

Joint Committee on Pensions, Investments, and Benefits

KPERS LONG-TERM FUNDING STUDY ASSIGNED BY LCC

CONCLUSIONS AND RECOMMENDATIONS

The following contains the recommendations of the Joint Committee on Pensions, Investments, and Benefits. (See Note regarding a subsequent meeting January 7, 2004.)

- ! The Committee recommends favorably to the State Finance Council the issuance of \$500 million in pension obligation bonds authorized by Section 16 of Chapter 155, 2003 *Session Laws of Kansas*. This recommendation fulfills the provision of Section 16(f) of Chapter 155 that “No bonds shall be issued pursuant to this section prior to the review and recommendation to the State Finance Council of such issuance by the Joint Committee on Pensions, Investments and Benefits.”
- ! The Committee recommends the following items be included in a bill to be introduced for consideration by the 2004 Legislature:
 - " Changing the actuarial cost method for all three plans—regular KPERS, KP&F, and Judges;
 - " Modifying the asset smoothing method;
 - " Reamortizing the unfunded actuarial liability if and when deemed prudent by the KPERS Board of Trustee;
 - " Modifying the statutory contribution caps for local employers; and
 - " Separating the state and school group into two groups for actuarial purposes in calculating individual contribution rates for the state group and for the school group.
- ! Regarding a long-range funding plan, the Committee regrets that a comprehensive package was not developed during the 2003 interim. The Committee believes that HB 2014 from the 2003 Session was one step in solving the KPERS long-term funding issue. Additional steps must be taken, including the disposition of recommendations regarding issuance of \$500 million in bonds and introduction of a new bill modifying actuarial methods and KPERS groups. Depending upon the disposition of these two recommendations, further steps will be required in developing a comprehensive plan during the 2004 interim.

Proposed Legislation: The Committee recommends one bill on this topic.

BACKGROUND

For the 2003 Interim, the Legislative Coordinating Council (LCC) assigned one study topic: to develop a long-range comprehensive funding plan to address the unfunded liability of the Kansas Public Employees Retirement System (KPERS). The study would include incorporation of the latest KPERS actuarial projections, an evaluation of how the increased employer's contributions and the potential issuance of pension obligation bonds (both authorized by the 2003 Legislature) and any changes in non-financing elements, such as a change in actuarial methodology, would affect the KPERS unfunded liability.

KPERS provides retirement, disability, and survivor benefits to more than 240,000 members and includes 1,450 participating employers. According to the most recent actuarial valuations, KPERS is not in actuarial balance, creating long-term funding concerns. In August of 2003, KPERS presented a report titled "Long-Term Retirement Funding Plan" which was intended to help develop an understanding of the problem and possible solutions. A "Long-Term Retirement Funding Plan: A Progress Report" was presented in October of 2003 in order to explain technical aspects of the long-term funding situation and more detailed options for addressing the issue.

According to the KPERS actuary, the areas for review should include:

- ! Changing the actuarial cost method;
- ! Modifying the asset smoothing method;
- ! Reamortizing the unfunded actuarial liability, including the reset date, amortization method and period; and
- ! Modifying the statutory caps, especially for local employers since no change has been made.

COMMITTEE ACTIVITIES

Recent Legislation and Actuarial Projections of Fiscal Impact. KPERS staff and the KPERS actuarial consultant provided long-term funding projections for the state and school group in order to estimate the fiscal impact of 2003 legislation enacted last session, plus other alternative options with financial and non-financing elements. The projections were included in a report of "Long-Term Retirement Funding Plan: A Progress Report."

Projections were based on a number of assumptions and are intended to portray long-term trends. It was noted that the most significant variable in the projections is investment performance, which tends to be volatile and not a constant amount. However, the model incorporates an assumed rate of return equal to 8.0 percent each year, and as actual investment returns vary from the constant rate, the variance has a significant impact on the model's projections. For the projections provided in reviewing fiscal impacts, it was assumed that the first year's earnings were 12.0 percent, based on the rate of returns this year (and not the 8.0 percent assumed rate that is used in subsequent years).

