The Rundown podcast transcript for Performance Audit report titled ***KPERS: Evaluating the Deferred Retirement Option Program*** – Released September 2020

Brad Hoff, Host and Recruiting and Training Manager: [00:00]
From the Kansas Legislative Division of Post Audit, this is The Rundown. Your source for news and updates from LPA, including performance audits recently released to the Kansas Legislature. I'm Brad Hoff. In September 2020, Legislative Post Audit released a performance audit evaluating the deferred retirement option program, commonly known as DROP. I'm with Andy Brienzo, principal auditor at Legislative Post Audit, who supervised this audit. Welcome to The Rundown, Andy.

Andy Brienzo, Principal Auditor and Supervisor: [00:35]
Thank you, Brad.

Brad Hoff, Host and Recruiting and Training Manager: [00:37]
So, before we start discussing the findings of the audit, talk about what the deferred retirement option program is and why it was created.

Andy Brienzo, Principal Auditor and Supervisor: [00:47]
The deferred retirement option program or DROP is available specifically to two employers. So, this is the Kansas Highway Patrol or KHP and the Kansas Bureau of Investigation or KBI. These are two of the employers - 112 state and local employers that are within the Kansas Police and Firemen's retirement system, or KP and F, which is one of the retirement systems that KPERS administers. So, this program is basically, in a nutshell, it allows retirement eligible staff to earn their salaries and retirement benefits at the same time. So, the overall goal is to incent staff who are eligible for retirement. So, very experienced staff, kind of towards the end of their careers, to defer retirement for the period that they're in DROP, which is between three and five years. So, that's kind of the overarching goal, is encourage deferred retirement, hence the name. There's a few other goals that the agencies identified. So, the legislature created DROP for the Kansas Highway Patrol in 2015 and then it expanded DROP to the KBI in 2019 and the KHP identified a couple of staffing issues in 2015 that they were hoping DROP would help them address. So, one was they felt like they didn't have enough road troopers. So, these are kind of the frontline law enforcement staff who are patrolling the highways in Kansas. And then they also

identified 65 counties that were understaffed and so they were hopeful that DROP would help them address these specific staffing issues in addition to just incenting experienced employees to defer their retirement. Actually those two goals, I'll talk about those in a little bit. We looked at whether DROP is actually helping address some of those issues.

Brad Hoff, Host and Recruiting and Training Manager: [02:37]
So how does DROP work?

Andy Brienzo, Principal Auditor and Supervisor: [02:39]
Okay. So, as I mentioned, this is a program that is for retirement eligible staff. So, once a KHP or KBI employee reaches retirement eligibility, they have to decide basically what to do. So, they can either retire and stop working at which point they will stop earning their salaries of course and begin receiving their monthly retirement benefits. They can also keep working outside of DROP. They can just keep working as they were before, they'd keep earning their salaries and critically they would keep accruing service credits. So, for each year that they work, within KP and F as a KHP or KBI employee, they are earning a service credit and the service credits help determine what their retirement benefit will ultimately be. So, if they work outside of DROP, they keep accruing those. Now, if they keep working, but join DROP, they will keep earning their salaries, of course, because they're still working, but they will stop accruing service credits. So, basically KPERS when they elect to join DROP will calculate what their monthly retirement benefit amount would be if they had retired instead and then they will get a monthly credit to their DROP account for the period that they're in DROP. So, this is three, four, or five years. As I mentioned before, this is an irrevocable decision. Once they decide to stay working and to join DROP for three or four, or five years, they can't change their mind, but they can end their DROP after three years without any consequences. And the consequences would be losing their interest. So, DROP participants, they, in addition to getting their monthly retirement benefit amount credited to their DROP account, they can also earn up to 3% annually in interest. That depends on how well the KPERS trust does as far as investment returns, but any DROP participant who leaves before three years, they'll lose that interest. But if they stick around after three years, they will get any interest they may have earned. And then when the DROP period is over, so after three to five years, the employee, will finally retire and whatever the contents of the DROP account are, will be paid to them in a lump sum or they can roll it over to another retirement account.

Brad Hoff, Host and Recruiting and Training Manager: [04:54]
Now the audit team conducted a survey of Kansas Highway Patrol and Kansas Bureau of Investigation employees and retirees. So, talk a little bit about what you guys learned from the survey results.

