

The Future of Public Pensions

Comparison of Virginia Retirement System To A Defined Contribution System For Employee Pensions

VML Annual Conference

Need for legislative request for local flexibility

October 4, 2010

Overview

1. Importance of Retirement Benefit

2. Mayor's Committee on Pensions

3. Virginia Retirement Plan - a defined benefit

- Background
- Funding
- Unfunded Liability
- Future
- Potential Modifications

4. Defined Contribution Plans

- Generic Description
- JLARC Study

5. Proposed Legislative Package Item

Importance of Retirement Benefits

- Recognition that retirement is part of employees' quality total compensation package
- Important for competitiveness as an employer
- Fair to Taxpayers

Mayor's Committee on Pensions

Councilman Harry Diezel	Chair
Councilman Glenn Davis	Vice Chair
Jim Flinchum	Managing Principal, Bay Capital Advisors
Anthony Jernigan	The Pinnacle Group
Hank Kim	Executive Director and Counsel for the National Conference on Public Employee Retirement Systems
Tom Langley	President, Langley & McDonald
Kenny Pravetz	Battalion Chief, Virginia Beach Fire Department

- Report Issued September 3, 2010
- Recommendation:
 - Flexibility to determine how to continue to provide benefits in a way that is fair to both employees and taxpayers
- Not full agreement on best direction for future
 - Some want to maintain commitment to employees
 - Some want to require employees to participate in Defined Contribution Plan

Virginia Retirement System (VRS)



Defined Benefit Plan



Retirement Income is Based on a
Formula

$AFC \times 1.7\% \times Yrs. = \text{Annual Pension}$



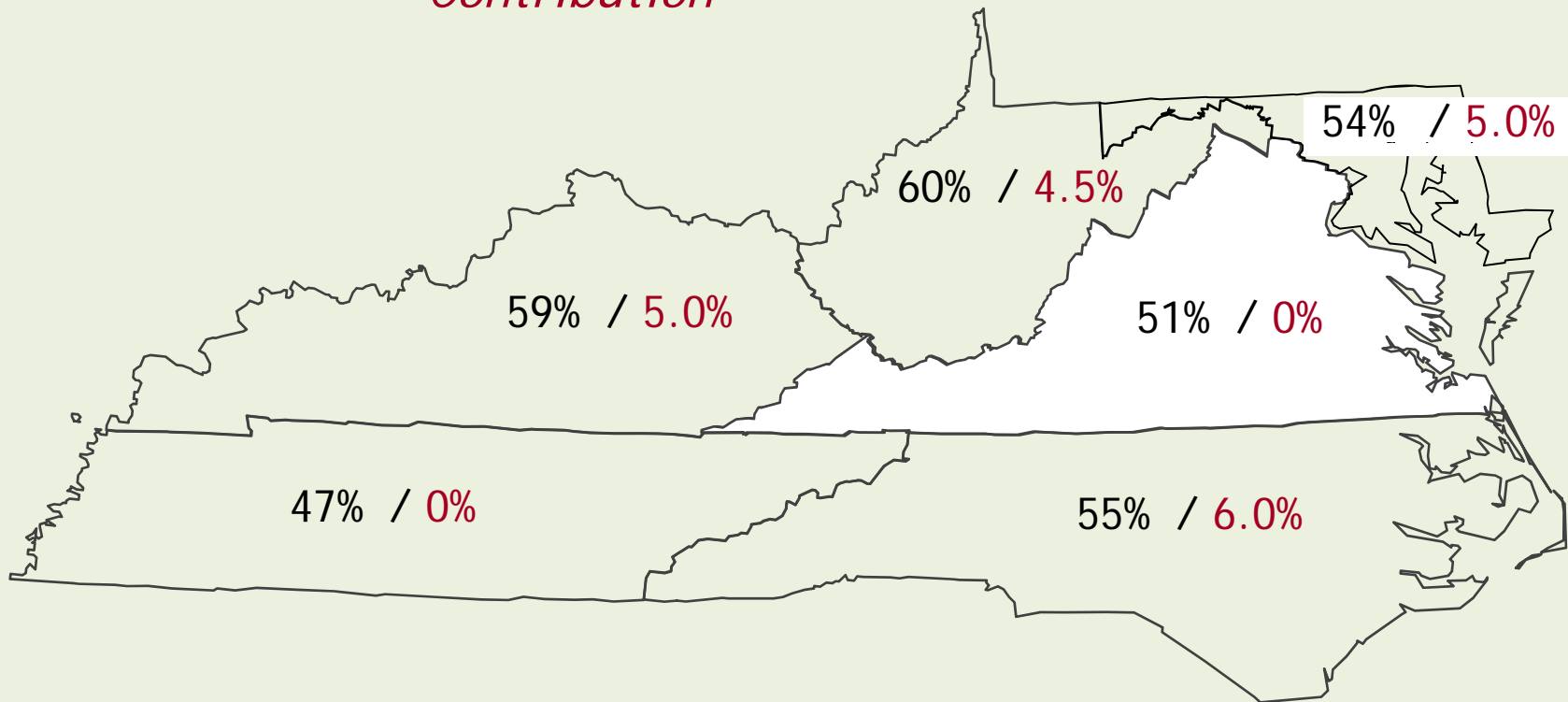
Not Based on
Contributions



Condition of employment
for VRS-Covered Position

Most Other Neighbor States Have Higher Income Replacement, But Employees Contribute

