

Report to the Governor and the General Assembly of Virginia

# VRS Oversight Report

JULY 2017



# Joint Legislative Audit and Review Commission

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## Overview

The Virginia Retirement System (VRS) administers retirement plans for employees of state and local governments. The two largest plans are the Teachers Plan and the State Employees Plan (Figure 1). Other pension plans include the individual retirement plans for 589 local political subdivisions and plans for state police officers (SPORS), other Virginia state law officers (VaLORS), and judges (JRS). VRS also administers several defined contribution retirement plans. In addition to retirement plans, VRS administers post-employment benefit programs. These include life insurance, sickness and disability, long-term care, and the retiree health insurance credit program.

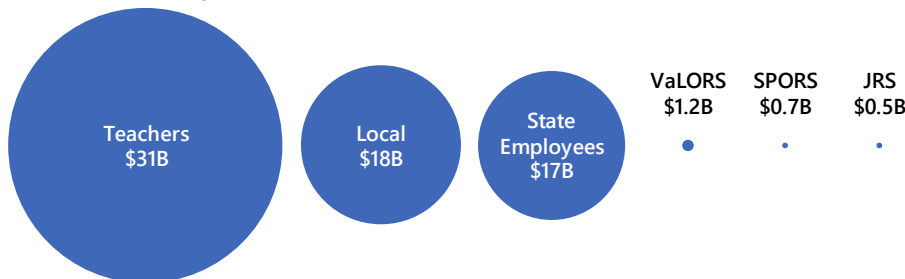
VRS serves approximately 675,000 members, retirees, and beneficiaries. Active members include current state and local employees and teachers in Virginia’s public school divisions. Others served by VRS include retirees, their designated beneficiaries, and “deferred” members, who are not actively employed and are not collecting benefits.

The financial assets used to pay VRS benefits are pooled in the VRS trust fund, which held \$72.4 billion in assets as of March 31, 2017. Ranked by value of assets, VRS is the nation’s 22nd largest public or private pension fund. In FY16, VRS paid \$4.4 billion in retirement benefits and \$0.4 billion in other post-employment benefits, not including benefits paid through the defined contribution plans.

VRS receives funds from three main sources: employer contributions, member contributions, and investment income. In FY16, VRS received \$0.1 billion in net additions to the trust fund (accounting for expenses and benefits paid out).

Investment income is critical to the health of the VRS trust fund, accounting for one-fourth of total additions in FY16. VRS investments generated a return of 10.7 percent for the one-year period ending March 31, 2017. The total annualized return over the 10-year period was 5.1 percent, which is below the 7.0 percent long-term (30+ year) rate of return that has been assumed by VRS for its investments.

**FIGURE 1**  
**VRS pension plans by assets**



SOURCE: VRS 2016 valuation report.

NOTE: Figures show total actuarial value of assets attributable to each retirement plan as of June 30, 2016. Trust fund assets attributable to other benefit programs are not shown. Figure for local plans is the aggregate of assets for political subdivisions that participate in VRS. Local plans hold more assets than the State Employees plan because they have typically been fully funded by local employer contributions, whereas State Employees plan has not been fully funded in the past. The State Employees plan is larger than the local plans as measured by pension obligations.

**FIGURE 2**  
**VRS fast facts**

**MEMBERSHIP** as of March 31, 2017



<b>345,992</b>	Actively employed members <sup>a</sup>
<b>198,581</b>	Retired members & beneficiaries
<b>130,682</b>	Inactive members
<b>675,255</b>	Total

**NET ADDITIONS** for fiscal year ending June 30, 2016<sup>b</sup>



<b>\$2.8 billion</b>	Employer contributions <sup>c</sup>
<b>\$1.0 billion</b>	Member contributions
<b>\$1.2 billion</b>	Net investment income
<b>-\$4.9 billion</b>	Benefits paid and other expenses <sup>d</sup>
<b>\$0.1 billion</b>	Net additions

**ASSETS** as of March 31, 2017



**\$72.4 billion**  
Total VRS trust fund assets

**INVESTMENT PERFORMANCE** as of March 31, 2017



	<b>1 year</b>	<b>3 years</b>	<b>5 years</b>	<b>10 years</b>
<b>Total return</b>	10.7%	6.3%	8.2%	5.1%
<b>Benchmark</b>	10.3%	5.7%	7.7%	4.6%
<b>Excess return</b>	+0.4%	+0.6%	+0.5%	+0.5%

SOURCE: VRS 2016 annual report and 2017 membership and investment department data.

