ADDENDUM I

A COMPARISON OF SIGNIFICANT RETIREMENT PROVISIONS BETWEEN

ARKANSAS PUBLIC EMPLOYEES RETIREMENT SYSTEM (APERS) AND RETIREMENT PLAN FOR EMPLOYEES OF CITY OF JONESBORO, ARKANSAS (City Plan)

The comparison of benefits provided in the attachment to this Addendum I provides highlights some of the more significant differences between the City Plan and APERS. It is clearly evident that that the benefits provided by APERS are superior. While one would expect that these enhanced benefits would cost more than those provided by the City Plan, we have been asked to provide cost estimates associated with these benefits and to make recommendations regarding the future of the City's retirement program.

The more significant differences between the two plans include:

1. The benefit multiplier for current accruals is equal to 2% under APERS compared to 1.50% under the City Plan.

2. Unreduced Normal Retirement Benefits are payable after completion of 28 Years of Service under APERS compared to age 65 with 10 Years of Service under the City Plan.

3. Under APERS, Final Average Compensation is based on the Participant's highest 3 consecutive Years of employment compared to a Participant's latest 5 years under the City Plan.

4. APERS provides for an annual 3% cost-of-living adjustment (COLA). The City Plan does not currently provide for a COLA.

5. The APERS plan provides for death benefits to surviving spouses and to dependents of Participants when a Participant dies prior to attainment of Early Retirement Age or Normal Retirement Age. Other than a return of a Participant's Employee contribution account, the City Plan pays death benefits only after a Participant attains Normal Retirement Age or, depending on the form of benefit selected by the Participant, after a Participant has commenced with Early Retirement Benefits.

6. The APERS plan provides immediate disability benefits to Participants that become disabled. The disability benefit provided by APERS is equal to the Participant's Accrued Benefit otherwise payable at the Participant's Normal Retirement Age. Disability benefit payments commence as of the date of disability and continue until the earlier of the date the Participant is no longer disabled or Participant's Normal Retirement Age.

7. APERS provides a Deferred Retirement Option Plan (DROP) that allows Participants to establish a tax-deferred account savings account after attainment of Normal Retirement Age (generally after 28 years of service) and accumulate for a period not more than 7 years. At retirement age, the Participant draws a lump sum benefit equal to the accumulated DROP account and begins drawing a monthly retirement benefit. DROP benefits accumulate in lieu of additional service credit.

8. APERS provides a Partial Annuity Withdrawal (PAW) for active Participants that have passed Normal Retirement Age and not elected a DROP. Under a PAW, eligible Participants may elect to receive up to 60 months of his/her monthly benefit in lump sum. Monthly benefits payable at actual retirement are actuarially reduced.

It is important to understand that the actual cost of a retirement plan cannot be known until the Plan is terminated or until the last Participant dies. This is true for the City Plan and for APERS. Estimated costs using various actuarial methods and assumptions can be used to project and value future liabilities and asset returns in order to provide a "best guess" in determining appropriate funding amounts for a plan. These valuations are prepared by the plan's actuary. The City Plan is valued by actuaries employed by The Principal Life Insurance Company (Principal). APERS is valued by Gabriel, Roeder, Smith & Company, an independent actuarial firm in Southfield, Michigan.

In its most recent Actuarial Valuation Report, the Principal actuaries recommended a contribution of $604,978 or approximately 7.65% of 2007 pay. As detailed in our Study Report, we believe that these results were obtained using fairly aggressive actuarial assumptions for a plan with a January 1, 2008, Actuarial Valuation Report date. Had Werntz & Associates, Inc. performed the 2008 valuation, our results would have resulted in a higher recommended contribution amount for 2008 (probably in the range of $655,000 or higher) or approximately 8.28% of 2007 pay. For purposes of comparing the cost of the various benefit enhancements, we utilized a 7% interest assumption for both pre-retirement and post-retirement purposes.

Currently, the funding for APERS is provided by both the Employer (12.54% of pay) and the Employee (5% of pay) contributions. The current total contribution rate for APERS is equal to 17.54% of pay! This is approximately 230% of the contribution rate we would recommend for the City Plan's current benefit structure. Even without Employee contributions, the Employer contributions are 163% of what we would recommend for the City Plan's current benefit structure. Employee contribution rates are set by APERS' Board of Trustees as provided for by statute. These rates are heavily influenced by the recommendations of their independent actuarial firm.

