# PRELIMINARY MINUTES

## KANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM STUDY COMMISSION

October 25-26, 2011
Room 346-S—Statehouse

### Members Present

Senator Jeff King, Co-chairperson
Representative Mitch Holmes, Co-chairperson (by telephone 10/26)
Senator Laura Kelly
Representative Steven Johnson
Representative Ed Trimmer
William Buchanan
Edward Condon
Frederick Proccia
Rebecca Proctor
Michael Ryan
Richard Stumpf
Brian Winter (by telephone 10/26)

### *Ex Officio* Members

Elizabeth Miller, Acting Executive Director, Kansas Public Employees Retirement System
Alan Conroy, Director, Kansas Legislative Research Department
Steve Anderson, Director, Division of the Budget

### Staff Present

Julian Efird, Kansas Legislative Research Department
Michael Steiner, Kansas Legislative Research Department
J.G. Scott, Kansas Legislative Research Department
David Wiese, Office of the Revisor of Statutes
Daniel Yoza, Office of the Revisor of Statutes
Connie Burns, Committee Assistant

### Conferees

Patrice Beckham, KPERS Actuary, Cavanaugh Macdonald Consulting, LLC
Brent Banister, Cavanaugh Macdonald Consulting, LLC
Paul Cleary, Executive Director, Oregon Retirement System (by telephone)
Marcie Frost, Deputy Director, Washington State Department of Retirement Systems (by telephone)
Dave Nelsen, Legal/Legislative Services Manager, Washington State Department of Retirement Systems (by telephone)
Mark Feldhausen, Budget and Benchmarking Director, Washington State Department of Retirement Systems (by telephone)

**Tuesday, October 25**
**Morning Session**

The meeting was opened by Co-chairperson Holmes. The Co-chairperson introduced the Commission's newest member, Frederick (Rick) B. Proccia, Jr., who succeeds Chris Long. This meeting was webcast live on the Internet.

## Report from KPERS Actuary on Models and Other Requested Information

Patrice Beckham, KPERS Actuary, Cavanaugh Macdonald Consulting, LLC, provided a chart with the advantages and disadvantages of implementing the different retirement benefit plans or other plan options (Attachment 1). She explained the advantages and disadvantages of each option.

The Commissioners requested different projections using the model with varying percentages; also with and without a COLA; different ages and service requirements (*i.e.* age 65 with 20 years, 30 years, and 40 years of service); several scenarios were run as examples of what the model could produce.

## Oregon PERS Hybrid Plan (conference call)

Paul R. Cleary, Executive Director, Oregon Public Employees Retirement System (OPERS), provided the Commission an overview of the Oregon System and the different types of retirement plans administered (Attachment 2).

There are four plan components: Tier One, Tier Two, the Oregon Public Service Retirement Plan (OPSRP) Pension Program, and the members' Individual Account Program (IAP). OPERS pays $3.0 billion annually in benefits, 87 percent of which ($2.6 billion) is injected directly into the Oregon economy. The Oregon Investment Council (OIC) oversees OPERS investments with staff support from the Oregon State Treasury. As of August 31, 2011, OPERS had a total valuation of $57 billion. Investments have generated over 70 percent of total OPERS revenue since 1970. OPERS was 65 percent funded in early 2003 (prior to legislation revising the plans), and grew to 112 percent funded in 2007. In 2010, OPERS is approximately 87 percent funded.

### *Oregon System Background*

Oregon combined a defined benefit (DB) plan with an Individual Account Program (IAP) to improve risk-sharing and to reduce liabilities under 2003 legislative changes. Pre-2003 members with 30-year service credit could retire with 100 percent of final average salary under a legacy "money match" method; that method involved matching the member's account and then annuitizing the balance. That OPERS plan was viewed as "unsustainable," with liabilities growing at 10-12 percent annually. Task forces were formed in 2002 and recommended a legislative solution, with the resulting 2003 revisions in the plans.

### *OPERS Pension Program Description*

Effective for all new hires on or after August 29, 2003, normal retirement age is 65 for general service and 60 for police and firefighters. The plan includes a DB and individual savings component for a hybrid-type plan.

*Defined Benefit Component*

The formula for DB includes a 1.5 percent annual benefit multiplier for general service and 1.8 percent for police and firefighters. No lump-sum vacation or accumulated sick leave can be included in the three-year final average salary. Funded by employers, the average normal cost is 6.35 percent, with no contributions required by members.

*Individual Account Program*

The Individual Account Program (IAP) became effective January 1, 2004. It is mandatory for all OPERS-covered state, local government, and school employees. IAP member contributions are deposited in accounts with no guaranteed earnings or employer "match" during working years or at retirement. Investment and administrative costs are deducted from earnings before crediting to member accounts. Money is invested as part of the OPERS "regular account," with no self-directed investment options. Earnings or losses are credited annually to member accounts, with no guaranteed rate of return. Retiring members may be paid the IAP account balance in a lump sum, a rollover, or in installments over a 5, 10, 15, or 20-year period. Alternatively, they may take withdrawals over their "anticipated life-span." A third party administrator (currently ING) provides account maintenance and payments.

