Virginia Retirement System
2015 Fiscal Impact Statement

1. **Bill Number:** HB1969

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

2. **Patron:** Jones

3. **Committee:** Committee referral pending

4. **Title:** Virginia Retirement System; cash balance retirement plan.

5. **Summary:** Directs the Virginia Retirement System to develop a proposed cash balance retirement plan and provide the proposal to the General Assembly no later than November 1, 2015.

6. **Budget Amendment Necessary**: Yes. Developing a proposal for a new retirement plan will require assistance from the Plan actuary. While it is not possible to determine the exact cost of actuarial services for this purpose, it is likely to be between $50,000 and $100,000.

7. **Fiscal Impact Estimates:** None.

8. **Fiscal Implications:** None.

9. **Specific Agency or Political Subdivisions Affected:** VRS.

10. **Technical Amendment Necessary:** No.

11. **Other Comments:** This bill directs VRS to develop a framework for a cash balance retirement plan and provide a proposal to the General Assembly by November 1, 2015. The proposal should broadly resemble the hybrid cash balance plan enacted by Kentucky in 2013. HB 1969 also directs VRS to examine cash balance plans in use by other states.

    VRS is aware of at least six state-sponsored cash balance plans in existence. California, Kansas, Kentucky, and Nebraska each sponsor a cash balance plan, while Texas maintains two separate cash balance plans. Several other states offer retirement plans that share characteristics with a cash balance plan, such as the money purchase plan in Montana.

    Generally speaking, benefits under a cash balance plan are based on the value of individual member accounts held by employees and maintained and managed by the plan sponsor or the state as in the examples provided above. Employees' accounts grow as they and their employers make regular contributions. The accounts are invested by the state pension plan as part of a pooled fund and the members do not have investment direction over the accounts.

Employee accounts are typically guaranteed a minimum rate of return. Excess returns can be shared with employees, saved for a year in which actual returns fall short of the minimum, or some combination thereof. Upon retirement, an employee receives a lifetime annuity that is calculated using the present value of his or her individual retirement account. The Internal Revenue Service classifies a cash balance plan as a type of defined benefit plan.

Kentucky Cash Balance Plan

HB 1969 requests that VRS develop a proposal that specifically considers the Kentucky Cash Balance Plan. The design of Kentucky's plan demonstrates the typical features associated with a cash balance plan. Under Kentucky's plan, all employees hired on or after January 1, 2014, participate in the new cash balance plan, which contains aspects of both a traditional pension plan and an individual retirement account.

An employee's retirement account consists of monthly employee contributions and monthly employer contribution credits. Employer contributions are not actually deposited into the member accounts. Instead, employer contributions are held in one large investment pool and accounted for on an individual basis. Upon retirement or a withdrawal of funds, an employee is entitled to the cash value of the employer contribution credits, as well as the interest accrued thereon. A nonhazardous duty member, the most common category of employee within the Kentucky Cash Balance Plan, contributes 5% of salary every month, while his or her account is also credited with a monthly 4% employer credit.

The Kentucky Retirement System manages the investment of the account and guarantees a 4% rate of return every year. When returns exceed 4%, the excess is shared between employees and a rainy day fund. This is called "upside sharing interest." An employee is eligible to receive upside sharing interest if 1) he or she was an active plan participant during the year in which excess returns were achieved and 2) the plan's rate of return exceeded 4% in the previous five fiscal years. When such conditions exist, an eligible employee is entitled to receive a 75% credit of any returns in excess of the guaranteed 4% rate. The remaining 25% is deposited into a rainy day fund, which is used to cover years in which returns fall short of the guaranteed rate. When an employee retires, his or her individual retirement account is converted to one of many annuity options. The annuity is solely based on the value of the individual retirement account, rather than on years of service or average final compensation in a defined benefit plan.

Kentucky's Cash Balance Plan was designed and is still estimated to cost about the same as its predecessor defined benefit plan. One major difference is that plan costs are much more predictable with the cash balance plan. This is largely due to the reduced number of actuarial assumptions that have to be made under the cash balance plan. Because individual salary growth, employee turnover, and other metrics are not necessary to calculate the annuity for a retiree of the cash balance plan, a reduced number of actuarial assumptions results in less variable costs from valuation to valuation. As opposed to the defined benefit plan, benefits for cash balance plan participants accrue more smoothly.

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