

DROP Interest Calculations

Tier 2 and Tier 1 “gap” Member contribution rates

May 2022



PSPRS has addressed the urgent matters over the past two years:

- Hiring new managers and filling vacancies
- Addressing 2020 audit findings
- Implementing new accounting systems and processes

PSPRS OPERATIONAL PRIORITIES

(Promises made) Related adopted budget priorities and Administrator goals:

- Continue the work in Accounting, changing processes, improving controls and transparency.
- Implementing systems (G/L, PAS, Investments, phone systems)

(Promises kept) The operational priorities for FY2022 and FY2023 have shifted more to reviewing programs and documenting processes.

- This is the continuing process to create the organization that meets the stated mission including Integrity, Trust and upholding the Fiduciary Duty
- Through the continuing work in many areas, two errors put in place by previous management have been discovered

In the past two years and going forward any needed corrections discovered:

1. Have been or will be corrected
2. Will result in additional reviews and documented policies to ensure compliance with the state law and IRS requirements
3. Will be communicated to trustees and impacted stakeholders by PSPRS

PSPRS OPERATIONAL PRIORITIES

As a result of the priority tasks two corrections are needed.

1. Discovered incorrect formula used for accumulating member DROP interest while designing new processes for the Pension Administration System
2. Discovered existing application by prior management of Tier 2 and Tier 1* additional member contribution “gap” calculations (referred to as Maintenance of Effort) was incorrect and contrary to statute

*Public safety members hired between July 20, 2011, and Dec. 31, 2011, are eligible to receive Tier 1 benefits but make contributions under Tier 2 statutes. This is due to a discrepancy in state law.

PSPRS OPERATIONAL PRIORITIES

Current status of the process:

- Staff has worked with the actuaries, fiduciary counsel and tax counsel to resolve and correct the errors prospectively
- Trustees requested to provide policy direction based on staff recommendations in compliance with state law and IRS guidelines and procedures
- Staff will implement policy direction and communicate issues and operational steps to impacted stakeholders

TIER2 MEMBER RATES - BACKGROUND

- Staff has reviewed member contribution rates paid for certain member groups
 - PSPRS Tier 2 (including those hired 7/20/2011 – 6/30/2017)
 - CORP Tiers 1 and 2
- Prior statutory application did not reflect phase-out of higher member rates

STATUTES – PSPRS

- Tier 2 member contribution rates are set by statute
 - Rate higher than that charged to Tier 1 members
 - Set rates but provisions to phase out to Tier 1 level as gross contribution decreases
 - Relevant statutory language shown below

For fiscal year 2015-2016 and each fiscal year thereafter, 11.65 percent of the member's compensation or 33.3 percent of the sum of the member's contribution rate from the preceding fiscal year and the aggregate computed employer contribution rate that is calculated pursuant to subsection B of this section, whichever is lower, except that the member contribution rate shall not be less than 7.65 percent of the member's compensation and the employer contribution rate shall not be less than the rate prescribed in subsection B of this section.

- ARS 38-843.E.6 -

EXAMPLE CALCULATIONS - PSPRS

	Prescott Fire	Yavapai Prescott Tribal Police	Gila County Sheriff's Dept.
Member Rate (FYE 2022)	11.65%	11.65%	11.65%
Employer Rate (FYE 2023)	34.77%	14.93%	8.65%
Member Rate (FYE 2023)	11.65%	8.86%	7.65%

- Calculation, by statute, takes 33.3% of the prior year's member rate and the current year's employer rate
 - For Prescott, $33.3\% \times (11.65\% + 34.77\%) = 15.46\%$ (max 11.65%)
 - For Yavapai, $33.3\% \times (11.65\% + 14.93\%) = 8.86\%$
 - For Gila, $33.3\% \times (11.65\% + 8.65\%) = 6.76\%$ (min 7.65%)

TIER 2 & TIER 1 “GAP” RECOMMENDATION ON BOARD DIRECTION

Tier 2 and Tier 1 “gap” contribution rates summary:

- **Impacts “better funded” plans**
- **Plans with large unfunded liabilities are not impacted**
- **The Maintenance of Effort does not change employers rates, so employers have paid correct amounts during this time**
- **Correct rates are in place for the fiscal year beginning 6/30/2022**

TIER 2 & TIER 1 “GAP” RECOMMENDATION ON BOARD DIRECTION

Tier 2 and Tier 1 “gap” contribution rates policy direction:

- New rates for FY2023 have been correctly calculated as part of the current actuarial valuation and are in place for July 1, 2022 implementation
- Direct staff to update past contribution amounts at close of FY2022
- Direct staff regarding the credit/refund process
- Direct staff regarding the rate of interest to apply, with consideration of the *Hall/Parker* decision
- Communicate the timeline and details to the impacted employers and members

DROP INTEREST RECOMMENDATION FOR BOARD DIRECTION

DROP interest calculations policy direction:

- As was previously reported to the Board it was determined that the current formula that calculates interest on participants DROP accounts is not appropriately programmed in the EPIC (old) system
- This was found as part of the PAS (new pension administration system) implementation in defining the process in the new system that calculated results different than EPIC
- The programming was embedded in computer coding and had to be “reverse engineered” to understand
- Through this project all process are being documented and dozens have been modified. This is the only PAS process needing this level of attention.

DROP INTEREST RECOMMENDATION FOR BOARD DIRECTION

DROP interest calculations policy direction:

- IRS reconciliation method and reporting procedure to be applied
- Implementation of new software code for existing EPIC system effective July 1, 2022
 - New PAS has been designed and documented with the correct formula application
- Staff will providing details and communicating with members and stakeholders over the next several weeks

PSPRS WHAT'S NEXT

(Promises made) Related adopted budget priorities and Administrator goals:

- Continue the work in Accounting, changing processes, improving controls and transparency
- Implementing systems (G/L, PAS, Investments, phone systems)

(Promises kept) Operational priorities

- Continue reviewing programs and processes
- Documenting processes to ensure accuracy in operations
- Continue core functions and responsibilities of the system
- Work with staff, actuaries, counsel and other agency departments when necessary, on data analysis
- Continue to be transparent with board and stakeholders



Questions, comments & discussion