

Report of the Joint Committee on Pensions, Investments and Benefits to the 2024 Kansas Legislature

CHAIRPERSON: Representative Nick Hoheisel

VICE-CHAIRPERSON: Senator Jeff Longbine

OTHER MEMBERS: Senators Brenda Dietrich, Michael Fagg, Cindy Holscher, and Pat Pettey; and Representatives Bill Clifford, Cindy Neighbor, Tobias Schlingensiepen, Sean Tarwater, Carl Turner, Laura Williams, and Rui Xu

CHARGE

Monitor, Review, and Make Recommendations Regarding the Retirement System

KSA 2022 Supp. 46-2201 directs the Committee to monitor, review, and make recommendations regarding investment policies and objectives formulated by the Kansas Public Employees Retirement System (KPERS) Board of Trustees; review and make recommendations relating to benefits for KPERS members; consider and make recommendations relating to the confirmation of members of the KPERS Board; review and make recommendations relating to the inclusion of city and county correctional officers as eligible members of the Kansas Police and Firemen's Retirement System; and review reports regarding working after retirement exceptions (KSA 74-4914 and 74-4937). In addition to its statutory duties, the Committee will consider these pensions matters:

- Environmental, social, and governance (ESG) criteria, ESG implementation and enforcement activities in other states, and states' investment boycott provisions associated with foreign adversaries;
- Possible options relating to KPERS Tier 3 plan design and its overall benefit value; and
- Other pensions legislation considered by the 2023 Legislature.

December 2023

Joint Committee on Pensions, Investments and Benefits

ANNUAL REPORT

Conclusions and Recommendations

The Joint Committee on Pensions, Investments and Benefits submits the following comments and recommendations:

- **Joint Select Committee.** The Committee recommends that legislative leadership establish a joint Select Committee to evaluate KPERS (the Kansas Public Employees Retirement System) Tier 3 and whether it is adequately meeting the needs of employees and employers. The Committee also acknowledges a forthcoming report from the Legislative Division of Post Audit on this topic. [*Note:* The Committee’s report to the 2023 Legislature included a similar recommendation]
- **Alternative investment cap removal.** The Committee recommends passage of legislation addressing the statutory alternative investment cap for the KPERS Trust Fund (presently limited to 15.0 percent of the total investment assets of the Fund) and delegate the selection of the overall cap to the KPERS Board of Trustees. The Committee also recommends pending legislation be amended to make the change in Board authority effective on publication of the *Kansas Register*. [*Note:* Two bills have been introduced on this topic, including the bill pre-filed by the Committee in the 2023 Session (SB 23).]
- **Working After Retirement study.** The Committee recommends the appropriate standing Committees (House Committee on Financial Institutions and Pensions, Senate Committee on Financial Institutions and Insurance) review working after retirement rules, including the statutorily prescribed waiting lists of 60 and 180 days; the employer contribution rate for the first \$25,000 of the retiree’s salary (FY 2023, rate of 14.33 percent) and the 30.0 percent employer contribution rate for earnings over the \$25,000 threshold; and the current 630-hour annual minimum for covered employees (school employers) and 1,000 hours of annual work (non-school employers).
- **Cost-of-Living Adjustments review.** The Committee recommends the appropriate standing Committees (House Committee on Financial Institutions and Pensions, Senate Committee on Financial Institutions and Insurance) review Cost-of-Living Adjustments (“COLAs”), including input from stakeholders and the fiscal impact of implementing a COLA.
- **Extraordinary KPERS payment.** The Committee recommends the House Committee on Appropriations and Senate Committee on Ways and Means review using some of the projected State General Fund surplus ending balance to make additional contributions toward the reduction of KPERS unfunded actuarial liability.

Proposed Legislation: None.

BACKGROUND

The Joint Committee on Pensions, Investments and Benefits was created in 1992 and is authorized by KSA 2023 Supp. 46-2201 to:

- Monitor, review, and make recommendations relative to investment policies and objectives formulated by the Kansas Public Employees Retirement System (KPERS or the Retirement System) Board of Trustees (Board);
- Review and make recommendations related to KPERS benefits;
- Consider and make recommendations on the confirmation of members nominated by the Governor to serve on the Board; and
- Introduce legislation it determines to be necessary.

