JLARC
JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION

Review of Retirement Benefits for Public Employees in Virginia

National Conference of State Legislatures
August 9, 2012

In This Presentation

Background

Study Process and Findings

Study Outcomes

Lessons Learned

About JLARC

- Research and oversight agency of Virginia General Assembly
  - Evaluates operations and performance of state agencies/programs
  - Conducts policy research and analysis on behalf of the legislature
- 15-member Commission, 28 staff
- Responsible for ongoing oversight of the Virginia Retirement System since 1994

Series of Modifications to VA's Retirement Plans Following Legislative Studies

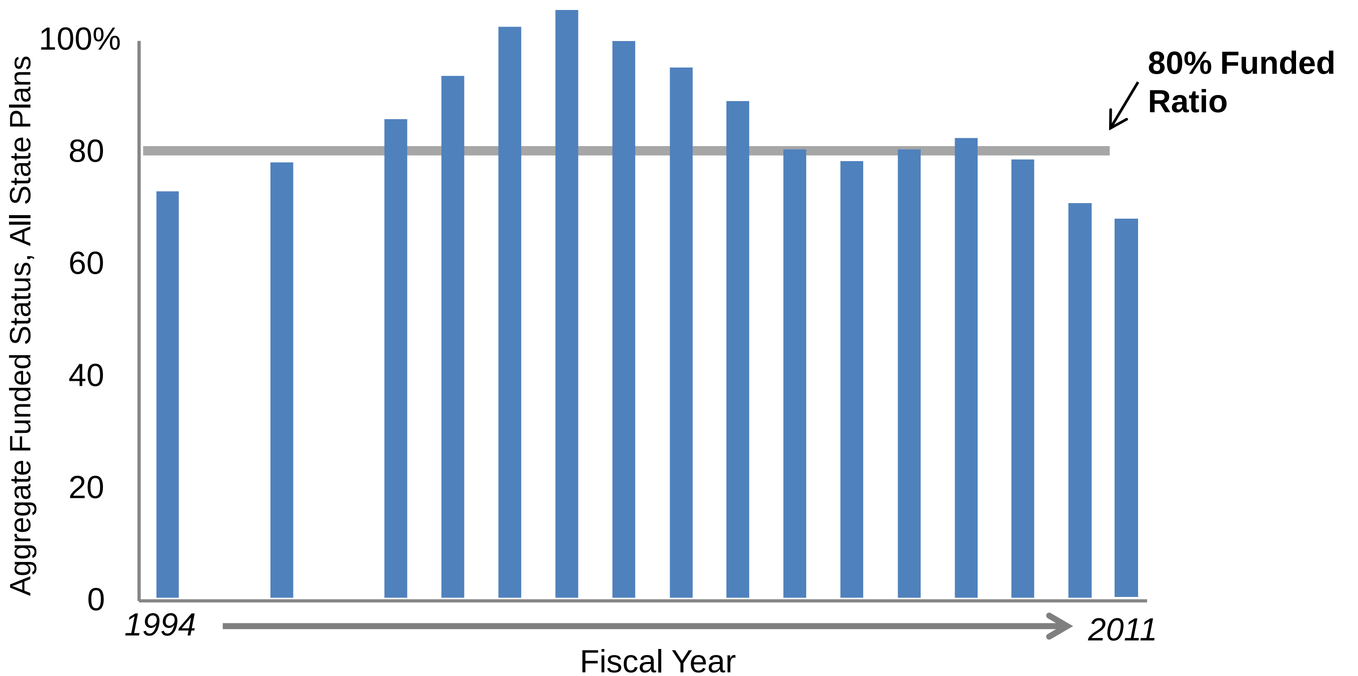
- JLARC studies of retirement plans conducted in 2008 and 2011
- Key changes made in 2010 and 2012 were consistent with study findings
- Changes have balanced desire to reduce future costs with importance of maintaining competitive benefit

Virginia Retirement System Profile

- 22nd largest public or private pension system in U.S.
- More than 600,000 members, retirees, beneficiaries
  - Avg. retirement age = 62*
  - Avg. service at retirement = 23 years*
  - Avg. benefit = $21K (39.6% of AFC)*
- Assets = $52.4 B (June 30 estimate)

