Overview of Rate Setting & Financial Status for the Virginia Retirement System (VRS)

House Appropriations Committee Retreat

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Overview of Rate Setting & Financial Status for the Virginia Retirement System

- ☑ Overview of Actuarial Rate Setting
- ❑ Impact of Investment Returns & Other Policy Assumptions
- ❑ Pension Reform in the 2010 Session – House Bill 1189
- ❑ Impact of 2010 Pension Reform – State Plans
- ❑ Impact of 2010 Pension Reform – Teacher & Locals
- ❑ Final Thoughts

Actuarial Rates are Set Based on a "Snapshot" as of June 30 Each Year

- Calculation includes factors that are known
  - **Demographic factors:** Employees age, sex, years of service, and current salary
  - **Financial factors:** Current value of the fund and current allocation of the fund
- Calculations includes assumptions for the future
  - **Demographic assumptions:** Retirement rates, death rates before and after retirement, disability rates, other termination rates and future salary increases
  - **Financial factors:** Future return on investments and future retiree COLAs

Two Parts to the Rate Setting Process

- **The Normal Rate** - The estimated contribution rate, as a percentage of payroll, that would need to be paid into the system for the cost of benefits that are expected to be accrued to the members during the fiscal year
- **The Unfunded Actuarial Accrued Liability (UAAL)** – Represents the difference between the asset values and the estimated total liabilities related to benefits already earned
    - The UAAL fluctuates from year to year based on market performance
    - The UAAL is impacted when benefit increases are approved for current plan members
    - The UAAL is than amortized over a period of time and calculated as a percent of payroll

Policy Assumptions

- The VRS Board of Trustees adopts rates based on certain policy assumptions and forwards them to the Governor and General Assembly
  - The assumed rate of return
  - The assumed COLA adjustments going forward
  - The amortization period for the UAAL
- The actuaries make other assumptions independently using industry best practices and plan experience
  - Future salary increases
  - Retirement rates
  - Mortality rates before and after retirement
  - Other turnover rates

Actuarial Value of the Fund

- Calculations are based on the “actuarial value” of the fund as opposed to June 30 market value of the fund to mitigate significant swings in the contribution rates

Actuarial Value at the Beginning of the Year

plus

Expected Return on Market Value at the Beginning of the Year

plus

5 year average of difference between actual and expected return on Market Value

plus

Contributions Paid into the Fund

minus

Benefits Paid out of Fund

Equals

Actuarial Value at the End of the Year

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VRS Board has Adjusted Policy Assumptions

