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Senate Bill 155

(As Engrossed January 25, 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

Senate Bill 155 affects the Arkansas State Highway Employees Retirement System (ASHERS).

Arkansas Code §24-5-119 provides for the redetermination of benefits each year, typically referred to as the cost-of-living adjustment or COLA. The current COLA is simply a 3% increase to the benefit each July 1 after the first twelve months' benefits have been paid. Before Act 335 of 1999, a COLA was awarded that was equal to the change in the CPI, but not greater than 3%; this is very similar to what is contained in this bill. Senate Bill 155 would change the fixed 3% COLA to the lesser of 3% or the change in the Consumer Price Index for Urban Wage Earners and Clerical Workers for the December immediately preceding July 1. However, in no event would the COLA be negative; that is, the benefit would not be reduced as a result of the COLA.

Fiscal Impact

The ultimate fiscal impact of this type of change will depend upon the behavior of the CPI in the future. The current assumption for the growth of the CPI that is included in the ASHERS valuation report is 2.5%. Please see the Assumptions section of this letter to see how that was applied to our estimates of fiscal impact. The table below shows an estimate of the impact to the key measures based on the current ASHERS assumptions. Remember that ASHERS has an employer contribution rate set by law of 12.90%. The resulting contribution for a 30 year amortization would be 12.56%. The impact is measured as if it was in effect on the valuation date of July 1, 2016.

	6/30/2016 Valuation (12.9% ER Contrib.)	Change in COLA To lesser of 3% and Change in CPI	Savings
Unfunded Actuarial Liability (millions)	$ 242	$ 165	$ 77
Gross Normal Cost (% of Pay)	12.50%	11.72%	0.78%
Average Member Contribution	6.00%	6.00%	
Net Normal Cost	6.50%	5.72%	0.78%
Available to pay UAL	6.40%	7.18%	0.78%
Current Employer Rate	12.90%	12.90%	
Years to Amortize UAL	Infinite	25.4	

Assumptions

All assumptions that were used in the July 1, 2016 actuarial valuation were used in report, with the exception of the amount of the COLA. The current assumption for the growth of the CPI that is included in the ASHERS valuation report is 2.5%. The actual assumption to be used for valuing the proposed COLA would be less than this 2.5% amount. This is because the actual COLA would vary around that 2.5%, and under various scenarios some years the CPI would be above 3.0%, but the COLA would be limited to 3.0%. Therefore, the single rate substitute for a COLA assumption would likely be in the 2.25% to (no more than) 2.50% range. We looked at some variations and chose a COLA assumption for the impact shown above. The system actuary notes that they assumed a level 2.25% COLA for their calculations. In our opinion, the results of our estimate and the system actuary's estimate are similar.

Policy Considerations / Other

To our knowledge, reductions in COLA for current benefit recipients have never been implemented in Arkansas. Although we are not attorneys and do not offer legal opinions, we would note the possibility of a Contracts Clause challenge to any reduction for current employees or benefit recipients. It is our understanding that a 1973 case, *Jones v. Cheney,* suggested that the General Assembly does have some power to make changes to a retirement system so as to render intact the actuarial soundness of the system (so long as the changes are not retroactive).

Sincerely,

Jody Carreiro

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Actuary