

## Virginia Retirement System 2016 Fiscal Impact Statement

**1. Bill Number:** SB 65

<b>House of Origin</b>	<input checked="" type="checkbox"/>	Introduced	<input type="checkbox"/>	Substitute	<input type="checkbox"/>	Engrossed
<b>Second House</b>	<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; open enrollment period.

**5. Summary:** Opens enrollment into the Virginia Sickness and Disability Program between October 1, 2016, and January 1, 2017, for eligible employees not currently participating in the program. Any employee electing to participate in the program would convert his sick leave balances to (i) additional retirement service credit on the basis of one month of service for each 173 hours of sick leave or (ii) disability credits on the basis of one hour of disability credit for each hour of sick leave. An election to participate in the program must be in writing and is irrevocable.

**6. Budget Amendment Necessary:** VRS estimates that one-time implementation costs of approximately \$85,650 will be necessary for systems changes and testing. Depending on the number of eligible members who elect this option, there may also be additional costs for the third-party administrator that are not covered by the current contract pricing. Additionally, participating employers pay the Short Term Disability (STD) benefit portion of Virginia Sickness and Disability Program (VSDP) costs directly. An increase in STD claims would impact individual agency budgets, although these costs may be partially offset by funds currently being used for the payment of sick leave.

**7. Fiscal Impact Estimates:** This bill provides eligible employees the opportunity to elect participation in the VSDP if not already participating. Eligible employees are defined pursuant to § 51.1-1100 and include state employees, members of the State Police Officers' Retirement (SPORS) System, members of the Virginia Law Officers' Retirement (VaLORS) System and certain employees of institutions of higher education who are not participants in an optional retirement plan for higher education. The bill would allow an electing member to convert accumulated sick leave to VRS service credit at a rate of one month for every 173 hours of sick leave or to convert sick leave balances to disability credits. There are approximately 12,350 employees not currently participating in VSDP who would be eligible to make the election. Exhibit 1 below compares the average age and service of the non-VSDP employees to those currently in VSDP by employer group.

**Exhibit 1**

Plan	Current VSDP Members		Non-VSDP Members
	Plan 1 & Plan 2*	Hybrid Plan *	Plan 1
<b>State Employees</b>			
Number of Employees	56,722	7,822	10,712
Average Pay	\$51,317	\$41,631	\$59,401
Average Age	48.41	36.83	55.79
Average Service	12.00	0.79	24.82
<b>SPORS</b>			
Number of Employees	1,407		587
Average Pay	\$49,178		\$70,443
Average Age	36.54		50.42
Average Service	9.08		24.87
<b>VaLORS</b>			
Number of Employees	7,765		1,055
Average Pay	\$36,445		\$44,933
Average Age	39.66		50.36
Average Service	7.79		20.75

\* All State employees in Plan 2 and Hybrid plan are covered by VSDP and therefore this proposed election will not be applicable to them.

Approximately 44% of the employees who would be eligible for the election will already meet the service requirements for an unreduced retirement at the proposed election date, even before adding the additional service converted from sick leave. Nearly 77% of the eligible employees already meet the requirements for a reduced retirement. Estimating the overall cost impact to the VRS pension plans as well as the impact to VSDP is difficult to quantify without knowing which and how many members will opt for VSDP.

Generally, VRS would assume that the savings to the pension plans from removing disability retirement and switching to VSDP would be offset by the cost increase in VSDP of adding the new members. Similarly, we would also expect the cost employers were incurring for providing the annual sick leave associated with members in the traditional disability retirement plan may offset the cost associated with providing STD benefits. Such offset may depend on leave balances each individual may have. VRS expects the proposed bill could result in some adverse selection and possible additional cost to VSDP.

The members eligible for the open enrollment are, on average, older and have more years of service than the current VSDP population, which tends to indicate a greater chance for incurring a disability claim. However, the ability for a member to convert his or her accumulated sick leave hours to retirement service may actually offset some of the adverse selection risk to VSDP as members may choose to join VSDP just to receive the extra retirement credits and then retire. That stated, if this population retires earlier than they would have otherwise with additional service credit added to their record, there will be an impact to the pension plan.

