County of Fairfax, Virginia

MEMORANDUM

DATE: February 15, 2012

TO: DISTRIBUTION

FROM: Susan Woodruff
Human Resources Director

SUBJECT: Personnel and Reorganization Committee Meeting – February 21, 2012

The next meeting of the Board Personnel and Reorganization Committee will be held on Tuesday, February 21 from 10:00 a.m. to 11:30 a.m. in the Fairfax County Government Center, Rooms 9/10. The following agenda items are scheduled for discussion:

- Line of Duty Resolution (item attached)
- Retirement Study Discussion (Q and A Response attached)

Attachments

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PERSONNEL AND REORGANIZATION COMMITTEE ITEM – February 21, 2012

LINE OF DUTY ACT – OPT OUT RESOLUTION

ISSUE:
Board approval to move forward to opt out of the Line of Duty Act Fund.

BACKGROUND:
The Line of Duty Act (LODA) was passed by Virginia's General Assembly in 1972 to provide a state-funded death benefit for public safety officers killed in the line of duty. Since that initial passage, the population covered by the LODA has been expanded and additional benefits added, including a health insurance component.

In 2010, the General Assembly shifted funding responsibility from the state for LODA benefits to local counties and municipalities for their covered populations. The legislature also created the LODA Fund as a voluntary, pooled funding mechanism and appointed the Virginia Retirement System (VRS) as the investment manager. Under the new law, local governments can either opt in or out of the VRS LODA trust – at this point, the State continues to be responsible for benefit eligibility determinations. Local governments opting out of the VRS fund can either pay claims on a self-insured basis or utilize other funding mechanisms, such as a "competing" trust created by the Virginia Municipal League (VML) and Virginia Association of Counties (VACO). The deadline for the opt out decision by localities is currently July 1, 2012.

After careful consideration of the options available, staff recommends that the county opt out of the VRS LODA Fund and fund LODA benefits on a self-insured basis. From the outset of this process, there has been a significant probability that the jurisdictions that will use the VRS fund and potentially the VML trust will be those with less than favorable experience and thus Fairfax, with its large pool of participants and low utilization, would be subsidizing the fund for other jurisdictions.

The opt out decision for the county was deferred as we waited for the state to provide more comprehensive guidelines for the program, define the full extent of administrative fees and potentially even repeal the funding decision. Indications are that repeal is unlikely at this point. And, while guidelines and administrative fee decisions are still in a state of flux, the potential cost of participation in the VRS LODA fund appears to be skyrocketing. The Virginia Department of Accounts (DOA), which administers the program for the State, has confirmed that it will propose rates for FY2013 that represent a 74 percent increase over the rates originally expected. This could mean a funding obligation for the county of $1.58 million versus the state's initial estimate of $906,521 for FY2013 alone. Future years could mean even further increases.

New legislation has been introduced to the General Assembly that (1) further extends the opt-out deadline to 2013 and (2) moves benefit eligibility determination authority to either localities or the VML/VACO trusts if localities opt out. We will continue to monitor these legislative activities as well as further administrative clarifications issued by DOA.

FISCAL IMPACT:
The anticipated cost to the county, if we opt out, is approximately $700,000 which will be funded in the FY 2013 budget.

RECOMMENDATION:
Staff recommends that the Board endorse opting out of the Virginia Line of Duty Act Fund. With Board endorsement, the necessary resolution will be returned for formal action at the March 20th Board meeting.

SUPPLEMENT TO FAIRFAX COUNTY POST-RETIREMENT BENEFITS REVIEW

We have answered the questions posed by Supervisor Herrity based on information readily available to us as noted below. There is a fair amount of information available online about these issues and we note a number of references to relevant online and other sources in the body of our answers. This is also a very dynamic area and getting subjective information such as "How are they working?" would require contacting and interviewing staff in the various government entities. While that is outside the scope of our current engagement we would be happy to undertake the effort with the County's authorization and to prepare a statement of work for the County's consideration.

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1. What are the feasibility and the advantages and disadvantages of switching to a defined contribution retirement plan, or some sort of hybrid plan, for new Fairfax County Government employees?

