OVERSIGHT VRS Report

JOINT LEGISLATIVE AUDIT & REVIEW COMMISSION
OF THE VIRGINIA GENERAL ASSEMBLY

VRS Biennial Status and Semi-Annual Investment Report July 2002

Profile: Virginia Retirement System Investments

Market Value of Assets: $36.8 billion

Number of External Managers:
Public Equity – 19 Fixed Income – 4

Number of External Investment Accounts:
Public Equity – 31 Fixed Income – 7

Number of VRS Investment Department Staff:
33 positions (3 vacant)

FY 2001 Investment Expenses: $109.8 million (29.2 basis points)
Estimate for FY 2002: $95.8 million (27.6 basis points)

FY 2001 Investment Department Operating Expenses: $6.3 million (1.7 basis points)
Estimate for FY 2002: $6.4 million (1.9 basis points)

Total Return on Investments

	10 years	*5 years*	*3 years*	*1 year*
	10.4%	9.2%	3.6%	1.3%
Performance/Intermediate Benchmarks				
(Time Periods Ending 3/31/02)		8.7%	1.8%	1.5%

Investment Policy Indicators (as of March 31, 2002)

	Asset Allocation (% of Total Assets)		*Asset Allocation* (% of Asset Class)		*Type of Management* (% of Asset Class)	
Asset Class	Target	Actual	Domestic	International	External	VRS
Public Equity	62.3%	62.1%	76.0%	24.0%	83%	17%
Fixed Income	25%	24.8%	98.2%	1.8%	66.4%	34.3%
Private Equity	6.5%	6.5%	90.7%	9.3%	100%	0%
Real Estate	4.5%	4.5%	95.0%	5.0%	100%	0%

INTRODUCTION

The Virginia Retirement System Oversight Act (Section 30-78 et seq. of the *Code of Virginia*) requires JLARC to prepare a biennial status report and semi-annual investment report concerning the Virginia Retirement System (VRS). This report includes both the semi-annual investment report for July 2002 and the third biennial status report. The first section of this report covers the investment program. The other sections of this report focus on the administrative aspects of VRS' program, the June 30, 2001 actuarial valuation, changes to the deferred compensation plan, as well as other benefit changes and enhancements.

SEMI-ANNUAL INVESTMENT REPORT: JULY 2002

As of March 31, 2002, the market value of the VRS pension fund was $36.8 billion. For the three- and five- and ten-year periods, the fund's performance exceeded the established intermediate benchmark for the period ending March 31, 2002 (Table 1). As was reported in the December 2001 semi-annual report, the VRS' investment returns for the one- and three-year period, 1.3 percent and 3.6 percent respectively, again fell short of the actuarial assumed investment return of eight percent.

The public equity program continues to be VRS' largest asset class comprising more than $22.8 billion or 62.1 percent of the portfolio. The public equity program consists of domestic and non-U.S. equities.

Domestic Public Equity. As domestic public equity comprises 47.1 percent of the portfolio, the domestic public equity market environment continued to impact the fund's overall investment performance. While it continues to be a challenging market environment, VRS' domestic public equity program exceeded its established performance benchmark for the fiscal year to date and the one- and three-year periods ending March 31, 2002. However, the program did not exceed the benchmark for the five-year period. In addition, the total U.S. equity program outperformed its Russell 3000 bench-

Table 1
VRS Investment Performance for Periods Ending March 31, 2002

Program/ *Performance Objective*	**Fiscal Year to Date**	**Prior 1 Year**	**Prior 3 Years**	**Prior 5 Years**
Total Fund	**-1.8%**	**1.3%**	**3.6%**	**9.2%**
VRS Performance Benchmark – Intermediate	*-1.3%*	*1.5%*	*1.8%*	*8.7%*
VRS Performance Benchmark- Long Term	*-1.7%*	*3.2%*	*1.5%*	*9.8%*
Total U.S. Equity	**-4.3%**	**2.4%**	**-1.0%**	**9.5%**
Russell 3000	*-4.8%*	*1.8%*	*-1.1%*	*10.2%*
Total Non-U.S. Equity	**-5.7%**	**-5.8%**	**-2.6%**	**-0.8%**
Salomon BMI Global ex U.S.	*-5.6%*	*-5.0%*	*-2.7%*	*-0.5%*
Total Fixed Income	**4.6%**	**5.3%**	**6.6%**	**7.8%**
Lehman VRS Custom	*4.7%*	*5.3%*	*6.5%*	*7.7%*
Total Private Equity	**-7.4%**	**-13.2%**	**27.9%**	**26.6%**
Russell 3000 plus 250 Basis Points	*2.7%*	*-8.9%*	*2.2%*	*12.7%*
Total Real Estate	**7.3%**	**12.2%**	**11.6%**	**10.6%**
Blend of NCREIF and NAREIT Indexes	*5.9%*	*10.6%*	*12.0%*	*12.2%*
Total High Yield	**4.2%**	n/a	n/a	n/a
VRS Custom High Yield	*4.8%*	*n/a*	*n/a*	*n/a*

