MINUTES

JOINT COMMITTEE ON PENSIONS, INVESTMENTS, AND BENEFITS

November 17, 2009
Room 545-N—Statehouse

Members Present

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

Staff

Alan Conroy, Kansas Legislative Research Department
Julian Efird, Kansas Legislative Research Department
Michael Steiner, Kansas Legislative Research Department
J.G. Scott, 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

Glenn Deck, Executive Director, Kansas Public Employees Retirement System
Robert Smith, Investment Officer, Kansas Public Employees Retirement System
Patrice Beckham, Kansas Public Employees Retirement System Consulting Actuary, Milliman, Inc.

Morning Session

Kansas Legislative Research Department staff provided background information in eleven reports on retirement matters from various sources for the Committee (Attachment 1).

Robert Smith, Investment Officer, Kansas Public Employees Retirement System (KPERS), presented an update on investment experience (Attachment 2). Stating that KPERS investments have gained 30 percent since March 2009, he provided comments regarding the current market environment, the economy, and investment returns. Noting that the Standard & Poor's 500 Index has regained 50 percent of its losses, he commented that borrowing is still constrained and consumer spending remains low. He said that even though interest rates remain low, consumer debt is holding down spending. Globally, the Gross Domestic Product (GDP) is "growing below trend," although Asia seems to have recovered from the recession. Mr. Smith noted investment opportunities and highlighted changes in investment allocations. Finally, he explained the investment process in relation to selecting investment managers and the costs of using outside managers to handle the portfolio's investments. Last year for FY 2009 ending June 30, for instance, KPERS paid over $24 million for investment-related services.

Answering questions, Mr. Smith said that real estate is currently one of the least desirable investments and that the real estate market will not recover quickly. He replied, however, that KPERS will not shift its six percent allocation from real estate to another sector. He explained that management fees are always negotiated and that managers' fees for global investments are higher because of higher costs for research and because international managers maintain offices in other parts of the world. Commenting on a previous decision to divest from all holdings related to Sudan, a member asked if a similar divestment might be considered for holdings with a presence in Iran. Mr. Smith said such a divestiture would be much more difficult to accomplish. Mr. Smith concluded by saying that future promising investment areas included infrastructure, timber, and energy, and that KPERS will review real estate strategy and structure.

Glenn Deck, Executive Director, KPERS, reviewed long-term funding options designed to reduce the KPERS unfunded actuarial liability (UAL) while maintaining a defined contribution plan (Attachment 3). Noting preliminary options considered at the previous meeting (September 2, 2009), he stated that the KPERS School Group is out of actuarial balance and, under the present statutory arrangement, will never reach the Actuarial Required Contribution (ARC) by 2034, the end of the 40-year amortization period.

Mr. Deck offered nine options (A to G) to address the KPERS long-term funding issue (Attachment 4). The different defined benefit options dealt with three components: adjusting the employer rate increase cap, adjusting the employee contribution rate, and creating a third tier of employees. Mr. Deck outlined the effects of each option on employers, employees, and the State General Fund. He stated that increases in employer contributions will take a number of years to have a positive effect, that changes in employee contributions are fraught with legal issues, and that a quick injection of money would require a large investment from pension obligation bonds.

Responding to questions, Mr. Deck replied: (1) That recent court decisions require any increase in an employee's contribution rate to include some offsetting increase in benefits; (2) That previous pension obligation bonds were helpful in bringing KPERS an infusion of cash that could be invested much sooner than increased employer contributions; and (3) That, on the contribution side, it would be difficult to separate the state pension system from the school pension system.

Afternoon Session

Mr. Deck outlined alternative defined contribution options for the Committee (Attachment 4). Explaining the difference between a defined benefit plan and a defined contribution plan, he said that the defined benefit plan specifies the benefits an employee will receive after retirement based on a formula. A defined contribution plan specifies the contribution rate that the employer and employee pay into the plan; most defined contribution plans are employee-directed and the retirement amount depends on the value of the account at retirement. He said the private sector trend for retirement plans tends toward defined contribution plans. In the public sector, Michigan and Alaska have mandatory defined contribution plans, six other states have optional defined-contribution plans, and seven states have hybrid plans. He stated that the Kansas Board of Regents has a mandatory defined contribution plan, that some local governmental entities and school districts have voluntary defined contribution plans, and that some state employees participate in a state-level deferred compensation plan with no employer matching contribution. A limited group of state officials may participate in a statutory defined contribution plan where the state pays 8.0 percent and nothing is required by the employee.

Mr. Deck compared the defined benefit and defined contribution plans as to various risks: investment, liability, longevity, inflation, asset allocation, and investment management. He noted that if KPERS were to move to a defined contribution plan, the new plan would not eliminate the KPERS current UAL, and the promised retirement benefits would have to be paid. He reviewed three options for a defined contribution plan and listed the consequences on the current UAL, the percentage of funding under each option, and the costs to the state (Attachment 4). He offered three scenarios to illustrate retirement adequacy under different options.

Members commented on variations of the different options and acknowledged the need to address the KPERS current UAL. Responding to a question, Patrice Beckham, KPERS Actuary, Milliman, Inc., replied that a hybrid plan will require increased funding unless the UAL is ignored. A member observed that a defined contribution plan would compound problems with the UAL. Several members requested more information on pension obligation bonds. Another member requested information from the Kansas Development Finance Authority. One member requested three variations on Option C (in Attachment 3).

Prepared by Gary Deeter
Edited by Michael Steiner and Julian Efird

Approved by Committee on:

December 14, 2009
(Date)