   We believe that this subject was covered to some extent in the report but we are happy to address the questions above directly here.

   First, our view is that the feasibility of switching to a defined contribution plan alone for new employees is altogether a matter of Virginia law. We commented on our understanding of the legal framework in the report, and it is our understanding that this question will be addressed directly by the County's Counsel in responding to question 9 below. We see no issue in terms of feasibility in a hybrid plan that provides a minimum defined benefit equal to at least two-thirds of the service allowance that would have been provided under the provisions of VRS, as the Virginia Code requires.

   As to advantages and disadvantages, two of the major advantages for a defined benefit plan are:

   - A defined benefit plan directly provides a solution to a need – the need to replace income at retirement for an employee who has spent his/her career in County employment. The defined benefit plan can be designed the same way a disability plan is designed – to replace any given percentage of that income intended, with adjustments for outside sources such as Social Security and tax differences.

   - Defined benefit plans are more efficient at meeting this need, both from the standpoint of providing most of the benefits to those who retire after a full career with the County (rather than more to short service employees who leave the County in early terminations) and because money invested by professionals generally earns a higher rate of return than retirement savings invested in defined contribution plans by individuals--see for example:

     http://www.towerswatson.com/united-states/newsletters/insider/3955

Defined contribution plans have advantages also. Two of them commonly cited are:

- They have a fixed upfront and long term cost. Once the money is paid, no future obligation arises. The employee is responsible for investments and for setting aside enough of his own money in combination with employer money and Social Security to finance his or her future income needs.

- The benefits are more visible than in defined benefit plans. Even young employees see accounts grow early in their careers. And, employees generally understand the basic designs of defined contribution plans (not necessarily concepts related to investing) better than they do defined benefit plans.

It is important to note that, while defined contribution plans have the benefit of fixed upfront and long term costs, that does not always mean that the introduction of these programs as a defined benefit plan replacement will result in a cost savings for the employer. For example, the maintenance of both a defined benefit system for current employees as well as a defined contribution program for new employees would be significantly more costly for the county for the foreseeable future. In addition, a defined contribution program that provides the level of retirement security consistent with the county's current retirement policy would be more costly, even if provided on a full-replacement basis to all employees, given the county's long-term historical investment management success.

With all of these factors considered in conjunction with the legal requirements in place in the Commonwealth, we continue to believe that the defined benefit plan model continues to best meet the needs of the county in satisfying the requirements of Virginia law as well as in providing a flexible and cost-effective platform for delivering retirement income security to career employees.

2. How many public entities across the nation have switched to a defined contribution plan?

   a. What have their experiences been in attraction and retention?

   b. Have any converted back?

About 10% of state and local government employees are covered by defined contribution plans. However, a good number of these are college staff covered by TIAA-CREF, a leading vendor for defined contribution plans offered by educational institutions, or something similar – and many of those had a choice between a defined contribution or a defined benefit plan.

There are several extensive studies on the topic. The following is a link to a compilation of studies gathered by the University of California. It lists states that converted to defined contribution plans and some of the issues faced as a result of the conversions In addition to providing data on the conversions, many of the studies provide insight into the documented preference of public sector employees for defined benefit programs.

http://ucrpfuture.universityofcalifornia.edu/files/2010/08/peb_ax_k-2_nasra-periscope-article.pdf.

The National Conference of State Legislatures (NCSL) also publishes periodic reviews of the current DB/DC landscape for state retirement programs. Below is a link to a recent report on Defined Contribution and Hybrid Plans that discusses the relatively small number of states that have opted to use either only a defined contribution approach for all or a portion of their employee bases as well as those that have explored hybrid approaches including cash balance programs. As noted in the study, these transitions have had mixed results, including decisions by some states like Nebraska and West Virginia to move back to either a defined benefit model or a hybrid. Recognizing that this is an issue that has received increasing attention over recent years due to the economic environment and the declining budgets of many public sector employers, we have provided an additional link to NCSL's most recent report on legislative activity in the states with regard to pension issues.

http://www.ncsl.org/issues-research/employment-working-families/state-defined-contribution-hybrid-retirement-plans.aspx

http://www.ncsl.org/issues-research/employment-working-families/2011-pension-and-retirement-enacted-legislation.aspx

3. Colorado, Florida, Louisiana, and Maine all offer defined contribution plans – How are they working? What are their experiences in attracting and retaining employees? What has the fiscal impact been?