Source: JLARC staff analysis of VRS data.

mark for eight consecutive quarters. As signs of an improving economic environment became more pronounced, the U.S. equity markets delivered slightly positive returns during the first quarter in 2002. Value style indices performed well this quarter relative to growth indices, while small capitalization indices outperformed large capitalization indices. The passive U.S. program outperformed the Russell 3000 performance benchmark. While the $11.0 billion Russell 3000 mandate matched the benchmark for the quarter, the internally managed Equal Weight S&P 500 portfolio allocation added value relative to the performance benchmark. The active U.S. program also outperformed the Russell 3000 program benchmark in the first quarter of 2002.

Non-U.S. Equity. The non-US equity portion of the fund outperformed its Salomon BMI Global (ex U.S.) benchmark during the first quarter of 2002. However, it has under-performed its benchmark in the fiscal year-to-date, one-, and five-year periods. The passive program slightly under-performed the benchmark, but this was primarily related to trading costs. The active non-U.S. program outperformed the benchmark in the first quarter. The Core and Core Plus managers added value, while the Small Cap managers continued to struggle relative to the benchmark. VRS staff are currently reviewing the Small Cap subprogram for improvement opportunities. The Emerging Markets managers continued to perform well in both absolute and relative terms.

Private Equity. As of March 31, 2002, the market value of the VRS' private equity program was $2.4 billion. VRS invests in private equity to accomplish two primary objectives – to provide enhanced returns relative to the public equity program and to diversify the overall retirement fund. While private equity can provide higher returns, it also has higher risks, is less liquid than public equity, and typically has higher fees than the traditional asset classes. Recently, the net cash flow generated by the program has turned negative. During the first four months of calendar year 2002, the program generated a net cash outflow of approximately $15 million. This negative outflow is primarily due to the fact that VRS has recently made new commitments to three distressed funds. These funds tend to draw down capital faster than buyout of venture funds.

Since its inception in 1989, however, the program has received distributions (cash inflows) that have exceeded drawdowns (outflows) by more than $1 billion. Market analysts note that the expected return for domestic private equity going forward stands at approximately 12.6 percent. Achieving returns of 12.6 percent seems to be a tall order given reports that private equity funds returned –11.4 percent last year with venture capital funds reporting an average return of –38.9 percent. For the one-year period ending March 31, 2002, the private equity program returned –13.2 percent. These returns are the result of high entry pricing and a dire lack of exit opportunities, combined with private equity write-downs of high valuations posted during the technology bubble of the late 1990s. Longer term, however, the private equity program continued to greatly exceed its benchmark for the three- and five-year periods. Similarly, the annualized rate of return since the inception of the program in April 1989 was 26.4 percent, exceeding its benchmark for the period by 6.2 percent.

