EXHIBIT D

LOPFI

ARKANSAS LOCAL POLICE & FIRE RETIREMENT SYSTEM

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October 8, 2008

Joint Committee on Public Retirement
and Social Security Programs
c/o Estella Smith, Committee Staff
State Capitol, Room 433
Little Rock, AR 72201

RE: Report of the Interim Study Committee

Ladies and Gentlemen:

Act 802 of 2007 formed an Interim Study Committee (ISC) on certain items concerning fire and police pensions. The ISC is to report to the Joint Interim Committee on Public Retirement (the Committee) by October 31, 2008. Following this cover letter is that report. The report covers the following items:

1. Background of issues studied
2. Primary Areas of Concern
   a. Disparity of premium tax growth and pension cost growth
   b. Increasing out of pocket expense to sponsoring locations
   c. Variance of cost among sponsoring locations
   d. Membership desire of increased benefits
3. Discussion of Potential Resolutions
   a. Effect of previous legislation
   b. Levelized LOPFI employer contribution rates
   c. Cost of Living increases for old, local plans
   d. Future consolidations of local plans into LOPFI
   e. LOPFI DROP

The members of the ISC look forward to discussing these matters with the Committee. Please let us know if you have any questions or comments.

Respectfully submitted,

JoAnne H. Bush
JoAnne H. Bush
LOPFI Chairman

Farris Hensley
Pension Review Board Chairman

Act 802 of 2007 directed a study of the sources of funding for local fire and police pension funds and the Arkansas Local Police and Fire Retirement System (LOPFI) and the design of the LOPFI DROP. An Interim Study Committee (ISC) comprised of board members of the Arkansas Fire and Police Pension Review Board (PRB) and LOPFI completed a thorough analysis on this topic. The findings and recommendations of the ISC must be provided to the Joint Interim Committee on Public Retirement and Social Security Programs (the Committee) by October 31, 2008, which is the purpose of this report.

Background

The LOPFI system is funded by required contributions from the participating employer groups. As of December 31, 2007 the LOPFI only portion of the system was 96% funded. The system includes the assets and liabilities of local fire and police pension funds that have consolidated administration with LOPFI. When viewed in this context 78% of the liabilities are covered by those assets.

A significant source of funding for the specific pension costs covered in this review is from a tax on the premiums of certain lines of insurance. A formula developed under Act 1797 of 2003, provides statutory guidance regarding the division of these taxes. The PRB is the body that prepares the comprehensive report used to distribute these monies each year. Once approved by the PRB, the report is provided to the Department of Finance and Administration for distribution of funds. A copy of the approved PRB Premium Tax Allocation Report is provided to the Joint Retirement Committee.

The state collects premium tax on all lines of insurance. A percentage of several lines of insurance premium tax are allocated to the premium tax formula for distribution. For June 2008, the premium taxes set aside for the formula were $46,062,754. The formula produces amounts allocated to the local plans and to LOPFI split between fire and police pensions. It also produces other amounts defined in the law which ultimately results in an amount for State Treasury general revenues. A summary of these amounts is in the following table.

	Old Local Plans	LOPFI	Total
Firefighter locations*	3,775,277	11,231,515	$ 15,006,792
Police locations*	2,171,274	12,041,114	14,209,836
General Revenues			7,937,847
Other items defined by law			7,526,396
Treasury Fee			1,381,883
Gross collections from defined premium lines			$ 46,062,754
*Note: Not all of these amounts were distributed, because of lack of compliance.			

The other items defined by law covers several special funds as follows:

Other Items Defined by Law	
Expense of Allocation	$ 232,200
Future supplement	1,920,071
Police supplement	764,400
Fire Protection Fund	635,580
State Police Pension Plan	2,786,105
Guarantee Fund	1,188,040
Total	$ 7,526,396

The necessary employer contribution for all local fire and police pension funds is about $38 million per year. The annual required employer contribution for LOPFI will total about $43 million for the 2008-year. The striking difference between the previous two statements is the employer contributions to local fire and police pension funds is the amount that is *recommended*, but not required, to be made on an annual basis to ensure assets are available to meet benefit payments. In contrast, the employer contributions to LOPFI are required, which ensures sufficient assets will be available to meet all benefit payments.

Primary Areas of Concern

The ISC determined that police and fire pension costs are growing at an annualized rate of approximately 5%, while distributions from insurance premium taxes are averaging a 3% growth rate. The growing disparity between ongoing costs versus allowed funding has created upward pressure on municipal budgets. On the LOPFI-side of the discussion, pension costs are determined on a location-by-location basis, which means the variation in 'out of pocket' expenses ranges from 3% of payroll to over 20% of payroll.

The result of this disparity in growth is that minimum required contribution under LOPFI (1% in 2008, 2% in 2009, and 3% in 2010) will be superseded by the growing costs. The expectation is for the minimum required out of pocket cost, after the premium tax allocation occurs, would continue to increase by .3% to .5% per year over the next six years following 2010. This is a cost problem as well as a budget-planning dilemma for the locations.

