ARKANSAS TEACHER RETIREMENT SYSTEM

Major Cost Reduction Items
ATRS Board of Trustees May Consider
For Legislation or Rule Making

I. The ability to reduce the unfunded liabilities of ATRS can begin with some simple concepts. There are limited ways to reduce the liabilities. In the simplest of terms, ATRS can **increase revenue**, pay out less **now**, or pay out less **in the future**. It begins at that simple level. As the ATRS Board studies how to reduce the unfunded liabilities of ATRS, the areas to reduce the liabilities can be put into 3 categories:

1. **Increase revenues.** This can be done two ways, either by having investment returns of more than 8% or by increasing the contribution rate for employers or members.

2. **Decrease current payouts.** This can be done by reducing the retirement benefits being paid to current retirees.

3. **Slow the accrual of future benefits.** This can be done by lowering the benefits that will be paid to current T-DROP and active members. Examples are: lower the multipliers, lower T-DROP interest rates, lower survivor benefits, raise age to get unreduced benefits, use a 4 or 5 year final average salary, and other benefit cuts.

II. **Anticipated Actuarial Needs and Suggestions Researched by Staff in Preparation for the 2013 Session.** These items are not recommended for action items, but for full disclosure. Updated actuarial figures estimate that ATRS is expected to need approximately 2.85% of payroll to bring its unfunded liabilities to a 30 year amortization.

If the ATRS investment return rate rises sufficiently between now and June 30, 2013, the cost cutting measures **may not be necessary at all.** Because ATRS assumes an 8% return on investments, the return must be greater than 8% to begin paying off the unfunded liabilities. Each 3% of return rate above 8% is equivalent to approximately a 1% employer contribution rate increase. If the return rate for the year ended June 30, 2013, were to be 18% or greater, then ATRS should be in great shape. If the return is not enough, then some of the following cost cutting measures may be necessary.

A. **1% Reduction for Noncontributory Service in T-DROP Formula (approved).** The ATRS Board has previously recommended legislation that would require a 1% reduction for each year of noncontributory salary used in the T-DROP reduction formula. This would make all service credit types have the same reduction: contributory, noncontributory, and reciprocal. The cost savings for this proposed legislation is **.08%** as a percent of payroll, equivalent to a .08% increase in the employer contribution rate, which would be recognized immediately by the actuaries.

B. **Rescind Future Impact of Optional Compounding of the Simple COLA in 2009.** The ATRS Board compounded the simple cost of living adjustment (COLA) in July 2009. Discussion with the actuaries placed the cost of this optional non-guaranteed benefit at about $180 million dollars. If the Board had authority to eliminate the future impact of this future compounding that was optional and voluntary, the current staff estimate is that it would be the equivalent of 50 basis points, or a .50% increase in the employer contribution rate.

C. **Four Year Final Average Salary Immediately.** The ATRS Board has the authority in the existing law to set the applicable number of years to be used in computing final average salary through the promulgation of rules. ATRS has been using the highest three years to calculate final average salary since April 1, 1998. By increasing the years in the formula to four, the immediate cost cutting savings would be **.39%** as a percent of payroll, equivalent to a .39% increase in the employer contribution rate**.**

D. **Five Year Final Average Salary Immediately.** As stated in the paragraph above, the ATRS Board has the authority in the existing law to set the applicable number of years to be used in computing final average salary through the promulgation of rules. ATRS has been using the highest three years to calculate final average salary since April 1, 1998. By increasing the years in the formula to five, the immediate cost cutting savings would be **.76%** as a percent of payroll, equivalent to a .76% increase in the employer contribution rate.

