MINUTES

JOINT COMMITTEE ON PENSIONS, INVESTMENTS, AND BENEFITS

August 21, 2002
Room 123-S—Statehouse

Members Present

Senator Dave Kerr, Chairperson
Representative Lloyd Stone, Vice Chairperson
Senator Jim Barone
Senator Steve Morris
Representative Ray Cox
Representative Vaughn Flora
Representative Al Lane
Representative Joe Shriver
Representative Clark Shultz

Staff Present

Julian Efird, Kansas Legislative Research Department
Alan Conroy, Kansas Legislative Research Department
Gordon Self, Revisor of Statutes Office
Mike Corrigan, Revisor of Statutes Office
Carol Doel, Committee Secretary

Committee Conferees

Glen Deck, Executive Director, Kansas Public Employees Retirement System
Rob Woodward, Chief Investment Officer, Kansas Public Employee Retirement System
Pat Beckham, Milliman USA, Kansas Public Employee Retirement System Actuary
Bruce Burditt, Chairperson, Board of Trustees, Kansas Public Employee Retirement System
Lt. Col. Sam Breshears, Kansas City, Kansas Police Department

Morning Session

Glen Deck, Kansas Public Employee Retirement System (KPERS) Executive Director, presented the Strategic Business Plan for the fiscal years 2002 to 2005 (Attachment 1). He introduced three members of the Board of Trustees in attendance: Bruce Burditt, Chairperson; Jerry Boettcher and Vern Chesbro. Mr. Deck explained to the Committee that the strategic plan identifies goals, establishes priorities, and reviews the various factors affecting KPERS, such as economic conditions and demographics as well as what is needed to solve problems confronting the agency.

Rob Woodward, Chief Investment Officer, KPERS, gave a report on the overall investment performance results for the period ending June 30, 2002 (Attachment 2) and provided an update on the fiscal year to date (Attachment 3). He reported that total portfolio performance was a negative 4.7 percent in FY 2002. For the past five years, the cumulative results for the total portfolio reflect a gain of 5.4 percent. There was a cash flow out of approximately $200 million more than was taken in last fiscal year. He pointed to positive investment performance on the part of the Treasury Indexed investments that returned 11.1 percent and real estate that returned 7.7 percent for the period ending June 30, 2002. Mr. Woodward concluded by presenting an unaudited estimate of the KPERS investment performance as of August 19, 2002. Returns to date this fiscal year have continued the negative tread with a decline of 2.6 percent since July 1. Once again, Treasury Indexed investments have provided positive performance with a return of 5.3 percent.

Pat Beckham, Milliman USA, who serves as actuary for KPERS, presented a summary of the annual valuation report and the complete document (Attachment 4). Ms. Beckham explained the process used to quantify the assets and liabilities of the system. She explained that currently there is not enough money coming in to fund benefits over the long term and that action needs to be taken to enhance long-term funding. The unfunded actuarial liability increased from $1.305 billion on December 31, 2000, to $1.780 billion on December 31, 2001, for all KPERS plans. The funded ratio, a more meaningful measure of the health of a retirement plan according to Ms. Beckham, decreased from 88.3 percent to 84.8 percent over the same period. Projections indicate further decreases in the funded status to 72 percent in 2011 and 66 percent in 2033, absent any substantial changes in KPERS funding.

The KPERS state and school portion of the unfunded actuarial liability is the single largest component of the unfunded liability, increasing from $1.119 billion in 2000 to $1.506 billion in 2001 on December 31. A statutory provision limits the rate of increase in employer contributions to 0.2 percent in any given year, and the actuarial calculations would require a contribution rate increase of 3.11 percent at a cost of more than $100 million in FY 2005 to address the long-term funding issue. Current law will limit the employer contribution rate to 4.78 percent in FY 2005, whereas the actuarial valuation reports indicates that the rate should be 7.69 percent in order to address the unfunded actuarial liability, Ms. Beckham pointed out.

Ms. Beckham also noted that calculations do not reflect $817 million of deferred investment loss that is part of the smoothing method used in the actuarial valuation. Since the investment experience in 2002 is likely to be less than 8.0 percent, there will be an additional increase in the unfunded actuarial liability next year, and additional deferred investment loss. The difference in actuarial and statutory contribution rates will result in increases in the unfunded actuarial liability each year, Ms. Beckham noted, with regard to the KPERS state and school group, as well as the KPERS local group. The other plans will experience increases in employer contribution rates in FY 2005, but since they do not have statutory caps, Kansas Police and Firemen (KP&F) will rise from 6.86 percent to 9.47 percent and Judges from 16.67 percent to 18.67 percent.

In conclusion, Ms. Beckham stressed that the KPERS plans are not in actuarial balance. A change in funding plan is needed to meet the challenges posed by the current contribution shortfall, deferred investment losses, and the negative investment experience.