COMMITTEE ACTIVITIES

The Legislative Coordinating Council authorized two meetings days for the Committee during the 2023 Interim. The Committee met on November 2 and November 3, 2023, to receive reports and updates and hold discussion on the KPERS 2022 actuarial valuation, KPERS budget and pension administration system modernization, pensions obligation bond proceeds, membership and retirement trends, investment performance, and implementation of 2023 legislation and law (Working after retirement, alternative investments cap removal, the Deferred Retirement Option Program [DROP], Kansas Police and Firemen's [KP&F] affiliation, and Environmental, Social and Governance investment policy/ foreign adversary investments). In addition to review and discussion on these matters, the Committee invited comment from public retirees and held a discussion on KPERS Tier 3 adequacy, with comment from concerned parties and information from KPERS representatives on alternatives to or modifications for consideration.

Review of KPERS Law and Legislation

A Senior Assistant Revisor, Office of Revisor of Statutes, reviewed relevant legislation pertaining to KPERS, including two bills enacted in law in 2023, eight bills with legislative consideration, and other KPERS bills introduced during the 2023 Legislative Session.

KPERS Bills Enacted into Law

HB 2196 authorized the affiliation of certain persons employed by the Kansas Department of Wildlife and Parks into the KP&F Retirement System on July 1, 2023. The bill also expanded the defined membership of the DROP to include any member of KP&F who is eligible to participate in DROP and extended the DROP sunset date from January 1, 2025, to January 1, 2031.

HB 2100 created the Kansas Public Investments and Contracts Protection Act and amended law governing the Kansas Public Employees Retirement Fund (Trust Fund) and investment standards to prohibit state agencies and other political subdivisions from giving preferential treatment to or discriminating against companies based on environmental, social, or governance (ESG) criteria in the procuring or letting of contracts; require fiduciaries of the Retirement System to act solely in the interest of participants and beneficiaries of the System; restrict state agencies from adopting ESG criteria or requiring any person or business to operate in accordance with such criteria; provide for enforcement of this act by the Attorney General; and indemnify KPERS with respect to actions taken in compliance with this act.

KPERS Bills with Legislative Consideration

HB 2025 would authorize a self-funded cost-of-living adjustment retirement benefit option for certain KPERS members.

HB 2102 would appropriate \$250.0 million from the State General Fund (SGF) to the Office of the State Treasurer for the repurchase of some, or all, of the outstanding portion of Kansas Development Finance Authority Series 2021K bonds.

HB 2103 and **SB 23** would remove the 15.0 percent alternative investment limit for the KPERS

Trust Fund and require the Board to establish an alternative investment percentage limit.

HB 2195, as amended by House Committee, would increase the amount of retirant compensation subject to the statutory employer contribution rate to the first \$50,000 of compensation earned by a retirant in a calendar year. The bill would also require participating employers to pay only the statutory employer contribution rate on all compensation of a retirant employed in a covered position through December 31, 2024. [*Note:* The bill, as introduced, would increase the threshold to \$30,000 per calendar year.]

HB 2272 would establish a KPERS working-after-retirement exemption for retirants employed by a Community Developmental Disability Organization (CDDO) in a licensed professional nurse, licensed practical nurse, or direct support position.

SB 172 would increase the KPERS lump-sum death benefit from \$4,000 to \$6,000.

SB 256 would provide KPERS Tier 3 members with an additional 1.0 percent dividend interest credit for one year.

KPERS 2022 Actuarial Valuation Report

The Committee reviewed the latest actuarial valuation, which serves as a snapshot of the financial condition of the Retirement System as of December 31, 2022. The Executive Director of KPERS indicated all membership groups remain at the full actuarially required contribution (ARC) rate, which is a key factor in reducing the unfunded actuarial liability (UAL) and improving funded ratios of each group. [*Note:* This annual actuarial valuation, which measures assets and liabilities, provides the basis for calculating future employer contribution rates.]

The 2022 valuation is used to set the fiscal year (FY) 2026 contribution rates for State/School employers and calendar year (CY) 2025 contribution rates for local employers, and it serves as the baseline for any cost studies performed in the 2024 Legislative Session.

Key Findings

Assets. As of December 31, 2022, the actuarial value of assets totaled \$26.5 billion. Actuarial assets are calculated by averaging, or “smoothing,” investment gains and losses over a five-year period. There is a net gain of almost \$1.9 billion to be realized in the outlying years. Net investments on a calendar-year basis decreased by 9.8 percent (market value). Due to smoothing, the return on actuarial assets gained 5.6 percent.