Legal Rights of Employees. Revisor of Statutes staff provided a legal briefing on the contractual rights of KPERS members. It was explained that the Kansas Supreme Court has found that the relationship of KPERS to its members falls under the contractual guarantees of the *U.S. Constitution*, thus limiting unilateral modification in the agreement to "reasonable changes" to maintain the integrity of the system. It also was noted that any such changes which result in disadvantages to employees must be accompanied by offsetting or counterbalancing advantages. Noting the paucity of case law on the subject, the briefing concluded that:

- ! There is a contract for pensions between the State and its employees which

creates rights protected from unilateral modification under the *U.S. Constitution*.

- ! Reasonable modification is allowed based on Supreme Court decision;
- ! Reasonable modification may be made if resulting disadvantages to employees are counterbalanced by offsetting advantages;
- ! Case law clearly states that the State cannot increase employee contributions without providing offsetting benefits;
- ! To justify an increase in employee contributions to bolster the financial future of the plan, there must be evidence that the employer cannot meet its obligations in the future and the employees' pensions are in jeopardy; and
- ! The employer may provide a new system for new employees and may provide options for existing employees to keep what they have or opt into new provisions.

KPERS State and School Group

In this section, the focus is on the state and school group of KPERS. A later section addresses the local group of KPERS.

Option A—Current Enhanced Contribution Rates. The 2003 Legislature in HB 2014 authorized that the statutory cap on the employer contributions for the KPERS state and school group will increase from 0.2 percent to 0.4 percent in FY 2006, to 0.5 percent in FY 2007, and to 0.6 percent in FY 2008 and subsequent fiscal years. The projected employer contributions from FY 2004 to FY 2033 would total \$13.3 billion without the statutory cap increase, and the higher caps will yield almost an additional \$9.3 billion, according to KPERS projections. Revenues totaling \$22.6 billion would be generated for long-term funding of the KPERS state and school group. Under this projection (Option A), the KPERS state and school group would have an unfunded actuarial liability of \$802 million in FY 2033, with a funded ratio of 96 percent. Contribution rates would rise to 18.44 percent in FY 2030, then decline until 2033.

Projected Fiscal Impact of HB 2014 on State Employer Contributions (Option A): FY 2004 to FY 2033 for State and School Group (In Billions)

<u>Pre-HB2014 Contributions</u>	<u>Additional Contributions Authorized by HB 2014</u>	<u>Total Contributions</u>
\$13.338 B	\$9.271 B	\$22.609 B

A series of policy options are available to help shape a core set of variables that might comprise a long-term plan in order to augment the enhanced employer contributions authorized in the 2003 legislation. The first component—bonding—was authorized by that legislation.

Pension Obligation Bonds. The 2003 Legislature authorized in HB 2014 the issuance of up to \$500 million in pension obligation bonds. The projected impact of infusing \$500 million in bond money into KPERS for investment could be improved by paying principal and interest from non-KPERS funds rather than paying principal

and interest from KPERS funds (including contribution increases). The 2003 legislation did not direct which source of money (KPERS or non-KPERS) should be used to make the bond payments. This policy decision would require adding an average of \$39 million annually if payments were made from non-KPERS money rather than KPERS money. The benefits would be realized in the latter part of the 30-year period and in the subsequent years after FY 2033.

Possible Actuarial Changes. A consideration of non-financing elements, such as actuarial changes, also were incorporated into KPERS projections. Some statutory changes would be required to implement these possible actuarial changes. All three of the following changes were recommended by the KPERS actuary and approved by the KPERS Board of Trustees for legislative consideration. These actuarial changes include modification of the actuarial cost methods, of the asset valuation method, and of the amortization period for the unfunded actuarial liability. The Board has

recommended authorization be granted to change the actuarial cost methods to the entry age normal method for all plans; to change the asset valuation method from a three-year to five-year asset valuation method for all plans; and to plan for reamortization of the KPERS state and school group's unfunded actuarial liability at some date in the future, depending upon a review of the actual conditions in selecting the optimal date for the change.

