



ARIZONA STATE RETIREMENT SYSTEM

A Component Unit of the State of Arizona

2015 POPULAR ANNUAL FINANCIAL REPORT

FOR FISCAL YEAR ENDED JUNE 30, 2015



Copper



Cattle



Cotton



Citrus



Climate

2016 Board Meetings

January	29
February	26
March	25
April	29
May	27
June	24
August	26
September	30
October	28
December	2

Meetings begin at 8:30 a.m. in the ASRS Phoenix Board Room at 3300 N. Central Avenue, 10th Floor, unless otherwise posted. Schedule is subject to change. For information please visit us at www.azasrs.gov.

Did You Know...

- Copper, Cattle, Cotton, Citrus and Climate: The Arizona Five C's have been the driving forces behind Arizona's economy and have traditionally been what made our towns and communities grow.
- All of the 5 C's are represented on the state seal.
- The average American home has 400 pounds of copper.
- 144 baseballs, 20 footballs, 18 volleyballs, 18 soccer balls or 12 basketballs can be made from one cow hide.
- Today's cotton gin can clean 190,000 pounds of cotton a day.
- Lemons were once so rare that kings presented them as gifts to one another.
- Climate makes all of the 5 C's possible.

ASRS Board of Trustees

As of June 30, 2015



Kevin McCarthy
Chair
Public



Thomas Connelly
Public



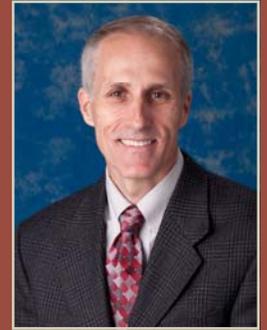
Professor Dennis Hoffman
Public



Dr. Richard Jacob
Educators



Thomas Manos
Retirees



Jeff Tyne
Public Subdivisions

ASRS Board Trustees are appointed to three-year terms by the governor and are confirmed by the Arizona State Senate. Four trustees of the Board must have a minimum of 10 years investment experience and each trustee who represents an ASRS member group shall have no less than five years of administrative management experience. There is no limit to the number of terms a Trustee may serve.

Message from the Director

To Our Members:

I am pleased to present the 2015 Popular Annual Financial Report (PAFR) for the Arizona State Retirement System (ASRS) for the fiscal year ended June 30, 2015.

The information presented here is a reader-friendly summary of the more detailed 2015 Comprehensive Annual Financial Report (CAFR), which is prepared on the accrual basis of accounting and presented in conformity with Generally Accepted Accounting Principles. The PAFR is not intended to supplement the CAFR; rather, it is a concise summary of the financial health, investment performance and key accomplishments of the ASRS throughout fiscal year 2015. I encourage you to visit our website at <https://www.azasrs.gov/content/annual-reports>, where you can find the CAFR.

The ASRS is a cost-sharing, multiple-employer, defined benefit pension system that provides benefits to approximately 579,000 public employees in the state. ASRS Executive Management continues to closely monitor the health and stability of the funds that support retirement benefits, long-term disability coverage and health insurance programs for our members. I am pleased to report that each of the programs remain sustainable.

In fiscal year 2015, the ASRS paid in excess of \$2.80 billion in benefits to approximately 138,000 retired annuitants, their survivors and approximately 4,000 disabled members.

Among our major initiatives over the past year was a continued review of our Strategic Asset Allocation Policy. This critical document sets the foundation for management of our total investment portfolio, which was \$35.2 billion at fiscal year-end. Net investment returns for fiscal year 2015 were 3.2% compared to 18.6% in fiscal year 2014, which reflects the impact of a slower global economy for much of the fiscal year.

The ASRS continues to be engaged in program and policy review and, when appropriate, will continue to seek legislative or other changes to ensure the retirement system operates efficiently and effectively. The ASRS has invested in technology and online solutions to achieve the highest level of service in a cost-efficient environment. We have improved work flows, focused on risk management and collaborated with our employees to nurture staff morale and sustain high levels of member satisfaction.

The ASRS is committed to prudent management of the overall operations and assets of the retirement system for the benefit of our members. At the same time, we are keenly aware of our responsibilities to the State of Arizona, its taxpayers, our members and employer partners.

We appreciate the cooperation extended by the Governor's Office and the State Legislature, which enables and empowers us to meet the challenges we face in today's economic climate. We would also like to express our gratitude to the ASRS Board for its support for and leadership in planning and conducting the financial affairs of the ASRS in a responsible and progressive manner.

