



Virginia Retirement System Overview

Senate Finance Committee

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Introduction



Portfolio experienced favorable investment gains

- 11.8 percent return for FY 2013
- Year-end balance grew to \$58.3 billion

Pension reform

- Will take time to show reduced liabilities
- Calls for increased contributions over next six years

New pension accounting rules issued by GASB and bond rating agencies

- Will affect liabilities and pension expenses reported by state and local governments
- Moody's is reporting much higher pension liabilities by using conservative discount rates

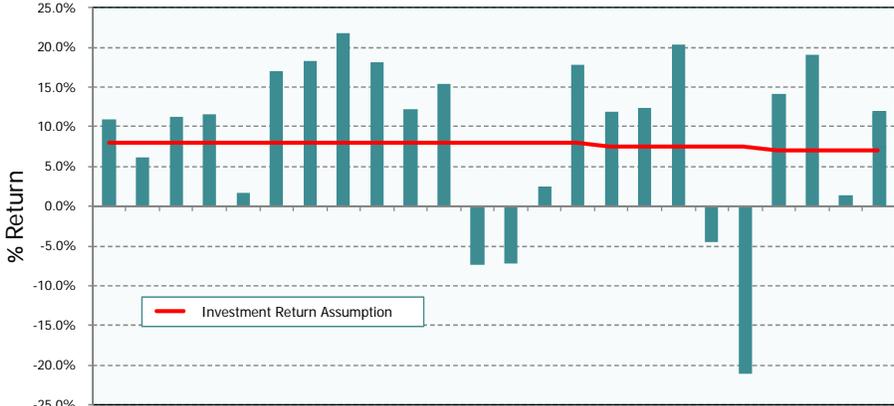
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VRS Portfolio

