



# Arizona House of Representatives House Majority Research REPORT

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**To:** **JOINT LEGISLATIVE AUDIT COMMITTEE**  
Senator Blendu, Chairman  
Representative Knaperek, Vice Chairman

**Date:** December 16, 2005

**Subject:** **Sunset Review of the Arizona State Retirement System**

Attached is the final report of the sunset review of the Arizona State Retirement System, which was conducted by the Senate Finance and the House of Representatives Public Institutions & Retirement Committee of Reference.

This report has been distributed to the following individuals and agencies:

Governor of the State of Arizona  
The Honorable Janet Napolitano

President of the Senate  
Senator Ken Bennett

Speaker of the House  
Representative Jim Weiers

Senate Members  
Senator Dean Martin, Cochair  
Senator Ken Chevront  
Senator Jorge Luis Garcia  
Senator Jack W. Harper  
Senator Jay Tibshraeny

House Members  
Representative Trish Groe, Cochair  
Representative Jennifer Burns  
Representative Meg Burton Cahill  
Representative Steve Gallardo  
Representative Marian McClure

Arizona State Retirement System  
Arizona State Library, Archives & Public Records  
Office of the Auditor General

Senate Majority Staff  
Senate Research Staff  
Senate Minority Staff  
Senate Resource Center

House Majority Staff  
House Research Staff  
House Minority Staff  
Chief Clerk

## COMMITTEE OF REFERENCE REPORT

### Senate Finance and House of Representatives Public Institutions & Retirement Committee of Reference

#### ARIZONA STATE RETIREMENT SYSTEM

##### *Background*

Pursuant to § 41 – 2953, Arizona Revised Statutes, the Joint Legislative Audit Committee (JLAC) assigned the sunset review of the Arizona State Retirement System (ASRS) to the Senate Finance and House of Representatives Public Institutions & Retirement Committee of Reference for review.

The ASRS was established in 1953 to provide retirement and other benefits for state employees, including university faculty and employees of political subdivisions who signed a membership contract. Active teachers voted to join ASRS in 1954, and transferred to ASRS January 1955. In 1970, the Legislature enacted the current ASRS benefit plan if 70 percent or more state employees and teacher voted to transfer to the new plan. This new plan became effective July 1, 1971. Most political subdivisions subsequently voted to join. Now ASRS provides disability, survivor and retiree health insurance benefits for the State, the three universities, all ten community colleges, 14 out of 15 counties and other political subdivisions.

As of June 30, 2005, ASRS has over 400,000 members, including nearly 70,000 retirees. Benefits are paid from the ASRS \$22 billion trust fund. The fund consists of contributions from members and employers as well as the income ASRS earns through investments. The ASRS is overseen by a board of directors that consists of nine members appointed by the Governor and confirmed by the Senate. Of the nine board members, four members must have substantial experience in economics, finance or investment.

##### *Committee of Reference Sunset Review Procedures*

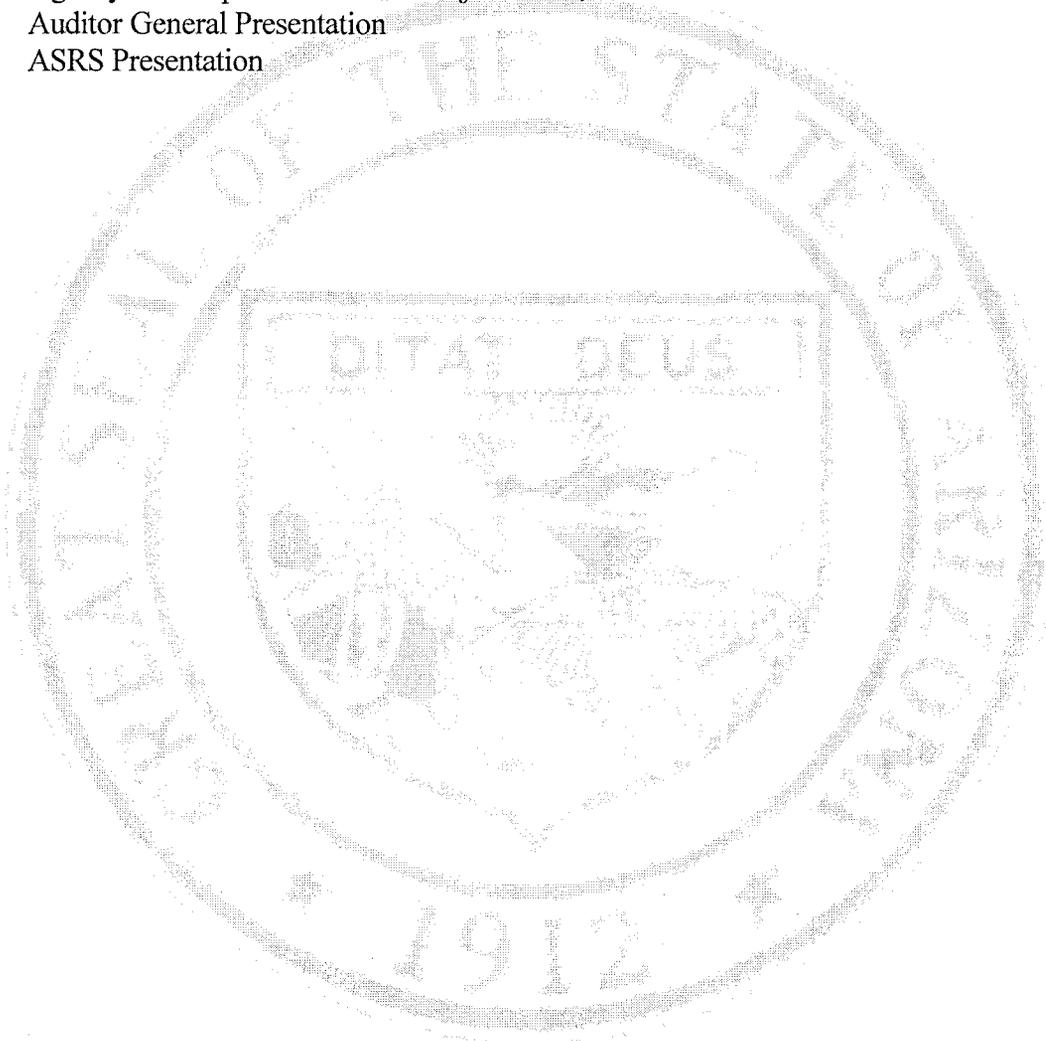
The Committee of Reference held one public hearing on Wednesday, November 16, 2005 to review the Agency responses, as required by A.R.S. § 41-2954, subsections D and F, and to hear and accept public testimony. Testimony was received from Lisa Eddy, Performance Audit Manager, Auditor General's Office; Paul Matson, Director, Arizona State Retirement System; Keith Meredith, Chairman of the Board, Arizona State Retirement System; and Anthony Guarino, Deputy Director, Arizona State Retirement System

***Committee of Reference Recommendations***

The Committee of Reference recommended that the Arizona State Retirement System be continued for ten years.

