MINUTES RECEIVED
CHIEF CLERK'S OFFICE
2-10-16

ARIZONA HOUSE OF REPRESENTATIVES
Fifty-second Legislature – Second Regular Session

COMMITTEE ON INSURANCE

Report of Special Meeting
Wednesday, February 10, 2016
House Hearing Room 4 -- 8:30 A.M.

Convened 8:35 A.M.
Recessed
Reconvened
Adjourned 12:10 P.M.

Members Present
Mr. Coleman
Ms. Larkin
Mr. Lovas
Ms. McCune Davis
Ms. Otondo
Mr. Robson
Mr. Livingston, Vice-Chairman
Ms. Fann, Chairman

Members Absent

Agenda
Original Agenda – Attachment 1

Request to Speak
Report – Attachment 2

Presentations

Name	Organization	Attachments (Handouts)
Pete Constant	Reason Foundation	3
Senator Debbie Lesko	Arizona State Senate	4
Jared Smout	Public Safety Personnel Retirement System	5
Mayor Harry Oberg	City of Prescott	6

Committee Action

Bill	Action	Vote	Attachments (Summaries, Amendments, Roll Call, Attendance)
SB1428	DP	7-1-0-0	7, 8
SB1429	DP	7-1-0-0	9, 10
SCR1019	DP	7-1-0-0	11, 12
	Committee Attendance		13

Adrian Luth, Chairman Assistant
February 10, 2016

(Original attachments on file in the Office of the Chief Clerk; video archives available at http://www.azleg.gov)

Conv: 8:35 A.M.
Adj: 12:10 P.M.

ARIZONA HOUSE OF REPRESENTATIVES
Fifty-second Legislature - Second Regular Session

SPECIAL MEETING AGENDA

COMMITTEE ON INSURANCE

DATE Wednesday, February 10, 2016 ROOM HHR 4 TIME 8:30 A.M.

Members:

Mr. Coleman	Ms. McCune Davis	Mr. Livingston, Vice-Chairman
Mr. Larkin	Ms. Otondo	Ms. Fann, Chairman
Mr. Lovas	Mr. Robson	

Bills		Short Title	Strike Everything Title
SB1428	DP 7-1-0-0	PSPRS modifications (Lesko, Begay, Bradley, et al) INS, RULES	
SB1429	DP 7-1-0-0	public retirement systems; special election (Lesko, Begay, Bradley, et al) INS, RULES	
SCR1019	DP 7-1-0-0	public retirement system benefits (Lesko, Begay, Bradley, et al) INS, RULES	

ORDER OF BILLS TO BE SET BY THE CHAIRMAN

AL
2/9/16

People with disabilities may request reasonable accommodations such as interpreters, alternative formats, or assistance with physical accessibility. If you require accommodations, please contact the Chief Clerk's Office at (602) 926-3032, TDD (602) 926-3241.

ATTACHMENT 1

SB1429, public retirement systems; special election

Support:

Ken Strobeck, LEAGUE OF ARIZONA CITIES & TOWNS; Jen Marson, AZ ASSOCIATION OF COUNTIES; Don Isaacson, FRATERNAL ORDER OF POLICE (AZ STATE LODGE); Jim Waring, representing self; John Flynn, Arizona Fire District Association; John Flynn, Arizona Fire Chiefs Association; James Mann, FRATERNAL ORDER OF POLICE (AZ STATE LODGE); Alison Zelms, Deputy City Manager, PRESCOTT, CITY OF; Barry Aarons, APACHE COUNTY, City Of Prescott, City Of Scottsdale, GREENLEE COUNTY; Mike Huckins, GREATER PHOENIX CHAMBER OF COMMERCE; Heather Wilkey, Town Of Gilbert; Mayor John Lewis, Mayor, Town of Gilbert, representing self; will buividas, representing self; Douglas Cole, Town Of Paradise Valley; Katherine Fischer, AZ CHAMBER OF COMMERCE; Michael Colletto, PROFESSIONAL FIRE FIGHTERS OF AZ; Craig Sullivan, County Supervisors Association; Bryan Jeffries, representing self; Rob Bohr, GOODYEAR, CITY OF; Stan Hoover, Other; Douglas Cole, TUCSON, CITY OF; John Wayne Gonzales, Legislative Liaison, City Of Phoenix; Andrew Greenhill, TUCSON, CITY OF; Ryan Peters, CHANDLER, CITY OF; Erin Roper, representing self

Neutral:

Jared Smout, PUBLIC SAFETY PERSONNEL RETIREMENT SYS; Douglas Cole, PSPRS

All Comments:

Jared Smout, PUBLIC SAFETY PERSONNEL RETIREMENT SYS: The PSPRS Board of Trustees fully supports the ballot initiative to change the PBI to a CPI-based COLA mechanism.; will buividas, Self: Phoenix Law Enforcement Association; Douglas Cole, PSPRS: Support eliminating PBI and replacing with COLA; Erin Roper, Self: The City of Kingman supports this bill.

SCR1019, public retirement system benefits

Support:

Ken Strobeck, LEAGUE OF ARIZONA CITIES & TOWNS; Jen Marson, AZ ASSOCIATION OF COUNTIES; Don Isaacson, FRATERNAL ORDER OF POLICE (AZ STATE LODGE); Jim Waring, representing self; John Flynn, Arizona Fire District Association; John Flynn, Arizona Fire Chiefs Association; James Mann, FRATERNAL ORDER OF POLICE (AZ STATE LODGE); Alison Zelms, Deputy City Manager, PRESCOTT, CITY OF; Barry Aarons, APACHE COUNTY, City Of Prescott, City Of Scottsdale, GREENLEE COUNTY; Mike Huckins, GREATER PHOENIX CHAMBER OF COMMERCE; Heather Wilkey, Town Of Gilbert; Mayor John Lewis, Mayor, Town of Gilbert, representing self; will buividas, representing self; Douglas Cole, Town Of Paradise Valley; Katherine Fischer, AZ CHAMBER OF COMMERCE; Craig Sullivan, County Supervisors Association; Bryan Jeffries, representing self; Michael Colletto, PROFESSIONAL FIRE FIGHTERS OF AZ; Rob Bohr, GOODYEAR, CITY OF; Stan Hoover, Other; Douglas Cole, TUCSON, CITY OF; John Wayne Gonzales, Legislative Liaison, City Of Phoenix; Andrew Greenhill, TUCSON, CITY OF; Ryan Peters, CHANDLER, CITY OF; Erin Roper, representing self

Neutral:

Jared Smout, PUBLIC SAFETY PERSONNEL RETIREMENT SYS; Douglas Cole, PSPRS

Oppose:

Justin Harris, representing self

ATTACHMENT 2

All Comments:

Jared Smout, PUBLIC SAFETY PERSONNEL RETIREMENT SYS: The PSPRS Board of Trustees fully supports the ballot initiative to change the PBI to a CPI-based COLA mechanism.; will buividas, Self: Phoenix Law Enforcement Association; Douglas Cole, PSPRS: Support eliminating PBI and replacing with COLA; Justin Harris, Self: As of last night the Arizona Police Associations and some other Directors have pulled support for this proposal. 10-5 APA DOES NOT support this legislation; Erin Roper, Self: The City of Kingman supports this bill.

PLEASE COMPLETE THIS FORM FOR THE PUBLIC RECORD

HOUSE OF REPRESENTATIVES

Testified

Please PRINT Clearly

Committee on ______ Bill Number SB1428

Date February 10, 2016 ☐ Support ☒ Oppose ☐ Neutral

Name Daniel Russo Need to Speak? ☒ Yes ☐ No

Representing Self/Individual Are you a registered lobbyist? NO

Complete Address 1334 E Chandler Blvd D-53-5 Phx AZ 85048

E-mail Address dante6901@gmail.com Phone Number 6025561443

Comments: ______

FIVE-MINUTE SPEAKING LIMIT

PLEASE COMPLETE THIS FORM FOR THE PUBLIC RECORD

HOUSE OF REPRESENTATIVES

Testified

Please PRINT Clearly

Committee on ~~SB1488~~ House Insurance Bill Number SB 1428

Date 02/10/2016 ☐ Support ☒ Oppose ☐ Neutral

Name JUSTIN HARRIS Need to Speak? ☒ Yes ☐ No

Representing ARIZONA POLICE ASSOCIATION Are you a registered lobbyist? NO

Complete Address ______

E-mail Address justinharris4436@gmail.com Phone Number (623) 205-9843

Comments: ______

FIVE-MINUTE SPEAKING LIMIT

ANALYSIS OF PROPOSED PSPRS PENSION REFORM

Prepared by:

Reason Foundation

Pension Integrity Project

January 29, 2016

ATTACHMENT 3

Reason

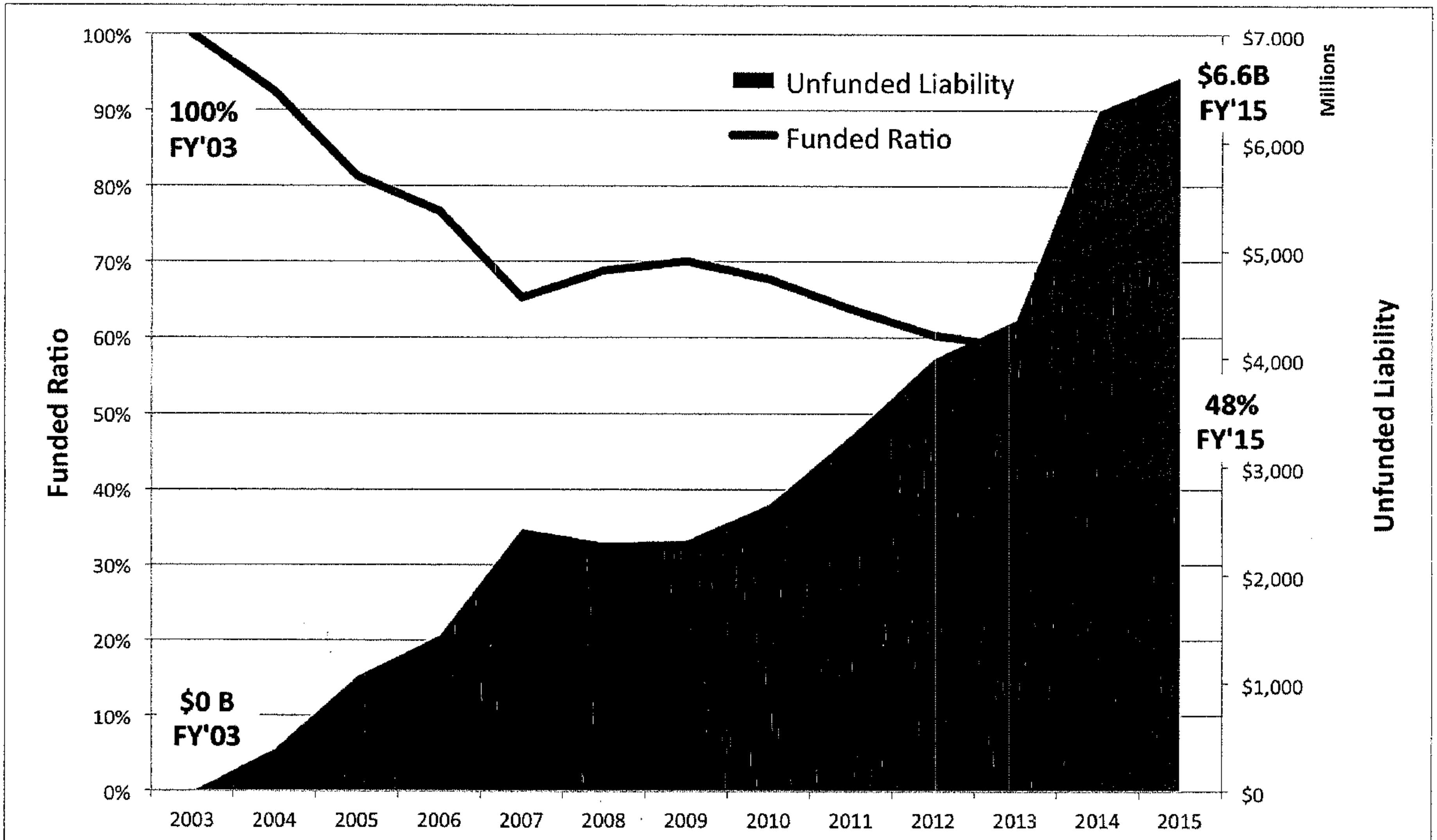
THE PROBLEM

Why PSPRS needs pension reform

PSPRS Challenges

1. PSPRS pension plan has seen a massive reduction in funded status and increase in unfunded liabilities over last decade.
2. Employer costs are skyrocketing for state agencies and local governments
   - Cities like Bisbee, Prescott are facing massive unfunded liabilities that threaten services, budgets.
3. Some previous legislative reforms have been struck down by the courts, and others are under litigation.

