The Meeting of the Board of Trustees of the Public Safety Personnel Retirement System (the “PSPRS” or “System”) will be held in the main public conference room of the administrative offices of PSPRS, 3010 East Camelback Road, Suite 200, Phoenix, Arizona 85016, commencing at 1:00 p.m. on Thursday, February 9, 2017. The meeting will continue until 5:00 p.m. or until the matters set forth in this agenda are otherwise addressed. Members of the Board of Trustees will attend either in person or by telephonic conference call. The Board of Trustees may vote to hold an executive session, which will not be open to the public, to discuss certain matters. The Board of Trustees reserves the right to consider agenda items out of their listed order.

This meeting is available to the public through “Go to Meeting” over the Internet or in person. Please see www.psprs.com for the computer link to the meeting. All persons wishing to attend are invited.

1. Call to Order; Roll Call; Opening remarks
   
   Mr. Brian P. Tobin
   Chairman

2. Call to the Public.

   This is the time for the public to comment. Members of the Board of Trustees may not discuss items that are not specifically identified on the agenda, except to address criticism from the public. Therefore, pursuant to A.R.S. § 38-431.01(H), the Board of Trustees’ reaction to any public comment is limited to addressing criticism or recommending that the Board of Trustees or Staff respond or study such comment or schedule the subject matter for further consideration at a later date after appropriate notice.

3. Discussion with representatives from Cortex regarding their risk-pooling and local board consolidation report and recommendations.

   Mr. Brian P. Tobin
   Mr. Jared A. Smout
   Administrator
   Mr. Tom Iannucci
   President, Cortex
   Mr. Clive Morgan
   Consultant, Cortex

4. Discussion with stakeholders regarding risk-pooling and local board consolidation and possible Action. (15 minutes)

   Mr. Brian P. Tobin

5. Discussion and possible Action on recommendations to the Legislature for setting the Employee/Employer contribution rate for Tier 3 PSPRS members.

   Mr. Brian P. Tobin
   Mr. Jared A. Smout
6. Review, discussion and possible Action on pending and passed actions and potential legislative proposals.

7. Discussion and consultation with legal counsel and Staff and possible Action regarding proposed legislation, ongoing, contemplated or threatened legal action involving the Trust and Plans, including vendor disputes, public record requests, personnel matters and actual or potential litigation and claims based on contract, tort or statute, including matters involving, judges Thompson, Hall and Fields. The Board may vote to discuss these matters in Executive Session pursuant to A.R.S. §§ 38-431.03(A)(1), (2), (3), (4) and (7) as set forth in item 8.

8. The Board of Trustees may vote to go into Executive Session (which will not be open to the public) to discuss matters pursuant to A.R.S. §§ 38-431.03(A) (1), (2), (3), (4) and (7), as applicable, including to receive legal advice from the Board’s attorneys on any matter listed on the agenda, including:

   a. Discussion and consultation with legal counsel and Staff regarding matters arising from public record requests or subpoenas, and ongoing or threatened legal action or claims involving the Plans or Trust not otherwise referenced above in Item 7, including but not limited to those involving the status of lawsuits challenging provisions of SB1609, as authorized by A.R.S. §§ 38-431.03(A) (2), (3).

9. Schedule future meeting date(s). (Currently scheduled for Wednesday, March 1, 2017.)

10. Adjournment.

A copy of the agenda background material that is provided to the Board of Trustees (with the exception of materials relating to possible executive sessions and/or materials exempt by law from public inspection) is available for public inspection at the PSPRS offices located at 3010 East Camelback Road, Suite, 200, Phoenix, Arizona. The agenda is subject to revision up to 24 hours prior to the meeting.

Persons with a disability may request a reasonable accommodation, such as a sign language interpreter, by contacting Michelle Pechan, Paralegal, at (602) 255-5575. Requests should be made as early as possible to arrange the accommodation.
STATE OF ARIZONA PUBLIC SAFETY PERSONNEL

RETIREMENT SYSTEM

REPORT ON RISK POOLING & LOCAL BOARD CONSOLIDATION

PREPARED BY

CORTEX APPLIED RESEARCH INC.

JANUARY 27, 2017
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EXECUTIVE SUMMARY

The Board of PSPRS retained Cortex to conduct a study to determine various methods by which risk pooling may be structured and by which Local Board consolidation and structure may be accomplished; and to determine which methods, if any, are in the best interests of the public safety personnel retirement system's fund, members, beneficiaries and employers.

Based on a review of relevant documentation and considerable outreach to PSPRS stakeholders including Local Boards, the Board of PSPRS, retiree groups, and employers, Cortex arrived at a number of findings and recommendations, which are summarized below:

RISK POOLING

Cortex considered the following three basic options for risk pooling:

Option 1 - The Status Quo. Under the status quo, risk pooling in Tier 3 would be identical to the approach currently used in Tiers 1 and 2. That is, none of the liability risks would be pooled, with the exception of death in the line of duty (arguably one of the most material Non-controllable Risks). Accordingly, each Local Employer will have a different liability, reflecting the actuarial experience of its employees, and a different required contribution rate, and may make additional contributions at its discretion, leading to further differences in funded status among Local Employers.

Option 2 – 100% Risk Pooling. Under option 2, the Tier 3 pension liabilities of all Employers in the System would be calculated together as a single liability pool, and each Employer and all employees are responsible for paying an identical contribution rate. If one Employer has a negative or positive actuarial experience due to demographic or economic factors, including both Non-controllable Risks and Controllable Risks, the resulting gains or losses will be shared proportionately among all Employers and employees in the System.

Option 3 – Hybrid Option. Under a hybrid option, Non-controllable Risks would be pooled where appropriate and Controllable Risks would generally not be pooled, but rather would be borne by the parties that incurred the risks and generated the additional costs for the System. Cortex considered three different ways of implementing the hybrid option:

- Option 3a) Charge-back Method. Under this approach, all liability risks are pooled, but all employees and the Local Employers in question are subsequently charged back for the costs
associated with any decisions the Employer in question makes that result in additional material costs being incurred by the pool.

- **Option 3b) Pool Longevity Risk and Disability in the Line of Duty.** Under this option, PSPRS would continue to pool the risk of death in the line of duty for active Tier 3 members, but would also pool disability in the line of duty and longevity risk. Longevity risk would be pooled by establishing a separate pooled account within PSPRS for all Tier 3 retirees and beneficiaries.

- **Option 3c) Separate Large and Small Employers for Risk Pooling Purposes:** Under this approach, large and small Employers will be treated differently for risk pooling purposes:
  - Employers with more than 100 employees will manage their active employees using the Status Quo approach, while their retirees will be assigned to a retiree pool established for all Tier 3 Employers.
  - Employers with less than 100 employees will have their active employees placed in an active lives pool along with those of all other small Employers, and their retirees will be placed in the same retiree pool noted above for all Tier 3 Employers.

Cortex considered the following criteria in evaluating the above options for risk pooling in Tier 3:

1. Promotes stability of contributions for Employers and employees;
2. Maintains equal cost (and therefore risk sharing) between Employers and employees;
3. Supports workforce mobility via consistent employee contribution rates across all employers;
4. Promotes accountability and equity in pension management (i.e. Employers are fully accountable for their pension/HR management decisions and cannot shift pension costs to other Employers or otherwise game the pension system);
5. Long-term benefit costs; and

Note that criterion 2 above reflects SB 1428, which requires that both employers and employees each pay 50% of the combined normal cost and unfunded liability (if any) for Tier 3. In fact, the language of SB 1428 could be interpreted as suggesting that the legislature contemplated an agent multiple system in which individual employers pay different rates. Representatives from cities and towns informed Cortex that they were under the impression that the intent of SB 1428 and the reform process was to produce a system whereby all employers paid an identical contribution rate. We believe that view is inconsistent with the provisions of SB 1428.
Risk pooling requires a trade-off among the above criteria:

- Maximum risk pooling is likely to support relatively stable contributions, increased workforce mobility, and ease of benefit administration; but may increase the likelihood that Employers will make management decisions that increase benefit costs and shift those costs onto other Employers and Employees in the System.

- Similarly, minimal or no risk pooling imposes maximum accountability on individual Local Employers for the costs of their human resource management decisions (i.e. controllable costs), but likely leads to higher contribution volatility for Local Employers.

Setting the contribution rates also involves trade-offs. For example, having equal contribution rates across all employers and employees necessarily reduces accountability as some employers and employees will implicitly pay for part of the costs associated with the human resource decisions (i.e. controllable costs) of other employers.

**Recommendations – Risk Pooling**

After considering the above criteria, relevant documentation, and input from stakeholders, Cortex has recommended Option 3b) in which PSPRS would continue to pool the risk of death in the line of duty for active Tier 3 members, but would also pool the risks of disability in the line of duty and longevity. Longevity risk would be pooled by setting up a separate account within PSPRS for all Tier 3 retirees and beneficiaries.

In considering the options for calculating the employer and employee contributions rates under the various risk pooling alternatives, we recognized that SB 1428 requires that the costs of each local fund be shared equally between the Local Employer and its employees, including the costs of any human resource decisions made at the local level. Any change to how contributions are shared would require an amendment to the statute.

During our stakeholder outreach, a number of stakeholders stressed the importance of maintaining uniform employee contribution rates to facilitate employee mobility. It appears the current legislation, however, does not support uniform employee contribution rates; to achieve such rates would require a change in legislation.

Below we describe two approaches to determining contribution rates; one that reflects the current legislation in which contributions are shared equally at the local level and another that would support the goal of uniform employee contribution rates across Tier 3, as expressed by stakeholders.

**Equal Contribution Rates at the Local Level**

Under this approach, the employee contribution rate should be calculated based on the funded status of the Local Employer plan and should include the payments required to fund 50% of the
unfunded liability and 50% of the normal cost, thus ensuring employees are responsible for 50% of the local and total cost of the plan.

When a Local Employer makes a human resource management decision that generates additional pension costs, the employee portion of the additional cost (i.e. 50%) will be paid by employees of that Local Employer only.

The advantages of this approach are:

- It is consistent with current legislation.
- Employees’ interests and the interests of Local Employers will be better aligned in regards to local human resource decisions, as each will have to pay 50% of the costs associated with local human resource decisions.
- There will be no sharing of costs with other employees in Tier 3, thus supporting equity among all Tier 3 employees.

The disadvantages are:

- The contributions rates for employees will be more volatile than under a uniform rate.
- There may be a possible reduction in job mobility as differences in employee contribution rates across the state could be an issue for a new employee.

**Uniform Employee Contribution Rates**

Under this approach, the employee contribution rate would be calculated based on the funded status of the total plan and should include the payments required to fund 50% of the aggregate unfunded liability and 50% of the normal cost, thus ensuring employees pay uniform rates and are responsible for 50% of the total cost of the plan.

Each Local Employer’s contribution rate will differ and would be calculated as its normal cost plus amortization payments for unfunded liabilities related to its own employees (resulting from both controllable costs and non-controllable negative demographic experience) less the aggregate employee contribution rate.

When a Local Employer makes a human resource management decision that generates added pension costs, the employee portion of the additional cost (i.e. 50%) will be paid by all employees in Tier 3 and not just the employees of that Local Employer.

Individual employers will fund 50% the cost of their human resource management decisions whereas the employees will fund 50% of the aggregate unfunded liability for Tier 3. This would lead to differences in contribution rates between employers and employees.
The main advantage of this approach is that it maintains a uniform Tier 3 employee contribution rate across the PSPRS, which promotes job mobility.

The disadvantages of this approach are:

- All Tier 3 employees in the System will pay for the human resource decisions that occur at individual Employers.
- It will require an amendment to the Statute.
- The contribution rates paid by the Local Employer will differ from those paid by their employees. These could be higher or lower depending on the Local Employer’s human resource activities. If an Employer’s contribution rate is lower than that of its employees, this could also be a concern, as there may be an expectation that they should always be equal.

Based upon this further analysis, Cortex believes equal contribution rates for both the employer and employee at the local level is the more equitable and accountable approach and most consistent with the intent of the Legislature as expressed in current legislation. If PSPRS instead believes that employee rates should be uniform across the System, it would need to pursue a change in legislation.

LOCAL BOARD CONSOLIDATION

PSPRS is administered at the local level by 233 Local Boards, 211 of which are responsible for less than 150 plan members. Cortex was asked to review options for consolidating the Local Boards and to provide recommendations.

Cortex considered three alternatives for Local Board Consolidation:

*Alternative 1 – Status Quo with Enhancements.* This alternative would maintain all current 233 Local Boards, but would attempt to enhance Local Board decision-making through improved governance training and procedures.

*Alternative 2 – A Single Board.* This alternative would consolidate all Local Boards to form a single state-wide Board responsible for all benefit administration matters.

*Alternative 3 – Partial consolidation.* There are a number of ways partial consolidation could be achieved. We focused on an approach in which all small Local Boards would be consolidated along county lines, while the largest Local Boards would remain separate and unchanged. In addition, small state agency Local Boards (i.e., all except Department of Public Safety) would be consolidated into a single State Agency Board. This would result in a minimum of 27 local county boards, 17 large Local Boards and one State Agency Board for a total of 45 Local Boards. All small Local Boards (including those of Indian Tribes and state agencies) would have the option of
applying for an exemption from consolidation based on whether they meet prescribed criteria or standards.

In evaluating the above alternatives, Cortex considered the following criteria:

1. The need to ensure that board members who are responsible for administering benefits have sufficient knowledge of the local workplace environment and circumstances that may be relevant to the administrative process, particularly as they may relate to disability benefits.

2. The need to provide services to plan members that are convenient and easy to access.

3. The need to ensure that benefit provisions are applied uniformly across the State, given that all members in PSPRS are subject to the same benefits provisions.

4. The need to ensure that administrative decisions are arrived at in a sound and objective manner.

5. The need to ensure benefit administration is carried out in a cost-effective manner.

Based on the above criteria, Cortex has recommended alternative 3, partial Board consolidation, based along county lines and with an option for small Local Boards to apply for an exemption. This alternative combines the advantages of the status quo with those of a single consolidated board:

1. It generates significant efficiencies by consolidating the small Local Boards to approximately 45 boards from 233.

2. It reduces the number of qualified board members that are needed to a more manageable number, approximately 170 as opposed to 817.

3. It spreads the administrative burden of the current Local Boards among 45 Boards rather than imposing it all on a single Administrative Board.

4. It would enhance the consistency of decision-making, as there would be far fewer boards involved in decision-making, as compared to the status quo.

5. While not quite as convenient for members as the status quo, members would not need to travel beyond their county in order to meet with their Local Board.

6. Independence of Local Board decision-making would be enhanced under this alternative, as Local County Boards would likely contain board members from throughout the county who would be less acquainted with members and claimants who may appear before them. At the same time, however, the Local County Board is likely to have a reasonable knowledge of workplace circumstances within their county, or will be able to build such knowledge over time.
The above recommendation is subject to successfully addressing the issues involved in implementation, which include, but are not limited to:

1. How would the composition of the local county boards be established?
2. What would be the impact on the current local board secretaries?
3. How would the new local county boards be supported from an administrative perspective? For example, would each local county board have its own administrative staff?
4. What additional costs would be associated with the new local county boards?
5. What specific governance criteria would be used to determine if an exemption would be granted?

If the implementation issues associated with a county board model cannot be adequately resolved, PSPRS may wish to consider Cortex’s secondary recommendation, which is a hybrid of alternatives 1 and 2 as follows:

- All local plans could continue to be governed by their existing Local Board, but would be provided additional governance training and support by PSPRS (i.e. Alternative 1 - Status Quo with Enhancements).

- Additionally, any Local Board could request to be consolidated into a new, state-wide administrative board (to be created), subject to a pre-determined stakeholder approval process and further subject to approval by the PSPRS Board based on possible pre-determined criteria. This represents a variation on Alternative 2 – A Single Board.
STUDY OBJECTIVES

Senate Bill 1428 enacted numerous important reforms for PSPRS including changes to the governance of the System and the creation of a new benefit tier (Tier 3). Two issues that were not addressed by the Bill include a) the extent and the basis of liability risk pooling to be established for Tier 3, and b) the extent, if any, to which the local boards (Local Boards) of the System should be consolidated.

Senate Bill 1428 imposed a requirement on the PSPRS Board to study the above two issues and report its recommendations to the Legislature on or before February 15, 2017. The relevant provisions of the Bill are reproduced below:

1. Within fifteen days after the effective date of the act, the public safety personnel retirement system shall commence a study to determine various methods in which risk pooling may be structured and Local Board consolidation and structure may be accomplished and to determine which methods, if any, are in the best interests of the public safety personnel retirement system's fund, members, beneficiaries and employers.

2. The study shall be presented to the board of trustees of the public safety personnel retirement system on or before January 15, 2017. The board shall consider the study and report its recommendations for legislation to the president of the senate, the speaker of the house of representatives and the governor on or before February 15, 2017.

The PSPRS Board retained Cortex Applied Research (Cortex) in June 2016 to undertake the above study and present its findings and recommendations to the PSPRS Board within the timeframes specified in the Bill. In interpreting the above legislative mandate, Cortex made the following assumptions about the scope of the review.

1. Investment risk is to be excluded from the risk pooling analysis because the assets of the System are already co-mingled for investment purposes for Tiers 1 and 2, and will continue to be co-mingled for Tier 3. Cortex believes such co-mingling is appropriate and we found no perceived need on the part of stakeholders to change this approach to managing investment risk.

2. The study of liability risk pooling is to be limited to Tier 3 only. While Cortex may comment on risk pooling for Tiers 1 and 2, Cortex will not be providing specific recommendations in that regard.

3. Options for Local Board consolidation are to be considered in relation to all three tiers. That is, if Local Boards are to be consolidated in some manner, the resulting board(s) should be responsible for administering all three tiers and not just Tier 3.
STUDY METHODOLOGY

See Appendix A for an overview of the basic process Cortex followed in completing the study.

BACKGROUND - PSPRS

The PSPRS was established in 1968 to administer retirement benefits to public safety personnel who are regularly assigned hazardous duty in the employment of the state of Arizona or a political subdivision thereof. Such personnel include firefighters, police officers, and highway patrol officers, as well as their beneficiaries. As of 30 June 2016, PSPRS served 18,706 active members and 15,224 retired members, beneficiaries, and terminated vested members.

PSPRS is an agent multiple-employer defined benefit pension plan, which means that the assets and liabilities of each employer (Employer or Local Employer) in the Plan are accounted for separately, thereby allowing for unique funding levels and contribution rates for each Employer. The assets of the participating employers are co-mingled for investment purposes but separate accounts are maintained for each individual employer. As a result, each participating Employer’s share of the pooled assets is legally available to pay the defined benefit pensions of only its members.

Historically, the administration of PSPRS has been carried out by the Board of PSPRS (the PSPRS Board) as well as by 233 Local Boards.

The PSPRS Board, prior to January 2017, consisted of seven members who serve five-year terms and are appointed by the Governor. The PSPRS Board is comprised of the following:

- Two elected members from a Local Board to represent the employees.
- One member appointed to represent this state as an employer of public safety personnel.
- One member appointed to represent the cities as employers of public safety.
- One member appointed to represent elected officials (county or state official, judge of the superior court, court of appeals, or supreme court).
- Two members of the public.

Effective January 2017, the number of members on the PSPRS Board will increase from seven to nine and the basis for nominations and appointments to the PSPRS Board will change. See paragraph “Changes in Governance of PSPRS” below

Each Local Board consists of five members as follows:

- A chairperson.
• Two appointed persons.

• Two PSPRS plan members who are elected by secret ballot election by all contributing members for that Employer group.

• The chairperson and two appointed members sit on both Local Boards (fire and police), if applicable.

Historically, the allocation of responsibilities between the PSPRS Board and the Local Boards has been as follows:

• Local Boards are responsible for determining eligibility for membership, as well as normal retirement benefits based on years of service, the annual benefit accrual rate, and final compensation. They also determine eligibility for disability benefits, survivorship benefits for spouses and children, post-retirement adjustments, and health insurance premium subsidies.

• The PSPRS Board, through the administrative offices of PSPRS, is responsible for receiving, accounting for, and investing the contributions from the Local Boards, and for distributing the benefits for each Local Board. The PSPRS Board, however, is not responsible for reviewing, nor does it have the duty to review, the actions or omissions of the individual Local Boards, but it does have the discretion to seek review or rehearing to protect the qualified status of the System as a whole and to ensure consistent application of the statutes governing the System.

Until recently, the System offered two different benefit tiers, referred to as Tier 1 and Tier 2. Members hired before January 1, 2012 were placed in Tier 1, while members hired on or after January 1, 2012 were placed in Tier 2. Senate Bill 1428, which came into effect in February 2016, introduced significant changes to the benefit structure and governance of PSPRS. These changes are summarized below.

**Changes in Benefit Structure**

Commencing July 2017, all new members of PSPRS will participate in a revised benefit structure, referred to as Tier 3. Compared to the prior benefit tiers, Tier 3 benefits are designed to support more stable contribution rates and be more sustainable over the long term. Key features of Tier 3 benefits are summarized below.

1. Whereas the benefits available under Tiers 1 and 2 were of a defined benefit nature, members of Tier 3 will be offered the choice of joining a defined benefit plan with similar benefits to Tier 2, or a defined contribution plan. For members who take the defined benefit option and do not contribute to social security, it will be a hybrid structure whereby the member will have both defined contribution and defined benefit components.
2. Employee contributions for Tier 3 members are 50% of the cost of the plan including payments made for any unfunded liabilities. Accordingly, members of Tier 3 will have a more direct interest in the funding and management of Tier 3, as they will share in the responsibility for paying any increased contributions necessary to fund Tier 3 benefits.

3. The maximum earnings under Tier 3 are now set at $110,000. The amount will be adjusted every 3 years based on a custom index. Under Tiers 1 and 2, maximum earnings are prescribed by the Internal Revenue Code, currently $265,000.

4. The Permanent Benefit Increases (PBI) available under Tiers 1 and 2 to enhance benefits to retirees has been replaced for Tier 3 members by a cost of living adjustment formula (COLA). For Tier 3, the amount of the COLA will depend on the funded ratio of the Tier 3 plan and will have a maximum increase of 2% based on the change in the Phoenix–Mesa Consumer Price Index. The COLA is payable after a waiting period of 7 years or at age 60. In determining the annual contributions to fund Tier 3, the actuarial liabilities will assume that the allowable COLA will be granted.

5. Future benefit improvements under Tier 3 can only be made if the cost of the improvement, calculated on a conservative actuarial basis, is funded over one year.

6. Disability and death benefit provisions under Tier 3 remain the same as under Tiers 1 and 2.

The following Table below provides a summary of the benefits available under Tier 1 and Tier 2, as well as the new benefits to be available under Tier 3.

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<th>Tier 1</th>
<th>Tier 2</th>
<th>Tier 3</th>
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<tbody>
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<td>On or after January 1, 2012</td>
<td>On or after July 1, 2017</td>
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<td>Defined Contribution only or Defined Benefit w/ Hybrid</td>
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<td></td>
<td></td>
<td>(for non-Social Security only; may opt out by 06/30/17)</td>
<td>(for non-Social Security only)</td>
</tr>
<tr>
<td><strong>Determination</strong></td>
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<td><strong>Employee Contribution Rate</strong></td>
<td>11.65% (includes 4% maintenance of effort)</td>
<td>DB: 11.65% (includes MOE) Hybrid: DB + 3%</td>
<td>DB: 50/50 split with ER DC: 9% + Disability Hybrid: DB + 3%</td>
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<tr>
<td><strong>Employer Contribution Rate</strong></td>
<td>Based on individual actuarial valuation</td>
<td>DB: Individual Valuation Hybrid: DB + 4% for short period of time; then 3%</td>
<td>DB: 50/50 split with ER DC: 9% + Disability Hybrid: DB + 3%</td>
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<td><strong>Salary Cap</strong></td>
<td>As set by Internal Revenue Code</td>
<td></td>
<td>$110,000 adjusted by custom index</td>
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<tr>
<td></td>
<td>Tier 1</td>
<td>Tier 2</td>
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<tr>
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<tr>
<td><strong>Determination</strong></td>
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<td>Automatic</td>
<td>Irrevocable choice (90 days; default to Hybrid)</td>
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<td><strong>Inter-System Transfers</strong></td>
<td>Total liability is transferred to new Employer with assets transferred at market funding level.</td>
<td>Total liability stays with previous Employer.</td>
<td></td>
</tr>
<tr>
<td><strong>Termination Refund</strong></td>
<td>Contributions plus match</td>
<td>Contributions + 3% interest</td>
<td></td>
</tr>
<tr>
<td><strong>Average Salary</strong></td>
<td>High 3 in past 20 years</td>
<td>High 5 in past 20 years</td>
<td>High 5 in past 15 years</td>
</tr>
<tr>
<td><strong>Normal Retirement</strong></td>
<td>20 years of service; no age 15 years of service; age 62</td>
<td>25 years of service; age 52.5 (not mutually attained)</td>
<td>15 years of cred service; age 55 (not mutually attained; actuarially reduced at 52.5)</td>
</tr>
<tr>
<td><strong>Disability and Survivor Benefits</strong></td>
<td>All 4 types of disability (Accidental, Catastrophic, Ordinary and Temporary) and survivor benefits are available to each tier where the determination, process and benefit amount will be the same as they are now. However, those who choose the DC only option will contribute to a separate disability fund where an actuarially determined equivalent amount will paid in conjunction with their DC fund. No survivor benefits are available for DC only participants.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Multipliers</strong></td>
<td>50% plus 2.0% for years &gt;20 and &lt;25</td>
<td>62.5% plus 2.5% for years &gt;25 (reduced by 4% for &lt;25 yrs.)</td>
<td>15 to &lt;17 years: 1.50%</td>
</tr>
<tr>
<td></td>
<td>2.5% for years &gt;25 (reduced by 4% for &lt;20 yrs.)</td>
<td></td>
<td>17 to &lt;19 years: 1.75%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>19 to &lt;22 years: 2.00%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>22 to &lt;25 years: 2.25%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>25+ years: 2.50%</td>
</tr>
<tr>
<td><strong>Deferred Annuity</strong></td>
<td>At least 10 years (double contributions)</td>
<td></td>
<td>Not Available</td>
</tr>
<tr>
<td><strong>Benefit Increases</strong></td>
<td>Up to 2%</td>
<td>No funding requirement</td>
<td>Payable after 7 years or age 60</td>
</tr>
<tr>
<td></td>
<td>No waiting period (to be confirmed after Court case)</td>
<td></td>
<td>70% to &lt;80% funded: 1.0% cap</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>80% to &lt;90% funded: 1.5% cap</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>90% or more funded: 2.0% cap</td>
</tr>
<tr>
<td><strong>Smoothing Period</strong></td>
<td>Determined by Board (currently 7 years)</td>
<td></td>
<td>Not more than 5 years</td>
</tr>
<tr>
<td><strong>Amortization Period</strong></td>
<td>Closed period of not more than 20 years</td>
<td></td>
<td>Not more than 10 years</td>
</tr>
<tr>
<td><strong>Amortized Rate</strong></td>
<td>Applied to Tier 1, 2, 3 and DC payroll</td>
<td></td>
<td>Only Tier 3</td>
</tr>
<tr>
<td><strong>Deferred Retirement Option Program (DROP)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Attainment of 20 years</strong></td>
<td>On or before</td>
<td>After</td>
<td>Not Available</td>
</tr>
<tr>
<td><strong>Contributory</strong></td>
<td>No</td>
<td>Yes</td>
<td>Not Applicable</td>
</tr>
<tr>
<td><strong>Interest Rate</strong></td>
<td>Assumed</td>
<td>Smoothed</td>
<td>Not Applicable</td>
</tr>
</tbody>
</table>
Changes to the Governance of PSPRS

Effective January 2017, the process for appointing individuals to the PSPRS Board and the minimum qualifications of PSPRS Board Members will change, as noted below.