*Oregon's Hybrid Experience*

In 2003, reforms redirected employee contributions of 6 percent of salary from legacy accounts to the IAP, effective January 1, 2004. The change reduced projected employer DB liabilities by $1.9 billion.

*Pros and Cons IAP Investment*

IAP dollars are co-mingled and invested with the OPERS large, diversified portfolio ($57 billion as of August 31, 2011), reducing investment expenses.

Administrative costs for all PERS programs are 8 basis points.

Institutional fund investment vehicles are available (*e.g.,* real estate and private equity).

The lack of self-direction differs from newer members who had 401(k) experience and expectations.

The lack of investment guaranteed return minimum differs from OPERS legacy account experience and expectations for older members.

**Continuation of Report from KPERS Actuary on Models and Other Requested Information**

Patrice Beckham and Brent Banister, Cavanaugh Macdonald Consulting, LLC continued their presentation, focusing on the Service-Based Stacked Tier plan, and provided the Commissioners with the ability to look at several different results, such as a Stacked Hybrid plan, Career Average plan, and DB/DC Hybrid (similar to Oregon).

Co-chairperson Holmes recessed the meeting till 1:30 pm.

**Afternoon Session**

**Washington State Department of Retirement Systems Plan (conference call)**

Marcie Frost, Deputy Director, Dave Nelsen, Legal/Legislative Services Manager, and Mark Feldhausen, Budget and Benchmarking Director, Washington Department of Retirement Systems, presented background material (Attachment 3). In the mid-1970s, Washington State had concerns over the consistency and sustainability of the state's public pension systems. In 1976, the Department of Retirement Systems (DRS) was created to administer all state retirement plans, and the Office of the State Actuary (OSA) was created to provide pension cost estimates. In addition to the governance changes, the Legislature also changed the benefit formula to save the state more than $900 million in the first 20 years. In 1977, Plan 2 was created.

**Changes in the 1990s**

Hybrid DB-defined contribution (DC) plans were added to provide members with access to self-directed investments and potentially higher market returns on their employee contributions, while employer contributions funded a smaller DB plan. The three plans added were the following:

- 1995 – Plan 3 of the Teachers' Retirement System (TRS) was created;
- 1998 – Plans 2/3 of the School Employees' Retirement System (SERS) were created; and
- 1999 – PERS Plan 3 was created for state and higher education employees, and in 2002 for local government employees.

It was the legislative intent to create new public retirement plans that would balance flexibility with stability; would provide both increased employee control over investments and protection of the public's investment in employee benefits; and would encourage the pursuit of public sector careers without preventing employees from transitioning into other public or private sector employment. The DB plans continue to provide public employees with a guaranteed pension at retirement age based on years of public service and with an element of inflation protection. The DC plans created a parallel retirement option where employees have choices regarding the investment of their retirement contributions and have the opportunity, along with the accompanying risk, to receive a full rate of return on their investments.

**Presentation on Guiding Legal Principals**

David Wiese, Office of the Revisor of Statutes, provided an overview of Guiding Principles for pensions (Attachment 4). The state retirement system creates a contract between the state and its employees who are members of the system. The contract is protected by the Contract Clause of the *U.S. Constitution*. Based on Kansas case law, it is uncertain as to when this contract is protected by the Contract Clause of the *U.S. Constitution*, but it is probably sometime after the first day of employment and certainly by the date of vesting. If the state makes changes to the pension plan, it is not free to impose a drastic impairment when a more moderate course would serve its purposes equally well.

When dealing with existing members, the Legislature may be able to make benefit changes in the plan as long as they: are prospective in nature; do not affect already accrued benefits of members; and are for the purpose of maintaining the integrity of the system, have any disadvantages counterbalanced by compensating advantages, or are small changes where the contractual right of employees are not significantly altered.

The Contract Clause does not prohibit small changes in the retirement plan if the contractual rights of employees are not significantly altered. Since no contractual relationship exists with future employees, the Legislature may set up any sort of retirement plan it wishes for future employees.

**Proposals from Commissioners for Potential Reforms for Existing Members**

Co-chairperson Holmes opened up the floor to entertain proposals from Commission members for potential reforms of the current plans for existing members. Ms. Patrice Beckham, Cavanaugh Macdonald Consulting, LLC, stated that the model would be available for the next morning session (October 26) to run the different scenarios.

The Commission requested information on types of Service Credit that can be purchased (Attachment 5). Prior to 2009, the most individual purchases was buying the year of service that some employees who had to wait 12 months to become contributing members. The Commission requested further information on how and why buy-backs were offered. The Commission developed a potential list of items to be discussed about the current plan and possible changes:

- Eliminate the cap on employer contributions;
- Repeal 2011 HB 2194;
- Increase years to vesting from five to ten years;
- Eliminate buy-back provisions;
- Eliminate legislators from the retirement plan or modify the plan for legislators;
- Treat taxable income as it is treated in private plans under ERISA ;
- Explore the possibility of bonding;
- Consider eliminating the 32 years of service cap for KP&F members;
- Eliminate or modify double-dipping;
- Look at limiting early retirement plans;
- Standardize retirement plans that the State of Kansas offers;
- Increase the retirement age and refund non-vested members immediately;
- Hard-wiring the funding by the state; and
- Close or freeze the current plan, either starting a new plan or Tier 3.

