November 1, 2023

Report to the General Assembly

Return to Work Provisions for Certain Retirees to Work in Temporary Positions

Chapters 690, 707 & 708 of the 2023 Acts of Assembly

Virginia Retirement System

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Executive Summary

Following publication of the Virginia Retirement System's (VRS) Return to Work Provisions Governing Virginia Retirement System (VRS) Retirees (RD856)- - December 15, 2022, the 2023 General Assembly shortened the required break in service from 12 months to six months before certain retirees could return to work full time and continue to receive a VRS retirement benefit. The legislation included an enactment clause that requires:

> That the Virginia Retirement System (VRS) shall analyze and review options available to local public school divisions for hiring retired instructional or administrative employees, specialized student support position employees, bus drivers or school security officers with at least 25 years of service into temporary or other non-full-time positions during the six-month break in service period required by § 51.1-155 of the Code of Virginia, as amended by this act, between retirement and becoming eligible to return to work full-time without impact to their retirement benefits. VRS shall complete its review and submit a report to the Chairmen of the House Committee on Appropriations and the Senate Committee on Finance and Appropriations by November 1, 2023.

Background

Return to work provisions in Virginia, such as those suggested by the report mandate and those implemented beginning with the teacher critical shortage return to work exception in 2001, are in response to the challenges public employers described when recruiting and retaining qualified employees.

In 2017, in response to state agencies' indication that recruiting and retaining qualified employees was difficult, the Joint Legislative Audit and Review Commission (JLARC) published their report, Total Compensation for State Employees, 2017 (RD116)- November 13, 2017, reviewing total compensation across the Commonwealth. JLARC made several recommendations in that report, generally focused on the importance of employee compensation and, in part, to "identify cost-effective approaches to ensure agencies can employ an effective workforce." The report found that more employees named salary as the most important factor in compensation over health insurance as the next most important factor. The report also indicated that employees gave salary dissatisfaction as the most common reason for considering leaving a job in the next year.

In their 2023 report, Virginia's K-12 Teacher Pipeline, JLARC noted that teachers primarily leave teaching for personal reasons, or due to unhappiness with low salary as well as lack of teacher support, workload, or ineffective leadership. JLARC suggested in the report that these root causes need to be addressed to effectively improve the teacher pipeline.

When considering opportunities to improve recruitment and retention of employees using retirement benefits as a tool, it is essential to understand that return to work exceptions generally do not affect recruitment or retention, and may negatively impact the VRS Trust Fund due to potential changes in retirement patterns that can result in paying benefits longer than anticipated. Conversely, higher salaries translate into overall higher retirement benefits, with minimal, if any, impact to the VRS Trust Fund.

Current Return To Work Provisions

Return to work refers to a retiree returning to post-retirement employment with the same employer or another employer in the same retirement system after a bona fide break in service while continuing to receive a retirement benefit. The current return-to-work provisions allowed by Virginia law and VRS policy provide considerable flexibility.

- Retirees can choose to stop their retirement benefit and return to full-time active employment, thereby earning additional service credit.
- Alternatively, there are several additional exceptions that allow a retiree to return to work with a VRS-covered employer and continue to receive retirement benefits. As long as there is no prearrangement, a retiree can accept:
  (i) a part-time position with the same VRS-participating employer they retired from in which the retiree can work up to 80 percent of full-time employment after the required one full calendar month break in service or with a different VRS-participating employer with no break in service;
  (ii) an interim position with a VRS-participating employer that typically lasts no longer than six months after the required one full calendar month break in service and approval from VRS; or
  (iii) a full-time position in one of the four categories allowed under the *Code of Virginia* after the required six consecutive calendar months break in service.

To comply with IRS guidance, service in any capacity for a VRS-participating employer, such as volunteer service, part-time work, or potentially contracting for a third-party and assigned to the same employer from which the member retired, does not count toward a bona fide break in service. A bona fide break in service requires a complete severance of employment with any VRS-participating employer. This means that the report mandate suggestion to allow retirees to work part time during the break in service prior to returning to work full time does not meet the IRS and related requirements for a complete break in service.

Recent Changes

The General Assembly recently passed legislation reducing the required break in service from 12 months to six months before certain retirees can return to work full time in positions set out in § 51.1-155(B)(3) and (4) of the *Code of Virginia*. Making further changes so quickly following this reduction will prevent VRS from compiling reliable data regarding the impact of either change. This is significant because, as discussed in the 2022 report, changes to the length of the break in service could impact retirement patterns and thereby affect the VRS funded status and contribution rates. The bond rating agencies look skeptically on plan sponsors and employers that do not fully fund the actuarially determined required contributions (ADC) which in turn could impact bond ratings.

As an example, in 2018, the Public Employee Retirement System of Idaho (PERSI) found that teachers were returning to work in increased numbers following a reduction in its break in service requirement. Teachers, with a starting salary of $25,000 and who retired after 30 years of service and then returned to work, cost the plan an estimated $28,192 per person, or an increase in liability of nearly 4.3% for each such member. At a 2023 National Association of State Retirement Administrators

(NASRA) conference, PERSI staff provided an update, advising that four years of data collected since the Idaho break in service requirement was reduced showed that teachers were retiring two years sooner than before the RTW provisions were enacted.

The Commonwealth has appropriated funds over the past several years to provide cash infusions for the VRS Trust Fund. These infusions were intended to help bring down the unfunded liability. It is likely that policy changes allowing retirees to return to work sooner and still stay within the requirements of federal law will have both an immediate and long-term impact on the unfunded liability of the Fund and on employer contribution rates that can be expected to potentially negate or at best minimize the effect of the recent cash infusions.

Federal Law and Internal Revenue Service Guidance

The fundamental element of any return-to-work provision is the bona fide break in service required by the IRS, i.e., the amount of time a retiree must have been separated from employment without a prearranged agreement with the employer to be reemployed. The one exception, if the plan documents authorize it, is in-service distributions with no break in service allowed by the IRS at normal retirement age but no earlier than age 59 ½ to avoid a tax penalty.

The IRS has provided limited guidance regarding when a retiree may return to covered employment while still being considered retired. The IRS utilizes a facts and circumstances test to determine if there is a bona fide break in service. This serves to protect the retirement plan from violating IRC rules related to prearrangement, and proper federal tax reporting and withholding and from unexpected and detrimental changes in retirement patterns, and to prevent double dipping, or even triple-dipping if a retiree also receives the hazardous duty supplement, which is intended to help bridge the gap from retirement to Social Security eligibility, or cost of living adjustments.

Essential to the consideration of the report mandate, the IRS indicated in Information Letter (INFO) 2000-0245 that, for purposes of retirement, an employee who moves from full-time to part-time service with the same employer has not experienced a complete severance of service, discussed in more detail in this report, and may not be eligible for a distribution from their retirement account.

Section 401 of the Internal Revenue Code (IRC) establishes numerous requirements that VRS as a qualified governmental plan must comply with in order to qualify for favorable tax provisions. These requirements include when and how a retiree may return to work for a system employer following retirement while continuing to receive a retirement benefit (an “in-service distribution”). While the IRC allows in-service distributions without a tax penalty with no break in service as early as age 59 ½, VRS is aware of only one public plan that allows in-service distribution at age 59 ½ and the policy option discussed in this report generally proposes to use existing VRS Normal Retirement Age as the threshold to minimize impacts to the plan.

Policy Options

In keeping with the referenced JLARC reports and the 2022 RTW report, this report discusses three workforce shortage policy options for the General Assembly to consider. They include an in-service distribution option with no break in service to retain existing employees, a retention bonus paid annually each year an employee continues to work following retirement eligibility to retain existing employees, and an overall salary increase to make positions more attractive to new and existing employees.

In-Service Distribution Option

The 2022 VRS report included a policy option that would allow certain retirees who had reached a specific age to retire and then immediately return to work with no break in service, as permitted by IRS guidelines, and continue to receive their retirement benefit. Throughout this report the option is referred to as an in-service distribution. This option would encourage employees who would otherwise retire and leave service entirely to instead retire and immediately return to service for at least some additional period of time. This would be a significant departure from how VRS currently administers retirement benefits, would require a substantial investment of time and effort to implement, and is anticipated to have a detrimental impact on the VRS Trust Fund.

IRS rules allow for in-service distributions as early as age 59 ½ without a tax penalty and without jeopardizing the plan's tax qualification. Virginia law would need to be amended to allow for in-service distributions. This option does not solve employee pipeline issues, and only temporarily relieves staffing shortages. The in-service distribution option is expected to have a measurable impact on retirement patterns, as evidenced by experience in other states.

Therefore VRS suggests narrower parameters, such as a higher eligibility age:

- Age 65 for general employees in Plan 1;
- Social Security Normal Retirement Age (SSNRA) for general employees in Plan 2 or the Hybrid Retirement Plan; and
- Age 60 for hazardous duty members (while NRA may be earlier for hazardous duty members, the IRS tax penalty would apply if a distribution were received prior to age 59 ½).

Note: As required under current return to work options in the *Code of Virginia*, employer contributions should be required on behalf of members returning to work using the in-service distribution option.

Currently, teachers retire on average at age 63. This in-service distribution option would have the same restrictions as existing return-to-work exceptions regarding early retirement programs, not increasing retirement benefits, and the employer paying employer contributions on the individual's compensation.

