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March 24, 2011

Ms. Gail H. Stone
Executive Director
Arkansas Public Employees Retirement System
One Union National Plaza
124 West Capitol, Suite 400
Little Rock, Arkansas 72201

Re: House Bill 1175

Dear Ms. Stone:

House Bill 1175 amends a section of Arkansas Code (ACA), namely § 24-4-803(c). Our analysis of the proposed changes to this section follows.

The legislation maintains the current interest rate for crediting DROP accounts in APERS for all members participating in the DROP on June 30, 2011. In effect, the legislation reverses the Board decision to lower the interest rate credited to DROP accounts for existing DROP members that would have become effective July 1, 2011. The interest crediting rate for members participating in the DROP as of June 30, 2011 was to be 3% and now is proposed by House Bill 1175 to remain at 6%. The Board will retain the power to set the interest crediting rate for DROP accounts for members who begin participation in the DROP after June 30, 2011.

We have reviewed the DROP participant population for the last five years. Based on our review:

(1) we would expect the number of DROP participants on June 30, 2011 to be approximately 1,800,
(2) annual DROP additions would be approximately $38.5 million (i.e., 75% of $51.3 million),
(3) the average length of time the 1,800 members have participated in the DROP is approximately three years, and
(4) average future participation in the DROP for these 1,800 members is expected to be approximately another three years.

If interest is credited at 6% on these members' DROP account balances, rather than 3%, the additional present value of interest costs will be about $11.7 million, which would increase the employer contribution rate by 0.04% of payroll based upon a 30-year amortization period.

We also tested this result over a likely range of outcomes: (1) with a lower number of DROP participants remaining in the DROP fewer years and (2) more DROP participants remaining in the DROP for more years. If the number of affected participants was 1,700 and they remained in the DROP, on average, for an additional two years, the additional present value of interest costs will be about $7.1 million which increases the employer contribution rate by 0.03% of payroll. If the number of affected participants was 1,900 and they remained in the DROP, on average, for an additional four years, the additional interest costs will be about $17.2 million which increases the employer contribution rate by 0.06% of payroll.

No assumption was made regarding the potential that a higher than expected number of members would choose to participate in the DROP before June 30, 2011 if this legislation was enacted. It is not expected that the results above would be materially affected in such an event.

One or more of the undersigned are Members of the American Academy of Actuaries (MAAA) as indicated, and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

Please feel free to contact us with additional questions or comments.

Respectfully submitted,

Mita D. Drazilov

Mita D. Drazilov, ASA, MAAA

David L. Hoffman

David L. Hoffman

MDD:DLH:dlh