

Senate Bill 184

(As Engrossed March 22, 2017)

Actuarial Cost Study prepared for
Joint Committee on Public Retirement and Social Security Programs
of the Arkansas 91st General Assembly

Provisions of the Bill

Senate Bill 184 affects the Arkansas Teacher Retirement System (ATRS). Section 1 of the bill also impacts the Arkansas Public Employees Retirement System (APERS).

Section 1

Senate Bill 184 adds an additional section, §24-2-409, to the code concerning DROP benefits under reciprocal service. This new section allows the Boards of ATRS and APERS to establish a program that will allow a transfer of the DROP balance of an APERS member to that member's ATRS TDROP balance. This only applies to members who are reciprocal in the two systems and last employed by ATRS. The APERS member that elects to make this transfer does so at the end of the APERS DROP period, which, under current law, is seven years in length. If a member has already completed their seven year APERS DROP and wants to transfer that balance to ATRS, they may do so by electing within two months of the program being established. There are several other items that are mentioned that must be included in such a program. Notably, a member who transfers their balance cannot receive a monthly benefit from either system for 24 months after the transfer is made.

Sections 2 and 3

Sections 2 and 3 of Senate Bill 184 amend Arkansas Code §24-7-1307, which deals with the interest credited to TDROP account balances. Current law allows the plan interest credit to be determined by the ATRS Board from time to time. Senate Bill 184 allows the Board to determine the rate by board resolution based on either a fixed rate or a variable rate formula tied to investment returns of the system. The bill also allows the Board to establish a "participation incentive rate," which appears to be an increased rate meant to encourage members to leave their TDROP balance on account or award longer participation in TDROP.

Reciprocal Service and DROP - Background

Arkansas Code §24-2-401 et seq. defines the rules concerning how a member that has service in more than one system can apply that service towards retirement. These are known as the reciprocal service rules. In general, if a member has 10 years in System1 and 20 years in System2, then they would have 30 years of reciprocal service and would be eligible to retire. The benefit is calculated by each system individually using their own formulas, except both systems use the highest final average salary among service between the two systems.

When both systems have a DROP program (§24-2-402(8)), the member combines service to determine eligibility for DROP in both systems. If eligible, the member then can begin participation in both DROP systems using the formula for their service in each system and the greater of the two final average salaries. The annuity payments would then begin when the member ceases employment in both systems (§24-2-403(b)), so that would be determined by the last (succeeding) system of employment. In the case of the individuals affected by this bill, annuities would begin when the member leaves service, reaches age 65, or reaches 38 total years of service including reciprocal years (§24-7-502).

We discussed the actual procedures currently followed by the two systems (before Senate Bill 184). The APERS DROP ends after seven years of participation and the ATRS DROP lasts up to ten years of participation. There is not a clear understanding between the two systems about how each manages the end of the DROP period. It is the opinion of ATRS officials that APERS requires members leave to their jobs when they reach seven years of participation the APERS DROP. It is the opinion of APERS officials that they have not required anyone to leave their jobs or take their balances until they leave employment with ATRS, at which point they have the usual options regarding the disbursement of their DROP accounts and the forms of their annuity payments.

Fiscal Impact

The requirement that both boards agree on the procedures needed to implement this program, including the amount of the transfer fee, should allow the systems to come to an agreement about which levers to use to balance any costs. The ability of ATRS to hold additional DROP money and receive the excess earnings above the DROP interest rate for some period of time. This should create a savings for ATRS. The ability to elect to make the transfer with some level of transfer fee implies to us that only those members who feel they can stay long enough to make more interest on the ATRS DROP than what is paid on the APERS DROP would transfer. This implies that someone would bear an economic cost: either the participant or APERS. Therefore, there may be a slight cost to the APERS system depending on the transfer fee level.

ATRS officials, as a result of Sections 2 and 3, feel that their board will set an interest rate on DROP accounts that may be lower than the rate currently paid. If this comes to pass, a 1% decrease in interest rate on the current DROP accounts of \$462 million, would result in a \$4.6 million per year savings to the ATRS system, which would reduce the time to pay off the Unfunded Actuarial Liability by about 1 month.

Policy Considerations / Other

We were not able to secure examples or counter-examples sufficient to prove whether a member was made to leave after seven years on APERS DROP. There are APERS members who have not requested their DROP balances that have been there for more than eight years. They are awaiting notice from those members that they have left ATRS and are ready to receive their benefits. Also,

Act 522 (Senate Bill 202) dealt with language in APERS code that seems to provide concern to ATRS officials. Senate Bill 184 would add a complicated program when it appears to us that the concern has been addressed. The primary result would be granting additional ATRS DROP interest to the accounts of members who otherwise would not have earned interest under APERS DROP.

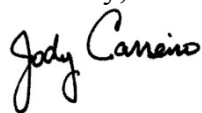
There is a concern that the payment of this type of a transfer would be considered a rollover under IRS law and mean that APERS has made an in-service distribution. An in-service distribution is only allowed in narrow cases in the IRS code and is not provided for in Arkansas Code for APERS at this time.

We also have a concern about (c)(6) of the proposed language. This is found on page 3 lines 27-30 of Senate Bill 184. We believe the intent is that the annuity is calculated in the same way as it was under APERS and reciprocal rules. The language can be easily read to say that the benefit would be recalculated at the end of the APERS DROP participation period. If this language were applied with that reading, there would be a cost increase to APERS. DROP benefits in all systems are based on the benefit at the time of beginning DROP participation based on the annuity benefit and that annuity benefit (usually with COLAs) is paid monthly beginning at the end of DROP participation.

At the end of (a)(3), line 3 and 4 of page 3, this member must elect the transfer “within two months of this act.” It would appear that to be consistent with the remainder of this bill, it should say “within two months of the program implementation.”

As noted above, in Section 2 of the Bill there is a new “participation incentive rate.” It appears that this would pay certain DROP members a higher rate than other DROP members.

Sincerely,



Jody Carreiro, A.S.A., M.A.A.A.
Actuary