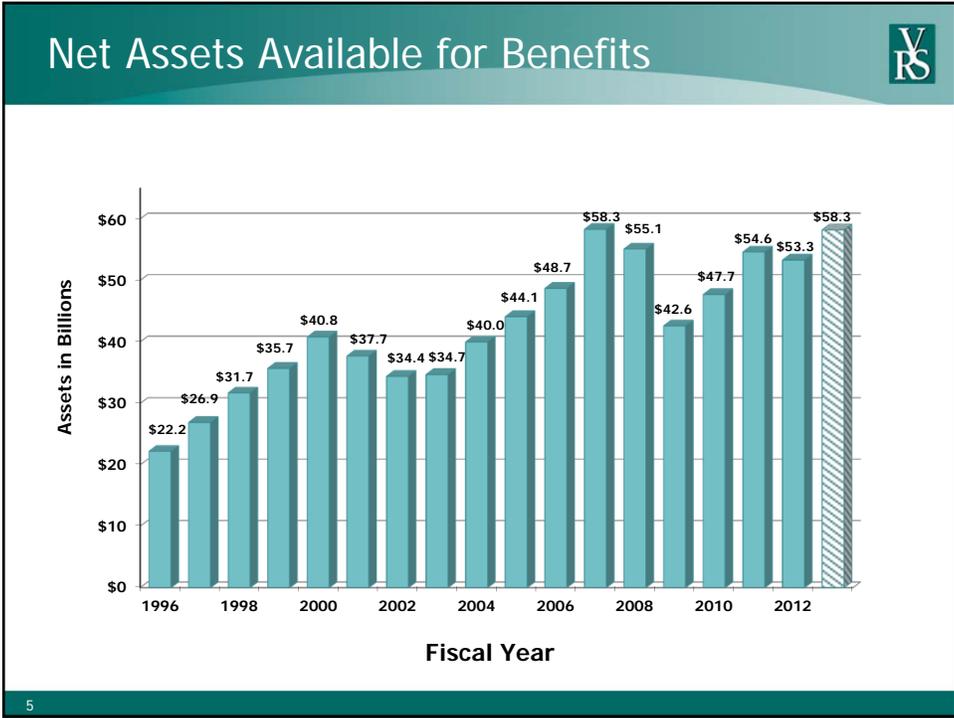


VRS Fiscal Year Returns

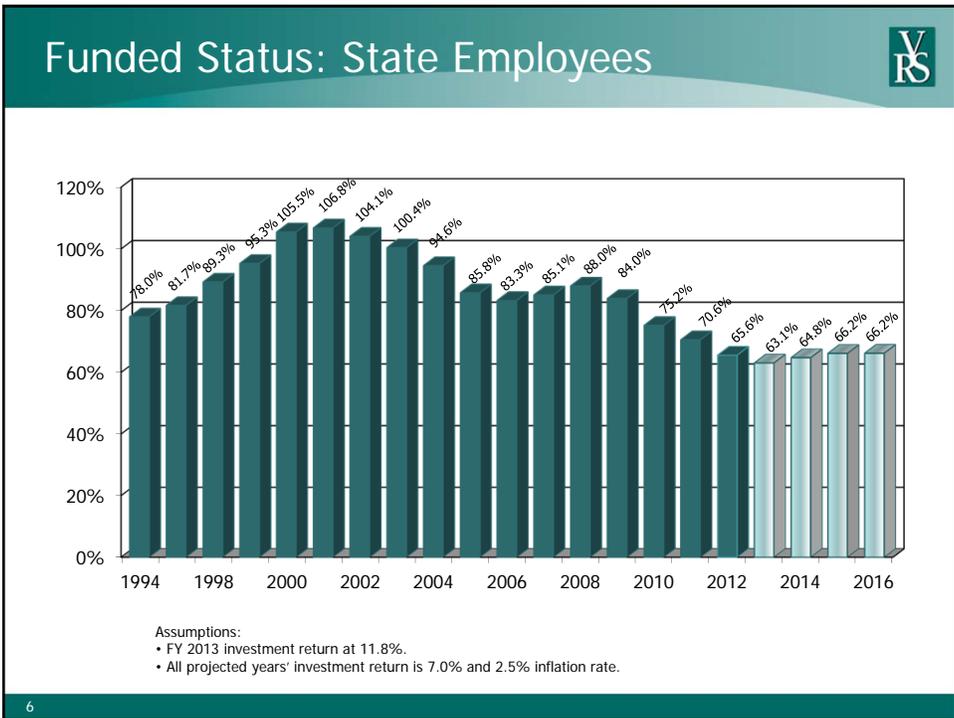


Year	% Return
1990	10.5%
1991	6.0%
1992	11.0%
1993	11.5%
1994	1.5%
1995	17.0%
1996	18.0%
1997	21.0%
1998	18.0%
1999	12.0%
2000	15.5%
2001	-7.0%
2002	-7.0%
2003	2.0%
2004	17.5%
2005	11.5%
2006	12.0%
2007	20.0%
2008	-4.0%
2009	-21.0%
2010	14.0%
2011	19.0%
2012	1.0%
2013	11.5%

