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Senate Bill 222

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 222 affects the Arkansas Local Police and Fire Retirement System (LOPFI).

Arkansas Code Annotated §24-10-706 describes the limitations placed on the duration of participation in the LOPFI Deferred Retirement Option Plan (DROP) program. Under current law, a police officer or firefighter may participate for at most seven years, and upon conclusion of participation he or she must terminate employment and begin receiving his or her monthly retirement benefit. The law does not explicitly allow for accumulated DROP balances to be left on account with the system post-termination. Senate Bill 222 would allow for a member's DROP balances to remain on account until the year the member turns 70.5, with interest being credited to the balances at 2% per year post-separation.

Fiscal Impact

According to the December 31, 2015 valuation report, there were 287 paid LOPFI members participating in DROP, with just over $8.5 million in annual DROP benefits. A review of data provided by the system suggested that approximately $17 million in DROP balances had accumulated for LOPFI DROP members as of the valuation date. As LOPFI is a fairly young system, the number of members on DROP, and the associated balances, will be expected to increase as time passes.

From an actuarial perspective, allowing members to leave balances on account should create savings for the system, as long as the interest rate credited to the accounts is less than the investment return of the plan. Over the long term, LOPFI would certainly be expected to clear the 2% return hurdle, so, *all other assumptions being met*, Senate Bill 222 would generate savings for the system. However, the cost of a DROP program like LOPFI's is not solely determined by the amount of interest credited to the accounts, nor by the reduction of the benefit while participating (25% or 28% in LOPFI's case). A large factor is how the availability of the DROP program affects retirement behavior of the system's members. As a rule of thumb, the earlier a member retires, the higher the cost to the system. An attractive DROP program tends to incentivize members to retire earlier than they otherwise may have. For that reason, anything which makes DROP more attractive to members could produce costly shifts in retirement behavior.

Unfortunately, due to the relatively young age of the LOPFI system, there is not sufficient historical data available to analyze DROP behavior. It is our opinion that Senate Bill 222 will result in a small savings to the system, but we would have to qualify this opinion based on how future DROP experience and retirement behavior develop within LOPFI.

Other

There will be additional administrative requirements which will involve some expense. The system officials do not feel this will be excessive.

The language added as section (d)(2) will ensure LOPFI remains in compliance with IRS rules regarding required minimum distributions from qualified plans.

Sincerely,

Jody Carreiro

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Actuary