   Attraction/retention/fiscal concerns are not addressed through readily available studies. However, design parameters and employee choice statistics are available from a number of sources, including the studies cited in the answer 2 above One of those specifically discusses the Florida experience.

   In 2000, Florida established an optional retirement plan for all current and future FRS participants. This legislation allowed existing to participants to make one of three choices: remain with the DB plan; switch to the DC plan but keep their existing DB service credit; or switch to the DC plan and transfer the cash value of their DB plan credit to their new DC account. Approximately 95% of existing employees elected to stay with the DB plan. Since the open enrollment period approximately 17 percent of new hires have elected to participate in the DC plan.

A study that focuses specifically on employee choice in DC and hybrid plans is of significant in this response:

http://www.nasra.org/resources/Milliman_DBDC_Choice.pdf

The Milliman study shows, among other things, new hire experience for Florida, Colorado and four other plans. New hires overwhelmingly enroll in the DB structure, with Florida representing the lowest percentage of employees choosing the DB structure at 74%.

Neither Louisiana nor Maine is mentioned in the studies we found.

Louisiana started an optional defined contribution system in 2000 known as the Optional Retirement System (ORP) but closed it to new entrants in 2007. There is also an ORP available to Louisiana educational employees, which remains open. Per the 2011 Consolidated Annual Financial Report of the teachers system, the DB plan had 86,742 active members and the ORP had 6,769 active members.

We found no mention of a primary statewide defined contribution system in Maine. There was an in-depth study of the state's retirement income and retiree health programs conducted in 2010, which seemed to recommend the continued use of a defined benefit plan as the cornerstone of Maine's system for many of the same reasons noted in our own study for the county.   Legislation to reform Maine's retirement plan was introduced in the summer of 2011, but still called for the use of a defined benefit plan for delivery of core benefits, although recommendations were included to change plan design for future years and to incentivize the use of the state's defined contribution plan through a matching contribution.   The Maine task force's report can be found at:

http://www.mainepers.org/PDFs/other%20publications/MainePERS%20Final%20URP%20Task%20Force%20Report%203-9-2010.pdf

4. What have the experiences in Montgomery County been in their transition to a hybrid model of defined benefits and defined contributions? How many employees choose defined contribution versus defined benefit? What are the ages of those employees and is there a trend in those that choose defined contributions? What has the budget impact been to Montgomery County?

   Comprehensive information regarding the transition of the Montgomery County retirement program to a hybrid model is not publicly available at this time. However, we had an informal conversation with one of our contacts at Montgomery County. Here is what we learned:

   Montgomery County Government transitioned to a DC plan in 1994. Our contact indicated that the number of actives still in the old DB plan is a relatively small group, after 17 years not surprising, so there must have been some kind of grandfathering or choice done at the time of the transition. Our contact was not certain about the budget impact since the contact was not employed by Montgomery County at the time of the change, but they have been told that there have been savings with this conversion to DC.

Then, in 2006, Montgomery County (for some unstated reason but perhaps in response to a union request) added a cash balance option and actives were given a choice (and new hires are given a choice) of which plan to be in – DC or cash balance. For the most part, the employer contribution is the same (8%, although our contact said for a few years lately the cash balance has been 6% but that went back to 8% recently). In the cash balance plan, there is a guaranteed investment rate of 7.25%. Our contact said that the older employees (like our contact, and several of the Council members) have elected the cash balance plan for the more secure, predictable income from the hybrid DB. Our contact said for those employees who had a choice, about 25% (1,000) elected the cash balance plan—the rest are in the DC plan.

Our contact surmised that the union is going to put a proposal on the table for more of a DB approach to retirement income delivery. The union goal is to get back to the traditional DB plan; and our contact thinks some Council members may support the idea.

