



VRS Hybrid Retirement Plan Employee Contributions

In brief

Hybrid retirement plan reduces employer costs and transfers some retirement risk to employees.

Most hybrid plan career employees* will achieve estimated 80% income replacement in retirement, including Social Security.

VRS could increase outreach and education to encourage additional voluntary contributions.

Plan design changes could increase retirement income replacement but would result in substantial state costs.

Cap on voluntary contributions may discourage employees from saving more.

*For examples in this report, a career employee has worked 26.5 years, which allows them to meet the Rule of 90 (age + years of service) to receive an unreduced benefit.

Primary research activities

- Interviews with subject-matter experts, other state hybrid retirement plans, employer representative organizations, and VRS staff
- Models of potential plan changes (VRS staff actuaries)
- Literature reviews
- Input from subset of state government employees (VGEA-administered survey)

VGEA = Virginia Governmental Employees Association

In this presentation

Background

Virginia's hybrid retirement plan

Outreach and education

Potential plan design changes

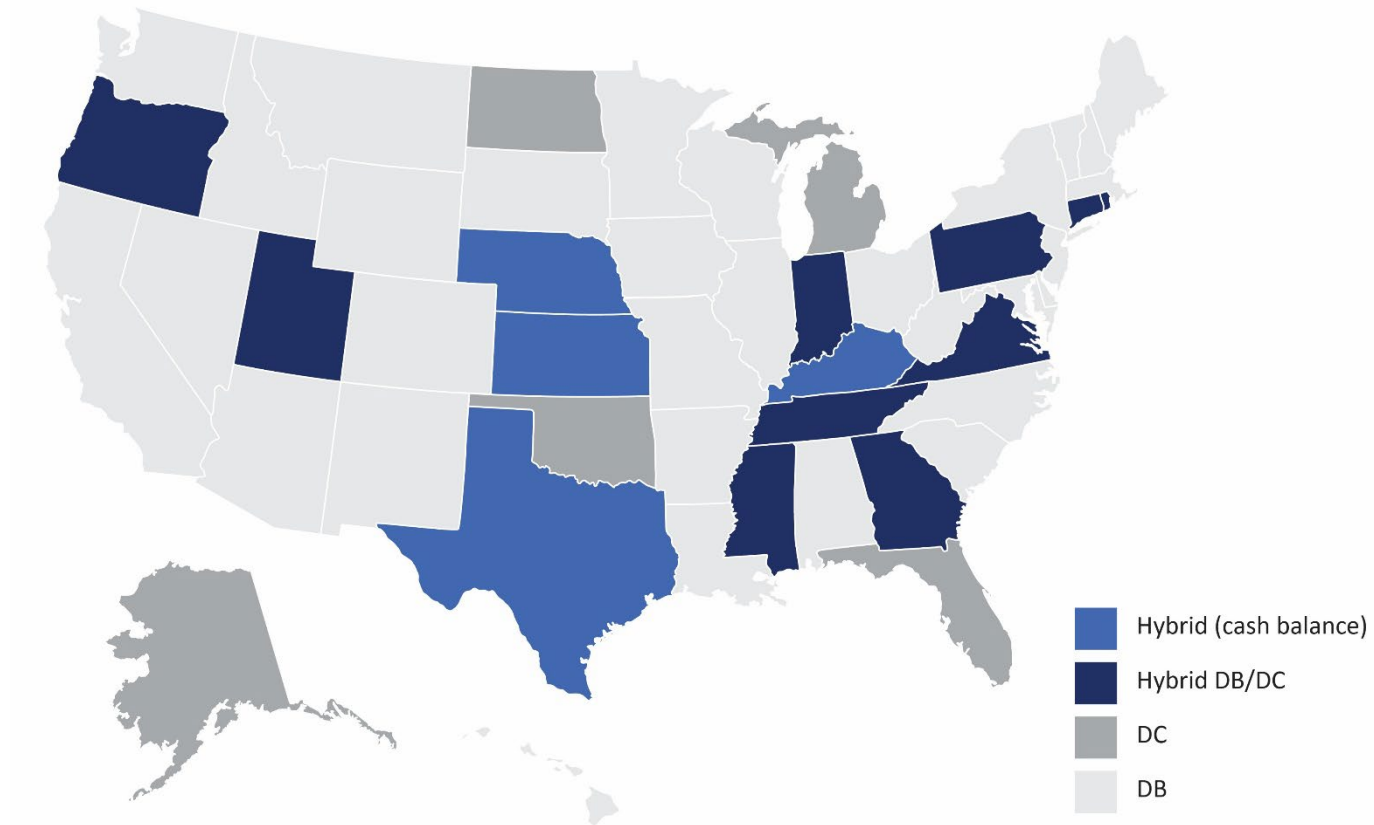
Public sector retirement plans help provide long-term employees with retirement income

