



Virginia Commission on Employee Retirement Security & Pension Reform

Public Pensions: 50-State Overview & Virginia Comparison

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pewtrusts.org

The Pew Charitable Trusts

- More than 40 active, evidence-based research projects
- Projects include public safety, immigration, elections, transportation, pensions, and state tax incentives
- All follow a common approach: data-driven, inclusive, and transparent

Pew's Public Sector Retirement Systems Project

- Research since 2007 includes 50-state trends on public pensions and retiree benefits relating to funding, investments, governance, and employee preferences
- Technical assistance for states and cities since 2011



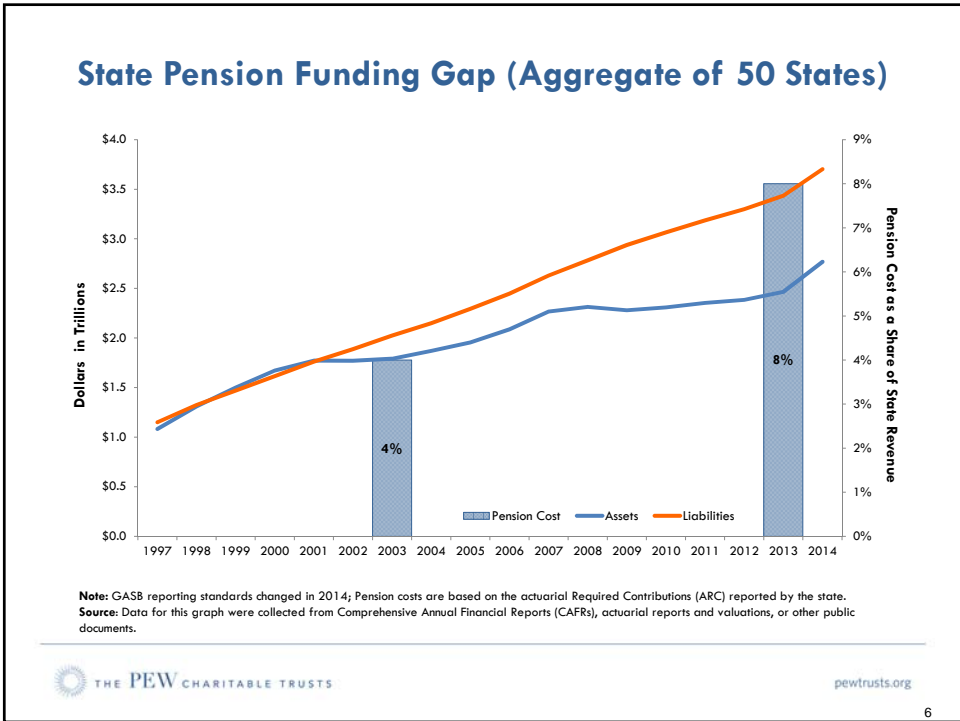
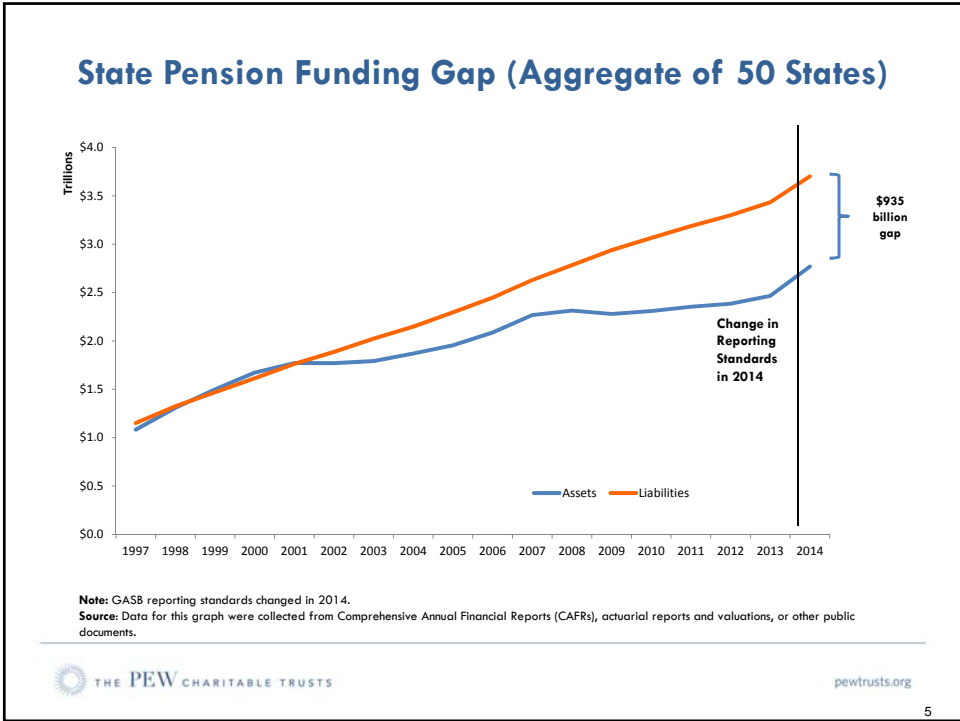
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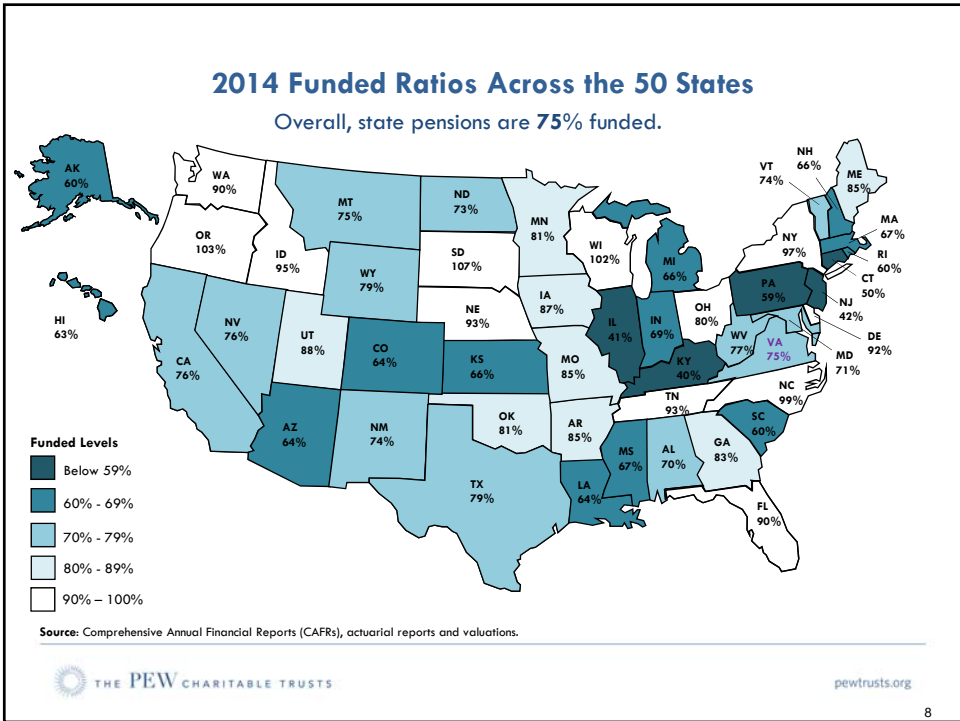
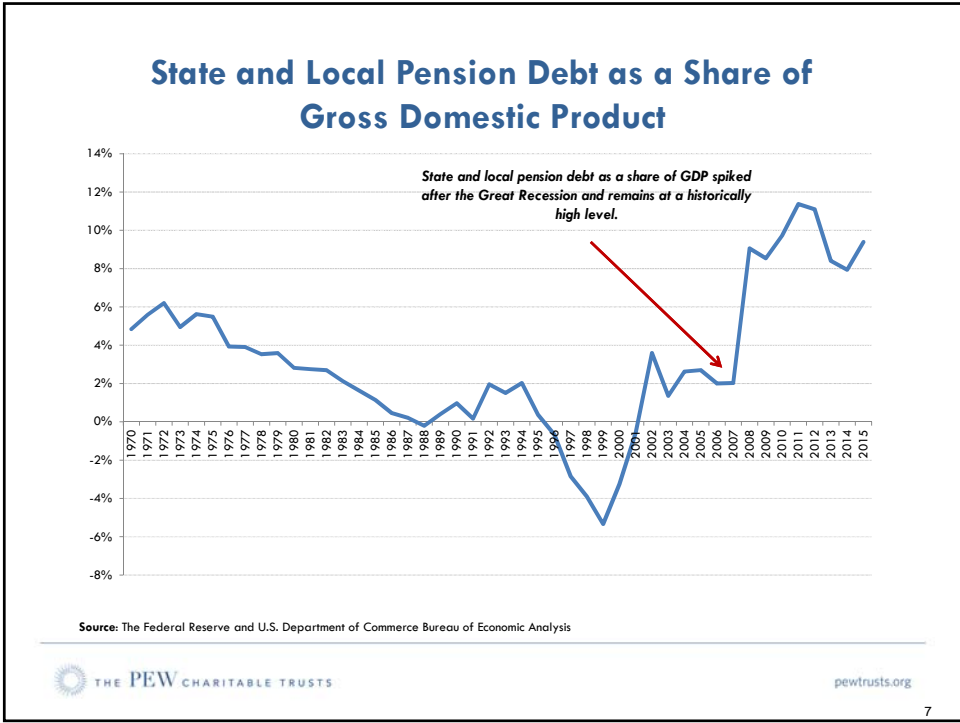
Overview

