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February 19, 2013

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

Re: Senate Bill 116

Dear Mr. Hopkins:

You have asked us for our analysis of Senate Bill (SB) 116 as it relates to the Arkansas Teacher Retirement System (ATRS).

Section 1 of SB 116 amends Arkansas Code Section 24-7-601(e) related to the calculation of final average salary that ATRS will use in the calculation of reciprocal retirement benefits. Under present statutes, when an individual with reciprocal service applies for retirement, the final average salary from each reciprocal system is calculated, and the highest one is selected and used by all reciprocal systems in calculating the benefit that each system will pay to the individual. Also under present statutes, if in any one of the reciprocal systems, the number of years of service is less than the number of years in the system's formula for final average salary, the final average salary calculation for that system is based upon the salary and service credit that exists in that system. If SB 116 becomes law, then beginning July 1, 2014, the final average salary calculation for a reciprocal system in which there is insufficient service to make the full calculation would be changed. In that case, ATRS would calculate a final average salary as though the service credit and pay with the reciprocal system had all been covered by ATRS. ATRS would then pay a benefit based upon the greater of the actual ATRS final average salary, or the final average salary so calculated. For example, suppose that an individual's ATRS covered pay has been $40,000 per year for the last three years of employment, and that the individual quits and works for a reciprocal system for one year at a salary of $100,000. Under present statutes, ATRS would pay a benefit based upon a final average salary of $100,000, which essentially allows a form of salary "spiking". If Senate Bill 116 becomes law, ATRS would pay a benefit based upon a final average salary based on the ATRS pay plus the reciprocal pay equal to $60,000 = ($40,000+$40,000+$100,000)/3. SB 116 would reduce an opportunity for spiking, in this case. We note that examples can be constructed where the effect of the bill would be to raise the final salary that ATRS would use in the calculation of benefits rather than lower it, but such examples appear to be unlikely to happen in reality.

The intention of Section (1) of SB 116 appears to be to reduce the potential for spiking that may occur with members who have reciprocal service, and we think the bill accomplishes its intent. We think that this section of SB 116 is likely to result in a small saving for ATRS. The saving would emerge gradually over time but would not affect the systems amortization period initially.

Section 2 of SB 116 modifies Arkansas Code section 24-7-601 (Credited service generally) as it relates to concurrent reciprocal service. Under present administrative practice, an individual with concurrent service credit is limited to a total of one year's service credit per year in all systems combined. We understand from ATRS staff that in cases where ATRS service is not credited, due to concurrent service issues, ATRS either does not receive, or must refund, employer contributions and employee contributions, if any.

SB 116 removes the one year service credit per year limitation beginning July 1, 2013 for all reciprocal units except alternate retirement plans and APERS. If SB 116 becomes law a person with a full time job covered by, for example, LOPFI, could also earn a partial year of service credit in ATRS at the same time. Vesting and retirement eligibility would be based solely upon ATRS service. Final average salary would be calculated in the same manner as for any other reciprocal situation. ATRS would receive full employer contributions based upon the ATRS covered pay for any such individuals. This section of the bill will cause a small increase in cost because the pay upon which ATRS receives contributions will tend to be lower than the pay on which the final average salary calculation will be based. The cost, if any, would emerge gradually over time. It would not affect the systems amortization period initially.

Summary: Section 1 of the bill saves money for ATRS, and reduces the ability for individuals in certain circumstances to "spike" their final average salary. This type of spiking can have a large effect when it occurs. Section 2 of the bill adds to cost, by including people in ATRS who would not otherwise be included. Based upon data provided by staff, very few people are likely to be affected by the provisions of section 2 of this bill, and the effect will tend to be small when it does occur. For example, out of 42 cases of people with concurrent service that staff reviewed, only a couple even had enough concurrent service to have earned 1/4th of a year of service credit in ATRS. Based upon this analysis, we estimate that the savings from Section 1 is likely to exceed the cost from section 2 and that there will be a very small net savings from this bill in total.

Recommendation: If this bill passes, we recommend that ATRS continue to maintain data on concurrent service and that associated costs, if any, are reviewed after the new provision has been in effect for a few years.

We hope this analysis meets your needs.

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.

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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JAK/BBM:sc