<sup>a</sup> Active membership included 150,633 teachers, 106,861 local government employees, and 88,498 state employees, state police, law enforcement officers, and judges. Within the retirement plans are three different benefit groups. Active membership by benefit group included 188,331 in Plan 1, 90,881 in Plan 2, and 66,780 in the Hybrid Plan.

<sup>b</sup> Includes all additions and deductions to the trust fund for VRS retirement plans and other benefits programs. <sup>c</sup> Includes approximately \$1.7 billion in state contributions. <sup>d</sup> Includes \$4.4 billion in retirement benefit payments, \$376 million in other benefits, \$105 million in refunds, and \$47 million in administrative and other expenses.

# 1. Trust fund investments

Management of the trust fund investments is one of the core responsibilities of VRS. The VRS Board of Trustees sets investment policies for managing the trust fund, including the desired asset allocation for the fund. The investment department manages investment programs within the guidelines set by the board. The investment department manages approximately one-third of the assets internally and contracts with external managers to manage other assets.

## Investment performance and asset allocation

The VRS trust fund held \$72.4 billion in assets as of March 31, 2017, an increase of \$5.3 billion from a year ago. Approximately \$25.3 billion of the trust fund was managed internally, including all fixed income and some public equities, real assets, and cash. The remaining \$47.1 billion was managed by external managers under VRS supervision.

The trust fund's investment returns were mixed relative to the long-term return assumption, but the fund has outperformed its benchmarks. For the one-year period ending March 31, the trust fund's investments achieved a return of 10.7 percent. However, the fund's three-year return of 6.3 percent and 10-year return of 5.1 percent were below the 7.0 percent long-term (30+ year) rate of return that has been assumed by VRS for its investments. The total fund outperformed its benchmark for all periods, short and long term (Figure 3).

**Public equity.** The public equity program continues to be the largest VRS asset class, with \$30 billion in assets. The program consists of stocks and other equity securities for publicly traded companies in the U.S. and abroad. Public equity investments are typically higher-risk investments relative to bonds and are expected to provide long-term capital growth and inflation protection. Forty-one percent of the program's assets are managed internally. The program outperformed its benchmarks over the longer periods but underperformed in the one-year period.

**Credit strategies.** The credit strategies program is the second-largest VRS asset class, with \$13 billion in assets. The program includes investments in emerging market debt, high yield bonds, convertible bonds, bank loans, and direct lending. Credit strategies investments are intended to provide higher income than traditional stock and bond investments and attractive, risk-adjusted returns. All of the program's assets are managed externally. The program outperformed its benchmarks for all periods.

**Fixed income.** The fixed income program is the third-largest VRS asset class, with \$12 billion in assets. The program consists of U.S. dollar-denominated securities, such as bonds and money market instruments, that pay a specific interest rate. Fixed income investments are typically lower risk relative to most other asset classes and are expected to generate steady returns even in down equity markets. All fixed income assets are managed internally. The program outperformed its benchmarks for all periods.

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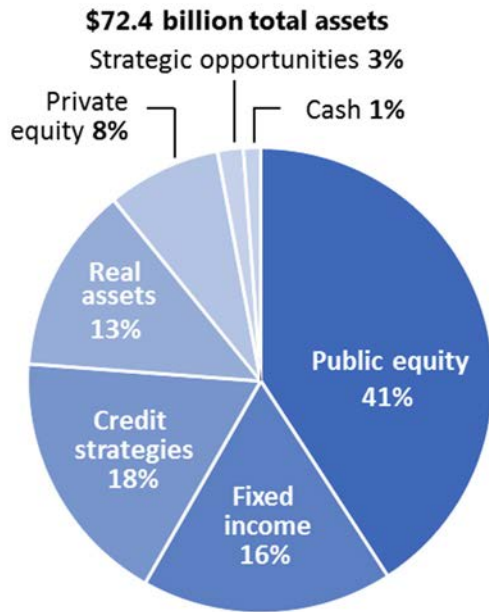
The VRS board adopts a **long-term return assumption** based on the advice of the VRS investment staff and actuary, and surveys from investment managers and consultants. This is the rate of return expected over the next 30+ years, based on projections of future market performance.

