Attachment #1
Potential Legislation -- Executive Director Update
November 16, 2012

The following items are legislative proposals that have been approved by the Arkansas Teacher Retirement System (ATRS) Board of Trustees (Board). This does not mean all of the proposal will become law; it only means legislation will be drafted and presented to the Arkansas General Assembly in 2013 as authorized by the ATRS Board.

Law Changes Approved by the Board Since 2011.

A. **Purchase of Service Credit After Reinstatement.** Based upon Board discussions, it appears that significant policy issues are involved in the termination of a school employee and subsequent required reinstatement. The policy questions are how service credit and other factors should be resolved in this circumstance. The ATRS Board has determined that members/employers should be allowed to purchase service credit during periods of termination and subsequent reinstatement at the actuarial cost of service.

B. **Allow New Employees of Colleges to Join ATRS.** ATRS staff has received input about college participation following Act 513 of the 2011 session. One request related to certain colleges that have decided to continue participation in ATRS wanting the option to allow any newly hired employee to participate in ATRS rather than limiting ATRS participation to only those with five (5) or more years of service in ATRS at the time of the new employment with the ATRS participating college.

   The original reason for the five (5) year vesting requirement was due to the fact that the University of Arkansas (U of A) System employers used that rule for new employees since a law did not require U of A participation and the U of A participated only as an educationally related institution. Due to this volunteer aspect of the U of A participation, the U of A set some limits, including the requirement for vesting, for a new employee to participate in ATRS. Since the U of A has declined to participate in ATRS after the passage of Act 513 of 2011, ATRS staff agrees that it is reasonable to allow participating colleges to allow any new employee to choose ATRS at the beginning of employment.

C. **Rule Making Authority to Allow ATRS to Collect Necessary Information From ATRS Employers to Properly Record Salary and**

Service Credit Records. Another carryover item from the 2011 session was the House Bill by Representative Pennartz on theft of funds by an ATRS member while employed at an ATRS employer. Correct salary and service credit records are important in order that ATRS can ensure its records are accurate, and that ATRS obtains contributions on all salary as defined by Arkansas law. The amendment was not heard in the 2011 session, and the ATRS Board and staff wanted to be sure this bill is heard in the 2013 session. Due to the ever-changing issues that arise, the proposal would now give the ATRS Board authority to designate required information to be provided by employers using the Board's rule making authority.

D. **1% T-DROP Reduction for Noncontributory Service.** Currently, ATRS has a 1.0% reduction in the T-DROP deposit formula for each contributory year of service credit that a member has with ATRS; and a 1.0% reduction for each reciprocal year of service credit a member has with another system, regardless whether the year is contributory or noncontributory. ATRS only has a 0.6% reduction for each noncontributory year an ATRS member has with ATRS. This means that if a member had thirty (30) years of contributory service credit and no noncontributory service, then the member would receive a deposit each month into their T-DROP account equaling **70%** of what the retirement benefit would have been, had the member retired.

A member with thirty (30) noncontributory years of service credit would receive **82%** of what the monthly benefit would have been had the member retired. In this instance, that would provide the noncontributory member with the same number of years of service with a 12% advantage over the contributory member. For clarity and ease of administration, a 1% reduction for all service types would be easier to administer and explain. In addition, this "advantage" does provide some disincentive for a member who is noncontributory to elect to become contributory while an active member of ATRS.

In addition, requiring a 1% reduction for all service credit types would be a cost savings since a noncontributory member would receive the same T-DROP deposit reduction that a contributory member receives. In cases where a member has mixed service, it would be easier to compute at ATRS and clearer to the member what the reduction would be.

E. **Disability Benefit Paid Only Back to Date the Completed Application is Filed.** Currently a member can obtain a quarter year of service credit in a fiscal year and if the member has a medical condition, the member can wait up to eighteen (18) to twenty-two (22) months before filing an application for disability benefits. If the disability application is approved, the member is paid disability benefits back to the first month he or she didn't work, even if that were twenty-two months before the date the application was filed. In order to encourage members to file a disability application in a timelier manner, and to prevent members from constantly missing the filing deadline, ATRS staff feels that often both the member and ATRS are disadvantaged by paying disability benefits back to the time the member last worked. The delay is often caused due to interaction between the ATRS disability benefit rules and a private disability policy. Many private disability policies reduce the private disability benefit once ATRS begins to cover the member with an ATRS disability benefit.

