2016 ARIZONA PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM PENSION REFORM

FUN! FUN! FUN!

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EDITORIAL THE REPUBLIC EDITORIAL BOARD

Pensions sliding into deeper hole if steps not taken

Figuring out the future of public-employee pension plans is a complicated business, usually.

For our convenience, however, the Arizona Auditor General's Office conducted a 10-year performance examination of the state's public-safety retirement system, as well as two other state retirement plans, and arrived at a simple one-word conclusion:

"Deteriorating."

That the Public Safety Personnel Retirement System, or PSPRS, is in bad shape is not a new finding.

Arizona's political leadership has known for years that its pension plan for retired public-safety officers was far worse off than other public-employee plans, none of which is flush with cash.

Leaders taken steps to stabilize the PSPRS, as well as the other two retirement systems examined by the auditor general, the Corrections Officers Retirement Plan and the Elected Officials' Retirement Plan.

The most serious of those efforts, however, was foiled in 2014 when the state Supreme Court concluded the state's contracts with retirees cannot be altered once offered.

As a result, the deterioration of the pension plans appears to be accelerating.

officer plans are "multiple employer" plans, meaning local agencies are responsible for their own pension obligations.

Some smaller local agencies do not have the resources to pay their end of those obligations this year, much less into the future.

PSPRS administrators point to recent court decisions as a major reason Arizona's public pensions can't pull themselves out of the liability hole. The auditor general agrees.

The auditors concluded that required permanent benefit increases keep the systems sliding toward insolvency.

Even if the systems earn more on investments, the formulas require them to increase payments to beneficiaries. Half of every earned dollar must be paid to members.

The systems, which are required to invest prudently and responsibly, would have to earn crazy money on investments to start growing again. That isn't going to happen.

"By design and structure, that (payout formula) depletes money out of the system faster than you can replace it with investment returns," PSPRS administrator Jared Smout said Tuesday.

