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House Bill 1209

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 1209 affects the Arkansas Public Employees' Retirement System (APERS).

APERS has historically provided different forms of multiple service credit for certain classes of employees within the system, notably for elected officials. Legislation passed in 1997 and 1999 eliminated multiple service credit for those state elected officials first elected after July 1, 1999. The only remaining multiple service credit, often called "two-for-one" credit, is for elected county or municipal officials covered by APERS. Arkansas Code Annotated §24-4-521 deals with the classes of employees who continue to receive "two-for-one" service credit. §24-4-521 was established by Act 151 of 2001, a technical corrections bill which reorganized APERS code and moved much of the language previously found in §24-4-301.

APERS was amended by Act 2084 of 2005 to implement a new contributory tier as required by Act 339 of 2003. Section 3 of Act 2084 limited the "two-for-one" elected service credit to a maximum of 10 years under the new contributory tier.

Act 563 of 2011 addressed the elected public officials who had not served before July 1, 2011, by requiring the officials and their employers to contribute an additional 2.5% of payroll in order to pay for this two-for-one service. Act 288 of 2013 clarified that these extra contributions were also required for contributory public elected officials (those first serving after January 1, 2014). The total of 5% of payroll additional contributions (2.5% from both employer and employee) was agreed upon to offset the cost of the "two-for-one" credit benefit.

House Bill 1209 would allow for the governing bodies of these public elected officials' municipalities or counties to choose whether to award this two-for-one credit on an annual basis by notifying APERS of their decisions each fiscal year.

Fiscal Impact

We estimate that about 700 employees of counties and municipalities covered by APERS would eventually become eligible under the current provisions. As of June 30, 2014 we understand only about 40, with average salary of $38,000, have earned the new elected official service credit. This low number is due to with the recent passage of Act 563 of 2011 and the timing of city and county elections.

The low number of participants earning elective service means that we do not have enough information to calculate a cost factor different from what was produced in 2011. That change in cost was just above 5% of payroll, so that is the amount that was used for the 2011 legislation (2.5% employee and 2.5% from the employer). Therefore, it remains our opinion that the current structure does not add to the unfunded liabilities of APERS.

The structure of House Bill 1209 is such that we believe that there could be a certain amount of adverse selection. Also, it seems logical that higher income municipalities or counties would be the ones that elect this coverage, and this would mean higher than average salaries for the employees who receive this extra credit. Our opinion would be that there would not be a significant change to the total cost of APERS, but House Bill 1209 would create additional opportunities for adverse selection which could cost the system for those individual cases.

Other

It appears to us that on page 5, line 34, the word "the" was unintentionally omitted.

The ability of the employer (in this bill, the governing body) to elect to change the contribution rate and benefit for the employee each year appears to conflict with the definitely determinable benefit requirement for qualified plans. For a plan to be qualified, the benefit formula (in the case of a defined benefit plan) must clearly define the benefit to be paid at normal retirement age as discussed in Internal Revenue Code §401(a) and regulation §1.401-1(b). In particular, IRS Revenue Ruling 74-385 discusses situations where the employer can elect to change the employee contribution or benefit formula each year. This ability, according to this Revenue Ruling, makes the benefit one that is not definitely determinable. Therefore, it is our opinion that adoption of House Bill 1209 as written could threaten the qualified status of APERS.

Another IRS requirement is that of nondiscrimination found in Internal Revenue Code §401(a)(4) and its regulations. This requirement is that the contributions or benefits of the plan do not discriminate in favor of highly compensated employees. One of the regulations, §1.401(a)(4)-4, discusses that all benefits, rights, and features must be currently and effectively available to non-highly compensated employees. The elected officials who are employees under the plan may not be a big enough group under the regulations to cause a violation, but the group would need to be monitored.

A qualified ERISA plan must state who has the ability to amend the plan. In a private, single employer plan, that is clearly the employer. In multiple employer plans, there is often a board of trustees. APERS states that the trustee of the plan is the state of Arkansas (ACA §24-4-205). It would appear that the legislature is the only body with authority to amend or change the plan. House Bill 1209 allows other bodies to change the terms of the plan.

There have been challenges in several states to laws that change the benefits of a contributory plan after vesting. In the Arkansas Constitution Article 2 §17, there is a contracts clause that has been the subject of various Attorney General Opinions in Arkansas as to how this protection applies to pension plans. We are not attorneys, but we do believe that this issue should be reviewed to avoid future legal challenges.

Sincerely,

Jody Carreiro, EA, ASA, MAAA
Actuary