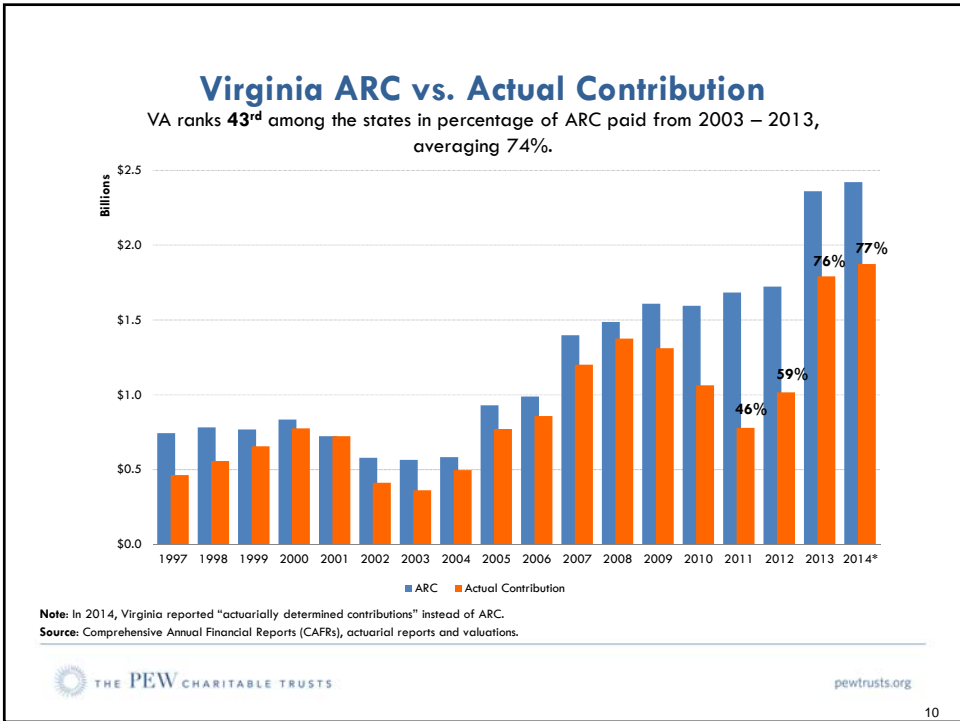
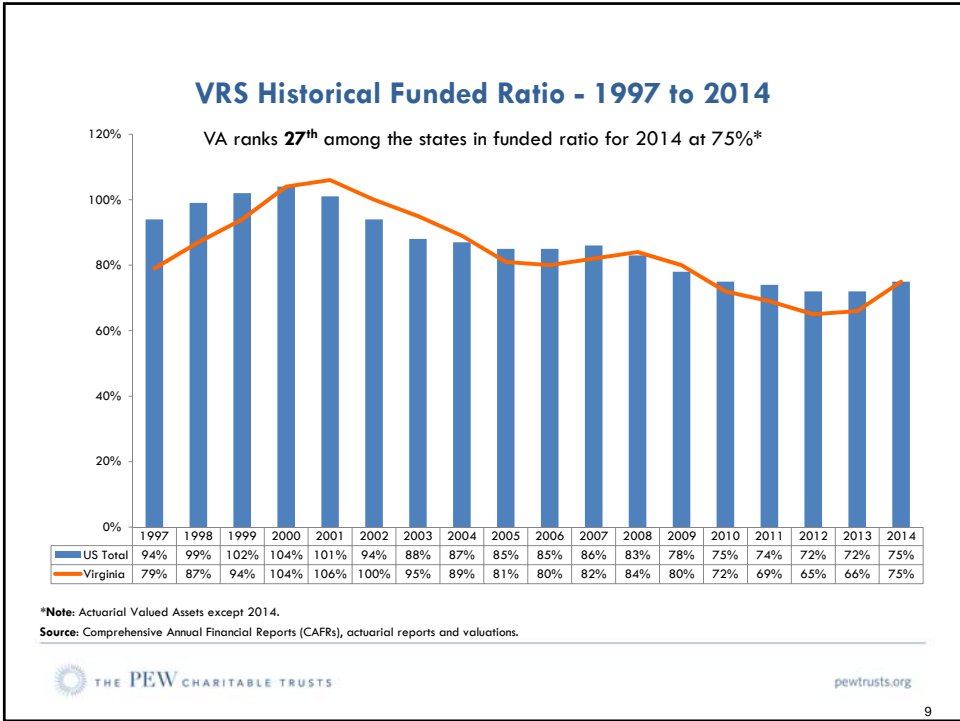
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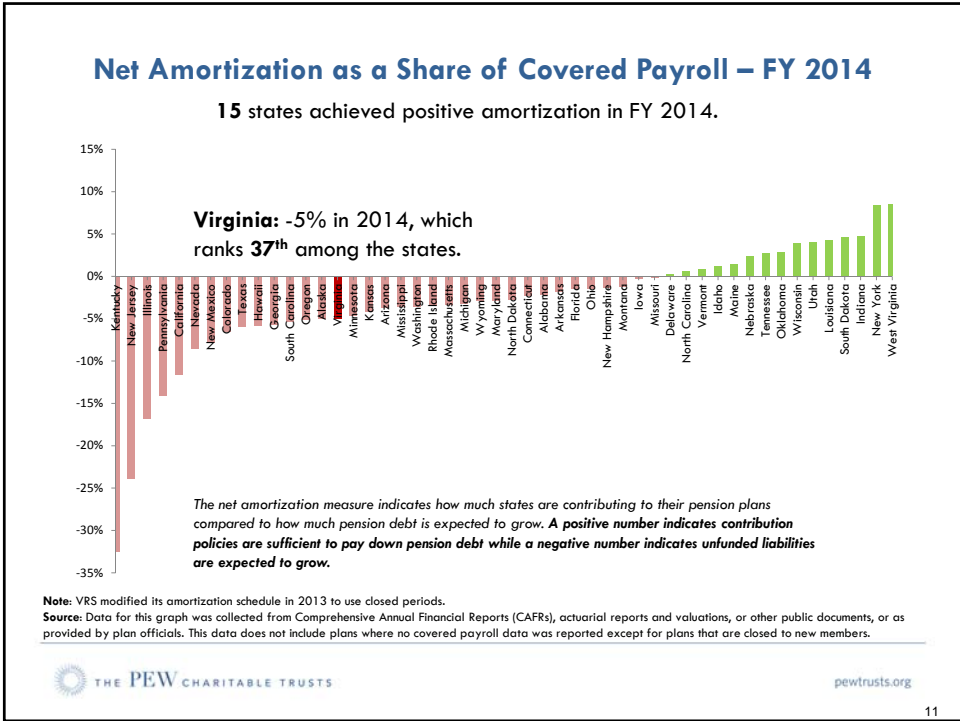
Pension Funding & Fiscal Health

