MINUTES

JOINT COMMITTEE ON PENSIONS, INVESTMENTS AND BENEFITS

September 2, 2009
Room 545-N—Statehouse

Members Present

Representative Rob Olson, Chairperson
Senator Steve Morris, Vice-Chairperson
Senator Jay Emler
Senator Anthony Hensley
Senator Laura Kelly
Senator Ruth Teichman
Representative Richard Carlson
Representative Geraldine Flaharty
Representative Terrie Huntington
Representative Margaret Long
Representative Sharon Schwartz
Representative Jeff Whitham

Staff

Julian Efird, Kansas Legislative Research Department
Mike Steiner, Kansas Legislative Research Department
Gordon Self, Office of the Revisor of Statutes
Kristen Kellems, Office of the Revisor of Statutes
Gary Deeter, Committee Secretary

Conferees

Vince Smith, Chief Investment Officer, Kansas Public Employees Retirement System
Glenn Deck, Executive Director, Kansas Public Employees Retirement System
Pat Beckham, KPERS Consulting Actuary, Milliman, Inc.
Dale Dennis, Deputy Commissioner, Kansas Department of Education

Vince Smith, Chief Investment Officer, Kansas Public Employees Retirement System (KPERS), provided an update on recent investment portfolio experience (Attachment 1). He said that pressures have lessened in the financial markets and that the global economy is beginning to advance; however, he warned that no cohesive recovery can be expected immediately. He reviewed possible threats to the KPERS portfolio and listed some opportunities, commenting that current market value (August 31, 2009) totaled $10.8 billion, an increase of 8.9 percent for the fiscal year since July 1, and a 14.9 percent increase for the calendar year 2009 to date. He noted, however, that investment return for FY 2009 was a negative (19.4) percent, although the twenty-five-year average annual cumulative return was above the target of 8.0 percent. Answering questions, Mr. Smith said real estate allocations (6.5 percent of the portfolio) are below the 10.0 percent cap and that excessive debt and oversupply will slow any real estate recovery, especially in commercial real estate. He said that emerging markets, especially high-population countries with a growing number of middle class workers, will provide new markets for the U.S. He noted that the KPERS cash holdings were increased last year in face of the uncertain markets, and have provided adequate reserves for payment of benefits.

Glenn Deck, KPERS Executive Director, reviewed the Sudan Divestment Report (Attachment 2). Noting the legislative directive in 2007 to begin a divestment of KPERS funds from Sudan-linked firms, he said that, except for the statutory exemption regarding commingled funds, KPERS is fully divested from Sudan-linked firms. Answering a question, Mr. Deck replied that the agency pays an outside firm $10,000 per year to monitor Sudan affiliations in order to detect any new links with firms not previously identified with involvement in Sudan.

Pat Beckham, KPERS Consulting Actuary, Milliman, Inc., outlined the December 31, 2008, actuarial valuation report that estimates future benefit payments and calculates the different employer contribution rates (Attachment 3). She summarized the report by saying that the Unfunded Actuarial Liability (UAL) increased by $2.7 billion during calendar year 2008, but that the actuarial value is greater than the market value, and the total liability is over $4.0 billion if a market-based figure is used. She noted that the KPERS School Group is out of actuarial balance, and even with favorable investment experience and increased employer contributions mandated by statute, the group will not be fully funded by 2034 to pay all promised benefits. She stated that the funded ratio for the KPERS School Group dropped from 63.0 percent to 52.0 percent on an actuarial basis of calculation and that the increasing statutory contribution rates would be insufficient to fully fund future retirement benefits, even if investments produce an average target return of 8.0 percent annually. She noted that contributions for all other KPERS groups (State, Local, Kansas Police and Firemen, and Judges) achieve an ARC date (Actuarial Required Contributions) prior to 2034 where assets equal liabilities. Only the School Group does not reach an ARC date in the time period based on current law.

Mr. Deck reported on the KPERS long-term funding issue for all groups, especially the School Group which faces a potentially serious funding shortfall (Attachment 4). He outlined the defined-benefit formula and noted that the employer contribution rate changes annually based on actuarial calculations, but that caps prevent the State, School, and Local annual group rates from increasing more than a limited amount. He also noted that 2007 legislation established a new plan design for KPERS state, school, and local employees hired after June 30, 2009, which established a new tier of membership and requires the employees to bear a greater share of the funding with a 6.0 percent contribution rather than the current 4.0 percent of other public employees under regular KPERS. He concluded by emphasizing that investment returns alone cannot fix the funding shortfall, and that the KPERS staff and Board of Trustees will undertake a comprehensive funding analysis over the next three months in order to provide alternative funding models addressing both short-to-mid-term cash flow and long-term sustainability.

Members discussed with Mr. Deck various options: increase employer contribution rate to be capped at 1.0 and 2.0 percent annually; reduce the multiplier in the benefit formula and create a third tier of defined benefits; and evaluate alternative retirement plans, such as defined contribution and blended defined benefit/defined contribution plans.

Next, Mr. Deck provided a status report on issues regarding working after retirement, noting that Kansas statutes and IRS regulations impinge on an employee's choices in working for a KPERS participating employer after retirement (Attachment 5). Reviewing recent legislation, he said that 2009 Senate Substitute for HB 2072 eliminated for three years the $20,000 earnings limitation for retirees who return to work for the same school district from which they retired after being off the payroll for at least 60 days. The same bill also included a number of other provisions that addressed licensed school professionals who return to work after retirement, including a requirement that the employing school district or private contractor pay an actuarial assessment to KPERS that is determined each year to partially cover the lost income when a new KPERS contributing teacher or administrator is not hired.

Mr. Deck said that, as of December 31, 2008, there were 2,672 KPERS retirees who had returned to work. For those rehired by a KPERS participating employer, 1,351 were rehired by the same employer (usually a school district) and 1,321 were hired by a different KPERS participating employer, typically a school district, and in 34 cases, private consulting firms that assigned them to school districts as contract employees. This year's data are being collected with the start of the new school term and a comprehensive picture should emerge by December on the effects of the new law on working after retirement.

Dale Dennis, Deputy Commissioner, Kansas Department of Education, responded to questions. He replied that the new law is being well received. He commented that the downturn in the economy has increased registrations for the free-lunch program and that student enrollment has increased even in rural areas, the latter which normally shows a decline. He replied that continuing the exemption of substitute teachers from 2009 Senate Substitute for HB 2072 has not resulted in abuses since substitute teachers are paid about half what a rehired or a contract teacher receives. He commented that the economic downturn has resulted in fewer eligible teachers retiring.

Julian Efird, Kansas Legislative Research Department, alerted the Committee to an impending decision of the State Finance Council that was in response to a proposal from the Secretary of Administration to restructure the 2010 annual repayment portion for principal related to the pension obligation bonds. Members questioned the policy of borrowing money to pay for borrowed money.

Prepared by Gary Deeter
Edited by Julian Efird

Approved by Committee on:

November 17, 2009
(Date)