E. **Four Year Final Average Salary in 2019.** ATRS staff has evaluated the effect of changing the years in the final average salary on July 1, 2013. The staff believes this could bring about a change in member behavior as members rush to retire in order to take advantage of the three year final average salary. This could leave classrooms empty, cause a disruption in education, and bring about a drain on the trust fund assets. If the final average salary years increase were to be pushed six years into the future, with a provision that **if** the unfunded liabilities of the System drops to 30 or less years, then the final average salary would remain unchanged at three years, then ATRS can have cost savings without harm to ATRS or the quality of education. The cost savings of this proposal would be .**26%** of payroll, equivalent to a .26% increase in the employer contribution rate**.** This proposal would give the fund adequate time to build assets before the need for an actual implementation, allow the Board to withdraw it if it is not needed, reduce the risk of a rush to retire, and still give the Board the flexibility to effect cost cutting measures as needed.

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G. **Eliminate $75 Stipend Flash Cut.** In the December 3, 2012, board meeting, the ATRS Board voted **not** to flash cut the stipend. Currently most ATRS retirees receive a $75 dollar per month benefit supplement called the "**stipend**". The stipend can be eliminated or reduced by legislation. Reducing the income of retirees would be a difficult undertaking. ATRS realizes many retirees are dependent on the added amount of $75 dollars from the stipend each month. The stipend was added to retirees' benefits on July 1, 1999. The original amount of the stipend was $50 per month, and was added to every retiree, survivor, and beneficiary regardless of the amount of service credit. The following year, the stipend was increased to $75 per month, again with no requirements for eligibility. Beginning with retirees on or after July 1, 2001, the eligibility requirement was raised to five years of service credit, and beginning July 1, 2007, the eligibility requirement was raised to ten years of service credit. As the number of retirements has grown, so has the cost of the stipend. The cost savings of a flash cut to end the stipend would be **1.51%** of payroll, equivalent to a 1.51% increase in the employer contribution rate.

H. Reduce Stipend to $50. The ATRS staff has also had a study performed to reduce the stipend by only $25 per month beginning July 1, 2013. Again, this is not a recommendation, but one of many options the staff feels it has a duty to report to the Operations Committee and Board. This cost savings of this proposal would be **.47%** of payroll, equivalent to a .47% increase in the employer contribution rate.

I. Eliminate $75 Stipend over Three Years. If the stipend were to be reduced by $25 each month for each of three fiscal years beginning July 1, 2013, the cost savings would be **1.39%** of payroll, equivalent to a 1.39% increase in the employer contribution rate. The stipend would be cut to first $50 dollars per month the first year, $25 dollars per month the second year, and would disappear in the third year.

J. Increase Employer Contribution Rate by 1%. ATRS could ask for an employer contribution rate increase. This proposed legislation could be drafted in such a way that the Board could scale the contribution rate back to a lower amount as the unfunded liabilities diminish. The benefit of this proposal would be **1.00%, 0.75%, or 0.50%** of payroll, or equivalent to a 1.00%, 0.75%, or 0.50% increase in the employer contribution rate**.** This proposal would affect all employers, including some state agencies and colleges. If the ATRS Board seeks an increase in the employer rate, the amount requested would be an ATRS Board decision. The General Assembly would be required to approve the increase before it could occur.

K. Increase Member Contribution Rate by 1%. The ATRS member contribution rate has been 6% of salary for contributory members for 43 years, including the current 2012-2013 year. Many states have increased member contribution rates in recent years. Again, this is intended to give the Operations Committee and Board full disclosure of possible funding measures. By increasing the contributory member contribution rate from 6% to 7%, ATRS would recognize an annual revenue increase in trust fund revenue equal to approximately **.70%** of payroll, equivalent to a .70% increase in the employer contribution rate.

L. Increase Member Contribution Rate by 2%. If the ATRS contributory contribution rate were increased from 6% to 8%, ATRS would recognize an annual revenue increase in trust fund revenue equal to approximately **1.40%** of payroll, equivalent to a .1.40% increase in the employer contribution rate.

M. Change Contributory Multiplier for Future Service to 2.10%. As staff began to look at cost cutting measures, each segment of membership was evaluated to see if the cost could be shared among the various groups. If the contributory multiplier were reduced from the current 2.15% to 2.10% on contributory service credit earned after July 1, 2012, (all previously earned service credit would remain at the 2.15% multiplier) the cost savings would be **.24%** of payroll, or equivalent to a .24% increase in the employer contribution rate**. For emphasis,** all previous years worked as a contributory member would remain at the current 2.15% multiplier.

