

Virginia Retirement System 2017 Fiscal Impact Statement

1. Bill Number: HB 1645

House of Origin	<input checked="" type="checkbox"/>	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: Loupassi

3. Committee: Appropriations

4. Title: State Sickness and Disability Program.

5. Summary: Eliminates the one-year waiting period for eligibility for disability benefits for vested local government employees commencing employment in a state position covered under the Virginia Retirement System (VRS), State Police Officers' Retirement System, Virginia Law Officers' Retirement System, or the hybrid retirement program. Under current law, employees who enter state service on or after July 1, 2009, are required to wait one year before they can receive benefits under the state sickness and disability program for non-work related disabilities. The bill eliminates this waiting period for local government employees who have at least five years of creditable service under VRS (including the hybrid retirement program) and those members in VRS covered by Enhanced Hazardous Duty Benefits upon commencing employment in a state position with no break in service. In addition, for purposes of determining the disability benefit payable, the bill provides that any such employee upon entering state service will be deemed to have a beginning balance of months of state service equal to the number of months of VRS creditable service credited to him as of his beginning employment date. The provisions of the bill do not affect disability benefits payable or eligibility for such benefits relating to illnesses or injuries occurring prior to July 1, 2017.

6. Budget Amendment Necessary: Yes. Item 489. VRS estimates that it will need an appropriation of an additional \$77,000 to cover costs of designing, coding, testing, and implementing the new waiting period rules for changes to the third-party administrator's (TPA) roster file, including potential additional fields required on the file. Included in the \$77,000 is at least 10 hours of development, testing, and production work for the TPA at the contracted rate of \$250 per hour. See Item 8.

7. Fiscal Impact Estimates: Eliminating the one-year waiting period for eligibility for non-work related disability benefits would be expected to increase the cost of the Virginia Sickness and Disability Program (VSDP) by 0.0004% of covered payroll, which would equate to approximately \$16,000 per year of additional contributions. Approximately \$7,600 would be from the General Fund and \$8,400 would be from the Non-General Fund per year.

8. Fiscal Implications: As of June 30, 2016, the funded status of VSDP stood at 169.4%. Actual census data from the last several years indicates that between 4.5% - 5.0% of "new"

hires have prior creditable service that could qualify them for immediate eligibility in the VSDP program as proposed in this bill. The change in plan provisions would have the following estimated cost impacts to VRS plan funding:

	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>
State - General Fund	\$ 6,100	\$ 6,100	\$ 6,100	\$ 6,100	\$ 6,100	\$ 6,100
SPORS - General Fund	300	300	300	300	300	300
VaLORS - General Fund	1,200	1,200	1,200	1,200	1,200	1,200
JRS - General Fund	-	-	-	-	-	-
Teacher - General Fund	-	-	-	-	-	-
TOTAL General Fund	\$ 7,600	\$ 7,600	\$ 7,600	\$ 7,600	\$ 7,600	\$ 7,600
State - Non-General Funds	\$ 8,200	\$ 8,200	\$ 8,200	\$ 8,200	\$ 8,200	\$ 8,200
SPORS - Non-General Funds	100	100	100	100	100	100
VaLORS - Non-General Funds	100	100	100	100	100	100
TOTAL - Non-General Funds	\$ 8,400	\$ 8,400	\$ 8,400	\$ 8,400	\$ 8,400	\$ 8,400
Teacher - Local Funds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Political Subdivisions - Local Funds	-	-	-	-	-	-
TOTAL Local Funds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Grand Totals	\$ 16,000	\$ 16,000	\$ 16,000	\$ 16,000	\$ 16,000	\$ 16,000

Estimated projections based on employee data and valuation results as of June 30, 2016 and assume a level population throughout projection period.

Payroll projections are assumed to remain level throughout projection period.

9. Specific Agency or Political Subdivisions Affected: VRS, all state agencies, and VRS-participating local government employees who transition into a VSDP-covered position.

10. Technical Amendment Necessary: No.

11. Other Comments: VSDP is a managed disability program that includes both short- and long-term disability. It replaced the former program of disability retirement for eligible employees and replaced the former sick leave program as well. It was first enacted in 1998 and made available to state employees, members of the State Police Officers' Retirement System, and qualifying part-time employees. Local government employees, certain employees of teaching hospitals, and certain employees of the Virginia Port Authority were excluded from participation. Eligible employees were provided with an opportunity to opt in to VSDP, and all new employees in eligible categories hired on or after January 1, 1999, were automatically enrolled. In 2002, a new enrollment period began, during which eligible employees were included in VSDP unless they opted out.

