STATE OF ARIZONA

OFFICE OF THE ATTORNEY GENERAL

ATTORNEY GENERAL OPINION by TERRY GODDARD ATTORNEY GENERAL November 24 , 2009	No. I09-009 (R08-059) Re: Management of the State's Defined Contribution Retirement System

To: Paul Matson, Director
Arizona State Retirement System

Questions Presented

The Arizona State Retirement System ("ASRS") operates a Defined Contribution Retirement System ("System") for certain public employees and retirees who were employed during the period of 1953 through 1976 and who did not subsequently elect to participate in the State's newer Defined Benefit Plan ("Plan"). There are approximately 1800 remaining System participants. You have asked the following questions relating to the accounts and monthly retirement benefits of the System participants:

1. Under the System as enacted by the Legislature in 1953 and as subsequently amended, and under Article 29 of the Arizona Constitution, are there any circumstances in which the ASRS must or may reduce the accounts and payments to System members and beneficiaries?

2. If the accounts and payments may be reduced, is there a minimum amount that must be paid to System members and beneficiaries? For example, is that portion of their benefits derived from contributions plus interest guaranteed, as opposed to the increased benefits resulting from funding surpluses? Are they entitled to at least the amount of the comparable benefit that would be received by a Plan member with the same number of years of service, retirement date and salary history?

3. If benefits cannot be reduced below the comparable Plan amount, would the benefit amount be measured prospectively from the date of reduction of System benefits, or would the ASRS take into account the entire amount that the member had received since the date of retirement before paying the System member the defined benefit plan amount?

4. If there are insufficient funds to pay legally required benefits to members entitled to a System benefit, what would be the lawful source of funds to pay remaining benefits? That is, if a certain level of benefits is required to be paid that is in excess of the System fund balance would the remaining benefits be payable from the Plan trust fund or only from a legislative appropriation?

5. Finally, if reductions in benefits are permissible and ultimately required, what is the lawful method for calculating the amount of each System member's benefit reduction?

Summary Answer

The plain language of Article 29 of the Arizona Constitution prohibits the reduction of benefit payments to System members. Because ASRS may not reduce System members' benefits, we do not reach the second, third, and fifth questions. If there are insufficient funds to pay benefits to System members who retired on or after July 1, 1981, those benefits would be payable from the Plan trust fund. If there are insufficient funds to pay benefits to System members who retired before July 1, 1981, the State is liable for the shortfall, and a legislative appropriation would be necessary to satisfy the obligation.

Background

In 1953, the Legislature created a hybrid defined contribution program for public employees—the Defined Contribution Retirement System. 1953 Ariz. Sess. Laws ch. 128. The System is a "defined contribution" program because each pay period the member and employer pay a specified (or defined) amount into a retirement account. Ultimately, a member's retirement benefit is based on the value of the account at retirement. It is a "hybrid" program because, unlike a typical defined contribution plan in which a retiree draws on his or her accumulated account balance during retirement, on the date of retirement the account value is converted into an annuity calculated using the member's age.

When it created the System, the Legislature provided a method whereby any trust fund "surplus"[1] (the value of the fund minus the total future retirement liabilities of the fund) could be distributed to retirees by increasing annuity payments. 1953 Ariz. Sess. Laws ch. 128, § 18(c). However, that enactment also gave ASRS the power to reduce or eliminate the enhanced annuity payments if "subsequent experience determines that the fund is inadequate to maintain reserves and to pay such benefits." *Id.* In 1960, the Legislature gave ASRS the authority to distribute a prorated portion of any surplus to non-retired members by increasing their retirement accounts. 1960 Ariz. Sess. Laws ch. 90, § 1. The 1960 enactment also preserved the right to reduce or eliminate the increases to annuities and retirement accounts in the event that there were insufficient reserves to pay the benefits deriving from the surplus.

Commencing in 1970, the Legislature embarked on a series of efforts to transition public employees into the State's newly created defined benefit Plan. All State employees who were System members were allowed to elect to participate in the Plan, and all new State employees

[1] The surplus generally derives from either investment returns in excess of anticipated returns, or amounts forfeited by members who withdraw from the System prior to retirement.

were required to participate in the Plan starting July 1, 1971.[2] 1970 Ariz. Sess. Laws ch. 134. In 1975, the Legislature required that all political subdivisions participating in the System begin participating in the Plan and give their existing employees the right to elect to participate in the Plan, and that all of their new employees hired on and after July 1, 1976, be members of the Plan. 1975 Ariz. Sess. Laws ch. 44. In 1980, the Legislature directed that all non-retired members of the System and their accounts were to be transferred to the Plan effective July 1, 1981.[3] 1980 Ariz. Sess. Laws ch. 238. The 1980 enactment included the following proviso in § 1(B):

> In no event may benefits payable under the retirement plan to a non-retired member of the state retirement system who has transferred to membership in the state retirement plan under this section be less than the retirement benefits payable to the member under the retirement system had the member remained a member of the system.

