

# VRS Overview

for the

## Joint Legislative Audit and Review Commission

July 9, 2012



Virginia  
Retirement  
System

# Agenda

## **VRS Overview**

- *Diana F. Cantor  
VRS Board Chairman*

## **Investments Overview**

- *Ronald D. Schmitz, CIO*

## **Administration Overview**

- *Robert P. Schultze, Director*

# Chairman's Remarks

*Diana Cantor*  
*VRS Board Chair*



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# VRS Board Members

Diana F. Cantor, *Chairman*

John M. Albertine, Ph.D., *Vice Chairman*

A. Marshall Acuff, Jr.

Edwin T. Burton III, Ph.D.

Robert L. Greene

Mitchell L. Nason

Colette Sheehy

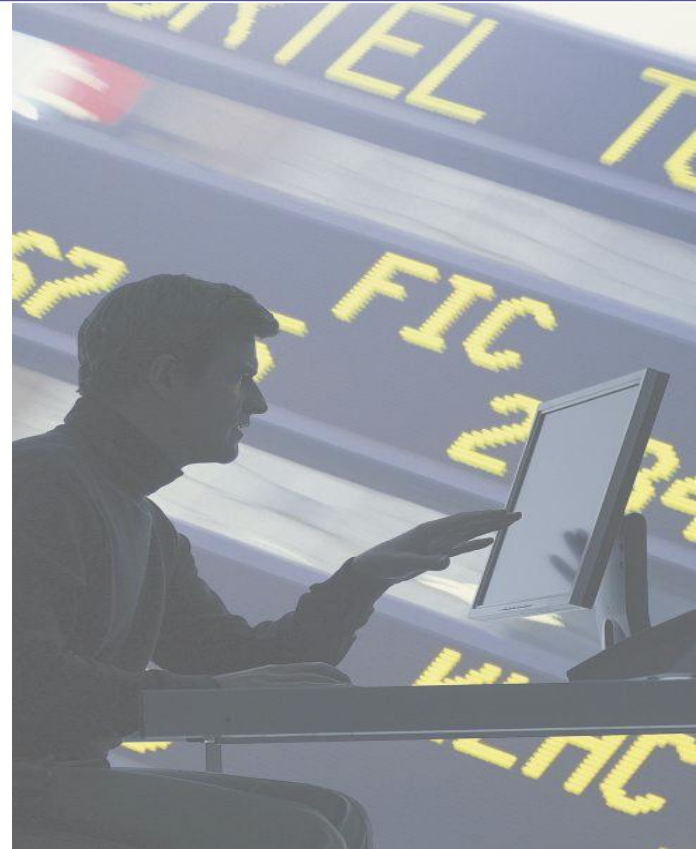
Paul W. Timmreck

Raymond B. Wallace, Jr.



# Investments

*Ronald D. Schmitz*  
*Chief Investment Officer*



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# CIO Transition/New Initiatives

- New CIO on board as of November 2011
- Transition going smoothly w/staff & Board of Trustees
- No major new initiatives – portfolio is well structured given Board's directive regarding risk/return
  - Continued investment into new Real Assets category
  - Continue to transition more assets to internal management
  - Fixed Income/Credit portfolios shifting slightly to higher liquidity/quality
  - DC Plans add Target Date Portfolios
- Board has established an Investment Policy Committee
  - The committee will work with an outside consultant on asset/liability
  - There will be a robust discussion about risk tolerance

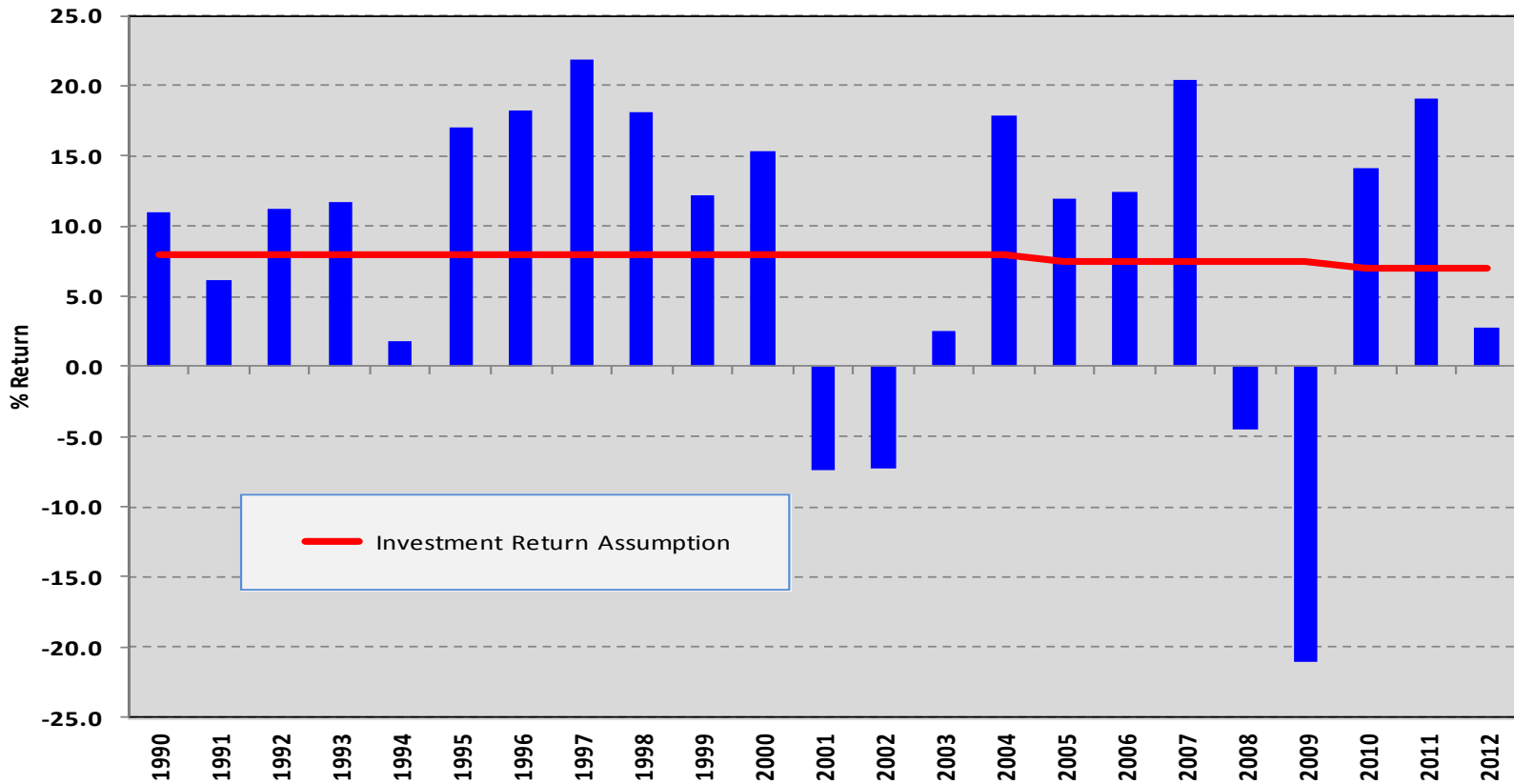
# Total Fund Performance

## Ending 3/31/12

	VRS (%)	Intermediate Benchmark (%)	Long-Term Benchmark (%)
1 Yr	4.0	3.2	
3 Yr	15.5	15.5	
5 Yr	2.1	2.1	
10 Yr	6.2	5.8	5.1
15 Yr	7.2	6.8	6.6
20 Yr	8.3	8.0	8.2