F. **Require Five (5) Years of Actual ATRS Salary for Disability and Survivor Benefits.** Currently ATRS allows a disability or a survivor application once a member has completed five (5) years of combined ATRS and reciprocal service. If an ATRS member has worked in the APERS system for seven years, in this example, and later works for one half year in ATRS, that member would be entitled to an ATRS disability benefit, if the conditions for disability retirement are met. The disability benefits might be quite small at ATRS, but it would still require the full Medical Committee review with benefits paid each month.

   In addition, if the same circumstance existed as above and the member died, ATRS would pay the survivors of a new member with one half year of service credit the same benefit it would pay a member with thirty (30) years of service in ATRS. ATRS would pay up to 60% of that new member's best salary (the salary that would have been paid in that fiscal year) to the member's minor children until the minor children reach age twenty-three.

   The survivor benefit is a very lucrative benefit. ATRS staff feels as a cost savings, that perhaps a member should have a greater connection to ATRS before disability or survivor benefits are paid than just a small amount of service. This proposal would be a cost savings and would also ensure that the funds of ATRS are appropriately directed for the benefit of members after an appropriate length of recognized service at ATRS employers.

G. **Define Pensionable Salary.** ATRS has a very liberal definition of salary. Often changing the definition of salary can be a method of cost savings by ensuring that only reasonable "pensionable salary" is actually included in the determination of final average salary. For instance, it may be possible for a home provided by an ATRS employer to be included as salary on that member's W2. If it is included on the member's W2, ATRS will treat the amount as salary. The same is true for cell phones, vehicles, sick days, annual leave, and the like. ATRS should tighten up the definition of salary that is currently used in the calculation of final average salary at ATRS.

H. Final Average Salary and Reciprocal Service. While reciprocity was designed to support mobility in state retirement systems without greatly injuring retirement benefits, there are certain aspects of combining reciprocal service which encourage anti-selection. One of the anti-selection features that ATRS has identified is the calculation of final average salary (FAS) between the state retirement systems. The ATRS law currently provides that ATRS will use the final average salary that is the higher of the reciprocal systems involved.

Each system is responsible for the calculation of its final average salary. ATRS' rules and procedures concerning reciprocal final average salary are that ATRS will use the highest final average salary of ATRS or the reciprocal system. For example, if a member has 27 years of service with ATRS and a final average salary of $40,000, that member can take a position covered by APERS, work one year for a salary of $60,000, and the member's 27 years of service at ATRS will be calculated with $60,000 as a final average salary. ATRS sees this as a problem that can be easily remedied by ATRS using some of its salary years in the FAS calculation if the member has less than 3 years with the reciprocal system that has a higher FAS than ATRS.

I. Define Manifest Injustice. As ATRS continues to try to work through years of various processes and procedures that often have legal compliance concerns, ATRS is lacking a broader definition of manifest injustice.

For instance, in the review that was undertaken by the ATRS Internal Auditor, the process of how ATRS handles Act 793 of 1977 claims, and how ATRS handles Act 808 of 1987 claims, have resulted in the ATRS executive staff determining that ATRS has incorrectly paid lump sum death benefits to beneficiaries of members retiring under both Acts 793 and 808. The total amount paid from the beginning of this process has not been determined. Since July 1, 2007, the beginning of the look back period established in 2011, $380,000 in lump sum death benefits have been paid that should not have been paid, according to the ATRS executive staff's determination.

If ATRS continues along its regular process in this regard, ATRS would find all the existing beneficiaries of these lump sum death benefit payments and seek repayment. Some of the payments went to estates which are no longer subject to collection. Others have died since the payment was made and are not subject to collection due in many instances. Others may have circumstances where income tax was paid on the payment. If ATRS seeks recovery of the full amount, then a great unfairness would result.

