

**REPORT OF THE
VIRGINIA RETIREMENT SYSTEM ON**

**The Use of Defined
Contribution Pension Plans
by Local Governments**

**TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA**



SENATE DOCUMENT NO. 12

**COMMONWEALTH OF VIRGINIA
RICHMOND
1992**

PREFACE

The following study was conducted under the authority of Senate Joint Resolution 209 which was approved by the 1991 Session of the Virginia General Assembly.

The study was conducted by the staff of the Virginia Retirement System (VRS).

The VRS acknowledges the cooperation of Powhatan County and the Town of Farmville in providing data for the completion of this study.

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Senate Joint Resolution 209

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EXECUTIVE SUMMARY

Senate Joint Resolution 209 directed the Virginia Retirement System to conduct a survey of localities with defined contribution retirement plans to determine if those plans are in compliance with Section 51.1-800(A) of the Code of Virginia (Appendix B), including the funding practices of the plans over the past ten years.

Because only two Virginia localities that are required to comply with Section 51.1-800(A) have defined contribution plans, Powhatan County and the Town of Farmville, the scope of the study was limited to the retirement plans of those localities.

The nature of defined contribution and defined benefit plans make them difficult to compare. Comparability is only as reliable as benefit projections under the two plans. Based upon benefit projections provided by the Town of Farmville, its plan appears to be comparable to VRS assuming no significant decline in investment earnings. Benefit projections were not provided by Powhatan County which makes any assumptions relative to comparability difficult.

Absent a mandate that all plans must have defined benefits, no further comparison can be made.

INTRODUCTION

Senate Joint Resolution 209 was approved by the 1991 General Assembly for the purpose of studying the extent to which defined contribution plans are being used by local governments and to determine their compliance with Section 51.1-800(A) of the Code of Virginia.

The Resolution directed VRS to conduct the study and to report its findings to the General Assembly.

The scope of the study was to identify those localities that are required to comply with Section 51.1-800(A), identify those with defined contribution plans, request information from those localities and evaluate that information relative to the requirements set forth in the Resolution.

BACKGROUND

In their broadest terms, pension plans may be described as either defined benefit plans or defined contribution plans. Under the defined benefit plan, the employer provides a determinable benefit, usually related to an employee's service and/or pay. Under this approach, the employer's cost is whatever is necessary to provide the benefit specified. Under the defined contribution plan, the employer's contribution is fixed and the contribution is accumulated to provide whatever amount of benefit it can purchase. Under the defined contribution plan, the employee's benefit becomes the variable, depending upon factors such as level of contributions, age at entry into the plan, retirement age and investment earnings or losses.

The VRS is a defined benefit plan as opposed to a defined contribution plan.

CURRENT LEGAL ENVIRONMENT

Section 51.1-800(A) of the Code of Virginia requires every county, city, and every town with a population of 5000 or more to participate in the Virginia Retirement System or to provide a local retirement system whose benefit for an employee at age 65 is at least equivalent to two-thirds of the benefit had the employee been covered under the VRS.

STUDY RESULTS

There are currently ten counties and cities that do not participate in the VRS as the primary pension plan for their employees. Some do provide VRS coverage for Constitutional Officers, but such coverage is not material to this study.

Those ten localities are:

<u>Counties</u>	<u>Cities</u>
Arlington	Charlottesville
Fairfax	Danville
Powhatan	Falls Church
	Newport News
	Norfolk
	Richmond
	Roanoke

There is also one town, Farmville, with a population of 5000 or more that does not participate in VRS. Farmville and Powhatan County have defined contribution retirement plans for their employees and are the subjects of this study.

In order to perform the study required by SJR 209, a survey instrument was developed and sent to the two affected localities (Appendix A). The surveys were returned on a timely basis and the required analysis accomplished.

Survey Results: The survey instrument sent to the affected localities included an employee profile citing an earnings history for an employee with thirty years of service. The localities were asked to provide a benefit for an employee fitting that profile at age 65 based upon their actual earnings assumption as well as earnings at two percent above and below the assumption. The results as compared to the VRS benefit were as follows:

	<u>Assumed Rate</u>	<u>Rate+2%</u>	<u>Rate-2%</u>
VRS	\$ 930/mo.	NA	NA
Farmville	1532/mo.	\$2389/mo.	\$ 989/mo.
Powhatan	No response to this question.		

