Virginia Retirement System
2017 Fiscal Impact Statement

1. **Bill Number:** SB 881

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

2. **Patron:** Spruill

3. **Committee:** Finance

4. **Title:** Virginia Retirement System (VRS); receipt of retirement allowance while employed in a covered position.

5. **Summary:** Permits a person who has attained the age of 62 to receive a retirement allowance from VRS and be employed in a VRS-covered position. The years of service and the compensation earned during such employment do not affect the amount of the retirement allowance during or after such employment. However, the retiree's compensation will be subject to employer contributions to the defined benefit plan under § 51.1-145.

6. **Budget Amendment Necessary**: Yes. Item 489. VRS estimates implementation costs at $262,150, with no additional ongoing costs. Programming will be required to implement employer contributions for retirees who are not also making employee contributions or accruing additional service. Programming will also be needed 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 1181 passes, certain programming costs can be allocated between both bills. There will also be impacts on 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 member who has attained the age of 62 and who is eligible for retirement to receive a retirement allowance from VRS and be actively employed in a VRS-covered position 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 SB 881, a member who is at least age 62 could elect to retire from VRS but continue to work in a VRS covered position and continue to receive a retirement benefit (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 while receiving the in-service distribution.

Members covered under LODA or re-employed retirees in LODA covered positions will still be covered by LODA, and would therefore be considered "active" employees requiring active premiums to be paid and therefore the provisions of SB 881 would not impact the premium levels of the LODA fund.

SB 881 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 employees not covered by hazardous duty benefits we have assumed 100% will elect the in-service distribution at age 62 if eligible for unreduced retirement (i.e., age 62 and 30 years of service for Plan 1 members and age 62 and meeting rule of 90 for Plan 2 and Hybrid members)
- For members eligible for reduced retirement at age 62 we have assumed a retirement (in-service distribution) rate of 30% for ages 62 and above, which is approximately twice the current expected retirement rates for those age 62 or above.
- For members with hazardous duty benefits coverage we have assumed 100% will opt for in-service distribution at age 62 or above.

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 $1.2 billion if the provisions of SB 881 were enacted.

