

## Virginia Retirement System 2011 Fiscal Impact Statement

**1. Bill Number:** SB1305

House of Origin	X	Introduced	<input type="checkbox"/>	Substitute	<input type="checkbox"/>	Engrossed
Second House	<input type="checkbox"/>	In Committee	<input type="checkbox"/>	Substitute	<input type="checkbox"/>	Enrolled

**2. Patron:** Ruff

**3. Committee:** Finance

**4. Title:** Virginia Sickness and Disability Program

**5. Summary:** Virginia Sickness and Disability Program; Opens enrollment into the Virginia Sickness and Disability Program between October 1, 2011, and January 1, 2012 for eligible employees not currently participating in the program.

**6. Budget Amendment Necessary:** Yes. The cost of this legislation will be reflected in increased employer contributions beginning in FY 12. In addition, the VRS will require one (1) additional FTE and an additional \$125,000 for administration of this legislation.

**7. Fiscal Impact Estimates:** The VRS is unable to predict how many of the approximately 16,000 eligible employees would elect to participate in the VSDP during the proposed open enrollment period. There are costs associated with potential increased utilization of the program benefits because this is a population that has now aged 12 years since the initial enrollment which makes the probability of claims that much greater. There are also potential costs associated with the long-term care benefit provided to employees, especially as it pertains to guaranteed issue and portability at retirement for these employees. These costs cannot be determined because VRS is unable to predict who will elect to participate. There is also a cost to the retirement program resulting in potentially further increasing unfunded liability of the state, state police and VaLORS plans. This cost would occur because of the ability of these employees to bank accrued sick leave as disability credits which can be converted at retirement to service credit. Estimates of the costs associated with the additional service credit are provided under Fiscal Implications.

**8. Fiscal Implications:** This bill, if enacted, will likely have a minimal fiscal impact on the VSDP rate because the rate is currently applied to the total state payroll. There are, however, costs associated with the open enrollment because of adverse selection on the part of those eligible and their higher than expected utilization. On the other hand, there is an offsetting of costs for the VRS disability retirement plan as these members move from the traditional disability retirement plan to the VSDP. The VSDP provides managed disability provisions and return to work incentives that do not exist under traditional disability retirement. Because of these factors, the actuarial cost of this bill is partially offset by actuarial gains as fewer incidences of disability retirement will occur.

### **Background on VSDP and Non-VSDP Members**

VRS has estimated the cost of the proposed bill based on the data, actuarial assumptions and methods used in the June 30, 2010 actuarial valuation of the State employees' retirement system, SPORS and VaLORS, including annual 7% interest and 2.5% COLA rates, and 20-year amortization of the unfunded liability. In addition, results are based upon sick leave balance data provided by DHRM for approximately 4,900 of the 16,000 members who have opted-out of VSDP. Data for agencies that do not use CIPPS and PMIS, the state's central payroll and leave systems, were not available. For those members for whom sick leave balances were not reported, average sick leave balance data was used to approximate missing values. In the table below we present a comparison of the June 30, 2010 actuarial valuation data for VSDP and non-VSDP members. As shown, the state employees eligible for the open enrollment are on average older and credited with more years of service than the state employees currently enrolled in VSDP.

	VSDP	Non-VSDP
<b>State Employees Plan</b>		
Number of employees	62,601	13,432
Average pay	\$45,455	\$49,799
Average age	46.60	53.88
Average service	10.60	23.67
<b>SPORS</b>		
Number of employees	1,033	734
Average pay	\$49,159	\$63,787
Average age	37.00	46.87
Average service	9.77	21.59
<b>VaLORS</b>		
Number of employees	7,895	1,839
Average pay	\$34,402	\$40,476
Average age	40.01	47.83
Average service	7.05	17.74

### **Previous VSDP Open Enrollments**

Two previous open enrollments were held for state employees. The first was in 1998 prior to the program's effective date of January 1, 1999. In that open enrollment 35 percent of eligible state employees enrolled. In the 2002 open enrollment, 36 percent of eligible employees enrolled in the program. In the first VSDP enrollment, employees immediately converted sick leave to VRS service credit. In the 2002 enrollment, employees' sick leave balances were converted to disability credits which could be used to offset short-term disability benefit reductions, cashed out upon termination under existing state policy, or converted to VRS service credit at the time of termination or retirement.

Although no one can predict the percent of members enrolling in VSDP, we expect the opportunity to convert sick leave balances to retirement service credits will provide a significant incentive for members. Therefore, in order to provide a range of costs for the conversion of accumulated sick leave to retirement service, VRS has calculated the impact of SB 1305 on the employer contribution rates to the pension plans under the following two alternative assumptions. For purposes of this review, VRS has assumed 100% of eligible members who enroll in VSDP will convert their sick leave balances to VRS creditable service, not disability credits.