PSPRS Degrading Solvency



Causes of PSPRS Problems

Reason

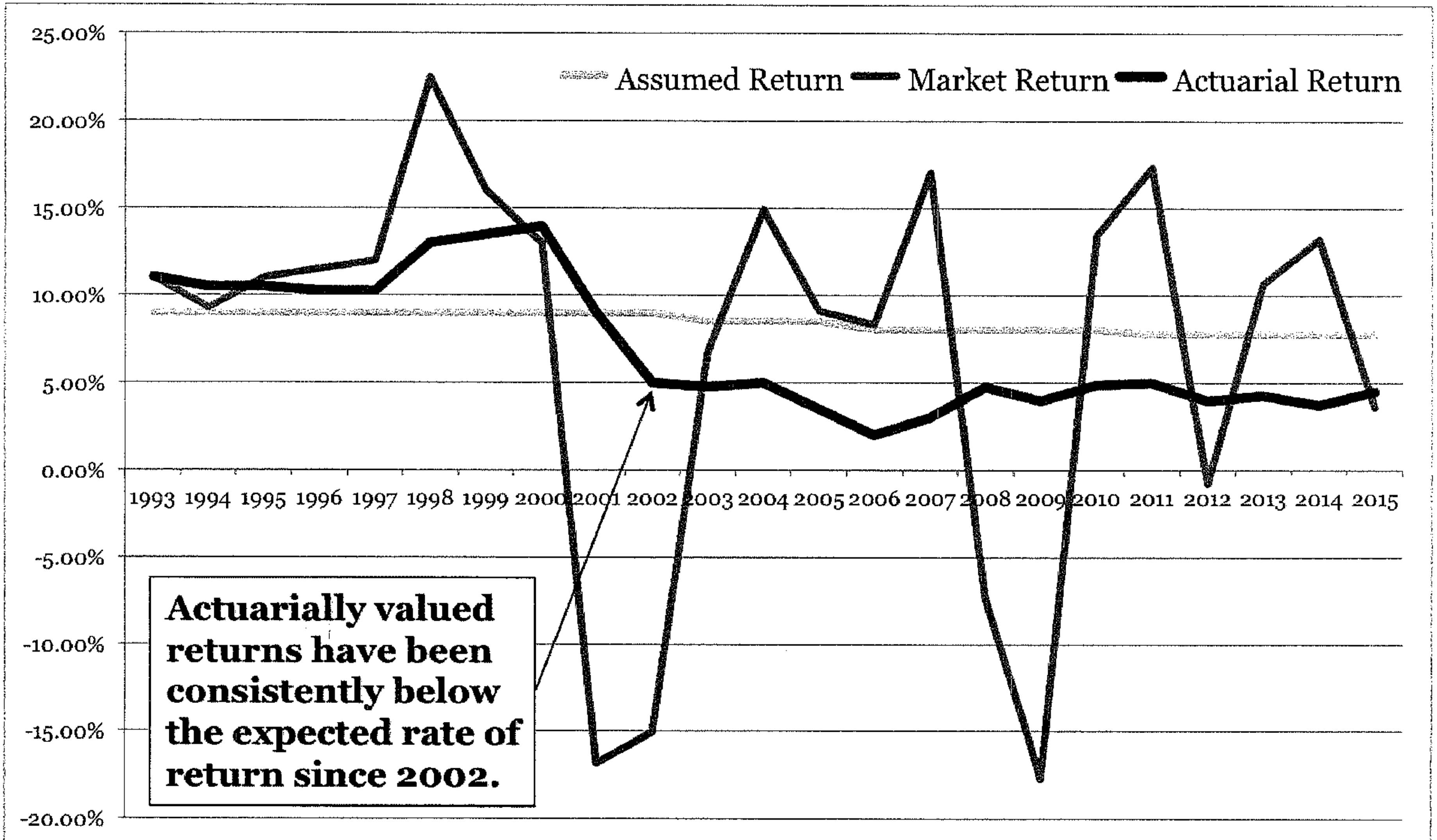
1. Permanent Benefit Increases (PBI) have undermined plan's solvency by skimming assets
   - For retirees before 2011, 50% of "excess" returns over 9% diverted to separate PBI fund
   - Diverted funds cannot be used to reduce unfunded liabilities, plan assets grow slower with part of the funds not allowed to earn interest over time
   - PBI benefit has not been pre-funded like a traditional pension COLA
   - For retirees after 2011, returns need to exceed 10.5% and no PBI unless funded ratio >60%
   - Until 2015, PBI had been paid out annually at 4% for over 20 years despite the continuing decline in funded status

2. PBI benefits are not distributed equitably, not tied to inflation, not paid each year

3. Underperforming investment returns, unrealistic expected rate of return

Causes of Problems With PSPRS:

PSPRS Actual Investment Returns, 1993-2015



Source: *PSPRS Presentation*, "The Past, Present, and Future of PSPRS: An Educational Employer Seminar," February 2015 and publicly available PSPRS valuation reports.

Causes of Problems With PSPRS:

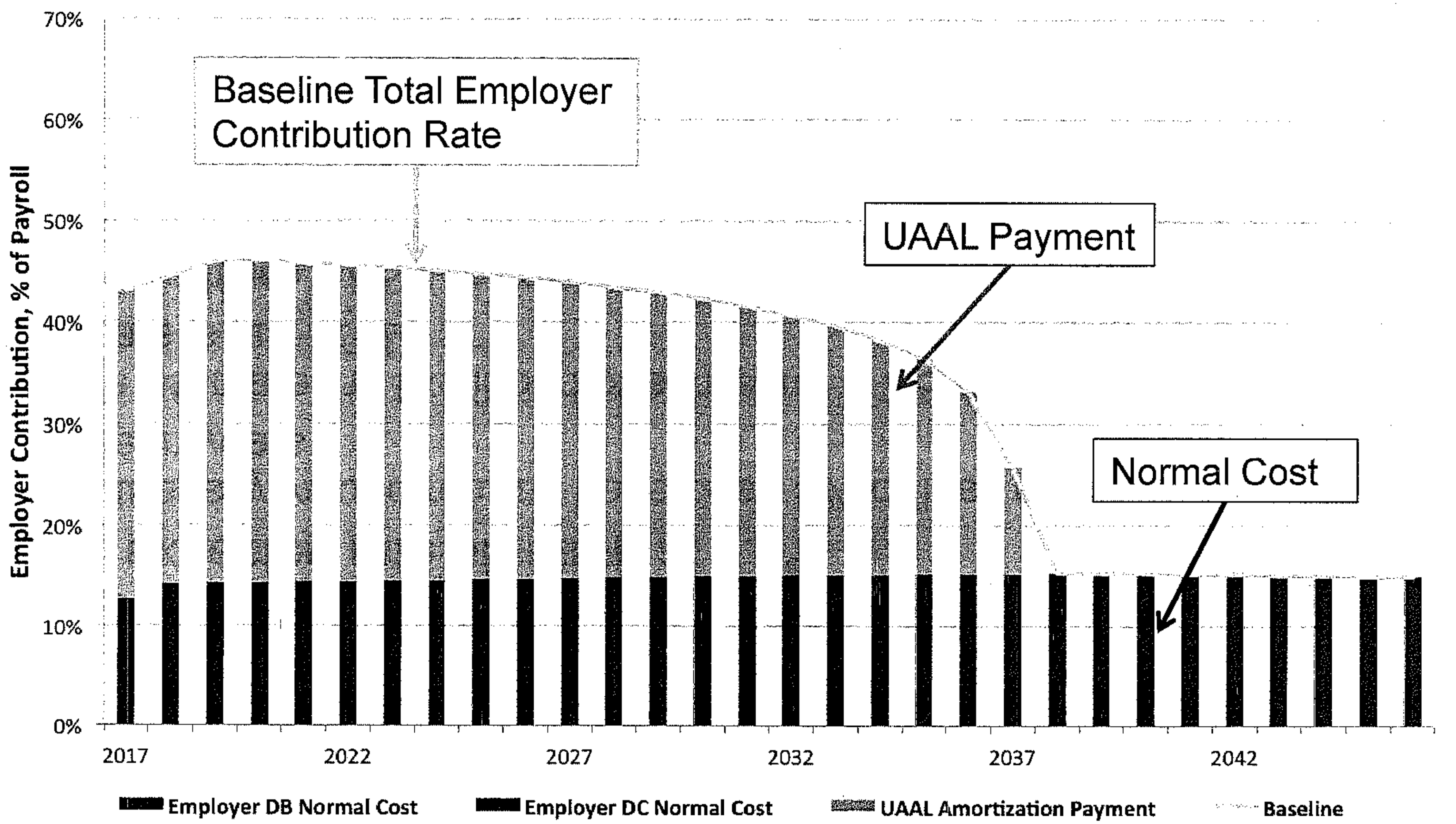
PSPRS' Expected Rate of Return is Unrealistic

Reason

- Based on the historic trend, PSPRS is using an unrealistically high expected rate of return at 7.5%
  - Actuarially valued returns have been 5% or less since 2002, nearly fifteen years
  - We estimate the likelihood of achieving a 7.5% return over the next 30 years is just 45%
- If the pattern of 5% average actuarial return continues, unfunded liabilities and normal cost will increase dramatically in the coming years

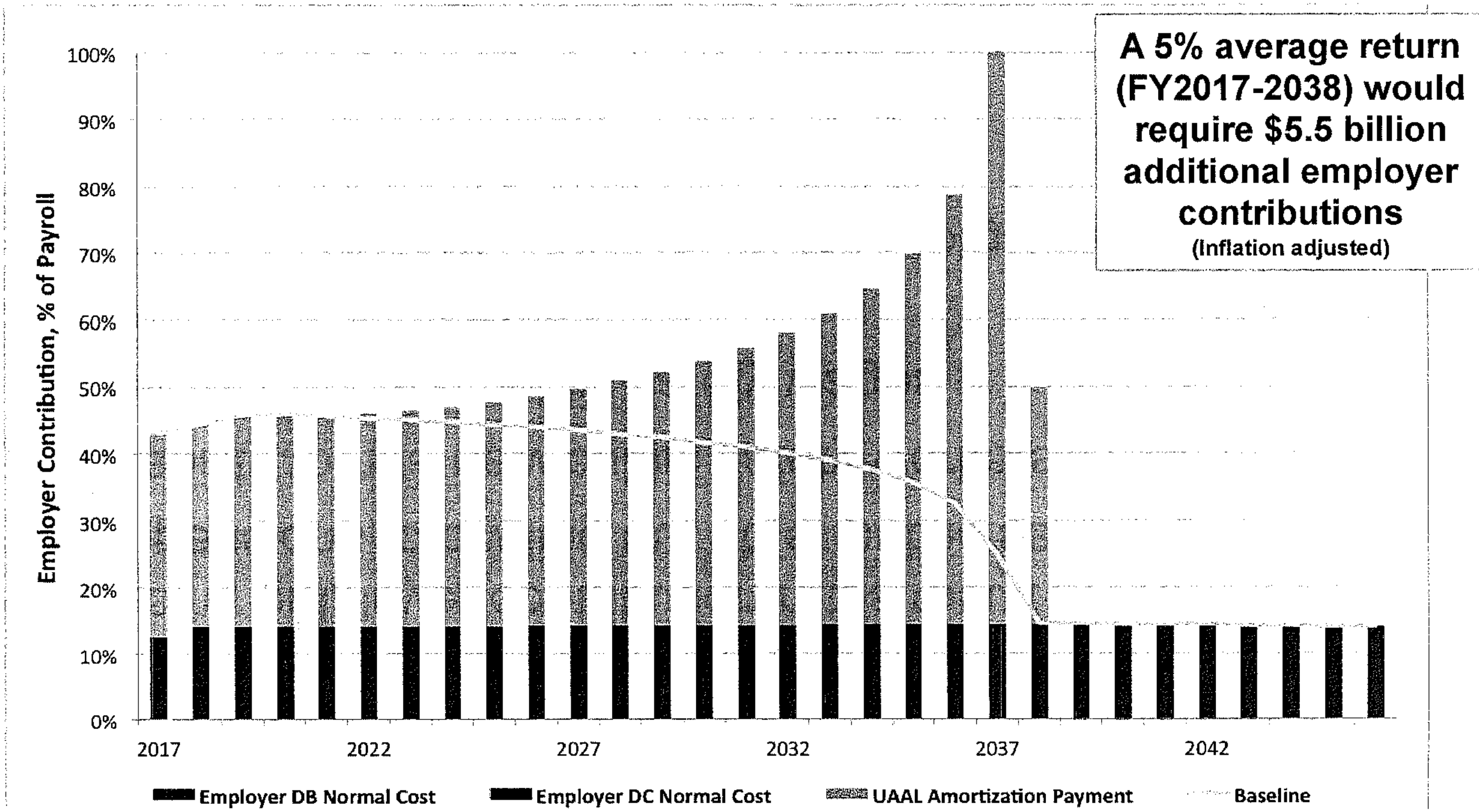
- Consider the following two figures:
  - the first shows forecasted employer contributions assuming no change to the plan and the 7.5% expected return;
  - the second shows the increase in forecasted employer contributions assuming the actuarial returns continue at 5%.

PSPRS Baseline
Employer Contribution as % of Payroll



PSPRS Baseline

Employer Cost & Funded Ratio, w/ 5% Return



The light blue bars <u>above</u> the yellow line represent $5.47 billion in *additional* pension debt payments for taxpayers if returns are just 5.0% instead of the expected 7.5%.

The Risks of Inaction

Reason

1. Rising employer contribution rates result in more money to pensions, crowding out other public services
2. Inability to hire new public safety workers
3. Inability to raise public safety wages
4. New tax & debt proposals
   - (e.g., failed Prescott PSPRS tax, pension obligation bonds)
5. Service-level insolvency
6. Municipal bankruptcy

THE PROCESS

A collaborative approach to develop a proposed reform for PSPRS

Goals of Pension Reform

Reason

Establish a retirement system that is affordable, sustainable, and secure:

1. Provide retirement security for all members (current and future) and retirees
2. Reduce taxpayer and pension system exposure to financial risk and market risk
3. Reduce long-term costs for employer/taxpayers and employees
4. Stabilize contribution rates
5. Ensure ability to recruit 21st century employees
6. Improve governance & transparency

The Reform Development Process

Reason

- Collaborative stakeholder working groups
  - Public safety associations, led by Professional Fire Fighters of Arizona, the Arizona Fraternal Order of Police (state lodge), Phoenix Law Enforcement Association
  - Legislative pension workgroup, led by Sen. Lesko & Rep. Olson
  - League of Cities & Towns pension reform task force
- Reason Foundation provided education, policy options, and actuarial support for all stakeholders, and facilitated consensus amongst stakeholders on conceptual design and reform framework
  - Separate negotiation tracks focused the fiscal elements of the reform, and the governance elements of the reform

THE SOLUTION

Fixing broken PBI design

Stable, affordable normal cost

Reduces taxpayer risk exposure by more than half

Minimizes contribution rate volatility

The Proposed Reform

1. Improvements for Current Members & Retirees

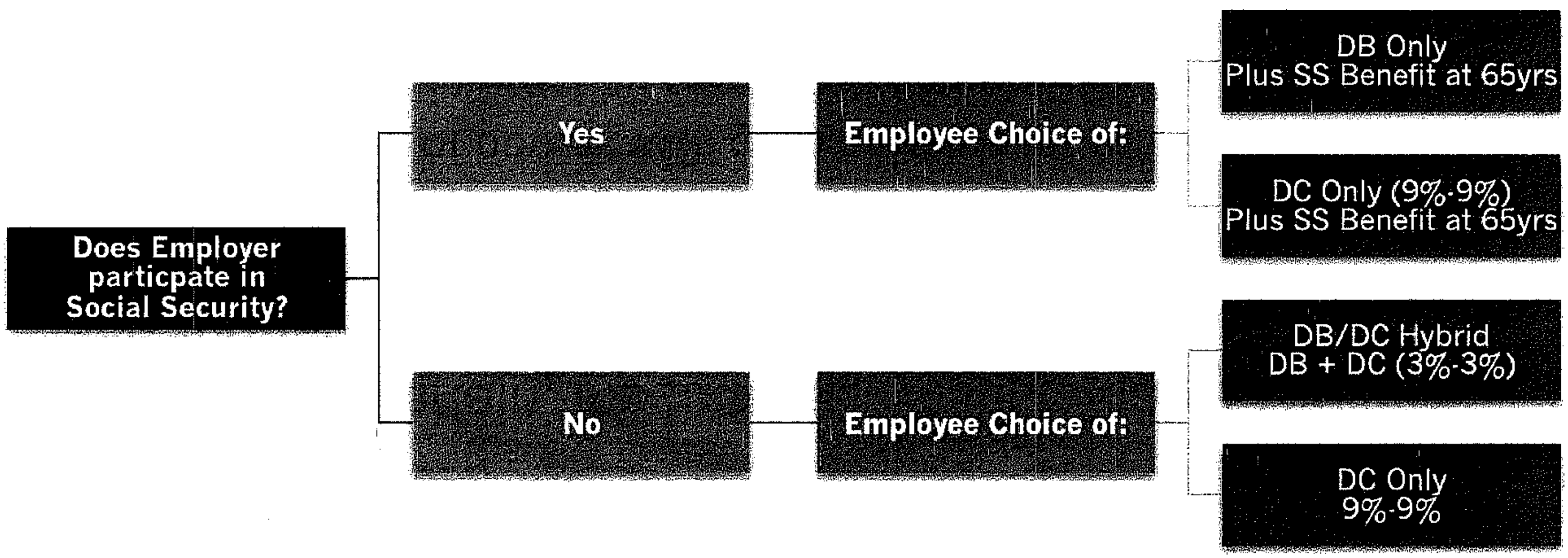
Reason

- Replace uncertain, inequitable, unsustainable PBI with pre-funded COLA that provides certainty and equity for retirees.
  - Requires constitutional amendment
  - An exchange of benefit with greater value for retirees
  - Serves public interest by correcting broken PBI that has been a major cause of increased unfunded liabilities
  - Compounding COLA based on regional CPI, capped at 2% max—provides certainty
  - Pre-paid—actuarially accounted for in advance as part of normal cost determination
- New "Catch-Up" Defined-Contribution Plan for Non-Social Security Tier 2 Participants Hired On or After January 1, 2012

Reason

The Proposed Reform
2. Changes for New Hires After July 1, 2017

- Option of electing to participate in either a new:
  1. Defined Contribution Only Plan, or
  2. Defined Benefit Hybrid Plan.