- The number of members on the PSPRS Board will increase from seven to nine and the basis for nominations and appointments to the PSPRS Board will change. The requirements for the members of the PSPRS Board who are not members of the System are that “they shall be independent qualified professionals who are responsible for the performance of fiduciary duties and other responsibilities required to preserve and protect the fund, and shall have at least ten years of substantial experience in an area” listed in the statute.

- In addition, Senate Bill 1428 creates an Advisory Committee of 10 members. The Advisory Committee will serve as a liaison between the PSPRS Board and the members and Employers. Any recommendations from this Committee to the PSPRS Board are only advisory in nature.
BACKGROUND – LIABILITY RISKS & POOLING

Liability risk pooling is the process of combining liabilities across Local Employers to produce large risk sharing pools, with the goal of reducing or eliminating large fluctuations in an Employer's or employees’ contribution rate caused by unexpected events such as the following:

1. Demographic events or risks including those relating to:
   
   (a) Death in retirement (longevity);
   
   (b) Death before retirement;
   
   (c) Disabilities;
   
   (d) Terminations;
   
   (e) Average age at entry; and
   
   (f) Average age at retirement.

2. Economic events/risk including those relating to:

   (a) Salary levels.

Some of the above cannot be influenced by the human resource management policies or decisions of individual Local Employers. These include death in retirement, death before retirement, disabilities, and terminations. Throughout this report, we refer to such risks as “Non-Controllable Risks.”

Some risks or events, however, can be influenced by human resource management decisions or policies of Local Employers. Throughout this report, we refer to these types of risks or events as “Controllable Risks.” Examples include:

- **Average Age at Entry**: Consciously seeking to hire new employees who are older than what was assumed will likely have a negative impact on required contributions.

- **Average Age at Retirement**: Offering programs or incentives to encourage employees to retire at a younger age than what the actuaries assumed will also have an impact on required contributions.

- **Salary Levels**: Establishing policies or practices that result in employees receiving significant salary increases immediately prior to retirement (often referred to as salary spiking) may result in final average salaries that are higher than what was assumed and will have a negative impact on pension costs.
• **Inconsistent Contribution Practices:** Establishing inconsistent policies or practices regarding how and when contributions are to be collected on earnings from third-party contract work.

When considering risk pooling for Tier 3, one must determine which, if any, of the above risks should be pooled, and which should not; and, furthermore, whether pooling should include Non-controllable Risks, Controllable Risks (i.e. due to human resource management decisions), or both.

**EVALUATION CRITERIA**

Cortex used the following criteria in evaluating the various options for dealing with risk pooling in Tier 3:

1. Promotes stability of contributions for Employers and employees.
2. Maintains equal cost (and therefore risk sharing) between Employers and employees.
3. Supports workforce mobility via consistent employee contribution rates across all employers.
4. Promotes accountability in pension management (i.e. Employers are fully accountable for their pension/HR management decisions and cannot shift pension costs to other Employers or otherwise game the pension system).
5. Long-term benefit costs.

Note that criterion 2 above reflects SB 1428, which requires that both employers and employees each pay in 50% of the combined normal cost and unfunded liability (if any) for Tier 3. (See Exhibit A for relevant excerpts from SB 1428).

In fact, the language of SB 1428 could be interpreted as suggesting that the legislature contemplated an agent multiple system in which individual employers pay different rates. Representatives from cities and towns informed Cortex that they were under the impression that the intent of SB 1428 and the reform process was to produce a system whereby all employers paid an identical contribution rate. Such a view, however, appears to be inconsistent with SB 1428.

As will be discussed further in our report, risk pooling requires a trade-off among the above criteria:

• Maximum risk pooling is likely to support stable contributions, increased workforce mobility, and ease of benefit administration; but may increase the likelihood that Employers will make
management decisions that increase benefit costs and shift those costs onto other Employers and Employees in the System.

- Similarly, minimal or no risk pooling imposes maximum accountability on individual Local Employers for the costs of their human resource management decisions, but likely leads to higher contribution volatility.

Setting the contribution rates also involves trade-offs. For example, charging equal contribution rates across all employers necessarily reduces accountability as some employers and employees will implicitly pay for part of the costs associated with the human resource decisions of other employers.

Determining the optimal trade-offs to be made with respect to the above issues was the fundamental challenge of the study and is the focus of Part I of this report.
Exhibit A

Excerpts from SB 1428

G. FOR MEMBERS HIRED ON OR AFTER JULY 1, 2017, THE EMPLOYER AND MEMBER CONTRIBUTIONS ARE DETERMINED AS FOLLOWS:

1. AS DETERMINED BY ACTUARIAL VALUATIONS REPORTED TO THE EMPLOYER AND THE LOCAL BOARD BY THE BOARD OF TRUSTEES, EACH EMPLOYER SHALL MAKE CONTRIBUTIONS SUFFICIENT UNDER SUCH ACTUARIAL VALUATIONS TO PAY FIFTY PERCENT OF BOTH THE NORMAL COST PLUS THE ACTUARILY DETERMINED AMOUNT REQUIRED TO AMORTIZE THE TOTAL UNFUNDED ACCRUED LIABILITY FOR EACH EMPLOYER ATTRIBUTABLE ONLY TO THOSE MEMBERS HIRED ON OR AFTER JULY 1, 2017. FOR EACH YEAR THAT NEW UNFUNDED LIABILITIES ARE ATTRIBUTABLE TO THE EMPLOYER'S OWN MEMBERS HIRED ON OR AFTER JULY 1, 2017, A NEW AMORTIZATION BASE REPRESENTING THE MOST RECENT ANNUAL GAIN OR LOSS, SMOOTHED OVER A PERIOD NOT MORE THAN FIVE YEARS AS DETERMINED BY THE BOARD, SHALL BE CREATED ON A LEVEL-DOLLAR BASIS OVER A CLOSED PERIOD EQUAL TO THE AVERAGE EXPECTED REMAINING SERVICE LIVES OF ALL MEMBERS BUT NOT MORE THAN TEN YEARS, AS DETERMINED BY THE BOARD.

2. THE REMAINING FIFTY PERCENT OF BOTH THE NORMAL COST AND ACTUARILY DETERMINED AMOUNT REQUIRED TO AMORTIZE THE TOTAL UNFUNDED ACCRUED LIABILITY AS DETERMINED PURSUANT TO PARAGRAPH 1 OF THIS SUBSECTION SHALL BE DIVIDED BY THE TOTAL NUMBER OF THE EMPLOYER'S MEMBERS WHO WERE HIRED ON OR AFTER JULY 1, 2017 SUCH THAT EACH MEMBER CONTRIBUTES AN EQUAL PERCENTAGE OF THE MEMBER'S COMPENSATION.

The words in **bold** are highlighted to show that Bill 1428 can be interpreted to suggest that the current agency system of differing contribution rates for each employer (and Tier 3 members) would continue under Tier 3.
PART I: REVIEW OF LIABILITY RISK POOLING

Before turning to our analysis of liability risk pooling, it is important to note a number of important observations regarding the design of Tier 3. These observations significantly influenced our analysis of risk pooling options:

**Observation 1 - Some Causes of Prior Funding Deficits Were Eliminated in Tier 3**

Tiers 1 and 2 contained several features that negatively impacted the funded status of some Local Employers. These features, however, were not incorporated into Tier 3 and will therefore not pose problems for the new Tier.

1. *The Permanent Benefit Increase (PBI)*

For Tiers 1 and 2, in years where the investment return exceeded 9%, 50% of any excess return above 9% was allocated to the PBI reserve. Annual increases were then given to retirees and beneficiaries, provided there was sufficient money in the PBI reserve account to fund them. This process of giving PBI increases had two main effects on Tiers 1 and 2:

(a) It negatively impacted the funded status of the PSPRS because the PSPRS received only 50% of any excess returns, which would reduce prior unfunded liabilities, but had to bear 100% of any deficits that arose; and

(b) It negatively impacted Local Employers with retired members who were receiving smaller than average pensions. This was due to the fact the PBI increase granted to an Employer’s retirees was calculated based on the average pension across all Local Employers rather than the actual average pension of a particular Employer’s retirees. Thus, the PBI that was paid by Local Employers with below average pensions was disproportionately higher. Conversely, Employers who had retirees with pensions greater than the average gained through this allocation approach.

Tier 3 does not contain a PBI provision and is therefore not subject to the above effects.

2. *Procedure for Transferring Members Between Employers*

Under Tiers 1 and 2, when a member transferred from one Employer to another, assets and liabilities were also transferred. The asset transfer was based on the average funded ratio of the PSPRS, not the individual Local Employer’s funded ratio. This meant that if a member transferred from a plan that was less well funded than the average, that plan would have an increase in its unfunded liability as more assets were transferred than were actually held for the transferring member.

This procedure was not carried over to Tier 3. Under Tier 3, no assets or liabilities will be transferred to the new Employer and the service and liability that existed before transfer will remain with the original Employer.
3. **Deferred Retirement Option (DROP)**

The benefits provided under the DROP provisions created additional liabilities for Tier 1, as the monthly DROP benefits were credited with interest at the assumed or smoothed rate of return. In years with lower negative returns, members still received the higher rate.

DROP benefits are not available under Tier 3 and so this risk is no longer applicable.

**Observation 2 - Controllable Risk (i.e. Salary Spiking Risk) Has Been Reduced in Tier 3**

Salary spiking is a way of improving pensions in an employee’s final years of employment. Because, however, there was no risk pooling in Tiers 1 and 2, any salary spiking that may have occurred in those tiers would only impact the Local Employer in question and could not be passed on to other Local Employers in the System. In our stakeholder outreach meetings, some concerns were raised as to whether this would continue to be the case in Tier 3 if risk pooling were instituted. This is a valid concern. We found however that Tier 3 includes two features that will significantly mitigate the risk of salary spiking:

(a) The maximum salary under Tier 3 is limited to $110,000 adjusted by the average change in the Public Safety Wage Index every 3 years to allow for inflation and other increases; and

(b) As a carryover from pension reform in 2011 (SB1609), the salary used in the benefit calculations will continue to be averaged over 5 years, whereas for Tier 1 it is only 3 years.

It is difficult to eliminate the risk of salary spiking altogether. In our opinion, however, it has become a much smaller risk for Tier 3.

**Observation 3 – Non-Controllable Liability Risks Unlikely to Have Major Impact on Tier 3**

Stakeholders appear to believe that pooling the liability risks of Tier 3 would significantly decrease contribution volatility. We believe it is important to temper stakeholders’ expectations in this regard. A review of the recent experience studies performed for Tiers 1 and 2 suggests that in fact pooling the Non-Controllable Risks of Tier 3, though useful, is unlikely to have a dramatic effect on aggregate contribution volatility, although Local Employers might have had differences affecting their individual contribution volatility.

The actual experience of the PSPRS regarding Non-controllable risks for the year 2009 to 2015 was close to the expected experience using the actuarial assumptions. It is possible that there were larger differences between the actual and expected experiences for individual Employers over this period, but, in general, we believe the impact on unfunded liabilities due to Non-controllable Risks would have been small.
An important Non-controllable risk that could materially affect the unfunded liabilities of individual Local Employers is death in the line of duty, particularly if it involves multiple members simultaneously. While such events are rare, they would have a significant impact on Employers if they were to occur. This risk however is already pooled across the System. For clarity, death in the line of duty is defined in statute as follows:

“For the purposes of this subsection, ‘killed in the line of duty’ means the decedent's death was the direct and proximate result of the performance of the decedent's public safety duties and does not include suicide. For actuarial valuation purposes, the actuarial present value of the amount computed under this subsection for a surviving spouse of a deceased member who is killed in the line of duty or who dies from injuries suffered in the line of duty, plus any amount payable for an eligible child under this section, shall be deposited directly into the Employer account and charged against the investment earnings of the fund before those earnings are distributed to each Employer.”

ARS 38-846, subsection D

While the risk of death in the line of duty is a relatively rare, but significant risk, longevity risk; i.e. retiree mortality, is a significant and ongoing risk of the System. Accordingly, much of our risk pooling analysis focused on longevity risk.

Observation 4 – Disability in Line of Duty

At the stakeholder feedback meetings in November 2016, there were a number of delegates who strongly recommended that the cost of any disability arising from service in the line of duty be pooled on a similar basis to that arising from death in the line of duty.

Cortex agrees with this recommendation, as it would protect smaller Employers from a significant risk if such disabilities were to occur.

Observation 5 – Investment Risk is the Most Material Risk in Tier 3

We recognize that Cortex’s mandate is limited to risk pooling and Local Board consolidation. Nevertheless, it is important to note that while these two issues are important, we believe the major funding risk to Tier 3 is the risk that investment returns for Tier 3 will fall short of the actuarial assumed earnings rate. If the assumed earnings rate is set too high, based on current capital market conditions, there is a significant risk that actual investment returns will fall short of the assumed rate and Tier 3 will fall into a deficit. If investment returns fall short over the first few years following the launch of Tier 3, the new Tier will immediately experience a deficit, which is likely to cause considerable concern among stakeholders and may overshadow all of the positive features of Tier 3.
We have highlighted the above “Key Observations” for a number of reasons:

1. To ensure stakeholders understand that a number of design issues in Tiers 1 and 2, which contributed significantly to the deficits experienced by some Employers in those tiers, have been mitigated in Tier 3.

2. To help ensure stakeholders have realistic expectations about the potential benefits to be gained from pooling additional Non-controllable Risks in Tier 3.

3. To ensure stakeholders recognize that the risk of salary spiking (a Controllable Risk) has been significantly mitigated in Tier 3.

4. To ensure stakeholders are aware that the most significant funding risk for Tier 3 is in fact the risk that investment returns will fall short of the assumed earnings rate, and the related risk of establishing an assumed earnings rate that is unrealistically high.

Options for Tier 3 Risk Pooling

Cortex has analyzed three basic options for pooling liability risk, as summarized below.

Option 1: Status Quo

Under the status quo, risk pooling in Tier 3 would be identical to the approach currently used in Tiers 1 and 2. That is, none of the liability risks would be pooled, with the exception of death in the line of duty (arguably one of the most material Non-controllable Risk). Accordingly, each Local Employer will have a different liability, reflecting the actuarial experience of their employees, and a different required contribution rate, and may make additional contributions at their discretion, leading to further differences in funded status among Local Employers.

Strengths

1. If the status quo is extended to Tier 3, the cost impacts of local decisions regarding benefits cannot be shifted to other Employers and employees in the System, but must instead be borne fully by the Employer in question and its employees.

2. While the status quo imposes a high degree of accountability on Local Employers for their own pension and benefit costs, it does provide pooling protection for one of the most significant Non-controllable Risks – death in the line of duty. That is, should any Employer experience extraordinary deaths in the line of duty, the impact on the Employer in question would be muted because this risk is pooled among all Employers in the System.

3. The status quo approach can be applied to Tier 3 with minimal additional investment in administrative systems and procedures. We would therefore expect implementation of Tier 3 to be relatively smooth from an administrative standpoint.
4. Stakeholders will be familiar with this approach and should find it easy to understand, given that it is the same risk pooling approach used in Tier 1 and Tier 2.

**Weaknesses**

1. Under the status quo, Local Employers are fully exposed to all Non-controllable Risks except death in the line of duty. That is, each Employer bears the full cost associated with such risks as longevity, death before retirement, disabilities, and terminations. This would lead to greater volatility in pension contributions than would otherwise be the case, particularly for smaller Employers and/or those with mature workforces. Significant contribution volatility may make it difficult for Employers to budget effectively for their operations on an annual basis, particularly given that they generally can only increase their revenues slowly over time to offset any increases in costs. Employees, who under Tier 3 are responsible for 50% of pension costs, would face even greater difficulty adjusting to significant changes in contributions from year to year.

2. The status quo results in different Tier 3 contribution rates among Employers, which may have a significant effect on workforce mobility. In the case of Tier 1 and Tier 2, for example, Employer contributions rates between 2012 and 2015 ranged between 8% and over 90% (See Table 2 below). Employers with relatively high contribution rates may have difficulty attracting and retaining personnel, and employees may have difficulty re-locating and accepting new jobs with employers that have relatively high pension contribution rates. It should be noted that Table 2 shows the range of contributions for Tiers 1 and 2. The actual range for Tier 3 is likely to be narrower as some causes of the Tier 1 and 2 unfunded liability have been eliminated in Tier 3.

<table>
<thead>
<tr>
<th>Year ending June 30</th>
<th>Minimum Employer Contribution including the unfunded liability</th>
<th>Maximum Employer Contribution including unfunded liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>10%</td>
<td>72%</td>
</tr>
<tr>
<td>2013</td>
<td>10%</td>
<td>72%</td>
</tr>
<tr>
<td>2014</td>
<td>8%</td>
<td>93%</td>
</tr>
<tr>
<td>2015</td>
<td>16%</td>
<td>97%</td>
</tr>
</tbody>
</table>

Source: GRS Actuarial valuations. Maximum contribution excludes 1 outlier at more than 100% contribution.
**Option 2: 100% Risk Pooling**

Under the status quo, only the risk of death in the line of duty is pooled. Under option 2, however, the Tier 3 pension liabilities of all Employers in the System would be calculated together as a single liability pool, and each Employer and all employees are responsible for paying an identical contribution rate. If one Employer has a negative or positive actuarial experience due to demographic or economic factors, including both Non-controllable Risks and Controllable Risks, the resulting gains or losses will be shared proportionately among all Employers and employees in the System. In effect, this approach serves as a form of group self-insurance against pension liability risk.

The strengths and weaknesses of a 100% risk pooling system are essentially the reverse of those associated with the status quo, and are summarized below:

**Strengths**

1. From a pension contribution standpoint, full risk pooling:

   (a) Provides Employers (particularly Employers with smaller and/or mature workforces) and employees with equal and relatively stable contribution rates, and therefore facilitates the operational planning and budgeting processes.

2. Supports workforce mobility, which benefits both Local Employers and employees:

   (i) Employers, large and small, would be on a level playing field, at least from a pension contribution standpoint, when attempting to recruit and retain employees.

   (ii) Members would be able to move among Employers throughout the System without being concerned about the pension contributions they would have to pay into the System (i.e. They would pay the same contributions regardless of where they choose to work).

2. From an administrative standpoint, a fully pooled system would likely be the simplest and least expensive to administer. It would require only a single actuarial valuation each year for Tier 3, rather than the current 233. It should be noted that actuarial valuations for Tiers 1 and 2 will still be required. Any reduction in actuarial fees however would likely be immaterial, given that total actuarial fees charged for performing actuarial valuations for Tier 1 and Tier 2, including all 233 plans, are currently only approximately $150,000. Local Boards and Employers would still need to review the annual valuation, but would likely need to devote less time to the process.
Weaknesses

1. Full liability risk pooling inevitably reduces the sense of accountability among Local Employers for decisions they make involving the management of their workforces or retirement programs. Individual Local Employers would have an incentive to make human resource or pension decisions that benefit them directly, while shifting some of the costs or risks of the decisions to the liability pool, which is borne by all Employers and employees collectively. For example, Employers that choose to hire more experienced police or firemen would likely reduce their new employee training costs and may enjoy better service, but would generate higher pension costs for the liability pool. Such cost shifting would create fiscal challenges for the other Employers, and for employees throughout the System.

It would be particularly challenging for relatively small Employers that would have to bear part of the costs or risks of decisions made by their much larger counterparts without receiving any of the corresponding benefits. Smaller Employers have an incentive to engage in similar practices, but, acting independently, their small size limits the impact they can have on other Employers (and employees) in the System.

The above problem extends to issues such as investment in employee training and wellness programs. During the stakeholder outreach meetings, we were informed that some Employers make relatively larger investments in staff training and wellness programs, which are expected to result in lower benefit costs in the long run. Under a fully pooled system, Employers that do not make such investments will also enjoy some of the benefits of the investments made by other Employers.

Some stakeholders were concerned that if salary spiking were to occur at certain Employers under a fully pooled system, it would impose higher required pension contributions on all Employers and employees in the System. However, as noted earlier in this report (see Observation 2, page 13) Tier 3 is less susceptible to salary spiking because of the lower maximum salary to $110,000 and the five year average salary. While some level of salary spiking may still occur under Tier 3 if a member’s actual earnings are considerably lower than the maximum cap, the potential harm to the pool, under a fully pooled approach, has been reduced significantly.

2. Under 100% risk pooling, total costs of a retirement system are likely to be higher than under other risk pooling models. This is because every time an employer considers a proposal whereby it reaps 100% of the benefits of the proposal but less than 100% of the costs, its analysis will naturally be biased in favor of the proposal. Examples of such proposals include strategies affecting age at entry or workforce reduction (early retirement programs).

Over time, this natural bias among employers to adopt such proposals will likely increase the total normal cost of a retirement system’s benefits to a level it would not otherwise have reached.
3. Under 100% risk pooling, individual Employers have far less flexibility with respect to how they fund their liabilities. For example, should an Employer wish to accelerate its payments towards its unfunded liability or over-contribute, it is unlikely to be able to do so, given that other Employers may not be in a position to make similar payments.

**Option 3: Hybrid Option**

Under a hybrid option, some liability risks would be pooled and some would be borne by individual Local Employers and all employees. If one is going to only pool certain risks, the most rational choice would be to pool only those liability risks Employers cannot influence (i.e. Non-controllable risks).

Liability risks that are Non-controllable and can therefore be appropriately pooled include:

- Longevity; the risk that actual mortality experience will differ from what was assumed. This is likely the most material Non-Predictable Risk.

- Death in the line of duty; the risk that the number of deaths in service will differ from the number assumed. (Note, death in the line of duty is already pooled in all three tiers.)

- Termination; the risk that the number of employees who terminate employment prior to retirement differs from what was assumed.

- Disability; the risk that the number of employees who retire due to disability differs from what was assumed. Disability includes both normal disability and disability in the line of duty.

In a hybrid approach, Controllable Risks should not be pooled. Examples include the following:

- **Controllable Risks Involving Age at Entry.** Employers with hiring practices that seek to recruit more experienced, but older employees, would generate added pension costs, which, under a pooled risk system, would be borne by all Employers in the System. The added cost of such a recruitment strategy can be significant, as illustrated in Table 3 below, which shows the normal cost incurred under Tier 3 by a large firefighter Employer when hiring new employees at different ages, assuming a starting salary of $50,000. The normal cost associated with hiring a 30 or 35 year old is almost twice the normal cost of hiring a 20 year old; therefore, Employers that only hire older employees will in effect impose additional costs on Employers who hire younger employees. There will be a similar pattern of contributions for the other Employer groups (i.e. Police and small Fire).

- **Controllable Risks Involving DC Plan Participation.** If the DC plan option is more prevalent at some Employers than at others, this would likely result in very different new entrant profiles among Employers along with different normal costs.
**Table 3**

<table>
<thead>
<tr>
<th>Age at entry</th>
<th>Total Normal Cost*</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>10.6%</td>
</tr>
<tr>
<td>25</td>
<td>14.6%</td>
</tr>
<tr>
<td>30</td>
<td>19.2%</td>
</tr>
<tr>
<td>35</td>
<td>19.4%</td>
</tr>
<tr>
<td>40</td>
<td>17.6% **</td>
</tr>
</tbody>
</table>

Source: GRS analysis

* Shared equally by Employer and employee. Based on current assumptions for large firefighter groups using a 7.4% assumed earnings rate and the current actuarial methodology to value the benefits.

** The decrease for new entrants aged 40 is due to the assumption that the member will only retire when eligible for the maximum benefits under Tier 3.

- **Controllable Risk Involving Workforce Reduction.** Another example involves Employers that seek to reduce the size of their workforces by offering early retirement programs or other incentives to encourage employees to retire early. Such strategies will typically increase the actuarial liability of the plan, as more employees retire with higher average earnings than was assumed.

- **Controllable Risk Involving Compensation Practices.** Finally, pursuing a strategy of offering more generous compensation than was assumed when estimating the liabilities of the System would impact the costs of the system and shift the resulting contribution increases to other Employers. Salary spiking would be one such strategy, which a number of stakeholders identified as a concern during our interviews.

**Strengths**

As the name implies, the hybrid approach offers some of the benefits associated with both the status quo and a fully pooled approach:

1. It allows all Employers and employees to benefit from sharing or pooling at least some of the liability risks in the Tier 3 benefit structure. This is particularly beneficial for smaller Employers and/or mature plans.
2. It provides the most equitable approach in that Employers that make human resource management decisions that generate additional pension costs will not be able to shift any of those costs onto other Employers and employees in the System.

Recommendation for Risk Pooling

Cortex recommends that the PSPRS implement a Hybrid approach for Tier 3 by pooling additional Non-controllable Risks and making Local Employers that make human resource decisions that generate added costs for the pool responsible for 50% of such added costs, with the remaining 50% being borne by employees. The hybrid approach promises somewhat lower contribution volatility than the status quo and imposes greater accountability on Local Employers than the 100% pooling option. The contributions rates however will be affected by the costs of any Controllable risks made by the Employer.

There are, however, a number of ways the Hybrid approach can be implemented. These are discussed below.

Option A: Charge-back Method

All liability risks are to be pooled, but all employees and individual Local Employers are subsequently charged back for the costs associated with any decisions that Employer makes that result in additional material costs being incurred by the pool.

This method requires that the actuaries evaluate the experience of each Employer on an annual basis and determine if there has been some decision on the part of an Employer that triggered an incremental cost to the pool. PSPRS would then ensure that the Employer in question and all employees make an additional contribution to cover the incremental cost.

In theory, this method would allow PSPRS to charge all employees and the relevant Employers for any material benefit costs associated with human resource decisions made at the Local Employer level that generate additional costs for the pool.

An example of a public system that uses the above model is the Arizona State Retirement System (ASRS). A number of stakeholders held out ASRS as a model that should be replicated by PSPRS. It should be noted, however, that stakeholders generally mistakenly perceive ASRS to be a fully pooled system. In fact, ASRS uses a hybrid approach in which Non-Controllable Risks are pooled and Employers are charged back for material costs associated with any employer termination incentive programs.

A drawback to the charge-back method is the potential difficulty involved in establishing clear rules for determining what constitutes a Controllable cost generated by an Employer, and how
to value and charge for it. Some of the challenges include establishing an appropriate assumed earnings rate to use (i.e. a risk free rate vs. the current assumed rate), calculating the value of the accrued liabilities that offset the additional cost, and specifying what benefits need to be valued. Disagreements are likely to arise over time, which, if not resolved, may lead to litigation. It could also result in large increases in employee contributions depending on the amortization period used.

**Option B: Pool Longevity Risk & Risk of Disability in the Line of Duty**

Under this option, PSPRS would continue to pool the risk of death in the line of duty for active members, but would also pool disability in the line of duty and longevity risk. Longevity risk would be pooled by setting up a separate pooled account within PSPRS for all Tier 3 retirees and beneficiaries.

Under this approach, when a member retires, the assets and liabilities applicable to the retiree are transferred to the separate pooled account using the current actuarial assumptions applicable for the year in which the member retires. The full actuarial reserve based on the actual pension and the current actuarial assumptions will be transferred from both the assets and liabilities of the Local Employer in question.

