SB184 – APERS Concerns-Summary

- **There has been no explanation of why Section 1 of the bill is even contemplated.**

- **Section 1 of SB 184 is Built on a False Narrative.**

- **The Memorandum from the Rose Law Firm only addresses ATRS tax status – not the Bill's effect on APERS tax-qualified status.**

- **Subsection (c) (6) of Section 1 Gives Windfall APERS Service Credits to Those Who are Eligible Invoke the Provisions of this Bill.**

- **Paragraph (c)(6) alone would be tremendously expensive to APERS by creating an additional 7 years of liability for every member who takes advantage of it, in addition to generating an artificially high final average salary for them.**

- **Interferes with vested rights of members because it prevents an otherwise eligible member from retiring for two years.**

- **Creates an impermissible in-service distribution not provided for in APERS statutes in addition to the potential tax consequences discussed above.**

- **Results in an initial lump sum transfer of approximately $12 million if every possible participant takes advantage of this. The cost in subsequent years would depend on the number choosing to participate.**

- **Simple mathematics and actuarial science dictate that if this is an enhancement for the member and/or ATRS, it comes at a cost to APERS.**

- **This is the first time in nearly 30 years' experience that an Arkansas retirement system has moved for legislation negatively affecting another system without consulting or conferring with the affected system.**

SB184 – APERS Concerns

- **There has been no explanation of why Section 1 of the bill is even contemplated.**

  It bears no relationship to Section 2 (Interest rate to be charged under the ATRS Code) or to Section 3 (Account credits under the ATRS Code).

  It amends the general section of the Retirement Code, Chapter 2, which applies to all state-level retirement systems, in order to divert APERS trust fund assets to ATRS.

  It bears no reference to anything enumerated in Section 4, the Emergency Clause.

- **Section 1 of SB 184 is Built on a False Narrative.**

  Contrary to what has been said in support of this bill, APERS does not "force" a teacher to terminate at the end of their participation in the APERS DROP. Instead the accumulated contributions remain on account until that teacher actually retires and begins receiving a benefit. Only upon notice and confirmation from ATRS that retirement has occurred do we begin distribution procedures in accordance with the member's wishes.

- **The Memorandum from the Rose Law Firm only addresses ATRS tax status – not the Bill's effect on APERS tax-qualified status.**

  APERS obtained a current tax-qualified determination letter from the IRS as a result of its 2014 Cycle C compliance program. A copy of that determination letter is attached. That determination letter did not address the changes contemplated under Section 1 of the Bill. Section 1 of the Bill will likely jeopardize APERS tax-qualified status.

  Section 1's contemplated payout of an APERS member's accumulated DROP account to ATRS before that member actually separates from service would run the risk of violating Section 401(a) of the IRC, which prohibits certain in-service distributions.

  Section 1's contemplated payout of an APERS member's accumulated DROP account to ATRS, which would be merged with ATRS assets, would run the risk of violating Section 401(a) of the IRC, which requires that plan asset distributions be for the sole use and benefit of the vested member. Under Section 1, the money would become part of the ATRS trust fund benefiting its overall funding status.

  Under section (c) (6) in Section 1, those who are eligible to participate gain an additional seven (7) years' worth of "free" unearned service credit (see below). IRC 415(n) prohibits a qualified plan from providing for more than five (5) years of such unearned credit, commonly known as "air time." APERS has no provisions for air time, free or otherwise.

- **Subsection (c) (6) of Section 1 Gives Windfall APERS Service Credits to Those Who are Eligible Invoke the Provisions of this Bill.**

  Subsection (c) (6) of Section 1 improperly allows those eligible to invoke the provisions of this Bill to obtain, without cost, an additional seven (7) years' of APERS service credit that is not permitted to those in the APERS DROP alone. Subsection (c) (6) requires that "The Arkansas Public Employees Retirement System **shall** calculate the member's monthly retirement benefit **as if the member retired at the expiration of the (APERS) plan participation term**." (Emphasis supplied).

  Under the APERS Code, a member entering the APERS DROP has his/her monthly retirement benefit calculated at the beginning of the DROP period. They do not receive additional APERS service credit after they enter the DROP. A.C.A. 24-4-802(c)(2) commands that "Under no circumstances shall a member receive service credit under any state-supported retirement system during a period of participation or following a period of such participation in the same retirement system's plan."

  However, those who are eligible to take advantage of Section 1 will now have their monthly APERS benefit calculated at the end of the DROP period, which would increase their APERS service credit by the number of years they were in the APERS DROP and presumably increase their final average salary by the amount of salary increases received while in the DROP as well, an unfunded windfall to those taking advantage of this provision. This result appears to have been specifically intended because subsection (a) of Section 1 creates an explicit exception to the APERS Code for those taking advantage of subsection (c)'s provisions.

- **Paragraph (c)(6) alone would be tremendously expensive to APERS by creating an additional 7 years of additional APERS service credit for every individual who takes advantage of it, in addition to generating an artificially high final average salary.**

- **Interferes with vested rights of members because it prevents an otherwise eligible member from retiring for two years.**

- **Creates an impermissible in-service distribution not provided for in APERS statutes in addition to the potential tax consequences discussed above.**

- **Results in an initial lump sum transfer of approximately $12 million if every possible participant takes advantage of this. The cost in subsequent years would depend on the number choosing to participate.**

- **Simple mathematics and actuarial science dictate that if this is an enhancement for the member and/or ATRS, it comes at a cost to APERS.**
- **This is the first time in nearly 30 years' experience that an Arkansas retirement system has moved for legislation negatively affecting another system without consulting or conferring with the affected system.**

