IN THE CIRCUIT COURT OF PULASKI COUNTY, ARKANSAS
SEVENTH DIVISION

LT. GLENN SLIGH, CAPT. MYRON HALL, CORP. RICKY BRIGGS, CAPT. LOYD FRANKLIN, SGT. MACK THOMPSON, MAJOR CLEVE BARFIELD AND OTHERS SIMILARLY SITUATED **PLAINTIFFS**

VS. **CASE NO. 60CV-12-344**

ARKANSAS STATE POLICE RETIREMENT SYSTEM, KIRK BRADSHAW, JOHN W. ALLISON, BRANT TOSH, BLAKE WILSON, DONNIE UNDERWOOD, JOE MILES, DR. JOHN SHELNUTT, IN THEIR OFFICIAL CAPACITY AS MEMBERS OF THE BOARD OF TRUSTEES OF THE ARKANSAS STATE POLICE RETIREMENT SYSTEM **DEFENDANTS**

AFFIDAVIT OF GAIL STONE

I, Gail Stone, after being sworn, state on oath as follows:

1. I am the Executive Director of the Arkansas Public Employees Retirement System (APERS). As the Executive Director of APERS, I serve as the Executive Secretary of the Arkansas State Police Retirement System (ASPRS) and Executive Director of the Arkansas Judicial Retirement System (AJRS). I have held my current positions since July 1, 2001. From 1998 until July 1, 2001, I was the Deputy Director of APERS. From February of 1991 until 1998 I was the Associate Director of Investments for the three retirement systems, and from August of 1990 until February of 1991 I was an Investment Supervisor for the systems.

2. From 1980 until 1990, I worked on Wall Street for the following corporations/firms in the following capacities: (1979 – 1980) Sullivan & Cromwell, New York, NY, Corporate Paralegal; (1979 – 1982) Shearson/American Express, Inc., New York, NY, Managed Account Representative – Futures; (1982 – 1984) Merrill Lynch Futures, Inc., New York, NY, Operations Manager; (1984 – 1987) Johnson Matthey & Wallace, Inc., New York,

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NY, Account Executive; (1987 – 1990) Altair Financial Corporation, Greenwich, CT, Vice President.

3. In 1979 I graduated from Smith College, Northampton Massachusetts, with a Bachelors of Art in Government.

4. As the Director of APERS and as the Executive Secretary of ASPRS and AJRS, I am familiar with the laws pertaining to these retirement systems and am responsible for interpreting, implementing and complying with these laws. I have authored retirement legislation, including a comprehensive revision to those chapters of Title 24 of the Arkansas Code, affecting the retirement system. I am also responsible for implementation of policies set by the Board of Trustees. I provide direction and guidance of staff efforts pertaining to collection and collation of employer reports and remittances, preretirement counseling, benefit payments and direction of investment activities.

5. In 1995, the General Assembly enacted legislation creating the Arkansas State Police Officers Deferred Retirement Option Plan, known as DROP, allowing troopers who have attained the requisite age and years of service the option to "retire" yet continue to work for a period of five years. *See* Act 967 of 1995, codified as Ark. Code Ann. § 24-6-301 (2000 Repl.). The trooper continues working and the retirement benefits (including the 3% COLA compounded annually) he would have collected had he ceased working, accumulate in the System for the period of time the trooper elects to participate in DROP – originally a maximum of five years. *See* Act 967 of 1995.[1] At the time the trooper leaves the DROP or is no longer eligible to continue in the DROP, the accumulated DROP balance is payable as a lump sum or a

[1] The period of time for participation in the DROP was increased to seven years. *See* Act 1969 of 2005, codified as Ark. Code Ann. § 24-6-304.

monthly annuity (Ark. Code Ann. § 24-6-305 (Rep. 2000)), alongside the regular monthly annuity of the trooper's benefits.

6. The legislation creating the ASPRS DROP provided that members were to "earn interest at a rate of two (2) percentage points below the rate of return of the investment portfolio of the state police retirement system, but no less than the actuarially assumed interest rate as certified by the actuary." At the time, the actuarially assumed interest rate was 7.75%. Act 1969 of 2005 provided for an increase in DROP participation of up to seven years and changed the interest rate for years six and seven to be the "actuarially assumed rate." Ark. Code Ann. § 24-6-304.

7. During the bull market of 2003 – 2007, several members in the DROP received inordinately high rates of interest due to accrued market rate minus 2% – some as high as 30% – resulting in tremendous strain on the System. For example, on February 1, 2010, the System paid out approximately $535,000 to a single individual. This was not a unique event. There were numerous excessive pay-outs including in excess of $1 million combined to just two individuals ($586,800 and $483,700) because of the portion of the DROP they had that accrued market rate minus 2%.

8. In 2007, legislation was passed authorizing the Board to set the interest rate on DROP balances. *See* Act 404 of 2007, codified as Ark. Code Ann. § 24-6-304(b)(1), which provides: "A member who participates in the plan shall earn interest at a rate set by the Board of Trustees of the State Police Retirement System that shall not be greater than the actuarially assumed investment rate of return for that time." Troopers' core retirement benefits were not affected by the legislation authorizing a change in DROP interest rates.

9. In 2009, due to the accelerating growth of pension liabilities, in conjunction with the precipitous decline of pension fund asserts, the System faced the real possibility of an asset shortfall when it came time to pay benefits in the near future. Therefore, the General Assembly authorized a one-time infusion of 9 million dollars from General Revenue to shore up the System. *See* Act 1242 of 2009. However, the 9 million dollar infusion was merely a temporary "band-aid" and not a solution.

