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Senate Bill 137

(As Engrossed March 20, 2013)
Actuarial Cost Study prepared for
Joint Committee on Public Retirement and Social Security Programs
of the Arkansas 89th General Assembly

Provisions of the Bill

Senate Bill 137 affects the Local Police and Fire Retirement System (LOPFI). As described below, this bill affects three distinct areas that we will label EE Interest, Vesting, and DROP.

The first area is interest on employee contributions (**EE Interest**). Under current law, LOPFI maintains individual deposit accounts for each member which are credited with 3% interest annually. If a member terminates employment before becoming vested, he or she is due a refund of these contributions, with interest. A member and his beneficiary are also guaranteed to receive at least the amount of accumulated contributions, with interest, as annuity payments during retirement. Senate Bill 137 would end the annual 3% interest crediting to members' deposit accounts. Additionally, the guaranteed return of contribution upon retirement would no longer take interest credits into account.

Vesting - Under current statutes, members of LOPFI are required to have five (5) years of credited service for vesting purposes and five (5) years of actual service to purchase additional service. Senate Bill 137 would require ten (10) years of actual service for members to be eligible for service purchases, voluntary retirement, disability retirement, death-in-volunteer-service benefits, and vesting.

DROP - Senate Bill 137 would also extend the DROP period from the current five (5) years to a new maximum of seven (7) years. Additionally, participants would receive a 3% cost-of-living adjustment (COLA) in their 6th and 7th years of DROP participation.

Senate Bill 137 also makes a small change concerning nonuniformed plans' investment advisors. This would subject investment advisors to the restrictions placed on APERS rather than LOPFI. We understand that this was simply a language oversight that needs correction.

Fiscal Impact

EE Interest - Senate Bill 137 generates a savings by not paying interest on the member deposit accounts in the future. This savings is realized when a non-vested member terminates and gets a refund of the member deposit account. This savings would be increased some by the effect of a longer vesting period, but would remain small. We estimate the overall savings, depending on changes in member behavior, would be 0.02% - 0.03% of payroll.

Vesting – The change that Senate Bill 137 creates in the vesting of benefits is only for future members of the system. Therefore, the savings will only be realized as new members are added to the system. The ultimate savings from this change would be about 0.20% of payroll. But, this savings would be realized over 15 – 20 years. In other words, the savings might be only about 0.01% every year over the next 20 years.

DROP – The DROP provisions of Senate Bill 137 have a fiscal impact that is highly dependent on member behavior. That is, will members enter DROP earlier or ultimately retire later if these provisions are enacted? Since the system is only 30 years old, there is not a lot of experience with DROP. We reviewed a wide variety of scenarios comparing the current DROP with the proposed provisions and found that without behavioral change the actuarial value is not significantly affected. That is, the cost impact is a savings, but not a significant savings.

If the assumptions are changed so that a later ultimate retirement is anticipated, a more significant savings is generated, on the order of about 0.20% of payroll reduction in the average paid member contribution rate of 18.01%. If members access DROP earlier in their career, or, if they access at an older attained age without a later ultimate retirement, there could be a small increase. Overall, it is our opinion that this change would result in a savings in the contribution rate between 0.05% and 0.20% of member payroll.

Related Legislation

Senate Bill 137 is an overarching bill which includes, along with the DROP provisions, the language of Senate Bills 72 and 124. If Senate Bill 137 is passed, we do not foresee Senate Bills 72 or 124 being presented to the committee.

Policy Issues – EE Interest

We reviewed federal pension law which would typically not allow this change, and found that those provisions do not apply to governmental plans. Therefore, the policy consideration is whether the legislature wants to require employee contributions and return those contributions without any interest if the members do not vest.

Policy Issues – Vesting

There are a few considerations that need to be given thought before deciding this vesting issue. As with the interest on member accounts, this would not be allowed in private plans, but it is allowed for governmental plans. All of our other statewide pension plans have 5 year vesting. We are not completely sure how having one of the reciprocal systems with a different vesting pattern than the others would affect reciprocity in general. It would appear to lessen the attractiveness of the LOPFI plan in recruiting new members if they know that 10 years is required to vest.

Policy Issues – DROP

The past several sessions whenever DROP related issues have come before this Committee, we have provided a similar list of policy issues. Here are some policy issues that the Committee should consider:

1. The Arkansas Teachers Retirement System has a 10-year DROP and the Arkansas Public Employees Retirement System has a 7-year DROP. But in our review of nearby states and in a national review of DROP provisions, the typical DROP is 3 to 5 years. The ATRS 10-year DROP is the longest we have found in the country.

2. The DROP proposition allows a "trade off" of a lump sum (DROP balance) for monthly retirement benefit. A person who enters DROP for 5 years has "traded" about 30% of their monthly benefit for a lump sum. If the period were increase to 7 years, the member could "trade" over 33% of their monthly benefit. The ability to "trade" about 1/3 of the monthly benefit for a lump sum may conflict with the objective of providing a livable guaranteed retirement income.

3. Longer DROP periods increase the possibility of public perception problems. The DROP accounts can become a significant dollar amount. For example, a typical member on DROP for 5 years has a lump sum that is 3 to 3.5 times their final salary. If the DROP period was extended to 7 years, that lump sum amount would grow to more than 4.5 times final salary.

Sincerely,

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Actuary