Although the Arizona Legislature has made numerous amendments to the System over the more than 50 years of its existence, the Legislature never eliminated ASRS' express right to reduce members' accounts and annuity payments that were derived from surplus funds. Even in 1995, when the Legislature repealed the System statutes entirely, it preserved both System members' rights to surplus and the State's right to reduce accounts and annuity payments that were based on surplus allotments. 1995 Ariz. Sess. Laws ch. 32, § 24.

In 1998, the Legislature approved Senate Concurrent Resolution 1009, 43d Leg., 2d Reg. Sess. (Ariz. 1998), which referred a constitutional amendment on public retirement systems to

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[2] The Legislature required ASRS to provide information to members to assist them in electing between the two programs. 1970 Ariz. Sess. Laws ch 134, § 6(C). The *Prospectus* prepared by the ASRS in response to this mandate noted several times that certain benefits under the System were not guaranteed. You noted in your letter that those few who chose to stay in the System and take the risk of pension reductions have generally received higher retirement payments than those who opted out and into the Plan.

[3] All references to "System members" in this opinion include employees who retired after July 1, 1981 (whose accounts were transferred to the Plan, but who retained the right to choose a System benefit upon retirement), as well as those employees who retired before July 1, 1981.

Arizona voters as Proposition 100. At the 1998 General Election, the voters approved Proposition 100, which is now Article 29 of the Arizona Constitution. Article 29 provides the following:

> **§ 1. Public retirement systems**
>
> **A.** Public retirement systems shall be funded with contributions and investment earnings using actuarial methods and assumptions that are consistent with generally accepted actuarial standards.
>
> **B.** The assets of public retirement systems, including investment earnings and contributions, are separate and independent trust funds and shall be invested, administered and distributed as determined by law solely in the interests of the members and beneficiaries of the public retirement systems.
>
> **C.** Membership in a public retirement system is a contractual relationship that is subject to article II, § 25, and public retirement system benefits shall not be diminished or impaired.

In your letter requesting this opinion, you indicate that over the years the ASRS Board has on multiple occasions increased retirement accounts and annuity payments of those individuals eligible to receive a System benefit. You further indicate that, due to the unprecedented disruption of world markets and for the first time since the creation of the System in 1953, there is potential that the funds set aside in reserve for System benefits might be insufficient to pay future annuity payments.

Analysis

I. Article 29 Prevents ASRS from Reducing System Annuity Payments.

When the Legislature created the System in 1953, it expressly gave the ASRS Board discretion, as a fiduciary, to reduce accounts and benefits. Under the program, the Legislature authorized ASRS to increase annuity payments when there was a surplus and to decrease those payments if "subsequent experience determines the fund is inadequate to maintain reserves and to pay such benefits." 1953 Ariz. Sess. Laws ch. 128, § 18(c). As explained below, the voters

removed this authority from ASRS upon passage of Proposition 100, which became Article 29 of the Constitution, by prohibiting the "diminish[ment] or impair[ment]" of retirement benefits.

Article 29 requires that public retirement systems be "funded with contributions and investment earning using actuarial methods and assumptions that are consistent with generally accepted actuarial standards." Ariz. Const. Art. XXIX, § 1(A). It also requires that "[t]he assets of public retirement systems . . . be invested, administered and distributed as determined by law solely in the interests of the members and beneficiaries of the public retirement systems." *Id.* §1(B). Finally, it establishes that "[m]embership in a public retirement system is a contractual relationship that is subject to article II, § 25, and public retirement system benefits *shall not be diminished or impaired.*" *Id.* §1(C) (emphasis added). The question is whether the language in Paragraph C stating that benefits "shall not be diminished or impaired" precludes ASRS from reducing benefits that were provided for in the legislation governing the System.

Fundamental principles of constitutional construction guide the analysis. *Jett v. City of Tucson*, 180 Ariz. 115, 119, 882 P.2d 426, 430 (1994). The principal purpose is to effectuate the intent of the framers of the provision and, in the case of a constitutional amendment, the intent of the electorate. *Id.*; *Hernandez v. Lynch*, 216 Ariz. 469, 472, ¶8, 167 P.3d 1264, 1267 (App. 2007). Intent is first to be determined from the provision's language; if that language is plain and unambiguous leading to only one meaning, then the text of the provision is followed as written, and no extrinsic matter is considered. *Kimu P. v. Arizona Dep't of Economic Sec.*, 218 Ariz. 39, 43, ¶16, 178 P.3d 511, 515 (App. 2008); *see also Jett*, 180 Ariz. at 119, 882 P.2d at 430. However, if the language is ambiguous, other principles of construction are utilized to determine intent. *Bentley v. Building Our Future*, 217 Ariz. 265, 270, ¶13, 172 P.3d 860, 865

(App. 2007). Language is ambiguous if there is more than one rational or reasonable interpretation. *Id.*

Determining whether Article 29 prohibits the reduction of System annuity payments requires analysis of the phrase "public retirement benefits shall not be diminished or impaired." Article 29 does not define "benefit", "diminish", or "impaired". Nor are these terms defined in Article 2 of Title 38 of the Arizona Revised Statutes, the statutory section addressing the state retirement system and the operations of ASRS.