***Attachments***

- 1) Meeting Notice
- 2) Minutes of the Committee of Reference Meeting
- 3) Agency factors pursuant to A.R.S. § 41-2954, subsection F
- 4) Auditor General Presentation
- 5) ASRS Presentation



# ARIZONA STATE LEGISLATURE

## INTERIM MEETING NOTICE OPEN TO THE PUBLIC

SENATE FINANCE AND HOUSE OF REPRESENTATIVES PUBLIC INSTITUTIONS AND  
RETIREMENT COMMITTEE OF REFERENCE FOR THE SUNSET HEARING OF:  
ARIZONA STATE RETIREMENT SYSTEM  
ELECTED OFFICIALS RETIREMENT PLAN  
PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM  
CORRECTIONS OFFICERS RETIREMENT PLAN

**Date:** Thursday, December 1, 2005

**Time:** 1:00 p.m.

**Place:** House Hearing Room 5

### AGENDA

1. Call to Order – Opening Remarks
2. Arizona State Retirement System (ASRS)
  - Presentation by the Auditor General
  - Response by the Arizona State Retirement System
  - Public Testimony
  - Discussion and Recommendations by the Committee of Reference
3. Presentation of Elected Officials Retirement Plan, Public Safety Personnel Retirement System, and Corrections Officers Retirement Plan
  - Public Testimony
  - Discussion and Recommendations by the Committee of Reference
4. Adjourn

#### Members:

Senator Dean Martin, Co-Chair  
Senator Ken Chevront  
Senator Jorge Garcia  
Senator Jack Harper  
Senator Jay Tibshraeny

Representative Trish Groe, Co-Chair  
Representative Jennifer Burns  
Representative Meg Burton Cahill  
Representative Steve Gallardo  
Representative Marian McClure

11/16/05  
jmb

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.

*Handwritten signature/initials*

ARIZONA STATE LEGISLATURE  
Forty-seventh Legislature – First Regular Session

SENATE FINANCE AND HOUSE OF REPRESENTATIVES  
PUBLIC INSTITUTIONS AND RETIREMENT COMMITTEE OF REFERENCE  
FOR THE SUNSET HEARING OF:  
ARIZONA STATE RETIREMENT SYSTEM  
ELECTED OFFICIALS RETIREMENT PLAN  
PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM  
CORRECTIONS OFFICERS RETIREMENT PLAN

Minutes of Meeting  
Thursday, December 1, 2005  
House Hearing Room 5 -- 1:00 p.m.

Cochair Senator Dean Martin called the meeting to order at 1:30 p.m. and attendance was noted by the secretary.

**Members Present**

Senator Garcia  
Senator Harper  
Senator Martin, Cochair

Representative Gallardo  
Representative McClure  
Representative Groe, Cochair

**Members Absent**

Senator Chevront

Representative Burns  
Representative Burton Cahill

**Speakers Present**

Lisa Eddy, Performance Audit Manager, Arizona State Retirement System  
Paul Matson, Director, Arizona State Retirement System  
Keith Meredith, Chairman of the Board, Arizona State Retirement System  
Anthony Guarino, Deputy Director of Arizona State Retirement System  
Jim Hacking, Administrator, Public Safety Personnel Retirement System  
Mike Colletto, Lobbyist, Professional Firefighters of Arizona

Lisa Eddy, Performance Audit Manager, Auditor General's Office, ASRS, presented the results of the Performance Audit and Sunset Review on the Arizona State Retirement System (ASRS) (see presentation handout, Attachment 1). A list of the findings presented is as follows:

SENATE FINANCE AND HOUSE PIR  
COMMITTEE OF REFERENCE  
FOR THE SUNSET HEARING OF:  
ARIZONA STATE RETIREMENT SYSTEMS  
December 1, 2005

1. The ASRS is generally managing its investments appropriately (p. 5, attachment 1);
2. ASRS should improve its performance in paying some benefits (p. 9);
3. ASRS may need to revise its plan to improve response times at its Call Center (p 14).

The presentation also included information on member and employer contribution factors, the viability of the original retirement system and the agency's sunset factors.

Paul Matson, Director, Arizona State Retirement System (ASRS) began his presentation by mentioning that there were a number of staff members of ASRS present and he introduced Dr. Keith Meredith, who has been Chairman of the Board for a little over a year. After complimenting the auditor staff on the professionalism of the audit Ms. Eddy had presented, he referred to the handouts of the presentation he was about to make (see Attachments 2 through 8). In pointing out Attachment 2 he stated he would be breaking it up into three sections: pp 1-16 about direct responses to the Auditor General's comments; pp 17-31 strategic planning items at ASRS, and pp 32-34 – 2006 legislative initiatives for the State Retirement System. He summarized the findings as follows:

Finding No. 1, ASRS investment management generally appropriate. The recommendation to adopt the six draft policies has been approved. They cover such things as funding process, audit process, appraisals and method of funding external investment managers in the real estate space.

Recommendation No. 2, in respect to monitoring other states' policies and procedures in this area. Mr. Matson reported that this was and is being done and will be continued. This recommendation contained three sub-recommendations for improving benefit payments: 1) timeliness of new retirees; 2) accuracy of new retirees' payments; and 3) timeliness of refunds. He said a lot of the timeliness and accuracy issues will be resolved by an information technology plan to be completed by 2007.

Regarding new retirees, the paperwork is to be done in ten days; this phase to be completed by December of 2006.

Some of the minor inaccuracies were deemed to be a function of two areas: 1) inadequate policies and procedures; and 2) inadequate training. The staff has now completed appropriate training to ensure that there is a homogenous understanding of how to do the calculations; and the update of the policies and procedures has been virtually completed.

Finding No. 3, regarding the Call Center, Recommendation No.1 is to monitor secondary reasons for calls. This is being investigated to determine if there is a combination of software ability and time allocation to do so. At present he has different perspectives from staff members and will continue the research over the next several months. The second item in this regard is the number of FDE's required in the Call Center. There are two different statistical analyses; one says 19 and one 24.