It is also important to understand that benefit accruals accumulated under the current City Plan cannot be transferred to APERS. This means that the benefits provided by APERS to Employees of the City of Jonesboro would only apply to service after adoption of APERS. Benefits already accrued under the City Plan would remain payable from the City Plan under the terms of the City Plan. In our Study Report, we attempted to show the cost of enhancing the benefits provided by the current City Plan by showing the cost of applying the enhancements to future service only, and on a basis that would apply the enhancements to both current and future service.

It was intended that the cost estimates in our Study Report be used in deciding which, if any, of the enhancements could be considered for the City Plan. Because of the inter-dependence of different benefit structures, we presented various combinations of benefit enhancements. This inter-dependence of cost can be illustrated by reviewing the relationship of the benefit multiplier and the salary averaging period. For example, if there is a cost associated with increasing the benefit multiplier from 1.50% to 2.00%, we would be remiss if we did not show the effect that a change in averaging period would have on this benefit enhancement. Decisions to add multiple benefit enhancements cannot be made without considering this inter-dependence.

Increasing the Benefit Multiplier

In our Study Report, we estimated that the cost of increasing the benefit multiplier for all service from 1.50% to 2.00% would increase the total recommended funding of the City Plan from $655,000 (8.28% of pay) to $1,045,000 (well over 13% of pay). If the 2.00% multiplier would apply only to future service, we estimated that the recommended funding would increase from $655,000 (8.28% of pay) to $811,000 (10.25% of pay). Please note that the estimates in this paragraph involve only a change in the benefit multiplier from 1.50% to 2.00%. Combining this change with other enhancements will significantly amplify the cost of increasing the benefit multiplier.

Adding a "28 & Out" Provision

In our Study Report, we estimated that the cost of providing unreduced benefits after completion of 28 Years of Service (assuming no other changes to the City Plan) would increase the total recommended funding of the City Plan from $655,000 (8.28% of pay) to $963,000 (over 12% of pay). This estimate was based on applying the "28 & Out" provision to both prior and future accruals. We did not calculate the cost of providing this benefit only to future benefit accruals. Please note that the estimates in this paragraph involve only adding the "28 & Out" benefit. Combining this change with other enhancements will significantly increase the cost of adding the "28 & Out" benefit.

Reducing the Salary Averaging Period

In our Study Report, we estimated that the cost of reducing the salary averaging period from 5 to 3 years would increase the total recommended funding of the City Plan from $655,000 (8.28% of pay) to $703,000 (approximately 8.89% of pay). Once again, our cost estimate assumes that this enhancement would apply to the entire benefit of the Participant rather than to future benefit accruals only. Again, this estimate assumes no other changes to the Plan. Combining this change with other enhancements will amplify the cost of reducing the salary averaging period.

Adding a 3% Cost of Living Adjustment (COLA)

We have previously not provided an estimated cost of adding an annual 3% COLA to the City Plan. We estimate that adding this benefit enhancement for current employees only (not retirees) would increase the total recommended funding of the City Plan from $655,000 (8.28% of pay) to $1,009,000 (approximately 12.76% of pay). Combining this change with other enhancements will also cause a significant increase in the cost of the City Plan.

Adding a Pre-Retirement Death Benefit

The minimum pre-retirement death benefit in the private sector is called a Qualified Pre-Retirement Survivor Annuity (QPSA). The QPSA is offset by any other death benefits otherwise provided by the plan. A QPSA is a death benefit payable to the surviving spouse of the Participant and is equal to (or the actuarial equivalent of) the payment that would have been made to the surviving spouse under the plan's Qualified Joint & Survivor Annuity (QJSA) option. In the case of a Participant who dies upon or before attaining the earliest retirement age under the Plan, the Participant had: (a) separated from service on the date of death, (b) survived to the earliest retirement age, (c) retired with an immediate QJSA at the earliest retirement age, and (d) died on the day after the day on which the earliest retirement age would have been attained. (If the participant had separated from service prior to death, the amount of the QPSA is calculated by reference to the actual date of separation from service rather than the date of death to prevent the participant from accruing benefits after separation from service.) For longer service married Participants, this benefit will be greater than the pre-retirement spousal death benefit payable under APERS. Note, however, that this benefit is only payable to a surviving spouse and only if the Participant is legally married as of his/her date of death. Unlike APERS however, a QPSA will not provide pre-retirement death benefits to dependent children.

