MEMORANDUM

To: House Insurance and Pensions

A.D.C.

From: Alan D. Conroy, Executive Director

Date: February 15, 2021

Subject: HB 2044; School employee contributions

HB 2044, as it pertains to KPERS, increases the employee contribution rate for employees of public school districts from 6% of compensation to 7.15% of compensation.

HB 2044 also appropriates $41.0 million to the Department of Education to fund a wage increase for public school district employees, which would impact KPERS covered payroll and future benefits affected members. However, KPERS has no role in employee payroll adjustments.

Current Law

All KPERS State/School members are required to contribute 6% of compensation. This is the required contribution rate regardless of the member's coverage group (KPERS 1, KPERS 2 or KPERS 3). The 6.0% rate is set statutorily in K.S.A. 74-4919.

Employer contribution rates were last changed by the 2012 Legislature. At the time, KPERS 1 members (membership dates prior to July 1, 2009) contributed 4% of compensation. KPERS 1 members were moved to a 6% contribution rate over two years, increasing 1% in CY 2014 and 1% in CY 2015. In conjunction with the increase in employee contributions, the statutory multiplier for KPERS 1 retirement benefit calculations was increased from 1.75% to 1.85%.

KPERS 2 members (membership dates between July 1, 2009 and January 1, 2015) and KPERS 3 members (membership dates on and after January 1, 2015) have always contributed 6% of compensation.

There are currently 286 school districts and 25 educational co-ops that we believe would be subject to the new employee contribution rate. In the last actuarial valuation, there were about 79,000 active members at these 311 employers. This represents about 75% of the 105,000 total active members in the KPERS State/School group.

Legal Considerations

There are no Internal Revenue Service rules that prohibit changes to employee contributions in governmental retirement plans like KPERS. However, there are two legal considerations to keep in mind when discussing contribution rate changes.

First is the contractual relationship between an employee and employer. The Contract Clause in the United State Constitution prohibits states from making laws impairing the obligation of contracts. This is commonly used to challenge state and local public pension changes. Courts have consistently found that vested pension benefits are protected by the Contract Clause.

KPERS

Second is a Kansas court case, *Singer v. City of Topeka*. In this decision, the Kansas Supreme Court found that member contributions cannot be increased without an "offsetting benefit."

Unfortunately, there is no definition of "offsetting benefit" in the Court's decision so it is not possible to give examples of what an offsetting benefit might be, or whether an increase in employee compensation would qualify as an offsetting benefit. However, there should be some balance between the changes.

Actuarial Impact
Each year, an actuarial valuation is completed to calculate the total contribution rate needed to fund the System on an actuarial basis. The total contribution takes into account both employee and employer contributions.

In a traditional defined benefit plan, like KPERS 1 and KPERS 2, employee and employer contributions are combined to pay the annual cost of future benefits and unfunded actuarial liability:

	Current Law
Employee Contribution	6.0%
Employer Contribution	14.09%
Total Required FY 2022 Contribution	20.09%

If the employee contribution rate increases, as it would under HB 2044, the employer contribution rate would have a corresponding decrease.

However, since January 1, 2015, new KPERS members have been enrolled in the KPERS 3 cash balance plan. In the latest valuation, more than 34,500 KPERS School members were in KPERS 3, which is about 39% of the total active KPERS School membership.

In a cash balance plan members have notional accounts that reflect the balance of employee contributions and employer pay credits. At retirement, a member's lifetime benefit is based on the account balance in their notional accounts. If a KPERS 3 member has their employee contribution increased, those contributions are credited to the member's notional accounts. Higher employee contributions will increase the cash balance account value at retirement, resulting in a higher benefit.

A higher retirement benefit increases the annual normal cost, which is the amount needed each year to fund future benefits. However, the increase in the normal cost rate due HB 2044 is less than the increase in the 1.15% employee contribution rate increase. The net impact of HB 2044 is a lower employer contribution rate.

If HB 2044 is enacted the FY 2022 State/School employer contribution rate would be recertified to from 14.09% (certified in the 12/31/2018 actuarial valuation) to 13.25%. With the FY 2022 State/School payroll projected to be $4.9 billion, the 0.84% reduction in the employer contribution rate would result in lower employer contributions of about $41.6 million from all funds in FY 2022. The employer contribution rates are projected to remain lower through the end of the amortization period of the legacy unfunded actuarial liability in FY 2035.

Administrative Impact
HB 2044 would require minor changes to KPERS' information technology system, updates to member and employer publications, and educational efforts for both members and employers. However, these changes can be completed within existing resources.

I would be pleased to respond to any questions the Committee has regarding HB 2044.