



# ARIZONA STATE RETIREMENT SYSTEM

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*Paul Matson  
Director*

## MINUTES OF A PUBLIC MEETING OF THE ARIZONA STATE RETIREMENT SYSTEM OPERATIONS, AUDIT & LEGISLATIVE COMMITTEE

**Wednesday, October 3, 2018  
2:30 p.m., Arizona Time**

A quorum of the Operations, Audit & Legislative Committee (OALC) of the Arizona State Retirement System (ASRS) met in public session in the 14th Floor Conference Room of the ASRS Office, 3300 N. Central Avenue, Phoenix, Arizona 85012.

Mr. Jim Hillyard, Chair of the OALC, called the meeting to order at 2:31 p.m.

The meeting was teleconferenced to the ASRS office at 4400 E. Broadway, Tucson, Arizona 85711.

### **1. Call to Order; Roll Call; Opening Remarks**

Mr. Jim Hillyard, Chair, welcomed the attendees and expressed appreciation for those in attendance.

Present: Mr. Jim Hillyard, Chair  
Mr. Clark Partridge, Vice-chair

Excused: Mr. Michael Miller

A quorum of the Committee was present for the purpose of conducting business.

### **2. Approval of the Minutes of the August 6, 2018 Public Meeting and Executive Session of the OALC**

**Motion:** Mr. Clark Partridge moved to approve the Minutes of the August 6, 2018, Public Meeting and Executive Session of the OALC. Mr. Jim Hillyard seconded the motion.

By a vote of 2 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved. The Trustee votes were as follows:

Mr. Jim Hillyard – approved  
Mr. Clark Partridge – approved  
Mr. Michael Miller – excused

### 3. Presentation, Discussion, and Appropriate Action Regarding the 2019 ASRS Legislative Initiatives

Mr. Anthony Guarino, Deputy Director and Chief Operations Officer, introduced Ms. Jessica Thomas, Government Relations Officer and Rules Writer and turned the presentation over to her. Ms. Thomas reviewed the seven proposed legislative initiatives with the Committee, along with two additional items for further discussion and consideration as follows:

1. **A.R.S. § 38-711:** Amend to indicate what is “compensation” for ASRS purposes for future members. This will:
  - a. Identify what types of payments are considered compensation for ASRS purposes for future members
  - b. Exclude employment benefits from being reported to the ASRS as compensation
  - c. Protect current members by maintaining the current definition and interpretation of “compensation”
2. **A.R.S. §§ 38-719 and 38-797.15:** Add to indicate the ASRS shall not pay interest unless specifically authorized by statute. This will:
  - a. Indicate that the ASRS will only pay interest on monies owed pursuant to the plan and the Long Term Disability (LTD) program if governing statute specifically provides for the ASRS paying interest
  - b. Ensure that the ASRS only pays interest as the legislature intended
  - c. Limit the risk of ASRS paying interest on monies owed for which the ASRS has not accounted actuarially
3. **A.R.S. § 38-726:** Add to indicate that the ASRS does not pay attorney fees unless the opposing party is successful on adjudication of the merits of a contractual argument. This will:
  - a. Indicate that attorney fees can only be awarded based on successful adjudication of the merits
  - b. Limit the risk of the ASRS paying attorney fees on successful cases based on contracts when contractual actions are not at issue
  - c. Protect the fund from paying out additional expenses related to appeals
4. **A.R.S. § 38-738:** Amend to indicate that Employers can pay for a Contributions Not Withheld via a current year adjustment. This will:
  - a. Allow the ASRS to continue accepting current year adjustments without any staffing or programing changes
  - b. Require the employer to obtain written consent from the employee to make a payroll adjustment
5. **A.R.S. § 38-748:** Amend to indicate that the ASRS shall charge the Employer an unfunded liability amount resulting from ineligible contributions. This will:
  - a. Indicate that the ASRS shall charge an unfunded liability amount for benefits paid to a member based on ineligible contributions reported to the ASRS
  - b. Protect the fund from unintended expense of additional benefits paid that should not have been reported to the ASRS