We've included below a link to a memorandum dated May 3, 2011 and associated materials which provide some insights into Montgomery County's current budget considerations and also includes an article discussing the relative merits of defined contribution and defined benefit plans in a public employer setting:

http://www.montgomerycountymd.gov/content/councli/pdf/agenda/cm/2011/110505/20110505_GO1.pdf

Based on our review of the March 17, 2011 memorandum linked below, we estimate that about 22% of the employees with a choice of DC or cash balance chose cash balance. That's about in line with our contact's comment on participation in the cash balance plan when given a choice. Montgomery County public safety employees are still covered under a DB approach and there are some employees remaining from before the 1994 transition. Overall, approximately 11% of county employees are in the cash balance plan, 37% covered under a DC approach and 52% covered under a DB approach.

http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/3-17-11AdditionalInformationaboutCurrentRetirementBenefits.pdf

5. Are there any recent surveys on the importance of recent college graduates looking for jobs on the importance of pensions in their job search?

While there are many studies available regarding factors considered by applicants of many demographic cross-sections in accepting jobs, there are not many that specifically provide rankings of those factors that include pension programs as opposed to more general retirement programs. In today's tougher job climate,virtually all surveys support the conclusion that the most important factor in making a decision to take a particular job is the starting salary for that job. Particularly for recent college graduates, pensions are not an important factor and logically they should not be, since the value of the accruing pension is minimal for young people in the early stages of their career.

For older and mid-career employees, pensions are a more important factor. Interestingly the Federal government does a periodic survey on the importance of benefits to existing employees and new hires. The last survey we were able to find was completed in 2006. The results of that survey are at http://www.opm.gov/surveys/results/Benefits/2006/importance_2006.asp. Pension benefits in general ranked very high in importance. Defined benefit plans were ranked Somewhat Important or higher by 96% of new employees and 99% of current employees. The results for defined contribution benefits were similar. Defined contribution benefits were ranked Somewhat Important or higher by 98% of new employees and 97% of current employees.

It is logical to assume that the importance of benefits may rank higher for Federal employment decisions among both new hires and current employees than would be the case in the private sector, since as our report indicated the combined defined benefit and defined contribution plans available to Federal workers are among the highest values in all the retirement plans we included for comparison purposes in that report.

6. For the prospective applicant pool for open positions where does defined benefit pension benefit fall in importance? How important is it in their employment decision compared to the other factors – salary, leave, health insurance, etc?

   From the government survey noted above, for new employees, the defined benefit pension plan was ranked as Important or Very Important by 89% of respondents, actually putting it above health benefits, retiree health and life insurance programs and just below the defined contribution plan.

7. How important is the pension plan in retention of current employees? Where was data obtained?

   The Federal government survey noted above also examines the data for current employees. Pension benefits in general ranked very high in importance. Defined benefit plans were ranked Somewhat Important or higher by 96% of new employees and 99% of current employees. Defined contribution benefits were ranked Somewhat Important or higher by 98% of new employees and 97% of current employees.

We would also point to the studies cited previously in this Q&A that have provided data demonstrating the high level of importance placed by public sector employees on defined benefit pension plans offered by their employers.

For Fairfax County employees specifically, we are told that no statistics are currently available on the importance of pension benefits in retention.

8. Please more fully describe the defined contribution plans in Richmond and Charlottesville. What is the feedback from the HR departments there on hiring and retention of employees? What % of employees are choosing the defined contribution plan vs. defined benefit plan? Other relevant details from the experience of these two cities?

The report contains some information on the Richmond plan. We have no direct information about the current employee satisfaction with the plan or how it is performing as an employee attraction/retention tool. We would be happy to contact the HR departments in Richmond and/or Charlottesville with authorization from the County.

The City of Richmond had a brief period in 2004, 2005 and 2006 when existing and/or new employees had a plan choice. Since July 1, 2006 new general employees have been required to participate in the defined contribution plan. The DC plan has employer contributions that vary between 5% and 10% depending on employees' service level. Sworn Public Safety employees participate in the DC plan at their option. According to the system's consolidated annual financial report as of June 30, 2011, among active public safety employees, there were 988 members in the DB plan and 59 in the DC plan.