- Retirement income typically comes from three primary sources
 - Retirement plans
 - Social Security
 - Other investments
- 80% replacement of annual pre-retirement income (from all sources) is typical benchmark

Different types of public sector retirement plans exist

- Defined benefit (DB) plans (i.e., traditional pension plans) – employer holds longevity and investment risks
 - Virginia's Plan 1 and Plan 2
- Defined contribution (DC) plans - employee holds longevity and investment risks (similar to a 401[k])
- Hybrid retirement plans - employers and employees share risks by incorporating features of DB and DC plans
 - Reduce employer costs because DB benefit is smaller

14 states have hybrid retirement plan for general state employees



Source: National Association of State Retirement Administrators and state retirement plan documents.

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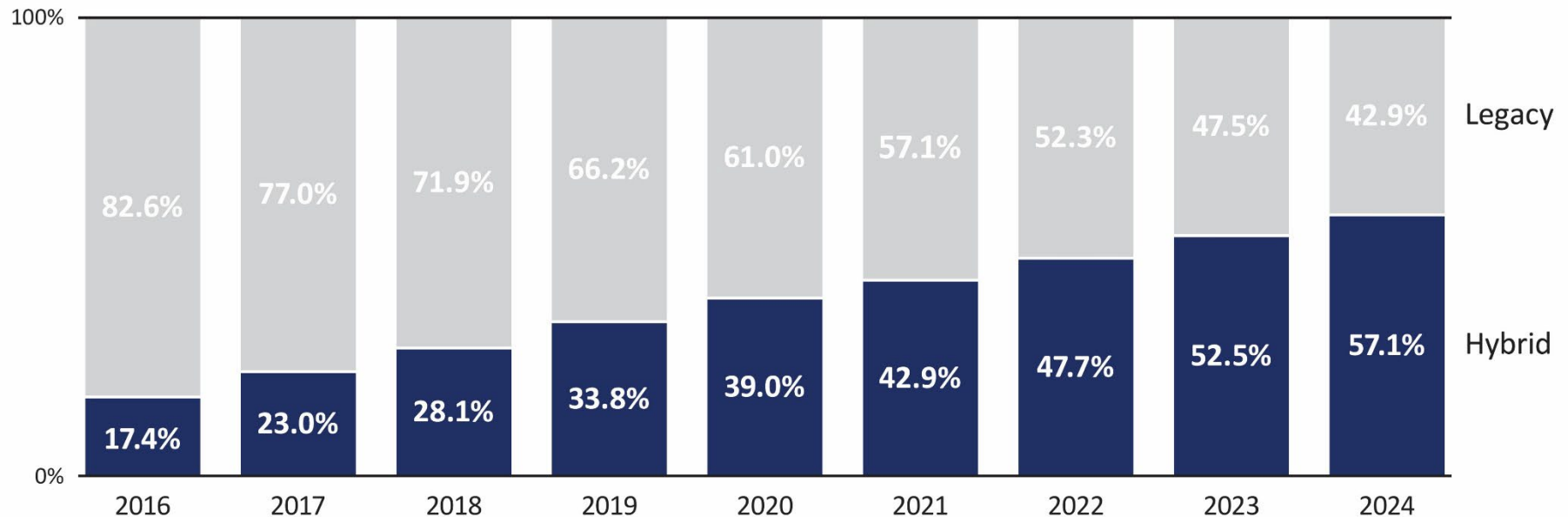
Outreach and education

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Virginia's hybrid plan includes DB and DC components

- Employees and employers make mandatory contributions to DB and DC components
 - Employees: 4% DB, 1% DC
 - Employers: Actuarial rate DB, 1% DC
- Employees can make up to 4% in voluntary contributions to the DC component
 - Employers match 1:1 for first 1%; 50% thereafter (total of 2.5%)
- 0.5% auto escalation every 3 years for voluntary contributions

Majority of Virginia's active state plan members are in the hybrid retirement plan



Source: JLARC staff analysis of VRS data. Only general state employees included. Hybrid plan also includes teachers and political subdivision retirement plans.

