

Virginia Retirement System 2020 Fiscal Impact Statement

1. **Bill Number:** SB 671-E

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

2. **Patron:** Mason

3. **Committee:** Finance and Appropriations

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

5. **Summary:** Provides that a political subdivision participating in the Virginia Retirement System may employ up to two retirees at a time to return to work in full-time positions. Such employees may receive their service retirement allowance during the subsequent period of employment provided that there was a bona fide break in service between retirement and employment in the full-time position and that there was no prearrangement for reemployment. The engrossed bill amends line 106 to specify that the bona fide break in service is one year. The engrossed bill also has an enactment clause requiring that an appropriation be included in the appropriation act in order for the bill to become effective.

6. **Budget Amendment Necessary:** Yes. Item 494. VRS estimates implementation costs for the bill at \$418,000 in FY 2020, with minimal ongoing costs in FY 2021 and beyond. This does not include the potential impact to current or future Teacher or local contribution rates or to the funded status of the Teacher or local plans, which are discussed below.

Programming will be required for employers to be able to enroll these retirees, to ensure that their retirement benefits are not suspended, and that service is not added to their records. This is similar to the current procedure for retirees in the teacher critical shortage program. There may also be impacts on VRS' continued modernization program, which, among other initiatives, has migrated from a mainframe-based system to a client server environment, but the cost and length of any delay cannot be calculated at this time.

7. **Fiscal Impact Estimates:** See fiscal implications in section 8 below for a detailed breakdown of estimated costs.

8. **Fiscal Implications:** Outside benefits counsel has confirmed that Internal Revenue Service (IRS) guidance allows specifically for a bona fide break in service with no prearrangement for re-employment, and the IRS makes the determination of whether there is a break in service using a facts and circumstances test. The IRS has not established a safe harbor severance period. IRS regulations under Internal Revenue Code (IRC) § 410, as cited in Private Letter Ruling 201147038, suggest that a one-year period without performing service might be considered a safe harbor.

VRS uses a one-year break in service for the teacher critical shortage program. In 2001, the Joint Legislative Audit and Review Commission (JLARC) adopted a resolution concurring with VRS regarding the minimum twelve month separation before a retiree could be rehired into a critical shortage position without loss of retirement benefits, consistent with the recommendation of the JLARC actuarial consultant.

Failure to meet the facts and circumstances test for a bona fide break in service could jeopardize VRS' plan qualification status, thereby affecting all members and retirees. Typically, individual retirees who return to work at more than 80% of a full-time position or are found not to have legitimately retired by completing the bona fide break in service must un-retain, with their retirement benefit ceasing, and the retirees must repay any benefit payments received since the time they returned to work. This may also affect eligibility for the State Retiree Health Plan administered by DHRM for state retirees or other retiree health insurance for local retirees.

The engrossed bill establishes a one-year break in service consistent with the teacher critical shortage program.

Currently, there are 593 political subdivisions that participate in VRS, which include but are not limited to counties, cities, towns, school divisions, sewer and water authorities, regional jails and regional libraries. Under the proposed legislation, all political subdivisions, including school divisions, would be allowed to hire in a full-time capacity up to two retirees at any given time. The retiree would have to serve a bona fide break in service before returning to work, and there cannot be a prearrangement for the return to work. VRS would use the one-year break in service period consistent with the existing teacher critical shortage program. Upon returning to work in the VRS-covered position, the retiree would not accrue additional VRS service credit, would not be eligible for increased benefits based on the post-retirement employment, and would not be eligible to receive any cash match contributions pursuant to Chapter 6.1 (§ 51.1-607 *et seq.*). If returning to work in a position that was similar to the retiree's pre-retirement position, the retiree could lose disability retirement benefits or Line of Duty Act benefits, as applicable.

VRS employer contribution rates are established as a percentage of an employer's VRS-covered payroll. When a position is removed from VRS coverage by a return-to-work exception or otherwise, there is a decrease in the funding of retirement benefits. In particular, legacy unfunded liabilities will not be paid off as expected. This bill requires that an employer include compensation paid to a retiree in its VRS-covered payroll for purposes of calculating employer retirement contributions, which helps to mitigate this impact.

Cost estimates are difficult to determine due to the broad nature of the bill and are heavily dependent on what plan the member retires from and which employer they return to work for after retirement. All school divisions will be impacted if any school division takes advantage of the bill since the Teacher plan is a cost-sharing pool. However, the impact to all other political subdivisions will depend on the unique circumstances of each political subdivision's plan, since political subdivision plans are individually rated and funded. The additional costs of earlier than expected retirements would be borne by the employers of the retiring members

through additional pension and, if applicable, health insurance credit payments paid over longer periods of time.

9. Specific Agency or Political Subdivisions Affected: VRS and all VRS-participating political subdivisions and school divisions.