Of course, the cost of adding a QPSA will depend on the adoption of any other benefit enhancements. For purposes of our Study, we assumed that the QPSA would be a Joint and 50% survivor annuity. If no other benefit enhancements are made, we have estimated in our Study Report that the total recommended funding would increase from $655,000 (8.28% of pay) to $715,000 (9.04% of pay).

Adding a Disability Benefit

In our Study Report, we recommended that disability benefits are generally better arranged through the purchase of a group long-term disability policy. If the City is not already providing this benefit in this manner, we would recommend exploring this alternative before further consideration is given to adding disability benefit provisions to the City Plan. Assuming no other changes to the City Plan, we estimate that adding disability benefit provisions similar to APERS would increase the total cost by an amount slightly less than the cost increase that would be attributable to adding a 50% QPSA Pre-Retirement Death Benefit (see above).

Adding a Deferred Retirement Option Plan (DROP)

In our Study Report, we described in detail the DROP benefit currently provided by APERS. We pointed out that the DROP benefit in APERS is only available to Participants that are eligible for the "28 & Out" unreduced retirement benefit. Once a Participant has satisfied the "28 & Out" requirement, the value of future accruals under APERS is significantly diminished, especially when a DROP provision is available to the Participant. Adoption of a DROP provision is relatively cost neutral if only those Participants who would have retired early elect the DROP feature. However, in a plan that provides for heavily subsidized early retirement benefits, employees that would have stayed even without the DROP feature, but stay and elect the DROP feature, will increase plan costs. Adding a DROP without adding a significant early retirement subsidy would not cause a significant increase in overall costs for the City Plan because there would little if no reason for a Participant to elect a DROP. Without knowing the specific retirement subsidy and the DROP, we cannot provide an estimated cost of adding DROP provisions to the City Plan.

Adding a Partial Annuity Withdrawal (PAW)

The monthly benefit payable at retirement to a Participant that has elected to take a PAW is actuarially reduced. If the reduction is equal to the actuarial equivalent of the PAW, then the addition of the PAW would be cost neutral to the Plan. Under APERS, only Participants that work beyond the date that they would otherwise be eligible for unreduced benefits (28 & Out) are eligible. Unless the City Plan is amended to provide for an earlier Normal Retirement Date, a PAW would only be available to vested Participants that elect to work beyond age 65. Even if the Normal Retirement Age were to be changed to an earlier date, the actuarial reduction in the retirement benefit (assuming actuarial equivalent) would make having a PAW cost neutral.

Combinations of Various Enhancements

As has already been discussed with the Retirement Committee, the City may decide to elect some, but not all of the most of the enhancements being considered. It is important to understand the inter-relationships between the various enhancements and that the cost of adopting multiple enhancements is not a matter of simply adding the dollar amounts or percentages together. In order to provide an estimated cost for the various combinations, we have attached Addendum II that provides estimated multipliers that apply to each enhancement.

Example 1

If the City were to decide to adopt only an increase the benefit multiplier from 1.50% to 2.00% (on all service), we estimate that the recommended funding would increase from 8.28% of pay to approximately 13.16% percent of covered pay (1.59 X 8.28%).

Example 2

If the City were to decide to adopt both an increase in the benefit multiplier from 1.50% to 2.00% (on all service) and reduce the salary averaging period from 5 to 3 years , we estimate that the recommended funding would increase from 8.28% of pay to approximately 14.09% percent of covered pay (1.59 X 1.07 X 8.28%).

Effect on Unfunded Liability

Making decisions regarding benefit enhancements based primarily on how adoption of the enhancements would affect the recommended funding for a plan is similar to deciding what the value of a large purchase based on what the monthly payment will be. It is crucial for the Retirement Committee to understand that applying benefit enhancements to past service will create an immediate unfunded liability that will be amortized over future periods. In turn, this unfunded liability will negatively impact the funded status of the City Plan. Based on our calculations, we have calculated that the assets of the City Plan ($6,822,000) covered only 94% of the Plan's estimated termination liability as of January 1, 2008. Based on recent market returns on assets, this funded ratio has undoubtedly deteriorated, perhaps significantly since January 1, 2008. We are all hopeful for a rebound in the financial markets, but we have yet to find professionals that can accurately predict when and to what extent such a rebound will occur. Until then, we believe that it would be prudent for the City to defer further discussions of adding benefit enhancements.