50 State Summary & Virginia History









- ### Funding Policy New GASB Requirements
- Net pension liability reported on the balance sheet
 - Assets reported on a market value basis
 - Actuarial Required Contribution (ARC) no longer a required disclosure
 - Additional detail on cost of new pension benefits earned by current workers (“service cost”)
 - Additional, although limited information on sensitivity analysis
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Funding Policy Virginia

- Virginia has paid an average of 74% of the ARC from 2003-2013
- Virginia is committed, via statute, to ramp up to 100% funding by FY 2018
 - §51.1-145, subsection K1 outlines the new funding policy in detail
- In June 30, 2013 legacy unfunded liabilities were set to a 30-year closed amortization schedule, with future unfunded liabilities to be amortized on a closed schedule over 20-year periods
- VA's investment return assumption of 7% is lower than the U.S. average of 7.4%

Pension Investments Recent Trends and Emerging Issues

Investments – Key Trends: More in Stocks and Less in Bonds

Public Pension Investments, 1954-2014

Allocations to equities and alternative investments have increased, while those to fixed-income investments have declined

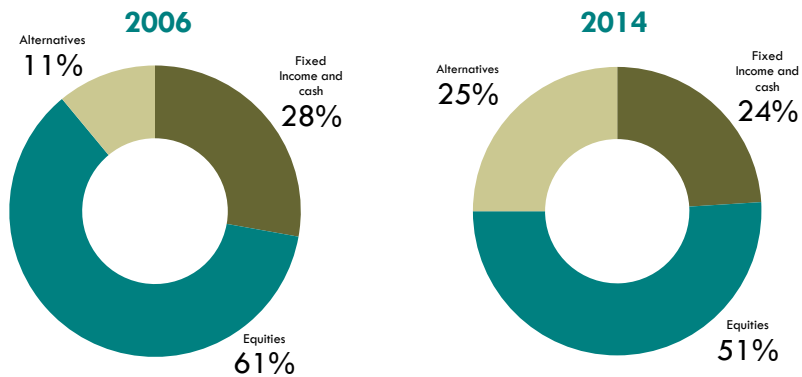


Source: U.S. Board Of Governors of the Federal Reserve System, *Financial Accounts of the United States, 1954 to 2014*; Pew Analysis of State Financial Reports

Investments – Key Trends: Increased Use of Alternatives

Public Pensions Include More Alternative Investments

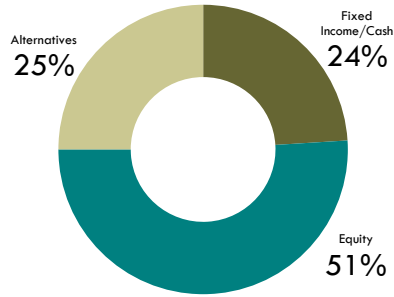
Share of pension assets in alternatives has more than doubled



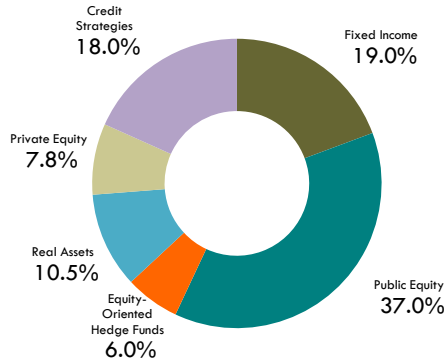
Source: Analysis by the Pew Charitable Trusts of State Comprehensive Annual Financial Reports, Public 100, and the Federal Reserve Financial Accounts of the United States.

Investments – Asset Allocations (U.S. Avg. & VRS)