Although the proposed bill would reduce the cost of disability retirement under VRS for members who elect to enroll in VSDP, the increase in liability associated with converting the sick leave balance to pension service would erase any savings and ultimately increase retirement plan costs by generating additional unfunded liability. Based on the accumulated sick leave balances collected for this analysis, 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)) may be able to retire approximately one year earlier by converting their sick leave balance to retirement service credits.

Pension plans rely on pre-funding of benefits so that contributions made throughout a member's career, along with investment income, will be used to pay for future retirement benefits. Since nearly 77% of these eligible employees are already eligible for retirement, there is not enough time to accumulate investment income to pay for the increased benefits. Without an immediate contribution to cover the increase in plan liability, the new unfunded liability will need to be paid over the next 20 years while the member is retired and at the expense of the next generation of taxpayers.

Although we cannot predict the percentage of members who would enroll in VSDP under this legislation, VRS expects that the opportunity to convert sick leave balances to retirement service credits will provide a significant incentive for members. The average sick leave balance for those who would be affected by this legislation is approximately 1,350 hours, which would equate to about 8 months of additional service if converted to service credit.

The impact of SB 65 on the pension plan contribution rates has been calculated under two alternative assumptions with respect to the conversion of accumulated sick leave to retirement service. The first scenario assumes that 50% of those members with the highest unused sick leave balances will elect to enroll in VSDP. Exhibit 2 below shows the potential impact on pension costs based on this scenario.

**Exhibit 2 - 50% of Members with Highest Sick Leave Balances Convert to VSDP**

	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>
State - General Fund	\$ 2,532,000	\$ 2,532,000	\$ 2,532,000	\$ 2,532,000	\$ 2,532,000	\$ 2,532,000
SPORS - General Fund	507,000	507,000	507,000	507,000	507,000	507,000
VaLORS - General Fund	586,000	586,000	586,000	586,000	586,000	586,000
JRS - General Fund	-	-	-	-	-	-
Teacher - General Fund	-	-	-	-	-	-
<b>TOTAL General Fund</b>	<b>\$ 3,625,000</b>					
State - Non-General Funds	\$ 3,393,000	\$ 3,393,000	\$ 3,393,000	\$ 3,393,000	\$ 3,393,000	\$ 3,393,000
SPORS - Non-General Funds	91,000	91,000	91,000	91,000	91,000	91,000
VaLORS - Non-General Funds	55,000	55,000	55,000	55,000	55,000	55,000
<b>TOTAL - Non-General Funds</b>	<b>\$ 3,539,000</b>					
Teacher - Local Funds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Political Subdivisions - Schools	-	-	-	-	-	-
Political Subdivisions - Non-Schools	-	-	-	-	-	-
<b>TOTAL Local Funds</b>	<b>\$ -</b>					
<b>Grand Totals</b>	<b>\$ 7,164,000</b>					

Estimated projections based on employee data and valuation results as of June 30, 2015 and assume a level population throughout projection period.

Payroll projections are assumed to remain level throughout projection period.

The immediate increase in unfunded liability that would result from this legislation, assuming 50% of the members with the highest sick leave balance elect to convert to VSDP, is approximately \$68.5 million.

The second scenario assumes that 100% of members with unused sick leave balances will elect to enroll in VSDP. Exhibit 3 below shows the potential impact on pension costs based on this scenario.

**Exhibit 3 - 100% of Eligible Members Convert to VSDP**

	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>
State - General Fund	\$ 3,376,000	\$ 3,376,000	\$ 3,376,000	\$ 3,376,000	\$ 3,376,000	\$ 3,376,000
SPORS - General Fund	746,000	746,000	746,000	746,000	746,000	746,000
VaLORS - General Fund	894,000	894,000	894,000	894,000	894,000	894,000
JRS - General Fund	-	-	-	-	-	-
Teacher - General Fund	-	-	-	-	-	-
<b>TOTAL General Fund</b>	<b>\$ 5,016,000</b>					
State - Non-General Funds	\$ 4,525,000	\$ 4,525,000	\$ 4,525,000	\$ 4,525,000	\$ 4,525,000	\$ 4,525,000
SPORS - Non-General Funds	133,000	133,000	133,000	133,000	133,000	133,000
VaLORS - Non-General Funds	84,000	84,000	84,000	84,000	84,000	84,000
<b>TOTAL - Non-General Funds</b>	<b>\$ 4,742,000</b>					
Teacher - Local Funds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Political Subdivisions - Schools	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Political Subdivisions - Non-Schools	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
<b>TOTAL Local Funds</b>	<b>\$ -</b>					
<b>Grand Totals</b>	<b>\$ 9,758,000</b>					

Estimated projections based on employee data and valuation results as of June 30, 2015 and assume a level population throughout projection period.

