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 1078

Actuarial Cost Study prepared for
Joint Committee on Public Retirement and Social Security Programs
of the Arkansas 90th General Assembly

Provisions of the Bill

House Bill 1078 affects the Arkansas Teacher Retirement System (ATRS).

Arkansas Code Annotated §24-7-706 provides for optional forms of monthly benefit payment that may be elected by a participant at the time of their retirement. Option A pays the surviving spouse 100% of the benefit when the retiree predeceases the spouse (Joint and 100% survivor). Option B is similar, but pays 50% to the surviving spouse (Joint and 50% survivor). Option C pays for the lifetime of the participant, but the first 120 monthly payments are guaranteed to be made even if the member dies during that period (10 year certain and life). Each of these optional forms pays a reduced benefit that is actuarially equivalent to the normal form, a straight life annuity. These factors are different for everyone and depend on the member's age and their spouse's age. For example, consider a female member age 62 with husband age 65 who has a normal form (straight life) annuity of $1,000 per month. This member would have an Option A benefit of $864.15, Option B benefit of $927.13, and an Option C benefit of $950.28.

This section also provides that upon the death of a beneficiary or marriage dissolution after retirement, the member can elect to return to the single life annuity benefit amount. This provision is usually referred to as a "pop-up" benefit, since the benefit returns or "pops" back up to the original benefit amount. We have reviewed the factors that ATRS uses and it appears that the actuarial equivalent factors, or reductions, include this "pop-up" provision

House Bill 1078 would make two changes to the option provisions of ACA §24-7-706. First, it would expand the "pop-up" benefit for Option C so that in the case of divorce or marriage dissolution that the member can elect another beneficiary or "pop-up" for divorce. The second item included in House Bill 1078 allows a member who marries after retirement to change their single life annuity to any other option after one year of marriage.

Fiscal Impact

Based on information provided by ATRS, about 80% of the age and service members that have retired have elected the normal form of a single life annuity. Of the 20% that have elected other options, 12% have elected Option A, 6% Option B, and 2% Option C. As mentioned above, we have reviewed the actuarial reduction factors that ATRS uses, and it appears they include the cost of the "pop-up" provisions in current law. We understand that ATRS would review to see if additional adjustment is needed because of the modification proposed to Option C by House Bill 1078. The actuarial equivalent factors, as adjusted, should reduce the increase in the value of the liabilities that would otherwise occur.

Other

Adverse selection or anti-selection occurs in pension plans when the member can make choices against the system (to their benefit). If a member elects Option C and is later divorced, it is to their advantage to wait as close to the end of the 10 years as possible and then elect to "pop-up" to the original benefit amount. Because of the factors being monitored and the limited number of people, this adverse selection should not significantly impact ATRS as a system, but it does provide members a new way to elect against the system.

Significant adverse selection exists with the marriage-after-retirement provisions. The classic example concerns the last Civil War "widow" who just passed away about 10 years ago. As a teenager, this lady married her husband when he was about 80, then continued to draw his pension until her death in 2003. Another example is that House Bill 1078 would allow someone who elected Option C, then divorces and remarries, to "pop-up" to the original benefit and then elect a benefit with survivor provisions.

The "pop-up" provisions typically available in the private sector are attached to joint and survivor options when the spouse at the time of retirement dies first. Private sector "pop-up" provisions are not usually provided for divorce after retirement. The private sector does not allow new beneficiaries after retirement, that is, marriage-after-retirement provisions.

Beneficiaries added after retirement may not have supported the teacher during their teaching career, yet could receive a lifetime income from ATRS. All marriage-after-retirement provisions should be considered in light of the statement of purpose for retirement systems in ACA §24-1-201 to provide a benefit for employees and their beneficiaries.

Sincerely,

Jody Carreiro

Jody Carreiro, EA, ASA, MAAA
Actuary