Senate Finance Committee

September 17, 2009

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Director

Virginia Retirement System

Agenda

- Rate Setting and Funding of VRS Benefits
- Projected Contribution Rates
- Policy Alternatives

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Rate Setting and Funding Benefits

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Rate Setting and Contributions

Code of Virginia establishes:

- Employer contribution:
  - Rate calculated during a biennial actuarial valuation
  - Valuation compares funds’ assets and liabilities
  - Valuation uses assumptions
    - Investment return
    - COLA increases
    - Rates of salary increase
    - Probabilities of retirement, termination, death and disability

- Member contribution:
  - 5% member contribution
  - Nearly all employers “pick up” contribution for employee

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Employer Contributions

- § 51.1-145 requires employer contributions to be determined in a manner so as to remain relatively level from year to year
- Each employer shall contribute an amount equal to the sum of
  - the normal contribution,
  - any accrued liability contribution
- Value of assets "smoothed" over a five-year period

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Asset Smoothing

- Asset gains/losses recognize 1/5 of the difference between actual market return and expected market return.
- Used by most public retirement systems
- Actuarial and market value recognized within reasonable time
- Most common period is five years
- Usage does not mean contributions remain level
- Prevents changes in contribution rates from being dramatic
- Public sector moving to longer periods; private sector moving to shorter periods
- Actuary cautions on changing period after big losses or gains

Funding VRS Benefits

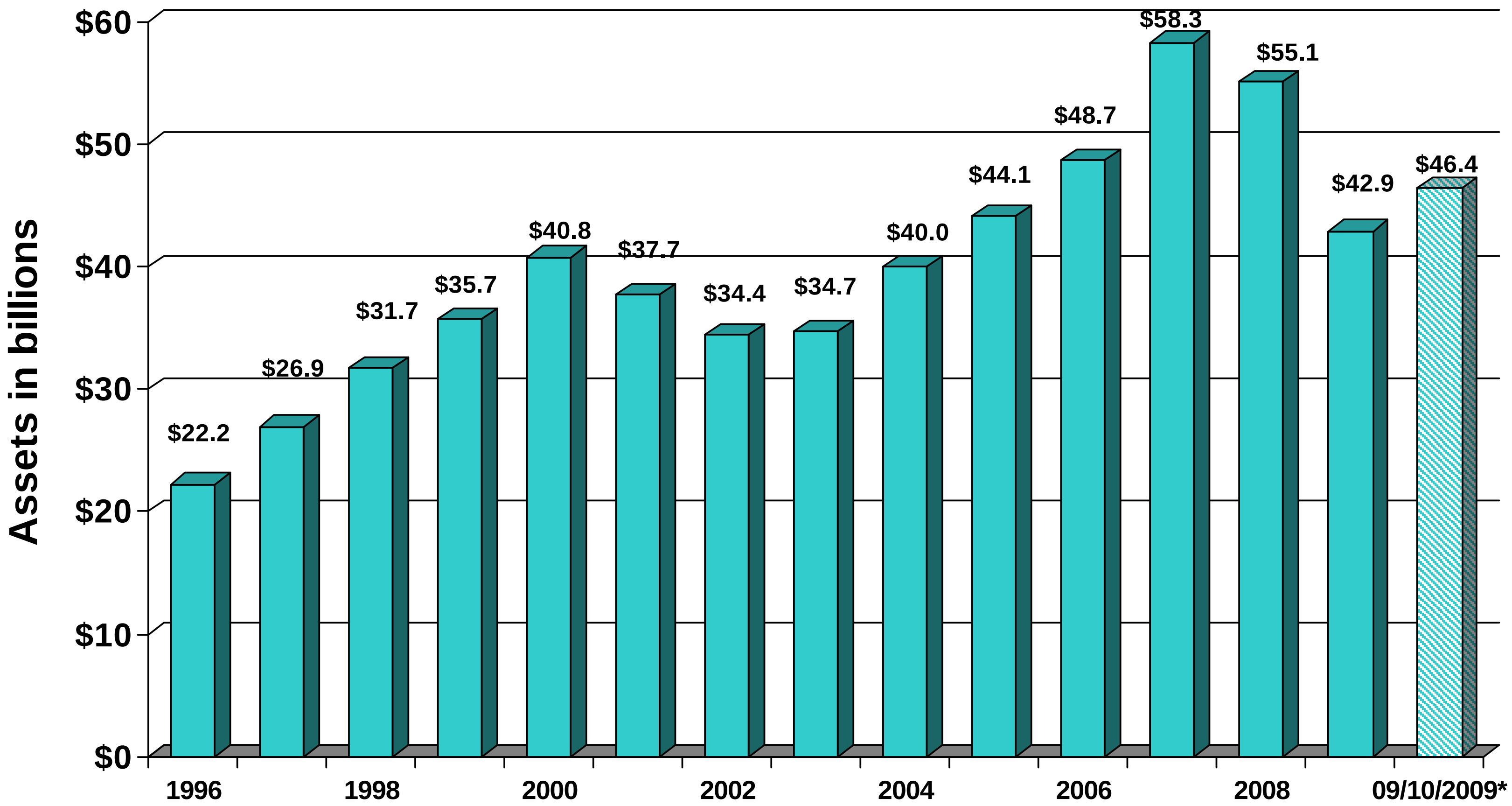
- 68% of benefit costs funded by investment earnings

- 32% of benefit costs funded by employee/employer contributions

Funded Status

- Compares assets available to pay benefits with present value of future liabilities
- Asset/liability ratio is typical measure
- Percentage of assets available to pay present value of all future liabilities (until the last member of the plan dies)

