



Pension Reform: Its Impact in Virginia

Virginia Association of Counties (VACo)

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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% member contribution▪ Offset with 5% salary increase JLARC updated study on pension reform

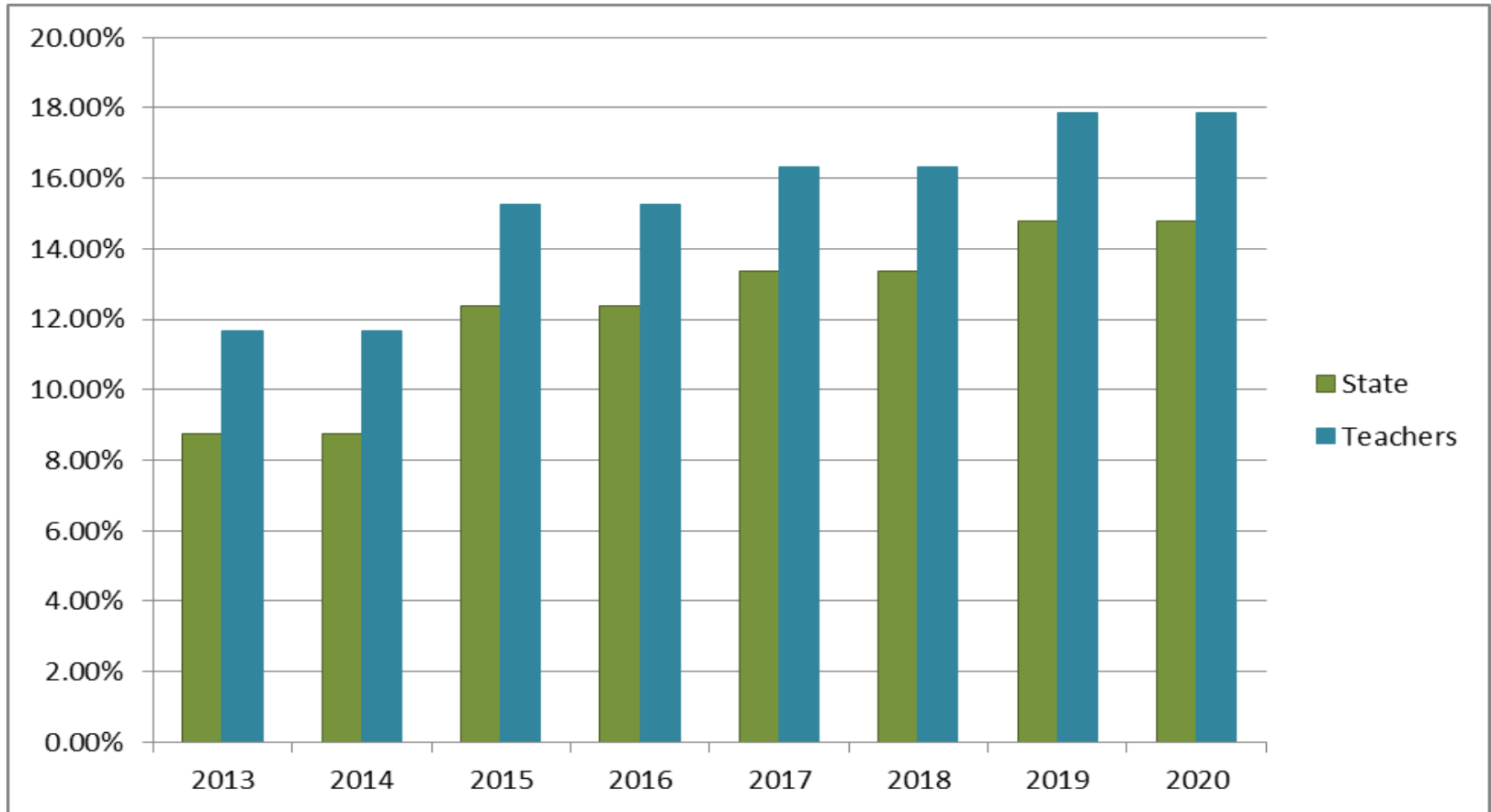
Pension Reform Efforts in Virginia



Year	Reform Effort																		
2012	<p>General Assembly requires:</p> <ul style="list-style-type: none"> ▪ Local employees pay 5% 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" data-bbox="320 1021 1816 1276"> <thead> <tr> <th></th> <th>July 1, 2012</th> <th>July 1, 2014</th> <th>July 1, 2016</th> <th>July 1, 2018</th> </tr> </thead> <tbody> <tr> <td>State</td> <td>67.02%</td> <td>78.02%</td> <td>89.01%</td> <td>100%</td> </tr> <tr> <td>Teachers</td> <td>69.53%</td> <td>79.69%</td> <td>89.84%</td> <td>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															
State	67.02%	78.02%	89.01%	100%															
Teachers	69.53%	79.69%	89.84%	100%															