In 2011, state legislators attempted

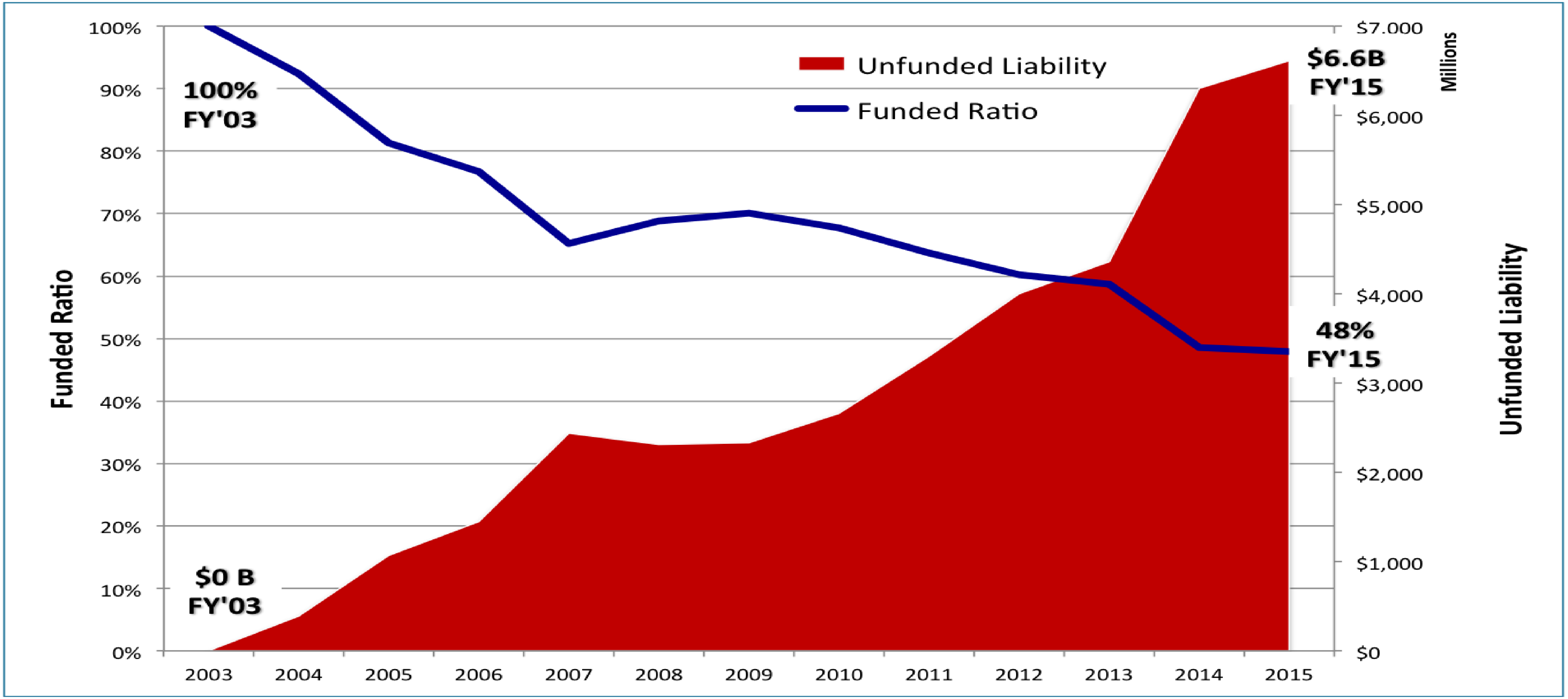
THE PROBLEM

How did we get here????

We Had 3 Major Problems

1. Underperforming investment returns (2 dramatic downturns in last decade)
2. Unrealistic expected rate of return
3. Permanent Benefit Increases (PBI) have hurt plan's solvency while giving 4% compounding retiree raises for 29 consecutive years while the system has been tanking

PSPRS Degrading Solvency



Causes of Problems With PSPRS:

PSPRS' Expected Rate of Return is Unrealistic

- 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
- If the pattern of 5% average actuarial return continues, unfunded liabilities and normal cost will increase dramatically in the coming years

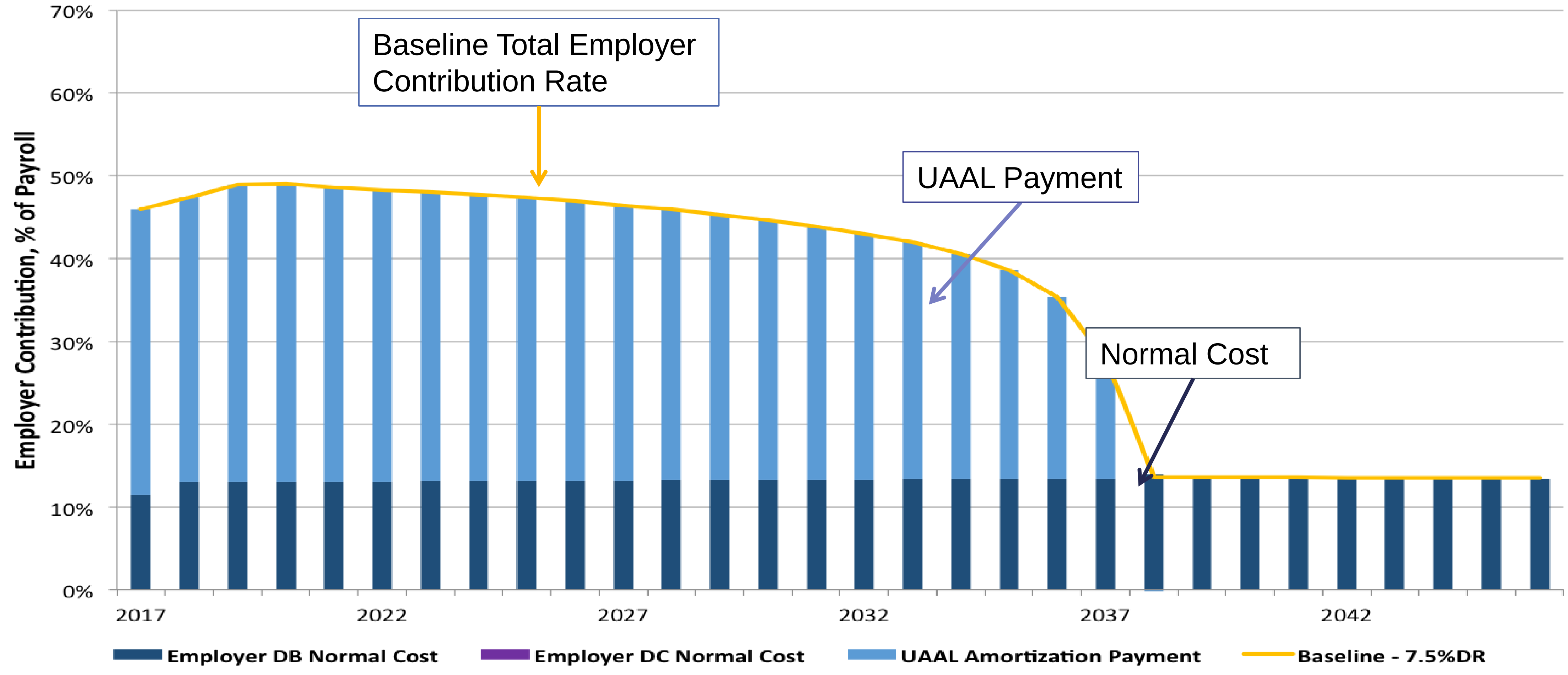
Causes of Problems With PSPRS:

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.