The American Heritage Dictionary defines "benefit" in one denotation as "[s]omething that promotes or enhances well-being; advantage" and in another, more specific denotation as "[p]ayments made or entitlements available in accordance with a wage agreement, insurance contract, or public assistance program." *The American Heritage Dictionary* 171 (2d Coll. ed. 1976); *Simpson v. Owens*, 207 Ariz. 261, 273, ¶35, 85 P.3d 478, 490 (App. 2004) (noting that, in construing statutes, courts may reference well-known and reputable dictionaries). Thus, "benefit" has a common meaning of "financial benefit" or a specific payment of money. *Downs v. Sulphur Springs Valley Elec. Coop.*, 80 Ariz. 286, 293, 297 P.2d 339, 343 (1956) (when construing language contained in constitutional provision adopted by a vote of the people, words "should be given the meaning most common to the ordinary individual"). Likewise, "impair" has a common meaning of "[t]o diminish in strength, value, quantity, or quality." *The American Heritage Dictionary* 644 (2d Coll. ed. 1976). And "diminish" is defined as "mak[ing] smaller or less or caus[ing] to appear smaller or less." *Id.* at 397. As a result, this constitutional language prohibits the reduction of the annuity payments to System members. But, even if the term "benefit" were ambiguous, application of other principles of construction would yield the same result.

Courts construe language in a provision as a whole, giving effect to each word and phrase, so that no part is rendered void, superfluous, contradictory or insignificant. *Pinal Vista Props., L.L.C. v. Turnbull*, 208 Ariz. 188, 190, ¶10, 91 P.3d 1031, 1033 (App. 2004); *see also Mejak v. Granville*, 212 Ariz. 555, 557, ¶9, 136 P.3d 874, 876 (2006) ("We must interpret the statute so that no provision is rendered meaningless, insignificant, or void."). As noted above, subsection C of Article 29 states that, "[m]embership in a public retirement system is a contractual relationship that is subject to Article II, § 25, and public retirement system benefits shall not be diminished or impaired." Article 2, section 25, of the Arizona Constitution states that "[n]o . . . law impairing the obligation of a contract[] shall ever be enacted." Thus, the first clause in Article 29 protects public employees' contractual rights in their public retirement plans. The rule that each phrase in a provision is to be given meaning so that it is not rendered superfluous compels the conclusion that the second clause—"public retirement system benefits shall not be diminished or impaired"—provides additional, substantive protection in the form of a prohibition against reduction of benefit payments.

The common definition of the terms discussed above and the placement of the phrase "benefits shall not be diminished or impaired" in the second clause of subsection C support the conclusion that Article 29 not only preserves the contractual rights that public employees hold in the terms of their retirement plans, but also prohibits ASRS from reducing the actual benefit payments to System members.[4]

[4] Because we answer in the negative the question of whether Article 29 of the Arizona Constitution permits the ASRS Board to reduce benefit payments to System members, we do not reach the questions in the opinion request relating to the allowable amount of reductions and the manner in which the ASRS Board would determine those reductions.

II. The Plan Trust Fund Is Liable for Shortfalls for Monthly Benefit Payments for Those Who Retired on or after July 1, 1981, and Legislative Appropriations Are Necessary for Shortfalls in Benefits for Those Who Retired Before July 1, 1981.

The 1980 legislation which transferred to the Plan all former System members who were not retired as of July 1, 1981, also directed that their accounts be transferred from the System to the Plan. 1980 Ariz. Sess. Laws ch. 238. As a result of this legislation, these individuals became Plan members and their funds were effectively comingled with the Plan trust fund. It follows that their annuities are payable from the Plan trust fund. Therefore, the Plan trust fund is responsible to make all their annuity payments, even if at retirement they elected a System benefit.

Those individuals who retired prior to July 1, 1981, remained in the System without any promise from the Legislature that they would be members of the Plan. Pursuant to Article 29 of the Constitution, the assets of public retirement systems are trust funds and can be distributed "solely in the interests of the members and beneficiaries." Ariz. Const. art. XXIX, § 1(B). Since they are not members of the Plan, the Plan trust fund cannot be used to make their annuity payments. Any shortfall in the System would be an obligation of the State and would require a legislative appropriation.

Conclusion

The plain language of Article 29 of the Arizona Constitution prohibits ASRS from reducing benefit payments to System members. As regards the lawful source or sources of funds to satisfy a shortfall in the System fund balance, the Plan trust fund would furnish the benefit payments of those individuals who retired on or after July 1, 1981, since those individuals now have benefits and accounts that are funded through the Plan. For those System members who retired before July 1, 1981, if there are insufficient monies remaining in the System trust fund to

pay all of their guaranteed benefits, those remaining benefits would require a legislative appropriation.

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