

# Virginia Retirement System

## 2023 Fiscal Impact Statement

**1. Bill Number:** SB 1289 S1

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

**2. Patron Prior to Substitute:** Deeds

**3. Committee:** Finance and Appropriations

**4. Title:** Virginia Retirement System; school bus drivers; return to employment.

**5. Summary:** Adds a new, separate exception to the return to work law for retired school bus drivers that provides that if a retired school bus driver was employed by a local school division then had a bona fide break in service of at least six months between retirement and employment as a school bus driver in a local school division with a critical shortage of school bus drivers as identified by the Superintendent of Public Instruction, the relevant school division superintendent, or the relevant local school board, such person is not required to establish a 12-month break in service that would otherwise be required by law. The bill requires employers to include, for all critical shortage teachers and bus drivers, these retirees' compensation in membership payroll subject to employer contributions under § 51.1-145 of the *Code of Virginia*. The bill also requires the Secretary of Education and Secretary of Transportation to convene a workgroup to identify specific strategies to address bus driver shortages across Virginia local school divisions. The bill has a delayed effective date of January 1, 2024.

**6. Summary of Impacts**

**Benefit(s) impacted:** For retirees who return to work full-time as a critical shortage school bus driver, the substitute retains the existing return-to-work exemption in § 51.1-155(B)(3) for “instructional and administrative personnel...licensed by the Board of Education” and school bus drivers and creates a new exception that allows retired school bus drivers to return to work full time as a bus driver with a six-month break in service in a school division that has identified a bus driver critical shortage. The existing legislation provides for a 12-month break in service for substantially the same population of bus drivers. The substitute removes the provision from the introduced bill that the break in service be during a time the bus driver would have otherwise worked, as well as the requirement that the school division must have at least a 20% vacancy rate for school bus drivers.

**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 related to filling VRS active covered positions with retirees.

**Impact to contribution rate(s) (see Item 9 for details):** Because this legislation 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 employer rates. Employer contributions for these retirees help 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 bus drivers, and the political subdivisions that fund them.

**VRS cost to implement (see Item 7 for details):** Approximately \$31,500 in FY 2023, \$69,000 in FY 2024, and minimal ongoing costs.

**Employer cost to implement (see Item 7 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 additional exception applicable only to certain critical shortage school bus drivers. The Superintendent of Public Instruction, local division superintendents, and local school boards may need to determine how critical shortage will be defined differently for this provision provided in the substitute as compared to the critical shortage teacher and school bus driver provision already established.

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

**NGF budget impacts (see Item 8 for details):** Approximately \$31,500 in FY 2023, \$69,000 in FY 2024, and minimal ongoing costs for VRS implementation.

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

Item 498. VRS will need a NGF appropriation of approximately \$31,500 in FY 2023 and \$69,000 in FY 2024 for implementation costs to cover the cost of programming and testing, as well as updating employee and employer communications to identify the separate critical shortage bus driver exception added to the existing critical shortage break in service provisions, 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.

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 the existing critical shortage 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. The substitute adds a separate break in service requirement of six months for critical shortage bus drivers.

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 bus driver positions with the current 12-month break in service compared to the total vacancies each year.

Exhibit 1- 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.

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, after 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 protection for the plans from changes in retirement patterns where active employees retire earlier than expected, while also documenting that the required severance of employment has occurred.

Using information provided in the fiscal year 2019 Virginia Annual School Report, 133 school divisions reported approximately 15,000 full-time equivalent bus driver positions across the Commonwealth. Using surveys conducted by the Department of Education in 2019 and by VRS in 2020, a combined 94 localities responded to the surveys and reported approximately 719 bus driver vacancies. The exhibit below highlights that bus driver vacancies exist across the state, but based on this survey data appear to be most prevalent in larger school districts in Tidewater, Central Virginia, the Valley, and specific larger schools in Northern Virginia.

Region	Full-Time Equivalents Bus Drivers Positions	Reported Bus Driver Vacancies	Percentage Vacant
1	1,830	129	7.0%
2	2,920	259	8.9%
3	1,150	9	0.7%
4	4,950	148	3.0%
5	1,480	99	6.7%
6	1,030	32	3.1%
7	940	18	1.9%
8	740	25	3.4%
Total	15,040	719	4.8%

Source: VRS analysis of VRS and VDOE data.