7 Performance is annualized and net of fees

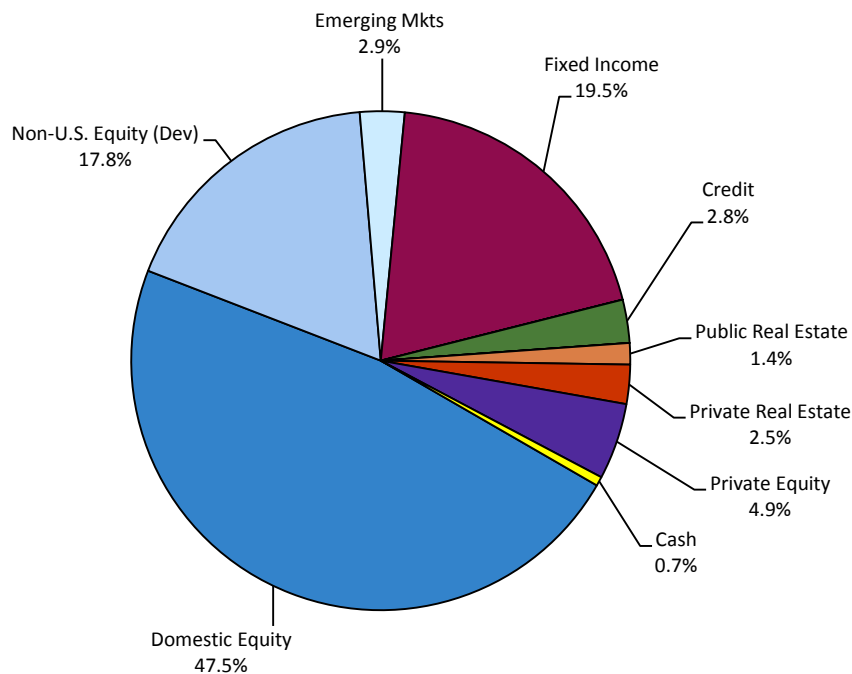
# VRS Fiscal Year Returns



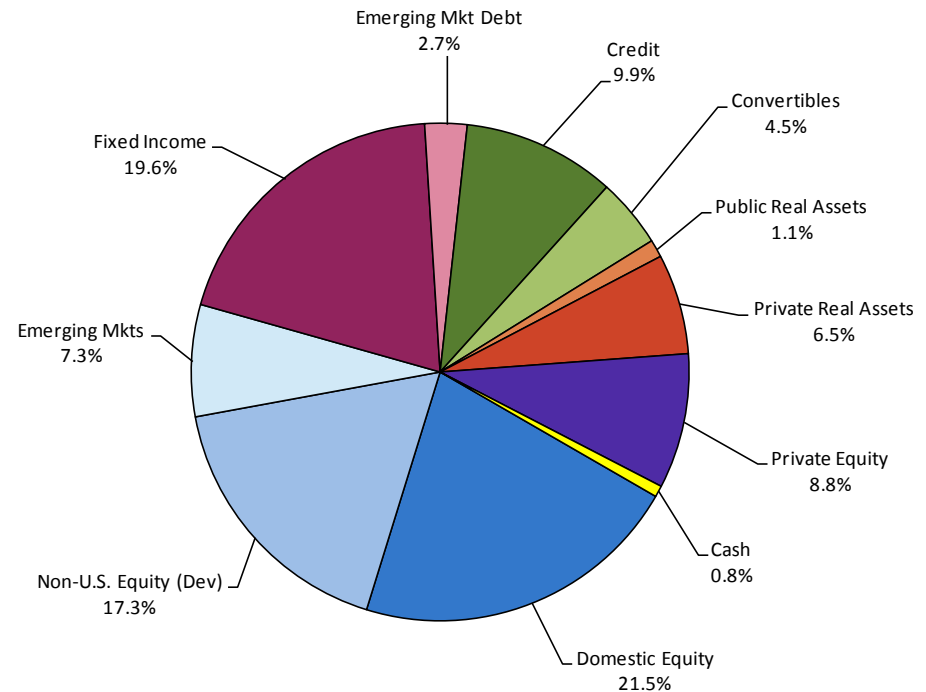
\* FY 2012 Through 3/31



# Asset Allocation: March 2005 vs. March 2012



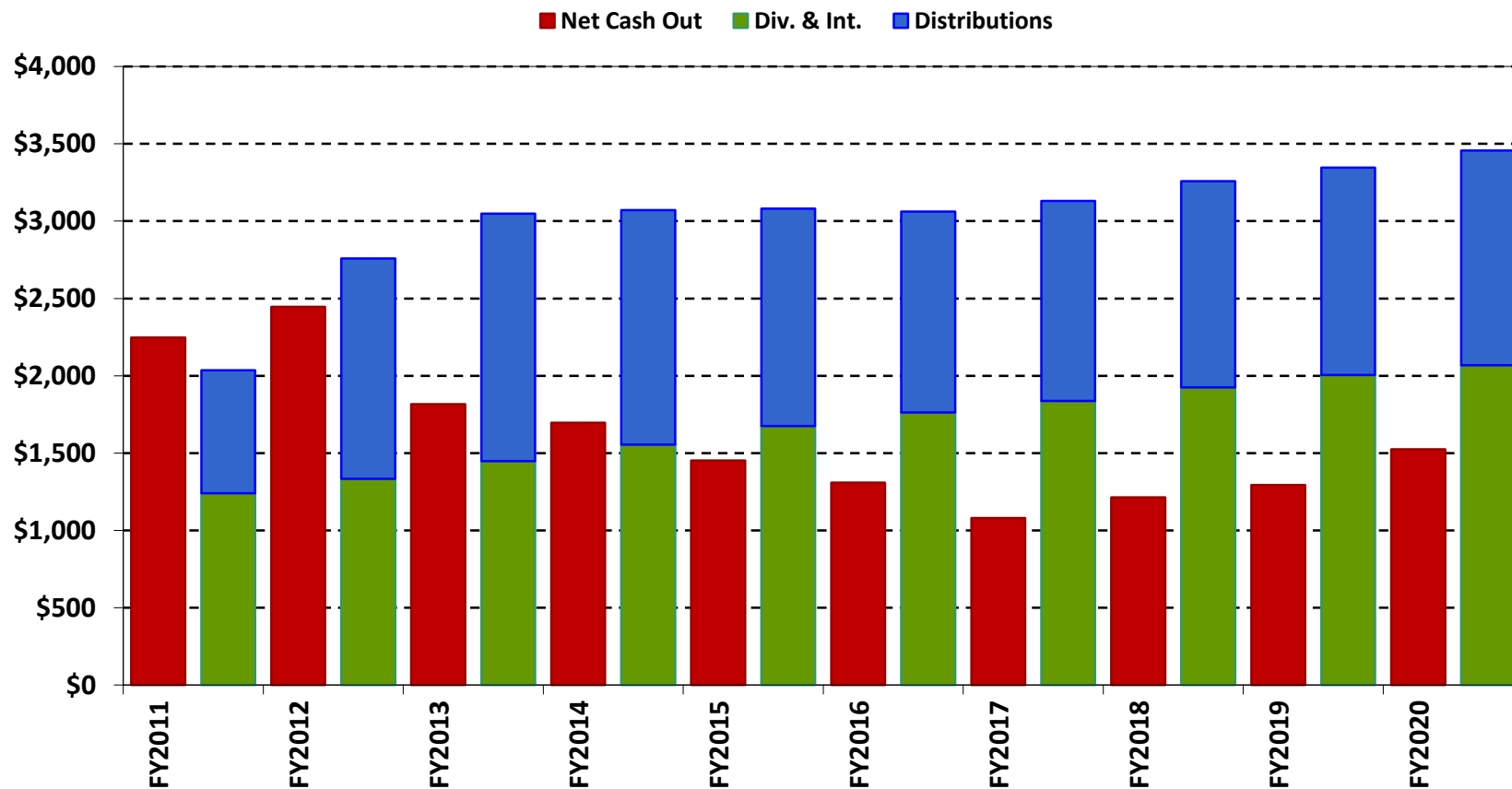
March 2005  
\$43.1 billion



March 2012  
\$54.2 billion

# Cash Flow Projection

## Cash Flow Projection - 10 Years (in millions)



# 2011's "Challenging Outlook"

Last year at this meeting Charles Grant made the following observations:

- Continued deleveraging in private sector, and eventually in public sector
- Potential for higher regulation and taxation
- Government policy will be challenging: austerity versus stimulus
- Headwinds to growth, especially in developed world
- Moderate equity returns expected

# The 2012 Outlook – More of the Same

- U.S. spending faces across the board cuts – unless Congress acts