**Approval of Minutes**

*Senator Kelly moved to approve the minutes for August 31, 2011, and minutes for September 22 and 23, 2011 as distributed. Representative Johnson seconded the motion. The motion carried.*

The meeting was adjourned until Wednesday, October 26, at 9:00 a.m.

**Wednesday, October 26**
**Morning Session**

The meeting was opened by Co-chairperson King.

### Continuation of Reports from KPERS Actuary

Patrice Beckham and Brent Banister, Cavanaugh Macdonald Consulting, LLC, presented items requested from previous meetings. The information included:

- Member behavior with respect to taking the partial lump sum option, known as the PLSO, at the time of retirement (Attachment 6);
- State and School Group employer contributions under the baseline projection and HB 2194 (Attachment 7). The Commission requested the same information for local governments to be available at the next meeting;
- Illustration of Career Average Defined Benefit Plan with and without indexation for 40-year and 25-year employee (Attachment 8); and
- The actuarial model was demonstrated for the State and School Group in which a pure DB plan was contrasted to a blended DB/DC hybrid plan (Attachment 9).

### Discussion on Stacked Hybrid Plan

Patrice Beckham and Brent Banister, Cavanaugh Macdonald Consulting, LLC, presented information related to the cost impact of changing to a stacked hybrid plan design for new hires (Attachment 10).

The stacked hybrid plan design consists of both a defined benefit plan and a defined contribution plan. The defined benefit plan provides defined benefits on wages up to the covered wage cap (the amount is set as part of the plan design). Contributions (from both employee and employer) on wages above the capped wage base are made to the defined contribution plan.

The pertinent measurement when analyzing this plan design for new hires is the normal cost rate (the ongoing cost of the benefit structure for active members). It reflects a shifting of the risk from the system to the member.

### Commission Deliberation on General Direction of Plans

The Commission continued trying out different interactive schemes, looking at the different plans. The Commission expressed some concerns about the administrative costs associated with managing the stacked hybrid plan.

Co-chairperson King recessed the meeting until 1:15 pm.

## Afternoon Session

The meeting was called to order by Co-chairperson King. The Commission continued to review the different scenarios for variations of the plans previously presented.

The Co-chairperson called for a vote to narrow the field and to explore the possible new plans for the next two meetings on New Plan Design. The results of the voting indicated the two preferred new plans:

- Cash Balance - no;
- Stacked Hybrid – yes;
- Traditional Hybrid – no;
- Defined Contribution – yes; and
- Current DB with changes per HB 2194 – no vote was taken.

## Commission Discussion

Co-chairperson King asked for the Commissioners to decide how to handle the items from the previous day's list of concerns about the current plan and possible changes. The Commissioners decided that three items would be considered along with the new plan design, and not as changes to the current plan.

- Close current plan Tiers 1 and 2; open tier 3 (undefined);
- Freeze DB plan benefits; replace with new plan (undefined); and
- Repeal 2011 HB 2194.

The Commissioners decided the other listed items would be handled as follows:

- Eliminate buy-back service credit purchases. A history of KPERS service purchases was provided (Attachment 11) to be considered at the November and December meetings;

- Refund non-vested members earlier than five years. A summary of membership data for KPERS inactive members was provided (Attachment 12) to be considered at the November and December meetings;

- Remove the 32-year cap for KP&F members and to recommend this to the Legislature for review;

- Eliminate sick and annual leave from pre-1993 calculations for final average salary (FAS) and consider this at the November and December meetings;

- Extend vesting from five to ten years and consider this at the November and December meetings;

- Eliminate double dipping after retirement and recommend this to the Legislature for review;

- Address calculation of legislator’s retirement benefits and consider this at the November and December meetings;

- Exclude legislators from KPERS, but not consider or recommend this to the Legislature;

- Hard-wire future KPERS state funding and consider this in the context of a new plan;

- Control or eliminate early retirement incentives and recommend this to the Legislature for review;

- Standardize all state retirement plans, including Regents plan, and recommend this to the Legislature for review;

- Make tax treatment consistent for different plans and recommend this to the Legislature for review;

- Review Pension Obligation Bonds and bonding and consider this at the November and December meetings;

- Adjust the current 1.75 multiplier to a lower figure and consider this in context of new plan;

- Remove statutory cap on annual KPERS participating employer contributions and consider this at the November and December meetings; and

- Prevent spiking in final average salary (FAS) and recommend this to the Legislature for review.

**Commission Discussion and Planning for Future Meetings**

The Commissioners were asked for specific plan designs and items for the next agenda, and for those requests to be sent to Mr. Efird as soon as possible.

The next Committee meeting is scheduled to be November 7-8, 2011. The meeting was adjourned at 3:25 p.m.

Prepared by Connie Burns
Edited by Julian Efird

Approved by the Committee on:

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(Date)