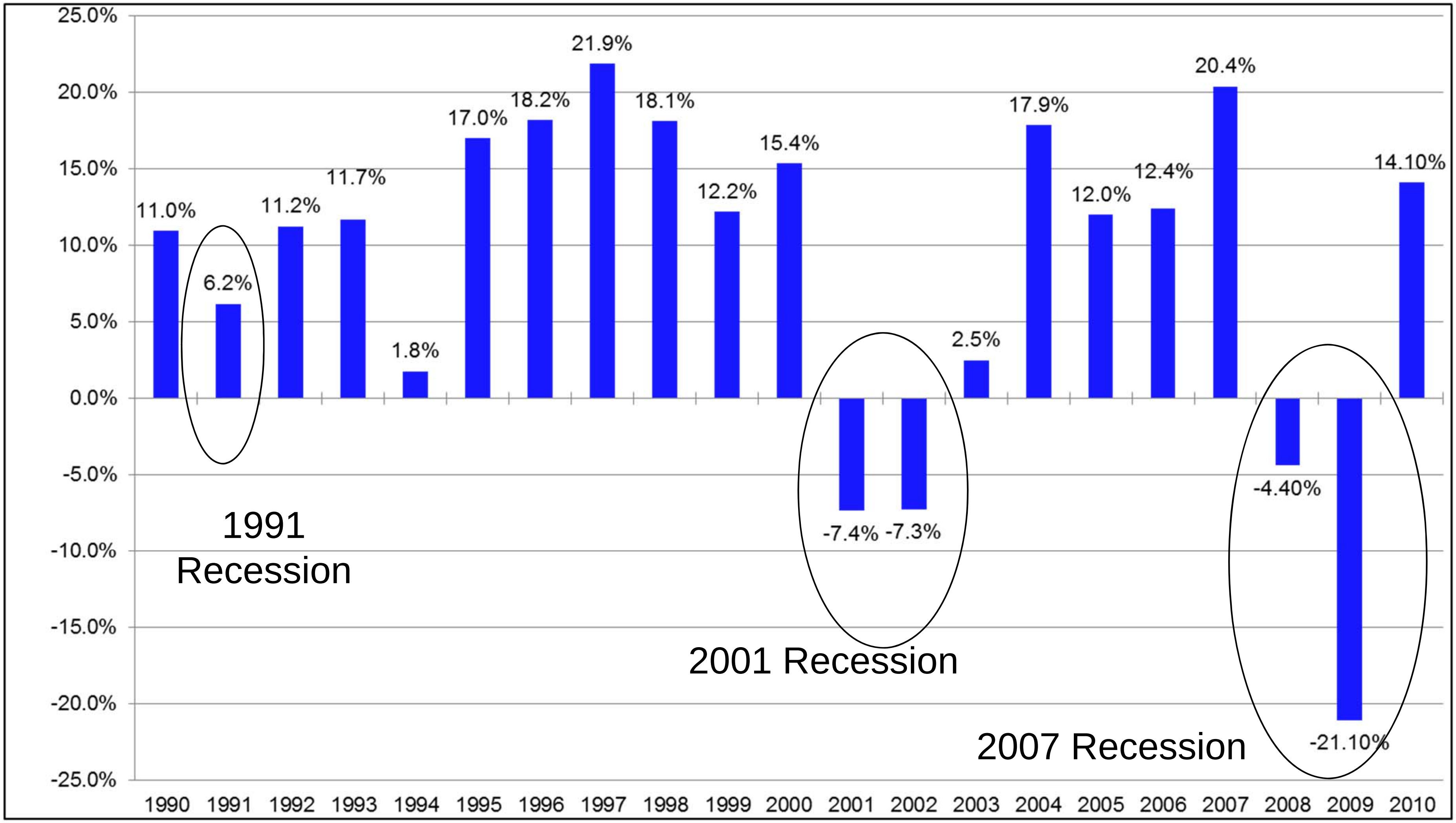
- Over the past 15 years the Board has made incremental changes to certain policy assumptions:
  - Decreased the assumed rate of return (ROR) from 8.0% to 7.5% in 2005 and to 7.0% in 2010
  - Incrementally decreased the amortization period from 30 years to 20 years from 1996 through 2006
- By contrast, the General Assembly has consistently used a 8.0% rate of return, 3.0% COLA and a 30 year amortization period as basis VRS contribution rate setting

General Assembly Assumptions Consistent with Other States and Plan Experience

- The National Association of State Retirement Administrators recently released a survey of the policy assumptions used by 98 public retirement plans
- Actual returns for the VRS fund since 1991 has been 8.16%
  - This period includes 3 recessions

	ROR	COLA	Amortization
Mean	8.0%	3.5%	24.8 years
Median	80.%	3.5%	28.0 years
Mode	8.0%	3.0%	30.0 years

VRS Actual Rate of Return Since 1990



- Rate of Return for FY 2011 through the end of October was 10.3%

Differences in Funded Status Based on Policy Assumptions

Funded status based on June 30, 2010 valuations

Program	VRS Board Assumptions *	General Assembly Assumptions **
State Employee	75.2%	80.8%
SPORS	66.8%	71.5%
VaLORS	58.6%	63.8%
JRS	66.5%	69.8%
Teachers	68.6%	74.1%

* VRS Board assumptions are a 7.0% rate of return and a 2.5% COLA

** General Assembly policy assumptions are a 8.0% rate of return and a 3% COLA

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Comprehensive Pension Reform to Ensure Long-Term Financial Viability for the System

- Enacted House Bill 1189 of the 2010 General Assembly Session
- Reforms apply to members entering the retirement system on or after July 1, 2010
- Included programmatic changes designed to decrease overall cost
- Included budgetary savings to the state by requiring new employees to pay the 5% employee contribution which the state has been paying since 1983
  - Gave school boards and localities the option of requiring their new employees to pay the 5% or a portion of the 5%