Retention Bonus Option

The second policy option, providing retention bonuses to employees for each year they continue active employment past full unreduced retirement eligibility, focuses more on retaining active employees rather than encouraging them to return after retirement. An eligible employee would continue to receive their regular active salary and would receive an annual bonus each year they continue to work after they reach retirement eligibility. Implementing a retention bonus program could encourage existing employees who would otherwise retire and leave service entirely to instead stay actively employed for at least some additional period of time.

Unlike the in-service distribution option, retention bonuses would not encourage employees who would otherwise stay actively employed to retire and return to work or pursue the in-service distribution option. This option will potentially cost the Commonwealth less overall than expanding return to work options or adding an in-service distribution with no break in service. It would also help preserve the long-term integrity of the VRS Trust Fund. Of vital importance, if the Commonwealth and local employers choose to pay this retention bonus, they would not be paying both a salary and retirement benefits plus other pension benefits such as cost of living adjustments or hazardous duty supplements. Retention bonuses for employees past retirement eligibility might also have a positive impact on retirement patterns since these bonuses could encourage members to stay actively employed longer. This policy choice also could potentially help resolve some staffing shortages, but is still a temporary stopgap that would help maintain the existing workforce rather than providing a comprehensive, long-term solution to develop or recruit new employees.

Salary Increase Option

The third policy option, salary increases for new and existing employees, was described in depth in the 2017 JLARC report on state employee compensation. This option would provide higher starting salaries for new employees as well as more frequent, larger, and more reliable raises for existing employees. This would potentially be instrumental in improving recruitment and retention of public employees. Salary increases do not directly impact retirement patterns, do not impact the health of the VRS Trust Fund since they are accompanied by associated employee and employer contributions, and have the added effect of increasing the average final compensation (AFC) used to calculate retirement benefits, thereby increasing retirement benefits.

Cost Impacts

The impact analysis assumes that the existing sunset and actuarial investigation provisions in § 51.1-155(D) of the *Code* will remain in place. It also assumes that employer contributions will continue to be paid on creditable compensation for any position filled by a retiree who receives retirement benefits from VRS while also actively working in a full-time VRS-covered position. The existing return to work exceptions appear to be under-utilized based on the numbers shown in the 2022 report. This could be due to the break-in-service requirement, but there may also be a somewhat limited pool of retirees who wish to return to work on a full-time basis. As shown in Appendix A, the current data shows an increase in use of all full-time return to work exceptions. This is likely due to the shorter break in service requirement effective July 1, 2023. For example, as noted in RD856, 18 retirees had returned to work under the critical shortage program between July 1 and October 5, 2022. There are 150 retirees who have returned to work under the critical shortage program between July 1 and October 25, 2023, approximately the same time frame.

Cost Impacts of In-Service Distribution Option

Cost impacts to VRS associated with return-to-work provisions are generally related to changing the patterns of retirement. The funding policy used by VRS collects funds over a member's working career, and in combination with investment earnings, provides the revenue to pay lifetime benefits to members after they retire. The age at which a member chooses to retire is a personal decision based on many factors and therefore it is difficult to model cost impacts without any historical experience on how members may react to relaxed provisions around returning to work after retirement or retiring from active status but continuing to work for a VRS employer. However, the Idaho retirement system found that, within four years of relaxing their return to work rules, teachers were retiring two years earlier on average.

Any provision or policy that incentivizes a member to retire earlier than they would otherwise will ultimately increase the cost of VRS-administered pension plans and related benefits. Shortening the period of time over which benefits are funded or lengthening the amount of time that a member receives benefits, will increase plan liabilities. The magnitude of the increase would depend on the significance of the change and the volume of members that it impacts. Idaho's experience was that teacher retirees returning to work cost the system an additional estimated $28,192 per person, in comparison with a $25,000 starting salary. Approximately 25% of the entire active VRS population, including state and local employees, are already eligible for a full unreduced retirement or an early reduced retirement but continue to work. Based on the population demographics, the in-service distribution option has the greatest potential to impact retirement patterns and increase the liabilities of the retirement plans.

Cost Impacts of Retention Bonus Option

A retention bonus option would allow active employees who have reached retirement eligibility to continue to work and receive a bonus for each additional year they work past retirement eligibility. This targets current active members and encourages them to continue working rather than encouraging active members to retire. Since bonuses are not included in creditable compensation, retention bonuses under this option would not impact employer or employee contributions, the VRS funded status, or employees' retirement benefits.

As noted above, approximately 25% of active state and local employees are already either eligible for a full unreduced retirement or currently meet the requirements for an early reduced retirement. The number of active state employees who would qualify for a retention bonus depends on whether the General Assembly would require members to be eligible for a full unreduced retirement (approximately 26,000 members) or whether they would only need to be eligible for an early reduced retirement (approximately 90,000 members).

Cost Impacts of Increased Salary Option

If the General Assembly chooses to implement higher starting or continuing salaries, this would increase VRS members' overall creditable compensation. These increases would be incorporated into the existing AFC and retirement benefit calculations. Since employer and employee contributions are paid as a percentage of salary, no actuarial impact is expected for the VRS Trust Fund, although employer contributions may increase. This option will increase retirement benefits since benefits are calculated based on creditable compensation.

Table of Contents

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Why We Did This Report

In December 2022, the Virginia Retirement System (VRS) published Return to Work Provisions Governing Virginia Retirement System (VRS) Retirees (RD856)- - December 15, 2022, required by Item 498 of Chapter 2 of the 2022 Special Session I Acts of Assembly. This report comprised a review of the return-to-work (RTW) provisions in place at the time governing VRS retirees, including an overview of the Internal Revenue Service (IRS) laws and regulations regarding return to work, an analysis of Virginia's return-to-work provisions compared to those of other public employee pension plans, and an actuarial analysis of potential modifications to the return-to-work provisions.

Subsequently, in 2023, the General Assembly passed HB 1630 (Chapter 707), SB 1289 (Chapter 690) and SB 1479 (Chapter 708), adopting some of the modifications discussed in RD856. Enactment clause 6 of these bills requires:

> That the Virginia Retirement System (VRS) shall analyze and review options available to local public school divisions for hiring retired instructional or administrative employees, specialized student support position employees, or bus drivers with at least 25 years of service into temporary or other non-full-time positions during the six-month break in service period required by § 51.1-155 of the Code of Virginia, as amended by this act, between retirement and becoming eligible to return to work full-time without impact to their retirement benefits. VRS shall complete its review and submit a report to the Chairmen of the House Committee on Appropriations and the Senate Committee on Finance and Appropriations by November 1, 2023.

The enactment clauses for SB 1289 and SB 1479 also include school security officers as roles to be considered in the report.

Return to work provisions in Virginia, such as those suggested by the report mandate and those implemented beginning with the teacher critical shortage return to work exception in 2001, are in response to public employers' challenges recruiting and retaining qualified employees.

Background

In 2017, in response to state agencies' indication that recruiting and retaining qualified employees was difficult, the Joint Legislative Audit and Review Commission (JLARC) published their report, Total Compensation for State Employees, 2017 (RD116)- November 13, 2017, reviewing total compensation across the Commonwealth. JLARC made several recommendations in that report, generally focused on the importance of employee compensation and, in part, to "identify cost-effective approaches to ensure agencies can employ an effective workforce." The report found that, when surveyed, more than twice as many employees indicated salary was the most important factor in compensation, over health insurance as the next most important factor. The report indicated that employees gave salary dissatisfaction as the most common reason for considering leaving a job in the next year.

The 2017 JLARC report calls salary "the most effective mechanism that Virginia can use to recruit and retain employees…".

The report further highlighted that, compared to other employers, state benefits are the most attractive factor in employee compensation since salaries are less competitive. The report determined that Virginia's retirement benefits were generally 136% of the market median, but salaries were at 91% (see Figure 2-1 on page 14 of the JLARC report). The JLARC reported noted that over a ten-year period, the state's spending on compensation decreased as a proportion of the operating budget, while spending on retirement benefits increased. In their 2023 report, Virginia's K-12 Teacher Pipeline, JLARC noted that teachers primarily leave teaching for personal reasons, or due to unhappiness with teacher support, workload, ineffective leadership, or low salary[1]. JLARC suggested in the report that these root causes need to be addressed to effectively improve the teacher pipeline.

When considering opportunities to improve recruitment and retention of employees using retirement benefits as a tool, it is essential to understand how VRS benefits are calculated.

- Employers participating in VRS pay an employer contribution rate which is set by the VRS Board following valuation by the VRS plan actuary.
- That employer contribution rate is included in the Commonwealth's Appropriation Act and employers pay it as a percentage of payroll.
- Further, employees pay an employee contribution rate as a percentage of their individual salary.
- Both contributions are invested by VRS, and the contributions plus investment income are used to pay the defined benefit (DB) portion of retirement benefits.
- Each retiree's DB benefits are calculated using a formula set forth in the Code of Virginia which includes their individual Average Final Compensation (AFC), which is the highest three consecutive years of salary for Plan 1 members and 60 months for Plan 2 and Hybrid Plan members.
- Additionally, for Hybrid Plan members the defined contribution (DC) component of retirement benefits is also based on a percentage of an employee's salary that they choose to contribute, plus any potential employer match for which they may qualify.