The above approach only pools Non-controllable Risks that arise post-retirement; specifically, longevity risk; i.e. the risk that retirees live longer than assumed. This approach therefore reduces the volatility of the unfunded liabilities by reducing any annual experience losses incurred due to retirees living longer than was assumed. The reduction in volatility occurs as a result of the law of large numbers applicable to larger risk pools. That is, by pooling the retired lives, it is more likely that actual longevity will be closer to what was assumed. Any differences between the actual and the assumed experience for the pool is likely to be small and should not significantly affect the overall contribution rate payable by Employers and Employees.

Under Option B, Local Employer decisions that impose additional costs on the System can only occur prior to retirement; therefore, these costs are not pooled under this approach but rather are borne by the individual Employer in question and employees. This prevents Employers from shifting costs to other Employers in the System. Option B is more efficient than Option A, as there is no requirement to calculate and charge back any additional contributions that result from Employer decisions.

Creating a separate account to pool post-retirement risks also offers other advantages, not necessarily related to risk pooling:

- The account provides greater benefit security for retirees and beneficiaries, as retirees are no longer dependent solely on contributions from their Local Employer to fund any unfunded liabilities. Instead, any unfunded retiree liability will be the responsibility of all Employers and active Tier 3 employees.
There are 2 methods to fund any retiree unfunded liability:

1. Calculate an amortization payment using the standard methodology set out in SB 1428 as a level percentage of the aggregate Tier 3 payroll. The employees will then pay 50% of this amount and the employers the remaining 50%. This percentage will be adjusted after each valuation.

2. The amount required to maintain the retiree pool at 100% funded is transferred from other gains or the interest income that occurred in the overall PSPRS fund. This approach does not change the overall unfunded liability in the PSPRS which will still be funded by employees and employers. However, it avoids the calculation of an additional contribution rate to be added to the respective amounts paid by the employee and employer.

The approach to be used should be discussed with the PSPRS actuaries.

- The account simplifies ongoing administration and actuarial valuations as all payments for retired lives will be made from one account instead of allocating the payments back to the individual accounts. The actuarial valuation for each Employer will only be for the active and terminated members, with a separate valuation for the retired members.

- Any gains in the separate account can be held in the account to offset future losses. That is, any surplus that arises due to actual deaths exceeding assumptions or investment returns exceeding the assumed return can be held as a reserve to offset any losses that might occur in the future. This approach will also stabilize the contribution requirements for the retiree separate pool.

The benefits of pooling the retirees in Tier 3 will not be realized for approximately 15 years when the first Tier 3 members retire. However, pooling of retiree liabilities may also be established for Tiers 1 and 2 to reduce contribution volatility in those tiers. The benefits of doing so would be realized immediately.

**Option C: Separate Large and Small Employers for Risk Pooling Purposes**

Under this approach, large and small Employers will be treated differently for risk pooling purposes:

a) Employers with more than 100 employees will manage their active employees using the Status Quo approach, while their retirees will be assigned to a retiree pool established for all Tier 3 Employers.

b) Employers with less than 100 employees will have their active employees placed in an active lives pool along with those of all other small Employers, and their retirees will be placed in the same retiree pool noted in a) above established for all Tier 3 Employers.
In determining what constitutes a small or large Employer we considered the size of the current Employers in the System, as illustrated in Table 4 below.

<table>
<thead>
<tr>
<th>Table 4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PSPRS Employers by Number of Employees</strong></td>
</tr>
<tr>
<td><strong>As at June 30, 2015</strong></td>
</tr>
<tr>
<td><strong>Number of active members</strong></td>
</tr>
<tr>
<td>Less than 50</td>
</tr>
<tr>
<td>Between 51 and 100</td>
</tr>
<tr>
<td>Between 101 and 150</td>
</tr>
<tr>
<td>Between 151 and 200</td>
</tr>
<tr>
<td>Between 200 and 500</td>
</tr>
<tr>
<td>Between 501 and 1000</td>
</tr>
<tr>
<td>Greater than 1000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

As the above table shows, there are 200 Employers with less than 100 members or 211 Employers with less than 150 members. There is no formula to calculate the optimal size at which risk pooling becomes feasible. Actuarial demographic assumptions are normally applicable to large groups, but much less applicable to small groups. Small Employers are more likely to regularly experience actuarial losses, with actuarial gains occurring infrequently. For example, consider an Employer with 30 active members. Assuming a 5% turnover assumption (on average), one would expect 1.5 members will terminate each year. In the first year, one member terminates and according to the actuary there is an experience loss. Such losses will continue each year until two or more members terminate, thus creating an experience gain. Pooling these small Employers will smooth out the demographic gains and losses for this group.

Option C is similar to Option B, but has the advantage of pooling additional demographic, Non-controllable Risks of the active members of smaller Employers.

Option C will add to the costs of an actuarial valuation, as more work will be required to analyze the separate pool for small Employers, but the Employer contribution rates for the smaller Employers will be more stable due to the pooling of Controllable risks and Non-controllable Risks.
Finally, by having the larger Local Employers operate under the status quo for their active lives, smaller Employers and their employees will be insulated from any cost impacts stemming from the human resource management decisions of larger Employers. This was a concern voiced by a number of stakeholders.

A drawback with Option C is that, under current legislation, any Employers that join PSPRS in the future are required to pay any prior unfunded liability associated with their employees upfront before joining PSPRS. Under the status quo pooling structure, such liability is simply incorporated into their individual Employer rate and is paid off over time. Forcing new Employers to pay any prior unfunded liabilities before joining PSPRS would likely serve as a significant barrier to joining. Accordingly, Option C would require a change in legislation to eliminate the requirement that new Employers pay off any prior unfunded liabilities and instead allow them to amortize it over time.

The California Public Employees’ Retirement System (CalPERS) uses an approach similar to Option C described above. CalPERS pools the demographic risks for small employers, which it defines as less than 100 employees, but uses an agent-multiple approach for all other employers. The costs for CalPERS’ small employers are calculated as:

- Normal cost for members; plus
- Amortization of pooled unfunded experience loss; plus
- Amortization of losses due to controllable risks; less
- Employee contributions.

This is equivalent to using the current PSPRS agency accounting methodology, but amortizes the pooled, Non-controllable items such as mortality, termination, and disability.

**Calculation of Employee and Employer Contribution Rates**

The discussion so far has focused on risk pooling. Another important issue is the determination of specific contribution rates for Local Employers and employees under the different risk pooling options.

In considering the options for calculating the employer and employee contribution rates under the various risk pooling alternatives, we recognized that SB 1428 requires that the costs of each local fund be shared equally between the Local Employer and its employees, including the costs of any human resource decisions made at the local level. Any change to how contributions are shared would require an amendment to the statute.

During our work and discussions with stakeholders, they expressed the following additional goals with regards to contribution rates:
1. There should be a uniform employee contribution rate across the System, in order to provide employee mobility and to put all employers on a level playing field for recruitment purposes.

2. Some felt employer contribution rates across the System should also be uniform.

3. Contribution rates should promote accountability/equity; i.e. Employers and employees should not have to make added contributions to pay for the human resource decisions of other parties that they did not benefit from.

When setting contribution rates, however, it is impossible to devise a method that satisfies all three of the above objectives, while also being consistent with the statutory requirement that contributions be shared equally at the local level.

Accordingly, if stakeholders believe that any of the above objectives should take precedence, then changes to the legislation will likely be required. For example, if it is critical to have a uniform employee rate for job mobility, then the employee rate must be calculated on the aggregate fund, not at the local level. This approach will require an amendment to the Statute. It should be noted, however, that under this approach, 50% of the costs associated with human resource decisions at one Employer will be paid by all Tier 3 employees (and not just the employees of the Local Employer in question).

If, on the other hand, the priority is to ensure that cost sharing should occur at the local level, then the PSPRS should continue with the current agency multiple system. This option is, we believe, set out in SB 1428 and therefore will require no changes to the Statute.

The following paragraphs deal with the two options for calculating the employee contributions in more detail.

A: Uniform Employee Contribution Rate

The employee contribution rate should be calculated based on the funded status of the total plan and should include the payments required to fund 50% of the aggregate unfunded liability and 50% of the normal cost, thus ensuring employees pay uniform rates and are responsible for 50% of the total cost of the plan.

Each Local Employer’s contribution rate will differ and would be calculated as its normal cost plus amortization payments for unfunded liabilities related to its own employees (resulting from both controllable costs and non-controllable negative demographic experience) less the aggregate employee contribution rate.

When a Local Employer makes a human resource management decision that generates added pension costs, the employee portion of the additional cost (i.e. 50%) will be paid by all employees in Tier 3 and not just the employees of that Local Employer.
The following table illustrates the impact of different events that could cause an unfunded liability on the Employer and Employee contribution rates:

<table>
<thead>
<tr>
<th>Events that could cause an unfunded liability for Tier 3.</th>
<th>Funding allocations</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Smoothed” investment return lower than the actuarial discount rate</td>
<td>Equal allocation to employer and employee as the impact is pooled</td>
</tr>
<tr>
<td>Lowering the actuarial discount rate</td>
<td></td>
</tr>
<tr>
<td>Changing the actuarial assumptions</td>
<td></td>
</tr>
<tr>
<td>Increasing Longevity for retirees</td>
<td></td>
</tr>
<tr>
<td>Death in line of duty</td>
<td></td>
</tr>
<tr>
<td>Disability in line of duty</td>
<td></td>
</tr>
<tr>
<td>Actual demographic experience differs from assumed assumptions</td>
<td>Employee contributions based on the overall experience for Tier 3</td>
</tr>
<tr>
<td>Human resource management decisions</td>
<td><strong>Employer contributions based on individual experience</strong></td>
</tr>
</tbody>
</table>

The above table shows that the majority of events that could cause an unfunded liability for Tier 3 will be pooled and will therefore be allocated to employees and Employers on an equal basis. The area where there is a potential difference in the allocation of costs arises when actual demographic experience differs from the assumptions, in which case the Local Employer in question will fund its experience and the employee contributions are calculated based on the experience of the pool. Cortex expects these differences in demographic assumptions to be small and to average out over time.

Individual employers will fund the cost of their human resource management decisions whereas the employees will fund 50% of the aggregate unfunded liability for Tier 3. This could lead to differences in contributions between employers and employees.

The main advantage of this approach is a uniform employee contribution rate across the PSPRS which will assist in job mobility.

The disadvantages of this approach are:

- All employees in the System pay for the human resource decisions of other Employers.
- It will require an amendment to the Statute.
- The contribution rates paid by the Local Employer will differ from those paid by their employees. These could be higher or lower depending on the Local Employer’s human resource activities. If an Employer’s contribution rate is lower than that of its employees,
this could also be a concern, as there may be an expectation that they should always be equal.

**B: Employee Contribution Rate equals Local Employer Contribution Rate**

The employee contribution rate should be calculated based on the funded status of the Local Employer plan and should include the payments required to fund 50% of the unfunded liability and 50% of the normal cost, thus ensuring employees are responsible for 50% of the total cost of the plan.

When a Local Employer makes a human resource management decision that generates added pension costs, the employee portion of the additional cost (i.e. 50%) will be paid by employees of that Local Employer.

In this case the employee will pay for 50% of all costs associated with the Local Employer plan.

The advantages of this approach are:

- No change to legislation.
- Employees’ interests and the interests of Local Employers will be better aligned in regards to local human resource decisions, as each will have to pay 50% of the costs.
- No sharing of costs with other employees in the Tier 3.

The disadvantages are:

- The contributions rates for employees will be more volatile than the uniform rate.
- There may be a possible reduction in job mobility as differences in employee contribution rates across the state could be an issue for a new employee.

Based upon this further analysis, Cortex believes equal contribution rates at the local level is the more equitable and accountable approach and most consistent with the intent of the Legislature as expressed in current legislation. Cortex believes that determining the approach to calculating contribution rates will require further discussion between the PSPRS and the legislature.

**Recommended Approach to Implementing a Hybrid Model**

Table 6 provides an overview of the three basic risk pooling options analyzed in this report. We have already recommended that PSPRS adopt Option 3, the hybrid option. Below we discuss our recommendations on how best to implement the hybrid option using either option 3(A), 3(B), or 3(C).
Cortex does not recommend option 3(A), the Charge-back Option, because of the difficulty we noted in defining clear rules for determining material costs to be allocated back to Local Employers, and the disagreements and potential litigation that might arise over time as a result.

Options 3(B) and 3(C), however, are both reasonable alternatives. Both are simpler and more efficient to administer than option A, as they eliminate the need to define and value any decisions by large Employers that had a material impact on employees and the other Employers in the System. They also eliminate the potential for legal disputes should an Employer believe that the amount charged back was unreasonable. The key difference between options 3(B) and 3(C) is that Option 3(C) provides for full risk pooling for small Employers, whereas under Option 3(B), small Employers are only able to pool the risks associated with disability in the line of duty and longevity.

The additional risk pooling that small Employers enjoy under Option 3(C) must be weighed against the potential risk that some small Employers will make decisions that impose costs on their peers. Table 5 depicts the number of active members within small Employers (Tiers 1 & 2). It reveals that at the present time, 11 of the 211 small Employers (5%) have a total of 1,315 active members out of a total of 6,946 active members (19%). This suggests that under Option 3(C), the largest of the small Employers could influence the total costs of the small Employer pool and shift costs onto the smallest Employers. As noted however in the “Key Observations” section of this report, the risk associated with salary spiking has been mitigated considerably in Tier 3, though other Controllable Risks could still be transferred from one small Employer to another and could be meaningful.

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>Number of Employers</th>
<th>Total Active Members</th>
<th>Average number of Active Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 50</td>
<td>159 (75%)</td>
<td>2,780 (40%)</td>
<td>17.5</td>
</tr>
<tr>
<td>51 to 100</td>
<td>41 (20%)</td>
<td>2,851 (41%)</td>
<td>69.5</td>
</tr>
<tr>
<td>101 to 150</td>
<td>11 (5%)</td>
<td>1,315 (19%)</td>
<td>119.5</td>
</tr>
<tr>
<td>Total</td>
<td>211 (100%)</td>
<td>6,946 (100%)</td>
<td>33</td>
</tr>
</tbody>
</table>

Many small Employers we heard from during stakeholder outreach appear to be in favor of pooling as much risk as possible to reduce the variability of their pension contributions, and would likely favor Option 3(C). Those Employers who raised concerns about Employers shifting costs onto other Employers will likely have a favorable view of Option 3(B), which effectively eliminates such risk. The optimal approach then depends on whether one places more importance on reducing contribution volatility or minimizing the possibility that Employers will make human resource management decisions that shift costs onto other Employers.
Cortex recommends Option 3(B) for the following reasons:

1. It offers risk pooling for longevity risk, which is one of the more significant of the Non-Controllable Risks. Admittedly, this would not impact contribution volatility until the first members begin retiring from Tier 3. It also offers risk pooling for disability in the line of duty, which is a significant risk. Unlike longevity risk, pooling the risk of disability in the line of duty will bring immediate benefits for Tier 3.

2. While Option 3(B) does not pool the remaining Non-Controllable Risks, we believe those risks do not have significant impacts on contribution volatility, based on recent experience studies of Tier 1 and Tier 2 benefits.

3. We understand some consideration is being given to pooling the retiree risks (i.e. longevity risk) of Tiers 1 and 2. This would reduce contribution volatility immediately for those two tiers. Assuming this is accomplished, implementing Option 3(B) for Tier 3 would lay the groundwork for consistent risk pooling across all three tiers in the future. Having a uniform approach to risk pooling across all tiers would facilitate efficient administration of the System. (It should be noted that any pooling of longevity risk being contemplated for Tiers 1 and 2 would not apply to any existing unfunded liabilities in those tiers.)

4. Option 3(B) imposes strong accountability on all Local Employers for any human resource management decisions they make.

5. This alternative also ensures that Local Employers fund the normal cost calculated based on the ages of their new members. The new member average age in Tier 3 will be affected by the members who elect the defined contribution plan option instead of the defined benefit plan option, making it difficult to set an average new entrant contribution rate that would be equitable to all employers.

6. Option 3(B) ensures that any inappropriate decisions that may occur at the Local Board level involving disability applications (other than disability in the line of duty) will only impact the Employer in question and will have no effect on other Employers in the System. A number of stakeholders shared their concerns regarding this issue during our stakeholder outreach. Note that Part 2 of this report, which deals with Local Board consolidation will address how the local board structure can be enhanced to minimize the potential for inappropriate disability decisions to occur in the first place.
### Table 6
**Summary of Risks Pooled under Identified Options**

<table>
<thead>
<tr>
<th></th>
<th>(1) Status Quo (SQ)</th>
<th>(2) 100% Risk Pooling</th>
<th>(3) Hybrid Option</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Large (SQ Active, Pooled Retirees); Small (Pooled Active &amp; Retirees)</td>
</tr>
</tbody>
</table>

#### Non-Controllable Risks
- **Death in Line of Duty**: X X X X X X
- **Death in retirement (longevity)**: X X X X X X
- **Death before retirement**: X X X
- **Disabilities in line of Duty**: X X X X X X
- **Disabilities before retirement**: X X X
- **Terminations**: X X X

#### Controllable Risks
- **Average age at entry**: X Chargeback X
- **Average age at retirement**: X Chargeback X
- **Salary Increases**: X Chargeback X

<table>
<thead>
<tr>
<th></th>
<th>Large Employers</th>
<th>Small Employers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Risks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Controllable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Controllable</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
PART II: REVIEW OF LOCAL BOARD CONSOLIDATION

As noted at the outset of this Report, there are currently 233 Local Boards that administer the benefits of Local Employers in PSPRS. The composition and responsibilities of the Local Boards and the PSPRS Board are summarized in the Background section on pages 3 and 4 of this report. Changes to the composition of the PSPRS Board, which take effect in January 2017, are also summarized therein.

We understand there is a wide range of views among PSPRS stakeholders concerning the need to consolidate the current number of Local Boards and the basis for doing so. Recent reforms to PSPRS, as enacted by Senate Bill 1428, did not resolve the issue of consolidation and Cortex was retained to study the issue.

This section of the report contains our analysis of Local Board consolidation along with our recommendations.

Overview of Current Local Board Structure

Below is a summary of relevant features of the PSPRS Local Board structure:

- Number of Local Boards: 233
- 211 of the above Local Boards are responsible for administering plans containing less than 150 members.
- The number of regular board meeting and the amount of board business conducted at said meetings, varies considerably among Boards depending on the size of the plan in question.
- Most, but not necessarily all, Local Boards employ independent legal counsel who attend Board meetings and advise the Board on their administrative duties.
- The vast majority of the Local Boards operate without a dedicated professional staff to support them. Instead, they are typically supported on a part-time basis by a staff person who is otherwise devoted to working for the Local Employer, normally in the human resources department. In contrast, the largest Local Boards have a dedicated professional staff to support them.
- The amount and consistency of governance-related training undertaken by the Local Boards varies considerably.
Evaluation Criteria/Factors

In evaluating the need for, and approaches to, Local Board consolidation, Cortex considered the following criteria and factors:

1. The need to ensure that board members who are responsible for administering benefits have sufficient knowledge of the local workplace environment and circumstances that may be relevant to the administrative process, particularly as they may relate to disability benefits.

2. The need to provide services to plan members that are convenient and easy to access.

3. The need to ensure that benefit provisions are applied uniformly across the State, given that all members in PSPRS are subject to the same benefits provisions.

4. The need to ensure that administrative decisions are arrived at in a sound and objective manner.

5. The need to ensure benefit administration is carried out in a cost-effective manner.

Alternatives

Cortex has identified the following alternative approaches to Local Board consolidation:

Alternative 1 – Status Quo with Enhancements

This alternative would maintain all current 233 Local Boards, but would attempt to enhance Local Board decision-making through improved governance training and procedures.

Advantages of this alternative include the following:

1. The status quo ensures that the highest degree of local knowledge is brought to bear on benefit administration decisions. A number of stakeholders indicated that Local Boards, which are comprised of local employees and citizens, are most likely to have a deeper understanding of local working conditions and first-hand knowledge of the membership. It was suggested that this can be invaluable, particularly in the context of disability hearings where Local Boards must determine whether an applicant can perform a comparable job given local circumstances. Without a good understanding of how local fire and police departments operate, it was argued, making such determinations can be very difficult.
2. It was suggested that Local Board members who personally know disability applicants may be more likely to discern the truthfulness of any testimony they provide in the course of disability hearings.

3. Having Local Boards is more convenient for members in the event they need to appear before the Board; e.g. for disability hearings. As a counter-argument to the above concern, stakeholders noted technology is available (e.g. video conferencing) that would allow plan members to appear before a Board, wherever the Board may be located, without the need for travel. Such technology is used by the ASRS to facilitate member attendance at board meetings.

We were also informed that if members wish to file a lawsuit against their Local Board in regards to a determination of that Local Board, with just a few exceptions, the suit must be filed in the county in which that Local Board is situated. Accordingly, ensuring that all benefit actions occur at the local level would facilitate the filing of any lawsuits by members.

Disadvantages of this alternative include the following:

1. The status quo is not a cost-effective option from the standpoint of the time and effort expended by Local Board members and staff. The Local Board structure requires at least one part-time staff person for each of the 233 Local Boards as well as over 800 board members. From a budget perspective, however, the direct costs are minimal, as Local Board members are not paid for their services and staff support is provided by the Local Employer. The only other administrative costs of note are those associated with any independent fiduciary counsel employed by many Local Boards. Currently, these are paid for by the Local Employers.

2. Many stakeholders perceive that the status quo is not conducive to objective and independent decision-making at the Local Board level. Members of Local Board who are personally acquainted with plan members and disability applicants may find it difficult to be independent and objective when assessing an application for death and disability benefits. Furthermore, Local Boards in small communities, where social relationships are tightknit, may also at times have to deal with pressures from individuals and groups beyond the individual claimant, which conflict with their duty to objectively evaluate benefit claims.

3. Administering the benefits through 233 different Local Boards poses considerable challenges in making sound and consistent decisions across the System on benefit administration matters. This concern was voiced by a number of stakeholders we met and who noted the following:
   - Board processes and procedures vary widely among Local Boards, particularly between the largest and smallest plans.
Smaller Local Boards make very few administrative decisions in a year while larger ones, such as those in Maricopa and Pima County, are called upon to make numerous decisions throughout the year. As a result, smaller Local Boards do not have an opportunity to build their knowledge and expertise of benefit administration. Inappropriate decisions are not only damaging to the specific plan members and Employers in question, but may set precedents that impact other members or Employers throughout the System.

Some stakeholders suggested that the correct response to perceived weaknesses in the quality of Local Board decision-making is not to eliminate Local Boards, but to invest more resources in local board training, policies, and procedures.

While Cortex supports governance training, we believe it is unlikely that such training could have a substantial and sustained impact across all Local Boards, particularly when many of them meet infrequently and have limited business to attend to. As noted above, the current structure requires over 800 board members to sustain it. In our experience working with public retirement systems across North America, it is extremely difficult, if not impossible, to identify such a large number of individuals with relevant qualifications, backgrounds, interest, and time availability. Board governance training, while helpful, will simply not be sufficient to ensure an adequate and consistent knowledge base across the 233 Local Boards over time.

**Alternative 2 – Consolidate all Local Boards to form a single state-wide Board responsible for all benefit administration matters (Board of Administration)**

Advantages of this alternative include the following:

1. A single Board of Administration would offer maximum efficiency, as it would only require a single set of Board members, supported by a single set of administrative staff and advisors.

2. The quality of board governance and decision-making under this alternative is similarly maximized:

   (a) Having a single Board of Administration would reduce the number of board members required for the System from approximately 800 to less than 10. Ensuring that highly qualified individuals are recruited to serve as board members would be far easier under this approach.

   (b) Having one Board of Administration would eliminate the risk of inconsistent benefit decisions and interpretations across the System. PSPRS would no longer need to review and monitor the actions and decisions of 233 Local Boards, but rather would focus on the activities of a single Board. Communications between PSPRS and the Board of Administration would similarly be enhanced, as there would exist only one line of communication, rather than 233.
3. A single Administrative Board, with board members drawn from across the State, would be better positioned to exercise independence and objectivity in assessing benefit claims, as the number of board members with personal knowledge of claimants or their friends and acquaintances is significantly reduced.

Disadvantages of this alternative are as follows:

1. Board members serving on a single Administrative Board will likely have limited knowledge of the people, working conditions, and requirements that exist within Local Employers and may have greater difficulty making certain benefit determinations, such as whether a disability claimant is fit to carry out other duties within the Local Employer.

2. Members who need to appear before the consolidated board would likely need to travel some distance to do so, as the new Administrative Board is likely to be located in a major city such as Phoenix. While technology may resolve this concern, for some members it may not be the preferred means of interacting with the Administrative Board.

3. Under this alternative, a single consolidated Board would be required to perform the work that had previously been performed by 233 Local Boards. While a single, highly qualified Board should benefit from efficiencies not available to many of the existing Local Boards, this is nevertheless a valid consideration. However, should workloads lead to unreasonable wait times for members and claimants, the new board could consider establishing a separate appeals committee or board to handle the more labor intensive and time-consuming activities relating to disabilities. The legislation that creates a consolidated Administrative Board should provide the new Board with the authority to delegate duties in this manner.

4. In our stakeholder outreach meetings, some of the Local Boards objected to the possibility of being consolidated into a single board. While they acknowledged that many Local Boards do in fact struggle to operate effectively, they felt that they themselves had the size, scale, and resources to function effectively and were in fact doing so. This view was primarily expressed by the Local Boards of the largest Employers, but a small Local Board we met with held a similar view, with justification in our view.
Alternative 3 – Partial consolidation.

There are a number of ways partial consolidation could be achieved. We have focused on an approach in which all small Local Boards would be consolidated along county lines, while the largest Local Boards would remain separate and unchanged.¹ In addition, small state agency Local Boards (i.e., all except Department of Public Safety) would be consolidated into a single State Agency Board. This would result in 27 Local County Boards, 17 large Local Boards and one State Agency Board. See Table 7 for an overview.

This alternative combines the advantages of the status quo with those of a single consolidated board:

1. It generates significant efficiencies by consolidating the small Local Boards to approximately 45 boards from 233.

2. It reduces the number of qualified board members that are needed to a more manageable number, approximately 170 as opposed to 817.

3. It spreads the administrative burden of the current Local Boards among 45 Boards rather than imposing it all on a single Administrative Board.

4. It would enhance the consistency of decision-making, as there would be far fewer boards involved in decision-making, as compared to the status quo.

5. While not quite as convenient for members as the status quo, members would not need to travel beyond their county in order to meet with their Local Board.

6. Independence of Local Board decision-making would be enhanced under this alternative, as Local County Boards would likely contain board members from throughout the county who would be less acquainted with members and claimants who may appear before them. At the same time, however, the Local County Board is likely to have a reasonable knowledge of workplace circumstances within their county, or will be able to build such knowledge over time.

Disadvantages of this alternative are as follows:

1. Partial consolidation, by definition, represents a compromise on certain issues. For example, partial consolidation will not achieve the maximum efficiencies one might expect from full consolidation. Cortex believes however that any shortfall would be

¹ We would like to credit Stan Hoover, who during our stakeholder outreach, provided us with considerable information including the background on his idea of consolidating the Local Boards along county lines.
minimal, and that partial consolidation, as envisioned above, would provide the System a considerable amount of the available efficiencies.

2. Any Local Boards that are small, but effective, would be required to be consolidated, and the local community would lose out on the benefits of having an effective Local Board. While Cortex did meet with one Local Board during the stakeholder outreach that would likely fall into this category, we believe it is the exception and far from the rule.