There is also a stated desire of the membership to increase the retirement multiplier under LOPFI from the current 2.7%/1.7% to 3.0%/2.0%. The differing rates reflect that the system covers members many of which do not have Social Security coverage. An adjustment in the multiplier would certainly increase costs to the locations; however, the members have expressed an interest in sharing the cost. The increased contributions under this type of arrangement would not dilute the premium tax allocation.

Potential Resolutions

One method is to equalize the LOPFI employer contribution rate for the paid service groups. For example, in the 2007 Legislative Session, Act 610 moved all volunteer groups under LOPFI to a uniformed employer contribution rate. The purpose was to provide a level field of required employer contributions for all groups with volunteer members. In 2008, the first year implemented, this meant each participating employer paid three dollars ($3.00), out of pocket, per member per month for their LOPFI volunteer members. The actual employer contribution for LOPFI volunteer members is $33.91 per member per month. Therefore, after the employer paid the required $3.00 contribution, the remaining $30.91 was funded by premium tax. For the 2009-year, the required contribution will increase slightly to $3.20. The expectation is for this level of increase to be consistent in the years ahead. This will provide a measure of predictability for all volunteer employers when preparing their budgets.

For paid service groups in LOPFI, each employer group has their costs calculated every year on an individual basis. This means City A has one employer contribution rate, while neighboring City B has a different rate. The average rate for 2008 is 15.11% of payroll; however, the range is 6% to 37% of payroll. This range is for the LOPFI coverage only, not the consolidation costs, and is before premium tax is distributed. Applying a uniformed employer contribution rate method for paid service groups would likely need to be implemented over several years. The reason for this is the available funding from premium tax compared to the required employer contribution for LOPFI coverage will increase the out-of-pocket cost for most of the smaller employer groups. However, if this method is used, and once it is fully implemented, each paid service group would contribute the same percentage of their payroll, which should result in a range of out of pocket cost of 7% to 9% compared to the current range of 3% to 20%. The balance of the employer cost would then be covered by premium tax.

For local fire and police pension funds, the ability to provide the necessary funding for benefit payments is viewed from a different perspective. The PRB has implemented administrative guidance to help all local pension funds accurately assess the financial stability of their fund. This guidance from the PRB was the result of Act 851 of 2007, which created definitive measures the board of trustees of each local pension fund must use to manage the pension fund in a responsible manner.

The guidance offered under Act 851 is but one step forward on a long path. Although each of the local pension funds are closed to new enrollment, i.e., no one else can join a fund, benefit payments will continue for another fifty-plus years. To accelerate the full funding of each of these pension funds, the ISC suggests creating further incentive to consolidate with LOPFI, with a cost of living adjustment (COLA) added to the plan design. By consolidating, a local pension fund assigns their administrative responsibilities and assets to LOPFI, which streamlines the administrative process of the local funds. This means LOPFI processes the monthly benefit payments, issues an annual 1099-R to each benefit recipient, and handles the investment of the pension fund's assets. LOPFI is then able to guarantee future benefit payments based on the required city contributions. Convening pension fund board of trustee meetings and filing an annual financial report with the PRB are no longer required upon consolidation.

The ability to consolidate with a COLA is an attractive benefit enhancement. When these local funds were created in the 1920's (Fire plans) and 1930's (Police plans), law did not specify that a COLA was part of the plan structure. This is a significant difference from LOPFI. LOPFI members have a 3% compound COLA built into the benefit design. A retired member of a local pension, who left employment fifteen years ago, has felt the erosion of their purchasing ability due to the lack of a COLA.

Providing the funding for COLA assistance is not inexpensive. An amendment to the current design of the Future Supplement Fund could help offset the cost of a COLA. In 2001, the Future Supplement Fund was created as a means to offer COLA assistance to the members of local fire and police pension funds. Because the amount of the distribution can vary significantly from year-to-year, a COLA would be a more stable long-term solution. In addition, it is important to remember that LOPFI members do not receive Future Supplement Fund distributions because LOPFI has a COLA. By amending the Future Supplement Fund, local pension funds could receive a standard COLA that would not deviate from one year to the next. The PRB is currently exploring the details of recommending this option to the legislature.

The ISC proposes an amendment that would allow current premium tax monies allocated to a specific local pension fund to follow that fund upon consolidation. This could encourage local pension fund consolidations, with possible funding help for a COLA.

The remaining topic for discussion is the LOPFI DROP. The ISC will not offer any suggested changes to this program for two primary reasons. First, the DROP is relatively new to LOPFI as it was added to the benefit design in the 2003 legislative session. The eligibility criteria and benefit accrual under the LOPFI DROP is meant to ensure no additional cost is incurred by the System, i.e., a cost-neutral design. In addition, LOPFI DROP participants are not permitted to return to LOPFI covered service, which reduces adverse selection. Potential modifications to the LOPFI DROP may produce changes in behavior that would remove the cost-neutral aspect. Second, the LOPFI membership seeks to provide a more attractive and livable lifetime retirement benefit via the multiplier. Provided that was successful, it would achieve a similar goal that was a part of initial development of DROP—encouraging members to remain with their employer.

In closing, the ISC appreciates the opportunity to share with the Committee details of the hours of work and data that comprise this summary report.