Actuarial Cost Method. By changing all plans (KPERS, KP&F and Judges) to the entry age normal (EAN) method, actuarial valuations will become more comparable and there is no material impact on long-term funding for the other plans. Currently, each plan uses a different method that makes comparisons among the KPERS, KP& F and Judges plans less meaningful. For the KPERS state and school group, changing to the EAN method would have an immediate impact on funding projections that could be estimated for December 31, 2003.

Fiscal Impact of Modifying Actuarial Cost Method on State Contributions

State and School Group	Old Method	New Method
Unfunded Actuarial Liability (UAL)	\$2.7 B	\$3.6 B
Funded Ratio	71%	66%
Employer Normal Cost Rate	5.28%	3.71%
Employer UAL Cost Rate	4.77%	6.19%
Total Employer Rate	10.05%	9.90%

A change in actuarial cost method will require legislation for KPERS, including the state, school and local groups. The Board has statutory authority to change methods for the Judges and KP&F plans which the KPERS actuary also recommends in making consistent methods apply to all KPERS plans.

Asset Valuation Method. By changing the asset valuation method to spreading gains and losses evenly over a five-year

period, there is no material impact on long-term funding. The current method calculates the expected value using the 8.0 percent assumed rate of return, then adds one-third of the difference between actual market and expected values. The new method would simplify calculations and be more easily understood.

The Board has statutory authority to change methods for the KPERS, Judges, and

KP&F plans, thus no legislation is required. The KPERS actuary recommends all KPERS plans use the same asset valuation method.

Amortization Period. Unfunded actuarial liabilities (UAL) are amortized over a forty-year period from June 30, 1993, for all three KPERS plans. A thirty-year maximum amortization period was incorporated into a new rule by the Governmental Accounting Standards Board in 1996. Reamortization does not reduce ultimate costs, but it does extend the time period and tends to level out payments to make annual contributions more affordable. However, total costs are increased with reamortization by extending payments over a longer time period. The KPERS actuary recommends that reamortization for the state and school group be undertaken at the appropriate time, probably about FY 2015. All three KPERS plans should conform to the same amortization period.

The KPERS actuary's recommendation, as adopted by the Board of Trustees, states: "Given the magnitude of KPERS' funding shortfall and the benefits of potential reamortization, it merits additional consideration as part of the long-term funding plan for the state and school group.

There are various options for length of period and fixed versus rolling amortization period. The optimal reamortization date will vary depending on the funding alternative selected; there is not one optimal date."

Legislation will be required to change the statutory amortization period which is currently set at 40 years for all three plans.

Option B—Recommended Actuarial Changes. The fiscal impact of making all three actuarial changes (Option B) was modeled, based on the assumptions that the UAL is reamortized in FY 2015 to a fixed period of 30 years, with a floor of 10 years; the asset valuation method is changed to five-year averaging; the actuarial cost method is changed to entry age normal; investment returns are 12 percent for calendar year 2003; and investment returns average 8.0 percent after 2003.

The projected state employer payments from FY 2004 to FY 2033 would total \$13.3 billion without the statutory cap increase, and the higher caps will yield almost an additional \$5.2 billion, according to KPERS projections. Revenues totaling \$18.5 billion would be generated for long-term funding of the KPERS state and school group.

**Projected Fiscal Impact of HB 2014
on State Employer Contributions
(Option B): FY 2004 to FY 2033 for State
and School Group (In Billions)**

<u>Pre-HB2014 Contributions</u>	<u>Additional Contributions Authorized by HB 2014</u>	<u>Total Contributions</u>
\$13.338 B	\$5.193 B	\$18.531 B

Under this projection (Option B), the KPERS state and school group would have an unfunded actuarial liability of \$7.4 billion in FY 2033, with a funded ratio of 69 percent. Contribution rates would rise to 12.91

percent in FY 2024, then gradually decline by 2033 to 12.65 percent. Option B would cost approximately \$4.1 billion less than Option A by making the actuarially recommended changes.

