SESSION OF 2003

CONFERENCE COMMITTEE REPORT BRIEF ON SENATE SUBSTITUTE FOR HOUSE BILL NO. 2014

As Recommended by Conference Committee
on April 30, 2003

Brief *

Senate Sub. for HB 2014 would modify statutes pertaining to public employee retirement and other benefits, including the Kansas Public Employees Retirement System (KPERS), KPERS employer retirement contribution rates, the Regents Retirement Plan, a local retirement plan, retirement annuities, death and disability benefits, issuance of pension obligation bonds, unclassified staff for KPERS, and a number of technical adjustments and clarifications in current KPERS law and procedures.

KPERS Long-Term Funding. One provision in the bill would provide a finance formula for increasing the moneys that must be appropriated by the state for its contribution of the employer share for annual payments to KPERS for the state and school groups. Beginning in FY 2006, the present statutory rate increase cap of 0.2 percent would be raised to 0.4 percent. In subsequent fiscal years the rate cap would be raised by 0.5 percent in FY 2007 and by 0.6 percent in FY 2008. Although this provision was included in conjunction with a bond issue, the contribution rate increase has been recommended by the KPERS actuary as a necessary change in order to bring the amount of state money flowing into KPERS up to the actuarially required level and to address a long-term funding issue. The present annual rate increase and resulting employer contributions will not provide for fully funding KPERS benefits on an actuarial basis over the next 30 years.

Death and Disability Moratorium. Another provision (from SB 47) would suspend employer contributions for the Death and Long-Term Disability Benefits plan administered by the Kansas Public

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Employees Retirement System (KPERS) for the period of April 1, 2003, to June 30, 2004. This change implements the Governor's recommended moratorium for five quarters and brings state law into conformity with actions approved in 2003 SB 6 which removed the funding from state agency budgets. The provision also authorizes local units of government to cease remitting their payments for five quarters.

Pension Bonds. The bill also authorizes three different bond issues and establishes a different set of requirements which must precede issuance of the potentially most expensive group of bonds. The three bond issues include the following:

First, the bill would designate certain active, inactive, and retired Regents unclassified employees and certain University of Kansas Hospital Authority employees as special members of KPERS. The remaining unfunded actuarial liability would not be assumed by KPERS. The bill would provide for issuing taxable revenue bonds, not to exceed $15.5 million, to finance a portion of the unfunded liability over 10 years. The Board of Regents would be responsible for payment of principal and interest on the bonds, subject to state appropriations. The bill also would provide for the Regents to contract with the University of Kansas Hospital Authority since it is no longer budgeted with the Regents institutions. Issuance of any bonds would be contingent upon the approval of the State Finance Council.

Second, the bill would incorporate the 13th check into a guaranteed annual benefit payment by permanently funding the state and local portions of the unfunded actuarial liability estimated at $35.9 million. The state portion would be paid by authorizing a $24.9 million bond issue to provide the actuarially required funding for the remaining period that benefits will be paid. The 10-year bond issue would be paid from an increase in the state's employer contribution rate beginning in FY 2005. The local portion would be assumed into the unfunded actuarial liability for that group and the rate increase would be authorized to begin in calendar year 2005 to amortize the $11.0 million liability to make the payment permanent for local retirees and their beneficiaries.

Third, the bill would incorporate provisions (from SB 260) to authorize issuance of a maximum of $750 million of taxable revenue bonds for the purpose of reducing a portion of the unfunded actuarial liability of the state and school groups of the Kansas Public Employees Retirement System (KPERS). The Kansas Development Finance

Authority (KDFA) would be the issuing agent and the bonds could be used to finance a portion of the pension liability, to pay the costs of issuing the bonds, and to provide for any required reserves for the bonds. Repayment of the bonds would be from moneys appropriated by the state. The decision to issue either tax-exempt or taxable revenue bonds would be delegated to the State Finance Council as one of its decisions in determining whether to issue bonds, or what kind of pension obligation bonds to issue -- taxable or tax-exempt.