Payroll projections are assumed to remain level throughout projection period.

The immediate increase in unfunded liability that would result from 100% of the eligible members converting their sick leave to service credit is expected to be approximately \$90.8 million. The cost estimates are based on data, actuarial assumptions, and methods from the June 30, 2015 actuarial valuation and do not take into account any offset of potential payout by employers for unused sick leave at time of retirement. This payout is for up to 25% of sick leave and is capped at \$5,000, pursuant to DHRM policy 4.55, which allows eligible employees with at least five years of continuous salaried state service who separate from state service to be paid for up to 25% of their accrued sick leave balance up to a maximum of \$5,000.

VRS also expects that there would be minor impacts to costs associated with the Health Insurance Credit (HIC) Program and Group Life Insurance (GLI) Program due to the accelerated retirement eligibility of some members. However, these impacts are expected to be less significant than the conversion of sick leave to pension service.

- 8. Fiscal Implications:** Allowing the conversion of accumulated sick leave to retirement service credit would enable eligible employees who take advantage of the opportunity to retire earlier. In some cases, long-term employees have accrued several years of sick leave. Any employee with at least 15 years of service who retires earlier than expected will also begin to receive a health insurance credit (HIC) earlier than expected. All eligible members will have at least 15 years of service. Accelerated retirement eligibility generally increases unfunded liabilities since contributions were not collected for the relevant period of service credit.

**9. Specific Agency or Political Subdivisions Affected:** VRS and all VRS participating employers, including colleges and universities, with eligible employees.

**10. Technical Amendment Necessary:** Yes. VRS suggests that, for administrative simplicity, the effective date for all members who opt into VSDP be the same date instead of staggered dates based on the actual date of the member's election. Likewise, VRS suggests that the opt-in period end on December 1, 2016, so that VRS has time to process all of the elections prior to the suggested effective date of January 1, 2017.

Line 24, replace "January 1, 2017" with "December 1, 2016".

Lines 28 and 29, replace "the first day of the pay period following the delivery of the notice of election to the Retirement System" with "January 1, 2017".

**11. Other Comments:** To date, there have been two election periods related to VSDP participation. The initial election was an opt-in period from January 1, 1999 through March 31, 1999. The second election period, under which all non-participating employees were covered by VSDP unless they opted out, was from October 1, 2002 through January 1, 2003. This legislation would allow any eligible employee who is not a VSDP participant as of September 30, 2016, to elect to participate in VSDP. The election must be in writing, would be irrevocable, and must be received by VRS between October 1, 2016, and January 1, 2017 (although VRS is requesting a related technical amendment). The effective date of participation for any eligible employee electing participation pursuant to this bill will be the first day of the first pay period following the delivery of the election notice to VRS. (Please see suggested technical amendments.) Upon election, a member may convert his or her accumulated sick leave to retirement service credit at a rate of one month of service credit for 173 hours of sick leave or convert his or her sick leave balance to disability credits. SB 65 does not limit the amount of sick leave that can be converted. However, any decision to convert sick leave balances must take place at the time of the member's election to participate in VSDP.

Current law (§ 51.1-142.2(D)) allows any member in service to purchase service credit for accumulated sick leave upon retirement but only in the amount the employer may provide as payment for unused sick leave (currently 25% of accrued sick leave up to a maximum of \$5,000). The member is required to pay the actuarial equivalent of the cost of any service purchased under this provision.

Below are two examples of the impact to VRS and the member under the proposed bill. The first example shows the impact for a State member already eligible for early retirement who has 1,500 hours of accumulated sick leave. The 1,500 hours of sick leave converts to 9 additional months of service. In this scenario the member will be eligible for an unreduced retirement benefit at age 60 with 30 years of service. Under this legislation, the member would be age 58 at the time of the open enrollment. If the member were able to convert the sick leave balance to additional months of service the member could retire 9 month earlier, at age 59 and 3 months with 30 years of service. Exhibit 4 provides the value of the benefit

before the conversion of sick leave and the value of the benefit under the proposed bill, which shows an increase in liability of \$12,700 for this member.

