

**EXPLANATION OF PROPOSED STATUTORY AMENDMENTS TO THE
ELECTED OFFICIALS' RETIREMENT PLAN
PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM
CORRECTIONS OFFICER RETIREMENT PLAN**

For the 2012 Legislative Session, the Board of Trustees of the Elected Officials' Retirement Plan, Public Safety Personnel Retirement Plan, and the Corrections Officer Retirement Plan ("the PSPRS System") proposes statutory amendments to the plans to clarify member rights and improve operation of the PSPRS System. The amendments are incorporated into three individual bills: one seventeen-section bill (the "Administrative Bill"); and two single-section bills (the "the Board Authority Bill" and "the Scrutinized Business Operations Bill"). There follows a summary explanation of the amendments included in each bill.

1. The Administrative Bill

Section 1 amends ARS § 35-1002 relating to swap agreements.

Amendment: The amendment adds language to ARS § 35-1002(B) modifying the exceptions to the general prohibition against government entities entering into swap agreements to expressly permit entering into swap agreements for the purpose of implementation of investment strategies.

Purpose: The amendment clarifies the authority of PSPRS System to enter into swap agreements for investment purposes. By way of explanation, on a basic level a swap is an agreement to exchange a series of cash flows by two parties seeking to mitigate existing financial exposure or to create a new exposure. The duty to pay a under the swap agreement is usually triggered by a particular event, the price of a security or the level of an index. The System benefits from using swap agreements to replicate exposures that could only be obtained by purchasing interests in numerous niche market investments. Entering a swap agreement avoids transactional costs associated with trading in numerous niche market investments. Also, swap agreements are generally standardized so the initial transactional cost can be spread over numerous investments. In addition, during market downturns swaps offer the System opportunities to benefit from the varying level of risk perceived by market players that will pay the System a premium in order to mitigate certain exposures that may be of concern to their creditors or their investors. Furthermore, swaps rather than futures permit the System to minimize tracking errors against performance benchmarks because the triggers and cash flow consequences for swaps are precisely determined.

Section 2 amends ARS § 38-822 relating Qualified Domestic Relations Orders for the Elected Officials' Retirement Plan.

Amendment: The amendment adds paragraph (B)(8) that authorizes the PSPRS System to implement court orders (domestic relations orders or QDROs) disposing of retirement

benefits as part of a divorce decree issued by courts outside of Arizona.

Purpose: The statute in its current form does not specifically authorize the PSPRS System to implement orders issued by courts outside of Arizona. The amendment clarifies that the PSPRS System has authority to implement out-of-state domestic relations orders. The change revises the state statute in accordance with the authority described in the applicable federal statutes. This change parallels the changes to Sections 11 and 17 for PSPRS and CORP, respectively.

Section 3 amends ARS § 38-843.05 relating to payment of alternate contributions by employers in the Public Safety Personnel Retirement System.

Amendment: The change revises: the provisions of paragraph (A) to clarify that the duty of an employer to pay the alternate contribution coincides with the restrictions on return to work set forth in ARS § 35-849; and, adds language to paragraph (B) to clarify the duty to notify the local board when a PSPRS employer hires a retired member.

Purpose: The changes to ARS § 35-843.05 clarify and facilitate the changes to ARS § 35-849 that expand the restrictions on retired members who return to work with a PSPRS employer. See the explanation for Section 7.

Section 4 amends ARS § 38-844, relating to requirements for payment of benefits for the Public Safety Personnel Retirement System.

Amendment: The amendment changes the reference to ARS § 38-849(D) in paragraph (H) to ARS § 38-849 (E).

Purpose: The change to the reference follows the amendments discussed at Section 7.

Section 5 amends ARS § 38-846, relating to payment of survivor benefits for the Public Safety Personnel Retirement System.

Amendment: The amendment adds language to paragraph (I) providing for payment of survivor benefits to a successor beneficiary that was not designated by the member upon submission of an application in writing by the beneficiary.

Purpose: From time to time a named beneficiary does not claim payment of survivor benefits because the beneficiary does not survive the member or neglects or refuses to apply. The change clarifies the authority of the Board to make payment of survivor benefits to next of kin upon submittal of a written application.

Section 6 amends ARS § 38-847 relating to the authority of local boards under Public Safety Personnel Retirement System.

Amendment: The amendment adds language to paragraph (D)(3) to provide an exception to the duty to provide a rehearing, amends paragraph (G) to require local boards to provide the Board of Trustees with a complete record of all actions taken on claims by members, and adds language to paragraph (K) to include medical boards as an appropriate source of information for the local board.

