Virginia Retirement System
2014 Fiscal Impact Statement

1. **Bill Number:** SB 385

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

2. **Patron:** Reeves

3. **Committee:** Finance

4. **Title: Virginia Retirement System and local government retirement systems; investments**

5. **Summary:** Authorizes the Virginia Retirement System and any local government retirement system to purchase investment grade life insurance policies and annuity policies on their members or retirees, provided that (i) the applicable retirement system offers a monetary benefit to a beneficiary selected by the member or retiree and (ii) the member or retiree consents to such retirement system having an insurable interest in him.

6. **Budget Amendment Necessary**: No. This bill authorizes but does not require VRS or other local government retirement systems to enter into investment grade life insurance or annuity policies on members and retirees.

7. **Fiscal Impact Estimates:** It is difficult to estimate the fiscal impact of borrowing money to purchase insurance policies on large numbers of state and local employees as VRS is unaware of any public pension plan that has implemented this type of program. VRS is unable to determine whether a life insurance program of this nature would constitute a good investment for the VRS Trust Fund. In theory, properly underwritten life insurance policies on large groups should provide no gain from or loss from mortality experience. Without actual experience or advice from experts, VRS can only express certain concerns about the viability of this program as an investment vehicle including:

   - Doubts as to whether profiting from the deaths of VRS members is good public policy. The American Council of Life Insurers (ACLI) adopted a policy statement opposing government owned life insurance intended to support state retirement funds. The ACLI opposes these forms of investment as tantamount to "wagering on human life".
   - Any gains to the VRS portfolio would probably take years to realize.
   - Illiquid life insurance policies could interfere with VRS' need to match cash flows with required pension payments.
   - Longevity risks inherent in life insurance policies would compound the existing longevity risks of the VRS pension program.

- Reliance on borrowing to purchase premiums and enhance returns adds interest rate risk. Many experts expect interest rates to rise in the years ahead, thereby increasing the cost of borrowing for this program.
- The investment of premiums in equity markets creates the prospect of substantial losses during market downturns, possibly triggering margin calls against other assets in the VRS portfolio.
- A combination of rising interest rates and falling equity values could put a program like this "underwater" and create a contingent liability against the VRS Trust Fund. Any such liabilities would be reportable to bond rating agencies.
- Legal expenses would be incurred to determine whether this type of investment would be allowable for a governmental plan.

8. **Fiscal Implications:** See Fiscal Impact Estimates above.

9. **Specific Agency or Political Subdivisions Affected:** VRS and any local government retirement systems that choose to exercise this option.

10. **Technical Amendment Necessary:** VRS staff are not experts on Virginia's life insurance statutes, but have concerns as to whether VRS would have a legally valid "insurable interest" in the lives of its members pursuant to § 38.2-301. SB385 does not amend § 38.2-301 of the Code of Virginia which requires that the proceeds of a life insurance policy must be payable to the insured or his personal representative or to a person who has an insurable interest in the insured at the time when the contract was made.

11. **Other Comments:** This provision is permissive and would allow VRS and all local retirement plans to purchase investment grade insurance policies and annuity policies on the lives of their employees or retirees. The legislation requires that the retirement plan must receive the employee's consent to enter into the insurance policy, and the retirement plan would also be required to provide an unspecified level of monetary benefit to a beneficiary selected by the member or retiree. The pension plan would be entitled to the remaining proceeds from the policy upon the member's death. The legislation further authorizes the retirement systems to borrow money from commercial financial institutions in order to purchase the insurance or annuity policies. The premise behind such an arrangement is that over time, the growth in the cash value of the life insurance policies, or the proceeds from the policies will exceed the cost of the policies and the interest on the borrowed funds used to purchase the policies.

    Insurance policies as investments are non-traditional assets for pension plans, with unique cash flow characteristics with which VRS has no experience. Such a program would likely require significant concentration risk and credit exposure to a small handful of insurers. This would be likely to create a large credit exposure that may prove to be unacceptable to VRS.

    Purchasing life insurance policies on VRS members and retirees could require leverage (borrowed funds) as VRS currently has approximately 630,000 members and retirees. The leverage in this case would likely be based on short-term interest rates, which are likely to rise over the long term. Such leverage would most likely require the fund to post margin collateral out of the fund's assets, adding additional risk. The sustainability of the leverage, in terms of the lender's long-term commitment to keep the program going, is also an unknown. Should lenders require earlier than expected repayment, the fund could face a significant liquidity demand that could prove detrimental to the fund.

This bill is identical to HB 514.

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