In Kansas, pension fix required open minds, long-term outlook

Cash-balance plan, changes to contribution cap among reforms

by Kansas Sen. Mitch Holmes (Mitch.Holmes@senate.ks.gov)

Like a smoker who is "going to quit tomorrow," or the well-intentioned dieter who will "start tomorrow," politicians find it easy to allow more-urgent funding requests to take priority over the chronic need to fix a pension plan that is seriously out of balance.

This is probably because the pension situation isn't an immediate crisis — it is still 10, 20 or more years from becoming a major meltdown in most cases. For better or worse, most legislatures are preoccupied with taking care of this year's problems.

Pensions move like aircraft carriers, not personal watercraft. With any change, it takes a long time to feel the benefit.

Hence, there is little "reward" for politicians who can turn around a slow-moving colossus. The volume of urgent requests presented to the appropriators, along with the lack of any short-term benefit resulting from changing pension courses, combine to make it easy to kick the can down the road.

Pension problems were years in making

Kansas was set up for failure when benefits were enhanced back in the early 1990s but funding was not increased accordingly.

In fact, the employer's contribution was statutorily capped (at a maximum increase of 0.1 percent increase over the previous year's level) in the same bill that retroactively enhanced benefits. Benefits were enhanced by about 20 percent, and employees' contribution levels remained constant at 4 percent of pay.

By the mid 1990s, the Kansas Legislature recognized the problem of the cap. It was doubled to 0.2 percent for a few years, then doubled again to 0.4 percent. When I entered the Kansas House in 2005, the cap had been 0.6 percent for several years.

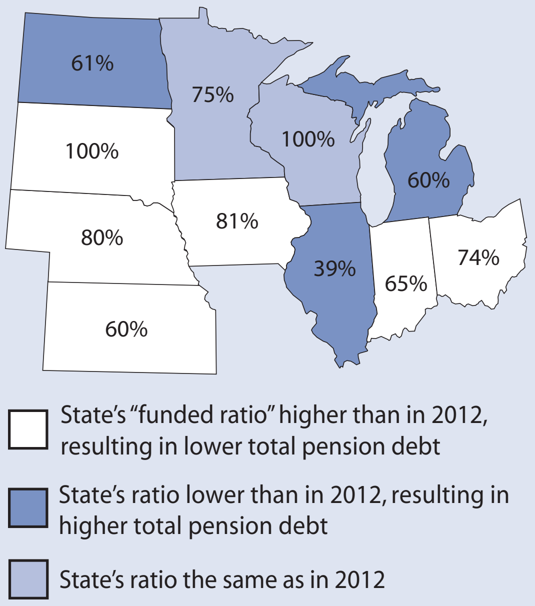
By 2007, Kansas had had significant sustained growth in revenues that surpassed projections for several years. But even with new money that was unanticipated, we still could not satisfy all the requests. The executive director for the Kansas Public Employees Retirement System was pleading with us to increase the state's contribution.

The attitude I observed year after year was, "Maybe we can add more next year ..." Of course, 2008 brought that era of revenue growth to a stunning reversal that led to rescission bills — as a result, there was no chance of adding more money to KPERS while cutting the budget.

In 2007, a special legislative committee attempted to fix the system. Under its plan, a new tier for future Kansas workers was created, with a higher employee contribution rate and a cost-of-living adjustment built into the formula. The actuaries stated that the policy and the math were in agreement.

But at the last minute, an amendment was added to allow for early retirement, completely destroying the math. One important lesson learned from this is that the policy and the math must be in agreement. Feeling generous while ignoring mathematical reality does not make good, sustainable policy.

% of public pension liabilities funded in Midwestern states, 2013



Note: The total U.S. funded ratio is 72 percent, the same as in 2012.

Source: Pew Charitable Trusts

In 2011, a newly inaugurated Gov. Sam Brownback charged our Legislature with fixing an ailing pension system for the sake of our children and grandchildren. The speaker of the House formed a standing committee and asked if I'd like to lead the effort

At the time, we went into the process assuming the solution would be to phase out the defined-benefit plan and start new employees on a defined-contribution plan (similar to a 401(k)).

Open minds, unexpected pension fix

The House committee quickly realized how little we knew about pensions. We spent the entire 2011 session just studying how the system works. We were assigned two meetings a week, but I called a third meeting on some weeks because we had so much material to cover. I had a very dedicated committee whose members attended faithfully, even for extra meetings on Fridays!

Not only did we study how the current system worked, we also tried to look at all possible alternatives. The alternatives included numerous plan types and also various ways to administer the different plan types.

Our minds were starting to change, and after a full session and a study commission, we saw that a cash-balance plan had many advantages over a defined-contribution plan.

For starters, a cash-balance is considered a defined-benefit plan by the IRS, so we could continue depositing contributions to the existing trust fund. This keeps the fund able to function into the future while taking advantage of the low cost of administering a large pool of reserves. It provides a guaranteed benefit for the members and still pays down the unfunded liability at the same time. We found it to be a better, faster way of getting out from under our unfunded liability.

Different systems, different fixes

Every pension system has unique circumstances, and the cash-balance option may not provide the same advantage to other Midwestern states' systems as it did for Kansas.

The statutory cap had to be addressed, also. While it would have been nice to remove it altogether and start paying the actuarially required contribution, we were so far behind that there was no possible way to pay the difference. So in addition to creating the new, cash-balance tier in KPERS, we began raising the cap incrementally starting in fiscal year 2012. The cap will disappear when it finally matches the actuarially required contribution level sometime before 2020.

Based on our experiences addressing the pension issue in Kansas, I'd like to offer this advice to other legislators or local policymakers with a pension system in trouble:

- Start now! If you put it off until next year, next year will never come. It may take the dedicated effort of one individual to start the ball rolling. The urgent requests that compete with a pension fix should be re-evaluated to see if they are really as urgent as presented. Our children's and grandchildren's future needs to be viewed as urgent, also. They will pay the price for our procrastination.
- Form a standing committee if one doesn't exist, and get all members up to speed on how retirement plans work. Don't rely on a special committee that only meets on the call of the chair, because members simply don't gain the depth of knowledge necessary to engineer a fix or redesign a system.
- Have an open mind. Don't lock yourself into a certain plan design until you know and understand other options. We thought we knew the answer at the beginning, but found a better solution for our particular situation by "leaving no stone unturned."

Don't let your pension fix become just another New Year's resolution!

Sen. Mitch Holmes, a Republican, was elected to the Kansas Senate in 2012 after serving eight years in the House.

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