Funded ratio and unfunded actuarial liability. The Retirement System’s overall funded ratio of assets to liabilities increased from 71.6 percent (2021 valuation) to 73.4 percent. [*Note:* The standards for public pension plans suggest a public retirement system should be funded between 80.0 and 100.0 percent of future liabilities owed.] The UAL for the Retirement System declined from \$9.8 billion (2021 valuation) to \$9.6 billion. Significant factors affecting the UAL in the 2022 valuation include employers contributing at the full ARC rate and the \$871.1 million in additional contributions included in 2022 SB 421.

The Executive Director noted that, if all funding assumptions are met in future years, the State/School Group UAL would increase until CY 2028 due to deferred investment losses, after which it would resume declining. Under these conditions, the legacy UAL for the State/School Group would be paid off in the 2039 valuation.

Contribution rates. The report indicated the ARC rates for KPERS State/School employers increased from 11.42 percent in FY 2025 to 11.56 percent for FY 2026, primarily due to negative investment returns. The statutory employer contribution rate continues to be at the full ARC rate for FY 2026, the sixth consecutive year the statutory and actuarial rates have been equal. The Committee and the Executive Director discussed the funding projections presented and the anticipated investment returns for CY 2024.

Pension Obligation Bond Proceeds

The Executive Director addressed pension obligation bonds, which serve as a form of arbitrage intended to reduce future employer contributions and improve the solvency of KPERS. Bond proceeds also serve to improve the funded status of the Retirement System. To date,

the State has issued three series of pension obligation bonds. The first was in 2004 for a total of \$500.0 million, gross of fees; the second in 2015 for \$1.0 billion, net of fees; and the third in 2021 for \$500.0 million, net of fees.

Series 2004C. The 2004 Legislature approved a \$500.0 million bond issue, which was issued with a 30-year maturity and an interest cost of 5.39 percent. KPERS received \$440.165 million in net proceeds. Annual debt service is approximately \$33.0 million from the Expanded Lottery Act Revenues Fund. As of December 31, 2022, the remaining principal balance was approximately \$331.1 million.

Series 2015H. The 2015 Legislature approved a \$1.0 billion bond issue, which was issued with a 30-year maturity and an interest cost of 4.68 percent. KPERS received \$1.0 billion in net proceeds. Annual debt service is approximately \$65.0 million from the SGF. As of December 31, 2022, the remaining principal balance was approximately \$880.6 million.

Series 2021K. The 2021 Legislature approved a \$500.0 million bond issue, which was issued with a 30-year maturity and an interest cost of 2.65 percent. KPERS received \$500.0 million in net proceeds. Annual debt service is approximately \$24.0 million from the SGF. As of December 31, 2022, the remaining principal balance was approximately \$488.1 million.

Responding to a question on the possibility of a discount on repurchase of Series 2021K bonds, the Executive Director of the Kansas Development Finance Authority (KDFA) indicated repurchasing now would result in a loss of around 30.0 percent. KDFA provided several alternatives, including an optional redemption, engaging with open market prices, tender offer solicitations, and buying U.S. Treasury securities.

Total returns. Average annualized total returns on the Retirement System's investment portfolio have exceeded the interest cost of the 2004C and 2015H bond issues, but not the 2021K bond issue. As of August 31, 2023, average annualized total returns were 7.24 percent for 2004C, 7.20 percent for 2015H, and -0.48 percent for 2021K. The three bond series have collectively exceeded interest costs by approximately \$769.0

million (\$496.0 million for 2004C, \$304.0 million for 2015H, and -\$31.0 million for 2021K).

KPERS Membership and Retirement Trends

Active and Retiree Membership Trends

The Planning and Research Officer, KPERS, provided information on active and retiree membership trends. The Retirement System currently has 151,984 active members, which is comparable to the number of active members in 2006. Among all groups, KP&F membership has grown steadily since 2005, while other groups have either fluctuated or declined in membership.