The Proposed Reform: New Hire Changes

A. Tier 3 Defined Contribution Only Plan Option

- Employees provided with a professionally-managed defined contribution plan, with contributions consisting of:
  - A required employer contribution of 9% of the employee's regular compensation; and
  - A required contribution by the employee of a minimum of 9% of that employee's regular compensation.
- Employees may elect to increase the employee's contribution up to the annual limits established by the IRS.
- 10-year vesting of employer contributions (immediate in event of disability retirement).
- Reasonable safeguards to ensure adequate long-term financial security, such as:
  - Prohibitions on borrowing against assets
  - Limited pool of funds to invest in, with options available for target-date funds and risk-based funds
  - Annuitization options
  - Member education and advice

The Proposed Reform: New Hire Changes

B. *Tier 3 Hybrid Plan – Defined Benefit Element*

Reason

- Stepped multiplier based on years of credited service:
  - 1.50% for 15.00-16.99 years of credited service
  - 1.75% for 17.00-18.99 years of credited service
  - 2.00% for 19.00-21.99 years of credited service
  - 2.25% for 22.00-24.99 years of credited service
  - 2.50% for 25+ years of credited service (same as current)
- 50/50 Cost Sharing:
  - All costs for Tier 3 D Hybrid Plan benefits are split 50/50 between employers and Tier 3 Hybrid Plan employees, including normal costs, future Tier 3 unfunded liability amortization costs, and administrative costs.
  - No caps on employer or employee contribution rates.
  - Tier 3 Hybrid Plan members will only contribute to any future unfunded liabilities on the obligations of the participants in the Tier 3 Hybrid Plan and no other PSPRS tier.

The Proposed Reform: New Hire Changes

B. *Tier 3 Hybrid Plan – Defined Benefit Element*

- Adopts sustainable COLA structure:
  - Compounding COLA based on regional CPI with cap of 2.0% max, unless the funded ratio of the plan falls below 90%.
    - If funded ratio of the plan is between 80-89.99%, cap reduced to 1.5%
    - If funded ratio of the plan is between 70-79.99%, cap reduced to 1.0%
  - No COLA will be issued in any year in which the funded ratio of the plan is below 70%
  - Pre-funded, actuarially accounted for in advance as part of normal cost determination
  - COLAs begin the first calendar year after the retiree reaches the 7th anniversary of their retirement date (or at age 60 regardless of whether the 7 year delay was met)

The Proposed Reform: New Hire Changes

B. Tier 3 Hybrid Plan – Defined Benefit Element

Reason

- Limits pension "spiking"
  - Reduces cap on pensionable compensation from $265,000 to $110,000
    - Cap adjusted every three years to account for real pay growth, as determined by a weighted average of actual changes in Arizona public safety pay scales
  - Final average salary = highest 5-year average
  - Maximum annual pension = 80% of final average salary (subject to pensionable compensation cap)
- Increases minimum benefit eligibility age from 52.5 years old to 55 years old.
  - Actuarially equivalent benefit available at age 52.5

The Proposed Reform: New Hire Changes
B. Tier 3 Hybrid Plan – Defined Contribution Element

Reason

- Tier 3 Hybrid Plan members not enrolled in Social Security provided with a defined-contribution plan with contributions consisting of:
  - A required employer contribution of 3% of the member's regular pay; and
  - A required contribution by the member of a minimum of 3% of that member's regular pay.
  - Upon initial employment, employees may elect to increase the employee's contribution up to the annual limits established by the IRS. (Required by IRS Code)

The Proposed Reform

3. Governance and Other Reforms

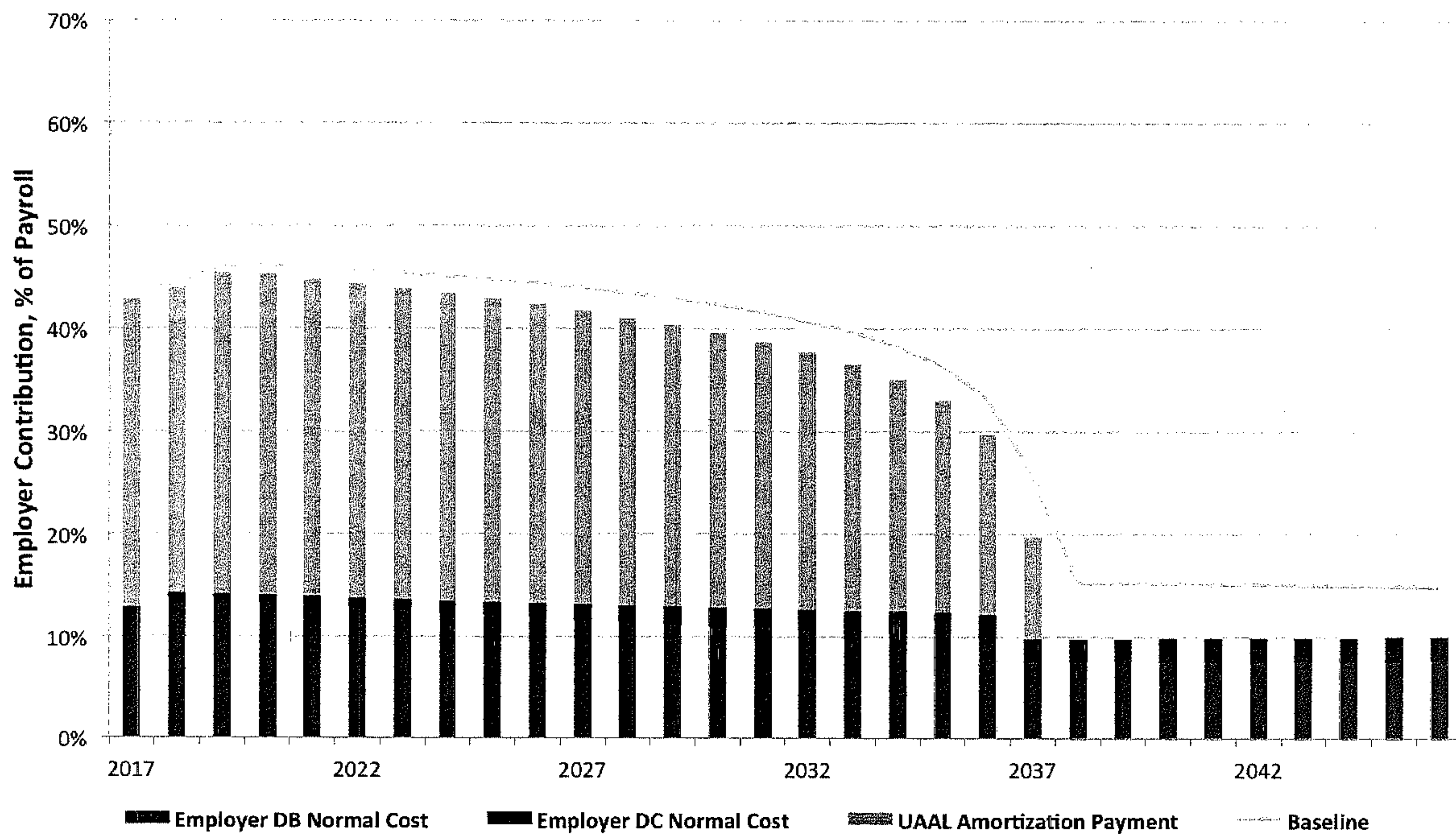
Reason

- Composition of PSPRS Board of Trustees will be modified to reflect the 50/50 sharing of costs and risks of the Tier 3 retirement formula.
- New unfunded liabilities associated with any future benefit increase required to be fully paid in the year of enactment and cannot be amortized over any period of years.
- At no time will any employer's or employee's annual payment to PSPRS be less than their share of actuarially determined normal cost. No credits against normal cost shall be factored in to annual employer or employee contributions.
- Incorporating comprehensive fiduciary standards in statute
- Ongoing discussions to determine the potential benefits of using risk pools or liability sharing amongst agencies

THE SOLUTION: FISCAL & RISK ANALYSIS

Employer Cost Forecast, as a % of Payroll

Baseline v. Proposed Reform



New Hire Cost Projection, Year 1 (2017-18)

Tier 2 v. Tier 3

Reason

	Reason Forecast		GRS Forecast (as of 12/23/15)	
	Tier 2	Tier 3	Tier 2	Tier 3
DB Multiplier	2.5%	2.5%*	2.5%	2.5%*
Employer DC Rate	0%	3%	0%	3%
Employee DC Rate	0%	3%	0%	3%
	Figures below in % of new hire payroll			
Total DB Normal Cost	21.1%	14.6%	20.85%	15.06%
Total DC Normal Cost (Hybrid DC + DC Only Plans)	0%	4.8% 6% Hybrid DC + 18% DC Only	0%	4.6% 6% Hybrid DC + 18% DC Only
Total New Hire Normal Cost	**21.1%**	**Blended Rate: 19.4%** Social Security: 14.6% Non-Social Security: 20.6% DC Only: 18%	**20.85%**	**Blended Rate: 19.6%**** Social Security: 15.06% Non-Social Security: 21.06% DC Only: 18%
Employer Normal Cost Contribution	13.45%	Social Security: 7.3% Non-Social Security: 10.3% DC Only: 9.0%	13.20%	Social Security: 7.53% Non-Social Security: 10.53% DC Only: 9.0%
Employee Normal Cost Contribution***	7.65% + 4% UAAL Contribution	Social Security: 7.3% Non-Social Security: 10.3% DC Only: 9.0%	7.65% + 4% UAAL Contribution	Social Security: 7.53% Non-Social Security: 10.53% DC Only: 9.0%

Note: All normal cost figures include the cost of providing the new 2% Max COLA. All figures are irrespective of whether SB1609 is reversed. Forecast assumes 65% of members are with employers who do not participate in Social Security, 30% are with employers that do participate in Social Security, and that 5% of new hires select the DC Only option. // *Rate adjusted down for those with less than 25 service years. // GRS reports the "ultimate" Tier 3 employee cost is 9.8% blended; since Tier 3 is a 50/50 cost split we interpret this to mean a 19.8% "ultimate" blended normal cost // ***Total Employee Contribution for Tier 2 is 11.65%: Normal Cost portion is 7.65%, plus 4% "Maintenance of Effort" contribution for the plan's unfunded liability.

Total Plan Cost Projection, Year 25 (2042-43)

Baseline Total System v. Proposed Total System

	Reason Forecast		GRS Forecast (as of 12/23/15)	
	Baseline Total System	Proposed Total System	Baseline Total System	Proposed Total System
DB Multiplier	2.5%	2.5%*	2.5%	2.5%*
Employer DC Rate	0%	3%	0%	3%
Employee DC Rate	0%	3%	0%	3%
	Figures below in % of new hire payroll			
Employer DB Normal Cost	14.9%	7.6%		
Employer DC Normal Cost	0%	2.3%		
Plan's Blended Employer Contribution Rate**	**14.9%**	**9.9%**	**13.2%**	**9.8%**
Total Employee Contribution Rates***	Tier 1: 7.65% Tier 2: 11.65%	Tier 1: 7.65% Tier 2: 11.65% Tier 3: 7.3% or 10.3%	Variable by Tier, Unstated	Variable by Tier, Unstated

Note: All normal cost figures include the cost of providing a PBI (Baseline) or COLA (Proposed). All figures are irrespective of whether SB1609 is reversed. Forecast assumes 65% of members are with employers who do not participate in Social Security, 30% are with employers that do participate in Social Security, and that 5% of new hires select the DC Only option. // *Rate adjusted down for those with less than 25 service years. // **Individual employer rates will vary based on participating in Social Security. Both "baseline" forecasts are statistically similar and within a reasonable margin of error for a 25 year forecast, the same is true for both "proposed" forecasts. The important analytical conclusion is that both forecasts show around a 30% reduction in costs. // ***Assumes 4% maintenance of effort contribution for Tier 2.