#### Exhibit 4

##### State Member - Example of Impact of Converting Sick Leave Balance to Additional Benefit Service

###### **Employee Statistics**

Employee Age on October 1, 2016	58.00
Years of Benefit Service	28.00
Average Final Compensation	\$65,000
Accumulated Sick Leave Balance	1500 Hours
Unreduced Retirement Date	Oct 1, 2018

###### **Current Value of Retirement Benefit and Unused Sick Leave Balance at Date of Retirement**

Unreduced Retirement Date	Oct. 1, 2018
Age at Retirement	60.00
Projected Years of Service at Retirement	30.00
Average Final Compensation	\$65,000
Projected Annual Retirement Benefit	\$33,150
Value of Retirement Benefit on 7/1/2016	\$485,200
Payout of Unused Sick Leave	\$5,000
Total Value of Retirement Benefit and Unused Sick Leave at Retirement	\$490,200

###### **Value of Retirement and Unused Sick Leave under Proposed Legislation at Date of Retirement (Accumulated Sick Leave is Converted to 9 Months of Additional Benefit Service)**

Unreduced Retirement Date	Jan. 1, 2018
Age at Retirement	59.25
Projected Years of Service at Retirement	30.00
Average Final Compensation	\$65,000
Projected Annual Retirement Benefit	\$33,150
Value of Retirement Benefit on 7/1/2016	\$502,900
Payout of Unused Sick Leave	\$0
Total Value of Retirement Benefit and Unused Sick Leave at Retirement	\$502,900

<b>Net Increase in Plan Liability</b>	<b>\$12,700</b>
---------------------------------------	-----------------

The second example shows the impact for a SPORS member who has 3,500 hours of accumulated sick leave. The 3,500 hours of sick leave converts to 1 year and 9 months of additional service. In this scenario the member is already eligible for unreduced retirement on the date of open enrollment. The member is age 50 with 25 years of service. If the member were able to convert the sick leave balance to additional months of service the member could retire with 26.75 years of service rather than 25 years of service. Exhibit 5 provides the value of the benefit before the conversion of sick leave and the value of the benefit under the proposed bill, which shows an increase in liability of \$28,000 for this member.

## Exhibit 5

### SPORS Member - Example of Impact of Converting Sick Leave Balance to Additional Benefit Service

#### Employee Statistics

Employee Age on October 1, 2016	50.00
Years of Benefit Service	25.00
Average Final Compensation	\$65,000
Accumulated Sick Leave Balance	3500 Hours
Unreduced Retirement Date	Oct 1, 2018

#### Current Value of Retirement Benefit and Unused Sick Leave Balance at Date of Retirement

Unreduced Retirement Date	Oct. 1, 2018
Age at Retirement	50.00
Projected Years of Service at Retirement	25.00
Average Final Compensation	\$65,000
Projected Annual Retirement Benefit	\$27,625
Projected Annual Supplement Payable to age 65	\$13,548
Value of Retirement Benefit on 7/1/2016	\$645,100
Payout of Unused Sick Leave	\$5,000
Total Value of Retirement Benefit and Unused Sick Leave at Retirement	\$650,100

#### Value of Retirement and Unused Sick Leave under Proposed Legislation at Date of Retirement (Accumulated Sick Leave is Converted to 21 Months of Additional Benefit Service)

Unreduced Retirement Date	Jan. 1, 2017
Age at Retirement	50.00
Projected Years of Service at Retirement	26.75
Average Final Compensation	\$65,000
Projected Annual Retirement Benefit	\$29,559
Projected Annual Supplement Payable to age 65	\$13,548
Value of Retirement Benefit on 7/1/2016	\$678,100
Payout of Unused Sick Leave	\$0
Total Value of Retirement Benefit and Unused Sick Leave at Retirement	\$678,100

**Net Increase in Plan Liability** **\$28,000**

Date: 2-1-16

Document: SB65.DOC/VRS