For Charlottesville, the following is from a 2008 report:

All new hires are given a one-time option to choose either the City Plan or the DC plan when they are hired. Under the DC plan, the City will make a contribution of 8% of the electing employee's base salary to their account, which is administered by a third party. DC plan contributions vest ratably over a three-year period. Employees determine how their account balance is invested from a range of available options. At June 30, 2008, there were 227 employees … enrolled in the DC plan.

There were 728 employees in the defined benefit plan. See Page 68 of

http://www.google.com/url?q=https://www.charlottesville.org/modules/ShowDocument.aspx%3Fdocumentid%3D12455&sa=U&ei=D_cvT5i9L8KcgweUmtztDw&ved=0CBIQFjAH&client=internal-uds-cse&usg=AFQjCNHnIxtVX_SRsGPWV6gRaN1hBAmM0Q

Question #9
Has the County Attorney determined that we cannot offer a defined contribution plan as an option? Basis?

With respect to whether the County has the authority to adopt a defined contribution retirement system, there is no case law on the issue. It is purely a matter of statutory construction of Virginia law. Va. Code Ann. Section 51.1-800 requires counties, cities, and towns with a population of over 5,000 to provide for the retirement of their employees. They have two choices: one, they can join VRS (which is what most jurisdictions do), or two, they can establish their own local retirement system. If they elect the latter, the local system must provide a benefit at retirement age that is at least two-thirds of the benefit that an employee would receive under VRS. Va. Code Ann. Section 51.1-801 permits any county, city, or town (there is no population limit stated), by ordinance, to establish a retirement system for their employees. (Note: this section also permits a locality to join VRS and to create a separate, supplemental retirement system in addition to VRS. The Educational Employees' Supplemental Retirement System is an example.)

None of these sections uses the terms defined benefit or defined contribution plan. However, the clear implication of the language is that a local plan intended to satisfy the requirements of Va. Code Ann. Section 51.1-800 must be a defined benefit plan, because the comparator is a defined benefit plan. Regardless, as a practical matter, as was discussed in the briefing on the retirement study's findings, there is no way that a defined contribution plan, by its very nature, can satisfy the two-thirds requirement, unless provision is made for a supplement to the payout to the retiree to bring it up to that level, if the pay out from the plan is less than that.

Under the urban executive county form, there is a statute, Va. Code Ann. Section 15.2-849(A)(7) (2008), which authorizes the Board of Supervisors, *inter alia*, to provide systems of retirement for all or any classes of officers and employees of the County but the adoption of the urban county executive form shall in no way affect any retirement system in effect prior to the adoption of the form. One could argue that "systems of retirement" is broad enough to include both defined benefit and defined contribution plans, but construing all of the statutes concerning local retirement together and taking into account the language "for all or any classes of officers and employees", the best construction is that this is intended to allow the creation of separate systems for different classes of employees, such as the County ultimately did with the creation of the Uniformed Retirement System.

There are two bills that were introduced to provide the option for localities of offering an alternative defined contribution plan, HB 257, and SB 506. SB 506 was stricken at the request of the patron (Wagner) on February 8, 2012, in the Senate Finance Committee. HB 257 (Stolle) is still pending in the House Appropriations Committee. However, the subcommittee to which it was assigned has recommended that it be laid on the table on February 9, 2012. If the full committee agrees, the bill will be effectively dead. A couple of points about the bills: First, the very fact that they have been introduced supports the argument that the current statutes do not authorize a defined contribution plan. Second, the bills include a provision permitting a locality that adopts such a plan to switch back to a defined benefit plan. Third, there is an impact statement that is accessible through the Legislative Information System, which discusses the effects and possible consequences of switching from a defined benefit to a defined contribution plan. In short, this analysis shows that any costs savings will only occur in the future and a defined contribution plan will incur other additional costs.