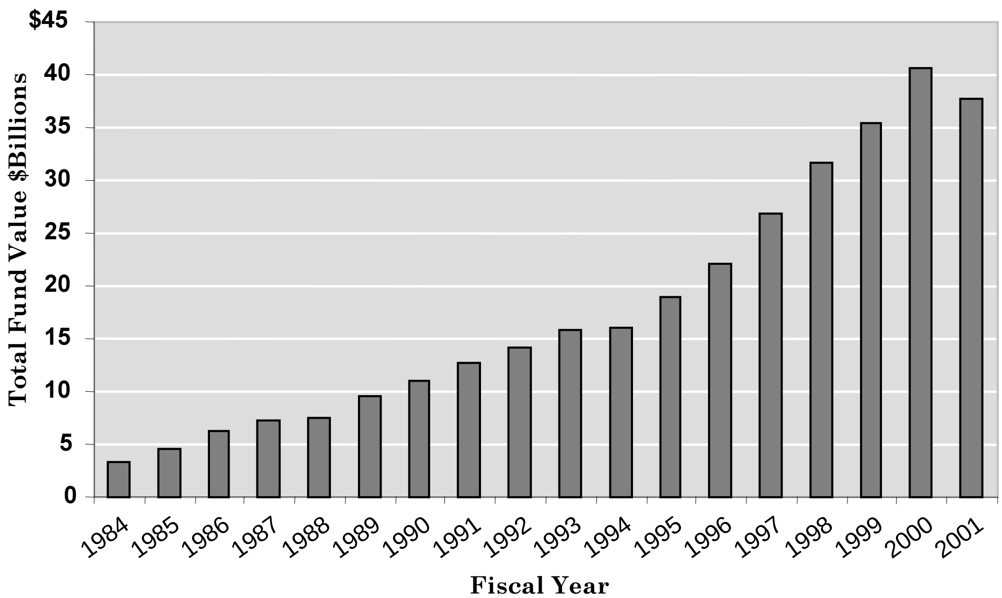
Real Estate Program. Both the real estate and fixed income programs provided necessary fund diversification, with positive returns of 12.2 percent and 5.3 percent, respectively, for the one-year period and both outperforming equities over the three-year period.

The real estate sector felt the effects of the slowing U.S. economy during the fourth quarter of 2001. A decline for the demand for space pushed up vacancy rates and adversely affected both rents and prices. However, the overall VRS real estate program continues to perform well for the quarter and year ending March 31, 2002 with total returns of 3.1 percent and 12.2 percent, respectively, comparing favorably to the custom benchmark returns of 2.7 percent and 10.6 percent. Longer term, the three-year return of 11.6 percent has made progress toward catching up to the custom benchmark of 12 percent. The five-year return of 10.6 percent remains under the custom benchmark of 12.2 percent.

Fixed Income Program. The objectives of the fixed income program are to reduce total fund risk through lower volatility, lower correlation, higher income, and the provision of a deflation hedge. However, bonds are entering a new territory of increased volatility. For example, rating agencies are downgrading issues more quickly and with less notice or warning. Despite increased challenges in the fixed income program, the VRS bond portfolio posted a 0.18 percent return in the first quarter of 2002, beating the benchmark by 11 basis points. Both the active and the passive components of the fixed income program performed well relative to their benchmarks. In addition, the VRS high yield portfolio returned 1.42 percent in the first quarter. VRS staff indicated that the high yield portfolio remains on track to deliver a long-term net return of at least 8 percent, and continues to demonstrate less volatility than equities. Additionally, the fixed income program has exceeded its benchmarks in the three- and five-year periods.

VRS Fund Growth. Figure 1 displays the growth in the VRS fund from FY 1984 through FY 2001. Over this period, the fund grew from $3.3 billion to $37.6 billion. However, as of March 31, 2002, the value of the fund was $36.8 billion. While the fund has consistently increased in value over this period, it is important to note that the substantial gains experienced in the late 1980s and 1990s

Figure 1
Growth in VRS Fund Value
FY 1984 – FY 2001



have slowed considerably. In addition, the events of the past year have increased volatility in the market. At the same time, drawdowns on the fund are increasing as more participants are reaching retirement. Analysts have warned of increased complexity in the markets and have forecast lower returns going forward. In light of the current market climate, continuing to maintain strong investment returns (the current actuarial assumed rate of return is 8 percent) will likely be a challenge for the VRS investment staff.

LEADERSHIP CHANGES AT VRS

Over the past several months, a number of changes in leadership have taken place at VRS. These include the hiring of a new director and the appointment of a new board chairman. In addition, several new individuals were appointed to the VRS Board of Trustees.

The Virginia Retirement System's Board of Trustees appointed W. Forrest Matthews, Jr. as agency director effective March 13, 2002. Mr. Matthews succeeded William H. Leighty, who resigned to become Chief of Staff for Governor Mark R. Warner. Mr. Matthews served as a VRS board member since March 1998 and chairman of the board since March 2001. He was Director of Finance for Henrico County since 1997. Prior to that, he served as Treasury Division Director for Henrico County and has held other responsible positions in both the County of Henrico and the City of Richmond. Mr. Matthews resigned his posts as chairman and member of the VRS board to accept the directorship.