KPERS has around 113,000 retirees and beneficiaries. The compound annual growth since 2006 is 3.44 percent. While the number of retirees and beneficiaries is expected to continue increasing, the rate of increase is projected to slow over time, reflecting expectations that members will work longer and retire at later ages. Notably, the impact of baby boomers is expected to stop in the next eight to ten years. Over the next 20 years, the number of retiree and beneficiary deaths is expected to surpass the number of new retirees each year. However, with survivor benefit options, not every death decreases the number of retiree and beneficiary members.

Speaking to broad trends, the Planning and Research Officer noted active membership has remained relatively flat for over a decade (155,446 in 2013 to 151,984 in 2022), while retirees and beneficiaries have steadily increased over time (86,843 in 2013 to 113,031 in 2022).

Pension Plan Maturity and Risk

Although pension plan maturity does not have a precise definition, the Planning and Research Officer explained one common metric is the ratio of retirees to active members. For KPERS, that ratio has continuously increased over the past 20 years. Additionally, the total liability attributable to retirees and beneficiaries has increased for all groups in that time frame. For example, for the State/School Group, the liability as a percent of total actuarial liability increases from 39.7 percent in 2003 to 53.5 percent in 2022. As more of total liability resides with retirees and beneficiaries, investment volatility will have a greater impact on

Retirement System funding because there will be comparatively fewer payroll dollars from active members and employers to spread costs over.

The Planning and Research Officer noted the Board and its consulting actuary are aware of these risks, reviewing various risk factors each year during the actuarial valuation. Furthermore, as a pre-funded plan and in contrast with pay-as-you-go plans, like Social Security, KPERS is designed to account for maturity risk through use of actuarially required contribution rates.

Investment Performance

The Chief Investment Officer (CIO), KPERS, provided an overview of the KPERS Trust Fund performance in FY 2023: a positive return of 7.4 percent, exceeding the actuarial rate of return of 7.0 percent but trailing the policy index, or asset class benchmark, of 8.4 percent. The portfolio's market value increased from \$24.3 billion in FY 2022 to \$25.6 billion in FY 2023.

The CIO noted the Board regularly conducts asset/liability studies, which are used to establish long-term asset targets. The most recent study was completed in May 2023, and the Board recommended the following targets for the portfolio:

- 43.0 percent global equity,
- 15.0 percent real estate,
- 13.0 percent core fixed income,
- 12.0 percent yield-driven assets,
- 11.0 percent private equity,
- 3.0 percent real return, and
- 3.0 percent cash equivalents.

Fund performance. In the past 3, 5, 10, 20, and 25 years, the portfolio experienced a low return of 6.9 percent for the 25-year average and a high return of 9.0 percent for the 3-year average. Compared with the policy index, or asset class benchmark, the Fund ranges from underperforming by 1.0 percent to outperforming by 1.6 percent for the above time periods.

In FY 2023, the portfolio experienced negative returns on real estate (9.7 percent) and fixed income (0.6 percent), largely due to interest rate-sensitive asset classes that responded to broader market changes. By contrast, fixed income returns

are about 13.0 percent as of September 30, 2023. The CIO noted total cash returns was about 3.5 percent in FY 2023 and are close to the long-term target of 3.0 percent.

Economic and market observations. The CIO indicated financial markets have struggled in the first three months of FY 2024 (July to September), with concerns about rising interest rates, inflation, central bank policy, and was putting pressure on markets. While the Retirement System's portfolio has maintained a positive return for the first nine months of 2023, returns were modest at 4.1 percent. Although financial markets are expected to remain volatile for the time being, the CIO emphasized the Retirement System's portfolio is structured for the long term.

KPERS Operating Budget and Pension Administration System Modernization

KPERS Operating Budget

The Executive Director of KPERS detailed the KPERS operating budget, which includes general expenses (such as staff, contracts, and office space), investment-related expenses (such as manager fees and investment staff), and administration of the Death and Disability and KPERS 457 programs.

KPERS estimates expenditures totaling \$73.9 million in FY 2024 and \$82.6 million for FY 2025, the majority of which is financed by the KPERS Trust Fund (\$72.9 million and \$81.6 million, respectively). General and investment-related expenses compose the largest portion of the operational budget, \$27.1 million and \$45.7 million, respectively, in FY 2024.

Benefits payments are considered non-expense items for budgeting purposes and are not included when discussing operational expenditures. KPERS estimates total benefits expenses of \$2.257 billion in FY 2024 and \$2.343 billion for FY 2025.