FY14 - US Average Asset Allocation



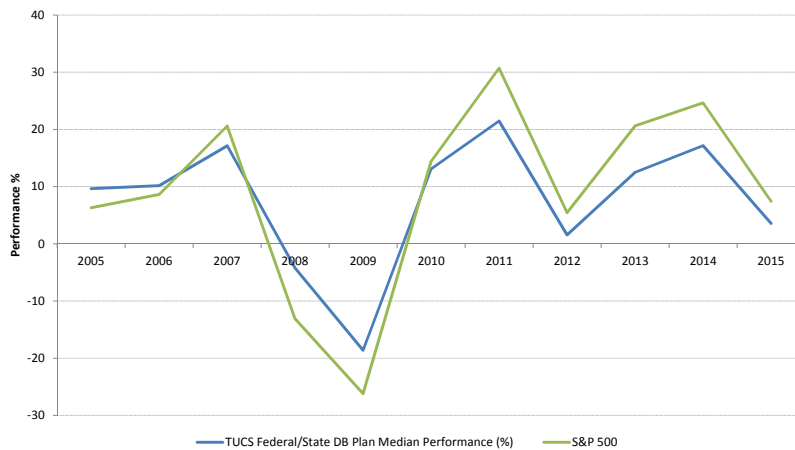
FY14 VRS Asset Allocation*



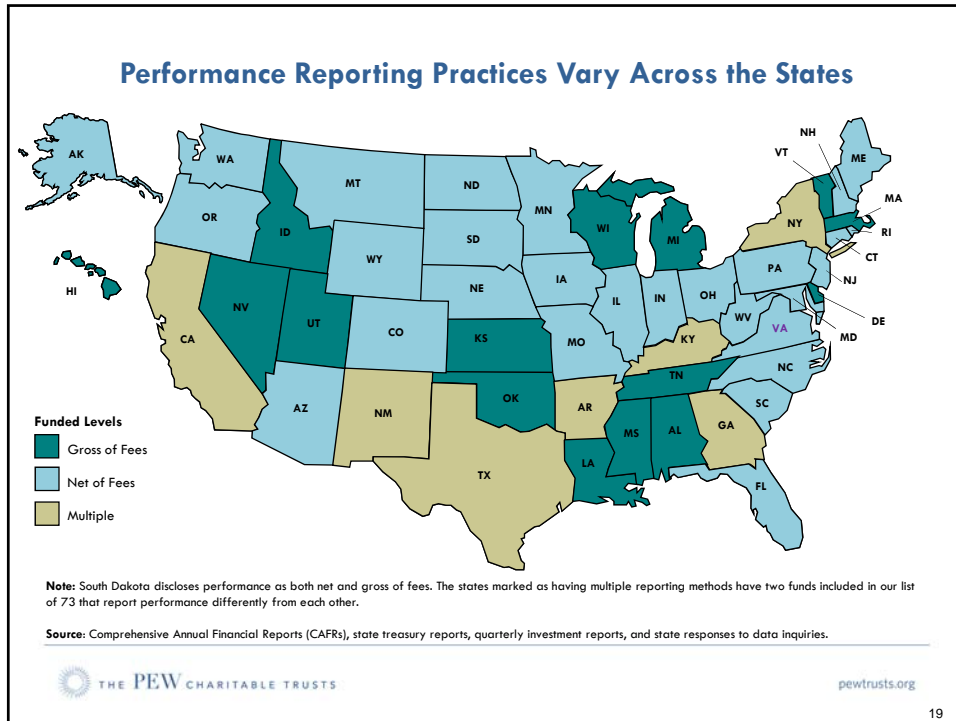
In fiscal year 2014, the Virginia Retirement System had 43% of assets allocated in alternative investments, nearly double the US average of 25%; 37% allocated in equities, below the US average of 51%; and 19% in fixed income, also below the US average of 24%.

***Note:** VRS classifies a total of 32% of assets in Alternatives.
Source: Comprehensive Annual Financial Reports (CAFRs), actuarial reports and valuations.

Volatility in Returns – S&P 500 and Pension Plan Returns FY 2005-2015



Source: Wilshire®, Trust Universe Comparison Service®



Foundations of Investment Transparency


- Clear and Detailed Online Statement of Investment Policy (VRS' Investment Policy is available upon request but not posted online)
- Investment Performance Reporting
 - Returns reported both net and gross of fees (VRS reports net of fees)
 - Include 20-year return data (VRS reports 1-, 3-, 5-, and 10-year data)
 - Returns presented by asset class ✓
- Fee Transparency
 - Comprehensive disclosure including performance fees (VRS studying options to report performance fees going forward)
 - Line item inventory of fees by investment manager ✓

Source: <investment transparency paper>

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Benefits
Recent Reforms & Virginia Snapshot

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Policymaker Considerations in Plan Design

- Retirement Security
- Recruitment and Retention
- Cost
- Cost Predictability

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Virginia Summary

- Virginia passed a new hybrid retirement plan via **HB 1130 & SB 498** in 2012, which took effect in 2014 for new workers, but does not include hazardous duty workers.
- In 2015, as part of a comprehensive report required by the legislature, VRS produced detailed analysis and provided several recommendations to modify the existing hybrid retirement plan.
- Policymakers have noted the relatively low level of voluntary retirement contributions.
- In addition to the Hybrid Plan and the Plan 1 and Plan 2 DB plans, VRS also manages several optional defined contribution plans, including one for higher education employees (45 out of 50 states have a similar model).

Note: Hybrid plan does not include hazardous duty workers.