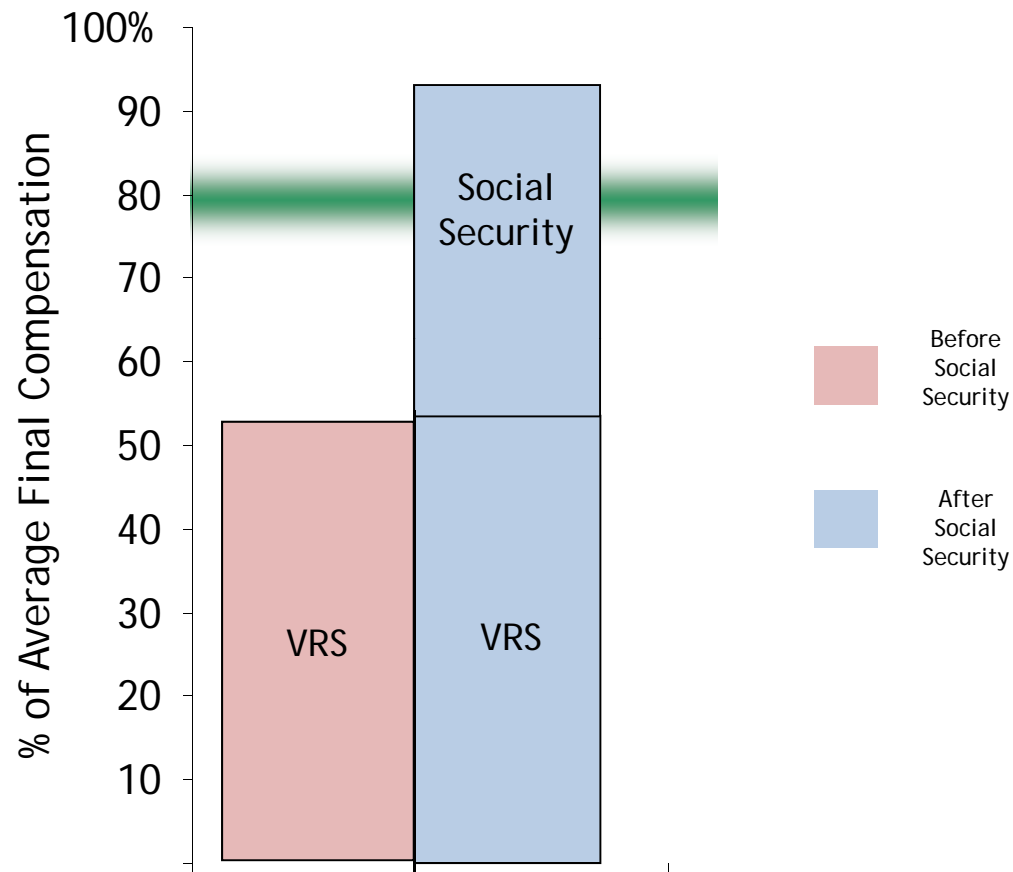
Income Replaced / Employee Contribution



Source: JLARC staff analysis of state retirement plan documentation, 2008.

Note: Va. Beach new employees hired 7-1-10 pay 5%.

VRS and Social Security Benefits Replace More Than 80% of Pre-Retirement Income



Source: JLARC staff analysis of VRS and Social Security Administration data, 2008.

Funding VRS Benefits

- ◉ Investment earnings – pay 68% of all benefit costs
- ◉ Employer contributions – set every two years, based on actuarial analysis and demographics
- ◉ Employee contributions – established in statute at 5% of salary; most employers, including Virginia Beach, pay on behalf of employee

Note: Va. Beach new employees pay 5% effective 7-1-10

Virginia Beach Contributions

(Percent of Payroll)

Fiscal Year	Rate
1998	11.88%
1999	13.59%
2000	13.59%
2001	13.01%
2002	12.50%
2003	11.00%
2004	11.00%
2005	15.25%

Fiscal Year	Rate
2006	15.25%
(7/1/06 - 11/30/06)	17.18%*
(12/1/06 - 6/30/07)	17.24%*
(7/1/07 - 12/30/07)	17.24%
(1/1/08 - 6/30/08)	17.95%*
2009	16.48%
2010	16.48%
2011	17.58%

*Note: Enhanced benefit coverage for hazardous duty employees added for EMS employees 12/1/06. Increased multiplier to 1.85% for hazardous duty employees 1/1/08.