Responding to a question on reviewing investment manager performance, the Executive Director indicated KPERS has a staff of 9 employees that closely monitor the 15 to 20 fund managers currently used.

KPERS Pension Administration System

The Executive Director outlined the purposes of the pension administration system, which provides the functionality needed to collect data and contributions from employers and to process and pay benefits. KPERS started using its present system in 2005. The existing system remains capable of providing these processes but, due to the required customizations over the years, has become less efficient and more unstable over time.

In 2020, the Board made the decision to begin the multi-year modernization effort. Additionally, the Legislature also authorized a comprehensive system assessment, which was completed in September 2020 by The Segal Group, a consulting firm. The assessment helped clarify how the database could be restructured to provide better service to all customers. In 2021, KPERS then used the findings from the assessment to begin establishing requirements for the new system. After an “Analysis and Retool” phase completed by the existing contractor, Sagitec, KPERS engaged with Sagitec to gauge the possibility of upgrading the existing system.

In 2022, KPERS determined Sagitec was unable to upgrade the existing system to meet established requirements. Accordingly, the Board approved a request for proposal (RFP) on a new pension administration system. In 2023, the Kansas Information Technology Office approved the project and KPERS released the RFP for bid. KPERS received two qualified responses to the bid when it closed in June 2023. After a vendor review process, the Board is expected to select a vendor in November 2023. [Note: On November 17, 2023, the Board selected Tegrit Software Ventures for the project, at an initial proposed cost of \$57.6 million to implement.]

In 2024, KPERS will begin implementation of the new system, with an estimated completion time of five years. KPERS anticipates modernization expenditures totaling \$9.0 million in FY 2024 and \$12.0 million for FY 2025, all financed from the KPERS Trust Fund. Most expenses will be for contractual services paid to the vendor.

Responding to a question on the implementation schedule, the Executive Director

confirmed the process would take about five years, due to the size and complexity of the system. To illustrate, the Executive Director said there are more than 3,000 requirements and 1,400 contributing employers to account for in the system design. The Executive Director highlighted this complexity as the reason off-the-shelf solutions would not work as well and the reason the RFP received only two bidders.

Contemporary KPERS Topics and Issues

The Planning and Research Officer for KPERS provided information on **HB 2196**, which expanded the membership of the DROP to include all KP&F members and authorized the affiliation of certain persons employed by the Kansas Department of Wildlife and Parks (KDWP) into the KP&F Retirement System.

Deferred Retirement Option Program

Under the DROP, eligible members with normal unreduced retirement initiate the calculation of retirement benefits but choose to defer the actual receipt of the benefits for a three-, four-, or five-year period. During the DROP period, the member does not earn additional service credits but continues to work and contribute into DROP. Retirement benefits are held in a separate account and, at the end of the period, the member receives the lump sum with interest. The DROP account can earn interest according to a statutory formula, and currently, the formula allows for 3.0 percent interest in any year in which KPERS investments reach the 7.0 percent investment return assumption.

In 2015, the DROP was created as a five-year pilot program for troopers, examiners, and officers of the Kansas Highway Patrol. In 2019, the DROP was expanded to include agents of the Kansas Bureau of Investigation. In 2023, HB 2196 expanded eligibility further to include all eligible KP&F members who elect to participate and extended the sunset date to January 1, 2031. Between 2015 and 2022, 67 members have enrolled in the DROP and about 130 members retired without enrolling in the program.

Upon enactment of HB 2196, approximately 540 to 600 members became eligible for the DROP, and another 350 to 450 are projected to become eligible within the next two years. The

Planning and Research Officer noted basic DROP functionality has been enabled to all KP&F members and employers within the pension administration system.

KP&F Affiliation

The Planning and Research Officer also discussed implementations of provisions in HB 2196 that expanded KP&F eligibility to certified law enforcement officers at the KDWP on July 1, 2023.

Speaking on the impact and costs of affiliation, the Planning and Research Officer stated 167 positions became eligible for coverage, moving approximately \$9.8 million in total payroll from KPERS to KP&F. Impacted members will keep their existing KPERS service as of July 1, 2023, after which time they would begin earning KP&F service. KPERS and KP&F service are combined for vesting and retirement eligibility calculations. Responding to a question on retirement benefits for newly affiliated members, the Executive Director indicated they would receive retirement benefits for both KPERS and KP&F. As an employer, KDWP is required to pay \$2.7 million in unfunded actuarial liabilities for KPERS benefits earned by the group of impacted employees, \$1.5 million of which was paid on July 1, 2023.