Summary of Virginia Benefits

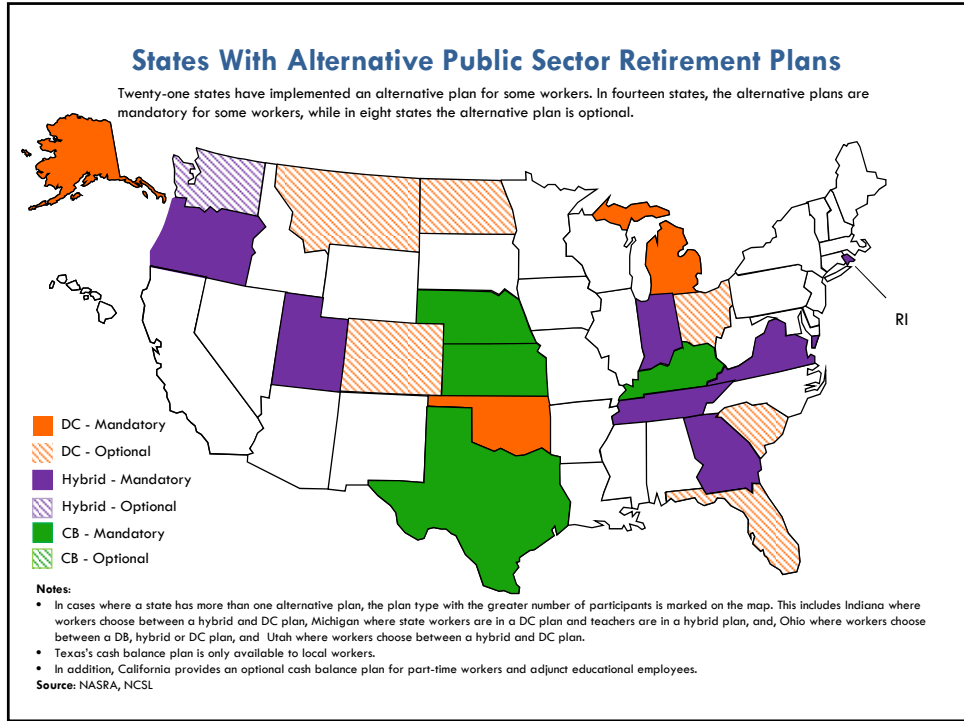
Virginia Retirement System	Hired on or after January 1, 2014 (Hybrid Plan Passed via HB 1130/SB 498 in 2012)	Hired after June 30, 2010	Hired before July 1, 2010 and vested on January 1, 2013
Multiplier	1% (DB)	1.65%	1.7%
Normal Retirement Age	Social Security age or rule of 90	Social Security Age or rule of 90	65 with 5 YOS or 50 with 30 YOS
Employer Contribution	Actuarially Determined Contribution (DB)/1%* (DC)	Rate enacted by General Assembly	Rate enacted by General Assembly
Employee Contribution***	4% (DB); 1%** (DC)	5%	5%
Vesting	5 years (DB); 4 years gradual (DC)	5 years	5 years
COLAs	Matches the first 2% increase in the CPI-U and half of any additional increase (up to 2%), for a maximum COLA of 3%	First 2% increase in the CPI-U and half of any additional increase (up to 2%), for a maximum COLA of 3%.	First 3% increase in CPI-U plus half of any additional increase (up to 4%) for a max. COLA of 5%
Covered by Social Security	Yes	Yes	Yes

*1% is mandatory; employer match of 1% on employee's first contribution, 0.25% match for each additional 0.50%. Employer will contribute 2.5% in matching contributions if employee contributes a total of 5%.

**1% is mandatory; may contribute an additional 4% in 0.5% increments. If employee wants to receive the full employer match to the DC plan, they need to contribute 5% total.

*** Local employees required to pay 5% contribution by way of salary reduction by SB 497 (2012).

Note: 2015 legislation (HB 2178/SB 1162) allowed school divisions the ability to elect to use 403(b) plans for the voluntary portion of the hybrid plan, and required the Virginia Retirement System to develop a cash balance plan proposal (HB 1969); Hybrid plan does not include hazardous duty employees.



Most Common Example of Hybrid Plan Is Side-By-Side DB/DC Design with 1% Multiplier for DB*

	DB Multiplier	Employee cont. to DB	Employer cont. to DC	Default employee cont. to DC	Number of investment options	Annuity offered for the DC
Georgia Employee's Retirement System	1%	1.25%	3% (3% matching, 0% mandatory)	5% (optional)	21	No
TN Consolidated Retirement System	1%	5%	5% (0% matching, 5% mandatory)	2% (optional)	26	No
Rhode Island Employee Retirement System (state and teachers)	1%	3.75%	1% (0% matching, 1% mandatory)	5% (mandatory)	23	Yes
Virginia Retirement System	1%	4%	3.5% (2.5% matching, 1% mandatory)	1% (mandatory)	23*	Yes
Washington Department of Retirement Services	1%	None	None	5% (mandatory)	13	Yes
Federal Government Retirement System	1%	0.8%	5% (4% matching, 1% mandatory)	3% (optional)	10***	Yes

*Note: VRS has 11 investment options plus a series of 12 target date funds. Note that the number here counts each target date fund separately. Additionally, VRS will be removing the emerging markets fund from their lineup effective July 29th, 2016.
 Source: Pew primer on hybrid plan design: www.pewtrusts.org/pensions; Original analysis and additional context initially provided in June 16, 2014 letter to the PA Senate Finance Committee

VRS - Recommended Changes to the Hybrid

Recommendation	Commentary
Change Employee Contribution to Defined Benefit Plan from 4% to 3% and to Defined Contribution Plan from 1% to 2%	VRS notes that this would also increase the employer DC match by 1% and that lowering the DB contribution would more closely match the percentage of normal cost contributed by members of the legacy plans.
Change Auto-Escalation from Every 3 Years to Every 2 Years	The current rate of auto escalation gets a worker to the maximum 4% contribution rate in 24 years. Changing the frequency of escalation to two years would get a worker to the maximum in 16 years.
Change Initial Contribution to 1% Mandatory (Current) and 0.5% Voluntary	VRS notes that this change would accelerate the above change in getting to the maximum contribution by an additional two years. Further, VRS estimates that, all changes considered, replacement income for a lifetime worker would be approximately equal to that of Plan 2.
HB 1072 (2016): This legislation proposed to make all the above changes, but would also reduce the employer's maximum matching contribution from 2.5% to 1.5% of creditable compensation. Status: Continued to 2017 via voice vote.	

Source: 2015 VRS Report, "Cash Balance Retirement Plans"

Further Hybrid Options - Active Choice

- **Active Choice** - Requires new employees to affirmatively elect to participate in the plan or affirmatively select non-participation. It differs from both active enrollment – where employees are not enrolled in their plan unless they opt-in – and auto-enrollment – where employees participate by default unless they opt-out.