Net Assets Available for Benefits



* Estimate as of 9-10-09

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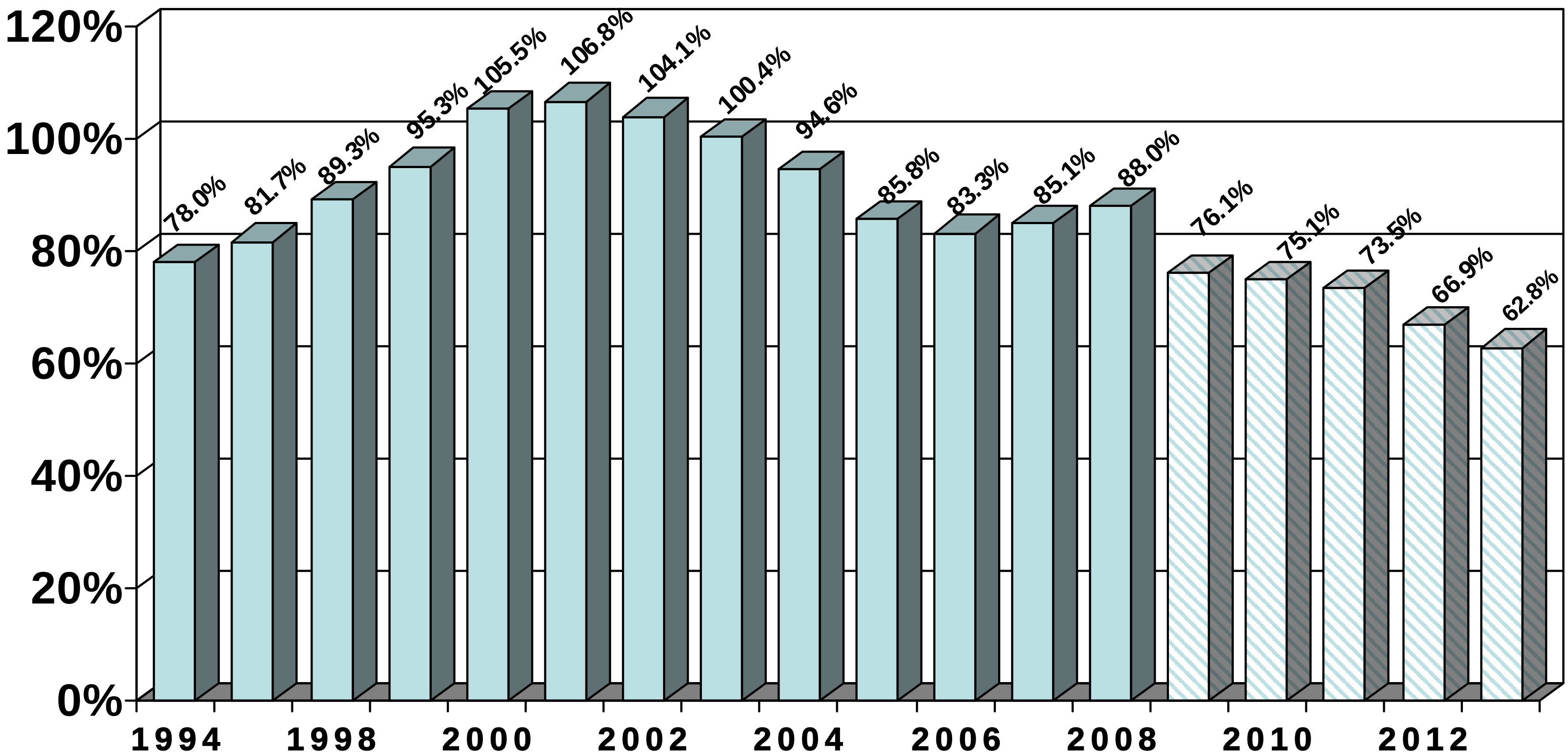
Funded Status: State Employees



Assumptions:
- FY 2009 investment return is -21.1%.
- All projected years investment return is 7.5% and 2.5% inflation rate.
- Employer contribution rates for fiscal year 2009 is fixed at 6.23% and for 2010 at 6.26% for state employees.

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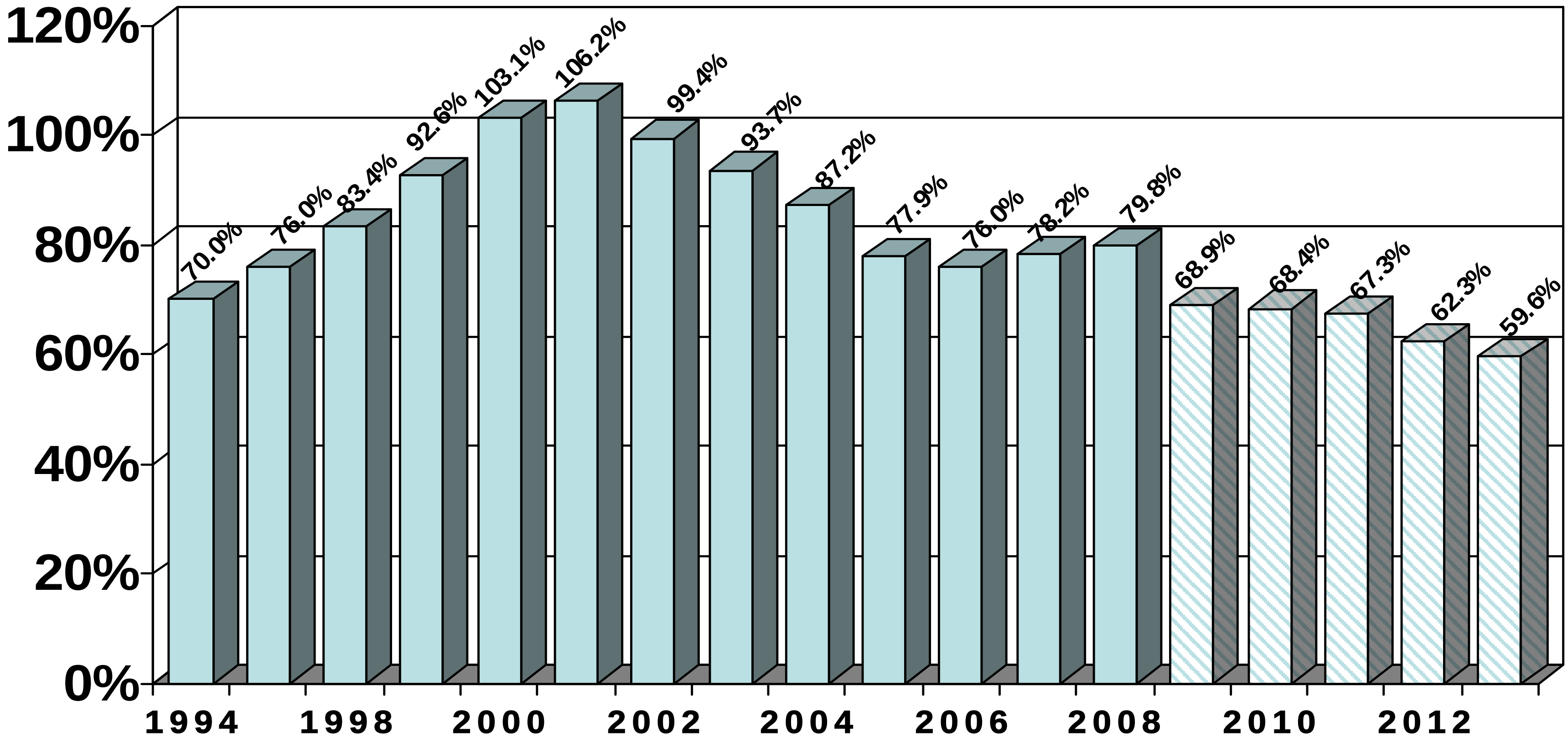
Funded Status: Teachers