Cochair Groe requested of Mr. Matson that he elaborate on how he plans to make these objections come to fruition when he discusses the second part of his presentation,

Continuing with his presentation, Mr. Matson reported ASRS has a plan that will invest 6 percent of the total fund invested in real estate -- geographically (nationally and possibly internationally) and by product groups (office buildings, hotels, retail, storage, etc.). The vast majority of assets, approximately 70 percent will be invested in core type real estate properties which are typically higher grade, more liquid and close to major city centers like San Francisco, Chicago, New York. Approximately 30 percent of these assets will be invested in non-core, mostly opportunistic, investments. These are typically investments through joint-venture projects. The current allocation for real estate is close to 0 percent.

Senator Martin asked about the general overall funding status to which Mr. Matson responded that it was 86.1 percent, though it was expected to drop to the low 80s over the next several years before it starts rising again; and that this rate is calculated by financial analysts and is irrespective of financial tactics.

Senator Martin then asked about the turnover factor. Ms. Matson responded that some would be five or more years; those more opportunistic, three years or less; that three or four years would end up being an average turnover holding period for a property.

Senator Martin then asked how joint venture partners are selected. Mr. Matson explained in detail the process of consulting a number of core real estate consultants and an internal chief portfolio manager.

Mr. Matson reported that the Information Technology (IT) plan is scheduled for completion by December 2007; within that framework an online website for members to check their balance, their statements and what the records show as far as account name and beneficiary is scheduled for completion by February 6, 2006.

Mr. Matson stated that the Call Center has now two types of staff members, one of which is higher paid, who although they do not do financial planning or give advice, have benefit advisor skills; the other type have call center skills. The first would be able to answer the questions on the spot that now are being answered by "I'll do some research and get back to you later." He reported that call time wait is now 3 minutes that he hopes to reduce it further.

Representative Groe asked Mr. Matson to explain what checks and balances were in place to ensure the success rate with as few employees as necessary. Mr. Matson answered that their internal audit department would next be auditing the Call Center and the time it takes to respond to calls.

Anthony Guarino, Deputy Director of ASRS, reported that the staff at the Call Center is at the number that the Auditor General has recommended and will stay at that number unless service deteriorates.

Representative Groe asked if there is a date for the internal audit. Mr. Guarino advised that a new internal auditor was just hired and that it is part of his mandate to schedule it; that Mr. Guarino would get back with a clarification of time schedule and details of what they will be doing. He said that additionally the plan is to monitor the call service daily and monthly report to the board of trustees.

Mr. Matson continued his presentation by giving summaries of his handout (Attachment 2) focusing on page 25 "Vision and Values" and page 28 "Impact of Cost Reduction Initiatives" and finally pages 33 and 34, "Legislative Public Policy Initiatives for 2006."

**Cochair Groe moved that the Committee of Reference recommend to the Legislature that the Arizona State Retirement System be continued for ten years. The motion carried by a voice vote.**

The next speaker was Jim Hacking, Administrator for the Public Safety Personnel Retirement System. (PSPRS) (Attachments 3 through 6). Mr. Hacking explained that PSPRS is the administrative entity that manages and administers benefits for three separate benefit plans in this state. All the retirement plans are authorized and operate under Title 38, ch 5, art. 3, 4 and 6 of the Arizona Revised States. It is governed by a board of 5 members all of whom are appointed by the Governor and two of whom must have some investment expertise. The PSPRS has a system of 210 local boards that are responsible for such things as determining eligibility to participate in the system, determining eligibility for benefits and actually calculating the benefits that are to be awarded. The central office monitors and audits the work that is done by the local boards of PSPRS.

In the case of the Corrections Officers Plan (Attachments 3, 4 and 7), they too have a system of local boards, 19 of them, and they perform functions similar to those of the Board of the PSPRS program.

Mr. Hacking then reviewed the options and constraints in trying to improve the fund (see Attachment 3, pp 11 and 12). Considering the constraints he emphasized that if the only thing to be done was that the amortization period was changed from 20 to 30 years, the 17.1 percent employer rate would be reduced to 15.44 percent in 2007; a 40-year period would make it even less. He reported that he is having research done to see what would happen if the salary growth assumption were reduced from 6 percent to possibly 5 or 5½ percent. He said that generally the result would be an improvement in the funding ratio of the systems and a concomitant reduction in the required employer contribution. As soon as he receives the projections from the Actuary he will share them with the Committee.

Mr. Hacking also suggested that consideration be given to making some changes in regard to the Deferred Retirement Option Plan (DROP) either by setting a statutory rate or interest to be credited to DROP participant accounts or imposing contribution requirements to one degree or another on either the employer or employee or both.

Mike Colletto, Lobbyist, Professional Firefighters of Arizona, was asked by Representative McClure what kind of action he would expect if the DROP program were continued for those already in it, but otherwise eliminated, or if the rate of return was tied to the actual interest rate that is in place by the federal government.

Mr. Colletto reported on a plan in which he has been involved and which is being called reverse DROP. He stated that the firefighters have also obtained a constitutional attorney who is reviewing both the constitution and case law. He said that the Firefighters' goal is to work on doing everything possible within the constitutional case law to lower the employers' contribution rates, and that they are actively working with them in that regard; that the Firefighters care greatly about the financial stability of this plan because they do not have Social Security.

**Cochair Groe moved that the Committee of Reference recommend to the Legislature that the Elected Officials Retirement Plan, the Public Safety Personnel Retirement System and the Corrections Officers' Retirement Plan be continued for ten years. The motion carried by a voice vote.**

Without objection, the meeting adjourned at 2:45 p.m.



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Pat Hudock, Committee Secretary  
December 6, 2005

(Original minutes, attachments and tape are on file in the Office of the Chief Clerk.)



## ARIZONA STATE RETIREMENT SYSTEM

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TOLL FREE OUTSIDE METRO PHOENIX-AND TUCSON 1-800-621-3778

contactus@asrs.state.az.us

Paul Matson  
Director

September 30, 2005

Representative Trish Groe  
Arizona House of Representatives  
1700 W. Washington  
Phoenix, AZ 85007

Dear Ms. Groe:

Enclosed is the Arizona State Retirement System (ASRS) response to the sunset factors requested by your office. We have also enclosed, as requested, a copy of the Board minutes for all meetings in Fiscal Year 2005 and the Annual Report for the Fiscal Year ended June 30, 2004.

If you have any questions or require further information, please contact my office at (602) 240-2031.

Sincerely,

A handwritten signature in cursive script that reads "Paul Matson".

Paul Matson  
Director

Enclosures

cc: Tami Stowe, House Research Analyst  
Senator Dean Martin  
Sean Laux, Senate Research Analyst

**1. An identification of the problem or the needs that the agency is intended to address.**

The Arizona State Retirement System (ASRS) provides retirement and disability benefits to its members and also provides access to health insurance coverage for its retirees.

Additionally, the ASRS is responsible for investing the contributions of employers and members in a manner that will ensure a long term rate of return and provide the benefits that have been promised.