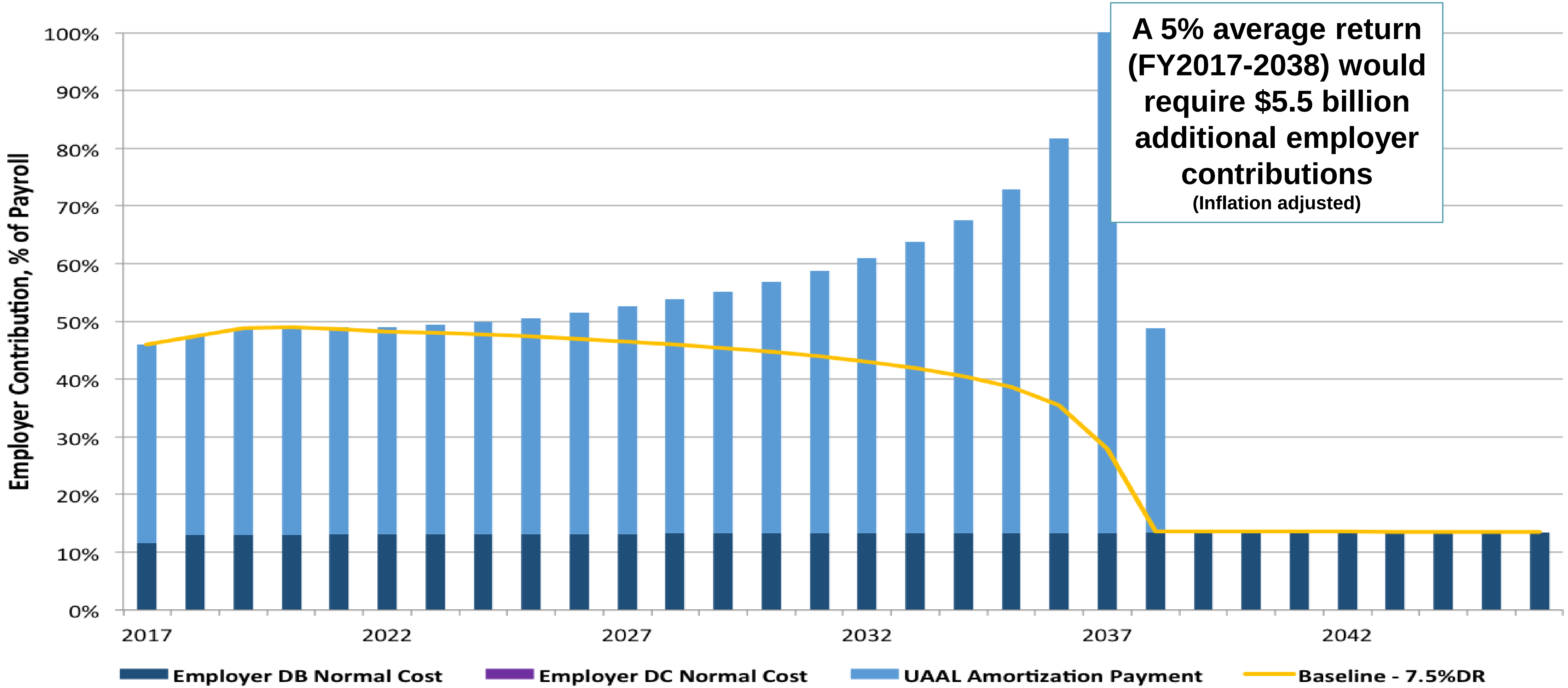
PSPRS 7.5% Assumed Interest

Employer Contribution as % of Payroll



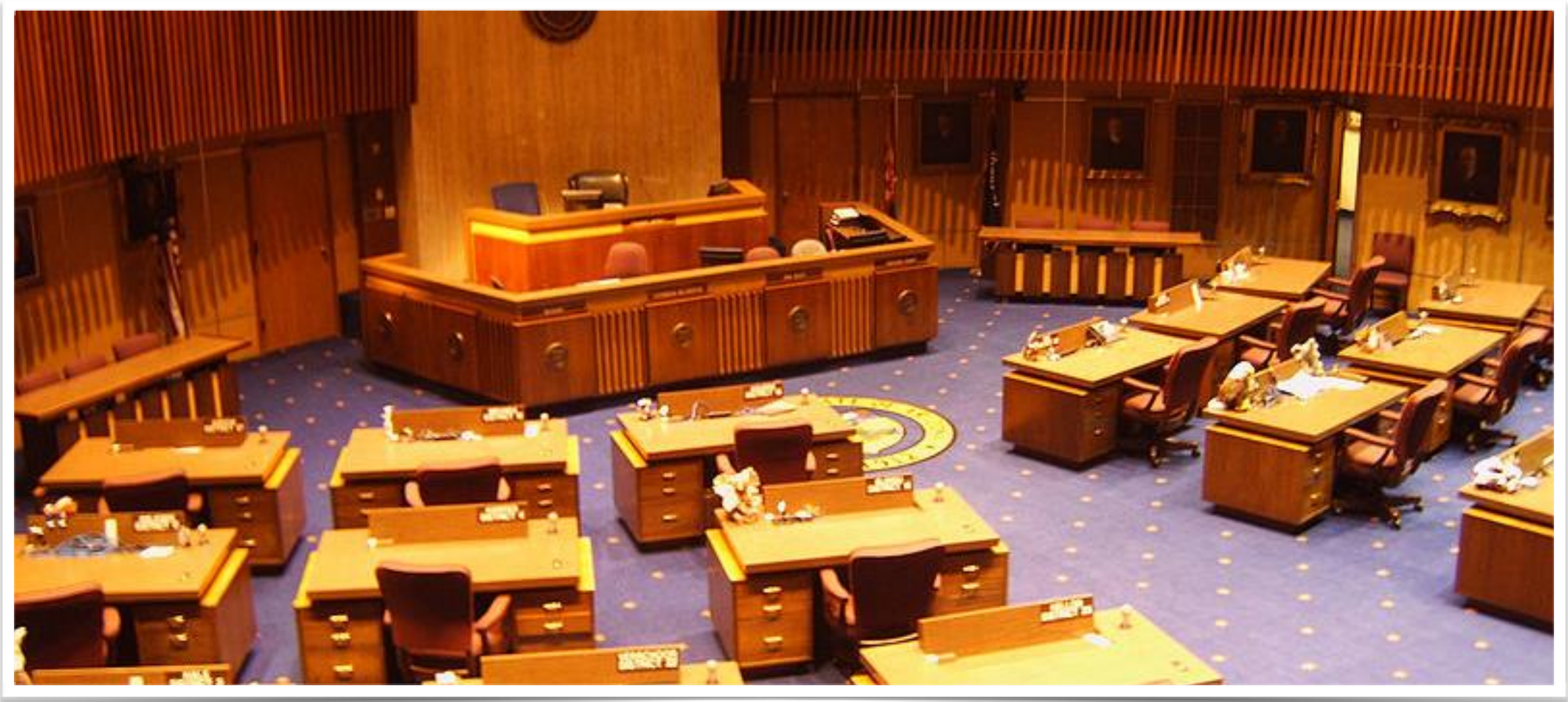
PSPRS

Employer Cost & Funded Ratio, w/ 5% Return



The light blue bars above the yellow line represent $5.5 billion in *additional* pension debt payments for taxpayers if returns are just 5.0% instead of the expected 7.5%.

PHOTO BY: Willem van Bergen



In 2011, the Arizona Legislature addressed pension reform.

We agreed with most of the reforms; however we held deep concerns that their solution – SB1609 – was not Constitutional.

Unfortunately....

In *Fields* in March 2014, the Arizona Supreme Court ruled that

SB1609 illegally diminished benefits of pension recipients.

