



March 13, 2017

Chairperson Pete DeGraaf, Chairperson
House Committee on Government, Technology and Security
Room 458-W, State Capitol Building
300 SW Tenth Ave
Topeka, Kansas 66612

RE: HB 2331; Enacting the Kansas Cybersecurity Act
HB 2359; Creating the Kansas Information Technology Enterprise Agency

Dear Chairperson DeGraaf:

HB 2331 would provide for the creation of the Kansas Information Security Office. As introduced, HB 2331 centralizes cybersecurity for all executive branch agencies, including KPERs. HB 2359 creates the Kansas Information Technology Enterprise (KITE) and would consolidate information technology administration among executive branch agencies. Due to the unique character and fiduciary obligations of KPERs, including KPERs as part of centralized cybersecurity or information technology functions raises several potential legal concerns. **These concerns are serious enough for the agency to request that KPERs be exempted from these bills, just like elected office agencies and Regents' institutions.** Attachment A contains specific language to accomplish this request.

Fiduciary obligations of the Board of Trustees. The Kansas Public Employees Retirement System, in its fiduciary capacity, exists for the sole purposes of delivering retirement, disability and survivor benefits to its members and their beneficiaries. Under state law and as a qualified pension plan under the Internal Revenue Code, KPERs is established as a trust, making KPERs Board of Trustees fiduciaries to the trust and its members.

Fiduciary duties “are imposed in order to prevent one in whom special trust or confidence is placed from representing his or her own interests over those of his or her charges. The goal of courts in imposing fiduciary duties is ensuring loyalty. To promote this goal, the courts require that a fiduciary act solely on behalf of its charge and that the fiduciary do so scrupulously and in good faith.”¹ These fiduciary principles are restated in statutory provisions establishing KPERs:

- **Exclusive Benefit Rule.** The fund is a trust fund and shall be used solely for the exclusive purpose of providing benefits to members and member beneficiaries and defraying reasonable expenses of administering the fund. K.S.A. 74-4921
- **Duty of Loyalty.** The board shall have the responsibility for the management of the fund and shall discharge the board's duties with respect to the fund solely in the interests of the members and beneficiaries of the system. K.S.A. 74-4921
- **Diversion of Assets.** At no time prior to the satisfaction of all liabilities with respect to members and their beneficiaries shall any part of the corpus and income be used for, or diverted to, purposes other than the exclusive benefit of the members and their beneficiaries. K.S.A. 74-49,123

¹ Unrau v. Kidron Bethel Retirement Services, Inc., 27 P.3d 1, 271 Kan. 743 (Kan. 2001).

As a result, the **KPERS Board of Trustees is subject to the highest legal and ethical standards**, and its obligations in carrying out KPERS' administrative and operational functions are **distinctive** among other state agencies and boards.

Legal concerns. These distinctive fiduciary obligations raise at least three potential legal concerns if KPERS is subject to HB 2331.

- **Diversion of assets.** To the extent that HB 2331 results in transfer or diversion of KPERS resources, including staffing, hardware, or other IT system assets, it may constitute a prohibited transaction under the Internal Revenue Code, which could threaten KPERS' status as a qualified plan.
- **Reasonableness of fees.** Similar concerns regarding a potential prohibited transaction would arise if the costs of the services are not commercially reasonable or if the costs are structured such that KPERS would effectively subsidize the costs for other executive branch agencies.
- **Penalties for administrative errors.** KPERS is obligated to administer the plan in accordance with the terms of the plan and IRS law, which requires accurate, effective, responsive, and timely IT resources. The consequences of errors can be severe. As a qualified plan, KPERS must be concerned with its extensive IRS reporting requirements. This status exposes KPERS to potential penalties associated with improper or delayed reporting. For instance, under Code Section 6651 large financial penalties are imposed for the failure to timely report and pay withholding taxes. Considering the amount of withholding regularly reported by KPERS, the penalty could be severe. It is estimated that the potential penalty for a late withholding return could reach almost \$1 million even if the return is less than one month late. Similarly, if KPERS filed an inaccurate 1099-R with the IRS, and also sent an inaccurate 1099-R to the participant, the IRS could impose a total penalty of \$500 for that one participant. KPERS currently has nearly 94,000 retirees and beneficiaries. Should KPERS have to wait for IT resources, the consequences could be very costly.

Cybersecurity is a priority. Given its fiduciary role, the KPERS Board of Trustees places a very high priority on cybersecurity, as reflected in its allocation of resources and expenditures for that purpose. As a result of KPERS' focus on cybersecurity, multiple Legislative Post Audit reviews of KPERS' security have found KPERS' cybersecurity to be exemplary among state agencies. According to a 2013 Legislative Post Audit report:

*Historically, we have seen that only one of our audited agencies had both a good security management process and good test results each year. As **Figure 1-4** on page 11 shows, only one agency, the Kansas Public Employees Retirement System (KPERS), had good outcomes for the three processes we tested even though five agencies had an adequate security management process. That is because, although a strong security management process helps, agency staff still face several challenges in securing their IT systems. For example, agencies often have limited IT resources, must work within a constantly changing security environment, and must meet a multitude of requirements regarding IT security. To overcome these challenges, agency management has to make IT security a top agency priority.²*

Given the potential legal issues that may be associated with including KPERS in centralized cybersecurity functions, we would respectfully request an amendment (Attachment A) to HB 2331 excluding KPERS from the definition of executive branch agency.

KPERS has a similar concerns about HB 2359, which would consolidate information technology resources under a centralized, cabinet-level agency. That bill, as written, would include KPERS in the consolidation, which would raise similar questions of fiduciary responsibilities and legal uses of the KPERS Trust Fund

² See "State Agency Information Systems: Reviewing Security Controls in Selected State Agencies (2013)," Pages 10-11.

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assets. **Therefore we respectfully request an amendment (Attachment A) that KPERS be excluded from the definition of executive branch agency in HB 2359 as well.**

I would be happy to provide additional information or respond to any questions that you or members of the House Committee on Government, Technology and Security may have. Thank you for your consideration.

Sincerely,

Alan D. Conroy
Executive Director
Kansas Public Employees Retirement System

cc: Members of the House Committee on Government, Technology and Security
Mr. Phil Wittmer – Executive Branch Chief Information Technology Officer
Mr. John Milburn – Director of Legislative and Public Affairs, Department of Administration
Ms. Katelin Neikirk, Legislative Fellow, Legislative Research Department
Ms. Natalie Nelson, Research Analyst, Legislative Research Department
Mr. Kyle Hamilton, Assistant Revisor of Statutes, Office of Revisor of Statutes
Ms. Jenna Moyer, Assistant Revisor of Statutes, Officer of Revisor of Statutes

Proposed Amendment to 2017 HB 2331

Amend New Section 2(i) as follows:

(i) "Executive branch agency" means any agency in the executive branch of the state of Kansas, but shall not include elected office agencies, the Kansas public employees retirement system, or regents' institutions.

Proposed Amendment to 2017 HB 2359

Amend Section 25(b) as follows:

(b) "Executive branch agency" means any ~~state~~ agency in the executive branch of ~~government~~ the state of Kansas, but shall not include elected office agencies, the Kansas public employees retirement system, or regents' institutions.