The long-term return assumption is one of the key assumptions used to determine the plan's funded status and employer contribution rates. The current long-term return assumption is 7%.

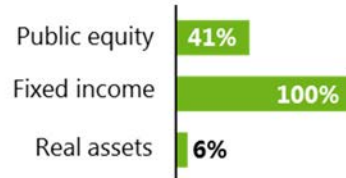
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**FIGURE 3**  
**Asset allocation and trust fund investment performance**

ASSET ALLOCATION as of March 31, 2017



**Internally managed assets**  
 (percent of asset class)



**TRUST FUND INVESTMENT PERFORMANCE**  
 for the period ending March 31, 2017

	<b>FY to date</b>	<b>1 year</b>	<b>3 years</b>	<b>5 years</b>	<b>10 years</b>
<b>Total fund</b>	8.7%	10.7%	6.3%	8.2%	5.1%
VRS custom benchmark	8.4	10.3	5.7	7.7	4.6
<b>Public equity</b>	13.3	14.0	6.5	9.7	4.9
Benchmark	13.5	14.4	5.9	9.0	4.4
<b>Credit strategies</b>	8.0	11.7	4.5	6.4	5.9
Benchmark	7.1	11.0	4.4	5.8	4.8
<b>Fixed income</b>	-1.1	1.6	3.2	2.8	5.0
Benchmark	-1.7	0.4	2.7	2.4	4.4
<b>Real assets</b>	8.0	10.9	11.7	11.9	6.1
Benchmark	5.3	7.4	9.7	10.2	6.0
<b>Private equity</b>	12.2	12.7	10.7	13.5	10.2
Benchmark	12.0	12.9	7.9	14.4	8.3
<b>Strategic opportunities</b>	8.1	9.1	3.1	n/a	n/a
Benchmark	7.6	9.7	3.6	n/a	n/a

SOURCE: VRS investment department data.

**Real assets.** The real assets program is the fourth-largest VRS asset class, with \$9 billion in assets.\* The program includes investments in real estate, infrastructure, and natural resources such as timber. Real assets investments are expected to reduce volatility of the total fund by offering returns that do not have a high statistical correlation to the public equities market. Most VRS real assets are managed externally. The program outperformed its benchmarks for all periods.

**Private equity.** The private equity program is the smallest of the five major asset classes, with \$6 billion in assets.\* Private equity is an alternative to traditional public equity and generally consists of ownership in companies that are not listed on public exchanges. Private equity investments are “opportunistic” investments that are intended to outperform public equity markets over the long term and enhance total fund returns. All private equity assets are managed externally. The program outperformed its benchmarks in the three-year and 10-year periods but underperformed in the one-year and five-year periods. The program achieved its intended purpose—to earn higher returns than the public equity program—in all periods except the one-year period, in which public equity returns were particularly strong.

**Strategic opportunities.** The strategic opportunities portfolio is the smallest asset class, with \$2 billion in assets. The portfolio allows VRS to gain experience with new investment approaches. Individual investments in this portfolio include three multi-asset class public investment managers and two multi-asset class private investment managers. All strategic opportunities assets are managed externally. The portfolio underperformed its benchmarks for the one-year and three-year periods, but has outperformed its benchmarks for the fiscal year to date. According to VRS staff, this portfolio contributes additional value by providing opportunities for the investment department to acquire exposure to new investment opportunities.

## **Investment policies and programs**

The VRS board sets investment policies, and the professionals in the investment department implement programs to fulfill those policies. The board has not made any significant changes to investment policies, benchmarks, or asset allocation over the past six months.