Governor Mark R. Warner named J. Douglas Conway, Jr., an employee of the Henrico County Division of Fire since 1979, to an unexpired term on the VRS Board. A past president of the Henrico Professional Firefighters Association and a former director of the Virginia Professional Firefighters Association, Mr. Conway has been a VRS member for 24 years. Mr. Conway will serve the unexpired term of W. Forrest Matthews, Jr., who was selected as VRS director by the board of trustees.

Governor Warner also appointed Vernard W. Henley of Richmond, the former chairman of Consolidated Bank & Trust Co., to the VRS Board of Trustees. As chairman of Consolidated Bank & Trust Co., Mr. Henley was responsible for the $9 million employee pension fund. Mr. Henley retired last year after 50 years in banking, including 43 years at Consolidated, a bank that traces its origins to pioneering entrepreneur Maggie L. Walker of Richmond. Mr. Henley succeeds R. William Bayliss, III, who was ineligible for reappointment.

The Joint Rules Committee appointed Raymond B. Wallace, Jr. to the Virginia Retirement System's Board of Trustees to serve a five-year term. He succeeds Elise L. Emanuel, who was ineligible for reappointment. In 1985, Mr. Wallace began a teaching career serving as a history teacher at Mills E. Godwin High School in Henrico County and retired from this position in 2000. Prior to his teaching career, Mr. Wallace was with Cauthorne Paper Company for 20 years, retiring as president of the company. Most recently, he served as Clerk to the House Counties, Cities and Towns committee.

Finally, Alfonso "Al" Samper of Richmond was appointed by Governor Warner to serve as chairman of the Board of Trustees of the Virginia Retirement System. Mr. Samper was originally appointed to the VRS Board last year. Mr. Samper, who served as Assistant State Treasurer (1992-93) and director of accounting and administration at the Virginia Department of the Treasury (1986-92), currently is a senior vice president at Wachovia Securities.

REVIEW OF VRS' 2001 ACTUARIAL VALUATION AND BENEFIT FUNDING

The employer contribution rates certified by the VRS Board of Trustees and the subsequent funding of these rates are very important to the future viability of the defined benefit plan administered by the VRS. The *Code of Virginia* requires that the VRS Board of Trustees conduct a biennial actuarial valuation for the purpose of analyzing the funds' assets and liabilities and to establish contribution rates for participating employers. In addition to describing the current financial condition of VRS, the report provides information required by VRS in connection with Governmental Accounting Standards Board Statement No. 25 (GASB No. 25). Due to a statutory change, the actuarial valuation is now prepared one year after the previous valuation as of the last day of VRS' plan and fiscal year (June 30th). The employer contribution rate determined by the June 30, 2001 actuarial valuation would be effective for the period beginning July 1, 2002 and ending June 30, 2004.

In determining the costs and liabilities, actuaries use assumptions about the future, such as rates of salary increase, probabilities of retirement, termination, death and disability, and an investment return assumption. Since the last valuation, no changes have been made to the assumptions. The most significant assumptions are (1) the assumed rate of investment return, currently set at 8 percent, (2) the assumption regarding future salary increases, which is currently based on a table that varies by service, and (3) the assumption regarding future increases in the automatic cost-of-living adjustment (COLA), currently set at 3 percent. In addition to the actuarial assumptions, the actuary also allocates costs to particular years. VRS uses the entry age normal method. The actuary also develops the value of actuarial assets. Finally, the valuation is based on an amortization method and period.