Andy Brienzo, Principal Auditor and Supervisor: [05:13]
We surveyed 111 DROP eligible current and former employees from KHP and KBI. So, that included 100 KHP staff and 11 KBI staff and we included both DROP participants and non-participants in the survey. We received 60 responses out of those 111, which is a response rate of about 54%. And of those 60 responses, 28 came from DROP participants. So that represents about 72% of the 39 staff who had joined DROP by April 2020, which is when we got our data. Now, the results of the survey are not projectable to KHP and KBI staff who didn't respond. So, we can't draw conclusions about all KHP or KBI staff from the survey and we can't draw conclusions about all DROP participants from the survey, but we did have a fairly strong response rate and I think we got some interesting, some interesting insights into how DROP has influenced retirement decision-making. Among DROP participants who responded, 25, told us that DROP was very important or extremely important to their retirement planning. Twenty-four said it was very important or extremely important to determining when to retire and 26 told us it was either very or extremely important to their financial security in retirement. We also got a sense of the primary reasons why the DROP participants who responded joined. Eighteen told us it was primarily more advantageous to them financially then there are other options. Three said they wanted the lump sum payout that it offers at the end of the DROP period, which can be pretty substantial and then three actually said they primarily wanted to pay for health insurance. So, KPF employees are generally retirement eligible before they're eligible for Medicare, which means that there can be a gap in insurance coverage between when they retire and when they become Medicare eligible and three respondents told us that they wanted to pay for health insurance with DROP. The other thing that we wanted to get at was whether DROP participants primarily were planning to delay retirement anyway. So, they joined DROP because it was available to them and it didn't, but it didn't actually incent them to change their retirement plans and only two participants told us that they were going to delay retirement anyway and that's why they primarily joined DROP.

Brad Hoff, Host and Recruiting and Training Manager: [07:50]
In addition to surveying, current [employees] and retirees from the Highway Patrol and the Kansas Bureau of Investigation, you also looked at how DROP affects state agencies and you looked at a variety of data, including costs, employees, career lengths, and some of the other specific goals for the program that you mentioned earlier. So, after looking at that evidence, what did the team conclude?

Andy Brienzo, Principal Auditor and Supervisor: [08:20]
Okay, so I'll start with costs. So we talked to KHP, KBI, and KPERS officials about how DROP might have affected their administrative expenses and they told us that they have not had to hire any extra staff to administer DROP. So, it's KHP and KBI and KPERS. They had enough existing administrative staff to absorb all DROP related duties. KPERS officials did tell us that they have add to upgrade their IT systems in order to administer DROP. It has cost them about $145,000, but that was the extent