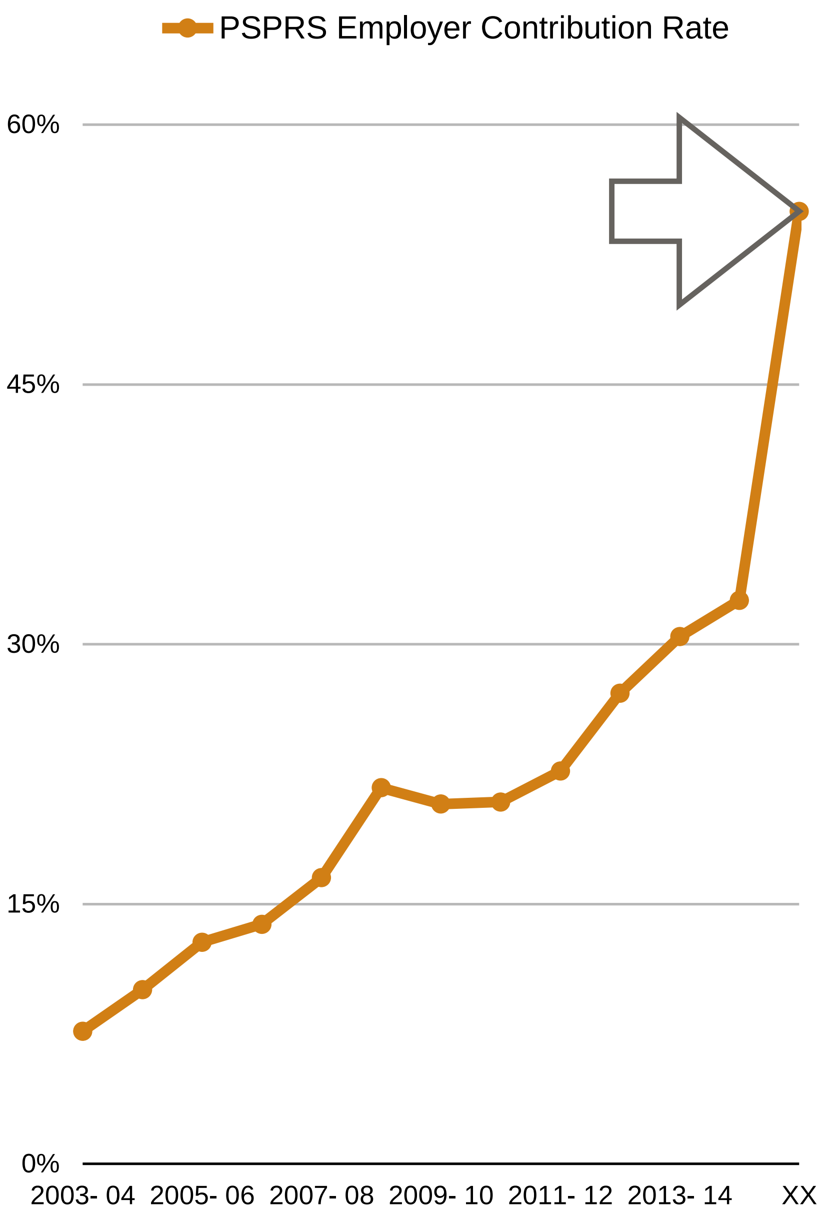
SB1609 illegally changed the retiree COLA formula.

Retired Judge Ken Fields PHOTO BY: Jack Kurtz/The Arizona Republic

$375 million.

This ruling will cost the fund (and AZ taxpayers)

- $40 million in back payments to retirees
- $335 million to re-establish the Excess Earnings Account
- **Making these payments will push employer contribution rates to more than 55%.**



MORE CASES TO COME………

Very likely that most of not all aspects of 1609 will be reversed.

Hall Case

The Risks of Inaction

1. Rising employer contribution rates result in more money to pensions, crowding out other public services
2. Inability to fill open positions
3. No funding for training or necessary equipment
4. Inability to raise public safety wages
5. New tax & debt proposals
   - (e.g., failed Prescott PSPRS tax, pension obligation bonds)
6. Service-level insolvency
7. Municipal bankruptcy
8. Inaction is not a choice

THE PROCESS

A collaborative approach to develop a proposed reform for PSPRS

The Reform Development Process

- Fire Fighters Develop a plan after SB 1609

- Collaborative stakeholder working groups
  - Public safety associations (PFFA, PLEA, FOP,)
  - Representatives from the Office of Governor Doug Ducey
  - Legislative pension workgroup, led by Sen. Lesko, 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 have 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

