



**O-1  
Kansas Public  
Employees  
Retirement System  
Retirement Plans and  
History**

**Reed Holwegner**  
Principal Research  
Analyst  
785-296-3181  
Reed.Holwegner@klrd.ks.gov

# **Kansas Legislator Briefing Book 2016**

## **Retirement**

### **O-1 Kansas Public Employees Retirement System Retirement Plans and History**

#### **KPERS Overview—Brief History of State Retirement and Other Employee Benefit Plans**

The Kansas Public Employees Retirement System (known generally as KPERS and referenced in this article as the Retirement System) administers three statewide plans. The largest plan, usually referred to as the regular KPERS plan, or simply as KPERS, has within it three tiers that include state, school, and local groups composed of regular state and local public employees; school district, vocational school, and community college employees; Regents' classified employees and certain Regents unclassified staff with pre-1962 service; and state correctional officers. A second plan is known as the Kansas Police and Firemen's (KP&F) Retirement System for certain designated state and local public safety employees. A third plan is known as the Kansas Retirement System for Judges that includes the state judicial system's judges and justices.

All coverage groups are defined benefit, contributory retirement plans and have as members most public employees in Kansas. Tier 1 of the KPERS plan is closed to new membership and Tier 2 closed to most new membership on December 31, 2014, except for certain state correctional personnel who will continue to be eligible for membership as new employees who are hired on and after January 1, 2015. Tier 3 of the KPERS plan became effective for new employees hired after January 1, 2015. The cash balance plan is a defined benefit, contributory plan, according to the Internal Revenue Service (IRS).

The primary purpose of the Retirement System is to accumulate sufficient resources to pay benefits. Retirement and death benefits paid by the Retirement System are considered off-budget expenses. Starting in FY 2000, retirement benefit payments, as proposed by the Governor and approved by the Legislature, were classified as off-budget, non-reportable expenditures. As the retirement benefit payments represent a substantial amount of money distributed annually to retirees and their beneficiaries, the historical growth in payments is tracked for informational purposes. Total benefits paid exceeded \$500.0 million for the first time in FY 2000. Today, more than \$1.3 billion is paid in annual retirement and death benefits.

The Retirement System also administers several other employee benefit and retirement plans: a public employee death and long-term disability benefits plan; an optional term life insurance plan; a voluntary deferred compensation plan; and a legislative session-only employee's retirement plan. The Legislature has assigned other duties to the agency in managing investments of moneys from three state funds: the Kansas Endowment for Youth Fund, the Senior Services Trust Fund, and the Treasurer's Unclaimed Property Fund.

The Retirement System is governed by a nine-member Board of Trustees. Four members are appointed by the Governor and confirmed by the Senate. One member is appointed by the President of the Senate. One member is appointed by the Speaker of the House. Two members are elected by System members. One member is the State Treasurer. The Board appoints the Executive Director who administers the agency operations for the Board.

The Retirement System manages assets in excess of \$16.5 billion. Annually, the Retirement System pays out more in retirement benefits than it collects in employer and employee contributions. The gap between current expenditures and current revenues is made up with funding from investments and earnings. The financial health of the Retirement System may be measured by its funded ratio, or the relationship between the promised benefits and the resources available to pay those promised benefits. In the most recent actuarial valuation on December 31, 2014, the funded ratio for the Retirement System was 62.3 percent, and the unfunded liability was \$9.468 billion. This is the amount of financing shortfall when comparing the Retirement System assets with promised retirement benefits.

The 2015 Legislature enacted SB 228 authorizing the issuance of \$1.0 billion in taxable bonds. In August 2015, the Kansas Development Finance Authority issued the bonds with an effective interest rate of 4.69 percent. The bonds, with interest paid semi-annually, will mature over the next 30 years, until 2045. The bonds' proceeds become part of the Retirement System's valuation on December 31, 2015, which will be used to determine the participating employer contribution rates for FY

2018. Debt service for the bonds is subject to appropriation and not an obligation of KPERS.

### **Brief History of KPERS**

KPERS was created by the 1961 Legislature, with an effective date of January 1, 1962. Membership in the original KPERS retirement plan (now referred to as KPERS Tier 1) was offered to state and local public employees qualified under the new law and whose participating employers chose to affiliate with KPERS. Another KPERS tier was created in 2007 for state, school, and local public employees becoming members on and after July 1, 2009. KPERS Tier 2 has many characteristics of the original plan, but with certain modifications to ensure that employees and employers will share in the total cost of providing benefits. A third tier was implemented January 1, 2015, for all new employees. The second and third KPERS tiers are described in the last section of this article.