Employer Cost/Savings Forecast, 2017-2046

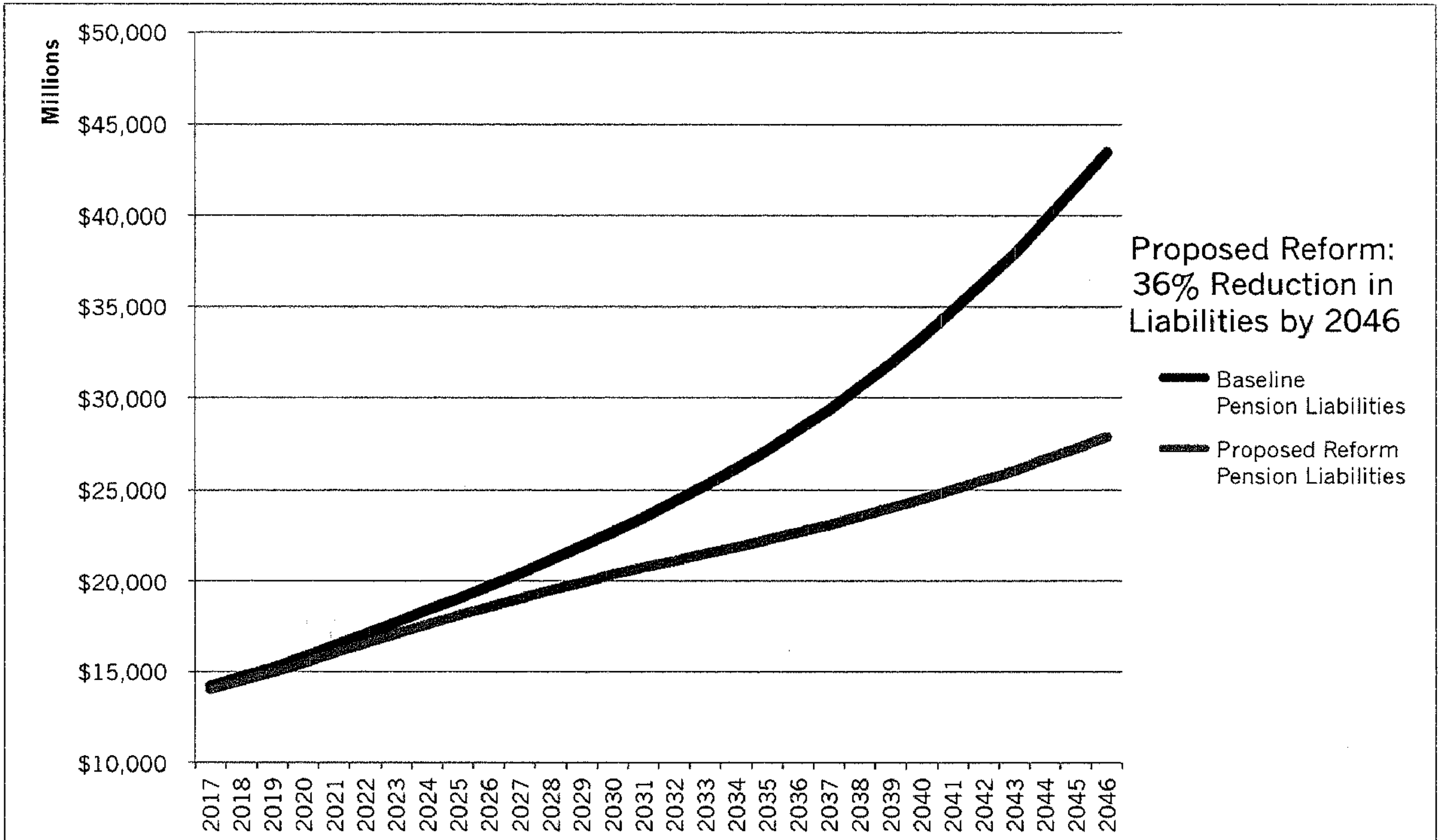
Baseline v. Proposed Reform (Inflation Adjusted)

Reason

	Employer Contributions		
	Baseline	**Proposed Reform**	**Savings from Proposed Reform**
2017-2021	$3.31 billion	$3.25 billion	$0.055 billion
2022-2026	$3.42 billion	$3.29 billion	$0.132 billion
2027-2031	$3.41 billion	$3.19 billion	$0.217 billion
2032-2036	$3.14 billion	$2.84 billion	$0.296 billion
2037-2046	$2.51 billion	$1.68 billion	$0.826 billion
2017-2046	**$15.8 billion**	**$14.3 billion**	**$1.5 billion**

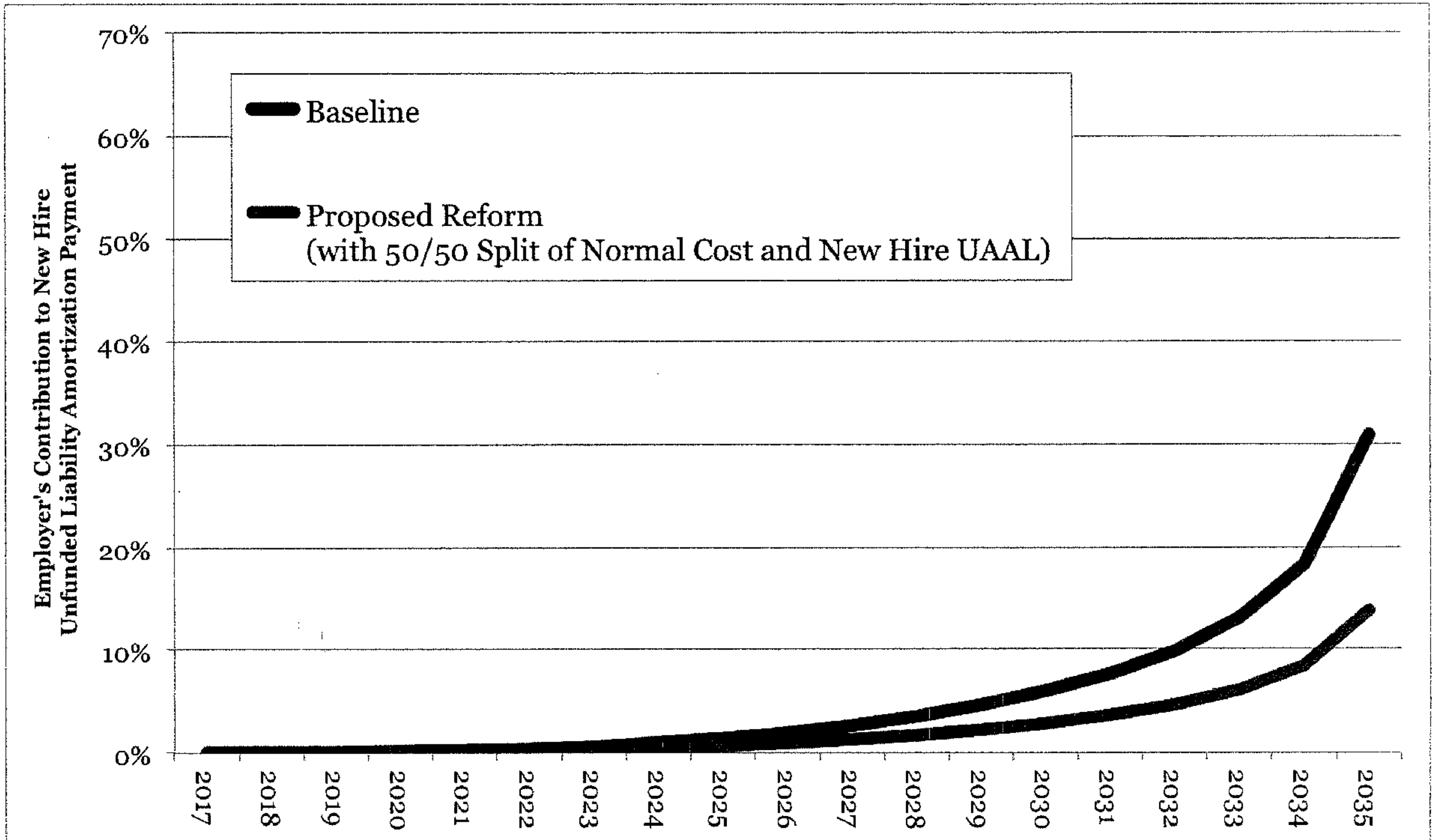
Accrued Liabilities Forecast

Change in Growth of Promised Pension Benefits, Baseline v. Proposed Reform



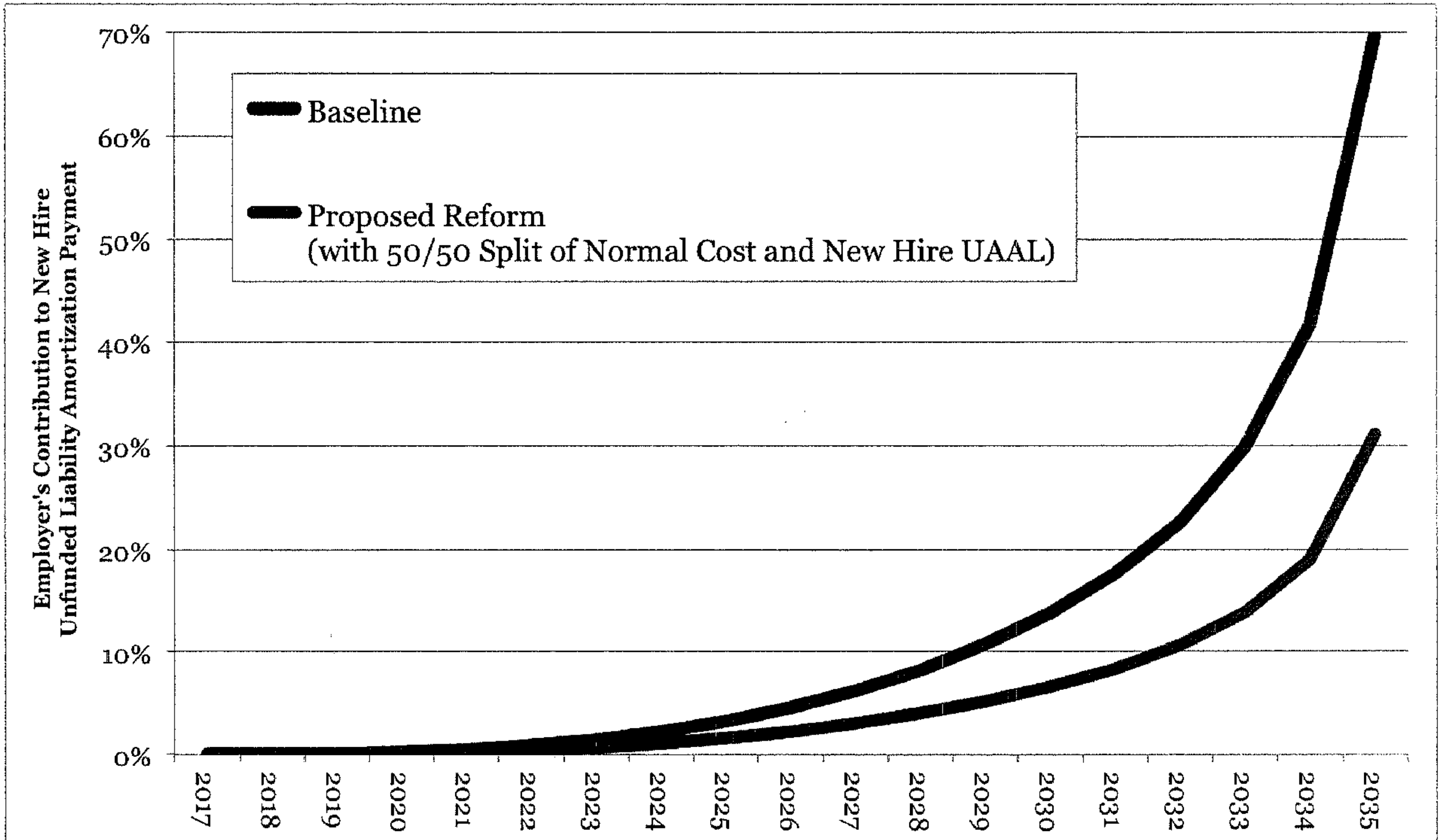
Employer Cost Forecast: Underperforming Assets

Additional in Employer Amortization Payments for New Hire Unfunded Liabilities
Assuming a 6.5% Actual Rate of Return, Baseline v. Proposed Reform

