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<b>ASRS-SP010</b> Contribution Prepayment Program (CPP) Policy/Agreement	Created: 09/07/2022
	Revised: 05/03/2024

## Purpose

To establish and implement a Contribution Prepayment Program (CPP) and explain and document the purpose, approach, methods, elections, and governance related to the CPP. The CPP is a program that enables Arizona State Retirement System (ASRS) participating employers (Employers) to prepay their ASRS pension contributions. The CPP covers only Employer ASRS pension obligations. The CPP does not cover obligations accruing under the health insurance premium benefit program, the long-term disability program, any other ASRS program, or employee pension obligations.

The CPP was developed in order to facilitate the prepayment of pension contributions for Employers who determine that it is in their best interest to prepay their future pension contributions.

The CPP was designed to allow Employers to have significant flexibility with respect to the deposit of any current or future cash with the ASRS for the purpose of prepaying Employer contributions. This CPP was also developed to provide Employers with flexibility with respect to when they may deposit the contribution prepayment funds to the ASRS, when to utilize the prepaid balances, and the length of time to apply an Employer's prepaid balance.

## Authority

A.R.S. § 38-737(D)

## Policy

### 1. Goal and Objectives

The goal of the CPP is to enable Employers to voluntarily deposit payments to the ASRS in excess of their current actuarially determined and legally required contributions and to accrue an earnings rate to these balances. "Employer Contributions" refers to both legally required contributions as well as any additional contributions by the Employer under this policy.

Prepaid contributions from Employers will be utilized to offset future Employer contributions. *Example: An Employer has an additional cash balance of \$1 million and determines that it is in its best interest to transfer that money to the ASRS via the CPP. The Employer makes the \$1 million contribution on June 30, 2023. Later, the Employer decides to use those funds to offset future contributions over a 10-year period, beginning July 1, 2025. As a result, the Employer's future contributions to the ASRS from July 1, 2025, to June 30, 2035, would be decreased by a pro-rated prepaid amount referred to as the "Offset Amount." Annually, the Employer's unused prepaid balances would increase or decrease by the actual rate of return of the ASRS' pension fund investment portfolio (see Section 3 below for more information on earnings accrual rates).*

## **2. Cash Transfer Process**

For a prepaid contribution to be amortized by an Employer, it must be received by the ASRS sixty days prior to applying any offset (or initiating the amortization) unless otherwise agreed to by the ASRS.

*Example: If an Employer wants to have Offset Amounts from prepaid balances starting July 1, the Employer would need to notify the ASRS on or before May 2 of the same year.*

## **3. Section 115 Trust**

If an Employer chooses to have the CPP contributions placed into an Internal Revenue Code Section 115 Trust, the Employer must provide the ASRS with written direction to the effect.

## **4. Earnings Accrual Rate**

The Employer will make an earnings accrual rate election (1) at the initial time of contribution and (2) at the time amortization of funds is elected. The Employer will elect to earn either the earnings accrual rate equal to the actual, compound, time-weighted, net of investment expenses, rate of return on the ASRS pension investment portfolio, or the actual rate of return of a short-term investment through the ASRS, as requested by the Employer and agreed to by the ASRS. When a deposit is made, the earnings accrual rate will be calculated starting the first business day after the date of deposit.

## **5. Amortization Inception Dates**

Amortization inception dates may begin at any time the employer and ASRS mutually agree, in writing, subject to the ASRS receiving a sixty-day notice unless otherwise agreed to by the ASRS.

## **6. Elections for Employers**

Once an election is made by the Employer, it can be changed by a mutually agreed upon written amendment between the Employer and the ASRS.

The Employer will have the following elections:

### **A. Amortization Initiation Date**

The Employer will determine when to initiate the amortization period. The Employer may elect to defer determination of the amortization period. The initiation period may begin sixty days following the deposit or may be postponed multiple years until such time as determined by the Employer.

A deferred amortization period could result in a larger or smaller CPP balance due to accrued earnings and therefore result in larger or smaller future annual amortization amounts to be offset against the otherwise required contribution amounts.

### **B. Amortization Period Length**

Once the Employer has chosen to initiate the amortization period, the Employer will determine the length of time over which the CPP balance will be amortized. The periods over which the CPP balance may be amortized may be determined by the Employer, however:

- The period may not be greater than thirty years;
- The amortization period and other details must be acceptable to the ASRS when considering systems, administrative, and financial implications.

