MINUTES

JOINT COMMITTEE ON PENSIONS, INVESTMENTS, AND BENEFITS

September 1, 2004
Room 123-S—Statehouse

Members Present

Senator Dave Kerr, Chairperson
Representative John Edmonds, Vice-Chairperson
Senator Anthony Hensley
Senator Steve Morris
Senator Ruth Teichman
Representative Ray Cox
Representative Geraldine Flaharty
Representative Vaughn Flora
Representative Margaret Long
Representative Bill McCreary
Representative Clark Shultz

Staff Present

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

Conferees

Glen Deck, Executive Director, Kansas Public Employees Retirement System
Rob Woodard, Chief Investment Officer, Kansas Public Employees Retirement System
Pat Beckham, KPERS Actuary, Milliman USA

Morning Session

An informational summary was distributed regarding SB 520, the 2004 Kansas Public Employees Retirement System (KPERS) Omnibus Bill, which provides for adjustments in public employee benefits, employer contributions, and actuarial calculations (Attachment 1).

Chairperson Kerr introduced Glenn Deck, Executive Director, Kansas Public Employees Retirement System, who presented an overview of KPERS operations (Attachment 2). KPERS has approximately 248,000 members and pays out $780 million annually in retirement, disability, and death benefits. KPERS is the 109th largest public pension fund in the U.S. and the 186th largest in the world.

Mr. Deck explained that the KPERS strategic business plan covers fiscal years 2002 to 2005. Goals are to invest and safeguard the funds for the sole purpose of providing benefits for members and their beneficiaries; to provide the best service possible to members and participating employers; and to create better awareness of benefits and programs

Mr. Deck related the major challenges to KPERS, with funding being the primary challenge. Two areas present problems with regard to funding: the retirement plan, which still has long-term funding issues, and the death and disability program, which has shorter term funding issues.

Reviewing KPERS funding, Mr. Deck reported significant progress in developing a long-term funding plan was made over the past two years. Due to the volatility of investment markets, the funding outlook remains volatile. Further plan design options need to be considered, Mr. Deck said. Death and disability funding is considered to be the highest short-term priority.

A number of technology improvements have been undertaken, according to Mr. Deck. Digital imaging of all records has been completed and all incoming documents are imaged upon receipt. A web-based reporting system was instituted for participating employers. Finally, replacement of the computer hardware and software is proceeding.

Both service and communications have been improved, Mr. Deck said. In FY 2004, 93 percent of all incoming calls were answered successfully, compared to 86 percent in FY 2003. Since January 2004, the answer rate has averaged 98 percent after the installation of new call center software.

In conclusion, Mr. Deck reported significant progress and results in all major initiative areas, and identified the major challenges as long-term retirement funding, death and disability program funding, and technology implementation. He related the need to continue to make improvements in member and employer services, with an emphasis on member education.

Next to address the Committee with the investment performance report for the period ending June 30, 2004 was Rob Woodard, KPERS Chief Investment Office (Attachment 3). Mr. Woodard reported the FY 2004 return as being 15.4 percent, which is well in excess of the actuarial expectation of 8.0 percent. However, the calendar year-to-date figure is 2.8 percent, and that is the return of most concern, since the December 31, 2004, actuarial valuation will use calendar year. Mr. Woodard's report was substantiated by charts and graphs showing the various investment portfolios and the relative returns by type of investments.

Mr. Woodard noted that possible revisions in asset allocation may occur after an upcoming review, and that the triennial asset/liability analysis would be undertaken this fall. He also presented the Committee with a preliminary unaudited interim investment report estimate as of August 27, 2004, which showed the total assets had a market value over $10.3 billion and a total return calendar year-to-date of 2.6 percent (Attachment 4).

In conclusion, Mr. Woodard stated that one of the most significant challenges is to try to invest the assets in such a fashion that they are able to generate the return necessary to fund the benefits and to keep the funding outlook stable. With investment return volatility, KPERS will consider alternative methods of investment to generate better and more predictable results at a minimum of cost, Mr. Woodard reported.

When asked about how the bond proceeds of $440 million were invested in the spring of 2004, Mr. Woodard said that they were spread across the various investment areas, based on the target allocation, rather than trying to time the market in any particular areas.

Next, Mr. Deck reported on the status of the Death and Long-Term Disability Benefits Program (Attachment 5). A review of the plan design objectives, statutory authority, and program history was presented, showing changes in benefit levels from 1966, when the program originally was established by legislation.

The impact on the Death and Disability Fund due to moratoriums on $100.3 million in employer contributions also was presented by Mr. Deck. Fund balances and funded ratios were highlighted, with the notation that the ending balance decreased from $189.6 million on June 30, 1999, and a funded ratio of 128 percent, to an ending balance of $27.8 million on June 30, 2004, with a funded ratio of 15 percent.