Specifically, A.R.S. § 38-712 states:

- A. The primary intent of the ASRS is to:
1. Provide an incentive in the recruitment and retention of employees of the highest possible quality.
  2. Contribute toward providing a total compensation package that is generally equivalent to comparable employment in other public and private organizations in this state.
  3. Provide a retirement system that encourages employees to remain in service for periods of time that will provide public employers with the full benefit of the training and experience gained by the employees.
  4. Provide an orderly method of promoting and maintaining a high level of service to the public through an equitable separation procedure that is available to employees at retirement or on becoming disabled.
  5. Provide a base retirement benefit that is less than one hundred percent of a member's post-retirement income requirements, recognizing that personal savings and social security also contribute toward total post-retirement income requirements.
- B. ASRS is a defined benefit plan as described in section 414(j) of the internal revenue code. As provided in section 38-771, some eligible members of ASRS are entitled to benefits under the defined contribution program administered by ASRS. With respect to the portion of ASRS that provides benefits to members entitled to benefits under the defined contribution program that are derived from employer contributions and that are based partly on the balance of the separate account of a member, ASRS is a plan described in section 414(k) of the internal revenue code and shall comply with all applicable provisions of section 414(k) of the internal revenue code.
- C. A public employee's retirement trust fund is established to afford an optimum degree of security to the members of ASRS. All monies and other assets of ASRS are a part of the trust fund. All accounts, depositories and funds of ASRS are included within the trust fund.

D. Except as provided in section 38-738, an employer does not have a beneficial interest in any asset of the trust fund, and no part of the trust fund may ever revert to or be paid, directly or indirectly, to an employer. All liabilities with respect to members and their beneficiaries shall be satisfied before any part of the corpus or income of the trust fund is used for or diverted to purposes other than for the exclusive benefit of members or their beneficiaries.

**2. A statement, to the extent practicable, in quantitative and qualitative terms, of the objectives of such agency and its anticipated accomplishments.**

The ASRS Vision and Values are as follows:

### **Our Vision**

For the benefit of our members, the Arizona State Retirement System will be a leading state benefit plan administrator in the areas of:

- Core member services
- Funded status
- Investment performance
- Operational effectiveness

This will be accomplished while keeping program benefits and associated costs relatively aligned and maintaining actuarial and fiscal integrity.

### **Our Values**

Our organizational culture will be based upon the following values:

- Service:** A commitment to service excellence will permeate the organization.
- Professionalism:** A highly capable workforce will promote a professional and respectful environment and lead the organization.
- Improvement:** A climate of continuous quality improvement and enhanced efficiencies will drive the organization.
- Diversity:** Engagement of diversity by the appreciation, recognition, and support for all people will propel the organization to ever greater achievement.
- Results:** A results-oriented approach to operations will energize the organization.

### Core Member Services

In 1994, the year the ASRS had its last sunset audit and performance review, the ASRS had a total membership of 207,000. Today, the ASRS provides services to over 400,000 members, including 70,000 retired and 5,000 disabled members.

Some of the core member services performed by the agency include:

- o Disbursement of retirement, survivor, and refund payments
- o Calculations of benefit estimates and service purchase requests
- o Coordination of health insurance and long term disability benefits with a third party vendor
- o Operating a member call center
- o Offering educational seminars for members and employers
- o Issuing annual benefit statements to members
- o Providing newsletters and other publications for members and employers
- o Collection and maintenance of retirement contributions and member account information
- o Compilation of yearly financial statements

ASRS members are generally pleased with the services of the ASRS, as indicated in the results of our member satisfaction survey.

### **Overall Member Satisfaction with ASRS**

	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
<b>ASRS employees provide good service to members</b>						
Satisfied	83%	83%	84%	87%	86%	81%
Neutral	11%	11%	9%	8%	9%	11%
Dissatisfied	6%	7%	7%	5%	6%	7%
<b>ASRS keeps its members informed of matters that affect them</b>						
Satisfied	83%	81%	80%	82%	80%	78%
Neutral	12%	15%	13%	13%	15%	15%
Dissatisfied	5%	4%	6%	5%	5%	7%
<b>ASRS is pleasant and easy to do business with</b>						
Satisfied	84%	82%	81%	86%	86%	78%
Neutral	10%	11%	10%	8%	8%	13%
Dissatisfied	6%	7%	8%	6%	6%	9%

\* Columns may not total 100% due to rounding

The ASRS goal is to achieve a member satisfaction rating of 90% or higher for its major business functions. Although the ASRS has not yet achieved this goal for all of its services, it is currently implementing a multi-year Information Technology and Business Re-Engineering effort aimed at substantially improving the efficiency of the services provided by the ASRS to its members. This project will reduce or eliminate manual work processes, improve the quality and accuracy of services, and improve the timeliness of service delivery to the growing population of ASRS members.

As mentioned in the sunset review and performance audit, the ASRS needs to improve the timeliness of some of its disbursement services. The ASRS believes the Information Technology Plan that is being implemented will allow us to accomplish this goal.

**Investment Performance**

The Investment Management Division of the ASRS is collectively responsible for the management and oversight of the ASRS' 22 billion dollar portfolio.

**ASRS Total Fund Performance**

For the period ending June 30, 2005

	Quarter	1 Year	3 Years	5 Years	10 Years	Inception 6/30/75
Total Fund	1.7%	8.5%	9.2%	2.2%	9.4%	10.9%
Benchmark	1.5%	7.8%	8.5%	1.3%	8.1%	9.1%
Excess Return	0.2%	0.7%	0.7%	0.9%	1.3%	1.8%

The ASRS has achieved its investment objectives for the long-term, although the ASRS, as well as most public and private pension funds across the country, did experience negative mid-term investment returns in 2001 and 2002.

As expressed in the report of the Office of the Auditor General, the ASRS manages its investments appropriately, utilizing industry standard practices and investment strategies.

**Funded Status**

The funded status of the ASRS has declined in recent years due to a combination of factors, such as significantly increased benefits, lower mid-term investment returns, very low prior contribution rates, and changing member demographics.

### **Funded Status** For Fiscal Years 1995 – 2004

1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
111.8%	113.2%	117.1%	120.7%	116.6%	120.4%	115.1%	106.4%	98.4%	92.5%

\* Values shown for 1996 and after are for 401(a) pension plan only

The ASRS has worked to improve its funding status and mitigate further increases to the contribution rate through a series of cost reduction initiatives. These initiatives have collectively reduced the increase in contribution rates by 1.4% and are projected to save the fund over 2 billion dollars in current and future liabilities.

