Virginia Retirement System
2020 Fiscal Impact Statement

1. **Bill Number:** HB 1029

House of Origin	☒	Introduced	☐ Substitute	☐	Engrossed
Second House	☐	In Committee	☐ Substitute	☐	Enrolled

2. **Patron:** L. Adams

3. **Committee:** Appropriations

4. **Title:** Early retirement; constitutional officers.

5. **Summary:** Provides that in certain circumstances a constitutional officer shall be eligible for the normal retirement allowance without requiring that such individual have 20 or more years of creditable service at the date of separation. The bill applies to a constitutional officer who (i) is involuntary separated from service because their office was lawfully abolished, as a result of their city reverting to town status, and (ii) is serving in such office at the time of reversion.

6. **Budget Amendment Necessary**: As stand-alone legislation, VRS considers implementation of this bill as "routine," and does not require additional funding. As a matter of course, the agency will review all legislation likely to be enacted prior to the passage by each chamber. If the aggregate number of "routine" bills likely to pass either chamber is unusually large or complex, it is possible that the agency will require authorization to expend additional non-general fund resources. If so, VRS will identify the costs and request such resources at that time. This does not include impact to current or future contribution rates or to the funded status of the plans, which are discussed below.

7. **Fiscal Impact Estimates:** See Item 8 below for a discussion of the fiscal implications.

8. **Fiscal Implications:** The proposed legislation would apply the provisions of § 51.1-155.1(C) to a constitutional officer in a city at the time the city reverts to town status regardless of the constitutional officer's vested status, age, retirement plan designation, or number of years of service at the time of reversion. Currently, that Code subsection applies to a constitutional officer who is involuntarily separated from service because his or her office is lawfully abolished and has 20 or more years of creditable service at the date of separation. That person may retire with an unreduced retirement allowance upon attaining age 50 if he or she is a Plan 1 member, or at age 60 if he or she is a Plan 2 member or Hybrid Plan member.

   An unreduced retirement allowance is calculated using the following formula: average final compensation times the appropriate retirement multiplier times total years of service credit at retirement equals the annual unreduced retirement allowance. A reduction factor is normally applied to the retirement allowance if the person retires prior to normal retirement age and does not have (i) 30 or more years of creditable service if he or she is a Plan 1 member or (ii)

a combination of age and service totaling 90 or more if he or she is a Plan 2 member or Hybrid plan member. The provisions of § 51.1-155.1(C) allow an affected constitutional officer to retire with an unreduced retirement allowance if he or she has at least 20 years of service, upon attaining the applicable age.

The proposed legislation eliminates the requirement that the constitutional officer have 20 or more years of creditable service at the time his or her office is lawfully abolished (when a city reverts to town status, the city's constitutional offices are abolished) in order to receive an unreduced retirement allowance.

There are 38 independent cities in Virginia, and there are five constitutional officers established under Article VII, § 4 of the Constitution of Virginia. Therefore, the maximum number of constitutional officers that could be affected by a city's reversion to town status is 190. Since 1995, three cities have reverted to town status (South Boston, Clifton Forge, and Bedford), and the City of Martinsville started the process to revert in 2019.

Because the process of a city reverting to town status is relatively rare, the overall fiscal implications of the proposed legislation are not readily quantifiable. For example, if a city reverted to town status and, notwithstanding § 51.1-155.1(C), all five of the constitutional officers were eligible for an unreduced retirement allowance, then the fiscal implications of the proposed legislation would be zero with respect to that reversion. On the other hand, if a city reverted to town status and all five constitutional officers had less than 20 years of creditable service, the fiscal implications could be substantial and material depending on the status of the former city's retirement plan that retains the liability for the affected constitutional officers who would be receiving unreduced retirement allowances.

In addition, constitutional officers may qualify for a health insurance credit (HIC) if they have at least 15 years of creditable service. Commencing the HIC benefit earlier than anticipated would also generate a loss to the Health Insurance Credit Program for Constitutional Officers, which is funded by the State. The magnitude of the impacts would be dependent on the number of members eligible and electing to commence benefits earlier than expected.

9. **Specific Agency or Political Subdivisions Affected:** VRS and any VRS employer that is a city reverting to town status.