On behalf of the ASRS staff, we look forward to serving you in the coming years.

Kind regards,

Paul Matson, Executive Director

Executive Staff



Paul Matson
Executive Director



Anthony Guarino
Deputy Director,
Chief Operations Officer



Gary R. Dokes
Chief Investment Officer

Delivering service with...

PRIDE

OUR VISION

For the benefit of our members... the Arizona State Retirement System will be a leading state benefit plan administrator in the areas of:

- Core Member Services
- Investment Performance
- Funded Status
- Operational Effectiveness

This will be accomplished while keeping program benefits and associated costs relatively aligned and maintaining actuarial and fiscal integrity.

OUR VALUES

Professionalism.

A highly capable workforce will promote a professional and respectful environment and *lead* the organization.

Results.

A results-oriented approach to operations will *energize* the organization.

Improvement.

A climate of continuous quality improvement and enhanced efficiencies will *drive* the organization.

Diversity.

Engagement of diversity by the appreciation, recognition and support for all people will *propel* the organization to ever greater achievement.

Excellence.

A commitment to service excellence will *permeate* the organization.

Significant New Legislation

Legislated Plan Changes Enacted by the 2014 Legislature of the State of Arizona:

- Charter Schools—The legislation allows charter schools that obtain their charters through a university to become members of the ASRS retroactive to July 1, 2011.
- Section 218 Agreements—The legislation eliminates the requirement that employees of ASRS employers must be covered by the state’s Section 218 agreement with the Social Security Administration. It also repeals the ASRS defined contribution plan established by Laws 2013, Chapter 216.
- Elected Officials—Retroactive to January 1, 2014, a state elected official who was elected or appointed before December 31, 2013, and who is a member of ASRS because they previously elected not to participate in the Elected Officials’ Retirement Plan (EORP) is no longer required to elect to continue or resume participation in ASRS in writing and is a member of ASRS without election.
- Applicable Interest Rate—The legislation confirms the ASRS practice of using a “stability period” to set and maintain the “applicable interest rate” for a year. The look-back month that is used to determine the applicable interest rate is the third full calendar month preceding the first day of the stability period.
- Compensation for LTD Benefit Determinations—The legislation changes the definition of “monthly compensation” to be the median of the last six pay periods of compensation, excluding the highest two and the lowest two such pay periods. If the member was employed for fewer than six pay periods, “monthly compensation” is the median monthly compensation based on the pay periods that the member worked.
- Background Checks—The legislation allows ASRS to perform background and credit checks on current and prospective employees.

These changes were taken into account in the most recent actuarial valuation.

Our History

In 1912, Arizona's first year of statehood, the first teacher retired with an Arizona State teacher's pension. From 1912 until 1943, Arizona teachers were granted pensions by the State Legislature if they had at least 30 years of service in Arizona schools and were 65 years of age or older. All teachers' pensions were \$50 per month; there were no member deposits or survivor benefits.

During the late 1930s and early 1940s, there was intense activity to create a formal retirement plan for Arizona teachers. The Legislature created the Teachers' Retirement System, effective July 1, 1943. All certified, full-time teachers were members, contributing to a retirement plan with a fixed benefit formula. The employer contribution rate varied, but could not exceed 5.03% of the first \$3,600 of teachers' salaries.

In 1953, the Arizona State Retirement System was created to provide retirement and other benefits for state employees, including university faculty and employees of the State's political subdivisions who signed a membership contract. Active teachers voted to join the ASRS in 1954, and transferred to the ASRS on January 1, 1955. The Teachers' Retirement System continued to pay retirement benefits to retired teacher members who were ineligible to join the ASRS.

In 1970, the Legislature agreed to enact the current Arizona State Retirement System Defined Benefit Plan if 70% or more of State employees and teachers voted to transfer to the new plan. More than 80% of eligible members voted for the new plan, which became effective July 1, 1971. Most political subdivisions have subsequently voted to join.

Today, more than a half-million of Arizona's public servants belong to the ASRS. Membership is comprised of state employees, the three state universities, community college districts, all 15 counties, most cities and towns, school districts, charter schools and other political subdivisions, such as fire and water districts.

Commitment to Service Excellence

The ASRS continually strives for excellence by participating in Pension Administration Benchmarking. The key advantages of benchmarking are:

- Creates a greater openness about strengths and weaknesses
- Engages and motivates staff as they experience change
- Facilitates teamwork and the willingness to adapt to change
- Opens organizations to new methods, ideas and tools to improve both service and cost effectiveness
- Facilitates learning from others and developing and applying new methods and best practices

2015 Member Statistics

Employee Members

Current Employees—Active	211,300
Retirees (including Beneficiaries)	137,942
Non Active	225,328
Long Term Disability Recipients	4,107
Total	578,677

Did You Know...

