

# Fiscal Note

**BILL #** SB 1145

**TITLE:** ABOR; optional retirement programs

**SPONSOR:** Petersen

**STATUS:** As Introduced

**PREPARED BY:** Morgan Dorcheus

## Description

The bill would make all university employees hired on or after January 1, 2023 eligible for the University Optional Retirement Program (UORP). Other than administrative officers, faculty and law enforcement, university employees now participate in the Arizona State Retirement System (ASRS).

## Estimated Impact

We cannot determine the overall fiscal impact of this bill, given that the impact involves multi-year changes across the University personnel system and interactions with the overall actuarial valuation of the ASRS system.

The bill's direct fiscal impact would involve the universities generating savings due to the UORP employer contribution rate being lower than the ASRS employer contribution rate. In the first year, we estimate the university savings as \$(270,500) from the General Fund and \$(1.1) million from tuition and other agency funds, for total savings of \$(1.4) million. These university savings would increase over time as new employees are hired and opt in to UORP, which would gradually increase the proportion of total University payroll that is enrolled in the UORP system. Whether the General Fund realizes these cost savings would depend on legislative action to recoup the savings from university budgets.

As university ASRS participation decreases, the ASRS contribution rate would increase to cover the existing cost of the system's unfunded liability, which increases costs for non-university employees and employers. ASRS estimates that the bill would shift a total of \$6.0 million to non-university contributors in the first year, but this estimate assumes that all newly-hired university employees opt to participate in UORP. Based on our research for retirement option selection in other states, we believe that UORP enrollment will be significantly less than 100% for newly eligible employees. Adjusting the formal ASRS analysis for this assumption would result in approximately \$750,000 in ASRS cost shifts to other non-university ASRS participants in the first year. This cost shift would increase in future years with the growth in the number of university participants in UORP. While we have attempted to estimate the initial impact of the cost shift, we are unable to determine the exact distribution of this cost shift among the state and other ASRS employers.

The overall impact would depend how many university employees choose to participate in UORP in the long term, the total magnitude of any ASRS cost shift, and how the cost shift would be shared between state entities and other non-state ASRS participants. Determining this overall impact would require a formal actuarial study and is outside the scope of this analysis.

## Analysis

The Arizona State Retirement System (ASRS) offers a defined benefit plan where state employees and their employers both make equivalent contributions as a percent of payroll. The ASRS contribution rate for both employees and employers during FY 2022 is 12.41%. Current statute requires all University employees to participate in ASRS, with the exception of: 1) Sworn police officers (who participate in the Public Safety Personnel Retirement System); and

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2) University faculty members and administrative officers who opt out of ASRS participation and instead enroll in the University Optional Retirement Plan (UORP). UORP is a defined contribution plan where the employee and employer contribute 7% of payroll. The bill would allow all non-police university employees hired on or after January 1, 2023 to participate in UORP.

The bill will have 2 different fiscal impacts:

- The Universities will see direct savings from each new employee that enrolls in UORP, since the 7% UORP employer contribution rate is (5.41)% below the current ASRS employer contribution rate of 12.41%. These direct savings would change in future years depending on standard variations in the ASRS employer contribution rate over time.
- The statewide ASRS employer contribution will be higher due to new University employees enrolling in UORP. ASRS retirement contribution rates are determined by calculating the total contribution necessary to meet the retirement system's future obligations. Currently, the contribution rate calculation includes anticipated enrollment of new employees in entities that participate in ASRS. By allowing some future participants to opt for UORP, the unfunded liability will be distributed among a smaller number of participants. Therefore, current and future participants would pay a higher contribution rate based on a smaller number of contributions from future employees.

#### Direct University Savings

During FY 2020 and FY 2021, the Universities hired 2,475 and 1,229 employees that were enrolled into ASRS because they were not eligible for participation in UORP. These types of employees would be eligible to participate in UORP under SB 1145. Based on this data, we assume newly-eligible hires will total 2,000 each year.

Of these 2,000 newly-eligible hires each year, we assume that 25% will elect to participate in UORP instead of ASRS. This assumption is based on the experience of the State of Florida, which since 2002 offers all new employees the option of selecting a defined benefit or defined contribution plan. The Florida Retirement System reports that as of FY 2020, 25.6% of all employees were enrolled in the defined contribution plan.

In addition, based on ABOR's FY 2021 Annual Personnel Report, we assume the average salary for the newly eligible positions is \$50,000.

Combining the following factors results in total estimated annual University savings of \$1.4 million: 500 new employees selecting UORP X \$50,000 average salary X (5.41)% contribution rate reduction = \$1,352,500. Based on the relative fund sources as reported in FY 2023 University budget requests, we assume 20%, or \$270,500, would be from the General Fund and the remaining \$1.1 million would be from tuition and other university funds.

As noted above, our estimate of this direct fiscal impact is based on drawing broad conclusions from recent Arizona University hiring data and retirement plan selection data from Florida. A more detailed estimate would require a formal actuarial study, which typically includes assumptions of new hires/retirements, payroll/salary growth, and other behavioral aspects such as benefit plan selection.

Since university General Fund appropriations do not revert at the end of each fiscal year, the state will only realize General Fund savings if the Legislature decreases each university's General Fund appropriation to recoup the estimated savings.

#### Increased Statewide ASRS Costs

In order to estimate the impact of a higher statewide ASRS employer contribution rate, we asked ASRS for their estimated fiscal impact of the bill. ASRS provided an analysis that estimates SB 1145 would result in \$6.0 million of annual contribution rate increases for non-university ASRS entities, however this amount includes the impact to both employees and employers. In addition, this ASRS estimate assumes all new university employees would choose to participate in UORP.

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Using the same assumptions as above, if only 25% of new university employees opted to participate in UORP, the cost shift in the first year would be approximately \$1.5 million, based on an informal adjustment of the ASRS cost estimate. Given the ASRS 50/50 cost sharing model, of the \$1.5 million shift, non-university employees and employers would each be responsible for \$750,000.

Because most ASRS contributors are non-state employees (87% of members), the bill could result in total net savings to the state General Fund as non-state contributors would realize a significant portion of the cost shift. Ultimately, the net impact would depend on a number of factors, including how the cost shift is shared between state entities and other non-state ASRS participants and how the ASRS contribution rate changes over time in response to the increasing UORP enrollment. Therefore, we cannot predict the overall cost shift impact of the bill without a formal actuarial analysis.

#### Forfeited Contributions

If an employee participating in UORP leaves university service before vesting (5 years), 100% of the employer contributions to the employee's account are forfeited. In FY 2020, ABOR reported \$2.1 million in forfeitures. Current statute requires that forfeited employer contributions "be refunded to the state". The bill would make changes to specify that the contributions are "forfeited to the institution and used to make future employer contributions". ABOR has indicated that this is a technical change to conform to federal IRS requirements governing how forfeitures can be used and is consistent with current practice.

#### **Local Government Impact**

To the extent that new university employees choosing to participate in UORP causes the ASRS contribution rate to increase, costs for local governments that participate in ASRS would increase. As noted above, these costs cannot be determined in advance without a formal actuarial study.

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