Assumptions:
- FY 2009 investment return is -21.1%.
- All projected years investment return is 7.5% and 2.5% inflation rate.
- Employer contribution rates for fiscal years 2009 and 2010 are fixed at 8.81% for teachers.

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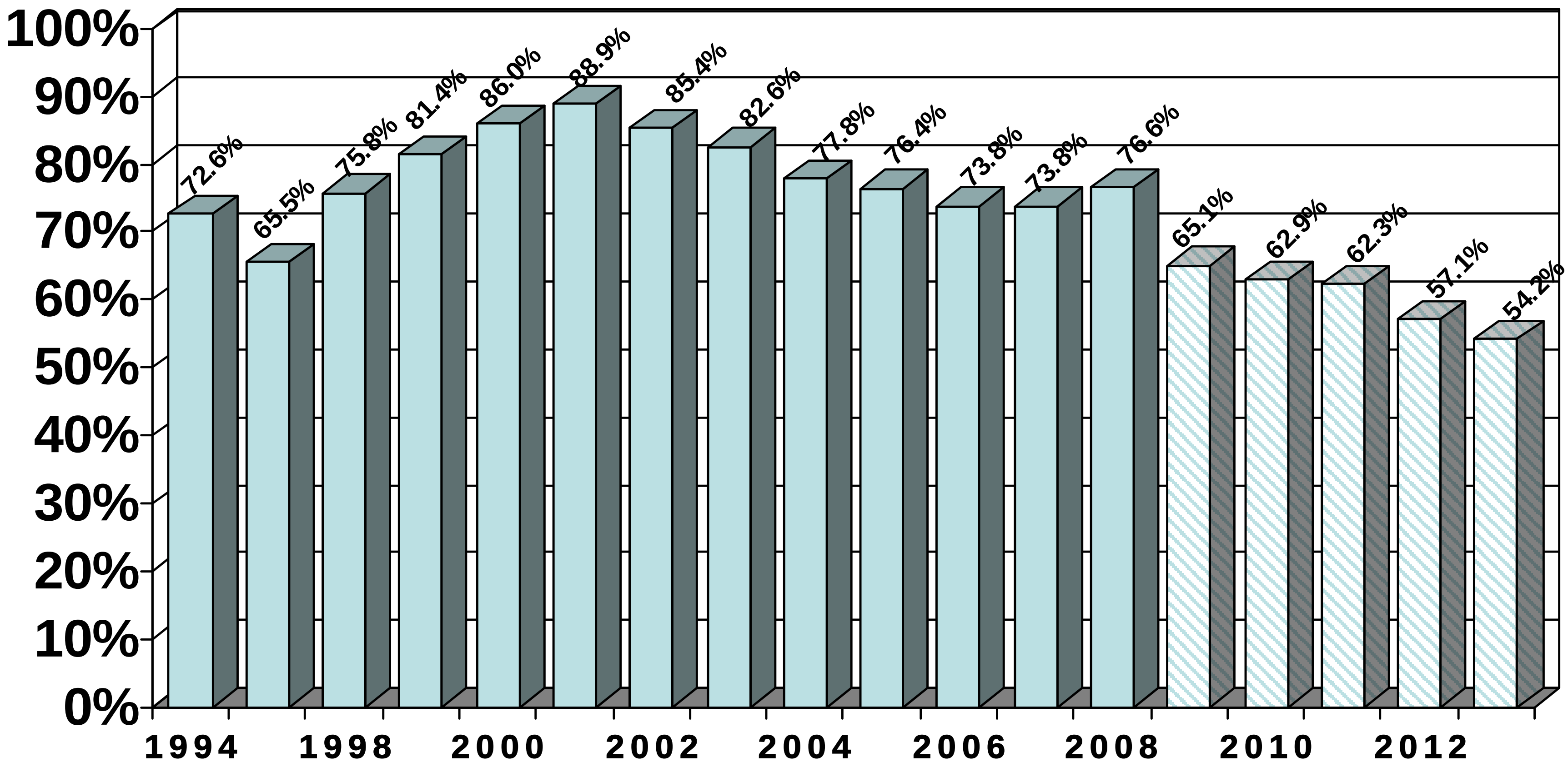
Funded Status: State Police



Assumptions:
- FY 2009 investment return is -21.1%.
- All projected years investment return is 7.5% and 2.5% inflation rate.
- Employer contribution rates for fiscal years 2009 and 2010 are fixed at 20.05% for SPORS.