Average age of active members:	45.7
Average Annual Salary:	\$43,841
Average age of retired members:	70.1
Average Monthly Retirement Benefit:	\$1,639

Employer Participants (including state agencies):	683
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Total Fund (market value):	\$35.5 Billion
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Total Fund Rate of Return (Fiscal year end June 30, 2015):	3.2%
10-Year Rate of Return:	6.9%
Rate of Return Since Inception:	9.9%



Copper—Arizona has led copper production in the U.S. since 1910 and has produced more copper than the other 49 states combined.

The first of Arizona's "Five Cs," copper is the state's most valuable mineral commodity, comprising 75% of the value of Arizona's total non-fuel mineral production. Due to this great resource, Arizona is also known as the Copper State and the Arizona Flag has a copper star to represent this.

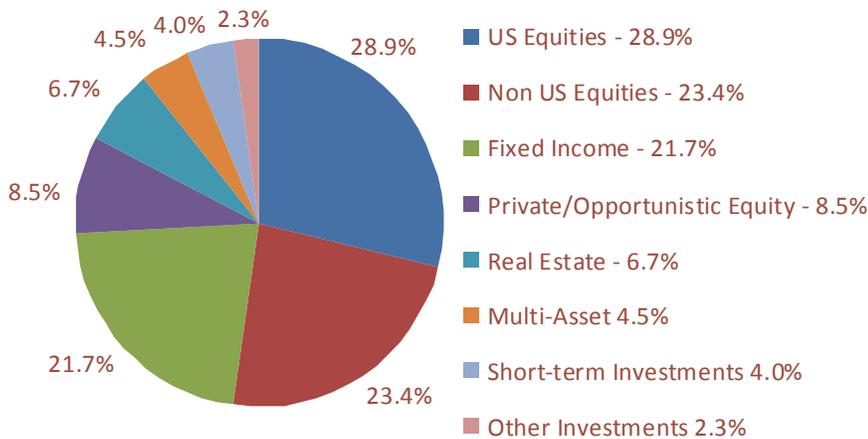
Investments

Results Summary

During fiscal year 2015, the ASRS investments were broadly diversified in domestic and international equities, domestic fixed income, real estate, private and opportunistic equity, multi-asset, and cash equivalent instruments.

At June 30, 2015, the ASRS held investments of \$35.2 billion, excluding securities lending balances, a decrease of \$0.4 billion from fiscal year 2014. The combined investment portfolio experienced a net return of 3.2% compared to the Interim Total Fund Benchmark return of 1.6%. The decrease in investments from fiscal year 2014 to fiscal year 2015, is primarily due to a slowed global economy for much of the fiscal year, which did improve in the last quarter of the fiscal year.

Schedule of Investments by Asset Class



Current Market Conditions

The U.S. economy slowed from the second quarter of 2014 levels through the first quarter of 2015 but recovered in the latest quarter as GDP increased 3.7% which was strong relative to the rest of the world. The global macroeconomic picture has muddled with ECB beginning a Quantitative Easing program that has marginally improved some economies while others languish, China leading a slowdown in Asian economies, and the commodity decrease materially affecting commodity producing countries.

The ASRS continues to implement the Strategic Asset Allocation policy and will allocate assets tactically within guidelines as market opportunities present themselves.

Investment Goals

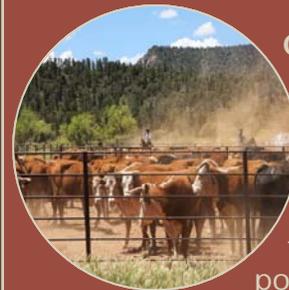
- Maximize Fund Rates of Return for Acceptable Levels of Fund Risk
- Achieve 75th Percentile Rates of Return Compared to Peers
- Achieve Long-term Fund Rates of Return Equal to or Greater than the Actuarial Assumed Interest Rate
- Achieve Long-Term Economic and Actuarial Funded Statuses of 100%
- Mitigate Contribution Rate Volatility

Annualized Time Weighted Rates of Return (After Fees)

(Retirement & Health Benefit Supplement)

	1 Year	3 Year	5 Year	10 Year	Since Inception (June 30, 1975)
ASRS Total Fund	3.2%	11.4%	11.8%	6.9%	9.9%
Benchmark*	1.6%	10.5%	11.2%	6.6%	9.6%

* Interim SAA Policy Benchmark



Cattle—Today, Arizona ranchers care for over 930,000 cattle and calves producing more than 380 million pounds of beef annually. A beef steer on average will supply us with 400 pounds of beef. Enough beef is produced from Arizona cattle to feed over 4.6 million people each year. The state's dairy industry produces over 3 billion pounds of milk a year.