PARTICIPANT INFORMATION PLEASE SELECT ONE OPTION

1) YES, I would like to contribute 3% of my salary on a pre-tax basis to the Massachusetts Deferred Compensation SMART Plan to supplement my retirement benefit.*

2) YES, I would like to contribute _____% of my salary on a pre-tax basis to the Massachusetts Deferred Compensation SMART Plan to supplement my retirement benefit.*

3) NO, I do not wish to supplement my retirement benefit by contributing any portion of my salary to the Massachusetts Deferred Compensation SMART Plan at this time. I understand there is a ten year creditable service vesting period for members of the separate state retirement system and I am not contributing to Social Security as a state employee.

- Although Active Choice systems are less effective than pure opt-out/default systems, they still result in significant improvements in voluntary retirement participation.
- Research on private-sector 401(k) enrollments indicate that active choice systems result in a **28%** improvement over opt-in systems (opt-out systems show **more than 50%** improvement).

Sources: Carroll et al., "Optimal Defaults and Active Decisions." Quarterly Journal of Economics 124, 4 (Nov. 2009); Mass. SMART Plan New Member Enrollment Form

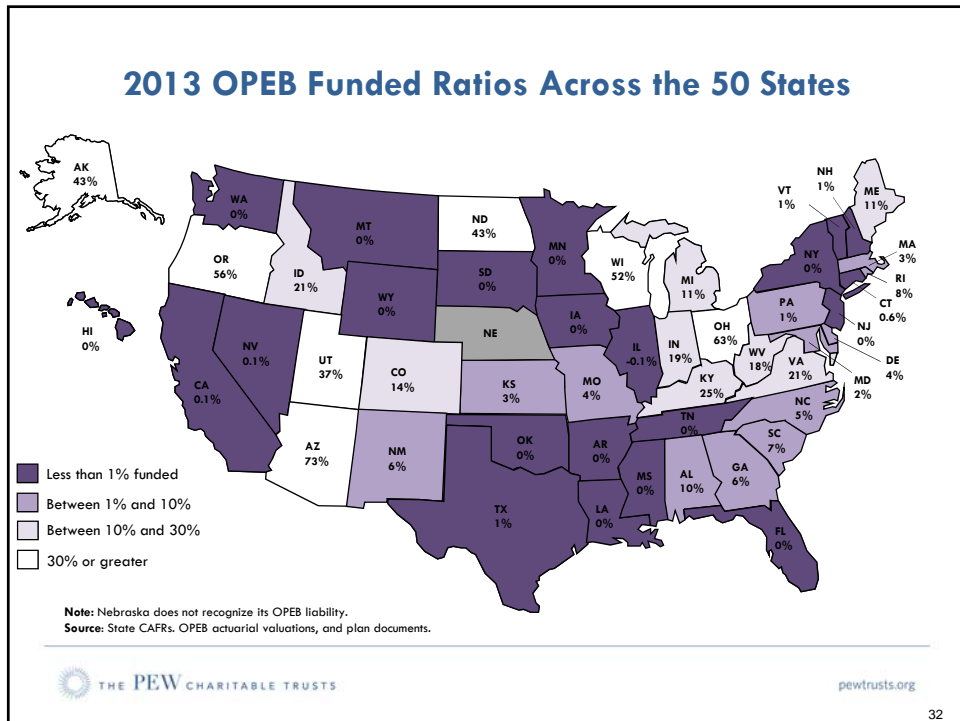
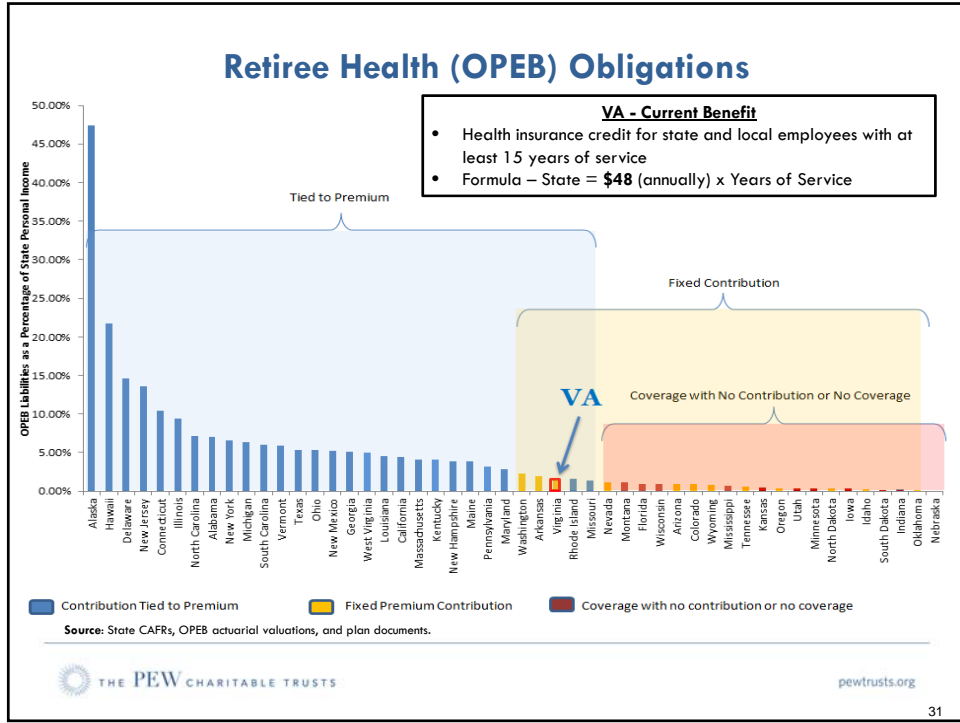
VRS - Optional Retirement Plan for Higher Education (ORPHE)