**3. An identification of any other agencies having similar, conflicting, or duplicate objectives, and an explanation of the manner in which the agency avoids duplication or conflict with other such agencies.**

There are three other public retirement systems in Arizona with similar functions to the ASRS:

- Public Safety Personnel Retirement System (PSPRS)
- Elected Officials' Retirement Plan (EORP)
- Corrections Officer Retirement Plan (CORP)

The Fund Manager of the PSPRS is responsible for the administration of all three defined benefit plans.

The functions of the PSPRS Fund Manager do not duplicate those of the Arizona State Retirement System because the PSPRS Fund Manager administers retirement plans for different groups of public employees than those covered within the ASRS.

The combined membership of all three plans is less than 10% of the ASRS membership. Due to the relatively small size of the PSPRS Fund, it could not administer the benefits of the ASRS without a significant increase in resources.

**4. An assessment of the consequences of eliminating the agency or of consolidating it with another agency.**

Even if the ASRS were to be eliminated, its functions cannot be. According to Article 29, Section 1, Paragraph C of the Arizona State Constitution, "Membership in a public retirement system is a contractual relationship that is subject to article II, section 25, and public retirement system benefits shall not be diminished or impaired."

If the ASRS were eliminated, all of the ASRS' 418,000 current members would still be entitled to retain their Arizona State Retirement System benefits. The current value of all fund liabilities is approximately 25.9 billion dollars.

If the ASRS were to be dissolved, another entity would be required to assume responsibility for the administration of retirement, retiree health insurance, and long term disability benefits on behalf of all the remaining members, until such time as all remaining members and beneficiaries have been paid. Because the ASRS provides one of three essential elements necessary for each member to effectively plan for retirement, the termination of the ASRS would significantly affect the health, safety, and welfare of its nearly 400,000+ members.

More than 70,000 members receive a monthly pension from the ASRS; another 5,000 receive monthly long term disability payments from the ASRS' disability administrator. In Fiscal Year 2004 these disbursements totaled \$1.4 billion. The financial well being of all these members could be interrupted or irretrievably harmed by the dissolution of the ASRS.

Nearly 42,000 retirees currently participate in medical or dental plans directly through the ASRS; if it were to be eliminated, all these members would see their health insurance coverage interrupted or eliminated. In fiscal year 2004, more than \$83.4 million dollars was paid to retirees in health insurance subsidies. Additionally, all the ASRS retirees who currently receive health insurance coverage through their former employer would see their health insurance supplement, paid to the employer by the ASRS, eliminated.

Though not immediate, the future retirees of the ASRS would also stand to be negatively impacted by the elimination of the ASRS.

In addition, the loss of retirement, retiree health insurance, and long term disability benefits would discourage future employees from joining and remaining in public service. As a result, many public employers would experience more difficulty hiring and retaining qualified personnel.

# Arizona State Retirement System (ASRS)

Sunset Review  
December 1, 2005



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## ASRS Services

- Over 400,000 members
- ASRS provides:
  - Pension & health insurance benefits
  - Disability
  - Educational services
- 197 FTE



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## ASRS Board

- 9 members
  - Board must have 5 ASRS members
  - Board must have 4 public members
  - Public members need significant experience in investment, economics or finance



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## ASRS Budget

- Estimated FY 2005 Expenditures
  - \$23.9 million
  - Expenditures are appropriated from Pension Fund
  
- \$31.8 million in non-appropriated funds
  - Investment management
  - Investment consulting
  - Actuarial consulting

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## Finding 1

**ASRS is generally managing its investments appropriately.**

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## Investment Management

- Investment approach of balancing long- and short-term strategies is common
  
- Long-term investment strategy
  - Investments are diversified
  
- Short-term investment strategy
  - Global Tactical Asset Allocation (GTAA)

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## Investment Management

- Investment returns strongly related to domestic stock market performance
- ASRS had 56% allocation to domestic equities
- Other public pension funds averaged 44.5%
- Performance suffered in 1999 - 2002

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## Investment Management

- ASRS diversifying into Real Estate
- Board approved up to a 6% allocation
- Need to approve and develop policies and procedures

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## Finding 2

**ASRS should improve its performance in paying some benefits**

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## Benefit Payments

- ASRS goal is to pay new retirees within 60 days
- 74% of payments were within 31 – 60 days
- Peer funds pay on average 75% of new retirees within 30 days



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## Benefit Payments

- Several factors caused delays
  - Payroll verification by employers
  - Manual calculations
  - Single monthly payment cycle



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## Benefit Payments

- ASRS' internal audit process identified & corrected inaccuracies
- Two factors created inaccuracies
  - Manual calculations
  - Inadequate procedures



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### **Benefit Payments**

- 👤 **Member refunds not consistently meeting goal of 45 days**
- 👤 **Two factors led to delays**
  - 👤 **Lengthy manual reviews**
  - 👤 **Two computer systems**



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### **Finding 3**

**ASRS may need to revise its plan to improve response times at its call center.**



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### **Call Center**

- 👤 **Call Center performance fell**
  - 👤 **Answer rates & wait times worsened**
  - 👤 **Member satisfaction decreased**



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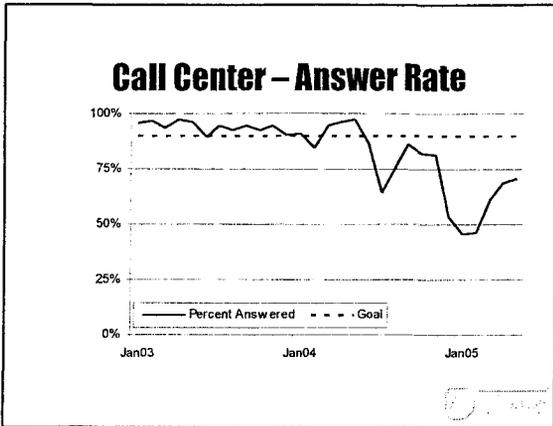
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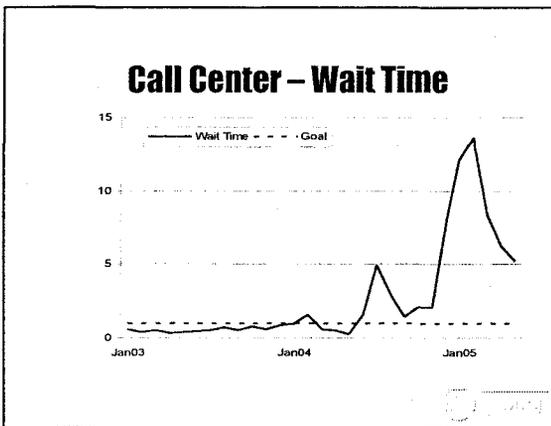
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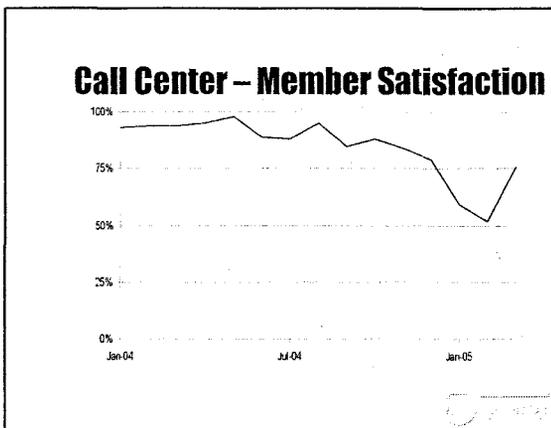
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## Call Center

### Three contributing factors

- More calls
- Fewer staff
- More time on other duties

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## Call Center

- Plan likely calls for too many staff
- Staffing model overstates needs
- Call volume projections too high
- ASRS Plan = 10 staff
- Auditor analysis = 5 staff

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## Questions?

