

Virginia Retirement System

2023 Fiscal Impact Statement

1. Bill Number: SB 1289

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

2. Patron: Deeds

3. Committee: Finance and Appropriations

4. Title: Virginia Retirement System; school bus drivers; return to employment.

5. Summary: Provides that if a retired school bus driver was employed by a local school division and had a bona fide break in service of at least three months between retirement and employment as a school bus driver in a local school division that identifies and experiences a critical shortage of school bus drivers reaching a vacancy rate that exceeds 20 percent, such person is not required to establish a 12-month break in service that would otherwise be required by law. The critical shortage and vacancy rate of school bus drivers in a local school division are subject to semi-annual reevaluation to determine whether a critical shortage continues to exist and whether the vacancy rate of school bus drivers in the local school division continues to exceed 20 percent. The bill requires an affected local school division to provide an annual report to the General Assembly identifying critical shortages, vacancy rates, and employment of school bus drivers, including those reemployed out of retirement, in the prior year. The bill also requires the Secretary of Education and Secretary of Transportation to convene a workgroup to identify specific strategies to address bus driver shortages across Virginia local school divisions.

6. Summary of Impacts

Benefit(s) impacted: For retirees who return to work full-time as a critical shortage school bus driver, this is a change to the return-to-work exemption in § 51.1-155(B)(3) and would be inconsistent with the current critical shortage teacher and bus driver and current school security officer return to work exemptions. The bill retains the requirement that the break in service be during a time the bus driver would have otherwise worked.

Impact to unfunded liability (see Item 9 for details): This provision is expected to change retirement patterns of future retirees and therefore will likely add to unfunded liabilities of the impacted plans. The shorter the break in service required, the more likely it is that active employees will be incentivized to retire earlier than anticipated to collect a retirement benefit, active compensation, as well as remain on active healthcare which typically is subsidized by the employer. Requiring employer contributions will help to mitigate the impact related to filling VRS active covered positions with retirees.

Benefits for bus drivers are currently covered under the individual political subdivision plans. However, not all localities choose to cover bus drivers in their VRS plans. Of the 133 school divisions in Virginia, VRS is aware of at least 25 of these localities that do not cover bus

drivers in their VRS local plan. In addition, there are 65 other school divisions where available data does not indicate whether or not bus drivers are covered members.

Determining the cost impact for this bill is difficult for several reasons:

- Bus drivers are currently covered under the individual political subdivision plans, so impacts will vary by school district depending on the number of positions vacant, the number of positions in a school division meeting the greater than 20% vacancy requirement, and the number that would be filled by retirees.
- Not all localities cover bus drivers under VRS, so the provisions of a return to work bill would not impact those employers. As stated above, we have identified 25 school divisions that currently do not cover bus drivers under VRS and 65 school divisions where data does not indicate whether or not bus drivers are covered members .
- The extent of vacancies to be filled has not been formally identified.

Because impacts will be dependent on the number of school bus driver positions that will be filled by retirees, as well as the status of the individual political subdivision plans that use the provision, it is difficult to develop a cost impact that would be applicable and meaningful to all employers impacted by this bill. Further, political subdivision plans have their own assets, liabilities, and plan demographics, so each local plan's impacts will be unique based on plan experience.

Impact to contribution rate(s) (see Item 9 for details): An increase in liability associated with changing retirement patterns is likely to occur with only a three-month break in service and would lead to increases in employer contribution rates. The size of the increases would depend on the volume of members who elect to retire and return to work. Because this legislation does not require employers to include the members' salary in the computation of employer contributions, the provision is expected to have an impact on employer rates. Requiring employer contributions for these retirees would help mitigate the impact on contribution rates.

Specific Agency or Political Subdivisions Affected (see Item 10): VRS, all school divisions that report bus drivers to VRS and with a school bus driver vacancy rate that is greater than 20%, and the political subdivisions that fund them.

VRS cost to implement (see Item 7 for details): Approximately \$31,000 in FY 2023, \$27,400 in FY 2024, and \$11,100 in ongoing years. This will create a different break in service requirement for certain critical shortage school bus driver positions than for other critical shortage positions and for retiree school security officers.

