Virginia Retirement System Modernization and Pension Reform Changes

FOCUS
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Barry C. Faison
VRS Chief Financial Officer
Agenda

- Overview of Virginia Retirement System
- Modernization Overview and Update
- GASB – New Standards
- History of Pension Reform in Virginia
- Questions
Overview of VRS
VRS Overview

• VRS is the 21st largest public or private pension system in the U.S.

• There are more than 600,000 members, retirees and beneficiaries.
## VRS Membership

<table>
<thead>
<tr>
<th>Category</th>
<th>As of December 31, 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Teachers</td>
<td>146,078</td>
</tr>
<tr>
<td>Political Subdivisions</td>
<td>103,289</td>
</tr>
<tr>
<td>State Employees</td>
<td>78,397</td>
</tr>
<tr>
<td>State Police Officers’ Retirement System</td>
<td>1,942</td>
</tr>
<tr>
<td>Judicial Retirement System</td>
<td>407</td>
</tr>
<tr>
<td>Virginia Law Officers’ Retirement System</td>
<td>9,249</td>
</tr>
<tr>
<td><strong>Total Active Members</strong></td>
<td><strong>339,362</strong></td>
</tr>
<tr>
<td>Retirees and Beneficiaries</td>
<td>168,003</td>
</tr>
<tr>
<td>Inactive and Deferred Members</td>
<td>116,125</td>
</tr>
<tr>
<td><strong>VRS Total Membership</strong></td>
<td><strong>623,490</strong></td>
</tr>
<tr>
<td></td>
<td>State</td>
</tr>
<tr>
<td>------------------</td>
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</tr>
<tr>
<td><strong>Actives:</strong></td>
<td></td>
</tr>
<tr>
<td>Average Age</td>
<td>48.1</td>
</tr>
<tr>
<td>Average Service</td>
<td>12.8</td>
</tr>
<tr>
<td>Average Salary</td>
<td>$48,681</td>
</tr>
<tr>
<td><strong>Retirees:</strong></td>
<td></td>
</tr>
<tr>
<td>Avg. Age @ Retirement</td>
<td>62.9</td>
</tr>
<tr>
<td>Avg. Service @ Retirement</td>
<td>20.8</td>
</tr>
<tr>
<td>Avg. Benefit @ Retirement</td>
<td>35.4%</td>
</tr>
<tr>
<td>Avg. Annual Benefit</td>
<td>$18,324</td>
</tr>
</tbody>
</table>

Information obtained from the June 30, 2012 Actuarial Valuation.
Benefits Administered

- Defined Benefit Pension Plans
  - VRS, SPORS, JRS, VaLORS

Hybrid Pension Plans (Coming January 1, 2014)
  - VRS, JRS

Other Post-Employment Benefit Plans
  - Group Life Insurance Program
  - Retiree Health Insurance Credit Program
  - Virginia Sickness and Disability Program
  - Virginia Local Disability Program (for local employees in the Hybrid Plan – coming January 1, 2014)
Net Assets Available for Benefits

Assets in Billions

- 1996: $22.2
- 1998: $26.9
- 2000: $31.7
- 2002: $35.7
- 2004: $37.7
- 2006: $34.4
- 2008: $40.0
- 2010: $42.9
- 2012: $47.7

- 2006: $44.1
- 2008: $58.3
- 2010: $55.1
- 2012: $54.6

- 2012: $53.3

VRS Fiscal Year Investment Returns

![Bar chart showing annual investment returns from 1990 to 2012. The chart includes a red line representing the investment return assumption.](image)
Overview and Update
• Multi-year, multi-phase project

• Introduced a web-based system

• Gives employers immediate access to member data and online access for enrollment and maintenance

• Increases customer service and convenience to members

• Requires employers to report only new or changed data

• Replaced 20-year-old technology infrastructure
Conversion and Transition Wrap Up

- The rollout period has closed
- Regular deadlines are being resumed for submitting information to VRS
- Employers are expected to confirm snapshots and make payments by the 10th of each month for data from the prior month
ACH Debit Payments

* Preferred method

- Automatic allocation of payments to the proper benefits
- Information received by VRS is secure
- Employer may wish to use a disbursement account or payroll account rather than their primary bank account
- Select “ACH Debit” under payment option when scheduling payment
Employer “pushes” payments to VRS