6. **A.R.S. § 38-729:** Amend to indicate that an Employer cannot purchase overlapping prior service credit for a member upon joining the ASRS. This will:
  - a. Ensure that a member cannot obtain overlapping service credit in a fiscal year when the Employer joins the ASRS
  - b. Make prior service purchase consistent with other types of service purchase and earned service
7. **A.R.S. § 38-797.07(11)(a):** Amend to change “position” to “occupation.” This will:
  - a. Indicate that the member cannot perform the duties associated with the member’s occupation vs. the member’s specific position which may include additional duties above and beyond those required for a specific occupation
  - b. Make ASRS LTD program standards more consistent with industry standards
8. **A.R.S. § 38-797.07:** Amend to indicate that the ASRS or the LTD Administrator may conduct active surveillance during an LTD investigation. This will:
  - a. Allow active surveillance of LTD member in order to resolve an LTD claim in dispute
  - b. Make ASRS LTD program more efficient by reducing possibility of LTD fraud
9. **A.R.S. § 38-766.02:** Amend to indicate that an Employer is not required to pay an Alternate Contribution Rate (ACR) if the employer is already paying contributions or an ACR for a member serving in that same position. This will:
  - a. Indicate that an employer does not owe an ACR for a retired member if the retired member is filling in for another employee for which the Employer is currently paying contributions or an ACR
  - b. Require employer to track who is filling-in for someone on a paid leave status for whom the employer is already making contributions

Ms. Thomas responded to questions from the Committee.

The Committee agreed item #8 is justified and worth pursuing; however, requested that Ms. Thomas perform some research to determine which is the best approach; submit as a standalone bill or incorporate it into the amendments for item #7.

With regard to item #9, the Committee recommends the ASRS remain neutral and work with the proposing entity on the bill language to be submitted.

**Motion:** Mr. Clark Partridge moved to approve the proposed 2019 legislative initiatives as discussed, and forward to the ASRS Board for approval. Mr. Jim Hillyard seconded the motion.

By a vote of 2 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved. The Trustee votes were as follows:

Mr. Jim Hillyard – approved  
Mr. Clark Partridge – approved  
Mr. Michael Miller – excused

#### **4. Presentation, Discussion, and Appropriate Action Regarding the 2019 ASRS Regulatory Agenda and Update on ASRS Rulemaking Initiatives**

Ms. Thomas provided the Committee with an update on the outstanding rulemaking activities on the 2017 and 2018 Regulatory Agendas as follows:

- 2017 – Two rulemakings have been completed and two have been postponed and placed on the 2018 Regulatory Agenda. One is still in progress – 2 A.A.C. 8, Article 10, Membership Eligibility. The Oral Proceeding was held yesterday, October 2, for public comment. The next step will be to work with staff to submit the Notice of Final Rulemaking with an anticipated submission to the Governor’s Regulatory Review Council next week.
- 2018 – The 2 A.A.C. 8, Article 5, Service Purchase and 2 A.A.C. 8, Article 7, Contributions Not Withheld have been completed with Oral Proceedings for public input scheduled for October 23. The remaining item, 2 A.A.C. 8, Article 1, R2-8-126, is currently being coordinated with staff to develop the rulemaking. Two additional rulemakings that were not on the agenda were worked on this year as well; the interest rate based on Board action, in addition to an LTD rulemaking to clarify what it means to be under the direct care of a doctor specific to the ailment.

Ms. Thomas presented the 2019 Regulatory Agenda containing three proposed rulemakings to the Committee as follows:

- 2 A.A.C. 8, Article 1, R2-8-122: Remittance of Contributions
- 2 A.A.C. 8, Article 1, R2-8-115: Return of Contributions Upon Termination of Membership by Separation from All ASRS Employment by Other Than Retirement or Death; Payment of Survivor Benefits Upon the Death of a Member
- 2 A.A.C. 8, Article 1, R2-8-120: Designating a Beneficiary; Spousal Consent to Designation

**Motion:** Mr. Clark Partridge moved to approve the proposed 2019 Regulatory Agenda as discussed, and forward to the ASRS Board for approval. Mr. Jim Hillyard seconded the motion.