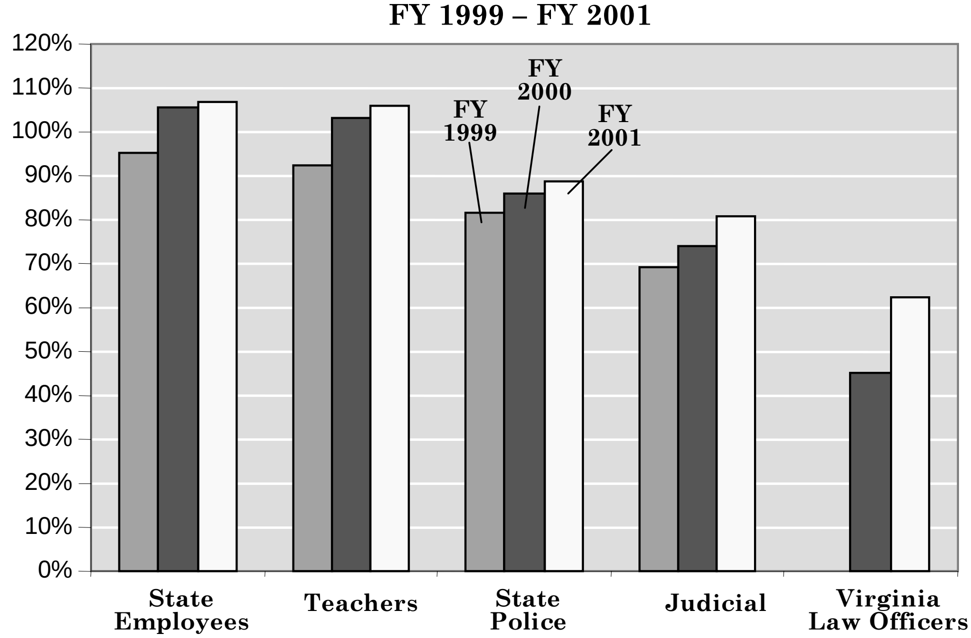
Board Certified Rates Address Systems' Funding Status. The member contribution rate of five percent is established by statute. In contrast, the employer contribution rates are calculated by the actuarial valuation. In consideration of the COLA implementation and funded condition of the State Police (SPORS), Virginia Law Officers (VaLORS), and State Judges (JRS) systems, the VRS Board of Trustees has developed a policy setting the employer contribution rate at 25 percent of payroll for SPORS and VaLORS, and 45 percent for JRS. The board mandated these rates to be effective until these systems have funded ratios (the ratio of actuarial value of assets to the actuarial accrued liability) of 90 percent or more. None of these funds had achieved a 90 percent funded ratio as of the valuation date. As shown in Figure 2, the funding status of SPORS as of June 30, 2001, continued to improve with assets covering 88.9 percent of liabilities. JRS and VaLORS have not achieved the same level of funding, with funding ratios as of June 30, 2001 of 80.9 percent and 62.6 percent respectively.

The actuary continued the policy begun with the June 30, 2000 valuation of calculating the contribution rate for State employees and teachers by combining the liabilities and assets of the employee groups. The resulting pooled rate complies with GASB No. 27 requirements. The pooled rate is then the required contribution rate for each respective group.

The funded ratio improved for all five groups since the last actuarial valuation. The improvement is largely due to the asset gains on the actuarial value of assets. Likewise, the calculated employer contribution rates decreased for all of the groups. In compliance with GASB 25, the calculated rates reflect full prefunding of the automatic COLA benefits. The Commonwealth has been phasing into this pre-funding rate over a period of five years, starting on July 1, 1997. Due to continued gains, the calculated rates in this valuation are now less than the previously scheduled phase-in

Figure 2

Funded Ratios of Retirement Systems FY 1999 – FY 2001



rates for all four original groups. Thus, there is no reason for the Commonwealth to consider those phase-in rates to determine contribution rates.

The actuarial valuation reflects the benefit provisions set forth in the *Code of Virginia*. Since the last valuation, there were two benefit changes. First, the State Police had their temporary supplement starting at retirement extended from age 65 to their Social Security retirement age. Second, the benefit multiplier for the Virginia Law Officers system was changed from 1.7 percent to 2.0 percent of pay with no temporary supplement for all new hires and rehires after July 1, 2001, as well as for current participants who made an election to change formulas. Due to the enhanced benefits available to members of SPORS, VaLORS, and JRS, the rates for these programs are substantially higher than for State employees and teachers.

Actuarially Calculated Rates Differ from Funded Employer Contribution Rates. When the VRS actuary presented the June 30, 2001 actuarial valuation to the VRS Board of Trustees in October 2001, he noted that significant and continuing fluctuations had occurred since the date of the valuation. In addition, the actuary stated that due to unprecedented world events, the uncertain investment climate was likely to continue for much of FY 2002. Because of this uncertainty, the actuary recommended that the contribution rates not be reduced from their 2001/2002 levels. In other words, the actuary recommended rates of 4.24 percent for State employees and teachers, 25 percent for SPORS and VaLORS, and 45 percent for JRS. Table 2 summarizes the actuarially calculated employer contribution rates from the last three valuation studies. In contrast, Table 3 summarizes the employer contribution rates funded by the Commonwealth.

