

Virginia Retirement System

2021 Fiscal Impact Statement

1. **Bill Number:** HB 2264

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

2. **Patron:** Leftwich

3. **Committee:** Appropriations

4. **Title:** Virginia Retirement System; retired law-enforcement officers employed as fingerprint examiners.

5. **Summary:** Allows a retired law-enforcement officer to continue to receive his service retirement allowance during a subsequent period of employment by a law-enforcement agency as a civilian fingerprint examiner, so long as he has a break in service of at least 12 calendar months between retirement and reemployment, did not retire under an early retirement program, and did not retire under the Workforce Transition Act of 1995.

6. **Summary of Impacts**

Benefit(s) impacted: Continued retirement benefits for certain retirees who return to work as civilian fingerprint examiners with law enforcement agencies.

Impact to unfunded liability (see Item 9 for details): Undetermined.

Impact to contribution rate(s) (see Item 9 for details): Undetermined.

Specific Agency or Political Subdivisions Affected (see Item 10): VRS-participating law enforcement agencies that hire retired law-enforcement officers as civilian fingerprint examiners.

VRS cost to implement (see Item 7 and Item 8 for details): Approximately \$142,000.

Employer cost to implement (see Item 7 and Item 8 for details): Undetermined.

Other VRS and employer impacts (see Item 8, Item 9, Item 11, and Item 12 for details): May impact both retirement and other post-employment benefits (OPEB) plans.

GF budget impacts (see Item 7 for details): None at this time.

NGF budget impacts (see Item 7 for details): VRS will need a budget amendment to implement the changes.

7. **Budget Amendment Necessary:** Yes. Item 477. VRS estimates implementation costs for the bill at \$142,000 in FY 2021, with minimal ongoing costs in FY 2022 and beyond. This does not include the impact to current or future contribution rates or to the funded status of the plans, which are discussed below.

Some new 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 and bus driver critical shortage program and in the school security officer (SSO) return-to-work 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. To mitigate impacts to the modernization program's ongoing implementation schedule (continued work required to move toward, and thereafter support, online-retirement processing), a manual process for collecting employer contributions may need to be deployed until an automated solution can be fully developed, tested, and put into production.

8. Fiscal Impact Estimates: See Item 9, below.

9. Fiscal Implications: Allowing a VRS retiree to return to work and be actively employed while continuing to receive a retirement allowance would impact both retirement and other post-employment benefits (OPEB) plans.

Return-to-work provisions have the potential to have financial impacts on VRS retirement plans due to the following implications:

- **Can incentivize members to retire earlier than originally expected.** Since members would be able to receive a retirement benefit and continue to receive compensation for working in a VRS-covered position, provisions of the bill could change retirement patterns. To illustrate, if members retire earlier than anticipated, the plan pays benefits earlier than expected and for a longer period. In addition, the plan has less time in which to earn investment income on member and employer contributions, which is necessary to fund benefits. Requiring longer breaks in service, such as a year or more, would help to avoid prearrangements of subsequent reemployment (precluded by the Internal Revenue Code) and mitigate altering retirement patterns of current members.
- **Can impact allocation of cost-sharing if replacing current covered positions with retirees.** Employers filling positions with retirees under the provisions of the bill could impact cost-sharing allocations if the payroll of these members is exempt from inclusion in valuation pay. As an example, payroll of a law enforcement agency that hires retirees as civilian fingerprint examiners will be smaller than anticipated if these positions that were formerly filled by active employees will now be filled by retirees, for whom no employer contributions are being made. This impact can be avoided by requiring that the payroll of retired members be included in the plan's covered payroll for VRS reporting, as is the case with this bill. While the member and employer would pay no normal cost since the member will not accrue additional benefit service, the covered payroll will be used to amortize the legacy unfunded liability payment under this legislation.

The implications of incentivized early retirement would impact individual political subdivision plans, SPORS, or VaLORS under the provisions of the bill, and the amount of impact would vary based on utilization of the provision within each of the plans. The additional costs of earlier than expected retirements would be borne by the local employers

of the retiring members through additional pension and health insurance credit payments paid over longer periods of time, or in the case of a member in SPORS or VaLORS, the cost would be shared by the pool of employers in those plans.

While researching the implications of this bill, we have not identified a large population associated with this position nor a critical shortage in filling the few open positions identified. Due to the size of this group and the few vacancies reported, the impact of this bill alone may not have significant cost impacts, however it is one in a series of recent bills adding various categories of employees who are allowed to return to work full-time after retirement. The more categories of employees who are allowed to return to work on a full-time basis, the higher the impact will be on retirement patterns, as these bills encourage members to retire earlier than they normally would have. Earlier than anticipated retirements require payment of retirement benefits for a longer period of time than was assumed when contribution rates were set, and over time will lead to higher contribution rates.

The Virginia State Police (VSP) indicate that there are 98 fingerprint examiners across the Commonwealth. VRS reached out to VSP, the Department of Forensic Services (DFS), the Department of Criminal Justice Services (DCJS), and 19 localities that VSP indicated employ fingerprint examiners for details on vacancies. Of the 22 agencies and localities that employ the 98 fingerprint examiners (14 who have responded so far):

- Some respondents clarified that their fingerprint examiners are sworn examiners, and therefore would not be the civilian fingerprint examiners covered by the bill.
- Not all of the entities responding would be considered a law enforcement agency under the bills.
- There are 69 full-time and part-time fingerprint examiners (sworn and civilian) among those reporting.
- At least six are part-time (not everyone specified whether their examiners are full-time or part-time).
- There are three vacancies (three separate entities each reported one vacancy).
- DCJS does not employ any fingerprint examiners.