Cotton—Since before our Statehood in 1912, cotton has been an important part of Arizona. Today, there are still over 250,000 acres of cotton

grown, which makes us part of the Cotton Belt. Arizona is third in the nation in producing Pima cotton. Cotton and parts of the plant are used for fabrics, tires, paper, fertilizer and more.

FAQs about Retiring

The ASRS offers a variety of annuity options from which members may select upon retirement. Annuity selections are made at the time of retirement and in most cases are irrevocable. Members who are married are required to name their spouse a beneficiary and are required to select a joint-and-survivor annuity of 50 percent or more. A spouse may waive this right with a Spousal Consent form.

Benefit Options Chosen

% of Benefit Recipients

Life Annuity	57.9%
100% Joint & Survivor	20.7%
50% Joint & Survivor	8.2%
66-2/3% Joint & Survivor	4.9%
15 Year Certain and Life	4.0%
10 Year Certain and Life	2.8%
5 Year Certain and Life	1.5%

Financial Summary

The ASRS administers retirement, health and long term disability benefits for teachers, state, county and other public municipal employees. ASRS benefits are funded by member and employer contributions and by earnings on investments. The ASRS has three funds, Retirement, Health Benefit Supplement (HBS) and Long Term Disability (LTD), to which the contributions are distributed according to actuarially determined contribution rates.

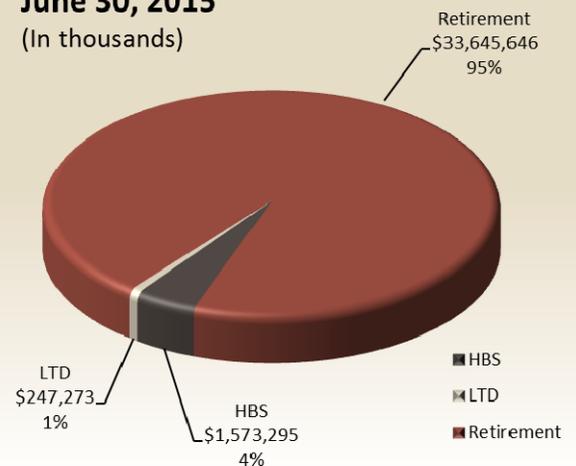
The ASRS' total fiduciary net position held in trust for benefits at June 30, 2015 was \$35.46 billion, a 0.2% decrease from \$35.53 billion at June 30, 2014. The retirement fund's fiduciary net position was \$33.6 billion compared to \$33.7 billion last year, a 0.1% decrease. The HBS' fund net position was \$1.57 billion at year end compared to \$1.56 billion at fiscal year 2014, a 1.1% increase. The LTD fund's fiduciary net position was \$247 million at year end compared to \$286 million last year, a 13.4% decrease. The decrease in the ASRS' total fiduciary net position and the fiduciary net position of its individual funds is primarily due to lower investment earnings and increased benefit payments, compared to fiscal year 2014.

For the 2015 fiscal year, member and employer contributions totaled \$2.11 billion, compared to the 2014 fiscal year contributions of \$2.06 billion. The increase is due to a 1.59% increase in contribution rates for retirement and HBS from 11.3% in fiscal year 2014 to 11.48% in fiscal year 2015. LTD contribution rates were reduced by 50% from 0.24% in fiscal year 2014 to 0.12% in fiscal year 2015. For employers, the alternate contribution rate increased from 9.20% in 2014 to 9.57% in 2015.

Deductions from the ASRS' net position held in trust for benefits consist primarily of pension, disability, health insurance, survivor benefits, member refunds and administrative expenses. For the 2015 fiscal year, pension, disability, health insurance and survivor benefits totaled \$2.8 billion, an increase of 4.0% over the \$2.7 billion paid during fiscal year 2014. The 4.0% increase is explained by an increase in total members or beneficiaries receiving benefits from 127,881 in fiscal year 2014, to 137,942 in fiscal year 2015. Refunds and transfers to other plans totaled \$256 million in fiscal year 2015, a 3.7% increase from the \$247 million paid out in fiscal year 2014. In fiscal year 2015, the cost of administering the ASRS benefits totaled \$30.6 million, a decrease of 1.8% from the \$31.1 million paid in fiscal year 2014, which is attributed to the ASRS' cost reduction initiatives.