Does not provide for the automatic allocation of payments to the proper benefits

Select “Other” under payment option

You must include supplemental payment record in the transaction for myVRS Navigator to attribute the payment to your account
Check Payments

- VRS is discontinuing the lockbox, employers are expected to adopt electronic payment methods (ACH Debit and ACH Credit)
- Select “Other” under payment option
- If you send multiple checks, you must schedule multiple payments
- Cannot combine multiple Organizations in a single payment
- If mailing checks, send it to VRS, Finance Control Department, P.O. Box 361, Richmond, VA 23218-0361
GASB - New Standards
Virginia law requires all state and local agencies (including VRS) to report financial statements in accordance with “Generally Accepted Accounting Practices”

VRS will provide data necessary valuation results required for disclosures

For Teacher cost-sharing pool, VRS will determine the “collective” data for the pool and the “proportionate share” for each locality
Governmental Accounting Standards Board (GASB) Change

- Reasons behind GASB changes:
  - Improve consistency and transparency
  - Enhance decision usefulness of pension information
- Extends only to financial reporting, not to funding
- Effective dates:
  - Plan Administrators – FY 2014
    - actuarial valuations as of June 30, 2013
  - Employers – FY 2015
    - actuarial valuations as of June 30, 2014 with analysis of changes since June 30, 2013
Governmental Accounting Standards Board (GASB) Change

● Assumed Investment Return
  - Based on long-term expected return on assets held in trust unless the fund is expected to be depleted before all benefit payments are made, or
  - Based on blended single-rate (long-term rate while assets are available and municipal bond index for remaining period)

● Projecting Assets
  - Benefit projections on closed group of participants
  - Contribution projections based on formal policies and past behavior
    ● If past compliance, then future assumes compliance
    ● If not, use average of last five-year payment history
Impact of Changes

- Significant liability will be brought onto the face of the financial statements
- Funded ratios will be impacted
- Marked-to-market assets will increase volatility of accounting expense and liabilities
- Impact to local governments:
  - Higher unfunded liabilities will be added to “long-term debt”
  - Apportionment of teacher cost-sharing plan liabilities will add even more to local liabilities
Impact of Changes continued

- Accrued pension expenses will increase significantly due to shorter amortization and unfunded liabilities
- Constituent pressure on local officials for plan design changes to reduce costs
- GASB changes will become effective for local governments for fiscal year 2015
- Similar GASB Standards for OPEBs are coming
VRS Actions

- Insure that Actuarial Valuation reports have the necessary plan and valuation information
- Develop a process for the allocation of Actuarial Valuation data for multiple-employer, cost-sharing pools (teachers)
- Work with the Auditor of Public Accounts to provide a way to make usable information available to locality auditors in a timely manner
- Prepare for similar changes for OPEBs
History of Pension Reform in Virginia
Pension Reforms July 1, 2010

- General Assembly established new plan for new employees hired on or after July 1, 2010 (Plan 2)
  - Normal retirement changed to Social Security normal retirement age
  - Unreduced benefits commencing at Rule of 90
  - Reduced retirement moved to age 60 with at least 5 years of service
  - Five-year AFC formula
  - Revised COLA formula
Pension Reform Passed by the 2012 General Assembly, effective July 1, 2012

• Local governments and schools systems begin to impose the 5 percent member contribution with offsetting raises:
  ▪ 83 percent of local government employers opted to impose a 5 percent member contribution with a 5 percent offsetting salary increase
  ▪ 60 percent of school boards opted to impose a 5 percent member contribution with a 5 percent offsetting salary increase

• Local governments elected either the VRS-certified contribution rate or the alternate rate:
  ▪ 90 percent of local governments elected the VRS-certified contribution rate
Pension Reform Passed by the 2012 General Assembly, effective January 1, 2013

- Non-vested Plan 1 members will become VRS Plan 2 members
- Benefit multiplier is reduced for Plan 2 members from 1.70% to 1.65%
- Cost-of-Living Adjustment (COLA):
  - No COLA until member who retires with less than 20 years of service has received an allowance for one full calendar year after reaching unreduced retirement age. All Plan 1 and Plan 2 members within 5 years of eligibility for an unreduced benefit as of 1/1/13 are grandfathered
  - COLA capped at 3% (first 2% of CPI-U plus one-half of the next 2%, for a maximum total of 3%) for Plan 2 members
Pension Reform: January 1, 2014