By a vote of 2 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved. The Trustee votes were as follows:

Mr. Jim Hillyard – approved  
Mr. Clark Partridge – approved  
Mr. Micheal Miller – excused

#### **5. Presentation, Discussion, and Appropriate Action Regarding the ASRS’ Performance in the CEM Pension Administration Benchmarking Survey for the Period Ending June 30, 2017**

Mr. Guarino introduced the topic as it pertains to operational effectiveness which is one of the six strategic priorities and turned the presentation over to Ms. Jody MacIntosh, Vice-President, CEM Benchmarking Inc.

Ms. MacIntosh provided the FY 2017 results for the ASRS and explained how the peer comparisons are done. She also discussed how the ASRS ranks among its peers. CEM's analysis also explains how the ASRS can make improvements to its score.

The ASRS has participated in the CEM pension benefit administration benchmarking study since 2001. Each year, the ASRS submits data regarding service features, transaction volume, and costs and staffing, broken down by activity, membership, and plan design. CEM compiles the results and provides a report detailing the cost effectiveness of the ASRS. Specifically, the report compares and contrasts:

- Peer Characteristics
- Service Levels
- Total Costs
- Cost by Activity
- Staff Costs and Productivity
- Transaction Volumes
- Complexity
- IT and Major Projects

Currently, the ASRS spends \$78 per active member and annuitant which is below the peer average of \$102. Additionally, the ASRS' service score was 89 which is above the peer median of 83 and in the top quartile of CEM's global universe. The service score increase over the last four years is largely due to improvements to the ASRS website, survivor pensions and newsletter.

## **6. Presentation, Discussion, and Appropriate Action Regarding the ASRS Benefits Disbursement Project Update**

Mr. Guarino introduced the topic as the ASRS will be changing the way it disburses benefit payments in a few months and stated this will be the most important project being worked on during this time. Mr. Guarino introduced Ms. Erin Higbee, Assistant Director and CFO, Financial Services Division (FSD); Ms. Sarah Korish, Program Manager, FSD, Ms. Valerie Burkett, Program Manager, Technology Services Division (TSD), and Meskel Assefa, Project Manager/Business Analyst, TSD, and turned the presentation over to them.

Ms. Higbee provided a summary of the problem that initiated this project and noted although the ASRS' total administrative costs were lower than both our peers and the universe; pension payment costs were higher than peer retirement systems. The primary reason for this is the reliance on a third party custodial bank to disburse benefits.

Ms. Higbee reviewed the solutions developed to address the problem: disbursement will move in-house; the ASRS will utilize the State's depository bank to issue Electronic Funds Transfer benefit disbursements; and the ASRS will take on other responsibilities formerly handled by State Street, e.g. tax payments, dues and levies to third parties payments, to name a few. Additionally, Ms. Higbee summarized the project benefits: administrative cost savings; reduced exposure of PII outside of the agency; increased available processing time, to name a few.

Ms. Assefa reviewed the implementation plan with the Committee, along with accomplishments to date and the remaining work to be done. The project was split into four phases prior to

implementation with a fifth phase to occur once the in-house disbursements begin. Additionally, Ms. Assefa reviewed the budget and introduced the core team members to the Committee.

Ms. Burkett reviewed the risk items and risk mitigation strategies, indicating this is not a complete list of the risks the project has faced as this project has spanned five years. The project team has remained consistent with only one team member transition during its course. Ms. Burkett added that even with some scope expansion, the project has remained within budget and on schedule.

In response to Trustee questions, Ms. Korish provided a brief summary of the debit card program which has been in place at the ASRS since 2011. Since inception, the ASRS has issued 6,100 debit cards with approximately 2,200 still active. Ms. Korish moved on to the review of the communication plan for in-house disbursements which will begin with members in October and then to employers in November. Communication will introduce enhanced flexibility and features for both our members and employers.

Ms. Higbee concluded by recognizing all the contributors of this project which spanned multiple divisions. She commended the core team members stating the continuity has been extremely valuable and instrumental. Ms. Higbee opened it up to additional questions; there were none.

## **7. Review of Recently Conducted Audits**

Mr. Adel Korish, ASRS Audit Officer, reviewed the following audit conducted by the Internal Audit Division (IAD), indicating this was an ad hoc audit assigned by Director Matson.