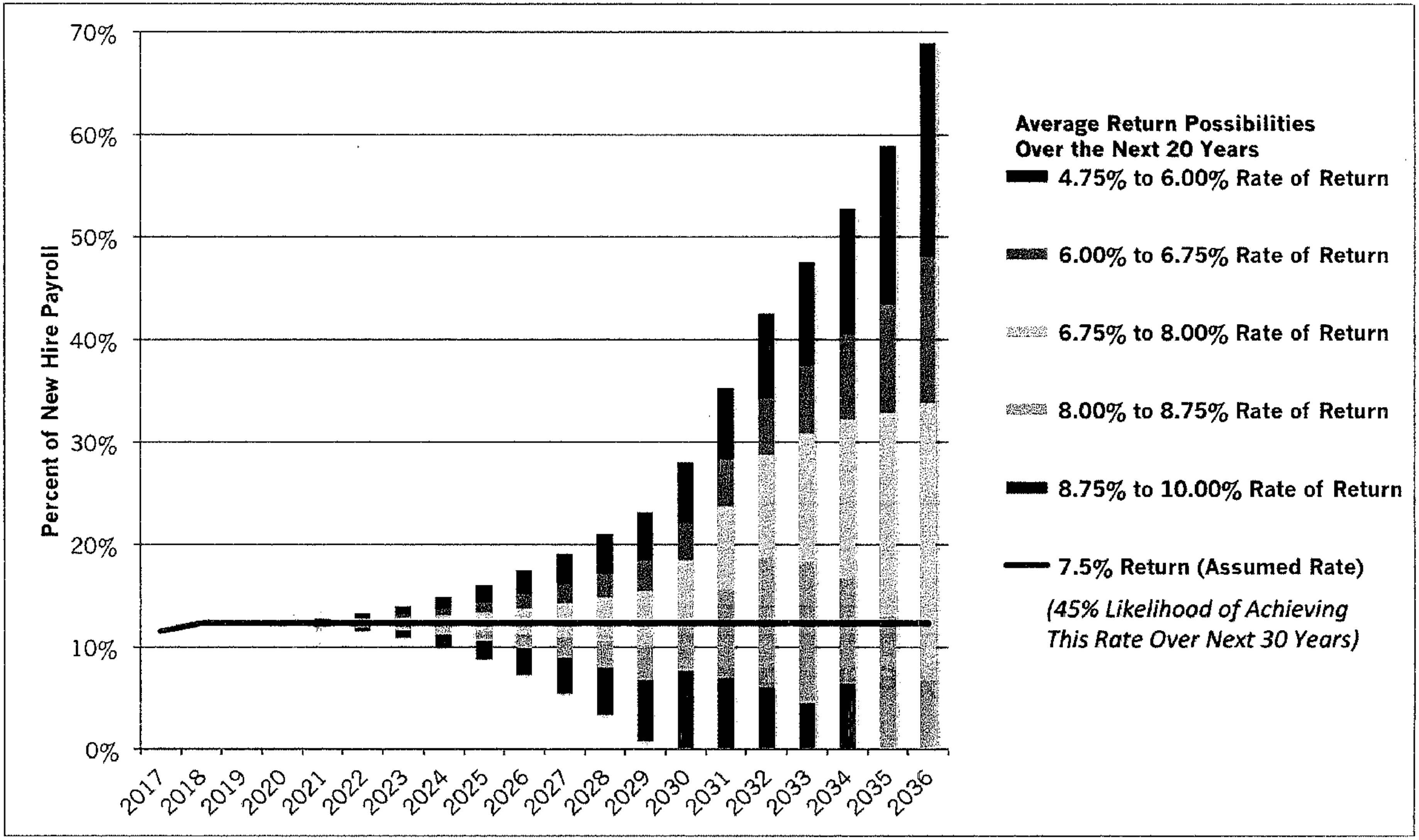


Employer Cost Forecast: Underperforming Assets

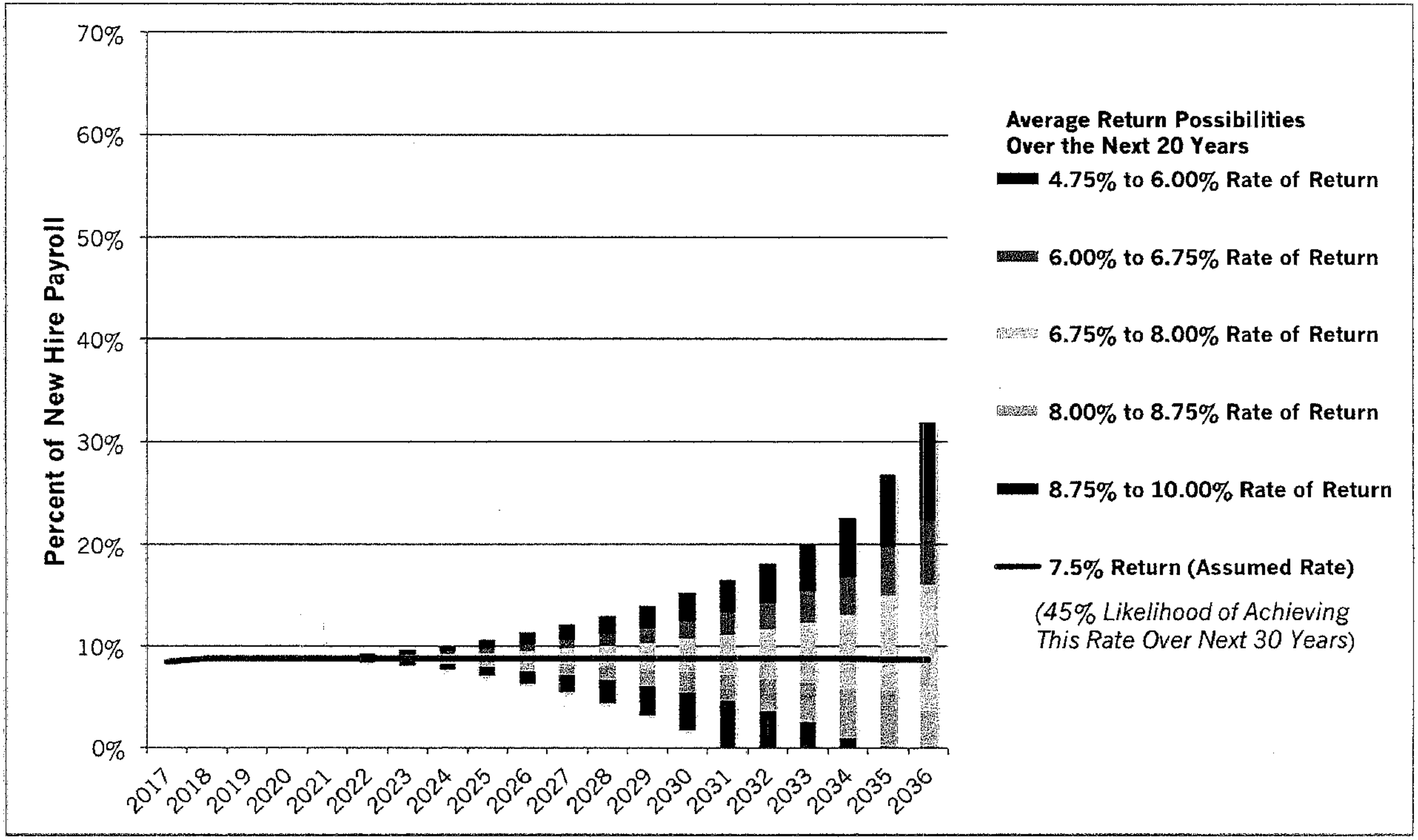
Additional in Employer Amortization Payments for New Hire Unfunded Liabilities Assuming a 5.0% Actual Rate of Return, Baseline v. Proposed Reform



Baseline: New Hire Volatility Forecast Employer Contribution Rate, as a % of New Hire Payroll



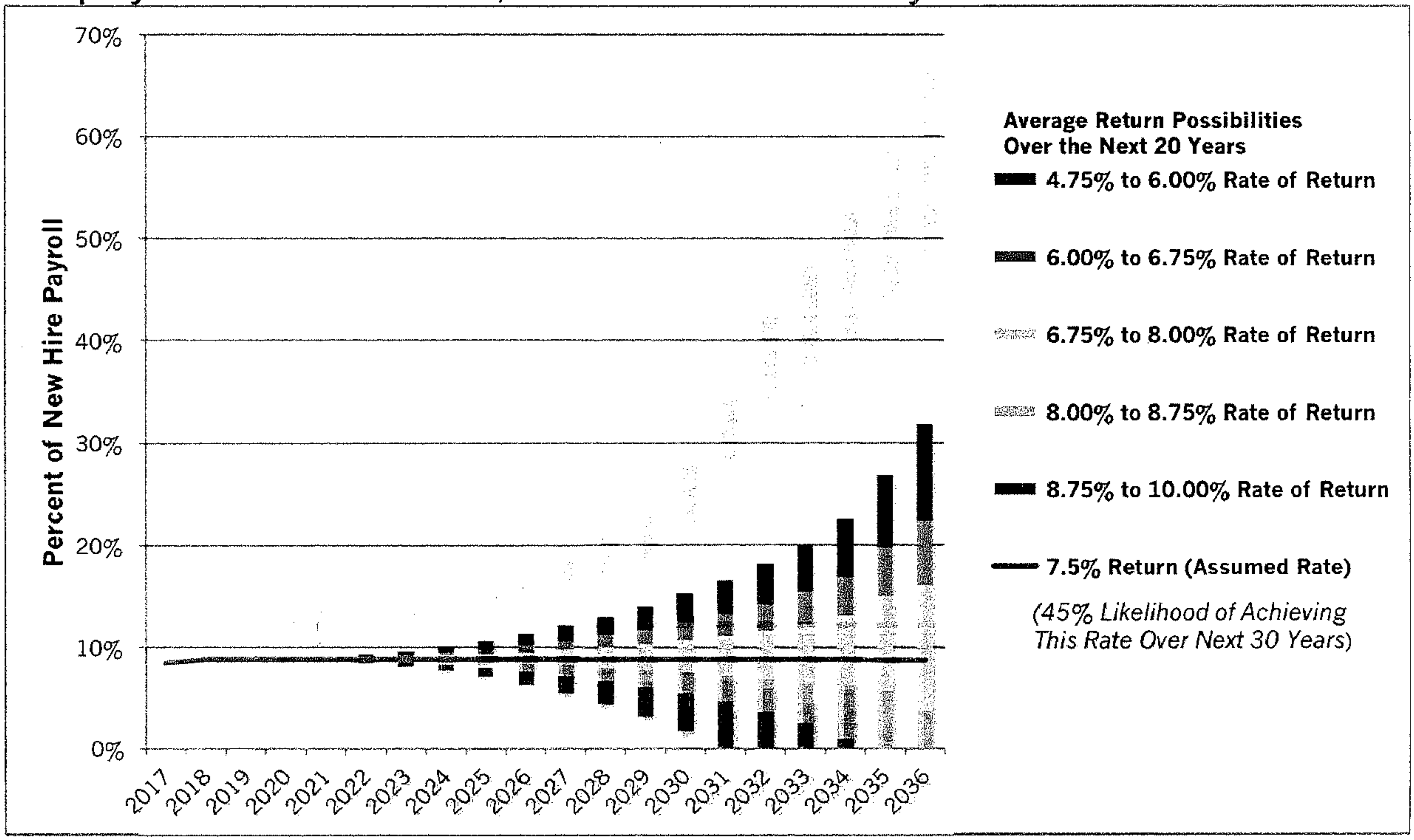
Proposed Reform: New Hire Volatility Forecast Employer Contribution Rate, as a % of New Hire Payroll



Comparing New Hire Volatility Forecasts

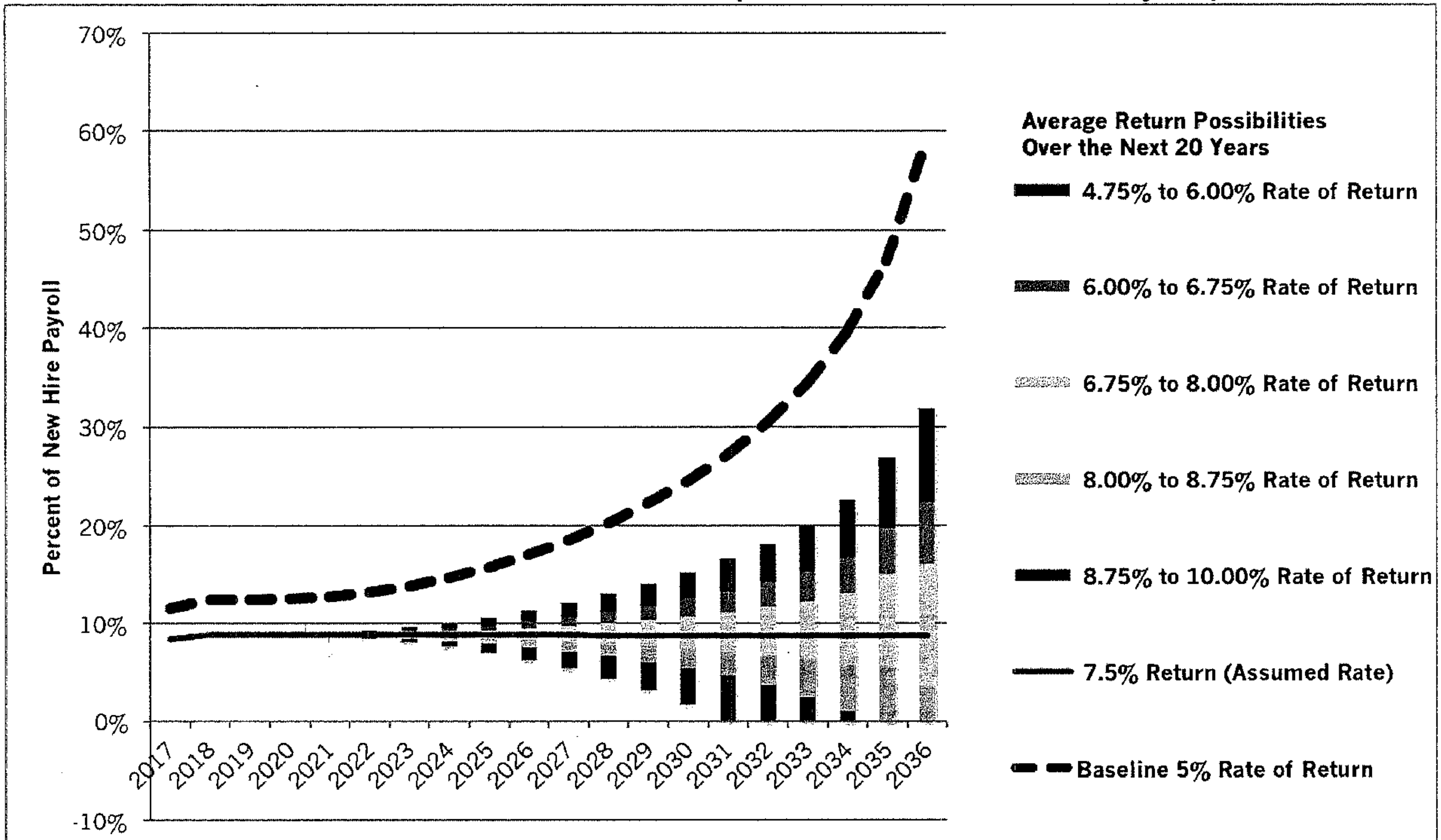
Proposed Reform (Foreground) v. Baseline (Transparent)

Employer Contribution Rate, as a % of New Hire Payroll



Comparing New Hire Volatility Forecasts

Proposed Reform v. Baseline Employer Contribution Rate if 5% Rate of Return Continues (as a % of New Hire Payroll)



CONCLUSION

Summarizing how the proposed reform will address the problems and challenges of PSPRS

How Well Proposals Meet Objectives

Reason

Element	Baseline	Proposed Reform
(1) Provide Retirement Security for Members & Retirees	**UNCERTAIN** *Broken PBI design & unfunded liabilities threaten plan solvency*	**YES** *Certain COLA and properly funded, future potential unfunded liability payments reduced*
(2) Reduce Costs for Employer/Taxpayers and Employees	**NO**	**YES** *New COLA design, equal cost sharing, stepped-multiplier based on years of service*
(3) Stabilize Contribution Rates for the Long-term	**NO**	**YES** *Employer/employee equal cost sharing*
(4) Reduce Taxpayer and Pension System Exposure to Financial and Market Risk	**NO**	**YES** *36% Reduction in Accrued Liabilities by 2046, 50% Reduction in Potential New Hire Unfunded Liability Costs for Taxpayers*
(5) Ensure Ability to Recruit 21st Century Employees	**SOME**	**YES** *New hires offered choice of hybrid or portable DC plan, new DB stepped-multiplier incentivizes retention*
(6) Improve Governance & Transparency	**NO**	Significant commitment by all stakeholders to substantive change to governance; details to be determined.

Conclusion

Reason

- ***Employee*** Benefits of Proposed Pension Reform
  - Pay lower annual employee contributions (effective pay raise for new tier employees)
  - Choice between retirement plan designs (Hybrid DB/DC or Full DC)
  - Employees without social security will have:
    - A portable element of retirement benefits (the DC account) with ability to customize investment strategy based on personal retirement goals
    - Professional DC plan management and retirement planning education and assistance

- ***Employer / Taxpayer*** Benefits of Proposed Pension Reform
  - Minimize volatility of annual employer contributions
  - Employees equally share costs and investment risk with taxpayers
  - Reduces overall risks, slows growth of unfunded liabilities

Questions?

Reason

Reason Foundation Pension Integrity Project

Pete Constant, Director of Pension Integrity Project
Former San Jose City Councilman, Retired Police Officer, and Pension Board Trustee
pete.constant@reason.org

Len Gilroy, **Director of Government Reform**
Based in Arizona
leonard.gilroy@reason.org

Anthony Randazzo, Director of Economic Research
anthony.randazzo@reason.org

Senator Lesko's PSPRS (Public Safety Personnel Retirement System) Reform Legislation 2-1-16

1.	Ballot Measure: Affects current employees & retirees Goal: Place on May ballot	Changes Pension Benefit Increase (PBI) Structure for retirees. All stakeholders have said that current payout structure is unsustainable. **STATUS QUO**: 4% compounded increase has been paid out for last 20+ years regardless of the fund's financial status. Payout is unpredictable based on investment rate of return. Until 2014 PSPRS did not include this cost in the normal cost of the fund. Fund is depleted, so no PBI payments were made last year and will not be paid this year. **CHANGE** structure to actual Cost of Living Adjustment based on regional Consumer Price Index (CPI) with a cap of 2%. **ADVANTAGE**: The status quo is unsustainable and is creating huge debts. The cost is much more predictable for both the employer and employees and can predictably be built into the normal cost of the fund.
2.	Add new tier for new hires. Old plan stays open, thus no added cost to close out a plan.	**STATUS QUO**: Tier 1 and Tier 2 employees exist depending on when they were hired. **CHANGE**: Add Tier 3 for new hires. **ADVANTAGE**: Adding a new tier allows reforms going forward without the costs of entirely closing out the old plan.
3.	50%/50% Employer/Employee Contribution into pension (change applies to new hires only)	**STATUS QUO**: Employees pay a maximum of 11.65% of their salary into their pension fund. Employers' % is NOT capped. For example, Prescott pays approximately 80% of their employees' salary toward their pension. Phoenix is approximately 50%. Thus in Phoenix, if a police officer is hired at $60K/yr; it costs Phoenix $90K/ yr. just for salary + pension. **CHANGE:** Employers and Employees split the cost of the pension 50%/50% just like ASRS (AZ State Retirement System) already does. **ADVANTAGE**: Both employers and employees have equal "skin in the game" and board decisions will affect both groups equally. Employers will immediately save money on every new hire, ranging from approximately 2.7%-5.6% of their salary. Risk to employers (taxpayers) is decreased and contribution rates will be less volatile.
4.	Pensionable Pay Cap (change applies to new hires only)	**STATUS QUO:** $265K/yr **CHANGE:** $110K/yr. An employee's pension pay will be based on a maximum salary of $110K/yr. The $110K will be adjusted based on actual avg. salary increases. **ADVANTAGE**: Limits pension spiking.