### ***VRS board addressed issues raised in JLARC review of pay plan for investment professionals***

The December 2016 JLARC oversight report included a review of VRS investment professionals’ pay. According to the report, the VRS pay plan for investment professionals has clear goals and generally aligns with other public funds. However, two practices lead to VRS professionals being paid more than most other large U.S. public fund

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\*Performance figures for the real assets and private equity programs do not reflect managers’ actual valuations of these investments as of March 31, 2017, because valuations of real assets and private equity lag behind other assets. Instead, performance figures are based on valuations as of December 31, 2016, adjusted for cash flows during the quarter that ended March 31, 2017.

managers: (1) an absolute return adjustment for incentive awards and (2) the inclusion of private sector organizations in the peer group for benchmarking total pay. The report suggested that the use of an absolute return adjustment should be reconsidered and, if kept, clearly articulated in the pay plan. The report also suggested that the board regularly review the types of public and private organizations that should be considered VRS's peers, and that the composition of the peer group should be clearly documented in the pay plan.

Following a review of the pay plan by the Administration and Personnel Committee over multiple meetings, the board voted to maintain the current absolute return adjustment and include language in the pay plan explaining the purpose and impact of the provision in more detail. The absolute return adjustment had been adopted after an extensive review of investment professionals' pay following the 2008-2009 recession. The adjustment is intended to account for market cycles and provide a systematic method to reflect both up and down markets in incentive compensation.

The board included language in the investment professionals' pay plan to clarify the process for selecting the funds to include in the peer group. Public fund peers will be chosen for their similarity to VRS using two main criteria: fund size and proportion of assets managed internally. The board may also consider other criteria to determine public peers. The board defined the private sector peer market as broadly as possible. Defining a narrower private-sector peer group is difficult due to the many dimensions within this market. The most obvious peers are the firms against which VRS has actually competed for staff, but this subset of private-sector peers pays more compared to the broader private market universe.



## 2. Defined contribution plans

VRS manages several defined contribution plans for its members. All state employees and many local VRS members may be eligible to participate in one or more of the plans (Table 1). Participants in these plans have their own accounts, and individual participants determine how their money is invested. The defined contribution plans are similar in structure to private sector 401(k) plans or personally owned individual retirement accounts (IRAs).

Some of the VRS defined contribution plans are intended to provide primary retirement benefits, whereas others are intended to supplement pension benefits. The aggregate value of participant accounts held in the VRS-managed defined contribution plans was \$4.0 billion as of March 31, 2017.

**TABLE 1**  
**VRS defined contribution plans**

<b>Plan</b>	<b>Description</b>	<b>Assets (\$M)</b>
Deferred compensation and cash match	State employees, and some local VRS members, can choose to make voluntary contributions to their Commonwealth 457 deferred compensation plan to supplement their retirement income. Most state employees receive a modest cash match from employers in their Virginia 401(a) cash match plan.	\$2,787
Optional plan for higher education <sup>a</sup>	Faculty at public colleges and universities may make an irrevocable one-time decision to participate in this defined contribution plan instead of the State Employees Plan. Employers are required to make contributions to participant accounts, and employees hired after July 1, 2010, are also required to contribute.	\$1,080
Hybrid	State and local members of the hybrid plan are required to contribute to their Hybrid 401(a) plan and can choose to make voluntary contributions to their Hybrid 457 plan. Employers make mandatory contributions to participant accounts and match a portion of voluntary contributions made by members. Members are also enrolled in the hybrid plan's defined benefit component.	\$149
Other <sup>b</sup>	Optional retirement plans for political appointees and school superintendents can be offered as alternatives to enrollment in the VRS State Employees or Teachers plans. School divisions may choose to offer the Virginia Supplemental Retirement Plan to certain employees who are already enrolled in the Teachers plan.	\$15

SOURCE: VRS administration and investment department data.

<sup>a</sup> The following institutions administer their own optional higher education plans: George Mason University, Virginia Commonwealth University, the University of Virginia, Virginia Tech, and the College of William and Mary. Faculty at these institutions are not eligible to participate in the VRS optional plan for higher education. <sup>b</sup> The amounts held in the other plans are as follows: Optional Retirement Plan for Political Appointees, \$14 million; Optional Retirement Plan for School Superintendents, \$0.4 million; and Virginia Supplemental Retirement Plan for certain educators, \$0.1 million.