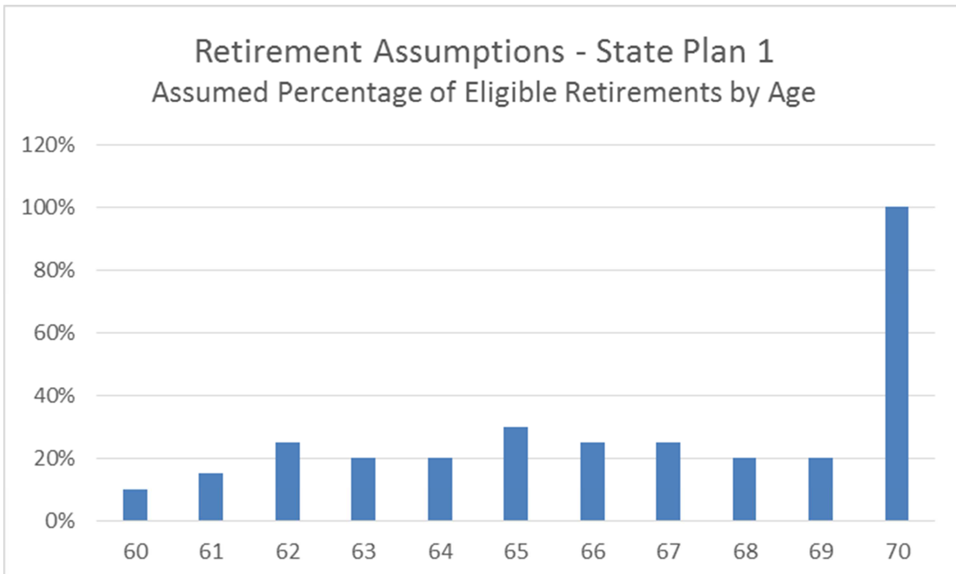
Exhibit 1

Impact on Actuarial Accrued Liabilities of Retirement Plans

Plan	6/30/2016 Valuation Results	Senate Bill 881	Increase in Unfunded Liability
State	$6,205,467,000	$6,670,024,000	$464,557,000
Teachers	$12,813,352,000	$13,189,965,000	$376,613,000
SPORS	$1,080,980,000	$1,081,139,000	$159,000
VaLORS	$748,767,000	$753,633,000	$4,866,000
JRS	$607,798,000	$677,460,000	$69,662,000
Political Subdivisons - Aggregate Results	$2,896,437,000	$3,163,825,000	$267,388,000
Total	$24,352,801,000	$25,536,046,000	$1,183,245,000

Under the current plan provisions, the normal retirement age for most members is either age 65 if in Plan 1 or social security normal retirement age if a member of Plan 2 or the Hybrid. Hazardous duty members' normal retirement age is age 60. While these are the assumed normal retirement ages, plan experience has shown that not everyone retires by those ages, and many work beyond normal retirement eligibility. Exhibit 2 below shows the current assumed rates of retirements for State Plan 1 members age 60 and above who have 30 or more years of service. Current plan experience shows that only approximately 20-25% of these members tend to retire beginning at age 62, and many retire after age 65.

Exhibit 2



Introducing a plan provision that would allow members to retire and receive their monthly benefit while also working and receiving a salary would increase the probability that members would leave earlier than previously anticipated. For the analysis of SB 881, VRS assumed that all members with 30 or more years of service would immediately retire in order to receive both their retirement benefit and continue to receive their salary. Exhibit 3 below is the change in assumptions used to model the impacts of SB 881.

Exhibit 3

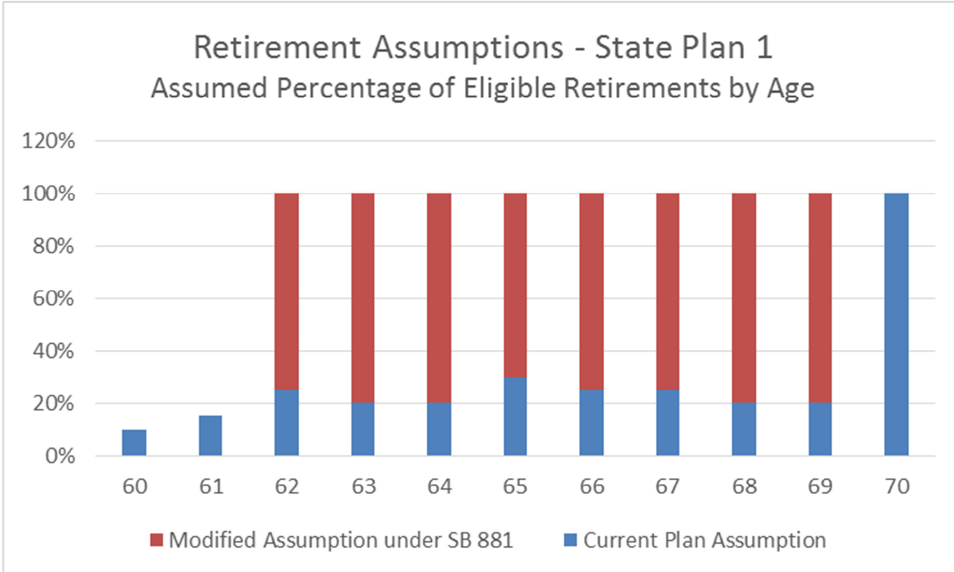


Exhibit 4 shows the number of active plan members who will be age 62 and have 30 or more years of service as of June 30, 2017, as well as the number of expected members meeting those requirements within the next five years.

Exhibit 4

Eligible for Unreduced Retirement at age 62

Plan	As of June 30, 2017	Within next 5 years
State	3,740	8,239
Teachers	3,202	8,739
SPORS	51	135
VaLORS	294	767
JRS	31	64
Political Subdivisons	1,748	5,094
Total	9,066	23,038

The large increase in liability is due to both anticipated retirements from current members already eligible to retire plus anticipated future retirements occurring earlier than expected. The provisions of SB 881 are expected to change retirement patterns that would have members retiring earlier than previously expected. Adjusting the in-service distribution age beyond age 62 and closer to normal retirement age for general employees would lower the costs of SB 881 significantly but would not eliminate the fiscal impact since VRS currently assumes not all members will retire on or before normal retirement age.