**Recommendations Regarding Local Board Consolidation**

*Primary Recommendation*

Cortex recommends that the PSPRS pursue partial consolidation, as follows:

In the case of any Local Employer, Indian tribe, or state agency that, as at January 2017, employs at least 250 police officers or 250 firefighters, both of the Local Boards would be excluded from consolidation (assuming it in fact has two Local Boards).

According to information provided by the PSPRS (PSPRS Demographics June 30, 2015) the Employers that would retain their Local Boards are as follows:

| Table 6 |
|---------------------------------|----------------|
| **Employer**                    | **Number of members** |
| Chandler Police                 | 305               |
| Chandler Fire                   | 186               |
| Department of Public Safety     | 981               |
| Glendale Police                 | 388               |
| Glendale Fire                   | 219               |
| Maricopa Sherriff Office        | 654               |
| Mesa Police                     | 748               |
| Mesa Fire                       | 382               |
| Phoenix Police                  | 2392              |
The 10,517 members employed by the above 17 Local Employers represent 56% of all active members in the PSPRS.

Under our recommendation, there will continue to be separate Local Boards for law enforcement and firefighters located in each county and a separate State Board.

To accommodate situations where a small Local Board consists of highly qualified board members and is operating effectively, small Local Boards, including those of Indian tribes and state agencies, should have the option of applying to be exempt from consolidation. Granting such an exemption would be subject to meeting specified governance criteria and would be the responsibility of the PSPRS Board. Exceptions would need to be reviewed periodically to ensure the governance standards continue to be met over time. Should the exemption be revoked at any time in the future, the Local Board in question would be consolidated and would not be able to re-apply for an exemption. An exempt Local Board could also waive its exemption at any time and join the Local County Board or the State Board. Similarly, larger Local Boards that would normally be automatically exempt from consolidation could opt into their applicable Local County Board at any time. Finally, Local Employers in which the employee count falls below the 250 threshold at some point in the future could either be required to be consolidated into the appropriate County Local Board or State Board at that time or could choose to opt in.

Table 7 shows how the Local Boards could be combined along county lines with a state Board for the smaller State Agencies.
Cortex further recommends that each Local County Board and State board be subject to standard fiduciary duties in the administration of benefits, including the duties of loyalty and prudence. Each Local County Board and State Board should have the same ability to sue and be sued that the current Local Boards have. The costs associated with any fiduciary lawsuits in relation to Tier 3 should be borne by the Tier 3 trust assets of the Local County and State plans and shared equally by the Local County and State Employers. We understand that such costs involving Tier 1 and Tier 2 are currently ultimately borne by the Local Employers and that this would remain unchanged for those tiers.

The above recommended model for Board consolidation is subject to successfully addressing the implementation issues involved, which include but are not limited to:

1. How would the composition of the local county boards be established?

2. How would the new local county boards be supported from an administrative perspective? For example, would each local county board have its own administrative staff? What would be the impact on the current local board secretaries?

3. What additional costs would be associated with the new local county boards?

4. What specific governance criteria would be used to determine if an exemption would be granted?

The above implementation issues were also identified by numerous stakeholders after the release of Cortex’s draft report.
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<td>Fire</td>
<td>No. of Members</td>
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<td>Camp Verde</td>
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<td>31</td>
<td>Chino Valley</td>
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<td>Jerome</td>
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<td>Cottonwood</td>
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<td>Mayer</td>
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<td>Northern Arizona University</td>
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<td></td>
<td>University of Arizona</td>
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<tr>
<td></td>
<td>Arizona State University</td>
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<td>Arizona Game and Fish Dept.</td>
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<td></td>
<td>Dept. of Law (State Attorney)</td>
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<td></td>
<td>Dept. of Emergency and Mil</td>
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<td>Arizona State Parks</td>
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<td></td>
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<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>370</strong></td>
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Summary of Primary Recommendation for Local Board Consolidation

Cortex’s primary recommendation is to:

1. Maintain the current Local Boards for all Employers, including state agencies, with more than 250 law enforcement employees or 250 firefighter employees (17 boards).

2. Combine all other Local Boards along county lines with a separate county board for firefighters and law enforcement in each county (27 boards).

3. Tribal Local Boards that do not meet the above threshold regarding number of plan members should be consolidated into the County in which they are located. Where a Tribe’s territory spans multiple counties, it would be consolidated into the County in which it has the largest territory.

4. Allow the option for any small Local Board (including Indian tribes and state agencies) to be granted an exemption from consolidation if they satisfy prescribed criteria or standards for effective governance.

Under this recommendation there will be a minimum of 45 Local Boards compared to the current 233. The advantages of this proposal are:

1. Improved independence of decision making as the members of the County Board will be less likely to be personally acquainted with plan members.

2. Ability to create local medical support to analyze new members and disability cases as there will be a larger number of cases for each county than for each Employer.

3. A larger pool of professional people to draw on when selecting the 3 non-members of each Local County Board.

4. With fewer boards, it will be easier for the PSPRS to educate and communicate policies to Local County Board members. In addition, it will also facilitate better communication from the Local Boards to the PSPRS.

5. Although the members of the Local Boards do not receive compensation, the overall time costs will be reduced, as the number of meeting across the PSPRS system will be reduced significantly.
Secondary Recommendation

If the implementation issues associated with a county board model cannot be adequately resolved, PSPRS may wish to consider Cortex’s secondary recommendation, which is a hybrid of alternatives 1 and 2, as follows:

- All local plans could continue to be governed by their existing Local Board, but would be provided additional governance training and support by PSPRS (i.e. Alternative 1 - Status Quo).

- Additionally, any Local Board could request to be consolidated into a new, state-wide administrative board (to be created), subject to a pre-determined stakeholder approval process and further subject to approval by the PSPRS Board based on possible pre-determined criteria. This reflects a variation on Alternative 2 – A Single Board.
APPENDIX A

Review Process

Phase I

In completing this study, Cortex reviewed a number of documents describing recent regulatory changes and the current methods for risk pooling and governance. Below is a list of specific documentation reviewed by Cortex and the originating entity:

- “The Past, Present and Future of PSPRS” Employer Seminar - Statewide Presentation (February 2015) – PSPRS
- 2015 PSPRS Summary of Benefits – PSPRS
- Pension Task Force’s preliminary recommendations – League of AZ Cities and Towns
- Actuarial Data (Pension and Health) as of June 30, 2015 – GRS
- PSPRS Performance Audit and Sunset Review – AZ Auditor General
- A Comparison of Arizona’s Two State Retirement Systems – AZ Auditor General
- PSPRS Governance Recommendations – League of AZ Cities and Towns
- SB1428 Pension Reform Matrix of Changes and Implementation Timeline – PSPRS
- Arizona Constitution Article 29
- PSPRS Annual Valuation June 30, 2015 – GRS
- Memorandum from GRS regarding Agent Multiple-Employer/Cost-Sharing Multiple-Employer Structures

Cortex held a number of outreach meetings and interviews with stakeholders in Phoenix in June 2016. All stakeholders were invited to attend the meetings or express their concerns via email. A document setting out the objectives of the study and discussion guide was circulated to all stakeholders prior to the meetings.

A diverse group of stakeholders participated in the outreach meetings. The stakeholders represented cities, towns, districts, Local Boards, and fire and police groups across the State of Arizona. Cortex also interviewed representatives of the League of Cities and Towns and the Reason Foundation, the Arizona Legislature, and the current consulting actuary to PSPRS, Gabriel Roeder Smith & Company (GRS).

The following table lists the stakeholder organizations and individual representatives who participated in the outreach meetings and interviews. During our interviews, Cortex did not specifically confirm whether individuals were representing the views of the organizations listed. Accordingly, if any of individuals listed in the table prefers that they
be listed as individuals only (i.e. the name of the organization is to be removed), please inform us and we will make the necessary changes in the final report.

<table>
<thead>
<tr>
<th>Organization</th>
<th>Individuals</th>
</tr>
</thead>
</table>
| Arizona Highway Patrol Association          | Jimmy Chavez  
                                           | Kelsey Lundy                                     |
| City of Mesa                                | Dee Ann Mickelson                                 |
| City of Phoenix                             | Scott Miller                                      |
| City of Prescott                            | Alison Zelms                                      |
| City of Scottsdale                          | Chanda Washington  
                                           | Jeffery Nichols  
                                           | Judy Doyle                                       |
| Counties                                    | Mike Townsend  
                                           | Shelby Scharbach                                 |
|                                            | Craig Sullivan                                     |
| Deputy State Controller                     | Mike Smarik                                       |
| Fraternal Order of Police                   | Jim Mann                                          |
| Phoenix Police Local Board                  | Will Buividas                                     |
| Green Valley Fire District                  | Mike Fox                                          |
| GRS Actuaries                               | Mark Buis  
                                           | Jim Anderson  
                                           | Francois Pieterse                                |
| League of AZ Cities and Towns               | Ken Strobeck  
                                           | Marc Skocypec                                    |
|                                            | Steve Moore  
                                           | Scott McCarty                                    |
| North West Fire District                    | Michael Brandt  
                                           | (Represented by Patricia Aguilar)               |
| Town of Paradise Valley                     | Kevin Burke                                       |
| Phoenix Fire Local Board                    | Brian Moore  
                                           | Brian Tobin, Board of Trustees (Chair)           |
| Professional Fire Fighters Assoc.           | Bryan Jefferies  
                                           | Joe Hester                                       |
| Reason Foundation                           | Anil (recent hire)                                |
|                                            | Anthony Randazzo                                  |
|                                            | Pete Constant                                     |
|                                            | Leonard Gilroy                                    |
| Retired Local Board Member                  | Stan Hoover                                       |
| Rio Verde Fire District                     | Jerry Fickes                                      |
| City of Sierra Vista                        | Barbara Fleming, CFO                              |
| State Legislature                           | Jeff Kros  
                                           | Lesli Sorensen                                    |
Cortex also received input from cities and towns through a number of emails. The following is a list of organizations and individual representatives that shared their views by email:

<table>
<thead>
<tr>
<th>Organization</th>
<th>Individuals</th>
</tr>
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<tbody>
<tr>
<td>Benson Local Board</td>
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<tr>
<td>City of Apache Junction</td>
<td>Bryant Powell</td>
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<tr>
<td>City of El Mirage</td>
<td>Lana Mook</td>
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<td>Justin Clifton</td>
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<td>Show Low City</td>
<td>Daryl Seymour</td>
</tr>
<tr>
<td>Sierra Vista Arizona</td>
<td>Mary Jacobs</td>
</tr>
<tr>
<td>Town of Eagar</td>
<td>Tami Ryall</td>
</tr>
<tr>
<td>Town of Payson</td>
<td>Laron Garrett</td>
</tr>
</tbody>
</table>

Finally, Cortex conducted limited external research to understand and analyze the methodologies used by other public funds in the United States in regards to risk pooling.

Cortex submitted a draft report of findings and recommendations to PSPRS in mid-October 2017, which was subsequently released to stakeholders for comment.

**Phase II**

PSPRS invited stakeholders to attend stakeholder feedback sessions regarding the draft report on November 2 and 3, 2016. Four sessions were held, each lasting approximately 2.5 hours. At each session, representatives of Cortex delivered an overview of the draft report and addressed questions from the audience. In total, over 150 stakeholders attended at least one of the sessions, either in person or on-line.

Stakeholders were also invited to submit written comments or questions. These were reviewed by Cortex and PSPRS, and were taken into consideration in the preparation of this final report. Copies of their submissions have been compiled in a separate volume and will be provided to the Board of PSPRS to accompany the final report.
Cortex expects to present its final report to the Board of PSPRS on December 21, 2016 and may modify the final report to address further questions or concerns raised by the Board at that time.
Appendix B
Cortex Response
To Stakeholder Submissions regarding Cortex’s draft Report

Risk Pooling

A number of stakeholders submitted comments regarding Cortex’s draft report findings and recommendations regarding risk pooling.

1. **Equal Contribution rates.** A number of stakeholders stated that SB 1428 requires that the contributions needed to fund the Tier 3 benefits (normal cost and unfunded liability) are to be allocated equally to the employees and employers. There were also comments that SB 1428 requires uniform contribution rates for all employers and employees. Some stakeholders approved of a chargeback process for employers that incur controllable costs to maintain equity between different employers.

   *Cortex Response.* Cortex believes SB 1428 could be interpreted as suggesting that the legislature contemplated an agent multiple system in which individual employers and employees pay different rates. Representatives from cities and towns informed Cortex that they were under the impression that the intent of SB 1428 and the reform process was to produce a system whereby all employers paid an identical contribution rate. We believe this view is inconsistent with SB 1428. See Exhibit A.

   It should be noted that a chargeback system, as used by other organizations, will allow for different contributions rates for employers and employees. It will also require monitoring and additional actuarial work to calculate the cost with the potential for discussion and possibly litigation.
Exhibit A

Excerpts from SB 1428

G. FOR MEMBERS HIRED ON OR AFTER JULY 1, 2017, THE EMPLOYER AND MEMBER CONTRIBUTIONS ARE DETERMINED AS FOLLOWS:

1. AS DETERMINED BY ACTUARIAL VALUATIONS REPORTED TO THE EMPLOYER AND THE LOCAL BOARD BY THE BOARD OF TRUSTEES, EACH EMPLOYER SHALL MAKE CONTRIBUTIONS SUFFICIENT UNDER SUCH ACTUARIAL VALUATIONS TO PAY FIFTY PERCENT OF BOTH THE NORMAL COST PLUS THE ACTUARILY DETERMINED AMOUNT REQUIRED TO AMORTIZE THE TOTAL UNFUNDED ACCRUED LIABILITY FOR EACH EMPLOYER ATTRIBUTABLE ONLY TO THOSE MEMBERS HIRED ON OR AFTER JULY 1, 2017. FOR EACH YEAR THAT NEW UNFUNDED LIABILITIES ARE ATTRIBUTABLE TO THE EMPLOYER'S OWN MEMBERS HIRED ON OR AFTER JULY 1, 2017, A NEW AMORTIZATION BASE REPRESENTING THE MOST RECENT ANNUAL GAIN OR LOSS, SMOOTHED OVER A PERIOD NOT MORE THAN FIVE YEARS AS DETERMINED BY THE BOARD, SHALL BE CREATED ON A LEVEL-DOLLAR BASIS OVER A CLOSED PERIOD EQUAL TO THE AVERAGE EXPECTED REMAINING SERVICE LIVES OF ALL MEMBERS BUT NOT MORE THAN TEN YEARS, AS DETERMINED BY THE BOARD.

2. THE REMAINING FIFTY PERCENT OF BOTH THE NORMAL COST AND ACTUARILY DETERMINED AMOUNT REQUIRED TO AMORTIZE THE TOTAL UNFUNDED ACCRUED LIABILITY AS DETERMINED PURSUANT TO PARAGRAPH 1 OF THIS SUBSECTION SHALL BE DIVIDED BY THE TOTAL NUMBER OF THE EMPLOYER'S MEMBERS WHO WERE HIRED ON OR AFTER JULY 1, 2017 SUCH THAT EACH MEMBER CONTRIBUTES AN EQUAL PERCENTAGE OF THE MEMBER'S COMPENSATION.

The words in **bold** are highlighted to show that Bill 1428 can be interpreted to suggest that the current agency system of differing contribution rates for each employer (and Tier 3 members) would continue under Tier 3.
2. **Disability in the line of duty.** At the stakeholder feedback meetings in November, there were a number of delegates who strongly recommended that the cost of any disability arising from service in the line of duty be pooled on a similar basis to that arising from death in the line of duty.

*Cortex Response:* Cortex suggests that the PSPRS implement the above additional pooling for all 3 tiers. It will probably require that a specific definition of disability be added to the statutes governing the PSPRS, which should apply to all members, not just those in Tier 3.

**Board Consolidation**

A number of stakeholders submitted comments regarding Cortex’s draft report findings and recommendations regarding board consolidation.

While comments varied, they tended to fall into the following categories:

1. **Exemptions.** A number of stakeholders indicated that the draft report suggested that Indian tribes and state agencies would not have the option to apply for exemption from the local county board.

*Cortex Response:* Cortex acknowledges that our draft report and accompanying PowerPoint presentation were unclear as to which local employers could apply to be exempt from consolidation. Our view was, and continues to be, that every local employer including Indian tribes and state agencies should have the ability to apply for an exemption from consolidation.

2. **Flexibility.** Some stakeholders asked if there was flexibility in how local boards were to be consolidated to reflect particular local circumstances. For example, could a local employer choose which county to join or could certain counties be divided into two parts (e.g. east and west).

*Cortex Response:* The goal of consolidation is to enhance efficiency and consistency of administration. Cortex sees no reason why exceptions could not be made if a particular employer can make a reasonable case for joining a different County board. One consideration, however, which was noted in our report, is that if an employee wishes to file a lawsuit against PSPRS, it needs to do so in the county where the action occurred. This fact may influence whether a local employer wishes to deviate from the county-based board model.

3. **Lack of Stakeholder Input.** A number of Indian tribes expressed concern that the tribes had not had an opportunity to provide input into Cortex’s analysis until after the draft report had been released.
**Cortex Response** We appreciate that the Indian tribes are disappointed that they did not provide input into the study until after the draft report was released. It is Cortex’s understanding that all local boards and employers were invited to meet with Cortex in person or by telephone during the outreach phase of the project. Cortex did not proactively approach or invite any specific local boards or employers to provide input, but simply met with those who responded to the mass invitations that were issued. We do, however, greatly appreciate the input provided by the Indian tribes during the second round of outreach as well as the written submissions they provided. We have taken that input into consideration in preparing our final report.

4. **Implementation.** A number of stakeholders indicated that additional details would be needed regarding the implementation of a county-based local board model before they could properly evaluate the recommendation. Implementation-related questions included:

a) How would the composition of the local county boards be established?

b) What would be the impact on the current local board secretaries?

c) How would the new local county boards be supported from an administrative perspective? For example, would each local county board have its own administrative staff?

d) What additional costs would be associated with the new local county boards?

e) What specific governance criteria would be used to determine if an exemption would be granted?

**Cortex Response.** Cortex acknowledges that many details must be addressed regarding the implementation of a local county board structure. We are currently working with PSPRS to begin addressing them. It is likely, however, that the details will not be determined prior to January 2017, in which case any roll out of the consolidated structure may need to be delayed.

In our final report, we have made our recommendation to consolidate small Local Boards along county lines subject to adequately addressing the implementation issues that have been identified.

Cortex has further suggested that if the implementation issues cannot be addressed in a satisfactory manner, then Cortex’s secondary recommendation should be considered, which is to establish a single state-wide administrative board and allow all Local Boards the ability to opt into the state-wide Board.

5. **Support for a County-based Model.** A number of stakeholders (i.e. the League of Cities and Towns as well as others) are supportive of the recommended County-based model and indicated it was a reasonable solution.

**Cortex Response:** Cortex appreciates the input provided and has no response.
6. **Lack of support for a County-based Model.** A number of stakeholders were of the view that the current model has operated well since inception and that there was therefore no need to change it, other than to provide current local boards with additional governance training and support. A primary concern with the recommended model appears to be the view that it will impose new costs on PSPRS (i.e. additional administrative staff) whereas such costs are currently paid for by Local Employers.

*Cortex Response:* As noted previously, there are numerous issues to be addressed regarding the implementation of a local county board model. One of those issues is to identify any incremental costs associated with a county model. Cortex believes incremental costs would be minimal if day-to-day administration functions (e.g. completing forms and applications and providing member counselling and communications) are assumed by staff at PSPRS with the support of additional member service-related technology. PSPRS would likely need to hire additional administrative staff and purchase additional information technology, but the costs would likely not be significant and would be spread across all employees and Employers in the System. If administrative functions are transferred to PSPRS in this manner, the remaining local county board costs would consist of governance-related costs (i.e. the costs of running local county board meetings), which would again be minimal.

If the above issue and other implementation issues cannot be addressed in a satisfactory manner, then PSPRS should consider Cortex’s secondary recommendation.
APPENDIX C
Other Issues

At the stakeholders’ meetings, a number of delegates raised concerns with the structure of Tier 3. The main concerns raised were:

1. Design and implementation of the Defined Contribution (DC) plan

   a) There was a concern that the time allowed (90 days) for a new member to make a decision on whether to select the DC plan or the defined benefit plan is insufficient. The feeling was that during this initial 90 days, the new member would be in training and would not able to find time to focus on making this important decision.

   b) The initial DC member communications need to focus on the risks associated with the investment returns and not on the results associated with achieving consistent 6% to 8% returns. The message we heard was that all the advantages and disadvantages of the two approaches need to be explained.

   c) There should be a separate advisory board that is only focused on DC issues such as education, communication, investment options for these members as the full board could be too involved in Tier 1 and 2 to focus on the DC issues.

2. Assumed earnings rate used for Tier 3

   As mentioned in the risk pooling section of the report, the largest risk to Tier 3 will be if the return on the fund is less than the actuarial assumed earnings rate or if the actuarial assumed earnings rate needs to be lowered in subsequent valuations. A number of the delegates suggested that the initial assumed earnings rate should be in the 5% to 6% range with one delegate suggesting that 4% would be a more reasonable figure.

   The actuarial assumed earnings rate should be considered in combination with the general actuarial salary increase assumption and expected inflation. The contributions must also be affordable to both members and employers as there is a 50% sharing for Tier 3 members.

   The decision on the actuarial economic assumptions must be made by the Board on advice from the actuaries to the fund.

   For discussion purposes the following table shows the expected normal costs for a new entrant profile with the Tier 3 benefit structure. The table was developed by the Reason Foundation using the model they had when discussing the new Tier 3 benefits. Please note that if the Board wants to consider other options the contribution rates must be calculated by the PSPRS actuaries.
For PSPRS Tier 3 (New Hire) DB Only:
- Gross normal cost with a 7.4% assumed earnings rate: 17.25%
- Gross normal cost with a 6.4% assumed earnings rate: 22.00%
- Gross normal cost with a 6.4% assumed earnings rate AND lowering the salary growth assumption (to 3%): 19.6%

Lowering the assumed earnings rate only will increase the normal cost by 4.75% to 22.0%. If the assumed earnings rate and the salary assumption were lowered by 1% the total increase would be 2.3%.

Notes on methodology: We are assuming the COLA at 1.75% annually, but the plan may direct GRS to calculate normal cost with some separate assumption on the COLA. We are factoring into the normal cost refunds based on existing patterns of pre-vesting termination, but it is likely that patterns will change given the option for individuals who are less likely to stay for a full career to select the DC only plan and it is possible that GRS will make some estimate of the change and adjust normal cost accordingly. Our new entrant profile used is for a hire at age 30.

3. Investment asset allocation for Tier 3

The question of whether the investment asset allocation applicable to Tier 1 and 2 is appropriate for Tier 3 was raised as there will be no retirees in Tier 3 for a considerable number of years. Current the retirees comprise 52% of the actuarial liability and the current DROP liability is 12%. It is also that the contribution inflow will exceed benefit for a long period of time.

4. Social Security Exemption

One delegate was concerned that they would lose their social security exemption and felt that the statues governing the PSPRS could state that social security exemption is applicable where required. Cortex has not researched this issue.

5. Communication of Financial positions for Tier 1 and 2 to employers

There was one delegate who felt that the communication of the financial results for each employer for Tier 1 and 2 benefits could be enhanced to help the employer understand the reasons for any changes and what could be done resolve the issue. They were trying to understand how to manage their unfunded liability contributions.
6. Disability in the Line of Duty

At the stakeholder feedback meetings in November, there were a number of delegates who strongly recommended that the cost of any disability arising from service in the line of duty be pooled on a similar basis to that arising from death in the line of duty. It will probably require a specific definition of disability to be added to the statutes governing the PSPRS and should also be for all members not just Tier 3.

We suggest that the PSPRS implement this additional pooling for all 3 tiers.
Compilation of Stakeholder Responses to Report on Risk Pooling and Local Board Consolidation

Prepared by Cortex Applied Research Inc. in cooperation with PSPRS

December 21, 2016
Jared – can I suggest that additional implementation suggestions be provided regarding the potential for smaller entities to join a single County-based board? The biggest question from my perspective, is who will staff the new combined Board? Who will lead the group of participants toward a single Board policy, procedure, meeting location, etc.?

I realize it may seem early to discuss implementation issues, but the unknown could lead to resistance on the part of the various agencies.

Kathleen Haggerty, HR Director
HR Department
City of Maricopa
p: 520-316-6806
f: 520-568-1480
Kathleen.haggerty@maricopa-az.gov

39700 West Civic Center Plaza, Maricopa, Arizona 85138
City Hall Open Monday-Thursday, 7:00 a.m.-6:00 p.m., closed Friday
Public Safety Personnel Retirement System
Administrator Jared A. Smout
3010 E. Camelback Road, Suite 200
Phoenix, AZ 85016-4416

Dear Mr. Smout;

I am writing in response to your request for feed-back on the Cortex risk pooling and board consolidation study.

I have been employed and retired under the Highway Patrol Retirement System and then transferred into PSPRS in 1969 when it and the Department of Public Safety came into existence. My retired years began in 1992 and continue to this day. To say that I am a “stakeholder” and am interested in the PSPRS system is an understatement. With all of the different approaches tried and approved over the years, PSPRS has prospered. The recent financial shortcomings will be overcome and all beneficiaries will receive the benefits that have been promised. I currently serve on the Town of Wickenburg PSPRS retirement board and through that channel I do keep up on the goings on within the system.

When seen on paper, the “233 local boards” graphic does seem extreme. This can be misleading in some cases, as in Wickenburg we have actually 3 boards; one for Police, one for Fire, and one for Dispatchers. These three iterations are actually the same board with members of Police, Fire, and Dispatch added for their specific needs. This system has been in place since 1969 (47 +/- years). During this time I cannot recall any distress about the functioning of the local boards. Each Public Safety agency is administered by their particular government entity and this includes the local PSPRS retirement board. THERE IS NO COST TO THE PSPRS FUND! The implications of the term “local” implies and carries out the services of PSPRS in the local environment. The employees and beneficiaries have contact with the system locally and don’t have to travel to the county seat or Phoenix for their contact. Any consolidation of these boards would put an undue burden on the employees and retirees in that they would have to personally travel to the site of the board for contact. Additionally the consolidated board would have the combined functions now carried out by the locals, and would undoubtedly need to hire administrative employees to carry out this responsibility. The consolidation would remove the board function from the local agencies who now provide the administrative functions at no cost to the fund. Monies for this administration would need to come from the PSPRS fund and would be an additional burden in a time when this is not welcomed.

When reviewing the alternative approaches to Local Board consolidation, I believe that Alternative 1-Status Quo with enhancements would be the best choice. All of the advantages listed under this choice are absolutely true. Local knowledge and understanding, and local working conditions are essential in analyzing applications for disability retirement. Comparable jobs can be considered in perhaps placing the employee in a suitable comparable position. The convenience of having the board local is a true benefit to the
employee/retiree. Technology such as video conferencing is available but a poor substitute for face to face meetings. The disadvantages are not totally correct. The first disadvantage states that “the status quo is not a cost effective option”. Time spent by local board administrators is well below 5% of their total work hours. (minimal). The local board meets annually and at other times when retiree business requires, i.e; retirement or review of proposed changes to the structure. These meetings usually take less than one hour to complete and usually occur 2 to 3 times per year. The times of the meetings are planned so as not to interfere with the regular business of the board members and tuned to the availability of others personnel needed. It is hard to say that something is “not cost effective” when there is no cost. The second disadvantage is almost accusatory in its nature. Stating that “Local Boards in small communities may not be objective when evaluating benefit claims”. The fact is that the knowledge of the claimant actually prepares the local board to better understand and objectively evaluate the claim. In my history, when this kind of conflict occurs, the specific board member with the conflict will recuse themselves from the proceedings. Another statement is that “inappropriate decisions are not only damaging to the specific plan members and employers in question, but may set precedents that impact other members or employers throughout the system”. Do we have specific examples of this happening?