* State employees

Studies Prompted by Plans' Increasing Costs and Declining Financial Status



- **Required contributions nearly doubled between 2000 and 2011**
- **Virginia merited rating of "Serious Concern" by 2012 Pew Center study**

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Key Study Questions

- Do current defined benefit plans achieve relevant goals?
- Are the defined benefit plans structured appropriately to balance employer and employee perspectives? If not, how could they be changed? Should an alternative plan be created?
- If an alternative plan is desirable, what options are available and which would best meet the needs of the State and local governments?

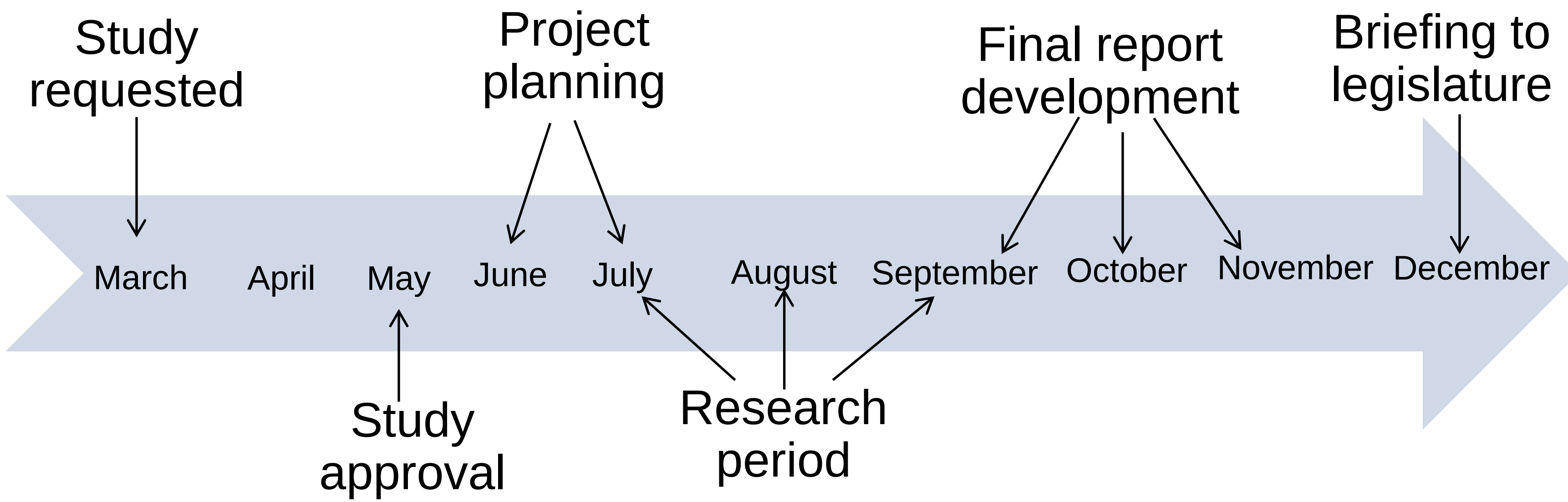
Staff Developed Framework for Evaluating Potential Changes

- Would changes maintain competitiveness of benefits?
- Would changes allow employees to retire with adequate income after a full career?
- Would changes reduce State's future costs?

Findings In Brief

- The VRS retirement benefits are an important component of State and local employees' compensation and contribute to the State's ability to remain competitive as an employer
- Changes to the benefits are not necessary to improve their effectiveness, but some modifications could be reasonable to reduce future costs
- There are options for providing an alternative type of retirement plan to employees, but enrollment is likely to be limited and costs could increase
- Developing a strategy to fully fund plans' costs would be a positive step, regardless of plan changes

Project Timeline



Resources and Research Activities

- Three staff members dedicated on full-time basis
- Consultation and analysis by two actuarial firms
- Two staff-administered electronic surveys
  - 5,000 State employees
  - 139 State agency HR managers
- Staff-administered interviews of 70+ individuals
  - 50 local government employees, including teachers and law enforcement
  - 8 large state agencies
  - 6 other states recently enacting pension changes
  - 5 interest groups representing public employees and employers
  - 3 national experts
- Consultations with VRS staff
- Literature review