2010 Pension Reform (HB 1189) Provisions Impacting All DB Plans

Provisions	Prior to July 1, 2010	Entering the System on or after July 1, 2010
Employee Contributions	**State Employees**: The state has paid the 5% employee contribution on behalf of the employees since 1983 in lieu of a pay raise **Schools/political subdivisions employees** All school divisions and most other subdivisions elected to pay the 5% employee contribution	**State employees** contribute 5% on pre-tax salary reduction basis. **Schools/political subdivisions employees** may contribute some or all of the 5%, depending upon the election by the employer
Average Final Compensation	Average of 36 highest consecutive months of creditable compensation	Average of 60 highest consecutive months of creditable compensation
COLA	Matches first 3 percent increase in the Consumer Price Index-Urban and one-half of the remaining increase up to a maximum COLA of 5 percent, when provided	Matches first 2 percent increase in the Consumer Price Index-Urban and one-half of the remaining increase up to a maximum COLA of 6 percent, when provided
Purchase of Prior Service Credit Below Actuarial Value	3 year window from day of membership at 5% of salary for each year purchases	1 year window from day of membership at "approximate normal rate" as established by the VRS Board

2010 Pension Reform (HB 1189) Provisions Impacting Regular VRS

Provisions	Prior to July 1, 2010	Entering the System After July 1, 2010
Normal Retirement Age	Age 65	Social Security Normal Retirement Age (currently 67 years of age for those born in 1960 or later)
Unreduced Retirement	Age 65 with at least 5 years of service or age 50 with at least 30 years of service	Normal Social Security retirement age with at least five years of service credit or when age and service equal 90
Reduced Retirement	Age 55 with at least 5 years of service or age 50 with at least 10 years of service	Age 60 with at least five years of service

2010 Pension Reform (HB1189)
Other DB Provisions

Provisions	Prior to July 1, 2010	Entering the System After July 1, 2010
Years of service adjustment factor for Judges	For those judges in service on December 31, 1994, service as a judge is weighted by a factor of 3.5. For those appointed or elected to an original term commencing on or after January 1, 1995, service as a judge is weighted by a factor of 2.5	Varies based on age when first appointed to the bench Prior to age 45 – 1.5 years of weighted service for each actual year of service on the bench Between ages of 45 and 55 – 2.0 years of weighted service for each actual year of service on the bench At age 55 or over – 2.5 years of weighted service for each actual year of service on the bench

2010 Pension Reform (HB1189)

- To administer the system going forward the Virginia Retirement System has established a two tiered retirement system
  - **Plan 1:** State, teachers and local government employees who were members of the retirement system as of June 30, 2010
  - **Plan 2:** State, teachers and local government employees hired on or after July 1, 2010, who were not already a member of the retirement system

