Fiscal Note

BILL # HB 2329

TITLE: ~~procurement; director; technical correction~~
NOW: CORP; employee enrollment; membership; election

SPONSOR: Payne

STATUS: As Amended by House MAPS

PREPARED BY: Gordon Robertson

Description

The bill would allow Corrections Officer Retirement Plan (CORP) members hired on or after July 1, 2025 to make a one-time election to participate in either the CORP defined benefit plan ("CORP DB Plan") or the Public Safety Personnel Retirement System Defined Contribution Retirement Plan ("PSPRS DC Plan"). In addition, the bill would allow CORP members hired between July 1, 2018 and the general effective date of the bill (who by default are in the PSPRS DC Plan) to make a one-time election to participate in the CORP DB Plan. The bill would also require the PSPRS Board of Trustees to provide education and information about the CORP DB Plan and the PSPRS DC Plan to CORP members hired on or after July 1, 2025 within their first 60 days of employment.

Estimated Impact

We estimate the bill will generate General Fund savings of up to $(1.8) million in FY 2025 based on a lower employer contribution rate in the CORP DB Plan relative to PSPRS DC Plan. This impact, however, only represents the short-term fiscal impact of the proposal by comparing the fixed PSPRS DC Plan employer contribution rate to the startup employer contribution rate of the CORP DB Plan as it opens to this new class of employees with no unfunded liability.

Over the long-term, if the CORP DB Plan for this class of employees generates unfunded liability, the employer contribution rate would likely increase above the PSPRS DC Plan employer contribution rate, generating increased costs to the state. The future change in the employer contribution rate would depend on a number of actuarial assumptions that we cannot estimate in advance.

We have not attempted to assess whether the bill would change the retention rate of CORP employees and any corresponding fiscal impact.

In addition, there will be additional administrative workload for PSPRS Staff associated with opening the CORP DB Plan to this new class of employees and providing the required educational materials to those employees. The actual cost of these changes would depend on the workload required to adjust the PSPRS Board of Trustees administrative systems and the specific materials used to comply with the bill's education and plan information requirements.

PSPRS staff estimates that alterations to the PSPRS administrative IT system to accommodate the additional retirement options available to members would cost between $1.5 million and $2.5 million in one-time IT expenses.

Analysis

<u>Benefit/Plan Changes</u>
Under current law, except for probation and surveillance officers employed by the Administrative Office of the Courts (AOC), all CORP members hired after July 1, 2018 (generally known as "Tier 3" members) are automatically enrolled in PSPRS DC Plan.

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Tier 3 AOC probation and surveillance officers are given the option to enroll in either the PSPRS DC Plan or the CORP DB Plan, with a selection required within 90 days; otherwise, the employee defaults to the defined benefit plan. The Tier 3 CORP DB Plan currently available to these AOC employees is a benefit structure specific to employees hired after July 1, 2018.

The bill would allow CORP members hired on or after July 1, 2025 to make a one-time election to participate in either: 1) the Tier 3 CORP DB Plan (same as currently only available to probation and surveillance officers); or 2) the PSPRS DC Plan. Under the bill, if the new employee does not make a selection within 90 days of employment, the employee defaults to the Tier 3 CORP DB Plan. In addition, the bill would allow existing non-probation/surveillance officer Tier 3 CORP members hired between July 1, 2018 and the general effective date of the bill to make a one-time election to participate in the CORP DB Plan.

<u>Fiscal Impact – Normal Cost</u>

The CORP employer contribution rate has 2 components. The first component is the normal cost, which is the immediate cost associated with the benefit being earned. The second component is the unfunded liability, which represents prior benefits earned by members that are unfunded due to changes in the plan's actuarial performance or assumptions.

The bill would create an entirely new class of defined benefit members – for example, there would now be Tier 3 employees at the Arizona Department of Corrections enrolled in a defined benefit plan. Because of this, in the short-term the employer costs would only relate to the normal cost, as there would not have been time for any unfunded liabilities to develop due to missed actuarial assumptions (for example, lower than expected investment returns).

The <u>employer</u> contribution rate for the CORP Tier 3 DB Plan is based on 33.33% (one-third) of the normal cost of the member's pension and health benefits. Based on actuarial data provided by PSPRS, we estimate that the total (employee + employer) normal cost of the CORP Tier 3 DB Plan newly available to members would be approximately 14%. The <u>employer</u> share of this cost would be 4.67% (14.0% X 33.33%).

Under the PSPRS DC Plan, the employer contribution rate includes a base 5% rate deposited into the member's retirement account as well as 50% of the normal cost associated with the member's health and disability benefits (currently 0.67% combined). Therefore the current <u>employer</u> contribution rate for the PSPRS DC Plan is 5.67%.

Comparing the 4.67% CORP DB Plan employer contribution rate to the 5.67% PSPRS DC Plan employer contribution rate results in a (1.00%) decrease in the employer contribution rate for CORP Tier 3 members.

The total FY 2025 Tier 3 salary base for state CORP employers is approximately $177 million. If applied against this entire salary base, the (1.00%) difference in contribution rates would generate up to $(1.8) million in savings in FY 2025 (*see Table 1*). Given the very small magnitude of non-General Fund sources used for these costs, for the purposes of this analysis these savings amounts are assumed to accrue entirely to the General Fund.

