Virginia Retirement System

2022 Fiscal Impact Statement

1. **Bill Number:** HB 473

   House of Origin ☒ Introduced ☐ Substitute ☐ Engrossed

   Second House ☐ In Committee ☐ Substitute ☐ Enrolled

2. **Patron:** Bulova

3. **Committee:** pending

4. **Title:** Virginia Retirement System; employer contributions

5. **Summary:** Separates the VRS Board of Trustees-certified blended (Plan 1, Plan 2, and Hybrid) Defined Benefit employer contribution rate from the estimated Hybrid Defined Contribution rate. The substantive provisions become effective on July 1, 2024. The bill's enactment clause allows VRS and VRS-covered employers to prepare for full implementation prior to the effective date. The bill contains technical amendments. The bill is requested by the VRS Board of Trustees.

6. **Summary of Impacts:**

   - Reduces the administrative burden on and improves operational efficiency for both VRS and its employers related to largely manual reconciliation efforts, especially as the hybrid retirement plan becomes the dominant plan
   - Allows additional flexibility surrounding the potential ability for members to change their voluntary contributions monthly instead of the current quarterly schedule
   - Allows member contributions to be invested more quickly

   <u>Impact to unfunded liability (see Item 9 for details):</u> None.

   <u>Impact to contribution rate(s) (see Item 9 for details):</u> This separates the existing blended defined benefit (DB) and defined contribution (DC) rates. It will allow VRS to more accurately provide contribution rates to employers and allow contributions to be invested sooner but will not change the factors used to determine those rates.

   <u>Specific Agency or Political Subdivisions Affected (see Item 10):</u> VRS, the Department of Accounts (DOA), the Department of Planning and Budget (DPB), and all VRS-participating employers.

   <u>VRS cost to implement (see Item 7 and Item 8 for details):</u> $1,026,000 between FY 2022, FY 2023, and FY 2024.

   <u>Employer cost to implement (see Item 7 and Item 8 for details):</u> There may be costs to employers for programming that will vary from employer to employer. The delayed effective date allows programming for implementation to occur during FY 2023 and FY 2024. DOA indicates estimated costs of $190,000 between FY 2023 and FY2024.

Other VRS and employer impacts (see Item 7, Item 9, Item 11, and Item 12 for details): This reduces the administrative burden on both VRS and VRS-participating employers. As much of the administrative is effort required is manual in nature and varies by employer, savings cannot be estimated at this time.

GF budget impacts (see Item 8 for details): None anticipated.

NGF budget impacts (see Item 8 for details): For VRS, approximately $510,000 NGF for VRS in FY 2023 and $514,000 in FY 2024. DOA indicates estimated NGF costs of $190,000 between FY 2023 and FY2024 related to this change for VRS-participating employers whose payroll is handled by DOA. Other NGF VRS-participating employers, such as school divisions and political subdivisions, may have programming costs related to this change.

7. **Budget Amendment Necessary**: Yes.

   Item 492. VRS implementation costs are estimated to be approximately $2,100 NGF in FY 2022, $510,000 NGF in FY 2023, and $514,000 NGF in FY 2024. This includes communication and outreach to, and documentation and training for, VRS-participating employers. It also includes two IT contractors over two years to conduct VRS programming and testing as well as to provide support for VRS-participating employers as employers update their systems.

   Item 268. DOA would be responsible for programming and testing changes to the payroll system for all state employers. DOA indicates estimated costs of $190,000 NGF between FY 2023 and FY2024. DOA advises that the bill will require DOA to decouple the existing Hybrid plan and configure and test the new plan (moderate complexity level rule changes). DOA would also need to adjust and test their interface between VRS and DOA and the VRS billing reconciliation programs.

   Individual VRS-participating employers may have programming costs in FY 2023 or FY 2024 related to this change. Political subdivisions would be responsible for changes to their payroll systems, although some may use the same system and benefit from cost efficiencies. While costs should be less than costs to implement the payroll changes initially required for the Hybrid Retirement Plan, the FIS for HB 1130 in 2012 did not include costs to participating employers, so it is difficult to estimate what current costs might be. These costs are indeterminate at this time.

8. **Fiscal Impact Estimates:** See Item 9 for more details.

Fiscal Impact Estimates/Expenditure Impact:

Fiscal Year	*Dollars*	*Positions*	*General Fund*	*Non-General Fund & Local Funds*
	$2,100		$0	$2,100
2023	$700,000		$0	$700,000
2024	$514,000			$514,000
2025				
2026				
2027				
2028				

While exact savings cannot be determined for FY 2025, going forward there will be administrative savings and operational efficiencies realized by VRS and VRS-participating employers due to the reduction in manual reconciliations.