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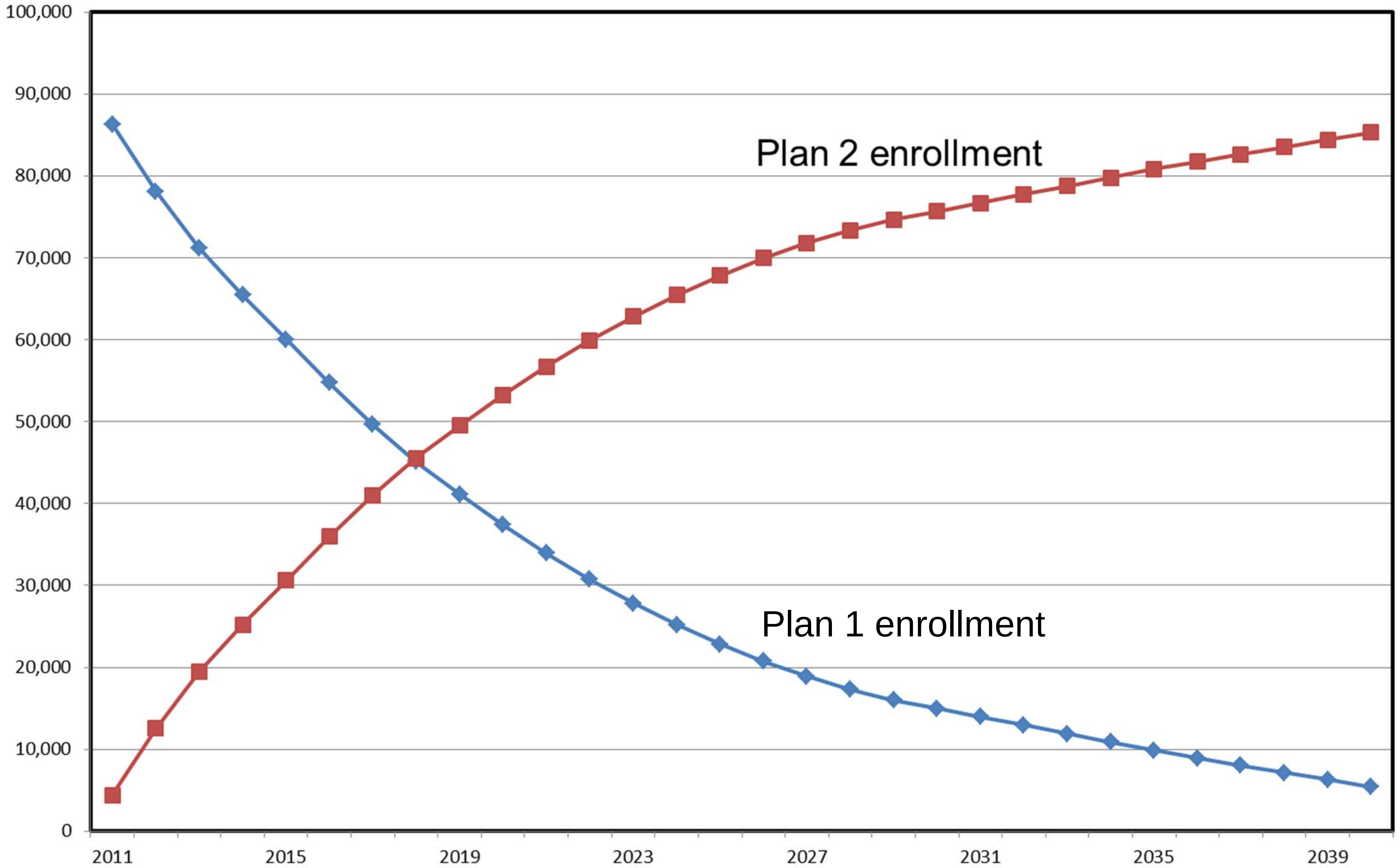
Lower Contribution Rates Required Under HB 1189

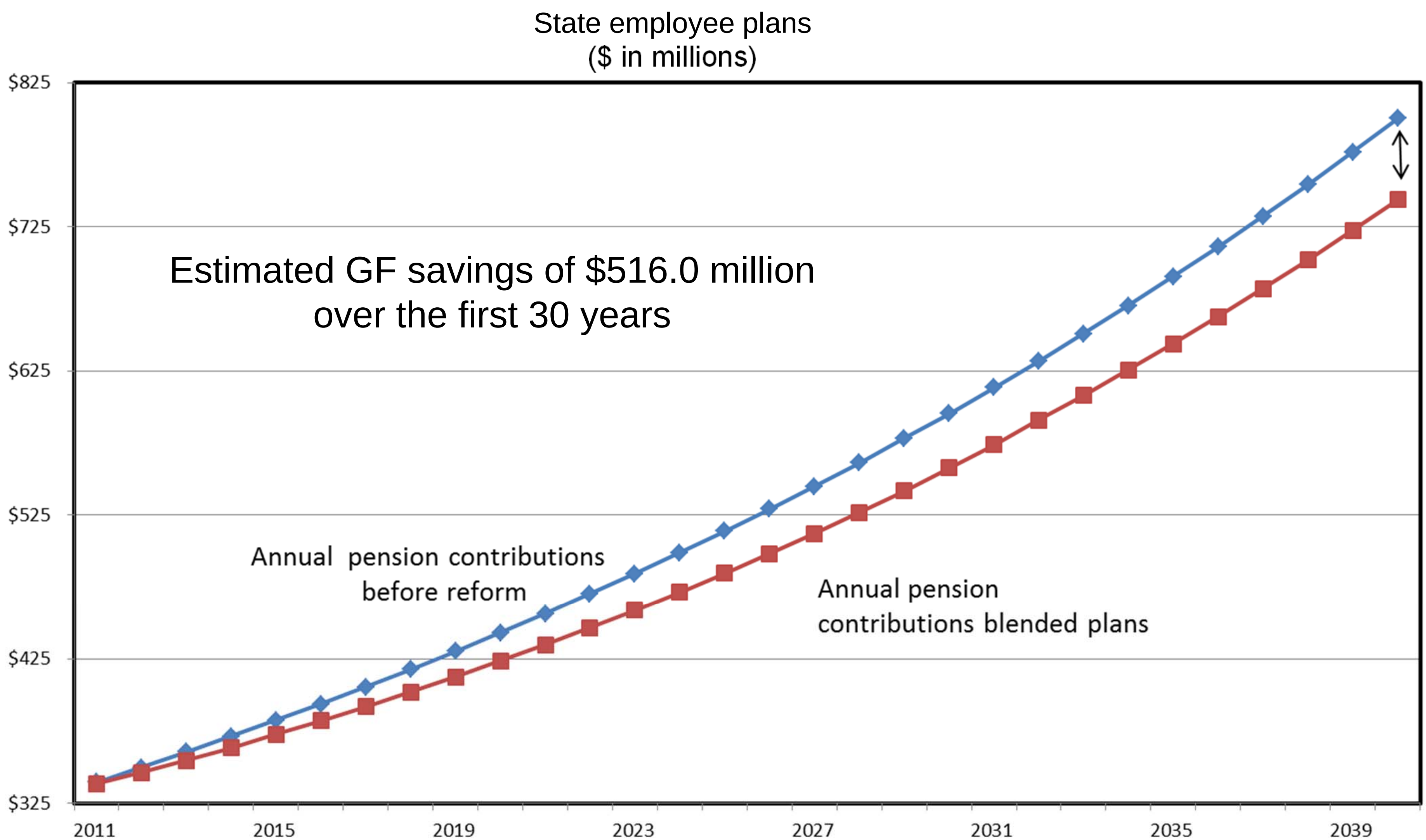
Program	Employer Paid Normal Cost Plan 1	Employer Paid Normal Cost Plan 2
State Employee	7.21%	1.86%
SPORS	12.74%	7.16%
VaLORS	10.09%	4.57%
JRS	34.33%	24.17%