**Projected Fiscal Impact of HB 2014
on State Employer Contributions (Option A)
and on State Employer Contributions After
Reamortization (Option B): FY 2004 to FY 2033**

State and School Group	Option A	Option B
Equilibrium (Contribution) Rate	18.31%	12.67%
UAL FY 2033	\$802 M	\$7,409 M
Funded Ratio FY 2033	96%	69%
State Payments	\$22,610 M	\$18,531 M

Option B reduces state payments by almost \$4.1 billion over the 30-year period when compared with Option A. The period for amortization is extended beyond FY 2033, however. There will be additional costs not reflected in these comparisons. The savings should be viewed as short-term savings because the total cost to the state will be higher, assuming all assumptions are met, since payments are extended beyond FY 2033. The KPERS actuary points out that this method tends to flatten out contribution rates earlier and make employer payments more affordable. Nearly all retirement plans reamortize, especially when the remaining amortization period becomes very short. In the case of the KPERS state and school group, the KPERS actuary recommends consideration of implementing this option at some future date.

Combining Alternatives into New Options. The options considered for the state and school group previously included:

! Option A: Current Law for Contributions, No Bonds.

! Option B: Current Law for Contributions, No Bonds, with Reamortization.

The projected impact of infusing \$500 million in bond money into KPERS for investment was considered without reamortizing and with reamortizing, as well as by repaying bonds with KPERS money and with non-KPERS money. Four alternatives were presented, two that include bonds with Option A and two that include bonds with Option B (and reamortization):

! Option J: Current Law for Contributions, with Bonds and KPERS Repayment.

! Option K: Current Law for Contributions, with Bonds and non-KPERS Repayment.

! Option H: Current Law for Contributions, with Bonds, KPERS Repayment, Reamortization.

! Option I: Current Law for Contributions, with Bonds, non-KPERS Repayment, Reamortization.

Projected Fiscal Impact of HB 2014 plus Reamortization on State Employer Contributions (Option A) and on State Employer Contributions, with Bonds (Option J & K): FY 2004 to FY 2033

<u>State and School Group</u>	<u>Option A</u>	<u>Option J</u>	<u>Option K</u>
Equilibrium Rate	18.31%	19.98%	14.76%
UAL FY 2033	\$0.8 B	\$1.2 B	\$0.6 B
State Payments	\$22.6 B	\$23.3 B	\$21.4 B

Compared with Option A, state payments would increase under Option J and a modest decrease of \$1.2 billion in state payments is noted in Option K which also produces a lower equilibrium rate. Without reamortization, none of these alternatives reduce state payments more than \$1.2 billion over the 30-year period. Contribution rate increases average \$37.9 million to \$55.8

million annually with these three alternatives.

Two other bond options, when augmented by the enhanced employer payments, include reamortization (Options H and I) and may be contrasted with Option B that relies only on increased employer payments plus reamortization.

Projected Fiscal Impact of HB 2014 plus Reamortization on State Employer Contributions (Option B) and on State Employer Contributions plus Bonds (Option H & I): FY 2004 to FY 2033

<u>State and School Group</u>	<u>Option B</u>	<u>Option H</u>	<u>Option I</u>
Equilibrium Rate	12.67%	12.65%	11.13%
UAL FY 2033	\$7.4 B	\$6.6 B	\$5.9 B
State Payments	\$18.5 B	\$18.4 B	\$17.8 B

The comparison of options indicates that each alternative has the potential to reduce the amount of state payments by \$4 billion to almost \$5 billion in the period ending with FY 2033. Reamortization causes an increase in unfunded liability by extending the period beyond FY 2033. However, it reduces the average annual increase required in state payments to between \$29.0 million and \$33.0 million annually.

contribution rate increases, employee contribution rate increases with enhanced benefits, lower benefit tiers for future employees, self-funded cost of living adjustments for future retirees, and cost of living adjustments for current retirees. None of these alternatives is addressed in this analysis in order to initially focus on the core options that may be addressed in any long-term plan. These other alternatives may be added to a core plan.