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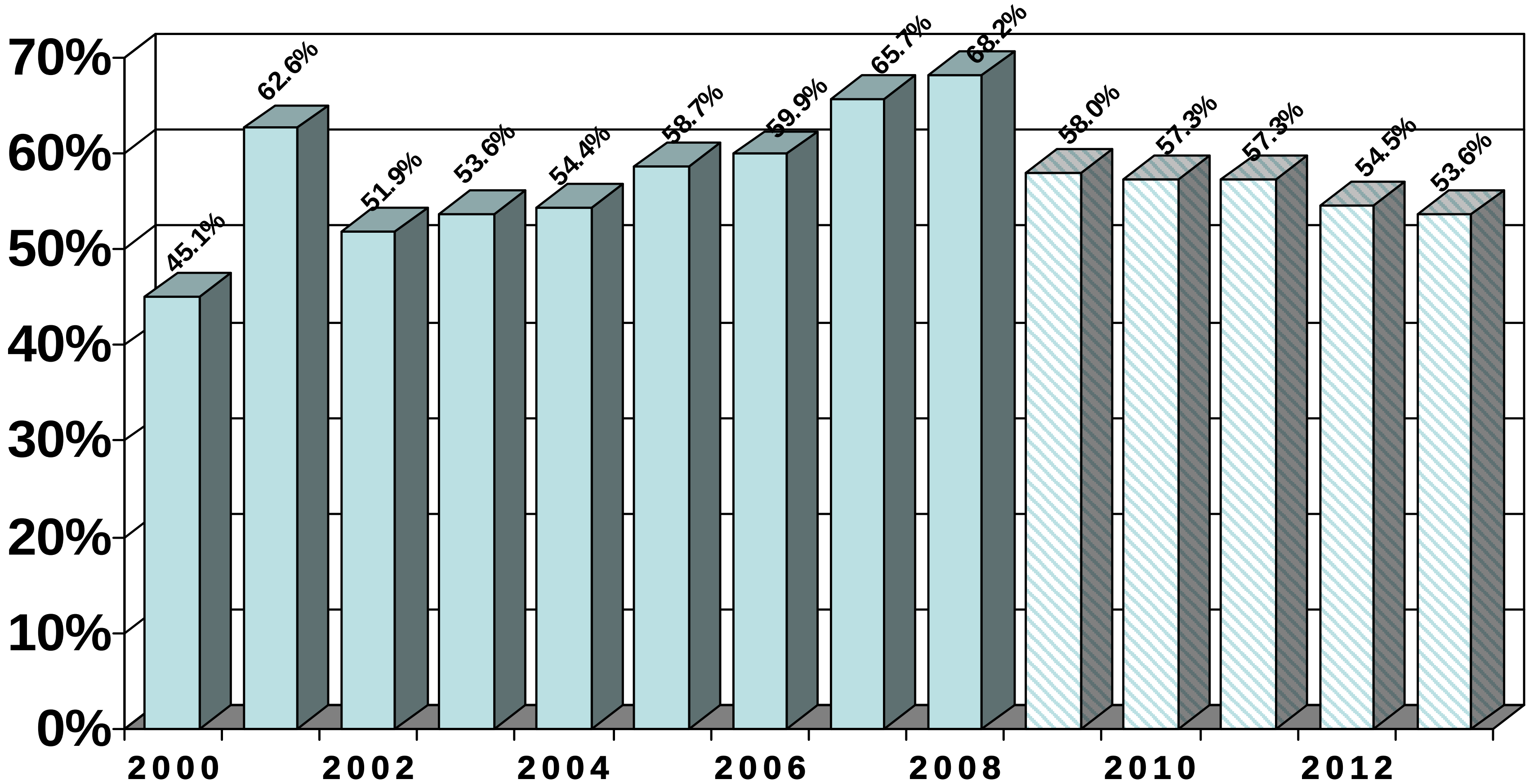
Funded Status: VaLORS



Assumptions:

- FY 2009 investment return is -21.1%.
- All projected years investment return is 7.5% and 2.5% inflation rate.
- Employer contribution rates for fiscal years 2009 and 2010 are fixed at 14.23% for VaLORS.