- Plan 1 cost includes 5% employee contribution pick up
- Rates based on June 30, 2010 valuation assuming 8% rate of return and 3% inflation and do not include the UAAL

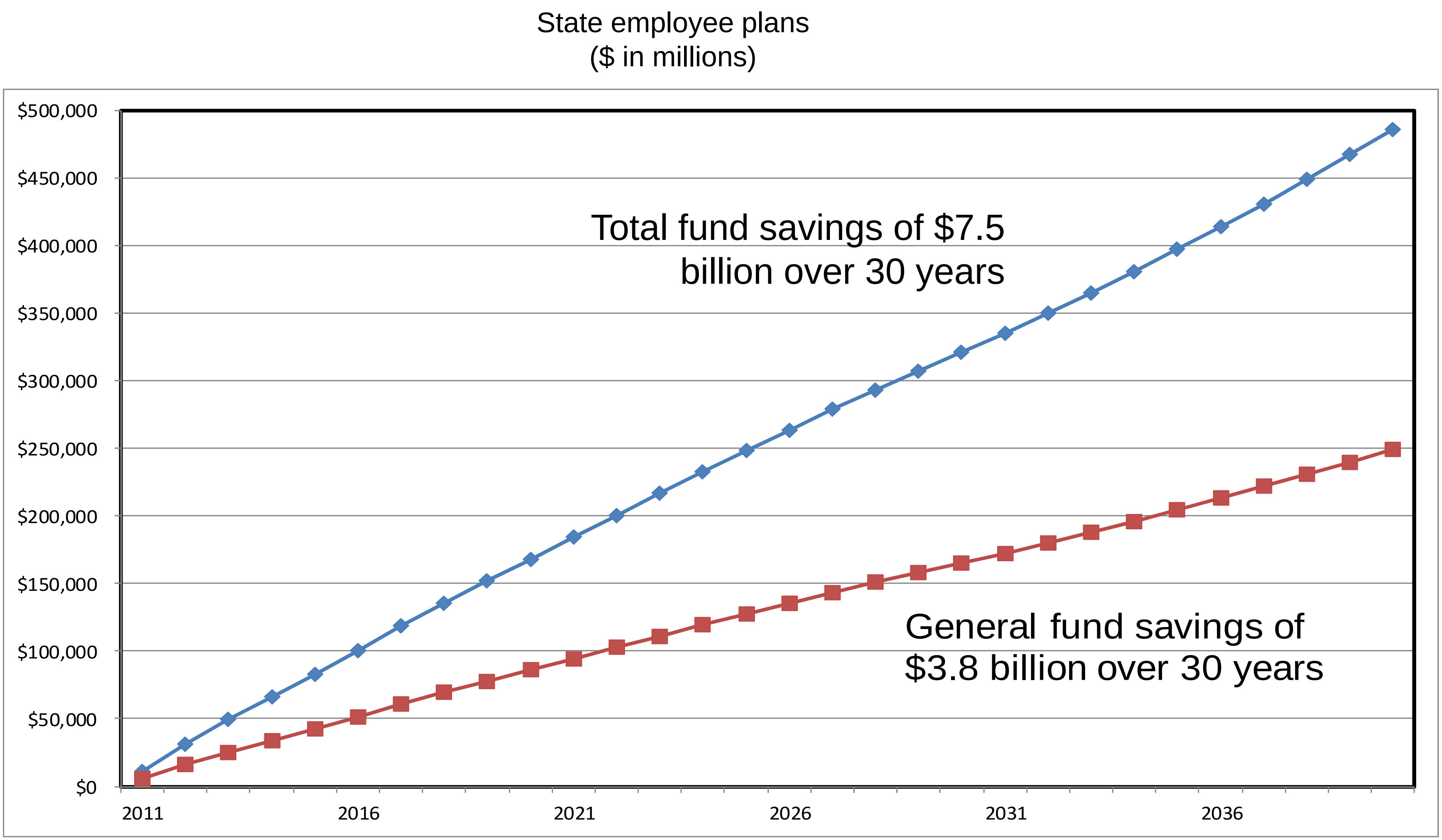
Projected Enrollment - All State Employee Plans