Research Period Divided into Five Phases

Phase I	Phase II	Phase III	Phase IV	Phase V
Analyze Competitiveness Of State Compensation & Retirement Benefits	*Identify Potential Changes to Existing DB Plans, Potential Alternative Plans*	*Obtain Input from VRS Members and HR Managers*	*Refine options* *Evaluate Impact of Options on Competitiveness, Recruitment, Retention, Retirement Income* *Determine Options for Cost Analysis*	*Analyze Future Cost Impact of Options*
<u>Consultant</u>	<u>Consultant and Staff</u>	<u>Staff</u>	<u>Consultant and Staff</u>	<u>Consultant</u>

Research Divided Between Consultants and Staff

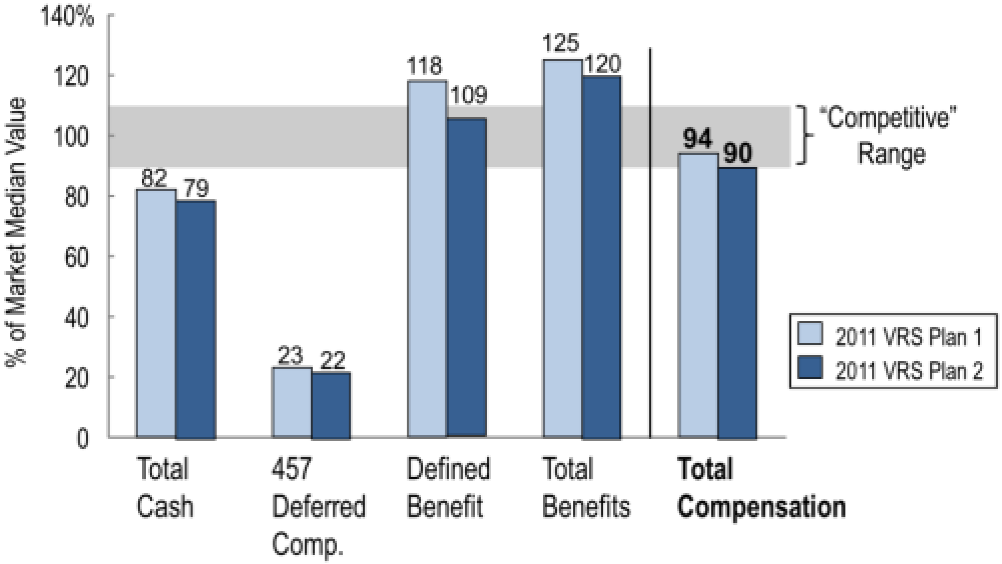
- Consultant staff
  - Total compensation analysis
  - Actuarial cost analysis
- JLARC staff
  - VRS membership input
  - State agency and interest group input
  - Research on other states
  - Literature review
  - Overall synthesis of information
- Joint consultant/JLARC staff effort
  - Development of potential DB plan changes and DB plan alternatives
  - Analysis of potential impacts of plan changes/plan alternatives
  - Assumptions made to conduct cost analysis

Phase I: Benefit Competitiveness

- How competitive is the total compensation package provided to State employees?
- How do the retirement benefits contribute to competitiveness?
- JLARC's actuary analyzed
  - Competitiveness of total compensation compared to market/peers
  - Competitiveness of retirement benefits compared to peers
  - Contribution of retirement benefits to total compensation

State's Total Compensation Package Marginally Competitive in 2011

- Total benefits, especially the State's defined benefit plan benefits, helped the state remain "marginally competitive" in 2011
- State salaries were not competitive
- Retirement benefits were competitive



Phase II: Potential Options for Change

- What changes could be considered that would mostly maintain benefits' competitiveness, reduce State costs, and allow for adequate income replacement?
- JLARC staff worked with actuary to develop potential changes to DB plan and alternative types of plans