of any administrative expenses. So, we didn't think that was a significant effect from DROP. So, in addition, we looked at whether DROP creates new staff expenses for KHP and KBI. So, the purpose of the program, as I mentioned before, is to encourage staff to stick around three to five years longer than they otherwise would have to defer their retirement for three to five years. And when that happens, of course, KHP and KBI are paying those staff for three to five years longer than they otherwise would have. So, it may extend the time that the agencies are paying DROP participants' salaries, but they were already paying those salaries to those staff. So, it doesn't, DROP doesn't create any new agency staffing expenses. And in reality, the agencies would have replaced those staff if they had retired with another employee who would have been paid a similar amount and there would have been some related training expenses and things like that and it would help offset any differences in salary levels. So, we also found that DROP didn't create any new staffing expenses. And then from the perspective of the pension plan of KP and F, DROP is actually designed to be cost neutral to the pension plan. So, because DROP participants are still working and drawing their salaries, they and their employers are actually still contributing to the KP and F pension plan in a way that they wouldn't be if they had retired instead. So, once a staff person, once an employee retires, they stop contributing to the system and they start drawing from the system in the form of their retirement benefits. Well, a DROP participant, they are drawing from the system and in the sense that they are getting a monthly DROP credit that equals their retirement benefit, but because they're still employed, they're actually still contributing to that system and so is their employer. So, when DROP works as intended, meaning it actually encourages someone to delay their retirement, KP and F gets those employee and employer contributions for longer and that helps the program be cost neutral to the pension plan. On the other hand, although DROP is designed to encourage staff to delay their retirement, so in other words, to retire later than they otherwise were going to, and later than they would have in the absence of DROP, it's possible that people will join DROP in anticipation of a pre-planned retirement date. So, this is kind of what I was mentioning when I mentioned before when we were asking our survey recipients whether they had primarily planned to delay retirement anyway, so they joined DROP too to benefit from it. This is similar to that. So, someone could join DROP three to five years before they were going to retire. So let's say they were going to retire at 60, whether DROP was there or not. So, they could join DROP at 55, not change their retirement plan, and then still benefit from the program and when that happens KPERS' actuarial liability may increase. So, the participant is drawing, as I said, the equivalent of their retirement benefit amount for the three to five years that they're in DROP. So, if they are not changing their plans and they're actually starting to draw those retirement benefits earlier than they otherwise would have. So, the liability to the system goes up and KPERS officials told us they don't currently have enough data to say whether DROP is cost neutral overall. In other words, whether people are joining in anticipation of a pre-planned retirement date or whether they are deferring their retirement because that's a major factor that contributes to whether the program is cost neutral. But regardless of any of this, in actuality, KPERS' unfunded actuarial liability has not increased because of DROP. So, KP and F employers as a group, and there's 112 of them, including KHP and KBI have to contribute enough to fund the system's liabilities. And so KPERS actuaries reassessed this each year and they will increase the employer rate to cover the program's costs if they decide that that's necessary to cover the actuarial liability of the pension plan. Okay. So, that's cost. The legislature gave KHP access to DROP earlier than KBI. KBI only received access in 2019. So, we had more data on KHP participants. And so we looked into them a little bit further, with regard to their DROP and retirement choices. And we found that current KHP DROP participants will likely work more years on average than non-participant retirees. So, we were looking specifically at the years, 2016 to 2019, and, KHP participants who joined DROP in those years will likely work more years on average than retirees from those years and then will likely work until more advanced ages on ever. So, we assume when we did this analysis that all the participants would complete the DROP periods they elected. So, that's kind of an important caveat and we can't predict exactly whether that will happen, but, we think it's fairly likely. So, from that perspective, it does seem that DROP participants, at least KHP DROP participants ,are working longer careers. In spite of this, we looked at, as I said, a few of the specific issues that KHP was hoping DROP would help them address. So, this is getting more troopers on the road and helping address some of the under staffing issues in the 65 counties that they identified. What we found though, is that DROP may be more effective, actually retaining higher ranking administrative staff than in retaining the frontline law enforcement staff that KHP were hoping DROP would help them help them retain. So, during 2016 to 2019, administrators made up about 14% of KHP retirees, but 36% of KHP DROP participants. And by contrast the frontline staff, so, these are the road troopers made up about 83% of KHP retirees, but only 64% of KHP DROP participants. So, frontline staff, are proportionately under represented. We also found that only eight participants total had come from any of those 65 understaffed counties that KHP identified in 2015 and so the majority of them are actually coming from counties without identified staffing shortages.

Brad Hoff, Host and Recruiting and Training Manager: [15:25]
The audit report noted that only 32% of eligible KHP and KBI employees have participated in DROP as of April 2020, but that more are likely to join. So, why does the team expect enrollment to grow in DROP?

Andy Brienzo, Principal Auditor and Supervisor: [15:45]
So, as you mentioned, 32% of eligible employees joined DROP as of April 2020. So, this is 39 of the 121 KHP and KBI staff who could have joined by then. Now on average, the staff who joined had 28 years of service when they entered DROP. So, current employees who are eligible for DROP, they're retirement eligible currently, have 22 years of service on average, and we think that as those staff continue accruing service credits and maybe they get a little closer to the average of 28 years, some of them will probably join DROP. In addition, we asked our survey respondents

about this and 10 currently employed non-participants who responded to our survey said that they do plan to join the program and five more said that they were unsure. So, of course they could join or not in the future.

Brad Hoff, Host and Recruiting and Training Manager: [16:33]
The report also has a section that discusses the potential effects of expanding DROP to all Kansas police and fire employers. So, I know the audit team, you guys talked to several of these employers. What did you learn from talking to these officials?

Andy Brienzo, Principal Auditor and Supervisor: [16:52]
DROP is currently only available to KHP and KBI employees. That's about 565 staff. Senate Bill 343 in the 2020 session would have expanded DROP eligibility to all 112 KP and F employers. They have about 7,500 total staff, but that bill didn't pass. It could be reintroduced in a future session, theoretically. So, we thought we would look into, kind of what might happen if it were to be passed in the future. So, as part of that, we talked to several KP and F employers outside of KHP and KBI who don't currently have DROP access about some of their thoughts about expansion. So, we tried to get a cross section of small and large state and local employers from across Kansas. And we had two university police departments, two fire departments, and a County Sheriff's office that we talked to and in some cases, we spoke with budget or human resources officials as well and most of them told us they thought DROP could be a useful recruiting and retention tool. They said both of these things are difficult for them. More employers thought it would help with retaining experienced staff than with recruiting new staff because new staff are generally young and retirement incentives are often not relevant to them. One employer said DROP might help retirees pay for health insurance. So, as I mentioned before, there's usually a gap between when KP and F employees retire and when Medicare is available. So, one of them thought this might help employees bridge that gap and then one mentioned that they thought DROP would actually help with succession planning. It would give them firmer retirement dates three to five years in advance because that's the DROP period that that participants have to select and that would help them schedule their hiring and promotion testing in a more efficient way and also they would consider allowing employees - their employees to join DROP if the legislature expanded at the agency as to approve DROP participation, but they all said they would consider allowing that and they all believe their employees would have an interest in an expanded DROP. But on the other hand, they did have concerns about the cost of all five of the employers that we talked to had concerns about the programs costs. So, employers have to make larger contributions if DROP increases KP and F's actuarial liability and KPERS officials told us that cost uncertainties is actually DROP's expansion biggest drawback.

