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January 28, 2011

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

Re: House Bill 1119

Dear George:

You have asked us for an analysis of House Bill (HB) 1119 as it relates to the Arkansas Teachers Retirement System (ATRS).

HB 1119 amends several sections of Arkansas State Code (Section 24-4-1002, Code Title 24, Chapter 5, Code Sections 24-6-223 and 413, and Section 24-10-616) related to the retirement systems administered by an agency of the State of Arkansas. Similarly, it amends code Section 24-7-715 of the Teacher Retirement Laws of the State of Arkansas related to benefit rights.

HB 1119 causes a partial loss of benefit rights in the event of a member either pleading guilty or ‘nolo contendere (no contest)’ to theft of property against the employer as defined under State code Section 5-36-103 (theft of property). In particular, Section 1(c) of the bill reads as follows.

> If a member, retirant, or beneficiary has pleaded guilty or nolo contendere to or been found guilty of theft of property against the employer under § 5-36-103, then the portion of the annuity based on employer contributions shall be recalculated to exclude the months in which the theft of property against the employer occurred beginning with thefts occurring on or after July 1, 2011.

We do not have any data regarding the number of members who would be affected or any data on which to base an estimate of the average magnitude of the decrease in pension payments that would occur. We expect that the number of individuals affected would be very small. The bill would likely produce a very small savings on an actuarial basis. The savings would likely have no measurable impact on the amortization period of ATRS (52 years as of June 30, 2010).

However, policymakers should consider the potential level of administrative costs associated with implementing and executing the procedures in this bill. Those costs could potentially exceed the savings the bill would otherwise produce and in the long run, actually produce a net cost that would increase the amortization period.

The bill, for example, puts ATRS in a position of having to interpret legal rulings and court judgments related to individuals, which can be multifaceted and involve complicated situations and pleadings. For example, the number of months during which the theft occurred may not be easy to determine. In fact, it may not be possible at all. Outside counsel may need to be retained to assist in the determination. An appeals procedure will have to be set up and monitored. Rules will need to be set up to determine the precise actuarial formula for the various recalculations that will occur. Those may be subject to legal challenge or shades of interpretation. Also, it is our understanding from

ATRS staff that ATRS information systems are set up for quarterly reporting, and the bill requires monthly activity on part of ATRS.

Finally, the bill affects only "the portion of the annuity based on employer contributions." It is not clear what this means.The annuity is funded by employer contributions, employee contributions, and investment return. The bill does not specify how the allocation among these funding sources will be made. If for example, the theft occurred shortly after retirement, arguments could be made that at that stage, the annuity was 100% based on employee money, since the employee money, in many people's minds comes out first. That argument would imply that benefits would not be affected at all. It could also be argued that since most contributions are made on a pre tax basis, almost all of the annuity is based on employer money and investment return, and essentially none from employee money. Finally, someone could argue that the IRS basis recovery rules should be used to define the split between employee money and other money, but that still leaves the impossible problem of determining the residual split of the "other money" between employer money and investment return in an unambiguous manner. There is no unambiguous way to make this calculation, and any method that ATRS selects will be open to shades of interpretation and potential legal challenge. It will certainly require complex calculations that few people will understand.

Rules and regulations will need to be developed in order to describe the manner in which the 'recalculation' of benefits would be completed in the cases involved. If the bill passes, we advise ATRS to seek guidance from Counsel as quickly as possible to at least minimize potential future problems.

The undersigned are Members of the American Academy of Actuaries and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

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

Sincerely,

Judith A. Kermans

Judith A. Kermans, EA, MAAA, FCA

Brian B. Murphy

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