The survey also requested a five year history of actual earnings as well as a ten year history of contributions. The results as compared to VRS experience were as follows:

EARNINGS

<u>Fiscal Year</u>	<u>VRS</u>	<u>Farmville</u>	<u>Powhatan</u>
86-87	13.2%	5.17%	14.2%
87-88	1.1	7.78	12.7
88-89	15.3	7.93	22.21
89-90	11.1	8.61	8.61
90-91	6.4	9.62	18.21

CONTRIBUTIONS

<u>Fiscal Year</u>	<u>VRS*</u>	<u>Farmville</u>	<u>Powhatan</u>
81-82	4.67%	NR	10.0%
82-83	6.15	4.67%	10.0
83-84	11.77	4.93	10.0
84-85	12.68	4.25	10.0
85-86	12.68	3.96	10.0
86-87	12.84	3.99	10.0
87-88	12.84	4.02	10.0
88-89	12.51	5.01	10.0
89-90	12.51	4.76	10.0
90-91	10.12	4.87	10.0

*Contribution shown for FY82 and FY83 is employer contribution only. State began paying 5% member contribution in October, 1983.

It should be noted that differences in the actual earnings shown above may be misleading because methodologies in computing yields may vary.

CONCLUSIONS

Because of the nature of their benefits, defined benefit plans such as VRS and defined contribution plans such as those of Powhatan County and the Town of Farmville are not readily comparable. The two means available to make such a comparison are ultimate benefit payments and, to a lesser degree, contributions over time.

In the case of Farmville, the benefit projections, should they hold true, indicate that the local system would meet the two-thirds comparability test. Should earnings decline significantly, future comparability may not be achieved. In the case of Powhatan, no benefit projections were provided. That leaves only contributions on which to compare plans. Contributions to the Powhatan plan are clearly at least two-third of those that the State contributes to VRS. But, absent benefit information, compliance with Section 51.1-800(A) cannot be assured.

The only means of providing a plan that is truly comparable to

VRS would be to provide a defined benefit plan with a formula providing benefits that are at least two-thirds of the VRS benefit. Both of the local plans studied fall short of that standard. This does not suggest to VRS that the benefits provided by either plan are not reasonable nor are the plans well funded. Absent further General Assembly mandates that would require defined benefit plans for those localities, no additional conclusions can be reached.

Should either Powhatan County or the Town of Farmville wish to consider covering their employees under the VRS, they may do so as provided for by statute.

1991 SESSION

LD9085114

SENATE JOINT RESOLUTION NO. 209

Offered January 18, 1991

Requesting the Virginia Retirement System to survey local governments on the use of defined contribution plans.

Patron—Emick

Referred to the Committee on Rules

WHEREAS, § 51.1-800 A of the Code of Virginia requires local governments which do not participate in the Virginia Retirement System to establish and maintain a local retirement system which provides a service retirement allowance that equals or exceeds two-thirds of the comparable service retirement allowance under the Virginia Retirement System; and

WHEREAS, the Virginia Retirement System and most of the independent local retirement systems are defined benefit plans, and the analysis of benefits required by § 51.1-800 A results in a comparison of similar products; and

WHEREAS, the retirement benefit provided by a defined benefit plan is often not comparable to the benefit provided by a defined contribution plan, a complicating factor which makes the Virginia Retirement System's task that much more difficult; and

WHEREAS, in addition to the problem of comparability, defined contribution plans do not require the employer to fund its retirement plan each year; and

WHEREAS, such a feature permits a defined contribution plan to meet the requirements of § 51.1-800 A one year and fall out of compliance the next; and

WHEREAS, defined contribution plans, therefore, require more vigilant monitoring; and

WHEREAS, the Joint Subcommittee Examining the Feasibility of Implementing Procedure for Reviewing Local Retirement Systems, established by Senate Joint Resolution No. 20 of the 1990 Session of the General Assembly, recommends that the Virginia Retirement System be charged with conducting a survey of the extent to which defined contribution plans are being used by local governments, identify such jurisdictions, and determine their compliance with § 51.1-800 A; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That the Virginia Retirement System be requested to conduct a survey of the local retirement systems to determine how many of such systems are defined contribution plans, which localities have implemented such plans, and the degree to which such plans are in compliance with § 51.1-800 A of the Code of Virginia. The survey should include a review of the funding practices over the past ten years for any defined contribution plans that may be identified.

The Virginia Retirement System shall report its findings and recommendations to the General Assembly and the Governor by December 1, 1991, as provided in the procedures of the Division of Legislative Automated Systems for the processing of legislative documents.