INTERNAL REVENUE SERVICE
P. O. BOX 2508
CINCINNATI, OH 45201

DEPARTMENT OF THE TREASURY

Date: AUG 18 2015

Employer Identification Number:
71-0847443
DLN:
17007038102004
Person to Contact:
PATRICIA M ISENBERG ID# 52138
Contact Telephone Number:
(412) 404-9745
Plan Name:
ARKANSAS PUBLIC EMPLOYEES
RETIREMENT SYSTEM
Plan Number: 001

STATE OF ARKANSAS
C/O ARKANSAS PUBLIC EMPLOYEES
124 W CAPITOL AVE SUITE 400
LITTLE ROCK, AR 72201

Dear Applicant:

Based on the information you provided, we are issuing this favorable determination letter for your plan listed above. However, our favorable determination only applies to the status of your plan under the Internal Revenue Code and is not a determination on the effect of other federal or local statutes. To use this letter as proof of the plan's status, you must keep this letter, the application forms, and all correspondence with us about your application.

Your determination letter does not apply to any qualification changes that become effective, any guidance issued, or any statutes enacted after the dates specified in the Cumulative List of Changes in Plan Requirements (the Cumulative List) for the cycle you submitted your application under, unless the new item was identified in the Cumulative List.

Your plan's continued qualification in its present form will depend on its effect in operation (Section 1.401-1(b)(3) of the Income Tax Regulations). We may review the status of the plan in operation periodically.

You can find more information on favorable determination letters in Publication 794, Favorable Determination Letter, including:

The significance and scope of reliance on this letter,
The effect of any elective determination request in your application materials,
The reporting requirements for qualified plans, and
Examples of the effect of a plan's operation on its qualified status.

You can get a copy of Publication 794 by visiting our website at www.irs.gov/formspubs or by calling 1-800-TAX-FORM (1-800-829-3676) to request a copy.

We based this determination letter solely on your claim that the plan meets the requirements of a governmental plan under Section 414(d) of the Internal Revenue Code.

STATE OF ARKANSAS

This determination letter applies to the plan and related documents you submitted with the application you filed during the remedial amendment cycle ending 2014.

You can't rely on this letter after the end of the plan's first five-year remedial amendment cycle that ends more than 12 months after we received the application. This letter expires on January 31, 2019. This letter considered the 2012 Cumulative List of Changes in Plan Qualification Requirements.

This letter is not a determination with respect to any language in the plan or any amendment to the plan that reflects Section 3 of the Defense of Marriage Act, Pub. L. 104-199, 110 Stat. 2419 (DOMA) or U.S. v. Windsor, 133 S. Ct 2675 (2013), which invalidated that section.

If you submitted a Form 2848, Power of Attorney and Declaration of Representative, or Form 8821, Tax Information Authorization, with your application and asked us to send your authorized representative or appointee copies of written communications, we will send a copy of this letter to him or her.

If you have any questions, you can contact the person listed at the top of this letter.

Sincerely,

Karen D. Truss

Karen D. Truss
Director, EP Rulings & Agreements

GRS

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March 21, 2017

Ms. Gail H. Stone
Executive Director
Arkansas Public Employees Retirement System
One Union National Plaza
124 West Capitol Avenue, Suite 400
Little Rock, Arkansas 72201

Re: Senate Bill 184, as Amended through March 17, 2017

Dear Ms. Stone:

You have asked us for our analysis of Senate Bill 184 (SB 184), as amended through March 17, 2017. The proposed legislation modifies Arkansas State Code Title 24, Chapter 2, Subchapter 4 as well as Title 24, Chapter 7, Subchapter 1307 concerning Deferred Retirement Option Plan (DROP) participants. Our analysis of the proposed amendments to § 24-2-409 as they pertain to the Arkansas Public Employees Retirement System (APERS) follows.

Our understanding of the current law is that when a member retires from the DROP in APERS, the participant must also retire from other Systems. SB 184 would allow a participant to delay retirement in APERS and continue employment in the Arkansas Teacher Retirement System (ATRS) until he or she reaches the maximum DROP period in ATRS. These activities would be subject to approval of the Boards of the two Systems.

Based upon our understanding, § 24-2-409 broadly allows an APERS member who elects to participate in the DROP in APERS and the DROP plan of the ATRS simultaneously to elect at the end of the APERS DROP term to transfer the DROP balance from APERS to ATRS. The member must continue in the ATRS DROP for at least two years after the transfer before retiring. A provision is included to allow the APERS Board to establish a processing fee for the transfer.

The data provided for the June 30, 2016 valuation showed 938 rehired retirees with payroll of $38.0 million and 1,526 DROP participants with payroll of $67.3 million. Total active members in APERS exceed 45,000 with payroll of nearly $1.8 billion. Given the relatively small number of DROP participants and the changes proposed, we anticipate no material financial effect for APERS as a result of adopting the proposed legislation. This conclusion includes the effect of a processing fee set at a level sufficient to offset the loss of investment income that would result from the transfer. However, our understanding is that APERS legal counsel believes the processing fee idea to be problematic and not possible to administer. In that event, we expect that the impact on APERS to be negligible but negative.

The preceding conclusion does not address the language proposed in § 24-2-409(c)(6). It may be possible to interpret that subparagraph to provide for a recalculation of the APERS benefit at the end of the DROP period based on service and salary beyond the date the member entered the DROP and still provide for the transfer and/or payment of the member's DROP balance. If that is the case,

there may be a meaningful, negative effect on APERS and a significant financial windfall for individuals exercising this option.

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.

Mita D. Drazilov 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 communication shall not be construed to provide tax advice, legal advice or investment advice.

Respectfully submitted,

Mita Drazilov

Mita D. Drazilov, ASA, FCA, MAAA

David L. Hoffman

David L. Hoffman

MDD:DLH:bd