Therefore, higher salaries translate into overall higher retirement benefits, with minimal impact to the status of the VRS Trust Fund.

2022 VRS Return to Work Report

VRS' 2022 return to work report covers RTW, federal laws and regulations on RTW, Virginia RTW laws, and RTW in other states in depth. The information is generally not included in this report to avoid repetition. However, some of the same discussion is included as needed to address the current study mandate. Current data on the number of retirees utilizing existing RTW exceptions is included in this report as Appendix A.

As discussed in detail in the 2022 report, return to work refers to a retiree returning to post-retirement employment with the same employer or another employer in the same retirement system after a bona fide break in service while continuing to receive a retirement benefit. The current return-to-

[1] JLARC, Virginia's K-12 Teacher Pipeline, Rpt576-1.pdf (virginia.gov)

work provisions provide considerable flexibility, especially for those who are returning on a part-time basis.

- Retirees can choose to stop their retirement benefit and return to full-time active employment, thereby earning additional service credit.
- Alternatively, there are several additional avenues for a retiree to return to work with a VRS-covered employer and continue to receive retirement benefits. As long as there is no prearrangement, a retiree can accept:

  (i) a part-time position with the same VRS-covered employer[2] they retired from in which the retiree can work up to 80 percent of full-time employment after the required one full calendar month break in service;
  (ii) an interim position with a VRS-covered employer that typically lasts no longer than six months after the required one full calendar month break in service and approval from VRS; or
  (iii) a full-time position in one of the four categories allowed under the *Code of Virginia* after the required six consecutive calendar month break in service (effective July 1, 2023; previously, full-time employment required a 12 consecutive calendar month break in service).

Benefits counsel advises that in order to comply with the IRC, the break in service precludes work in any capacity, such as volunteer service, part-time work, or potentially contracting for a third-party and assigned to the same employer from which the member retired.

Before being employed full-time with a VRS-participating employer in any of the statutorily permitted position categories while continuing to receive a VRS retirement benefit, Virginia law requires a retiree to have a break in service of six consecutive calendar months from the date of retirement. To comply with IRS guidance[3], this break in service prohibits work in any capacity for a VRS-participating employer, such as volunteer service, part-time work, or potentially contracting for a third-party and assigned to the same employer from which the member retired. For retirement purposes, the Commonwealth is considered a single employer. Each school division and each locality are individual employers.

The 2022 report included several policy options for consideration. The Recommendation to require employer contributions for retirees returning to work and Option One to reduce the length of

[2] For retirement purposes, the Commonwealth is considered one employer.

[3] 26 CFR § 1.409A-1(h)(1)(i) and 26 CFR § 410(a)-7 Elapsed time. (b) Definitions- (2) Severance from service date. For purposed of this section, a "severance from service" shall occur on the earlier of- …(ii)…an employee remains absent from service (with or without pay) with the employer or employers maintaining the plan for any reason other than quit, retirement, discharge or death, such as vacation, holiday, sickness, disability, leave of absence, or layoff."

the break in service to six months for existing categories of positions to which a retiree may return to work in a full-time position were enacted during the 2023 General Assembly session.

Option Two from the 2022 report discussed allowing retirees who have reached a specific age to return to work with no break in service and begin receiving a retirement benefit, consistent with Internal Revenue Service (IRS) guidelines. Throughout this report, this is referred to as the "in-service distribution[4]" option. While IRS rules allow for this arrangement with certain stipulations, it is not currently permitted by Virginia law. There were no bills introduced in 2023 based on the in-service distribution option discussed in the 2022 report. This report focuses on Option Two as one of the topics in the Policy Options section, since it appears to fulfill the study mandate.

Recent Changes

The General Assembly recently passed legislation, effective July 1, 2023, reducing the required break in service from 12 months to six months before certain retirees can return to work full-time in positions set out in § 51.1-155(B)(3) and (4) of the *Code of Virginia*. Making further changes so quickly following this reduction will prevent VRS from compiling reliable data regarding the impact of either change. This is significant because, as discussed in the 2022 report, changes to the length of the break in service could impact retirement patterns and thereby affect the VRS funded status, contribution rates, and bond ratings.

A 2018 actuarial study of the Idaho retirement system found that return to work provisions were changing the retirement pattern for teachers. Teachers returning to work in critical shortage positions was estimated to be increasing liabilities for these members by approximately 4.3%.[5] Data presented at a 2023 conference indicated that in the four years since a reduction in the required break in service was permitted, teacher retirement patterns further changed and teachers retired nearly two years earlier than before RTW provisions were enacted. As the provisions have not changed, staff continue to monitor the situation.

In 2018, the Public Employee Retirement System of Idaho (PERSI) found that teachers were returning to work in increased numbers following a reduction in its break in service requirement. Idaho teachers who retired after 30 years of service and then returned to work cost the plan an estimated

[4] In-service distribution refers to any arrangement where a retirement plan participant receives retirement benefits while serving in any position with a covered employer (i.e., an employer participating in VRS; employers who hire employees mandated to be members of VRS, as defined in Title 51.1 of the *Code of Virginia*). Return to work is also a type of in-service distribution, but specifically requires a break in service. References in this report to in-service distributions are intended to refer to Option Two that does not require a bona fide break in service. Such references are not intended to include existing return to work opportunities described immediately below.

[5] http://www.idsba.org/wp-content/uploTads/2021/06/2021-Educator-RTW-ISBA.pdf

$28,192 per person in additional liability (compared to an average starting salary of $25,000). At a 2023 National Association of State Retirement Administrators (NASRA) conference, PERSI staff provided an update, advising that four years of data collected since the Idaho break in service requirement was reduced showed that teachers were retiring two years sooner than before the RTW provisions were enacted. As discussed further below, changes in retirement patterns such as this negatively impact plans. Idaho's earlier retirement ages mean that employees are contributing a percentage of their salary for two fewer years, employers are making employer contributions for two fewer years, PERSI has two fewer years to invest these contributions and earn interest to fund benefits, and retirement benefits are being paid to these retirees for an additional two years. According to the 2018 study, PERSI estimated that employer and employee contribution rates for teachers would both need to increase in the following rate-setting period to account for the increased costs.

The Commonwealth has appropriated funds over the past several years to provide cash infusions for the VRS Trust Fund. These infusions were intended to help bring down the Fund's unfunded liability. It is likely that policy changes allowing retirees to return to work sooner and still stay within the requirements of federal law will have both an immediate and long-term impact on the unfunded liability of the Fund and on employer contribution rates. Anticipated increases in the unfunded liability as a result of these changes can be expected to potentially negate or at best minimize the effect of the recent cash infusions.

Most alternative RTW provisions proposed recently will increase the VRS Trust Fund's unfunded liability and increase costs related to future employer contributions. The increased expenses could eliminate the positive effect of recent cash infusions to the Fund.

In any scenario that allows retirees to return to work sooner after retirement and continue to receive their retirement allowance, active members are encouraged to retire sooner than they would absent these exceptions. Earlier retirements change retirement patterns and cause deviations from plan assumptions.

VRS' return-to-work provisions are designed to balance protecting the plans while allowing flexibility for employers and retirees. Virginia's provisions are largely consistent with those in numerous other states and are generally aligned with national trends regarding return to work. However, some plans are narrowing their current RTW rules and increasing break-in-service requirements.

Federal Law and Internal Revenue Service Guidance

Other than in-service distributions allowed by the IRS at no earlier than normal retirement age[6] or age 59 ½[7] with no break in service, if the plan documents allow, the fundamental element of any return-to-work provision is the bona fide break in service required by the IRS, i.e., the amount of time a

[6] Normal retirement age is defined by the plan but must meet specific IRS rules. If distributions commence at normal retirement age but prior to 59 ½, a 10% early distribution tax penalty applies to the member.
[7] In general, distributions from the 457(b) plan components of the VRS Hybrid Plan cannot be made prior to age 59 ½.

retiree must have been separated from employment without a prearranged agreement with the employer to reemploy. As noted in VRS' 2022 report, the IRS has provided limited guidance regarding when a retiree may return to covered employment while still being considered retired. The IRS utilizes a facts and circumstances test to determine if there is a bona fide break in service. As such, state return-to-work laws and plan policies typically are designed to require a IRS bona fide break-in-service. This serves to protect the retirement plan from violating IRC rules related to prearrangement and proper federal tax reporting and withholding and from unexpected and detrimental changes in retirement patterns, and to prevent double dipping, or even triple-dipping if a retiree also receives the hazardous duty supplement, which is intended to help bridge the gap from retirement to Social Security eligibility, or cost of living adjustments.

Break in Service and the Early Distribution Tax Penalty

As further noted in the 2022 report, IRS guidance under IRC § 410, as cited in Private Letter Ruling (PLR) 201147038, suggests that a one-year period without performing service might be considered sufficient to establish the requisite break in service to constitute a separation from employment. Additionally, the IRS indicated in Information Letter (INFO) 2000-0245 that, for purposes of retirement, an employee who moves from full-time to part-time service with the same employer has not experienced a complete severance of service, discussed in more detail below, and may not be eligible for a distribution from their retirement account. This means the suggested parameters of the study mandate, to allow retirees to return to work part-time after one full calendar month and allow the next five months of part-time work to be considered part of their six full calendar months break in service, do not provide a required six month complete break in service and are unlikely to meet the IRS' facts and circumstances test for a bona fide break in service.