Prior to issuing any bonds, a procedure that must be followed is established in the bill. The Joint Committee on Pensions, Investments and Benefits would be directed to conduct an investigation into the pros and cons of issuing pension obligations bonds, to consult with the KPERS Board of Trustees on the feasibility of issuing such bonds, and to exercise the due diligence in evaluating this question before making a recommendation to the State Finance Council. Next, the State Finance Council would be delegated authority to approve the issuance of bonds and to determine the lowest cost of financing -- taxable vs. tax-exempt bonds. First, the decision to issue bonds; the amount and type of bonds to be issued or the amounts and types of bonds if in more than one issue; and the interest rates and length of period or periods to maturity shall be approved by resolution of the State Finance Council. Second, the bill would require the terms for repayments to be included in contracts between the Department of Administration and KDFA, and subject to approval by the State Finance Council. Such contracts would have to include payment arrangements regarding amounts and procedures for transfer of state moneys; terms and conditions regarding principal amounts, interest rates, and maturity schedules; and other terms and conditions necessary or desirable to provide for the repayment and to secure the bonds. Integral to this process is the role of the Governor's authority in calling for meetings of the State Finance Council and for setting the agenda of items to be considered at the meetings.

Legislator Benefits. Several provisions in the bill would address benefits for legislators, including retirement, death and disability.

First, the bill would amend current law regarding legislators who are also unclassified employees of the Board of Regents or a state university. Existing law provides that, beginning with the 2001 Legislative Session, a Regents employee elected to the Legislature may choose to have the Board of Regents make contributions to the Regents retirement plan on the employee's behalf while the employee holds elected office. This bill would allow any employee who made use of that provision in existing law to elect to have retroactive contributions made to the Regents retirement plan for legislative service prior to January 8, 2001. For any legislator who elects this option, the Board of Regents would be required to submit a request to the Director of Legislative Administrative Services to calculate the amount that would be contributed to the employee's retirement plan by the Board. After this calculation is made, the Director would certify to the Board the amount of contribution required. The Board would then make the contribution on behalf of the employee.

Second, the bill would modify the current statutory listing of state employees who are eligible to participate in the defined contribution plan in which the employer contributes 8.0 percent of gross salary to employees' individual retirement accounts in the state's deferred compensation trust. Added to the list would be legislators who have retired from a KPERS participating employer and who are no longer eligible for membership as an active KPERS employee if already retired. The bill would exclude death and disability coverage for the legislators who elect the defined contribution plan.

Third, a clarifying amendment would allow any legislator who voluntarily chooses not to participate in KPERS also to be able to participate only in the KPERS administered death and disability plan. Retired legislators still would be ineligible for this plan since they have a $4,000 death benefit from KPERS for their designated beneficiary.

Local Pension Plan. The bill would exempt from participating in the Kansas Police and Fireman's (KP&F) Retirement System employees of not-for-profit non-governmental entities who later are employed by a participating employer under KP&F.

KPERS Staffing. A provision(from SB 12) would allow the KPERS Board of Trustees authority to assign new and vacant positions to either the unclassified or classified service, subject to a limitation that no more than 25 percent of the staff could be in the unclassified service. The status of current classified employees would not be changed.

Clarifying Amendments. Three provisions (from SB 13) would clarify that a partial lump sum option may be selected by a joint annuitant if the member dies before retiring; update statutory references to the current Internal Revenue Service code; and correct an erroneous reference in a Kansas Police and Fireman's Retirement System law.

All provisions in the bill would be effective upon publication in the *Kansas Register*.

