

Arizona Supreme Court strikes pension reforms

PSPRS still expected to save \$475 million due to 2016 measures

ARIZONA - The Arizona Supreme Court overturned two provisions of state law designed to provide financial relief to underfunded retirement plans managed by PSPRS. The Hall v. EORP lawsuit follows a similar loss in 2014 and cements the practical and legal limits of pension reform efforts.

"The reforms struck down in recent years were the products of good faith efforts to put Arizona public safety retirement plans on a stable and sustainable path forward," PSPRS Board of Trustee Chairman Brian Tobin said. "The court's decision amplifies the importance and achievement of Proposition 124 passed into law this year. Without this key measure passed by lawmakers, Governor Ducey and the public, PSPRS-managed retirement plans, retirees, members and employers would be facing a far more uncertain future."

In Hall, the Arizona Supreme Court determined that 2011 legislative reforms that increased employee contribution rates and modest reductions to pension benefit increases were unconstitutional. The court's ruling impacts employees who were already hired or retired by the effective date of the 2011 law.

In response to the ruling, PSPRS must provide partial refunds to impacted members who under the contested law had their retirement contribution rates rise above the existing 7.65 percent level. Likewise, those who retired after the effective date of the 2011 legislation may be owed retroactive benefit increases calculated under the previous permanent benefit increase (PBI) formula.

Preliminary and unaudited estimates by PSPRS indicate that contribution refunds and retroactive pension increases could reach \$220 million. The long-term adverse impacts of the Hall decision are offset by additional savings created by Senate Bill 1428 and Prop 124, both of which became law this year.

"While this ruling is unfortunate, the impacts would have been worse without the reform efforts of Prop 124 and SB1428," said PSPRS Administrator Jared Smout.

The 2016 pension reform efforts in SB1428 created a new employee benefit "tier" set for those hired after July 1, 2017, which effectively avoids the legal challenges associated with enacting laws that impact currently serving employees. In crafting Prop 124, which voters passed overwhelmingly in May, public safety stakeholders and lawmakers replaced the costly permanent benefit increase formula in the state constitution, as opposed to previous changes made in state law that were overturned in the Hall decision.

Despite the financial impact of the court's opinion in Hall, retirement plans managed by PSPRS are still expected to save an estimated \$475 million in long-term costs due to changes to state law and the constitution in 2016. The combined assets of the PSPRS, Corrections Officer Retirement Plan (CORP) and the Elected Officials Retirement Plan (EORP) are currently valued at \$8.7 billion.

The individual actuarial valuations for fiscal 2017-18 expected in the coming weeks will reflect pension reform efforts passed in 2011 and 2016 that mitigate the full effects of Hall but will not include the impact caused by the return of additional contributions and retroactive benefit increases. Due to the timing of the Hall ruling and the immediate lack of precise refund and benefit increase payment amounts, it is most likely

that the smaller, incremental effects of the lawsuit will not be factored into individual employer funding levels and rates until the June 30, 2017, valuations are released next year.