Range of Options Considered

- Alternative plan designs
  - Combination DB/DC plan
  - Cash balance plan
  - Defined contribution plans
- DB plan changes
  - Employee contributions
  - Retirement age
  - Benefit multiplier
  - COLA
  - AFC

Phase III: Employee/Employer Input

- From employees' perspective
  - What role do VRS benefits play in decisions to join/remain in public sector workforce?
  - How satisfied are employees with their retirement benefits?
  - How many employees might elect to participate in an alternative type of plan?
  - How might employees respond to changes to their current DB plan?
- From employers' perspective
  - What role do the VRS benefits play in recruitment/retention?
  - How might changes impact recruitment/retention?

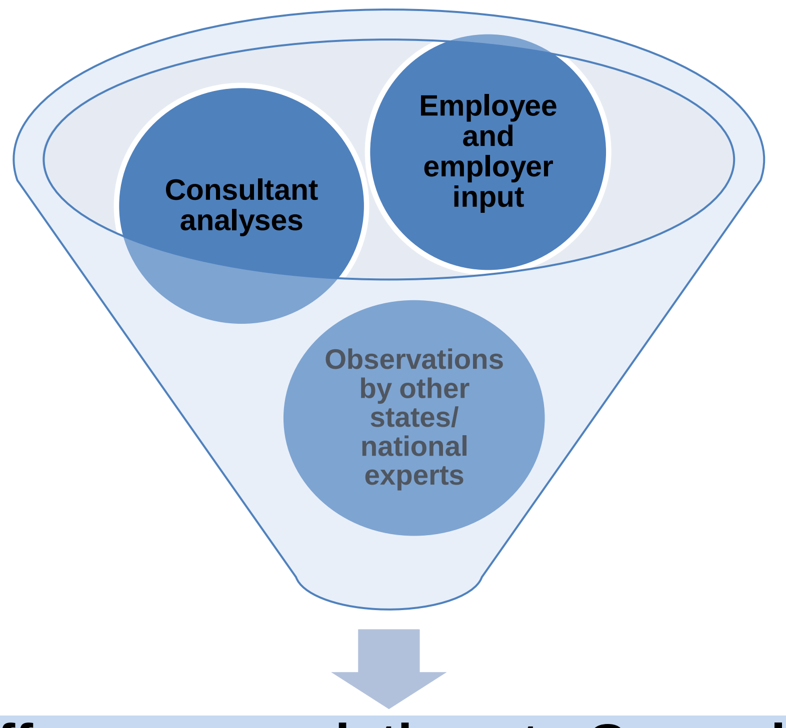
Employee/Employer Input Helped Refine Options

- Better understanding of importance of retirement benefits in employees' decisions to join and remain in public sector
- Better understanding of attractiveness of alternative plans to vested/non-vested employees
  - Most would stay in DB plan if given choice, but more expressed interest in combination plan
  - New employees more willing to consider alternative plan

Phases IV-V: Final Options Development and Cost Analysis

- Based on the evaluation of the potential impact of changes on the State and on employees, which options should be submitted for cost analysis?
- Step 1: JLARC actuary evaluated potential impact of changes identified in phases II and III on recruitment, retention, competitiveness, and income replacement
- Step 2: JLARC staff identified 13 options for cost analysis
- Step 3: VRS actuary conducted analysis of cost impact through FY 2022

Report Conclusions/Recommendations Informed By Multiple Sources



JLARC staff recommendations to General Assembly

Actions by Governor and General Assembly

Final Report Evaluated DB Plan Changes

- No plan changes necessary to improve effectiveness
- Four changes would be reasonable to address cost concerns
  - Longer AFC period
  - Lower multiplier
  - Reduced COLA
  - Deferred COLA
- Three modifications discouraged:
  - Higher employee retirement age
  - Higher employee contributions

Projected Impacts of Four DB Plan Changes

Option	Negative Effect on Recruitment	Negative Effect on Retention	Negative Effect on Retirement	Estimated Cumulative Cost Reduction Through FY 2022 (millions)
(1) 60-month AFC	None	Minimal	Minimal	$509.5
(2) 1.6% multiplier	Moderate	None	Minimal	$165.5
(3) 3% COLA	None	Moderate	Minimal	$369.3
(4) Deferred COLA	None	None	Moderate	$430.4
Total				***$1,065***

