

February 1, 2017

Ms. Robyn M. Smith
Executive Secretary
Arkansas State Highway
Employees Retirement System
PO Box 2261
Little Rock, AR 72203

Re: Actuarial Impact of Proposed Legislation JNL004

Dear Robyn:

You have requested that Gabriel Roeder Smith & Company (GRS) determine the actuarial impact on the Arkansas State Highway Employees Retirement System (ASHERS) of proposed legislation, which we will refer to as JNL004.

Background

In 1997 legislation was enacted that allowed members of the Arkansas Public Retirement Systems (including ASHERS) to purchase military service credit after attaining five years of service. However, due to administrative error, ASHERS has continued to use the ten years of service as its eligibility requirement that existed before the 1997 law change. After the recent discovery of the administrative error, ASHERS was required to charge members who wanted to purchase their military service credit interest from their five years of service eligibility date even though the members may have been waiting (erroneously) to attain ten years of service in order to purchase the military service credit.

The purpose of the bill is to open a 30-day window that would allow two separate events to take place. First members of ASHERS who have at least five years of credited service as of August 20, 2015 and who can show that they were relying on the ten years of service eligibility requirement before purchasing their military service would be able to purchase their military service without paying interest on the first five years of time following their five years of service eligibility.

Secondly, members who have already purchased military time but were required to pay interest from the date they earned five years of service will be reimbursed for the interest they paid since it is assumed that they were waiting on the ten years of service requirement.

Financial Impact

ASHERS has examined their membership and approximated the lost revenue and refund cost of the legislative proposal. They have segregated their employees with known military service into three groups. The first group is those employees who recently purchased their military time but who were required to pay interest from their five years of service eligibility date. There are two

employees in this group and they would be refunded approximately \$5,932 if the legislation is enacted.

The second group is comprised of those employees who have at least five years of actual service with ASHERS but who have not attained ten years of service yet. In theory, these employees could have been waiting to attain ten years of credited service before purchasing their military service. There are 25 employees in this group. If they all purchased their service immediately, but were required to pay interest from their five years of service date they would collectively pay about \$129,992 in interest. The proposed legislation would forgive this interest charge. Note that the \$129,992 cost number would be a maximum potential fiscal impact as some members will not purchase their military time and therefore, the legislation would have no impact on them.

Finally, the third group is comprised of employees with military time who already have ten years of service with ASHERS. In theory, these employees could have already bought their military time, as they have all already passed their erroneous ten years of service eligibility requirement for purchasing their military time. It is unclear to what extent the proposal would forgive the first five years of their interest charges if they decide to purchase their military service during the 30-day window. There are 25 employees in this group who would be forgiven approximately \$152,235 in interest charges if they are not charged for the period between when they earned five years of service and ten years of service.

Therefore, in total there are 52 employees known to be impacted by the window. It is known that 2 employees would receive refunds totaling \$5,932. The remaining cost of the legislation is not exactly known as the cost is dependent on the actions taken by the impacted employees. The proposal is about interest charges on the purchase price of the military service purchase. However, the employees must still come up with the funds to purchase the military service. These are not insubstantial amounts of dollars and many employees will find it difficult to come up with the funds and will not purchase their military service. If no employees decide to purchase their military service during the window then the total impact would be the aforementioned \$5,932. However, if all 50 employees purchase all of their eligible military service during the window then the lost revenue could be approximately \$282,227.

Other Comments

Currently, the Arkansas Code prohibits benefit enhancements for a retirement system whose funding period exceeds 30 years, which ASHERS currently does. However, it can be debated whether this is a benefit enhancement or the correction of a benefits administration error. We suggest that you speak with your legal counsel about whether this would be a violation of the benefit enhancement provisions of the statute.

The costs shown above are based on the possible estimated cash flows to ASHERS before and after the proposal. However, we believe it is important to note that the purchase price of the military service does not cover the actuarial cost of the service credit. It is often the case that the price charged for purchasing military service is subsidized by the retirement system. In other words the full actuarial cost is not charged to the employee as a reward for providing service to this country.

This is often a policy decision, not an actuarial decision. Because of the number of unknowns involved with how many employees may actually purchase their military service during the window and because the policy of providing a subsidized purchase price is not the issue behind the proposed legislation, we have not estimated the additional actuarial impact of the proposed legislation.

Basis of Calculations

Our calculations are based upon information provided by ASHERS staff.

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.

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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