(1) 50% of non-VSDP members with the greatest accumulated sick leave will enroll in VSDP and convert their sick leave balances to retirement service.

(2) 100% of eligible members will enroll in VSDP and convert their sick leave balances to VRS creditable service.

In the calculations of the proposed bill's impact, VRS has assumed the affected membership will retire earlier than expected and with greater service than anticipated by the original valuation data and assumptions. To do so, VRS adjusted the members' data assuming the conversion of all accumulated sick leave into retirement service. If no such adjustments to the data are made at this time, actuarial losses would not be generated until the actual dates of retirement, and the funding of these actuarial losses would be delayed. As pre-funding assumes investment income will be generated and be used to reduce the additional cost, the calculations assume the additional liability resulting from the sick leave conversion would begin to be funded as of June 30, 2010.

In the tables below we present the estimated cost impact of converting sick leave balances to retirement service credits under SB 1305 to the State, SPORS and VaLORS retirement systems.

(1) Cost impact assuming 50% of non-VSDP members with the greatest accumulated sick leave will enroll in VSDP and convert their sick leave balances to retirement service. Using this assumption, the additional creditable service generate an approximately \$57.2 million increase in the accrued unfunded liability across the three plans.

	<u>FY12 Cost</u>	<u>FY13 Cost</u>	<u>FY14 Cost</u>	<u>FY15 Cost</u>	<u>FY16 Cost</u>	<u>FY17 Cost</u>
State - General Fund	\$ 2,015,000	\$ 2,075,000	\$ 2,137,000	\$ 2,201,000	\$ 2,267,000	\$ 2,335,000
SPORS - General Fund	414,000	426,000	439,000	452,000	466,000	480,000
VALORS - General Fund	612,000	630,000	649,000	668,000	688,000	709,000
JRS - General Fund	-	-	-	-	-	-
Teacher - General Fund	-	-	-	-	-	-
<b>TOTAL General Fund</b>	<b>\$ 3,041,000</b>	<b>\$ 3,131,000</b>	<b>\$ 3,225,000</b>	<b>\$ 3,321,000</b>	<b>\$ 3,421,000</b>	<b>\$ 3,524,000</b>
State - Non-General Funds	\$ 2,340,000	\$ 2,410,000	\$ 2,482,000	\$ 2,556,000	\$ 2,633,000	\$ 2,712,000
SPORS - Non-General Funds	94,000	97,000	100,000	103,000	106,000	109,000
VALORS - Non-General Funds	57,000	59,000	61,000	63,000	65,000	67,000
<b>TOTAL - Non-General Funds</b>	<b>\$ 2,491,000</b>	<b>\$ 2,566,000</b>	<b>\$ 2,643,000</b>	<b>\$ 2,722,000</b>	<b>\$ 2,804,000</b>	<b>\$ 2,888,000</b>
Teacher - Local Funds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Political Subs - Schools	-	-	-	-	-	-
Political Subs - Non School	-	-	-	-	-	-
<b>TOTAL Local Funds</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Grand Totals</b>	<b>\$ 5,532,000</b>	<b>\$ 5,697,000</b>	<b>\$ 5,868,000</b>	<b>\$ 6,043,000</b>	<b>\$ 6,225,000</b>	<b>\$ 6,412,000</b>

- (2) Cost impact assuming 100% of eligible members will enroll in VSDP and convert their sick leave balances to VRS creditable service. Using this assumption, the additional creditable service will generate an approximately \$77.4 million increase in the accrued unfunded liability across the three plans.

	<u>FY12 Cost</u>	<u>FY13 Cost</u>	<u>FY14 Cost</u>	<u>FY15 Cost</u>	<u>FY16 Cost</u>	<u>FY17 Cost</u>
State - General Fund	\$ 2,945,000	\$ 3,033,000	\$ 3,124,000	\$ 3,218,000	\$ 3,315,000	\$ 3,414,000
SPORS - General Fund	652,000	672,000	692,000	713,000	734,000	756,000
VALORS - General Fund	918,000	946,000	974,000	1,003,000	1,033,000	1,064,000
JRS - General Fund	-	-	-	-	-	-
Teacher - General Fund	-	-	-	-	-	-
<b>TOTAL General Fund</b>	<b>\$ 4,515,000</b>	<b>\$ 4,651,000</b>	<b>\$ 4,790,000</b>	<b>\$ 4,934,000</b>	<b>\$ 5,082,000</b>	<b>\$ 5,234,000</b>
State - Non-General Funds	\$ 3,420,000	\$ 3,523,000	\$ 3,629,000	\$ 3,738,000	\$ 3,850,000	\$ 3,966,000
SPORS - Non-General Funds	148,000	152,000	157,000	162,000	167,000	172,000
VALORS - Non-General Funds	85,000	88,000	91,000	94,000	97,000	100,000
<b>TOTAL - Non-General Funds</b>	<b>\$ 3,653,000</b>	<b>\$ 3,763,000</b>	<b>\$ 3,877,000</b>	<b>\$ 3,994,000</b>	<b>\$ 4,114,000</b>	<b>\$ 4,238,000</b>
Teacher - Local Funds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Political Subs - Schools	-	-	-	-	-	-
Political Subs - Non School	-	-	-	-	-	-
<b>TOTAL Local Funds</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Grand Totals</b>	<b>\$ 8,168,000</b>	<b>\$ 8,414,000</b>	<b>\$ 8,667,000</b>	<b>\$ 8,928,000</b>	<b>\$ 9,196,000</b>	<b>\$ 9,472,000</b>

