GRS
Gabriel Roeder Smith & Company
Consultants & Actuaries

One Towne Square
Suite 800
Southfield, MI 48076-3723

248.799.9000 phone
248.799.9020 fax
www.gabrielroeder.com

March 12, 2015

Mr. David B. Clark
Executive Director
Arkansas Local Police and Fire Retirement System
620 W. 3rd, Suite 200
Little Rock, Arkansas 72201-2212

Re: House Bill 1204

Dear Mr. Clark:

House Bill (HB) 1204 proposes to amend Section § 24-10-706 of Arkansas Code. Our analysis of the proposed amendments to this section as they pertain to the Arkansas Local Police and Fire Retirement System (LOPFI) follows. This report is intended to be used by LOPFI for purposes of estimating the increase in employer contribution rates as a result of this proposal and should not be relied upon for any other purpose.

The proposed change to this Section allows a DROP participant to leave their DROP account balance on deposit with LOPFI after termination of employment, until age 70 1/2. Interest on this balance would receive annually the greater of 2% less than the LOPFI annual market return or 0%.

We did not explicitly model this proposed benefit change, however we expect that employer contributions would increase by 0.02%-0.07% if this legislation were enacted. The basis for this estimate is 1) that interest credits in excess of projected LOPFI annual returns would result, 2) that one-fifth to one-half of LOPFI members eligible to participate in the DROP would do so and 3) to provide an upper end on this estimate, that most would choose to leave their monies on deposit.

Based on current capital market assumptions and current plan investment policy, the proposed legislation is expected to generate interest credits that are about 0.60% higher (i.e., 60 basis points) than projected LOPFI annual market returns. Regardless of any other assumption, the proposed legislation requires LOPFI to payout interest at a rate higher than LOPFI is expected to earn.

The interest credits would vary significantly from one benefit recipient to another. This is evident in the past if LOPFI average returns are compared for relatively short periods (10 years or less).

Currently, a DROP participant, upon termination of employment, may receive their DROP balances as a lump sum or as an annuity. The additional option of leaving their monies on deposit with LOPFI exposes LOPFI employers to additional investment and anti-selection risks. This would be the case even if the interest crediting plan did not generate interest credits in excess of projected LOPFI returns. Analysis of these additional risks is outside the scope of this study.

Please review this letter carefully to ensure that we have understood the bill properly. The analysis in this letter should not be relied upon if there is doubt about our understanding of the bill. 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.

We did not review this bill for compliance with Federal, State, or local laws or regulations, and internal revenue code provisions. Such a review was not within the scope of our assignment.

Heidi Barry is a Member of the American Academy of Actuaries (MAAA) and meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein. This report relies on the annual actuarial valuation report as of December 31, 2013.

Circular 230 Notice: Pursuant to regulations issued by the IRS, to the extent this communication (or any attachment) concerns tax matters, it is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) marketing or recommending to another party any tax-related matter addressed within. Each taxpayer should seek advice based on the individual's circumstances from an independent tax advisor.

This communication shall not be construed to provide tax advice, legal advice or investment advice.

Respectfully submitted,

David L. Hoffman

Heidi G. Barry, ASA, MAAA

DLH:HGB:bd