ATRS ceased paying the lump sum death benefits while the executive staff made a thorough review. Lump sum death benefits have not been paid for about eight (8) months, while ATRS executive staff processed the issues and legal circumstances of these two special and complex acts.

ATRS staff believes the appropriate action is to seek legislation that would allow ATRS to write off these sums as a specific manifest injustice declaration under the law. In addition, ATRS staff feels that with appropriate guidance from the Board, if these type issues arise in the future, instead of having special legislation each time, a new law could be passed to give ATRS greater discretion than currently exists.

ATRS staff will work with the Board to develop a more flexible definition of manifest injustice in the law to address these issues at a Board level without waiting two (2) years in the event a new issue such as these Acts 793 and 808 payments are discovered. All the recipients of death benefits through Acts 793 and 808 are innocent recipients who should not be adversely affected due to an interpretation mistake at the ATRS staff level over a decade ago on very complicated and vague acts.

In addition, at times a manifest injustice may be found if a member misses a deadline due to a communication issue or mistake by ATRS staff. Although it provides significant extra duties on ATRS staff and the Board, another issue on manifest injustice may be considering allowing a filing deadline to be extended due to manifest injustice circumstances. Although such authority should be greatly limited, it could be foreseen that a person injured in a car accident or similar circumstance, with a pending deadline, could be given additional time if it is established that they were incapable of filing the documents at the time the document was due, although they had intended to do so before the deadline. An extension could also be allowed if ATRS staff gave incorrect **written** advice.

It is a difficult decision to agree to establish a broader definition of manifest injustice to allow a deadline waiver, but in the member appeal process, occasionally circumstances have been seen that warranted this proposal.

J. **Standardize Interest Rates on All Funds Due to ATRS.** Currently, ATRS has a fairly good record of obtaining employer contributions and member contributions from ATRS employers. With the development of charter schools, at times, ATRS has had occasional difficulty collecting both member and employer contributions from a few charter schools. ATRS proposes that contributions, that are not paid timely, accrue interest at 8% per annum, to treat the funds as if they had been in the ATRS portfolio and receiving the assumed rate of return. Currently these sums are at a 6% interest rate.

K. **Allow Retirees Who do not Retire on the First Day of a Calendar Quarter to Use Current Year Salary in Final Average Salary if it is One of the Highest Salary Years.** Currently, if a member does not retire on a July 1, an October 1, a January 1, or an April 1, that member's final year's salary cannot be included in the determination of final average salary if the member retires in the final year of work.

   ATRS also imposes a service penalty for someone retiring in the last year when they are active, to prevent members from leaving school early, by only allowing completed quarters of the year to be reflected in service credit. For instance, a member retiring on January 1, while still in active service, can only receive a half-year of service credit since the fiscal year is one-half over in January, even if they had worked 160 days. The same is true for a quarter year on October 1, and three-quarters of a year on April 1.

   ATRS staff thinks the service penalty is enough to prevent retirements which would leave a school district in a lurch. ATRS thinks it is appropriate to allow a member who is retiring on the beginning of a month other than the four quarters to receive salary credit for the existing year if the salary could otherwise be used in the calculation of final average salary.

   Remember, a member can use the salary if they retire at the beginning of a quarter in any event. A member waiting until May 1 to file a retirement application currently cannot not use the current year's salary, whereas, a member retiring on April 1, could do so. Both would be limited to three-quarters of a year of service credit whether an April 1, or May 1, retiree if the member were actively employed in the existing fiscal year.

