



November 2, 2023

To: Joint Committee on Pensions, Investments and Benefits

From: Steven Wu, Managing Fiscal Analyst

Re: History of the Kansas Public Employees Retirement System

Retirement System Overview

The primary purpose of the Kansas Public Employees Retirement System (known generally as KPERS and referenced in this memorandum as the Retirement System) is to accumulate sufficient resources to pay benefits to retired state workers statutorily entitled to those benefits.

The Retirement System administers three statewide plans:

- **KPERS.** The largest plan, usually referred to as the regular KPERS plan or as KPERS, includes state, school, and local groups composed of regular state and local public employees; school district, vocational school, and community college employees; Board of Regents (Regents) classified employees and certain Regents unclassified staff with pre-1962 service; and state correctional officers. As of December 2022, this plan has 143,849 active members;
- **Kansas Police and Firemen's Retirement System (KP&F).** A second plan, known as the KP&F Retirement System, is for certain designated state and local public safety employees. As of December 2022, this plan has 7,868 active members; and
- **Kansas Retirement System for Judges.** A third plan, known as the Kansas Retirement System for Judges, is for the state judicial system's judges and justices. As of December 2022, this plan has 267 active members.

All coverage groups within the Retirement System are defined benefit, contributory retirement plans and have as members most public employees in Kansas. Retirement and death benefits paid by the Retirement System are considered off-budget expenses. Starting in fiscal year (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.

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 (KPERS) in managing investments of moneys from three state funds: the Kansas Endowment for Youth Fund, the Senior Services Trust Fund, and the State Treasurer's Unclaimed Property Fund.

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

The Retirement System manages approximately \$24.52 billion on a market value basis and \$26.45 billion in actuarially-valued assets. The Retirement System annually pays out more in 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, which is the relationship between the promised benefits and the resources available to pay those promised benefits. In the most recent actuarial valuation on December 31, 2022, the funded ratio for the Retirement System was 73.4 percent, and the unfunded actuarial liability was \$9.567 billion. This is the amount of financing shortfall when comparing the Retirement System assets with promised retirement benefits.

The Legislature has previously taken action to increase state and local employer contributions to provide enhanced resources for the long-term financing of KPERS. In 2004, the Legislature authorized issuance of \$500.0 million in pension obligation bonds to be repaid from the State General Fund (SGF) in order to augment state employer contributions [designated as the 2004C bond issue]. In 2015, the Legislature authorized issuance of \$1.0 billion in pension obligation bonds [2015H], and in 2021, the Legislature authorized issuance of another \$500.0 million in such bonds [2021K]. The pension obligation bonds are reflected in the Department of Administration's budget rather than in the KPERS agency budget.

Additionally, the 2022 Legislature transferred \$1.125 billion SGF directly to the KPERS Trust Fund. Of that amount, the first \$253.9 million SGF paid off outstanding accounts receivable for KPERS-School employer contributions withheld in FY 2017 and FY 2019 ("layering payments"), while the remaining \$871.1 million SGF was applied to the KPERS-School unfunded actuarial liability.

A Brief History of KPERS

KPERS was created under law enacted in 1961, 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. As of December 2022, there were 46,500 active members in the KPERS Tier 1 plan. 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 employees and employers will share in the total cost of providing benefits. A third tier was implemented January 1, 2015, for all new employees.

Tier 1 of the KPERS plan is closed to new membership and Tier 2 is closed to most new membership as of December 31, 2014; certain state correctional personnel are eligible for membership in Tier 2. 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).

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 as of 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 exclusively governmental. Amendments to KSA 74-4910 also broadened the definition of which governmental officials and officers were eligible for KPERS membership.

KPERS Tier 1

In 2012, the Legislature modified the KPERS Tier 1 plan design components and the participating employer funding requirements for contributions. Several 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 Revenues Fund to the KPERS Trust Fund after other statutory expenses have been met.

KPERS Tier 2

In 2007, the Legislature established a Tier 2 plan 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 until 2014, when it increased from 4.0 percent to 5.0 percent, and in 2015, when it increased from 5.0 percent to 6.0 percent. The contribution rate remains at 6.0 percent today.

The Tier 2 plan 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 10 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.

The Legislature in 2012 established a Tier 3 plan for KPERS state, school, and local employees effective January 1, 2015, and made the existing KPERS members, hired between July 1, 2009, and December 31, 2014, 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. As of December 2022, there are 23,792 active members in the KPERS Tier 2 plan.

KPERS Tier 3

In 2012, the Legislature implemented a third tier of the KPERS plan, enacting three major changes: higher employer contributions, higher member contributions, and a cash balance plan for new members beginning January 1, 2015. As of December 2022, there are 73,557 active members in the KPERS Tier 3 plan.

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** (the period of employment necessary for benefits to accrue)—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;
- **Early retirement**—age 55 with 10 years of service;
- **Default form of retirement distribution**—single life with 10-year certain annuity;
- **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;
- **Electronic and written statements**—the Board shall provide information specified. Certain quarterly reporting is required; and
- **Powers reserved to adjust plan design**—the Legislature may prospectively change interest credits, employer credits, and annuity interest rates.

