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House Bill 1374

(with Proposed Amendment No. 1)
Actuarial Cost Study prepared for
Joint Committee on Public Retirement and Social Security Programs
of the Arkansas 91st General Assembly

Provisions of the Bill

House Bill 1374 affects the Arkansas Teacher Retirement System (ATRS).

Arkansas Code §24-7-727 concerns cost of living adjustments (COLAs) in ATRS. Typically, the COLA in ATRS is what is known as a "simple" COLA; that means that the benefit is increased only as a percentage of the base benefit amount rather than "compounded" over time. However, the ATRS Board has the power to compound the COLA from time to time in order to increase the base amount. Statute also provides the ATRS Board the authority to reverse such a compounding, provided that the liability amortization period is greater than 30 years. House Bill 1374 modifies this 30 year threshold to 18 years and adds new subsections allowing such reversals to be phased in and allowing proxy formulas to be applied when members have changes in benefits due to divorce, remarriage, or death.

Fiscal Impact

ATRS was unable to provide precise data to estimate the impact of a reversal of the 2009 compounding. We used the data available to arrive at a rough estimate of the potential impact, assuming a reversal of the 2009 compounding happened by 2018. The actual impact will depend on the timing of the reversal and how any phase-in is implemented by the ATRS Board.

We would estimate that such a reversal would save at least $125 million in liability to ATRS under current assumptions. More expansive reductions/reversals in compounding could result in savings of more than $225 million, but we would anticipate that the ATRS Board would take measures to ensure benefit levels were not lowered as a result of the phase-in language, so that level of savings may be unlikely. These levels of savings would roughly correspond to reductions in the amortization period of between 2 and 3.5 years under current assumptions.

We understand that there was also a compounding event in 2001; if that compounding were reversed, we would anticipate that savings estimates would increase, again, depending on the details of implementation. The language in the proposed amendment seems to suggest that only the 2009 compounding is in focus.

We would note that the estimates described might not be additive with the effects arising from other potential benefit changes that the ATRS Board may implement.

Policy Considerations / Other

There are a total of eight bills (SB 141, SB 185, SB 186, SB 187, SB 218, HB 1286, HB 1373, and HB 1374) that alter the authority granted to the ATRS board to set benefits and contribution rates. Benefits and contribution rates historically had been set by the legislature, and the ATRS board adopted policy to implement them. In 2013, several Acts granted expanded authority to the ATRS board in certain situations. Act 967 of 2013 granted the ATRS Board the power to reverse a compounding in certain situations.

Originally many of these bills contained language which suggested that benefits may be altered based on current and future actuarial assumptions. We had concerns about potential issues with IRC 401(a)(25) if this wording were present; we are more comfortable with the wording present in House Bill 1374 with the proposed amendment.

The group of 2013 Acts created the language in question with the 30-year threshold. The 18-year number is an approximation for the amortization period at which the system will *at least* pay the interest on its unfunded liability. Many public plan pension actuaries consider this a best-practice for systems using a level percentage-of-payroll amortization of liabilities.

Sincerely,

Jody Carreiro

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