KPERS Board Guidelines—Proxy Voting; Investment Criteria; Foreign Adversary Investments

HB 2100 established requirements for a proxy voting advisor and established restrictions on ESG criteria. Speaking on implementation, the Planning and Research Officer said the Retirement System’s Statement of Investment Policy, Objectives, and Guidelines (IPS) was updated to align with, and add definitions contained within, the bill, including social, political, or ideological interests (SPI).

Proxy voting. HB 2100 required engagement of a proxy voting advisor to manage and vote the Retirement System’s proxy ballots—a role previously held by investment managers. Subsequent to passage of the bill, the Board hired Egan-Jones as the System’s proxy voting advisor, which began operations on July 1, 2023.

Investment criteria. Pursuant to the bill, KPERS also updated the IPS such that managers under consideration for hire must provide certain written disclosures, including to act only upon financial factors when discharging their duties on behalf of the Retirement System’s asset and to report non-compliance with HB 2100 within ten days of discovery.

Foreign adversary investments. “Foreign adversary,” as defined in the The Code of Federal Regulations (15 CFR 7.4), includes the People’s Republic of China, the Republic of Cuba, the Islamic Republic of Iran, the Democratic People’s Republic of Korea, the Russian Federation, and the Venezuelan regime of Nicolás Maduro. The CIO of KPERS indicated the Retirement System does not hold any investments in Cuba, Iran, and North Korea, nor is the Board aware of investments associated with the Maduro Regime. Further, in 2022, the Board directed KPERS to liquidate investments in Russian securities in a timely and prudent manner, and to ensure that no new investments in Russian securities are made by investment managers.

The CIO noted the System does have exposure to China and the Hong Kong Special Administrative Region, though the nature of that exposure has changed with enactment of HB 2100, which prompted the System to exit two international equity commingled investment trusts.

Currently, the System owns shares of 15 companies representing \$365 million, or 1.5 percent of total fund assets. No stocks owned by the System are traded on China’s A-share market, which represents companies incorporated in China with shares that trade in the Chinese Yuan. Additionally, the Board adopted new benchmarks to communicate updated risk and return preferences to investment managers. As of November 1, 2023, international equity managers are permitted to invest up to 25.0 percent of the portfolio in U.S. equities.

Working After Retirement

The Executive Director reviewed working after retirement implications and requirements, noting the waiting period and prohibition on prearrangements are in place to satisfy an Internal Revenue Service requirement that, for qualified

401(a) plans, a *bona fide* retirement must take place before distributions occur.

The requirements for KPERS-covered work positions (effective January 1, 2018) include:

- 180-day waiting period to return if younger than 62 years old and 60 days if 62 or older;
- No prearranged agreement to return;
- No earnings limitation on retirees returning to work; and
- Statutory KPERS contributions at the statutory rate for the first \$25,000 in earnings and 30.0 percent for all earnings above \$25,000.

The Executive Director then detailed two bills with legislative consideration that would change working after retirement policy.

HB 2195 would make an adjustment to existing working after retirement rules to raise the employer contribution threshold and waive the threshold for an 18-month period. The estimated cost on the bill, as introduced, is \$1.4 million annually for the employer contribution threshold and \$5.5 million to waive the threshold.

HB 2272 would add an exemption from employer contributions for retirees hired as licensed nurses or direct support workers at CDDOs. The Executive Director stated this would apply to approximately 50 positions each year.

Alternative Investments Cap

The Executive Director indicted the Board utilizes two investment strategies related to alternative investments: private equity (investments in funds that provide capital to companies that are not publicly traded on an exchange) and infrastructure (investments in funds that provide financing for physical assets such as roads, bridges, and telecommunications). With recent market volatility, the Retirement System's alternative investment portfolio reached 14.1 percent as of June 30, 2023.

In 1992, the Legislature statutorily defined alternative investments and set a cap of 10.0 percent of total investment assets of the KPERS Trust Fund. In 1993, the cap was reduced to 5.0 percent. From 2000 to 2002, steep declines in public equity markets caused the System's alternative investment portfolio to exceed the statutory 5.0 percent cap, prompting KPERS to stop allocations as required by statute.

