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Pension Rationale for Public Employees

It should be noted that the oft stated reason for public pensions was to help recruit talented employees to the public sector when they would be presented greater income possibilities in the private sector. Once employed, the second component of this rationale was to retain these talented and now experienced employees in the public sector. This original reasoning becomes extremely pertinent in light of the present teacher shortage and the fact that the shortage is caused by the small pool of potential employees not because of increased numbers leaving the profession. It has become more and more evident that potential public servants are indeed investigating retirement options when choosing the location of their employment.

The Challenge of Retirement

One of the national sources on retirement information is an organization known as National Institute on Retirement Security. (www.nirsonline.org) NIRS researches pension facts and issues on all pensions (public & private) and retirement issues. One of their latest is a state by state retirement report called the "Financial Security Scoreboard." There is a nationwide concern regarding the future of retirement in all states. With the encouragement for the creation of small businesses, fewer and fewer employees have retirement support through their company, and subsequently the average amount saved for retirement is more in line with what one should have saved at 30 years of age than a retirement total. If this trend continues the retirement burden will be shifted to the state(s) and will become a "you can pay me later situation". The reduced number of pensions and reduced investment will lead to the need for more public support when people retire because they won't have their own funds. Twenty five of the 50 states (and the Federal Government) have been discussing this potentially. Five of the states have passed legislation to have some requirements set up for business owners. (Kansas is not one of the 5 or 25.)

"On March 12, 2015, the National Institute on Retirement Security released new research which calculates that the U.S. retirement savings crisis continues to worsen, and that the typical working household still has virtually no retirement savings. When all households are included--not just households with retirement accounts--the median retirement account balance is $2,500. The median retirement account balance had declined from $3,000 for all working-age households as reported in a previous 2013 report."

"For near-retirement households, the new analysis finds that the median retirement account balance is $14,500. Also, some 62% of working households age 55-64 have retirement savings less than one times their annual income, which is far below what Americans need to be self-sufficient in retirement."

"Even after counting households' entire net worth--a generous measure of retirement savings--two thirds (66 percent) of working families fall short of conservative retirement savings targets for their age and income is based on working until age 67. <u>Due to a long-term trend toward income and wealth inequity that only worsened during the recent economic recovery, a large majority of the bottom half of working households **cannot meet (afford)** even a substantially reduced saving target."</u>

The Purpose of KCPR

The sole purpose of the origin, some thirteen years ago for the formation of KCPR, has always been the achievement of a COLA for KPERS Benefit recipients. It could be argued that the same goals that were set out originally have been at least mildly achieved. In 2007 and 2008 the legislature granted KPERS recipients a $300 bonus and prior to the Brownback election there was a so called Tier II plan which provided a 2% COLA for 'New Hires'. This achievement was lost in the 2012 legislation following the KPERS Commission which was convened in 2011 by Governor Brownback. Please note that as part of Tier II the employee contribution was raised over time from 4% to 6%. When the COLA was taken away, the increased contribution was not! Counting the1987 legislation (effective in 1988); there have been 17 COLA raises. Since that time, there have been no benefit increases. Further, in excess of 82% of the present KPERS recipients have received **no** COLA increase.

The KPERS Commission

Following the KPERS Commission of 2011, legislation was enacted in 2012, which closed KPERS as it was previously constituted for 'New Hires'. With the exception of the Judges and the Police and Fire and the correction officers, the rest of KPERS was put under a "Cash Balance Retirement Plan." (I should be noted that they all lost the COLA they had been granted.) KPERS, KPERS School and the legislature were put under the "Cash Balance Plan." The 'New Hires' in these groups are subject to the new system which basically requires a 50% increase in contribution with an anticipated benefit at retirement of approximately 50% less.

The KPERS Commission was assembled because of the growing UAL, the 2008 economic downturn and a rising movement among conservatives to do away with public pensions. We were informed by a prominent Kansas Senator, "We (the State) need to get out of the pension business." As you will learn, getting out of the pension business is not legally possible.