School districts generally were not authorized to affiliate with KPERS until the 1970s, but there were three affiliating in 1963 as the first exceptions to the general rule. Two more school districts affiliated in 1966. Later in 1966, four of the five school districts that had affiliated with KPERS were dissolved by the Legislature effective July 1, 1966. No other school districts became affiliated with KPERS until 1971, when a general law brought the old State School Retirement System (SSRS) and its individual members into KPERS.

The 1970 Legislature authorized affiliation with KPERS on January 1, 1971, for any public school district, area vocational-technical school, community college, and state agency that employed teachers. Other public officials and officers not addressed in the original 1961 legislation had been authorized, beginning in 1963, to participate in KPERS as the result of a series of statutory amendments to KSA 74-4910, *et seq.*, that broadened participation to include groups defined as public rather than governmental exclusively. Amendments to KSA 74-4901 also broadened the definition of which governmental officials and officers were eligible for KPERS membership.

## Calculation of Retirement Benefits and Eligibility for KPERs

KPERs Tier 1 and Tier 2 retirement benefits are calculated by a formula based on years of credited service multiplied by a statutory percentage for the type of service credit multiplied by final average salary.

For credited service, two categories were defined in the 1961 KPERs legislation: participating service, which was equal to 1.0 percent of defined salary for each year, and prior service equal to 0.5 percent of defined salary for each year. In 1965, the Legislature raised the prior service multiplier to 0.75 percent. In 1968, the prior service multiplier was raised to 1.0 percent, and the participating service multiplier was increased to 1.25 percent for all years of service.

In 1970, legislation set the participating service for school employees to be the same as other regular KPERs members, which was 1.25 percent at that time. The prior service multiplier for education employees was set at 1.0 percent for years under the SSRS and 0.75 percent for years of school service not credited under the SSRS. In 1982, legislation increased the participating service credit for state, school, and local KPERs members from 1.25 percent to 1.4 percent of final average salary for all participating service credited after July 1, 1982.

In 1993, legislation raised the multiplier to 1.75 percent for all years participating service for members who retired on or after July 1, 1993. Three different qualifications for normal retirement were established: age 65, age 62 with ten years of service; and 85 points (any combination of age plus years of service).

Legislation enacted in 2012, as subsequently clarified during the 2013 Legislative Session, applied a multiplier of 1.85 percent to Tier 2 members retiring under early retirement provisions, as well as to those retiring at the normal retirement dates.

## Contribution Rates for KPERs

KPERs Tiers 1, 2, and 3 are participatory plans in which both the employee and employer make contributions. In 1961, employee contributions were statutorily set at 4.0 percent for the first \$10,000 of total annual compensation. The \$10,000 cap was eliminated by 1967 legislation. Tier 2 employee contribution rates were set at 6.0 percent by statute beginning July 1, 2009. Tier 1 employee contribution rates increased from 4.0 to 5.0 percent in 2014, and to 6.0 percent on January 1, 2015.

In the 1961 legislation, initial employer contributions were set at 4.35 percent (3.75 percent for retirement benefits and 0.6 percent for death and disability benefits) of total compensation of employees for the first year, with future employer contribution rates to be set by the KPERs Board of Trustees, assisted by an actuary and following statutory guidelines.

In 1970, the employer contribution rate for public education employers was set at 5.05 percent from January 1, 1971, to June 30, 1972, with subsequent employer contribution rates to be set by the KPERs Board of Trustees. In 1981, the Legislature reset the 40-year amortization period for KPERs until December 31, 2022, and accelerated a reduction in the employer contribution rates in FY 1982 to 4.3 percent for state and local units of government (KPERs nonschool) and to 3.3 percent for education units of government (KPERs school).