Table 2
Summary of Actuarially Calculated Employer Contribution Rates
(Excluding Health Credit)

	2001 Valuation for FY 03 – FY 04	2000 Valuation for FY 2002	1999 Valuation for FY 2001
State Employees	3.6%	4.24%	5.22%
Teachers	3.6%	4.24%	7.54%
State Police Officers (SPORS)*	12.11%	13.52%	15.70%
State Judges (JRS)**	30.61%	39.04%	41.23%
Virginia Law Enforcement Officers (VaLORS)*	13.22%	16.01%	N/A

* Board specified rate is 25% of payroll until 90% funded
** Board specified rate is 45% of payroll until 90% funded
Source: JLARC staff analysis of VRS actuary's valuation.

Table 3
Summary of Funded Employer Contribution Rates
(Excluding Health Credit)

	FY 2002***	FY 2001
State Employees	2.12%	5.22%
Teachers	3.6%	7.54%
State Police Officers (SPORS)*	12.5%	25%
State Judges (JRS)**	22.5%	45%
Virginia Law Enforcement Officers (VaLORS)*	8.07%	16.15%

* Board specified rate was 25% of payroll until 90% funded
** Board specified rate was 45% of payroll until 90% funded
*** The 2002 Appropriation Act specified the contribution rates for the VRS State, SPORS, VaLORS, and JRS to the levels computed by the VRS actuary in the June 30, 2001 valuation study. In addition, the Act specified further adjustments to the employer contributions due to the anticipated savings associated with dormant accounts. The impact of this legislation in FY 2002 was to reduce the contribution rates for the VRS State, SPORS, VaLORS, and JRS to zero effective with the report for January 2002. For the teacher group, the legislation reduced the rate to 3.6%.
Source: JLARC staff analysis of VRS documents and Appropriation Acts.

RETIREE HEALTH INSURANCE CREDIT AND GROUP LIFE INSURANCE RATES

As part of the June 2001 actuarial valuation, the actuary also calculated new rates for the retiree health insurance credit and group life insurance programs. The rate for the health insurance credit for State employees, including SPORS, VaLORS, and Judges, is 1.86 percent. For teachers, the rate is 1.13 percent. For the group life insurance program, the rate is 0.98 percent. The rates for both of these programs have increased since the last valuation.

The VRS group life insurance benefit is funded through a mechanism consisting of required contributions from participating employers, plus investment returns on those contributions. During the early 1990's, the actuarially determined rate for the group life insurance program decreased several times. These decreases were largely due to the program's favorable mortality and investment experience. Since 1990, however, the group life insurance rates have not been funded at the rate determined by the VRS actuary. For example, no contributions were made to the group life insurance program in FY 1994, FY 1997, FY 1999, and FY 2000. As noted above, the actuarially calculated group life insurance rate has recently increased. The VRS actuary noted that the current rates reflect the cost of the "premium holidays" or those years when no contributions were made to the fund. If the calculated contributions had been made as scheduled, the actuary noted that the calculated rates reflected in the June 30, 2001 valuation would have been lower.

DEFERRED COMPENSATION AND CASH MATCH PLANS HAVE RECENTLY BEEN ENHANCED

VRS has statutory responsibility for administration of the State's deferred compensation program (DCP). The program was created in 1980 under the authority granted by section 457 of the U.S. Internal Revenue Code, and is often referred to as a 457 plan. Since its inception, the plan has undergone a number of changes that have been designed to improve administration and increase the utility of the program to participating employees, as well as increase program participation by eligible employees.

EGTRRA Implementation Leads to Modifications in the 457 Plan. Recently, the federal Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) was designed to expand individual options to increase opportunities for retirement savings. The implementation of EGTRRA made a number of significant changes to the State's 457 DCP plan. First, contribution limits were increased. Second, EGTRRA removed certain limitations to investing in both 403(b) and 457 plans. EGTRRA also allowed for the use of 457 funds for the purchase of service in a defined benefit plan.

As a result of EGTRRA, effective January 1, 2002, participants are able to contribute up to $11,000 to their DCP account Thereafter, the maximum deferral limits will increase by $1,000 annually until 2006 when the maximum deferral limit will be $15,000. After 2006, the maximums will be indexed in $500 increments.