10. Technical Amendment Necessary: No.

11. Other Comments:

Background

Currently, a VRS retiree cannot collect a VRS retirement benefit while simultaneously working full-time in a VRS-covered position absent specific statutory authority that is in compliance with applicable Internal Revenue Code provisions. There are limited exceptions to this rule under the *Code of Virginia*, such as retirees working in statutorily-defined critical shortage teaching positions. Most often, however, an individual working in a full-time position for a VRS-participating employer cannot simultaneously collect a VRS retirement benefit. In the case of a VRS retiree returning to work full-time in a VRS-covered position, the retiree must “unretire” and resume active VRS participation. When the individual chooses to subsequently retire again, VRS will recalculate the new retirement benefit to include the additional service credit earned.

Under the engrossed bill, all political subdivisions would be allowed to hire in a full-time capacity up to two retirees at any given time with no prearrangement. The retiree would have to serve a bona fide break in service of one year before returning to work. Upon returning to work in the VRS-covered position, the retiree would not accrue additional VRS service credit, would not be eligible for increased benefits based on the post-retirement employment, and would not be eligible to receive any cash match contributions pursuant to Chapter 6.1 (§ 51.1-607 *et seq.*). The employer would be required to pay contributions for these employees.

Return to work provisions are more typically focused on a particular area where there is a shortage of employees and difficulty recruiting—either for the specific job or in a geographic area. This bill does not target a particular job type or geographic area but instead is broad-based, allowing for potentially up to 1,186 retirees to return to work across the state.

One-Year Break in Service

The engrossed bill provides for a bona fide break in service of one year, consistent with the existing teacher critical shortage program. There are two primary reasons why specifying a one-year break in service before a retiree would be eligible to return to work in a position contemplated by the bill is appropriate. First, a one-year break in service would mitigate any possibility of an unlawful prearrangement to return to work, which is specifically prohibited by this bill. Likewise, the one-year break in service reduces the likelihood that the bill would create any major shift in retirement patterns. Further, in 2001, the Joint Legislative Audit and Review Commission (JLARC) adopted a resolution concurring with VRS regarding the

minimum twelve-month separation before a retiree could be rehired into a teacher critical shortage position without loss of retirement benefits, consistent with the recommendation of the JLARC actuarial consultant.

Current Return-to-Work Options

Retirees may currently return to work part-time without losing VRS retirement benefits following a bona fide break in service with no prearrangement. In most cases, a VRS retiree may return to work on a part-time basis with a VRS-participating employer and continue receiving retirement benefits. When working in a “non-covered” (i.e., part-time, temporary, or provisional) position, a VRS retiree is not in violation of § 51.1-155(B) and may continue to work while also collecting his or her retirement benefit. To be considered working in a non-covered position on the basis of part-time employment, a retiree must work 80% or less of the hours required of the comparable full-time position.

In the case of someone working under a 9-, 10-, or 11-month contract, this 80% threshold would be based on the 9-, 10-, or 11-month full-time equivalent position. Alternatively, for a twelve-month employee, the 80% threshold may be based on a normal full-time work schedule (i.e., 2,080 hours per year). Under this latter scenario, a VRS retiree would be able to work more hours per year in a part-time position compared to a retiree with a 9-, 10-, or 11-month contract.

The following table demonstrates the number of hours that a VRS retiree may currently work on a part-time basis depending on the nature of the full-time equivalent position:

Contract duration for full-time equivalent position:	Part-time work limit (hours per year) based on the 80% threshold:	Approximate part-time work limit (hours per week)*
12 months	1,664	32
11 months	1,525	29
10 months	1,387	27
9 months	1,248	24

*Part-time work in excess of 29 hours may implicate requirements of the Affordable Care Act (ACA).

Health Insurance Impact

Health care issues related to retirees returning to work should also be considered. Each political subdivision’s health insurance provisions likely differ, but typically if a retiree is eligible for active employee coverage, he or she would move to the active plan, if eligible. In most cases, when a retiree comes back to active employment that provides eligibility for health insurance coverage, the retiree prefers to have the employer contribution. In general, Medicare would consider that the active coverage should be primary when coverage due to current active employment is available. While the state’s policy allows for a retiree to return to the retiree health insurance program immediately upon loss of active coverage, because

each political subdivision may offer different health care insurance coverage, it is difficult to generalize about the health care impact of a retiree returning to work for a non-state employer.

The employer shared responsibility provisions of the Affordable Care Act (ACA) require that applicable large employers (generally, 50+ employees) offer affordable, minimum essential coverage to full-time (30 or more hours/week) employees and their dependents. The employee does not have to take the coverage, but in order to comply with ACA requirements, the employer would need to confirm through ACA reporting that the offer was made. A retiree health plan may or may not include provisions allowing for the retiree to leave the retiree health care program in order to receive coverage in another plan and then return to the former retiree health plan at a later date.

