Kansas Public Employees
Retirement System

Administrative Impact of HB 2545

House Committee on Pensions & Benefits ▪ February 17, 2012

Overview

- The new plan design has been evolving, and KPERS' evaluation of the new plan design's operational impact and administrative issues is a work in progress.
- Therefore, cost estimates are currently under development.
- The fiscal impact on KPERS' administrative costs is expected to be large, relative to KPERS' current administration budget, for both implementation and ongoing costs.
  - This is consistent with the experience of the State of Washington.
  - The costs are likely to be proportionally larger given KPERS' current operating budget.
    - A "CEM Benchmarking Study" of 88 pension systems indicated that, KPERS' cost per active member of $44 was 4th lowest in the entire benchmarking study universe. (Peer average of $90.)
- The KPERS Board is responsible for implementing and administering the plan in a manner consistent with federal law or fiduciary duties.
- KPERS must evaluate administrative issues in light of its fiduciary duty to members of both the existing defined benefit plan and the new plan.

Complexity and Time Constraints

- There are two overarching and related administrative concerns with HB 2545 – the plan's complexity and its implementation timeframe.
- Multiple levels of administrative and legal complexity are introduced as a result of –
  - Simultaneous elections under HB 2194 (97,000 vested members) and the new plan (53,000 non-vested members).
  - The plan's approach to crediting interest to the employer annuity account.
  - The separation of the Tier 3 employee-directed accounts into two different plans, based on employer or job type.
    - Employees of schools, community colleges, universities, and certain other employees would be in an Internal Revenue Code 403(b) plan.
    - All other employees would be in a plan established under Internal Revenue Codes 401(a), 414(d), and 414(k) – i.e., the non-403(b) plan.
    - Tier 3 assets will be treated as part of the KPERS trust fund with respect to the assets in the cash balance portion of the plan and the non-403(b) employee-directed accounts.
    - The 403(b) plan must be in a separate trust and assets cannot be comingled according to current law.
- This complexity would also need to be managed by 1,500 participating employers.

Complexity and Time Constraints (continued)

- The bill's effective date (July 1, 2013) and the January 1, 2014, implementation date of Tier 3 would entail operational, fiscal, and fiduciary risks.
- Examples of key administrative impacts and issues follow.
- Taken individually, most could be adequately addressed given sufficient time and funding.
- However, their cumulative impact raises concerns about KPERS' ability to successfully implement the new plan design without the necessary resources.
- KPERS' tax counsel advised that the plan's effective date should be based on receipt of a favorable determination letter from the IRS, followed by an appropriate time interval for implementation.

Employer Reporting

- Implementation of the new plan design would require KPERS and 1,500 KPERS employers to make changes to their payroll and accounting systems.
- Employers will need to remit employee contributions to a third-party administrator for Tier 3, while sending Tier 1 and 2 contributions to KPERS.
- To ensure the proper amount of employee and employer contributions are remitted and recorded on a timely basis, KPERS is assuming employer reporting of compensation and contribution amounts for members each payroll period. Currently, this member-level detail is reported annually.
- This shift comprises a major element of the IT system modifications that KPERS would need to undertake.
- The change in reporting scope and frequency also is likely to entail significant information system and other operations costs for each employer.

KPERS Portfolio Investment Option

- Establishing employee-directed accounts requires a service provider contract for plan administration, investment, educational, and recordkeeping services.
- Two factors increase the complexity and cost of providing these services – the KPERS defined benefit portfolio investment option and the 403(b) plan.
- KPERS must offer an investment option "similar to" the KPERS defined benefit portfolio.
- Assets from non-403(b) employee-directed accounts can be invested in the KPERS portfolio.
- The support of investment, defined contribution plan, legal, and accounting consulting services is needed to develop this non-403(b) option.
  - How much of the portfolio's asset mix should be used in the option considering fiduciary duties, cash flow, and valuation issues?
  - Cannot readily be valued on a daily basis -- assume that valuation of the investment option would be on a monthly basis.
- Use of the KPERS portfolio investment option as the default investment raises fiduciary concerns.

Separate 403(b) Plan

- Further analysis is required to determine which members qualify for 403(b) plans.
- Many eligible KPERS employers are offering 403(b) plans for supplemental retirement savings.
  - IRS requires coordination of all 403(b) plans offered to an employee, including limits on contributions and coordination of distributions.
  - What happens if an employee is already "maxing out" under an existing 403(b) plan?
- If multiple investment providers are available through the 403(b) plan, KPERS will need to contract with a service provider through which they are coordinated.
- Assets from 403(b) accounts cannot be invested directly in the KPERS portfolio; they must be in a separate trust.
  - Would need to select or contract for development of a custom option external to KPERS portfolio or explore the viability of establishing a collective trust.
- Separate funding and segregation or allocation of administrative expenses for the 403(b) plan is required due to the "exclusive benefit rule" of trusts.
  - These controls would be further complicated as each member participating in the 403(b) plan would also have an employer-annuity account in the KPERS trust.

Communication, Education, and Support

- KPERS has a fiduciary duty to provide clear, accurate, timely communication about benefits and member rights and responsibilities.
- Effective communication is particularly critical with irrevocable, one-time elections.
  - The potential for appeals is high if communications are not abundantly clear.
  - Approximately 53,000 nonvested members and all 1,500 employers are affected (during the same window as HB 2194 elections for all other active members).
- Communication during and after implementation is more complex with the multi-faceted plan design.
- KPERS and employers do not have readily available means to target messages to subsets of employees.
- The annuity account's variable interest credit and the defined contribution component complicate communicating about expected retirement benefits.
- Communications with employers are also critical as they are traditionally the primary member contact.
- Extensive business process changes would need to be communicated to employers.

Staffing and Operating Expenditures

- **Temporary and Permanent Staffing:**

Project management	Accountants
Defined contribution plan management	Investment analyst staff
Employer and member education coordinators and representatives	Legal staff
Multimedia and publication writer staff	IT help desk staff
IT network administration and applications development	Benefit specialists & managers

- **Other Operating Expenses:** additional office space; office equipment; communications, postage, and office supply expenses; due diligence travel; IT support; and software license agreements.
- **Contractual Services:** a range of consulting and professional services.
- **IT expenditures:** extensive information system modifications; additional network capabilities and associated hardware; software licensing and maintenance agreements; data storage; security measures; and disaster recovery.