Under the category of Risk Pooling, I believe that Option B: Status Quo plus a Retiree Pool would best fit the need. This option would be the easiest to administer while having positive effect in protecting the employer from the unknown. This account would also provide greater benefit security for retirees and beneficiaries while simplifying administration and actuarial valuations.

In summary, we have a retirement system that is 47 +/- yrs into its operation. In my experience, any change to something of this magnitude will alleviate a few of the known problems now but will undoubtedly cause new problems with the new structure that are totally unknown. Some of the items that this report did not deal with are: any potential make up of the consolidated board(s, where the administrative staff will come from, and who pays?? I submit that any problem with a small local board can and will still occur in the new configuration. It is a managers chore to pick the model that is the best for the needs and go with the known problems, avoiding the unknown.

Larry N. Thompson
P O Box 20369
Wickenburg, AZ 85358
October 31, 2016

Public Safety Personnel Retirement System
Administrator Jared A. Smout
3010 East Camelback Road, Suite 200
Phoenix, AZ 85016-4416

Dear Mr. Smout:

Congratulations on your new position as Administrator for the Public Safety Personnel Retirement System. We are looking forward to working with you as the system moves forward toward being more financially stable. As Mayor of the Town of Wickenburg, I serve as Chairman of the Personnel Retirement Board for Police, Fire and Dispatch. Both Police and Fire fall under the Public Safety Personnel Retirement System (PSPRS), with Dispatch under the Correction Officer Retirement Plan (CORP).

We received the report from Cortex Applied Research regarding Risk Pooling and Local Board Consolidation. We held a meeting on October 26, 2016, to discuss the report and the recommendation was to send a letter with our input on the report from a small municipality standpoint. This letter was then approved unanimously by both the Police (126) and Fire (217) Boards at a special meeting on October 31, 2016.

Regarding the Risk Pooling, we support the recommendation from Cortex of Alternative 3(B) Status Quo plus a Retiree Pool. We cannot stress enough the importance of having a single employee contribution rate that is consistent. As a small municipality, we struggle to be competitive with larger agencies in our pay. If we were further disadvantaged by having a higher contribution rate, we would have even more recruitment and retention issues.

Regarding the Local Board Consolidation, we do not agree with changing a system that has worked since 1969. Our recommendation would be Alternative 1, Status Quo with Enhancements. The board currently works at no cost to the system as the members are volunteers and it takes very little staff time to prepare items for the board. Most of the staff work also has to be done by our Human Resources Office in the preparation of retirement paperwork and calculations. If the boards were consolidated to one statewide board or even county boards, there will have to be staff hired for those boards, costing the system money. We also fundamentally disagree with the report's implication that local boards cannot evaluate a member objectively in disability cases. The local boards know these members and care about them, but also know their role is to be objective and look at options for the members. Much of the decision is based on
the medical information, but it is also to see if there are other positions at the Town that this person can fill so he or she does not have to quit working. A statewide or even county board will not know all the different departments at the Town nor the capabilities, knowledge and background of members to know what other options are available. In addition, being a small town means that we often know these members’ habits and routines and are better able to discern the truthfulness of their claims.

We agree that additional training is needed for the boards, but disagree that education has been given to the boards as is stated in the Summary Annual Financial Report. Our board would be willing to go to trainings, host trainings for boards or have a trainer attend one of our meetings. ASRS has an Annual Employee Conference to let at least one employee from each organization know the changes and answer questions. These trainings happen in seventeen locations throughout the state over a month’s timeframe. If PSPRS did something similar, we would be better trained to know our roles and duties. We do not think the local boards are “broken,” but we would welcome additional training.

We stand ready to do our part in support of this system.

Yours Truly,

[Signature]

John Cook, Mayor
Chairman of the Public Safety Retirement Boards for the Town of Wickenburg
I will be attending in person on Thursday afternoon and a few of our Board Members will be attending via the webinar on Wednesday afternoon. They've asked me to forward the following questions to you. If you can answer them prior to the Wednesday webinar, that would be great. Thank you.

Some issues I have regarding options:

- **Option B:** While this seems to be a positive approach, what happens if the risk pooling exceeds needs for unfunded retiree liability for all Employers?
- **Option C:** Need to ensure legislation (not always guaranteed) is completed for prior unfunded liabilities, and determination and coordination with the right people.

Also, would like to make sure any Advisory board has representation from VVFD.
November 1, 2016

Mr. Jared Smout, Administrator
Arizona Public Safety Personnel Retirement System
3010 E. Camelback Road
Phoenix, AZ 85016

Re: Cortex Draft report

Jared,

I have reviewed the draft report of the Cortex review of the issues related to risk sharing and local Board consolidation for the Arizona Public Safety Personnel Retirement System. My comments, questions, and suggestions follow.

Let me start by saying that I am impressed with the quality and scope of the report, particularly the key observations, the analysis of the strengths and weaknesses of the various options, and the resulting proposed recommendations. I am in general agreement with the recommendation for both the risk sharing and the local Board consolidation.

Just a couple of quick points: The observation on PBI’s is spot on, and although it does not change the conclusion of the observation it should be noted the PBI changed for those retiring after August 1, 2011 - currently subject to resolution of the Hall lawsuit, and soon to be replaced with SB1428 change to a COLA. And, under the Evaluation/Criteria Factors for local board consolidation I think they should add that “decisions need to be made on a timely basis”.

The section on Background - Liability Risks & Pooling is the key to understanding their analysis of the pooling concept. First, although it is identified later in the analysis, the major risk factor, Interest, is already pooled. Second, they have identified the demographic and economic risks (interest might qualify as an economic risks - some of these risks they classify as “non-predictable” and cannot be influenced by management and the remaining risks are classified as those that can be influenced by management. I disagree that risks such as death should be classified as non-predictable, in fact they are very predictable and are the basis for the actuarial assumptions used in the pricing and valuations - the key, as noted, is that they are not controlled and managements cannot influence the risk. The assumptions for these risk factors are the starting point, and although the variations year to year are unpredictable, over time the results
should closely conform to the assumptions (assumes the assumptions were appropriate in the first place). Granted over time assumptions may change but the annual valuations adjust for those changes. The Cortex study does confirm that, other than interest, the so-called “non-predictable” risks experience for the 2009-2015 period was close to the expected experience.

With respect to Tier 3, Cortex recommends the status quo with the exception of pooling the longevity risk – their Option B under Option 3 (Hybrid). I am in agreement with the recommendation. BUT IF there is still concern for the “risk” for the smaller employers and Cortex were to fall back to their Option C (Separate Large and Smaller Employers for Risk Pooling Purposes) I would be inclined to set the cut-off at 50 rather than the proposed 100 – no specific actuarial justification, just my speculation that employers with 50 plus employees are large enough to handle their own experience (also ties into their recommended status quo except for the very small employers). Note: I could accept the cut-off at 100 provided a District with less than 100 employees could opt for status quo (as noted in the report).

As to local board consolidation (applies to all Tiers) the Cortex recommendation is a partial consolidation - the cutoff would be set at 250 employees, Districts with more than 250 employees would retain their local board, while those Districts with less the 250 employees would fall under a county board (separate Boards for Fire and Police). I have no problem with the recommendation.

One concern about the tie-in between the two CORTEX recommendations - given status quo plus longevity pooling, valuations for Tier 3 will need to be made for each District (not really an issue since valuations will still need to be completed for Tiers 1 & 2), but those Districts (proposed cut-off at 250) that no longer have a local board will not have an entity to review the annual valuations as required. Will the county boards be tasked with that requirement or will the smaller Districts be tasked with that requirement?

I do have a couple of questions. What is the basis for allocating “pooling charges” for the longevity risk (and I’d be inclined to include the investment risk on the pooled account – might actually be the bigger risk)? Can I assume that permanent and total disabilities will be included in the longevity pool?

Given the status quo (with longevity pooling) recommendation for Tier 3, I concur that a single employee rate across all Districts is the key consideration. I’m thinking that the actuaries will initially develop a normal cost based upon a set of demographic parameters and a single set of actuarial assumptions (as opposed to the current set of four) and then set the employee rate 50% of that normal cost in order to comply with SB1428. If, and when, unfunded liabilities develop, the overall plan valuation will calculate the contribution rate for the unfunded liabilities and the employee rate will then increase by 50% of that unfunded contribution rate. It is important to note that District rates will vary over time based on their
own experience and demographic make-up. You will eventually have a range of District rates, some with a rate less than the so-called 50% employee rate and some with a rate higher than the so-called 50% employee rate.

Although it is outside the scope of the review, the Plan may want to consider pooling the longevity risk for Tiers 1 & 2. However I’m not sure that I would recommend such action until interest rates improve.

Also outside the scope of the review is the question of the actuarial interest assumption (sometimes referred to as the discount rate) for the Tier 3 Plan. The current assumption for Tiers 1 and 2 is 7.4%. I strongly advocate for a lower assumption, perhaps as low as 5%-6%. I recognize that a lower rate would increase the normal cost today but serve to reduce the potential for higher rates if unfunded liabilities develop. It should be noted that the rate for the current year (ending 6-30-16) based on the amortization schedule (7 year) is just below 6.5% (my estimate) and still below the interest assumption.

And finally, the recent issue of “In The Public Interest” published by the Society of Actuaries Social Insurance and Public Finance Section has an excellent article on “Understanding the Argument for Market Valuation of Public Pension Liabilities”. The article is worth some discussion prior to the actuaries and the Board sets the Tier 3 interest assumption.

Thanks,

Michael Fox
Public Member, Green Valley Fire District Local Pension Board
Thank you Jared for the response and information. It’s very understandable that as of now PSPRS may not have all the answers to how operationally these areas would work and that PSPRS is aware of some of the areas of concern. I feel better having emailed.

It would seem that for those board that would be grouped with other boards, that the employer side would still have to assist with most of the paperwork process aspect, however, maybe some of the local board secretaries would be able to provide some recommendations for streamlining the process. I could probably think of some ideas that might be helpful, but not sure if PSPRS is looking for recommendations.

Thank you again for your quick response and I look forward to the webinar tomorrow!
Have a great day!

Thank you,

Kristen Venditte

HR Analyst (Benefits/Workers Comp)
City of Peoria - Human Resources Dept
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Office Hours: Monday - Thursday  7:30am - 6pm
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Having said that, it took me a little while to be able to separate in my head the governance and administrative functions of the local board. As such, much, if not all, of the retirement process (paperwork, member counseling, etc.) would still need to be handled by each individual employer where all the decisions (governance) are handled by the new board. You also bring up a good point about all the issues a local board currently meets on that could potentially complicate things. Further, I recognize adding this additional layer by separating the board from the employer would certainly slow down the process.

No doubt all these questions will be brought up (but not solved) during these meetings.

Also, just so it is clear, should this recommendation move forward Peoria would be part of the Maricopa County Police and Fire Boards, not the state agency board. Only state agencies would be placed in the state agency board.

Thanks again for sharing.

Jared

From: Kristen Venditte [mailto:Kristen.Venditte@peoriaaz.gov]
Sent: Tuesday, November 01, 2016 3:02 PM
To: Jared Smout <Jared@psprs.com>
Cc: Don Mineer <Don@psprs.com>
Subject: Question for upcoming Meeting/Webinar

Good afternoon Jared,

I currently serve as the Local Board Secretary for our Police and Fire boards. I have reviewed the draft report submitted to PSPRS by Cortex regarding the consideration of risk pooling and local board consolidation. I have signed up for the webinar on Thursday and look forward to the information that will be presented.

In reviewing the draft report in particular to Cortex’ review of the local boards I see their recommendation is to do a partial local board consolidation. If that recommendation stands the City of Peoria’s local boards would likely be consolidated into a single State Agency Board. I’m curious how that will affect employees when it comes time for them to want to retire, enter DROP, retire from DROP, etc.

I meet with our employees and assist them in completing the required forms to submit them to PSPRS (once officially approved by the board) in a timely manner for processing. I’m just wondering how the process would change for our employees if we become part of the State Agency board. Would someone in HR still be working with them on the forms or would they be directed to meet with someone on the State Agency Board and the City would just be notified once an employee has been approved? There are so many parts to the current process and just curious as to how that would change moving forward.

There are quite a few things that the local boards meet on besides the retirements and also curious how that would change moving forward for the employee and us as the employer (ex: new hires, disability retirements, survivor benefits, retirees and the ACR rates).
I’m not sure if this is something that can be addressed in the webinars, but wanted to email to inquire regardless. If anything, my questions mainly surround on how a partial local board consolidation will operationally change processes for those that would become part of the State Agency Board. I hope the email above makes sense, I was finding it a little hard to put my questions into email format. If you have any other questions please let me know.

Thank you,

Kristen Venditte

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Jared Smout

From: Don Mineer
Sent: Wednesday, November 02, 2016 9:59 AM
To: Jared Smout
Subject: Fw: Riskpooling and board consolidation

Jared,

Questions that came in Wed morning.

Don

From: Joel Beck <jkbeck72@msn.com>
Sent: Wednesday, November 2, 2016 9:19 AM
To: Don Mineer
Subject: Riskpooling and board consolidation

Good Morning.....a voice from your past--

I had three questions on the info you sent out, called and talked to Larry who recommended I email you and they could be answered in the meetings you all are having now. Complicated enough?

1. Who will make the decision on the consolidation---Governor---St Legislature---?

2. What would the Boards look like or be made up of?
   (I understand the big cities would not be included and that it would probably be within counties.)

3. Anything else I would need to know as a Board Member for Oro Valley Police.

Thanks for you time!
Kitty Beck
Jared,

Based on the presentation today and discussions with my department, I do not believe the Salt River Pima-Maricopa Indian Community would support Local Board Consolidation. We liked the idea of the Risk Pooling.

Thank you,

Lieutenant Steve Larson

480.362.7938 office
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Scottsdale, Arizona 85256

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Our Board Members that attended the webinar this afternoon have the following questions/comments:

1. County boards will be by county boundaries - why not by regions and reciprocal agreements in fire departments. For example, Sedona would be part of Coconino Board? They may be more akin to the Verde Valley. Also, many of our county boundaries are huge (ie, Yavapai) and may be better off by region.
   a. If the county board option is chosen, can the counties be split in to 2 boards rather than one? Yavapai County, for example, has a strong split between the east and west county with regards to the college, county representation, etc. The concern is that the larger employers reside on one side of the mountain and will not fairly represent the smaller agencies.
   b. If a agency’s boundaries cross county lines, why can’t the agency be allowed to chose which county board they belong to?

2. Board Consolidation:
   a. Clearly, they were not ready to reveal this one without a lot more thinking and conversations.
   b. Was there an impact study done? Seems like the smaller, local boards would have more at stake since there are 211 of them. What is the impact? Why do they need consolidations if they are functioning and following the procedures and rules of PRSRS? The Website is pretty clear how to manage.
   c. Most local board member composition is fair and balanced to the area.
   d. Do not agree with single board - ie, like ASRS.
   e. Will Boards be both Fire and Police?
   f. Whatever boards look like need to determine if it’s elected / appointed, and assure that it’s no political and would benefit a particular area.
   g. Like the opt out of consolidation - but...who’s going to set up those parameters and rules?
   h. Perhaps with consolidation PRSRS can provide consistent training for the regions - or appoint regional staff in local fire depts. to do this training. They really do know procedures and could help nearby areas that need assistance.

3. Comments:
   a. Please don’t create another bureaucracy that is not defined.
   b. I am part of a local board and I think the impact could be huge for the smaller districts.
   c. Remember that our public employees should benefit from whatever decisions are made.

Lisa Elliott
Administrative Manager
Verde Valley Fire District
(928) 634-2578 extension 6
(928) 646-5737 fax

Show respect to people who don’t even deserve it. Not as a reflection of their character, but as a reflection of yours. - Dave Willis
RE: Slide #43 - Arizona's rural areas (and often fire districts) cross county lines. How will those smaller districts be consolidated and who will board members be chosen?
Hello Mr. Smout,

Thank you for the webinar provided today by PSPRS in reference to recommended strategies for changes that will be effective 07/01/16 and thereafter.

During the replies to audience questions, it was suggested that we send recommendations to you regarding implementation of administrative duties. I submitted the following question during the webinar which the speaker said would be taken into consideration when implementation is addressed:

- Currently, HR staff is required to serve as secretary for each local board. If county boards are created to serve several entities instead of local boards which each serve only one entity, would the secretary position then become an elected/appointed volunteer position in the same way the rest of the board positions are currently filled? It would be preferable for employers (particularly for small employers with limited staff) to refrain from having a paid staff member of their municipality, school district, or fire district be required to perform duties for a new board with an increased workload which serves multiple entities from outside of their local tax area.

Multiple employers and current board secretaries expressed similar concern throughout the Q&A over the growing administrative duties related to the new and larger county boards proposed by PSPRS. Consolidation would mean more board activity due to new hires, terminations, regular retirements, DROP retirement, and the unfortunate disability retirements which would now be tied to multiple employers instead of a single employer. Meetings of boards representing multiple employers would be both longer and more frequent. As such, the burden of hours that board secretaries are required to dedicate to board related duties would be greater than ever before; there is also the concern of both time and monetary expense as a result of increased travel that would be required for county board meetings. HR staff members from multiple employers expressed fear that the requirement of serving as board secretaries will remain assigned to local HR when the boards grow from a local to a county level. When an audience member posed the fourth similar question expressing fear that the bulk of administrative board duties would continue to fall on HR, I was encouraged that the speaker suggested the PSPRS should consider centralizing the administrative function at PSPRS; the speaker also commented that centralization at PSPRS is the most obvious option to explore which was a relief to hear as an HR staff member. I wholeheartedly encourage the PSPRS to thoroughly explore and to implement an option that would relieve local HR staff of board duties when the transition to county boards is made. Please differentiate local HR duties from board secretary duties when forming larger boards and ensure that the boards create their agendas, facilitate their meetings, submit their minutes, and conduct their IME processes independently. It is a natural assumption that HR would continue to complete DROP and regular retirement workbooks for our employees; we have their earnings history in our payroll records as well as access to the local board portal; HR staff uses both sources of information to verify the high 3 years of earnings for an employee (and if we are to continue to perform those duties effectively, I encourage the PSPRS to continue to provide local HR staff with access to the online portal). It is also logical that HR would continue to collect pre-employment physical forms from our Police and/or Fire Departments to forward the documents to the board for new hires. However, the board should be independent enough to complete their own portion of duties that follow.

Please take my comments into consideration. Individual HR departments cannot realistically accommodate duties for multi-employer boards.
I very much thank you for being willing to accept suggestions regarding implementation of the proposed changes to the PSPRS boards.

Best regards,

Kelli Schwein - Human Resources Analyst

Town of Payson
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Payson, AZ 85541
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Fax: (928) 474-1151
kschwein@paysonaz.gov
Jared Smout

From: Don Mineer
Sent: Friday, November 04, 2016 1:42 PM
To: Jared Smout
Subject: FW: STAKEHOLDER MEETING 11-03-2016

Jared,

Additional comments from a board member as feedback.

Don

From: Paul Hemmes
Sent: Friday, November 04, 2016 1:36 PM
To: Don Mineer <Don@psprs.com>; Christian Palmer <CPalmer@psprs.com>
Subject: FW: STAKEHOLDER MEETING 11-03-2016

Paul C Hemmes
Programmer
Web Services Support

From: Garcia John [mailto:garciaj@mcao.maricopa.gov]
Sent: Friday, November 04, 2016 12:29 PM
To: webmaster <webmaster@psprs.com>
Subject: STAKEHOLDER MEETING 11-03-2016

I was only able to listen in on the risk pooling discussion. I do agree with the findings and recommendations for a hybrid solution. I was pulled away for a conflicting unplanned meeting.

As a board member for over 20 years of a large member pool and a small member pool, and with local government budget experience, I have seen the disparity between employee and employer risk allocations and the annual contribution rate creep. I believe that by implementing the suggested option members, employers, and the fund will benefit.

As the chairman of two local boards I can say that I and my fellow board members are concerned about moving to either a regional or state-based board governance solution. We predict that the volume of matters that would have to go before a regional or state model may overwhelm the board. It would take longer for decisions to be made, it may lead to “rubber stamping” of actions, and it could lead to poor decisions. When you remove the local knowledge of the agency, duty requirements, and knowledge of personnel that the current model was designed to do, you increase the risk of either approving disability applications when the local board would know enough to disapprove an application that actually does meet the criteria. Or, the reverse of disapproving applications that are substantiated by local knowledge of the members and their jobs. While we acknowledge the benefits of central or regional governance, we do not feel that they would outweigh the benefits of the status quo.

Thank you for providing us the opportunity to share our thoughts and concerns.
John S. Garcia, MBA, CPM
Management Analyst
Information Technology - Operations Division
Maricopa County Attorney's Office
Telephone: (602) 372-5022
From: Larson, Steve <Steve.Larson@SRPMIC-nsn.gov>
Sent: Tuesday, November 08, 2016 11:07 AM
To: Jared Smout
Subject: Feedback to risk pooling and board consolidation study

- The Salt River Pima-Maricopa Indian Community (SRPMIC) Salt River Police Department (SRPD) and Salt River Fire Department (SRFD), were the first Police and Fire Departments within Indian Country Jurisdiction within the State of Arizona to become full partner members in the Arizona Public Safety Personnel Retirement System (AZPSPRS), in October 1999.
- Combined membership of the Salt River Police Department (SRPD) and Salt River Fire Department (SRFD) totals almost 200 AZPSPRS members.
- The Salt River Police Department (SRPD) and Salt River Fire Department (SRFD) Local Board is the largest Local Board within Indian Country Jurisdiction within the State of Arizona and factually we assisted and were the role models to the other 15 Indian Country Jurisdiction Police and Fire Departments who have since 1999 joined the AZPSPRS.
- SRPD recommends that we would support a position of no change to local boards. Each local board is unique and they are the local voice of each individual Community, the definition and vision created by the architects of the AZPSPRS statues especially about local boards was to ensure each local board had the authority to administer actions that affected their members because they know their members and Community best.
- Additional analysis specifically related to actuarial data, information, metrics and statistics is required; however encourage great caution about consolidation concepts ("one size fits all" theorem) such as proposals to consolidate local boards, definitions of large and small employers (Risk Pooling, as indicated on slide 21 and others) and who determines definitions and rule sets (e.g.: what is a large employer, small employer, etc.). What research, fact-based evidence and sources are being used to propose making potentially critically impactful changes to AZPSPRS since each Community, local board and demographics are different around the State. As an example to illustrate our point please, how many Tribes were contacted, consulted or interviewed to obtain their perspective regarding the Risk Pooling and Local Boards study?

Lieutenant Steve Larson

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480.362.5934 fax
10005 E. Osborn Rd.
Scottsdale, Arizona 85256
Good Afternoon, Jared –

At their November 2, 2016, meetings, the Phoenix Local Fire and Police Boards discussed the Cortex report and requested that I provide the following stakeholder feedback to you and PSPRS.

On page 14 of the report, the last sentence states: “If investment returns fall short over the first few years following the launch of Tier 3, the new Tier will immediately experience a deficit, which is likely to cause considerable concern among stakeholders and may overshadow all of the positive features of Tier 3.” The Phoenix Local Boards wanted me to express their concern over the fact that Tier 3 does not have a contribution cap for its defined benefit/hybrid members. The City of Phoenix Employees Retirement Plan’s Tier 2 had a similar 50% split of the contribution with the City, with no cap. Actuarial losses quickly increased member contributions to over 15% of compensation. As a result, the City had an extremely difficult time attracting and retaining employees. It was only after the City voters approved an 11% contribution cap was the City able to reduce some of that difficulty. The Local Boards are concerned that actuarial losses experience by the PSPRS Tier 3 will have a similar effect – significantly increasing member contributions, thereby reducing the ability of Police and Fire employers to hire and retain new recruits.

The Phoenix Local Boards also wanted me to request that the term “stakeholders” in the above-quoted passage be clarified to include Tier 3 defined benefit/hybrid members themselves. Not only employers will suffer if the actuarial losses dramatically increase contributions; those members will shoulder 50% of the increases, which will be a serious concern to them.

Please let me know if you have any questions or concerns about the above feedback.

Scott

Scott A. Miller
Retirement Program Administrator
City of Phoenix Employees’ Retirement System
200 West Washington Street, 10th Floor
Phoenix, AZ 85003

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Jared,

I was at the Green Valley Fire District Local Pension Board meeting today and the subject of the Local Board consolidation was discussed after the meeting. It may be a bit premature, but the fire participants raised a question concerning the composition of the "county" local board (Green Valley would fall under the Pima county local board). Will the county board have representation from from the fire participants (currently 2 of the 5 members are fire participants)? If yes, how will they be chosen or elected? I anticipate that both fire and police will want to be represented on their respective county Boards.

On a related issue, the Local Board fire participants have provided a valuable conduit for PSPRS information to the local firefighters - that likely disappears under a county Board. The ability to communicate to the local firefighters will be critical, particularly with respect to the decision that new Tier 3 participants will need to make. Just something to keep in mind as you move forward.

Mike

Sent from my iPad
November 10, 2016

Public Safety Personnel Retirement System

Mr. Jared Smout, Administrator
3010 E. Camelback Road Suite 200
Phoenix, AZ 85016-4416

Dear Mr. Smout:

The Coalition of DPS Retirees, Inc., is a group of several hundred Arizona Department of Public Safety retirees, of which most are retired members of the PSPRS. This group of retirees has been in existence since the early 1990s with the goal to keep our retirees advised of current retirement, health insurance and other factors affecting the retirees. We hold monthly meetings to discuss these items and any legislation that could affect the pensions and retirement benefits of our members. We have an Executive Board comprised of seven (7) members, five of whom are PSPRS retirees, and two are PSPRS surviving spouses.

As the Chairman of the Coalition of DPS Retirees, Inc., I am representing the combined opinions of our Executive Board and the members of the Coalition. Many of our members have expressed the desire for the CDPSPR Board to send a formal response to the Draft report by the Cortex Applied Research regarding Risk Pooling and the Consolidation of the local Boards.

Since we as a group, are all retired, our primary concern is with the consolidation of the local boards. We understand there are approximately 233 local Boards who deal with the normal retirements of police and the each of these individual boards make recommendations for normal retirements and also recommend disability retirements prior to normal retirement dates. These boards have been operating since the inception of the PSPRS in 1969, and from all appearances, have performed their duties properly and in accordance with the statutes that govern PSPRS. We know the AZDPS Board meets every month to consider normal retirement requests and when necessary, to consider a disability retirement for whatever medical issue that requires it. The individuals who make up the DPS Board have sufficient information provided to them by the Department to come to a reasonable decision for such retirement. Once their decision is made, they forward their recommendation(s) for retirement to PSPRS. PSPRS then accepts the recommendation of the local Board and processes the retirement paperwork. Up to the point of PSPRS receiving the recommendation for retirement, all expenditures for time and administrative function are performed at no cost by the local Board and are absorbed by their
agency. Only when PSPRS begins the actual processing of the retirement paperwork, are any costs incurred by PSPRS.