Afternoon Session

Mr. Deck addressed the long-term funding outlook (Attachment 5). He explained that the Board of Trustee's primary objectives are to inform all interested parties of the long-term funding issue for the KPERS; to develop an understanding of the history, underlying causes, financial impact and possible solutions for the issue; and to serve as a catalyst in developing a long-term funding plan. He also provided an overview of the funding sources, funding history, magnitude of the long-term funding gap, as well as alternatives to improve the funding. Mr. Deck explained the actuarial funding objectives for the KPERS plans.

Mr. Deck asked Mr. Burditt, to address the long-term funding outlook. Mr. Burditt stated that he wished to support Mr. Deck's report regarding current funding being sufficient to provide the promised benefits to the retired members for decades, noting that it is not a crisis situation, but it is a situation that needs attention.

Mr. Deck continued with reports on various other KPERS matters, including the Death and Disability Program funding status. The next actuarial report will be available in January 2003 (Attachment 6). Following nine quarters of moratorium on employer contributions, the funded status of the program has been reduced to 75 percent at the end of FY 2002, with the fund balance declining from $193.7 million in FY 2000 to $108.8 million in FY 2002.

Another report presented by Mr. Deck addressed catastrophic life insurance coverage which is underwritten by Security Benefit Company of Topeka (Attachment 7). Currently, 156,000 public employees are covered by the employer provided basic group coverage. There is also opportunity for employees to purchase optional group life coverage through payroll deduction. Following September 11, 2001, reinsurance could not be obtained for a nuclear, chemical, or biological terrorism event. A request for proposals is being developed for FY 2004 coverage in light of recent developments.

A report was presented on the retirant dividend payment (also known as a 13th check) and a potential funding problem for 2003 (Attachment 8). All retirees and joint annuitants of retirees who retired prior to July 2, 1987, receive an annual retirant dividend payment in October which is often referred to as a "13th check." Mr. Deck noted a potential shortfall in funding the 2003 payment in October of next year. Currently, 15,319 retirees and joint annuitants of retirees are eligible for this payment, with an average benefit of $475. The average age of these retirees and beneficiaries is 84. Representative Stone requested a further report on ways to address the Retirement Dividend Payment issue be submitted to the Committee at the November meeting.

An issue involving substitute teachers and the KPERS post-retirement earnings limitation was reviewed by Mr. Deck (Attachment 9). KPERS retirants employed as "substitute teachers" by their former employers are exempted by law from a $15,000 post-retirement earnings limit for persons who return to work for their pre-retirement employer. There is no definition of the term "substitute teacher" in the retirement or school statutes, according to Mr. Deck. KPERS became aware that some retirees were working on a regular, ongoing basis for the whole school year, and being called a "substitute teacher." KPERS has developed a new method of determining if an arrangement may be classified as "substitute teaching." Under the new KPERS interpretation, substitute teachers are assigned as follows: daily call, replacement (hired when the regular teacher did not complete the school year), or temporary (hired for a set time period when the regular teacher is off, but plans to return).

Also submitted for the Committee to review were reports on the partial lump sum option experience (Attachment 10), KPERS litigations status (Attachment 11), KPERS statement of revenues and expenses (Attachment 12), the Treasurer's Unclaimed Property Fund (Attachment 13), and KPERS membership data (Attachment 14).

Chairperson Kerr asked staff to brief the Committee on two topics referred by the Legislative Coordinating Council: a House Committee of the Whole amendment to 2002 HB 3009 and 2001 HB 2233. Following discussion on HB 3009, Chairperson Kerr indicated that he would prefer to take testimony on HB 3009 regarding legislative retirement issues and the subject will be addressed at the November meeting. HB 2233 was introduced in the 2001 Legislature and carried over to the 2002 Session. The bill would allow persons currently enrolled in Tier I of KP&F to retire without penalty after 32 years of credited service. The fiscal note indicated an actuarial cost of $3.0 million.

Lt. Col. Sam Breshears of the Kansas City, Kansas Police Department testified in support of HB 2233. Lt. Col. Breshears explained that he was a police cadet for two years prior to becoming a sworn law enforcement officer. When he turned 21 years of age, he switched from the KPERS plan to KP&F. He has two years of KPERS credit which he cannot utilize toward the KP&F retirement. At age 53, he will have 32 years of service, but under KP&F, he can not retire until age 55 without taking a reduction in benefits. Following Lt. Col. Breshears' testimony, Chairperson Kerr called for discussion from the Committee regarding HB2233. No further action was taken.

Chairperson Kerr asked the Committee whether anything further was to be done regarding publicizing the KPERS long-term funding shortfall. Representative Shriver suggested that the information should be presented to the Budget Committee. Chairperson Kerr suggested the possibility of a letter to all members of the House and the Senate making them aware of the problem. It was the consensus of the Committee to send a letter to members of the Legislature about the situation discussed.

The next meeting of the Pensions, Investments, and Benefits Committee was set for November 12, 2002.

Prepared by Carol Doel
Edited by Julian Efird

Approved by Committee on:

November 19, 2002