

Senate Bill 232

(As Engrossed February 19, 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 232 affects the deferred compensation plan that is administered by the Employee Benefits Division (EBD). The current deferred compensation plan administered by EBD is referred to as the Arkansas Diamond Plan.

The Arkansas Diamond Plan provides state employees an opportunity to save pre-tax dollars for retirement, above the basic defined benefit plan provided by the state (i.e. APERS, ATRS, ASHERS, etc.). The Diamond Plan is also available to other political subdivisions of the state that elect coverage, i.e. cities and counties. It is a qualified deferred compensation plan under section 457 of the Internal Revenue Code.

Senate Bill 232 amends the Arkansas Code, authorizing the deferred compensation plan to add automatic enrollment. This automatic enrollment feature would only apply to employees of the state whose employing departments are participating in the deferred compensation plan. The practical effect of the bill is that all new employees beginning January 1, 2014 would automatically be enrolled to defer 3% of salary into the Arkansas Diamond Plan. This is in addition to the 5% that they are required to contribute for participation in APERS. As defined in federal law and regulations, the employee would have the option to increase or decrease this amount of deferral. The employee can even elect not to defer. By regulation, they have the first 90 days of employment to change their mind and if they elect not to participate at all, can be returned their deferrals during that period. If the employee makes no elections at the time of employment, 3% will be deferred from their salary and it will be invested in a default investment account chosen by EBD.

Automatic deferrals were added to federal code by the Pension Protection Act of 2006. They were first available to plans beginning in 2008. This was primarily a law change for 401(k) deferral plans, but was also made available to other deferral type plans (403(b) or 457). Studies of 401(k) plans that were the first to use this provision have shown that they do encourage an increased average deferral rate for the participants.

EBD estimates that 19,000 of 32,000 state employees who are eligible do not participate in the Arkansas Diamond Plan. This is about a 40% participation rate.

Fiscal Impact

Since the state does not contribute to the deferred compensation plan, the primary cost will be for administrative changes needed to implement this provision. We are told there will be programming costs (\$175,000) and possibly some additional staff needed by EBD. Much of the administrative cost would be borne by the third party administrator that actually packages the Arkansas deferred compensation plan as Arkansas Diamond Plan. They are paid based on a percent of the assets invested as agreed to by EBD in their contract. EBD does not expect any change in these charges.

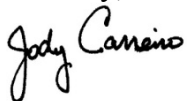
Other Issues

The primary policy issue for the committee to consider is how effective the automatic enrollment will be when layered on top of the defined benefit plan. All new state employees must participate and contribute 5% of salary to APERS (6% to ATRS or ASHERS). Senate Bill 232 would add an additional 3% deferral to this amount. This would mean a new employee would be required to defer a total of 8% of salary. The question becomes whether automatic enrollment would produce increased savings given the employees ability to opt out.

The Arkansas Diamond Plan is the “packaging” of the third party administrator. The bill refers to it by name in two places. Although the bill also notes that this applies to any “subsequent deferred compensation plan”. The definition on page 2, lines 19 and 20 only refers to Arkansas Diamond Plan.

Finally, please note that there are significant notice and election requirements to meet the rules and regulations associated with IRS section 414(w), which allows automatic elections. EBD will adopt rules to align the deferred compensation plan with federal rules, but the implementation will mostly be entrusted to the third party administrator. The state, through the EBD, will retain the fiduciary responsibility for the implementation of the rules.

Sincerely,



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Actuary