VRS OVERSIGHT Report

***VRS Oversight Report* is published periodically by the Joint Legislative Audit and Review Commission (JLARC) in fulfillment of Section 30-78 *et seq.* of the *Code of Virginia*. This statute requires JLARC to provide the General Assembly with oversight capability concerning the Virginia Retirement System (VRS), and to regularly update the Legislature on oversight findings.**

JLARC Staff Assigned to VRS Oversight:
Glen S. Tittermary, Senior Division Chief
Patricia S. Bishop, Principal Legislative Analyst
Paula Lambert, Research Assistant
John Long, *VRS Oversight Report* Editor

The Joint Legislative Audit & Review Commission
Suite 1100, General Assembly Building
Capitol Square, Richmond, Virginia 23219
(804) 786-1258 Fax: (804) 371-0101

Due to EGTRRA, the maximum deferral limit is now based on 100 percent of the employee's includible compensation. Beginning in 2002, employees age 50 or more are permitted to contribute an additional catch-up contribution of up to $1,000 in 2002 ($2,000 in 2003, $3,000 in 2004, $4,000 in 2005, and $5,000 in 2006) for all plan years, except during the three years prior to normal retirment age when using the regular 457 catch-up provision.

EGTRRA also removed the coordination requirement for the 457 plan. Prior to the new EGTRRA provisions, the 457 dollar limit was reduced dollar for dollar by employee elective deferrals under 403(b) and 401 (k) plans. By removing the coordination requirement, employees at institutions of higher education who were participating in 403(b) plans now have the opportunity to participate in the 457 plan and not exceed maximum deferrals. Under EGTRRA, funds from 403(b) and 457 plans may be transferred tax-deferred to a governmental defined benefit plan to purchase permissive service credit or to repay the defined benefit plan for a prior refund. This new feature, which allows the employee to pay for the cost of purchasing service through a plan-to-plan transfer, has been very popular with employees who wish to purchase service under VRS' new purchase of service provisions.

In addition to the enhancements created by EGTRRA, the 2002 Appropriation Act allowed all employees effective July 1, 2002, including wage employees, to participate in the Deferred Compensation Plan. Previously, wage employees were not allowed to participate in the plan. Another enhancement to the program is the addition of the self-directed brokerage account (SDB). The self-directed brokerage account is for knowledgeable investors who acknowledge and understand the risks associated with the mutual fund investments contained in the SDB Account. Finally, the employer rather than the employee now pays the participant fee for the oversight of the DCP plan by VRS.

Employer Cash Match Program Results in Increased Participation. A significant employee benefit related to the deferred compensation plan was passed by the 1999 General Assembly and became effective in January 2000. The Virginia Cash Match Plan is an employer-paid cash match program for qualified employees who are making contributions to the Deferred Compensation Plan. It is regulated by Section 51.1-606 of the *Code of Virginia* and is classified as a defined contribution plan within the Internal Revenue Code Section 401(a). The employer match amount on a semi-monthly basis is 50 percent of a participant's contribution to the Deferred Compensation Plan or a maximum of $20 per pay period. Effective July 1, 2002, the 12-month waiting period for the cash match plan for those employees participating in the DCP plan has been eliminated.

Participation in the deferred compensation program has continued to increase over time from 4,111 participants in FY 1990 to more than 30,000 in FY 2002. In December 1999, prior to the implementation of the cash match plan, the total 457 Plan participation was 16,384. By December 2001, participants in the deferred compensation plan had increased to 27,793, an approximately 70 percent increase. Some of this increase might well be attributable to the availability of the cash match. By the end of May 2002, the total participation in the 457 Plan was 30,957 and 26,792 participants had cash match accounts. Also at May 31, 2002, there were 829 employees of colleges and universities contributing to the 457 Plan compared to 335 at the end of December 2001. This increase can be mainly attributed to the EGTRRA changes related to the coordination requirement.

PROGRAM CHANGES AND ENHANCEMENTS INCREASE WORK VOLUME AND COMPLEXITY OF ADMINISTRATION

Since 1999, many changes have been made to the benefits and programs administered by VRS. These changes range in complexity from relatively minor program clarifications or modifications to the establishment in October 1999 of the Virginia Law Officers' Retirement System (VaLORS). VRS staff have faced significant challenges in administering these new programs as well as keeping up with changes to existing programs.