Cumulative Pension Fund Savings of $883.5 Million Over 30 Next Years



Cumulative Savings of $7.5 Billion Over 30 Years from Reinstating the 5% Employee Contribution



Defined Contribution Changes from HB 1189

- HB 1189 also aligned the university/state contribution for faculty in Optional Retirement Plans from 10.4% to 8.5%, consistent with rates paid at peer institutions
  - Universities have the option of increasing contribution up to 8.9% using their own funds
  - Contribution rates for the ORP for political appointees has also been reduced to 8.5 %

Program	Contribution For Benefit
DB – State Employee	1.86%
DC – Higher Education or Political Appointee	8.50%

* DB rate based on normal cost for the June 30, 2010 valuation assuming 8% ROR and 3.0% COLA.

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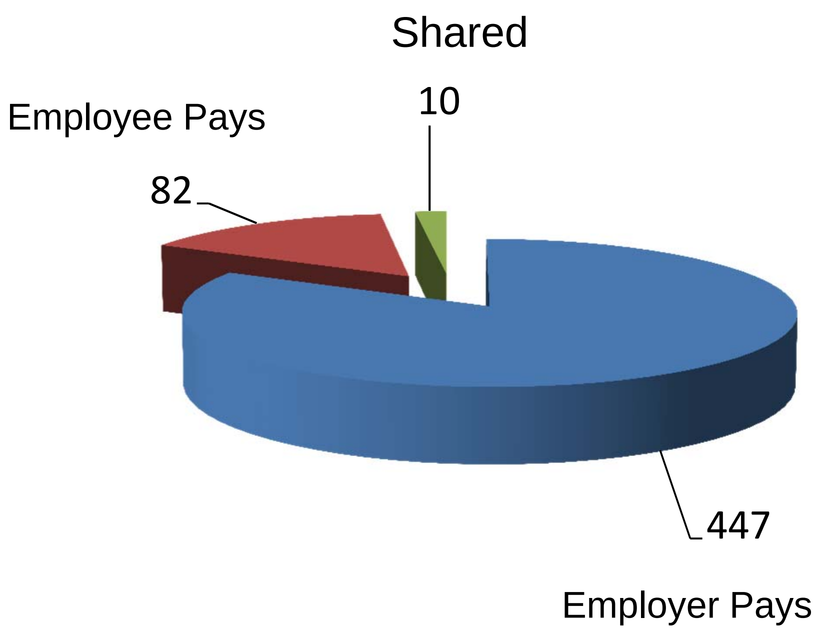
Over 80% of School Divisions and Local Plans Continue to Pay the 5% EC



