

Retired Member Issue

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What is it?

KPERS retirees who started receiving a monthly benefit *before* July 2, 1987, are eligible to receive an additional annual retirement payment up to a maximum of one month's benefit, often referred to as the "13th check." These retirees have been receiving a 13th check since it was created in 1980, but the payment is conditional based on KPERS investment income. If there is not enough income in any given year, according to a formula set by Kansas statute, retirees will not receive a full 13th check.

Why do we have it?

The Kansas Legislature created the 13th check as an alternative to a cost-of-living increase for that group. Members who started receiving a benefit after July 2, 1987, had their retirement benefits calculated at a higher rate than previous retirees and are not eligible for the additional payment.

The current average age for retirees in this group is 84. Their average monthly benefit is \$475.

The problem

Due to negative investment returns in the past two years, KPERS investment income may not meet the requirements under the statutory formula, and retirees may not receive the full 13th check in October 2003.

The future

With less than six months left in the fiscal year, it is difficult to predict what will happen in the investment markets. If the markets do well and KPERS meets the necessary income requirements, the full 13th check for 2003 will be paid in October as it has been in the past.

Continued poor market returns will create a problem with the 13th check in 2003, and a full monthly benefit will not be paid. KPERS has brought this to the Legislature's attention in advance to give it time to consider options. New legislation may be proposed in the upcoming legislative session to address the situation.

A Message From the Executive Director

This edition of *KPERS Papers* is filled with what seems like pages of negative news. Older retirees have their 13th check in question, KPERS is in need of a solid long-term funding plan to ensure the System's financial health, and some investment markets have experienced losses over the past two years. Yes, we are in difficult economic times and our national, state and local leaders face significant challenges.

On the bright side, no matter the current or future economic picture, the State of Kansas guarantees your benefits. Over the last 40 years, we have continued to provide dependable member benefits through the ups and downs. KPERS is a defined-benefit plan, which means that your benefits depend on your final average salary and years of service, not how much money you contributed or how well the market performs.

In the past year, you may have heard news about employees in private sector defined-contribution plans and their financial devastation. Many retirement dreams crumbled with the market volatility of the past few years. Defined-contribution benefits depend on investment returns. Your KPERS benefits are protected from that volatility.

Over time, the U.S. economy goes through cycles. Many of you faced and met the challenges of the Great Depression and World War II. Our country then had a time of prosperity and growth in the 1950s and 60s. In the 70s we experienced a significant bear market and faced crippling double-digit inflation toward the end of the decade. Our economy has a way of correcting itself when it swings too high or too low. We have just come off a decade of prosperity and strong investment market returns. We will recover again. It just takes time.

As part of the recovery process, State and local leaders need our support and innovation. If you are concerned or have a good idea, get involved. Thank you for your years of public service. Your experience may uniquely qualify you to provide insight and solutions to some of the challenges we are currently facing.

Better times will return. In the meantime, KPERS Board of Trustees and staff are committed to our fiduciary responsibility of providing your benefits and administering the Retirement System with quality and dependability.

Please contact me if there are ways we can improve our service or if you have specific concerns and questions.



Glenn Deck
Executive Director

KPERS 2003 Legislative Agenda

Proposed Bills

This year's KPERS legislative package includes two bills: one bill with three technical amendments and a second bill that relates to the Board's authority to select staff. If passed, the bills should make the law clearer and improve our ability to provide benefits.

What about a COLA?

A bill likely will be introduced, as it often is, for KPERS retirees to receive a cost-of-living increase. The State of Kansas is facing significant budget issues with a sizable funding shortfall. Because of this fiscal environment, a COLA bill will face a difficult road. In addition to constraints caused by the current State budget situation, a COLA requires an increase in contributions from the State general fund to pay for it. For this reason, it will be competing with other programs and services for scarce budget resources.

Other Bills Affecting KPERS

Generally, 30 to 35 bills that affect KPERS are introduced from various sources during the legislative session. KPERS will provide a legislative summary throughout the session on our web site, www.kpers.org. We can also add you to our mailing list to receive a summary by e-mail or postal mail. Please call the KPERS office or send an e-mail to CRafferty@kpers.org.

All KPERS legislation that is passed this session will be summarized in the next *KPERS Papers* issue.

For information about other bills introduced in the Kansas Legislature call the Legislative Reference Section of the Kansas State Library at 296-2149 or (800) 432-3924, or on the web at www.kslegislature.org/cgi-bin/index.cgi.

KPERs Mails 1099-R Forms for Your 2002 Tax Returns

January 31, KPERs mails each benefit recipient an envelope marked “*Important Tax Return Document Enclosed.*” Inside are 1099-R forms with information for 2002 federal tax returns.

In general, KPERs benefits are subject to federal taxes, but not Kansas state taxes. Information and Internal Revenue Service instructions are printed on the back of the 1099-R form. If you have questions about your taxes, please contact a tax professional or the IRS.

Box 1: Amount KPERs paid you last year.

Box 2a: Taxable part of that amount.

Box 2b: Taxable amount not determined.

