Osborn, Carreiro & Associates, Inc.

ACTUARIES ● CONSULTANTS ● ANALYSTS

One Union National Plaza, Suite 1690
124 West Capitol Avenue
Little Rock, Arkansas 72201
(501)376-8043 fax (501)376-7847

House Bill 1287

(As Engrossed March 2, 2017)
Actuarial Cost Study prepared for
Joint Committee on Public Retirement and Social Security Programs
of the Arkansas 91st General Assembly

Provisions of the Bill

House Bill 1287 affects the Arkansas Teacher Retirement System (ATRS).

Subchapter 5 of Chapter 7 of Title 24 concerns membership in ATRS. House Bill 1287 would add a new section, §24-7-506, to deal with outsourced employees and their employers. The language in the bill is extensive, but the main effect of the legislation would be to require certain covered employers (those that enter into agreements to cover services "common to the normal daily operation on the premises of the covered employer" paid for with public funds) to make an irrevocable election to become either a "participating employer" in ATRS or a "surcharge employer" within 60 days of the outsourcing agreement being made. Embedded or outsourced employees of a surcharge employer would not accrue service credit in ATRS, but the employer would have to remit a monthly surcharge to the system (starting at 0.5% of salaries in 2018 and increasing up to 4% in 2022).

Fiscal Impact

ATRS would experience a cost savings as a result of House Bill 1287. The full impact would depend on how many outsourcing agreements are in place and would be made in the future, as well as on how many employers would choose to participate versus pay surcharges. Based on a review of data provided by the system, it appears that ATRS had 36,604 covered support employees in the 2012 valuation and only 33,568 in 2016. If we assume this loss of approximately 3,000 covered support positions is primarily due to outsourcing, we can arrive at an estimate of the outsourced payroll. Average support salaries are on the order of $23,500, and ATRS internal data suggests that many outsourced employees earn less than $10,000 per year. If we assume that the average outsourced employee would carry $20,000 in covered payroll, then the total affected outsourced pay would be on the order of $60 million.

According to the 2016 valuation report, at current assumptions, the net employer normal cost for a support position is 6.56% of payroll. This means that, on average, 7.44% of payroll goes towards paying off the unfunded liability for each covered support member. If we assume that the demographic makeup of the support positions are otherwise similar, then this 7.44% of increased contributions (14.00% current rate less the 6.56% of employer normal cost) would be a savings to ATRS for each employer which elected to participate in ATRS. This would amount to

Osborn, Carreiro & Associates, Inc.
ACTUARIES ● CONSULTANTS ● ANALYSTS

approximately $4.5 million in annual contributions if the $60 million payroll estimate is accurate and each outsourced employer elected to participate in ATRS.

If we instead assume all outsourcing employers elected to become surcharge employers, the surcharge would eventually create a 4% increase in contributions on the affected payroll. That would ultimately result in $2.4 million in additional contributions. We would anticipate that most outsourcing employers are cost-conscious and would elect to pay the surcharge rather than the 14% full contribution rate. If this $2.4 million annual increase in contributions came to fruition, we would anticipate the reduction in contribution rate for a 30-year amortization at about 0.08% or, equivalently, a reduction in the amortization schedule of approximately 9 months at current contribution rates and assumptions.

If the outsourcing trend continues, the impact of House Bill 1287 would increase over time; in very general terms, the surcharges (or elections to participate) would serve to reduce the impact of decreased contributions that the system would otherwise experience when a position is eliminated.

Other

This bill represents a policy decision regarding the trend of outsourcing employees and its impact on the Teacher Retirement System. In the private sector, "leased employees" would, in many cases, have to be covered by the retirement plan.

Additionally, it is our understanding that part of the state's school funding formula goes towards paying for support staff. Those calculations presumably anticipate coverage by ATRS, so some of the state's intended contributions to ATRS are being diverted by school districts who choose to outsource employees. The impact of this, in broad actuarial terms, is that those employers who continue to cover more of their employees (i.e. those who do not outsource) bear an increased burden to pay off the system's liabilities.

Sincerely,

Jody Carreiro

Jody Carreiro, A.S.A, M.A.A.A.
Actuary