ATTACHMENT 4

5.	Minimum Benefit Eligibility Age (Change applies to New Hires Only)	**STATUS QUO:** No minimum age for tier 1 employees; 52.5 yrs. old for tier 2 employees. **CHANGE**: Minimum 55 yrs. old, or 52.5 with actuarially reduced benefit. Note employee can retire prior to 55 yrs. old, but is not eligible for benefit payments until 55 yrs. old. **ADVANTAGE**: Reduces costs and helps the fund actuarially.
6.	Minimum years of service required (Change applies to New Hires Only)	**STATUS QUO:** 20 years of service for tier 1 employees (early retirement w/reduced benefit after 10 years) and 25 years of service for tier 2 employees **REFORM**: Full benefit: 25 years of service for new tier 3 employees; reduced benefit: 15 years of service.
7.	100% Defined Contribution (DC) option (applies to New Hires only)	**STATUS QUO:** This is currently not available **CHANGE:** New hires will be allowed to choose between the defined benefit option and the 100% defined contribution option within the first 90 days of hire. Employer and Employee contributions are mandated at 50%/50% of normal cost of pension. Funds will be managed professionally and withdrawals and loans will not be allowed for boats, etc. prior to retirement. **ADVANTAGE**: Increases portability of retirement funds for employee. Employee can give retirement benefits to any beneficiary instead of the status quo that limits benefit payments to surviving spouses or minor or disabled adult children. Allows Employers to hire older, more experienced workers and not force them to pay into a defined benefit retirement plan that they will not benefit from. Employer risk is decreased.
8.	Multiplier rate Change (applies to New Hires only)	**STATUS QUO:** 2.5%. Thus if someone retires with an average salary of $100,000, the per year pension payment would be: $100,000 x 2.5% x # of years of service. **CHANGE**: Stepped multiplier: 2.5% for 25 years of service (yos); 2.25% for 22 yos; 2% for 19 yos; 1.75% for 17 yos; 1.5% for 15 yos. **ADVANTAGE**: Reduces cost and helps the fund actuarially.
9.	Defined Contribution Hybrid component for employees that do NOT receive Social Security (applies to New Hires only)	**STATUS QUO:** No Defined Contribution plan. Some employees, mostly fire fighters, do not currently pay into or receive social security benefits (disparity in benefits amongst similar employees). **CHANGE**: For employees that do not receive social security: The employer will match employee 3% contribution into a defined contribution plan. The employee can contribute in excess of 3% up to the IRS limit. **ADVANTAGE:** This will help employees without social security benefits save for retirement and make their retirement savings more equitable to employees that do receive social security.

10.	Governance Changes: More accountability and transparency for PSPRS.	**STATUS QUO:** 7 member PSPRS board **CHANGE:** 9 member PSPRS board and form an advisory council More PSPRS reporting and accountability, along with incorporating comprehensive fiduciary standards in statutes.
11.	Who is in Support of this legislation so far:	Governor's office, League of Cities & Towns, County Supervisors Assoc., Professional Fire Fighters of AZ, PLEA (Phoenix Law Enforcement Association), the Fraternal Order of Police (FOP) State Lodge, PSPRS, AZ Association of Counties, AZ Chamber of Commerce, and the Greater Phoenix Chamber of Commerce. Other stakeholders that have been involved in negotiations are in the midst of finalizing their support.

PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM
CORRECTIONS OFFICER RETIREMENT PLAN
ELECTED OFFICIALS' RETIREMENT PLAN
3010 East Camelback Road, Suite 200
Phoenix, Arizona 85016-4416
www.psprs.com
TELEPHONE: (602) 255-5575
FAX: (602) 255-5572

Administration
Jared A. Smout
Administrator
Ryan Parham
Assistant Administrator-CIO

SUPPLEMENTAL MEMO FROM THE ADMINISTRATOR

Jared A. Smout

At the request of a number of people, I have asked GRS to provide a supplemental graph of stochastic projections for which many are accustomed to seeing. I do this for purposes of shorter term projections than what has been provided in the GRS report. As such, a number of questions may arise for which I hope to provide satisfactory answers below.

First, it is important to understand the facts and assumptions in place for each scenario in order to further understand what has changed when comparing the different scenarios in the graph:

Scenario		Employee Rate	PBI or COLA	Other Benefits
Proposed Scenario (SB1609 reversed)	Tier 1a		1.75% COLA	As prescribed on pages 1 & 2 of GRS Memo
	Tier 1b			
	Tier 2a	7.65%		
	Tier 2b	7.65% + 4% MOE		
	Tier 3	7.53%		
Proposed Scenario (SB1609 not reversed)	Tier 1a		1.75% COLA	As prescribed on pages 1 & 2 of GRS Memo
	Tier 1b			
	Tier 2a	7.65% + 4% MOE		
	Tier 2b			
	Tier 3	7.53%		
June 30, 2015 (aka "status quo")	Tier 1a		2.00% PBI	Current law
	Tier 1b		0.50% PBI	
	Tier 2a	7.65% + 4% MOE		
	Tier 2b			
If SB1609 is reversed	Tier 1a		2.00% PBI	Current law
	Tier 1b			
	Tier 2a	7.65%		
	Tier 2b	7.65% + 4% MOE	0.50% PBI	

For purposes of this table:

- Tier 1a = Members retired on or before July 2011
- Tier 1b = Members retired after July 2011
- Tier 2a = Members hired prior to January 1, 2012 and not yet retired
- Tier 2b = Members hired on or after January 1, 2012
- Tier 3 = New members hired on or after the effective date of reform

ATTACHMENT 5

Questions that may arise from the table:

- **Why is there a Tier 1a and 1b in your table?**
When certain parts of SB 1609 were reversed by the *Fields* case in 2014, only those who were retired prior to the effective date of SB1609 were determined to be the class of members effected for which the old PBI mechanism was reinstated (9% investment return, reserve fund for future PBIs, no funding level requirement). These are considered Tier 1a to differentiate them from those who retired after the effective date (Tier 1b).

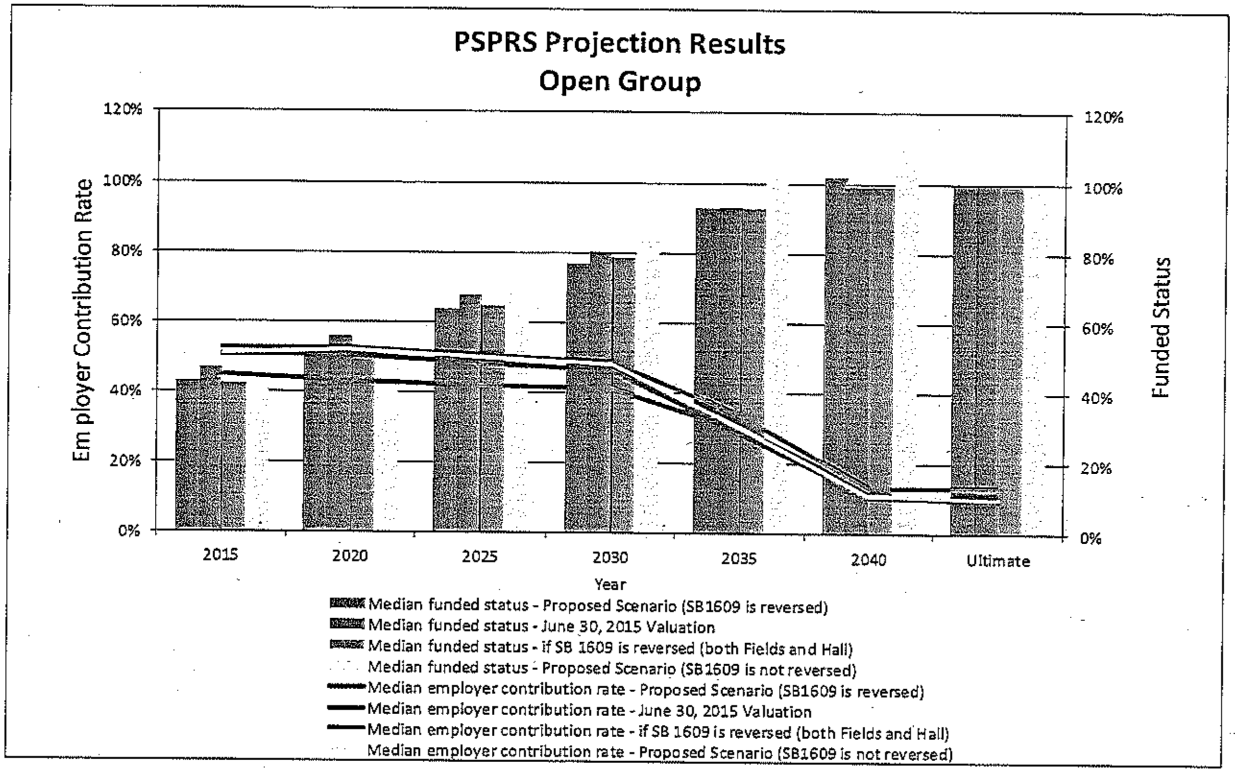
- **Why is it important to understand this distinction?**
As mentioned previously, Tier 1a have the old PBI mechanism reinstated for them and Tier 1b fall under the new mechanism created by SB1609 (10.5% investment return, no reserve fund, tiered funding levels). Because of these two different mechanisms, different assumptions need to be applied to how their PBI is projected to be paid out in the future. Based on our actuaries modeling, the projection for Tier 1a is a 2.00% compounded increase in their benefit each year, but the actual could be anywhere between 0% and 4% depending on the investment return. For Tier 1b, the projection is 0.50% compounded each year because of the higher required investment return and the funding level thresholds that must be met. It is important to understand that this 2.00% and 0.50% are not the cost of the PBI, but the projected percentage increase in each member's benefit.

- **Can you explain further what the maintenance of effort (MOE) is and what it is designed to do?**
The total cost of funding the pension system is paid by a split between the employee and the employer. For almost the past 20 years prior to 2011, the employee rate was 7.65%. In 2011, SB1609 gradually increased that rate in annual increments to 11.65% today. The MOE is the difference between 7.65% and that increased rate, being 4% today. Without the MOE, any increase in the employee rate would translate into an equal decrease in the employer rate, thereby only shifting the cost to the employee and not have any added effect on the funding status. Therefore, as part of SB1609, the MOE is not allowed to offset the employer rate, but is designed to help increase the funding status at a greater pace.

- **Absent reform, how does the *Hall* case affect Tiers 1 and 2?**
For those hired before January 1, 2012, the only two changes from SB1609 being considered by the *Hall* case are the increase in the employee contribution rate and the change to the PBI mechanism. Only those tiers affected by that contribution rate or PBI mechanism change will be the only ones who have those changes reversed. It is possible that only one change gets reversed and the other remains intact, but for purposes of these studies it is assumed that both changes get reversed. Members hired on or after January 1, 2012 fall under the provisions of SB1609 and will continue to pay a higher contribution rate and follow the PBI mechanism that has a higher investment return threshold and tiered funding level requirements.

- **If the *Hall* case reverses those provisions of SB1609, what needs to happen to make the members whole?**
All the MOE received since 2011 for those hired before January 1, 2012 will need to be returned and, for years there were investment returns over 9%, a PBI will need to be paid out to those who retired after July 2011. Doing so will increase employer costs in order to make up the difference for contributions lost and increased benefits being paid out.

- **Why is the projected PBI/COLA in the Proposed Scenarios 1.75% for all tiers?**
Current reform is proposing to change both PBI mechanisms for Tiers 1 and 2 to be a regional CPI-based COLA capped at 2.00%. Historically, this CPI was been 1.75% annually and will therefore be the number used to project the new increase for all tiers, but will be reviewed and adjusted accordingly as appropriate going forward.



Employer Contribution Rates	2015	2020	2025	2030	2035	2040	Ultimate
Proposed Scenario (if SB1609 is reversed)	51.0%	50.8%	48.7%	46.7%	28.9%	10.9%	9.8%
Proposed Scenario (if SB1609 is not reversed)	51.0%	52.0%	50.3%	48.5%	30.4%	11.1%	9.8%
June 30, 2015 Valuation	45.2%	43.2%	42.2%	41.5%	29.6%	13.2%	13.2%
If SB 1609 is reversed	52.7%	52.6%	51.0%	49.1%	33.9%	13.2%	13.2%

Median Funded Rate	2015	2020	2025	2030	2035	2040	Ultimate
Proposed Scenario (if SB1609 is reversed)	43.5%	50.9%	64.0%	77.4%	93.0%	102.4%	100.0%
Proposed Scenario (if SB1609 is not reversed)	43.5%	53.9%	68.4%	83.7%	101.7%	112.9%	100.0%
June 30, 2015 Valuation	47.1%	56.1%	68.3%	80.7%	93.5%	99.7%	100.0%
If SB 1609 is reversed	42.5%	51.5%	65.3%	79.0%	93.0%	99.7%	100.0%

Questions that may arise from the graph:

- **What can be attributed to the large employer rate increase between the *June 30, 2015* and the *If SB1609 is reversed* scenarios?**
  The largest component of that increase will be due to the projected PBI payout changing from 0.50% to 2.00% for Tiers 1b and 2a.

- **Why is the employer rate for the *Proposed Scenario (if SB1609 is not reversed)* higher than the *Proposed Scenario (if SB1609 is reversed)*?**
  As mentioned previously and shown in the table, if SB1609 is reversed then the employee contribution rate reverts to 7.65% for Tier 2a with a corresponding return of their MOE going back to 2011 (some members in Tier 1b will also receive a return of their MOE). It seems counterintuitive to think losing those extra contributions will actually reduce the employer rate under the *Proposed Scenario (if SB1609 is reversed)*. However, remember that the MOE does not affect the employer contribution rate, so the elimination of those additional contributions does not play into the difference between the employer rates for these two proposed scenarios because both scenarios are only utilizing the 7.65% employee rate.