- U.S. taxes are almost sure to be “raised” as reduced tax rates are set to expire
- The Fed’s Operation Twist expires at year-end
- Europe faces similar hurdles – only higher
- China/Asia growth is slowing

# 2012 Outlook

- Debt burden still high – deleveraging will continue
- Developed world growth will be sub-par
- Emerging world growth will be higher than developed economies but lower than the recent past
- It will take time to achieve balance
- VRS is positioned for a moderate return environment



# Administration

**Robert P. Schultze**  
*Director*



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# VRS Overview

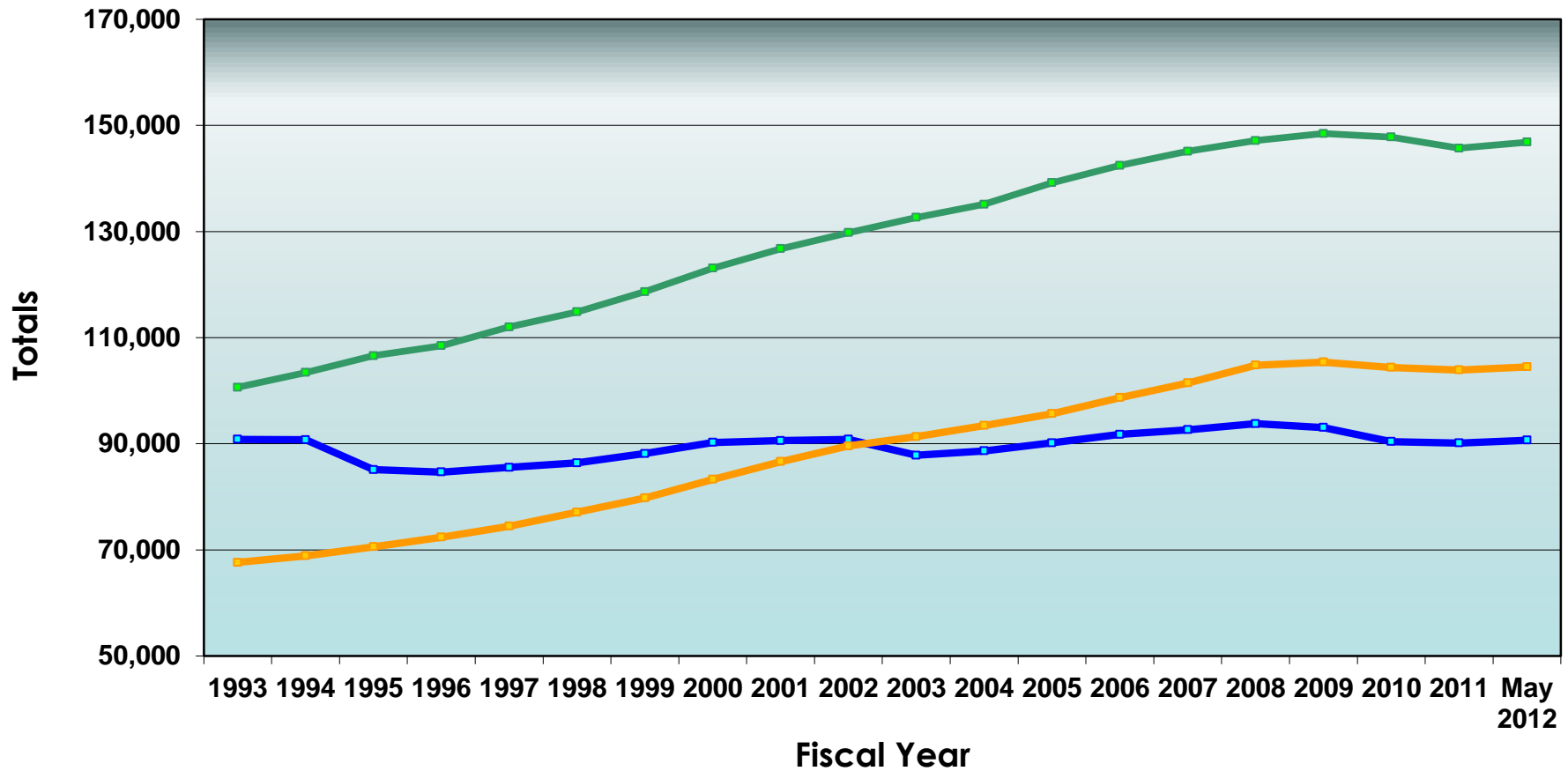
## VRS Overview

- VRS is the 22nd largest public or private pension system in the U.S.
- There are more than 600,000 members, retirees and beneficiaries.