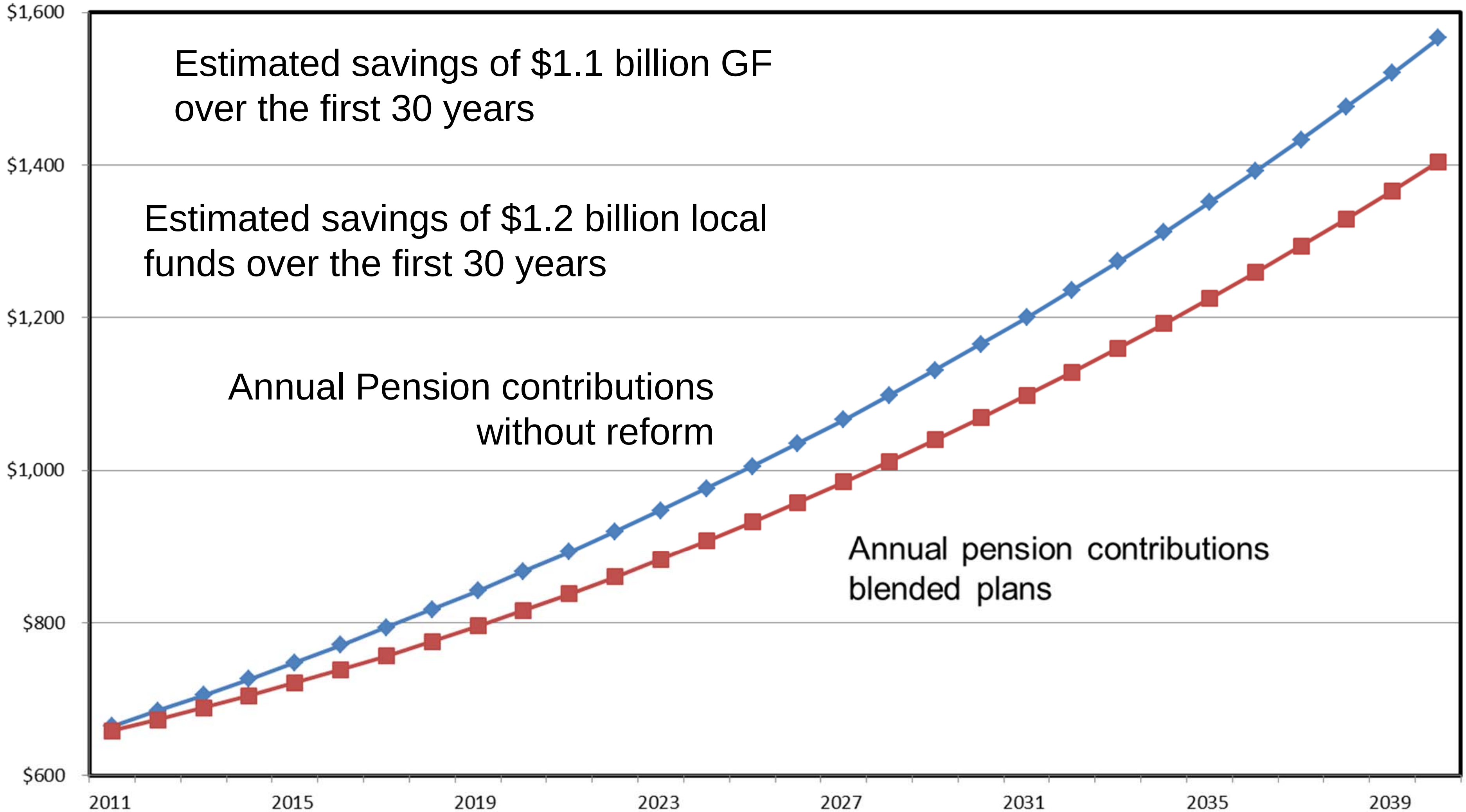
Distribution of Employee Paid Contributions

	Entire 5%	Portion of 5%	0%
Schools	6	1	129
Counties	23	3	61
Cities	7	3	28
Towns	10	2	86
Other	36	1	143