- **Military Call-up – Internal Process**

The IAD provided two reports for this audit. One that identified the service credit gaps found during the review which was the primary purpose of the audit. The second report identifies pertinent observations made during the audit that were deemed outside the scope and objective of the audit.

The IAD found four instances where service credit was found to be in error. Each of these instances happened to have a retirement service credit gap of only 0.08 years of service. Management agreed with the findings and is in the processing of correcting the errors.

Noted in the pertinent observations report were four issues concerning internal controls. Three of the issues have been addressed and corrected with the fourth in the process of being addressed.

## **8. Presentation, Discussion, and Appropriate Action Regarding the Internal Audit Quarterly Update**

Mr. Harold Mackey, Chief Internal Auditor, reviewed the proposed changes to the Audit Plan for Fiscal Year (FY) 2019 with the Committee and responded to questions. The Committee indicated that since the Committee only meets quarterly management should be given discretion to address issues and/or redirect hours in the interim to mitigate risk. Mr. Paul Matson, Director, confirmed there is an allocation in the IAD annual budget for the Director or

OALC Chair to request ad hoc audits. Mr. Hillyard stated if additional hours were required, he is comfortable allowing Mr. Matson to make the decision with a follow-up discussion to occur at the next regularly scheduled OALC meeting.

**Motion:** Mr. Clark Partridge moved to approve the Internal Audit Plan as updated, specifically:

1. Suspending quality reviews for Service Purchase while the newly implemented system is maintained by the TSD Scrum development team until November 2018. Once the system is turned over to the TSD production support team after the warranty period, IA will resume quality reviews.
2. Discontinuing quality reviews for Refund Processing. If a significant change is scheduled for Refund Processing, IA will reassess the need to re-engage in performing Refund Processing quality reviews.
3. Developing a quality review process for the soon-to-be released In-house Disbursement system.

Mr. Jim Hillyard seconded the motion.

By a vote of 2 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved. The Trustee votes were as follows:

Mr. Jim Hillyard – approved  
Mr. Clark Partridge – approved  
Mr. Michael Miller – excused

Mr. Mackey concluded with a review of the quarterly audit report and provided the status of projects IAD is currently working on.

## **9. Presentation, Discussion, and Appropriate Action Regarding the 2019 OALC Meeting Schedule**

**Motion:** Mr. Clark Partridge moved to approve the proposed 2019 OALC meeting schedule as presented with meetings beginning at 2:30 p.m. for a duration of approximately 3 hours. Mr. Jim Hillyard seconded the motion.

By a vote of 2 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved. The Trustee votes were as follows:

Mr. Jim Hillyard – approved  
Mr. Clark Partridge – approved  
Mr. Michael Miller - excused

## **10. Requests for Future Agenda Items**

None were requested.

## **11. Call to the Public**

Mr. Steve Ramos representing Arizona Education Association Retired members, requested to speak regarding the legislative agenda item for discussion #9, A.R.S. § 38-766.02, pertaining to ACR to express concern. Mr. Ramos expressed retirees were in favor of employers being exempted from paying ACR if the retiree were filling in for a member who was making contributions and were surprised when the legislation did not pass in this manner in previous years. Mr. Ramos indicates the statute is not clear as to whether the ACR can be passed on to the retirees.

## **12. The next regular public OALC meeting is tentatively scheduled for Wednesday, January 9, 2019, at 2:30 p.m., at 3300 N. Central Avenue, in the 14<sup>th</sup> Floor Conference room, Phoenix, Arizona.**

Mr. Hillyard noted the next OALC meeting is scheduled for Wednesday, January 9, 2019 at 2:30 p.m.

## **13. Adjournment of the OALC**

**Motion:** Mr. Clark Partridge moved to adjourn the meeting at 4:45 p.m. Mr. Jim Hillyard seconded the motion.

By a vote of 2 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved. The Trustee votes were as follows:

Mr. Jim Hillyard – approved  
Mr. Clark Partridge – approved  
Mr. Michael Miller – excused

Respectfully Submitted,

Melanie A. Alexander  
Committee Administrator  
ARIZONA STATE RETIREMENT SYSTEM