Virginia Retirement System (ORPHE)	ORPHE Plan 1 (Hired before Jul. 1, 2010)	ORPHE Plan 2 (Hired after Jul. 1, 2010)
Employer Contribution	10.4% (entire contribution made by employer and set by statute)	8.5%*
Employee Contribution	N/A	5%**
Vesting	Immediate	Immediate
Distribution Options	Systematic, full or partial lump-sum, annuity purchase to produce lifetime benefit, rollover to new plan or into IRA	Systematic, full or partial lump-sum, annuity purchase to produce lifetime benefit, rollover to new plan or into IRA
Covered by Social Security	Yes	Yes

* The employer contribution rate has been lowered from previous plan tiers. The rate was 10.4% for employees hired between July 1991-2010.
 ** Some institutions contribute an additional 0.4% of compensation for the employee

Benefits

Retiree Health Care Benefits (OPEB)



Governance

Fiduciary Protections

- Increased complexity, risk, and cost of pension fund investments suggests need for increased clarity in fiduciary protections for plan beneficiaries.
- The Uniform Management of Public Employee Retirement Systems Act, or the Model Act, was legislation developed in 1997 with the goal of an ideal pension fund governance structure. The Act has 9 key provisions.
- This is just one potential framework for approaching governance and fiduciary responsibilities.
- While many protections existing in legal decisions across states, using explicit statutory language to define fiduciary rules increases clarity for plan administrators, board members, and participants.

Key Fiduciary Provisions

VA law currently includes all provisions most commonly adopted in the states.

Fiduciary Element	Plans Adopting	VRS
Exclusive purpose of providing benefits	100%	Yes
Prudence requirement	97%	Yes
Diversification of investments	74%	Yes
Solely in the interest of participants	69%	Yes
Reasonable administrative expenses	62%	Yes
Economically targeted investments first prudent	41%	No
Impartially for different participants	31%	No
Fiduciary Training Required	26%	No
Good faith interpretation of law	19%	No

Note: Data should be considered preliminary. The Pew Charitable Trusts continues to analyze statutory language along with evidence of how that language is interpreted by the legal authorities in each state.

Source: Comprehensive analysis by the Pew Charitable Trusts of state laws governing the largest public retirement plans in each state.

VRS - Board Composition

VRS is governed by a nine member Board of Trustees appointed in nearly equal measure by the Governor and the Joint Rules Committee of the General Assembly. The Board then appoints a Director, Chief Investment Officer, an Investment Advisory Committee, and an Internal Auditor. No elected official may serve on the Board.

Method of Selection	Elected	Appointed	Ex-Officio
Governor appoints two who must have at least five years of experience in the direct management, analysis, supervision or investment of assets		2	
Governor appoints one who must have five years of direct experience in management and administration of employee benefit plans		1	
Governor appoints one who must be a local government employee.		1	
Governor appoints one who must be a faculty member or employee of a state-supported institution of higher education.		1	
Joint Rules Committee appoints two who must have a minimum of five years of experience in the direct management, analysis, supervision, or investment of assets.		2	
Joint Rules Committee appoints one who must be a state employee.		1	
Joint Rules Committee appoints one who must be a teacher.		1	

Note: VRS Board composition was modified in the mid 1990's following a comprehensive review by the Joint Legislative Audit and Review Commission.

Source: Comprehensive analysis by the Pew Charitable Trusts of state laws governing VRS.

Principles for Fiscal Sustainability and Retirement Security

No one-size-fits-all solution, but **key principles** can guide any reform process.

- **Fiscal sustainability principles**

- Commit to fully funding and paying for pension promises.
- Manage investment risk and cost uncertainty.
- Follow sound investment governance and reporting practices.

- **Retirement security principles**

- Target sufficient contributions and savings to help put employees on a path to a secure retirement.
- Invest assets in professionally managed, pooled investments with low fees and appropriate asset allocations.
- Provide access to lifetime income in retirement.

Appendix

Key Pension Terms

- **Actuarial Required Contribution (ARC)** – This is the sum of the actuarial cost of benefits earned in the current year (called service cost or normal cost) and an additional payment on the unfunded actuarial accrued liability (UAAL) called the amortization payment.
- **Assumed Rate of Return** – Estimated return on investments used by actuaries to project the rate of return on plan assets and calculate the value of plan liabilities.
- **Funded Ratio** – Assets divided by the actuarial accrued liabilities. A measure of fiscal health.
- **Net Amortization** – A measure of whether state pension funding policies are sufficient to reduce, or amortize, pension debt in the near term.
- **Pension Debt** – The difference between the actuarial accrued liability and the value of plan assets on hand. Also referred to as the Unfunded Actuarial Accrued Liability (UAAL).

Plan Type Definitions

- **Defined Benefit Plan (DB)**: traditional pension plan with a fixed monthly retirement income benefit based on age, years of service, and worker's salary.
- **Defined Contribution Plan (DC)**: 401(k)-style plan with the retirement benefit based on accumulated employer and employee contributions, and returns on those investments.
- **Hybrid Plan**: plan that combines elements of DB and DC plans; "Side-by-Side" is the most common type of hybrid plan, where employees get a reduced DB benefit plus a DC account.
- **Cash Balance Plan (CB)**: plan where benefit is based on employee and employer contributions that are pooled and professionally managed with a guaranteed minimum rate of return and annuitization option at retirement.