Final Report Evaluated Defined Contribution Plan

- Minimum contributions of 10%

  - 5% mandatory employee contribution

  - 5% employer contribution

- Maximum contributions of 17%

  - employer match of 100% of up to 3.5% of employee-elected contributions above 5%

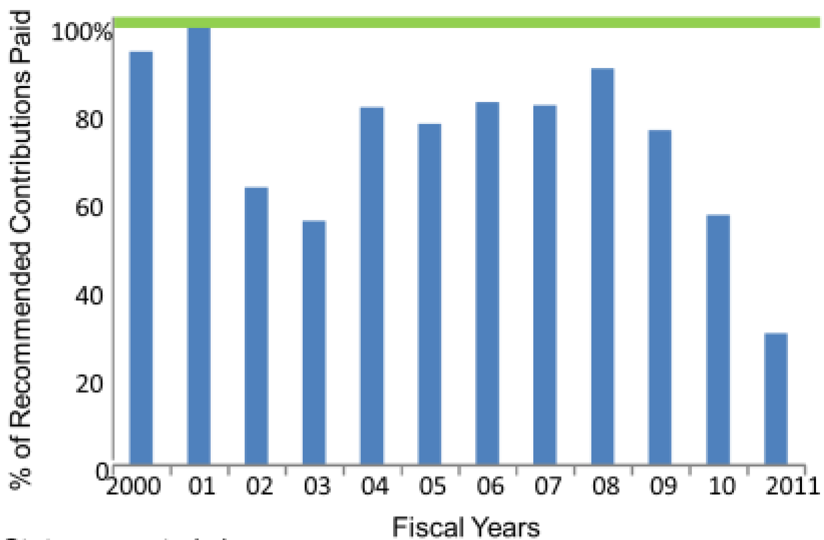
Final Report Evaluated "Combination" Plan

- **Combination plan**
  - DB component:
    - 1.0% benefit multiplier on five-year AFC
    - 3% max cost-of-living adjustment
    - 4% mandatory employee contribution into DB component
  - DC component:
    - Minimum total contributions of 2%
      - 1% employee, 1% employer
    - Maximum contributions of 8.5%
      - Maximum employer match of 3.5% on 5% employee contribution

Alternative Plans' Advantages Depend on Objectives

Advantages of the Combination Plan
Recruitment of long-term employees
Retention of employees
Adequate retirement income
Reduction in costs
Greater level of interest among employees than DC plan
Advantages of the Defined Contribution Plan
Recruitment of short-term employees
Benefit portability
Reduction in government's future benefit obligations
Increased employee responsibility

Paying Full Annual Costs Key to Sustainability



*For State-supported plans

- Fully funding recommended contributions "key to maintaining the pension plan on a sound basis." (VRS actuary)
  - Benefit reductions, alone, would not make the plan sustainable
- Report recommended fiscal impact analysis if proposed contribution rates are less than recommended
- Report also notes:
  - *"Developing and implementing a strategy to fully fund the employer contribution would represent a positive step toward improving the financial condition of the plan."* (p. 124)

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2012 Plan Changes Consistent With Study Options/Recommendations

$3.6 billion in reduced retirement costs for State-supported plans over 20 years

Plan adopted to make progress toward full funding

Non-vested members	**Changes to benefit calculations, eligibility provisions, and COLA**
All Members	**Delayed COLA for reduced benefit retirees (exception for employees near full retirement*)**
New Members (hired on/after 1-1-14)	**Mandatory hybrid retirement plan**

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Challenges and Possible Solutions

Challenge	Possible Solution
Expertise and objectivity	Issue RFP for retirement benefits consultant
Managing consultant or third-party resources	High level of clarity about research questions, expectations about deliverables, timing of deliverables, and relationship to total project At least two project team members familiar with consultants' role Regular status updates
Data availability	Use existing retirement system actuary
Short timeframe	Maintain focus by developing guiding principles and priorities up front
Opposition from interest groups	Balance input from interest groups with general plan members
Logistics of employee feedback	Surveys are helpful in quantifying employee feedback Focus groups helpful in developing survey questions and providing context

Challenges/Solutions (Cont.)