Fiduciary Net Position by Fund - June 30, 2015

(In thousands)



Combined Statements of Fiduciary Net Position

Retirement, Health Benefit Supplement and Long Term Disability Funds Combined

The ASRS Combined Statements of Fiduciary Net Position reflects the resources available to pay benefits to members and beneficiaries at the end of the fiscal year. The Combined Statements of Fiduciary Net Position is presented with a more detailed analysis in the complete ASRS June 30, 2015 Comprehensive Annual Financial Report.

Combined Statements of Fiduciary Net Position

ASSETS	AS OF JUNE, 30 2015
Cash, Receivables and Prepaids	\$317,175
Investments at Fair Value	35,237,203
Security Lending*	<u>314,730</u>
Total Assets	35,869,108
LIABILITIES	
Payables and Other Liabilities	88,164
Securities Lending*	<u>314,730</u>
Total Liabilities	<u>402,894</u>
FIDUCIARY NET POSITION	35,466,214

NOTE: All numbers presented in thousands of dollars.

*The ASRS' custodial bank enters into agreements with borrowers to loan securities and have the same securities redelivered at a later date. Security lending assets represent the cash collateral received from the borrowers that the ASRS has reinvested. Security lending liabilities represent the cash collateral that the ASRS must return to the borrowers upon expiration of the loan. The ASRS receives a spread for its lending activities.

Largest Participating Employers

<u>Participating Employer</u>	<u>Covered Employees</u>
Department of Administration	27,327
Maricopa County	9,305
Mesa Unified School District 4	8,531
University of Arizona	7,013
Tucson Unified School District	6,247
Maricopa County Community College District	5,911
Arizona State University	5,485
Pima County	4,885
Gilbert Unified School District 41	4,477
Chandler Unified School District 80	4,154
All Other	127,965
Total	<u>211,300</u>

<u>Employer Units</u>	<u>Number</u>
School Districts	238
Charter Schools	137
Cities and Towns	79
Counties	15
Special Districts	94
Community College Districts	10
Universities	3
State Government	1
Total	<u>577</u>

Did You Know...

To help members navigate the process of retiring from the ASRS, a new dashboard has been released, called **Retirement Central**. Retirement Central puts everything a member needs to know about retiring from the ASRS in one place. The new dashboard includes video tutorials, webcasts, benefit estimators, information on health insurance and what members need to know if they are considering returning to work after retirement.

Retirement Central categories include:

- Estimate Your Benefits
- Can You Afford to Retire?
- Supplement Your ASRS Pension
- Download a Timeline
- Consider Your Options
- Let Us Help You
- Review Your Healthcare Options
- You're Retired; Now What?
- Return to Work

It's All Right Here! www.azasrs.gov



Citrus—Due to Arizona's climate, citrus ripens prior to orchards in Southern California which allows farmers to sell their produce

to the eastern markets first. Today Arizona has approximately 20,000 acres of orchards and is the second largest producer of lemons, third largest producer of tangerines and in the top ten for both oranges and grapefruit.

Combined Statements of Changes in Fiduciary Net Position

Retirement, Health Benefit Supplement and Long Term Disability Funds Combined

The ASRS Combined Statements of Changes in Fiduciary Net Position reflects the financial activity of the agency for the fiscal year ended June 30, 2015. The statement presents information to illustrate how the ASRS fiduciary net position changed during the fiscal year, as a result of the financial activity (i.e., contributions, investing activity, expenses). This is a summarized version of the data presented and analyzed in the ASRS June 30, 2015 Comprehensive Annual Financial Report.

ADDITIONS	FOR THE YEAR ENDED JUNE, 30 2015
Member Contributions	\$1,042,679
Employer Contributions	1,069,232
Other Income	31,507
Service Credit Purchase and Transfers In	20,702
Investment and Security Lending Income	1,050,271
Investment and Security Lending Expenses	<u>(158,367)</u>
Total Additions	3,056,024
DEDUCTIONS	
Retirement and Disability Benefits	2,805,420
Survivor Benefits	33,034
Refunds and Transfers	256,243
Administration and Other	<u>30,576</u>
Total Deductions	<u>3,125,273</u>
NET CHANGE	(69,249)
Fiduciary net position beginning of year	<u>35,535,463</u>
Fiduciary net position end of year	\$35,466,214

NOTE: All numbers presented in thousands of dollars.