Estimated Employer Contribution Rates

in Accordance with Pension Reform



Assumptions:

- FY 2013 investment return at 11.8%.
- Future years' investment return is assumed to be 7.0% with 2.5% inflation rate.
- Employer contribution rates are net of employee contributions.
- Rates include 10-year payback of deferred contributions.

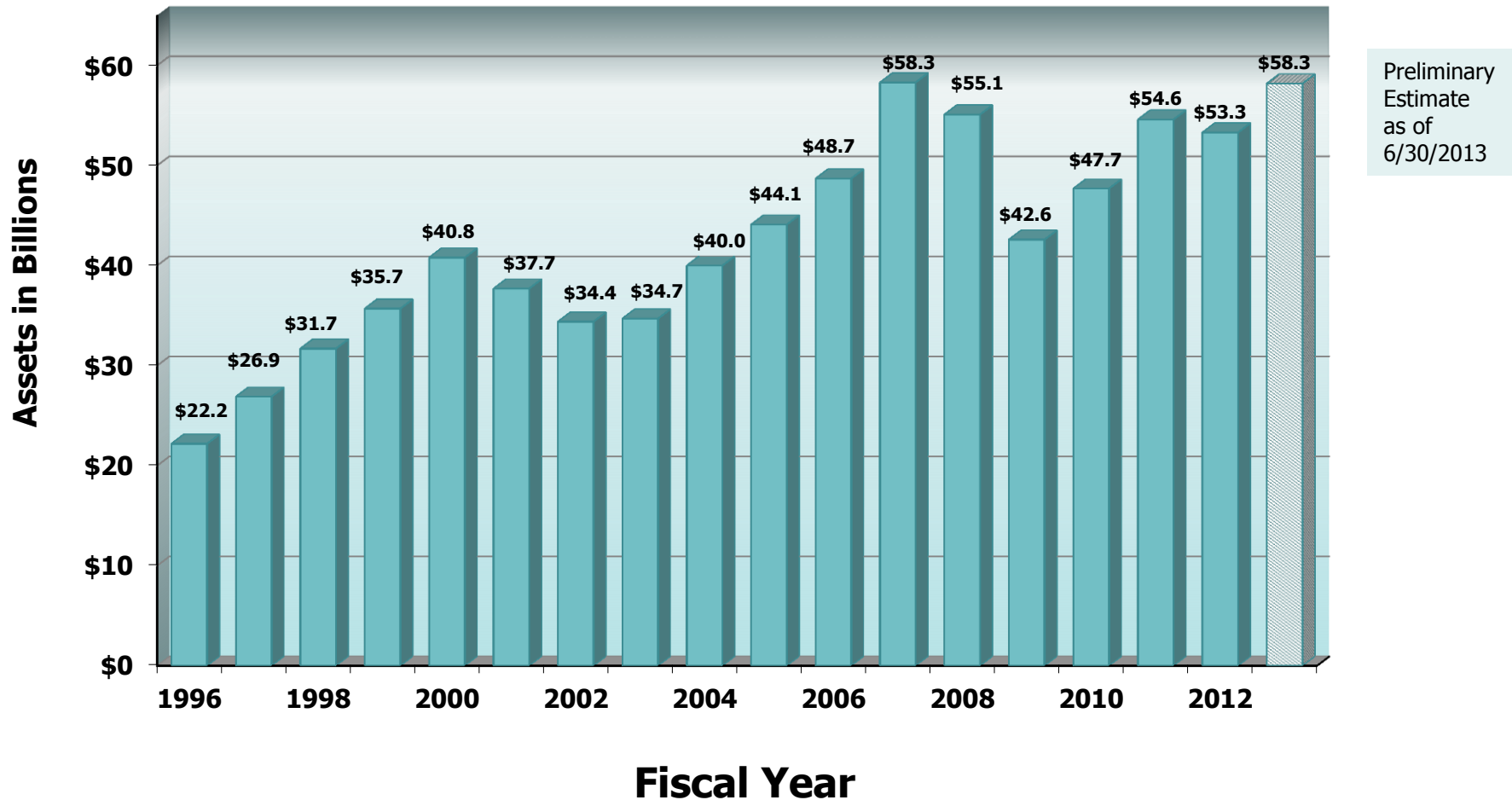
Impact of VRS Pension Contributions on State Budget