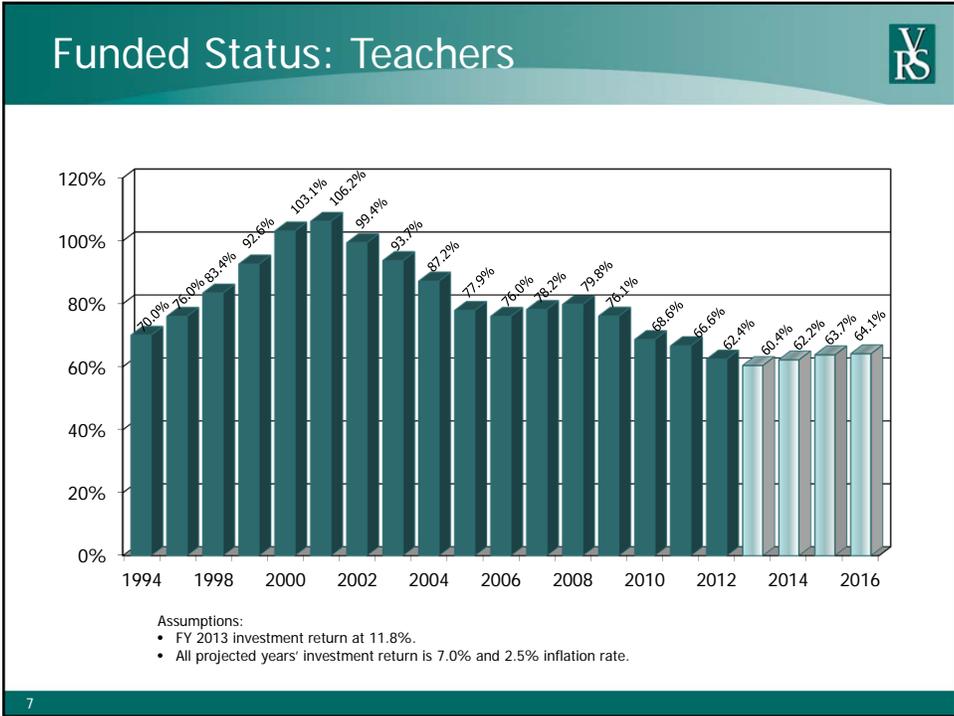
Investment Return Assumption: 7.5%



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Reasons for Decline in Funded Status

Decline in funded status:

- Investment returns affected by two major recessions
- Still recognizing investment losses from FY2009 (five-year smoothing)
- Material savings from pension reform will not be realized for 8-10 years
- Employer contribution rate in FY2012 for the state plan averaged one-third of actuary's required levels

	State	Teachers
2010-2012 Percent of VRS Contributions Funded	31.5%	39.7%
2012-2014 Percent of VRS Contributions Funded	67.0%	69.5%

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Pension Reform



Pension Reform Efforts in Virginia



Year	Reform Effort
2008	General Assembly requests JLARC Compensation Study
2010	General Assembly creates Plan 2 for members hired on or after July 1, 2010: <ul style="list-style-type: none"> ▪ Normal retirement changed to Social Security normal retirement age ▪ Unreduced benefits commencing at Rule of 90 ▪ Reduced retirement moved to age 60 with at least five years of service ▪ Members required to pay 5 percent member contribution (Local Option) ▪ COLA formula revised ▪ Five-year AFC formula
2011	General Assembly enacted 5/5 program for Plan 1 state employees <ul style="list-style-type: none"> ▪ State employee Plan 1 members pay 5 percent member contribution ▪ Offset with 5 percent salary increase JLARC updated study on pension reform

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Pension Reform Efforts in Virginia



Year	Reform Effort															
2012	<p>General Assembly requires:</p> <ul style="list-style-type: none"> ▪ Local employees pay 5 percent member contribution, phased in by July 1, 2016, with salary offset ▪ Non-vested Plan 1 employees benefit structure change, January 1, 2013; approximately 35,000 active members converted from Plan 1 to Plan 2 ▪ A hybrid plan for all general state and local employees hired on or after January 1, 2014 <p>General Assembly proposes to phase-in contribution rates for the teacher and state plans to the VRS board-certified rates:</p> <table border="1" style="width: 100%; border-collapse: collapse; margin-top: 10px;"> <thead> <tr> <th></th> <th style="text-align: center;">July 1, 2012</th> <th style="text-align: center;">July 1, 2014</th> <th style="text-align: center;">July 1, 2016</th> <th style="text-align: center;">July 1, 2018</th> </tr> </thead> <tbody> <tr> <td style="text-align: left;">State</td> <td style="text-align: center;">67.02%</td> <td style="text-align: center;">78.02%</td> <td style="text-align: center;">89.01%</td> <td style="text-align: center;">100%</td> </tr> <tr> <td style="text-align: left;">Teachers</td> <td style="text-align: center;">69.53%</td> <td style="text-align: center;">79.69%</td> <td style="text-align: center;">89.84%</td> <td style="text-align: center;">100%</td> </tr> </tbody> </table>		July 1, 2012	July 1, 2014	July 1, 2016	July 1, 2018	State	67.02%	78.02%	89.01%	100%	Teachers	69.53%	79.69%	89.84%	100%
	July 1, 2012	July 1, 2014	July 1, 2016	July 1, 2018												
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Pension Reform – July 1, 2012