Minimize contribution rate volatility

ELIMINATE THE PBI

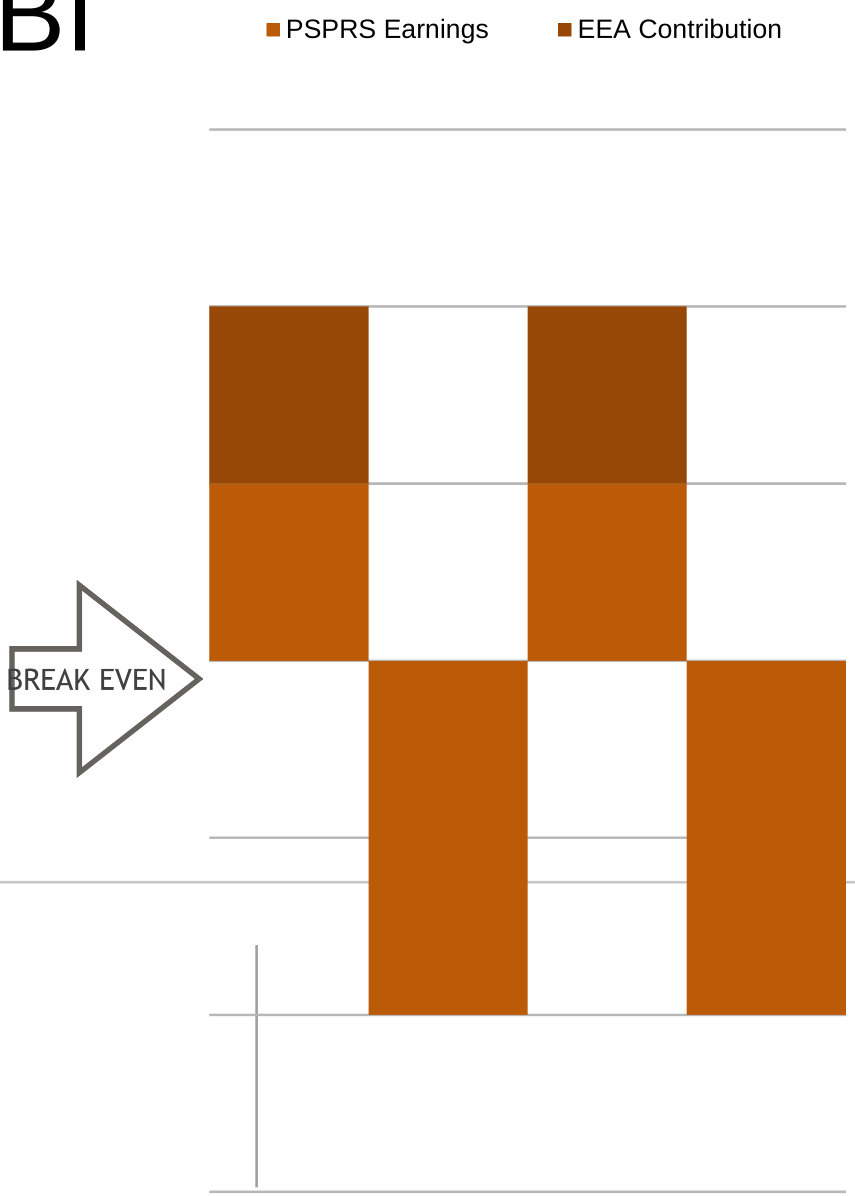
Today, if PSPRS earns over the 9% assumed earnings rate, half that money stays in the Fund.

The other half goes into the Excess Earnings Account.

By draining the main fund during profitable years, we slow its recovery and lower the funded level.

Actuaries say the Excess Earnings Account is 80% of the PSPRS problem.

Why? Because for 29 consecutive years retirees have received a 4% annual COLA. That simply isn't sustainable.



CREATE GENERATIONS/TIERS

- Tier 1 – 20 years of service prior to January 2012
- Tier 2a – Hired prior to January 2012
- Tier 2b – Hired after January 2012
- Tier 3 – Hired after July 2017

