Overview of Arkansas PERS Funding Condition

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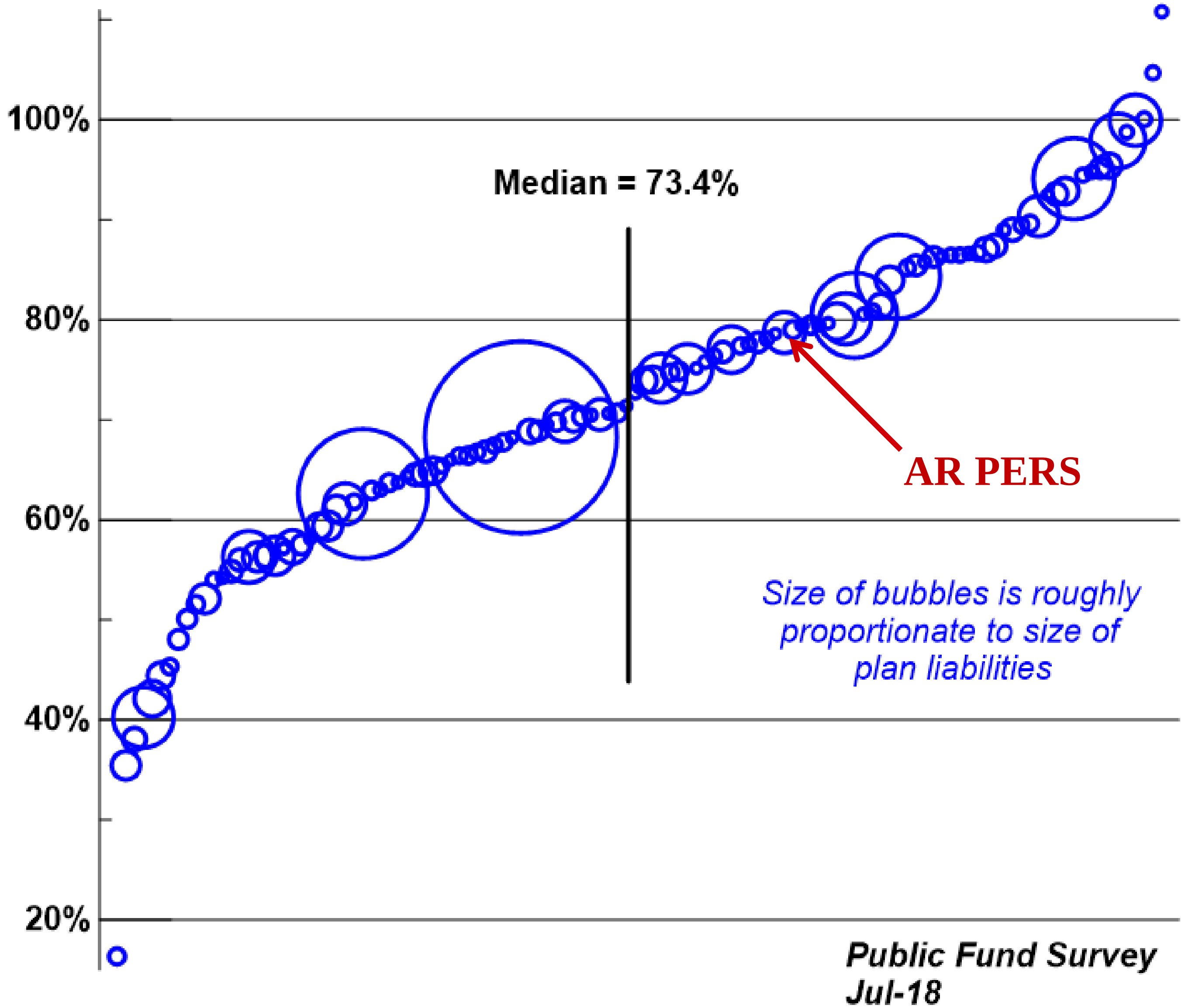
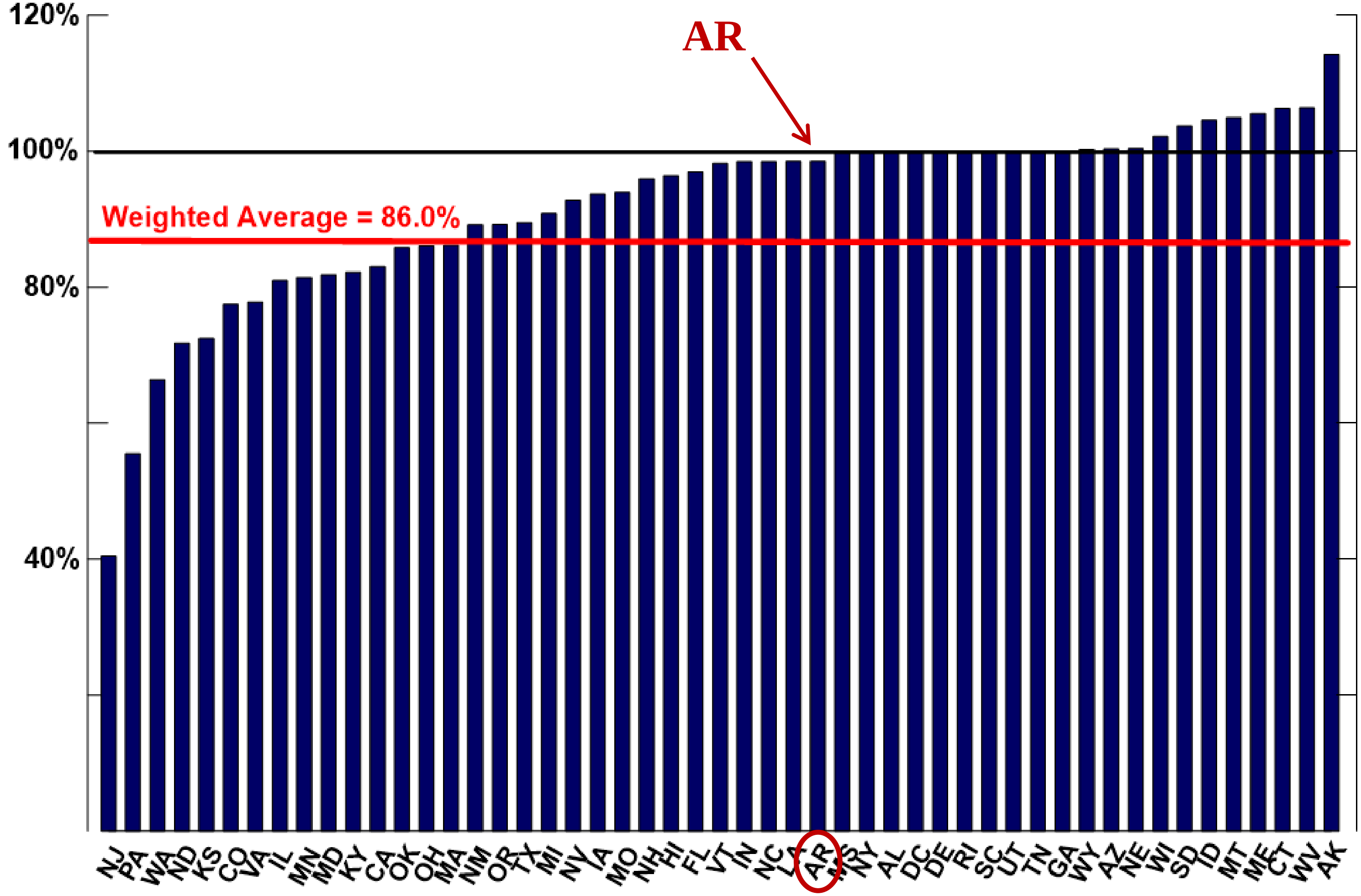
Broad Observations