Other Alternatives. In addition, there were other alternatives that included such elements as additional employer

Summary and Conclusions for KPERS State and School Group. KPERS listed a number of factors to consider in evaluating the options: funded ratio, UAL amount, contribution rate, equilibrium date/rate,

increase in annual contributions, total contributions for multiyear period, and present value of multiyear contributions. The following table summaries some of the factors in conjunction with certain options.

**Comparison of Options for KPERS
State Employer Payments and Contributions**

<u>State and School Group</u>	<u>Option A</u>	<u>Option J</u>	<u>Option K</u>	<u>Option B</u>	<u>Option H</u>	<u>Option I</u>
Equilibrium Rate	18.31%	19.98%	14.76%	12.67%	12.65%	11.13%
UAL FY 2033	\$0.8 B	\$1.2 B	\$0.6 B	\$7.4 B	\$6.6 B	\$5.9 B
Funded Ratio FY 2033	96%	95%	98%	69%	73%	76%
FY 2033 Rate	17.71%	20.16%	13.81%	12.65%	12.47%	10.87%
Total State Payments	\$22.6 B	\$23.3 B	\$21.4 B*	\$18.5 B	\$18.4 B	\$17.8 B*
Net Difference to A	--	\$ 0.7 B	\$ (1.2) B	\$ (4.1) B	\$ (4.2) B	\$ (4.8) B
Bonds	No	Yes	Yes*	No	Yes	Yes*
Reamortize	No	No	No	Yes	Yes	Yes

*assumes non-KPERS repayment of bonds with those funds included in state payments.

First, the six options may be contrasted in terms of contributions (state payments) over the 30-year period. Option A is current law, with an estimated cost of \$22.6 billion without reamortization and without issuing any pension obligations for long-term funding. Bonds without reamortization add \$700 million to state payments (Option J), while bonds repaid with non-KPERS funds and without reamortization (Option K) produce \$1.2 billion in state contribution savings. Reamortization produces \$4.1 billion in savings for state payments without issuing bonds (Options B), and extends the time period for payments beyond 30 years. When reamortization is combined with bonds paid by KPERS funds (Option H), savings in state payments total \$4.2 billion. A combination of bonds paid with non-KPERS funds and reamortization (Option I) produces the greatest savings with \$4.8 billion less in state payments over the 30-year period.

Option I has the greatest savings potential over the 30-year period. It also minimizes the future state payments after FY 2033. The contribution rate for Option I is 10.87 percent, which is 1.6 percent less in FY 2033 than the next lowest rate of 12.47 percent for Option H. The difference in cost to the state is approximately \$102 million for one year in FY 2033. In order to implement Option I, the state would have to make bond payments for principal and interest with non-KPERS funds for 30 years. The total non-KPERS expenditures would be approximately \$1.108 billion over 30 years. Even with making the bond payments with non-KPERS funds, Option I costs less in terms of total state payments than any other option over the same 30-year period, with estimated expenditures of \$17.8 billion.

The other evaluation factors indicate Option I makes a positive contribution toward a long-term funding plan. The

funded ratio never drops below 60 percent over the 30-year period, and rises to 76 percent in FY 2033. The UAL amount rises from \$2.2 billion to slightly less than \$6.5 billion, but begins to decline after 2025. The contribution rates flatten out after reamortization in FY 2015, generally in the 11 percent range before starting to decrease in the 2030s. No other option produces lower contribution rates. The equilibrium date occurs in FY 2018, the earliest of any option. The increases in annual state payments average \$29.0 million per year for Option I, while the next lowest average is found in Option H with \$32.5 million annual increased payments. Current law (Option A) will require average annual increased state payments of \$48.4 million.

Options B and H each produce more than \$4 billion in potential state contribution savings over the 30-year period. The difference in savings added by bonds is \$88 million for Option H. The average annual increase in state payments in Option H with bonds is \$32.5 million, while the average increased amount for Option B is \$33.0 million. Option H improves the long-term funding for KPERS state/school more than Option B when evaluated by the funded ratio, UAL amount, FY 2033 contribution

rate, and equilibrium date/rate. Paying for bonds with KPERS funds reduces the additional positive fiscal impacts noted in Option I. The FY 2033 contribution rate for Option H requires \$102 million in additional state payments than Option I. With reamortization, each option will have continuing payments in FY 2034 and beyond for normal cost and unfunded liability associated with the KPERS state and school plan.

