Virginia Retirement System
2012 Fiscal Impact Statement
Revised

1. **Bill Number:** HB1130

   House of Origin ☐ Introduced ☐ Substitute ☐ Engrossed

   Second House ☐ In Committee X Substitute ☐ Enrolled

2. **Patron:** Patron Prior to Substitute—Howell

3. **Committee:** Finance

4. **Title as Substituted:** Virginia Retirement System; hybrid retirement plan created.

5. **Summary:** The substitute bill creates a new hybrid retirement program, administered by the Virginia Retirement System (VRS), that contains a defined contribution and a defined benefit component. Under the substitute bill, all new general state and local employees, including school board employees, commencing employment on or after January 1, 2014 would be enrolled in the hybrid plan rather than the traditional defined benefit retirement plan. Employees in-service on December 31, 2013 would be given the opportunity to make a one-time, irrevocable election to participate in the new hybrid program. The hybrid program would not be available to hazardous duty employees eligible to participate in LEOS, SPORS, or VaLORS. Nor would it be available to judges or employees of the Virginia Port Authority, the Virginia Outdoors Foundation, or the teaching hospitals. The substitute bill provides that new employees currently eligible for the optional retirement plans at the colleges and universities as well as political appointees and school superintendents would have the option to join either the new hybrid retirement plan or the existing optional defined contribution plans currently available to them. The substitute bill also adds a provision that requires the General Assembly to phase in contribution rates that are at least equal to set percentages of the contribution rates certified by the Board, culminating in contribution rates that are at least 100% of the certified rates for all plans by July 1, 2018. The provision allows the General Assembly to set contribution rates less than the applicable minimum percentages set out only upon a recorded affirmative vote of two-thirds of the members elected in each house.

6. **Budget Amendment Necessary**: Yes. While this bill does have significant costs associated with systems development, these cannot be ascertained at this time. The ability to accurately predict costs is complicated because VRS is replacing its current technology systems. As a result, legislative changes will likely need to be made to both the current and the future systems, depending on the effective date of the legislation. The introduction of significant changes at this time will likely cause a delay in the overall project schedule, resulting in additional payments to the vendor. Further, the cost for implementing a single piece of legislation cannot be calculated precisely due to economies of scale. The actual cost to implement all legislation enacted during a given session will more than likely be less than the sum of the costs attributed to individual bills. Therefore, VRS is not providing specific

systems costs for this bill, but will calculate the total for all VRS bills once they have been acted upon favorably in both houses and prior to the conference committee report.

Additional estimated costs to implement this bill that are not related to systems development are $1.3 million. These estimated costs include actuarial calculator updates, revising and reprinting all VRS publications and the web site, legal and compliance costs, additional positions for the customer contact center due to increased call volume, training and design personnel, third-party administrator costs, and RFP costs.

7. **Fiscal Impact Estimates:**
   The plan will be available beginning January 1, 2014. As such the cost/savings to state and local employers would be minimal in FY2014.

   Table 1 is an updated10 year projection of the estimated changes to contribution rates assuming all new hires are members of the hybrid plan and 5% of current non-vested employees also elect to move to the hybrid plan design. All tables assume that all employers would opt for the disability program and therefore include the 0.48% of payroll as an employer cost.

Change in projected contribution rates due to addition of Hybrid Plan										
	TABLE 1									
	Effect when Contributing Minimum Contribution to DC Plan									
Fiscal Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
State	-0.62%	-0.55%	-0.62%	-0.56%	-1.31%	-1.27%	-1.93%	-1.88%	-2.43%	-2.40%
Teachers	-0.16%	-0.08%	-0.17%	-0.09%	-0.48%	-0.42%	-0.75%	-0.69%	-0.95%	-0.90%
	Effect when Contributing Maximum Contribution to DC Plan									
Fiscal Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
State	-0.14%	0.10%	0.19%	0.40%	-0.22%	-0.06%	-0.61%	-0.45%	-0.89%	-0.77%
Teachers	0.22%	0.45%	0.50%	0.70%	0.42%	0.58%	0.35%	0.49%	0.33%	0.45%

Table 2 shows the estimated savings from the Total Fund over the next 20 years by biennium.