Note that the amounts amortized need not be the same dollar amount each year or period if agreed to by the ASRS.

In general, longer amortization periods would be expected to result in smaller annual Offset Amounts that last for a longer period of time.

Extensions to the amortization period would automatically result if the amortization of an Employer's prepaid contributions plus accrued earnings exceeded an Employer's actuarially determined and legally required contributions for a particular year.

If it is determined that the prepaid contributions plus accrued earnings do not cover a full year extension, the ASRS will extend the period to such time as the Employer's prepaid balance becomes zero, should the Employer wish to utilize the full prepayment amount.

## **7. Aggregation and Disaggregation of Prepaid Contributions**

**Aggregation Not Required:** An Employer will retain the same election options with respect to amortization inception dates and amortization periods for CPP amounts contributed to the ASRS on different dates.

**Disaggregation:** An Employer may disaggregate a CPP contribution into different amounts and retain the same election options with respect to amortization inception dates and amortization periods for each amount.

**Limitation:** No CPP contribution may be disaggregated into amounts less than \$100,000.

## **8. Offset Process**

CPP contributions and earnings will be utilized to offset future Employer contributions required by the ASRS.

Once an amortization election has been made by an Employer, the Employer will determine the dollar amount to be utilized by the Employer during the fiscal year to offset Employer contributions due throughout the year.

The contribution file sent by the Employer to the ASRS, which details the member and employer contributions, shall reflect the full employee and employer contribution amount due and not adjusted for prepaid contributions to be applied.

An Employer will reduce the dollar amount of each payroll deposit to the ASRS for Employer by the dollar amount to be utilized based on the amortization schedule.

*Example: If the amortization schedule for the Employer resulted in an offset of \$2.6 million during the upcoming fiscal year, then \$100,000 (\$2.6 million divided by 26 payroll cycles) would be applied to each of the Employer's 26 pay periods, therefore resulting in an actual payroll cash transfer amount of the actual amount due, less \$100,000.*

If an Employer has multiple reporting Employers listed in the ASRS' most recent applicable governmental accounting standards report but wants to be considered as one reporting unit, then the ASRS will allocate prepayments between Employers based on the written preferences stated by the reporting unit and follow any applicable statute, legal agreement, or ordinance enacted for such a purpose. Any discrepancy between what the Employer reports and what the reporting unit receives is not an issue to be resolved by the ASRS, and the ASRS will not determine the accuracy for either party.

Note: For Employers who engage in an annual 26-pay period cycle, in years where a 27<sup>th</sup> payroll occurs, the Employer must make an affirmative declaration that an offset shall be used for the 27<sup>th</sup> payroll. If the declaration is not made, the ASRS will not include a 27<sup>th</sup> offset.

### **9. Employer Payroll Process**

An Employer participating in the CPP shall submit payroll contribution files reflecting the full employee and Employer contribution rate in effect for the fiscal year. It will be the sole responsibility of the Employer participating in the CPP, and not the ASRS, to ensure the Employer's payroll/contribution reporting system is able to accommodate this requirement.

Contribution files reflecting the full retirement contribution rates for employees and Employers are required because the files will ensure member accounts accurately reflect the appropriate contribution amounts for the period.

### **10. Limit on CPP Contributions: Magnitude**

The minimum CPP prepayment contribution amount the ASRS will accept is \$100,000 per Employer.

For investment management portfolio construction and risk management reasons, the ASRS may limit the CPP prepayment contribution amount per year per Employer.

### **11. Limit on CCP Contributions: NPL**

The ASRS will not accept additional CPP prepayment contributions from an Employer once the Employer's NPL is zero or less, as reported in the ASRS' most recent governmental accounting standards report, or once the sum of the NPL plus any unamortized pre-payment balance is zero or less.

### **12. Required Employer CPP Balance Utilization**

There is no requirement as to when the CPP balance must be utilized, unless either Federal or State laws require utilization.

### **13. Employer Responsibilities**

An Employer must have the ability to maintain and transmit to the ASRS its contributions file representing the total actual contributions due to the ASRS, which includes both the actual contributions paid during each payroll cycle and any offset amounts made according to the amortization schedule.

