February 13, 2013, House Financial Institutions and Pensions, HB 2197

Testimony of Jarold W Boettcher, Manhattan, KS, former KPERS Trustee, 1991 to 2008.

KPERS was created in 1961 with the consolidation of administrative for public employees, teachers, and the judiciary into the Public Retirement System for the State of Kansas, the origins of which were included in the Constitution of the State of Kansas in 1863

Serious engagement of the Legislature began in the 1960's when the Teachers and State and Local Government combined. The funds are still are separate but are merged for reporting purposes.

The first significant controversy was created in the late 1980's, early 1990's with direction from the Legislature to invest $400 million in Private Equity Investments, exclusively in the State of Kansas. At the time, this figure would have been in the range of 5 to 10% of assets. The goal of the State may have been constructive but was put together haphazardly with little research and with little recognition of the fiduciary responsibility of the Fund's Trustees.

The commitment of significant investments to be made in Kansas, in existing and in start-up companies is labeled as private equity. Announcement of the intent to invest funds directly was widely publicized and attracted a number of what proved to be unreliable partners, law firms, accounting firms, and some who claimed to be Investment people. The result? There were many lawsuits.

Good Intentions were present but with the result being – a disaster. About $200+ million was lost.

We should remember the larger national financial disaster in the mid to late 1980's, involving many Savings and Loans institutions and their lending practices. Changes in federal law permitted S&L's to become more like banks but without needed regulatory oversight, enabled many such institutions to become more aggressive. Many investments were made in Kansas – some were legitimate. some were not. The most famous and largest failure was Home Savings & Loan, based in KC, took bankruptcy and KPERS suffered a large loss.

Disclosure of these investments and their failure led to public outcry to investigate KPERS. How could this happen?

This all happened in 1990-1991. I became a Trustee in 1991, initially appointed by Governor Joan Finney. I served as a Trustee through the beginning of 2008, including 5 years as Chairperson of the Board and over 5 years as Chair of the Investment Committee. I was appointed as a Trustee by 4 different Governors, 2 Republicans and 2 Democrats.

Governor Finney appointed herself as a Trustee and served for about a year. Attorneys were hired. Investigations initiated and continued for 4 or 5 years and most, eventually, were settled for sums far less than the damages incurred. Other lawsuits were abandoned, after assessment of prospects for recovery. I have served in numerous capacities as a volunteer for different organizations, as Chair of investment committees, etc. An early revelation to me in 1991 was that KPERS did not have a chief investment officer. Why? I do not know. All supervision and oversight were done by a 3rd party consultant and internal accounting staff. I was appointed as Chair of Investment Committee. A search process for a CIO lead to the hiring of Elizabeth Miller, as CIO in 1992. She served for 7 or 8 years and went back to school to get her PhD. KPERS went through 3 other CIO's but Elizabeth came back a few years ago and serves today.

The staff at KPERS is both experienced and professional. The Actuary used by the system has been in that capacity for over 20 years and very much up to the duties and responsibilities of that position. A 3-year review cycle is used with a new analysis to be done in 2019.

An example of notable benefits legislation, with minimal consideration of cost, is the Rule of '85, which was passed in the 1993 to 94 period, the first evidence of exploitation of KPERS assets in a program which has never been funded. Increasing benefits at no current cost was very attractive to many legislators. One member of the Legislature appeared at a meeting of Trustees and told us "We got it done." We (the Legislature) passed Rule of 85, where with a total of age and years of service adding to 85, could retire with full benefits. The Legislator told the Trustees "there is more good news - we didn't pay for it". He was very proud.

Funding battles started in the late 1990's and continue today. A formal analysis is done every 3 years by the Funds' Actuary – this will be done in 2019. Also, it is evidence that the Fiduciaries of the plan are increasingly concerned over developing trends to delay some progress which has been achieved and again defer payment of current bills to the future. Several current Trustees have expressed their concerns as well.

Recognition has increased of the need to close the funding gap between assets and liabilities through increased contributions. Debt has been incurred to both increase funding and defer payment. As compared to the Teachers, the City and State portion of the fund is better funded, even if still below 80%, a figure which has become widely used as being a measure of adequate funding. The teachers' retirement plan is more underfunded, which reflects more payroll flexibility at Cities, Counties, and the State itself which is not present in the School System – which is funded entirely by the State. Does controversy over funding of the schools sound familiar? I think so.

Attempts have been made to restore funding for decisions to sweep funds destined for KPERS over the years. The State was on a path to reach 80% funded ratio by 2033-2034. In order to save money and spend it elsewhere, the amortization period would extend to the late 2040's with increased cash outlays of over $7 Billion. The current plan would again effectively use what should have been and was scheduled to be, KPERS money, financed by incurring new debt and again, the deferral of a today's problem to some 20 or 30 years down the road. The proposed plan obligates future legislators with these issues. Another example of short-term decision making is the use of Kansas Highway funds to balance the state budget. Future taxpayers will also pay for that action, the same as for KPERS funding 25 to 30 years out. Today, KPERS is still on a schedule to be 80% funded by 2025-2026, but with this bill, that year would become funded in 2035, at an additional cost of $7.4 Billion, paid for in the out years.

Do not put it off funding decisions for two more decades. The problem only becomes larger and ever more difficult to resolve, requiring more trade-offs to get through another more budget session. It is disturbing that we continue to put off important decisions which affect future generations. Passage of Legislation to, once again, defer a partial resolution to a problem is all too familiar and requires increased focus, debate, and discipline, which are clearly lacking today. Attitudes and opinions need to change regarding decisions on current and future KPERS funding.