Employer cost to implement (see Item 7 for details): Minimal employer costs are anticipated for implementation.

Other VRS and employer impacts (see Item 7, Item 9, Item 11, and Item 12 for details): VRS will need to reach out to individual school divisions to communicate this limited exception applicable only to certain critical shortage school bus drivers.

GF budget impacts (see Item 8 for details): No immediate impact expected.

NGF budget impacts (see Item 8 for details): Approximately \$31,000 in FY 2023, \$27,400 in FY 2024, and \$11,100 in ongoing years for VRS implementation.

7. Budget Amendment Necessary: Yes.

Item 498. VRS will need a NGF appropriation of approximately \$31,000 for implementation costs in FY 2023.

8. Fiscal Impact Estimates: More detail on the fiscal impact is explained in Item 9 below.

9. Fiscal Implications: Item 498 of Chapter 2 of the 2022 Special Session I Acts of Assembly required VRS to review the current return to work (RTW) provisions governing its retirees. It has been published to the DLAS website at [RD856 \(Published 2022\) - Return to Work Provisions Governing Virginia Retirement System \(VRS\) Retirees – December 15, 2022](#).

Internal Revenue Service (IRS) guidance under Internal Revenue Code (IRC) § 410, as cited in Private Letter Ruling 201147038, suggests that a one-year period without performing service might be considered a safe harbor to establish severance from employment prior to a retiree returning to work for a plan employer. 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. Qualification as a governmental plan allows pre-tax employee contributions and exemption from taxation on investment earnings, among other tax benefits. Historically, investment earnings fund approximately 2/3 of benefit costs.

Outside benefits counsel has confirmed that 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 or not there is a break in service using a facts and circumstances test. The IRS has not established a definite safe harbor severance period but has indicated that 12 months may be a sufficient period of time.

VRS uses a one-year break in service for the bus driver and teacher critical shortage program. In 2001, when the teacher critical shortage program was first implemented, the Joint Legislative Audit and Review Commission (JLARC) adopted a resolution concurring with VRS regarding the minimum one-year 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. In addition, to be eligible for this program the bus driver or teaching position must be 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. In addition to reducing the required break in service to three months, which must be during a time when the employee would otherwise be working (i.e., not summer for a school bus driver), the bill adds additional requirements related to the school bus driver vacancy rate in each school division.

While VRS along with benefits counsel believes that a 12-month break in service before a retiree can return to work full time remains optimal to ensure compliance with IRS guidance

and to minimize any potential negative impacts from changing retirement patterns, the report referenced above includes several options for consideration, including reducing the required break in service for critical shortage teachers and bus drivers and RSSOs to six months. If the break in service is reduced below six months, it becomes less clear that it would comply with IRS guidance. A break in service of only three months prior to allowing a retiree to return to work full-time as a school bus driver would be on the shorter end of breaks that are allowed by other retirement plans. Further, shorter breaks in service deployed in other states tend to be accompanied by additional provisions such as income and hour limitations, stoppage or offset of the retirement benefit for specified periods, as well as age and service minimums. Rarely are shorter breaks in service deployed without also requiring additional restrictions.

As described in the Return to Work report referenced earlier, Exhibit 1 shows the number of retirees filling critical shortage bus driver positions with the current 12-month break in service compared to the total vacancies each year.

Exhibit 1- Retirees Employed as Critical Shortage School Bus Drivers

School Year	Number of retirees filling critical shortage bus driver positions	Total bus drivers needed	Total vacancies
2020-2021	20	2,440	281
2021-2022	20	1,847	467
2022-2023*	24	2,761	596

Source: VRS data on retirees and VDOE data on bus driver vacancies

*Through November 15, 2022.

Further, in 2021-2022, 10 bus drivers returned, and in 2022-2023, 11 bus drivers returned. Three of the bus drivers returning in 2022-2023 were returning for their third year (originally RTW in 2020-2021). Overall, there have been 42 unique retirees filling those 65 spots. A total of 23 bus drivers returned for more than one year.