Other Considerations

We have not reviewed the investment and service contract currently in place with The Principal Financial Group (Principal). Before any serious discussions occur regarding discontinuing using either their investment services or their actuarial services, **we would recommend that the City Attorney review these contracts to determine what costs might be involved with terminating their services.**

If the City elects to be covered under APERS, it is crucial for the Retirement Committee to understand that the enhanced benefits available under APERS will only be available with respect to benefits accrued subsequent to coverage under APERS. **All benefits accrued by Employees prior to that date will continue to be determined under the terms of the City Plan.** The City could explore the idea of purchasing additional service credit under APERS. However, it is highly likely that the cost of purchasing additional credits would be prohibitive. In general, service credit can be purchased under APERS by paying the funding (plus interest) amount that would have applied for those years for which you are buying service credit. Remember, the current rate is 17.52% of covered payroll!

If the City elects to be covered under APERS, the City must still address what to do with the current City Plan. It will be important that the Retirement Committee to take a critical look at the Actuarial Valuation Report as of January 1, 2009, as prepared by The Principal. The City should expect to see an increase in recommended funding for the City Plan for the 2009 Plan Year. This Report will be especially interesting because it will be the first report generated since the recent market decline. Special attention should be paid to the funded status and the actuarial assumptions used to value the Plan's liabilities. The 2008 Actuarial Valuation Report from The Principal did not appear to provide a "termination liability", that is, the value of liabilities measured using market interest rates. We would recommend that this be requested from The Principal if not included in the 2009 Report. Discussions should also be opened with The Principal about the cost of funding if the Plan were to be frozen.

It was evident during our prior meetings in Jonesboro that the City Plan is not meeting the needs or desires of the City and its Employees. If the cost of adding the various enhancements is more than the City is able to budget for, one option that could be explored would be to use Employee contributions to offset the additional cost. Whatever level of Employee contributions can be justified will represent a direct offset to the total annual funding requirements of the City Plan. We would caution you, however, **that the introduction of Employee contributions should be made concurrent with benefit enhancements that will improve the perceived value of the City Plan, particularly if the enhancements apply to prior service credits.**

The decision of whether to join APERS or not is a difficult one. The APERS plan definitely has advantages in terms of the benefits provided. The Principal recommended a 2008 contribution of $604,978. The Employer contribution to APERS would have been 12.54% of 2008 covered pay. Based on 2007 covered pay as reported in the 2008 Actuarial Valuation Report prepared by The Principal ($7,909,631), the Employer funding for 2008 would have been $991,868 (164% of the recommended funding for the City Plan) and the funding provided by Employee contributions would have been $395,482 for a total of $1,387,349 (229% of the recommended funding for the City Plan). These costs would be in addition to any costs associated with maintaining a presumably frozen City

Plan; primarily funding an amortization of any unfunded accrued liabilities. **Yes, APERS provides better benefits than the City Plan, but APERS costs considerably more than the City Plan.**

Benefits provided by APERS are set by statutes created by state legislators. **Contributing members have little or no say in what APERS will look like into the future.** If the legislature passes laws that increase benefits, it is likely that the funding requirements will increase. Funding levels for APERS are determined by APERS Board of Trustees. For electing municipalities, any such changes are effective as of January 1st of each year and remain in effect until changed by APERS Board. **Members are required to adhere to any changes in funding levels as determined by APERS Board.**

Conclusions

As consultants, we would recommend that any further discussions of benefit enhancements be deferred until the funded ratio of the City Plan improves. If continuation of the City Plan in its current form is not an option, the City should request additional information from The Principal Financial Group that addresses the continued projected funding that would be needed to continue the City Plan on a "frozen" basis. This funding projection should be included in any further decision-making being considered by the City.

If, for example, the City should elect to adopt APERS, the cost of funding the "frozen" City Plan should be added to the current 12.54% City contribution with concurrent implementation of the mandatory 5% employee contribution. Or, if the City should desire to move from the current defined benefit structure to a defined contribution structure, the cost of funding the "frozen" City Plan should be added to the projected contribution requirements for the new plan.

Regardless of the City's decisions regarding the City Plan and/or APERS, a well-designed communications program should be developed to convey what will be happening. Without such a program, each Employee's perception of what is happening with the City Plan will become fact (right or wrong).