



PSPRS 2016 First Quarter newsletter

Open enrollment for retirees' insurance to begin



PSPRS partners with the Arizona State Retirement System (ASRS) to offer retirees medical and dental coverage each year. The open enrollment period to receive this coverage or make changes to existing coverage will take place from October 24 to November 11, 2016.

Each year, open enrollment is passive, meaning that retiree action is *not required* to continue existing coverage for Medicare and non-Medicare retirees. However, new coverage plans are available and there are scheduled informational meetings across the state that are being conducted by the Arizona State Retirement System, which administers retiree insurance coverage.

Additionally, retirees of PSPRS-managed retirement plans will be able to visit with a United HealthCare representative who will work out of the PSPRS Phoenix office during the open enrollment period. Please call PSPRS at 602-255-5575 to schedule a consultation.

Open enrollment packets will be mailed to retirees of PSPRS, CORP and EORP in early October and are expected to arrive at homes between October 11 and October 14.

Please click [here](#) to view the statewide open enrollment meeting schedule, which includes meetings in Casa Grande, Flagstaff, Glendale, Kingman, Mesa, Prescott Valley, Show Low, Sierra Vista, Tempe and Yuma.

Service purchase season is now open

PSPRS is experiencing a high volume of service purchase inquiries from members looking to take advantage of a change in state law.

As of Aug. 6, 2016, the discount rate used for service purchase cost calculations is the same as the PSPRS assumed earnings rate currently set at 7.4 percent. However, this rate will only be used until June 30, 2017, after which it will be replaced by the rate of the 10-year Treasury note plus 2 percent.

The cost of service purchases, also known as “buy-backs,” varies according to a host of factors, including salary, age and years until retirement. But, the use of the 7.4 percent assumed earnings rate for purchases will produce a lower cost for members who seek to purchase service during this window of time.

PSPRS is encouraging public safety employees to use their online service purchase cost estimator periodically as prices can vary over time due to changing factors from actuarial valuations and the complex formula used to determine costs.

With increased interest in service purchase options, which has helped Arizona draw public safety employees from out-of-state jurisdictions, PSPRS is increasing its outreach efforts and services. The online service purchase estimator now includes a feature that allows a user to compare the current estimated cost that relies on the current discount rate to the cost that would be produced under the Treasury note rate that will become effective in July 2017.

As of Aug. 6, 2016, PSPRS members also have the option of entering payroll deduction agreements (PDAs) to help pay for service purchases. A PDA cost estimator that allows users to select the amount deduction from paychecks and number of pay periods has also been made available online by PSPRS.

In September, PSPRS also launched its first [service purchase educational video](#) featuring Tony Jenkins, an Active Member Services team leader who personally handles service purchases for members of PSPRS-managed plans. Jenkins advises members to use the service purchase cost estimator before contacting PSPRS for official price quotes that remain valid for 90 days.

That was the good news, and, yes, it is good news

It’s hard to imagine a time when investment returns of 1 percent can be considered positive, but under today’s global economic conditions members of PSPRS-managed plans should be encouraged with the 2016 fiscal year results.

Gross of fees returns for the PSPRS portfolio hovered just above 1 percent for the fiscal year ending June 30, and after investment fees were paid (net of fees) the pension fund’s returns amounted to more than six-tenths of 1 percent. Causes for the slow year for public pensions were evident: Major economies treaded water despite drastic efforts to spark growth through next-to-nothing or even negative interest rates.

Leaders of the PSPRS investment team, including Chief Investment Officer Ryan Parham, are disappointed with the results but still recognize that the \$8.3 billion portfolio designed to withstand economic turbulence did its job. According to investment consultant NEPC, PSPRS outperformed two-thirds of peer public pension funds while taking less investment risk than 96 percent of their peers.

Prior to the PSPRS Board of Trustees’ meeting, NEPC consultant Allan Martin was asked whether the 2016 fiscal year numbers placed PSPRS within the nation’s “elite” plans that operate highly diversified portfolios built to grind out gains and prevent losses in the toughest environments. “Absolutely,” said Martin, who later told the board that the PSPRS investment team continued to improve its peer rankings on 1, 3, 5 and 10-year average returns, despite its purposeful avoiding of riskier investments or strategies that have the potential for producing higher returns. No pension plan in the country, he added, had earnings at or above their assumed earnings rates. According to the National Association of State Retirement Administrators, the average assumed earnings rate for public pensions is 7.62 percent, while many public pensions and endowments posted losses during the 2016 fiscal year.

For the second year in a row, PSPRS private equity investments (the buying of private assets and companies) continued to excel. For the 2016 fiscal year, the private equity portfolio returned more than 11 percent, which was a major contrast to stall-outs in U.S. equities and losses in foreign stocks and markets.

And more good news

The three Phoenix Police officers injured in the September attack captured on video at a QuikTrip convenience store are all recovering and expected to return to duty on various schedules dictated by the extent of their injuries, according to Phoenix PD spokesman Sgt. Jonathan Howard.

The three officers were injured in the early hours of September 13 when suspect Marc Payne sped his car into the group standing in front of the store located on Camelback Rd. and 25th Ave. Payne was taken into custody after fighting the officers, who responded to the unprovoked attack with non-lethal means. Payne is facing charges of attempted murder and assault.

Remembrance: Rose Mofford

Arizonans, including PSPRS, are still saddened by the September loss of Arizona icon Rose Mofford, who passed away at 94 years of age.

