

Virginia Retirement System

2010 Fiscal Impact Statement

1. **Bill Number:** HB727

House of Origin X Introduced Substitute Engrossed

Second House In Committee Substitute Enrolled

2. **Patron:** Purkey

3. **Committee:** Appropriations

4. **Title:** Local defined contribution retirement plan.

5. **Summary:** Permits any locality or school board to establish a defined contribution retirement plan in lieu of any other retirement plan, for employees hired after such plan is established.

6. **Fiscal Impact Estimates:**

6a. **Expenditure Impact:** Any such plans established pursuant to this legislation will be administered by localities and school boards, so there will not be any impact to the Commonwealth.

7. **Budget Amendment Necessary:** No

8. **Fiscal Implications:** House Bill 727 permits any locality or school board to establish a defined contribution retirement plan in lieu of any other retirement plan, for employees hired after such plan is established.

The employee population for the defined contribution (DC) plan will be very slow in developing. As a result, it may take many years before the employer will begin to realize any cost savings anticipated by creating a DC plan.

Since new hires will not be joining the current defined benefit (DB) plans, the payroll base under these plans would begin to decline immediately. Since the base is used to fund the systems' unfunded accrued liabilities (UAAL), the VRS contribution rates as a percent of payroll will increase. In addition, locals adopting a defined contribution plan will have to continue funding the current unfunded liabilities for the pension plan, the retiree health insurance credit and the life insurance benefits of the current DB plan.

9. **Specific Agency or Political Subdivisions Affected:** VRS, employers and members of political subdivisions and school boards

10. **Technical Amendment Necessary:** See Other Comments below.

11. **Other Comments:** Any such plans will be administered by the locality or school board. DC plans provide features not usually found in DB plans, such as portability, investment choice, personal responsibility, and lump sum payouts. However, DC plans do not offer many of the

advantages of DB plans such as preretirement death and disability benefits, post-retirement inflation protection, lower expense ratios and higher average investment returns.

The provision in the bill that provides for an option for local employees to switch back to VRS and purchase service under VRS could have potential costs.

The VRS would expect the members who decide to transfer to the DB plan and pay full actuarial cost for service credits will do so in part because they see a greater pension benefit from the DB plan and are more committed to staying until retirement. We anticipate the turnover rate for these members would be lower than the current actuarial assumptions. This would eventually generate some actuarial losses.

While this bill provides for transfers to be made in an actuarial cost-neutral manner, this legislation does not address potential costs associated with benefits these employees would be eligible for as members of VRS: (1) lifetime disability benefits; (2) purchase of service at a substantially discounted rate (military, public service, etc.); and 3) ability to substantially increase benefits with late-career salary increases.

Specifically, paragraphs G thru I provide for a member of a locally established DC plan to terminate employment with that locality and, upon taking subsequent employment with a VRS covered employer, such individual would be eligible to purchase service credits in VRS with assets accumulated in his prior employer's DC plan. These purchases would be conducted at full actuarial cost.

However, upon completing the purchase, nothing in the bill would prevent such a member from taking advantage of other purchase provisions for such service as prior military service or prior public service at less than full actuarial cost. Furthermore, such an employee could have a progressive and chronic illness and could, shortly after the transfer to VRS, apply for permanent disability from VRS. Either of these scenarios would be detrimental to VRS. Accordingly, VRS would suggest that purchase of prior service under §51.1-142.2 should be made at actuarial cost. In addition, a waiting period before someone would be eligible to retire for disability would help to mitigate any adverse selection.

Date: 1/27/2010 psb

Document: HB727.DOC