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# Arizona State Retirement System (ASRS)

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Presentation to the  
ASRS Legislative Committee of Reference  
with regard to  
the ASRS Sunset Audit and Findings and other  
important ASRS Initiatives

Presented by Paul Matson, Director  
November 10, 2005

# Table of Contents

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1. Sunset Audit Findings, ASRS Response, and Current Status of Implementation
2. Cost Saving Initiatives at the ASRS
3. 2006 Legislative Public Policy Initiatives

# Sunset Audit Findings, ASRS Response, and Current Status of Implementation

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## **ASRS Performance Audit and Sunset Review**

- ❑ Auditor General Findings and Recommendations
- ❑ Agency Response
- ❑ Current Status

# Finding 1: ASRS' investment management generally appropriate

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## **Recommendation 1:**

- ❑ The ASRS Real Estate Committee should adopt their draft policies and procedures for investment in real estate.

## **Agency Response:**

- ❑ The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

## **Current Status:**

- ❑ 3 policies have been approved
- ❑ 3 additional policies are pending approval

# Finding 1: ASRS' investment management generally appropriate

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## **Recommendation 2:**

- ❑ The ASRS should use procedures developed by other state pension plans to help guide its future development of real estate investment procedures.

## **Agency Response:**

- ❑ The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

## **Current Status:**

- ❑ The ASRS has discussed with several parties (state pension plans and consultants) policies and procedures as they relate to institutional real estate investment programs.

Though the conversations were instructive, all parties clearly recognized the distinctions that exist among state (and private) real estate plans re: their structure (real estate model) and plan implementation. As such the development of ASRS existing (and future) real estate procedures will be less guided by those developed by other state pension plans but rather more by ASRS's use of concise language deemed to provide a significant level of due diligence and oversight of ASRS's real estate plan operations.

## Finding 2: ASRS should improve its performance in paying some benefits

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### **Recommendation 1:**

- To improve the timeliness of paying new retiree annuities, ASRS should:
  - a. Complete the incorporation of the new retiree function into its main data system by December 2006 to allow it to initialize annuities based on currently available data instead of waiting for employer verification of final payroll details.
  - b. Complete its ongoing project to convert members' paper and microfiche files to electronic images by June 2006.
  - c. Study the cost of implementing a second monthly pay date for new retirees' annuities, weighing any potential impact upon currently scheduled IT projects against the benefit of reducing new retirees' wait times for receiving annuity payments.

### **Agency Response:**

- The findings of the Auditor General are agreed to and the audit recommendations will be implemented.

Fast and reliable benefit processing is a critical business objective for the ASRS, and a cornerstone of the agency's business re-engineering and technology efforts. Once the ASRS' efforts in these areas are fully complete, members of the ASRS will experience benefit payment processing service that is equal to or better than its peer retirement systems.

As suggested, we will study whether it is feasible and cost effective to implement recommendation 1c in a way that will provide a more immediate benefit to members, yet avoid disruption to planned efforts to improve this process.

### **Current Status:**

- See next slide

## Finding 2: ASRS should improve its performance in paying some benefits

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### Current Status:

- a. Complete the incorporation of the new retiree function into its main data system by December 2006 to allow it to initialize annuities based on currently available data instead of waiting for employer verification of final payroll details.
  - The new retirees project is scheduled to begin on January 2006 and end on December 2006. Currently, the project manager and lead analyst are working on the detailed project plan, specifically to prioritize functionality deliverables and schedule necessary resources.

One of the central objectives of the new retiree project is to distribute 90% of initial payments to new retirees within ten business days of retirement. In discussing how best to accomplish this objective, the ASRS has identified three key business processes that must change:

1. Eliminating the requirement of receiving an employer verification of final payroll before processing a new retiree payment; and
2. Eliminating, where possible, manual business processes associated with calculating and adjusting pension amounts; and
3. Eliminating the constraints associated with a monthly batch payment process

The ASRS expects the new retiree automation project to eliminate current constraints and help the agency meet its objective of providing more timely service without requiring a significant infusion of resources.

## Finding 2: ASRS should improve its performance in paying some benefits

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### Current Status (continued):

- b. Complete its ongoing project to convert members' paper and microfiche files to electronic images by June 2006.
  - The June 2006 completion date for the Backfile Conversion segment of the imaging project has been extended 2 months to August 2006. This extension will not negatively affect the deliverables or benefits expected from any of the projects scheduled for 2006, including the new retiree project.
- c. Study the cost of implementing a second monthly pay date for new retirees' annuities, weighing any potential impact upon currently scheduled IT projects against the benefit of reducing new retirees' wait times for receiving annuity payments.
  - Staff will be meeting in late November to begin this analysis.

**Note:** in Fiscal Year 05, members did not indicate that they were dissatisfied with the new retiree process in general, with less than 10% dissatisfaction for all attributes associated with this service.

## **Finding 2: ASRS should improve its performance in paying some benefits**

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### **Recommendation 2:**

- ❑ To improve the accuracy of paying new retiree annuities, ASRS should update all procedure documents related to processing new retirees, and provide training to its staff for the automated calculation of the highest average monthly salary once this new function is operational.

### **Agency Response:**

- ❑ The finding of the Auditor General is agreed to and the audit recommendation will be implemented. Revisions of desk procedures related to the processing of new retirees are currently under development. For example, a new automated calculation of the highest average monthly salary was implemented in July 2005. Training associated with the new salary calculation has been completed for some staff, and is in the process of being completed for others. This new calculation, and also the revised desk procedures, will be incorporated into our efforts to further automate and re-engineer this business process in 2006.

