

Virginia Retirement System

2023 Fiscal Impact Statement

1. **Bill Number:** HB 1850

House of Origin ☒ Introduced ☐ Substitute ☐ Engrossed

Second House ☐ In Committee ☐ Substitute ☐ Enrolled

2. **Patron:** Subramanyam

3. **Committee:** Appropriations

4. **Title:** Virginia Retirement System; return to work.

5. **Summary:** Reduces from 12 to six months the required break in service for a teacher, school administrator, school bus driver, or school security officer to return to work full time and continue to receive his pension under the Virginia Retirement System (VRS). The employer of such individuals shall include their compensation in membership payroll for purposes of the employer contribution to VRS.

6. Summary of Impacts

Benefit(s) impacted: This legislation changes the currently required 12-month break in service to a six-month break in service for retirees who return to work full-time as a critical shortage teacher, school bus driver, administrative employee or school security officer under the return-to-work exemptions in § 51.1-155(B)(3) and (4).

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 will help mitigate any impacts.

The exhibit below provides the number of Teachers 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 5% of the current Teacher active population. We would 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.

Teacher Plan Active Population June 30, 2022

	Employer Count	Percentage of Active Population
Total Actives	153,500	
Eligible for Full Unreduced Retirement Over Age 65/SSNRA	3,200	2.1%
Eligible for Full Unreduced Retirement Under Age 65/SSNRA	4,800	3.1%
Eligible for Reduced Retirement Under Age 65/SSRNA	29,900	19.5%
Total Eligible to Retire as of June 30, 2022	37,900	24.7%

* Note Plan 1 members Normal Retirement Age is 65 while Plan 2 and Hybrid Plan is Social Security Normal Retirement Age (SSNRA)

Impact to contribution rate(s) (see Item 9 for details): Because this legislation 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 helps to mitigate any impact on contribution rates.

Specific Agency or Political Subdivisions Affected (see Item 10): VRS, school divisions that employ retirees as critical shortage teachers and bus drivers, and localities that assign sworn law enforcement personnel to schools as school security officers.

VRS cost to implement (see Item 7 and Item 8 for details): Approximately \$107,000 in 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 individual school divisions to communicate this change to the length of the required break in service applicable to critical shortage teachers, school bus drivers, and administrative employees, and school security officers.

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

NGF budget impacts (see Item 8 for details): Approximately \$107,000 NGF in FY 2023 for VRS implementation.

7. **Budget Amendment Necessary:** Yes. Item 498. VRS will need a NGF appropriation of \$107,000 to cover estimated implementation costs.
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.

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.

As described in the Return to Work report referenced earlier, Exhibit 1 shows the number of retirees filling critical shortage teacher positions with the current 12-month break in service compared to the total vacancies each year (vacancy data only available from the Department of Education beginning with the 2016-2017 school year).

Exhibit 1- Retirees Employed as Critical Shortage Teachers

School Year	Number of retirees filling critical shortage teacher positions	Total teachers & administrators needed*	Total vacancies**
2008-2009	74		
2009-2010	53		
2010-2011	44		
2011-2012	44		
2012-2013	41		
2013-2014	38		
2014-2015	20		
2015-2016	17		
2016-2017	39	96,130	5,699
2017-2018	58	96,034	6,392
2018-2019	64	98,462	7,613
2019-2020	82	99,898	1,695
2020-2021	53	100,522	1,708
2021-2022	72	100,967	1,892
2022-2023**	18	101,924	2,006

Source: VRS data on retirees and VDOE data on teacher and administrator vacancies (may include additional positions not eligible for critical shortage RTW)

*VDOE data not available for 2008-2016

**VRS data available through October 5, 2022.

DOE advises that data collection changed in 2019-2020, accounting for the difference in vacancies.

As described in the Return to Work report, Exhibit 2 shows the number of retirees filling critical shortage school bus driver positions with the current 12-month break in service compared to the total vacancies each year.

Exhibit 2- 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.

As described in the Return to Work report, Exhibit 3 shows the number of retirees filling retiree school security officer positions with the current 12-month break in service.

Exhibit 3- 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.

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, following 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. A six-month break in service, however, could still serve as a deterrent for active employees to retire, while documenting that a severance of employment has occurred.

Because the teacher retirement plan is pooled (all employers pay the same rate), school divisions that have more teachers retiring and returning to work will essentially be shifting costs to school divisions that do not have large numbers of earlier than anticipated retirements.

10. Specific Agency or Political Subdivisions Affected: VRS and school divisions that employ retirees as critical shortage teachers and bus drivers, and as retiree school security officers.

11. Technical Amendment Necessary: No.

12. Other Comments:

Overview

This legislation reduces the bona fide break in service from 12 months to six months for existing critical shortage positions: teachers, school bus drivers, and administrative

employees, as well as retiree school security officers. The bill also requires employers to include these retirees' compensation in membership payroll subject to employer contributions under § 51.1-145 of the *Code of Virginia*. Currently employers of retiree SSOs must pay employer contributions, but this is a new requirement for school divisions that employ critical shortage teachers and bus drivers.

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. 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 an 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, following a break, 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 teacher 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.

Break During Summer Months

There is no specific guidance from the IRS related to the timing of a break in service for teachers 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 as terminated during the summer break period when they will teach the following school year. Even for teachers 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 teacher’s retirement date and pay (if annualized) and benefits can be extended during the summer break period.

The IRS has recognized the unique nature of teacher summer breaks under the Affordable Care Act (ACA) 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 teachers, 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 59 ½ 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 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.

This bill is similar to HB 1630, HB 2107, HB 2292, SB 1107, SB 1411, and SB 1479.

Date: 1/19/2023

Document: HB1850.DOC/VRS