	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

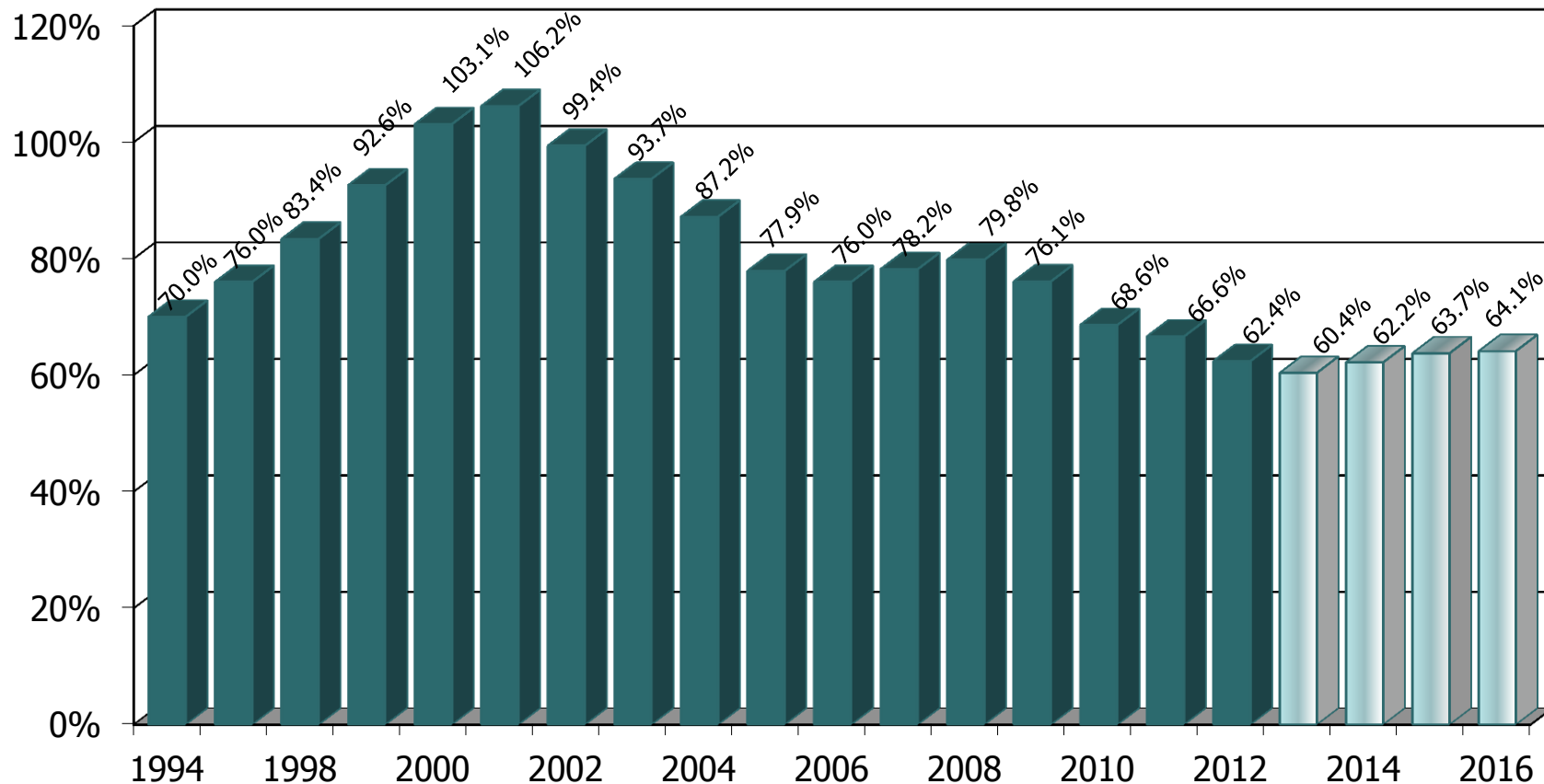


Pension Funded Status

Net Assets Available for Benefits



Funded Status: Teachers



Assumptions:

- FY 2013 investment return at 11.8%.
- All projected years' investment return is 7.0% and 2.5% inflation rate.

