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November 15, 2018

The Honorable Thomas K. Norment, Jr.
Co-Chairman, Senate Finance Committee
Senate of Virginia
P.O. Box 6205
Williamsburg, VA 23188

The Honorable Emmett W. Hanger, Jr.
Co-Chairman, Senate Finance Committee
Senate of Virginia
P.O. Box 2
Mount Solon, VA 22843-0002

The Honorable S. Chris Jones
Chairman, House Appropriations Committee
House of Delegates
P.O. Box 5059
Suffolk, VA 23435

Dear Co-Chairman Norment, Co-Chairman Hanger, and Chairman Jones:

Pursuant to the requirements of Item 474, Paragraph O. of Chapter 2, 2018 Special Session I (2018 Appropriation Act), this letter serves as a report on the unfunded liability attributable to institutions of higher education that have established their own optional retirement plan (“opt-out” institutions) under § 51.1-126(B) of the *Code of Virginia* and the estimated level of additional contributions to be collected by the Virginia Retirement System (VRS) from the associated surcharge.

By way of background, the concept of applying a surcharge was first introduced in an amendment to § 51.1-145 (N) passed during the 2012 General Assembly Session. That amendment provided an unfunded liability surcharge as part of the employer contribution rate for universities, including the opt-out higher education institutions. However, this Code language requirement was later removed by Item 468, Section T of the 2013 Appropriation Act.

The opt-out institutions under § 51.1-126(B) include the College of William and Mary, George Mason University, the University of Virginia (UVA), Virginia Commonwealth University (VCU) and Virginia Polytechnic Institute and State University (Virginia Tech). These institutions also participate in the VRS defined benefit plan and their employees are covered in the VRS State Plan. The State Plan includes an unfunded liability that all employers in the plan contribute to paying down over time.

The total unfunded liability of the State Plan is allocated proportionately to all employers of the plan based on covered payroll of all active members enrolled in the defined benefit plans. The cost allocation method assumes that all employers are ongoing entities that will maintain a relatively level active population covered by the plan. This provides fair allocation of plan costs among participating employers over time.

As of June 30, 2018 the opt-out institutions accounted for approximately \$1.3 billion, or 24%, of the State Plan's unfunded liability. The liability is detailed further in the following table.

University	Proportionate Share of Liability	Net Pension Liability	Number of Actives
College of William and Mary*	1.78%	\$96,549,000	1,325
George Mason University	3.19%	\$172,885,000	2,181
University of Virginia**	7.59%	\$411,019,000	5,481
Virginia Commonwealth University	5.26%	\$284,679,000	3,608
Virginia Tech	6.46%	\$349,811,000	4,793
Total Five Opt-Out Universities	24.29%	\$1,314,943,000	17,388
Total ORPHE Opt-In Universities			
	17.56%	\$950,691,000	13,063
Total State Plan			
	100.00%	\$5,413,632,000	74,582

* Includes VA Institute of Marine Science

** Includes UVA's College at Wise

Opt-out institutions appear to have begun re-designating certain positions, historically only eligible to participate in the VRS defined benefit plans, as eligible for the institutions' Optional Retirement Plan for Higher Education (ORPHE), a defined contribution plan. Over time, this expansion in the positions eligible for the ORPHE has resulted in a decrease in the population participating in the VRS defined benefit plan as the percentage of members electing ORPHE coverage has increased. This change in the member population covered under the defined benefit plans will shift legacy unfunded costs to all other employers participating in the State Plan.

To account for this shifting of plan membership and the resulting legacy unfunded liabilities in the State Plan, Item 474, Paragraph O. of the 2018 Appropriation Act requires opt-out institutions to pay a surcharge in addition to their regular contribution to the State Plan. Specifically, the surcharge applies to employees of opt-out institutions who began participating in an optional retirement plan on or after January 1, 2014, and who, as of that date, were not directly engaged in the performance of teaching duties. The surcharge does not apply to employees of entities described in § 51.1-126.1, § 51.1-126.3 and Chapter 24 of Title 23.1, which includes certain employees of teaching hospitals, employees of the UVA Medical Center and the VCU Health Systems Authority. In accordance with the 2018 Appropriation Act, the surcharge is calculated "in an amount equal to the difference between the total retirement contribution rate required on behalf of State employees and the rate payable by the Commonwealth under § 51.1-126(F)(1) for Optional Retirement Plan for Higher Education employees who became a member on or after July 1, 2010." For fiscal years 2019 and 2020, the surcharge subtracts the Plan 2 ORPHE contribution from the contribution rate paid by all state employers as follows:

13.52% (State Employer Contribution Rate)
 -8.5% (Plan 2 ORPHE)

5.02% Surcharge

Following the enactment of the current Appropriation Act in June 2018, VRS began coordinating with the opt-out institutions to identify the employee population subject to the surcharge. Through this collaboration, VRS has developed a process for determining the monthly surcharge amount, which will be billed on a quarterly basis. Based on the September 30, 2018 surcharge-eligible population, the annual amount expected to be collected from the opt-out institutions is approximately \$9.0 million. Details of this amount are as follows:

Employer	Employer Code	Members Identified			Creditable Compensation of Members			Quarterly Surcharge
		October 2018	November 2018	December 2018	October 2018	November 2018	December 2018	
College of William and Mary	30204	215	215	215	\$1,369,570	\$1,369,570	\$1,369,570	\$206,257
Virginia Institute of Marine Science	30268	13	13	13	\$76,390	\$76,390	\$76,390	\$11,504
University of Virginia – Academic Division	30207	854	854	854	\$6,122,087	\$6,122,087	\$6,122,087	\$921,986
University of Virginia’s College at Wise	30246	25	25	25	\$95,130	\$95,130	\$95,130	\$14,327
Virginia Polytechnic Institute and State University	30208	584	584	584	\$3,933,806	\$3,933,806	\$3,933,806	\$592,431
Virginia Commonwealth University	30236	240	240	240	\$1,609,972	\$1,609,972	\$1,609,972	\$242,462
George Mason University	30247	240	240	240	\$1,718,486	\$1,718,486	\$1,718,486	\$258,804
Total		2,171	2,171	2,171	\$14,925,441	\$14,925,441	\$14,925,441	\$2,247,771

* Amounts above are estimated based on September 2018 census and will be updated when member information is made available.

Of the 13.52% total contribution rate paid by participating state employers for fiscal years 2019 and 2020, 8.04% of that rate accounts for the standard amortization payment associated with paying down the unfunded liabilities of the plan. Therefore, while the surcharge does help to mitigate the shifting of legacy unfunded costs among participating state employers, the 5.02% paid by the opt-out institutions for employees formerly only eligible for the defined benefit plan will be less than the standard amortization payment of 8.04% paid by State Plan employers over the next two fiscal years.

Please feel free to contact me with any questions or if I can be of further assistance.

Sincerely,



Patricia S. Bishop
 Director

cc: Jennifer Davis, George Mason University (jjdavis@gmu.edu)
 Karol Gray, Virginia Commonwealth University (kgray8@vcu.edu)
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