Pension Reform Passed by the 2012 General Assembly, effective January 1, 2014

- Hybrid plan becomes the retirement plan for all general public employees hired on or after January 1, 2014
- Hazardous duty members are exempt from the hybrid plan
- General Assembly proposes to phase-in contribution rates for the teacher and state plans to the VRS board-certified rates

<table>
<thead>
<tr>
<th></th>
<th>July 1, 2012</th>
<th>July 1, 2014</th>
<th>July 1, 2016</th>
<th>July 1, 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>State</td>
<td>67.02%</td>
<td>78.02%</td>
<td>89.01%</td>
<td>100%</td>
</tr>
<tr>
<td>Teachers</td>
<td>69.53%</td>
<td>79.69%</td>
<td>89.84%</td>
<td>100%</td>
</tr>
<tr>
<td>Hybrid Plan Features</td>
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<tr>
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<tr>
<td><strong>Eligibility</strong></td>
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<tr>
<td>▪ Those that participate in regular VRS (state employees, JRS, teachers and local government employees) automatically enrolled in hybrid plan from date of hire</td>
<td></td>
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</tr>
<tr>
<td>▪ Public safety employees without hazardous duty coverage enrolled in hybrid plan from the date of hire</td>
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<tr>
<td>▪ One-time election window for current employees</td>
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<tr>
<td>▪ New ORP eligible employees may elect the hybrid plan or ORP</td>
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</tr>
<tr>
<td>▪ Current ORP employees not eligible to participate in new hybrid plan</td>
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<tr>
<td>▪ Public safety employees with hazardous duty coverage will not participate in the hybrid plan, but retain current plan provisions (VaLORS, SPORS, local enhanced hazardous duty coverage)</td>
<td></td>
<td></td>
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</tr>
<tr>
<td><strong>Disability</strong></td>
<td></td>
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<tr>
<td>Provides a new optional disability program for localities. The localities will be enrolled in the VRS-administered program unless they provide a disability program with comparable coverage from another source</td>
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</tbody>
</table>
# Pension Reform: January 1, 2014

## Hybrid Plan Features

<table>
<thead>
<tr>
<th>Multiplier</th>
<th>DB component has a 1.00% multiplier to produce a nearly 30% replacement rate after 30 years of service</th>
</tr>
</thead>
</table>
| Contributions | ▪ Employee voluntary contributions automatically increased every three years by one-half a percentage point, unless the employee opts out or the employee is already at the maximum voluntary contribution of 4.00%  
▪ Employee contribution of 4.00% to the DB plan  
▪ Employer contributions to the DB plan based on actuarial valuations  
▪ Employer contributions to the DC component consist of mandatory 1.00% match, plus a 100% match on first 1.00% elected by the employee, plus a 50% matching contribution on the next 3.00% elected by the employee.  
▪ Maximum DC contributions as much as 5.00% from employee (1.00% mandatory and 4.00% voluntary) and 3.50% from employer (1.00% on the mandatory and 2.50% on the voluntary) |
## Contributions in the Hybrid Plan

<table>
<thead>
<tr>
<th></th>
<th>Employee</th>
<th>Employer</th>
</tr>
</thead>
<tbody>
<tr>
<td>DB Plan Contribution</td>
<td>4.00%</td>
<td>Actuarially Determined Rate</td>
</tr>
<tr>
<td>Less DC Employer Contributions</td>
<td></td>
<td>Less DC Employer Contributions</td>
</tr>
<tr>
<td>DC Plan Contributions:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Mandatory Contribution</td>
<td>1.00%</td>
<td>1.00%</td>
</tr>
<tr>
<td>Voluntary Contributions</td>
<td>0.50%</td>
<td>0.50%*</td>
</tr>
<tr>
<td>Voluntary Contributions</td>
<td>0.50%</td>
<td>0.50%*</td>
</tr>
<tr>
<td>Voluntary Contributions</td>
<td>0.50%</td>
<td>0.25%*</td>
</tr>
<tr>
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<td>0.50%</td>
<td>0.25%*</td>
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<tr>
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</tr>
<tr>
<td>Voluntary Contributions</td>
<td>0.50%</td>
<td>0.25%*</td>
</tr>
<tr>
<td>Total Voluntary Contributions</td>
<td>4.00%</td>
<td>2.50%</td>
</tr>
<tr>
<td>Total Maximum</td>
<td>9.00%</td>
<td>Actuarially Determined Rate</td>
</tr>
</tbody>
</table>

