LEGISLATIVE CHANGES FOR KCPSRS

In 2012 the Board of Trustees of the Kansas City Public School Retirement System (KCPSRS) voted to bring forward a legislative proposal designed to improve the financial health of the retirement system. The bill passed and Governor Nixon signed it into law in June 2013. Due to the decline in the financial markets, the system has experienced lower funding levels since 2009 and is expecting the funding levels to drop even further before any improvement is attained. This new legislation will improve the ability of the system to get back to full funding in a more expedient manner.

KCPSRS is a defined benefit retirement program that collects and invests contributions from employers (KCMSD, the Library District, Charter Schools, KCPSRS) and employees in the system, and pays a lifetime monthly benefit to those eligible for full retirement. Until December 31, 2013, the formula is a benefit at full retirement of 2% of a member's final average salary (highest continuous four year average salary) times years of contributing service.

Full retirement eligibility was age 60 or the "rule of 75" (combination of age and years of service equaling 75). For example an employee with 25 years of service was eligible for full retirement at age 50 (25 years service + age 50 equals the number 75).

The new legislation creates a tier of benefits only for new employees hired after 12/31/2013. These new employees will accumulate a benefit at 1.75% for each year of contributing service, and full retirement will be at age 62 or "the rule of 80".

Both the employers and employees used to contribute 7.5% of salary to the retirement system to fund the benefit program. This contribution rate was set in Missouri state statute and has been at 7.5% since 1999. KCPSRS was the only teacher retirement system in Missouri with a fixed contribution rate. The other two teacher plans have variable contribution rates that change as the funding needs of each plan change.

The new law provides for a variable contribution rate for all KCPSRS employers and employees that will increase or decrease each year as the funding needs change. The rate of increase or decrease in any year will not exceed ½% of salary, with a maximum rate of 9% and a minimum rate of 7.5%.

Rationale for the Legislative Changes

The changes in this legislation are designed to improve the financial health of the system. Although the current funding levels are considered healthy, with the recent drop in funding levels, the fixed 7.5% contribution rate no longer covers the total cost of keeping the system strong for the long term. These changes will improve the long term ability to pay benefits and reach full funding at a much quicker pace.

In summary, the legislation will result in the following changes:

1. Contributing employees and employers will initially see their contribution rate increase in ½% increments annually up to 9% until full funding is reached and then the rate will begin to drop back down, and
2. Employees hired after December 31, 2013 will accumulate benefits at a rate of 1.75% and will be required to work a little longer before being eligible for full retirement benefits.

Contribution Rates also Factor in System Health

The Kansas City Public School Retirement System (KCPSRS) has been very well funded over the last fifteen years and had twelve straight years with a funding level in excess of 100% from the beginning of 1997 through the end of 2008. In the last three years, the funding level has moved from 99.4% to 93.1% to 84.9% last year.

Pension experts tell us that a plan funded at better than 80% is very healthy. But how is the funding level calculated, and is the funding level the <u>only</u> determinant of the health of a pension plan?

The funding level simply is the percentage of the plan's long term liabilities covered by the current assets. It is calculated by dividing the assets by the plan's liabilities. Each year an actuarial firm analyzes the benefits accumulated by all members of the system (both working and retired) and estimates the funds required at that date to pay those benefits over the lives of the members and retirees. This number is the <u>liability</u> figure. The <u>asset</u> figure is the amount of funds the system holds for investment, adjusted through a smoothing process by recognizing a portion of the gains or losses for each year over a five year period.

The reason KCPSRS' funding level has been moving in a downward trend is mostly the result of the market crash of 2008-2009. The drop in the value of investments has had a direct effect on the numerator of the funding level. <u>However, the decline in enrollment and corresponding reduction in district staff has also had a negative effect on the system,</u> as the number of retirees has increased and the number of active members has decreased.

In January 2009 the system had 4,648 contributing members, in January 2012 that number was 3,284. This is a drop of 29% in contributing members. At the same time the number of retirees in January 2009 was 3,247 and by January 2012 that number had increased to 3,829. This is an increase of 18%. <u>The decline in active members has resulted in a significant drop in contributions coming into the system from both employers and members.</u>

This highlights the issue of using the funding level as the sole measurement of the health of a system. There are actually two factors at play: the funding level, and the <u>actuarial required contribution.</u> If the assets on hand are less than the calculated liabilities, the difference (the unfunded liability) needs to be paid down in a methodical manner through contributions. The actuary calculates this like a mortgage payment. The total contributions to the system each year need to be sufficient to cover the cost of new benefits earned in the year by active members plus an amount required to cover the "mortgage payment" on the unfunded liability and administrative costs. This is the actuarial required contribution. Effective with the actuarial valuation of the system as of January 1, 2012**, the actuarial required contribution is now greater than the old statutory contribution of 7 ½%.**

It is true that KCPSRS was funded at 84.9% at the beginning of 2012, which under normal circumstances indicates the plan is still very well-funded. But, the fact that the actuarial required contribution now exceeds the old statutory 7.5% contribution indicates the need to make changes to secure the long-term health of the system. The legislative changes this year is a result of these concerns, and addresses the factors that determine the system's long term health.

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