

Virginia Retirement System

2023 Fiscal Impact Statement

1. **Bill Number:** HB 2292

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

2. **Patron:** Williams

3. **Committee:** Appropriations

4. **Title:** Virginia Retirement System; school resource officers.

5. **Summary:** Requires localities to provide enhanced retirement benefits to school resource officers. The bill also allows a retired law-enforcement officer to return to work as a school resource officer after a break in service of at least 12 months without impacting his retirement benefits.

6. **Summary of Impacts**

Benefit(s) impacted: Individual local plans that participate in VRS and employ school resource officers (SRO). The bill requires localities to provide enhanced benefits for SROs. This bill also allows a retired law enforcement officer to return to work full time as a SRO following a twelve-month break in service.

Impact to unfunded liability (see Item 9 for details): The impact of the proposed legislation related to § 51.138 will vary by employer for those employers that employ SROs. Under the legislation related to § 51.1-155, law-enforcement officers would be able to receive a retirement benefit and an enhanced hazardous duty supplement (which is an additional payment to bridge law enforcement retirees to social security retirement age) if eligible, and following a 12-month break, also receive a full-time salary, and active employee healthcare coverage. VRS expects that this could incentivize eligible law enforcement officers to retire earlier than they otherwise would have, which will likely add to the unfunded liability of the plan from which they retire. Requiring employer contributions for the position they take after retiring, as this legislation does, will help to mitigate impacts to that plan's contribution rates, but will not help the plan they retired from if it was a different employer.

Impact to contribution rate(s) (see Item 9 for details): The impact of the legislation related to § 51.138 will vary by employer for those employers that employ SROs. Because the proposed legislation related to § 51.1-155 requires employers to include the retirees' salary in the computation of employer contributions, the provision is not expected to have as much of an impact on the employer rates. Employer contributions for these retirees help mitigate any impact on contribution rates. However, depending on the volume of members who retire earlier than expected, the plans from which they retire could see an increase in

costs due to the increased liability associated with retiring earlier than expected in order to receive a pension, enhanced hazardous duty supplement, active healthcare, as well as a full-time salary.

Specific Agency or Political Subdivisions Affected (see Item 10): VRS and participating local employers that employ SROs.

VRS cost to implement (see Item 7 and Item 8 for details): Approximately \$273,000 for FY 2023.

Employer cost to implement (see Item 7 and Item 8 for details): The impact of the legislation related to § 51.138 will vary by employer, however, the average employer cost for political subdivisions to provide enhanced hazardous duty benefits as of the last rate-setting valuations was 20.46% as compared to 8.07%, which is the average employer cost for general employees. The impact of the legislation related to § 51.1-155 is expected to have minimal costs to employers for implementation.

Other VRS and employer impacts (see Item 7, Item 9, Item 11, and Item 12 for details): The contribution rate and unfunded liabilities, if any, of the local participating employers that employ SROs will reflect the additional costs related to the coverage under § 51.1-138.

GF budget impacts (see Item 8 for details): No impact expected since this applies to local employers.

NGF budget impacts (see Item 8 for details): Approximately \$273,000 in FY 2023 for VRS implementation.

7. Budget Amendment Necessary: Yes.

Item 498. VRS will need a NGF appropriation of approximately \$273,000 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 local contribution rates or to the funded status of the 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:

Legislative Provisions Related to § 51.1-138

While the costs to provide these benefits will vary by employer due to the underlying demographics of each employer, the average employer cost for political subdivisions to provide enhanced hazardous duty benefits as of the last rate-setting valuations was 20.46% as compared to 8.07%, which is the average employer cost for general employees. The higher cost is due to both earlier retirement eligibility as well as the cost of the hazardous duty supplement, which is currently \$1,222 per month for those with at least 20 years of hazardous duty service.

Under § 51.1-138(B), localities can make an irrevocable election to provide enhanced hazardous duty benefits to any or all of the various categories of employees listed. This bill will require localities to provide enhanced hazardous duty coverage to SROs. The locality will choose between a 1.7% multiplier with a hazardous duty supplement and a 1.85% multiplier with a hazardous duty supplement for the retirement benefit. The hazardous duty supplement is currently equal to \$1,222 per month and continues until Social Security normal retirement age. The supplement is increased every two years based on Social Security cost of living adjustments. The VRS normal retirement age for employees eligible for enhanced hazardous duty coverage becomes age 60 rather than 65, and employees are eligible for an unreduced benefit at age 60 with at least five years of service credit or at age 50 with at least 25 years of service credit.