10. The System's actuary, Gabriel, Roeder, Smith & Co., performs annual valuations and analyses. Their reported valuations show that the funded status of the System fell from 96% in FY 2000 to just 63% in FY 2009, and from 74% to 63% in one year alone (FY 2009). This failure was two-pronged in nature: stunning back-to-back investment losses in FY 2008 and FY 2009 of (10.74%) and (23.40%). In FY 2009 the market value of the invested assets totaled $158,706,639. At that same time, the unfunded actuarially accrued liability stood at $206,318,613.

11. A liability is created by a member working one more year or a retiree living one more year. The liability is unfunded when the System doesn't have sufficient assets to cover the liability. An unfunded liability occurs when assets have fallen below what has already been committed to members, retirees and beneficiaries now and into the future. As explained in the previous paragraph, in FY 2009 the System had unfunded liabilities in excess of $206 million.

12. The Trustees must always consider is that there is a larger and larger pool of retirees, while the number of active members is more or less stagnant. The System is paying out vast amounts of money in retirements benefits because there are more retirees than workers. In May of 2009, the ratio of active to retired members was less than 1:1.

13. In FY 2009, $7,318,952 in investments had to be liquidated in order to pay benefits and DROP payouts.

14. For the current 598 retired troopers, the projected liability is roughly $424,580,000 based on the assumption that ASPRS retirees will draw retirement benefits for approximately 20 years. I arrived at this projected liability for the 598 troopers as follows. The average benefit to a trooper is approximately $35,500 year. $35,500 x 598 x 20 more years of drawing benefits = $424,580,000. The System now has $276 million. My example does not include the following 3 factors: 1) active members already entitled to a benefit but not yet drawing; 2) the 3 per cent cost of living adjustment that is compounded annually; and 3) the surviving spouse benefit (discussed below), all of which are significant additional commitments. At present, the System does not have sufficient funds to pay the current regular monthly benefits absent significant contributions from some outside source.

15. There are on-going concerns with the viability of the Tier I system of liabilities that will continue even beyond the time the last Tier I member[2] dies. This is due to the automatic survivor benefit. A married retirant's benefit is not reduced in order to provide for the surviving spouse. Upon the death of that member, the spousal benefit is 75% of the retirant's benefit and continues until the surviving spouse's remarriage or death. Ark. Code Ann. § 24-6-214. Many Tier I members have spouses who are several years younger; thus, the member's liability stream often continues for years, even decades, after the member's death. This benefit is a significant drain on the System. From the enactment of this statutory provision alone in the early 1990's the System's liabilities grew at nearly $1 million per year.

[2] " 'Tier I' refers to covered employment for those first hired on or before April 2, 1997, as provided for in § 24-6-201, et seq." Ark. Code Ann. § 24-6-201(21).

16. Recognizing the gravity of the situation, the Board of Trustee voted to reduce the interest rate on DROP balances to 3.25% effective July 1, 2009. The change in the interest rate was applied prospectively only. The interest earned on DROP balances prior to July 2, 2009 was not affected.

17. Additionally, the factors that played into the decision by the ASPRS board of trustees to lower the DROP interest rate were, inter alia, where the prevailing 7-year U.S. Treasury Note rate stood in the open market (about 2.60%), the imperative to bring the costs of "extras" under control (i.e. COLA, interest crediting, etc.) in order to avoid having to actually cut basic benefits, and to mitigate the ultimate cost to taxpayers if the System actually failed.

18. A trooper's retirement benefit is not like a certificate of deposit or a 401K fund, which are discrete accounts held in an individual's name. Member benefits are held by the System in a pool of money with all of the trust funds. Members, including DROP participants, can view an online portal to see the approximate balance ultimately due them once they fully retire. The approximate balance for any given member, including DROP participants, is simply an accounting construct. All of the System's funds are held collectively in an account and/or subaccounts and there are no accounts held in individual member names. Pursuant to Arkansas Code Annotated § 24-6-304(b)(a) & (2), a "member who participates in the [Arkansas State Police Officers Deferred Option Plan] shall earn interest at a rate set by the Board of Trustees . . . and the "interest shall be credited to the individual account balance of the member on an annual basis." The reference to the "individual account balance of the member" does not mean there is a discrete account for each member. Rather, as explained above, the amount of interest owed for an individual member can be mathematically computed.

19. None of the funds at issue is this case come from member contributions. The Arkansas State Police Retirement System became non-contributory on January 1, 1978. *See* Act 793 of 1977. Since at least 1995, there has not been a currently active contributory member. As noted above, the Arkansas State Police Officers Deferred Option Plan (DROP) was created by legislation passed in 1995. *See* Ark. Code Ann. §§ 24-6-301, *et seq.* "When a member begins participation in the Arkansas State Police Officers Deferred Option Plan, *the employer contributions shall continue to be paid*." Ark. Code Ann. § 24-6-303(a) (emphasis added). The employer contributions are state monies appropriated from the legislature via the ASP's appropriation acts.

ACKNOWLEDGMENT

I, Gail Stone, state on my oath that the above and foregoing facts are true and correct to the best of my knowledge, information and belief.

Gail H. Stone
GAIL STONE

STATE OF ARKANSAS/
COUNTY OF PULASKI/

SUBSCRIBED AND SWORN to before me, a Notary Public on this 30th day of September, 2014.

LINDA MCGRATH
NOTARY
My Comm. Expires
JAN. 14, 2024
#12396761
PUBLIC
WHITE COUNTY, ARK.

Linda McGrath
Notary Public

My Commission Expires:

1-14-2024