Projected Savings by Biennium - Total Fund										($Millions)
	TABLE 2									
	Assuming Minimum Contribution to DC									20 Year
	FY 15/16	FY 17/18	FY 19/20	FY 21/22	FY 23/24	FY 25/26	FY 27/28	FY 29/30	FY 31/32	FY 33/34	Total
State	$ 39.79	$ 40.49	$ 87.89	$ 129.96	$ 164.66	$ 196.02	$ 217.82	$ 236.19	$ 251.10	$ 261.72	$ 1,625.65
Teachers	$ 16.50	$ 18.21	$ 61.52	$ 99.36	$ 127.56	$ 157.29	$ 175.26	$ 194.75	$ 212.42	$ 226.93	$ 1,289.79
Total	$ 56.28	$ 58.70	$ 149.41	$ 229.31	$ 292.22	$ 353.32	$ 393.08	$ 430.94	$ 463.52	$ 488.66	$ 2,915.44
	Assuming Maximum Contribution to DC									20 Year
	FY 15/16	FY 17/18	FY 19/20	FY 21/22	FY 23/24	FY 25/26	FY 27/28	FY 29/30	FY 31/32	FY 33/34	Total
State	$ 1.47	$ (20.15)	$ 9.40	$ 35.87	$ 56.66	$ 77.97	$ 90.40	$ 101.33	$ 109.57	$ 113.96	$ 576.47
Teachers	$ (46.75)	$ (82.60)	$ (69.55)	$ (57.97)	$ (53.89)	$ (43.45)	$ (45.46)	$ (44.49)	$ (44.03)	$ (47.24)	$ (535.43)
Total	$ (45.28)	$ (102.75)	$ (60.15)	$ (22.10)	$ 2.77	$ 34.51	$ 44.94	$ 56.84	$ 65.54	$ 66.72	$ 41.04

Table 3 shows the estimated savings from the General Fund over the next 20 years by biennium.

Projected Savings by Biennium - General Fund											($Millions)
	TABLE 3										
	Assuming Minimum Contribution to DC										20 Year
	FY 15/16	FY 17/18	FY 19/20	FY 21/22	FY 23/24	FY 25/26	FY 27/28	FY 29/30	FY 31/32	FY 33/34	Total
State	$ 18.02	$ 18.33	$ 39.80	$ 58.84	$ 74.56	$ 88.76	$ 98.63	$ 106.95	$ 113.70	$ 118.51	$ 736.08
Teachers	$ 6.21	$ 6.85	$ 23.14	$ 37.38	$ 47.99	$ 59.17	$ 65.93	$ 73.26	$ 79.91	$ 85.37	$ 485.22
Total	$ 24.22	$ 25.18	$ 62.94	$ 96.22	$ 122.54	$ 147.93	$ 164.56	$ 180.21	$ 193.61	$ 203.88	$ 1,221.30
	Assuming Maximum Contribution to DC										20 Year
	FY 15/16	FY 17/18	FY 19/20	FY 21/22	FY 23/24	FY 25/26	FY 27/28	FY 29/30	FY 31/32	FY 33/34	Total
State	$ 0.67	$ (9.13)	$ 4.26	$ 16.24	$ 25.65	$ 35.30	$ 40.93	$ 45.88	$ 49.61	$ 51.60	$ 261.02
Teachers	$ (17.59)	$ (31.07)	$ (26.16)	$ (21.81)	$ (20.27)	$ (16.35)	$ (17.10)	$ (16.74)	$ (16.57)	$ (17.77)	$ (201.43)
Total	$ (16.92)	$ (40.20)	$ (21.91)	$ (5.57)	$ 5.38	$ 18.96	$ 23.83	$ 29.14	$ 33.05	$ 33.83	$ 59.59

Table 4 shows the estimated savings from the Non-General Fund over the next 20 years by biennium.