Separating the State and School Group.

KPERS presented information about the fiscal impact of reestablishing a state group and a school group. Prior to 1987, there were separate nonschool and school groups. Included in the nonschool group until 1988 were the local units of government. A local group was established in 1988, the year after the school group was added to the nonschool group in 1987.

The KPERS actuary prepared the December 31, 2002, valuation with information about separate state and school groups. That information is extended in the KPERS report that separates state and school into separate groups for other comparative purposes.

Projected Fiscal Impact of HB 2014 on State and School Combined (Option B) and on a Separate School Group and State Group (Option S): FY 2004 to FY 2033 (In Billions)

	<u>Pre-HB 2014 Contributions</u>	<u>Additional Contributions Authorized by HB 2014</u>	<u>Total Contributions</u>
State and School Group	\$13.338	\$5.193	\$18.531
School Group	\$9.981	\$5.141	\$15.122
State Group	3.357	(0.011)	3.346
TOTAL	<u><u>\$13.338</u></u>	<u><u>\$5.130</u></u>	<u><u>\$18.468</u></u>

The marginal difference in costs for reamortization of the State and School Group (Option B), compared with a reamortized School Group and a State Group without

reamortization (Option S), is shown. Savings of \$63 million in state contributions over the 30-year period appear possible when separating the state and school groups.

Projected Fiscal Impact of HB 2014 in Option B for State/School Group and After Split of the State Group and School Group in Option S: FY 2004 to FY 2033

	Option B	Option S
Equilibrium (Contribution) Rate	12.67% State/School	8.96% State 14.31% School
UAL FY 2033	\$7,409 M State/School	\$70 M State \$7,878 M School
Funded Ratio FY 2033	69% State/School	99% State 58% School

Additional comparisons between options are presented in terms of equilibrium rate, unfunded actuarial liability, and funded ratio. When considered as a separate group, the state component would reach equilibrium at 8.96 percent under current law, and by FY 2033 have an unfunded actuarial liability of \$70 million, with a funded ratio of 99 percent. The School Group would fare much worse by itself and not part of the combined group.

KPERS Local Group

The KPERS local group has a lesser problem in long-term funding than the KPERS state and school group. The 2003 Legislature took no action to increase employer contributions or to raise an existing statutory cap on contribution

increases. The KPERS actuary noted that the same problem of long-term funding, only to a lesser degree, impacts the KPERS local group. A need to confront the unfunded actuarial liability applies to the local group of KPERS, and the KPERS actuary recommended that the Legislature also address this issue.

A statutory cap limits annual local contribution rate increases to no more than 0.15 percent. The KPERS actuary recommends an adjustment or elimination of the cap since the model (Option L1) that is based on current law does not produce an equilibrium contribution rate in the next 30 years. No modification of the local cap was adopted last Session when the KPERS state and school group's cap was changed in HB 2014. The KPERS actuary reviewed three alternatives (Options L2, L3, L4).

**Projected Fiscal Impact on Local Employer Contributions (Option L1)
Compared with Modifications of Contribution Rates
(Options L2, L3, L4): CY 2003 to CY 2032**

<u>Local Group</u>	<u>Option L1</u>	<u>Option L2</u>	<u>Option L3</u>	<u>Option L4</u>
Equilibrium Rate	None	5.44%	8.32%	7.60%
Equilibrium Date	None	CY 2005	CY 2013	CY 2009
UAL FY 2033	\$2.6 B	None	\$32 M	\$12 M
Funded Ratio FY 2033	65%	100%	100%	100%

Each of the alternatives would produce a fully funded local plan by CY 2032. Option L2 would raise the contribution rate immediately to the actuarially required amount. Over 30 years Option L2 requires the least amount of average annual increase (after the first year spike) and of total contribution increase, but has higher contributions required for the first four to six years. Option L3 has the same scheduled increases that was adopted for the state and school group last year. Option L4 is an accelerated version of L3.

