



February 3, 2011

Mr. Larry Dickerson
Executive Secretary
Arkansas State Highway
Employees Retirement System
PO Box 2261
Little Rock, AR 72203

Re: Actuarial Impact of House Bill No. 1119 (HB 1119)

Dear Larry:

You have requested that Gabriel Roeder Smith & Company (GRS) determine the actuarial impact on the Arkansas State Highway Employees Retirement System (ASHERS) of HB 1119. This bill amends the following sections of the Arkansas Code: § 24-4-102, 24-5-205, 24-6-223, 24-6-413, 24-7-715, and 24-10-616.

The amended sections add clauses which allow the State of Arkansas retirement systems (including ASHERS) to reduce the benefits of members who plead guilty, nolo contendere, or are found guilty of the theft of property against the employer. In such cases, the benefit would be recalculated to exclude the months of service in which the theft occurred from the portion of the annuity provided for by employer contributions. The bill specifies that the reduction will only apply to thefts that occur on or after July 1, 2011.

It is probable that the bill will reduce future pension benefits for some current or future members of ASHERS. However, we don't believe the number of members impacted will be of sufficient quantity to provide a material impact to the System. Therefore, we conclude that if HB 1119 becomes law it will have no material impact on the funded status and contribution requirements of ASHERS.

We would like to point some possible concerns we have the administration of the bill. The bill states that the portion of the annuity provided for by employer contributions will be reduced. We believe this language leaves some ambiguity as to how the calculation of the reduction would be performed. We can think of several possible ways that the determination of the reduction could be performed, three of which are discussed below.

One possible way to determine the portion of the total benefit that is employee provided would be to annuitize the employee's contribution balance and then subtracting this amount from the member's total annuity. The remaining amount would be the employer piece which could then be prorated based on service excluded due to theft vs. total service. However, even this methodology has two alternatives: (1) determine the employee's portion of the annuity reflecting the automatic COLA, or (2) determine the employee's portion of the annuity ignoring the automatic COLA.

Another possible way to determine the employee's portion of the annuity would be to multiply the total annuity by the ratio of the employee's contribution rate to the total rate (employee plus employer). However, it is possible that this may produce a significantly smaller employee provided

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annuity than other methods. As you are aware, the total normal cost percentage of the System is 13.68% of pay. The normal cost is often referred to as the cost of the average member's benefit earned under the plan. With a total contribution rate of 18.90% of pay (6.00% from the employees and 12.90% from the employer) there is more than 5% of the total contribution rate being used for something other than the normal cost of the plan. Therefore, using this methodology may understate the proportion of the total annuity that is actually paid for by the member. There are several other methods that could be used. We would be happy to discuss this issue with you at your convenience.

A third possible alternative for determining the employee's portion of the annuity would be to multiply the total annuity by the ratio of the employee's contribution rate to the total normal cost rate. However, even this methodology has the issue that the normal cost percentage can change over time. Therefore, there would need to be a procedure to identify which normal cost rate would be used, the normal cost rate during the theft, the normal cost rate during when it is determined the member is subject to the reduction (pleads guilty or is found guilty), or the average of the normal cost rates during the period of theft.

One last item we would like to discuss is the reference to portion of the annuity based on employer contributions. While we understand the reasoning for this language, we would just like to point out that this might be interpreted as excluding benefits accrued during the Deferred Retirement Option Program (DROP). As you know, the member's benefit is frozen when a member enters DROP. Therefore, excluding service earned after a member enters DROP may technically have no impact on the member's benefit. We believe the authors of the bill may want to reconsider the language to make sure that member's who commit theft while in DROP are impacted similarly to those that are not in DROP.

Joe Newton is a member of the American Academy of Actuaries and meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

If you have any questions regarding this estimated impact statement, please don't hesitate to contact us.

Sincerely,



Lewis Ward
Consultant



Joseph P. Newton, FSA, MAAA, EA
Senior Consultant

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