Challenge	Possible Solution
Broad spectrum of potential change options	Obtain early input on potential options from retirement system staff Be realistic about budget and time for conducting analysis Focus first on (1) options legislature/employees most likely to understand and find reasonable and (2) specific options of interest to legislature/Governor
No apparent "magic bullet"	Evaluate plans against other employers' plans to identify "low hanging fruit" Consider whether changes are warranted to funding policies instead of or in addition to specific plan changes Present thoroughly analyzed options for consideration, as opposed to recommendations
Unintended consequences of changes	"Vet" options with a few key stakeholders Consider impact of changes on: income replacement potential of plans turnover, particularly of experienced employees near retirement ability to recruit/retain qualified employees financial status of existing plan Consider likelihood of legal challenges for each change option

Key Takeaways

- Plan modifications reduce costs of future benefits earned; do not address accrued liabilities
- Certain plan changes can exacerbate costs of existing liabilities
- Changes will require trade-offs; presenting options for policymakers as opposed to recommendations may be reasonable

Key Takeaways (Cont.)

- Researchers' conclusions and credibility strengthened by input from variety of stakeholders, especially employers and employees
- Comprehensive analysis of potential impacts/unintended consequences improves impact of research
- Use of third-party experts expands resources available to researchers and strength of conclusions

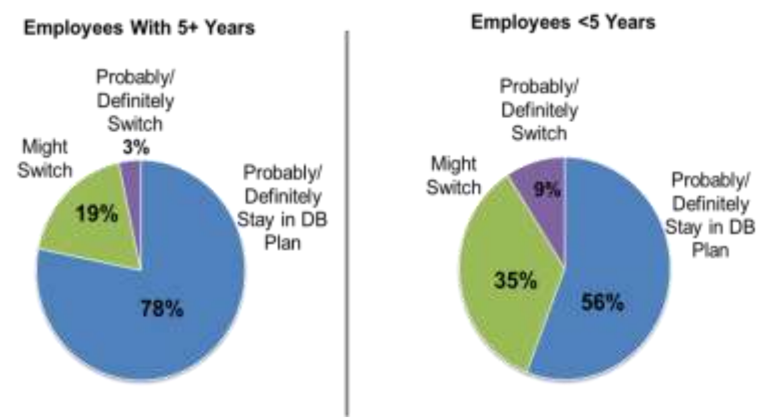
Appendix

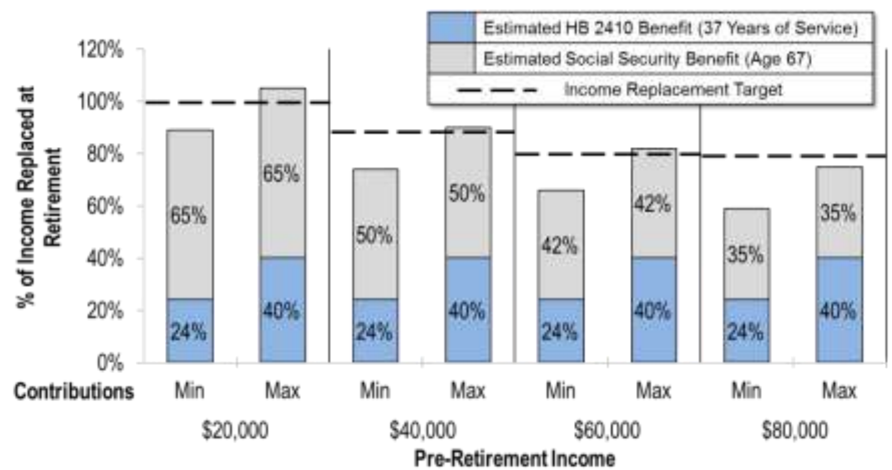
Additional Information on Alternative Plan Designs