Brad Hoff, Host and Recruiting and Training Manager: [19:15]
So talk more about these cost increases and what that looks like in practice.

Andy Brienzo, Principal Auditor and Supervisor: [19:21]
KPERS' actuaries estimated how expanding DROP during the 2020 legislative session would have affected KP and F's actuarial liability, which if that goes up and then employer contribution rates go up to help cover that actuarial liability increase. They found that expanding DROP would likely increase the employer contribution rate by between 0.17% and 1.16%. And that range is dependent on how staff use the program. So, that depends on whether they are actually deferring retirement as the program intends, retiring later than they were otherwise going to, or if they're simply joining DROP in anticipation of when they were going to retire anyway. That's the more expensive scenario so that helps explain why there's a range. We also talked to KPERS about whether the expansion would create any administrative costs for them. They thought they would need $65,000 in additional one-time IT work to administer an expanded DROP and they would probably have to hire an extra benefits analyst at about $74,000 annually.

Brad Hoff, Host and Recruiting and Training Manager: [20:28]
The audit team also had an opportunity to compare DROP in Kansas to similar programs in other states. What did you learn in these comparisons?

Andy Brienzo, Principal Auditor and Supervisor: [20:41]
So, we compared Kansas DROP to four similar programs in other states. One from Colorado, one from Iowa, and actually two from Nebraska, one of which is the city of Omaha's program, which KPERS officials told us was the model for Kansas' program. And we found that Kansas' DROP, which is designed to be cost neutral, is similar in a lot of ways to these other programs. So, they are also designed to be cost neutral and they use a lot of the same cost neutral elements to try to achieve this. So, for example, all the systems limit the amount of interest they pay participants. Most systems require participants and employers to keep contributing to the pension system and then most encouraged participants to delay joining the deferred retirement program. So, in Kansas, as I mentioned before, participants stop accruing service credits, which means that their retirement benefit amount is locked in in most cases when they join DROP. So, by waiting to join DROP, and they can get a bigger benefit. And actually joining DROP later is less expensive for the retirement system. Now, the one that we reviewed that is, was least like Kansas was Nebraska's, but they told us that they closed their program to new participants, actually partially due to costs. They had the fewest features among the plans that we reviewed for achieving cost neutrality. So, they were the most different, from Kansas, which as I mentioned, includes a lot of those cost neutral elements of the different programs that we looked at.

Brad Hoff, Host and Recruiting and Training Manager: [22:14]
Finally, what is the main takeaway of the report?

<u>Andy Brienzo, Principal Auditor and Supervisor:</u> [22:17]
So, the main takeaway I would say is that in its current form, DROP costs the state very little, it is cost neutral, designed to be cost neutral to KP and F and includes a lot of the cost neutral elements. So, we saw on the other plans that we reviewed, it doesn't create new staffing expenses thus far as it is not meaningfully increased administrative costs and yet our survey results suggest that DROP participants are factoring DROP into when they retire. It's an important part of their financial planning and retirement and the data from KHP shows that KHP DROP participants are likely to work longer careers on average. So, it does seem to be meeting its goal in general of influencing retirement behavior, perhaps encouraging staff to defer retirement a little bit later than they otherwise would have. It's impossible to predict exactly what would happen if it were expanded to all 112 KP and F employers- probably increase employer costs by a small amount, but overall it seems to be a relatively inexpensive program that does meet some of its goals in helping shape people's retirement behavior.

<u>Brad Hoff, Host and Recruiting and Training Manager:</u> [23:33]
Andy Brienzo is a principal auditor at Legislative Post Audit. He supervised an audit that evaluated the deferred retirement option program in Kansas. Andy, thank you for taking the time to walk me through the findings.

<u>Andy Brienzo, Principal Auditor and Supervisor:</u> [23:45]
Thank you, Brad.

<u>Brad Hoff, Host and Recruiting and Training Manager:</u> [23:46]
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