Purpose: The change to paragraph (D)(3) clarifies that a PSPRS local board need not afford a claimant a rehearing if doing so is contrary other applicable law. The change recognizes that state employees who are members of PSPRS may be entitled to hearing before the state Office of Administrative Hearings pursuant to the Uniform

Administrative Hearing Procedures described by ARS § 41-1092 *et seq.* The change to paragraph (G) clarifies the duty of local boards to provide the System all documents submitted for the determination of benefits upon the claim of a member including instances when a Local Board appoints a medical board to determine eligibility for disability benefits. The change to paragraph (K) is a clean-up change clarifying that a medical board is an appropriate source of information to be used by the local board in determining a claim for benefits.

Section 7 amends ARS § 38-849 relating to the Public Safety Personnel Retirement System provision for members who return to work.

Amendment: The amendment adds new language at paragraph (C) providing conditions and restrictions on the right of a member who previously terminated membership and received a refund of contributions to restore forfeited service credit in the event that the member returns to the same employer within two years after termination. The amendment also restates previous paragraph (C) as paragraph (D) and adds language providing conditions and restrictions on the right of a member who previously terminated membership and received a refund of contributions to restore forfeited service credit in the event that the member returns to work for any PSPRS employer or to the member's previous employer after a period of two years. In addition, the amendment restates previous paragraph (D) as paragraph (E) and extends the minimum separation period from 60 days to one year for retired members who return to work with the employer from which the member retired.

Purpose: The changes to revised paragraphs (C), (D), and (E) conform the provisions of PSPRS to those of CORP. In addition, with regard to the extension of the separation period from 60 days to one year in revised paragraph (E), pursuant to IRS guidance a qualifying plan must condition eligibility for retirement benefits on the retiring member's to "separation" from his or her employer. The IRS deems that a period of separation is "bona fide" only if the retiring employee has no expectation of returning to work before the end of the separation period. By extending the minimum separation period in PSPRS from 60 days to the one-year period provided in CORP, the Board seeks to discourage members from attempting to "bridge the gap" by means that may subject the plans to scrutiny by the IRS.

Section 8 amends ARS § 38-853 relating to purchase of service credit for the Public Safety Personnel Retirement System.

Amendment: The amendment strikes the two-year limitation set forth in paragraph (A) for purchase of service credit and adds language requiring a member to apply to the Board for purchase of service credit.

Purpose: The change strikes two-year limitation period for transfer of credited service for members who terminate and return to work with a PSPRS employer to conform PSPRS to CORP. Deletion of the general two-year requirement is required by the changes described in Sections 3 and 7. The change also clarifies that a member must apply for purchase of service credit in a form acceptable to the Board.

Section 9 amends ARS § 38-853.01 relating calculation of redemption of prior service for the Public Safety Personnel Retirement System.

Amendment: The amendment adds paragraph (D) providing for the calculation of redemption in service credit.

Purpose: The change conforms the provisions of PSPRS to CORP.

Section 10 amends ARS § 38-859 relating medical boards for the Public Safety Personnel Retirement System.

Amendment: The amendment adds language to paragraph (A)(6) authorizing medical boards to determine the proximate cause of death for a member killed in the line of duty.

Purpose: The change seeks to facilitate the information available to local boards in the determination of eligibility for death benefits by expanding the authority of medical boards to determine the proximate cause of death for a member killed in the line of duty.

Section 11 amends ARS § 38-860 relating Qualified Domestic Relations Orders for the Public Safety Personnel Retirement System.

Amendment: The amendment adds language at paragraph (B)(8) that authorizes the PSPRS System to implement court orders (domestic relations orders or QDROs) disposing of retirement benefits as part of a divorce decree issued by courts outside of Arizona.

Purpose: The statute in its current form does not specifically authorize the PSPRS System to implement orders issued by courts outside of Arizona. The amendment clarifies that the PSPRS System has authority to implement out-of-state domestic relations orders. The change revises the state statute in accordance with the authority described in the applicable federal statutes. This change is parallel to Sections 2 and 17 of the bill for EORP and CORP, respectively.

Section 12 amends ARS § 38-884 relating to the Corrections Officer Retirement Plan.

Amendment: The amendment adds language to paragraph (J) providing for forfeiture of service credit for members who terminate and receive a severance refund and provides conditions for restoration of service credit.

Purpose: The changes to paragraph (J) clarify that termination and receipt of a severance refund results in forfeiture of service credit and conforms CORP to similar provisions of PSPRS.

Section 13 amends ARS § 38-893 relating authority of local boards for the Corrections Officer Retirement Plan

Amendment: The amendment adds language to paragraph (D)(2) requiring local boards to hear claims within 90 days and provides remedies in the event that a local board fails to do so. In addition, the amendment adds language to paragraph (G) to require local boards to provide the System with a complete record of all actions taken on claims by members, and adds language to paragraph (K) to include medical boards as an appropriate source of information for the local board.