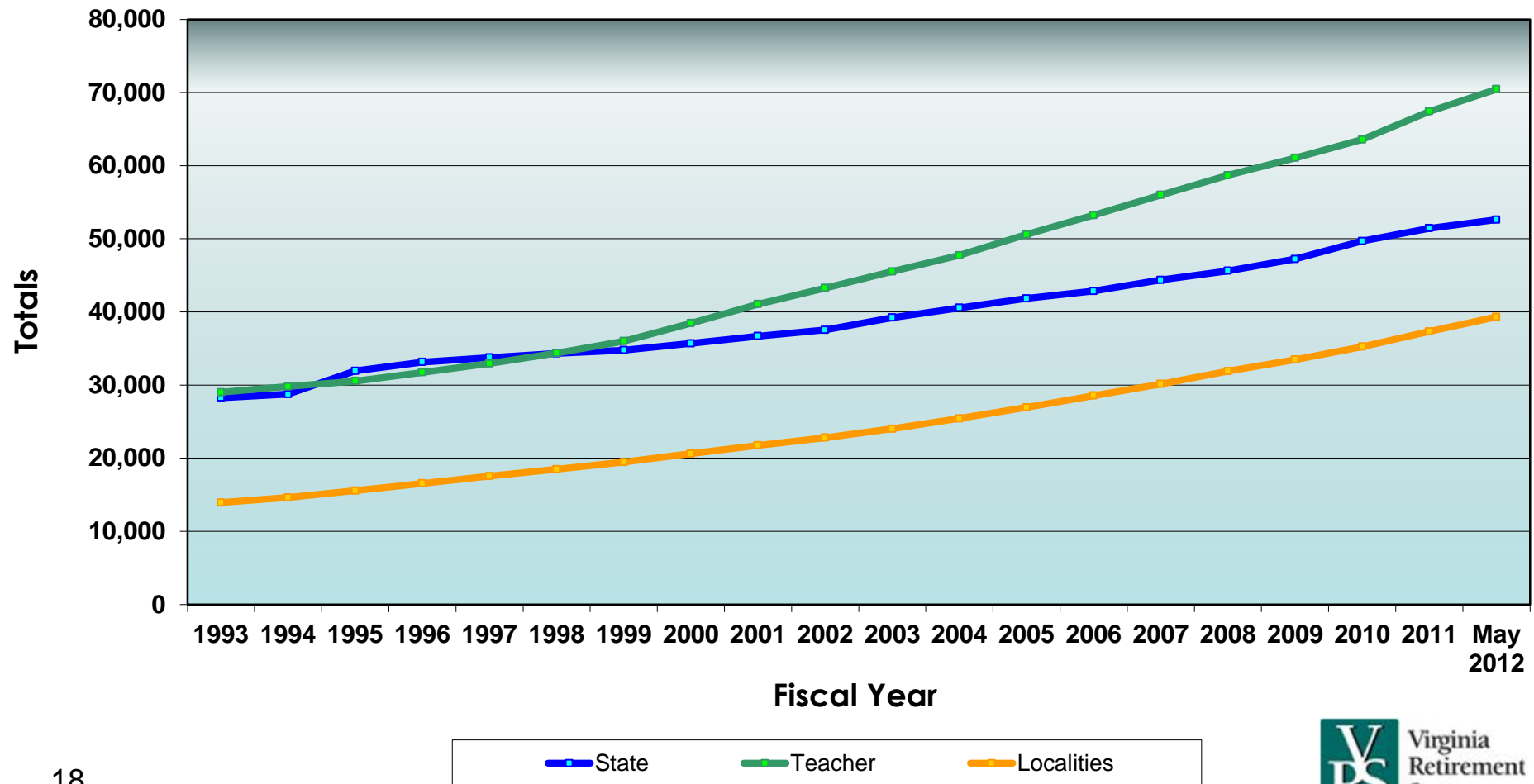
# VRS Total Membership

Teachers	146,859
Political Subdivisions	104,499
State Employees	78,980
State Police Officers' Retirement System (SPORS)	1,892
Judicial Retirement System (JRS)	384
Virginia Law Officers' Retirement System (VaLORS)	9,410
Total Active Members	342,024
Retirees/Beneficiaries	162,357
Inactive/Deferred Members	111,031
<b>VRS Overall Impact</b>	<b>615,412</b>