Finding

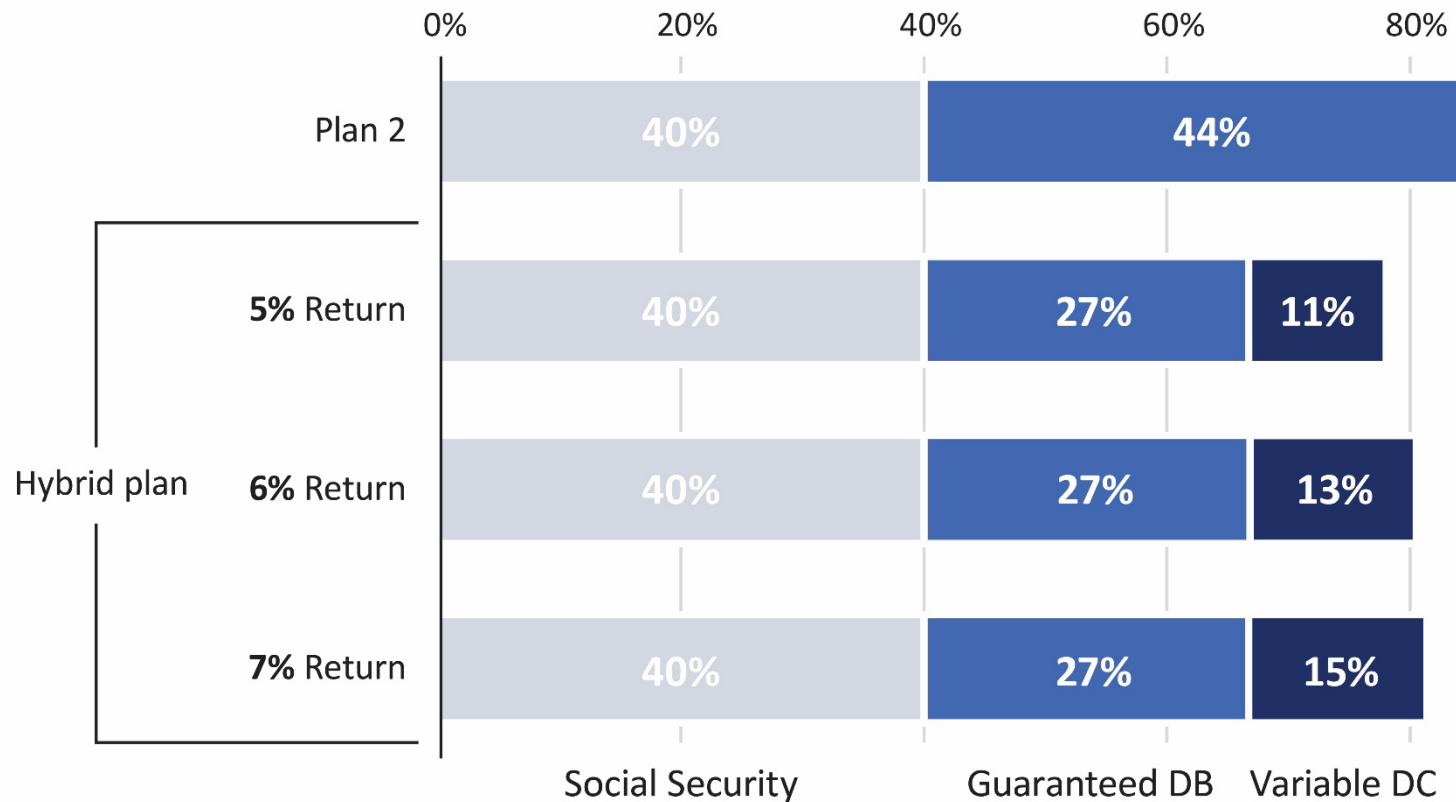
Virginia's hybrid retirement plan reduces employer costs and transfers some retirement risk to employees, which were primary reasons for adopting the plan.