Exhibit 5 below shows the combined cost impacts to both retirement and OPEB plans assuming SB 881 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 5

	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY2023
State - General Fund	$ 13,103,000	$ 13,103,000	$ 13,103,000	$ 13,103,000	$ 13,103,000	$ 13,103,000
SPORS - General Fund	$ 157,000	$ 157,000	$ 157,000	$ 157,000	$ 157,000	$ 157,000
VaLORS - General Fund	$ 173,000	$ 173,000	$ 173,000	$ 173,000	$ 173,000	$ 173,000
JRS - General Fund	$ 675,000	$ 675,000	$ 675,000	$ 675,000	$ 675,000	$ 675,000
Teacher - General Fund	$ 9,200,000	$ 9,200,000	$ 9,200,000	$ 9,200,000	$ 9,200,000	$ 9,200,000
TOTAL General Fund	$ 23,308,000	$ 23,308,000	$ 23,308,000	$ 23,308,000	$ 23,308,000	$ 23,308,000
State - Non-General Funds	$ 17,561,000	$ 17,561,000	$ 17,561,000	$ 17,561,000	$ 17,561,000	$ 17,561,000
SPORS - Non-General Funds	-	-	-	-	-	-
VaLORS - Non-General Funds	16,000	16,000	16,000	16,000	16,000	16,000
TOTAL - Non-General Funds	$ 17,605,000	$ 17,605,000	$ 17,605,000	$ 17,605,000	$ 17,605,000	$ 17,605,000
Teacher - Local Funds	$ 13,800,000	$ 13,800,000	$ 13,800,000	$ 13,800,000	$ 13,800,000	$ 13,800,000
Political Subdivisions - Local Funds	$ 17,884,000	$ 17,884,000	$ 17,884,000	$ 17,884,000	$ 17,884,000	$ 17,884,000
TOTAL Local Funds	$ 31,684,000	$ 31,684,000	$ 31,684,000	$ 31,684,000	$ 31,684,000	$ 31,684,000
Grand Totals	$ 72,597,000	$ 72,597,000	$ 72,597,000	$ 72,597,000	$ 72,597,000	$ 72,597,000

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. VRS requests a delayed effective date to January 1, 2018 to allow time for programming necessary to implement the provisions of SB 881.

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.

    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 881 would allow VRS retirees who are age 62 or older to return to work in a VRS covered position and keep collecting a retirement allowance in addition to their salary. For example, a VRS-covered employee age 62 or older could retire while working in a VRS-covered position and, without any break in service, begin collecting a retirement allowance. Furthermore, existing VRS retirees age 62 or older would be permitted to return to VRS-covered employment without interrupting receipt of their VRS retirement benefits.

SB 881 also provides that the employer must apply the employer contribution rate to the retiree's compensation. This provision helps account for and offset the additional cost to the VRS Trust Fund caused by employing a retiree in an otherwise VRS-covered position who would not be making retirement contributions. While the employer contribution does help offset the cost of retirees returning to covered positions, it does 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 the contributions. See Exhibit 1, which shows an increase in unfunded liability of $1.2 billion.

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 at age 62 instead. As a result, the VRS Trust Fund will pay benefits for three years 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 a retirement at age 62, 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*.

<u>Affordable Care Act Implications</u>

There are Affordable Care Act (ACA) implications associated with this legislation. While the legislation does not address health benefits, 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 is older than age 62. When the individual retired, he or she elected to participate in the State Retiree Health Benefits Program. Upon return to VRS-covered employment, SB 881 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 a 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 1181, which also allows certain VRS retirees to work in a VRS-covered position while collecting a monthly retirement allowance. SB 1181, however, would allow a retiree of any age to return to a covered position so long as the individual retired from a position covered by the Line of Duty Act.

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