Box 4: Total amount of federal income tax withheld.

Box 5: Amount that is not taxable.

Box 7: Type of benefit paid to you and its tax status.

Box 9b: This amount will only appear the first year you receive benefits.

In the lower right corner is your retirement date. If you made KPERs contributions *before 1984*, you have already paid taxes on those contributions. Their total is shown by IRS net investment in the same box, along with the amount you have been paid from your pre-1984 contributions, up to December 31, 2002. Some retired State employees also have a health insurance premium total.

If you retired before July 1986: KPERs doesn’t calculate your taxable amount. If you have recovered all your

previously-taxed contributions under the IRS *Three-Year Rule*, your benefit is fully taxable.

If you retired after June 1986: You were notified at retirement about the amount that KPERs calculated as nontaxable. If you chose a different method to figure your nontaxable portion, attach a note to your tax return showing that you are using a different method.

If you retired *July 1, 2001, or later*, and received part of your retirement benefit as a partial lump sum, you will receive an additional 1099-R. If your PLSO was directed to more than one account, you will receive a separate 1099-R for each account.

Direct Rollovers to a Qualified Plan or IRA

Box 1: Amount of the rollover distribution.

Box 7: IRS code for a rollover (G for an IRA and H for a qualified plan).

Payments Made Directly to You

Box 1: Amount of the PLSO paid directly to you.

Box 2a: Taxable amount of the PLSO payment

Box 4: Federal tax KPERs withheld from the PLSO payment (20 percent of the amount in Box 2a).

Box 5: Amount of the PLSO that is not taxable.

Box 7: Type of benefit paid to you and its tax status.

Beneficiaries

If you are a deceased member’s beneficiary, your benefit has the same tax status as the deceased member’s benefit.

A Complete Beneficiary Form Ensures the Right Person Gets Paid

As a KPERs retiree, your beneficiary will receive a \$4,000 death benefit when you die. You can even name a funeral establishment to directly receive this benefit.

You may change beneficiaries any time by completing a Designation of Beneficiary form (KPERs-7/99). Each time you complete the form, it cancels all those you have previously completed. Every time you complete the form,

please be sure to fill in *both* the primary and contingent beneficiary sections. If you only complete the contingent section and leave the primary blank, you will have no primary beneficiary, even if a past form names one.

You can download a Designation of Beneficiary form at www.kpers.org/FORMS.htm or call the InfoLine, (888) 275-5737 or (785) 296-6166, to receive one by mail.

Why Have Your Retirement Payments Directly Deposited?

Instead of mailing you a check, KPERS can deposit your monthly retirement benefit right into a savings or checking account.

- Your money is available immediately, even if you are away from home.
- It's dependable and you'll never experience a delay because of the mail.
- It's easy for you to change the bank account we deposit in.
- It protects against lost or stolen checks.
- It's simple for you to sign up.

Complete a Direct Deposit form (KPERS-15B) from the web or call us.

- www.kpers.org/FORMS.htm
- (888) 275-5737 or (785) 296-6166

System Needs New Long-Term Funding Plan to Address Shortfall

The Retirement System's most recent actuarial valuation showed that its total unfunded actuarial liability had grown to \$1.8 billion as of December 31, 2001. Over the long-term, this means that the System has not accumulated enough assets to provide the benefits already earned by existing members.

As with other retirement systems, the existence of an unfunded actuarial liability is not in itself harmful or unusual. But the rate at which KPERS' liability is increasing and projections of significantly higher employer contribution rates are cause for concern. It is crucial that a new funding plan be put in place over the next few years.

This funding shortfall is critical to the System's long-term financial health and is the most important issue facing the Retirement System. A sound funding plan that incorporates higher contributions must be developed to ensure the System's long-term financial health.

In spite of future funding concerns, benefits for retirees and current employees are safe and guaranteed by law. The System operates on a time horizon of 30 to 40 years for its funding and has approximately \$8 billion in assets available to pay benefits for decades.

Background

In 1993, the Kansas Legislature significantly increased benefits for KPERS members and set up a 40-year payment plan to pay for it. To reduce the budget impact, the Legislature planned to gradually increase employer con-

tribution rates until the rates reached the recommended actuarial contribution rate. This benefit increase and its funding was a turning point. It was the first time that the System delayed using the full actuarial contribution rate to pay for benefit improvements, and instead, set up a gradual payment schedule with statutory limits on increases in employer contribution rates.

These increases were designed so that the statutory employer contribution rates would meet the actuarial rates required to fully fund benefits. Under current State law, employer contributions may increase annually by 0.2 percent for State/school members and by 0.15 percent for local members.

Where We Are Now

By fiscal year 2005, State and school employers should contribute 7.69 percent of payroll to pay for promised benefits. The employer rate, capped by statute, is scheduled to be 4.78 percent, or 62 percent of the amount actually necessary to fund current obligations. If the State were to contribute at the full actuarial rate in fiscal year 2005, its annual contribution to the System needs to increase by approximately \$100 million.