N. **Change Noncontributory Multiplier for Future Service to .75%.** As the contributory multiplier in the benefit formula was evaluated, so was the noncontributory service credit multiplier. Staff gave two suggestions for reductions to the formula for noncontributory service credit earned after July 1, 2013. All previous years worked as a noncontributory member would remain at the current 1.39% multiplier. The first proposal would reduce the current 1.39% multiplier to .a 75% multiplier for all noncontributory service credit years worked after July 1, 2013. This cost saving would be .**78%** of payroll, equivalent to a .78% increase in the employer contribution rate. One difference here is that a noncontributory member can avoid a reduction by signing a simple one page form to become contributory and get the much higher contributory multiplier.

O. **Change Noncontributory Multiplier for Future Service to .6%.** The second noncontributory multiplier proposed for a cost study would reduce the current 1.39% multiplier to .6% on all noncontributory service credit earned after July 1, 2012. All previous years worked as a noncontributory member would remain at the current 1.39% multiplier. Although the reduction appears to be harsh, this is one area that the individual noncontributory members can remedy. By signing a one page form to change to contributory status at the beginning of a fiscal year, then these members would not be impacted if this proposal were to be adopted. The cost savings for this proposal would be .**91%** of payroll, equivalent to a .91% increase in the employer contribution rate.

P. **Discounted Purchase of Benefit Rights for Inactive Vested Members.** 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 members 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. The members with mixed service of contributory and noncontributory can do the same. The members that are totally noncontributory have no method of cashing out their service for immediate payment. The Board has recommended this proposed legislation to allow 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.

This would affect over 12,000 inactive vested members if the member choses to take a settlement payment. This proposal would require Board action from time-to-time to open a window for these discounted liquidations. This program would be totally voluntary, and would be a cost saving of **.42%** of payroll, equivalent to a .42% increase in the employer contribution rate.

Q. Refund Contributions after Five Years of Inactivity. This proposal was a law in the early years of Arkansas Teacher Retirement. Members who were required to cash out were often disadvantaged if they return to covered employment, due to the cost of repaying refunds. With the actuarial cost service in effect now, very few members would ever be financially able to restore the service credit. However, this was another segment of members that ATRS staff considered when evaluating the various populations of membership data. This cost savings for this proposal would be approximately **.24%** of payroll, equivalent to a .24% increase in the employer contribution rate.

R. Tier 2 Low Cost. ATRS staff proposed two different tier plans for cost studies by the actuaries. The least costly plan would require 30 years of service credit for full voluntary retirement, no stipend would be provided, the cost of living adjustment would be set by the Board with a range of 0% to 2.5%, and the noncontributory multiplier would be set at .7%. The ATRS staff is hesitant to establish another tier of benefits due to the overhead of administration. Even if the tier could be rolled back into the regular retirement plan at some future date, there would be some retirees in the tier plan for many years due to the combination of ATRS service credit with reciprocal service credit from other Arkansas public retirement systems. The cost savings of this tier would be approximately **.60%** of payroll over time, equivalent to a .60% increase in the employer contribution rate.

S. Tier 2 High Cost. ATRS staff developed this tier with as many cost reductions as possible. The provisions of this tier included 35 years of service credit requirement for full voluntary retirement, vesting at 10 years of service, age based retirement would increase from 60 to 65 (less than 35 years of service credit), no stipend, 0% to 2.5% cost of living adjustment to be set by the Board, 10 years of service credit requirement for survivor or disability retirement, a six month separation period for all retirees, regardless of service credit or age, no death benefit, and a noncontributory multiplier of .7%. The actuaries estimated a cost savings of approximately **1.07%** of payroll over time, equivalent to a 1.07% increase in the employer contribution rate.