CHANGE GOVERNANCE

TRYING TO PREVENT THIS FROM EVER HAPPENING AGAIN

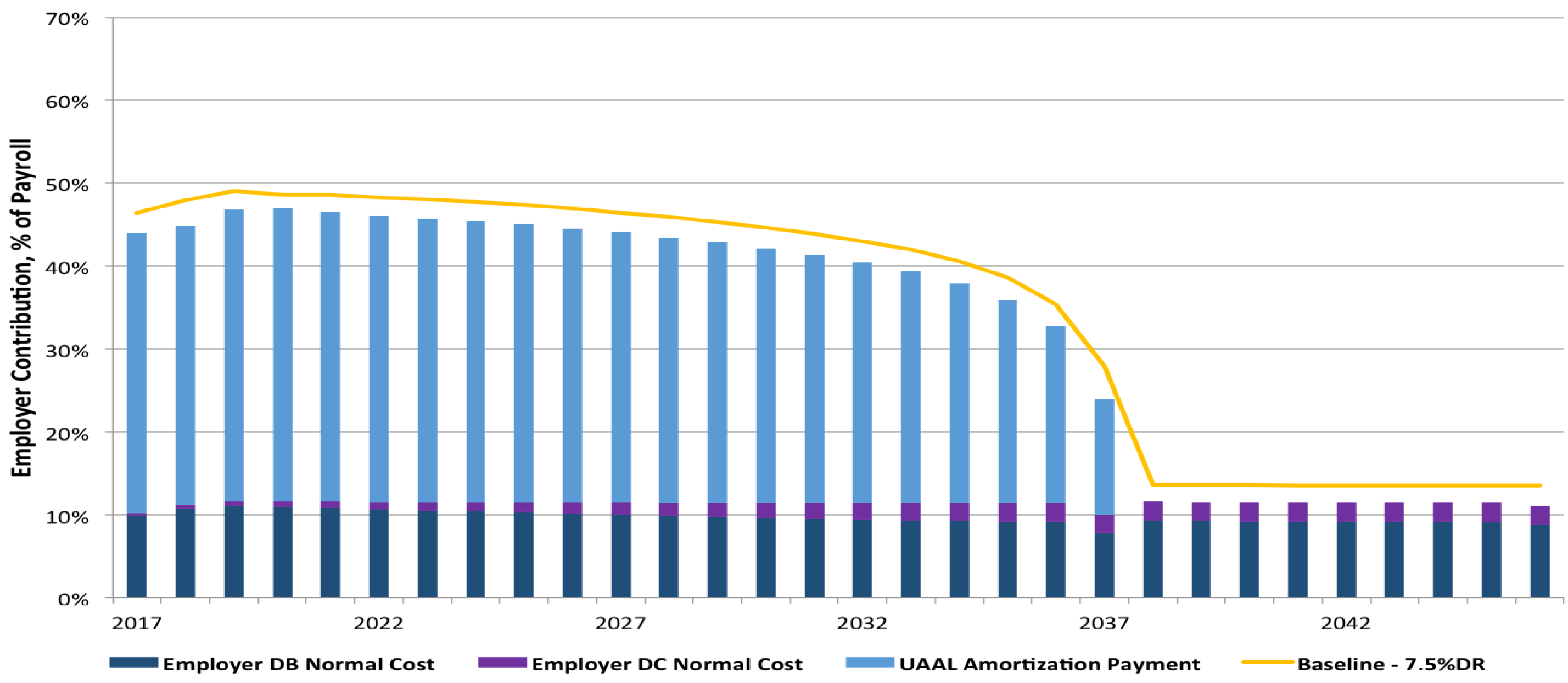
GOVERNANCE

- Guardrails
- Balance the risk between employees and employers
- Balance seats on the PSPRS board to reflect risk
- New generation not responsible for past liability
- Best practices from many other well designed systems

- 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. Remember when times were good, the employers paid very little. This would not happen again.
- Addition of advisory committee to include other stakeholders

THE SOLUTION IMPACT:

FISCAL IMPACT: EMPLOYER PAYROLL COSTS WILL GO DOWN



TOTAL SAVINGS TO THE PSPRS

1/2 BILLION DOLLARS OVER NEXT 30 YEARS

21% REDUCTION IN LIABILITIES

PREDICTABLE AND STABLE FUTURE

CONCLUSION

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

How Well Proposals Meet Objectives

Element	Baseline	Proposed Reform
(1) Provide Retirement Security for Members & Retirees	**UNCERTAIN** *Broken PBI design & unfunded liabilities threaten plan solvency*	**YES** *Retained a sustainable 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** *21% Reduction in Accrued Liabilities by 2046, 50% Reduction in Potential New Hire Unfunded Liability Costs for*
(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.

THE PLAN EXECUTION

POLITICAL PROCESS TO GET THIS DONE

Legislative

Senate unanimous – 49 House

GOVERNOR DUCEY SIGNS PUBLIC SAFETY PENSION REFORM

The Washington Times

THE ARIZONA REPUBLIC

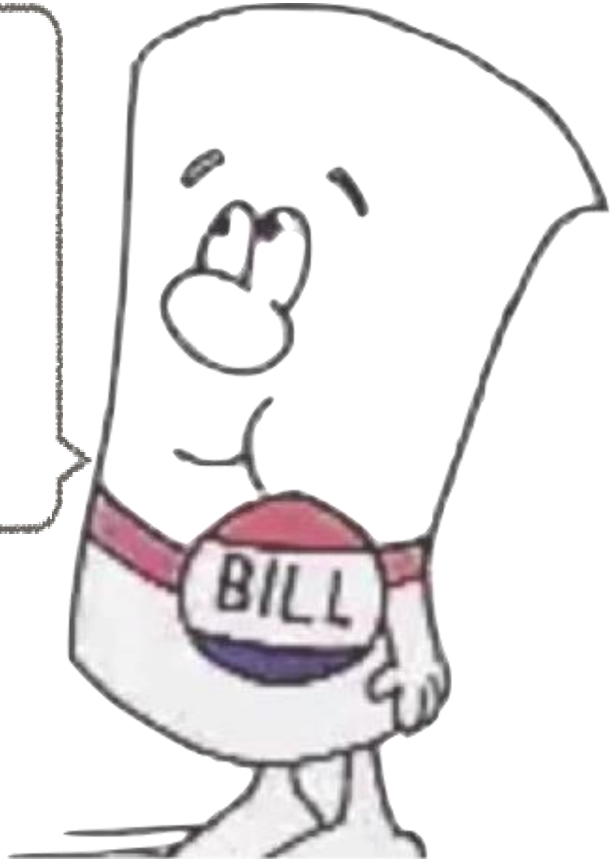
ARIZONA CAPITOL TIMES
Your Inside Source for Arizona Politics, Government and Business