As far as the legal aspects go, because state law is the determinative factor, what other states do is irrelevant to whether the County has the authority to do something similar. With respect to Richmond and Charlottesville, for a variety of reasons the fact that one Virginia locality is doing something is not necessarily determinative of whether another may do so, particularly in the case of cities and towns, as opposed to counties. Cities and towns, in addition to general law, are governed by charters, which may contain authority not found in the general statutes. The Virginia Code is full of examples where particular jurisdictions or particular classes of jurisdiction may do things that others may not. Finally, except in the rare instances where the Attorney General decides to act, e.g., in the case of collective bargaining in the 1070's. or in the case of Arlington County's health plan in the 2000's, there is no entity specifically designated to check on compliance with state law. Somebody with standing (i.e., who has been specifically injured by a challenged action or policy) has to bring suit. The City of Richmond relied on a provision in its charter for the authority to enact retirement plans, rather than Va. Code Ann. Section 51.1-801. Participation in its defined contribution plan is mandatory for new non-public safety employees. However, public safety employees, police and fire, have the option of either joining the legacy defined benefit plan or the new defined contribution plan. The defined contribution plan in Charlottesville is optional; employees may join either the defined contribution or defined benefit plan when hired.

Questions (from Supervisor Cook):

Assuming no changes to current policy are made, provide a financial analysis that demonstrates when we could expect the funding level of our three retirement systems to return to the 90% corridor. Assuming the rule of 80 is adjusted to a rule of 85 (for new hires only), how does that timeline change?

Response:

Cheiron, the actuary to all three County retirement systems, has addressed this question in the drafts of the most current (FY 2011) actuarial valuation reports (AVRs), which have been approved by each system's Board of Trustees. (Cheiron will provide the final reports by the end of March.) For purposes of their analyses, Cheiron assumes that all actuarial assumptions remain constant, and that no ordinance changes are made. The AVRs indicate that as of July 1, 2011, the three systems have the following funded ratios: The Employees' Retirement System (ERS) = 70.7%; the Police Officers Retirement System (PORS) = 80.5%; and the Uniformed Retirement System (URS) = 77.7%. (Note that this response refers only to the "raw" funded ratios; under the County's approved funding method, the adjusted "corridor" ratios are somewhat higher.)

In this period of high market volatility and very low interest rates, it would be easy to conclude that the systems' future investment returns will be constrained. Yet, over the long term, all three systems have handily beaten their 7.5% assumed annual rate of return on investments. The Aon study observed that "Investment performance (of the three systems) was determined to be among the leaders nationwide." For example, during the past two fiscal years the largest fund (ERS) experienced returns of 25.2% (FY 2010) and 23.6% (FY 2011). For this reason, in the AVRs, Cheiron projects investment returns over the next 15 years based on the average annual returns that each system has earned since 1980 (ERS = 10.41%; PORS = 10.32%; and URS = 9.58%) This time period includes the "bursting of the tech bubble" and the financial crisis, among other challenges.

Because investment returns can vary significantly from year to year, Cheiron makes its projections using different scenarios, e.g., if the systems experience poor returns early, if the systems experience favorable returns early. Based on these various scenarios, Cheiron's projections show all three of the systems surpassing the 90% funded level by as early as 2014 and as late as 2019. Of course, no one can predict what future returns will be; if the systems' returns are significantly less than they have been in the past, attainment of a 90% funded level could take longer.

It is important to note that during the period when all three systems are approaching and surpassing a 90% funded ratio, Cheiron projects a decline in the required employer contribution rates. If, on the other hand, the County contributions rates were held fixed at their current levels, each system is projected to reach the 90% funded level more quickly.

With regard to the second question, currently, members of the Employees' Retirement System (ERS) become eligible for normal retirement at age 65 with 5 years of eligibility service or at age 50 or older when age plus eligibility service totals 80 or more (i.e. the "rule of 80"). If the rule of 80 is changed to a rule of 85 for new hires (only), it would have no impact on the above projections. Savings that the ERS experienced as the result of such a change would occur well after the system exceeded a 90% funded ratio.

The Police Officers and Uniformed Retirement Systems do not employ a rule of 80; rather, normal retirement eligibility is based on age and/or years of creditable service.