

# Virginia Retirement System

## 2023 Fiscal Impact Statement

**1. Bill Number:** SB 1411

**House of Origin** ☒ Introduced ☐ Substitute ☐ Engrossed

**Second House** ☐ In Committee ☐ Substitute ☐ Enrolled

**2. Patron:** Norment

**3. Committee:** Finance and Appropriations

**4. Title:** Virginia Retirement System; return to work for law-enforcement officers.

**5. Summary:** Allows a retired law-enforcement officer to return to work full time as a law-enforcement officer and continue to receive his pension under the Virginia Retirement System (VRS). Such person shall be required to have a break in service of at least 12 calendar months before re-employment.

**6. Summary of Impacts**

**Benefit(s) impacted:** For retirees who may return to work full-time as law-enforcement officers under the bill, this is an addition to the return-to-work exemption in § 51.1-155(B)(4) and, therefore, consistent with the current school security officer return to work exemption.

**Impact to unfunded liability (see Item 9 for details):** This provision is not expected to have a large impact on changing retirement patterns of future retirees and therefore is not expected to meaningfully impact unfunded liabilities or contribution rates, although requiring employer contributions and a 12-month break in service, as this bill does, will help mitigate the impact.

The exhibit below provides the number of SPORS, VaLORS, and local hazardous duty members who were eligible to retire as of June 30, 2022. Members who have qualified for unreduced retirement are more likely to take advantage of return-to-work provisions, and as the exhibit shows below that represents about 7% of the current active hazardous duty population. We also expect that members in the third group with eligibility for reduced benefits could also elect to retire and continue working in certain circumstances in order to boost take home pay by collecting a retirement benefit and continuing to be paid a full-time salary.

**Local Hazardous Duty Active Population June 30, 2022**

	Employer Count	Percentage of Active Population
Total Actives	26,100	
<b>Eligible for Full Unreduced Retirement Over Age 60</b>	<b>630</b>	<b>2.4%</b>
Eligible for Full Unreduced Retirement Under Age 60	1,020	3.9%
Eligible for Reduced Retirement Under Age 60	2,550	9.8%
Total Eligible to Retire as of June 30, 2022	4,200	16.1%

**SPORS Active Population June 30, 2022**

	Employer Count	Percentage of Active Population
Total Actives	1,880	
<b>Eligible for Full Unreduced Retirement Over Age 60</b>	<b>80</b>	<b>4.3%</b>
Eligible for Full Unreduced Retirement Under Age 60	220	11.7%
Eligible for Reduced Retirement Under Age 60	140	7.4%
Total Eligible to Retire as of June 30, 2022	440	23.4%

**ValORS Active Population June 30, 2022**

	Employer Count	Percentage of Active Population
Total Actives	7,360	
<b>Eligible for Full Unreduced Retirement Over Age 60</b>	<b>330</b>	<b>4.5%</b>
Eligible for Full Unreduced Retirement Under Age 60	180	2.4%
Eligible for Reduced Retirement Under Age 60	900	12.2%
Total Eligible to Retire as of June 30, 2022	1,410	19.2%

**Impact to contribution rate(s) (see Item 9 for details):** Because this legislation maintains 12-calendar-month break in service and requires employers to include the members' salary in the computation of employer contributions, the provision is not expected to have as much of an impact on employer rates. Employer contributions for these retirees help mitigate any impact on contribution rates.

**Specific Agency or Political Subdivisions Affected (see Item 10):** VRS, and state or local employers who hire retirees as law-enforcement officers, as well as current employers of law-enforcement officers throughout the State.

**VRS cost to implement (see Item 7 and Item 8 for details):** Approximately \$361,000 for FY 2023.

**Employer cost to implement (see Item 7 and Item 8 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 employers to communicate this limited exception applicable only to retiree law-enforcement officers.

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

**NGF budget impacts (see Item 8 for details):** Approximately \$361,000 in FY 2023 for VRS implementation, with minimal ongoing costs.

**7. Budget Amendment Necessary:** Yes.

Item 498. VRS will need a NGF appropriation of approximately \$361,000 in FY 2023 to cover the cost of programming and testing, as well as updating employee and employer communications, with minimal ongoing costs. This does not include the potential impact to future contribution rates or to the funded status of the state or local plans, which are discussed below.

**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.

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. This legislation maintains the existing 12-month break in service.

As an example of the use of this provision to date and as described in the Return to Work report referenced earlier, Exhibit 3 shows the number of retirees filling full-time school security officer positions with the current 12-month break in service.

Exhibit 1- Retirees Employed as Full-time School Security Officers

Year	Number of retirees filling school security officer positions
2020-2021	10
2021-2022	14
2022-2023*	19

Source: VRS data

\*Through November 15, 2022.

Another factor that makes larger shifts in retirement patterns more likely 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, 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. A 12-month break in service, however, can deter active employees from retiring earlier than anticipated and document that a severance of employment has occurred.

Employer contributions are crucial to mitigating the impacts of changing retirement patterns (earlier than anticipated retirements). This legislation maintains the required employer contributions.

**10. Specific Agency or Political Subdivisions Affected:** VRS and the Commonwealth and its agencies and political subdivisions that employ law-enforcement officers.

**11. Technical Amendment Necessary:** Yes. VRS is requesting that the effective date of this legislation be delayed until January 1, 2024 to allow for necessary systems adaptations along with necessary system validation testing. A delayed effective date will also allow for communications and outreach to affected employees and employers and updating web and handbook content. As VRS is implementing major legislation from the 2022 session as well as several critical infrastructure initiatives, and a large number of VRS-related pieces of legislation are being proposed this year, additional time is needed in order to provide for the effective implementation of concurrent legislative initiatives.

**12. Other Comments:**

Overview

The bill adds an exemption for a retired law-enforcement officer to return to work full time as a law-enforcement officer. The bill does not change the current requirement for retirees to have a 12-calendar-month break in service or for employers to include these retirees'

compensation in membership payroll subject to employer contributions under § 51.1-145 of the *Code of Virginia*.

#### Importance of Employer Contributions

Requiring employer contributions for retirees who return to work, as this bill does, is critically important to mitigating potentially negative impacts to plan funded status and future contribution rates related to employees retiring earlier than anticipated. 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

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 potentially a hazardous duty supplement, and, after a 12-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 law-enforcement officer could retire with a reduced benefit as early as age 50 with at least 5 years of service credit or with an unreduced benefit at age 60 with at least five years of service credit or age 50 with at least 25 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.

#### 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 59 ½ would incur a 10% tax penalty payable by the retiree, not the plan.

The bill is similar to SB 1107, which adds fingerprint examiners and forensic technicians as a position law enforcement retirees can return to full-time and continue to receive retirement benefits, and HB 2292, which adds school resource officers as a position law enforcement retirees can return to full-time and continue to receive retirement benefits.

This bill is also similar to HB 1630, HB 1850, HB 2107, and SB 1479.

**Date:** 1/20/2023

**Document:** SB1411.DOC/VRS