

Virginia Retirement System 2017 Fiscal Impact Statement

1. **Bill Number:** SB 1181

House of Origin	<input checked="" type="checkbox"/>	Introduced	<input type="checkbox"/>	Substitute	<input type="checkbox"/>	Engrossed
Second House	<input type="checkbox"/>	In Committee	<input type="checkbox"/>	Substitute	<input type="checkbox"/>	Enrolled

2. **Patron:** Reeves

3. **Committee:** Finance

4. **Title:** Virginia Retirement System; return to employment by retired public safety employees.

5. **Summary:** Authorizes a person who is retired from a position covered under the Line of Duty Act and receiving a service retirement allowance to continue to receive such retirement allowance if rehired in a position covered for retirement purposes. The bill provides that such new employment does not affect the person's retirement benefit and that such employee is not eligible to participate in the cash match plan, the group life insurance program, or the sickness and disability program.

6. **Budget Amendment Necessary:** Yes. Item 489. VRS estimates implementation costs at \$248,650 with no additional ongoing costs. Programming will be required to allow retirees who return to work under the provisions of this bill to have access to myVRS for active employees. Merging certain characteristics of active employees and retirees in the same member is a significant departure from the current system structure. If a similar bill, SB 881, passes, certain programming costs can be allocated between both bills. There will also be impacts in VRS' modernization program, which, among other initiatives, will migrate from a mainframe-based system to a client server environment, but the cost of the delay cannot be calculated at this time.

7. **Fiscal Impact Estimates:** Allowing a VRS retiree to return to work and be actively employed while continuing to receive a retirement allowance would impact both retirement and other post-employment benefits (OPEB) plans. Additional detail on cost implications can be found in Item 8 below.

8. **Fiscal Implications:** Under the proposed legislation, a member who has retired from a position covered under the Line of Duty Act, §§ 9.1-400 et seq. of the *Code of Virginia*, could elect to retire from VRS but continue to work in a VRS-covered position and continue to receive a retirement benefit (i.e., an in-service distribution). The member would not receive any future benefit accruals while working and would, therefore, not be required to make member contributions to the plan. Members electing the in-service distribution would be considered retired for retirement, group life, health insurance credit, VSDP and/or VLDP benefits. The member would be eligible to receive cost-of-living increases on the service retirement benefit while receiving the in-service distribution.

Members covered under LODA or re-employed retirees in LODA-covered positions would still be covered by LODA and would, therefore, be considered “active” employees requiring active premiums to be paid to the LODA Fund, if applicable. This means that the provisions of SB 1181 would not impact the premium levels of the LODA fund.

SB 1181 is expected to provide an incentive to members to take an in-service distribution and continue working since they can receive a retirement benefit as well as receiving pay. It is anticipated that the incentive to take the in-service distribution will be greater for members eligible for unreduced retirement at age 62. Therefore, for purposes of generating the estimated cost impact, the retirement rates were increased as follows:

- For members with hazardous duty benefits coverage we have assumed 100% will opt for in-service distribution at age 62 or above.

The use of “covered under the Line of Duty Act” as a definition for eligibility does not easily lend itself to the retirement plan valuation process since the Line of Duty Act is not a retirement plan or benefit tier. In order to estimate the impacts of SB 1181 on the VRS retirement plans, the results reflect the indicated change to all active members of VaLORS and SPORS, as well as those active members of political subdivisions identified as receiving enhanced hazardous duty benefits.

The proposed changes would have an impact on both the plan normal cost rate as well as an immediate impact on the accrued liability. The exhibit below shows that the estimated total increase in unfunded liability across all plans would be approximately \$33.5 million if the provisions of SB 1181 were enacted.

Exhibit 1

Impact on Actuarial Accrued Liabilities of Retirement Plans

Plan	6/30/2016 Valuation Results	Senate Bill 1181	Increase in Unfunded Liability
SPORS	\$1,080,980,000	\$1,081,139,000	\$159,000
VaLORS	\$748,767,000	\$753,633,000	\$4,866,000
Political Subdivisions - Aggregate Results	\$20,659,120,000	\$20,687,564,000	\$28,444,000
Total	\$22,488,867,000	\$22,522,336,000	\$33,469,000

Under the current plan provisions, the normal retirement age for most members covered under LODA is age 60. While this is the assumed normal retirement age, plan experience has shown that not everyone retires by age 60 and many work beyond normal retirement eligibility. Exhibit 2 below shows the current assumed rates of retirements for hazardous duty members for age 60 and above.

Exhibit 2

Assumed Number of Retirements - Hazardous Duty

Age	Less than 25 Years of Service	25 or More Years of Service
60	25%	40%
61	35%	40%
62	50%	100%
63	50%	
64	100%	

Current plan experience shows that approximately 50% of members with less than 25 years of service retire beginning at age 62 while 100% of those with 25 or more years of service are expected to retire. Adding the provisions of SB 1181 would suggest that the percentage assumed to retire at ages 62 and above should be increased to 100%.