IRS guidance (Information Letter (INFO) 2000-0245) indicates that an employee who moves from full-time to part-time service with the same employer has not experienced a complete severance of service and may not be eligible for retirement distributions.

Section 401 of the Internal Revenue Code (IRC) establishes numerous requirements that qualified governmental plans, including VRS, must comply with in order to qualify for favorable tax provisions[8]. These requirements include when and how a retiree may return to work for a system employer following retirement while continuing to receive a retirement benefit (an "in-service distribution"). Virginia law does not allow for in-service distributions, except for the return-to-work provisions expressly providing for a return to work after a break in service for critical shortage positions identified by the Department of Education and school security officers that all require a break in service. While the IRC allows in-service distributions without a tax penalty with no break in service as early as

[8] Tax Consequences of Plan Disqualification | Internal Revenue Service (irs.gov)

age 59 ½[9], Option Two proposes to generally use the highest existing VRS Normal Retirement Age as the threshold to minimize impact to the plan.

Maintaining VRS' status as a qualified governmental plan is paramount as such status allows members to make pre-tax retirement contributions and provides an exemption from taxation for the VRS Trust Fund's investment earnings. These and other benefits allow members to defer taxation and, since investment income accounts for approximately two-thirds of a retiree's pension benefit, exemption of investment earnings from taxation is critically important for VRS members as well as the overall fiscal health of VRS. Further, investment income contributes to VRS' funded status, which impacts the Commonwealth's bond rating.

It is also necessary to recognize that a bona fide break in service helps to protect retirees from a 10% early distribution tax penalty assessed by the IRS (See 26 US Code § 72(t)). In Edwards v. Commissioner, T.C. Memo 1989-409, aff'd, 906 F.2d 114 (4th Cir. 1990), the Tax Court decided that just a reduction in an employee's work schedule from full-time to part-time does not constitute a separation from service. Instead, a true separation from service occurs when an employer no longer exercises or retains the right to exercise the direction and control necessary under the common law rules to maintain the relationship of employer and employee. Of importance to retirees, this means that if the IRS finds that a retiree has returned to work with the same employer from which they retired without a bona fide break in service, the retiree may be considered to have received an early distribution from their retiree account. In such cases, the retiree will have to pay a federal 10% early distribution tax penalty if they are not at least 59½. In addition, the IRS requires VRS to properly report all payments which are potentially subject to the 10% early distribution penalty, and VRS could be liable for any misreporting.

A bona fide break in service helps protect retirees who are younger than 59 ½ from a federal 10% early distribution tax penalty.

The U.S. Code requires the additional 10% tax on in-service distributions paid to members prior to age 59 ½ unless an exception applies. Relevant exceptions include:

- distributions made after the member's death;
- distributions made due to the member's disability (defined by federal law);
- substantially equal periodic payments commencing after the member separates from service and payable over the life of the member or the member and designated beneficiary;
- distributions made to a member who separates from service after age 55 (age 50 or 25 years of service for public safety);
- distributions pursuant to a qualified or approved domestic relations order; and

[9] In 2022, NASRA updated data utilized in a 2018 report, *Balancing Objectives in Public Employee Post-Retirement Employment Policies: Reassessing Barriers to Continued Work,* a report on post-retirement employment policies—return-to-work policies—for public retirement systems across the United States published by NASRA and the Center for State and Local Government Excellence (SLGE). Of the 85 plans surveyed, only South Dakota reported allowing an in-service distribution as early as age 59 ½.

- distributions made due to a levy under USC § 6331.

Note that both the substantially equal payments (retirement benefit payments) and distributions to a member after separation (refunds) require a separation of service.

In PLR 201147038, the IRS determined that

> Employees who "retire" on one day in order to qualify for a benefit under the Plan, with the explicit understanding between the employee and the employer that they are not separating from service with the employer, are not legitimately retired. Accordingly because these employees would not actually separate from service and cease performing services for the employer when they "retire" these "retirements" would not constitute a legitimate basis to allow participants to qualify for early retirement benefits (which are then immediately suspended). Such "retirements" will violate section 401(a) of the Code and result in disqualification of the Plan under section 401(a) of the Code.

Note: In PLR 201147038, the IRS uses the term "early retirement benefit" to describe any benefit that commences prior to normal retirement age as specified in the plan.

The IRS also stated in PLR 201147038 that

> When an employee legitimately retires, he separates from service with the employer. Accordingly if both the employer and employee know at the time of "retirement" that the employee will, with reasonable certainty, continue to perform services for the employer, a termination of employment has not occurred upon "retirement" and the employee has not legitimately retired.

This language is important when considering the report mandate because the IRS does not refer to the employee stopping work; instead, the IRS refers to "perform(ing) services." Outside benefits counsel indicates that this includes volunteer services, part-time work, and consulting. Accordingly, the report mandate proposal allowing a retiree to work part-time during the required six-month break in service before returning to work full-time would not complete the required break in service. It may also violate the prohibition against a prearrangement to return. Further, in INFO 2000-0245 to U.S. Senator Sarbanes, the IRS explained that a retirement distribution could be made only when the employer/employee relationship is completely severed.

In the 2004 proposed regulations on phased retirement amending Treasury Regulation § 1.401(a)-1(b) and adding § 1.401(a)-3, the IRS stated that

> [A]pproaches, such as permitting benefits to be fully available if an employee works reduced hours as part of phased retirement or permitting distributions of the entire accrued benefit to be paid as of a specified age prior to normal retirement age, are <u>fundamentally inconsistent with the §1.401(a)-1(b) principle that benefits be paid only after retirement</u>. (Emphasis added.)

Final Treasury regulations provide that a reduction in hours is not retirement, and retirement benefits may not be paid just due to a reduction in hours. Outside counsel has indicated that this cumulative guidance means that “service” includes part-time work, volunteer service, and contracting, and that all such service must stop during the bona fide break in service.

Virginia Law and Policy

In keeping with the available IRS guidance, and as required by the *Code of Virginia* § 51.1-155(B)(3) and (4) as amended effective July 1, 2023, VRS uses a six-month break in service when looking at statutory exceptions for retirees wishing to return to work full-time in a VRS-covered position. (VRS recommends a 12-month break in service.) This six-month break-in-service requirement is a change from the long-standing 12-month break-in-service that had been in place since 2001 and was the result of considerable analysis and review by VRS and the Joint Legislative Audit and Review Commission (JLARC). The break-in-service requirement is intended to satisfy IRS guidance, to protect the VRS plan qualification under the IRC, and to minimize the incentive for employees to retire earlier than they otherwise would. Failure to meet the IRS' facts and circumstances test for a bona fide break in service could jeopardize VRS' plan qualification status, thereby affecting all members and retirees. Since the break in service was only recently changed, it is unclear whether the IRS will consider a six month break in service sufficient. There has not been enough time to determine what impact this change will have on VRS retirements.

Virginia law currently allows retirees to return to work only for limited positions and only after the required break in service.

When returning to work part-time, retirees are required by VRS policy to have a break in service of one full calendar month during a time when the retiree would otherwise have worked. As required by the IRS, neither the full-time nor part-time return-to-work option allows for the post-retirement work with a VRS employer to be prearranged prior to retirement.

Current Virginia law and the VRS plan documents do not provide for an in-service distribution without a break in service. Legislation would be required. Current Virginia law allows generally for employers to provide bonus payments. However, legislation tailored to the proposed retention bonuses or amendments to existing language may be required.

Returning To Work After Retirement

PLR 201147038 references several court cases that confirm the word “retire” has its usual meaning: “to withdraw from one's position or occupation; to conclude one's working or professional career.” This implies a complete withdrawal or conclusion.

The Commonwealth and the IRS recognize that there are circumstances under which a retiree should be allowed to return to work. Allowing retirees to return to work may also help employers address temporary workforce shortages and provide retirees with additional income. The return to work by retirees is not likely to be a long-term solution to workforce issues, however, if there are fewer workers to replace these employees when they ultimately leave the workforce. The proposal in the report mandate exacerbates this workforce challenge by functionally discouraging employees at retirement age from remaining employed full-time for longer and encouraging more retirement-eligible employees to retire and then return to work with less time required for a complete break in service. Data from Idaho, discussed below in Actuarial and Plan Impacts of Return to Work, illustrates the negative impact on retirement patterns of reducing break in service times, particularly for teachers.

Allowing a retiree, regardless of the number of years of service, who has returned to work part-time with the same employer after one full calendar month break in service to then return to work full-time even though they have worked part-time during the required six consecutive calendar month break in service contradicts the common definition of retirement and IRS guidance regarding separation from service. Further, limiting the retirees who can use this provision to only those who have a certain number of years of service, or creating a second set of return-to-work eligibility rules for the same positions, could create confusion for retirees and employers as well as a more complicated administrative process. At a minimum, it expands the different employment categories by creating two more groups for each proposed position: designated retirees who return to work part-time in what would otherwise be a full-time critical shortage or school security officer position after a one-month break in service and plan to convert to full-time after another five months; and designated retirees who completed the one-month break in service, worked part-time for five months in what would otherwise be a full-time critical shortage or school security officer position, and moved into a full-time critical shortage or school security officer position.