# Active Members

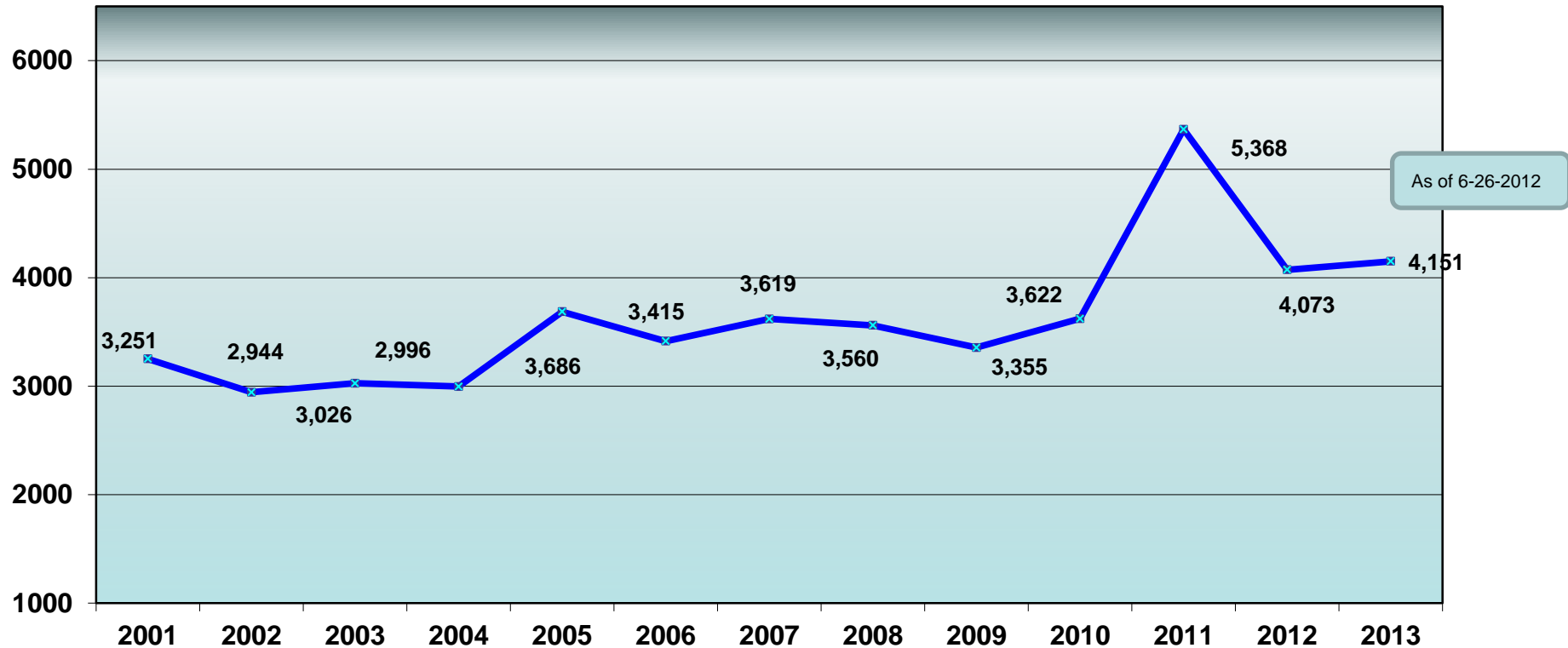


# Retirees





# July Retirements by Fiscal Year



# Benefit Comparison

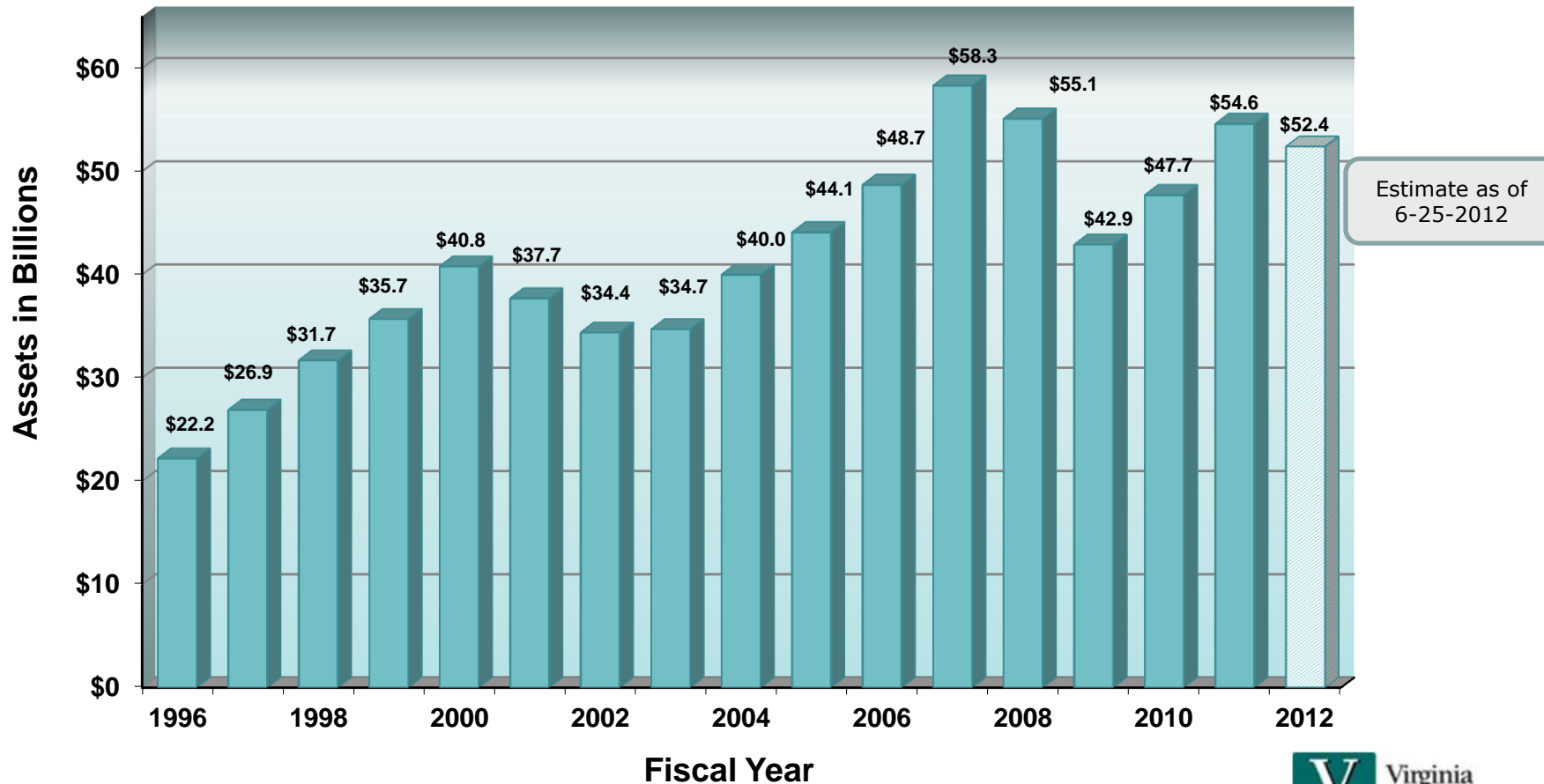
	State	Teachers	Local
<b>Actives:</b>			
Average Age	48.0	45.2	46.1
Average Service	12.9	11.8	10.9
Average Salary	\$48,619	\$47,363	\$39,282
<b>Retirees:</b>			
Avg. Age @ Retirement	62.2	61.1	61.7
Avg. Service @ Retirement	23.3	24.4	20.5
Avg. Benefit @ Retirement	39.6%	41.5%	35.0%
Avg. Annual Benefit	\$21,118	\$24,359	\$15,446

Information obtained from the June 30, 2011 Actuarial Valuation.