* Indicates the employer required match if the employee elects to make optional contributions.
Estimated Income Replacement Ratio

Final Pay $40,000

Age 60 with 30 Years of Service

<table>
<thead>
<tr>
<th>Assumptions &amp; Methods:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Replacement Ratios are equal to the annuity payable at selected retirement age divided by the compensation in final year before retirement.</td>
<td></td>
</tr>
<tr>
<td>For purposes of calculating the social security replacement ratio at age 60, the replacement ratio is the expected benefit amount that will become payable at social security normal retirement date unadjusted.</td>
<td></td>
</tr>
<tr>
<td>Salary increases are assumed to be 4% per year. Inflation/Cost-of-Living is assumed to be 2.5% per year.</td>
<td></td>
</tr>
<tr>
<td>Mortality assumptions used to annuitize defined contribution balances are those prescribed by Internal Revenue Code 417e(3) for calculating minimum lump sum balances in 2011.</td>
<td></td>
</tr>
<tr>
<td>Defined contribution plan balances assume 6% pre-retirement investment returns.</td>
<td></td>
</tr>
<tr>
<td>Defined contribution plan balances are converted to annuity at retirement assuming a 4% investment return and a 2.5% benefit increase annually in retirement. It is unlikely that an individual could purchase an annuity that included the 2.5% increases, but in order to be comparable to the defined benefit annuity, we have included this feature.</td>
<td></td>
</tr>
<tr>
<td>SB 498 Hybrid Minimum contributions assume 1% employee contribution and corresponding 1% employer match. Maximum contributions assumes 5% employee contribution and corresponding 3.5% employer match.</td>
<td></td>
</tr>
<tr>
<td>Assumes member works entire career under one benefit formula. (No transition)</td>
<td></td>
</tr>
</tbody>
</table>

Age 67 with 37 Years of Service

SB 498 Hybrid Minimum contributions assume 1% employee contribution and corresponding 1% employer match. Maximum contributions assumes 5% employee contribution and corresponding 3.5% employer match.
Estimated Income Replacement Ratio

Final Pay $80,000

Age 60 with 30 Years of Service

Age 67 with 37 Years of Service

Assumptions & Methods:

Replacement Ratios are equal to the annuity payable at selected retirement age divided by the compensation in final year before retirement.

For purposes of calculating the social security replacement ratio at age 60, the replacement ratio is the expected benefit amount that will become payable at social security normal retirement date unadjusted.

Salary increases are assumed to be 4% per year. Inflation/Cost-of-Living is assumed to be 2.5% per year.

Mortality assumptions used to annuitize defined contribution balances are those prescribed by Internal Revenue Code 417e(3) for calculating minimum lump sum balances in 2011.

Defined contribution plan balances assume 6% pre-retirement investment returns.

Defined contribution plan balances are converted to annuity at retirement assuming a 4% investment return and a 2.5% benefit increase annually in retirement. It is unlikely that an individual could purchase an annuity that included the 2.5% increases, but in order to be comparable to the defined benefit annuity, we have included this feature.

SB 498 Hybrid Minimum contributions assume 1% employee contribution and corresponding 1% employer match. Maximum contributions assumes 5% employee contribution and corresponding 3.5% employer match.

Assumes member works entire career under one benefit formula. (No transition)
Hybrid Plan Implementation

- What it will involve, payroll system issues, processes (VNav modifications, 3rd party to manage participant DC money, participants able to access same investment options as in current state 457, voluntary contribution election by employee). Design is similar to federal plan.

- Hybrid business rules – same as new DB rules used in VNav regarding effective dates of changes

- Employees can change their voluntary elections quarterly. Auto escalation provision every three years

- Maximum employer contribution rate based on DB employer contribution rate. Total amount is allocated to DC and DB plans