Source: VRS

Table 2
Virginia Beach Annual Contribution VRS Pension



**Comparison of Major Benefit Provisions for Local Employees
Current Employees and New Employees
07-01-10**

	<u>PLAN 1</u>	<u>PLAN 2</u>
Benefit Formula:		
-General Employees	AFC x YRS Service x .0170	No Change
-Public Safety	AFC x YRS Service x .0185 (plus \$12,456 annually until social security)	No Change
AFC Calculation	3 Highest Years	5 Highest Years
Unreduced Retirement:		
-General Employees	50 Years Old/30 years Service	Age and Service = 90
-Public Safety	50 Years Old/25 Years Service	No Change
COLA	First 3% of CPI + Next 4% of CPI x 0.5 Cap of 5%	First 2% of CPI + Next 8% of CPI x0.5 Cap of 6%
Local Employee Contribution	Currently 5% paid by City No option to change	Optional 0-5%

****as set forth in #HB1189 and HB30 (BUDGET) (State Budget (HB30) does not impose employee contribution on current state employees; does require 5% contribution for new State employees).**

Selected VRS Information for Virginia Beach

- Current VRS rate paid by City: 17.58% of payroll: \$50.5m
 - Sworn Officers 23.19% of payroll
 - General Employees 14.53% of payroll
- Actuarial study projects rates will increase 1.5% more in FY13 to total of 19.13%
- City of Virginia Beach VRS has an unfunded liability of \$275.1 million at June 30, 2009, or 80% funded (most recent data, based on 2008 data)
- In 2002 unfunded liability was \$23 million or 97% funded

Unfunded Liabilities at June 30, 2009

- VRS state employees:\$2.9 Billion
 - Teachers (entire state): \$8.1 Billion
 - Total local employees in VRS: \$2.2 Billion
- } 84% funded
- The City of Virginia Beach: \$275.1 Million, or 80% funded
 - Caused by investment performance and actuarial assumptions different than actual

Virginia Retirement System Investment Performance Summary As of June 30, 2010

10 Year	3.1%
5 Year	3.1%
3 Year	-4.9%
1 Year	14.1%
Quarter	-4.0%
Month	-0.8%
Fiscal YTD	14.1%
Calendar YTD	-0.5%

Examples of Modifications to Defined Benefit Plan

- Many states have changed benefits for new members (and in some cases current members)
- ⦿ Increase employee contribution
- ⦿ Increase age and service requirements
 - Normal retirement 65 age
 - Actual average 62/30 Year
- ⦿ Longer periods for average final compensation (AFC)
- ⦿ Caps on salary or on benefits
- ⦿ Reductions on multiplier

JLARC Study

Retirement Benefits

Less Important for New Employees:

- Rarely an employer's primary recruiting tool
- Less than 1/2 of employees agreed that VRS retirement plan played significant role in decision to work for State
 - Ranked 4th as reason to work for the State

Retirement Benefits Retain Longer-Tenured Employees:

- 93% of agencies agreed
- 3/4 of employees within 5 yrs of retirement agreed
- More important for longer tenured than for recently hired employees (Mercer)

Future

- It is unlikely future investment performance will resolve underfunding
- Funded status will decline further
- GASB Preliminary Views Pension Accounting and Financial Reporting
 - Portion of unfunded liabilities will be recorded on the employer's balance sheet beginning in 2013
 - Changes in discount rate
 - Annual rates paid by City will be higher
- Potential solutions
 - Plan design changes
 - More funding \$

Defined Benefit (DB) Plans More Cost Effective

- DB less expensive than DC for same level of benefit
 - Longevity risk pooling in DB saves 12%
 - Maintenance of portfolio diversification saves 5%
 - DB superior return save 26%
- Study by AON consulting
- “No one can dispute that public pension plans have efficiently and prudently discharged their responsibilities to provide stable and secure income streams — a record that DC is unlikely to achieve” – Girard Miller

Defined Contribution (DC) Plans

- ◉ No implicit or explicit guarantee of retirement income
- ◉ Employers (and usually employees) contribute to plan over career
- ◉ Amount of funds in account to meet retirement needs depends on:
 1. amount of “ER” and “EE” contributions
 2. investment returns
 3. lifespan
 4. individual investment portfolio management
- ◉ Employee bears investment risk

Advantages and Disadvantages of Defined Benefit and Defined Contribution Plans

DEFINED BENEFIT

Advantages:

- ✓ Employees are guaranteed specific benefit for life at time of retirement
- ✓ Benefit amount is formula driven including years of service and salary
- ✓ Rewards long term employees
- ✓ More cost effective than DC plans to provide the same level of benefit

Disadvantages:

- Employer responsible to ensure system has sufficient funds
- Requires actuarial projections
- Difficult to include in budget projections

DEFINED CONTRIBUTION

Advantages:

- ✓ Employees and employer contribute a specific amount each period
- ✓ Employee is responsible for investment decisions
- ✓ Tends to be more portable
- ✓ Generally has shorter vesting period
- ✓ Easier to administer
- ✓ Easy to include in budget projections

Disadvantages:

- Employee is not guaranteed specific amount at retirement
- Less cost effective than DB plans to provide the same level of benefit

Proposed Legislative Package Item

- ⦿ Amend *Code of Virginia* to enable Virginia localities to:
- ⦿ Develop a defined contribution plan instead of the current VRS defined benefit plan for new employees
 - Full portability
- ⦿ Option: allow Virginia Beach to be able to develop its own DC plan as a model for the state