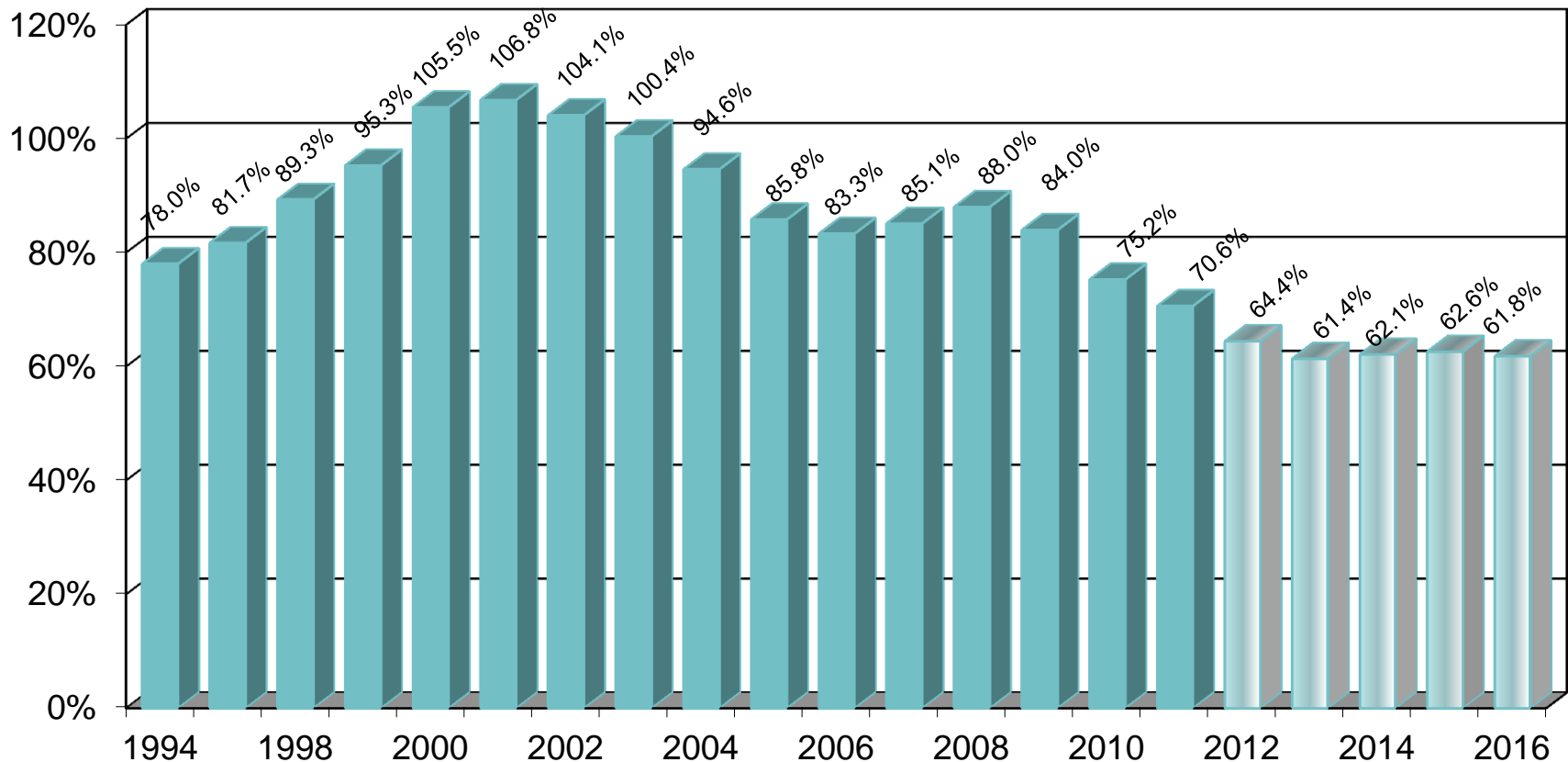
# Funding VRS Benefits

- 66% of benefit costs funded by investment earnings
- 34% of benefit costs funded by employee/employer contributions

# Net Assets Available for VRS Benefits



# Funded Status: State Employees

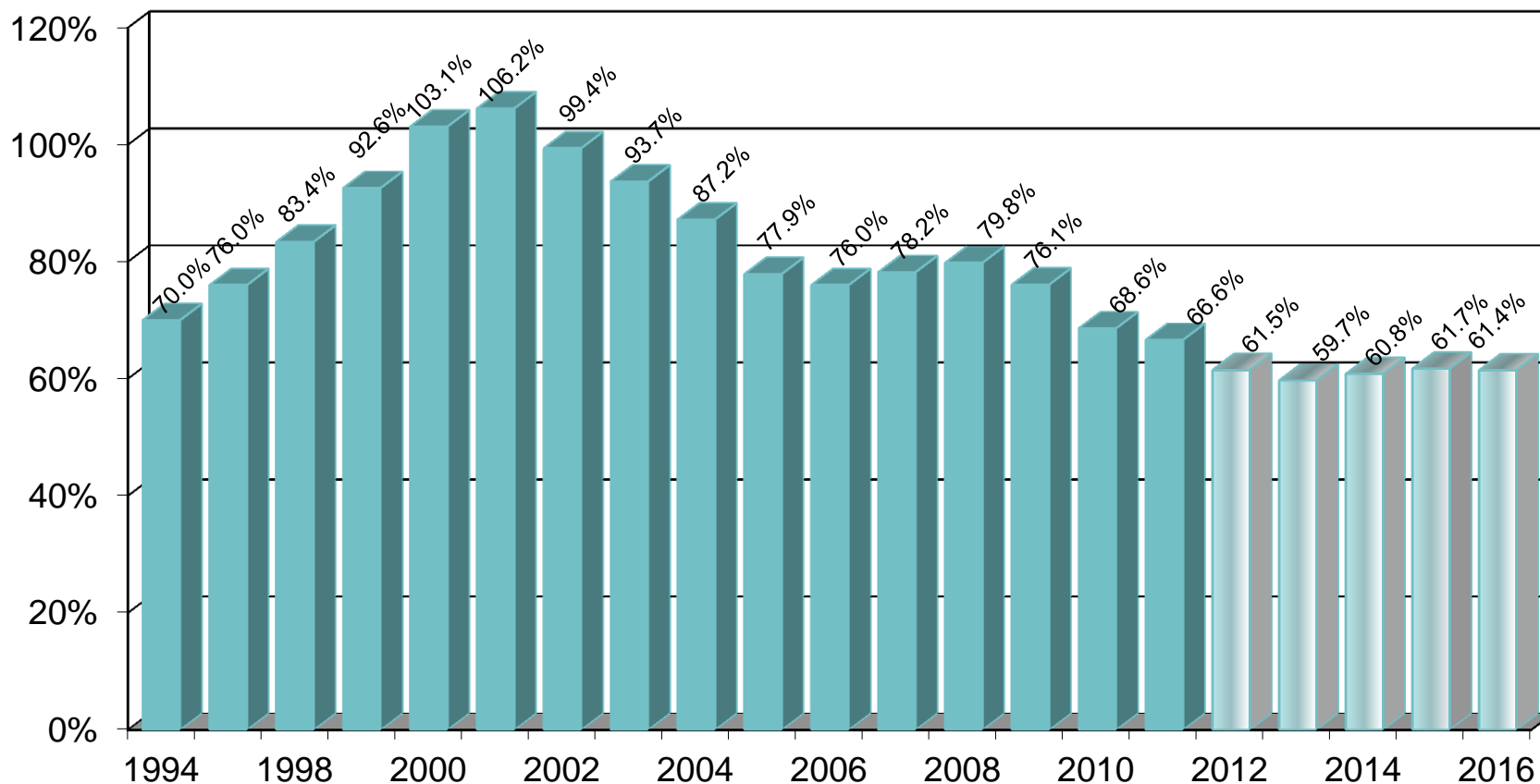


Assumptions:

- FY 2012 investment return estimated at 2.0%.
- All projected years' investment return is 7.0% and 2.5% inflation rate.



