Report of the Joint Committee on Pensions, Investments, and Benefits to the 2015 Kansas Legislature

Chairperson: Senator Jeff King

Vice-chairperson: Representative Steven Johnson

Other Members: Senators Anthony Hensley, Mitch Holmes, Laura Kelly, and Ty Masterson; and Representatives John Edmonds, Daniel Hawkins, Charles Macheers, Gene Suellentrop, and Ed Trimmer

Charge

- Working after retirement;
- Future pension reforms for corrections workers; and
- Discuss legislation and policies under consideration for the 2015 Session.

January 2015

Joint Committee on Pensions, Investments, and Benefits

Report

Conclusions and Recommendations

The Joint Committee concludes the current break-in-service requirements for persons returning to work after retirement should be reviewed. The post-retirement provisions which are scheduled to sunset on June 30, 2015, should be addressed. The 2015 Legislature should consider the ability of the Kansas Public Employees Retirement System (KPERS) to recapture benefits, if certain conditions are present.

The Joint Committee concludes members in the KPERS Correctional groups, along with local law enforcement personnel who meet the training requirements, should be enrolled in the Kansas Police and Firemen's Retirement System (KP&F). The additional employer contribution funding for those who were in KPERS Correctional should come from the State General Fund.

- The Joint Committee concludes pension obligation bonding and emerging retirement plan trends in the private sector should be reviewed during the 2015 Legislative Session.

Proposed Legislation: None.

Background

The Joint Committee on Pensions, Investments and Benefits was created in 1992 and is directed by KSA 46-2201 to:

- Monitor, review, and make recommendations relative to investment policies and objectives formulated by the KPERS Board of Trustees;
- Review and make recommendations related to KPERS benefits; and
- Consider and make recommendations on the confirmation of members nominated by the Governor to serve on the KPERS Board of Trustees.

The Joint Committee may introduce legislation it determines to be necessary.

The Legislative Coordinating Council charged the Joint Committee to study working after retirement and pension reforms for corrections workers.

Committee Activities

The Joint Committee met on November 17 and December 19, 2014. It reviewed KPERS long-term funding, working after retirement, pension reforms for corrections workers, disability benefits for certain law enforcement officers, and the Governor's Allotment Plan.

Review of KPERS Long-Term Funding

The Joint Committee reviewed the valuation report of the KPERS actuary, which is a snapshot of the financial condition of the retirement plan as of December 31, 2013. The actuarial valuation, which is different from the market valuation, was estimated to be $14.6 billion. Actuarial assets are calculated by "smoothing" investment gains and losses over a five-year period. A market value higher than the actuarial value means that deferred investment gains will flow through valuations over the subsequent four years. There is an estimated $1.2 billion in deferred gains. Due to investment gains over the past two years, the funding status has improved for all membership groups (KPERS state, school, and local groups; Kansas Police and Firemen's Retirement System; and Judges Retirement System). It is believed that legislative reforms enacted in 2012, including increased employer and employee contributions, will continue to aid in improving funding. Assuming all actuarial assumptions are met in the future, KPERS will be fully funded at the end of the amortization period (FY 2033).

Investment returns make up the largest source of income for benefits distributed. KPERS' investment portfolio had a 17.7 percent total return for calendar year 2013. As of June 30, 2014, KPERS' annualized, time-weighted total return over a 20-year period was 8.9 percent.

Recent Changes to Law

A provision of 2012 HB 2333 requires any cost of legislation determined by KPERS' consulting actuary be reported to the Joint Committee. During the 2013-2014 Legislative Biennium, two enacted bills were determined to affect the actuarial costs. The first bill, 2013 HB 2213, changed the cap on the benefits for KP&F members from 80 percent of final average salary to 90 percent. Based on the 2012 valuation, the change increased the unfunded actuarial liability of the KP&F plan by $13.3 million. KP&F member contributions were increased from 7.0 percent for all years up to the benefit cap (32 years) and 2.0 percent thereafter to 7.15 percent for all years of service, effective July 1, 2013. No increase was necessary in employer contributions to fund the actuarial cost of the change. The second bill, 2014 HB 2533, made changes to the KPERS Tier 3 cash balance plan including decreasing the guaranteed interest crediting rate from 5.25 percent to 4.0 percent and eliminating the Board of Trustee's role in granting dividend credits in favor of a formulaic dividend. The actuarial cost is an estimated nominal savings for the State-School Group of $3.0 billion over 48 years ($251.8 million in present value). Changes do not reduce the unfunded actuarial liability, which means the majority of the cost savings are due to the lower normal cost rate after the unfunded actuarial liability is fully paid.

Working after Retirement

Staff from the Office of Revisor of Statutes, the Kansas Legislative Research Department, and KPERS provided information, respectively, regarding the current law on working after retirement, the history of those policies, and statistics and options for future policy.