1. The movement against all pensions, public and private, was apparently fostered to lower taxes and/or pension contributions. It was also apparent that private companies and legislators were having a great deal of problem resisting the temptation to get their hands on pension money. In order to fund a pension system over time, a huge amount of money must be accumulated to pay the benefits.
2. This accumulation in public pensions includes employee contributions, employer contributions and investment income. [Pension plans are designed so that approximately 60% of the balances in these pension trust funds are from investment income.]
3. The large financial institutions have also been hoping to get their hands on this money as well. It is considered in pension circles that a defined benefit pension system, such as KPERS, is traditionally about a 50% cheaper way to accumulate retirement funds than a defined contribution (401k) type of retirement plan.
4. Those who have followed the KPERS story have witnessed attempts to move to a DC (Defined Contribution - 401k type) pension plan. Over the last 20 years there have been three credible attempts. There were numerous 'suits' (as we called them) representing various financial companies in attendance at the related committee meetings. Once it became obvious to all that changing to a DC (defined contribution) was extremely more expensive than the existing plans and the legislature lost interest in changing to a DC pension , the 'suits' disappeared.
5. One of the companies who had been totally opposed to doing anything that would increase the UAL and later testified in behalf of a DC told me (while looking at the floor), that the change was a "business decision" because the company leaders feared that if they didn't testify in favor of the DC and a DC plan passed, they would be punished by not receiving any of the potential investment opportunities. [At this time the possibility of investing approximately $15 Billion was the bait! Today, the net asset value of the KPERS Trust Fund hovers around $20 Billion.]

Some interesting findings came out of the KPERS Commission! (Note that these legal opinions were offered by Koch Brother Attorneys.)

1. Those members currently receiving retirement benefits would/will have to be paid as presently defined.
2. Anyone who is presently vested would, at the time of retirement, most likely have to be paid! Only very extenuating circumstances would prevent this!
3. The system for the 'new hires' would not need to be covered under the old system. It was, however, designed in such a way that the funds would not need to be held in individual accounts.

Why Defined Contribution (DC) has been rejected

One of the main reasons that a defined contribution plan or some other extreme variance, such as privatization, has not been seriously pursued is that any drastic change which would require the closing of the present system, and moving to individual accounts, would greatly increase the cost of the pensions system and/or require the UAL be paid off in an extremely accelerated rate. The amount of money invested in the individual accounts could no longer be invested as a whole. Some other reasons that further change has not occurred is resistance from the KPERS members and the IRS requirements placed on any pension or retirement, public, private, or individual. The concern regarding this final reason can't be in any way minimized!! There also looms, while not totally litigated, the question/s surrounding the application of contract law.

KPERS Underfunding

The underfunding of KPERS by the legislature is in its 24th year. The failure to properly fund the KPERS Retirement System has led to concern over the size of the Unfunded Actuarial Liability (UAL). According to the KPERS Actuary, <u>the following levels would be present if KPERS had been adequately funded:</u>

   a. KPERS would be funded at the ratio of 80% rather than 65%;
   b. The unfunded actuarial liability would be \$3.6 Billion instead of the present \$6.3 Billion;
   c. The employer contribution would be at 7.95% rather than 13.23%.

1. Because of the UAL, the legislature was required to issue two bond issues, one in 2004 for \$440 Million and one in 2015 for \$1 Billion, just to achieve the present funded level of 65%.
2. KPERS originated in 1962 and merged with the Kansas Teacher's Retirement System in 1971. (The statutes require that any organization joining KPERS must be fully funded. The legislature made the decision to join the two programs, and subsequently contributed an additional \$10 Million a year to fully fund the Kansas Teacher's Retirement System portion of KPERS from 1971-1982, at which time they stopped the "enhanced" contribution.) <u>(This action has led to our comments that KPERS School has been underfunded two times in the past and now another underfunding is about to begin?)</u>
3. The result of the KPERS Commission in 2011 was legislation which created the "Cash Balance" retirement plan known as Tier III. **A statutory Contribution rate for paying off the UAL was also established by 2012 legislation.** This Legislation established a 'pay off' strategy. A scheduled rate of payment was established and enacted. Again, this was a scheduled payment, not the actuarial required amount! **Therefore, the present plan of funding KPERS is actually underfunding the underfunded plan!**
   A. As a partial example, between the years 2007-2011, KPERS was underfunded a total amount of \$774 Million.
   B. Following the 2012 legislative plan to "fix" KPERS (2012-2019), the underfunding has/is planned to continue in the amount of \$837 Million.
   C. Therefore, just from 2007-2019 an additional \$1.6 Billion is planned to be underfunded.
   D. **The Unfunded Actuarial Liability (UAL), following the 2012 legislation, was scheduled to be amortized in 2033. There are rumblings that the amount should be amortized until 2043 (Ten more years.) This action alone would increase the UAL an additional \$4.9 Billion.**