The Committee recognizes there has been no testimony from local units as to which alternative option would be preferred. There are variances in one-time and in annual cost increases that when spread across all local participating governments may or may not be considered significant impacts. Further hearings will be required during the 2004 Session to determine the option preferred by local units of government.

CONCLUSIONS AND RECOMMENDATIONS

The Joint Committee on Pensions, Investments, and Benefits makes the following recommendations.

! The Committee recommends favorably to the State Finance Council the issuance of \$500 million in pension obligation bonds authorized by Section 16 of Chapter 155, 2003 *Session Laws of Kansas*. This

recommendation fulfills the provision of Section 16(f) of Chapter 155 that “No bonds shall be issued pursuant to this section prior to the review and recommendation to the State Finance Council of such issuance by the Joint Committee on Pensions, Investments and Benefits.”

The Committee in this recommendation stresses the fact that this is only one piece of the ultimate solution dealing with the unfunded actuarial liability. The Committee’s recommendation was adopted in conjunction with materials provided by the Kansas Development Finance Authority dated November 25, 2003, with specific reference to the amortization schedule on pages 10-11 of that document that includes capitalized interest for three years preceding payments of both principal and interest. The net proceeds to KPERS would be approximately \$455 million in this schedule, with the capitalized interest taken out of the par amount of \$500 million in bonds. Under this option, it was not anticipated that KPERS would be responsible for repayments. The burden would fall to the State General Fund or some other funding source. The Committee considered tobacco revenues as an alternative source, but that funding plan did not gain approval.

! The Committee recommends the following items be included in a bill to be introduced for consideration by the 2004 Legislature:

- " Changing the actuarial cost method for all three plans—regular KPERS, KP&F, and Judges.
- " Modifying the asset smoothing method.
- " Reamortizing the unfunded actuarial liability if and when deemed prudent by the KPERS Board of Trustee.
- " Modifying the statutory contribution caps for local employers.
- " Separating the state and school group into two groups for actuarial purposes in calculating employer contribution rates separately for the state group and for the school group.

Regarding the statutory contribution cap increase for local employers, the Committee recognizes there has been no testimony from local units as to which alternative option would be preferred. There are variances in one-time and in annual cost increases that when spread across all local participating governments may or may not be considered significant impacts. Further hearings will be required during the 2004 Session to determine the option preferred by local units of government.

- ! Regarding a long-range funding plan, the Committee regrets that a comprehensive package was not developed during the 2003 interim. The Committee believes

that HB 2014 from the 2003 Session was one step in solving the KPERS long-term funding issue. Additional steps must be taken, including its recommendations regarding issuance of \$500 million in bonds and introduction of a new bill modifying actuarial methods and KPERS groups. Depending upon the disposition of these two recommendations, further steps will be required in developing a comprehensive plan during the 2004 interim.

The fiscal note on issuing bonds and passing proposed new legislation must be considered before those next steps are taken because one action without the other one has consequences in the billions of dollars. The 30-year fiscal note on the recommended bond issue includes both revenues and expenses that cannot be computed until bonds actually are issued. The estimated fiscal note for \$500 million in bonds has a cost of approximately \$1.133 billion in principal and interest payments, and a net present value benefit to KPERS of approximately \$455.4 million. The recommended actuarial changes over the same 30-year period have the potential of saving the state more than \$4.0 billion in contributions. Bonding and paying for the bonds with non-KPERS funds could save an additional \$500 to \$700 million in state contributions to KPERS over 30-years, offsetting in part the costs for principal and interest.

Note: *The Chairperson scheduled a special Committee meeting for January 7, 2004, with a single agenda topic: reconsideration of the Committee recommendation that pension obligation bonds should be repaid with non-KPERS money. The issue to be discussed is whether bond principal and interest should be paid from KPERS employer contributions. That issue was raised in conjunction with the scheduling of a State Finance Council meeting, and the Committee's reconsideration of its recommendation has been suggested as a step to precede a State Finance Council meeting.*