Report of the Joint Committee on Pensions, Investments and Benefits to the 2017 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 Alcala, John Edmonds, Daniel Hawkins, Jerry Henry, Charles Macheers, Gene Suellentrop, and Ed Trimmer

CHARGE

The Joint Committee is directed to monitor, review, and make recommendations regarding the retirement system pertaining to:

- Legislation enacted during the 2016 Legislative Session affecting the Kansas Public Employees Retirement System (KPERS);
- The overall funding ratio for the Retirement System; and
- Various reports statutorily required to be submitted by KPERS and other state agencies to the Joint Committee.

December 2016

Joint Committee on Pensions, Investments, and Benefits

Annual Report

Conclusions and Recommendations

The Joint Committee requests KPERS report the investment performance of the proceeds of the 2004 and 2015 bond series to the members of the Joint Committee.

When considering future modifications of working-after-retirement policy, the Joint Committee suggests legislation be considered that would allow retirees to return to public employment if certain hardship conditions are met.

The Joint Committee recommends the State honor its obligation to contribute the approximately $97 million that was delayed in FY 2016, plus 8 percent interest.

Proposed Legislation: A bill that would exempt Regents' schools and employed retirees from certain working-after-retirement rules.

Background

The Joint Committee on Pensions, Investments and Benefits was created in 1992 and is directed by KSA 2016 Supp. 46-2201 to:

- Monitor, review, and make recommendations relative to investment policies and objectives formulated by the Kansas Public Employees Retirement System (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.

Committee Activities

The Joint Committee met September 12, 2016, to review KPERS long-term funding, the performance of pension obligation bonds, and newly enacted provisions pertaining to working after retirement. The Joint Committee also acknowledged receipt of information submitted by KPERS.

Review of KPERS Long-Term Funding

The Joint Committee reviewed the 2015 actuarial valuation, which is a snapshot of the financial condition of the Retirement System as of December 31, 2015. The actuarial valuation of System assets, which includes the $1.0 billion proceeds of the recently issued pension obligation bonds, was estimated to be $17.409 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 deferred investment gains will flow through valuations over the subsequent four years.

An estimated $515 million in net deferred loss is to be realized in the outlying years.

The funding status has improved for four membership groups (KPERS state, school, and local groups and the Judges' Retirement System). The funded ratio for the Kansas Police and Firemen's Retirement System (KP & F) decreased by 10 basis points to 74.0 percent. The unfunded actuarial liability for the entire system decreased in 2015 by $929 million, leaving $8.539 billion remaining to be funded. The funded ratio increased from 62.3 percent in 2014 to 67.1 percent in 2015. Legislative reforms enacted in 2012, including increased employer and employee contributions, will continue to improve funding. Assuming all actuarial assumptions are met in the future, KPERS will be fully funded at the end of the amortization period in calendar year 2033.

Bond Proceeds, 2015 Series

The Executive Director of KPERS explained the bonds were invested within a few days after receipt in accordance with KPERS' target asset allocation plan. Some adjustments have been made to rebalance the asset mix in domestic equity, private equity, and real estate. The 2015 pension obligation bonds were issued with an effective interest rate of 4.688 percent. Over the long term, a return over 4.7 percent would outperform the interest cost of the pension obligation bonds.

The first annual period for investment of the bond proceeds ended in August 2016. KPERS had not received the financial performance report by the date of the Committee's meeting.

Overview of 2016 Legislation Enacted; Implementation of New Provisions

Staff from the Office of Revisor of Statutes provided an overview of House Sub. for SB 168, which amended several provisions pertaining to a moratorium for KPERS death and disability contributions for the last quarter of FY 2016 and all of FY 2017, accidental death benefits for members of KPERS Tier 3, the sharing of account information with vendors associated with the KPERS 457 plan, tax treatment of Roth 457 plans, the establishment of a new 401(a) deferred compensation plan for local government employees, recalculation of final average salary for a KP & F member who participates in the Deferred Retirement Option Program, and working after retirement (which is discussed in a separate section).

KPERS staff reminded Committee members the KPERS 457 Plan is a deferred compensation plan for public employees and consists of contributions by employees only. This plan is the "third leg" of the "retirement stool" which allows state and local employees to have sound retirement incomes consisting of their Social Security income, KPERS benefits, and personal savings. KPERS is working on three initiatives to enhance KPERS 457: a Roth 457(b) plan; a pension data-sharing agreement with Empower, the current record keeper; and a 401(a) plan option for local employers. KPERS' goal was to present these plans to the Board of Trustees during its meeting on September 30, 2016. Implementation would occur in 2017.