Retired teachers and administrators, retired school bus drivers, retired specialized student support position employees, and retired school security officers would each be expanded under the parameters of the report mandate.

Additional return-to-work provisions could result in detrimental changes to retirement patterns, incentivizing retirements earlier than plan assumptions (which are based on historical experience), and could be viewed as facilitating “double dipping” by employees (i.e., the concurrent receipt of a pension benefit and a salary both funded by public dollars). Detrimental changes to retirement patterns are more likely to occur with shorter breaks in service or with an in-service distribution option with no required break that both incentivize members to retire sooner than anticipated.

Further, the VRS plans are assumed to be ongoing entities. While we do not assume a growing member base, we do assume a level population, meaning that when a member terminates or retires their VRS-covered position will be filled by a new active member. This allows VRS to collect contributions as a percentage of covered payroll. If more positions are filled by retirees and their pay is not included in the covered payroll of the employer, employer contribution rates will inherently increase since they will be spread over a smaller covered payroll. In the pooled plans, this could result in all employers paying higher contributions, even if they do not fill positions with retirees instead of active members. Under the current *Code of Virginia*, the required break in service, limited exemptions, and employer contributions required for retirees returning to work are the only protections for the VRS Trust Fund.

Actuarial and Plan Impacts of Return to Work

When reviewing Virginia laws prior to the 2022 report, Gabriel, Roeder, Smith & Company (GRS), VRS’ plan actuary, commended Virginia’s current return-to-work program as consisting of solid, well-thought-out options. GRS suggests that best practices are to require a break in service of sufficient length to discourage employees from retiring simply to take advantage of the return-to-work capability.

It is difficult to create a return-to-work program that incentivizes retired members to return to work without also encouraging current active members to retire and keep working.

Overview of Impacts Under Three Policy Options

Option Two from the 2022 report, without a break in service, is likely to instead encourage retirement so individuals can receive both a salary and retirement benefits. While this policy choice could potentially be an opportunity to help resolve some staffing shortages, it is by nature a stopgap that temporarily maintains the existing workforce with potentially significant corresponding negative impacts to the VRS Trust Fund rather than a comprehensive, long-term solution to develop or recruit new employees. Importantly, this change would likely reverse the positive effects of recent cash infusions made to the Fund.

Retention bonuses for employees in critical shortage positions for each year they continue active employment past retirement eligibility might have a positive impact on retirement patterns in that it would be likely to encourage members to stay actively employed longer. The employee would continue to receive their regular active salary and would receive the annual bonus each year after they reach retirement eligibility. This policy choice also could potentially help resolve some staffing shortages, but is also a stopgap that temporarily maintains the existing workforce without providing a comprehensive, long-term solution to develop or recruit new employees.

Higher salaries, more frequent raises, or other compensation changes such as those described in the 2017 JLARC compensation report would be potential long-term tools that would improve staffing pipelines, improve recruitment of new employees, and improve retention of existing employees, without negatively impacting the VRS Trust Fund. Further, as described above, higher salaries increase retirement benefits without significant risk to the Fund and without jeopardizing VRS' plan qualification status.

Effect of Changes to Retirement Patterns

Earlier than anticipated retirements require payment of retirement benefits for a longer period than was assumed when contribution rates were set. While Virginia's statutory return to work exceptions require that employer contributions be made for retirees returning to work full-time in a critical shortage position or as a school security officer, these contributions do not fully protect the VRS Trust Fund from the deleterious impacts of paying benefits sooner, for longer, and without adequate time to fund the benefits. Over time this scenario will lead to higher contribution rates. If a provision is implemented that allows members to receive their retirement benefit at age 65 while continuing to actively work in a VRS covered position, retirement patterns will change. This will shorten the period of time over which VRS currently assumes members will work, thus increasing normal cost rates to compensate for shorter period over which to accumulate investment income. This is more likely if Virginia implements an in-service distribution option. Since the IRS does not require a break in service for in-service distributions past a certain age, there is little reason for a member who meets the age requirements not to retire, begin receiving a retirement benefit, and then immediately return to employment and also receive a salary. Higher contribution rates will directly impact state and local budgets. Less restrictive return to work provisions could result in higher contribution rates. When contribution rates sharply increase, employers' ability to make 100 percent of the actuarially determined required contributions (ADC) diminishes. The bond rating agencies look skeptically on plan sponsors and employers that do not fully fund the ADC which in turn could impact bond ratings.

Higher contribution rates are more likely if an in-service distribution is implemented, since there is no break in service required to deter members from retiring immediately upon eligibility, begin receiving a retirement benefit, and immediately returning to employment and receiving a salary.

When an employee retires earlier than assumed, it adds costs to the plan since retirement benefits may be paid for a longer period than anticipated when contribution rates were set. Further, the plan has less time to generate the investment earnings needed to fund benefits. Historically, approximately two-thirds of benefits are funded by investment income, so this is an important element to consider. Allowing members to retire and immediately return to work, as suggested in Option Two, is expected to impact retirement patterns and the VRS Trust Fund overall more than current return to work provisions that require a meaningful break in service.

Allowing members to retire and return to work with no break in service means that VRS benefits will be paid sooner than expected, with less time for contributions to be invested and generate earnings needed to fund benefits, which will also be paid for longer than expected.

Retirees returning to work full-time under existing exemptions in the *Code of Virginia* do not accrue additional retirement benefits. Further, return to work is considered an exception only for these limited circumstances since it can have negative impacts on VRS retirement plans by incentivizing members to retire earlier than originally expected and increasing cost-sharing requirements for all employers in the plans if replacing current covered positions with retirees. The implications of incentivized early retirement would impact individual political subdivision plans and VRS plans, and the amount of the impact would vary based on utilization of the provision within each of the plans.

Current Virginia Return-to-Work Options

Since retirement is understood as leaving the workforce, in general, under current law a retiree who returns to VRS-covered (typically full-time) employment must “unretire” and become an active member again, ending the retirement benefit in accordance with § 51.1-155(B)(1) of the *Code of Virginia*. Retirees who stop receiving a retirement benefit and return to active VRS-covered employment accrue additional service and compensation. Virginia's current return to work opportunities that do not require unretiring were discussed in detail in the 2022 report. Only a summary is provided here for ease of reference. See Appendix A for updates to the 2022 report data on use of existing options.

Part-time or Non-covered Employment

In general, retirees can continue to receive retirement benefits while working in a part-time position of up to 80% of the hours of VRS-covered position with a VRS-participating employer after a bona fide break in service of one full calendar month over a period when they would otherwise be working. Part-time employees generally do not accrue retirement benefits and are not reported to VRS.

Interim Employment

In some limited cases, retirees can work in a full-time interim position for up to six months without interruption in retirement benefits. These arrangements are generally for executive positions, such as county administrators, chief financial officers, and other positions that are crucial to the organization and may be difficult to fill quickly. Employers must receive VRS approval before hiring a retiree in the position and VRS requires a one full calendar month bona fide break in service.

Full-Time Employment Exemptions: Critical Shortage and School Security Officer Positions

In general, a retiree is not permitted to be employed full-time with a VRS-participating employer and continue to receive VRS benefits. The General Assembly has established four position categories that are exempt from this general rule if the employee has a bona fide break in service of six consecutive calendar months from the date of retirement. An eligible retiree may return to work full-time in one of these position categories and continue to receive retirement benefits if they meet the statutory requirements:

- instructional or administrative employees licensed by the Board of Education in a critical shortage position (since 2001),
- school bus drivers in a critical shortage position (since 2020),
- school security officers (since 2020), and
- specialized student support personnel employees in a critical shortage position (since July 1, 2023).

These employed retirees do not accrue additional retirement benefits.

Difference Between Existing Return-to-Work Provisions and the 2023 Report Mandate

There are three differences between current law and the report mandate: the types of retirees allowed to use the mandate’s proposed RTW exception; the length of service the retiree must have; and the length of the required break in service. The enactment clause in the 2023 bills requesting this report covers only retired instructional or administrative employees, specialized student support position employees, bus drivers, or school security officers with at least 25 years of service. The report mandate is to review whether this limited group of retirees would be allowed to work in temporary or part time positions during the six month break in service without impact to retirement benefits and without impacting the six-month break required. Limiting this opportunity to only retirees from these positions and only for retirees with at least 25 years of service is more restrictive than current law specifies.

Retirees Allowed to Return to Work

Current law allows "any person receiving a service retirement allowance under this chapter" to return to work full-time in designated positions under § 51.1-155(B)(3) and (4) and continue to receive their retirement benefit if the retiree holds any required credentials or certifications for the position they wish to return to. The 2023 report mandate considers only certain "retired instructional or administrative employees, specialized student support positions employees, bus drivers, or school security officers …." This would mean that a retiree who retired from a different position but is otherwise qualified for a critical shortage or school security officer position would not be eligible for the proposed exception.

Length of Service

Under current law, there is no length of service requirement retirees must have met in order to be eligible to return to work full-time and continue to receive their retirement benefit as long as they are eligible to retire. The report mandates require that members who retire from eligible positions must have had at least 25 years of VRS service prior to retirement to take advantage of the additional exception.