- Based on conventional metrics used to measure the condition of public pension plans, Arkansas PERS is in good shape
- The plan’s funding level is well above the national average
- Key actuarial assumptions are more conservative than national averages
- The state and other PERS employers have a strong record of making required pension contributions
- As a percentage of all spending by the State of Arkansas and all of its political subdivisions, excluding monies from federal sources, Arkansas spends about 3.5 percent on pension benefits for its public employees

Public Pension Funding Levels, FY 17

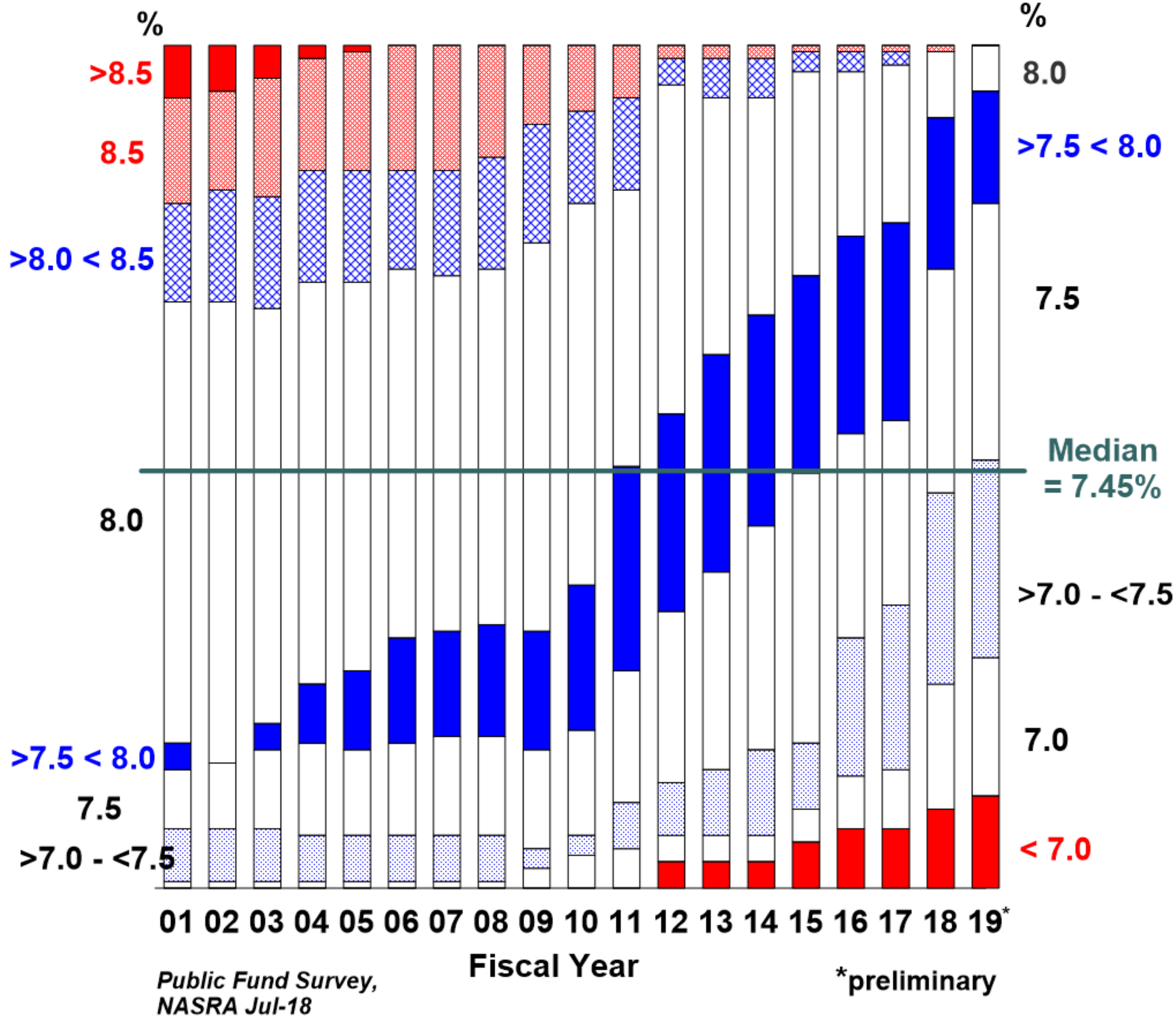


Weighted Average of Contributions Paid as a Percentage of Actuarially Recommended
FY 01 to FY 16



"State and Local Government Contributions to Statewide Pension Plans: FY 16," NASRA 2018

Investment Return Assumptions, FY 01 to latest



AR PERS: 7.15%

Overview of Moody's and S&P Global Comments About Arkansas Pensions

Moody's

- Arkansas is among the 20 top performing states as measured by pension liabilities as a percentage of own-source revenue

- Arkansas is among the states least exposed to a severe market decline

S&P Global

- Public pensions are neither an asset nor a burden to the state's creditworthiness.

Public Pensions and Stress Testing

- Stress testing is not new to public pension plans
- Examples of public pension stress tests:
  - **Actuarial valuation**
    - APERS conducts annually
  - **Experience study**
    - APERS conducts every 5 years
  - **New GASB standards** requiring reporting of funding condition based on plus- and minus-one percent of actual investment return assumption
    - APERS reports annually

Stress Testing:
Actuarial Standards of Practice No. 51

For actuarial valuations conducted beginning later in 2018 and after, **ASOP 51** requires the actuary to "identify risks that may reasonably be anticipated to significantly affect the plan's future financial condition."

Examples of risks include:

- investment risk (the potential that investment returns will be different than expected);
- asset/liability mismatch risk (the potential that changes in asset values are not matched by changes in the value of liabilities);
- interest rate risk (the potential that interest rates will be different than expected);
- longevity and other demographic risks (the potential that mortality or other demographic experience will be different than expected); and
- contribution risk.

Stress Testing: Actuarial Standards of Practice No. 51 (continued)

"The actuary should assess the … potential effects of the identified risks on the plan's future financial condition. The assessment should take into account circumstances specific to the plan (funding policy, investment policy, funded status, or plan demographics)."

Perils of Funding Based on a Risk-Free Investment Return

- Funding a pension benefit assuming a very low investment return would result in
  - Sharply increased plan costs
  - Greater cost volatility in response to changes in inflation and interest rates
  - Uneven distribution of costs among generations of taxpayers
  - Misallocation of capital, by overfunding the plan in anticipation of low investment returns

Public Sector Analogies to Funding Based on a Risk-Free Investment Return

- **Public Utilities**
  - Permanently maintaining reservoirs, water storage facilities, and electric storage capacity at maximum levels in case of extreme drought or record heat
- **Rainy Day Funds**
  - Maintaining and continuously paying into emergency funds in anticipation of economic decline or emergency
- **Highway and Road Maintenance**
  - Storing salt and sand at maximum capacity in case of worst-case winter weather
- **Road Speed Limits**
  - Reducing maximum speed limits to levels that ensure few vehicle accidents, in order to eliminate injuries and deaths