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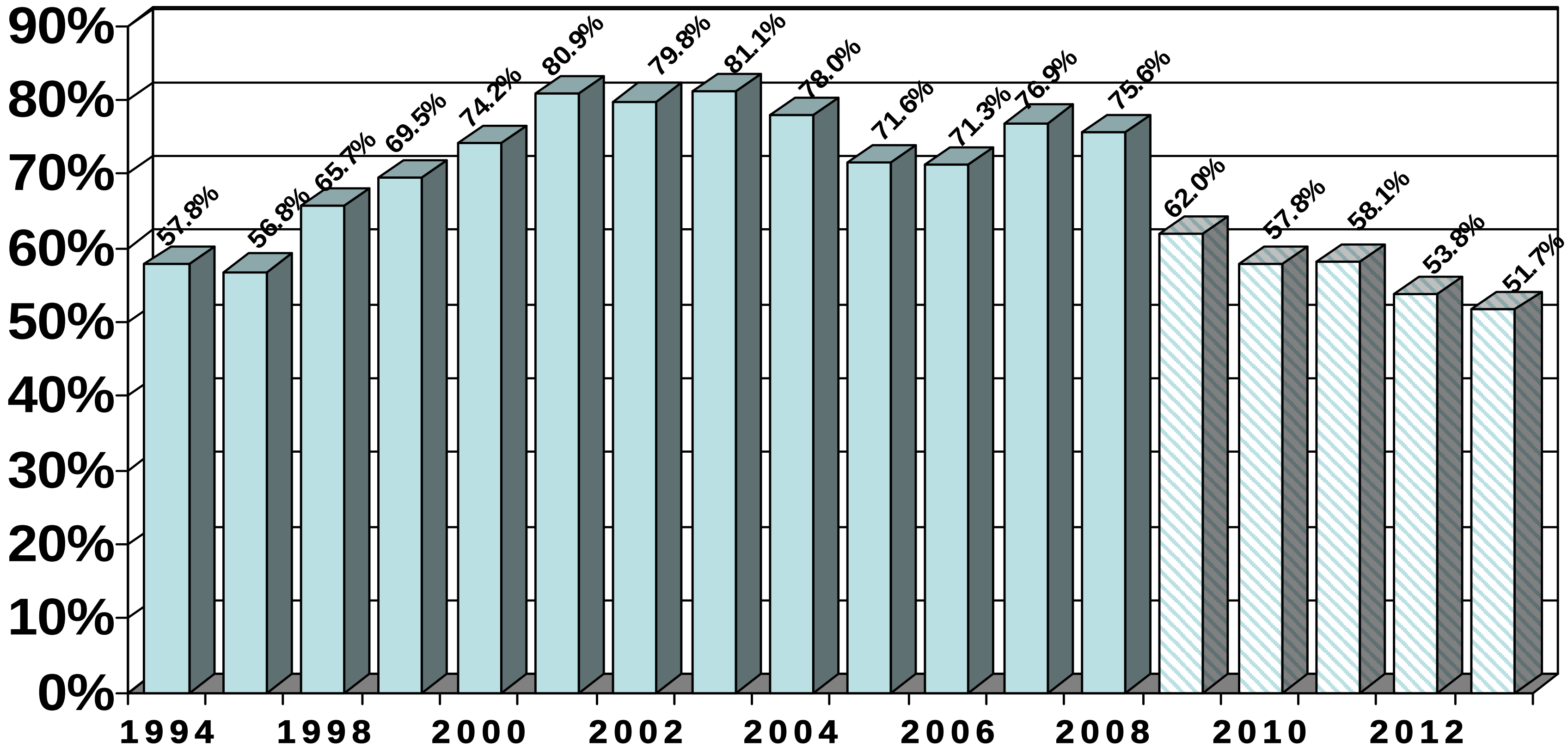
Funded Status: JRS



Assumptions:
- FY 2009 investment return is -21.1%.
- All projected years investment return is 7.5% and 2.5% inflation rate.
- Employer contribution rates for fiscal years 2009 and 2010 are fixed at 34.51% for JRS.

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Projected Contribution Rates

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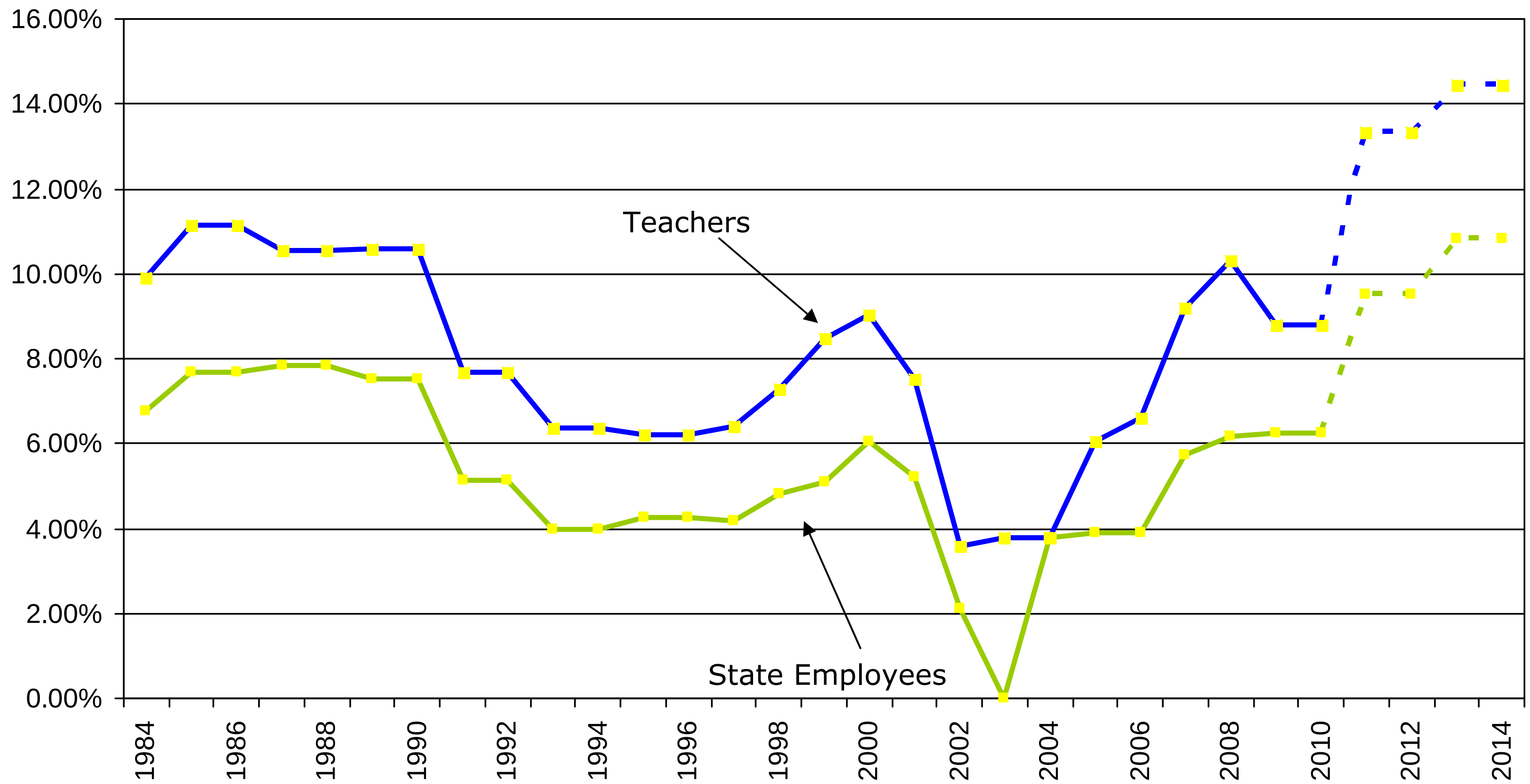
Teacher and State Contribution Rates FY ‘84 – ‘14