While these requirements potentially limit the pool of candidates, VRS Plan 1 members must be age 65 with 5 years of service or age 50 with 30 years of service, and Plan 2 and Hybrid Retirement Plan members must either be age 67 with 5 years of service or achieve the Rule of 90 between age and service to receive an unreduced service retirement. A reduced service retirement could be taken much sooner for all three plans but is a substantially lower benefit. Even if the 25 years must be served in the same type of position, the requirement to have at least 25 years of service does not provide meaningful limits on the retirees who may qualify for this exception.

It is important to note, however, that in the 2016 Normal Retirement Age (NRA) Advanced Notice of Proposed Rulemaking (ANPRM)[10] Treasury and the IRS state that a governmental plan such as VRS should not provide for a Normal Retirement Age (the age a member is eligible for an unreduced retirement benefit) that is earlier than at least 25 years of service or age 60 with five years of service. Allowing members with less service to take advantage of the suggested proposals would likely not comply with the ANPRM.

Break in Service

Current law and VRS policy require that if a retiree returns to work part-time with less than six consecutive calendar months break in service, they must fully separate from part-time employment and complete a subsequent full six consecutive calendar month break in service before they may return to eligible full-time positions and continue to receive their retirement benefit.

The proposal in the report mandate would allow the specified retirees to complete a one calendar month break in service, return to temporary or other non-full-time positions (part-time positions) in the positions described in § 51.1-155(B)(3) and (4), and have the time served in the

[10] Advanced Notice of Proposed Rulemaking on Applicability of Normal Retirement Age Regulations to Governmental Pension Plans, 81 FR 4599. https://www.federalregister.gov/documents/2016/01/27/2016-01639/applicability-of-normal-retirement-age-regulations-to-governmental-pension-plans

temporary or part-time position count toward the six consecutive calendar months break in service. Presumably, the intent is that they would be allowed to return to work full-time in an eligible position under § 51.1-155(B)(3) or (4) upon reaching the six consecutive calendar month mark from retirement even if they have been working for a VRS-participating employer during that time. This is contrary to IRC guidance that all employment, including part-time (and even volunteer) employment with a VRS-participating employer, must stop to be considered a break in service.

Policy Options

In the 2022 report, VRS included several policy options for the General Assembly to consider that would allow VRS retirees to return to work sooner while continuing to receive their retirement benefits. One option that was not considered during the 2023 General Assembly session is Option Two, allowing an in-service distribution with no break in service (retire and immediately return to work) after a specific age. A second option is to formalize a retention bonus for each year employees in specific positions remain actively employed after retirement age. A third option is to provide salary increases as recommended in the 2017 JLARC compensation report to improve recruitment of new employees and retention of existing employees who have not reached retirement age.

From a fiduciary standpoint, any return-to-work program such as the in-service distribution option should be structured to balance providing some flexibility for retirees to return to work in certain circumstances with not incentivizing current active employees to simply retire earlier in order to collect both retirement benefits and an active salary. If the General Assembly's intent is to solve for particular workforce issues, then a targeted approach with any of the three policy options may isolate the variables that may help fill positions without negatively impacting the retirement plan. The three policy options are discussed below, with actuarial analyses that follow.

The options included in the 2022 report and the additional options included in this report were designed with risk mitigation in mind. Since, as noted in the 2022 report, under § 51.1-160 of the *Code of Virginia*, VRS members receiving disability retirement generally cannot return to work and continue to receive their retirement benefits, none of the options allow VRS members retired for disability to return to work and continue to receive a disability retirement benefit.

Table 1 below summarizes the possible variations of Option Two, the retention bonus option, the salary increase option, and their impacts. In general, the Option Two variations will be more costly and will take more time to prepare for from an implementation standpoint if they apply only to certain positions versus all jobs or all existing exceptions uniformly. For example, the 2023 report mandate suggests the proposal should only apply to certain retirees. The implementation for this would be more costly than applying it to all retirees. Nevertheless, overall impact to the VRS Trust Fund will be greater if the provision is not narrowly tailored. The 2023 report mandate also suggests the proposal should also only apply to these certain retirees if they have at least 25 years of service. This will add additional implementation costs.

Table 1. Summary of Option and Impacts

Options	Policy Change	Additional Employees	Implementation Cost
Original Option Two from 2022 report- Allow any retiree who retires past a specific age to continue to work with no break in service while receiving retirement benefits*	Provides additional flexibility	Any employee who reaches the designated age (plan Normal Retirement Age and at least age 59 ½ to avoid an IRS tax penalty)	$620,000 (one-time); $15,000 (per year, ongoing)
Option Two for Retirees from Specific Positions- Allow only retirees from critical shortage or school security officer positions who retire past a specific age to continue to work with no break in service while receiving retirement benefits*	Provides additional flexibility for high need positions	Any employee in critical shortage or school security officer positions who reaches the designated age (plan Normal Retirement Age and at least age 59 ½ to avoid an IRS tax penalty)	At least $620,000 (one-time); $15,000 (per year, ongoing)
Option Two for Retirees with Minimum Years of Service- Allow only retirees from any position who retire past a specific age with a minimum number of years of service to continue to work with no break in service while receiving retirement benefits*	Provides additional flexibility and may help to prevent significant changes to retirement patterns	Any employee who reaches the designated age (plan Normal Retirement Age and at least age 59 ½ to avoid an IRS tax penalty) and has a minimum number of years of service	At least $620,000 (one-time); $15,000 (per year, ongoing)
Option Two for Retirees from Specific Positions and With Minimum Years of Service- Allow only retirees from critical shortage or school security officer positions who retire past a specific age and with a minimum number of years of service to continue to work with no break in service while receiving retirement benefits*	Provides additional flexibility and may help to prevent significant changes to retirement patterns	Any employee in critical shortage or school security officer positions who reaches the designated age (plan Normal Retirement Age and at least age 59 ½ to avoid an IRS tax penalty) and has a minimum number of years of service	At least $620,000 (one-time); $15,000 (per year, ongoing)
Retention Bonus- Provide a bonus to each critical shortage employee or school security officer each year the employee remains actively employed after reaching retirement eligibility	Does not require a break in service and avoids significant changes to retirement patterns	Any employee in critical shortage or school security officer positions who becomes eligible for retirement	No implementation cost (there may be some minimal cost if VRS reporting is required to determine eligibility)
Salary Increase- Increase starting salaries for each critical shortage employee or school security officer and provide regular salary increases	Does not require a break in service and avoids significant changes to retirement patterns; automatically increases retirement benefits by increasing AFCs	Any employee in critical shortage or school security officer positions who becomes eligible for retirement	No implementation cost

*All in-service distribution variations assume employer contributions will be paid; requiring employer contributions and age restrictions serve to help mitigate impacts to the VRS Trust Fund of retirees returning to work, and demonstrates compliance with IRC.

It should be noted at the outset that, as demonstrated by the analysis of retirement plans from other states in the 2022 report, Virginia's current return-to-work provisions are consistent with many of these other plans.

As the fiduciary of the plan, VRS encourages a cautious, deliberate approach to any changes in return-to-work laws in Virginia or the enactment of any expansions of the existing exceptions. Expanding return-to-work rules could have a negative impact on the VRS Trust Fund, as demonstrated by Idaho's experience with the shorter break in service resulting in a lower average retirement age. In general, VRS would recommend that the General Assembly ensure that any expansion be time-delimited with a sunset of no more than five years from its effective date. A sunset provision should coincide with the existing sunset provision of 2028 in § 51.1-155(B)(3) of the *Code of Virginia*. This allows VRS and the General Assembly to both evaluate the effectiveness of the changes and analyze the effects of changes on the VRS Trust Fund, the funded status of the plans, and future employer contributions. Such an evaluation would be consistent with the statutory requirement that VRS complete an actuarial investigation every four years of the experience under the return-to-work laws governing critical shortage and school security officer positions.[11]

The impact to ancillary benefits, such as COLAs, the hazardous duty supplement, and the HIC should be considered.

There are additional questions that the General Assembly may wish to consider if changes such as Option Two or retention bonuses are recommended:

- **Cost-of-living adjustment (COLA)** - Current retirees receive a COLA in accordance with § 51.1-166 of the *Code of Virginia*. Should retirees opting to return to full-time employment in a VRS-covered position while continuing to receive retirement benefits in addition to a salary also continue to receive COLAs, designed to address the impact of inflation on retirement benefits, while employed in a full-time position with a VRS employer?
- **Enhanced Hazardous Duty Supplement** – The enhanced hazardous duty supplement, currently $16,884 annually, is provided to certain hazardous duty retirees in accordance with § 51.1-206(B), § 51.1-217(B), or § 51.1-138 (B) of the *Code of Virginia*. The supplement was created to help hazardous duty members who generally retire at an earlier age due to the physical and mental requirements of the job, and adds to their income from the date of retirement until age 65 or Social Security retirement age (depending on the plan from which they retire) in an effort to bridge their income until they become eligible for Social Security. Is this supplement needed if they return to a full-time VRS covered position after retirement before age 65 or Social Security eligibility and continue to receive their retirement benefit in addition to a salary?
- **Health insurance credit (HIC)** – Many VRS retirees qualify for a HIC under Title 51.1, Chapter 14 of the *Code of Virginia*, which can be used to offset the cost of healthcare premiums in retirement. If they return to full-time employment in a VRS-covered position after retirement

[11] Va. Code § 51.1-155(B). This requirement was enacted in 2020, 2020 Va. Acts ch. 968, 969, and the initial actuarial analysis will be completed in fiscal year 2025 as part of the quadrennial actuarial experience study.

and elect active employee health care, often subsidized by the employer, should they be allowed to use HIC benefits to further offset the cost of active healthcare premiums?