# Funded Status: Teachers



Assumptions:

- FY 2012 investment return estimated at 2.0%.
- All projected years' investment return is 7.0% and 2.5% inflation rate.

# Reasons for Decline in Funded Status

- Decline in funded status:
  - Two recessions since 2000, producing investment returns below actuarial assumptions
  - More conservative estimates of long-term future investment gains:
    - Pre-2005: 8.0%
    - 2005 – 2009: 7.5%
    - 2010 – Present: 7.0%
  - Long-term trend (since mid-90s) of funding contribution rates below board certified rates; will likely continue through 2018-2020 biennium
- Pension reform will produce gradual improvement over the next 20 years

# Retirement Contribution Rates

	<b>Board Certified 2013 &amp; 2014</b>	<b>Fiscal Year 2012*</b>	<b>Rates 2013 &amp; 2014</b>
State	13.07%	3.21%	8.76%
Teachers	16.77%	6.33%	11.66%
SPORS	32.62%	11.09%	24.74%
VaLORS	19.52%	7.08%	14.80%
Judges	54.11%	32.13%	45.44%

Contribution rates do not include the 5% member contribution rate. \* Fiscal year 2012 retirement system contribution rates for state plans shown in the table above are blended rates. The blended rate was derived from the state paying one rate for the first three quarters of the fiscal year and a higher rate for the last quarter. Fiscal year 2012 retirement contribution rates for state plans for the two periods are as follows: 2.08% and 6.58% for State; 7.73% and 21.16% for SPORS; 5.07% and 13.09% for VaLORS; and 28.65% and 42.58% for JRS.

# Contribution Impact

## Impact of VRS Pension Contributions on State Budget

	Fiscal Year 2012	Fiscal Year 2013
General Fund Budget	\$16.3 billion	\$17.3 billion
General Fund Allocation for Retirement: State Employee VRS Contributions Teacher VRS Contributions <b>Total:</b>	\$107.2 million <u>\$166.2 million</u> <b>\$273.4 million</b>	\$233.7 million <u>\$302.8 million</u> <b>\$536.5 million</b>
Percent of General Fund Allocated for VRS Pension Costs	1.67%	3.10%
Average Allocation Among States (Boston College Center for Retirement Research)	3.80%	n/a

# VA Retirement System Liabilities

## Unfunded Liabilities by Plan

Plan	6/30/2011 (in billions)
State Employees (includes SPORS, JRS, VaLORS)	\$7.33
Teachers	\$12.60
Local Political Subdivisions	\$4.02
<b>Total</b>	<b>\$23.95</b>



# Upcoming GASB Standards Change

- GASB changing standards for pension liabilities:
  - New standards approved June 25, 2012
  - Standards are effective for actuarial valuations as of June 30, 2013 for VRS and as of June 30, 2014 for employers
- Reported liabilities will increase due to a discount rate that blends long-term investment assumption with municipal bond rate
- Unfunded liabilities of cost-sharing plans (school teachers) must be apportioned among participating employers
- Standards will require mark to market (asset smoothing no longer used)

# Pension Reform Initiatives



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# Pension Reform Efforts in VA

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"><li>▪ Normal retirement changed to Social Security normal retirement age</li><li>▪ Unreduced benefits commencing at Rule of 90</li><li>▪ Reduced retirement moved to age 60 with at least five years of service</li><li>▪ Members required to pay 5 percent member contribution (Local Option)</li><li>▪ COLA formula revised</li><li>▪ Five-year AFC formula</li></ul>
2011	General Assembly enacted 5/5 program for Plan 1 state employees <ul style="list-style-type: none"><li>▪ State employee Plan 1 members pay 5% member contribution</li><li>▪ Offset with 5% salary increase</li></ul> JLARC updated study on pension reform
2012	General Assembly requires: <ul style="list-style-type: none"><li>▪ Local employees pay 5% member contribution, phased in by July 1, 2016, with salary offset</li><li>▪ Non-vested Plan 1 employees benefit structure change, January 1, 2013</li><li>▪ A hybrid plan for all general state and local employees hired on or after January 1, 2014</li></ul>

# 2012 General Assembly Summary



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# 2012 Legislation

## Employer Contributions Effective July 1, 2012

Appropriation Act Item Number	Description
Item 468 (H)	<p>Provides that local governments and school divisions must select an employer contribution:</p> <ul style="list-style-type: none"><li>▪ The rate <b>certified</b> by the VRS Board of Trustees for the 2012-2014 biennium; or</li><li>▪ The <b>alternate</b> rate, which is the higher of the current rate certified by the VRS Board for FY 2011-2012 or 70 percent of the VRS Board-certified rate for 2012-2014.</li></ul>

## Employee Contributions Effective July 1, 2012

Bill Number	Patron	Description
SB 497	Watkins	Requires members employed by local government or school boards to pay the 5% employee contribution, effective July 1, 2012. All local employers authorized to phase in the 5% contribution over a maximum of five years and must provide salary increases to offset these mandatory contributions. All new hires must pay the full 5% employee contribution.

# 2012 Legislation

## HB 1130/SB 498 (Howell/Watkins)

### DB Plan Changes Effective January 1, 2013

Plan Feature	Group	Comment
<b>60-month AFC</b>	General state employees, SPORS, VaLORS, JRS, teachers and localities (including local hazardous duty with enhanced benefits)	Applies to Plan 1 members who are not vested as of 1/1/13. Already applies to Plan 2 members.
<b>1.65% multiplier for service after 1/1/13</b>	General state employees, teachers, localities and JRS (Does not apply to SPORS, VaLORS or local hazardous duty with enhanced benefits)	Applies to Plan 1 members who are not vested as of 1/1/13 and Plan 2 members.
<b>Rule of 90</b>	General state employees, teachers and localities (Does not apply to SPORS, VaLORS or local hazardous duty with enhanced benefits)	Applies to Plan 1 members who are not vested as of 1/1/13. Already applies to Plan 2 members.
<b>COLA</b>	General state employees, SPORS, VaLORS, JRS, teachers and localities (including local hazardous duty with enhanced benefits)	Employees (all Plan 1 and Plan 2 members) within 5 years of eligibility for an unreduced benefit as of 1/1/13 are grandfathered. No COLA until member who retires with less than 20 years of service has received an allowance for 1 full calendar year after reaching unreduced retirement age.
<b>COLA</b>	General state employees, SPORS, VaLORS, JRS, teachers and localities (including local hazardous duty with enhanced benefits)	Applies to all Plan 2 members and Plan 1 members who are not vested as of 1/1/13. COLA capped at 3% (first 2% of CPI-U plus one-half of the next 2%, for a maximum total of 3%).