  So what is causing it? The actuaries have to make an assumption, based on experience, of how many members might quit each year and apply for a refund of their contributions. Under *Proposed Scenario (if SB1609 is not reversed)*, if an employee quits and applies for a refund, we have to return his contributions that were made in the amount of 11.65% of his salary. If the contribution rate reverts to 7.65% in *Proposed Scenario (if SB1609 is reversed)*, then we only have to refund 7.65% of his salary. Having to return more to the member at 11.65% means the employer has to make up more for those lost contributions that are refunded, thereby increasing the employer rate. So, while the MOE doesn't affect the employer contribution rate when received, it does affect it when refunded.

  To illustrate the effects of MOE and the trade-off of a lower employer contribution rate in *Proposed Scenario (if SB1609 is reversed)*, you can see that the funding level increases faster under the *Proposed Scenario (if SB1609 is not reversed)*.

- **Why do both the proposed scenarios appear more expensive than the "status quo"?**
  One of the main purposes for this reform is to correct the flawed PBI mechanism where outperforming investment returns actually serve to increase the liabilities instead of pay them down. In order to change that, it is being taken to the ballot to allow a constitutional change for only that benefit. To withstand legal scrutiny, there are a number of criteria that must be met, one being that a contingent benefit is being replaced with a guaranteed benefit. The PBI is contingent on investment performance and the COLA is guaranteed based on CPI.

  So, changing the mechanism changes the assumption to where any savings from those who were being projected at a 2.00% payout being reduced to 1.75% is offset by those at 0.50% being raised to 1.75%. While this may be more expensive in the short-term, getting rid of the flawed mechanism will produce greater stability and confidence in our projections by reducing the volatility created by the uncertainty of that flaw.

  Additionally, as stated at the top of page 3 of the GRS memo, "It should also be noted that potential savings will occur gradually over time as current active members are replaced by members who receive the new tier of benefits." And I would like to add "...and the unfunded liability is paid off." It is important to note that the unfunded liability is a debt that must still be paid. So, the value of fixing the flawed PBI may not come through until later if looking at a fiscal analysis of the total System now. Therefore, the most appropriate way to consider the merits of the proposed changes is by looking at the changes to new hires.

Key Points – Public Safety Personnel Retirement System (PSPRS)

Presented at Senate Finance Committee Hearing

February 3, 2016

Harry Oberg, Mayor of Prescott

I come to you today as probably the main poster child of why we need reform of the system.

Prescott owes right now $71 million in unfunded pension debt – a staggering sum for a town of 40,000. We know this will increase due to the return on investment. And if the outstanding Parker and Hall cases go against the tax payer the cost will go north of $100 million.

Since 2007, PSPRS employer rates have increased from 18% to over 75%, for Prescott's 120 public safety employees - more than a 300% increase.

That means Prescott pays $49,000 per public safety employee in pension cost every year.

In the last four years alone, the City has absorbed more than $3 million in public safety pension payment increases, and pension cost is almost 30% of the police and fire annual operating budgets.

Pension increases have forced reductions to quality of life services and amenities - community events, library hours and programming, and recreation programs.

Our hard-working employees have seen stagnating wages, many people have not received any pay raises since 2008, reduced health and leave benefits, and layoffs of personnel – increasing turnover rates in departments that provide basic health and safety resulting in additional training cost which is significant.

Prescott has exhausted options for absorbing pension cost increases – all that's left now are more layoffs and we have gone before the public resulting in a death spiral of basic services.

We made $1 million in cuts and higher user fees that went into effect effective January 1, 2016, requiring reductions to police and fire staffing – 8 positions frozen – and causing fire station brownouts due to insufficient personnel.

Without action, the pension cost will continue to eat away at the services that we provide to our residents and visitors, and damage the very fabric which has held us together for 150 years.

Rest assured we are continuing to look at the overall spending portfolio to do everything we can to control expenses and maintain essential services.

During last fall's election, when I became Mayor, our citizens overwhelmingly rejected a tax increase to prop up the broken pension system. When speaking to individuals regarding the tax proposal, the major concern was continuing to add financial support to a system that is still broken. We may be able to go back for a sales tax increase for the existing debt that we know we will still owe, but reform is essential to any tax effort.

I am here today to support these consensus-based bills, which will provide stability for communities like Prescott, so that we can alleviate future problems and move forward.

ATTACHMENT 6

Creation of a sustainable pension tier for new employees will provide stability for the City and its public safety employees.

That new tier is essential to stop the financial bleeding so that Prescott can move forward with paying off its unfunded liability and stabilize its future pension cost.

The ballot measure capping the COLA will increase the value of the trust and decrease the cost of repaying Prescott's $71 million in unfunded pension liability.

I ask you to please move this legislation forward so that I can put Prescott tax dollars to work more constructively to grow our economy and provide services, instead of throwing good money after bad.

Thank you

HOUSE OF REPRESENTATIVES

SB 1428
PSPRS modifications
Prime Sponsor: Senator Lesko, LD 21

X Committee on Insurance

Caucus and COW

House Engrossed

OVERVIEW

SB 1428 creates a new retirement benefit structure for public safety personnel hired on or after 7/1/2017 (Tier III) with two options: a defined benefit plan (Tier III PSPRS) and a defined contribution plan (PSPDC) and outlines contribution rates, retirement benefits and disability benefits for the plans. SB 1428 creates a new mechanism to offer a cost-of-living increase (COLA) applicable to retirees, current members and new Tier III members. SB 1428 expands the Public Safety Personnel Retirement System Board (Board) to nine members, outlines membership criteria, describes the appointment process and establishes a PSPRS Advisory Committee (Committee). SB 1428 requires the Board to study methods for risk pooling and local board consolidation. Several sections of SB 1428 are conditional upon the enactment of SCR 1019 by a vote of the people at the May 17, 2016 special election.

PROVISIONS

COLAs for PSPRS Tier I, Tier II and Tier III

General COLA Changes

1. Requires the PSPRS actuary to include the projected COLA cost in the calculation of normal cost and accrued liability.
2. Repeals the current permanent benefit increase statutes and replaces them with a new COLA benefit structure.

Tier I and II COLAs

3. Allows retired members and survivors hired before 7/1/2017 to receive a compounding COLA in the base benefit. The annual adjustment is based on the average change in consumer price index (CPI), up to 2% of the member's base benefit and is made on July 1 of each year.
   a. Uses CPI from Phoenix-Mesa.
4. Prorates the first COLA paid based on retirement date and requires the first normal COLA payment to be made the year after.

Tier III COLAs

5. Provides a graduated COLA payment model based on the overall funded status of the Tier III PSPRS Plan for members hired on or after July 1, 2017 as follows:
   a. 2% of the base benefit if the funded ratio is at least 90%
   b. 1 ½% of the base benefit if the funded ratio is at least 80% but less than 90%
   c. 1% of the base benefit if the funded ratio is at least 70% but less than 80%

ATTACHMENT 7

d. No COLA is provided if the funded status is lower than 70%

6. Provides that a retiree or survivor is eligible for a COLA beginning the earlier of either:
   a. The first calendar year after the 7th anniversary of retirement, or
   b. When the retired member is/would have been 60 years old
7. Defines *funded ratio* as the ratio of the market value of assets to the actual accrued liabilities.

Tier III (New Hires): General

8. Allows employees hired on or after 7/1/2017 to elect to either solely participate in the new PSPRS Tier or the PSPDC.
   a. The election is irrevocable for the employee's employment with any employer under PSPRS.
   b. Participation begins 90 days after the employee's hire date.
   c. If the employee doesn't make an election, the employee is automatically enrolled in PSPRS.
9. Enrolls employees who select Tier III PSPRS in the PSPDC automatically if they are not covered by the Federal Old Age and Survivors Insurance System (Social Security).
   a. If an employee not covered by Social Security moves to a covered employer, the employee cannot continue to contribute to the employee's PSPDC account while covered.
   b. If the employee later moves to an employer who is not covered by Social Security, the employee must again contribute to the employee's PSPDC account. If the employee originally elected to contribute additional money to the employee's PSPDC account, the employee must pay the amount previously elected while working for an employer who is not covered.

Defined Contribution Plan (PSPDC)

<u>General</u>

10. Establishes the PSPDC and requires the Board to design and administer the PSPDC.
11. Outlines the purpose and legislative intent of the PSPDC.
12. Prescribes Board duties.

<u>Contributions</u>

13. Requires the following contribution amounts from both employees and employers:
    a. For employees who are members of PSPRS and are not covered by Social Security: 3%
    b. For employees in the PSPDC and not in PSPRS: 9%
14. Vests participant monies immediately and fully vests participants in PSPDC after 10 years of service. Employer contributions vest at a rate of 10% per year.
15. Permits participants to make a one-time irrevocable election to contribute more than the specified amount, up to the amount allowable under the Internal Revenue Code. If a higher amount is selected, that amount is the contribution rate for the remainder of the participant's employment with any employer under PSPRS.
16. Requires employers to pay all contributions to PSPDC and allows employers to reduce compensation to make the required payment on behalf of the employee. Employees cannot

directly contribute to the PSPDC. Specifies how contributions are to be treated for tax purposes.

Catch Up Provision

17. Provides a "catch-up" PSPDC account for members of PSPRS who are not covered by Social Security and who were hired after 10/1/2012 but before 7/1/2017 as follows:
    a. Participants contribute 3% per year
    b. Employers contribute various amounts depending on the year in which the participant was hired:
        i. 2012: 4% for seven years, 3% after
        ii. 2013: 4% for six years, 3% after
        iii. 2014: 4% for five years, 3% after
        iv. 2015: 4% for four years, 3% after
        v. 2016: 4% for three years, 3% after; and
        vi. 1/1/2017-6/30/2017: 4% for one year and 3% after

Disability

18. Establishes the PSPDC Disability Program (PSPDC Disability) for participants in PSPDC who elected to exclusively participate in the PSPDC.
19. Requires all PSPDC participants to participate in PSPDC Disability.
20. Requires employers and employees to contribute an amount determined by the Board that is necessary to pay ½ of benefits under and the costs of administering PSPDC Disability. Specifies how the contribution rate will be determined by the PSPRS actuary. Outlines the process for paying contributions, penalties for delinquent payments and adjustment for overages in payment.
21. Specifies that participant contributions to PSPDC Disability are not refundable. Contributions by the employer are irrevocable and must be used as benefits or to pay expenses associated with PSPDC Disability.
22. Requires the Board to use the same procedures and method for determining eligibility and calculating payments under PSPDC Disability as are used for the PSPRS disability program.
23. States that a PSPDC participant who meets the requirements for a disability pension under PSPRS receives a monthly benefit equal to the monthly disability pension provided to a PSPRS member hired on or after 7/1/2017, reduced by the monthly annuitized value of the participant's annuity account (excludes COLA). Prescribes the method for calculating the annuitized value of the annuity account.
24. Outlines requirements of the Board in administering, managing and operating PSPDC Disability.
25. Establishes the PSPDC Disability Trust Fund (Fund) to pay benefits under and costs of administering PSPDC Disability. The Board administers the Fund.
26. Describes how monies in the Fund are managed, how abandoned monies are handled, interest accrual and custody of the Fund.

Miscellaneous

27. Allows retirees of the PSPDC Plan to obtain health and accident coverage through agreement with the Arizona State Retirement System in the same manner as retirees from other systems. Specifies that the participant pays the premium for coverage.

28. Defines *annuity account, assets, board, compensation, defined contribution plan, disability program, employer, employer contribution, participant, pensionable compensation,* and *system*. Note: two definitions of *participant* are provided for purposes of the conditional enactment clause.

Tier III Defined Benefit Plan (Tier III PSPRS)

Contribution Rate

29. Requires employers of Tier III PSPRS members to pay 50% of the normal cost and actuarially determined amount required to amortize the total unfunded accrued liability (UAL) for each employer (amount only attributed to Tier III PSPRS members). Outlines the formula for making the UAL determination.

30. Requires Tier III PSPRS employees to pay the remaining 50% of normal cost and the amount required to amortize the UAL, divided by the total number of the employer's Tier III PSPRS employees so that each member contributes an equal percent of compensation. Requires member contributions to begin simultaneously with membership and be made through payroll deduction.

31. Prohibits the employer from contributing less than the normal cost for that Fiscal Year (FY).

32. Prohibits the Board from suspending contributions unless:
    a. The actuary determines that continuing to accrue excess earnings could result in disqualification of System's tax-exempt status.
    b. The Board determines that receiving additional contributions would conflict with its fiduciary responsibility.

Monthly Pension Calculation

33. Establishes a multiplier for determining a Tier III PSPRS member's monthly pension amount. A member must retire after the normal retirement date to be eligible. In determining the pension amount, the member's average monthly benefit compensation is multiplied by the number of whole and fractional years of credited service, multiplied by:
    a. 15 years up to 17 years of service: 1.5%;
    b. 17 years up to 19 years of service: 1.75%;
    c. 19 years up to 22 years of service: 2.0%;
    d. 22 years up to 25 years of service: 2.25%; or
    e. 25+ years of service: 2.5%.

34. Limits the maximum pension to 80% of the average monthly benefit compensation.

35. Allows a member to retire early at 52 ½ years of age with at least 15 years of credited service and provides an actuarially equivalent retirement benefit to the multipliers listed above.

36. Allows a Tier III PSPRS member to be eligible for retirement and benefits if the member terminates employment prior to meeting the age requirement for normal retirement but later attains the normal retirement date (age 52 ½ for early retirement or age 55) and meets the credited service requirement for normal retirement (at least 15 years of service).

37. Limits the amount of a Tier III PSPRS member's compensation used for determining pension benefits to $110,000. Allows the limit to be adjusted for inflation pursuant to the average change in the *public safety wage* index. Sets a ceiling for pensionable compensation at the maximum compensation limit under § 401(a)(17) of the Internal Revenue Code. The first adjustment will occur in FY 2021 and every third FY after.
38. Outlines the process and types of employers used to determine the *public safety wage index.* Specifies which agencies will be included in the first calculation of the *public safety wage index.*
39. Allows a member who terminates employment before age 55 to receive pension benefits if the member attains a normal retirement date and meets the credited service requirement for normal retirement. This is a retirement benefit and it is eligible for COLA increases.
    a. Current Tier I members have the option of a deferred annuity that is not considered a retirement benefit. Members must reach 62 years of age and have at least 10 years of service.
    b. Current Tier II(b) members do not have this option.

<u>Miscellaneous</u>

40. Defines *average monthly benefit compensation* as the five consecutive years within the last 15 years with the highest average. Includes a period of nonpaid or partially paid industrial leave based on the compensation the employee would have received if not on industrial leave.
41. Defines *normal retirement date* as the first day of the month after the employee completes 15 years of credited service, if the employee is at least 55 years old.
42. Defines *retirement* or *retired* as termination of employment after a member meets the age and credited service requirements for normal retirement.
43. States that if a member's employment is terminated, the liability associated with the member's service stays with the employer.