For any statutory changes, VRS will need sufficient time to implement programming and communication efforts to its employers and members. The analysis of each option in the 2022 report included an estimate of the time and funding that may be necessary for implementation. Since VRS systems are designed to prevent a member from receiving a retirement benefit while receiving a salary as an active employee, VRS' implementation costs for the in-service distribution option are estimated at approximately $620,000 in one-time costs, with approximately $15,000 annually following initial implementation. Additionally, it will be more costly and will take more time for a provision or requirement that applies only to certain positions versus all jobs or all existing exceptions uniformly. Although suggested, changes to the COLA, hazardous duty supplement, and HIC will also increase costs to implement. Additional information regarding variables in costs are discussed further below. The costs discussed here do not include potential impacts to the VRS Trust Fund such as generating liabilities from experience that differs from assumptions or to employer contribution rates.

Policy Option: In-Service Distribution With No Break in Service (Option Two)

Of particular relevance to the report mandates, the in-service distribution with no break in service option (Option Two from the 2022 report) would allow retirees who have reached a specific age to return to work with no break in service, consistent with IRS guidance. Implementing this program could encourage employees who would otherwise retire and leave service entirely to instead retire and immediately return to service for at least some additional period of time. However, it could also encourage employees who would otherwise stay actively employed to retire as soon as they are eligible for the program and return to work. The option would be a significant departure from how VRS currently administers retirement benefits, would require a significant investment of time and effort to implement, and is expected to have a detrimental impact on the VRS Trust Fund, discussed in more detail below.

Consistent with existing Virginia return to work laws, VRS recommends that employer contributions be required for any retiree returning to work full-time, including if Option Two is implemented. This helps to partly protect employer contribution rates and offset the impact to the VRS Fund when replacing VRS active covered positions with retired members, which could lower covered payroll.

The in-service distribution option without a break in service would set a specific age after which a person who has retired can return to full-time employment with a participating employer while continuing to receive retirement benefits. Under this option, all retirees who reach the specified age would be able to return to work full-time with a participating employer with no break in service. Note that the elimination of the break-in-service requirement cannot be applied universally and can only be applied in circumstances when a retiree has reached a certain age.

Keeping in mind the likely potential detrimental impacts to the plans discussed in the Actuarial Analysis section, the higher Normal Retirement Age (NRA)[12] for each plan would be the recommended

[12] The IRS has established that in-service distributions may be allowed as early as age 59 ½ without a tax penalty, or older as required by the plan. 26 U.S.C. § 72(t).

threshold for most VRS retirees to be allowed to return to work full-time in a covered position. Since the IRS specifies age 59 ½ as the earliest an individual could receive an in-service distribution without a tax penalty, the recommended ages below do not allow for in-service distributions based on service rendered, where the member retires and immediately returns to work while receiving a retirement benefit, even if the service rendered would otherwise allow the member to retire.

VRS proposes the following ages for an in-service distribution option:

- General employees Plan 1 – Age 65
- General employees Plan 2/Hybrid – Social Security Normal Retirement Age
- Hazardous duty members - Age 60.

Note: As required under current return to work options in the *Code of Virginia*, employer contributions should be required on behalf of members returning to work using the in-service distribution option.

None of the return-to-work options are applicable to JRS as recall of retired judges is covered in Title 16.1 and Title 17.1.

In addition to the requirement that the retiree has reached the requisite age threshold, this option would require that, like the existing statutory exceptions:

- the retiree has not retired under an early retirement incentive program;
- the service performed and compensation received by the retiree during employment will not increase, decrease, or affect in any way his retirement benefits, including the cash match under chapter 6.1 (§ 51.1-607 et seq.), if the retiree elects to continue to receive the retirement allowance while employed; and
- the employer must include the person's compensation in membership payroll subject to employer contributions.

The average retirement age for Virginia teachers is age 63. Although the IRC allows in-service distributions with no break in service as early as age 59 ½ without an early distribution penalty, using a General Employee allowable in-service distribution age that is lower than those suggested would be more likely to change retirement patterns Shortening a members expected working lifetime and therefore increasing the annual cost of funding benefits would result in higher employer costs.

As noted above, a lower age for public safety employees would be applicable since these employees may retire earlier from public safety positions, as early as age 50 with 25 years of service, in recognition of the more hazardous and physically demanding nature of the positions.[13] However, IRC permits an in-service distribution without tax penalties only after age 59 ½. Using the highest NRA for each plan takes this into account. With respect to the federal HELPS Act, VRS' outside benefits counsel notes that in order to exclude a portion of retirement plan distributions used to pay health insurance

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[13] The *Code of Virginia* also allows VRS members working in hazardous duty positions (members of the State Police Officers' Retirement System (SPORS), the Virginia Law Officers' Retirement System (VaLORS), and certain employees of local governments whose employers have elected enhanced hazardous duty benefits) to retire earlier than most other members. These employees may retire with an unreduced retirement benefit as early as age 60 with at least five years of service or age 50 with at least 25 years of service credit. Alternatively, they may retire with a reduced benefit as early as age 50 with at least five years of service credit.

premiums from federal gross income, federal law requires eligible public safety officers to have a break in service. VRS cannot provide tax advice or address how Option Two might affect tax benefits from the HELPS Act. The mental and physical demands of public safety positions should be carefully considered when determining whether to allow in-service distributions with no break in service for individuals in these positions. Please see the VRS and Department of Criminal Justice Services' *Report to the General Assembly: Return to Work for Law-Enforcement Officers Retired from VRS* for additional discussion.

Also relevant is that while individuals may be eligible for Social Security benefits if they retire earlier, Medicare eligibility does not begin until age 65. Members who retire under an in-service distribution option and then return to work and receive active health insurance coverage will not be immediately impacted. Any impact on Medicare eligibility upon a second retirement should be considered.

Policy Option: Retention Bonus

Another policy option to consider that would focus more on retaining existing employees rather than encouraging them to return after retirement would be to provide retention bonuses for employees for each year they continue active employment past retirement eligibility. An eligible employee would continue to receive their regular active salary and would receive an annual bonus each year they continue to work after they reach retirement eligibility. This bonus could be limited to certain positions, such as critical shortage and school security officers positions, or could be effectuated for other employees. Implementing a retention bonus program could encourage existing employees who would otherwise retire and leave service entirely to instead stay actively employed longer for at least some additional period of time.

Unlike the in-service distribution option, retention bonuses would not encourage employees who would otherwise stay actively employed to retire and return to work or pursue the in-service distribution option. This new policy option would likely require an appropriation and associated language to provide retention bonuses for each year eligible employees continue active employment past retirement eligibility. While it is not necessary for implementation, as with other bonuses members could choose to defer some or all of this bonus to their defined contribution plan retirement account within the contribution limits permitted by the IRS.

This option will potentially cost the Commonwealth less overall than expanding return to work options or adding an in-service distribution with no break in service. It would also help preserve the long-term integrity of the VRS Trust Fund. Of vital importance, if the Commonwealth and local employers choose to pay this retention bonus they would not be paying both a salary and retirement benefits plus other pension benefits such as cost of living adjustments or hazardous duty supplements.

Retention bonuses for employees past retirement eligibility might also have a positive impact on retirement patterns since these bonuses could encourage members to stay actively employed longer. This policy choice also could potentially help resolve some staffing shortages, but is still a temporary stopgap that maintains the existing workforce rather than providing a comprehensive, long-term solution to develop or recruit new employees. The retention bonus option would give eligible employees a retention bonus for each year they continue to work after reaching retirement eligibility.

This policy option would not be administered by VRS, although VRS could help confirm retirement eligibility. Bonuses do not directly impact retirement patterns, and do not impact the health of the VRS Trust Fund or retirement benefits since bonuses are not considered creditable compensation for retirement benefit calculations. The *Code of Virgini*a and the Appropriation Act provide authorization for bonuses, although legislation may be required to codify eligibility parameters and budget funding or language may be necessary to ensure funds are available.

Policy Option: Salary Increase

As noted earlier, the 2017 JLARC report describes more fully suggested salary increases as a key option for improving recruitment and retention of public employees. This option would provide higher starting salaries for new employees. It would also provide more frequent, larger, and more reliable raises for existing employees. The *Code of Virginia* and the Appropriation Act provide authorization for salaries, although legislation may be required to codify expectations and budget funding or language may be necessary to ensure funds are available.

This policy option would not be administered by VRS. Salary increases do not directly impact retirement patterns, do not impact the health of the VRS Trust Fund since they are accompanied by associated employee and employer contributions, and have the added effect of increasing the AFC used to calculate retirement benefits thereby increasing retirement benefits.