E. **The present UAL stands at $9.06 Billion.**

The Future of KPERS

First please note - The legislation that was implemented to establish Tier III also closed Tier II to new members (except for correction officers) and modified its benefits for those who were already in Tier II. Tier II had established a 2% COLA (At Retirement) for 'New Hires' who were hired while Tier II was in effect. The legislation referred to above, which established Tier III, also eliminated Tier II, except in the case of the correction officers. They were allowed to stay in Tier II, but they no longer have a COLA.

Under Tier III, as of January 1, 2015, all KPERS employees, with the exception of KP&F, Judges, and Correction Officers, are now enrolled in the Cash Balance system upon their hiring. (The only group that has a choice in whether or not to become a KPERS member are the legislators, statewide elected officials, and some staff members of elected officials.) The retirement age is the same as KPERS II members (those who joined between July 2009 and January 2015), which is age 55 with 10 years of service for early (reduced) retirement, 60 years of age with 30 years of service or 65 years of age with 5 years of service.

Under the Tier I KPERS Pension Plan, the calculated annual retirement benefit for a 30-year employee is between 52.5 and 55.5% of the employee's final average salary (depending on the number of years of service before and after January 1, 2014). When the Tier III plan was first implemented, the estimated retirement benefit changed from an absolute calculated benefit amount based on a formula, to annuitization of account balances at retirement. Benefit estimates based on expected interest credits vs the minimum guaranteed interest credits, were initially 43% and 34% of the employee's final average salary. The following year the legislature adjusted some of the inner workings of the plan and the percentages fell to an estimated 40% to 28%. The actuary has informed KPERS that since the estimated investment return has been reduced from 8% to 7.75%, that the next estimated benefit will be reduced even farther.

Under Sam Brownback

When then Governor Brownback's guided tax cuts were enacted, State revenues were greatly reduced. Federal mandated funding requirements to the State must be paid. The 'Decessionary Funding', for a lack of a better term, part of the budget the State legislature has direct control over, is greatly limited. School funding, [K-12, and higher education], highway funds and KPERS Contributions become very vulnerable to reduction. It should be pointed out that those who favor tax cuts and reduced spending never really point out where the overspending is or what should be cut except in very general terms. The legislators who want the cuts, reduced revenue requires, don't want to be responsible for saying what should be cut.

In an attempt to balance the budget, the governor repeatedly took aim at the KPERS contribution, particularly since the Billion Dollar bond issue referenced above. The bond issues, particularly the second one, were controversial as far as the state was concerned, but not so to the KPERS Trust Fund. The contribution was needed. *It should be noted that the cost of the Billion Dollar bond issue was 4.7%. [The bond cost is paid by the General Fund,* ***not*** *from the KPERS Trust Fund.] Sadly, if Governor Brownback had not played politics with the bond issue and it had been enacted a year earlier, the bonds could have been purchased at approximately a 2% rate.*

The contribution of a billion dollars was then used, a year after its enactment, as an excuse to begin the underfunding once again. (Note #4 on the previous page.)

As of May 2018, the calculations on the bond issues are as follows: The first bond issue netted KPERS $440 Million. To the investment income on <u>those</u> bonds are $280 Million. On the second, $1 Billion the net investment income is $94 Million.