MEMORANDUM

To: House Financial Institutions and Pensions

From: Alan D. Conroy, Executive Director

Date: March 13, 2019

Subject: HB 2329; School employee contributions

HB 2329, as it pertains to KPERS, increases the employee contribution rate for employees of public school districts from 6% of compensation to 7.15% of compensation.

HB 2329 also appropriates funding for a wage increase for public school district employees, which would impact KPERS covered payroll and future benefits affected members. However, KPERS has no role in employee payroll adjustments.

Current Law
All KPERS State/School members are required to contribute 6% of compensation. This is the required contribution rate regardless of the member's coverage group (KPERS 1, KPERS 2 or KPERS 3). The 6.0% rate is set statutorily in K.S.A. 74-4919.

Employer contribution rates were last changed by the 2012 Legislature. At the time, KPERS 1 members (membership dates prior to July 1, 2009) contributed 4% of compensation. KPERS 1 members were moved to a 6% contribution rate over two years, increasing 1% in CY 2014 and 1% in CY 2015. In conjunction with the increase in employee contributions, the statutory multiplier for KPERS 1 retirement benefit calculations was increased from 1.75% to 1.85%.

KPERS 2 members (membership dates between July 1, 2009 and January 1, 2015) and KPERS 3 members (membership dates on and after January 1, 2015) have always contributed 6% of compensation.

There are currently 286 school districts and 25 educational co-ops that we believe would be subject to the new employee contribution rate. In the last actuarial valuation, there were about 79,000 active members at these 311 employers. This represents about 75% of the 105,000 total active members in the KPERS State/School group.

Legal Considerations
There are no Internal Revenue Service rules that prohibit changes to employee contributions in governmental retirement plans like KPERS. However, there are two legal considerations to keep in mind when discussing.

First is the contractual relationship between an employee and employer. The Contract Clause in the United State Constitution prohibits states from making laws impairing the obligation of contracts. This is commonly used to challenge state and local public pension changes. Courts have consistently found that adjustments to vested benefits are only allowable in certain circumstances.

KPERS

Second is a Kansas court case, *Singer v. City of Topeka*. In this decision, the Kansas Supreme Court found that member contributions cannot be increased without an "offsetting benefit."

Unfortunately, there is no definition of "offsetting benefit" in the Court's decision so it is not possible to give examples of what an offsetting benefit might be, or whether an increase in employee compensation would qualify as an offsetting benefit. However, we know there should be a balance between the two.

Actuarial Impact
Each year, an actuarial valuation is completed to calculate the total contribution rate needed to fund the System on an actuarial basis. The total contribution takes into account both employee and employer contributions.

In a traditional defined benefit plan, like KPERS 1 and KPERS 2, employee and employer contributions are combined to pay the annual cost of future benefits and unfunded actuarial liability:

	Current Law
Employee Contribution	6.0%
Employer Contribution	14.43%
Total Required FY 2021 Contribution	20.43%

If the employee contribution rate increases, as it would under HB 2329, the employer contribution rate would have a corresponding decrease.

However, since January 1, 2015, new KPERS members have been enrolled in the KPERS 3 cash balance plan. In the latest valuation, more than 36,000 KPERS State/School and Local members were in KPERS 3, which is about 25% of the total active membership.

In a cash balance plan members have notional accounts that reflect the balance of employee contributions and employer pay credits. At retirement, a member's lifetime benefit is based on the account balance in their notional accounts. If a KPERS 3 member has their employee contribution increased, those contributions are credited to the member's notional accounts. Higher employee contributions will increase the cash balance account value at retirement, resulting in a higher benefit.

The increased benefit increases the annual normal cost, which is the amount needed each year to fund future benefits. However, the increase in the KPERS State/School normal cost rate due to the higher KPERS 3 benefits is less than the increase in the School contribution rate so the net impact is a lower employer normal cost rate for KPERS 3 members.

The State/School employer contribution rate is projected to decrease by slightly less than 1% starting in FY 2022 (decreasing from 14.42% to 13.51%). Employer contribution rates remain lower through the end of the amortization period of the legacy unfunded actuarial liability in FY 2035. Over the long-term, the employer normal cost for the KPERS State/School group is 0.0% (i.e. the employee is fully funding the retirement benefit), although there is likely to be some employer contribution in future years due to actual System experience over time.

Administrative Impact
HB 2329 would require minor changes to KPERS' information technology system, updates to member and employer publications, and educational efforts for both members and employers. However, these changes can be completed within existing resources.

I would be pleased to respond to any questions the Committee has regarding HB 2329.