9. **Fiscal Implications:** The bill is intended to reduce the administrative burden on both VRS and VRS-participating employers due to current structure's resulting required reconciliation efforts.

The Department of Planning and Budget (DPB) will need to include separate entries in each appropriation bill beginning with July 1, 2024 for the Board-certified defined benefit (DB) employer contribution rate for all covered employees and the estimated statutory defined contribution (DC) component of the employer contribution rate for Hybrid Retirement Plan employees.

Exhibit 1 provides a comparison of the expected employer contributions under the current method and the proposed method for FY 2021. The first three columns represent the expected contributions to be collected based on the FY 2021 contribution rates and the valuation payroll from June 30, 2020. The DC rates included in the FY 2021 blended contribution rates are based on actual experience from FY 2019. The current method columns show how actual employer contributions are first applied to the DC contributions and the remaining amounts are allocated to the DB plan. To estimate experience for FY 2021 below, the estimated DC rates based on voluntary member contribution elections as of June 30, 2020 are applied to the hybrid payroll. The proposed method, "Unblend DB & DC rates" columns show how the actuarially determined defined benefit rate would be fully funded as well as the actual hybrid DC matching contributions. The final two columns reflect the difference in funding under the current and proposed methods. As shown, there could be variations in funding dependent upon the actual DC hybrid matching contributions provided during each fiscal year, but the DB plan would receive the full actuarially determined contributions under the proposed method. The actual amount of employer DC matching contributions are dependent on the actual voluntary contributions made by employees.

Exhibit 1- Impact of Unblending DB and DC Contribution Rates

Using FY 2021 contribution rates and payroll as of June 30, 2020.

		Expected Rates			Current Method			Unblend DB & DC Rates			Impact of Proposed Method	
Employer	6/30/2020 Payroll	DB Rate	DC Rate	Total Rate	DB Rate	DC Rate	Total Rate	DB Rate	DC Rate	Total Rate	Current Amount Paid to DB Plan Above or (Below) Required Rate	Plans Would Receive More or Less Under Proposed Method
JRS	74,734,000	28.49%	1.35%	29.84%	28.51%	1.33%	29.84%	28.49%	1.33%	29.82%	0.02%	Less
Estimated Cash Contributions		*$ 21,291,700*	*$ 1,008,900*	*$ 22,300,600*	*$ 21,306,700*	*$ 994,000*	*$ 22,300,600*	*$ 21,291,700*	*$ 994,000*	*$ 22,285,700*	*$ 15,000*	
State	4,428,496,000	13.67%	0.79%	14.46%	13.70%	0.76%	14.46%	13.67%	0.76%	14.43%	0.03%	Less
Estimated Cash Contributions		*$ 605,375,400*	*$34,985,100*	*$ 640,360,500*	*$ 606,704,000*	*$33,656,600*	*$ 640,360,500*	*$ 605,375,400*	*$33,656,600*	*$ 639,032,000*	*$ 1,328,600*	
Teachers	8,448,340,000	16.06%	0.56%	16.62%	16.01%	0.61%	16.62%	16.06%	0.61%	16.67%	-0.05%	More*
Estimated Cash Contributions		*$1,356,803,400*	*$47,310,700*	*$1,404,114,100*	*$1,352,861,800*	*$51,252,400*	*$1,404,114,100*	*$1,356,803,400*	*$51,252,400*	*$1,408,055,800*	*$ (3,941,600)*	
Locals	5,405,393,000	10.71%	0.55%	11.27%	10.70%	0.57%	11.27%	10.71%	0.57%	11.28%	-0.01%	More*
Estimated Cash Contributions		*$ 579,036,100*	*$29,900,500*	*$ 608,936,700*	*$ 578,304,900*	*$30,659,700*	*$ 608,964,600*	*$ 579,036,100*	*$30,659,700*	*$ 609,695,800*	*$ (731,200)*	

*Results vary by employer.

Please see Item 12 for examples of how the current DB and DC blended rate impacts employees.

10. **Specific Agency or Political Subdivisions Affected:** VRS, DOA, DPB, and all VRS-participating employers.

11. **Technical Amendment Necessary:** No.

12. **Other Comments:** The bill separates the employer defined benefit (DB) rate and the employer defined contribution (DC) rate, which are currently blended.

The bill is intended to:

- Reduce the administrative burden on and increase efficiency for both VRS and its employers from increasing and largely manual reconciliation efforts as the hybrid retirement plan becomes the dominant plan
- Potentially allow members the flexibility to change their voluntary contributions monthly instead of the current quarterly schedule
- Allow member contributions to be invested more quickly

Currently, the blended monthly employer contribution rate consists of the Board-certified DB rate and an estimate of the statutorily required employer DC contributions.

