

March 21, 2017

Mr. George Hopkins
Executive Director
Arkansas Teacher Retirement System
1400 West Third Street
Little Rock, Arkansas 72201

Re: Senate Bill 184 of 2017

Dear Mr. Hopkins:

You have asked us for an analysis of Senate Bill (SB) 184 as it relates to the Arkansas Teacher Retirement System (ATRS). Our analysis reflects an amendment that we received on March 20, 2017.

Background

Under Section 24-2-403(b), in the case of a person who participates in two or more reciprocal systems, the date the person's annuity becomes payable by each system is to be determined by the provisions in force for each system separately. However, the statute specifically prohibits a person from drawing an annuity benefit from a reciprocal system if the member remains employed by an employer that is covered by another reciprocal system. Our understanding of this statute is that if a member with reciprocal service retires from one reciprocal plan then the member typically must also retire from the other reciprocal plan. In the particular case of a person who participates in both TDROP and the APERS DROP, if the person wants to or must retire from either system, the person must retire from both systems.

Description of Senate Bill 184

SB 184 modifies Arkansas Code Title 24, Chapter 2, Subchapter 4 to add an additional Section 24-2-409 entitled "Transfer of Deferred Retirement Option Plan Balance." SB 184 allows APERS and ATRS to establish a program to authorize the transfer of a completed APERS DROP balance to ATRS under certain conditions. The Boards of both systems must approve the program by resolution. The program becomes effective upon the approval by the second system.

Section 1 of SB 184 allows a member to transfer his or her DROP account balance from the Arkansas Public Employees Retirement System (APERS) which has a 7 year deferred retirement term to the ATRS which has a 10 year deferred retirement term as long as certain requirements are met. The amount of the transfer to ATRS would be the completed DROP balance in APERS, potentially reduced by a reasonable processing fee set by the APERS Board as part of the approval resolution. The requirements are that the member must:

- A. Be actively employed in a position covered by the Arkansas Teacher Retirement System at the time of the simultaneous deferred retirement option plan entry;
- B. Have completed the maximum deferred retirement term in the APERS of 7 years;
- C. Have at least two (2) years of continuing eligibility to participate in the Arkansas Teacher Retirement System's deferred retirement option plan; and
- D. Apply to transfer his or her deferred retirement option plan balance by notifying the Arkansas Public Employees Retirement System and the Arkansas Teacher Retirement System of the intended balance transfer at least two (2) months before the member completes the maximum deferred retirement term in APERS. Members who have already completed the maximum deferred retirement term in APERS on the effective date of the Act have two months to apply to transfer DROP balances to ATRS provided that they notify both APERS and ATRS of the intended balance transfer.

If a balance transfer is authorized, then:

- 1. If the member has not reached the maximum deferred term in APERS on the date that SB 184 is enacted and the balance transfer occurs at a later date, the member is not eligible to draw a benefit from either APERS or ATRS for 24 months from the date he or she reaches the maximum APERS deferred retirement term.
- 2. If the member has already reached the maximum deferred term in APERS on the date that SB 184 is enacted, the member is not eligible to draw a monthly retirement benefit from either APERS or ATRS until 24 months after the month in which the balance transfer occurs.
- 3. The balance transferred is subject to the requirements of the ATRS DROP ("TDROP") in effect at the time of the transfer.
- 4. Both APERS and ATRS must treat the transferred balance as a benefit component of the ATRS after the date of the transfer.
- 5. APERS may not pay a monthly benefit to the member until the member retires from his or her ATRS covered position.
- 6. APERS must calculate the retirement benefit as if the member had retired at the expiration of the APERS DROP participation term.
- 7. The requirements of the TDROP shall apply to a member when the member's APERS balance is transferred to ATRS.

Sections 2 and 3 of SB 184 modifies language in Sections §24-7-1307(c) and (e), respectively, codifying a process by which the Board may determine the plan interest rate to credit to TDROP accounts. In particular, SB 184 allows the Board to adopt either fixed or variable interest rates and requires that the fixed or variable rate be determined prior to the beginning of the fiscal year. Section 2 also provides for the Board to adopt, by resolution, a TDROP participation incentive rate during a fiscal year if investment returns justify an incentive rate for the fiscal year. We understand this to mean that, in a particular year, ATRS might credit more than the pre-determined fixed or variable rate, if investment returns justified such additional crediting.

Analysis of Section 1 of Senate Bill 184 Related to Balance Transfers

We understand from ATRS staff that when an ATRS member who simultaneously participates in both the ATRS TDROP and the APERS DROP after entering the DROP plans as an employee of an ATRS employer and reaches the maximum 10 year deferred retirement period in TDROP, the person must either retire from ATRS and APERS or the person will have to forfeit the APERS drop account.

