Virginia Retirement System
2004 Fiscal Impact Statement

1. **Bill Number** HB661

House of Origin	☒ Introduced	☐ Substitute	☐ Engrossed
Second House	☐ In Committee	☐ Substitute	☐ Enrolled

2. **Patron** Bell

3. **Committee** Appropriations

4. **Title** Virginia Retirement System; defined contribution plan.

5. **Summary/Purpose:**

Virginia Retirement System; defined contribution plan. Creates a new defined contribution plan for all employees who enter on or after July 1, 2004, into any position covered by any retirement plan administered by the Virginia Retirement System. The employee has 90 days after entering into such a position to elect to participate in the defined contribution plan or the retirement plan for which he is otherwise eligible.

6. Fiscal Impact has not been determined. See #7 and #8.

7. **Budget amendment necessary:** Yes. Initial establishment of a defined contribution plan requires significant administrative costs. There are also ongoing cost associated with such a plan. Under the exclusive benefit provisions, DB trust funds may only be used to defray the costs of the DB plan so a general fund appropriation is necessary to defray the costs of establishment of the DC plan. Ongoing costs will require either an administrative fee to the participants or additional general fund appropriations. If this Bill is successful, an additional appropriation to VRS in the amount of $2.5 million (GF) in FY05 and $1.9 million (GF) in FY06 will be necessary. These amounts include the establishment of 4 FTE's for plan administration.

8. **Fiscal implications:** This Bill allows the VRS Board of Trustees to set the level of contributions into the defined contribution (DC) plan. In other DC plans, the General Assembly has set the contribution rate at 10.4% of pay. The Bill also allows the Board to establish rules for administration of the plan, including selection of the array of investment options available to participants. In providing the option for allowing employees to elect the DC plan, there are fiscal implications for the existing defined benefit (DB) plans.

   The VRS actuary has analyzed the impact of HB 661, which creates a defined contribution plan for future new entrants into VRS. The new entrant, at hire, will make an election to enter the current defined benefit plan or the new defined contribution plan. Initially, the creation of this plan may not affect the contribution rates for the defined benefit plan of VRS. However, over time, the anti-selection of the new entrants will force contribution rates for the defined benefit plan of VRS higher as fewer members enter VRS (lowering the covered payroll to pay off any unfunded liability) and those members that do enter the defined benefit plan will be older than the current new entrant profile (raising the normal cost for the group as a whole).

Over the long term time horizon of a defined benefit plan, payroll is assumed to increase. When calculating the amortization cost of an unfunded liability as a percent of pay, actuarial standards allow this increasing payroll assumption to be recognized. As payroll grows, more money will be contributed for the unfunded liability even if the contribution rate as a percentage remains constant. Currently the payroll growth rate assumption for all VRS plans is 3.0%. As current active members retire, some new entrants will elect to enter the defined contribution plan, reducing the covered payroll for VRS. This effect can force a lowering (or elimination) of the payroll growth rate assumption, thus increasing the contribution rate as a percentage of pay (in the near term it would also increase the actual dollar amortization payment) needed to amortize the unfunded liability.

Also, when a new entrant elects which plan to enter, we must assume the individual will make the correct choice from a value standpoint. For younger employees, this election will be to enter the defined contribution plan. They have a much longer time period to let the assets compound, to account for fluctuations in the financial markets, and are a much more mobile group. The older participants will elect the defined benefit plan as their time horizon is much shorter and the contribution rate will not pay for the same accrual rate that VRS grants. As the average age of the new entrants into VRS rises, the normal cost for the plan will increase as well. Because the normal cost percentage will increase and the amortization payment will increase, the overall costs of the defined benefit plan will increase on a per participant basis due to the implementation of the defined contribution plan, however the overall costs of VRS may be less if the contribution rate to the defined contribution plan is lower than the current contribution rate to the defined benefit plan.

Ongoing administrative fees for this plan must be paid by either the employer or the individual participant.

9. Specific agency or political subdivisions affected: VRS and all participating employers.

10. Technical amendment necessary: No

11. Other comments: None

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