Virginia Retirement System
2009 Fiscal Impact Statement

1. **Bill Number:** HB2154

   House of Origin X Introduced ___ Substitute ___ Engrossed

   Second House ___ In Committee ___ Substitute ___ Enrolled

2. **Patron:** Purkey

3. **Committee:** Appropriations

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

5. **Summary:** Virginia Retirement System; defined contribution retirement plan. Creates a new defined contribution retirement plan for all employees who begin employment on or after July 1, 2009, in lieu of participating in any other retirement plan administered by the Virginia Retirement System. All other employees may elect to participate in the plan in lieu of participating in any other retirement plan administered by the Virginia Retirement System.

6. **Fiscal Impact Estimates:** Start-up and ongoing costs of this bill will include the procurement and monitoring of third party administrators, legal expenses for developing and maintaining plan documents, educational materials for new members, training of employers, and other costs associated with the establishment and maintenance of a defined contribution (DC) plan. However, depending upon certain plan design features and whether the Board is given authority to assess fees to employer/employees, these costs could potentially be covered from various sources including reversions of nonvested contributions, membership fees charged to employers, and recordkeeping fees charged to employee accounts.

   Estimated Administrative Costs:
   FY09 Start-up Costs: $560,000* NGF 1 FTE
   FY10 Ongoing Costs $430,000 NGF 4 FTEs

   *This amount reflects the cost for a Third Party Administrator for this new program which` could be as high as $100,000

7. **Budget Amendment Necessary:** Yes. Initial establishment of a defined contribution plan requires significant administrative costs. Assuming that start-up and ongoing costs could be covered as described above, they could be funded by DC plan reversions and administrative fees. An increase in the VRS maximum employment level will also be necessary to manage the program and oversee the third party administrator.

8. **Fiscal Implications:** The contribution rates for the defined contribution (DC) plan will be established by the General Assembly. In other DC plans administered by VRS, the General Assembly has established the employer contribution rate at 10.4% of pay. The ultimate impact on total costs to the Commonwealth will be a function of the employer contribution rate for the new plan as established by the General Assembly and the proportion of current VRS members who elect the new DC plan.

According to the VRS actuary, establishing a mandatory DC plan for new hires would result in the payroll base of the VRS defined benefit plan to begin declining. This payroll base is used to fund the defined benefit plans' unfunded accrued liabilities (UAL) and assumes a growth rate of 3 percent each year, and as it declines, the impact of the UAL on the employer contribution rate will increase. Requirements under the Governmental Accounting Standards Board (GASB) statements 25 and 27 could lead to a reduction in the plans' payroll growth assumption for addressing the UAL or even require a move to a level dollar approach from the level percent of payroll currently used.

Finally, providing existing VRS defined benefit plan members the option of joining the DC plan will lead to anti-selection transition costs. In other words, members would likely choose the plan that they perceive to be in their financial best interest. The actuary reports that younger VRS members would be more inclined to select the DC plan while older members would select to remain in the VRS DB plans. Yet, the cost to fund the younger member's DB benefits is less than the cost of funding an older member's benefits.

9. **Specific Agency or Political Subdivisions Affected:** VRS, state agencies, school boards, and local political subdivisions participating in VRS

10. **Technical Amendment Necessary:** Yes. In order for the Board of Trustees of the Virginia Retirement System to establish a Defined Contribution (DC) plan, the following areas should be addressed in the bill:

Eligibility to Participate:

Current language stipulates that "any position" is eligible for DC Plan coverage. Clarification of whether employees who currently have a DC Plan choice (college faculty, political appointees, and school superintendents) should be allowed another DC Plan choice is necessary.

Vesting Schedule and Reversions of Forfeited Funds:

Consistent with existing VRS DC plans, the proposed legislation does not provide for a vesting provision or the reversion of forfeited contributions upon termination prior to the vesting date. A vesting schedule, coupled with reversion of a portion of contributions could be considered to reduce the cost of a new DC plan.

Administrative Fees:

VRS will need a revenue source to cover administrative costs of monitoring third party administrators, the legal expense of maintaining plan documents, educational materials for new members, training of employers, information systems programming, and other costs directly related to the development and maintenance of this new program. These costs cannot be paid using funds deemed to be Defined Benefit Trust funds as federal regulations require that such defined benefit funds must be used solely for the benefit of the members and beneficiaries of the plan. Typically, DC plans allow charges to employers and to members for covering administrative costs. Reversions can also be used to defray administrative costs or to reduce future employer contributions, but may not be sufficient to fully cover the costs.

Disability Insurance/Disability Retirement

The provisions of House Bill 2154 are silent on disability insurance or income protection for employees in the DC plan. Currently, state employees in a defined benefit plan are enrolled in either the Virginia Sickness and Disability Program (VSDP) or eligible for the traditional VRS disability retirement. All other members (local political subdivisions and teachers) of the VRS defined benefit plans are eligible for coverage under the traditional VRS disability retirement. Should some type of disability coverage for DC plan members be desired, language could be added to require that some type of employer or VRS sponsored coverage be available, either at the cost of the employer, employee, or on a shared basis.

Employer Contributions:

Current language requires contributions to a DC plan to be made from the "Commonwealth". However, local governments, school boards, and other political subdivisions should make contributions on behalf of their own employees. Language should be broadened to allow contributions from all employers.

Limitations on Election to Join a Retirement Plan and Switching Between Plans:

For members hired before July 1, 2009, the General Assembly may wish to consider additional language that would allow for a plan to plan transfer of a member's defined benefit assets to the member's Defined Contribution account.

Enactment Clause:

The VRS is requesting an enactment clause that would delay implementation of this legislation for at least one year to allow sufficient time to develop the plan design, plan documents, education and training materials for employers and employees, procurement of a third party administrator and the selection of investment options.

Such a delayed implementation date would allow the VRS to plan and implement the consolidation of similar VRS DC plans under one consolidated plan document for ease of administration and reduction of administrative costs.

11. **Other Comments:** House Bill 2146 is similar to House Bill 1941 introduced in the 2007 Session of the General Assembly. House Bill 1941 was referred to JLARC for inclusion in its 2008 study of compensation and retirement.

    The JLARC Report, *State Employee Total Compensation*, developed three defined contribution options. These included a Combination Plan, a Cash Balance Plan and a new Defined Contribution Plan. (Pages 101-104 of the report specifically address the establishment of a new defined contribution plan.) As set out in the report, each of the options would apply only to newly-hired employees and current employees in the standard VRS plan who are not yet vested in their VRS benefit. Limiting the change to non-vested employees likely makes implementing these alternatives somewhat easier because they will affect only a small portion of the current workforce. This also means that the reduction in annual costs and long-term risk associated with these alternatives does not fully materialize for decades—until the last active employee in the current plan has retired and the active workforce is covered under the new plan. In addition, there will be increased administrative costs and complexity during this lengthy transition period while the State concurrently maintains multiple plan designs.

JLARC's actuary, PriceWaterhouseCoopers (PwC), reported that because a newly established defined contribution plan would apply only to newly-hired employees, there would be a transition period lasting several decades. PwC estimated that once all State employees are in the defined contribution plan (as outlined in the report), the employer contribution would be 4.94 percent of payroll less than the current approach.

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