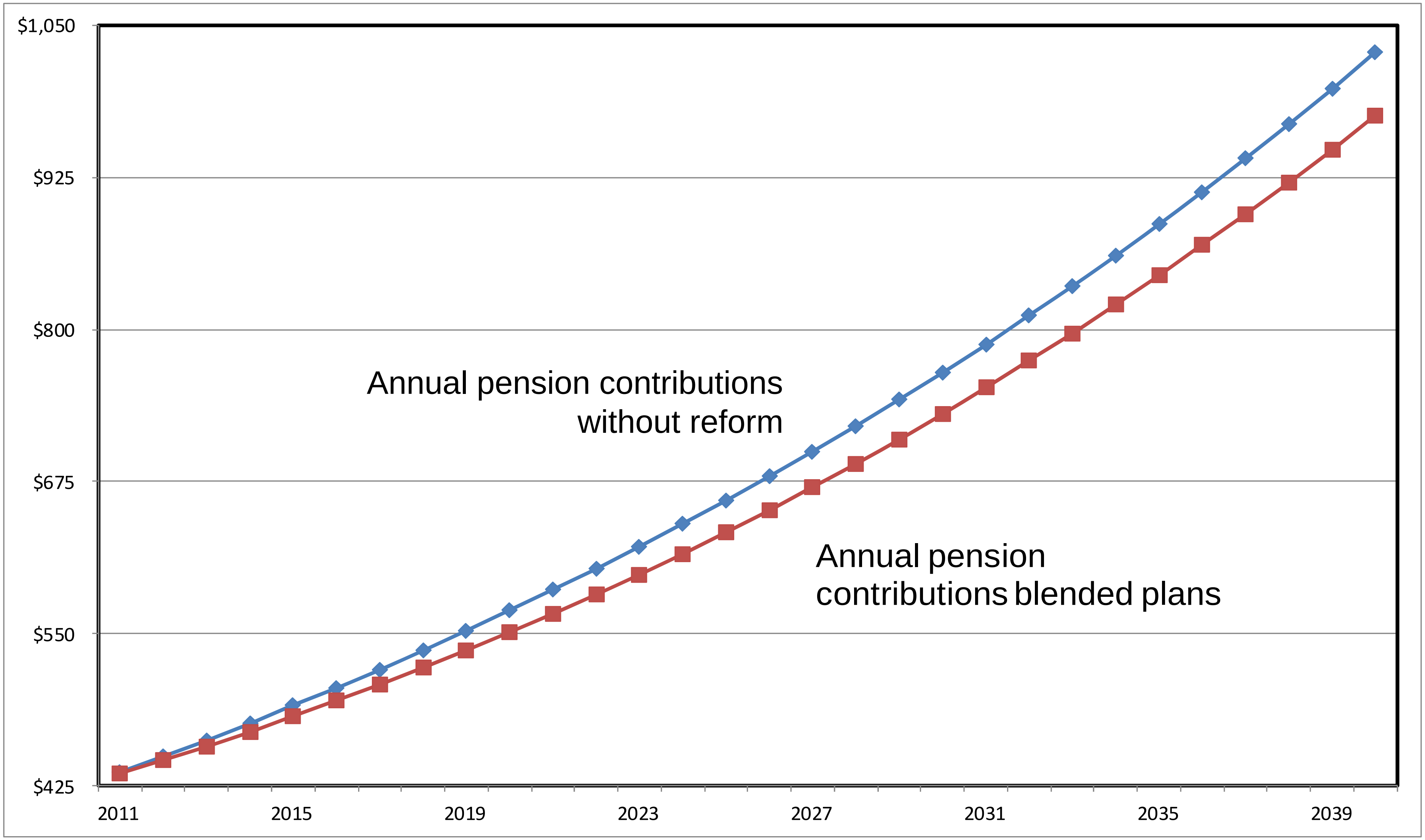
In FY 2011, the total cost of the 5% employee contribution is approximately $600 million across the teachers and local plans

Cumulative Pension Fund Benefit Savings of $2.3 Billion Over 30 Next Years for Teachers Plan

($ in millions)



Cumulative Pension Fund Benefit Savings of $798.5 Million Over 30 Next Years for Local Plans



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Final Thoughts

- Benefit reforms adopted in HB 1189 will significantly reduce pension fund costs resulting in savings across all plans of approximately $4.1 billion over the first 30 years

- Reinstituting the 5% employee contribution will result in savings of $7.5 billion for Virginia's budget over the first 30 years

- Substantial savings will be realized by the localities and school divisions as a result of HB 1189
  - The extent of the savings is dependent on local actions related to the 5% employee contribution