Projected Savings by Biennium - Non-General Fund											($Millions)
	TABLE 4										
	Assuming Minimum Contribution to DC										20 Year
	FY 15/16	FY 17/18	FY 19/20	FY 21/22	FY 23/24	FY 25/26	FY 27/28	FY 29/30	FY 31/32	FY 33/34	Total
State	$ 21.77	$ 22.16	$ 48.10	$ 71.11	$ 90.10	$ 107.27	$ 119.19	$ 129.25	$ 137.41	$ 143.22	$ 889.57
Teachers	$ 10.29	$ 11.36	$ 38.38	$ 61.98	$ 79.57	$ 98.12	$ 109.33	$ 121.48	$ 132.51	$ 141.56	$ 804.57
Total	$ 32.06	$ 33.51	$ 86.47	$ 133.09	$ 169.67	$ 205.39	$ 228.52	$ 250.73	$ 269.91	$ 284.78	$ 1,694.14
	Assuming Maximum Contribution to DC										20 Year
	FY 15/16	FY 17/18	FY 19/20	FY 21/22	FY 23/24	FY 25/26	FY 27/28	FY 29/30	FY 31/32	FY 33/34	Total
State	$ 0.80	$ (11.03)	$ 5.14	$ 19.63	$ 31.00	$ 42.66	$ 49.47	$ 55.45	$ 59.96	$ 62.36	$ 315.45
Teachers	$ (29.16)	$ (51.52)	$ (43.38)	$ (36.16)	$ (33.62)	$ (27.11)	$ (28.36)	$ (27.75)	$ (27.47)	$ (29.47)	$ (334.00)
Total	$ (28.36)	$ (62.55)	$ (38.24)	$ (16.54)	$ (2.61)	$ 15.56	$ 21.11	$ 27.70	$ 32.49	$ 32.89	$ (18.55)

Charts above contain two scenarios: the first assumes the employer match to the DC plan is based on the minimum required amount of 1.0%, while the second scenario assumes the maximum 3.5% employer match is contributed to the DC plan. Payroll growth is assumed to remain flat throughout the projection period.

8. **Fiscal Implications:** Employers' contribution rates for the hybrid plan will be set at the same rate as established for the legacy defined benefit plan. As contributions are collected by VRS, payments to satisfy the requirements of individual members' DC accounts will be posted first. Residual contributions will then be posted to the employers' DB accounts. In this way, contributions above and beyond the requirements of the hybrid plan will serve as excess contributions to the legacy DB plan's unfunded liabilities. Assuming the concurrence of future General Assemblies, these excess contributions will serve as a

constant source of new revenues for the legacy DB program which will remain the dominant driver of retirement costs for years to come. The reduction in costs associated with this plan design will be realized gradually as new state and local employees join the program. While initial cost savings associated with the plan design will be minimal, they will serve to reduce the ongoing or normal cost of the plans collectively and help to contain employer costs going forward. Because the legacy defined benefit plan is not being closed in order to implement the hybrid plan, the more significant contribution rates that would otherwise result from a complete shift to a defined contribution plan are avoided.

The provision requiring a phase-in of the full amount of the Board-certified rates will ultimately have a positive impact on the unfunded liability by fully funding the certified contribution rates going forward. The plan actuary currently assumes full payment of certified rates in future years, and if the full amount is not contributed, the shortfall is added to the unfunded liability for that year's valuation.

9. **Specific Agency or Political Subdivisions Affected:** VRS, all state agencies, most local employees and employers, school divisions and their employees, who are eligible for the hybrid program.

10. **Technical Amendment Necessary:** No

11. **Other Comments:** A number of other states have adopted hybrid retirement plans in various forms. States that administer some form of hybrid plans as a mandatory or optional primary retirement benefit for broad classes of employees include Georgia, Indiana, Ohio, Michigan, Oregon, Utah, and Washington.[1]

The substitute bill changes participation in the hybrid plan from optional to mandatory for all new state and local employees commencing employment on or after January 1, 2014, with the exception of those groups identified in item 5 above. Employees in service as of December 31, 2013 that have been identified as eligible in item 5 above, will have until April 30, 2014 to make an irrevocable election to participate in the hybrid plan.