Not all of the localities surveyed are covered by VRS. Employers that are not covered by VRS could hire a VRS retiree full time with no impact on the retiree's benefits. One locality reported that it employs a VRS retiree part time and would prefer to employ the retiree full time.

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 of one full calendar month during a time the employee would otherwise have worked and 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 based on part-time employment, a retiree must work 80% or less of the

hours required of the comparable full-time position. For a 40-hour week, this translates to 32 hours per week or 1,664 hours per year.

10. Specific Agency or Political Subdivisions Affected: VRS and any employer, as defined in § 51.1-124.3, that is a law enforcement agency and employs retired law enforcement officers as civilian fingerprint examiners. As discussed below, there are two definitions of “law enforcement agency” in the *Code of Virginia* and it is uncertain which, if any definition is intended to be used for the purposes of this bill.

11. Technical Amendment Necessary: No.

12. Other Comments: Under the bill, a member who has retired from a sworn law-enforcement officer position under Title 51.1 (SPORS, VaLORS, or local law-enforcement officers) and who, following a one-year break in service, is hired by a law enforcement agency as a civilian fingerprint examiner, may work full-time and continue to receive a retirement benefit (i.e., an in-service distribution). The bill also provides that the retiree will not be eligible to receive any cash match contributions pursuant to Chapter 6.1 (§ 51.1-607 et seq.) for which active employees are eligible. The bill also requires employer contributions, which serve to mitigate the potential impacts related to changes in retirement patterns.

The retiree would not receive any future benefit accruals while working and would, therefore, not be required to make member contributions to the plan. Retirees who return to work under this provision would be considered retired for retirement, group life, health insurance credit, VSDP and/or VLDP benefits, if applicable. The member would be eligible to receive cost-of-living increases on the service retirement benefit while receiving the in-service distribution.

While the impact of this bill alone may not have significant cost impacts, it is one in a series of recent bills adding various categories of employees who are allowed to return to work full-time after retirement. The more categories of employees who are allowed to return to work full time while receiving a retirement benefit, the higher the impact will be on retirement patterns, as these bills encourage members to retire earlier than they normally would have. Earlier than anticipated retirements require payment of retirement benefits for a longer period of time than was assumed when contribution rates were set, and over time will lead to higher contribution rates.

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 and bus driver critical shortage program and for the SSO 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. That approach was used also in the SSO program and it is applied again in this bill.

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-retire, with their retirement benefit ceasing, and the retirees must repay any benefit payments received since the time they returned to work. The retiree would also need to confirm health care eligibility rules at the time he or she is contemplating a return to work.

The bill adopts a one-year break in service before a retired law-enforcement officer can return to work as a civilian fingerprint examiner. Also, under this bill, employer contributions are required while the retiree is working, although the retiree will not receive corresponding service credit and will not pay employee contributions.

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. Specifically, legacy unfunded liabilities will not be paid off as expected. This bill does require that an employer include compensation paid to a retiree hired into a civilian fingerprint examiner position in its VRS covered payroll for purposes of calculating employer retirement contributions, which helps to mitigate this impact.

Allowing a VRS retiree to return to work and be actively employed while continuing to receive a retirement allowance would impact both retirement and other post-employment benefits (OPEB) plans.

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 complies 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 bus driver and teaching positions and SSO 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.

One-Year Break in Service

The bill provides for a one-year break in service, consistent with the bus driver and teacher critical shortage provisions and the SSO return to work provisions.

A key reason that the critical shortage bus driver and teaching exception and the SSO exception have 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. Ensuring that an unlawful prearrangement to return to work does not take place is critical in pension plans, because not doing so can adversely impact both the member and VRS' qualified plan status under the IRC.

Health Insurance Impact

Health care issues related to retirees returning to work should also be considered. Each employer's health insurance provisions may 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 locality 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 later.

Additional Information Related to Disability Retirement and LODA Benefits Eligibility

It is possible for a retired officer's level of compensation to affect his eligibility for benefits under LODA if the current earned income equals or exceeds the salary of the position at the

time of disability, indexed for inflation. (*See* Va. Code § 9.1-401(C)(4)). Any retiree receiving LODA benefits must be careful to weigh the implications, if any, of the contemplated work and salary on the retiree's continued eligibility for those LODA benefits.

Most retired officers receiving LODA benefits are also drawing a disability retirement benefit that may possibly make them ineligible for work as a civilian fingerprint examiner under the bill. VRS has communicated clearly and consistently through its publications and other outlets that a disability retiree cannot return to a position that requires the same or similar duties as those performed prior to disability retirement. The physical requirements of the civilian fingerprint examiner position, however, differ from those of a law enforcement officer. It is therefore not clear that a disability retirement recipient would be precluded from working in the position of a civilian fingerprint examiner, and the determination would depend on the nature of the disability and the job description, duties, and requirements.

The bill is identical to SB 1409.

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