# 2012 Legislation

## HB 1130/SB 498 (Howell/Watkins)

**Beginning January 1, 2014**

<b>Rates</b>	Board-certified rate fully funded by the 2018-2020 biennium. General Assembly would no longer use its own economic assumptions



# 2012 Legislation

## HB 1130/SB 498 (Howell/Watkins)

### Launch of the Hybrid Plan January 1, 2014

<b>Eligibility</b>	<ul style="list-style-type: none"><li>▪ Those that participate in regular VRS (state employees, JRS, teachers and local government employees) automatically enrolled in hybrid from date of hire</li><li>▪ Public safety employees without hazardous duty coverage enrolled in hybrid from the date of hire</li><li>▪ One-time election window for current employees</li><li>▪ ORP employees may elect the hybrid</li><li>▪ Current ORP employees not eligible to participate in new hybrid</li><li>▪ Public safety employees with hazardous duty coverage will not participate in the plan, but retain current plan provisions (VaLORS, SPORS, local enhanced hazardous duty coverage)</li></ul>
<b>Disability</b>	Provides a new optional disability program for localities. The locality must choose either to join the VRS-administered program or provide a disability program with comparable coverage from another source

# 2012 Legislation

## HB 1130/SB 498 (Howell/Watkins)

### Launch of the Hybrid Plan January 1, 2014

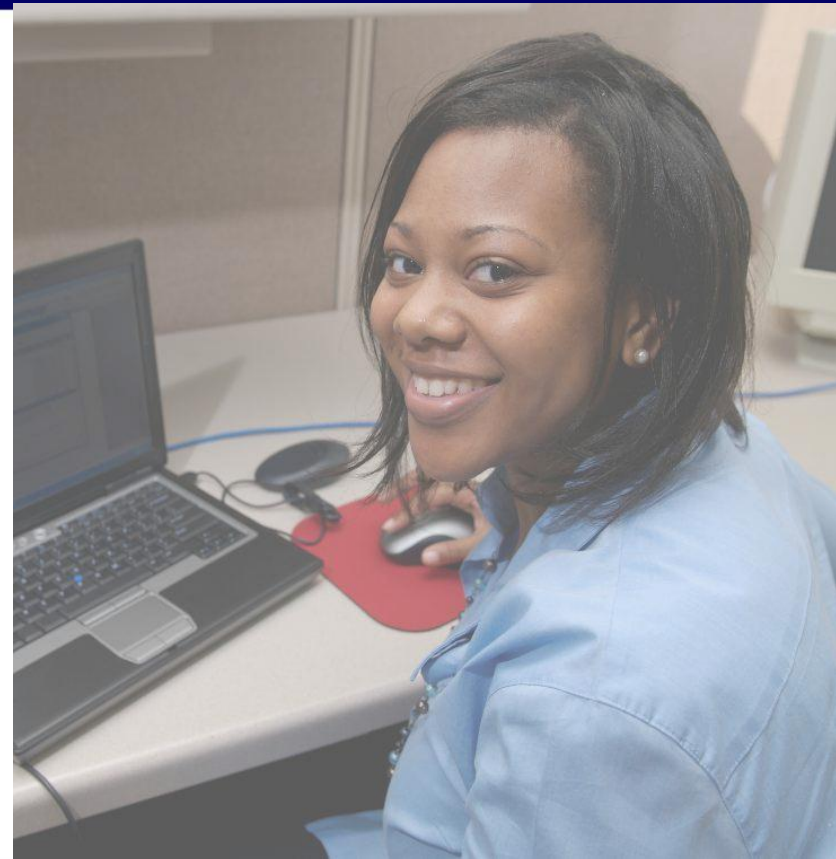
<b>Multiplier</b>	DB component has a 1.0% multiplier to produce a nearly 30% replacement rate after 30 years of service
<b>Contributions</b>	<ul style="list-style-type: none"><li>▪ Employee contributions automatically increased every three years by one-half a percentage point, unless the employee opts out or the employee is already at the maximum contribution of 5% to the DC component</li><li>▪ Employee contribution of 4% to the DB plan</li><li>▪ Employer contributions to the DB plan based on actuarial valuations</li><li>▪ Employer contributions to the DC component consist of mandatory 1% match, plus a 1% match on first percent elected by the employee, plus a one-half percent matching contribution on the next 3% elected by the employee. Total contributions as much as 5% from employee and 3.5% from employer</li></ul>

# Contributions in the Hybrid Plan

	Employee	Employer
DB Plan Contribution	4%	Actuarially Determined
DC Plan Contributions:		
Mandatory Contribution	1%	1%
Optional Contributions	1%	1%*
Optional Contributions	1%	.5%*
Optional Contributions	1%	.5%*
Optional Contributions	1%	.5%*
	Total Optional Contributions: 4%	2.5%
<b>Total Maximum</b>	9%	3.5% + Actuarial

\* Indicates the employer required match if the employee elects to make optional contributions.

# Legislative Implementation



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# Implementation Planning

- Legislative implementation planning has begun:
  - Implementing July 1, 2012 legislation
  - Project team has formed to implement the hybrid plan
  - Work has begun on the RFP for the implementation of the hybrid and DC Plan
    - Anticipate issuing the RFP this summer or early fall
    - Select vendor by the end of the calendar year
    - Vendor will work in tandem with current vendor for one year
  - Pension reform will delay Phase 4 Modernization implementation to focus on legislative initiatives



# Other Customer Service Initiatives



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# Modernization Update

- Several significant initiatives completed
  - Off-site hosted data center, disaster recovery data center, new telephony solution, network, centralized print solution
- Phase 3 implementation scheduled for October 2012
  - Reengineer employer reporting and collection of contributions
- Vendor missed key deadlines, so we restructured the contract; VRS taking leading role
- Pension reform implementation will delay Phase 4



# Upcoming DC Plan Changes

- DC Plans Lineup Changes:
  - Introducing Target Date Portfolios
  - Providing a path approach to make investing easier:
    - Do-It-For-Me Path
    - Help-Me-Do-It Path
    - Do-It-Myself Path
  - Streamlining investment options
  - Implementing July 23
  - Changes will serve as a sound foundation for new hybrid plan

**Thank you!**



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