At the time of its original enactment, VSDP did not include a waiting period for non-work related disability benefits, but the waiting period was added for new participants in 2009. There is no waiting period for work-related disability benefits. Under VSDP, the number of days of short-term disability at 100% income replacement is linked to the number of years of service (between one and five). The lowest amount of income replacement is 60%. Employers are required to pay the cost of short-term disability and to hold the employee's position open for six months (the maximum length of short-term disability, except for a

limited exception for SPORS that allows one year for work-related injuries). If a member is found to be disabled following the period of short-term disability, the VSDP fund pays for long-term disability benefits and the employer is no longer required to hold the position open.

This bill would eliminate the one-year waiting period for any local government or school division employee who is vested (has 60 months of creditable service) in a VRS defined benefit retirement plan, including the hybrid retirement plan, prior to becoming a VSDP participant. HB 1645 defines “employee vested prior to participating in the program” as an employee who: 1) was working in a VRS-covered position under Chapter 1 of Title 51.1 with at least five years of creditable service, and 2) did not have a break in service between his or her most recent VRS-covered position and the position through which the member becomes eligible for VSDP participation.

Similar waiting periods are industry standard in managed disability program plan designs. Consistent with industry standards, one of the primary reasons for the addition of the waiting period was to avoid adverse selection. Adverse selection occurs when someone who believes he or she is likely to need disability benefits selects a VSDP-eligible position in order to use the benefit. VRS traditional disability retirement avoids or minimizes adverse selection by requiring that, in order to be eligible for disability retirement, a pre-existing disability must have substantially worsened following the commencement of VRS employment. Linking the number of days of short-term disability at 100% income replacement to the length of service was a cost-saving measure, as well as an additional deterrent to adverse selection.

Local employees who are eligible for a similar managed disability plan, the Virginia Local Disability Program (VLDP), or an equivalent plan adopted by their employer, also have a one-year waiting period for non-work related benefits upon initial hire or when moving from one employer to another. For example, a teacher who moves from Henrico to Chesterfield would have to satisfy a one-year waiting period before becoming eligible for non-work short- and long-term disability benefits.

By removing both of these limitations for VRS-covered employees who are vested based on local service that is not covered by VSDP, it is more likely that there will be a higher usage level of VSDP short- and long-term disability benefits than was assumed when the rates were determined. In addition, since no VSDP contributions would have been made for these local employees prior to their being deemed eligible, any long-term disability benefits paid out would not have been prefunded and could lead to the creation of an unfunded liability.

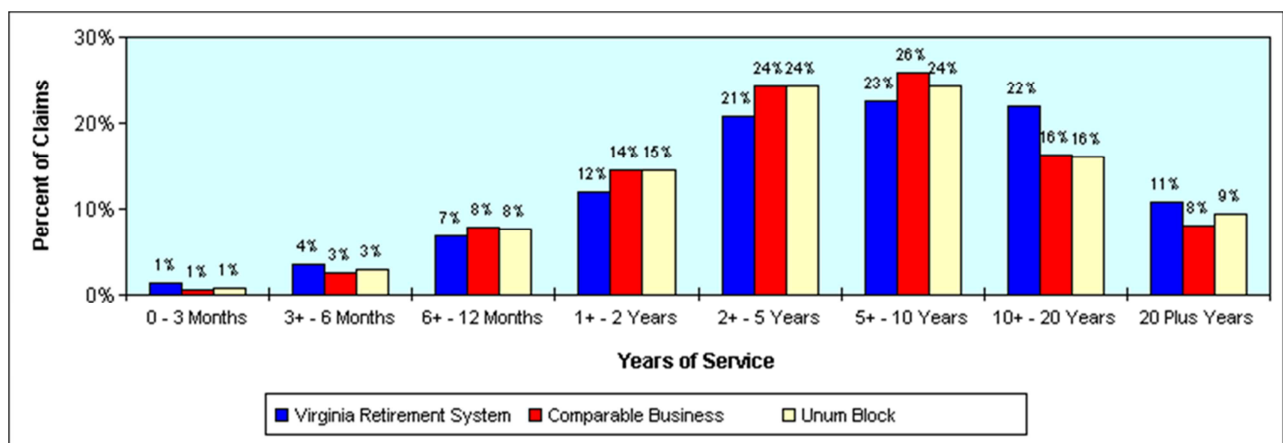
A higher rate of adverse selection could also impact an agency’s ability to perform its core responsibilities. As the intent of the existing one-year waiting period is to prevent adverse selection, HB 1645 would remove that protection in some cases. When an employee goes out on a VSDP short-term disability claim, the employer must keep the disabled employee’s position open until either 1) the employee returns to work, or 2) the six-month short-term disability period expires. Upon expiration of the short-term disability period, the employer may elect to terminate the employee. Keeping a position open for an extended period of time may be burdensome for an agency that has a fixed number of FTE positions. An agency may

need to redistribute work among its other employees, reschedule its other employees, or hire temporary employees to perform the job duties of the disabled employee.