Official Use By Clerks

Agreed to By The Senate

- without amendment []
with amendment []
substitute []
substitute w/amdt []

Agreed to By The House of Delegates

- without amendment []
with amendment []
substitute []
substitute w/amdt []

Date: _____

Date: _____

Clerk of the Senate

Clerk of the House of Delegates

VIRGINIA RETIREMENT SYSTEM

USE OF DEFINED CONTRIBUTION PENSION PLANS
BY LOCAL GOVERNMENTS

Locality _____

Plan Administrator _____

Phone Number _____

Name of Person Completing This Survey _____

_____ Phone _____

Name of Local Retirement Plan _____

Check the MAJOR employee groups covered by this retirement plan:

_____ General employees _____ Non instructional school employees

_____ Sheriff's office _____ Fire

Check the classifications of employees covered by this retirement plan:

_____ Salaried _____ Hourly _____ Full time _____ Part time

Check all of the benefits offered by this retirement plan:

_____ Normal Retirement _____ Early Retirement

_____ Disability Retirement

Using the following employee profile, provide an estimate of the basic monthly benefit payable to a 65 year old employee retiring under this retirement plan. Also, provide an estimated benefit if the interest rate assumption is reduced by 2.0% and if the interest rate assumption is increased by 2.0%.

<u>YEAR</u>	<u>AGE</u>	<u>EARNINGS</u>	<u>YEAR</u>	<u>AGE</u>	<u>EARNINGS</u>	<u>YEAR</u>	<u>AGE</u>	<u>EARNINGS</u>
1	36	\$4,985	11	46	\$7,620	21	56	\$14,843
2	37	5,181	12	47	7,999	22	57	16,180
3	38	5,284	13	48	8,401	23	58	17,809
4	39	5,549	14	49	9,224	24	59	18,789
5	40	5,685	15	50	9,801	25	60	19,705
6	41	5,917	16	51	10,384	26	61	20,863
7	42	6,023	17	52	11,160	27	62	21,752
8	43	6,385	18	53	11,930	28	63	22,398
9	44	6,741	19	54	12,645	29	64	23,826
10	45	7,204	20	55	13,649	30	65	25,000

Estimated benefit at current interest \$ _____
 Estimated benefit at 2% under current rate \$ _____
 Estimated benefit at 2% over current rate \$ _____

VIRGINIA RETIREMENT SYSTEM

USE OF DEFINED CONTRIBUTION PLANS
BY LOCAL GOVERNMENTS

Please provide a five year history of actual earnings performance on the trust fund supporting this plan:

<u>Fiscal Year</u>	<u>Earnings Rate (%)</u>
1986-87	_____
1987-88	_____
1988-89	_____
1989-90	_____
1990-91	_____

Please provide a ten year history of the contribution level to the plan expressed as a percent of payroll:

<u>Fiscal Year</u>	<u>Contribution Rate (%)</u>
1981-82	_____
1982-83	_____
1983-84	_____
1984-85	_____
1985-86	_____
1986-87	_____
1987-88	_____
1988-89	_____
1989-90	_____
1990-91	_____

Please enclose a copy of your current summary plan description as required by Section 51.1-1001 of the Code of Virginia and a copy of your most recent (1989-90 or 1990-91) annual report as required by Section 51.1-1003 of the Code of Virginia.

Completed surveys should be returned by Friday, October 25, 1991, to:

Wallace G. Harris
Virginia Retirement System
P.O. Box 3-X
Richmond, VA 23207

ARTICLE 1.

General Provisions.

§ 51.1-800. Counties, cities, and certain towns to establish local systems or participate in Virginia Retirement System. — A. Every county and city, and every town having a population of 5,000 or more, shall provide a retirement system for those officers and employees listed in subsection B either (i) by establishing and maintaining a local retirement system which provides a service retirement allowance to each employee who retires at age sixty-five or older which equals or exceeds two-thirds of the service retirement allowance to which the employee would have been entitled had the allowance been computed under the provisions of the Virginia Retirement System or (ii) by participating directly in the Virginia Retirement System. The Board of Trustees of the Virginia Retirement System shall determine whether a local retirement system satisfies the criterion of (i) above, taking into account the difference between the employee contribution rates under the local retirement system and the Virginia Retirement System. If any local retirement system fails to satisfy the criterion of (i) above, the Virginia Retirement System shall promptly notify the governing body of the county, city, or town which maintains such local retirement system of the deficiency. If, within ninety days of such notice, the local retirement system, or its governing body, fails to correct the deficiency or to persuade the Virginia Retirement System that its original findings were in error, then the Virginia Retirement System shall notify the Comptroller. The Comptroller shall withhold from such locality the payment of its share of net profits from the operation of the alcoholic beverage control system as provided for by § 4-22 until such time as the Virginia Retirement System may notify him that criterion (i) above is being satisfied.