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, new law set the participating service for school employees to be 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 1.00 percent for years under the SSRS and 0.75 percent for years of school service not credited under the SSRS. In 1982, enacted legislation increased the participating service credit for state, school, and local KPERS members from 1.25 percent to 1.40 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 of 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).

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 percent to 5.0 percent in 2014, and to 6.0 percent on January 1, 2015.

In 1961, initial employer contributions were set at 4.35 percent (3.75 percent for retirement benefits and 0.60 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 Board, 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 Board. 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 4.30 percent for state and local units of government (KPERS non-school) and to 3.30 percent for education units of government (KPERS school).

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

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 non-school group. The amortization period for the combined State/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. In 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 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 1.20 percent above the previous year's contribution rate. According to the most recent actuarial analysis provided to KPERS, the statutory rate for the State/School group will equal the actuarial contribution rate in FY 2024 at 12.57 percent. In calendar year 2033, 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 State/School "legacy" UAL, which is estimated to be \$6.195 billion in FY 2024, is projected to be eliminated sometime after calendar year 2040. The failure of employers participating in KPERS to contribute at the actuarial rate since 1993 has contributed to the long-term funding problem. In more recent years, the State/School statutory rate as been at the full actuarial rate; FY 2025 will represent the fifth consecutive year the statutory and actuarial rates have been equal.

The long-term solvency can also be affected by market performance, changes to benefits, and actuarial assumptions, especially the assumed rate of return. Historically, the assumed rate of investment return was 8.0 percent. In 2017, the Board reduced the rate to 7.75 percent, and in 2022, the Board reduced the rate to 7.00 percent.

Retirement Benefits and Adjustments

The original 1961 KPERS legislation provided for the non-alienation 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." (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 COLA was not included in the original 1961 legislation. Over the years, the Legislature has provided *ad hoc* post-retirement benefit adjustments for certain retirees and their beneficiaries, but the vast majority of retirees have never received a COLA.

Other Recent Revisions

Working after retirement. With regard to substantive policy, the Legislature enacted a new working-after-retirement provision, which took effect on January 1, 2018. For retirees under the age of 62, there is a 180-day waiting period before returning to work. If the retiree is 62 or older, a 60-day waiting period applies. There must be no prearranged employment agreement between the retiree and the public employer that is affiliated with KPERS. For covered positions, the employer pays the statutory contribution rate on the first \$25,000 of compensation and, for that portion of compensation greater than \$25,000, the contribution rate is equal to 30.0 percent.

Covered positions for non-school employees are those that are not seasonal or temporary and whose employment requires at least 1,000 hours of work per year; covered positions for school employees are those that are not seasonal or temporary and whose employment requires at least 630 hours of work per year or at least 3.5 hours a day for at least 180 days. For non-covered positions, the employer makes no contributions.

None of the above provisions sunset.

Starting on January 1, 2018, all retirees who had retired prior to that date in state, local, and licensed or unlicensed school positions are not subject to an earnings limitation. Employers will pay the statutory contribution rate on the first \$25,000 of compensation and, for that portion of compensation greater than \$25,000, the contribution rate will be equal to 30.0 percent for retirees employed in covered positions.

Employer contributions. With regard to fiscal policy, the aforementioned 2012 legislation also modified the rate of increase in the annual caps on participating employer contributions. The 0.6 percent cap increased 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/School group reaches an 80.0 percent funded ratio.

Legislation in 2016 provided the Governor with enhanced allotment authority and specifically allowed for the reduction of FY 2016 employer contributions to KPERS. In total, \$97.4 million in previously approved FY 2016 employer contributions to the State/School group were delayed.

Legislation in 2017 froze FY 2017 employer contributions at FY 2016 levels, reducing approved contributions by approximately \$64.1 million. FY 2018 employer contributions remained at their statutory level, and FY 2019 employer contributions were reduced by approximately \$194.0 million from their statutory amount. Repayment of the FY 2017 and FY 2019 reductions were approved via layered amortization of a level dollar amount over 20 years.

Legislation in 2018 transferred \$56.0 million from the SGF to the KPERS Trust Fund in FY 2018, which was due to receipts exceeding consensus revenue estimates for the fiscal year

by at least that amount. An additional \$82.0 million was transferred from the SGF to the KPERS Trust Fund in FY 2019.

Legislation in 2019 repaid the total reduction in FY 2016 employer contributions authorized in 2016. Additional interest was included for a total amount repaid of \$115.0 million from the SGF to the KPERS Trust Fund in FY 2019. Separate legislation transferred an additional \$51.0 million from the SGF to the KPERS Trust Fund in FY 2020.

Legislation in 2021 authorized the issuance of up to \$500.0 million in pension obligation bonds, which reduced employer contribution rates in future years.

Legislation in 2022 appropriated \$1.125 billion in funding above the annual employer contribution rate to the School group. This includes \$253.9 million for reduced contributions in FY 2017 and FY 2019 and \$871.1 million in additional contributions.