Pension Reform Passed by the 2012 General Assembly, effective July 1, 2012

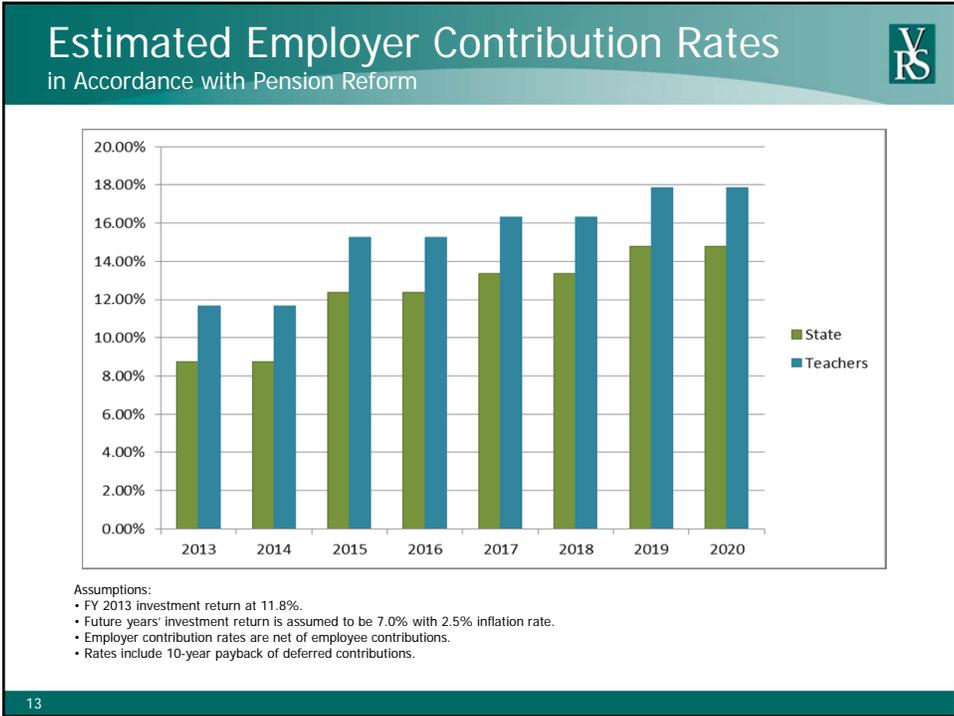
Local governments and schools systems begin to impose the 5 percent member contribution with offsetting raises:

- 83 percent of local government employers opted to impose a 5 percent member contribution with a 5 percent offsetting salary increase
- 60 percent of school boards opted to impose a 5 percent member contribution with a 5 percent offsetting salary increase

Local governments elected either the VRS-certified contribution rate or the alternate rate:

- 90 percent of local governments elected the VRS-certified contribution rate

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Cost Estimate for Next Biennium

- General Assembly's proposed phase-in contribution rates to the VRS board-certified rates:

	July 1, 2012	July 1, 2014	July 1, 2016	July 1, 2018
State	67.02%	78.02%	89.01%	100%
Teachers	69.53%	79.69%	89.84%	100%

- Moving to next funding level, effective July 1, 2014, will require approximately \$160 million more in General Fund contributions in each year of biennium

Contribution Impact

Impact of VRS Pension Contributions on State Budget

	FY2012	FY2013	FY2013 Using VRS Certified Rates
General Fund Budget	\$16.3 billion	\$17.1 billion	\$17.1 billion
General Fund Allocation for Retirement:			
State Employee VRS Contributions	\$107.2 million	\$233.7 million	\$327.0 million
Teacher VRS Contributions	<u>\$166.2 million</u>	<u>\$302.8 million</u>	<u>\$435.5 million</u>
Total:	\$273.4 million	\$536.5 million	\$762.5 million
Percent of General Fund Allocated for VRS Pension Costs	1.67%	3.13%	4.46%
Average Allocation Among States (estimated) (Boston College Center for Retirement Research)	5.75%	n/a	n/a

