SB 259	HB 2333
State/School	$22.141	$19.034	$30.141
Local Units	5.745	4.279	8.415
Total	27.886	23.313	38.556

Administrative Cost. For implementing the Tier 3 CB plan, KPERS staff estimated additional resources would be required, including $2.75 million from the KPERS Fund and 11.0 FTE positions for new staff. An additional 3.0 FTE positions would be needed in subsequent fiscal years.

KPERS; plan design; Tier 1; Tier 2; Tier 3; Cash Balance Plan; HB 2194; unfunded actuarial liability; salary cap exemption; legislator retirement benefits; fourth quarter moratorium; ELARF; KPERS Trust Fund

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