We also understand the each of the local boards operate within the guidelines and have much better contact and knowledge with the potential retiree and any recommendations made by his/her department are made by persons within his/her agency.

If the consolidation of the local Boards is done, the affected individuals and Boards will have to travel to wherever the consolidation point might be, to present their recommendations. This will put an undue hardship on both the local Board and the affected employee. A consolidation of the Boards means a special staff would have to be implemented at a cost to be borne by PSPRS, to oversee these consolidated Boards. This would be a further drain on the funds of the PSPRS, that has not been the case for nearly 48 years. If the actions of the individual boards had been a problem, it surely would have surfaced many, many years ago.

For this reason, the Coalition of DPS Retirees is not in favor of the consolidation of the local Boards as presented, but the Alternative 1-Status Quo with enhancements may be the best choice since the majority of the advantages of this option are true. The local knowledge of working conditions, comparable jobs that can make accommodations for the employee are better known and the convenience of not having to travel to another locale by the employee/retiree and or the local supervisors who are making the recommendation(s) for disability retirement is more cost effective.

During our regularly scheduled monthly meeting on November 9, 2016, we discussed the draft report and read the letter written to you by Mr. Larry Thompson on October 30, 2016, regarding his thoughts on both the consolidation and risk pooling and agree with his assessment on both. We feel that if the current system with the individual boards has not presented a problem, then there is no need to fix what isn’t broken.

Respectfully Submitted,

Colin Peabody, Chairman
CDPSR Inc.
November 14, 2016

Jared Smout  
PSPRS System Administrator  
3010 E. Camelback Road, Suite 200  
Phoenix, Arizona 85016

Dear Mr. Smout:

The Fort McDowell Yavapai Nation ("Nation") is submitting this formal written comment to the Cortex Draft Report to Stakeholders, dated October 17, 2016. There are several areas of concern and issues that the Nation deems must be addressed.

First and foremost, the Cortex draft report does not reflect the input and/or consultation with any of the 10 Arizona Tribal entities that are participants in PSPRS. The list of stakeholders that were consulted in the Appendix A is devoid of tribal representation. The appendix states that all stakeholders were invited to participate and attend meetings, yet none of the Nation’s board members or the Nation as an employer, nor any other tribal entity the Nation’s representatives have contacted had any prior knowledge of such meetings or opportunities to participate in this process.

The draft report appears to make assumptions regarding Tribal employers and consolidation of local boards that disregards the sovereignty of each Tribal entity that participates in the PSPRS.

The first public meeting for input on the completed draft report indicated in PowerPoint slides that the report recommends a partial consolidation that would allow larger employers that would remain autonomous local boards to “opt in” for consolidation of local boards if they choose. Alternately, small employer local boards that would be consolidated based on size could “opt out” of consolidation if they demonstrate competence. The third bullet point stated that Tribal Local boards “will” be consolidated. This reflects the lack of respect and understanding that the PSPRS has for the tribal entities that participate in PSPRS.

Next, the recommendations for risk pooling of Tier 3 that the Nation would find most preferable is the Alternative 3 Hybrid Option with the pooling of risk for non-predictable risks, and the maintaining of management risks of each employer retained by the individual employer. Additionally, the Nation prefers the status quo of un-pooled liability risk except for line of duty deaths, and the pooling of retirees in Tier 3. It is important to note that the report does not address Tier 1 and Tier 2 pooling of risks, but that this is
clearly the desire of the PSPRS board. The Nation is not in favor of Tier 1 and Tier 2 pooling, since the funding levels for the Nation are in much better shape than those employers that have negatively impacted the system through pension spiking and other management decisions, and the Nation is not in favor of the transferring of those risks that were predictable and preventable.

Finally, the Nation does agree that the partial consolidation of the local boards is a workable recommended alternative. However, tribal sovereignty is a key factor that must be considered in the ability to opt in or opt out of consolidation tribal local boards. Those tribal local boards that choose to opt out of consolidation must have that option.

Of equal importance regarding the consolidation of local boards section of the report, the Nation agrees with the statement that “the correct response to perceived weakness in the quality of the Local Board decision-making is not to eliminate the Local Boards, but to invest more resources in local board training, policies, and procedures.” It is our opinion that the PSPRS must improve in their efforts to deliver the governance training to the local boards that would exist following consolidation.

On behalf of the Fort McDowell Yavapai Nation, these written comments are respectfully submitted this 14th day of November, 2016.

Sincerely,

FORT MCDOWELL YAVAPAI NATION

Bernadine Burnette, President
Jared,

Attached please find our formal response to the Cortex Report on Risk Pooling & Local Board Consolidation. I request that you forward this to the Cortex team and enter it into the official public record. I also included an article from the Arizona Capitol Times regarding the Hall case that I request be included as well. Please let me know if you need anything else.

Thanks,

Ken

Ken Strobeck
Executive Director
League of Arizona Cities and Towns
(602) 258-5786 office
(602) 501-4989 cell

I. The League of Arizona Cities and Towns disagrees with the consultant’s recommendation of Option 3-Hybrid regarding pooling of Tier 3 risks and liabilities. Instead, the League strongly favors Option 2-100% Risk Pooling & Hybrid Approach A-100% Pooling with Charge Back.

Discussion:

The passage of SB1428 in the 2016 Legislative Session provided a historic opportunity to create a new tier of the public safety employee retirement system without the shortcomings and missteps of Tiers I and II. This legislation opened the door for a fundamentally different system model, under the principle of being one single, unified plan rather than a series of separate employer plans.

Crucial to this new tier is the concept of equal cost sharing and the creation of a single system for Tier III employees.

The language of the bill notes that after July 1, 2017, all public safety officers will be required to pay an equal share, 50-50, of all costs of the retirement plan.\(^1\)

\(^1\) FOR MEMBERS HIRED ON OR AFTER JULY 1, 2017, THE EMPLOYER AND MEMBER CONTRIBUTIONS ARE DETERMINED AS FOLLOWS:

1. AS DETERMINED BY ACTUARIAL VALUATIONS REPORTED TO THE EMPLOYER AND THE LOCAL BOARD BY THE BOARD OF TRUSTEES, EACH EMPLOYER SHALL MAKE CONTRIBUTIONS SUFFICIENT UNDER SUCH ACTUARIAL VALUATIONS TO PAY FIFTY PERCENT OF BOTH THE NORMAL COST PLUS THE ACTUARIALY DETERMINED AMOUNT REQUIRED TO AMORTIZE THE TOTAL UNFUNDED ACCRUED LIABILITY FOR EACH EMPLOYER ATTRIBUTABLE ONLY TO THOSE MEMBERS HIRED ON OR AFTER JULY 1, 2017. FOR EACH YEAR THAT NEW UNFUNDED LIABILITIES ARE ATTRIBUTABLE TO THE EMPLOYER’S OWN MEMBERS HIRED ON OR AFTER JULY 1, 2017, A NEW AMORTIZATION BASE REPRESENTING THE MOST RECENT ANNUAL GAIN OR LOSS, SMOOTHED OVER A PERIOD NOT MORE THAN FIVE YEARS AS DETERMINED BY THE BOARD, SHALL BE CREATED ON A LEVEL DOLLAR BASIS OVER A CLOSED PERIOD EQUAL TO THE AVERAGE EXPECTED REMAINING SERVICE LIVES OF ALL MEMBERS BUT NOT MORE THAN TEN YEARS, AS DETERMINED BY THE BOARD.

2. THE REMAINING FIFTY PERCENT OF BOTH THE NORMAL COST AND ACTUARIALY DETERMINED AMOUNT REQUIRED TO AMORTIZE THE TOTAL UNFUNDED ACCRUED LIABILITY AS DETERMINED PURSUANT TO PARAGRAPH 1 OF THIS SUBSECTION SHALL BE DIVIDED BY THE TOTAL NUMBER OF THE EMPLOYER’S MEMBERS WHO WERE
(Assumes participation in the Defined Benefit Plan). There is no accommodation in the statute for differential contribution rates for “base” benefits, employer-discretionary decisions or other items or any differential rates between employees and employers. The plan is envisioned to be a single, unified entity with all employers and employees sharing the costs equally. Any suggestions to do otherwise fundamentally undermines the basic principle of the legislation, invites the “gaming” of the system, and sets up an inevitable fragmentation of the system in which there will be differential rates between employers for the same plan benefits. Despite assurances from the consultant that those differences will initially be minor, there is no guarantee that they will not grow substantially over time and re-create the chaotic system that is currently the case for Tiers I and II, eventually leading to a new round of benefit increases that will be borne entirely by the employers as we are experiencing under the system today. This very matter was one of the major drivers for the need for legislation creating the new Tier III.

It was never anticipated that the legislation would be opened up in order to re-visit the contribution rate. That matter was discussed, negotiated and agreed on as a core principle of the new tier. The charge to the Board, and to the consultant, was to work out the mechanism of pooling that would conform to the 50-50- contribution rate.²

As noted in the report, this model pools all liability risks and charges back employers for Human Resources decisions that incur additional material costs. Using this model, the PSPRS Board would set an actuarial boundary that triggers the charge back mechanism. Rules can be adopted that explain the actuarial standards to be used and to provide for an appeal of the initial decision. This process assures all members that the plan will remain consistent for all employers and employees and that deviations by individual employers will be made up by those specific employers. This will require a periodic re-set, annually or

² Sec. 18. Study; risk pooling; local board consolidation and structure; recommendations
A. Within fifteen days after the effective date of this act, the public safety personnel retirement system shall commence a study to determine various methods in which risk pooling may be structured and local board consolidation and structure may be accomplished and to determine which methods, if any, are in the best interests of the public safety personnel retirement system’s fund, members, beneficiaries and employers.
B. The study shall be presented to the board of trustees of the public safety personnel retirement system on or before January 15, 2017. The board shall consider the study and report its recommendations for legislation to the president of the senate, the speaker of the house of representatives and the governor on or before February 15, 2017.
biannually, to assure the rate is keeping up with costs. Again, as noted in the report, ASRS uses this system successfully now and could be used as a knowledgeable resource for the PSPRS administration to call on for advice in implementation.

By pooling all members into one system, no individual employer will be able to make decisions that materially affect the entire group. That is fundamental to the law of large numbers. There will always be disagreements about the value of certain employer benefits, but that is where the board-adopted process must come in, to resolve those differences and make decisions that benefit the system as a whole.

The consultants were not able to provide any examples of where the Hybrid Option & Hybrid Approach B were operating successfully. Rather than being simple to administer, as the consultant admits the 100% Risk Pooling is, the Hybrid system invites multiple contribution rates, each with their own separate calculations based on individual local plans.

PSPRS must exercise this opportunity to leave behind the allegiance to hundreds of separate plans, and commit to the concept of working together in one plan for the benefit of all members. There is only one chance to create this unified system. If Tier III starts out with differential rates, even small ones between employers, it is not a single system; it remains a series of separate employer-based plans. It would be impossible to unscramble the egg if the plan starts out fragmented rather than unified.

II. The League does not oppose the consultant’s recommendation of Option 3 Partial Consolidation for the Local Board Consolidation Alternative.

Discussion:

While we continue to support the concept of further Board consolidation, the logic of the consultant to maintain separate Boards for the largest employers and to merge the remaining plans into county-based Boards, is a fair compromise.
State Supreme Court rules state retirement plan law unconstitutional

By: Howard Fischer, Capitol Media Services  
November 10, 2016 , 12:07 pm

A 2011 state law requiring employees to pay more into their retirement plans is unconstitutional, the Arizona Supreme Court ruled Thursday, meaning higher future expenses for state and local governments.

In a divided ruling, the justices said that when judges took the bench they were told they would have to contribute just 7 percent of the earnings to the Elected Officials Retirement Plan. Acting Supreme Court Justice Randal Howe, writing for the majority, said that became part of their contract with the state.

What that means, Howe said, is that the state could not unilaterally boost the judges’ contribution to 10 percent in 2011 rising to 13 percent two years later, even if lawmakers said that was necessary to maintain financial stability of the pension fund.

The case affects more than those judges who were on the bench as of 2011 when the law changed. It also means refunds of about $220 million to about 26,000 state and local police, fire fighters and corrections officers who are in other government-run pension plans that made similar hikes in employee contributions, hikes that Thursday’s ruling found illegal.

What remains to be decided is how the pension funds make up the money they have to refund. They could assess the government employers retroactively or simply boost what the employers have to pay in the future to make up the lost cash.

Employees have no financial reason to let the pension funds keep the extra money. Their retirement benefits are based on a percentage of their salaries, a figure that is unaffected by how much they contributed during their working years.

Joyce Garland, the chief financial officer for the city of Tucson, said she does not know what the ruling will cost taxpayers — or when. She said when the high court struck down another change in pension laws two years ago the city was given several years to pay off the additional funds needed.

Doing nothing about the loss is not a likely option: Christian Palmer, spokesman for the three affected funds, said the ruling adds $1.3 billion in unfunded liabilities to the retirement plans which have assets of about $8 billion and liabilities of $16 billion.

Thursday’s ruling drew a stinging dissent from Justice Clint Bolick, who insisted that there is no contract between the government and its workers on pension contributions. He called the concept “a work of legal fiction to which the likes of John Grisham could only aspire.”

And Bolick said while Thursday’s ruling “portends a huge financial windfall” for those who will get back the “a burden the taxpayers will shoulder.”

As it turns out, Bolick is the only actual member of the Supreme Court to have a voice in this case.

The other four justices disqualified themselves as they were on the bench when the 2011 law was approved.
have a financial stake in the issue. Bolick was appointed earlier this year; the other four who heard this case are judges from lower courts who were named since 2011.

This is the second financial setback in as many years for the retirement plans. Two years ago the justices struck down another provision of the same law that reduced automatic cost-of-living increases for retired judges.

At the heart of the dispute is a provision in the Arizona Constitution which said that “public system retirement benefits shall not be diminished or impaired.”

Howe said that was not a problem in the 1990s when the retirement system was generating high returns. But decisions to invest in tech and telecommunications companies “made the plan vulnerable to major financial shocks.”

By 2011, he said, the plan’s assets were just 62 percent of liabilities, down from 121 percent in 1998. That year, in a bid to fix the problem, lawmakers made two changes. One was that now-overturned in future cost-of-living increases. Thursday’s ruling involves the mandate to put more into the pension fund.

Two judges sued on behalf of themselves and others to strike that down. Howe said lawmakers acted improperly.

“The law in Arizona has been clear that public employees are contractually entitled to the retirement benefits specified in their initial employment contract,” he wrote for the majority. And Howe said that contract included just how much they get when they retire but also how much they have to pay to get those pension benefits.

Bolick, however, said even if there was a contract between the state and the judges and other employees it could be voided because was based on the “mutual mistake” of how much the retirement funds would be earning the cost of future pensions.

Thursday’s ruling does not affect the much larger Arizona State Retirement System with its more than 21 active state and local workers and teachers. Its formula requires employees to match employer contributions 50-50 basis, a ratio that has remained the same.
Mr. Smout,

We have reviewed the attached report from Cortex related to the issues of pooling and board consolidation for the new Tier III of PSPRS and I wanted to provide you with feedback from the City of Goodyear’s perspective.

**Pooling of Risks and Liabilities**
The City of Goodyear disagrees with the consultant’s recommendation of Option-3 Hybrid for the pooling of Tier III risks and liabilities. The provisions of SB1428 which passed during the 2016 legislative session provided for a single, unified plan with all employers and employees sharing the costs equally. We believe that the consultant’s recommendation conflicts with the provisions of the legislation and will result in different rates between employers who are providing the same benefits.

We feel strongly that 100% risk pooling is the most appropriate step for the long-term sustainability and effectiveness of the Public Safety Retirement System. The pooling of all risks and liabilities will result in consistent practices and contribution rates among all employers and it will benefit all of its members.

**Consolidation of Boards**
The City of Goodyear understands and appreciates the benefits of board consolidation. However, as a smaller city, we also value the effectiveness of our local board and appreciate the importance of our board members’ understanding of local working conditions and first-hand knowledge of the membership.

Overall, we feel that the consultant’s recommendation of partial consolidation represents a fair and appropriate compromise as long as there is an option for exemption for those smaller local boards that operate effectively and consist of highly qualified board members. Partial consolidation with the option of exemptions provides many advantages, including increased consistency of decision-making, increased number of qualified board members to choose from and less administrative burden among the local boards. This option also provides employers the ability to maintain some local control and the members will not have to travel as far for meetings as they may have to if it was consolidated down to one statewide board.

Thank you for your consideration of our feedback and I am happy to answer any questions you may have.

Sincerely,

Brian Dalke, CEcD
City Manager
City Manager’s Office
City of Goodyear, Arizona
Office: 623-882-7070
Mobile: 623-693-0015
brian.dalke@goodyearaz.gov
www.goodyearaz.gov
November 16, 2016

VIA E-MAIL AND U.S. MAIL

Public Safety Personnel Retirement System of the State of Arizona
Attn: Jared Smout, PSPRS Administrator
3010 E Camelback Rd, Ste 200
Phoenix, Arizona 85016

RE: City of Yuma Response to the Draft Report on Risk Pooling & Local Board Consolidation
Prepared by Cortex Applied Research, Inc.

Dear Mr. Smout:

I. The City of Yuma Urges Option 2-100% Risk Pooling & Hybrid Approach A-100% Pooling with
Charge Back.

Consultant’s statement that “[t]he strengths and weaknesses of a 100% risk pooling system are
essentially the reverse of those associated with the status quo” is telling of the possibilities that 100%
risk pooling offers. Foremost, it is the opportunity to create a stable, fully-funded retirement system for
public safety employees that does not unfairly burden employers. The City of Yuma recognizes that
some employers may benefit more than others under such a system, but also views the ability to
spread benefits and risks out among hundreds of employers as the best way to stabilize a system that
is in a free fall.

Using this system provides stability for both employers and employees because the plan will remain
consistent for all employers and employees and deviations by individual employers will be made up by
those specific employers. The City is very encouraged by the success of the ASRS, which has thrived
despite the recent economic downturn, using this exact same method. The City encourages PSPRS to
model its approach similarly, which will also allow the PSPRS administration to call on ASRS for advice
in implementation.

Moreover, by pooling all members into one systems removes the ability of a single employer to make
decisions that materially affect the entire group. As noted above, the City recognizes that creating a
single system from hundreds of smaller systems will generate disagreements about the value of certain
employer benefits, but that is where the board-adopted process must come in, to resolve those
differences and make decisions that benefit the system as a whole. Finally, Option 2, by consultant’s
own admission, is simple to administer which benefits everyone.

PSPRS must exercise this opportunity to commit to the concept of working together in one plan for the
benefit of all members. There is only one chance to create this unified system. If Tier III remains a
series of separate employer-based plans, it will be next to impossible to unify the plans later.
II. Needs to be a 50/50 Employer/Employee Contribution Rate

The proposed method under Alternative 3(B) would do away with the 50/50 split of PSPRS contribution rates between the employer and employee. This raises a number of concerns for the City.

First, consultant’s draft recommendation ignores the language in SB1428 which requires an equal, 50-50 contribution rate between employers and employees. When the language of SB1428 was discussed among the stakeholders and deliberated by the Legislature, the 50-50 contribution rate was a fundamental principle of Tier 3. The consultant’s recommendation minimizes this principle, jeopardizes the solution stakeholders worked so hard to achieve.

Second, because the recommendation contradicts SB1428, it also undermines the intent of the voters and the integrity of the voting process. Accordingly, anything other than a 50/50 contribution rate is likely to invite lawsuits that could delay the implementation of Tier 3 and further weaken PSPRS. The City would likely join in such a lawsuit.

Third, as part of consultant’s initial observations, consultant recognized that “[i]f investment returns fall short over the first few years following the launch of Tier 3, the new Tier will immediately experience a deficit, which is likely to cause considerable concern among stakeholders and may overshadow all of the positive features of Tier 3.” The purpose of creating a 50-50 contribution between Employers and employees was meant to prevent this exact issue. Consultant’s differential contribution rates proposal would increase the likelihood of experiencing the very problem consultant wants to avoid. Consultant must follow the strict language of the SB1428 which requires all employers and public safety employees to pay an equal, 50-50 share, of all retirement plan costs. To do otherwise may also cause and legally allow employers to pull out of PSPRS altogether.

III. Conclusion

Consultant’s recommendation misses an opportunity to prevent future insolvency and the City of Yuma will not support their recommendation. Consequently if their recommendation were followed, the parties would be likely to find themselves in a similar position in the near future and deliberating how to set up the terms of Tier 4.

Sincerely,

Douglas J. Nicholls, PE, RLS
Mayor

cc: Sen. Don Shooter
    Sen. Debbie Lesko
    Sen. Lynne Pancrazi
    Rep. Darin Mitchell
    Rep. Steve Montenegro
    Rep. Lisa Otondo
    Rep. Charlene Fernandez
    Rep.-Elect Jesus Rubalcava
    Ken Strobeck
November 16, 2016

Jared A. Smout, Administrator
PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM
3010 E Camelback Rd, Ste 200
Phoenix, Arizona 85016

Subject: Cortex Study – Arizona Fraternal Order of Police Response to Draft

The Arizona Fraternal Order of Police would like to express our appreciation to the Cortex Group for the opportunity to share our observations on the proposal to consolidate local boards within the Arizona Public Safety Personnel Retirement System (PSPRS).

We believe Cortex representatives were very quick to grasp the complex issues of the unique PSPRS local board structure implemented by the legislature decades ago. During the study process, Cortex gave us, and other stakeholders, the opportunity to discuss and express our concerns.

Representatives from AZ FOP attended all four of the Cortex presentations. There are a few areas, not specifically addressed in the draft, that we would like Cortex, the Arizona Public Safety Personnel Retirement System (PSPRS) administrator, the PSPRS Board of Trustees and the legislature to consider if a recommendation is made to consolidate local boards.

Local board duties and construction are found in ARS 38-847. This statute is where board structure and the local board process is outlined. If local board consolidation is considered by the legislature, this section of law will need a significant makeover.

County Oriented Consolidated Board Construction:

It should be noted, PSPRS local boards and support structure already exist at the county level. Keep in mind, if local boards are consolidated, additional support may be required by PSPRS staff, with an unknown price tag, in the member application and other administrative functions. Our observations are made to make consolidation, if pursued, consistent amongst the boards, provide continuity of the process and enhance member services statewide.

We would suggest the goal of local board consolidation, i.e. county oriented consolidated local boards, should be to provide member education, legal prudence, fiduciary responsibility and strive for objectivity in the hearing of applications for benefits, while providing quality member service and convenience to the employer, employee and the Public Safety Personnel Retirement System.

Frankly, the justification for county oriented consolidated local boards is documented by Cortex in the draft study and recommendations. What may need more explanation, is that each county already has the responsibility to establish and operate a PSPRS local board. Each county is currently supporting the administrative activities required of a local board. The infrastructure exists. What the new process or procedure needs to determine is how the consolidated local board members are appointed or elected.

For appointed members, we are sure there are current situations where municipality and county governments are required to fill governmental/community representative positions. Perhaps the employer representatives have a few suggestions to facilitate board appointments when multiple jurisdictions are involved.
We can think of some simple proposals. The first would be to ask the current sitting PSPRS county local board chairman to be appointed to an initial two-year term. Going forward, the county, municipality or district employer participants could establish an agreed upon policy of appointment criteria for the employer appointed positions.

To fill citizen board member positions a similar process could be used.

We would observe that five of the Arizona counties have less than 100 Police members, and three of the counties have zero fire members, one has less than 100 fire members. These county oriented consolidated local boards will spend most of their effort at administrative functions as required by the current law. Those local boards may have an occasional disability application of which PSPRS should offer mentorship in the process. Of the remaining ten counties Pima, Pinal and Maricopa would be exempt, per the Cortex proposal, by their size. A separate county orientated consolidated local board would need to be established in Pima, Pinal and Maricopa County.

We have concerns about the Cortex recommendation which would allow an exemption for an existing small local board to opt out of the county oriented local board consolidation. While we recognize that some small boards may currently operate very effectively, experience tells us, effective operation is a result of the outstanding individual leadership of the current board members. Our concern is that when those very dedicated small local board members are replaced or retire, the effectiveness of the board may not continue.

We heard from some employers that they sometimes felt that some local boards had a perceived conflict of interest on disability issues or were ineffective. Specifically discussed, were smaller local boards where everyone on the local board may know the disability applicant and/or family members. Some employer representatives indicated, in the past, benefits may have been granted that were inappropriate. These concerns are discussed in the Cortex Report.

Not as obvious in the Cortex report, are those unusual cases where an employing agency simply failed to establish local boards, exerted inappropriate pressure on local board members, or took steps to obstruct valid disability applications.

Knowing those concerns, why would the opt out recommendation allow those perceptions/actions to be further perpetuated? Especially, if research shows that a small board rarely needs to meet or conduct business. We feel those effective and efficient agency board members and citizen members should be recruited to serve on the consolidated board. In any event, if an exemption is to be granted, it must be based on specific, verifiable and continuing performance standards for that local board. We would also propose that it is not the local board’s decision to seek an exemption. The decision to request an exemption should be made by the municipality’s mayor or city manager, after careful review of past and projected board activity.

We would suggest that the process which allows for an opt out, also allow for the consolidated boards from Maricopa County to split if desired on an east & west side orientation. Specifically, in Maricopa County, the police and fire consolidated local board would serve over a thousand members. Allowing an east & west optional consolidation would reduce the burden on the Maricopa County consolidated local boards. If requested, Maricopa County would have a three-way split: (1) current Maricopa County existing local board, (2) a new east side consolidated local board & (3) a west side consolidated local board.

**County Oriented Consolidated Boards Costs:**

The cost of county oriented consolidated boards was brought up in the question and answer session at one of the presentations. Our observation is that intergovernmental agreements (IGAs) are used regularly between local government entities. We are confident these minor costs could easily be shared and agreed upon on an equitable basis. The costs of administrative, legal and court recorder transcript services (if used) could be shared equally. Independent medical exams costs, incurred because of individual applications for disability, should be paid for by the agency of record on the application. This is also why a local board member from that agency should sit on the board in review of the application. Ensuring an agency representative on the consolidated local board is discussed later in this document.
County Oriented Consolidated Board Participants:

The Cortex study recommendation to establish county oriented local boards will significantly reduce the number of local boards and the number of people required to staff those local boards. If consolidation is pursued, we agree and believe the number of local board appointed and elected members, state-wide, will be reduced and efficiency will be enhanced. If done correctly, local board consolidation will also enhance consistency in the decisions made by those consolidated local boards.

However, we would like to recommend that employers participating in a consolidated local board be required to establish a process whereby plan member participants continue to elect at least two member representatives to sit on the consolidated local board. Each agency should also allow the election of an optional local board member who would sit on agency specific disability applications. Basically, when an agency specific disability is on the agenda, the optional elected member would replace, in voice and vote, one of the other elected board members. It might be advisable for agencies to also identify an optional appointed member, in each agency, to represent the interests of the agency.

These optional elected/appointed local board members bring the knowledge discussed by Cortex, as a resource to the board, to understand their agency’s human resource policies, procedures, past precedent and where records of interest to the process may be found. Acting as an arbiter of the facts surrounding an application related to existing documents within an agencies records. This also insures adequate due process and representation for the applicant and employer as the public record is compiled by the local consolidated board.

We would propose that any accidental, catastrophic or ordinary disability which originates from an agency, an elected and appointed optional member from that agency must sit on that board for the entirety of the hearing process. Since that agency would be paying the cost of an IME and will be the focus of any litigation, this presence is imperative.