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- ## Changes Scheduled for January 1, 2014
- VRS conducted competitive procurement for hybrid record keeper; awarded to ICMA-RC; resulted in lower fees
 - System modifications underway:
 - VRS
 - Third-party Administrators: Minnesota Life, Unum, Univita, ICMA-RC
 - VRS employers
 - Employer communication efforts:
 - Website information, VLDP resolution packages, webinars, outreach sessions, special outreach to Top 50 employers
 - Member communication efforts:
 - Hybrid election window promotion begins at the end of the year with a calculator tool available; election January 1 – April 30, 2014
 - Development of handbooks and other communications underway
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New Pension Accounting Rules

Virginia Retirement System Liabilities

Unfunded Liabilities by Plan

Plan	6/30/2012 Funding (in billions)	6/30/2012 GASB * (in billions)	6/30/2012 Moody's * (in billions)
State Employees (includes SPORS, JRS, VaLORS)	\$8.70	\$9.00	\$19.30
Teachers	\$14.70	\$15.16	\$31.73
Local Political Subdivisions	\$4.74	\$4.96	\$12.51
Total	\$28.14	\$29.12	\$62.57

* GASB and Moody's unfunded liabilities are estimates based on guidance provided to date. Moody's unfunded liability is based on 4.13% discount rate.

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Upcoming GASB Accounting Changes



- GASB changing standards for financial reporting for pension plans:
 - Standards are effective for financial statements (CAFR) as of June 30, 2014, for VRS and as of June 30, 2015, for employers.
- Reported liabilities may increase if the General Assembly doesn't stick with phasing in the contribution rates. A discount rate that blends long-term investment assumption with municipal bond rate would be required if full contribution is not funded.
- Standards will require mark to market (asset smoothing no longer used).
- Unfunded liabilities of cost-sharing plans (school teachers) must be apportioned among participating employers.
- GASB is eliminating ARC and is requiring pension administrators to develop their own funding standards.

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Implications for Funding Standards



- Brings sharper focus to funding standards
 - Full funding of ARC avoids higher liabilities caused by blended discount rates
 - Raises questions about non-employer entities (state government) sharing in liabilities otherwise apportioned to local governments
- Employers have greater stake in funding progress as it may affect their borrowing capacity
- VRS Board of Trustees recently adopted new funding standards
 - Actuarial Cost Method – Entry Age Normal level of pay
 - Asset Smoothing Method – Five-year smoothing of investment experience
 - Amortization Policy – Two-part amortization
 - 30-year fixed on legacy liabilities
 - 20-year tiered amortization of liabilities for each year after

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Understanding New Guidelines

State and local governments will need to distinguish several separate pension calculations that will be derived in different manners for distinct purposes.

	Books	Bonds	Budgets
Purpose	Standardized Financial Reporting of pensions for accounting	Testing the degree to which pension obligations impact the government ability to repay bonded debt	Determining pension contribution to properly fund benefits
Primary Audience	Users of government financial statements	Rating Agencies	Policymakers

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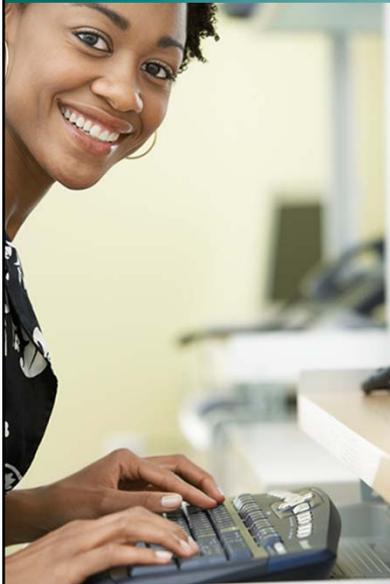
Conclusion

- Pension reform communication and systems development on target for hybrid implementation January 1, 2014
- Long-range plan for sustaining VRS:
 - Plan design changes will produce significant cost reductions in 8-10 years
 - VRS will achieve reasonable future returns
 - Future General Assemblies will increase contribution rates to actuarially required levels

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Questions?



Thank you!