Current Law

Under KSA 2014 Supp. 74-4914, KPERS members are subject to a waiting period of 60 days before a member may return to work for an employer who participates in KPERS. When returning to work for the same employer, retirees are subject to a $20,000 earnings limitation. The State of Kansas is considered a single employer, but each school district is considered a different employer. The $20,000 cap does not apply to retirees employed as substitute teachers or to officers, employees, or appointees of the Legislature. Nurses who return to work for a state institution are also exempt. There is no earnings limitation for a retiree who works for a different participating employer, and no employee contribution is required. However, the employer is required to make a contribution at the actuarial contribution rate plus the statutorily prescribed employee contribution rate (Tiers 1 and 2 = 6.0 percent, each). Retirees who provide service to a participating employer through a third-party contractor are still subject to restrictions.

Certain licensed school personnel, as specified in KSA 2014 Supp. 74-4937(3), are exempt from the $20,000 cap. The participating employer of that retiree must pay to KPERS the actuarially determined employer contribution based on the retiree's compensation during the period of employment plus 8.0 percent. Retirees make no employee contribution. This exemption expires on July 1, 2015, and after that date KPERS and its actuary are required to report the experience to the Joint Committee on Pensions, Investments and Benefits.

History of Working After Retirement

The Legislature has alternated between a policy of restrictions and a policy of no restrictions for certain retirees who go back to work for a participating employer, including state agencies, local units of government, school districts, other governmental entities, and other educational institutions. In the early 1960s when KPERS was established, there were restrictions on returning to work after retirement if the employment was with a participating KPERS employer. Most of the post-retirement restrictions were eliminated by the mid-1980s. Starting in 1988, new restrictions were instituted. Since then, exceptions to the statutory restriction have been authorized gradually and later revised.

Statistics and Future Policy Options

KPERS staff and its actuary examined the employment records of over 6,600 individual retirees who returned to work in one or more years from calendar years 2007 through 2013. While the conferees cautioned that the data examined was not necessarily reliable enough to make conclusions about all post-retirement behavior, they observed school retirees made up the largest group returning to work. Of the retirees returning to work for the state, for local governments, and in non-licensed positions for school employers, larger numbers were returning to the same employer, most likely on a part-time basis due to the earnings cap. For local and school employers, over 50 percent of retirees who returned to work for the same employer did so within a few months of retiring. Those returning to state employment appeared to wait slightly longer. While it was difficult to quantify compensation after returning to work, due to a variety of job arrangements, it was observed that the earnings cap may have caused the average compensation to be less. On average, a licensed school retiree returning to work for the same employer had significantly lower compensation than one who worked for a different school district.

When considering future policy options, it was suggested post-retirement goals, the length of a *bona fide* separation before returning to work, the extent and quantity of benefits, the age of the retiree, earnings, hours worked by the retiree, length of re-employment, the employer, the type of position, and employer contributions be considered.

Pension Reforms for Corrections Workers

Staff from the Office of Revisor of Statutes, the Kansas Legislative Research Department, and KPERS, respectively, provided information regarding the current law on corrections workers, the history of those policies, and the benefit structure for KPERS Correctional members.

Current Law

Security officers of the Department of Corrections are members of KPERS. The officers are divided into two groups. Group A (C55) is for the security officers whose positions are classified as correction officers and their supervisors. Group B (C60) is for security officers who work within a correctional institution and have regular contact with inmates but who are in positions not classified as corrections officers, such as support personnel. The minimum retirement date for a person in Group A is either at age 55 with a minimum of 3 consecutive years of experience or when the person has 85 points, which is the sum of years of service plus age. The minimum retirement date for a person in Group B is either at age 60 with a minimum of 3 consecutive years of experience or when the person has 85 points. Early retirement for Group A is allowed at age 50 with 10 years of service, and for Group B it is allowed at age 55 with years of 10 years of service.

For security officers who are in Tier 2, the normal retirement date for those in Group A is age 55 with 10 years of service, including 3 years immediately preceding retirement. For Tier 2 members who are in Group B, the normal retirement age is 60 with 10 years of service, including 3 years immediately preceding retirement. To be eligible for early retirement in Tier 2, Group A security officers must be age 50 with 10 years of experience, including 3 years immediately preceding retirement. For Group B the early retirement date is age 55 with 10 years of service, including 3 years immediately preceding retirement. Retirement benefits for security officers are calculated in the same manner as for other KPERS members (1.85 percent x years of service x final average salary).

Starting January 1, 2015, newly hired security officers are exempted from the cash balance plan and become members of KPERS Tier 2.