- Projected rates are based on an 8% rate of return, a 3% inflation rate and a 30-year amortization.
- These employer rates do not include the 5% member contributions that are also paid by employers.

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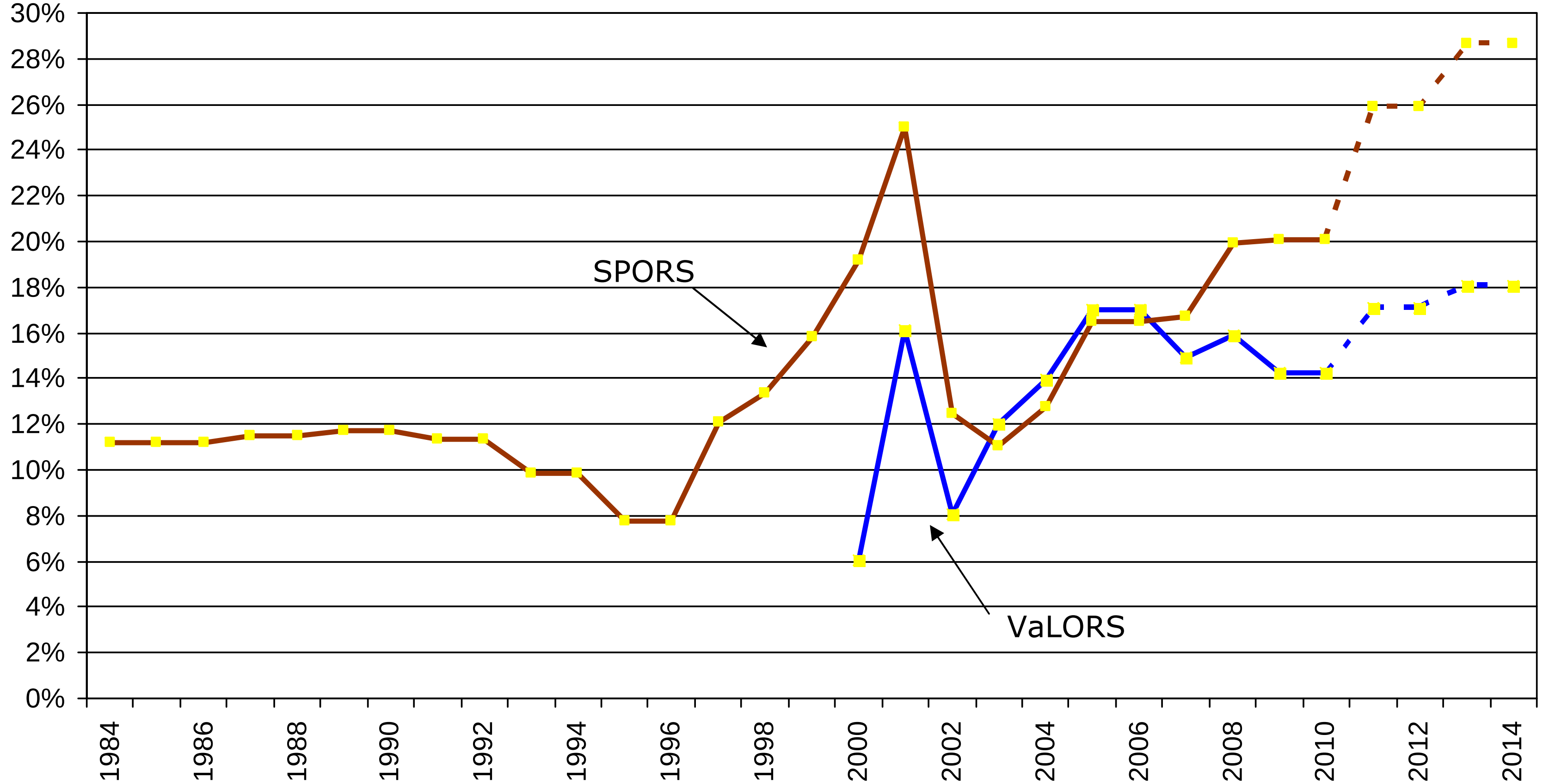
VaLORS, SPORS Contribution Rates FY '84 – '14



- Projected rates are based on an 8% rate of return, a 3% inflation rate and a 30-year amortization.
- These employer rates do not include the 5% member contributions that are also paid by employers.