Optional Defined Contribution (DC) Plan Findings

- No retention feature included in plan
- DC plan could potentially provide adequate income replacement*, but most employees will not contribute enough to reach recommended income targets
- State's costs expected to increase by between 1% and 4% through FY 2022 for general State employees and teachers
- Existing $19.9 billion in unfunded liabilities contributes to higher costs

If offered the option to participate in a defined contribution plan:

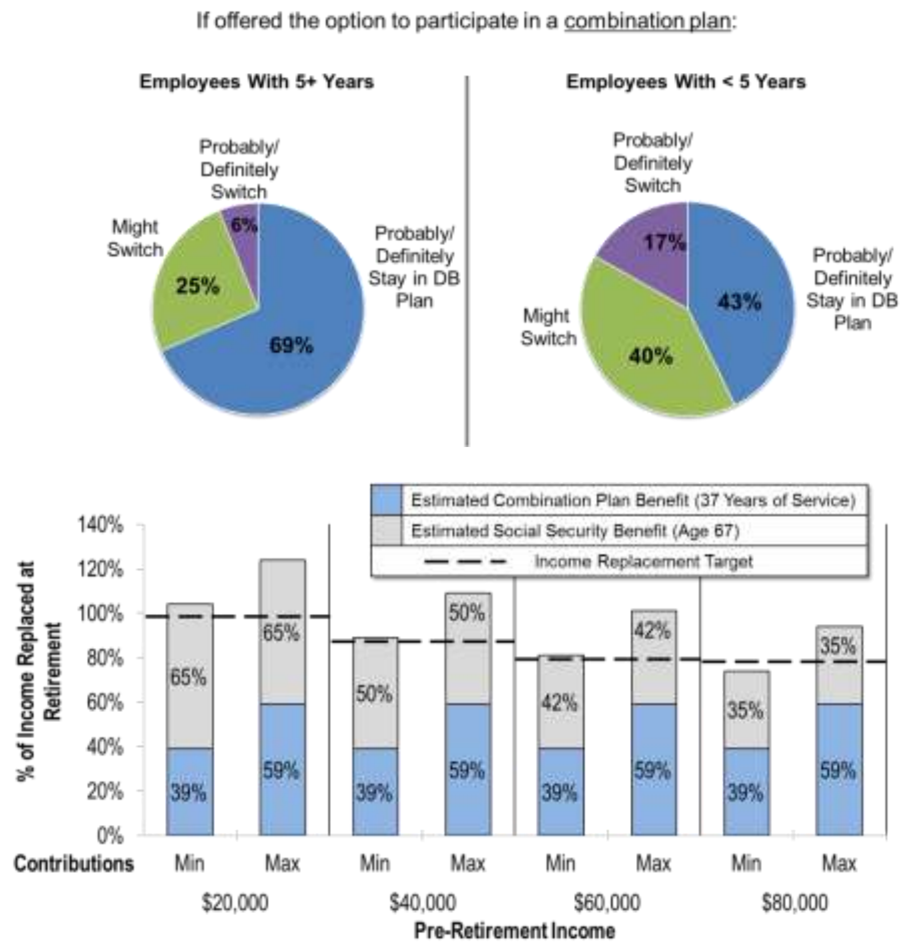




*When paired with unreduced Social Security benefits

Optional Combination Plan Findings

- Retention feature of DB element included
- Combination plan is more likely to provide employees with adequate retirement income than the DC plan design*
- Could result in cost reductions of 0.96% or cost increases of 0.27% through FY 2022 for general State employees and teachers
- Range of costs determined by employee participation and employee-elected contributions
- Cost savings partially a result of lower costs of DB feature



*When paired with unreduced Social Security benefits

Guidelines Recommended for Any Alternative Plan

- To help participants maximize value
  - comprehensive and ongoing education effort for all employees
  - a diverse, but simple investment platform
  - employee contributions that could automatically increase
- To ensure that plan is attractive
  - disability benefit
  - one opportunity to switch plans within first five years
- To maintain financial health of defined benefit plans
  - optional for employees
  - continued funding of existing liabilities in the defined benefit plans

For More Information

The final report can be accessed via

http://jlarc.virginia.gov/reports/Rpt422.pdf

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