The Employer will be responsible for determining the actual cash amount due to the ASRS each payroll cycle. This cash amount will be equal to the actuarially determined contribution rate less any offsets determined by the amortization schedule.

Intra-Year Adjustments: Each year, any differences between the sum of the Employer's offset amount as determined by an amortization schedule and the actual cash payments made by the Employer, and the amount actually due by the Employer, will be calculated by the Employer by May 1 of each year and added or subtracted as appropriate from the remaining CPP balance. In the case where the CPP balance is insufficient, an additional amount will be required from the Employer by May 31 of the current year. It is expected that such annual differences will be minimal.

#### **14. Actuarial Processes**

The ASRS will continue to retain an external actuary to conduct annual valuations of the ASRS plans, including the specific total retirement fund funded status and contribution rate.

The contribution rates determined by the ASRS' external actuary will apply to all ASRS Employers, whether or not individual Employers participate in the CPP. The contribution rate will be determined such that non-participating Employers and employees will not be impacted as a result of CPP contributions for participating Employers. Each Employer will determine how the CPP prepayments will be utilized to offset the actuarially determined contribution rate. As a result, all Employers will have the same contribution rate – paid either with new contributions or a combination of new contributions and amortization offset payments.

The aggregate funded status of the ASRS will account for CPP contributions according to current Actuarial Standard of Practice (ASOP).

The ASRS will continue to retain an external actuary to conduct an experience study of the ASRS plans every four years or less. This actuary may be the same actuary that conducts the annual valuations.

The ASRS will continue to retain an external actuary to conduct an actuarial audit of the ASRS Plans every five years or less. The actuarial firm that performs the actuarial audit shall not be the same firm that performs the actuarial valuation or the actuarial experience study.

#### **15. Final Year Utilization**

General Accounting, after consultation with the ASRS actuarial service firm, will notify an Employer when their final year of utilization has commenced based on the information stated in the contract or agreement.

#### **16. Transparency and Mutual Understanding**

This policy is intended to enable a uniform understanding of how the CPP will be implemented.

This Policy is also intended as a guide for internal decision-makers to share principal points of the program with potential participants (Employers) and external policymakers (e.g., Legislature and Executive Office).

The ASRS Director is solely responsible for the interpretation of this Policy.

#### **17. Documentation**

The ASRS will provide the following to Employers who contemplate or participate in the CPP:

- I. A copy of this Policy.

- II. A contract or agreement between ASRS and the Employer to be executed prior to participation in the CPP.
- III. An annual statement of the Employer's CPP balance.

Should the Employer want a standard amortization schedule, then the ASRS may also provide the following to participating Employers:

- IV. An amortization schedule of offsetting Employer contributions once the Employer has determined to initiate the CPP offset. The amortization schedule may utilize the ASRS assumed rate of return and may be adjusted every year to reflect the actual, compound, time-weighted, net of investment expenses, rate of return on the ASRS pension investment portfolio.

## **18. Governance**

This Policy will be referenced in the ASRS [Board Governance Policy Handbook](#) as a responsibility of the Board to approve in original form and in any future revised forms. This Policy will be referenced in the ASRS Board Governance Policy Handbook as a responsibility of the ASRS Director to implement, manage, and interpret.

This Policy will be referenced in the ASRS Board Governance Policy Handbook for the ASRS Director to review and present to the ASRS Board at the following times:

- Whenever a significant event impacts the CPP, or
- Whenever an ASRS Board member recommends a discussion or revision, or
- Whenever the ASRS Director recommends a discussion or revision.

### **Definitions**

Aggregation: Aggregation refers to an Employer combining their pre-paid contributions made at different points in time into one or more larger amounts.

Disaggregation: Disaggregation refers to the ability of an Employer to separate a pre-paid contribution into two or more smaller amounts.

Amortization Period: The duration for which an Employer will utilize pre-paid deposits as an offset to their mandated contributions.

Governmental Accounting Standards Report: The annual ASRS Schedule of Employer Allocations, and Pensions and OPEB amounts by Employer report.

Net Pension Liability: The unfunded benefit obligation based on the market value of the assets and projected benefit obligation of the Defined Benefit Pension Plan of the ASRS as of the date of calculation.

Initiation Period: The initial date requested for an offset to begin.