Source: [VDOE website](#)

While the bill may encourage recently retired bus drivers to return to work and continue to receive their retirement benefit while drawing a salary, the proposed bill, as written, could also influence current bus drivers to retire and return to work so that they could also receive retirement income and a full-time salary simultaneously. This bill does not restrict members from other VRS plans from retiring early and returning to work as a bus driver in order to receive retirement income in addition to salary.

Benefits for bus drivers are currently covered under the individual political subdivision plans. However, not all localities choose to cover bus drivers in their VRS plans. Of the 133 school divisions in Virginia, VRS is aware of at least 25 of these localities that do not cover bus drivers in their VRS local plan. In addition, there are 65 other school divisions where available data does not indicate whether or not bus drivers are covered members.

The substitute will create two break in service requirements for critical shortage school bus driver positions: (1) with a six-month break in service for a retiree who previously served as bus driver; and (2) the existing exemption that requires a 12-month break in service for any retiree under Chapter 1 who returns to work hired by a local public school board as an instructional or administrative employee required to be licensed by the Board of Education or as a school bus driver in a critical shortage teacher or bus driver position.

Determining the cost impact for this bill is difficult for several reasons:

- Bus drivers are currently covered under the individual political subdivision plans, so impacts will vary by school district depending on the number of positions vacant and the number that would be filled by retirees.
- Not all localities cover bus drivers under VRS, so the provisions of a return-to-work bill would not impact those employers that do not provide coverage to bus drivers. As stated

above, we have identified 25 school divisions that currently do not cover bus drivers under VRS and 65 school divisions where data does not indicate whether or not bus drivers are covered members.

Because impacts will be dependent on the number of school bus driver positions that will be filled by retirees, as well as the status of the individual political subdivision plans that use the provision, it is difficult to develop a cost impact that would be applicable and meaningful to all employers impacted by this bill. Further, political subdivision plans have their own assets, liabilities, and plan demographics, so each local plan's impacts will be unique based on plan experience.

The implications of incentivized early retirement would impact individual political subdivision plans under the provisions of the proposed legislation, and the amount of impact would vary based on utilization of the provision within each political subdivision plan. The additional costs of earlier than expected retirements would be borne by the local employers of the retiring members through additional pension and, if applicable, health insurance credit payments paid over longer periods of time.

**10. Specific Agency or Political Subdivisions Affected:** VRS, public school divisions that employ retirees as critical shortage bus drivers, political subdivisions that fund these school divisions, the Secretary of Education, and Secretary of Transportation.

**11. Technical Amendment Necessary:** No.

**12. Other Comments:**

Overview

The substitute creates a second exemption that reduces the bona fide break in service to six months for certain critical shortage school bus driver positions. The substitute removes the provision that the break includes any period during which the person would have otherwise worked. The substitute also requires employers to include, for all critical shortage teachers and bus drivers, 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. The substitute also requires the Secretary of Education and Secretary of Transportation to convene a working group to identify specific strategies that could be implemented to temporarily and permanently address shortages of bus drivers in local school divisions across Virginia. There is a delayed effective date of January 1, 2024.

Since the substitute does not make the same change to the break in service for other critical shortage positions or to subdivision (B)(4), it creates a second, different bona fide break in service requirement for bus driver critical shortage positions than is required for teacher and other bus driver critical shortage positions, and retired school security officers.

### Importance of Employer Contributions

Requiring employer contributions for retirees who return to work, as this substitute does for critical shortage positions and retains for SSOs, 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 a strong 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, after a six-month break receive a full-time salary and employer-subsidized health insurance, it is more likely that retirement-eligible employees would pursue this option.

As an example, a Plan 1 school bus driver 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. A six-month break in service, as provided in the substitute, is more likely to satisfy the IRS guidance than a shorter break.

### Break During Summer Months

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

The IRS has recognized the unique nature of school summer breaks under the Affordable Care Act 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 school division employees who do not work year round, 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. The substitute removes the provision in the introduced bill that the break includes any period during which the person would have otherwise worked.

#### 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 59½ 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 Affordable Care Act (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.

Finally, the bill requires the Secretary of Education and Secretary of Transportation to convene a workgroup to identify specific strategies that could be implemented to temporarily and permanently address shortages of bus drivers in local school divisions across Virginia.

**Date:** 2/2/2023

**Document:** SB1289S1.DOC/VRS