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Retirement

S-1 Kansas Public Employees Retirement System Retirement Plans

KPERS Overview and Brief History of State Retirement 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 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's judicial system judges and justices.

All coverage groups are defined benefit, contributory retirement plans and have as members most public employees in Kansas. Tier 3 of the KPERS plan becomes effective for new employees on January 1, 2015, and although called cash balance plan, it is a defined benefit, contributory plan, according to the Internal Revenue Service (IRS). Tier 1 of the KPERS plan is closed to new membership and Tier 2 will close 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.

The primary purpose of the Retirement System is to accumulate sufficient resources in order to pay benefits. Retirement and death benefits paid by the Retirement System are considered off-budget expenses. In FY 2000, the Governor made, with the Legislature approving, retirement benefit payments as non-reportable expenditures. Since 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 in FY 2000 exceeded $500.0 million for the first time. Today more than $1.0 billion is paid in annual retirement and death benefits.

The Retirement System also administers several other employee benefit and retirement programs: 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.

A nine-member Board of Trustees is the governing body for the Retirement System. 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 $13.8 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, the funded ratio for the Retirement System was 56.4 percent on December 31, 2012. Using market value for assets, the funded ratio was 59.0 percent. Using market-based data, the unfunded liability was $9.7 billion on December 31, 2012. This is the amount of financing shortfall when comparing the Retirement System assets with promised retirement benefits. The actuarial unfunded liability of $10.25 billion did not reflect all of the recent investment losses or gains.

Brief History of KPERS

The Kansas Public Employees Retirement System (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. The new 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. The second KPERS tier is described in the last section of this document. A third tier will be implemented January 1, 2015, for all new employees.

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 which had affiliated with KPERS were dissolved by the Legislature effective on 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 which 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 which was equal to 0.5 percent of defined salary for each year. In

1965 legislation, the prior service multiplier was raised to 0.75 percent. In 1968 legislation, the prior service multiplier was raised to 1.0 percent, and the participating service multiplier was increased that year to 1.25 percent for all years of service.

In 1970 legislation, participating service for school employees was set as the same as for 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 which were not credited under the SSRS. In 1982 legislation, the participating service credit for state, school and local KPERS members was increased from 1.25 percent to 1.4 percent of final average salary for all participating service credited after July 1, 1982.

In 1993 legislation, the multiplier was raised 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 10 years of service; and 85 points (any combination of age plus years of service).

Contribution Rates for KPERS

KPERS Tier 1 and Tier 2 are participatory plans in which both the employee and employer make contributions. In 1961 KPERS legislation, 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 are set at 6.0 percent by statute beginning July 1, 2009.

In the 1961 legislation, initial employer contributions were statutorily 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. The KPERS Board of Trustees engaged Martin E. Segal & Company as actuarial consultants.

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 legislation, 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).

During the 1980s, the Legislature capped the actuarial contribution rates for employers on numerous occasions in statutory provisions. In 1988 legislation, 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. The 1993 legislation 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, and the Legislature has modified the annual cap to its present level of 0.6 percent in an effort to close the gap. Future cap increases are authorized in recent legislation.

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 that: "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 KPERS retirement benefits were exempted in 1961 legislation 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.

In 1972 legislation, the Legislature provided for the first cost-of-living adjustment (COLA) to KPERS retirees by increasing benefits by 5.0 percent for anyone who had retired on or before June 30, as provided in the 1972 legislation. Over the years the Legislature provided additional *ad hoc* post-retirement benefit adjustments for retirees and their beneficiaries. No automatic COLA was authorized until the new KPERS Tier 2 was established in 2007 for future KPERS members as described in the last section of this document.

New KPERS Tier 2 and Tier 3 for members

In 2007 legislation, a Tier 2 for KPERS state, school and local employees was established, effective July 1, 2009, and with the existing KPERS members becoming 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 KPERS Tier 2 for employees hired on or after July 1, 2009, continued the 1.75 percent multiplier; allowed normal retirement at age 65 with five 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 cost-of-living adjustment (COLA) at age 65 and older; and required an employee contribution rate of 6.0 percent.

In 2012 legislation, a Tier 3 for KPERS state, school and local employees was established, effective January 1, 2015, and with the existing KPERS members becoming 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.

The new KPERS Tier 3 will have the following plan design components:

- Normal retirement age - age 65 and five 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 five years of service; 4.0 percent for at least five, but less than 12 years 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 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 would be transferred from the Expanded Lottery Act Revenue Fund to KPERS Trust Fund after other statutory expenses are met.

The KPERS Tier 1 changes 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 2013 for an election.

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 unfunded actuarial liability of the state and school group reaches an 80.0 percent funded ratio.

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