Arizona Daily Star

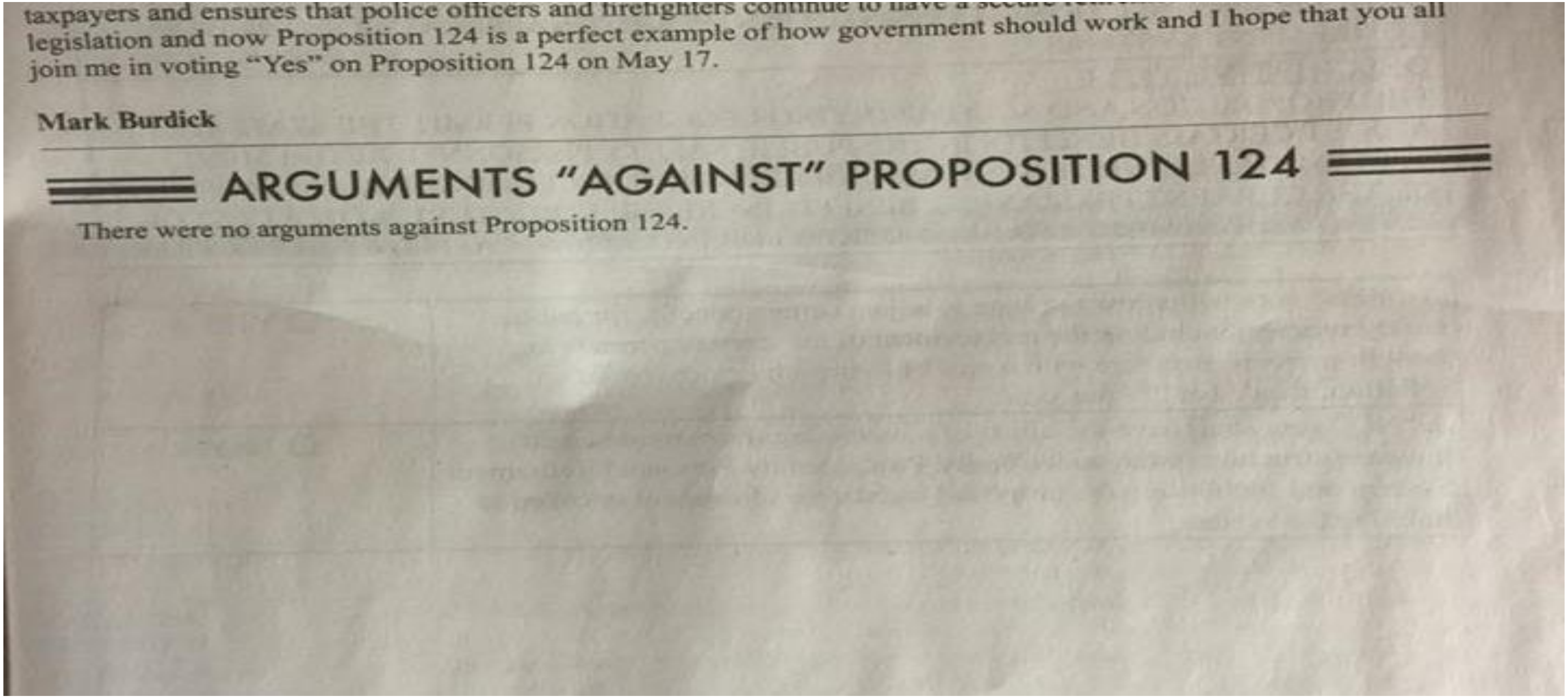
The Daily Courier

ARIZONA CONSTITUTION:
Our referendum's basic language?

"The benefits of the beneficiaries shall neither be diminished nor impaired except for the provisions in Bill XXXX, as passed by the Legislature in 2016".



NO OPPOSITION……WHAT?


taxpayers and ensures that police officers and firefighters continue to have a
legislation and now Proposition 124 is a perfect example of how government should work and I hope that you all join me in voting "Yes" on Proposition 124 on May 17.

Mark Burdick

ARGUMENTS "AGAINST" PROPOSITION 124

There were no arguments against Proposition 124.

PASSED BY 80%

NEXT UP………..CORRECTIONS

- 2018 BALLOT

QUESTIONS????