Summary: VRS Hybrid Retirement Plan Employee Contributions

WHAT WE FOUND

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

Cost savings for the state was a key motivation for the Virginia General Assembly to adopt the hybrid retirement plan, and the plan will cost the state less than the legacy defined benefit (DB) retirement plans—Plan 1 and Plan 2. The hybrid plan costs the state less because the DB benefit for hybrid plan employees has been reduced, and hybrid plan employees pay a greater percentage of their DB benefit. Even though employers provide a partial cash match to employees' defined contributions (DC), the majority of hybrid plan members are not taking advantage of the full employer match, which further decreases employer costs.

Another key goal of adopting the hybrid retirement plan was transferring some of the longevity and investment risks associated with retirement benefits from employers to employees. Hybrid plan employees now bear the longevity and investment risks associated with the DC component of their plan.

WHY WE DID THIS STUDY

JLARC undertook this review as part of JLARC's ongoing oversight required by the Virginia Retirement System Oversight Act (§30-78 et. seq.). The hybrid retirement plan has been in place for over 10 years, and as of 2024, the majority of VRS active members are covered by the hybrid plan. Now that the state has over a decade of experience, JLARC staff reviewed the hybrid retirement plan to determine whether the state's goals for adopting the plan in 2012 are still being met and whether retirement plan members will be able to meet retirement income replacement goals. While the plan covers state employees, teachers, and local employees, this review focuses primarily on state employees. However, many of the findings apply to teacher and local employee retirement plan members and employers. Any changes to the hybrid plan would affect these groups as well.

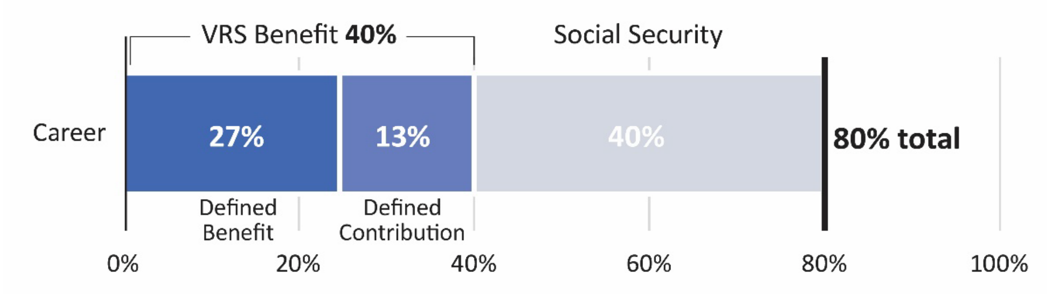
ABOUT THE HYBRID RETIREMENT PLAN

The Virginia General Assembly adopted the hybrid retirement plan in 2012 for most new general state employees, teachers, and local employees. The hybrid retirement plan includes defined benefit and defined contribution components to which employers and employees contribute. The General Assembly adopted the plan because of concerns over the cost of the state's retirement plans and the decreased funded status of the VRS trust fund following the Great Recession. The goals of the plan were to reduce the cost of the retirement plan and to transfer some of the retirement risk to employees. The hybrid plan became the default state retirement plan for most non-public safety employees hired after January 1, 2014.

Hybrid plan will allow most career employees to achieve an estimated 80 percent income replacement in retirement when including Social Security

The hybrid retirement plan, as structured, is generally adequate to allow most career employees (who have worked enough years to receive an unreduced retirement benefit) to receive an estimated 80 percent income replacement in retirement if Social Security is included. (Actual replacement ratios may be higher or lower because Social Security benefits vary by income.) Approximately 80 percent of annual pre-retirement income is a typical goal for adequate income in retirement.

Hybrid plan will allow most career employees to receive an estimated 80 percent income replacement in retirement, including Social Security



Assumes an illustrative employee who works a full career (26.5 years of service) to receive an unreduced benefit, has an average final compensation (AFC) of $74,725 (the statewide average), and receives an annual investment return of 6 percent on their DC contributions. For comparison, a Plan 2 member with the same AFC and length of service would receive an estimated income replacement of 84 percent.

Because of the hybrid plan's structure, hybrid employees must make higher contributions than employees in the legacy pension plans to receive a similar benefit. To receive a benefit comparable to a Plan 2 member, a hybrid plan member must contribute approximately 7 percent annually on average over the course of their career compared to a Plan 2 member who must make an annual 5 percent contribution.

Hybrid plan members could replace more income in retirement, but the majority passively remain at the default contribution level

Most hybrid plan members do not choose to make additional voluntary contributions to the DC component of their plan when they are hired, but they could replace more income in retirement if they did. Hybrid plan members start at a default voluntary contribution of 0 percent unless they make an "active election" to contribute additional income. Choosing a higher voluntary DC contribution would not only increase their employee contributions but allow them to take fuller advantage of the employer match (which would also increase employer costs). Without actively electing to make a voluntary contribution when hired, it will take an employee 24 years to reach the maximum voluntary contribution (4 percent) and receive the full employer match. Hybrid plan members may not actively elect an initial voluntary contribution rate above 0 percent for a variety of reasons, but the most cited reason in research on retirement savings is inertia and passivity.

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

VRS currently has multiple outreach efforts and educational tools to encourage hybrid plan members to make voluntary contributions to their DC accounts. However, some of the tools are dependent on employers' HR staff informing employees of them. Additional tools provided by VRS directly could help encourage hybrid plan members to actively elect higher voluntary contribution rates. These could include an online training module as part of state employees' required onboarding and targeted outreach to members.

Changes to Virginia's hybrid retirement plan design could help employees increase their retirement income replacement

Some General Assembly members have been concerned about whether the hybrid retirement plan negatively affects employee recruitment and retention because it is less generous than the legacy DB plans. Legislation enacted during the 2025 session moves judges from the hybrid retirement plan back to Plan 2 starting in FY26. If the General Assembly wanted to help hybrid plan members save more for retirement, it could consider several incremental changes. The General Assembly could take steps to accelerate employees' voluntary DC contributions or change the allocation of employees' contribution between the DB and DC components of the plan. These potential changes would be consistent with the research on retirement savings that shows plan design has the greatest influence on employee savings.

Auto-enroll members at a voluntary contribution above 0 percent – Virginia is unique among states in enrolling new hybrid plan members at a 0 percent voluntary contribution rate. Virginia's hybrid plan could auto-enroll new members at 0.5 percent or 1 percent.

Implement an annual auto escalation – Virginia's auto-escalation of 0.5 percent for voluntary contributions every three years for hybrid plan members is unusually slow. Virginia's hybrid plan could have an annual auto escalation of 0.5 percent or 1 percent. This would increase retirement income replacement the most of the potential changes considered in this report.

Change the allocation of hybrid plan employees' mandatory contribution between their DB and DC components – Instead of the existing allocation for members' mandatory contribution of 4 percent to the DB component and 1 percent to the DC component of their plan (for a total mandatory contribution of 5 percent), the allocation could be changed to 3 percent and 2 percent, respectively. This would reduce the employee contribution obligation to the DB portion of the plan and increase the employees' mandatory contribution to the DC component (for a total of 2 percent).

Changing hybrid retirement plan's design would result in substantial state costs

Changing the hybrid retirement plan's design would result in substantial state costs. This review did not analyze the total state costs for the potential changes reviewed, but to give a sense of the magnitude, employer costs would increase by an estimated $40 million annually if all current state hybrid plan employees were contributing the maximum 4 percent in voluntary contributions. The most costly potential change reviewed would be adopting an annual automatic escalation (either 1 percent or 0.5 percent annually). Changes to the hybrid plan would also increase costs for the teachers