NOTICES OF EMERGENCY RULEMAKING

Under the Administrative Procedure Act, an agency may determine that adoption, amendment, or repeal of a rule is necessary for immediate preservation of the public health, safety or welfare and the notice and public participation requirements are impracticable. Under this determination, the agency may adopt the rule as an emergency and submit it to the Attorney General for review. The Attorney General approves the rule and then files it with the Secretary of State. The rule takes effect upon filing with the Secretary of State and remains in effect for 180 days. An emergency rule may be renewed for one 180-day period if the requirements of A.R.S. § 41-1026 are met. If the emergency rule is not renewed or the rule is not permanently adopted by the end of the 180-day period, the emergency rule expires and the text of the rule returns to its former language, if any.

NOTICE OF EMERGENCY RULEMAKING

TITLE 2. ADMINISTRATION

CHAPTER 8. STATE RETIREMENT SYSTEM BOARD

PREAMBLE

1. **Sections Affected**	**Rulemaking Action**
Article 2	
R2-8-123	Amend

2. **The specific authority for the rulemaking, including both the authorizing statute (general) and the statutes the rules are implementing (specific):**

Authorizing statute: A.R.S. § 38-714(F)(5)

Implementing statutes: A.R.S. §§ 38-714(H)(3) and 38-737

3. **The effective date of the rules:**

February 24, 2003

4. **Is this rulemaking a renewal of a previous emergency rulemaking?**

No

5. **The name and address of agency personnel with whom persons may communicate regarding the rule:**

Name: Fred W. Stork

Address: 3300 N. Central Avenue
P.O. Box 33910
Phoenix, AZ 85067-3910

Telephone: (602) 240-2052

Fax: (602) 264-6113

6. **An explanation of the rule, including the agency's reasons for initiating the rule:**

Acting on the recommendation of its consulting actuaries, the Board is amending subsection (2) of the rule, respecting the method for calculating the actuarial value of the assets of the Arizona State Retirement System ("ASRS") defined benefit plan ("Plan").

The ASRS invests a substantial portion of its assets in securities. Even though the securities market may represent a sound long-term investment, it is subject to short-term, sudden and wide swings in value. To stabilize contribution rates in relation to market swings, the Board, on the recommendation of its actuaries, for some time has prescribed in R2-8-123 a method for determining the actuarial value of assets that "smoothes" the impact of market swings on the value of the Plan's assets when the Board's actuaries perform an actuarial valuation of the Plan.

Prior to this emergency rulemaking, subsection (2) of the rule established the actuarial value of the ASRS plan's assets as equal to the market value of the assets less a five-year phase-in of the difference between expected and actual investment returns. Subsection (2) of the rule also restricted the resulting value to not less than 80% or more than 120% (a 20% corridor) of the market value of assets.

Every other year, the Board's actuary calculates the required employer and employee contributions to the ASRS. Required contributions are a percentage of compensation of all employees and are a function of the actuarial value of assets (including market gains and losses) and the actuarial value of liabilities. Prior to this emergency rulemaking, subsection (2) of this rule required that investment gains and losses be recognized actuarially over a five-year period for the purpose of "smoothing" the biennial changes in contribution rates resulting from market gains and losses. Actuarial valuation calculations for the fiscal year ending June 30, 2002, disclosed that the five-year "smoothing" and 20% corridor would result in the contribution rate's increasing from the current 4.00% (2% employers and 2% employees) of employees' compensation to 12.34% (6.17% employers and 6.17% employees) of employees' compensation.

The Board and its actuary concluded that an increase of that magnitude was not necessary to maintain the actuarial soundness of the Plan and was not appropriate under existing economic conditions and budgetary restraints.

As a result of the repeal of the 20% corridor, the total employer and employee contribution rate, effective July 1, 2003 declined from 12.34% (6.17% employers and 6.17% employees) of employees' compensation to 11.02% (5.51% employers and 5.51% employees) of employees' compensation. As a result of extending the "smoothing" period from five years to ten years, the total contribution rate declined further from 11.02% (5.51% employers and 5.51% employees) of employees' compensation to 10.40% (5.2% employers and 5.2% employees) of employees' compensation.

7. A showing of good cause why the rule is necessary to promote a statewide interest if the rule will diminish a previous grant of authority of a political subdivision of this state:

Not applicable

8. The summary of the economic, small business, and consumer impact:

Both public employers and employees contribute to the ASRS plan. The difference between the 6.17% employer/employee contribution rate required prior to this rulemaking and 5.2% employer/employee contribution rate under this emergency rule is 0.97% of $6.989 billion of employees' annual compensation. This difference amounts to a reduction in ASRS contributions for FY 2003-2004 of $67.8 million for public employers and $67.8 million for public employees. The state's portion of this difference is about 24%, or about $16.3 million for FY 2003-2004.

When the market turns upward again, this longer ten-year smoothing method will keep the contribution rate higher for a longer period of time, thereby stabilizing the fund. The effect of market changes will be more gradual in the future. This will result in more stable contribution rates for employers and employees in the future.

9. Any other matters prescribed by statute that are applicable to the specific agency or to any specific rule or class of rules:

Not applicable

10. Incorporations by reference and their location in the rules:

None

11. An explanation of the situation justifying the rule's adoption as an emergency rule:

Employers and employees contribute equally to the ASRS. Arizona's schools, cities, counties and the state are all currently facing extreme budgetary challenges. The state has identified the need for additional reductions of up to $500 million in the budget for the current fiscal year and an additional revenue shortfall of $1 billion for fiscal year 2003-2004. An increase in the employer contribution rate from 2.00% to 6.17% will have the immediate effect of reducing funding for Arizona's state, county, city and educational programs by approximately $291 million. Participating ASRS employers are currently preparing their budgets for fiscal year 2004. Decisions on cutting programs or increasing revenue to address costs are currently being made. Those employers need to know immediately what their ASRS contribution cost will be so that they can plan adequately for program reductions or revenue increases.

12. The date of the Attorney General's approval of the emergency rule:

February 20, 2003

13. The full text of the rules follows:

TITLE 2. ADMINISTRATION

CHAPTER 8. STATE RETIREMENT SYSTEM BOARD

ARTICLE 2. RETIREMENT SYSTEM

Section
R2-8-123. Actuarial Assumptions and Actuarial Value of Assets

ARTICLE 2. RETIREMENT SYSTEM

R2-8-123. Actuarial Assumptions and Actuarial Value of Assets

The Board adopts the following for actuarial valuations as of June 30, 1996, and thereafter:

1. No change
   a. No change
   b. No change

c. No change
d. No change
e. No change
f. No change
g. No change
h. No change

2. Actuarial Value of Assets: <u>Effective for the fiscal year of 2002 valuation and thereafter</u>, ~~The~~ the actuarial value of assets is equal to the market value of assets less a ~~5-year~~ <u>ten-year</u> phase-in of the excess ~~(shortfall) between~~ <u>of actual</u> over expected investment return ~~and actual income with the resulting value not being less than 80% or more than 120% of the market value of assets.~~ <u>for fiscal years 2002 and later years, and a five-year phase-in of such excess for fiscal years before 2002</u>.