Hybrid plan reduces employer costs

- Employer costs reduced compared to Plan 2 for several reasons*
 - DB benefit reduced compared to Plan 2
 - Employees pay a greater share of their annual benefit
 - Majority of members not taking full advantage of DC employer match
- Hybrid plan members pay more for their benefit
 - 7% annually throughout career vs 5% for a Plan 2 member for a comparable benefit

*In 2015, VRS estimated \$23.6M in total savings for the state plan in the 2015–2016 biennium from pension reform, most of which came from the switch to the hybrid retirement plan.

Investment rate of return on DC component is not guaranteed, and income replacement can vary

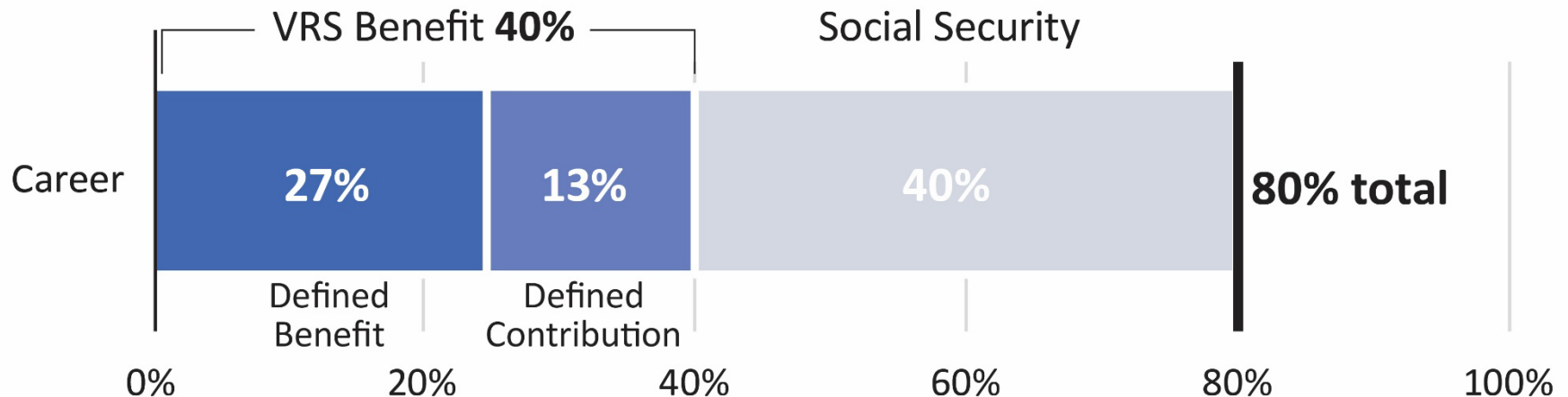


Finding

Hybrid retirement plan will allow most career employees to achieve approximately 80 percent income replacement in retirement, including Social Security.

Plan members could save more for retirement, but majority passively remain at default contribution.

Most career employees will receive 80% income replacement, with Social Security



- Plan 2 member with the same characteristics would receive estimated 84% income replacement

Based on a state plan employee working a full career to receive an unreduced benefit and an average final compensation of \$74,725 (statewide average).

Voluntary contributions above hybrid plan defaults would increase employees' income replacement

- Higher voluntary contributions would replace more income, but only 1/3 of employees actively chose a higher rate
 - Default voluntary contribution rates - 0% initial; 0.5% auto escalation every 3 years
- Research overwhelmingly shows that employees passively stay with retirement plan design defaults
- Other reasons for not making higher voluntary contributions*
 - Virginia's hybrid plan is confusing
 - Reluctance to reduce current income or other financial goals

Active elections are as of April 1, 2025. *Based on a survey administered by VGEA of a subset of state employees in the hybrid retirement plan.

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VRS could increase outreach and education to hybrid plan members to encourage increased voluntary contributions.

Required training for new employees could encourage higher voluntary contributions

- VRS largely relies on employers to share hybrid plan information
- Online hybrid retirement plan training module could be part of DHRM 'Required Training' for new state employees
 - Training would be developed by VRS
- Would help ensure all new employees receive consistent message on importance of voluntary contributions

DHRM = Department of Human Resource Management

Recommendation

The General Assembly may wish to consider directing VRS to develop an introductory online training video and DHRM to include the video as part of required training for newly hired state employees.