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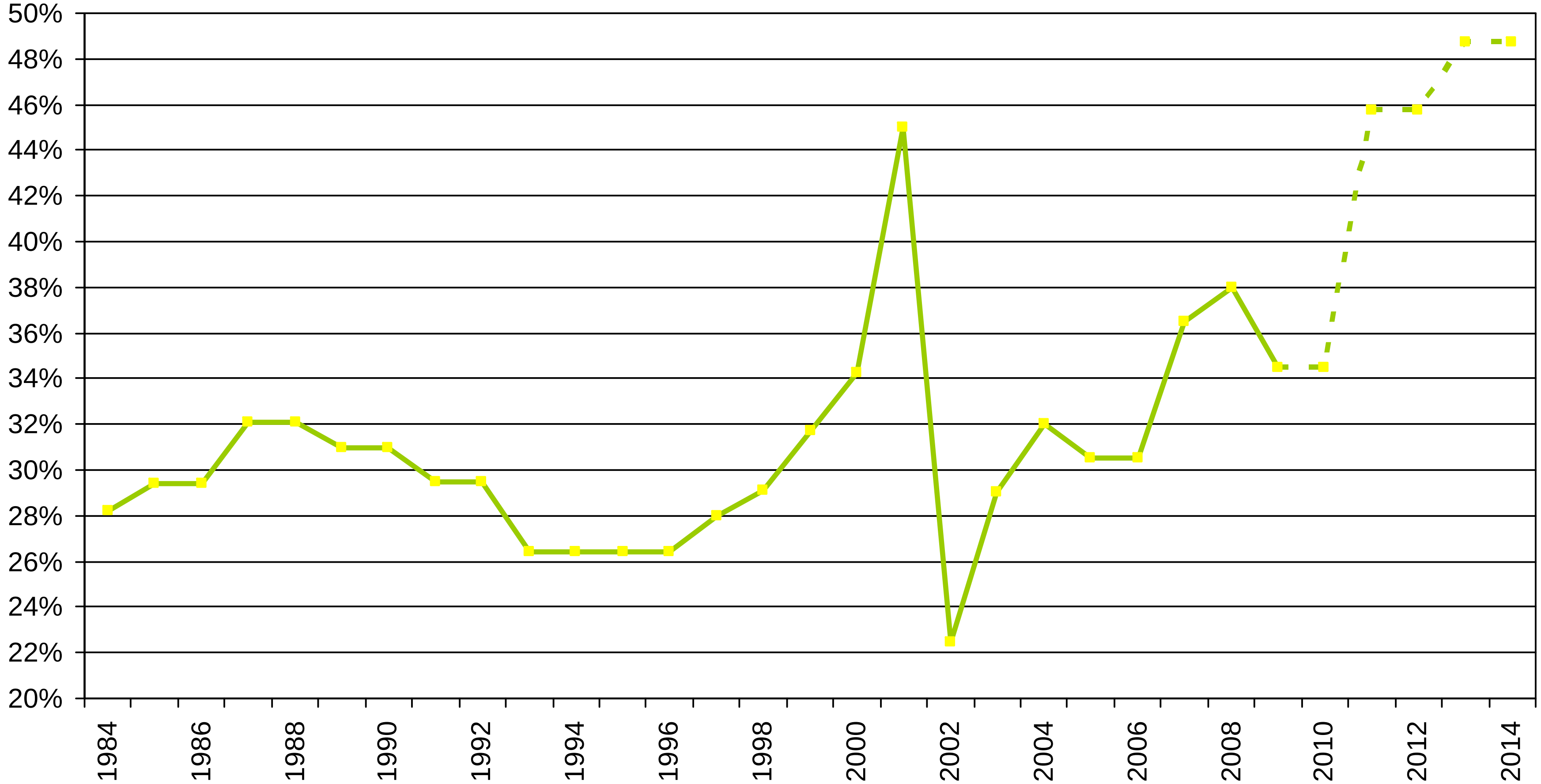
JRS Contribution Rates FY '84 – '14



• Projected rates are based on an 8% rate of return, a 3% inflation rate and a 30-year amortization.

• These employer rates do not include the 5% member contributions that are also paid by employers.

Projected Employer Contribution Rates

	Current Rates* FY 2010	Projected Rates* FY 2010-12	Potential Annual Cost Increase	Estimated General Fund Portion
State Employee	6.26%	9.51%	$142.7 million	$69.2 million
Teacher	8.81%	13.33%	$374.7 million	$147.3 million
VaLORS	14.23%	17.11%	$13.6 million	$12.6 million
SPORS	20.05%	25.93%	$7.6 million	$6.5 million
JRS	34.51%	45.71%	$8.3 million	$8.3 million

*Current and projected rates are based on assumptions applied in the 2009 Appropriations Act (8% rate of return, 3% inflation rate, and a 30-year amortization). Board requested rates will be based on the following assumptions (7.5% rate of return, 2.5% inflation rate, and a 20 year amortization period), and will likely be higher.

- FY 2009 investment return is -21.1%.
- These employer rates do not include the 5% member contributions that are also paid by employers.

Policy Alternatives

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Policy Options

- Employer pays the full actuarial rate
- Implement employee-paid member contributions
  - (currently 5% member contribution picked up by the employer)
- Reduce benefits
- Provide new members with alternate plan
  - Optional Retirement Plan’s (ORP) defined contribution rate is 10.4%

Estimated Cost Avoidance from Plan Design Changes Identified by JLARC

Benefit Change	Reduction in Contributions (% Payroll)*	Annual General Fund Savings**	Annual Non-general Fund Savings**
Employee-paid Member Contribution (2%)	• State 1.95% • VALORS 1.94% • SPORS 1.98%	$37.2 million $6.8 million $1.9 million	$39.5 million $0.5 million $0.3 million
Employee-paid Member Contribution (2%)***	• Teachers 1.97%	N/A	$146.1 million (Local Funds)

*Estimated rate reduction calculated by JLARC and PWC.

**Based on estimated FY 2010 covered payroll and assumes immediate and full implementation.

***Member contributions for teachers are not funded through the SOQ formula. Any savings associated with employee-paid member contributions for teachers would accrue to the school division/locality. To implement employee-paid member contributions, school divisions and their local governing bodies would have to make a formal election.

Notes: JLARC & PWC assumed that the contributions would be phased in over a four-year period. PWC and JLARC rate reduction analysis not completed for JRS.