Background

HB 2014 originally was introduced by the Joint Committee on Pensions, Investments and Benefits to address the issue of legislators who are ineligible for KPERS participation while they are on leave of absence from a Regents institution to serve in the Legislature. Legislation enacted in 2001 addressed the issue for prospective service, and allowed members on leave from a Regents institution to continue participation in defined contribution plans rather than be covered by KPERS. HB 2014 authorizes retroactive payments for previous years when no contributions had been made for legislative service. A former chairperson of the Joint Committee on Pensions, Investments and Benefits testified in support of the bill during a hearing in the House Committee on Higher Education. The House Committee adopted technical amendments suggested by a representative of KPERS. The fiscal note submitted by the Division of the Budget on the bill states that, according to the Board of Regents, the employing state educational institution would make the retirement contributions out of existing budget resources. It is estimated to cost less than $20,000 by the Division of Legislative Administrative Services.

Benefits for Legislators

The Senate Committee on Ways and Means amended four other provisions into the bill: a defined contribution plan for legislator retirement that would provide annuities, an exemption for a local retirement plan, the moratorium for death and disability contributions paid by public employers, and the incorporation of a closed group into KPERS. Three changes were recommended by the Subcommittee on KPERS Issues after reviewing the proposed legislation and various House and Senate bills. The moratorium originally was passed by the Senate earlier this Session in SB 47, as amended by the Senate Committee of the Whole.

A Subcommittee of Senate Ways and Means formulated the legislator recommendations to assist seven current members of the

Legislature who have retired from a KPERS participating employer and now serve in the Legislature. They are unable to "unretire" and join KPERS again. No contributions are paid for retirement, death, or disability insurance for these legislators. Likewise, they do not pay the 4.0 percent employee contribution to KPERS. The fiscal note for participating in the 8.0 percent defined contribution plan is less than $10,000 if all seven members elected to participate. Currently, eligible participants in the defined contribution plan include part-time legislative employees who typically work during the Session and intermittently during the Interim. Also eligible to select either KPERS coverage or the 8.0 percent defined contribution plan are staff in the leadership offices of the Legislature, as well as a number of executive branch appointees listed in statute. The fiscal note for this provision is less than $10,000 for the 8.0 percent defined compensation plan.

Local Pension Plan

The amendment pertaining to local governments originally was introduced as HB 2013. The bill was requested by the City of Overland Park in order to retain a separate pension plan for members of its fire department. The department is a not-for-profit non-governmental entity, and will be merged with the city on July 1, 2003. The bill would allow the continuation of the existing pension plan by not requiring affiliation with KP&F when the department is incorporated into the city.
There is no cost associated with the Overland Park Fire Department amendment.

KPERS Staffing

The provision from SB 12 was recommended by the Joint Committee on Pensions, Investments and Benefits in order to allow the KPERS Board more flexibility in hiring staff. There is no fiscal effect indicated by KPERS. The Legislature previously removed the FTE limitation from appropriations bills in order to allow flexibility in staffing levels to be determined by the KPERS Board. Currently, unclassified positions are designated in statute by title of the position. The bill would strike the listing of titles.

Clarifying and Technical Amendments

The provisions from SB 13 were recommended by the Joint Committee on Pensions, Investments and Benefits in order to correct or resolve several problems identified by the KPERS Board. The Senate Committee amended the bill to clarify that a surviving spouse of a member, who dies before retirement, may elect any option in lieu of receiving the member's contributions, *including election of a partial lump sum option (PLSO) where up to 50 percent of benefits may be taken at time of retirement.* The KPERS Executive Director testified in support of the bill as introduced, and indicated that the Legislature needed to make a policy choice regarding the PLSO amendment. Current law has been interpreted by KPERS to deny surviving spouses an election of the PLSO. However, the law is not consistent in whether the Legislature previously determined that the election should be denied.

Death and Disability Contribution Moratorium

The Governor proposed a moratorium for the fourth quarter in FY 2003 and for four quarters in FY 2004 on payments by KPERS participating employers who provide for death and disability coverage of public employees. This bill would implement all five quarters of the moratorium.

