GRS

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February 20, 2013

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

Re: Estimated Actuarial Impact of HB 1125 – Elimination of Lump Sum Vacation Pay from Inclusion in Average Earnings

Dear Larry:

You have requested that Gabriel Roeder Smith & Company (GRS) determine the estimated actuarial cost impact of HB 1125, a bill that would exclude lump sum vacation payments from inclusion in the Average Compensation used in the determination of retirement benefits paid by the Arkansas State Highway Employees Retirement System (ASHERS). The proposal would be effective for members who retire on or after the effective date of July 1, 2013.

Background

The benefits of members retiring from ASHERS are computed based on their Average Compensation which is the highest annual compensation paid a member during any period of thirty-six consecutive months of creditable service with a state employer. Under current ASHERS's statutes, members who retire without entering into DROP may include in their Average Compensation the lump sum payout of their unused vacation leave. The bill would eliminate the ability of retiring members to include this lump sum payout in their Average Compensation.

Cost Analysis

In determining the actuarial liabilities of ASHERS, we do not currently assume that retiring members will receive a lump sum payment of unused vacation leave. When a member retires and increases their Average Compensation by including lump sum vacation leave, an actuarial loss occurs if the inclusion of those additional earnings increases the Average Compensation to an amount greater than was expected by the actuarial assumptions.

The proposed legislation should eliminate any actuarial losses that were occurring as a result of the current rules. Therefore, if HB 1125 becomes law it will have no financial impact on the current funded status and current contribution requirements of ASHERS. However, it should improve the funded status over time as losses that are currently experienced when a retiring member includes lump sum vacation pay in their Average Compensation will be eliminated.

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To help quantify the possible impact on the System of the proposed legislation we determined the impact on the current liabilities of the System if we assume that future benefits for retiring members will be reduced by the exclusion of the lump sum vacation payment from Average Compensation. ASHERS does not capture or retain any information regarding the inclusion of lump sum payments for unused vacation leave. Therefore, we performed the analysis assuming that retiring members on average have one month of unused vacation leave, and then again assuming the members had on average three months of unused vacation leave. These amounts are educated guesses based on our work with other retirement systems and should give the reader some idea of the impact of the proposed legislation. It should be noted that these only apply to members who did not go into DROP (we currently assume 65% of active employees will enter DROP). Members who enter DROP freeze their benefit accrual and therefore cannot increase their Average Compensation at termination.

If retiring members on average have one month of unused vacation leave it is expected that the bill will eliminate future actuarial losses with a present value of $3.9 million. If retiring members on average have three months of unused vacation leave it is expected that the bill will eliminate future actuarial losses with a present value of $11.5 million. As stated above, this will not impact the current funded status of ASHERS as these are the elimination of future losses which are not recognized in the current liabilities of the System.

Data and Assumptions

Our analysis is based on the actuarial data and financial information as of June 30, 2012 and all assumptions and methods used for the June 30, 2012 actuarial valuation. Note that we have assumed that the passage of the bill will not impact a member's decision to retire. It is possible that members who are retirement eligible and who are not currently planning to retire between now and the effective date of the legislation, will decide to retire before the effective date of the legislation if they have significant amounts of unused vacation leave. This would most likely create an actuarial loss for the System. Because no data is available regarding current unused vacation leave balances, we have not attempted to quantify this possible impact. However, we believe the impact would be less than the overall gains that will be achieve by the exclusion of the unused vacation leave after the effective date.

Our calculations are based upon assumptions regarding future events, which may or may not materialize. Please bear in mind that actual results could deviate significantly from our projections, depending on actual plan experience. Our calculations are also based upon proposed plan provisions that are described above.

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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