The current structure can lead to DC reconciliation issues in large part because of the different payroll cycles used by VRS-participating employers and the fact that DB business rules do not match up with DC business rules. For example, DB business rules require contributions on a monthly basis, while DC business rules are on a pay period basis, which can vary by employer. Corrections for DB contributions can be handled as a payroll correction. DC corrections require more complex adjustments, including the calculation of missed earnings and any overpayments must be returned to the employee.

The proposal may require some employers to modify payroll programming and will require VRS programming as well. Once complete, however, the changes will make the process easier for employers and for VRS as well as reduce the need for reconciliations.

VRS had preliminary discussions with DOA, the Department of Human Resource Management, DPB, representative employers, and other stakeholders.

Examples

Below are examples of how the current DB/DC blended contribution rate can impact employees.

The example below illustrates the anticipated monthly retirement contributions due from a hybrid member, and the amount of contributions that are actually withheld from the employee's last paycheck when they separate from employment mid-month.

Example 1: Mid-month termination

(Semi-monthly State payroll cycle used for illustrative purposes. Actual scenario may vary.)

Annual Salary:	$46,000	
Separation Date:	12/9/2021	
Last Paycheck:	12/15/2021	
	Semi-monthly salary:	Monthly Salary:
	$1,916.67	**$3,833.33**
	Only Paycheck in December with deductions:	Monthly contributions expected for retirement:
Employee		
4% DB Employee Contribution	$76.67	$153.33
1% DC Mandatory Employee Contribution	$19.17	$38.33
4% DC Employee Voluntary Contribution	$76.67	$153.33
Total Employee for December:	**$170.51**	**$344.99**
Employer		
1% DC Mandatory Employer Contribution	$19.17	$38.33
2.5% DC Employer Match	$47.92	$95.83
Total Employer for December:	**$67.09**	**$134.16**

In Example 1, in order to receive defined benefit service credit for the month of December, the employee must pay the full amount due for the month across all sources ($345), which is calculated using the monthly salary. If the employer is unable to withhold the full $345 from the employee's only paycheck in December due to termination of employment mid-month, the employer must change the employee's separation date to remove any service for December. This requires that DC contributions be returned to the employee directly from the third-party recordkeeper for the DC plans and any employer contributions be forfeited back to the employer, even though the employee had compensation that would have allowed the employee to contribute for the first half of the month. In this example, this results in the employee missing their own contributions of $95.84, and the employer matching amount of $67.09. While the employee will receive a refund of their contributions, they won't be added to retirement savings and the employee won't receive the matching employer contributions.

Under a typical DC plan structure, contributions are paid based on compensation received for each pay period and the partial-month contributions would have been allowed to stay in the plan. Due to the linkage to the DB business rules related to service credit being granted on a monthly basis, DC contributions are currently due based on a monthly amount. Therefore, in the scenario above, the employee contributions ($95.84) already remitted must be removed from the DC plan. This causes a large number of reconciliation issues for employers and removes savings from employees' DC retirement accounts, including employer contributions. In this case, the employer DC contributions would total $67.09 for the pay period and would be forfeited back to the employer.

Example 2: New Hire/Transfer

(Monthly State payroll cycle used for illustrative purposes. Actual scenario may vary.)

Annual Salary:	$46,000		**Monthly Salary:**	$3,833.33	
				Per pay period contributions	**Missed opportunity= 3 months (Oct-Dec)**
Hire Date:	9/10/2021		**4% DC Employee Voluntary Contribution:**	$153.33	$460.00
First Paycheck:	10/1/2021		**2.5% DC Employer Match:**	$95.83	$287.50
VRS Enrollment:	9/20/2021		**Total:**	$249.16	$747.50
Quarterly Deadline for Voluntary Contribution Elections:	9/15/2021	To be effective 10/1/2021			
Earliest employee could have elected:	9/23/2021	To be effective 1/1/2022			

Example 2 demonstrates that an employee who is hired just after the quarterly deadline for electing voluntary contributions in the Hybrid Retirement Plan loses the opportunity to make $460 in voluntary contributions and the corresponding $287.50 in employer matching contributions, for a total of $747.50 in missed contributions, in addition to the earnings that would have accrued on those funds over time.

In addition, members who transfer from one employer to another and continue to be covered by the Hybrid Retirement Plan must restart their voluntary contributions based on the quarterly schedule currently in place.

This legislation will have the additional impact of allowing employees to make changes to their voluntary contribution amounts on a monthly basis instead of the current quarterly basis.

The bill has a delayed implementation date of July 1, 2024, to allow time for communications and implementation for VRS, DOA, and the 800+ VRS-participating employers, as well as to coincide with the new biennial Board-certified DB contribution rates.

Date: 1/13/2022

Document: HB473.DOC/VRS