The fiscal note indicates that savings of $6,123,070 for the state will result in FY 2003, including $5,265,070 in State General Fund and $858,000 in special revenue fund expenditures. In addition, local units of government will save an estimated $1.59 million, according to KPERS. FY 2004 savings for the state will total an estimated $21,144,360 from all funds, with $17,758,360 in State General Fund and $3,386,000 in special revenue funds. In addition, local units of government will save an estimated $6.6 million, according to KPERS.

Pension Obligation Bonds

Regents Bonds. The bill includes provisions from SB 90. The bill designates a closed group comprised of Regents and Hospital Authority employees as special members of the KPERS in order to fund their retirement benefits. According to KPERS, there were 1,113 total members of the group as of December 31, 2001, when the last valuation was performed. Members of this group have prior service credit under KPERS, but also have been under the Regents or Hospital Authority defined contribution plans more recently.

The KPERS actuary calculates the remaining unfunded actuarial liability at $16.9 million for Regents institutions and $466,912 for the

KU Hospital Authority. The bill anticipates a $2.0 million assessment to be paid in the 2003 Omnibus bill by the Regents institutions for an initial lump-sum payment to KPERS. This portion is not addressed in the bill, but the Omnibus bill would need to establish a first-year payment from the Regents institutions of $2.0 million in FY 2004. Subsequent payments over 10 years, beginning in FY 2005, would repay bonds costs estimated at $15.2 for the Regents portion of the pension revenue bond issue. Total principal, issuing costs, and interest are estimated at $18.8 by the Kansas Development Finance Authority.

The revised fiscal note suggests this bill would reduce FY 2004 Regents contributions from $9,086,631 to $2,000,000 for a savings of $7,086,631. The bill also reduces future Regents employer contributions estimated at $12.1 million in FY 2005 and $15.0 million in FY 2006 to an estimated annual average payment of $1,884,000 for 10 years. Three-year savings are estimated at $30.2 million, and multiyear savings could range from $18.0 to $21.0 million, depending upon the final cost of the bond issue. The portion of a bond issue to finance the KU Hospital Authority is estimated at $475,000, with a 10-year additional cost of $126,273 for interest charges. Any repayments would be subject to a contact with the Board of Regents.

Annual Dividend Payment Bonds. The conference committee recommends that a second closed group of approximately 15,000 KPERS retirees and beneficiaries be incorporated into the retirement plan, and that future payments for the 13th check be funded on an actuarial reserve basis by the state issuing pension bonds rather than depending upon "profits" on KPERS investments to guarantee benefits for the remaining life of the state's retired recipients and beneficiaries. The bond issue would be handled in conjunction with the previous issue in order to reduce issuance costs. These bonds also would be issued on a 10-year repayment schedule, with annual payments estimated at $3.2 million and paid out of an increase in KPERS state and school contributions authorized to begin in FY 2005. Total cost of the $24.9 million issue is estimated at $31.8 million, with interest charges of $6.9 million at an average of 4.38 percent.

The local portion of the unfunded liability of approximately $11.0 would be assumed by KPERS and the local contribution rate would be increased in calendar year 2005 to pay off the liability over 10 years. No bonds would be issued for the local portion of the liability since the local employer contribution rate is considerable lower than the state's and only has to increase 0.15 percent each year due to its funding status.

Long-Term Funding Bonds. The original bill (SB 260) was introduced at the request of Senator Steven Morris, Chairperson of the Senate Ways and Means Committee. Senator Morris told the Committee that he served during the 2002 interim on the Joint Committee on Pensions, Investments and Benefits when the long-term KPERS financing problem was reviewed. In developing alternatives to address how to reduce the unfunded liability and the gap between what is paid by the state and what needs to be paid, the concept of pension obligation bonds was reviewed by the Joint Committee. Senator Morris said he believes in order to jump-start discussions about addressing the long-term KPERS funding problem, he asked for introduction of SB 260 as an alternative financing plan involving bonds and increased employer contributions to focus attention on the matter. He stressed that the longer the Legislature waits to act, the more the problem will grow in magnitude. The combination of bonds and higher state contributions should be available as alternatives to address the problem, and he urged passage of SB 260 by the 2003 Legislature to help address the KPERS long-term financing problem.