Funding Status

Funding Status

The ASRS conducts two actuarial valuations each year for the Retirement Fund, one for accounting purposes and one for funding purposes. The differences between the two methodologies are described in the table below.

Item	Accounting Methodology	ASRS Funding Methodology
Actuarial Method	Entry Age Cost	Projected Unit Credit
Assets	Market Value	Actuarial Value
Permanent Benefit Increase Included?	Yes	No
Discount Rate	8%	8%

In order to determine the Retirement Fund's total pension liability for accounting purposes, the ASRS used the most recently available actuarial valuation, dated June 30, 2014, and rolled it forward to June 30, 2015.

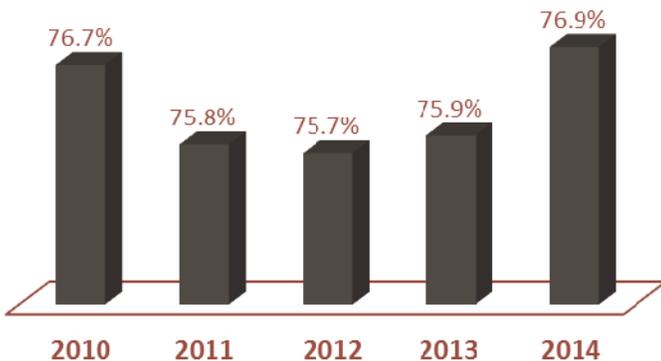
Net Pension Liability of Employers June 30, 2015

Total pension liability	\$ 49,222,083
Retirement fiduciary net position	(33,645,646)
Employers' net pension liability	<u>\$ 15,576,437</u>

The funded status represents the percentage of future pension benefits covered by the pension plan's assets at each respective fiscal year end.

Actuarial Value Funded Status

■ Total Plan



Climate—Arizona's climate is mild, meaning there isn't much change in the weather. Due to the consistently sunny weather, more than 40 million people visit Arizona per year, helping our towns and cities prosper. Climate also plays a key role in Arizona's agricultural industry. Due to the semi-arid climate and average annual rainfall of 12 inches, farmers are able to plant and harvest crops every month of the year.

Contribution Rate

Contribution Rate

The contribution rate, as determined by the annual actuarial valuation, is designed to ensure that the ASRS fund remains adequate to meet current and future obligations to members. The Arizona Revised Statutes provide statutory authority for determining employee and employer contribution amounts as a percentage of covered payroll. Employee contributions are applied toward the Retirement and Long Term Disability Plans. Employer contributions are applied toward the Retirement Plan, Health Insurance Premium Supplement Plan and the LTD Plan.

The statutory contribution rate and the actuarially determined contribution rate for the year ended June 30, 2015 was 11.60% for both the employee and employer portion. Employees paid 11.48% retirement and .12% long term disability. Employers paid 10.89% for retirement, .59% for the health insurance premium supplement and .12% for long term disability.

	2015	2014
Retirement Contribution Rates		
Member	11.48	11.30
Employer	10.89	10.70
HBS Contribution Rates		
Employer	0.59	0.60
LTD Contribution Rates		
Member	0.12	0.24
Employer	0.12	0.24

OUTSTANDING ACHIEVEMENT AWARD



The Government Finance Officers Association of the United States and Canada (GFOA) has given an Award for Outstanding Achievement in Popular Annual Financial Reporting to ASRS for its Popular Annual Financial Report for the fiscal year ended June 30, 2014. The Award for Outstanding Achievement in Popular Annual financial Reporting is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government popular reports.

In order to receive an Award for Outstanding Achievement in Popular Annual Financial Reporting, a government unit must publish a Popular Annual Financial Report, whose contents conform to program standards of creativity, presentation, understandability and reader appeal.

An Award for Outstanding Achievement in Popular Annual Financial Reporting is valid for a period of one year only. We believe our current report continues to conform to the Popular Annual Financial Reporting requirements, and we are submitting it to GFOA.

DELIVERING SERVICE WITH PRIDE

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www.azasrs.gov



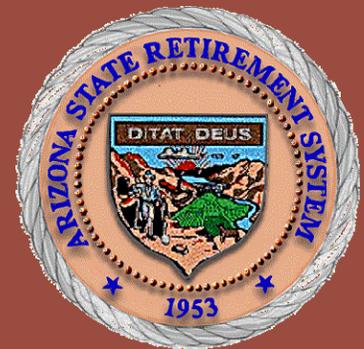
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