The shorter the break in service, the more likely it is that active employees will take advantage of the opportunity to retire earlier than anticipated, which will potentially lead to larger shifts in retirement patterns.

Another factor that makes larger shifts in retirement patterns more likely with shorter breaks in service is the availability of active employee health insurance, which is typically subsidized by employers. Many employees delay retirement due to the high cost of pre-Medicare health insurance. If employees can retire and, after a short break, receive a pension, earn a full-time salary and have access to employer-subsidized health insurance, there is little reason that retirement-eligible employees would not take this option.

Using information provided in the fiscal year 2019 Virginia Annual School Report, 133 school divisions reported approximately 15,000 full-time equivalent bus driver positions across the Commonwealth. Using surveys conducted by the Department of Education in 2019 and by VRS in 2020, a combined 94 localities responded to the surveys and reported approximately 719 bus driver vacancies. The exhibit below highlights that bus driver

vacancies exist across the state, but based on this survey data appear to be most prevalent in larger school districts in Tidewater, Central Virginia, the Valley, and specific larger schools in Northern Virginia.

Region	Full-Time Equivalents Bus Drivers Positions	Reported Bus Driver Vacancies	Percentage Vacant
1	1,830	129	7.0%
2	2,920	259	8.9%
3	1,150	9	0.7%
4	4,950	148	3.0%
5	1,480	99	6.7%
6	1,030	32	3.1%
7	940	18	1.9%
8	740	25	3.4%
Total	15,040	719	4.8%



While the bill may encourage recently retired bus drivers to return to work and continue to receive their retirement benefit while drawing a salary, the proposed bill, as written, could also influence current bus drivers to retire and return to work so that they could also receive retirement income and salary simultaneously. This bill does not restrict members from other VRS plans from retiring early and returning to work as a bus driver in order to receive retirement income in addition to salary.

The implications of incentivized early retirement would impact individual political subdivision plans under the provisions of the proposed legislation, and the amount of impact would vary based on utilization of the provision within each political subdivision plan. The additional costs of earlier than expected retirements would be borne by the local employers of the retiring members through additional pension and, if applicable, health insurance credit payments paid over longer periods of time.

10. Specific Agency or Political Subdivisions Affected: VRS, public school divisions that report bus drivers to VRS, political subdivisions that fund these school divisions, the Secretary of Education, and Secretary of Transportation.

11. Technical Amendment Necessary: No.

12. Other Comments:

Overview

This legislation creates a separate exemption that reduces the bona fide break in service to three months for certain critical shortage school bus driver positions and specifies that the break includes any period during which the person would have otherwise worked. The bill does not require employers to include these retirees' compensation in membership payroll subject to employer contributions under § 51.1-145 of the *Code of Virginia*. The bill also requires the Secretary of Education and Secretary of Transportation to convene a working group to identify specific strategies that could be implemented to temporarily and permanently address shortages of bus drivers in local school divisions across Virginia.

Since the bill does not make the same change to other critical shortage positions or to subdivision (B)(4), the bill creates a second, different bona fide break in service requirement for bus driver critical shortage positions in school divisions with a 20% vacancy rate than is required for teacher and other bus driver critical shortage positions, and retired school security officers.

Importance of Employer Contributions

This bill does not require employer contributions for retirees who return to work. Requiring employer contributions for retirees who return to work, however, is critically important to mitigating potentially negative impacts to plan funded status and future contribution rates related to employees retiring earlier than anticipated. The shorter the required break in service the more likely employees are to retire earlier than anticipated, with the resulting change in retirement patterns. While not completely making up for the impact of changing retirement patterns, requiring employer contributions helps to make up for some of the potential negative actuarial consequences related to filling VRS active covered positions with retirees.

Eligibility for Active Employee Healthcare Coverage

In addition to the shorter break in service providing a strong incentive for active employees to retire and return to work, eligibility for active employee health insurance coverage, which

is typically subsidized by employers, will likely encourage even more active employees to retire earlier than anticipated. One reason many employees delay retirement until age 65 is Medicare eligibility. If active employees can retire at age 50, receive a pension with cost-of-living adjustments and, after a three-month break receive a full-time salary and employer-subsidized health insurance, it is likely that most retirement-eligible employees would pursue this option.