Since localities have their own actuarially determined contribution rates based on their individual plan experience, the increases in liabilities and contribution rates associated with this benefit enhancement will vary by employer and will depend upon such elements as the number of SROs, their years of service, and other demographic data and information.

Legislative Provisions Related to § 51.1-155

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.

10. Specific Agency or Political Subdivisions Affected: VRS and participating local employers that employ SROs.

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: This bill would require localities to provide SROs with enhanced hazardous duty benefits under § 51.1-138.

This legislation also adds an exemption for retired law-enforcement officers to return to work full-time under § 51.1-155(B)(4) after a 12-calendar-month break in service when the retiree is assigned to a local public school division as a SRO. The bill does not change the current requirement for employers to include these retirees' compensation in membership payroll subject to employer contributions under § 51.1-145 of the *Code of Virginia*.

Legislative Provisions Related to § 51.1-138

Local employers that participate in VRS typically may make an irrevocable election to provide categories of hazardous duty employees specified in § 51.1-138 with benefits equivalent to those provided under the State Police Officers' Retirement System (SPORS). This bill makes the provision of these SPORS equivalent benefits to SROs mandatory. Benefits for SPORS members include a supplement payable from retirement until the retiree's Social Security normal retirement age, as well as a higher multiplier of 1.85%, instead of 1.7%. Currently, employers may elect either the 1.7% multiplier or the 1.85% multiplier. Age and service requirements for an unreduced retirement benefit also differ for those with enhanced hazardous duty benefits. SPORS normal retirement age is 60. Eligibility for an unreduced benefit is age 60 with at least five years of service credit or at age 50 with at least 25 years of service credit.

This bill applies the enhanced benefits only to service earned on or after the effective date. In order to retire with the enhanced benefits an eligible SRO must generally have at least five years of hazardous duty service except in limited circumstances for employees who were in service on June 30 and July 1, 2002.

Local employees who are not eligible for enhanced hazardous duty benefits under § 51.1-138, and who were hired for the first time on or after January 1, 2014, are in the Hybrid Retirement Plan. Under this legislation, SROs (except for those with prior service) whose localities had not already elected the enhanced hazardous duty benefits would be moved to Plan 2 instead of the Hybrid Plan. SROs with prior service who are in Plan 1 or Plan 2 would remain in the same plan.

Whether to provide these enhanced benefits is typically a local election funded by each separately actuarially rated locality that participates in VRS. If the bill is enacted, any participating locality that employs law-enforcement officers as SROs will be required to provide enhanced hazardous duty benefits to its full-time SROs under § 51.1-138. In general, electing these benefits would increase the locality's contribution rate and its liabilities, however the prospective application would mitigate the impact.

In its 2008 report, *Review of State Employee Total Compensation*, <http://jlarc.virginia.gov/pdfs/reports/Rpt378.pdf>, the Joint Legislative Audit and Review Commission (JLARC) developed an assessment of several occupational groups and rated these groups based on level of risk and responsibility (see Appendix D, pages 156-57). In addition, JLARC developed a set of guidelines that could be used in conjunction with its risk and responsibility assessment to ascertain if a given occupation merits consideration for inclusion in enhanced benefits. While the report focused more specifically on roles within state government agencies and evaluating such roles for potential membership in VaLORS, JLARC's guidelines could be applied when reviewing the inclusion of new employee groups for coverage with enhanced hazardous duty benefits. Below is an excerpt from JLARC's report:

“...Indicators such as informal SPORS and VaLORS membership criteria and actual enhanced plan membership indicate that any employee being considered for enhanced benefits should show an elevated risk of job-related injury and be directly responsible for protecting the safety of others, especially members of the public. Based on the work conducted during this review, JLARC staff have compiled a set of guidelines that can be used in conjunction with the assessment presented Table D-2 to ascertain if a given occupation merits consideration for enhanced benefits...”

In 2023, the Joint Legislative Audit and Review Commission (JLARC) is undertaking a comprehensive review of hazardous duty eligibility and benefits.

Legislative Provisions Related to § 51.1-155

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, especially with a shorter break in service, requiring employer contributions helps to partially address some of the potential negative actuarial consequences.

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. A 12-month break in service makes it 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.

This bill is also similar to hazardous duty bills HB 1571 and HB 2327 regarding election of enhanced benefits for dispatchers.

The bill is similar to SB 1411, which allows law enforcement retirees to return to full-time employment as a law-enforcement officer after a 12 month break in service and continue to receive retirement benefits, and SB 1107, which adds fingerprint examiners and forensic technicians as positions to which law enforcement retirees can return on a full-time basis after a two month break in service and continue to receive retirement benefits.

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