In 2004, local employers should contribute 4.64 percent of payroll. The statutory local rate is scheduled to be 3.22 percent. Local employers will only be contrib-

continued on back...

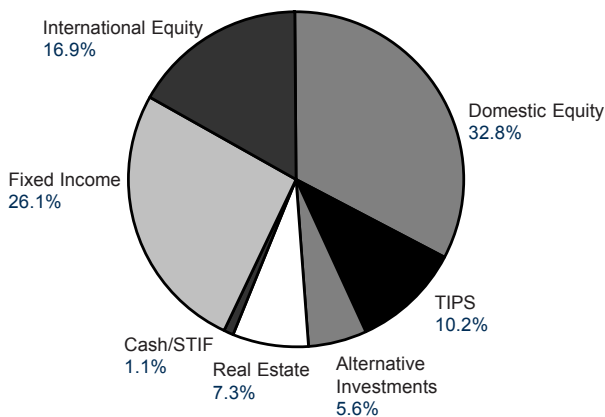
KPERS Investment Summary – The Big Picture

With the recent market volatility, some retirees may be concerned about their retirement benefits. As an active member, you accumulated a retirement benefit throughout your career. It is important to understand that the State of Kansas guarantees your benefit, even during bumpy economic times.

Although your benefits are guaranteed, investment returns are important to the System’s overall health. Asset allocation has been an important tool in helping the KPERS fund weather weak equity markets during the last two years. KPERS invests in many broad investment sectors:

- domestic equity
- international equity
- fixed income
- treasury inflation protected securities (TIPS)
- real estate
- alternative investments
- cash

Portfolio Asset Allocation as of November 30, 2002

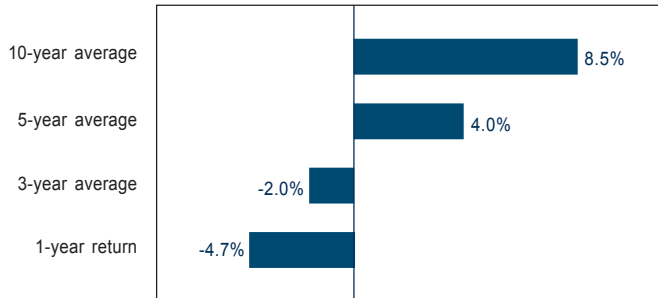


By investing in these sectors, other types of investments can help offset some of the potential losses in the portfolio during times of negative volatility in equities. For example, through the first five months this fiscal year, the Dow Jones Industrial Average lost 3.8 percent and the S&P 500 lost 5.4 percent* while the KPERS fund was down 2.7 percent. Our investments in fixed income securities helped offset some of the losses in the equity markets.

Most member benefits will not be paid until well into the future. The KPERS investment fund focuses on this longer-term horizon, helping to ensure that the assets

necessary to meet these obligations are available when they are needed. KPERS assumes that over the long term our investments will earn 8 percent. During the last ten years, the KPERS plan has exceeded this return by delivering 8.5 percent.

Investment Performance for the period ending November 30, 2002



KPERS must be willing to accept some short-term risk in the portfolio to gain the long-term 8 percent return. Sometimes, this short-term risk works in the System’s favor and sometimes it works against the System. For example, from 1995 to 2000 the System averaged a 15.4 percent return rate. But, during fiscal years 2001 and 2002, the fund was down 7.3 percent and 4.7 percent, respectively. By accepting these short-term ups and downs, the System has been able to meet its longer-term goals.

For more detailed information on investment performance see our web site at www.kpers.org/INVperf.html.

**These index returns may not reflect the effects of dividend reinvestment.*

2003 Benefit Payment Schedule

January 31	July 31
February 28	August 29
March 31	September 30
April 30	October 31
May 30	November 26
June 30	December 29

New Long-Term Funding Plan (cont.)

uting about 69 percent of what is necessary to fund current obligations.

This payment approach creates a long-term funding situation similar to making partial payments on a home mortgage and adding the unpaid amount to the mortgage principal.

Working for a Solution

Without changes in future contributions, the System's unfunded actuarial liability will continue to grow. The longer we wait, the greater the cost to future generations of taxpayers.

The Retirement System's objective is to help develop a consensus among the Board of Trustees, the Legislature, the Governor, and other state and local officials on a responsible long-term funding plan. The plan will need to increase employer contributions to a level that will restore the System to actuarial balance and ensure its long-term financial health. Ideally, such a plan will be developed during 2003 with authorizing legislation introduced during the 2004 legislative session.

For more detailed information, review the Long-Term Funding Outlook Report, Parts I and II, on our web site, www.kpers.org.

Mission Statement of the Retirement System: The Kansas Public Employees Retirement System, in its fiduciary capacity, exists to deliver retirement, disability and survivor benefits to its members and their beneficiaries.

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611 S. Kansas Ave., Suite 100, Topeka, KS 66603-3803
E-Mail: kpers@kpers.org
Home Page: www.kpers.org
Phone: (785) 296-6166
Toll-Free: 1 (888) ASK-KPERS (275-5737)
Fax: (785) 296-6638

