

February 17, 2017

Mr. George Hopkins
Executive Director
Arkansas Teacher Retirement System
1400 West Third Street
Little Rock, Arkansas 72201

Re: House Bill 1365

Dear Mr. Hopkins:

You have asked us for our analysis of House Bill (HB) 1365 as it relates to the Arkansas Teacher Retirement System (ATRS).

Arkansas Code §24-7-202 (32) currently defines salary to include all remuneration paid to a member who is employed in a position covered by ATRS on which the employer is required to withhold federal income tax, unless the remuneration results from a contract buyout agreement, settlement, claim, judgment, arbitration award, decree, or court ordered payment to a member. Remuneration from a contract buyout settlement, claim, judgment, arbitration award, decree, or court ordered payment is only included in the definition of salary if such remuneration exceeds the amount paid to the member for regular services.

Sections 1 and 2 of HB 1365 modify Arkansas Code § 24-7-202(32)(A) and (C). Taken together, the two sections change the definition of salary to include all remuneration paid to a member on which the employer is required to withhold federal income tax *or on which federal income tax would be due* except for remuneration that results from a contract buyout agreement, settlement, claim, judgment, arbitration award, decree, or court ordered payment to a member, regardless of the amount paid.

We understand that the change to the definition of salary accomplishes two objectives:

1. It clarifies the intent of the statute that salary does not depend on an employee's election (or other special situation) regarding employer withholding.
2. It excludes from the definition of salary all remuneration that results from contract buyout agreements, etc. regardless of amount, and regardless of their status with respect to federal income tax.

Section 3 of HB 1365 modifies Arkansas Code §24-7-735(b)-(d) concerning the settlement of claims and judgments between covered employees and covered employers participating in ATRS to:

1. Remove from current law §24-7-735(b) which requires employer contributions on remuneration that results from a contract buyout agreement, settlement, claim, judgment, arbitration award, decree, or court ordered payment to a member (under §24-7-708).

2. Replace it with language requiring that the employer provide ATRS with a copy of the settlement agreement or court order so that the system can take action to prevent the accumulation of service credit for any payments that are not the result of on-site work for the employer.
3. Prohibit the accumulation of service credit or salary credit under a settlement agreement or court order except under certain conditions outlined in §24-7-735.
4. Relabel current subsection (d) as (c) and expand its provisions to allow either employees or employers to purchase additional service credit years or additional salary in the case of a settlement agreement or court order to resolve a claim of wrongful termination or underpayment of salary that should have been paid.
5. Modify (new) subsection (c)(1)(A) to add two subsections that allow the member to add the (purchased) salary to their final average salary and add it to the member's "official salary record".
6. Require in new subsection (d) that the additional salary purchase be made with the same factors that are used for annuitization of T-DROP distributions and to specify that the calculation is to be made assuming that the member would have retired immediately at the time of the salary purchase.

Our understanding of the effect of this bill is as follows. Present law would require certain lump sum settlements (which could potentially be large) to be automatically included in the final average salary calculation and thereby to increase the ATRS benefit payable to the affected member.

Although current law requires payment of employer contributions on those amounts and also requires that the amounts must be in excess of the wages earned by the member for regular service (to be included in the definition of salary), the result in many cases would be a loss to the system. HB 1365 removes this possibility (and therefore this potential net loss) from the statute, but allows the employer to purchase additional service or salary credit on behalf of a member in order to resolve a claim of wrongful termination. The end result of HB 1365 seems to us to be twofold.

1. With proper drafting of the court order or settlement agreement, the member can be put in the same position she or he would be in if HB 1365 is not enacted.
2. The portion of the cost of the settlement agreement or court order that is currently being shifted to ATRS (and which acts to increase the contribution rate or amortization years) will, if HB 1365 is enacted, be borne by the specific employer involved in the situation.

We think that HB 1365 will result in a savings to ATRS because certain losses that would otherwise occur will be avoided. We do not have specific data upon which to measure the savings. If, for example, one person per year is affected and the amount of loss avoided is \$100,000 per year, the savings to ATRS would be less than 0.01% of payroll or one amortization month.

We hope this analysis meets your needs.

Please review this letter carefully to ensure that we have understood the bill properly. The analysis in this letter should not be relied upon if there is doubt about our understanding of the bill. Our analysis relates only to the plan changes described in this correspondence. In the event that other plan changes are being considered, it is very important to remember that the results of separate actuarial analyses cannot generally be added together to produce a total. The total can be

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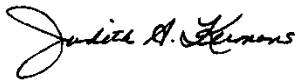
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considerably greater than the sum of the parts due to the interaction of various plan provisions with each other, and with the assumptions that must be used.

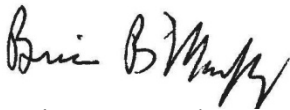
We did not review this bill for compliance with Federal, State, or local laws or regulations, and internal revenue code provisions nor did we attempt to determine whether these changes would contradict or negate other related State, or local laws. Such a review was not within the scope of our assignment.

Brian B. Murphy, Judith A. Kermans and Heidi G. Barry are Members of the American Academy of Actuaries (MAAA) and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein.

Sincerely,



Judith A. Kermans, EA, MAAA, FCA



Brian B. Murphy, FSA, EA, MAAA, FCA



Heidi G. Barry, ASA, MAAA

JAK/BBM:rmn