### **Current Status:**

- ❑ Training – All of the staff who use the workbooks for the new average monthly salary calculation have been trained on the new process.
- ❑ Desk Procedures – Desk procedure revisions are proceeding as planned and are anticipated to be complete by January 2006. Further revisions will be completed in conjunction with new retiree project scheduled for 2006.

## **Finding 2: ASRS should improve its performance in paying some benefits**

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### **Recommendation 3:**

- ❑ To improve the timeliness of paying refunds, ASRS should complete its efforts to fully incorporate this function into its main computer system by April 2006.

### **Agency Response:**

- ❑ The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Automation and process re-engineering efforts are underway and are proceeding as planned. It is our expectation that the entire refund process will be significantly improved when this effort is complete, including reducing the turnaround time for some payments to as few as ten business days.

### **Current Status:**

- ❑ The forfeiture project is on schedule for release in the first quarter of 2006. We anticipate that the agency will start seeing an improvement in timeliness in the second quarter of 2006.

## **Finding 3: ASRS should monitor and assess its plan for improving call center performance**

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### **Recommendation 1:**

- ❑ To provide more accurate call volume projections to assist in future staffing plans, ASRS should consider the feasibility of tracking both the primary and secondary reasons for incoming calls.

### **Agency Response:**

- ❑ The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

We agree that it is beneficial in many ways to have data regarding the reason(s) for a member's call. Accordingly, we will work to improve our reporting in this area. Any changes made to our reporting capabilities must carefully weigh the benefit of receiving additional data versus the additional time it may take for call center agents to record the data.

### **Current Status:**

- ❑ Analysis has only recently begun on this effort due to the recruitment and training of new staff and also due to high call volume associated with member statements and open enrollment.

## **Finding 3: ASRS should monitor and assess its plan for improving call center performance**

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### **Recommendation 2:**

- ❑ If the call center is able to achieve its performance objectives with fewer staff than required by the staffing plan, ASRS should redeploy any excess staff to other areas requiring assistance.

### **Agency Response:**

- ❑ The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

At this time, it is evident to us that both a higher number and more highly skilled staff are needed to improve call center performance. However, should the ASRS meet its performance goals for the call center with fewer staff than anticipated, staff will be utilized to improve the timeliness of its service audit process, walk-in service, responses to member e-mails, correspondence, and appeals.

### **Current Status:**

- ❑ See next slide

## **Finding 3: ASRS should monitor and assess its plan for improving call center performance**

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### **Current Status (continued):**

- ❑ If the call center is able to achieve its performance objectives with fewer staff than required by the staffing plan, ASRS should redeploy any excess staff to other areas requiring assistance.

### **Allocation of FTE's at the Call Center**

- ❑ The total number of call center staff that have been appropriated to date is as follows:
  - 1 manager
  - 2 front line supervisors
  - 22 call center agents (6 of these were appropriated in July 2005)
- ❑ In March 2005, staff allocated 24 call center agent FTE's to the call center to combat higher than previously projected call volumes (at the time there were only 14 agents in the call center, though an additional 6 had been recommended in the budget)
- ❑ Auditors have projected that only 19 call center agent FTE's will be required
- ❑ The ASRS has currently assigned 20 call center agent FTE's to the call center and plans to:
  - monitor service levels
  - adjust staffing levels accordingly, if necessary

## Finding 3: ASRS should monitor and assess its plan for improving call center performance

---

### Current Status (continued):

- ❑ If the call center is able to achieve its performance objectives with fewer staff than required by the staffing plan, ASRS should redeploy any excess staff to other areas requiring assistance.

Call Volume		
FY	Total	(+/-)
2003	180,240	4%
2004	204,161	13%
2005	256,661	26%

### Call Center Statistics and Projections

- ❑ The ASRS has set a goal of answering 80% of calls within 20 seconds, which is consistent with best business practices
- ❑ The ASRS has projected that call volume will increase 10% in each of the next two fiscal years
- ❑ The ASRS has projected that it will need 24 call center agents to achieve this goal (an addition of four over the 20 allocated currently)
- ❑ The ASRS budget request includes a request for these additional four agents

Abandonment Rate		
FY	Average	(+/-)
2003	4.37	-80%
2004	7.36	68%
2005	32.22	338%

Wait Time		
FY	Average	(+/-)
2003	31.87	-89%
2004	51.44	61%
2005	223.24	334%

## Finding 3: ASRS should monitor and assess its plan for improving call center performance

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### Current Status (continued):

- ❑ If the call center is able to achieve its performance objectives with fewer staff than required by the staffing plan, ASRS should redeploy any excess staff to other areas requiring assistance.

### Classification Levels, Salaries, and Training of Call Center Staff

- ❑ The ASRS revised its staffing plan for the call center in the Spring of 2005. As a result of higher classification levels, salaries, and training for call center staff, the agency now has the capability to easily shift member services staff to other work areas (seminars, walk-ins, or production) as needed.
- ❑ Of the 20 call center agents:
  - 14 are classified as grade 19
    - ❑ Average salary = \$32,000
  - 6 are classified as grade 15
    - ❑ Average salary = \$27,000
- ❑ Two Levels of Training:
  - Call Center Training (5 weeks)
    - ❑ All agents receive this level of training
  - Benefit Advisor Training (an additional 4 weeks)
    - ❑ Grade 19 classified agents will receive this additional training

## Finding 3: ASRS should monitor and assess its plan for improving call center performance

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### Classification Levels, Salaries, and Training of Call Center Staff (continued)

Why did the agency decide to increase the classification level?

- The old model was not working
  - Of the 43 call center agents (Temp or grade 15) hired between July 2003 and July 2005:
    - 27 (63%) have left the agency
- Having a higher skill set employee at the call center will ensure members receive thorough, detailed, correct, and complete answers to questions, which should help the agency reduce the instances of:
  - Repeat or follow-up calls
  - Walk-in traffic associated with inability to answer questions
- Higher skill set employees can be easily redeployed to other areas when needed to address backlogs
- The cost of the higher skilled employees should provide the agency with staffing and turnover levels that are more consistent with normal levels

# Cost Saving Initiatives at the ASRS

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Surplus / Deficit and Contribution Rate  
"Plan of Action"  
Review & Status Update

Presented by Paul Matson, Director  
December 17, 2004

# Background

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2002 – Issue Identification

1Q03 – Issue Prioritization (High)

1Q03 – Proactive Issue Dissemination

2Q03 – Determination of Plan of Action

2Q03 – Implementation of Plan of Action

## Three Phase Plan (With Overlapping Time-Frames)

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Phase I: Financial Impact = Short Term or Large  
Action = Immediate

Phase II: Financial Impact = Short Term or Modest  
Action = Short Term

Phase III: Financial Impact = Long Term or Small or  
Residual  
Action = Medium Term  
Action = Plan Review and  
Cultural Change

