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March 15, 2017

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

Re: House Bill 1374

Dear Mr. Hopkins:

You have asked for our analysis of House Bill (HB) 1374 as it relates to the Arkansas Teacher Retirement System (ATRS). Our analysis reflects an amendment that we received on March 13, 2017.

HB 1374 modifies Arkansas State Code § 24-7-727 concerning compound cost of living adjustments (COLA) under the ATRS.

Under current statutes, the ATRS Board is permitted to compound the cost of living adjustment. In a year in which the Board compounds the adjustment, the cost of living adjustment for that year is 3% of the prior year's benefit, and the base for future adjustment becomes the benefit payable after the compounding. The Board compounded the COLA for the July, 2009 increase. Current statutes also provide the Board with the authority to reverse a compounding of the COLA for all retirants and TDROP participants provided that the amortization period for unfunded liabilities exceeds 30 years. When a compounding is reversed, the COLA in that year is replaced by the simple COLA. This means that the base benefit becomes the base benefit without regard to the compounding, and future COLAs are based on 3% of that base benefit. Future benefits are not reduced to recover additional benefits paid because of the compounding.

Section 1 of HB 1374 modifies Arkansas Code §24-7-727(b)(6) to provide that the Board may reverse a compounding of the COLA if the ATRS actuary certifies to the Board that the amortization period to pay the unfunded liabilities exceeds 18 years and the Board determines, by resolution, that a reversal of the compounding that occurred in 2009 is prudent to maintain actuarial soundness. Effectively, this changes the 30 year threshold for reversal to 18 years.

Section 2 of HB 1374 adds a new subsection (7) to §24-7-727(b). New subsection (7) permits the Board resolution reversing a compounding COLA to include a chart or proxy formula to be applied when a benefit changes due to divorce, remarriage, or death of either the member or the member's spouse. It also adds a new subsection (8) to §24-7-727(b). New subsection 8 permits the Board to phase in the reversal (by resolution), and requires that a reversal be applied at the beginning of the fiscal year.

Precise data to estimate the effect of a reversal is not readily available at this time. Consequently we have used approximate techniques to estimate the savings in connection with a reversal of the 2009 compounding of the COLA. Based upon those techniques, and assuming that the reversal takes place no later than the July 1, 2018 increase, we estimate that the savings in liability will be on the order of $103 Million to $165 Million. Such a saving would reduce the amortization period by about 1.7 to 2.7 years. If a more precise result is needed and additional data becomes available, we would be happy to update this estimate.

Users of this information should be aware that estimates of changes in amortization periods are heavily dependent on actuarial assumptions and on the amortization period before the change. Please refer to the full actuarial report of the June 30, 2016 valuation for a complete description of actuarial assumptions and methods.

Please review this information carefully to ensure that we have understood the bill properly. The analysis in this letter and report 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 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 law or regulations, and internal revenue code provisions. Such a review was not within the scope of our assignment.

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 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 or legislation currently under consideration. 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

Judith A. Kermans, EA, MAAA, FCA

Brian B. Murphy

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Heidi G. Barry

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JAK/BBM:sc