## Plan performance

Participants in the VRS defined contribution plans may choose from a menu of 20 different investment options. These options include (1) diversified target-date portfolios, (2) individual investment options, and (3) self-directed brokerage accounts. Participants pay a flat administrative fee every year and additional investment fees according to the options they select. Participants in the Optional Retirement Plan for Higher Education may also choose to invest in options available under two other providers, TIAA and Fidelity. Participants who use one of these two providers pay investment, administrative, and other fees based on the provider they choose and the investment options they select.

**Target-date portfolios.** Participants may select a diversified investment portfolio in accordance with their target retirement date. These portfolios include a broad spectrum of investments, such as different types of stock, bond, and real estate funds. The mix of investments is automatically adjusted over time to become more conservative as the participant approaches retirement age. The target-date portfolios, which hold \$841 million in assets, met or exceeded all of their performance benchmarks (Table 2).

**Individual options.** Participants may select from one or more individual options to build a customized investment portfolio based on their personal preferences. The options include different types of stock, bond, money market, and real estate funds, and a fund that reflects the investments held by the VRS trust fund. The individual options, which hold \$2.1 billion in assets, met or exceeded nearly all of their performance benchmarks (Table 2). One option failed to meet its one-year benchmark.

**Self-directed brokerage accounts.** The brokerage accounts allow participants to select from thousands of publicly traded mutual funds, exchange-traded funds, and individual securities. Participants who use brokerage accounts have full control over their investments, down to the individual securities held in their portfolio. The brokerage accounts hold \$37 million in assets. Because all investment decisions are made by the account holders, no performance benchmarks for the brokerage accounts are presented.

**Additional options under the Optional Retirement Plan for Higher Education.** Participants in the Optional Retirement Plan for Higher Education (ORPHE) can choose to invest with TIAA or Fidelity rather than the VRS defined contribution plan. Under TIAA, participants may select a diversified portfolio option or build a custom portfolio from different types of stock, bond, money market, and real estate funds. Under Fidelity, participants may select a target-date portfolio or build a portfolio from a choice of investment options. The TIAA and Fidelity programs hold \$1 billion in assets. The investment options under TIAA and Fidelity underperformed many of their performance benchmarks (Table 2). Investment performance for these options is reported net of fees for investment, administrative, and other services, whereas the performance of the investment options offered under the other defined contribution plans are reported net of investment fees only because of differences in how plan fees are structured.

An additional \$47 million is held with private providers that VRS no longer partners with under the higher education retirement plan. VRS does not track investment performance for these deselected providers because participants can no longer contribute to them through the plan.

**TABLE 2**  
**Investment performance of VRS defined contribution plans**

for the period ending March 31, 2017

	1 year	3 years	5 years	10 years
<b>Options available for all plans</b>				
<b>Target date portfolios</b>				
Met or exceeded benchmark	<u>10</u>	<u>9</u>	<u>9</u>	<u>7</u>
Total number of options	10	9	9	7
<b>Individual options</b>				
Met or exceeded benchmark	<u>9</u>	<u>10</u>	<u>10</u>	<u>9</u>
Total number of options	10	10	10	9
<b>Additional options under the higher education plan</b>				
<b>TIAA</b>				
Met or exceeded benchmark	<u>4</u>	<u>3</u>	<u>3</u>	<u>3</u>
Total number of options	10	10	10	10
<b>Fidelity</b>				
Met or exceeded benchmark	<u>16</u>	<u>12</u>	<u>12</u>	<u>8</u>
Total number of options	24	23	23	22

SOURCE: VRS investment department data.

NOTE: (1) Options at top are available to all plan participants. (2) Total number of investment options reported for a given period can change because longer-term performance data is not available for newer options. (3) Performance of target-date and individual options is reported net of investment fees but not administrative fees. Performance of the additional options under the higher education plan is reported net of investment and embedded record keeping and plan administration fees, where applicable. (4) Some funds are passively managed. Passively managed investment options are expected to trail their benchmarks by the expense ratio (fees) charged by the investment managers. Returns for these options were adjusted to remove the estimated effect of these fees. Actively managed options are expected to outperform the market and were measured against the benchmark without any adjustment for manager fees. Capital preservation investment options, such as stable value and money market funds, are expected to generate returns at or above zero and were assessed relative to that benchmark.