Working After Retirement; Implementation of New Provisions; Related Issues

Working-after-retirement rules that permit employees to simultaneously work and receive KPERS benefits encourage earlier retirements, which has a cost to the Retirement System because there is a shorter period for contributions and a longer period for benefit payouts.

The Executive Director of KPERS discussed the implementation of new provisions and related issues regarding working after retirement. He described the old rules as effective until the end of FY 2016 and explained changes had been made because the temporary rules for licensed school professionals were initially scheduled to sunset on June 30, 2015, but were extended to June 30, 2016. The Legislature wanted to find a more permanent plan rather than continuing to extend the sunset. The IRS requires a *bona fide* retirement take place before distributions can occur. If an employer pre-arranges with an active member to retire and to return to work as a retiree, the member's retirement is not *bona fide* in the eyes of the IRS. Other circumstances, such as reemployment of a retiree as an independent contractor or through a third party, may cause questions about whether a legitimate retirement occurred.

The annual earnings limitation increased from $20,000 to $25,000 beginning July 1, 2016. Employers must report all rehired retirees to KPERS. The employer and employee must certify that no prearrangement has occurred. The 60-day waiting period for retirement benefits has not changed. The Executive Director also discussed the provisions for grandfathered positions (*e.g.*, licensed school professionals and other retirees) and also great-grandfathered positions (non-licensed) pertaining to rules if rehired by a different employer or the same employer. After reviewing the law with KPERS' tax counsel, it was determined all employees of KPERS-affiliated employers would be subject to the new rules, even if the position was not a KPERS-covered position.

A representative from the Kansas Board of Regents and the President of Fort Hays State University discussed the impact on the Regents System created by the 2015 and 2016 post-retirement legislation. A retiree who returns to work for a Regents institution is subject to the new rules even if the retiree is employed in a position covered by the Regents Mandatory Retirement Plan. Paying the 30 percent surcharge would be cost prohibitive for universities. The Board's staff requested legislation be introduced to create an exemption to KSA 2016 Supp. 74-4914: If a KPERS retiree is hired to a position covered by the Regents Mandatory Retirement Plan, the employee would not be impacted by the compensation limitation and the employer would not be affected by the new KPERS contribution requirement.

Representatives from the departments of Children and Families and Education expressed concerns about the applicability of working-after-retirement provisions to personnel associated with the respective two agencies. Two members of the public also questioned the effect the new post-retirement employment rules may have on individuals facing unique circumstances.

Receipt of KPERS Reports

The Joint Committee acknowledged receipt of the statutorily required Sudan Divestment Report.

Conclusions and Recommendations

The Joint Committee requests KPERS report the investment performance of the proceeds of the 2004 and 2015 bond series to the members of the Joint Committee. When this matter was discussed during the Interim, the performance analysis for the 2015 proceeds was not yet complete. As the State works to balance its budget, it is essential for the Legislature to know how well these special investments are working for the future solvency of the Retirement System.

The Joint Committee recommends a bill be introduced to exempt Regents' schools and employed retirees from certain working-after-retirement rules. It has come to the Committee's attention that some recently enacted changes to the law are having unintended consequences for positions covered by the Regents Mandatory Retirement Plan, which is not part of KPERS. The Board of Regents estimates that 140 KPERS retirees are re-employed on the campuses, mainly at the schools of education.

When considering future modifications of working-after-retirement policy, the Joint Committee suggests legislation be considered that would allow retirees to return to public employment, the earnings cap notwithstanding, if certain hardship conditions are met.

When the 2011 KPERS Study Commission proposed reforms, it was estimated the Retirement System would be fully funded by 2033. Due to increased contributions by both employers and employees, recent market performance, and the creation of a hybrid system, KPERS is expected to meet that goal. The State-School Employer Group should meet its actuarially required contribution rate in FY 2020, which would be a milestone success. However, both the Legislature and the Governor must refrain from the temptation to balance the budget by reducing or delaying future contributions, which only delays the inevitable—making future contributions more expensive than they should be. The Joint Committee recommends the State honor its obligation to contribute the approximately $97 million that was delayed in FY 2016, plus 8 percent interest. Once public employees have performed their work for the people and State of Kansas, public employers must honor their obligations to ensure the financial integrity of KPERS so that, among other purposes as specified in KSA 74-4901, the Retirement System may promote “economy and efficiency in the administration of governmental affairs.”