HB 1645 would be a change to the current VSDP provisions, where an employee who becomes disabled but has not yet satisfied the one-year VSDP waiting period for non-work related disability will have his or her position held open only for a shorter period of time mandated by the federal Family and Medical Leave Act (FMLA). The agency may not have to hold the position open at all if the employee does not qualify for FMLA coverage, which also requires a waiting period.

The proposed change in HB 1645 would create an eligibility difference between VSDP and VLDP for teachers and political subdivisions. As indicated above, VLDP requires a one-year waiting period for non-work related disabilities.

The cost impacts for HB 1645 are based on the population in effect during the last valuation of the plan. For HB 1645, costs were based on the assumed impact of employees with less than 1 year of service as of June 30, 2016. The costs are only for the long-term disability portion of the benefit. Therefore, the impact of short-term disability costs on individual employers needs to be considered before adjusting the current eligibility period. As we discussed above, these costs are borne by the employers. While the cost impacts to long term disability for removing the one-year eligibility period do not appear to be large in magnitude, it is important to keep in mind that employers will pick up the initial costs associated with short term disability payments of between 60% and 100% of the member's pay. Analysis performed in 2009 during the establishment of the one year waiting period suggested that approximately 12% of all short-term disability claims came from members with less than 1 year of service. The exhibit below shows the distribution of short-term disability claims by year of service for the two year period ending June 30, 2008. HB 1645 would apply to members with at least 5 years of service with a local government, this could actually put these members into the largest cohort of STD claims, those with 5-10 years of service, who accounted for about 25% of all short term disability claims during the review period.



VSDP is essentially a risk sharing insurance pool for long-term disabilities. Similar to other insurance products, the change in annual costs for increased eligibility or other plan

modifications depends on the expected rate and impact of the new feature. Based on recent plan experience we would not expect many potential members to meet the eligibility requirements stated in HB 1645 and then incur a claim within the first year of being hired. However, if adverse selection became an issue where people with pre-existing conditions moved to a VSDP-covered position specifically in order to be covered by long-term disability, then costs would rise accordingly for everyone in the plan.

Gap Coverage Available During the One-Year Waiting Period

New state employees generally can pay for optional non-work-related disability coverage during the one-year VSDP waiting period when they do not have employer coverage. This information is provided to new employees upon hire and can also be found in the VSDP handbook. According to the Fringe Benefits Management Company website, the gap coverage available can be obtained through a number of providers. The employee's costs for the optional coverage vary depending on an individual's specific coverage and circumstances, but generally range between \$10 and \$50 on a semi-monthly basis. These rates will vary by company and due to underwriting may also take into account an individual employee's specific circumstances.

To improve communication and education on this topic VRS will publish articles to explicitly cover this topic in our Employer Update newsletter as well as make this a focal point of VSDP training that is scheduled to be provided to the state HR community in the spring of 2017. VRS will also address this issue in our employer manual. In addition, DHRM will address this issue by adding clear direction in their new employee orientation guidance document and by referencing the guidance document at least annually in its Spotlight publication for benefit administrators.

Department of Human Resource Management Statement

VRS consulted with DHRM on HB 1645, and DHRM provided the following statement:

Affording this benefit to employees having no prior state service advantages them over vested employees with prior state service.

For employees in the VSDP, state service is recognized not only in establishing income replacement rates for disability claims but also for allocations of family/personal leave and sick leave. Counting local government service in establishing these rates would create inequities with the rates established for other employees not having state employment experience. Such disparities are transparent to employees and fuel employee dissatisfaction.

Compensation and benefit/leave programs vary widely among the localities and other public sector employers and differ from those established for state employees. There is no reciprocity among the various entities. State service is not recognized by local governments when state employees enter employment with the localities and participate in their benefits programs. Including local government service in the formula for state employee benefits minimizes the value of state service.

The definition of state service applies to a variety of benefits for state employees. Local government, federal government, or private sector tenures are discounted as service time for this purpose. The definition and measurement of state service is an important factor in state employees' perception of equity in their benefits programs, recognition of their employment with the Commonwealth, and rewards for continued state employment. Employees take pride in their service tenures. The proposed legislation would diminish that value for state employees and set a precedent for service with other employers to be credited toward state employee benefits programs.

Date: 01-19-2017

Document: HB1645.DOC/VRS