**Plan management**

VRS manages the defined contribution plans through contracts with private companies. These companies provide account administration and investment management services to plan participants. VRS's management activities are overseen by the Defined Contribution Plans Advisory Committee. The committee is appointed by the VRS board and provides guidance to the board and staff.

***Unbundled options available for Optional Retirement Plan for Higher Education***

Starting in January 2017 participants in ORPHE are able to select from the defined contribution investment options available under the deferred compensation, hybrid, and other defined contribution plans. The investment options under these plans are referred to as “unbundled” because they separate administration and investment services. VRS made these options available to provide lower-cost and more transparent options. The TIAA and Fidelity investment options still are available to ORPHE participants.

As of March 2017, 10 ORPHE participants had selected the unbundled options and several have transferred balances from their previous provider. The vast majority of ORPHE participants still hold accounts with TIAA and Fidelity. VRS expects that over time and as new faculty are hired, more ORPHE participants will select the unbundled options.

***Rebranding of unbundled defined contribution plans***

VRS intends to rebrand its unbundled defined contribution plans as the Defined Contribution Plan, or DCP, this summer. The rebranding, which will apply to all of the unbundled plans, will be communicated to participants and employers through newsletters, employer updates, and the VRS website.

### 3. Legislation enacted in 2017

Through legislative action, the General Assembly can adjust contribution rates and funding, benefits and eligibility, and other aspects of VRS retirement plans and benefits programs. In 2017, the General Assembly enacted several pieces of legislation that will affect VRS (Table 3).

**TABLE 3**  
**VRS legislation enacted by 2017 General Assembly**

<b>Appropriation Act § 4-5.02 (a)</b>	<b>Outside counsel for investments.</b> Allows VRS to hire outside counsel related to investments and to notify the Office of the Attorney General as soon as practicable. This is an expansion of existing authority for outside counsel related to foreign securities litigation.
<b>HB 1768</b>	<b>Stress testing and reporting policies.</b> Requires VRS to develop and regularly report sensitivity and stress test analyses under various economic and investment scenarios; provide an online statement of investment policy; report investment performance data, including 20- and 25-year information; and report aggregate investment performance and expenses, such as carried interest.
<b>HB 2243</b>	<b>Line of Duty Act.</b> Clarifies Line of Duty Act provisions related to health insurance and training, and codifies provisions from the Appropriation Act. Modifies disqualification provisions for surviving spouses.
<b>SB 1118</b>	<b>Line of Duty Act, eligibility firefighter trainees.</b> Clarifies that firefighter trainees enrolled in a fire service training course offered by the Virginia Department of Fire Programs, or any other required training course, are eligible for Line of Duty Act benefits.
<b>HB 2245</b>	<b>Virginia Research Investment Committee.</b> Expands the role of the Virginia Research Investment Committee and authorizes moneys from the Research Investment Fund to reimburse VRS for its investment services.
<b>SB 1371</b>	<b>Volunteer Firefighters' and Rescue Squad Workers' Service Award Fund Board.</b> Requires board to meet at least annually; previously board was required to meet at least quarterly.

SOURCE: Virginia Legislative Information System and VRS.

#### **General Assembly authorized VRS to employ outside counsel for investment transactions**

The 2017 General Assembly authorized VRS to employ outside counsel for investment transactions. Any such arrangements must be reported to the Attorney General as soon as practical. Prior to VRS receiving this authority, the Attorney General hired outside counsel for VRS's investment transactions. The legislation is an extension of existing authority VRS has to employ outside counsel for foreign securities litigation (Appropriation Act § 4-5.02 (a)). VRS indicated that the authority was needed for investment transactions because such transactions often required specialized legal assistance and tend to be sophisticated, complex, and time sensitive.

## **General Assembly adopted recommendations of retirement reform commission**

The 2017 General Assembly adopted legislation (HB 1768) implementing recommendations made by the Commission on Employee Retirement Security and Pension Reform last December. The legislation requires VRS to

- adopt a policy to develop and regularly report on sensitivity analyses and stress testing,
- provide detailed investment information online, including the VRS investment policy statement and performance data for the 20- and 25-year periods, and
- regularly report investment performance and expenses, including carried interest fees.