PSPRS Board of Trustees and PSPRS Advisory Committee (Committee)

<u>Board Makeup</u>

44. Increases the PSPRS Board of Trustees (Board) from seven to nine members on 1/1/2017 and outlines membership of the Board as follows:
    a. Two members representing law enforcement:
        i. One appointed by the President of the Senate, one by the Governor.
        ii. At least one appointee must be an elected local board member.
        iii. Nominations are forwarded from a statewide association representing law enforcement in the state to the appointing officials.
            — At least three nominees must be forwarded for each position.
    b. Two members representing firefighters:
        i. One appointed by the Speaker of the House, one by the Governor.
        ii. At least one appointee must be an elected local board member.
        iii. Nominations are forwarded from a statewide association representing firefighters in the state to the appointing officials.
            — At least three nominees must be forwarded for each position.
    c. Three members representing cities or towns

i. One appointed by the President of the Senate, one by the Speaker of the House and one by the Governor.
ii. Represent taxpayers or employers, cannot be members of PSPRS.
iii. Nominations are forwarded from an association representing cities and towns.
— At least three nominees must be forwarded for each position.

d. One member representing counties, appointed by the Governor:
i. Represents taxpayers or employers, cannot be members of PSPRS.
ii. Nominated by an association representing county supervisors.
iii. At least three nominees must be forwarded.

e. On member appointed by the Governor from a list of nominees forwarded by the Board.
i. The Board must forward at least three nominees.
ii. Nominees are first selected from a list of five received by the Committee.

45. States that Board members who are not PSPRS members must be independent qualified professionals who are responsible for the performance of fiduciary duties and other responsibilities required to preserve and protect the fund. They must have at least 10 years of substantial experience in specific areas of expertise.

46. Prohibits a *securities dealer* (A.R.S. 44-1801) who is involved in securities or investments related to PSPRS investments from serving on the Board.

47. Requires appointees to be chosen from the list of appointees provided to the elected official making the appointment.

48. Allows Board members to be reappointed.

49. Provides that Board members may only be removed for cause by the appointing power or due to vacating the member's seat. Outlines the process for removal for cause or vacating the office.

50. Requires Board vacancies to be filled for the vacancy of the term and specifies that vacancies are filled in the same manner as initial appointment.

51. Requires the Board to select a Chair from its members every calendar year.

52. Prescribes the initial appointment process for the Board. Initial nominees are due on 8/1/2016 with the first appointment being made by 11/1/2016. Eight members will elect the Chair who will appoint the Committee. In turn, the Committee will forward at least five nominees to the Board for determining the ninth member of the Board. The Board will select three nominees to send to the Governor and the Governor will select the ninth member of the Board from that list by 12/1/2016.

53. Provides initial terms of service for Board members.

Advisory Committee

54. Establishes a 10-member Committee on 1/1/2017 to serve as a liaison between the Board and its members.
a. Outlines Committee membership.

   b. Committee members are appointed by the Chair of the Board from names submitted by specified groups.

Governance

55. Requires the Board and any other PSPRS fiduciary to discharge duties:
    a. Solely in the interest of members and beneficiaries;
    b. For the exclusive purpose of providing benefits and paying reasonable administrative expenses;
    c. With care, skill and caution under the circumstances that a prudent person acting in a like capacity familiar with the matters would use in the conduct of an activity of like character and purpose;
    d. Impartially, taking into account differing interests of members and beneficiaries;
    e. Incurring only appropriate and reasonable costs; and
    f. Pursuant to a good-faith interpretation of the law governing the plans and systems under the Board.

56. Outlines specific considerations for the Board to make in investing and managing assets.

57. Requires the Board to:
    a. Diversify investments unless the trustee reasonably determines that it is clearly prudent not to; and
    b. Make a reasonable effort to verify facts relevant to the investment and management of assets.

58. Allows the Board to:
    a. Invest in any kind of property or type of investment consistent with these governance principles; and
    b. Consider benefits created by an investment in addition to only considering the investment return, but only if the trustee determines that the investment providing collateral benefits would be prudent without the collateral benefits.

59. Requires a trustee with authority to invest and manage assets to adopt a statement of investment objectives and policies for each retirement plan and system administered by the Board. Outlines information that must be included in the statement.

60. States that in evaluating trustee or fiduciary performance:
    a. Compliance with the governance principles must be determined in light of the facts and circumstances existing at the time of the action; and
    b. Decisions must be evaluated in the context of the portfolio as a whole and as part of an overall investment strategy as described.

61. Permits an employer, member, beneficiary or fiduciary to maintain an action:
    a. To enjoin an act, practice or omission violating the governance principles; and
    b. To redress the violation of or enforce governance principles.

62. Allows the court to award reasonable attorney fees and costs to either party.

63. Defines *fiduciary* and *trustee.*

Miscellaneous

64. Requires PSPRS to study methods for structured risk pooling and local board consolidation. The study:
    a. Will consider which methods, if any, are in the best interests of PSPRS stakeholders.
    b. Must be presented to the PSPRS Board by 1/15/2017.
    c. Must be considered by the Board. The Board is required to report any recommendations for legislation to the President, Speaker and the Governor by 2/15/2017.

65. Requires any *future benefit increase* adopted by the Legislature for any PSPRS member to be fully paid in the year of enactment (amortization over a period of years is prohibited). Splits the cost for future benefit increases as follows:
    a. Benefits for members hired before 7/1/2017 are paid by the employer; and
    b. Benefits for members hired on/after 7/1/2017 are split equally between the employee and the employer.

66. Outlines the actuarial method that must be used to calculate the cost of the *future benefit increase*.

67. Includes any benefit increase that leads to a change in the present value of future benefits or a change to accrued liabilities in the definition of a *future benefit increase.*

68. Requires each employer to make contributions to PSPRS that are sufficient to meet normal cost plus the actuarially determined amount required to amortize the unfunded accrued liability on a level percent of compensation basis for of all the employer's employees who are PSPRS members or PSPDC members, over a closed period of not more than 20 years as established by the Board.
    a. Current law provides for a rolling period of at least 20 but not more than 30 years.

69. Enrolls an employee who qualifies for disability within the first 90 days of employment in Tier III PSPRS for the remainder of the employee's employment as of the date of disability and grants the employee an accidental disability pension.

70. Makes sections related to the COLA for existing members and retirees, along with the section providing "catch up" payments under the PSPDC for employees hired after 1/1/2012 but before 7/1/2017 conditional upon the amendment of the Arizona Constitution by the passage of SCR 1019 at the May 17, 2016 special election.

71. Contains a legislative findings and intent clause.

72. Contains a severability clause.

73. Makes technical and conforming changes.

CURRENT LAW

A.R.S. Title 38, Ch. 5 governs state retirement plans, including the four plans that fall under the Public Safety Personnel Retirement System:

- PSPRS, covering law enforcement & firefighters;
- Corrections Officer Retirement Plan (CORP), covering correctional officers, specific prison personnel, probation and surveillance officers and some dispatchers;
- Elected Officials Retirement Plan (EORP), covering city, county and state elected officials along with judges. NOTE: this plan is closed to new members; and

- Elected Officials Defined Contribution Retirement System (EODCRS), the successor plan to EORP covering the same individuals.

These four Plans are governed by the Board, comprised of seven members appointed by the Governor and subject to Senate confirmation (A.R.S. § 38-848).

Benefit Structure

- **Tier I** covers members hired before 1/1/2012 and provides:
  - 20 year retirement (80% max):
    - — Uses the member's three highest years of salary (consecutive) in the last 20 years to establish the pension amount.
  - Retirees are eligible for a permanent benefit increase (PBI) if there is money available in the separate PBI account, up to 4% per year.
  - The PBI account is funded with ½ of all returns greater than 9% in any given year.

- **Tier II(a)** includes members who had less than 20 years of service on 1/1/2012.
- **Tier II(b)** covers members hired on or after 1/1/2012 and provides for:
  - 25 year retirement (max 80%), with a minimum age of 52 ½:
    - — Uses the five highest consecutive years of salary in the last 20 years for establishing the pension amount.
  - Retirees are eligible for a PBI only when returns exceed 10.5% and funded status is greater than 60%.
  - PBI amounts range from 2%-4% and are triggered based on funded status.

ADDITIONAL INFORMATION

According to the Arizona Public Safety Personnel Retirement System Actuarial Valuation (June 30, 2015), there are 237 participating employer groups representing 33,041 PSPRS members at various phases of participation (active, inactive, retired, disabled, survivors). The average age at retirement is 51.5 years old and the average annual pension is $59,974. The average number of years of service provided prior to retirement is 23.5. PSPRS has a current funded status of 50.3%.

PSPRS is an "agent multiple-employer" plan where employers pool assets for investment purposes but retain their own individual obligations (liabilities). Member contributions are statutorily capped at 11.65%, while the average employer rate is 42.61% (FY 2017). Actual funded status and employer rates vary across the plan (see Appendix III of actuarial valuation).

ARIZONA HOUSE OF REPRESENTATIVES
Fifty-second Legislature - Second Regular Session

ROLL CALL VOTE

COMMITTEE ON **INSURANCE** BILL NO. SB 1428

DATE February 10, 2016 MOTION: DP

	PASS	AYE	NAY	PRESENT	ABSENT
Mr. Coleman		X			
Mr. Larkin		X			
Mr. Lovas	X	X			
Ms. McCune Davis		X			
Ms. Otondo		X			
Mr. Robson		X			
Mr. Livingston, Vice-Chairman			X		
Ms. Fann, Chairman		X			
		7	1	0	0

COMMITTEE SECRETARY

APPROVED:

Karen Fann Chairman

KAREN FANN, Chairman
DAVID LIVINGSTON, Vice-Chairman

ATTACHMENT 8

HOUSE OF REPRESENTATIVES

SB 1429

public retirement systems; special election
Prime Sponsor: Senator Lesko, LD 21

X Committee on Insurance

Caucus and COW

House Engrossed

OVERVIEW

SB 1429 is an emergency measure that submits a constitutional amendment to public safety retirement at the special election on May 17, 2016.

PROVISIONS

1. Adds, in conjunction with the education finance special election held on May 17, 2016, a measure to amend the Arizona Constitution to provide for changes to public safety retirement by a vote of the people.
2. Requires submission of the Legislative Council analysis, Joint Legislative Budget Committee summary and arguments, with appropriate fee, to the Secretary of State (SOS) by February 23, 2016.
3. Applies general election laws except that the tabulation of votes by congressional districts is not required.
4. Contains an emergency clause.

CURRENT LAW

Any amendment to the Arizona Constitution may be proposed by: 1) the Legislature upon approval of a majority of members elected; or 2) an initiative petition signed by a number of qualified electors as outlined. The SOS is required to submit the proposed amendment to the vote of the people at the next general election, unless the Legislature calls for a special election. The proposed amendment is approved and ratified upon a majority of the qualified electors voting thereon. If more than one proposed amendment is submitted at any election, the proposed amendment must be voted in such a manner that the electors may vote for or against the proposed amendments separately (Arizona Constitution, Article XXI, §1).

ADDITIONAL INFORMATION

Laws 2015, First Special Session, Chapter 2 set forth provisions for holding a special election on May 17, 2016, to vote on education finance.

ATTACHMENT 9

ARIZONA HOUSE OF REPRESENTATIVES
Fifty-second Legislature - Second Regular Session

ROLL CALL VOTE

COMMITTEE ON INSURANCE BILL NO. SB 1429

DATE February 10, 2016 MOTION: DP

	PASS	AYE	NAY	PRESENT	ABSENT
Mr. Coleman		X			
Mr. Larkin		X			
Mr. Lovas		X			
Ms. McCune Davis		X			
Ms. Otondo		X			
Mr. Robson		X			
Mr. Livingston, Vice-Chairman			X		
Ms. Fann, Chairman		X			
		7	1	0	0

[signature]
COMMITTEE SECRETARY

APPROVED:

Karen Fann Chairman

KAREN FANN, Chairman
DAVID LIVINGSTON, Vice-Chairman

ATTACHMENT 10

HOUSE OF REPRESENTATIVES

SCR 1019

public retirement system benefits
Prime Sponsor: Senator Lesko, LD 21

X Committee on Insurance

Caucus and COW

House Engrossed

OVERVIEW
SCR 1019, upon voter approval, provides an exception for certain adjustments to the Public Safety Personnel Retirement System (PSPRS).

PROVISIONS
1. Excludes certain adjustments to PSPRS from the prohibition of diminishment or impairment of benefits as provided in SB 1428 enacted by the 52nd Legislature, Second Regular Session.
2. Provides that the Legislature's ability to modify prospective PSPRS member benefits is unrestricted.
3. Requires the Secretary of State to submit this proposition to the voters at a special election held on May 17, 2016.
4. Makes technical changes.

CURRENT LAW
PSPRS is funded with contributions and investment earnings using actuarial methods and assumptions. The assets, including investment earnings and contributions, are separate and independent trust funds and are required to be invested, administered and distributed solely in the benefit of the members and beneficiaries of PSPRS. Membership in PSPRS is a contractual relationship and benefits are prohibited from being diminished or impaired (Arizona Constitution, Article XXIX, § 1).

ADDITIONAL INFORMATION
According to the PSPRS 2015 actuarial report, there are 237 participating employer groups representing 33,041 PSPRS members at various phases of participation (active, inactive, retired, disabled, survivors). The average age at retirement is 51.5 years old and the average annual pension is $59,974. The average number of years of service provided prior to retirement is 23.5. PSPRS has a current funded status of 50.3%.

PSPRS is an "agent multiple-employer" plan where employers pool assets for investment purposes but retain their own individual obligations (liabilities). Member contributions are statutorily capped at 11.65%, while the average employer rate is 42.61% (FY 2017). Actual funded status and employer rates vary across the plan.

ATTACHMENT 11

ARIZONA HOUSE OF REPRESENTATIVES
Fifty-second Legislature - Second Regular Session

ROLL CALL VOTE

COMMITTEE ON INSURANCE BILL NO. SCR 1019

DATE February 10, 2016 MOTION: DP

	PASS	AYE	NAY	PRESENT	ABSENT
Mr. Coleman		X			
Mr. Larkin		X			
Mr. Lovas		X			
Ms. McCune Davis		X			
Ms. Otondo		X			
Mr. Robson		X			
Mr. Livingston, Vice-Chairman			X		
Ms. Fann, Chairman		X			
		7	1	0	0

COMMITTEE SECRETARY

APPROVED:

Karen Fann Chairman

KAREN FANN, Chairman
DAVID LIVINGSTON, Vice-Chairman

ATTACHMENT 12

ARIZONA STATE LEGISLATURE

Fifty-second Legislature - Second Regular Session

COMMITTEE ATTENDANCE RECORD

COMMITTEE ON **INSURANCE**

CHAIRMAN: Karen Fann VICE-CHAIRMAN: David Livingston

DATE	02/10 /16	/16	/16	/16	/16
CONVENED	8:35A. m	m	m	m	m
RECESSED					
RECONVENED					
ADJOURNED	12:10 P.M.				
MEMBERS					
Mr. Coleman	X				
Mr. Larkin	X				
Mr. Lovas	X				
Ms. McCune Davis	X				
Ms. Otondo	X				
Mr. Robson	X				
Mr. Livingston, Vice-Chairman	X				
Ms. Fann, Chairman	X				

√ Present --- Absent exc Excused

ATTACHMENT 13