Actuarially recommended employer contribution amounts for the state and school group are determined by assessing the unfunded actuarial liability (UAL) of both groups and combining the separate amounts to determine one.

During the 1980s, the Legislature capped the actuarial contribution rates for employers on numerous occasions in statutory provisions. In 1988, the Legislature established two employer contribution rates, one for the state and schools and one for the local units of government. Previously, the state and local employer rate had been combined as the KPERs nonschool group. The amortization period for the combined state and school group was extended from 15 to 24

years, with employer contribution rates set at 3.1 percent for the state and 2.0 percent for the local employers in FY 1990.

The 1993 legislation introduced the statutory budget caps that would limit the amount of annual increase for employer contributions and provided a 25.0 percent increase in retirement benefits for those who retired on and after July 1, 1993, and an average 15.0 percent increase in retirement benefits for those who retired before July 1, 1993. In order to finance the increased benefits, the Legislature anticipated phasing in higher employer contributions by originally setting a 0.1 percent annual cap on budget increases. The gap between the statutory rates and the actuarial rates that began in the FY 1995 budget year has never been closed.

Legislation in 2015 (SB 228) authorized the issuance of pension obligation bonds. The Legislature reduced the statutory rate for participating employer contributions for FY 2016 and FY 2017 to 10.91 percent and 10.81 percent, respectively. In FY 2018 and subsequent fiscal years, the contribution rate may increase by no more than 1.2 percent above the previous year's contribution rate. According to the most recent actuarial analysis provided to KPERS, with the inclusion of the bond proceeds, the statutory rate is projected to equal the actuarial contribution rate in FY 2019 at 13.55 percent. In calendar year 2027, the funded ratio is estimated to reach 80.0 percent, which is the minimum ratio for which pension plans are considered by retirement experts to be adequately funded. The UAL is estimated to be funded in calendar year 2035.

The failure of KPERS participating employers to contribute at the actuarial rate since 1993 has contributed to the long-term funding problem. Other problems, such as investment losses, also have contributed to the shortfall in funding.

### **Retirement Benefits and Adjustments**

The original 1961 KPERS legislation provided for the nonalienation of benefits. The KPERS Act stated: "No alteration, amendment, or repeal of this act shall affect the then existing rights of members

and beneficiaries, but shall be effective only as to rights which would otherwise accrue hereunder as a result of services rendered by an employee after such alteration, amendment, or repeal." This provision is found in KSA 74-4923.

The 1961 legislation exempted the KPERS retirement benefits from all state and local taxation. In other words, no taxes shall be assessed, and no retroactive reduction of promised benefits may be enacted. Any change in benefits must be prospective, unless it involves a benefit increase, which may be retroactive in application, as in the case of increasing the multiplier for all years of service credit.

An automatic cost-of-living adjustment (COLA) was not included in the original 1961 legislation. Over the years, the Legislature provided additional *ad hoc* post-retirement benefit adjustments for retirees and their beneficiaries.

### **KPERS Tier 2 and Tier 3 for Certain New Members**

Legislation in 2007 established a Tier 2 for KPERS state, school, and local employees effective July 1, 2009, and made the existing KPERS members a "frozen" group in Tier 1 that no new members could join. The employee contribution rate for the "frozen" KPERS Tier 1 remained 4.0 percent.

The Tier 2 for employees hired on or after July 1, 2009, continued the 1.75 percent multiplier; allowed normal retirement at age 65 with 5 years of service, or at age 60 with at least 30 years of service; provided for early retirement at age 55 with at least ten years of service and an actuarial reduction in benefits; included an automatic, annual 2.0 percent COLA at age 65 and older; and required an employee contribution rate of 6.0 percent.

Legislation in 2012 established a Tier 3 for KPERS state, school, and local employees effective January 1, 2015, and made the existing KPERS members a "frozen" group in Tier 2 that no new members could join, except for certain state correctional personnel. The employee contribution rate for the "frozen" KPERS Tier 2 remained set

at 6.0 percent, but the COLA was eliminated and a new, higher multiplier of 1.85 percent was authorized to be applied retroactively for all years of credited service and for future years of service.