In 2004, the Legislature changed the cap from 5.0 percent of total investments to 1.0 percent of annual commitments to alternative investments, after which point KPERS resumed allocations.

In 2012, the Legislature authorized annual new investments in the alternative investment portfolio, up to 5.0 percent of the total market value of total assets as measured from the preceding calendar year. Further, the Legislature added the current overall cap of 15.0 percent on total alternative investments as a percentage of total investments.

HB 2103 and SB 23 would remove the alternative investments cap on the KPERS Trust Fund and require the Board to establish such a limit. The Executive Director indicated delegating authority to the Board would allow for consideration of asset allocation strategies that would diversify the portfolio and insulate it from risk. The Executive Director noted all other current limitations (*e.g.*, at least two qualified institutional buyers, and any individual alternative investment cannot exceed more than 2.5 percent of the total alternative investments) would remain in place. Since the law became effective in 2012, the Board's strategic investment plan has increased the allocation to alternative investments to help increase returns while minimizing risk.

The Executive Director conveyed the Board's concerns that, as alternative investments approach the statutory cap, it will be limited in its ability to set future investments policies because of the cap. For example, new investments in private equity and infrastructure would stop and new commitments in those sectors could not be made. Further, the Executive Director noted losing access to the alternative investment asset class would increase overall risk by restricting the System's ability to diversify investments across economic cycles.

Cost-of-Living Adjustments

Representatives of public retirees provided testimony about cost-of-living adjustments (COLAs), which modify benefits to counteract the impact of economic changes, such as inflation.

A representative from the Kansas Association of Chiefs of Police, Kansas Sheriffs Association, and Kansas Peace Officers Association mentioned that in KPERS' first 36 years of existence, there were 16 *ad hoc* COLAs implemented and 5 one-time benefit payments to retirees, as well as a 13th benefit check paid to members from 1980 to 1987. The representative noted retirees' purchasing power from KPERS benefits since 1998, when the last permanent adjustment was made, has decreased by 47.0 percent; that is, \$100 in 1998 has the equivalent purchasing power as \$52.96 today. The representative also compared KPERS benefits with the Wichita Employees' Retirement System (WERS), which has similar benefits in relation to retirement benefit calculations but with an annual 2.0 percent COLA beginning 36 months after retirement.

A representative from the Kansas Coalition of Public Retirees and the Kansas Association of Retired School Personnel testified that the UAL is the primary reason why the cost of COLAs appears high and is the result of underfunding for 25 years, from 1994 to 2019.

KPERS 457 Deferred Compensation Plan

The Deferred Compensation Plan Officer for KPERS provided an overview of KPERS 457, which is a voluntary governmental 457(b) deferred compensation plan available to all state agencies. Currently, the KPERS 457 plan has over \$1.4 billion in assets, with approximately 61,000 eligible participants and 27,000 participants with a balance.

The Deferred Compensation Plan Officer noted the benefits of the plan to both employer and employee. For the employer, there is no cost to join and no minimum number of employees needed. Furthermore, KPERS handles the fiduciary duties normally borne by employers, and the Deferred Compensation Plan's service provider, Empower, handles communication and education services for participants. For employees, KPERS 457 offers lower administrative and

investment costs than other accounts. At retirement, employees may leave money in the plan, withdraw as needed, roll money into another retirement account, or receive scheduled withdrawals.

Special Topic—KPERS Tier 3

The Planning and Research Officer for KPERS provided an overview of the KPERS Tier 3 cash balance plan. In response to the 2008 recession and a 2011 study commission, the 2012 Legislature created a cash balance plan for members that begin employment on or after January 1, 2015. Differing from KPERS Tier 1 and 2 plan design, the KPERS Tier 3 plan is based on the member's contributions and earning retirement credits from the employer, which are tracked throughout the member's career. Interest is applied to the two accounts, and the benefit is based on the total account balance at retirement and has nothing to do with the number of years worked or finalized average salary.