Exhibit 3 shows the number of active plan members who will be age 62 and meet the eligibility for retirement as of June 30, 2017 as well as the number of expected members meeting those requirements within the next five years.

Exhibit 3

Eligible for Unreduced Retirement at age 62

Plan	As of June 30, 2017	Within next 5 years
SPORS	51	135
VaLORS	294	767
Political Subdivisions Hazardous Duty Members	439	1,269
Total	784	2,171

The increase in liability is due to both anticipated retirements from current members already eligible to retire plus anticipated future retirements occurring earlier than expected.

Exhibit 4 below shows the combined cost impacts to both retirement and OPEB plans assuming SB 1181 were enacted effective July 1, 2017. The increase in costs reflects the increase in normal cost rates as well as an additional rate to pay down the increase in the unfunded liabilities associated with this bill over the next 20 years.

Exhibit 4

	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY2023</u>
State - General Fund	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
SPORS - General Fund	\$ 136,000	\$ 136,000	\$ 136,000	\$ 136,000	\$ 136,000	\$ 136,000
VaLORS - General Fund	\$ 126,000	\$ 126,000	\$ 126,000	\$ 126,000	\$ 126,000	\$ 126,000
JRS - General Fund	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Teacher - General Fund	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
TOTAL General Fund	\$ 262,000					
State - Non-General Funds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
SPORS - Non-General Funds	-	-	-	-	-	-
VaLORS - Non-General Funds	12,000	12,000	12,000	12,000	12,000	12,000
TOTAL - Non-General Funds	\$ 36,000					
Teacher - Local Funds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Political Subdivisions - Local Funds	\$ 1,874,000	\$ 1,874,000	\$ 1,874,000	\$ 1,874,000	\$ 1,874,000	\$ 1,874,000
TOTAL Local Funds	\$ 1,874,000					
Grand Totals	\$ 2,172,000					

Estimated projections based on employee data and valuation results as of June 30, 2016 and assume a level population throughout projection period.

Payroll projections are assumed to remain level throughout projection period.

9. Specific Agency or Political Subdivisions Affected: VRS, state agencies, and all local VRS-participating employers.

10. Technical Amendment Necessary: Yes. SB 1181, as written, would jeopardize plan qualification for VRS because there is no age threshold on the retiree’s ability to return to covered employment and continue to receive his or her retirement allowance. See further discussion in “Other Comments.” It is possible under SB 1181 for a retiree under the age of 62 to take an in-service distribution in violation of Internal Revenue Code provisions and relevant Treasury Regulations governing qualified pension plans. VRS requests a delayed effective date to January 1, 2018 to allow time for programming necessary to implement the provisions of SB 1181.

11. Other Comments: VRS is a governmental retirement plan that must comply with certain provisions of the Internal Revenue Code (“IRC”) in order to maintain its status as a qualified plan for federal tax purposes. The federal Pension Protection Act of 2006 added IRC § 401(a)(36), which provides that a pension plan shall not be disqualified solely because it permits an in-service distribution to an employee who is age 62 or older and who is not separated from employment at the time. This language allows, but does not require, a qualified pension plan such as VRS to permit in-service distributions for those age 62 and older. In general, in-service distributions to retirees younger than age 62 who return to work full time in a covered position would violate the IRC and jeopardize VRS’ qualified status.

Currently, the *Code of Virginia* does not permit a VRS-covered employee to receive a VRS retirement allowance while working in a VRS-covered position, except in limited circumstances set out in § 51.1-155(B). Currently, in order to begin receiving a retirement

allowance, a VRS member must end VRS-covered employment for at least one full calendar month during a period he or she would otherwise be working (e.g., a teacher's calendar month break in service cannot take place over summer break). Once retired and collecting a retirement allowance, a retiree can only return to work for a VRS-participating employer while continuing to receive his or her retirement allowance if 1) there was a bona fide break in service, as described above; 2) there was no prearrangement between the employer and retiree to return to work; and 3) the work is not in a VRS-covered position (i.e., a permanent full-time, salaried position or certain permanent part-time, salaried positions). If a retiree returning to work does not satisfy these requirements, then § 51.1-155 of the *Code of Virginia* requires his or her retirement allowance to cease while so employed. In doing so, the retiree essentially "unretires" and begins accruing additional creditable service for each month worked.

When the person subsequently ends VRS-covered employment again, the person "re-retires" and his or her retirement allowance is recalculated to include additional creditable service earned. However, cost-of-living adjustments ("COLAs") applied to the retirement allowance during the first retirement will not be carried over into the second retirement.

If enacted, SB 1181 would allow VRS retirees of any age to return to work in a VRS covered position and keep collecting a retirement allowance in addition to his or her salary. SB 1181, as written, would jeopardize plan qualification for VRS because there is no age threshold on the retiree's ability to return to covered employment and continue to receive his or her retirement allowance. It is possible under SB 1181 for a retiree under the age of 62 to take an in-service distribution in violation of IRC provisions and relevant Treasury Regulations governing qualified pension plans.