We believe elected board members have three basic responsibilities:

- Educational Responsibility: informing the members of their agency on the PSPRS system, the benefits and requirements within the system and the process to make application and obtain those benefits.
- Legal Responsibility: to interpret the law in an appropriate manner. To avoid arbitrary or capricious decisions.
- Fiduciary Responsibility: to not grant benefits that are not earned and documented in the public record.

County Oriented Consolidated Board Required Training:

We believe there should be a requirement that all members of the local and consolidated board be required to attend local board training as determined and required by PSPRS. Members should not be allowed to serve and county oriented consolidated boards should not be impaneled until they have successfully completed this training and are sworn in to office.

Suggested topics for this PSPRS training:

- Open Meeting Law
- Ethics, Legal & Fiduciary Review Training
- PSPRS Title 38 Overview
- PPSRS Local Board Responsibilities and Duties
- PSPRS Local Board guidelines
- Building a Disability Public Record for Review
- Precedent Setting Case Studies

Respectfully,

Stan Hoover, Chairman
Arizona Fraternal Order of Police
Pension Oversight Committee
November 16, 2016

Mr. Jared Smout, Administrator
Arizona PSPRS
3010 E. Camelback Road, Suite 200
Phoenix, AZ 85016

RE: Cortex Report

Dear Mr. Smout:

We thank you for allowing us to be a part of the Cortex study procedure. This experience has made us think “out of the box of Rio Verde” and try to see what is best for the whole plan. The report that we reviewed convinced us that we could easily accept most of the findings in the Cortex report. Two items, however, stick out as areas where something else might be considered.

The first of these is “disability in the line of duty” referred to in many publications as “accidental disability.” This is always included under the general title of “disability.” “Disability in the line of duty” is actually a less predictable risk than “death in the line of duty” and should be treated in the same manner and pooled. Sometimes economics can enter into the disability picture more than it would with “death in the line of duty”. An individual member with an injury might be called an “accidental disability” to stop workers’ compensation payments, which gets charged back without realizing the extra cost to the pension plan. One claim could totally ruin the plans of a smaller group of members. We feel that separation of the types of disability is needed and “disability in the line of duty” should be pooled, just as it is for mortality.

The second item has to do with the administration of local boards. Overall, most small local boards (and many larger ones) are not equipped educationally to judge medical conditions of a member for hiring, disability, recovery from disability, etc. To determine qualification for retirement, they must go back to their staff or the PSPRS staff. In order to send individuals for medical exams (if they can determine that one is needed) they must determine who is qualified to provide such examinations. Often this creates double examination.

We feel all of this could be better handled by a single administrative source, i.e., an expansion of your staff. Decisions could be made based upon all the reports by an
administrator, not the local board. Costs could be absorbed the same way that the other administrative costs are handled. In the long run, this should cost the system less.

If any group feels the decision handed down is incorrect, they can request an appeal. The appellate board would come from two parties picked by the appealing group from other groups of similar size and location. The administrator picks two additional parties, and the four would pick an independent fifth party as its chair. Their decision could be final, or another review group could be established depending upon how far you want to carry this.

This method requires no local boards. For groups that feel they are missing financial news on their plan, a committee could be established to review the actuarial report, etc.

Again, thank you for letting us be a part of this process. Please let us know if you have any questions.

Respectfully,

George Kattermann
Rio Verde

Jerry W. Fickes
Rio Verde

JWF:lfd
November 17, 2016

Delivery via Email to Jared Smout at jared@psprs.com
Mr. Brian Tobin
Chairperson
State of Arizona Public Safety
Personnel Retirement System
3010 East Camelback Road, Suite 200
Phoenix, Arizona 85016

RE: State of Arizona Public Safety Personnel Retirement System’s Proposed Changes and Requested Stakeholder Comments

Dear Chairman Tobin:

This letter provides the comments of the Salt River Pima-Maricopa Indian Community ("SRPMIC" or "Community") in regards to the State of Arizona Public Safety Personnel Retirement System’s ("PSPRS") proposals for the following: 1) liability risk pooling for Tier 3, and 2) the consolidation of local boards.

Before providing our specific comments, it is important to note that in 1999, the SRPMIC became the first Indian tribe in the State of Arizona to participate in the PSPRS. Since the Community joined PSPRS, over a dozen other Indian tribal entities have followed our lead. When combined, the Salt River Police Department ("SRPD") and Salt River Fire Department ("SRFD") have over 200 PSPRS members.

Since joining the PSPRS, the Community has taken its local board responsibilities seriously and carried out its responsibilities in compliance of all legal requirements. The Community does not find staffing a local board to be financially burdensome, time consuming or inconvenient.

In the area of Tier 3 Liability Risk & Pooling, the Community Supports Option 3, Hybrid Approach B. Option 3B would pool the retired members who are collecting benefits, and transfer their assets and liabilities to the pool. In addition, the
SRPMIC would remain responsible for the human resources management risks that we control directly (meaning the Community’s hiring practices and members). If a PSPRS member transfers their employment to a different jurisdiction, the liability of that member would stay with their previous employer. We believe that this concept would be beneficial to entities, similar to the Community, whose PSPRS plans are well-funded. Previously, when a member transferred to a new jurisdiction, their individual retirement savings transferred to their new employer. For example, if an employee is in a well-funded plan, such as the Community’s plan and decides to transfer to a government with a poorly funded plan, when the employee transfers, the poorly funded plan receives the benefit of our well-funded plan.

The Community supports option 3B and believes it to be a financially sound proposal that would provide more security to the retired members, and more stable contribution rates for the employers and active members.

In the area of Local Board Administration, the Community Supports Option 1, maintaining the Status Quo with Enhanced Training in regards to the Local PSPRS Boards. The Community strongly opposes the recommendation of Cortex to consolidate all the tribal local boards and have tribal PSPRS members serviced by county PSPRS local boards. This proposal contradicts the government-to-government relationships that Indian tribal governments have with Federal and State governments. In addition, dis-establishing the Community’s local board is a significant change in the administration of the PSPRS, and is not what the Community originally signed up for when it joined the PSPRS. If the PSPRS decides to dis-establish all tribal local boards, the Community may re-consider whether we should continue to opt into the PSPRS system.

According to the presentation, the Community is considered a small entity as we have less than 250 members in either the SRFD or SRPD, however, we feel that the Community has enough participants to justify our own PSPRS local board. For example, if we were dissolved, our members would be forced to go before the Maricopa County local board. The Community and its police officers and fire personnel would lose their voice in a sea of many other jurisdictions. Each local board is unique and they are the local voice of each individual community.

Finally, it is troubling that Cortex would make the recommendation to dissolve all tribal local boards without any meetings or official discussions with the tribal governments who participate and pay into the PSPRS. Tribal governments are strongly committed to their public safety personnel and make funding their PSPRS systems a top priority.
The Community is committed to its public safety personnel and has carried out its local board responsibilities with the utmost professionalism.

The Community appreciates your time and consideration in addressing this important matter. If you have any questions, please contact Gary Bohnee, SRPMIC Office of Congressional and Legislative Affairs, (480) 362-2737 or gary.bohnee@srpmic-nsn.gov.

Sincerely,

Delbert W. Ray, Sr.
President

cc: Jared Smout, PSPRS System Administrator
UNITED PHOENIX FIRE FIGHTERS ASSOCIATION (Representing Professional Fire Fighters in Phoenix, Tempe, Glendale, Peoria and Chandler)

COMMENTS ON THE REPORT ON RISK POOLING & LOCAL BOARD CONSOLIDATION

PART I: RISK POOLING
Recommendations Regarding Risk Pooling

UPFFA SUPPORTS THE CORTEX RECOMMENDATION OPTION 3: HYBRID OPTION

COMMENT: Employee contributions for Tier 3 members are 50% of the total cost of the plan including payments made for any unfunded liabilities. Accordingly, members of Tier 3 will bear more risk associated with the employer’s human resources choices and responsibilities. Simply adding an additional two Board of Trustee members’ will not outweigh the risks associated with employment practices. Minimal or no risk pooling imposes maximum accountability on individual Local Employers for the costs of their human resource management decisions, but likely leads to higher contribution volatility.

DISPUTES TO OBSERVATION 1 - Some Causes of Prior Funding Deficits Were Eliminated in Tier 3
The report states that “Tiers 1 and 2 contained several features that negatively impacted their funded status. These features, however, were not incorporated into Tier 3 and will therefore not pose problems for the new Tier. Deferred Retirement Option (DROP) The benefits provided under the DROP provisions created additional liabilities for Tier 1, as the monthly DROP benefits were credited with interest at the assumed or smoothed rate of return. In years with lower negative returns, members still received the higher rate.”

COMMENT: For Tier 2B employees the amount that represents interest at a rate equal to the average annual return of the System over the period of years established by the Board of Trustees cannot exceed the System’s assumed investment rate of return but will be at least two percent. The rate for Fiscal Year 2015-2016 was 3.1%. Continuing this benefit under the Tier 2 scheme would not cause any significant funding deficit and should have been incorporated in any benefit structure for all public safety officers. Any costs associated with the benefit could have been amortized over the lifetime of the public safety officer’s years of service.
DISPUTES TO OBSERVATION 2 - Management Risk (Salary Spiking Risk) Has Been Reduced in Tier 3

Salary spiking is a way of improving pensions in an employee’s final years of employment. Because, however, there was no risk pooling in Tiers 1 and 2, any salary spiking that may have occurred in those tiers would only impact the Local Employer in question and could not be passed on to other Local Employers in the System. In our stakeholder outreach meetings some concerns were raised as to whether this would continue to be the case in Tier 3 if risk pooling were instituted. This is a valid concern. We found however that Tier 3 includes two features that will significantly mitigate the risk of salary spiking:

COMMENT: (a) The maximum salary under Tier 3 is limited to $110,000 (adjusted by the average change in the Public Safety Wage Index). We believe that this feature is another unfair provision that falls disproportionately on the employees. Employees, who in some cases by no fault or motivation of their own, will exceed this salary cap. When the salary cap is reached the employer achieves one of the only reductions in their contribution rates attributed to SB1428, all at the cost to the employee. Employers should be held to a greater standard to reduce “spiking.” PSPRS found little to no widespread evidence of “salary spiking” during its review as a result of the SB1609 study committee process. We believe the “1428 cap” should be raised to $140,000 and when the cap is reached the employee/employer normal pension contributions should flow directly into a members defined contribution (401(a)) account.

(b) As a carryover from pension reform EFFORTS in 2011 (SB1609), the salary used in the benefit calculations will continue to be averaged over 5 years, whereas for Tier 1 it is only 3 years.

It is difficult to eliminate the risk of salary spiking altogether. In our opinion, however, it has become a much smaller risk for Tier 3.

COMMENT: Alternatives to further reduce salary spiking that do not hurt legitimate employee compensation abilities include widening the final average compensation (FAC) from 5 to 7-10 years. Allowing employees to continue to earn salaries at, near or above the $110,000 limit, but limiting pensionable income at that level, financially hurts legitimate wage earning Arizona public safety officers including those that do some of the most dangerous investigations or work extra hours doing hazardous jobs. Clearly, having a low cap with a corresponding stop in employer contributions, there is a cost saving to the employers at the expense of the employees. It also is an unfairly low limit when it comes to compensation for middle managers and executive level officers in larger public safety departments.

Observation 3 – Non-Predictable Liability Risks Unlikely to Have Major Impact on Tier 3

Contribution Volatility

Stakeholders appear to believe that pooling the liability risks of Tier 3 would significantly decrease contribution volatility. We believe it is important to temper stakeholders’ expectations in this regard. A review of the recent experience studies performed for Tiers 1 and 2 suggests that in fact pooling the Non-Predictable Risks of Tier 3, though useful, would be unlikely to have a dramatic effect on contribution volatility. The Actual non-predictable experience of the PSPRS for the year 2009 to 2015 was close to the expected experience using the actuarial assumptions. It is possible that there were larger differences between the actual and expected experiences for individual Employers over this period, but, in general, we believe the impact on unfunded liabilities due to Non-Predictable Risks would have been small.

COMMENT: We believe that this conclusion gives adequate confidence in the PSPRS, the Board of Trustees and their actuaries. It is good to note and emphasize the conclusion from this unbiased source.
Observation 4 – Investment Risk is the Most Material Risk in Tier 3

We recognize that Cortex’s mandate is limited to risk pooling and Local Board consolidation. Nevertheless, it is important to note that while these two issues are important, we believe the major funding risk to Tier 3 is the risk that investment returns for Tier 3 will fall short of the actuarial discount rate. If the discount rate is set too high, based on current capital market conditions, there is a significant risk that actual investment returns will fall short of the discount rate and Tier 3 will fall into a deficit. If investment returns fall short over the first few years following the launch of Tier 3, the new Tier will immediately experience a deficit, which is likely to cause considerable concern among stakeholders and may overshadow all of the positive features of Tier 3.

In the “Key Observations” section stakeholders must be aware that the most significant funding risk for Tier 3 is in fact the risk that investments will fall short of the discount rate and the related risk of establishing a discount rate that is unrealistically high.

**COMMENT:** Policy makers should reconsider their statutory changes and allow the smoothing period for amortizing investment gain and losses in the financial markets for Tier 3 employees be extended from 5 years to 7 years at the discretion of the Board of Trustee. Additionally, policy makers should reconsider changing the allowable amortization period back to at least thirty years from statutorily limited closed twenty years for Tier 1 and 2 and from the statutorily limited closed 10 years for Tier 3 to at least thirty years at the discretion of the Board of Trustees. One thing that pension systems have learned is that cyclical economic times call for alternative solutions to resolve economic conditions that negatively affect pension systems, both on the upside and the downside. The Board of Trustees should be permitted, through sound actuarial and governance standards, to adjust factors necessary to allow for consistent reasonable costs despite cyclical economic markets.

**PART II: REVIEW OF LOCAL BOARD CONSOLIDATION**

**Recommendations Regarding Local Board Consolidation**

**COMMENT:** The United Phoenix Fire Fighters Association supports partial Local Board consolidation so long as an employer that employs at least 250 police officers or 250 firefighters, both of the Local Boards would be excluded from consolidation (assuming it in fact has two Local Boards).

Any smaller local boards that are operating effectively may apply for an exemption provided they meet specified criteria for governance.

**APPENDIX B OTHER ISSUES**

**Design of the Defined Contribution (DC) plan implementation**

**COMMENT:** The time allowed (90 days) for a new member to make a decision on whether to go the DC or the defined benefit route is too short. In many cases the new member would be in initial training and not able to fully focus on the decision.

**Discount rate used for Tier 3**

**COMMENT:** If the discount rate for Tier 3 employees is lowered, there is a corresponding increase in the ARC (Annual Required Contribution). This should be strongly considered prior to any change in PSPRS investment assumptions, especially considering the fact that employees will be required to pick up 50% of any additional costs associated with investment assumption reductions. Policy makers should also reconsider the SB1428 imposed statutory
changes and allow the smoothing period for amortizing investments gain and loses in the financial markets for Tier 3 employees be extended from 5 years to 7 years at the Board of Trustee discretion. The decision on the actuarial economic assumptions should be made by the Board on advice from investment experts and the fund actuaries.

Thank you for your consideration.

Sincerely,

Steve Beuerlein
President
United Phoenix Fire Fighters Association Local 493
To: PSPRS System Administrator Jared Smout  
VIA email to: jared@psprs.com.

The Sedona Fire District PSPRS Local Board met today to discuss the Cortex Report and offer formal feedback to PSPRS. After discussion, our Board came to consensus and wishes to submit the following:

**Liability Risk Pooling**
We are in favor of Hybrid Approach 3B, as recommended by the Cortex Report; however, we do have some reservations without having all the facts and figures presented.

**Local Board Consolidation**
We are in favor of Local Board Consolidation Alternative 3 – Partial Consolidation, as recommended by the Cortex Report; however, we have strong reservations because of serious questions in implementation, as follows:

- Travel for our members – either to appear before the Board or to participate on a regional Board; considering the sizes of the two counties (Coconino and Yavapai) in which Sedona Fire District is situated, this could involve hours of travel time plus costs of fuel, food, etc. Will there be some reimbursement for mileage or other considerations? Or, would Board Members be allowed to teleconference into meetings? Or, have other remedies for this been discussed or considered by PSPRS and/or Cortex?
- How would the membership of the regional/county Boards be determined – through election or appointment? And would one agency be allowed to have a greater number of Board Members which could skew objectivity?
- Meetings would either be on a much more frequent basis than is currently the case for smaller agencies or monthly meetings would be for a much longer duration.
- Were there specific reasons why Coconino County was determined for Sedona Fire District (rather than Yavapai)? Would we be able to “choose” which county board in which we want to participate?

Overall, our Local Board understands the value of consolidation, the merit of which it represents, and the potential long term enhancements to the process behind the concept, but we need answers before we could formally approve these changes.

Thank you for the opportunity to provide feedback.

Respectfully submitted,

Tricia Greer, SFD PSPRS Local Board Secretary
Mr. Smout,

Please consider the following comments in review of the PSPRS Draft Report on Risk Pooling and Local Board Consolidation.

1. Serious consideration should be given to pooling Tiers I and II. Creation of a retiree pool will provide a safeguard against risk, make it more reasonable for member entities to finance the existing (significant) unfunded liability of Tiers I and II, as the longevity and interest rate risk will then be pooled, and would allow for creation of a low cost pooled financing option (similar to WIFA) for elimination of the debt. This would save taxpayers significant cost over the near and long term.

2. Shifting to a single statewide board should not be overly cumbersome as long as clear rules and governance are in place to guide decisions. If clear rules/governance exist, then Board decisions should be swift and fairly straightforward. The City still prefers one statewide board, however partial consolidation (45 boards) is preferable to the current system.

Thank you for the opportunity to comment.

Alison Zelms
Deputy City Manager
November 17, 2016

PSPRS
Jared Smout, System Administrator
jared@psprs.com

Re: Cortex Draft Report on Risk Pooling and Local Board Consolidation

Dear Mr. Smout:

At its meetings of November 3 and November 17, 2016, the Town of Marana Local Board discussed the above-referenced draft report. On behalf of and at the request of the Local Board, this letter is to express concerns and reservations regarding the recommendations in the draft report.

While the Local Board believes it is healthy to study the current system to seek out improvements, it is very skeptical of the recommendations to pool employer risk and dissolve the vast majority of local boards. The Marana Local Board believes that efficiencies are best achieved through individual employer/jurisdictional accountability. Pooling risks and removing individual employer/jurisdictional oversight at the micro level can only lead to a general sense that the risks and oversight of the PSPRS are somebody else’s problem.

Due to the very serious concerns about the sustainability of the PSPRS, the Marana Local Board believes that it is critical for each jurisdiction, big or small, to closely scrutinize all management and benefits decisions. Any steps toward risk and administrative consolidation would be counter-productive, leading to further system malaise and greater administrative costs.

The Marana Local Board appreciates the opportunity to comment on the draft report. Please let us know if we can provide any additional information.

Sincerely,

[Signature]

Jennifer Mangialardi
Local Board Secretary
Dear Mr. Smout:

Our firm represents the ASU Police Department’s Local Board in PSPRS matters. On behalf of the Local Board, please consider this email confirmation that the ASUPD’s Local Board wishes to join in the response and input provided to you by the UAPD’s Local Board (attached), regarding the Cortex report on the risk pooling and local board consolidation proposals. Thank you very much.

Kristin A. Green, Esq.
Goering, Roberts, Rubin, Enos, Brogna & Treadwell-Rubin, P.C.
3567 E. Sunrise Dr. #101
Tucson, AZ 85718
(520)577-9300 ph.
(520) 577-0848 fax
November 17, 2016

Mr. Jared Smout
System Administrator
State of Arizona Public Safety Personnel Retirement System
VIA Email: jared@psprs.com

Re: Cortex Report on Risk Pooling & Local Board Consolidation

Dear Mr. Smout:

The University of Arizona Police Department ("UAPD") PSPRS Local Board ("Local Board") has reviewed the Cortex Report ("the Report") on Risk Pooling & Local Board consolidations and offers the following as an affected stakeholder, on the report.

In summary, if asked to render a choice on the available options, the "status quo" approach is perceived as best meeting the needs of the UAPD and its Local Board. As to the consolidation recommendations, the Local Board has concerns at this time, discussed further below. However, the report needs to be supplemented to provide substantive recommendations for the actual structure consolidated boards would take, including appropriate representation of each consolidated agency, on the new board. We also would like more detail on how consolidated boards would be staffed and how that staff would be paid for, as well as what the governance process is intended to be. Without those specifics, the Local Board cannot make an informed choice on the current options. We would reserve our right to respond further, as those matters are addressed in more detail.

The UAPD Local Board has the following questions and concerns:

1) What if we do not want to consolidate?
2) While it appears as if the County boards might be able to apply for an exemption, it does not give that option to the State agencies.
3) Would there be an option for the University police departments to consolidate together, separate and apart from the other State agencies, or to join a regional or a County board?
4) Will the State Board retain members from each organization as it does for the individual agencies?
5) If assimilated, how will conflict between ABOR standards to those of the other agencies be addressed if they differ?
6) Where will the meetings take place?
7) What if the other State agencies do not contribute at the same rate?
8) What are the standards of Governance that we should be maintaining?
9) What happens to our Rules and Procedures? Our Rules and Procedures were specifically designed for us at the U of A.
10) What are the perceived training failures, leading to the recommendations?
Regarding the above, the Local Board offers the following:

Opting out appears to only be an option for the County boards, and not available to the State consolidated board. The non-University departments proposed to be consolidated, have very different functions than we do as a University Police Department. The Universities are subject to ABOR requirements as well, that the other agencies are not. This could create jurisdictional discussions on policy - are we following ABOR or state rules? Perhaps, at least the University agencies should be allowed to opt out of the State consolidated board, in favor of an ABOR-only consolidation, or to have the option to individually join a closer County or regional board.

The report does not fully describe how any consolidation of Local Boards might actually happen, which is of concern to the UAPD Local Board. For example, the traditional Board structure is for 5 members only. Since there are 8 agencies to be consolidated, would that structure be expanded, to ensure that each agency had representation?

If so, what would that look like? Would that consist of two delegates per agency (one elected and one civilian member), or rotate a single representative per agency, that would go back and forth between elected and civilian on a rotating basis? Alternatively, would the delegate count in the new consolidated board be weighted, based on the number of System members in each agency? Who would have the final say as to proposed civilian members: the agency or the System? Would elected members be chosen at large by all consolidated agencies, or by each individual one represented on the board? The composition of the new board proposed needs clear representations that mirror the agencies in the state system.

There is potential for an imbalance between the large and small agencies in the proposed State board consolidation. It is probably true that NAU and ASU will contribute at roughly the same rate, as we are all governed by ABOR, but what about the other 5 agencies? Depending on the structure, there is room for smaller agencies to have less of a say in what is determined, while still being charged back with a share of those costs. How those charges would be distributed among the consolidated agencies, is also of concern.

Right now it is very convenient for our Local Board to meet locally. Of necessity, a State-wide board would change that, and likely increase the cost of travel for Board members, and System members who need to appear for their own matters, rather than reducing costs. For that reason, we would recommend that consideration be given to how technology might assist with a State board. More importantly, our suggestion of allowing at least the University agencies to opt out of the State consolidated board, in favor of a closer County or regional board, should be strongly considered to assist with this issue.

As to staffing, would the State board and its consolidated agencies, have a voice in selecting its own staff or would that be dictated by the System? If the latter, would there be an RFP process in which applicants with whom the consolidated agencies might be familiar, could apply to serve as Secretary, counsel, medical examiners, or court reporters? Would those expenses be pooled, and if so, how would the consolidated agencies be charged back?

As to governance, it is unclear whether the consolidated State board would be mandated to use System-generated Rules. The UAPD Local Board has worked diligently with counsel over the
last 10 years, to develop and refine our Rules and Procedures, allowing us to navigate the system’s statutory obligations at greater cost savings. There is no reference in the report to preservation of the types of creative processes UAPD has in place now. We also have concerns about which structure will control what the State board does. For example, the University Departments must operate consistently with ABOR policy, which may not be consistent with what the other state agencies must do. We think the risk is great, that this process could create a one-size-fits-all approach that may force decisions and expenses of one agency on another, without meaningful input.

As to training, we work very hard to abide by all of the rules and regulations imposed on individual boards, and have been participating in regular training, through counsel and other PSPRS offerings. If training is mandated once a year to keep the current structure in place, we will certainly comply, as we have been. Our members have been to many training classes over the years. Other than new rules and regulations, they are often a repeat of the previous classes. If there are perceived training failures with specific Local Boards, intervention with them individually may be preferred to consolidation.

If you have any questions or require clarification, please do not hesitate to contact me.

Sincerely,

Mary Barleycorn  
Chairman, UAPD Local Board  
Business Manager, Senior  
University of Arizona  
University Information Technology Services  
P.O. Box 210073  
Computer Center, Room 218  
Tucson, Arizona 85721-0073  
(520) 626-4558  
(520) 626-1391
November 17, 2016

Mr. Jared Smout  
System Administrator  
State of Arizona Public Safety Personnel Retirement System  
VIA Email at  jared@psprs.com

Re: Cortex Report on Risk Pooling & Local Board Consolidation

Dear Mr. Smout:

The Paradise Valley PSPRS Local Board (“Local Board”) has reviewed the Cortex Report (“the Report”) on Risk Pooling & Local Board consolidations and offers the following stakeholder feedback on the report.

In summary, the risk pooling reforms recommended by the Report are inconsistent with the reform the Town/Local Board understood would be accomplished between Senate Bill 1428 and Proposition 124. Risk pooling is a key to limiting unfunded liability for the plan and making a more predictable retirement benefit for both employer and employee. Therefore, the Local Board is not in favor of recommended reform 3(B); however, is more likely to support reform 3(C). Further the Local Board would prefer option 3(A) over 3(B) with more details. The Town is not ready to render judgement on the Local Board Consolidation recommendations at this time as the implementation and operational logistics need to be further fleshed out to make a reasoned determination.

In support of these conclusions the Local Board offers the following observations:

1. The Report recommendations are built around the philosophy of “maximum accountability on all Local Employers” (p27 #4). This is a bit of misdirection by the authors. Local employers have nothing near maximum accountability. They don’t set the benefits, they don’t set the contribution rates, and they don’t invest the proceeds. These are the 3 biggest factors to risk and asset management and associated accountability of the financial health of a plan.

So to frame the idea of age of hire and salaries offered as irresponsible local actions that make risk pooling impractical is a paper tiger. It’s not to say there isn’t an impact but it is certainly overstated. Municipalities have been living for years with the financial consequences, or accountability, of the Legislature and the PSPRS board managing this plan. To now say that risk pooling presents some unreasonable risk for one local plan against another is an overstatement in the scale of risks.

2. The “retiree pooling” is really offering towns/plans nothing more than a possible discount annuity program. The towns/plan can get the same risk reduction with a whole lot less administrative overhead and legislative oversight or risk of change if it were just given the ability to buy annuities on the open market. Pooling the longevity risk among small employers to maintain a better chance of hitting the actuarial assumptions makes sense not just for the longevity risks but for all risks.
3. The report asserts that recommendation 3(B) is pooling the disability risk. Again, we request further explanation. Our understanding of the proposed system is the member starts in the local plan—so status quo. If the member feels they have a disabling event they apply to the local board (or consolidated board under recommendation of the Report). The local board incurs the costs of evaluation and makes the decision. A PSPRS actuarial then determines the cost of providing that member his or her benefits for the remaining life and then transfers the person and the required amount from the local plan to the retiree pool. This is not pooling the local plans risk of disability. It’s the same, if not worse, risk for a local plan because it would appear the local plan has bought an annuity with no opportunity to review the disability case and perhaps one day reduce the plan’s cost. We are not clear on how this is pooling a Non-Predicatable Risk of disabilities as the Report claims.