Source: VRS analysis and JLARC's Review of State Employee Total Compensation

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Estimated Cost Avoidance from Plan Design Changes Identified by JLARC

Benefit Change	Eventual Reduction in Contributions (% Payroll)[a]	Eventual General Fund Savings[b]	Eventual Non-general Fund Savings[b]
Increase retirement age for non-vested VRS members & new hires (60) [c]	•State 0.45% •Teachers 0.88%	$8.6 million $25.7 million	$9.1 million $39.6 million (Local Funds)
Reduce COLA for new retirees [d]	•State 1.15% •VALORS 1.31% •SPORS 2.02% •Teachers 1.36%	$21.9 million $4.6 million $1.9 million $39.6 million	$23.3 million $0.4 million $0.3 million $61.2 million (Local Funds)

[a]Estimated rate reduction calculated by JLARC and PWC. Analysis by JLARC and PWC not completed for JRS.

[b]Illustrative examples of eventual savings based on estimated FY 2010 covered payroll.

[c]Does not apply to SPORS and VALORS. Once all members fall under the new minimum age requirements, PWC estimated the new approach would result in an ARC of approximately 0.5% to 0.9% of payroll less than the current approach.

[d]Once all retirees fall under the new COLA provisions, PWC estimated that the ARC would be between 1% and 2% of payroll less than the current approach.

Source: VRS analysis and JLARC's Review of State Employee Total Compensation

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Realizing Savings from Plan Design Changes Takes Time

- Due to legal restrictions, benefit changes usually can only be applied to new members
- Employer contribution rates are based on annual actuarial valuations, which are snapshots of the liability picture at a point in time
  - Rates depend on the benefits promised to the members at each valuation date
  - It takes many years before the membership with lower benefits becomes a significant portion of the active membership
  - Any savings will only emerge as the active population shifts from the higher benefit structure to the lower benefit structure
- Active members are only a piece of the liability picture
- Changing benefits for actives does nothing to reduce the retiree liability

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Other Policy Options Identified by JLARC

- New benefit structure for new hires and/or non-vested members
  - Combination Plan
  - Cash Balance Plan
  - Defined Contribution Plan

- Cost savings not immediate
  - Will take 20 to 30 years to realize savings

Estimated Cost Avoidance from Changes Identified by JLARC

	Reduction in Employer Contributions for State Employees after 40 years (As a % of future payroll)	Reduction in Employer Contributions for Teachers after 40 years (As a % of future payroll)
Combination Plan	1.94%	3.33%
Cash Balance Plan	3.33%	4.00%
Defined Contribution Plan	4.94%	5.88%
Source: JLARC's Review of State Employee Total Compensation and PWC analysis		

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Plan Design Changes Identified by PWC & JLARC

	Applicable				Savings/Cost Avoidance	
Benefit Change	**Current Members**	**Non-vested members**	**New Hires**	**Current Retirees**	**Immediate**	**Long-term**
Employee-paid Member Contribution (2%)*	√	√	√		√	
Increase retirement age 60**		√	√			√
Reduce COLA for new retirees***	√	√	√			√
Combination Plan			√			√
Cash Balance Plan			√			√
Defined Contribution Plan			√			√

*PWC & JLARC assumed that the contributions would be phased in over a four-year period.

**PWC and JLARC did not apply retirement age design change to SPORS and VALORS.

***JLARC & PWC suggested that the General Assembly could consider exempting active employees within several years of retirement eligibility from this change. Such an exemption could help limit the extent to which employees in this group may have to alter their retirement plans. This exemption could also help avoid a sudden increase in employee retirement—and therefore loss of experienced employees—just prior to the effective date.

Governor's Budget Reduction Plan

- Reduce state and teacher employer contributions to VRS for the three month period April – June of 2010
  - Reduction will not affect benefit provisions and will not affect the accumulation of contributions in member accounts
  - The state will continue paying the 5% member contributions that are picked up and paid for by employers
- Suspend contributions to VRS for OPEB programs for April – June of 2010, except for local government health insurance credit
- One unpaid day of leave for state employees on May 28, 2010. Unpaid leave will not affect
  - VRS retirement benefits or
  - life insurance coverage

Governor's Budget Reduction Plan

Reduce State and Teacher Employer Pension Contributions for 4th Quarter FY 2010		
Employer Group	**Projected Fourth Quarter Employer Contribution (GF and NGF)**	**Funds Captured in Governor's Reduction Plan***
State Employees	$56.88 million	$34.2 million
VALORS	$12.55 million	$10.2 million
JRS	$5.08 million	$4.3 million
SPORS	$5.07 million	$4.0 million
Teachers	$179.4 million**	$51.3 million***
Total Pension Reduction	**$259.0 million**	**$104.0 million**

*Removes Federal, Trust and Agency, Internal Service, and Transportation funds from the NGF amounts

**VRS data includes local funds as well as instructional and support staff

***Includes only those costs included in the SOQ formula

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Governor's Budget Reduction Plan

Suspend OPEB Contributions to VRS for April – June 2010		
	Projected Fourth Quarter Employer Contribution (GF and NGF)	**Funds Captured in Governor's Reduction Plan***
Group Life Insurance** **(All Groups)**	$34.59 million	$8.5 million
Retiree Health Insurance Credit (State)	$13.41 million	$8.2 million
Retiree Health Insurance Credit (Teachers)***	$21.17 million	$6.1 million
VSDP (State)	$9.80 million	$8.1 million
Total	**$78.97 million**	**$30.90 million**

*Removes Federal, Trust and Agency, Internal Service, and Transportation funds from the NGF amounts

**VRS data includes political subdivisions

***VRS data includes local funds as well as instructional and support staff

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Governor's Budget Reduction Plan

- VRS had planned to receive about $2.4 billion in contributions in the budget approved by the General Assembly for FY2010
- Reduced state and local contributions are estimated to be about $338.0 million
- Reduction represents a 14.1% reduction in contributions to the VRS Trust Fund

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Questions?