L. **Members With 28 Years of Service or 60 Years of Age Cannot Apply for Disability Retirement.** Currently, a member who has reached age sixty (60) or who has over twenty-eight (28) years of service credit has an incentive to forego regular age and service retirement and obtain disability retirement. The member who retires under age and service retirement is limited to service credit for the pro rata year of service credit worked in the last year of employment. A member who is approved for disability retirement and has 160 days of service credit can retire at any time during the last year of employment and receive a full year of service credit instead of being limited to the number of completed quarters of the last year of employment. ATRS sees several members choose to go through the disability retirement process and add the administrative cost to ATRS, when they could have retired as a regular age and service retiree. This process often gives a small increase to their benefit of up to a half-year of service credit. This simple change will provide that if a member is eligible for age and service retirement, then they cannot apply for disability retirement at ATRS to take advantage of this loop hole.

M. **Survivor Benefits Become Effective the Date of the Completed Application.** ATRS typically finds deceased members very quickly and notifies the family/beneficiaries about ATRS programs and benefits. For various reasons, at times, survivors and others wait long periods of time without claiming the survivor benefits that they know exists. It is uncertain the motivation for these decisions but it is not uncommon for these to occur. At one time, high interest rates by ATRS were a part of the reasoning. The proposal is that survivor benefits begin after the effective date the completed survivor application is properly filed with ATRS to prevent large back payments.

N. **Discounted Buying of Inactive Vested Service Credit.** ATRS staff continues to look for ways to address the liabilities on the ATRS balance sheet. Currently, the ATRS liabilities in total include liabilities of about $700 million dollars to members who are, or will become inactive vested members. This means that over 4% of the ATRS liabilities are to members who are no longer on a career path and are no longer involved in delivering the educational curriculum to Arkansas schools.

Many of these people also wish to cancel their service and obtain an immediate payment versus being entitled to receive a monthly retirement benefit that may not occur for 20 or more years into the future. Members who are totally contributory have somewhat of an option now, and that is to obtain their contributions plus interest. Those with mixed service of contributory and noncontributory can do the same. Those that are totally noncontributory have no method of cashing out their service for an immediate payment. This brought ATRS staff to look at a potential program of allowing all these members to have an occasional opportunity granted by the ATRS Board opening a window for these members to exchange their right to a benefit in the future for an immediate cash payment now to take these liabilities off the ATRS books at a discount.

For a summary, ATRS has over 12,000 inactive vested members. The current liability to these current inactive vested members is a little over $400 billion dollars that will grow to $700 billion dollars over time as the reserve grows each year, and as the member gets closer to age 60. This means that the average inactive vested member has a reserve account set up by ATRS worth about $33,000. Each year as an inactive vested member reaches another year closer to age 60, their reserve balance increases. If ATRS can design a program to allow these members to take a set dollar amount now and surrender their right to a future benefit, it can be mutually beneficial to the inactive member and to ATRS.

The inactive member often wants an opportunity to sever their relationship with ATRS in return for money that can be rolled into an IRA, or otherwise available for the inactive member to use. It can be beneficial to ATRS because these reserve accounts can be eliminated for significantly less than the current reserve value, and the reserve accounts value will not continue increasing annually as these members get closer to age 60. Over time, ATRS may be able to trade some cash payments to reduce hundreds of millions of dollars in liabilities. That reduction can assist ATRS in addressing its funding levels.

This proposed legislation will require Board action from time-to-time to open a window for these discount liquidations. In some instances, these members are more than 20 years away from having a benefit and would be anxious to obtain something now rather than wait that amount of time for a benefit. This program would be totally voluntary, meaning that members who did not want to cash in their rights for future benefits would just decline to participate in the opportunity provided by ATRS.

O. **Permanently Delete Service Credit on Years on Which Employee Contributions Are Owed.** ATRS finds that many members owe contributions on service credit from many years ago which has accrued significant amounts of interest. These members are usually found at the time of retirement. ATRS' current policy is to hold up retirement payments until the balance is paid in full. This creates a hardship on many of our retirees who do not have money readily available to pay off these accounts. The proposal is to write into law that ATRS will delete the year or years in question, which means the members will not be able to claim any service credit for those year or years deleted, if the member instructs ATRS to do so by signing a form to forfeit the service credit. If the member has paid partial contributions on the year or years in question, ATRS will refund the contributions to the member without interest.