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%

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

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

- 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

Comparison of Standards



	Books	Bonds		Budget
	GASB	Moody's	Fitch	VRS
Discount Rate	7% (Adjusted downward if projected assets not expected to cover projected liabilities)	5.47% - 2010 5.67% - 2011 4.13% - 2012 4.81% - 2013	7%	7%
Amortization Period	Some expensed immediately, some over future working lifetimes, investment returns over 5 years	17 years	Not Calculated	30 year closed period - (Legacy Unfunded as 6/30/13) 20 Year closed period – (Tiered Amortization of new unfunded after 6/30/13)
Asset Value	FMV	FMV	5-year smoothing	5-year smoothing
Annual Pension Expense	Difference between prior year Net Pension Liability(NPL) and current year NPL Consists of: Normal Cost plus Amortization of change in NPL amortized over various time periods depending on source of change	Normal Cost at new discount rate plus Amortization of unfunded liability over 17 year period	Not Calculated	Normal Cost plus Amortization of unfunded liability (see amortization period above for details)

Unfunded Liabilities by Plan

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

* GASB unfunded liabilities are estimates based on guidance provided to date.

Teacher Cost-Sharing Plan Unfunded Liabilities

Top 10 Largest Localities



School Board	Total Estimated NPL	Percent of Total Payroll	FY 2012 Creditable Compensation
Fairfax County	\$ 2,658,222,600	17.52%	\$ 1,227,329,600
Prince William County	967,109,900	6.37%	446,524,900
Loudoun County	885,260,500	5.83%	408,734,200
Virginia Beach	816,243,600	5.37%	376,868,300
Chesterfield	543,905,600	3.59%	251,127,000
Henrico County	507,381,000	3.35%	234,263,200
Arlington County	490,038,900	3.23%	226,256,200
Chesapeake	450,935,900	2.97%	208,201,900
Norfolk	431,111,600	2.84%	199,048,800
Newport News	328,252,800	2.17%	151,557,800
Total Teachers Plan	\$ 15,160,259,000		\$ 6,999,652,800

GASB Accounting Expense

Top 10 Largest Localities



School Board	2012 Pension Expense Based on 6.33% of Payroll	2012 Pension Expense Based on 12.91% of Payroll	2012 Pension Expense Based on GASB 68
Fairfax County	\$ 79,100,000	\$ 161,400,000	\$ 255,800,000
Prince William County	28,500,000	58,000,000	92,000,000
Loudoun County	26,300,000	53,700,000	85,100,000
Virginia Beach	24,300,000	49,500,000	78,500,000
Chesterfield	16,100,000	32,800,000	52,000,000
Henrico County	15,100,000	30,800,000	48,800,000
Arlington County	14,500,000	29,600,000	46,900,000
Chesapeake	13,300,000	27,200,000	43,100,000
Norfolk	12,900,000	26,200,000	41,600,000
Newport News	9,700,000	19,800,000	31,300,000
Total Teachers Plan	\$ 450,434,000	\$ 918,658,000	\$ 1,456,377,000

Estimated Net Pension Liability (NPL)

Assuming June 30, 2012, Liabilities (Compensation & Retirement Steering Committee Members)



School Board	Estimated Share of Teacher Plan NPL	County School Plan	County Plan	Total
Albemarle County	\$ 159,809,100	\$ 4,715,900	\$ 45,404,300	\$ 209,929,300
Augusta County	110,448,200	2,229,800	20,955,000	133,633,000
Campbell County	76,399,300	85,300	14,622,700	91,107,300
Carroll County	42,408,200	2,338,200	9,031,700	53,778,100
Chesterfield County	543,906,600	31,395,500	264,884,300	840,185,400
Essex County	18,540,000	1,015,400	1,669,100	21,224,500
Henrico County	507,381,000	3,797,100	360,095,900	871,274,000
Isle of Wight County	62,088,600	1,223,000	8,793,600	72,105,200
Prince George County	66,675,200	4,845,600	18,723,900	90,244,700
Rockingham County	120,932,500	5,750,600	23,922,500	150,605,600
Wise County	64,479,300	4,638,600	13,984,300	83,102,200
York County	131,286,900	3,581,500	39,983,100	174,851,500

- Significant liability will be brought onto the face of the financial statements
- Funded ratios will be impacted, particularly by Moody's proposed changes
- Mark-to-market will increase volatility of accounting expense and liabilities
- Impact to local governments:
 - Apportionment of teacher cost-sharing plan liabilities will add to local liabilities, reflected on financial statements
 - Could affect local government bond ratings
- Accrued pension expenses will increase significantly due to shorter amortization and unfunded liabilities
- Users of financial information will likely be confused over conflicting accounting standards



Thank you!