VRS Adds Oversight and Administration of the ORP. In 2000, school superintendents were afforded the opportunity to participate in an optional retirement plan (ORP) rather than VRS. In 2001, VRS gained responsibility for centralized administration and oversight of the optional retirement plan, including the college and university ORP and the superintendents' ORP. In addition to the ORP programs, the Volunteer Firefighters' and Rescue Squad Workers' Pension Fund was authorized effective July 1, 2000.

New Retirement Options Made Available. In 2001, several new retirement options were made available. For example, the Partial Lump-Sum Option Payment (PLOP) was established. The PLOP allows members who work beyond their normal retirement age to elect a lump-sum distribution up to 36 times their monthly retirement allowance in a single lump-sum payment at the time of retirement. With the addition of the PLOP, effective July 1, 2001, the leveling option was eliminated. In addition, legislation passed by the 2001 and 2002 General Assemblies allowed retired teachers and school administrators, under limited circumstances, to draw their retirement benefits and continue to work full-time. Finally, a higher multiplier of 2.0 percent, instead of 1.7 percent, was established for all newly enrolled employees in VaLORS. The previous supplement for VaLORS was repealed, but all current VaLORS covered employees were given the option to elect the new multiplier in lieu of the previous multiplier and supplement.

Purchase of Service Streamlined. Legislation passed by the 2001 General Assembly, streamlined the purchase of service process making it easier for employees to understand the cost of purchasing service and promoting the purchase of service early in employees' careers, when it is less costly to them and the retirement system. As a result of the new purchase of service process, VRS is currently receiving thousands of service credit applications each month.

Life Insurance Program Enhanced. The Life insurance program was also enhanced during this period. Legislation passed by the 2001 General Assembly allowed retirees to continue optional life insurance coverage into retirement, and coverage was extended to spouses and dependent children of retirees. In addition, the reduction in benefits for group life insurance was changed to reduce one full year after retirement. Subsequent decreases will then be taken once a year. Additional benefits were added to cover employees in the event of accidental death. For example, if an employee dies as a result of an accident more than 75 miles away from home, the coverage provides transportation and associated costs up to $5,000 for bringing the remains back to the employee's hometown for burial. The coverage will also provide an additional benefit up to $50,000 if an employee dies in an accident while properly wearing a safety restraint. Additional benefits will also be paid if an employee dies or suffers a covered dismemberment as a result of a felonious assault in the workplace.

Virginia Sickness and Disability Program Expanded. Over the past several years, a number of aspects of the Virginia Sickness and Disability Program (VSDP) program were clarified and a new benefit was added to the program. The technical clarifications made to VSDP include: benefits not being paid to employees disabled while in the act of committing a felony; benefits not being paid to employees during periods of incarceration; benefits not being available to employees who do not comply with the requirements of the program; the waiting period beginning the first day of a disability or maternity leave; work-related, short-term disability benefits being payable if the employee takes periodic absences due to major chronic conditions; and employees only receiving one benefit regardless of the number of agencies for which they worked. In addition, those State employees who want to participate in VSDP will be able to do so in the fall of 2002 during an open enrollment. Similarly, all State employees will be covered under VSDP unless they opt out of the program during the enrollment period.

LONG-TERM CARE COVERAGE FOR VSDP PARTICIPANTS

In addition to the technical changes to the VSDP program, the 2001 session of the General Assembly provided funds for the Virginia Retirement System to implement an employer-paid, Long-Term Care (LTC) insurance program for State employees participating in the Virginia Sickness and Disability Program (VSDP). This employer-funded long-term care benefit is administered by Aetna Life Insurance Company for the Virginia Retirement System.

The employer-paid LTC benefit provides a $75 basic daily benefit with a two-year lifetime maximum benefit of $54,750. Qualified participants will be reimbursed for actual expenses incurred, up to $75 a day, for licensed nursing care, hospice care facility, or an assisted living facility. If the participant is receiving care at home, the plan pays 50 percent of the maximum daily benefit amount, or $38 a day for care by a registered or licensed professional nurse, or home health aid, and for physical, occupational, speech, or respiratory therapy.

This new benefit became effective March 1, 2002. As a result of this new program offered by VRS, Aetna has agreed to reduce premiums by 8 percent for the voluntary, employee-paid Long-Term Care program provided through the Department of Human Resource Management (DHRM).