Mofford's career in public service spanned more than five decades and included a long tenure working for Secretary of State Wesley Bolin, namesake of the capitol plaza. In 1988, during her own fourth term as Secretary of State, Mofford became governor after the impeachment of Governor Evan Mecham.



Photo courtesy of www.azcentral.com

The former governor retired from public service in 1991 as a member of the Elected Officials' Retirement Plan. Mofford was a frequent and popular visitor to the PSPRS office. It was not unusual for staff members to bring their children to work when Mofford was scheduled to visit, much to the joy of the Globe native.

"White car, white hair and white clothes," recalled PSPRS Communications Manager Lori Matthews of Mofford's visits. "She was great with staff, great with their kids and a humble but larger than life personality."

Matthews is one of three employees – including Don Mineer and LaDawn Toger – who worked for PSPRS in the 1990s when Mofford would visit. Mofford's background and unusual rise to governor was groundbreaking for women, said Matthews.

"She was a very intelligent woman without an education who elevated herself all the way up to governor through hard work and time," Matthews said. "She was most certainly a woman ahead of her time."

Known for her calm demeanor and old-fashioned beehive hairdo, Mofford told the *Arizona Capitol Times* years ago that she was most proud of bringing stability to Arizona in light of the Mecham impeachment and her efforts to save Arizona's Cactus League spring training games.

Hurry up and wait for Hall decision

After hearing arguments in *Hall v. EORP* in February, the Arizona Supreme Court has yet to release its opinion on whether employee contribution rate increases and limits on pension increases passed into law in 2011 will remain in effect. The lawsuit against Senate Bill 1609, which was implemented to improve the financial health and sustainability of PSPRS-managed plans, was filed by two judges, Phillip Hall and Jon Thompson, who contended the bill violated state and federal constitutional clauses.

At issue is whether the increases to EORP (Elected Officials' Retirement Plan) employee contribution rates are legal because the rate isn't defined as a "benefit" under the state constitutional pension clause. Also at question is whether existing law defining that a member's "right to benefits" vests, or becomes active, upon retirement applies to Tier 1 members who retired on or after Aug. 1, 2011, or remain active.

In ruling on *Hall*, the court could uphold or strike the contribution increases and PBI adjustments or apply impacts of its own. It is not known by PSPRS when a ruling can be expected. Typically, the court gives litigants 24 hour notice before an opinion is released.

A handful of members of PSPRS-managed plans have reached out to PSPRS with questions about the scope and timing of the pending opinion. Others have inquired about how previous contributions would be refunded in the event of a victory by the *Hall* plaintiffs and how refunds would impact the overall funding level of PSPRS, which is currently about 50 percent.

DROP rates for the 2017 fiscal year

Tier 1 DROP participants – those who had 20 years of service prior Jan. 1, 2012 – will receive DROP interest rate growth of 7.4 percent for fiscal year 2017. The slight reduction from last year's rate is due to the PSPRS Board of Trustees' decision to reduce the assumed earnings rate on the advice of their actuarial consultants.

DROP participants who amassed 20 years of credited service and elected for deferred retirement on or after Jan. 1, 2012, will receive DROP interest rates of 4.5 percent along with 2 percent growth for their additional contributions paid into their DROP accounts.

The Big Short – how it works and how it works for PSPRS



Those who saw the movie the Big Short, which chronicled how several investors made mountains of cash by betting on the demise of the housing market, would be interested in how PSPRS uses the securities lending market to earn extra dough. PSPRS outside counsel Marc Lieberman of the Kutak Rock law firm laid out the process at the September meeting of the PSPRS Board of Trustees.

Betting the "short" is somewhat of the opposite of the "buy low, sell high" adage, but the process is less complicated than it appears. The typical "short" investor is a hedge fund with a belief that a particular stock or security – like the housing bonds that crumbled in the movie – is overvalued and ready to fall.

The investor then goes about borrowing the security in question from a lender, like a pension fund, by paying a fee and offering collateral investments to the lender or both. From here, the "short" investor sells the security based on his or her prediction that it will lose value and be available to purchase at a lower

cost. If the “short” investment is correct, the investor pockets the difference between the original value of the security and the lower price at which the security was re-purchased in order to return to the lender.

For example, a “short” investor borrows IBM stock and sells it for \$100 a share. Still owing the lender the amount of stock borrowed, the investor waits to buy IBM stock when it falls in value to \$90 a share. The investor then returns the shares to the lender and has earned \$10 per share, minus interest paid to the lender.

“Short” investments are risky propositions for investors but there is more upside with less inherent risk for the lender, which uses the collateral assets to make short-term investments with the help of an “agent” bank. The lender, which is given collateral valued slightly more than the securities borrowed by the “short” investor, splits the investment returns with the agent bank before returning the collateral and receiving the securities it lent to the “short” investor.

During the board meeting, trustees listened intently and asked what exact risk level does PSPRS take on by lending its securities. There is some but losses are rare, acknowledged Lieberman, noting PSPRS only lost money during a swap in which it received collateral that was inherently overvalued – AAA-rated mortgage bonds, which after Lehman Brothers’ demise were rated below investment grade.

At any given time PSPRS has an available lending pool of roughly \$2 billion worth of securities and that, on average, 20 percent of these assets are being lent to investors betting on the “short.” During a typical month, PSPRS generates more than \$200,000 through its securities lending program, amounting to roughly \$2.4 million in annual earnings. A majority of institutional investors lend out their securities to generate income like PSPRS.