Teacher Critical Shortage Program

There is currently a limited exception in § 51.1-155(B)(3) that allows a VRS retiree to return to work full-time in a VRS-covered, critical shortage teaching position without impact to his or her retirement allowance. These provisions are set to expire July 1, 2025, and were intended to address the difficulty that some schools face in recruiting qualified teachers. In order to take advantage of this provision, however, each of the following requirements must be met:

- The VRS retiree must have been receiving a retirement allowance for a certain period of time preceding his employment as provided by law;
 - Note: VRS requires one year for the “certain period of time.”
- The VRS retiree cannot be receiving a retirement benefit pursuant to an early retirement incentive program from any local school division within the Commonwealth; and
- At the time the VRS retiree is employed, the teaching position to which he or she is assigned must be among those identified by the Superintendent of Public Instruction pursuant to subdivision 4 of § 22.1-23, by the relevant division superintendent, pursuant to § 22.1-70.3, or by the relevant local school board, pursuant to subdivision 9 of § 22.1-79.

A key reason that the critical shortage teaching exception has not resulted in major shifts in retirement patterns is because of the requirement that an individual must have been receiving a retirement allowance for at least one full year before becoming eligible to return in the critical shortage capacity and without impact to the retirement allowance. In addition, the one-year requirement reduces the risk for abuse of the rules that might otherwise result in an unlawful prearrangement, which is contrary to provisions of the Internal Revenue Code (IRC), between an employer and retiring employee to establish post-retirement employment. An unlawful prearrangement to return to work is a challenge with retiring members in pension plans and one that can adversely impact both the member and VRS’ qualified plan status under the IRC. In addition, the eligibility criteria (set forth above) for the critical shortage program is narrowly tailored and applies in limited circumstances.

Based on information reported by school divisions to VRS, below are statistics on the number of full-time critical shortage teaching positions filled with a VRS retiree since FY 2009.

DOE Region	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Total CS Positions	% of total CS positions
Region 1	9	12	9	6	5	8	3	1		4	7	11	75	13.07%
Region 2	13	7	8	11	8	6	5	6	15	14	17	17	127	22.13%
Region 3	7	5	3	3	2	2	2	2	1	7	3	16	53	9.23%
Region 4	29	17	14	13	17	16	3	5	18	18	22	18	190	33.10%
Region 5	2	2	2	2	2	2	1	1	1	3	2	1	21	3.66%
Region 6	5	4	2	2	2	3	5	1	3	6	6	5	44	7.67%
Region 7	7	5	3	3	3					2	1	3	27	4.70%
Region 8	2	1	3	4	2	1	1	1	1	4	6	11	37	6.45%
Total	74	53	44	44	41	38	20	17	39	58	64	82	574	100.00%

Region 1 - Charles City, Chesterfield, Dinwiddie, Goochland, Hanover, Henrico, New Kent, Powhatan, Prince George, Surry, Sussex, Colonial Heights, Hopewell, Petersburg, Richmond

Region 2 - Accomack, Isle of Wight, James City (Williamsburg), Northampton, Southampton, York, Chesapeake, Franklin, Hampton, Newport News, Norfolk, Poquoson, Portsmouth, Suffolk, Virginia Beach, Williamsburg (James City County)

Region 3 - Caroline, Essex, Gloucester, King George, King William, King and Queen, Lancaster, Mathews, Middlesex, Northumberland, Richmond, Spotsylvania, Stafford, Westmoreland, Colonial Beach, Fredericksburg, West Point

Region 4 - Arlington, Clarke, Culpeper, Fairfax, Fauquier, Frederick, Loudoun, Madison, Orange, Page, Prince William, Rappahannock, Shenandoah, Warren, Alexandria, Falls Church, Manassas, Manassas Park, Winchester

Region 5 - Albemarle, Amherst, Augusta, Bath, Bedford, Campbell, Fluvanna, Greene, Highland, Louisa, Nelson, Rockbridge, Rockingham, Buena Vista, Charlottesville, Harrisonburg, Lexington, Lynchburg, Staunton, Waynesboro

Region 6 - Alleghany, Botetourt, Craig, Floyd, Franklin, Henry, Montgomery, Patrick, Pittsylvania, Roanoke, Covington, Danville, Martinsville, Roanoke, Salem

Region 7 - Bland, Buchanan, Carroll, Dickenson, Giles, Grayson, Lee, Pulaski, Russell, Scott, Smyth, Tazewell, Washington, Wise, Wythe, Bristol, Galax, Norton, Radford

Region 8 - Amelia, Appomattox, Brunswick, Buckingham, Charlotte, Cumberland, Greenville, Halifax, Lunenburg, Mecklenburg, Nottoway, Prince Edward

This bill, which allows for retirees to return to work in a full-time covered position without cessation of their retirement benefits, is similar to SB 54 and HB 1495 relating to hiring of retirees for school security. It is also similar to HB 351 and SB 324, which require the Superintendent of Public Instruction to survey local school divisions to identify critical shortages of school bus drivers by geographic areas and local school division and would allow retirees to return to work as bus drivers. HB 351 and SB 324 require an analogous survey conducted by the Superintendent for bus drivers in addition to the existing survey for critical shortages of teachers.

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