10. **Technical Amendment Necessary:** Yes. The language "regardless of the age or number of years of creditable service of the member at the time of the entry of the order of reversion" means that the VRS member could receive a retirement allowance without vesting to such an allowance (i.e., prior to the member having at least five years of creditable service before he or she is ordinarily eligible to draw a retirement allowance).

    The concept of vesting is central to the administration of pension benefits. To ensure consistency with applicable federal law and other provisions of the *Code of Virginia* with respect to eligibility for a retirement allowance, cost of living allowance, group life insurance and other benefits, the language in the previous paragraph should be amended to read, ". . .

~~regardless of the age or number of~~ *provided the member is at least age 50 and has at least five* years of creditable service ~~of the member~~ at the time of the entry of the order of reversion."

External benefits counsel advises that the provision contain a minimum age requirement to avoid potential compliance issues with applicable U.S. Department of Treasury regulations. The technical amendment suggested above would result in an eligible constitutional officer needing to be at least age 50, regardless of plan designation, in order to take advantage of the early unreduced benefit under § 51.1-155.1. While the IRC does not specifically define minimum age for this purpose, VRS specified age 50 as the minimum age for this requirement, because it is consistent with other provisions in Title 51.1.

11. Other Comments:

Background

Subsection C of § 51.1-155.1 was added in 2011 to permit any constitutional officer who has 20 or more years of creditable service, and whose office is abolished, to retire with unreduced benefits (i) at the age of 60 if the officer is first elected to office after July 1, 2010, and (ii) at the age of 50 for all others.

This bill would allow any constitutional officer, regardless of age, years of service or vested status, to retire with a lifetime benefit if the city she or he represents reverts to town status. While reversions are not a common occurrence, allowing members to retire with an unreduced benefit prior to age 50 (or age 60 for Plan 2 and Hybrid retirement plan members) with at least 20 years of service is a departure from current provisions, and could negatively impact the funded status of the local plan.

Allowing a member to receive a lifetime retirement benefit without vesting would impact numerous other sections of Title 51.1, which assume that a member must in general have at least 60 months of service in order to vest to retirement and other benefits. VRS is concerned that the proposed legislation would create a negative precedent with respect to early retirement for constitutional officers of a city that is reverting to town status since they would be treated in a different manner than other constitutional officers and other positions outlined elsewhere in § 51.1-155.1. Further, benefits counsel advises that in order to ensure IRC compliance, minimum age and service provisions should be established for the receipt of distributions from the defined benefit plan.

Another consideration related to vesting is that the bill does not appear to accelerate vesting to any employer matching funds in a defined contribution plan, such as the Hybrid Retirement Plan. If a constitutional officer participating in the Hybrid Retirement Plan retired pursuant to HB 1029's provisions, then he or she would not necessarily be fully vested to the employer contributions within the Hybrid Plan without the requisite number of years of service (i.e., four years for 100% vesting to the employer contributions).

Early Distribution Penalty

After reviewing HB 1029, external benefits counsel opined that members who are not yet age 59 ½ who retire under the provisions of this bill may be subject to 10% early distribution penalties imposed by the IRS. Assuming that a person who retires under this bill has a bona fide separation from service, the early distribution penalty does not appear to apply to the pension (defined benefit) portion of the retiree's benefit. However, the penalty may apply to a retiree's defined contribution plan distribution if taken before age 59½.

IRC § 415(b) Limit

Internal Revenue Code § 415(b)(2)(C) provides that a plan shall not be considered qualified if it provides for the payment of a defined benefit that exceeds the limitation amount ($230,000 for 2020). This limit is reduced in the case of individuals who commence their benefit before age 62. This reduction is substantial. For example, the annual defined benefit for most individuals who retire in 2020 at age 40 would be limited to $57,097.

Bona Fide Separation from Service

The IRS requires that all retirees must have a bona fide separation from service before becoming eligible for a distribution. This means that a constitutional officer whose position was eliminated could not take advantage of HB 1029's provisions if he or she returned to service with the same employer before having a bona fide separation from service. With a few exceptions unrelated to this bill, VRS generally requires a separation of at least one full calendar month (e.g., a separation date of February 15th results in a bona fide separation from service having occurred on April 1st) prior to returning to work on a part-time basis for the same employer in any capacity. In addition, there cannot be a prearrangement to return to work, which the IRS would not consider to be a bona fide separation from service.

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