SB 1181 also removes eligibility for any benefits under the following chapters from a retiree who returns to work under the provisions of the bill: Chapter 5 (Group Life Insurance); Chapter 6.1 (Cash Match Plan); Chapter 11 (State Sickness and Disability Program); and Chapter 11.1 (Disability Program for Hybrid Retirement Program Participants).

Under SB 1181, neither employer nor employee contributions would be required, but retirees who return to work under this provision would not be able to increase, decrease, or affect in any way their retirement benefits as a result of returning to work.

Unlike SB 881, which requires employer contributions to be made for retirees who return to work, this legislation does not require contributions. Even if employer contributions were required, they would not fully account for the impact to the Trust Fund of changing retirement patterns resulting in the Fund paying more years of retirement benefits than had been assumed in calculating contributions. The lack of employer contributions, however, exacerbates this impact. See Exhibit 1, which shows an increase in unfunded liability of \$33.5 million.

To illustrate, a person might have stayed actively employed until age 65 (when he/she would become eligible for Medicare). However, under the provisions of this bill, the person retires earlier. As a result, the VRS Trust Fund will pay benefits longer than it otherwise would

have. Plan assumptions have been developed and are subsequently modified based on actual experience versus that which has been assumed. Contribution rates developed did not anticipate an earlier retirement, particularly when data and trends have indicated that members have actually been working longer or retiring at later ages. This legislation will likely result in the system paying retirement benefits for longer periods of time than anticipated.

While it may be viewed as a mechanism to retain skilled and experienced workers, there is currently an existing method that does not impact the Trust with the same magnitude. As explained earlier, retirees can return to work on a part-time basis if they meet the return to work requirements.

It should be noted that if a VRS member retires based on disability (for those who are eligible for disability retirement) and returns to work in a VRS covered position, § 51.1-160 of the *Code of Virginia* provides that his or her disability retirement allowance shall cease. Therefore, a disability retiree would not be able to take advantage of the provisions of this bill and still receive a disability retirement allowance. A VRS member who is on long-term disability under the Virginia Sickness and Disability Program (VSDP) or the Virginia Local Disability Program (VLDP) or a comparable plan would also not be able to continue receiving LTD benefits if he or she were to return to a VRS covered position pursuant to §§ 51.1-1112(F) and 51.1-1157(D), respectively. Likewise, a Line of Duty Act (LODA) beneficiary who is receiving LODA benefits based on a disability determination would not be able to continue receiving LODA benefits (health insurance coverage) if he or she returns to a position listed in § 9.1-400 of the *Code of Virginia*.

Affordable Care Act Implications

There are unknown Affordable Care Act (ACA) implications associated with this legislation. The ACA requires an employer to offer health insurance to any employee who works an average of 30 hours or more per week over the course of a year. This rule presents a number of scenarios in which ACA implications are unknown.

For example, assume that an individual has already retired from VRS-covered employment and that when the individual retired, he or she elected to participate in the State Retiree Health Benefits Program. Upon return to VRS-covered employment, SB 1181 would permit the individual to continue collecting the monthly VRS retirement allowance, even if working in a VRS-covered position. On the health insurance front, however, the ACA would require that the VRS-participating employer offer the individual health insurance. It is unknown whether 1) the individual could continue to participate in the State Retiree Health Benefits Program while an active employee and, if so, 2) whether such retiree coverage would satisfy the ACA's "offer" requirement.

If the retiree coverage does not satisfy the "offer" requirement, a retiree returning to VRS-covered employment (especially with a state agency) would have the option of employer-provided, subsidized health insurance versus the State Retiree Health Benefits Program, and the retiree would most likely select the subsidized insurance at a lower price. This situation

would, in essence, create a new status of employee—a retired/active employee who is drawing a retirement benefit but has certain benefits (i.e., health insurance) enjoyed by active employees. Moreover, for each retiree who elects the active employee health insurance coverage there would be a corresponding increase in the subsidy. Finally, if a retiree does elect the active employee health insurance coverage, in lieu of the State Retiree Health Benefits Program, it is possible that the retiree would not be eligible to return to coverage under the State Retiree Health Benefits Program when the retiree terminates VRS-covered employment.

In contrast, under current state policy, an employee may retire and return to a wage job as long as he or she works for less than 30 hours per week on average during the ACA look-back measurement period.

Other scenarios present similarly unknown issues related to ACA requirements.

This bill is similar to SB 881, which also allows a VRS retiree to work in a VRS-covered position while collecting a monthly retirement allowance. SB 881, however, is limited to anyone age 62 or older, including those who did not retire from a LODA-covered position. SB 881 also requires the employer to make contributions based on the retiree's salary.

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