In some cases, the legislation codifies practices that VRS has already implemented, such as posting its investment policy statement and 25-year performance data online. VRS conducts sensitivity analyses and stress testing on an ad hoc basis. In response to the legislation, the board adopted a policy to develop and regularly report sensitivity and stress test analyses. The board approved a stress testing report at its June 8th meeting, which has been submitted to the General Assembly. VRS is in the process of determining the best method for reporting carried interest and other expenses.

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**Carried interest** is a share of profits that private equity or hedge fund managers receive as compensation. Carried interest seeks to motivate a fund manager to work toward maximizing returns.

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## 4. Benefits administration and agency management

Administration of member benefits is one of the core responsibilities of VRS. In order to carry out this and other duties, the agency must be effectively managed. Recent actions relating to benefits administration and agency management include minor changes to actuarial assumptions, increased voluntary contributions of Hybrid Plan members, the transfer of administration of the Line of Duty Act program to VRS, and the appointment of several board members.

### VRS board adopted changes in actuarial assumptions

The board adopted several changes in actuarial assumptions, which are expected to increase employer contribution rates for the state retirement plan by approximately one percentage point. These changes, along with others identified during the actuarial valuation, will be reflected in the employer contribution rates certified by the board in the fall for inclusion in the upcoming biennial budget.

The changes, which were recommended by the VRS actuary and based on the actuary's most recent experience study (sidebar), included changes to demographic assumptions, such as mortality and retirement rates, and several minor methodological changes. The actuary did not recommend changes to economic assumptions, such as the investment rate of return assumption of seven percent.

### Automatic escalation increased the percentage of hybrid plan members making voluntary contributions; few members opted out

The Hybrid Plan combines elements of a traditional defined benefit retirement plan with a 401(k)-style defined contribution plan. Hybrid Plan members include most state employees, teachers, and local employees hired on or after January 1, 2014, and now constitute 19 percent of the total active VRS membership. (State employees in the SPORS and VaLORS plans, and local employees with enhanced hazardous duty benefits, are not part of the Hybrid Plan.) The Hybrid Plan has lower costs and liabilities than the defined benefit plans it replaced, and is expected to gradually reduce state and local retirement costs as it grows to cover an increasing proportion of the workforce.

Hybrid plan members must make voluntary contributions to the defined contribution component of their plan in order to ensure they have sufficient benefits to retire. Hybrid Plan members who make only the minimum required one percent contribution to the defined contribution component, and retire at 65 with 30 years of service, would receive a benefit equal to about one-third of their final salary. These members may not be able to afford retirement, even with social security benefits. By comparison, members in the traditional Plan 1 and Plan 2 pension groups would receive benefits equal to about half of their final salary and would be better able to retire. Hybrid plan members who contribute the maximum voluntary contribution amount would receive a benefit that is potentially higher than the Plan 1 and Plan 2 groups.

The percentage of hybrid plan members making voluntary contributions increased dramatically in 2017 due to a statutory automatic rate escalation that took place in

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Experience studies compare actual economic and demographic experience with expected experience based on current assumptions, with the goal of better aligning plan assumptions with actual experience.

The VRS actuary's most recent experience study covered FY13-FY16.

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**Hybrid plan members contribute** a total of 5% to 9% of salary toward their retirement benefits. Members must contribute 4% of salary toward their defined benefit component.

Members are required to contribute 1% of salary to their defined contribution component and may voluntarily contribute up to an additional 4%.