The Executive Director of KPERS presented a review of the long-term funding problem, and how pension obligation bonds might play a role in helping to address the issue. He stressed that KPERS was not advocating any particular alternative, but that he had been asked to focus by Senator Morris on the use of pension obligation bonds and their role in a possible comprehensive solution to the long-term financing issue. He also indicated that higher employer contribution rates would be required regardless of whether bonds were used as one alternative in addressing the KPERS problem of long-term financing.

For the KPERS state and school groups, the State of Kansas makes employer contributions to pay a portion of the costs for providing retirement benefits. In the most recent actuarial valuation of December 31, 2001, the state and school groups had an unfunded actuarial liability of $1.5 billion. In order to calculate the amount of employer contributions that should be paid, the KPERS actuary computes the amount of 5.03 percent required to pay the normal cost of providing retirement benefits, and also computes the amount of 2.66 percent required to amortize the unfunded actuarial liability. These two calculations determined that a rate of 7.69 percent of the projected annual payroll for KPERS state and school members should be paid by the state in FY 2005. However, a statutory cap limits the amount to no more than 4.78 percent, for a gap of 2.91 percent in FY 2005. The gap is projected to continue widening in subsequent fiscal years.

Revenue bonds are treated as if they were taxable pension obligation bonds. Any bonds issued would yield moneys that could be applied to reduce the $1.5 billion unfunded actuarial liability, without having to immediately ramp up the employer contribution rate to the level recommended by the KPERS actuary. By reducing the unfunded liability through the infusion of bond proceeds, the moneys invested in what may be higher-yielding securities could produce savings for the state in the long-term if the interest rate paid on the bonds is less than the rate of return earned on the proceeds placed in pension plan investments.

In addition to providing an infusion of bond money, the bill also would increase the state's rate of contribution according to the following multiyear schedule:

	Incr.	Rate
FY 2004	0.20%	4.58%
FY 2005	0.20	4.78
FY 2006	0.40	5.18
FY 2007	0.50	5.68
FY 2008	0.60	6.28
FY 2009	0.60	6.88
FY 2010	0.60	7.48

In FY 2004, the *Governor's Budget Report* indicates the state will spend approximately $179 million on KPERS state and school payments for active employees. However, $6.2 million of that amount is money attributed to FY 2003 payments that will be made during FY 2004 since no supplemental appropriation was recommended for FY 2003. The KPERS actuary's calculation indicates that the state should be spending an additional $101 million, for a total of $280 million at a rate of 7.05 percent in FY 2004. A KPERS document of March 13, 2003, indicates that state contributions, which currently are scheduled to rise 0.2 percent each year, under provisions in this bill (as included from SB 260) would increase an additional $7.1 million in FY 2006, $18.3 million in FY 2007, $33.9 million in FY 2008, $50.2 million in FY 2009, and $67.3 million in FY 2010 by implementing the new staggered rate hikes. The contribution rate increases are not predicated on the issuance of bonds, and would take effect regardless of whether bonds were issued or not issued.

The bill does not require that any of the $750 million in bonds be issued. The legislation is permissive, and approval of the State Finance Council, subject to convening by the Governor, is required before any bonds may be issued. KPERS presented an example based on issuing $750 million in bonds in its document of March 13, 2003. Various other alternatives could be modeled. For a 30-year bond issue, the estimated true interest cost would be approximately 6.0 percent with a level debt payment structure and with all bonds issued at one time. Annual bond payments for principal and interest could be less than $54.0 million per year, depending on factors when the bonds were issued and bond issue repayment schedule. The net effect is expected to lower KPERS employer contributions. The model indicates an estimated present value of the difference in contributions would be $137 million that the state might save if bonds are issued at an interest rate below the 8.0 percent KPERS investment return assumption.