Targeted outreach could help encourage increased voluntary contributions

- 2023 study found participants receiving “personalized nudges” 3X more likely to increase contributions
- Some other states with hybrid plans use targeted outreach
 - TN and GA send emails approximately quarterly to employees not contributing enough to meet income replacement goals
 - Some states contact members on work anniversaries to remind them about increasing contributions

Recommendation

VRS should make regular targeted outreach to hybrid plan members not contributing the maximum 4% in voluntary contributions to remind them to consider increasing their contributions.

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Changes to the hybrid retirement plan's design (i) could help employees increase their retirement income replacement and (ii) would result in substantial state costs.

Potential plan change: Auto-enroll members at a voluntary contribution above 0%

	Estimated income replacement (%)	Estimated employer DC contributions
Current plan – baseline	80%	\$41,700
Auto-enrollment		
Auto-enroll new members at 1%	84%	\$50,600
Auto-enroll new members at 0.5%	82%	\$46,200

NOTE: Assumes an illustrative state plan employee working a full career to receive an unreduced benefit, estimated 40% income replacement from Social Security, and an average final compensation of \$74,725. Estimated employer DC contributions are over the employee's career.

Potential plan change: Implement an annual auto escalation

	Estimated income replacement (%)	Estimated employer DC contributions
Current plan – baseline	80%	\$41,700
Annual escalations		
1% annual escalation of member contributions	87%	\$55,700
0.5% annual escalation of member contributions	86%	\$53,400

NOTE: Assumes an illustrative state plan employee working a full career to receive an unreduced benefit, estimated 40% income replacement from Social Security, and an average final compensation of \$74,725. Estimated employer DC contributions are over the employee's career.

Potential plan change: Change split for employee mandatory contributions to 3% DB/2% DC (from 4% DB/1% DC)

	Estimated income replacement (%)	Estimated employer DC contributions
Current plan – baseline	80%	\$41,700
DB/DC split for mandatory 5% member contribution	84%	\$50,600

Employer would cover the 1% contribution to the DB plan that the employee had been making.

NOTE: Assumes an illustrative state plan employee working a full career to receive an unreduced benefit, estimated 40% income replacement from Social Security, and an average final compensation of \$74,725. Estimated employer DC contributions are over the employee's career.

Changing hybrid retirement plan would result in substantial state costs

- Review did not calculate fiscal impact to the state of each potential change, but costs would likely be in the millions
 - To give a sense of potential magnitude of additional costs, estimated to cost \$40M annually if all state hybrid plan employees contributed the maximum 4%
 - Employer costs for hybrid plan members in the teachers and political subdivision plans would also increase
- Most costly potential plan change would be adopting an annual automatic escalation (1% or 0.5%)
- VRS DB plans still have approximately \$20B in unfunded liabilities, which employers will need to pay down over the next 18 years

Finding

Virginia's cap on voluntary contributions may unnecessarily discourage increased contributions.

Virginia has a 4% cap on voluntary DC contributions for hybrid plan members

- Creates complexities for members wishing to make voluntary contributions up to the IRS annual limit*
 - Contributions beyond 4% must go to separate COV 457
 - As a result, members have four separate DC accounts, including employer match
 - Contribution approach for Hybrid 457 and COV 457 is different (percentage vs. flat amount)
- Other states allow voluntary contributions up to the IRS annual limit in one account

*IRS annual limit in 2025 was \$23,500.

Recommendation

The General Assembly may wish to consider increasing the contribution limit for the Hybrid 457 account to the IRS annual contribution limit.

JLARC staff for this report

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Appendix: Employee assumptions used for potential plan changes

General state employee

6% annual investment return

Average Final Compensation (AFC) = \$74,825 (based on statewide average salary from the 2024 actuarial valuation)

Years of Service = 26.5 (allows an unreduced DB retirement benefit based on age and years of service for illustrative employee in report)

Age at Retirement = 67

Social Security benefit = 40% income replacement (Social Security income replacement varies by income)

DC balances annuitized for simplicity

Note: Income replacement estimates only based on VRS benefit and Social Security. Does not include any other retirement savings employees may have.