# Levers

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## Actionable

## Issues

## Actioned

X

Benefits:

Guaranteed  
No Board Position

X

√

Investments:

Relative and Variable

√

√

Assumptions:

Cost Shifting

√

√

Methods:

Actual Current and  
Future Savings

√

# Phase I

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## Planning

- Problem Dissemination: Board & Staff
- Problem Concurrence: Board & Staff
- Solution Congruence: Board & Staff
- Determine Plan of Action
- Implement Plan of Action

## Phase I (continued)

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### Actions

- Creation of Equity and Efficiency Review Team (EERT)
- Recommendation from EERT, Management, Staff, Trustees, Actuary
- Service Purchase Legislation, Proposed and Implemented change from Normal Cost to Actuarial Present Value
- Increase Interest Rate on PDAs from 0% to 8%
- Correction of PBI Reserve Account
- Early Retirement Incentives Limited
- LTD Legislative Changes Implemented
- LTD Investment Changes Implemented
- Actual Investment Return for 2004

## Phase II

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### Planning

- Review Phase I Plan of Action

### Actions

- Reinstatement of Equity and Efficiency Review Team
- Continued Engagement
- Account Balance Accrual Rate Change (4%)
- Current Legislative Review Process
  - Pop ups
  - AHCCCS

## Phase III

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- Enhanced "Program & Benefit" Cost Dissemination Initiative
- Culture Change: Vision & Values
- Total Plan Review
- Remaining Program Changes
- Remaining Methodological Changes
- Asset Allocation Review
- Horizon Issues:
  - System Design
  - Health Insurance Design



# Arizona State Retirement System ASRS

## Our Vision

For the benefit of our members, the Arizona State Retirement System will be a leading state benefit plan administrator in the areas of:

- Core Member Services
- Funded Status
- Investment Performance
- Operational Effectiveness

This will be accomplished while keeping program benefits and associated costs relatively aligned and maintaining actuarial and fiscal integrity.

## Our Values

Our organizational culture will be based upon the following Values:

- |                         |  |
|-------------------------|--|
| <b>Service:</b>         | A commitment to service excellence will permeate the organization.   |
| <b>Professionalism:</b> | A highly capable workforce will promote a professional and respectful environment and lead the organization.                                   |
| <b>Improvement:</b>     | A climate of continuous quality improvement and enhanced efficiencies will drive the organization.   |
| <b>Diversity:</b>       | Engagement of diversity by the appreciation, recognition, and support for all people will propel the organization to ever greater achievement. |
| <b>Results:</b>         | A results-oriented approach to operations will energize the organization.  |

# Three Phase Plan

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## % Complete

### By Time                      By Action

Phase I	100%	95%
Phase II	75%	75%
Phase III	60%	60%

# Impacts to Date

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1. Significant Dollar Savings
2. Significantly Reduced Contribution Rate Increases
3. Culture Shift
  - Re-engineering Programs = Past
  - Preventative Perspective = Future
4. Engagement of Decision Makers and Subject Matter Experts

## Impact of Cost Reduction Initiatives

### Amounts in Millions of Dollars

Action	Reduction in Total Contribution Rate*	Annual Reduction in Total Contribution Amount	Present Value of Savings on Actuarial Valuation Basis	Present Value of Savings on Open Group Basis
Service Purchase				
Change from normal cost to actuarial present value	.60%	\$43.8	\$338.9	\$1,217.6
Increase interest rate on PDAs from 0% to 8%	.20%	\$14.6	\$177.4	\$262.2
Total Service Purchase Savings	.80%	\$58.4	\$516.3	\$1,479.3
Decrease interest credited on withdrawn contributions from 8% to 4%	.30%	\$21.9	\$191.3	\$542.0
Early Retirement Incentives	.22%	\$16.1	\$195.2	\$289.1
Correction of PBI Reserve	.05%	\$3.5	\$42.0	\$42.0
LTD Legislative changes	.03%	\$ 2.2	\$26.6	\$39.5
Total	1.40%	\$102.1	\$971.4	\$2,391.9

\*\*These effects on the total contribution rate are multiplied by current payroll to give annual savings amounts in the next column. The annual savings amounts are then converted to the present values shown in the last two columns. On the Actuarial Valuation Basis, the savings from basing service purchases on actuarial present value is a reduction in future service liabilities. For the reduction in the interest crediting rate, the savings arise from reductions in future service and past service liabilities. Other Actuarial Valuation Basis savings are reductions to past service liabilities, i.e., capitalizations of the annual savings amounts over 30 years. On the open group basis, present values are generally perpetuities that anticipate the savings effect on current and future members. The exception is the PBI change, which is a one-time correction.

Some of these changes will not be reflected in their entirety in the 2004 valuation report, but will be captured in future reports as actuarial gains. For example, the Plan valuation contains no assumption on Payroll Deduction Agreements (PDAs), so the absence of interest charges in the past has been reflected as an actuarial loss. The change to 8% interest charges will end the losses and eventually reduce the total contribution rate by .20%.

# Member Cost Reduction Initiatives

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\* HI RFP Process & Results

## What's Next

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### By Phases

1. Wrap up of Phase I
2. Completion of Phase II
3. Continued Work on Phase III

# What's Next

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## By Actions

- Implementation of LTD Investment Changes
- Implementation of Legislative Initiatives and Notifications
- Plan Design Review
- Asset Allocation Review
- Horizon Issue Research and Conclusions
- Reinforcement of Vision & Culture
- Implementation of Above While Maintaining Other Initiatives:
  - \* IT Program
  - \* Budget
  - \* Strategic Plan
  - \* Service Maintenance
  - \* Service Remedies
  - \* Others

2006 Legislative Public Policy  
Initiatives



**ASRS Legislative Public Policy Initiatives  
Planned for 2006**

# Legislative Public Policy Initiatives for 2006

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1. Repeal modified DROP program
  - Estimated Savings Range: 0.52% to 1.04%
2. Modify the investment manager requirement that requires 3 years of experience of handling \$250 million in assets
3. Clarify statutory language dealing with retirement incentive programs offered by employers
4. Changes to the LTD program dealing with pre-existing conditions and offset limitations
  - Estimated Savings = 0.32%

# Legislative Public Policy Initiatives for 2006

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5. Modify the way employer contributions are refunded when a non-retired ASRS member leave membership
  - Estimated Savings Range: 0.50% to 0.74%
6. Allows Healthcare Group to bid, if it chooses, on the ASRS retiree healthcare contract
7. Modify the current rescinding option as it applies to the post-2001 retirees
  - Estimated Savings Range: 0.18% to 0.36%
8. Conform retirement statutes to Internal Revenue Code, U.S. Code, state statute, and ASRS practices