As an example, a Plan 1 school bus driver could retire with a reduced benefit as early as age 50 with at least 10 years of service credit or at age 55 with at least five years of service credit. While Plan 2 and Hybrid Retirement Plan members have different age and service requirements, this legislation is most likely to apply to current Plan 1 members.

Significance of Required Break in Service

The 12-calendar-month break is intended to satisfy IRS guidance, to protect the VRS plan qualification, and to minimize the incentive for employees to retire earlier than they otherwise would. When an employee retires earlier than assumed, it adds costs to the plan since retirement benefits will be paid for a longer period of time than anticipated when contribution rates were set.

From a policy perspective and consistent with advice from benefits counsel, VRS remains committed to the use of a break in service sufficient such that it serves to maintain compliance with the Internal Revenue Code, demonstrates no pre-arranged agreement for reemployment and protects the trust fund by making it less likely that employees will retire earlier than anticipated to take advantage of return-to-work provisions. A break in service of only three months would be among the shorter breaks in service allowed by other retirement plans and it would not clearly comply with IRS guidance. Other states that allow shorter breaks in service typically accompany the shorter break with other limitations, such as age, service, income, and benefit offset or stoppage. Rarely are shorter breaks in service deployed without also requiring additional restrictions.

Break During Summer Months

There is no specific guidance from the IRS related to the timing of a break in service for school division employees for purposes of meeting the bona fide break in service requirement. However, 26 CFR § 1.410(a)-7 includes in the definition of “severance from service date” that time away from service following severance does not include vacation, holiday, sick leave, leave of absence, and other typically scheduled time away. Schools do not treat teachers or bus drivers as terminated during the summer break period when they will work the following school year. Even for teachers or bus drivers who retire at the end of a school year, the last day of employment is not always clear for IRS purposes, as the last day of work is not typically the same as the retirement date and pay (if annualized) and benefits can be extended during the summer break period.

The IRS has recognized the unique nature of school summer breaks under the Affordable Care Act regulations by requiring that a specified number of hours during the break be taken into account for purposes of determining full-time status. Not allowing summer breaks to

count toward the one calendar month break in service prior to returning to part-time employment has been a longstanding VRS policy position in order to best demonstrate that the IRS bona fide break in service rules are satisfied for school division employees who do not work year round, and the language has been maintained after consultation with benefits counsel. Having such a provision helps to demonstrate that a true break in service has taken place.

No Prearrangement for Re-employment

Importantly, regardless of the break in service period of time, the IRS requires that a member cannot have a prearranged agreement prior to retirement to return to employment. Thus, the longer the required separation from service is, the more likely the member and employer did not enter into a prearranged agreement for reemployment.

Importance of Maintaining Plan Qualification

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. Qualification as a governmental plan allows pre-tax employee contributions and exemption from taxation on investment earnings, among other tax benefits. Historically, investment earnings fund approximately 2/3 of benefit costs. In addition, if the IRS were to determine that a separation in service has not taken place, plan distributions to a retiree younger than age 59½ would incur a 10% tax penalty payable by the retiree, not the plan.

Affordable Care Act Implications

While VRS does not administer healthcare, our understanding is that all positions in educational institutions require a 26-week separation before returning to service with the same employer in order to avoid a potential Affordable Care Act (ACA) tax penalty.

DHRM has provided guidance to state employers related to the ACA break in service. Other VRS participating employers must rely upon their own benefits counsel or human resource departments for ACA guidance. VRS participating employers are strongly encouraged to consult their human resource departments or DHRM in the case of state agencies for further information.

Finally, the bill requires the Secretary of Education and Secretary of Transportation to convene a workgroup to identify specific strategies that could be implemented to temporarily and permanently address shortages of bus drivers in local school divisions across Virginia.

The bill is identical to HB 2303.

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