

Virginia Retirement System 2015 Fiscal Impact Statement

1. Bill Number: SB687

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

2. Patron: Marsden

3. Committee: Finance

4. Title: Virginia Retirement System; average final compensation.

5. Summary: Provides that if an employee receives increases in compensation related to a promotion or new position in the last four years of service that exceed 400 percent of the employee's average annual compensation during the preceding three years, then the employee's service retirement allowance shall be based upon average annual compensation during the employee's final ten years of service. The provision would not apply to an employee who returns to service after at least a one year gap in service, who receives a judicial appointment, or who is elected Governor or Attorney General.

6. Budget Amendment Necessary: No.

7. Fiscal Impact Estimates: Members who work a full career with lower compensation and who then experience large increases in compensation just prior to retirement generate large unfunded liabilities that the employer has to pay well after the member has retired, historically anywhere from 20-30 years based on the amortization period . This is because most contributions intended to fund this member's pension benefit have been based on the lower expected average final compensation amount. SB 687 proposes that members who experience large increases in compensation just prior to retirement, sometimes referred to as "pension spiking," should have a longer averaging period to more accurately reflect their career average.

SB 687 would require VRS to review a prospective retiree's final four years of service to determine if any compensation during this period exceeded 400% of their average final compensation during the preceding three years.

Since this bill would only be effective for members who had compensation that exceeded 400 percent of an average annual compensation after July 1, 2015, VRS cannot accurately predict the number of members who may be impacted by this legislation. As an example, we reviewed the valuation data as of June 30, 2014 to see how many active members could potentially be impacted by the provisions of this legislation. VRS identified approximately 47 active plan members whose compensation in fiscal year 2014 exceeded 400% of the employee's average annual compensation for the fiscal years 2008 through 2010 (Exhibit 1

below). However, a majority of these members are early in their careers and will more than likely wear away the effects of these increases over time. Thirteen of the members identified are eligible for retirement, but only one is eligible for unreduced retirement at this time. Of the 47 plan members who could be impacted if this bill were already effective, five are former members of the General Assembly.

Exhibit 1 below shows the number of members who could have been impacted if this legislation were in place now.

Exhibit 1

Employer	Employees Impacted by Provisions of Proposed Legislation	Employees Impacted who are Eligible for Retirement
State	10	6
Teachers	33	7
SPORS	0	0
ValORS	0	0
Judges	0	0
Locals	4	0
Total	47	13

The cost impact of this bill depends heavily on each specific member affected and can only be determined once a member applies for retirement. The actual cost impact on plan rates will depend on the number of members retiring, and the plan from which they retire. Due to the fact that the State and Teacher plans are cost sharing pools, members retiring from the State and Teacher plan are less likely to impact the total plan rate, but a member retiring from a local employer (which is separately rated) could greatly influence an employer's rate.

- 8. Fiscal Implications:** See Fiscal Impact Estimates above.
- 9. Specific Agency or Political Subdivisions Affected:** VRS, members of State, Teachers, SPORS, ValORS, JRS and local plans.
- 10. Technical Amendment Necessary:** Yes.

A cross reference to the definition of "average final compensation" in § 51.1-124.3 may be helpful:

Line 26, after "years," insert "notwithstanding the definition of average final compensation in § 51.1-124.3,"

To clarify that the bill is intended to impact only increases in compensation of 400% or more that occur on or after July 1, 2015, the following amendment may be helpful:

On line 22, delete ", on or after July 1, 2015,"

On line 23 after “a new position,” insert “on or after July 1, 2015”

- 11. Other Comments:** SB 687, as currently drafted, could potentially impact not only those members who may be going from a long term \$18,000 position as a General Assembly member to a \$100,000+ position at a State agency, but also a VRS member not in the General Assembly. For example, the proposed bill would also apply to a VRS member who was making an average salary of \$15,000 per year five years ago and who is now making \$60,000 per year.

Depending on the intent of the legislation, it could be restricted so that it would apply only to members of the General Assembly. This would prevent the potential for unintended consequences that could result when this provision is applied to all VRS members.

Another option that could be used to avoid “pension spiking” and possible manipulation of average final earnings involves bifurcating the benefits earned as a General Assembly member from those as a member in another VRS covered position, creating an “A+B” approach. This approach would have less of a negative impact on the fund while still allowing the member to accrue additional benefits from another employer without causing a significant increase in benefit. For example, for a member who has 22 years in the General Assembly and then leaves to work for another VRS employer for three years and ultimately retires with 25 years of service, the current policy allows an increase in pension benefit from \$6,700 to \$63,750 over a three-year period.

Current Method					
Plan 1 Member	Employer	Service Period	Years of Benefit Service	Average Compensation	Annual Accrued Benefit
Member serves 22 years in General Assembly	General Assembly	1/1/1994 - 1/1/2016	22.00	\$ 18,000	\$ 6,732
Leaves GA and takes high paying position for 3 years	Other VRS Service	2/1/2016 - 2/1/2019	3.00	\$ 150,000	
Current method allows all service to be used with higher average final compensation (3 year Avg)	Retirement		25.00	\$ 150,000	\$ 63,750

Under the A + B approach, the member’s service and compensation while a member of the General Assembly would generate a benefit for his or her time served at the lower salary. Any service and compensation after leaving the General Assembly would be explicitly used to generate any additional benefit earned without taking into account the years of service as a General Assembly member.

A + B Approach

	Employer	Service Period	Years of Benefit Service	Average Compensation	Annual Accrued Benefit
Member serves 22 years in General Assembly	General Assembly	1/1/1994 - 1/1/2016	22.00	\$ 18,000	\$ 6,732
Leaves GA and takes high paying position for 3 years	Other VRS Service	2/1/2016 - 2/1/2019	3.00	\$ 150,000	7,660
Proposed method would combine benefit earned in GA with benefit earned after leaving GA	Retirement		25.00		\$ 14,382

Below is the benefit that would be generated under the proposed SB 687. The benefit is reduced, but the member still generates a loss to the fund because he or she is able to use all service earned at a lower compensation when calculating the final benefit on a much higher average final compensation.

Proposed Legislation

Plan 1 Member	Employer	Service Period	Years of Benefit Service	Average Compensation	Annual Accrued Benefit
Member serves 22 years in General Assembly	General Assembly	1/1/1994 - 1/1/2016	22.00	\$ 18,000	\$ 6,732
Leaves GA and takes high paying position for 3 years	Other VRS Service	2/1/2016 - 2/1/2019	3.00	\$ 150,000	
Proposed method still allows all service to be used but AFC becomes 10 year average	Retirement		25.00	\$ 57,600	\$ 24,480

The legislation does not apply to employees who have had at least a one-year break in service between the former position and returning to covered employment at the higher compensation, those who accept an appointment as a judge and become a member of the Judicial Retirement System, and those who are elected to the offices of Attorney General or Governor of the Commonwealth.

This bill is identical to HB 1316.

Date: 1-22-2015

Document: SB687.DOC

Amended from original submission.