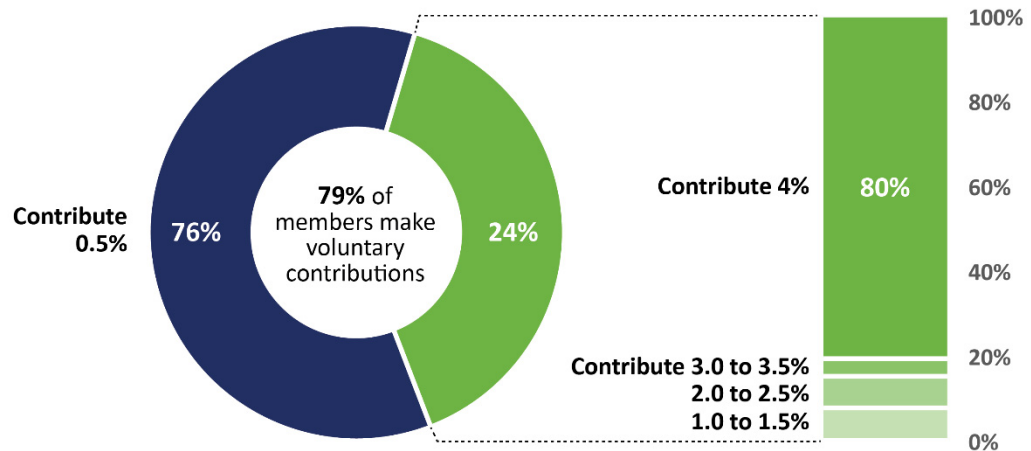
Employers are required to contribute to a member's defined benefit component at the actuarially determined rate. Employers are required to contribute 1% of salary toward a member's defined contribution component and provide up to an additional 2.5% in matching contributions, based on a member's voluntary contributions.

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January. The statutory escalation brings participants into the voluntary contribution component of the program unless they opt out. As of March 31, 2017, 79 percent of hybrid plan members were making voluntary contributions compared to approximately 15 percent in October 2016. Under the automatic escalation, voluntary contributions for members who were not contributing the maximum amount increased by 0.5 percent unless the member actively chose a different increase amount or decided to not allow the increase. (Three percent of eligible members opted out of the automatic escalation.) The increase applied to hybrid plan members hired on or before September 1, 2016.

Even though most hybrid plan members are now making voluntary contributions, the majority are only contributing the 0.5 percent of their salary that occurred as a result of the automatic escalation (Figure 4). Statute requires a 0.5 percent automatic escalation of voluntary contribution rates every three years, with 2017 being the first automatic escalation (§ 51.1-169 C.3). For members who do not actively elect to increase their contribution rates, it will take 24 years to reach the maximum contribution amount of four percent. Most members who have elected to make voluntary contributions beyond the 0.5 percent automatic escalation amount are already making the maximum contribution of four percent.

**FIGURE 4**  
**Percentage of hybrid plan members making voluntary contributions by contribution amount, March 2017**



SOURCE: VRS.

VRS continues to explore ways to increase voluntary contribution rates of Hybrid Plan members through campaigns and online tools designed to educate and increase awareness among employers and employees. VRS is currently exploring self-directed automated escalation, which would allow members to set a schedule to increase their contributions according to their preferences.



## **Line of Duty Act eligibility determination will transition to VRS in July**

VRS will assume eligibility determinations for the Line of Duty Act program in July. The Department of Human Resource Management (DHRM) will administer the LODA health benefit plans. These responsibilities were transferred from the Department of Accounts to VRS and DHRM as part of a series of broad changes the General Assembly made to the program in 2016. These changes originated with a 2014 JLARC report, which identified options for improving the program's administration and financial sustainability.

## **Board member appointments**

Troilen Seward was appointed to a second term by the General Assembly's Joint Rules Committee in February 2017. She was originally appointed to the board in 2012. Her new term will expire in 2022. A retired superintendent of the Dinwiddie County Public Schools, Seward serves as the board's statutorily required teacher representative.

Lieutenant Mitchell Nason was appointed as board chair by the governor in May 2017, subject to confirmation by the General Assembly. He was originally appointed to the board in 2008 and is serving his second term. His current term and chairmanship will end in February 2018. A firefighter and paramedic with the Prince William County Department of Fire and Rescue, Nason serves as the board's statutorily required local employee.

O'Kelly McWilliams III was appointed to the board by the governor in May 2017, subject to confirmation by the General Assembly. His term will expire in 2022. McWilliams is an office managing partner with the law firm of Gordon & Rees Scully Mansukhani. He serves as the board's statutorily required member with employee benefits experience.

The VRS board is a supervisory board that is directly vested with authority for managing and overseeing most aspects of the retirement system. The board delegates day-to-day management responsibilities to the VRS director and chief investment officer.







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