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Jon Hummell, Interim Director

Division of the Budget

Sam Brownback, Governor

March 5, 2014

The Honorable Jeff King, Chairperson
Senate Select Committee on KPERS
Statehouse, Room 341-E
Topeka, Kansas 66612

Dear Senator King:

SUBJECT: Fiscal Note for SB 425 by Senate Committee on Ways and Means

In accordance with KSA 75-3715a, the following fiscal note concerning SB 425 is respectfully submitted to your committee.

SB 425 would make several amendments to the Kansas Public Employees Retirement System (KPERS) Act of 2015 and the cash balance plan that will go into effect January 1, 2015. Under current law, cash balance plan members receive a guaranteed interest credit of 5.25 percent per year with interest credited to the member's account balance quarterly. Additional credits of up to 4.0 percent may be granted at the discretion of the KPERS Board of Directors provided certain conditions are satisfied. SB 425 would lower the guaranteed interest credit to 4.0 percent and require the Board to provide additional interest credits based on a formula in the bill which is equal to 75.0 percent of the five-year average net compound rate of return on the market value of the system's assets above 6.0 percent on a rolling five-year average. The base year for this interest crediting formula would be calendar year 2015 and between 2015 and 2018 the additional interest credits would be capped at 1.5 percent.

Currently, when a member retires under the cash balance plan the account balance must be converted to a monthly benefit, which is determined by annuity conversion factors based on a 6.0 percent interest rate and a mortality table selected by the Board. SB 425 would change the annuity conversion interest rate to the actuarial assumed investment rate of return established by the Board minus 2.0 percent.

SB 425 would also allow security officers within the Department of Corrections to become members of the Kansas Police and Firemen's Retirement System (KP&F) on July 1, 2014. Currently, security officers have their own retirement groups. Security officers currently employed with the Department of Corrections would receive KP&F benefits based on all future service on and after the effective date. Security officers who are vested under Corrections Groups and become members of KP&F would have retirement benefits computed under

Corrections Groups requirements if employment is terminated prior to their attaining vested benefits under KP&F. The Division of the Budget and the Governor must include the amount required to satisfy the employer's obligation as certified by the KPERS Board of Trustees in the annual budget. The Department of Corrections must pay to the system the amount sufficient to satisfy the obligation.

KPERS' consulting actuary completed an actuarial cost study on the combined effects of modifying the cash balance plan and moving security officers to KP&F. For the purposes of the cost study, it was assumed that the transfer of Department of Corrections employees would be effective January 1, 2015 with the first full year of KP&F contributions occurring in FY 2016. Assuming all actuarial assumptions are met, total employer costs for FY 2016, including KPERS State/School Group costs and KP&F costs, are estimated to increase by $6.8 million. It is projected that the amount needed for Department of Corrections to pay the higher contribution rates for the KP&F system is also $6.8 million for FY 2016. Half of that amount, or $3.4 million, would be needed for FY 2015 to satisfy the mid-fiscal year transfer of the Department of Corrections members to KP&F. Of the expenditures budgeted for salaries and wages for the Department of Corrections in FY 2015, 96.7 percent is funded from the State General Fund. If this percentage is used, additional State General Fund resources of approximately $3.3 million in FY 2015 and $6.6 million in FY 2016 would need to be appropriated to the Department of Corrections to satisfy the transfer requirements.

Over the long term, the net effect of SB 425 would be increased contributions for the Department of Corrections and decreased employer contribution rates for other KPERS State/School Group employers. For the KPERS State/School Group, the bill could eventually reduce employer contribution rates which would result in decreased employer contributions of approximately $3.0 billion or $251.7 million on a present value basis using a discount rate of 8.0 percent. However, increased contributions related to the transfer of Department of Corrections members to KP&F membership are projected to increase those costs by $809.3 million. Using the same percentage from above, $782.5 million from the State General Fund would be needed over the long term to implement SB 425. When the KP&F transfer costs are netted out against the KPERS State/School Group reductions, the total employer costs could be reduced by $2.2 billion, or $133 million present value.

SB 425 would not affect Local Group contribution rates in FY 2014 or FY 2015, however, the bill is expected to reduce rates over the long term for total projected savings of $1.14 billion, or $99.4 million on a present value basis. Moving state correctional officers to KP&F would affect the costs of local KP&F employers. The change would result in a net decrease in the employer contribution rates beginning in CY 2016 for local KP&F employers. The estimated employer contribution decrease totals about $6.9 million for CY 2016.

The changes to the cash balance plan in SB 425 are not expected to have a large fiscal effect on KPERS' administrative costs. However, administrative costs would be incurred from implementing the transfer of Corrections Group members to KP&F. This would include making changes to computer systems, member education and publications, and project management services. KPERS states it would manage these additional costs within the current expenditure authority. Any fiscal effect associated with SB 425 is not reflected in *The FY 2015 Governor's Budget Report*.

Sincerely,

Jon Hummell,
Interim Director of the Budget

cc: Faith Loretto, KPERS
Jeremy Barclay, Corrections