

February 16, 2011

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

Re: House Bill 1140

Dear George:

You have asked us for an analysis of House Bill (HB) 1140 as it relates to the Arkansas Teacher Retirement System (ATRS). Our understanding of this Bill as it relates to ATRS is described below. If our understanding is in any way incorrect, please let us know prior to using the results of our analysis.

HB 1140 modifies Arkansas Code Section 24-7-202 (27) related to the definition of Salary and the calculation of Final Average Salary. It deletes much of the language contained under item 24-7-202 (27) and creates a new Section 24-7-735 under Code Title 24, Chapter 7, Subchapter 7 entitled "Calculation of final average salary". The new Section 24-7-735 contains most of the 24-7-202 (27) language along with what appear to be some modifications to improve clarity and equity. New Section 24-7-736 contains relocated language related to Salary Contracts that is unchanged in meaning from the similar language that had been in 24-7-202(27).

New Section 24-7-735 provides for partial years of service to be included in the calculation of final average salary if a member has *'a partial service year that is higher than a full service year'*, and allows members with a break in covered employment of eight or more years between any of the member's three highest salary years an exemption from the 120% /\$5,000 rule.

This Bill appears to be attempting to resolve a potential equity issue in the application of the 120%/\$5,000 rule. Average salary levels can change significantly over an 8 year period simply due to inflation. An individual who has a break in service of 8 or more years could have his or her entire sequence of highest average salaries capped because of salary inflation that happened during the break in service and that is in no way related to the individual. Based on discussions with ATRS staff, there are only 2 or 3 people who might be impacted each year by this change. If, for example, 3 retirements were affected each year by this change and the increase in final average compensation of each affected retiree was \$2,000 the cost of this Bill would be less than 0.002% of payroll and there would be no measurable impact on the amortization period (52 years as of June 30, 2010). Even though there is a slight cost to correct this inequity, the overall savings generated by the comprehensive ATRS legislative package should be more than sufficient to offset this slight cost. Policymakers will need to balance equitable treatment of individuals against the very small additional cost. If data on members in this specific situation can be provided, we would be pleased to refine our numerical estimate of the cost.

We have the following technical comments for Counsel on the drafting of this Bill:

1. 24-7-735 (c) (1) provides that the Board of Trustees shall set the number of years to be included in the final average salary calculation.
2. 24-7-735 (d) and 24-7-735 9(c)(2)(B) refer specifically to the member's 3 highest salary years. Should the numeral "3" be included here since it appears to conflict with 24-7-735(c)(1)?
3. 24-7-735 (d) exempts the entire highest salary sequence from the application of the 120%/\$5000 rule if there is a break in service of 8 or more years between any of the member's three years. Was this intended or was the intention to only omit the 120% restriction when comparing the salary prior to break and the salary following the break?

We hope this analysis meets your needs.

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.

The undersigned are Members of the American Academy of Actuaries and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

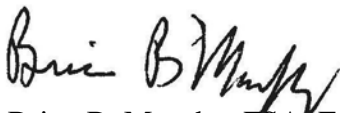
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Sincerely,



Judith A. Kermans, EA, MAAA, FCA



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

JAK\BBM:bd