4. Employer Contribution. This was raised in the town-hall presentations and can be seen on slide 35 of the Cortex slides. The Cortex Report is recommending a variable employer contribution rate. This is absolutely contrary to the reform and puts towns/local boards back in the status quo situation. The Cortex speaker actually said PSPRS would need to ask the Legislature to change this provision to enable variable contribution rates by the employer. This event seems to occur under scenario 3(B) anytime the local plan becomes underfunded. This is exactly the conditions the towns/local boards were trying to cure with the reforms that have taken place to date. Therefore recommendation 3(B) appears contrary to that effort.

5. In terms of the board consolidation, the recommendation made by the Report may be workable depending upon how a county board gets appointed. However, given the interest in greater pooling, such a county board may be contrary to the desired risk pooling outcomes preferred. Either way, more information on operational aspects is definitely required prior to a determination of support or oppose.

Conversely, recommendation 3(C) in the report appears to more closely hit the reforms desired. The Local Board would like the option explored in more detail before a full endorsement, but believe this has better potential.

If you have any questions or require clarification, please contact the Local Board Secretary, Kevin Burke who also serves as the Town Manager.

Sincerely,

Richard Fincher
Chairman

Cc: Paradise Valley Mayor & Council
Kevin Burke, Secretary & Town Manager
Peter Wingert, Police Chief
November 18, 2016

Sent via e-mail to: jared@psprs.com
Jared Smout
PSPRS System Administrator
3010 E Camelback Rd. Ste 200
Phoenix, Arizona 85016

RE: Feedback on risk pooling and board consolidation study

Dear Mr. Smout:

I serve as the Chairman of the Local Board ("Board") for the San Carlos Apache Tribe. Our Board has had the opportunity to review the two-part study on risk pooling and board consolidation drafted by Cortex Applied Research ("Cortex") and Cortex’s recommendations to the PSPRS Board. Cortex recommended that PSPRS implement partial consolidation of local boards to the geographic county in which they are located.

Cortex further recommends that small local boards be permitted to apply for an exemption to consolidation into a county board provided they meet specified criteria for governance. According to Cortex, granting such exemption could rest with the PSPRS Board and would need to be reviewed periodically to ensure the standards continue to be met over time.

This recommendation is of great concern to the San Carlos Apache Tribe. As a federally recognized Indian Tribe, the San Carlos Apache Tribe possesses tribal sovereignty and it is not in the best interest of the San Carlos Apache Tribe (or any other Tribe) for their Police and Fire Departments’ local boards to be consolidated into a county board. PSPRS members employed by a Tribal police or fire department will have different workplace circumstances that will not be known or easily understandable by a county board that will most likely be composed of individuals who lack experience dealing with Tribal governmental entities. This lack of understanding of Tribal governance may prevent a county board from making proper decisions for the Tribe’s officers.
Therefore, we strongly urge the PSPRS Board to exclude Tribal local boards from any requirement to consolidate into either a single state-wide board or a county board.

Please contact me if you have any questions.

Sincerely,

Jonathan Kitcheyan
Local Board Chairman
November 18, 2016

VIA E-MAIL

Brian P. Tobin, Chairperson
Public Safety Personnel Retirement System
c/o PSPRS System Administrator Jared A. Smout
jared@psprs.com

RE: Gila River Indian Community Comments on Risk Pooling and Board Consolidation Study

Dear Chairman Tobin:

Please consider these the Gila River Indian Community’s comments on the draft study done of risk pooling and board consolidation by Cortex Applied Research, Inc. and dated October 17, 2016.

As the Cortex study notes, the Community has almost 200 participants in the PSPRS who are employees of the Gila River Fire Department and Gila River Police Department. The Public Safety Personnel Retirement System was established by statute as a public retirement system and is a state entity governed by a board of trustees. Several of Arizona’s Indian tribes, including the Community, participate in the system. Because of the growth of tribal public safety personnel in recent years, and through intergovernmental agreements and AZPOST certification, tribal public safety employees have a significant positive impact in Arizona, both on and off-Reservation.

One of the Community’s major concerns with implementing the recommendations of the Cortex study is PSPRS’s failure to consult with the Community and other Arizona tribes. The list of stakeholders in Appendix A to the Cortex report does not identify any tribes or tribal entities. Executive Order 2006-14 (Sept. 14, 2006), requires executive agencies of the State to develop and implement tribal consultation policies and to integrate the input generated from tribal consultation into decision-making processes. Because PSPRS is an executive agency of the State, the Community requests that this policy should be followed.

525 West Gu u Ki · P.O. Box 97 · Sacaton, Arizona 85147
Telephone: 520-562-9841 · Fax: 520-562-9849 · Email: executivemail@gric.nsn.us
prior to any decision eliminating local boards. The Community's understanding is that other tribes in the PSPRS feel the same.

A specific concern of the Community is the recommendation to eliminate local tribal board and "absorb" those boards into newly-created county boards. The PSPRS is administered through local boards (A.R.S. § 38-847) and the Community has its own board. These boards each reflect the sovereignty of the employing agency, whether a state entity, county or Indian tribe. Cortex proposes creating new county boards and simply consolidating Indian tribe boards into those county boards. Absorbing the Community's local board into a new Pinal County board fails to take into account tribal sovereignty considerations, as well as the unique nature of public safety in Indian County. At a minimum, Indian tribes (particularly smaller tribes) would be forced to compete with several other agencies for representation on county boards. One possible option not discussed in the Cortex report would be the creation of a joint tribal board specifically for Arizona's Indian tribes.

Finally, the Community will need additional time to fully review the risk pooling recommendations and their impact on the Community.

Thank you for your consideration in this matter.

Sincerely,

Stephen R. Lewis, Governor
Gila River Indian Community

cc: Chief Thomas Knapp, Gila River Fire Department
    Chief Kathleen Elliot, Gila River Police Department
    Community Treasurer Robert Keller
Hi Jared,

This e-mail includes my comments to the Report On Risk Pooling & Local Board Consolidation prepared by Cortex. I am requesting that these comments be entered into the official public record.

I disagree with Cortex’s recommendation of Option 3-Hybrid regarding pooling of Tier 3 risks and liabilities. I support Option 2-100% Risk Pooling & Hybrid Approach A-100% Pooling with Charge Back. The passage of SB1428 in the 2016 Legislative Session provided a historic opportunity to create a new tier of the public safety employee retirement system without the shortcomings and missteps of Tiers I and II. The language of the bill notes that after July 1, 2017, all public safety officers will be required to pay an equal share, 50-50, of all costs of the retirement plan. There is no accommodation in the statute for differential contribution rates for “base” benefits, employer-discretionary decisions or other items or any differential rates between employees and employers. The plan is envisioned to be a single, unified entity with all employers and employees sharing the costs equally. The recommendation(s) to do otherwise fundamentally undermines the basic principle of the legislation; It was never anticipated that the legislation would be opened up in order to revisit the contribution rate. That matter was discussed, negotiated and agreed on as a core principle of the new tier. The passage of SB1428 was direction to the Board, and to the consultant to work out the mechanism of pooling that would conform to the 50-50 contribution rate.

This process assures all members that the plan will remain consistent for all employers and employees and that deviations by individual employers will be made up by those specific employers. ASRS currently uses this system successfully.

I also disagree with Cortex’s recommendation of Alternative 3 Partial Board Consolidation. I continue to support the concept of consolidating all Local Boards to form a single state-wide Board responsible for all benefit administration matters. A consolidated single board would offer maximum efficiency and eliminate the risk of inconsistent benefit decisions and interpretations that currently exists with 233 Local Boards. Cortex acknowledges that partial consolidation (Alternative 3) by definition represents a compromise on certain issues. I do not believe that the two disadvantages Cortex has listed for Alternative 3 are representative of sufficient input from those of us who would fall under the Partial Board Consolidation. If
PSPRS does not move to a single state-wide Board Sierra Vista would prefer to remain with the Status Quo as opposed to the partial consolidation.

Sincerely,
Barbara Fleming
Chief Human Resources Officer
City of Sierra Vista

The Human Resources on-call telephone number is: (520) 559-0936 for after hours emergencies

City of Sierra Vista
1011 N. Coronado Drive
Sierra Vista, AZ 85635
(520) 417-4411/office
(520)452-7028/fax
Mr. Smout,

Here are my comments to the Report On Risk Pooling & Local Board Consolidation prepared by Cortex Applied Research Inc. on October 17, 2016. I request that these comments be forwarded to CORTEX and be entered into the official public record.

I disagree with Cortex’s recommendation of Option 3-Hybrid regarding pooling of Tier 3 risks and liabilities. I support Option 2-100% Risk Pooling & Hybrid Approach A-100% Pooling with Charge Back. The passage of SB1428 in the 2016 Legislative Session provided a historic opportunity to create a new tier of the public safety employee retirement system without the shortcomings and missteps of Tiers I and II. The language of the bill notes that after July 1, 2017, all public safety officers will be required to pay an equal share, 50-50, of all costs of the retirement plan. There is no accommodation in the statute for differential contribution rates for “base” benefits, employer-discretionary decisions or other items or any differential rates between employees and employers. The plan is envisioned to be a single, unified entity with all employers and employees sharing the costs equally. The recommendation(s) to do otherwise fundamentally undermines the basic principle of the legislation; It was never anticipated that the legislation would be opened up in order to revisit the contribution rate. That matter was discussed, negotiated and agreed on as a core principle of the new tier. The passage of SB1428 was direction to the Board, and to the consultant to work out the mechanism of pooling that would conform to the 50-50 contribution rate.

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Regards,
Charles P. Potucek
City Manager
Good afternoon Mr. Smout,

I would like to give some feedback on the recommendations of the Cortex report regarding risk pooling and local board consolidation.

1) I would only support their Option 3 Hybrid of Tier 3 risks if the employee/employer contribution split remains 50%. I agreed that cities like Sierra Vista should not pay for actions that are under the control of other cities, like only hiring personnel with 5 years experience. However, if this evolves into a non-50/50 contribution split, I feel this goes against a key point of the legislation.

2) I do not agree with partial board consolidation. I felt the legislation was clear that, in the end, there should be one consolidated board.

Thank you.

David Felix
Chief Financial Officer
City of Sierra Vista
Good afternoon,

The Yuma County Sheriff’s Office comments as an employer are as follows:
Local Board consolidation makes no sense. The report states that it is to cut cost but we pay for those cost.
Risk pooling is an abstract meaning that has little effect on us.

Thank you,

Yuma County Sheriff’s Office
From an employer’s perspective, we are looking for predictability in contribution rates and the ability to manage the costs that drives these rates. Senate Bill 1428 created Tier 3 and several very important reforms for PSPRS. Included in those are changes that will help in controlling and predicting our costs; such as the salary cap of $110,000 and the 50/50 split for the employee/employer contribution rate.

Cortex recommends utilizing Option 3: Hybrid Option utilizing Alternative 3(B) Status Quo plus a Retiree Pool.

Cortex noted the strengths and weaknesses of each Option including Status Quo, 100% Risk Pooling and the Hybrid Option. We agree the Status Quo is not an option. We also agree Non-Predictable Risks should be pooled and employers should be responsible for Management Risks.

The Hybrid Option approach definitely appears to be necessary to ensure accountability on employers. Maricopa County supports the recommendation of Option 3: Hybrid Option utilizing Alternative 3(B) Status Quo with Retiree Pool, but also feels the Hybrid Option with a Charge-Back Method 3(C) warrants further discussion. This option provides for what appears to be the same risk pooling and accountability. As the report mentions, even though ASRS utilizes what appears to be a fully pooled system it is actually using a hybrid approach in which Non-Predictable Risks are pooled for the employers are charged back for pension costs associated with any material decisions they make (Management Risks). I believe most think the ASRS is 100% pooled which is not the case as the report states. But, it still holds employers accountable for Management Risks.

With 233 local boards providing like functions which are open to inconsistent application, the consolidation of the local boards should be effective. The concept recommended by Cortex seems reasonable and necessary. An additional consideration may be to have one disability board for the entire Plan to ensure consistency in practices. It will be important for PSPRS to coordinate this effort by communicating not only with the local board, but representatives of the actual employer.
It is critical to the future of Arizona to provide a public safety defined benefit pension as a tool to support the recruitment and retention of public safety officers and that system needs to be managed for the members, citizens and taxpayers of Arizona.

As the Local Board Chair for Coconino County I disagree with the consultant’s recommendation of Option 3-Hybrid regarding pooling of Tier 3 risks and liabilities and instead, supports Option 2-100% Risk Pooling & Hybrid Approach A-100% Pooling with Charge Back.

Pensions are difficult to manage and are a challenge for every state and likely most counties around the world. It is misguided to believe that changing a few rules in the system will resolve the problems that have occurred over time.

The Permanent Benefit Increase (PBI) was a major factor in the past problems with the PSPRS. The PBI added increased volatility to the systems applying this process. However, volatility is inherent in all pension systems. How the volatility is managed through the system structure and governance is far more important.

The current structure and the proposed structure do not tie together the authority, resources and responsibility of managing PSPRS. There is nothing magical about the ASRS. The ASRS is structured that the authority, resources and responsibility fall to the Board of Trustees.

The Trustees of the PSPRS have access to expertise in pensions, including actuaries, to provide guidance based on the direction of the Trustees. The current and Cortex proposed PSPRS structure maintain the authority and resources with the Trustees, yet passes the responsibility to fund the liabilities to local jurisdictions that do not have the resources, experience or expertise to manage a pension system, especially the smaller jurisdictions.

The PBI is not a mystery. It is math formula. How the result of the PBI was managed, or not managed, is the problem. The responsibility to understand the actuarial reports and how each individual jurisdiction varied from the many generic assumptions applied was passed down to the individual jurisdictions. These local governments do not have the resources or expertise to modify the actuarial calculated contributions for each unique circumstance. The fact that the Cortex report at one point even references that actuarial calculations are prepared for each jurisdiction if extremely troubling and not completely accurate. The PSPRS actuaries prepare at the direction of the Board, calculations for each jurisdiction based on a set of generic assumptions that are identical across the state (small and large police and small and large fire). This is not even close to the expertise needed to advise local governments on decisions needed, nor do these governments have the resources to have this work done. This would cost well beyond the $150,000 stated as the cost by Cortex.

The calculation and management of unfunded liabilities is very complex. However, there is a simple explanation for where unfunded liabilities come from. Unfunded liabilities are caused by wrong assumptions that result in a lower calculated normal cost. If unfunded liabilities grow over time the question for the governance body is what assumptions are different from the reality that occurred. The continuation of not changing the assumption of estimating future PBI’s is not because the math changed. It is because of the governance structure. Under a proper governance structure the PBI could, and should, have been managed. Changing the math formula for a cost of living adjustment does not fix the governance and structural problems.
In addition, the justification for not pooling liabilities is overstating cost-shifting concerns that are not supported by any data. The ASRS and Social Security operate across multiple employees with varying levels of and types of wages. The higher an organization's wages, the more contributions are paid to fund the future benefits based on the percentage applied. There will be inequities in any system, as there are huge generational inequities in the current PSPRS tier I & II systems. To raise one potential inequity not supported by data is not depicting level of impact of decisions being recommended.

Pooling all liabilities would structure the system so the resources, expertise and responsibility for the system would all fall to the same entity. A missing reality in the Cortex analysis is the assumption of local jurisdictions is that if the Actuarially Required Contribution (ARC) is being paid annually that their individual system is appropriately being funded. However, the ARC may not be relevant as each jurisdiction's ARC is calculated using a generic set of assumptions that may or may not be relevant and would require actuarial analysis for each jurisdiction to make the appropriate adjustments to the overall actuarial analysis completed for the larger system.

There will be volatility in all of the state's pension systems in the future. Changing the math formulas does not eliminate volatility and does not change how the systems are managed. To expect a different result in the management of the systems without changing the structure and governance is doing the same thing and expecting a different result.

The passage of SB1428 in 2016 provides an opportunity to address many of the issues that led to the deficits our future generations will pay for. Please make the appropriate changes needed to not add to those future deficits.

As the Chair of the Local Board for Coconino County I disagree with the consultant’s recommendation of Option 3-Hybrid regarding pooling of Tier 3 risks and liabilities and instead, supports Option 2-100% Risk Pooling & Hybrid Approach A-100% Pooling with Charge Back.

Michael F. Townsend
Deputy County Manager
Coconino County, Arizona
November 18, 2016

Jared Smout  
PSPRS System Administrator  
3010 E. Camelback Road, Suite 200  
Phoenix, Arizona 85016

Dear Mr. Smout,

The Pascua Yaqui Tribe is responding to the Report on Risk Pooling & Local Board Consolidation, (Report) prepared by Cortex Applied Research Inc., dated October 17, 2016. The Report was commissioned in response to Senate Bill 1428 which enacted reform to the Public Safety Personnel Retirement System (PSPRS) and directed a study of risk pooling and consolidation of local boards. According to the Report, Cortex began meeting with Stakeholders in or around June 2016 in order to draft a report and recommendation to be submitted to the Legislature, on or before February 15, 2017. Like other participating Native American tribes and nations, the Pascua Yaqui Tribe was never informed of this study or provided an opportunity to participate as a Stakeholder.

The Pascua Yaqui Tribe’s Public Safety Board was only recently advised of the study and the deadline to respond. This is very disconcerting considering the number of tribal employers participating in PSPRS and the fact that our firefighters not only serve our Native American communities, they serve local and state governments through co-operative agreements. As an Employer and Stakeholder in the PSPRS, the Pascua Yaqui Tribe would expect that its board representatives would have been provided notice and an opportunity to participate in the process.

With the absence of representation, the Report makes uninformed assumptions regarding Native American tribes and nations. Like other tribes and nations, the Pascua Yaqui Tribe is a sovereign nation with unique and independent laws, customs, and culture. The recommendation of consolidation of local boards ignores this reality and disregards the sovereignty of each Native American tribe and nation that participates in the PSPRS. Moreover, the recommendation to mandate that tribal local boards to consolidate, as reflected in Cortex PowerPoint Presentation, while providing other governments “opt out” or “opt in” opportunities, is disrespectful to say the least.

In Part II, of the Report, entitled “Review of Local Board Consideration”, the Pascua Yaqui Tribe concurs with the recommendation that PSPRS invest in the local boards to ensure the boards and its members have the necessary resources, training, policies, and procedures to be successful. The
idea of eliminating local boards cannot be entertained in the least. It would leave a vacuum and create confusion for participants and employers. The Pascua Yaqui Tribe opposes the consolidation of tribal local boards based on tribal affiliation. The assumption that tribes are homogeneous is a misperception. Each tribe/nation is an independent sovereignty and must be provided the same “opt in” and “opt out” options provided to other jurisdictions.

The Pascua Yaqui Tribe agrees with the recommendations for risk pooling of Tier 3 and prefers Alternative 3 Hybrid Option along with the pooling of risk for non-predictable risks, and the maintaining of management risks by the individual employer. The Pascua Yaqui Tribe also prefers the status quo of un-pooled liability risk, except for line of duty deaths, and the pooling of retirees in Tier 3. The Pascua Yaqui Tribe is not in favor of Tier 1 and Tier 2 pooling, since the funding levels for the Tribe are fare better than for those employers that have permitted pension spiking and made other detrimental management decisions, and the Tribe does not agree with the transfer of risk that could have been avoided through effective management.

On behalf of the Pascua Yaqui Tribal Public Safety Employees, I submit these comments and urge you to reconsider the recommendations made by Cortex Applied Research Inc.

Sincerely,


Robert Valencia, Chairman
Pascua Yaqui Tribe


Chief Andre Matus Sr.
Pascua Yaqui Tribe Fire Department
Good afternoon Jared,

I am sending feedback on behalf of City of Surprise to the Risk Pooling and Board Consolidation Study. I apologize for the lateness in the day in sending you this information. We more questions about how the consolidation of the local board will be administered which we understand the details are still being considered and so I will list a few things we have for our feedback:

1) What if an employer expect in the future to have 250 members in either police or fire due to growth? Can they opt out of the consolidation board so they do not have to disband their current local board? Otherwise, if they are required to disband the local board initially and later required to have own separate board it would be a hardship to create a board and get caught up to speed on the board requirements if we no longer have one. We believe in the future Surprise will reach the 250 members where we would be required to have our own board so would like to know if this would be an option for us to keep our local board separate.

2) In the draft study on page 39, we noticed our name of our city is misspelled. Can you please correct it to show “Surprise” instead of “Sunrise”.

3) When would the local board be required to consolidate since the proposal is showing January 2017? Will this be feasible for board to disband and consolidate over a short period of time.

Right now, these are the only feedback we can provide at this time.

Thank you for allowing us to participate,
Chanda

Chanda Washington
Senior Human Resources Analyst
City of Surprise Human Resources
16000 N. Civic Center Plaza
Surprise, AZ 85374
Direct Line (623) 222-3542
Confidential Medical Fax (623) 222-3504
chanda.washington@surpriseaz.gov

City Hall offices open at 8 a.m. and close at 5 p.m. Monday through Friday. More info at www.surpriseaz.gov.
Hi Jared
Forwarding our comments per Ken Strobeck.
Best regards.
Charlie Cassens

Sent from my iPad

Begin forwarded message:

From: Ken Strobeck <kstrobeck@azleague.org>
Date: November 18, 2016 at 10:35:48 AM PST
To: Charlie Cassens <cassensc@lhcaz.gov>
Subject: Re: PSPRS Consultant Response

Thanks, Charlie. Did you send your comments to PSPRS? You can send them to Jared Smout at Jared@psprs.com.
Happy Thanksgiving to you too!
Ken

Sent from my iPhone

On Nov 18, 2016, at 1:14 PM, Charlie Cassens <CassensC@lhcaz.gov> wrote:

Hi Ken –

Thanks for the opportunity to state that Lake Havasu City is in support of the concept of Board consolidation to benefit all members. We strongly believe it needs to include a Third Party Administrator to process disability retirement applications. A TPA removes the HIPPA risk for employers in addition to removing the emotional factor in the decision making process. Should the determination be to continue separate boards for large employers and county merged boards for others, the TPA concept should still be considered. And as you know, in Lake Havasu City, we are concerned that additional contributions to PSPRS will be hindered by the expenditure limitation rule, which we are up against now. If there is any way to correct that problem with new legislation, we would be very interested in championing that consideration.

Thanks and Happy Thanksgiving!

Charlie Cassens
Executive Committee Members and Intergovs:
As discussed at the Executive Committee meeting on Friday, the consultant has delivered their report on the issues of pooling and board consolidation for the new Tier III of PSPRS. I mentioned that we disagreed with the pooling recommendation which would result in having differential contribution rates for the new tier. We see that decision as missing a unique opportunity to create a new, unified system and threatening to repeat the mistakes of Tiers I and II.
I am attaching the full consultant report and my draft response for your review. If you have any questions or suggestions, I would appreciate hearing from you.
Also, if you or someone from your city or town is also concerned about this, I would encourage you to send your comments in for the consultant to consider before issuing their final report. The deadline is November 18th. Comments should be sent to: Jared Smout, PSPRS Administrator at Jared@psprs.com. Ultimately, the new PSPRS Board will make a recommendation to the legislature about these two issues early in the next session.
Thank you,
Ken

Ken Strobeck
Executive Director
League of Arizona Cities and Towns
(602) 258-5786 office
(602) 501-4989 cell

<image001.jpg>
Statutory Authority

The ASRS has a formal statute that prescribes when a chargeback should occur. Relevant excerpts from Statute 38-749 include:

38-749. Employer termination incentive program; employer payment of actuarial cost; definition

A. If a termination incentive program that is offered by an employer results in an actuarial unfunded liability to ASRS, the employer shall pay to ASRS the amount of the unfunded liability. ASRS shall determine the amount of the unfunded liability in consultation with its actuary.

B. An employer shall notify ASRS if the employer plans to implement a termination incentive program that may affect ASRS funding.

C. If ASRS determines that an employer has implemented a termination incentive program that results in an actuarial unfunded liability to ASRS, ASRS shall assess the cost of the unfunded liability to that employer. If the employer does not remit full payment of all monies due within ninety days after being notified by ASRS of the amount due, the unpaid amount accrues interest until the amount is paid in full. The interest rate is the interest rate assumption that is approved by the board for actuarial equivalency for the period in question to the date payment is received.

D. For the purposes of this section, "termination incentive program" means:

1. A total increase in compensation of thirty per cent or more that is given to a member in any one or more years before termination that are used to calculate the member’s average monthly compensation if that increase in compensation is used to calculate the member’s retirement benefit and that increase in compensation is not attributed to a promotion.

2. anything of value, including any monies, credited service or points that
the employer provides to or on behalf of a member that is conditioned on the member’s termination except for payments to an employee for accrued vacation, sick leave or compensatory time unless the payment is enhanced beyond the employer's customary payment.

In summary, the ASRS has a legislative framework in place to allow it to charge back for:

- Salary increases greater than 30% compounded over the period prior to retirement.
- Any change in the service used to calculate the benefits.
- Any early retirement program instituted by an employer.

It should be noted that the above framework is designed to charge back employers for termination incentive programs, but does not address other practices or programs such as hiring older or younger employees.

Since the above statute was adopted in 2005, ASRS informed us that it has identified approximately 107 potential Employer Termination Incentive Programs as defined by A.R.S. 38-749(D)(2). However, some of these Employers ultimately chose not to implement a Termination Incentive Program, so the ASRS has only invoiced approximately 23 Employers for Termination Incentive Programs that were in fact implemented. These programs included approximately 533 employees and the ASRS has collected approximately $18.5 million in unfunded liabilities as a result of Employers implementing Termination Incentive Programs as defined by A.R.S. 38-749(D)(2).

ASRS also indicated that there have been three cases of employers challenging the calculations used by ASRS to determine amounts owing in respect of termination incentive programs, one of which resulted in a court trial. In response, the ASRS has spent the last nine months developing a “Rule” (to be approved by the GRRC) that will set out the specific basis for calculating chargebacks in the future. They believe that this Rule, once published, will reduce the likelihood of any future challenges and litigation and will better position ASRS to prevail should any litigation occur in the future.

**ASRS Calculation Methodology**

To date, all calculations performed by ASRS to determine charge-backs are done using the current basis for actuarial valuations. They do not use more conservative assumptions and do not view this as a concern.

**Size of Chargeback**

ASRS has not established its own thresholds for materiality. Instead, ASRS chargebacks are based on the thresholds and provisions in the governing legislation.

**Administration**

For calculating charge-backs applicable to individuals, the process has been relatively more manual in nature, but will be automated in the future. The ASRS has audited employers to check the data they supply.

For early retirement programs, the ASRS relies on notification from the individual employer, but may conduct audits if necessary. The employer is charged for the additional cost.
Cost of Monitoring

Currently the ASRS has one full time employee monitoring the termination incentive program and working with the employers and the actuary to recover the additional liability.

It should be expected that over time the PSPRS will also need one person who allocates 50% of his or her time to this function.

It should be noted:

- The ASRS only focuses on salary increases for the termination incentive program and does not monitor or chargeback for any other non-salary related events.
- The ASRS only charges the employer, as contributions are not shared with the employees, as is the case under the PSPRS Tier 3.

We trust the above background will be helpful to you and the Board and would be pleased to discuss it at any time.
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