Mr. Deck said that future employer contributions for the Death and Long-Term Disability Benefits Program, beginning July 1, 2005, will need to be approximately 1.0 percent of covered payroll in order to fund the present level of benefits. That funding level will require statutory change during the 2005 legislative Session, since the present rate of 0.6 percent will be insufficient to fund a pay-as-you-go program.

Mr. Deck also presented charts and graphs showing the cost projections through FY 2011, and the resulting employer contribution rates if present benefit levels are maintained. He discussed possible changes to the program and gave examples of standard plan design provisions that the KPERS Board of Trustees might consider in revising plan design.

Mr. Deck summarized the next steps to be taken. He said the KPERS Board of Trustees would be selecting a new plan administrator at the September 2004 Board meeting. The Board then will consider plan design modifications at its October 2004 meeting. Any requested changes and recommendations will be presented to the Joint Committee later in the fall of 2004.

Afternoon Session

Chairperson Kerr introduced Pat Beckham, Milliman USA, the KPERS actuary who reviewed the results of the actuarial evaluation as of December 31, 2003 (Attachment 6). Ms. Beckham explained that a valuation is a type of inventory of the system with a comparison of the assets that are on hand and the liabilities which are the future benefits promised to members. In her report, Ms. Beckham related that there were changes in actuarial methodologies, the provisions of SB 520 and the pension obligation bonds that impacted the valuation results.

Regarding actuarial changes, all groups were moved to "entry age normal," and the asset valuation methodology was changed to a five-year recognition of gains and losses on market value, Ms. Beckham stated.

The provisions of SB 520 provided for increased caps on future employer contributions of local units of government to match the state caps, split the state and school group into two separate groups for valuations purposes, and allowed unreduced Kansas Police and Fire retirement benefits after 32 years of credit service, according to Ms. Beckham.

Finally, the net proceeds of pension obligation bonds issued March 10, 2004, were recognized as a receivable in the valuation to account for assets of $440.2 million invested, Ms. Beckham reported.

The good news reported by Ms. Beckham concerned a long-term improvement in the funded status as a result of recent legislative changes. By splitting the state and school into separate groups. Ms. Beckham said the state group would be in actuarial balance by FY 2007. Under current caps, the school and local groups would be in actuarial balance by 2033, Ms. Beckham said.

The bad news reported by Ms. Beckham was that the unfunded actuarial liability had increased by $757 million and that deferred investment losses still must be taken into account. The unfunded actuarial liability is expected to increase in future years, Ms. Beckham predicted.

In conclusion, Ms. Beckham reviewed the major steps taken in developing a long-term funding plan: the high priority given the long-term funding plan coupled with strong investment returns which dramatically improved the funding outlook, and the challenges to long-term funding that will require close monitoring.

Mr. Deck returned to report on the long-term funding outlook and issues. Graphs were submitted to show the funding progress, state and school group projections, local group projections, and the potential impact of investment volatility (Attachment 7).

As reflected in the December 31, 2003, actuarial valuation, the state group is projected to reach a temporary equilibrium in FY 2007, according to Mr. Deck. The statutory rate cap increase would cause the state contribution to be an amount greater than the actuarial amount in FY 2007, a difference estimated to be $4.88 million, Mr. Deck said. It was proposed by Mr. Deck that any funding saved could be redirected to the school group. Over the period to FY 2033, Mr. Deck estimated that the state could save approximately $775 million in total contributions to the school group.

At the request of Chairperson Kerr, Mr. Deck included information in Attachment 7, beginning on page 10, to show projected cost increases for school contributions with normal payroll growth and with no payroll growth. Several plan design options also were prepared for the Committee's consideration at the direction of Chairperson Kerr, including a new employee tier a new employee tier with a defined contribution plan component, and a new employee hybrid plan combining defined benefit and defined contribution elements. Other design issues were raised by Mr. Deck, including cost-of-living adjustments (COLA), lower vesting, elimination of first-year waiting, and higher employee contributions for benefit enhancements.

Chairperson Kerr opened the floor for discussion regarding the various retirement plan design options and the death and disability issue, reminding members that alternatives need to be developed and prepared so recommendations can be made to the Legislature next session.

Interest was expressed in a new employee tier with a defined contribution plan. There were suggestions for a COLA option. Enhanced employee contributions also were suggested. KPERS was asked to provide information at the next meeting.

Regarding the death and disability issue, members expressed interest in the return to work incentive. Enhanced employee contributions also were discussed. The Revisor of Statutes Office was asked for information regarding adjustments in benefits and employee contributions. Chairperson Kerr requested that the KPERS staff provide information from other states regarding death and disability plans.

Chairperson Kerr announced the next meeting would be November 17-18, with one additional day reserved if needed later. The meeting was adjourned.

Prepared by Carol Doel
Edited by Julian Efird

Approved by Committee on:

November 18, 2004
(date)