Effective January 1, 2015, the KPERS Tier 3 has the following plan design components:

- 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—4.0 percent;
- Discretionary Tier 3 dividends—Modified formula based on KPERS funded ratio for awarding discretionary credits, and capped for early years;
- 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 years of service; 5.0 percent for at least 12 but less than 24 years of service; and 6.0 percent for 24 or more years of service;
- Vesting—5 years;
- Termination before vesting—interest would be paid for the first 2 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—5-year service requirement and if spouse had been named primary beneficiary, provide retirement benefit for spouse when eligible;
- Tier 3 early retirement—age 55 with 10 years of service;
- Default form of retirement distribution—single life with 10-year certain;
- Annuity conversion factor—2.0 percent less than the actuarial assumed investment rate of return;
- 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 joint 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
- Employer credits and the guaranteed interest crediting are to be reported quarterly.

The 2012 legislation also further modified the KPERS Tier 1 plan design components and the participating employer funding requirements for contributions. Several other provisions enhanced supplemental funding for KPERS, first, by providing that 80.0 percent from sales of state property would be transferred to the KPERS Trust Fund and, second, by providing for annual transfers of up to 50.0 percent of the balance from the Expanded Lottery Act Revenue Fund to the KPERS Trust Fund after other statutory expenses are met.

The KPERS Tier 1 changes in 2012 included increasing member contributions from 4.0 percent to 5.0 percent on January 1, 2014, and to 6.0 percent on January 1, 2015, with an increase in multiplier to 1.85 percent for future service only, effective January 1, 2014. An alternative election, if approved by the IRS, would have allowed Tier 1 members to elect a reduction in their multiplier to 1.4 percent for future service only and retention of the current 4.0 percent employee contribution rate, effective January 1, 2014. No IRS approval was received in time for an election.

In a private letter ruling dated May 4, 2015, received after the deadline to hold an employee election, the IRS denied members an option to reduce contributions, reasoning to do so would violate the Internal Revenue Code's requirement that a state plan must have a one-time, irrevocable election that must be made no later than when an employee first becomes eligible under the plan. To allow a secondary election would make the plan resemble a cash or deferred arrangement (similar to a 401K) and would risk the plan's tax deferred status under federal tax law.

The 2012 legislation also modified the rate of increase in the annual caps on participating employer contributions. The current 0.6 percent cap would increase to 0.9 percent in FY 2014, 1.0

percent in FY 2015, 1.1 percent in FY 2016, and 1.2 percent in subsequent fiscal years until the UAL of the state and school group reaches an 80.0 percent funded ratio.

Legislation in 2014 modified Tier 3 components. The following Tier 3 provisions were included in that legislation:

- Changed the base year from 2016 to 2015 for initial calculation of interest credits on annuity savings accounts and on retirement annuity accounts;
- Reduced the minimum guaranteed crediting rate from 5.25 percent to 4.0 percent for both types of accounts;
- Revised the formula for determining the additional discretionary interest credits for both types of accounts; and
- Reduced the initial annuity interest rate credit from 6.0 percent at time of retirement to an interest rate equal to 2.0 percent less than the actuarial assumed investment rate of return, as established by the KPERS Board of Trustees upon the member's annuity start date. The current earnings assumption was set at 8.0 percent by the KPERS Board of Trustees in 1987.

For more information, please contact:

Reed Holwegner, Principal Research Analyst  
[Reed.Holwegner@klrd.ks.gov](mailto:Reed.Holwegner@klrd.ks.gov)

Mark Dapp, Fiscal Analyst  
[Mark.Dapp@klrd.ks.gov](mailto:Mark.Dapp@klrd.ks.gov)

J. G. Scott, Assistant Director for Fiscal Affairs  
[JG.Scott@klrd.ks.gov](mailto:JG.Scott@klrd.ks.gov)

Kansas Legislative Research Department  
300 SW 10th Ave., Room 68-West, Statehouse  
Topeka, KS 66612  
Phone: (785) 296-3181  
Fax: (785) 296-3824