History of KP&F Membership

Prior to the establishment of KPERS in 1961, the Legislature created other retirement plans for certain governmental employees, including two plans for public safety (law enforcement) state employees. Both plans eventually merged with KPERS in some manner, either consolidating with KPERS to provide membership for eligible members or transferring the administration of the continuing plans to the administration of the KPERS Board of Trustees. In 1968, employees of the State Highway Patrol and the Kansas Bureau of Investigation were authorized to participate in the KP&F plan. The separate pension boards relating to those two agencies were abolished, and the funds were transferred to KPERS for administration. KP&F membership was broadened to include university police officers in 1988; Capitol Police Officers and Motor Carrier Inspectors in 2004, when the groups were reorganized into the State Highway Patrol; enforcement officers in the Office of State Fire Marshal in 2005; and firefighters serving the 190th Kansas Air National Guard as non-military employees.

Over the years various groups of state employees have been unsuccessful in gaining KP&F membership: correctional security officers in the Department of Corrections, the Division of Alcoholic Beverage Control of the Department of Revenue, the Kansas Lottery, the Kansas Racing and Gaming Commission, the Office of Securities Commissioner, Court Services Officers, and the Enforcement Division of the Department of Wildlife, Parks and Tourism.

Other Testimony

The Secretary of Corrections provided testimony supporting the transfer of juvenile correctional officers and parole officers to KPERS Corrections, noting the creation of KPERS Tier 3 will only further increase the disparity in the retirement plans offered to front-line staff, which may impact recruitment, retention, or employee morale. According to the agency, transferring these officers to KPERS Corrections would impact 393 employees. Of this, 134 are currently participating in Tier 2. Currently 1,918 employees are in KPERS Corrections, with 745 of those employees in Tier 2. The additional cost in employer contribution is estimated at $1.9 million, which the agency suggested come from the State General Fund.

The Joint Committee also received testimony from individual corrections workers who either supported or were opposed to the transition. A representative of the Kansas Organization of State Employees encouraged the Joint Committee to address pay and safety at the same time pension membership was considered.

Other Issues

Definition of "police." The Joint Committee heard testimony from county law enforcement officials regarding KPERS' interpretation of the definition of the term "police," and variations of the word, so as to deny KP&F disability benefits to sheriffs' deputies who worked in a jail or detention center. A representative of the Kansas Association of Chiefs of Police, the Kansas Peace Officers Association, and the Kansas Sheriffs Association proposed an amendment to the definition, specifying that certified law enforcement officers who are assigned to a jail, detention center, or other correctional facility shall not be denied benefits.

Governor's Allotment Plan. The Director of the Budget explained the portion of the Governor's Allotment Plan that would reduce the employer contribution rate to the FY 2012 level. The roll-back will be a reduction in employer contribution amounts for six months that will not be carried forward into the Governor's FY 2016 and FY 2017 budget proposals. The employer contribution rate will be restored to its statutorily set level. The Joint Committee was requested to study additional short-term reform options, such as revising the method used to calculate asset valuations (moving from an actuarial method to a market value method) and considering the impact of reamortization of the actuarial liability by extending the amortization period. The Director of the Budget also requested three long-term options be studied:

- Issuing pension obligation bonds to reduce the unfunded actuarial liability with net proceeds in the amounts of either $1.0 billion or $1.5 billion with debt service from a source other than employer contributions;
- Revising the plan design for new hires and non-vested KPERS members to include:
  - Member election of cash-balance or defined-contribution plan; or
  - A hybrid cash-balance, defined-contribution plan; and
- Emerging trends in the private sector such as annuitization.

Conclusions and Recommendations

The Joint Committee concludes the 2015 Legislature should review the current break-in-service requirements in concert with the ability for members to unretire without penalty; and it should consider the ability of KPERS to recapture benefits, should a member return to employment before the end of the break-in-service requirements.

The Joint Committee concludes the working-after-retirement provisions that are set to expire at the end of FY 2015 should be addressed by the 2015 Legislature.

The Joint Committee concludes the 2015 Legislature consider moving KPERS Correctional retirement from a subgroup of the KPERS plan to a subgroup of the KP&F plan.

The Joint Committee concludes the 2015 Legislature should review the possibility of including juvenile corrections and parole officers in the KPERS Correctional retirement plan and consider funding from the State General Fund for the additional employer contribution.

The Joint Committee concludes the 2015 Legislature should consider amending state law to allow sheriffs' deputies who meet the training requirements of KP&F retirement, but whose primary job duties in local jails exclude them from KP&F eligibility, be enrolled as KP&F members.

The Joint Committee concludes the potential for bonding to increase the assets in the KPERS Trust Fund and for reamortizing the payment of the unfunded actuarial liability should be reviewed by the 2015 Legislature.

The Joint Committee concludes the 2015 Legislature should review, with the assistance of the KPERS Board and staff working with insurance companies, the emerging retirement plan trends in the private sector.