Table 1

HB 2329 - Change in Tier 3 Agency Normal Costs

	FY 2025 Salary Base	(1%) Change in FY 25 Cost
Corrections Officer - ADC	$ 166,088,400	$ (1,660,900)
Corrections Officer - DJC	$ 10,388,100	$ (103,900)
Detention Officer - DPS	$ 353,700	$ (3,500)
Total	$ 176,830,200	$ (1,768,300)

The actual short-term General Fund impact would depend on the actual proportion of employees who elected to participate in the CORP DB Plan instead of remaining in the PSPRS DC Plan. For comparison purposes, as a percentage of payroll, the AOC Probation/Surveillance Officer employer group (with the current DB/DC option) has approximately 61% of employees enrolled in the CORP DB Plan.

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The employee contribution rate for the CORP Tier 3 DB Plan is based on the remaining 66.67% (two-thirds) of the normal cost of the member's pension and health benefits. We estimate that the required employee contribution rate for the CORP Tier 3 DB Plan newly available to members would be 9.33% (14.0% X 66.67%).

Under the PSPRS DC Plan, members may choose retirement account contributions of anywhere from 5% up to the maximum limit established by the federal IRS, with a default rate of 7%. In addition, the employee is required to pay 50% of the normal cost associated with the member's health and disability benefits (currently 0.67% combined). Assuming this default 7% base contribution rate, along with the 0.67% for health/disability benefits, the current employee contribution rate for the PSPRS DC Plan is 7.67%.

Fiscal Impact – Unfunded Liability Cost

In the short-term, the bill is not expected to have an additional fiscal impact due to unfunded pension liabilities. This is based on 2 separate issues:

- "Legacy" Tier 1/Tier 2 Pension Liabilities – Under the state's recent pension reforms (for both PSPRS and CORP), unfunded pension liability payments for the now closed Tier 1 and Tier 2 plans are paid by the employer on the entire payroll base. Under that process, the plan actuaries calculate a percentage rate to assess for Tier 1/2 unfunded liabilities. That same percentage rate is then added to the employer normal cost for Tier 1/2 defined benefits employees and also added to the employer normal cost for Tier 3 defined contribution employees. Therefore, the bill allowing for the shift of Tier 3 PSPRS DC Plan employees over to the Tier 3 CORP DB Plan will not impact any payments for closed employee tiers, as the same percentage rate would be assessed regardless of plan choice.
- Tier 3 Unfunded Pension Liabilities – As noted above, in the short-term the newly added Tier 3 CORP DB Plan employees would have no unfunded pension liability associated with them.

Over the long-term, if the CORP DB Plan for this class of employees generates unfunded liability, the state's cost under the bill would increase. Under the Tier 3 CORP DB Plan's structure, any unfunded liability associated with Tier 3 employees is shared 50/50 between the employee/employer. Therefore, if the bill generates Tier 3 unfunded liabilities for these employees, it is likely that the 4.67% employer normal cost plus the 50% employer share of unfunded liability will exceed the 5.67% PSPRS DC Plan employer contribution rate. The future change in the CORP DB Plan employer contribution rate would depend on a number of actuarial assumptions that we cannot estimate in advance.

Fiscal Impact – PSPRS Administrative Costs

PSPRS Staff estimates that administrative costs to implement the bill would be between $1.5 million and $2.5 million for one-time IT development costs.

In addition, the bill requires the PSPRS Board of Trustees to provide employees hired after July 1, 2025 with "interactive, objective educational training, counseling, and participant-specific plan information" about both the CORP DB Plan and the PSPRS DC Plan. We estimate that this policy change required by the bill would generate additional workload for PSPRS Staff related to providing the required educational materials for new employees. The actual cost of the retirement education requirements would depend on the amount of time necessary to develop and disseminate the materials.

Local Government Impact

We estimate the bill would also generate short-term savings related to detention staff employed by each county and the city of Avondale (the latter being the only city with a detention class). As with state agencies, all Tier 3 CORP detention staff are automatically enrolled in the PSPRS DC Plan, so the same (1.00%) decrease in employer contribution rates applies to each of these local employer groups. By multiplying this change in employer contribution rates against the total local Tier 3 salary base, we estimate the bill would generate up to $(457,100) in local government savings in FY 2025 (*see Table 2).*

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Table 2

HB 2329 - Change in Tier 3 Local Normal Costs

	FY 2025 Salary Base	(1%) Change in FY 25 Cost
Apache County	$ 608,000	$ (6,100)
Cochise County	$ 889,300	$ (8,900)
Coconino County	$ 1,696,600	$ (17,000)
Gila County	$ 1,138,300	$ (11,400)
Graham County	$ 1,259,500	$ (12,600)
La Paz County	$ 444,700	$ (4,400)
Maricopa County	$ 17,560,700	$ (175,600)
Mohave County	$ 2,078,700	$ (20,800)
Navajo County	$ 1,332,400	$ (13,300)
Pima County	$ 8,517,600	$ (85,200)
Pinal County	$ 1,989,700	$ (19,900)
Santa Cruz County	$ 996,300	$ (10,000)
Yavapai County	$ 4,006,800	$ (40,100)
Yuma County	$ 3,123,200	$ (31,200)
City of Avondale	$ 60,200	$ (600)
Total	**$ 45,702,000**	**$ (457,100)**

3/11/24