Purpose: The change to paragraph (D)(2) clarifies the due process rights of members and conforms the provisions of CORP to PSPRS. The change to paragraph (G) clarifies the duty of local boards to provide all documents submitted for the determination of benefits upon the claim of a member including instances when a Local Board appoints a medical

board to determine eligibility for disability benefits. The change to paragraph (K) is a clean-up change that clarifies that a medical board is an appropriate source of information to be used by the local board in determining a claim for benefits.

Section 14 adds new section ARS § 38-895.02 relating retroactive payments of benefits for the Corrections Officer Retirement Plan

New Section: The new section limits retroactive payment of benefits to the 90-day period prior to application.

Purpose: The new section conforms CORP to EORP and PSPRS.

Section 15 amends ARS § 38-904 relating payment of death benefits for the Corrections Officer Retirement Plan

Amendment: The amendment adds language to paragraph (A) providing for payment of death benefits to a successor beneficiary that was not designated by the member upon submission of an application in writing.

Purpose: This change parallels the change to PSPRS described in Section 5. From time to time a named beneficiary does not claim payment of death benefits because the beneficiary does not survive the member or neglects or refuses to apply. The change clarifies the authority of the Board to make payment of death benefits to next of kin upon submittal of a written application.

Section 16 amends ARS § 38-909 relating to the Corrections Officer Retirement Plan

Amendment: The amendment adds language to paragraph (A) clarifying limitation of applicability to subdivisions of the state.

Purpose: The change parallels the change described in Section 9 and conforms the provisions of CORP to PSPRS.

Section 17 amends ARS § 38-910 relating Qualified Domestic Relations Orders for the Corrections Officer Retirement Plan.

Amendment: The amendment adds language at paragraph (B)(8) that authorizes the PSPRS System to implement court orders (domestic relations orders or QDROs) disposing of retirement benefits as part of a divorce decree issued by courts outside of Arizona.

Purpose: The statute in its current form does not specifically authorize the PSPRS System to implement orders issued by courts outside of Arizona. The amendment clarifies that the PSPRS System has authority to implement out-of-state domestic relations orders. The change revises the state statute in accordance with the authority described in the applicable federal statutes. This change is parallel to Sections 2 and 10 of the bill for EORP and PSPRS, respectively.

2. The PSPRS Board Authority Bill

Section 1 amends ARS § 38-848 providing for the authority of the Board of Trustees of the Public Safety Personnel Retirement System.

Amendment: The amendment adds language to paragraph (M) authorizing the Board to enter into employment contracts with the administrator and assistant administrators. The

amendment also makes several minor clean-up changes to the section.

Purpose: The change clarifies the authority of the Board to enter into employment contracts with the administrator and assistant administrators as that authority was not specifically provided for in the PSPRS Statutes.

3. The Scrutinized Business Operations Bill

Section 1 amends ARS § 38-848 providing for the authority of the Board of Trustees for the Public Safety Personnel Retirement System.

Amendment: The amendment adds language to paragraph (M) that clarifies that certain investment contracts are not investments in Sudan or Iran and that such contracts do not provide support to terrorists or in any way facilitate illegal immigration to the United States, and accordingly those contracts do not involve the procurement or provision of goods, equipment, labor, materials or services that would trigger the requirements of the Arizona Sudan Act, ARS § 35-391 *et seq.*, the Arizona Iran Act, ARS § 35-393 *et seq.*, or ARS § 41-4401(A).

Purpose: In the context of entering into investment contracts, the System scrupulously avoids any direct investment that would trigger the prohibitions and disinvestment requirements of the compliance Arizona Sudan Act, ARS § 35-391 *et seq.*, the Arizona Iran Act, ARS § 35-393 *et seq.*, or ARS § 41-4401(A) (“the Acts”). Also, in compliance with the Acts, the System annually reports all indirect holdings (i.e. investments in funds held by the System along with other investors) in companies deemed to have “scrutinized business operations” and requests the managers of those funds to provide the System with an alternate investment without holdings in companies with “scrutinized business operations.” Even so, uncertainty as to whether investment contracts may be “procurement or provision of goods, equipment, labor, materials or services” that would trigger prohibitions in the Acts requires the System to negotiate with fund managers to warrant that they do not violate the procurement and immigration related restrictions set forth in the Acts. Because these warranties are particular to the State of Arizona, fund managers are reluctant to incur legal costs to negotiate them. As a result, the System incurs substantial transactional and opportunity costs with no apparent advantage to the interests of the state vis-à-vis the objectives of the Acts. The System estimates that negotiation of the warranties often results in an additional two months and \$5,000 to \$15,000 in legal costs for each investment contract. On several occasions the System has lost out on lucrative investment opportunities with funds that have refused to provide the procurement-related warranties requested by the System after protracted negotiation. The System would avoid these transactional and opportunity costs if the Legislature clarified that investment contracts are not procurement or provision of goods, equipment, labor, materials or services within the context of the Acts.