### **VRS Pension Impact of 100 Percent Eligible VSDP Enrollment**

As noted above, it is difficult to precisely predict the rate at which eligible employees would enroll in VSDP. However, the opportunity to convert sick leave balances to retirement service credits will provide a significant incentive for members. From the sick leave balances available, it appears that those members close to unreduced early retirement (i.e., age 50 and 30 years of service (State employees) or 25 years of service (SPORS and VALORS)), members may be able to retire approximately one year earlier by converting their sick leave balance to retirement service credits. The result is an actuarial loss to the system

as this additional service credit has not been included in the employer contribution rates in any prior valuation.

### **Impact on VRS Disability Retirement and the VSDP Trust Fund**

The proposed bill would likely reduce the cost of the disability retirement benefit under VRS for members who elect to enroll in VSDP. On the other hand, the cost of VSDP would increase as a result of providing disability benefit coverage to the new enrollees. VRS has valued all State, VaLORS, and SPORS actives as if they were in VSDP, and then valued as if all were not in VSDP (in both the pension and OPEB models). Our results indicate that the value/cost of the traditional disability retirement benefit is greater than the value/cost of the VSDP benefit. Therefore, although VRS expects that the proposed bill could result in some anti-selection; overall VRS would expect a net experience gain in the transfer of the VRS disability retirement benefit to the VSDP long-term disability benefit. The actual experience gain or loss and cost impact to VRS and VSDP as a result of this cost shifting is difficult to quantify without knowing which and how many members will opt for VSDP.

In addition, the actuary noted that the absence of any pre-existing condition exclusion or other underwriting requirement also increases the risk of adverse selection against VSDP. As a protective measure for the VSDP Trust Fund, the actuary advised that one option available to VRS would be to require underwriting as condition of enrollment in VSDP. However even if this tool was utilized, there may still be a cost to VRS since a member denied enrollment in VSDP would still be eligible for disability benefit through the traditional VRS disability retirement program. Finally, the actuary noted that the conversion of sick leave hours to retirement service may offset some of the anti-selection risk to the VSDP fund as discussed above. In general, older employees have larger sick leave balances and may retire earlier than currently expected by converting their sick leave balance to retirement service credits. Earlier than expected retirement would impact VRS as reflected in the costs presented in the tables above, but would reduce the cost to VSDP since these members would not be eligible for disability benefits once they retire.

### **Long-Term Care Administrative Costs**

Currently, the long-term care insurance program is administered by private third party administrators under contract with VRS. The administrative expenses of VSDP and long-term care insurance are enrollment based, so additional enrollees will increase administrative costs. Premiums for long-term care insurance for VSDP members are paid by the state and are based on age at the time of enrollment. The actuary estimates that annual costs for new enrollees for the VSDP LTC program will be \$761,000, and that annual cost will diminish quickly to \$367,000 per year in 2016. The rapid decline results from the fact that most of the individuals eligible for the benefit change are close to retirement age. The projected costs based on 50% enrollment rate are as follows:

	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>	<b>FY 2015</b>	<b>FY 2016</b>
<b>Long-term care Benefit</b>	\$761,400	\$589,300	\$458,600	\$398,700	\$366,800

**9. Specific Agency or Political Subdivisions Affected:** VRS, eligible state employees, and VSDP participating agencies

**10. Technical Amendment Necessary:** No

**11. Other Comments:**

The bill would provide an open enrollment for three months beginning October 1, 2011 permitting members in the State employees' retirement system, SPORS, and VALORS to enroll in VSDP. Members in VSDP could convert their sick leave balances to creditable and eligibility service credits under VRS on the basis of one month of VRS service for each 173 hours of accumulated sick leave.

**Date:** 01.27.2011

**Document:** SB1305.DOC