[1] NASRA ISSUE BRIEF: State Hybrid Retirement Plans, November 22, 2011, http://www.nasra.org/resources/HybridBrief.pdf

Proposed Hybrid Defined Benefit and Defined Contribution Schedule

Employer Contribution	Employee Contribution
To DB: determined actuarially	To DB: 4% (mandatory)
To DC: 1.0% (mandatory)	To DC: 1% (mandatory)
To DC: employer match 1%	To DC: 1% (optional)
To DC: employer match ½%	To DC: 1% (optional)
To DC: employer match ½%	To DC: 1% (optional)
To DC: employer match ½%	To DC: 1% (optional)
Total possible employer DC contribution: 3.5%	Total possible employee DC contribution: 5%
Total possible employer contribution: 3.5% plus actuarially determined DB contribution	Total possible employee contributions: 9%

Based on employee surveys conducted by JLARC and using data collected by other employee benefit firms, it is expected that approximately 80% of hybrid plan members will opt for the minimum contribution initially. Below is a chart of expected savings from the General Fund over the next 20 years assuming that 80% of hybrid plan members contribute the minimum DC amount and receive the mandatory 1.0% matching contribution while 20% of hybrid plan members contribute the maximum amount and receive 3.5% match from employer each year.

Projected Savings by Biennium - General Fund

TABLE 5

Assuming 80% Contribute Minimum and 20% Contribute Maximum Contribution to DC

	FY 15/16	FY 17/18	FY 19/20	FY 21/22	FY 23/24	FY 25/26	FY 27/28	FY 29/30	FY 31/32	FY 33/34	20 Year Total
State	$ 14.55	$ 12.84	$ 32.69	$ 50.32	$ 64.78	$ 78.07	$ 87.09	$ 94.73	$ 100.88	$ 105.12	$ 641.07
Teachers	$ 1.45	$ (0.74)	$ 13.28	$ 25.54	$ 34.33	$ 44.07	$ 49.33	$ 55.26	$ 60.62	$ 64.74	$ 347.89
Total	$ 15.99	$ 12.11	$ 45.97	$ 75.86	$ 99.11	$ 122.14	$ 136.41	$ 150.00	$ 161.50	$ 169.87	$ 988.96

Vesting of the employer contributions to the defined contribution component would begin at 20% after the first year of continuous participation in the program, increasing by an additional 20% per year until full vesting at the end of the fifth year of continuous participation. If an employee terminates employment with an employer prior to achieving 100% vesting, contributions made by an employer on behalf of the employee that are not vested will be forfeited. No loans or hardship withdrawals may be made from the employer or employee contributions to the defined contribution component.

The bill also contains an auto-escalation provision which would serve to automatically increase employee contributions by one-half of one percent of a member's creditable compensation every three years until members reach their maximum contribution to the DC plan of 5%. Employee contributions increased in this manner would also be subject to the requisite matching employer contributions. Employees would be allowed to opt out of any automatic increase in their DC contributions.

The defined benefit component has a 1.0 multiplier. Members transferring to the new hybrid plan will have their creditable service as of the date of the transfer applied to the multiplier in effect prior to the transfer in calculating the DB benefit; the 1.0 multiplier will apply to all future service earned subsequent to the transfer to the hybrid plan.

The traditional disability program associated with the legacy DB plan would not be available to members of the new hybrid plan. Instead, a new disability program for political subdivision and school board employees would become available for employees participating in the hybrid plan if their local employer elects to participate in the program. This program would be modeled after the Virginia Sickness and Disability Program (VSDP) for state employees. Local employers would be given a one-time irrevocable election to enroll their hybrid members in the new disability program or the ability for their governing body to opt out upon passing a resolution on or before January 1, 2014, stating that it has or will establish and maintain comparable disability coverage for its eligible employees. Such comparable coverage need not include provisions similar to § 51.1-1178, related to long-term care insurance. The average cost to local governments of the local disability program provided in the substitute bill is initially estimated to be about .48% of covered payroll for the long-term disability and the long-term care components of the program. The costs of the short-term disability component of the program would be separately borne by participating employers. The cost estimates in tables 1 through 5 above assume that all employers would opt for the disability program and therefore include the 0.48% of payroll as an employer cost.

Participants in the hybrid plan would also be eligible for group life and the health insurance credit program pursuant to the existing eligibility requirements of those programs.

Under a new provision added in the substitute bill, the General Assembly would be required to phase in contribution rates that are at least 100% of the certified rates for all plans by July 1, 2018. In order to set contribution rates that are less than the minimum phase-in percentages set out in the provision, two-thirds of the members elected in each house would have to vote in favor of lower contributions.

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