ATRS Staff further informs us that the main purpose of Section 1 of this bill is to encourage experienced members who are participating in DROP plans of both ATRS and APERS but who have reached the (shorter) maximum DROP participation period in APERS to transfer the APERS DROP account balances to ATRS and then work a few more years in a position covered by ATRS. The minimum number of years would be two. It could be considerably more than that, since ATRS has a provision for continuing in TDROP beyond 10 years.

Section 1 of SB 184 will cause some ATRS members in the above situation to delay retirement from the ATRS employer (because they would have the option of transferring their APERS DROP balance to ATRS rather than forfeiting it, and therefore to extend their participation in TDROP). In particular, it ensures that neither system (ATRS nor APERS) pays a monthly retirement benefit to affected members for at least 24 months after the transfer. The delay in paying a retirement benefit is a source of savings to ATRS because, among other things, the retirement benefit is always greater than the plan deposit to TDROP. The bill could encourage affected members to now stay employed for 3 years or even longer following the balance transfer, resulting in a savings to ATRS.

Many ATRS TDROP participants continue in employment beyond 10 years and remain in TDROP. In such cases, the member is paid interest on the T-DROP balance but receives neither plan deposits nor monthly benefits. ATRS, however, receives full employer contributions on the salaries of such members, which assists ATRS in paying down its liabilities and in reducing the amortization period. In addition, extended participation in TDROP also produces a savings for ATRS because ATRS (historically) credits less interest on TDROP balances than it earns on investments. This bill would allow affected members to delay retirement beyond the 10 year period. We have no means by which to quantify the amount of savings related to delaying retirement beyond the 10 year TDROP participation period because we do not have access to data regarding members who would potentially be affected by the provisions.

Section 1 of SB 184 also provides an opportunity for ATRS to earn money on DROP account balances transferred from APERS to ATRS provided that the interest credited to those accounts continues to be less than the rate of interest earned on ATRS plan assets generally. We have no data on which to produce an accurate estimate of the savings this activity would generate, so we have illustrated the potential effect by making certain illustrative assumptions that we have discussed with ATRS staff. In particular, we assumed that:

1. \$1 Million per year would be transferred from APERS into the ATRS TDROP.
2. The transferred funds would remain in TDROP for three years.

3. The funds would be credited with interest at the rate of 3% less than ATRS earns on investments.

Under those assumptions, the transferred balances would, in the long run be equivalent to an annual savings to ATRS of \$90,000 per year. Savings beyond that amount could be generated in circumstances wherein people who transfer balances to ATRS from APERS remain in TDROP beyond ten years.

Analysis of Section 2 and 3 of Senate Bill 184 related to Interest Crediting

Currently, T-DROP accounts are credited with 2% less interest than the System's (actual) rate of return (but not less than a floor of 2%, nor greater than a cap of 6% interest on the mean balance) each year. Senate Bill 184 requires neither a floor nor a cap on the TDROP crediting rate. If SB 184 results in less interest credited to TDROP accounts than currently is being credited, it will save money for ATRS. We understand from ATRS staff that that is the intention. We cannot quantify the savings precisely, because it is not known at this time what method the Board will use, so we illustrate the possible effect with an example as follows:

If interest credits on all accounts decreases by 1% on average from current expected amounts, the result will be a reduction in the amortization period of approximately 4 months to 1 year based on the June 30, 2016 valuation results.

Finally, we understand from discussions with staff that the participation incentive described in Section 2 is intended to be small and only to be used in extraordinary years. We understand that even with the incentive, interest credits in an incentive year would not exceed rates currently being credited. While the incentive may slightly offset some of the savings described above, we do not expect that effect to be material, given the above understanding. In any case, present statutory wording would have allowed an incentive to be paid.

Conclusion

In total, we think that Senate Bill 184 will provide a savings to ATRS, although the amount of such savings cannot be determined precisely in advance. We have provided estimates of potential savings in the previous paragraphs of this letter.

Users of this information should be aware that estimates of changes in amortization period are heavily dependent on actuarial assumptions and on the amortization period before the change. Please refer to the full actuarial report of the June 30, 2016 valuation for a complete description of actuarial assumptions and methods.

We hope this information meets your need.

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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 nor did we attempt to determine whether these changes would contradict or negate other related State, or local laws. Such a review was not within the scope of our assignment.

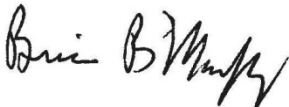
Brian B. Murphy, Judith A. Kermans and Heidi G. Barry are Members of the American Academy of Actuaries (MAAA) and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein.

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

Sincerely,



Judith A. Kermans, EA, MAAA, FCA



Brian B. Murphy, FSA, EA, MAAA, FCA



Heidi G. Barry, ASA, MAAA

JAK/BBM:rmn