The two components of interest credited under the cash balance plan are the guaranteed portion and the dividend. The guaranteed interest credit rate on the member and employer accounts is 4.0 percent, and the discretionary dividend credit is a dividend design (KSA 74-49,306) equal to 75.0 percent of the five-year average net compound rate of return above 6.0 percent, as determined by the Board for the calendar year and the four preceding years. [Note: Since 2015, the Tier 3 plan serves as the primary retirement plan for new KPERS members. Some employees in corrections positions continue to be enrolled in KPERS Tier 2.]

The Planning and Research Officer noted CY 2023 was the eighth year of the KPERS Tier 3 plan. The dividend is reviewed by the Board each March, and over the first eight years of KPERS Tier 3, the formulaic interest dividend credit has applied four times. Increases occurred in CYs 2017 (1.1 percent), 2019 (0.825 percent), 2020 (2.475 percent), and 2021 (3.525 percent).

Adequacy from Stakeholders

A representative from the Kansas National Education Association (KNEA) characterized KPERS Tier 3 benefits as "tremendously inadequate," particularly with regard to income

replacement ratios and COLAs. The representative indicated the current benefit structure hampers teacher recruitment and retention and is in need of reform. Accordingly, the representative requested hearings and action on KPERS Tier 3 reform and COLAs.

A representative from the Kansas Association of Chiefs of Police, Kansas Sheriffs Association, and Kansas Peace Officers Association highlighted critical shortages in recruiting and retaining dispatchers and jailers, particularly due to low pay and inadequate benefits. Comparing benefits across KPERS plans, the representative requested an end to KPERS Tier 3 in its current form, preferably with a return to KPERS Tier 2.

A representative from the Riley County Clerk's Office shared accounts from two retirees, describing their experiences with KPERS retirement benefits. The representative also indicated they do not use KPERS Tier 3 as a recruitment and retention tool when engaging with employees, partly due to the difficulty of understanding and educating on the plan.

Review of Alternatives

The Executive Director of KPERS provided a comparison of general plan design components in defined benefit, defined contribution, and cash balance plans. In particular, he indicated the KPERS Tier 3 cash balance plan design has three components that can be adjusted to enhance benefits: increasing interest crediting, increasing employer credits, and increasing annuity rates.

Additionally, the Executive Director noted two pending bills that could serve as potential alternatives to the current KPERS Tier 3 plan.

SB 230 would create a defined contribution plan modeled on the federal Thrift Savings Plan for all new KPERS-eligible employees on July 1, 2025. Existing members would have the option to switch from their current plan into the new defined contribution plan. Key features of the plan would include:

- Mandatory 6.0 percent employee contribution;

- Optional employee contributions ranging from 1.0 to 10.0 percent;
- Base employer contributions of 4.0 percent;
- Additional employer contributions of 0.5 or 1.0 percent if the employee is making optional contributions;
- Additional employer contributions to the UAL of existing plans;
- Ability to withdraw or roll over contribution accounts and interest after termination or retirement;
- Annuity options from an insurer at retirement, as an alternative to 100.0 percent lump sum distributions; and
- The opportunity to elect into the Thrift Savings Plan, if allowed by the Internal Revenue Service.

HB 2365 would close the KPERS Tier 3 cash balance plan. New members after July 1, 2024 would be enrolled in KPERS Tier 2 and existing active KPERS Tier 3 members would be converted to KPERS Tier 2 by January 1, 2024.

CONCLUSIONS AND RECOMMENDATIONS

The Committee submits the following comments and recommendations:

- **Joint Select Committee.** The Committee recommends that legislative leadership establish a joint Select Committee to evaluate KPERS Tier 3 and whether it is adequately meeting the needs of employees and employers;
- **Alternative Investment Cap Removal.** The Committee recommends passage of legislation to address the present alternative investment cap on the KPERS Trust Fund and the delegation of authority on the Board to establish a cap. The

Committee also recommends the bill be effective upon its publication in the *Kansas Register*;

- **Working After Retirement.** The Committee recommends the appropriate standing Committees review working after retirement rules, including the statutory prescribed waiting lists, the employer contribution rates and the compensation threshold specified, and the current minimums prescribed for covered employees (school and non-school employers);

- **Cost-of-Living Adjustments.** The Committee recommends the appropriate standing Committees review COLAs, including input from stakeholders and the fiscal impact of implementing a COLA; and
- **Extraordinary KPERS Payment.** The Committee recommends appropriations committees review using some of the projected SGF surplus ending balance to make additional contributions toward the reduction of KPERS UAL.