

SECTOR COMMENT

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Virginia Pension Reforms Are Credit Positive

From [Weekly Credit Outlook](#)

Last Monday, Virginia Governor Robert McDonnell signed legislation that makes several changes to the Virginia Retirement System (VRS), which the state estimates will reduce its pension contributions by \$3.6 billion over the next 21 years. The changes build on reforms the Commonwealth of Virginia (Aaa negative) enacted in 2010 and 2011 and put it on a more sustainable path to fully funding its pension commitments, which is credit positive. Virginia's legislation also reflects an ongoing trend among states to find flexibilities in their retirement systems to rein in their long-term liabilities.

The Virginia legislation establishes a hybrid pension/401(k)-style contribution plan for new state and local employees and reduces benefits for unvested state employees. In addition to lower annual employer contributions, the measures affecting pensions lower total unfunded liabilities for state and local employee plans by nearly \$9 billion by 2031.

State and local employees in the new hybrid plan will pay 4% of their salaries toward the pension defined benefit component and 1% of their salaries into the defined contribution component of the plan. Employers will pay a mandatory 1% to the defined contribution component, and will match up to 3.5% for employees who make the maximum allowable contributions of 9% of salary. The hybrid retirement plan will be mandatory for new state and local government employees beginning 1 January 2014, except for police, firefighters and other public safety first responders. Current employees will have the option to join the new hybrid plan.

In the new law, cost of living adjustments (COLA) for employees with fewer than 20 years of service who retire early are deferred until their normal retirement date. For non-vested employees and new employees starting on 1 January 2013, the reform caps COLAs at 3% per year and slightly reduces the formula used to set the pension amount (except for public safety employees). Average final compensation for all employees will be calculated based on the highest 60 months of salary, rather than the current 36 months.

The governor has also made amendments to companion pension legislation that the legislature will consider on 18 April. It includes a requirement that local government employees contribute 5% of their salaries toward retirement. The mandatory contribution is offset by a pay raise from the localities, which can phase-in the requirement and the pay raise over five years.

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Which retirement benefits enjoy absolute legal protection and which may be amended is an issue to be determined by individual state courts. In recent months, courts in Arizona, Florida, and New Hampshire have ruled that the respective states cannot implement certain benefit changes affecting current employees, although in each case these initial decisions are being appealed. At the same time, courts in Colorado and Minnesota have ruled that the states may make certain changes affecting current employees and retirees. New York, on the other hand, recently enacted legislation reducing pension benefits only for new employees hired after 1 April 2012.

A March 2012 study by the US Government Accountability Office found that since 2008 at least 18 states have passed legislation affecting COLAs and 38 states have enacted legislation altering other aspects of current, future or retired employee pension benefits. In 2011 alone, 17 states enacted cost-saving legislation affecting current employees or retirees, as summarized in the exhibit below.

States Enacting Pension Changes in 2011 Affecting Current Employees and/or Retirees

Reduced or Eliminated COLAs	Increased Employee Contributions	Reduced Benefit Formula	Raised Retirement Age or Increased Service Requirements
Arizona	Alabama	Nebraska	Maine
Florida	Arizona	New Hampshire	North Dakota
Maine	Colorado		
Maryland	Florida		
New Jersey	Kansas		
Oklahoma	Maryland		
Washington	Nebraska		
	New Hampshire		
	New Jersey		
	New Mexico		
	North Dakota		
	Texas		
	Wisconsin		
	Virginia		

Source: Survey by National Conference of State Legislatures (plus Virginia changes enacted in 2011 after the NCSL survey)

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