Actuarial Analysis of Potential Policy Options

This analysis considers the impact of the options on continued stable contribution rates for employers and on the soundness of the plan, as required by § 51.1-145 of the *Code of Virginia*. The analysis below assumes that the existing sunset and actuarial investigation provisions in § 51.1-155(D) of the *Code* will remain in place. It also assumes that employer contributions will continue to be paid on creditable compensation for any position filled by a retiree who receives retirement benefits from VRS while also actively working in a full-time VRS covered position.

Cost impacts to VRS associated with return-to-work provisions are generally associated with changing the patterns of retirement. The funding policy used by VRS collects funds over a member's working career, and in combination with investment earnings, provides the revenue to pay lifetime benefits to members after they retire. The age at which a member chooses to retire is a personal decision based on many factors and therefore it is difficult to model cost impacts without any historical experience on how members may react to relaxed provisions around returning to work after retirement or retiring from active status but continuing to work for a VRS employer.

Any provision or policy that incentivizes a member to retire earlier than they would otherwise will ultimately increase the cost of VRS-administered pension plans and related benefits. Either shortening the period of time over which benefits are funded, or lengthening the amount of time that a member receives benefits, will increase plan liabilities. The magnitude of the increase would depend on the significance of the change and the volume of members that it impacts.

The current return-to-work policy allows retirees to return to work part-time with the same employer after a one full calendar month break in service as long as they work no more than 80% of the hours of a full-time employee. As mentioned in the 2022 report, VRS does not require part-time employees to be reported to VRS, therefore VRS does not have data concerning how many retirees are currently taking advantage of this policy. However, VRS data indicate that there is no evidence that the current policy causes changes in retirement behavior patterns since it does not incentivize retirement.

Similarly, the critical shortage return-to-work exceptions that are in place also appear to have minimal impact on VRS costs. Currently, these programs appear to be under-utilized based on the numbers shown in the 2022 report. This could be due to the break-in-service requirement, but there may also be a somewhat limited pool of retirees who wish to return to work on a full-time basis. It may also be because retirees can return to work on a part-time basis after a one full calendar month break in service. However, based on limited experience and data following the 2023 changes to the break-in-service legislative requirements from 12 to six months, there has been a noticeable uptick in utilization. It is necessary to recognize that the driving force behind retirement and whether a retiree would even consider returning to work will vary by member. The level of their pension benefits, their individual health status, the overall state of the economy, as well as financial well-being, family, and job-related characteristics all can play a part in a decision to return to work.

Analysis of In-Service Distribution Option: Retirees Past a Specific Age to Continue to Work While Receiving a Retirement Benefit With No Break in Service

An in-service distribution option would allow retirees who have reached a specific age to continue to work while receiving a retirement benefit with no break in service. Under this option, all members who reach the specified age and who are vested would be able to return to work full time with a participating employer with no break in service. While this is offered as an option for return to work, it would be better classified as a retention policy, as it more directly targets current active members rather than retired members. Also, it is important to note that the elimination of the break in service requirement cannot be applied universally and can only be applied, due to IRS requirements, in circumstances when a retiree has reached a certain age. Further, this is an approach rarely used by other public pension plans due to the likelihood of changing retirement patterns and associated potential for adverse impacts to plans.

As discussed earlier in the report, in 2018, Idaho found that teacher retirees returning to work cost the system an additional estimated $28,192 per person in additional liability. This was based on a $25,000 starting salary and retirement after 30 years of service. Virginia's starting salary for teachers with a Bachelor's degree averages $43,852[14], and Virginia teachers generally retire at age 63.

VRS is a mature retirement system and has a fair number of active members who either are already eligible for a full unreduced retirement or currently meet the requirements for an early reduced retirement. Table 2 below shows the number of members currently eligible for retirement.

[14] VRS calculation using VDOE data on the 2021-2022 starting salaries in the 2020-2021 Teacher Salary Report at [Education Workforce Data & Reports | Virginia Department of Education]

Table 2. VRS Members Eligible for Retirement as of June 30, 2023

	Total actives	Eligible for full *unreduced* retirement	% of actives eligible for *unreduced* retirement	Eligible for reduced early retirement	Total eligible for retirement (reduced or unreduced)	% of actives eligible for retirement
By Plan						
Local	87,929	6,903	8%	16,331	23,234	26%
Local HD	26,845	1,773	7%	2,517	4,290	16%
SPORS	1,920	312	16%	130	442	23%
State	79,238	7,980	10%	15,595	23,575	30%
Teachers	153,151	8,116	5%	29,438	37,554	25%
VaLORS	7,543	516	7%	885	1,401	19%
Total	**356,626**	**25,600**	**7%**	**64,896**	**90,496**	**25%**
By Benefit Tier						
Plan 1	115,231	22,213	19%	53,556	75,769	66%
Plan 2	78,247	2,019	3%	6,795	8,814	11%
Hybrid	163,148	1,368	1%	4,545	5,913	4%
Total	**356,626**	**25,600**	**7%**	**64,896**	**90,496**	**25%**

Source: VRS data as of June 30, 2023

Approximately 7% of the entire active population, including state and local employees, or 25,600 members, are already eligible for a full unreduced retirement, but continue to work. Another 64,900 members are eligible for an early reduced retirement, so as of June 30, 2023 in total approximately 25% of the active population are eligible to retire.

Based on the population demographics, the in-service distribution option has the greatest potential to impact retirement patterns and increase the liabilities and cash flow requirements of the retirement plans. While the IRS provides some flexibility in the setting of the age for benefits to begin without a break in service, VRS along with its plan actuary would strongly caution against selecting an age that is below the current highest "Normal Retirement Age" as defined in the plans. Selecting an age for the in-service distribution option that is below the Normal Retirement Age would have a greater impact on retirement patterns, which would ultimately increase costs significantly across the pension plans. Further, retirement distributions prior to age 59 ½ result in tax penalties.

To provide some insight into how many members might be eligible for an exception such as that described in the report mandate, the tables below show how many active members currently meet similar criteria.

Table 3 shows how many retired VRS Teacher Plan employees have at least 25 years of service, as suggested in the report mandate. VRS reporting does not differentiate between most types of employees, so data is not available specifically for bus drivers.

Table 3. Retirees with at least 25 years of service, by current age.

Current Age	< 25 years of service	≥ 25 Years of Service	Total
< age 55	219	415	634
Age 55-64	5,445	7,818	13,263
65-74	21,683	24,480	46,163
75-84	13,082	16,696	29,778
85+	3,581	3,977	7,558
Total	**44,010**	**53,386**	**97,396**

Source: VRS data as of June 30, 2023

Table 4 shows how many active VRS Teacher Plan employees have at least 25 years of service, as suggested in the report mandate. VRS reporting does not differentiate between most types of employees, so data is not available specifically for bus drivers.

Table 4. Active Teacher Plan Members with at least 25 years of service, by current age.

Current Age	< 25 years of service	≥ 25 Years of Service	Total
< age 35	35,288	0	35,288
Age 35-44	39,321	10	39,331
45-54	37,422	6,619	44,041
55-64	22,617	7,251	29,868
65-74	3,135	1,221	4,356
75+	182	85	267
Total	**137,965**	**15,186**	**153,151**

Source: VRS data as of June 30, 2023

The IRC allows in-service distributions as early as age 59 ½ without a tax penalty. Table 5 below shows the number of active members as of June 30, 2023 who would meet the eligibility for Option Two at the IRS' earliest allowed age of 59 ½. This represents approximately 12% of the active population.

Table 5. VRS Active Members Currently Eligible for Retirement Under an In-Service Distribution Option, at Age 59 ½

	Total actives	Eligible for full *unreduced* retirement	% of actives eligible for *unreduced* retirement	Eligible for reduced early retirement	Total eligible for retirement (reduced or unreduced)	% of actives eligible for retirement
By Plan						
Local	87,929	5,701	6%	8,234	13,935	16%
Local HD	26,845	712	3%	71	783	3%
SPORS	1,920	91	5%	3	94	5%
State	79,238	6,308	8%	7,222	13,530	17%
Teachers	153,151	5,318	3%	10,145	15,463	10%
VaLORS	7,543	341	5%	39	380	5%
Total	**356,626**	**18,471**	**5%**	**25,714**	**44,185**	**12%**
By Benefit Tier						
Plan 1	115,231	15,087	13%	15,570	30,657	27%
Plan 2	78,247	2,017	3%	5,602	7,619	10%
Hybrid	163,148	1,367	1%	4,542	5,909	4%
Total	**356,626**	**18,471**	**5%**	**25,714**	**44,185**	**12%**

Source: VRS data as of June 30, 2023

Although VRS is not supportive of expanding retiree return to work options, if the General Assembly were to adopt this option, VRS would recommend the following ages for an in-service distribution option:

- General employees Plan 1 – Age 65
- General employees Plan 2/Hybrid – Social Security Normal Retirement Age
- Hazardous duty members - Age 60[15].

Note: As required under current return to work options in the *Code of Virginia*, employer contributions should be required on behalf of members returning to work using the in-service distribution option.

The recommended ages above generally mirror the higher age component of VRS plan normal retirement ages for unreduced benefits for VRS Plan 1, Plan 2, and the Hybrid Retirement Plan, and for SPORS and VALORS, all with at least five years of service.

- For VRS Plan 1, members may retire with an unreduced benefit at 65.
- For VRS Plan 2 and Hybrid, members may retire with an unreduced benefit at Social Security Normal Retirement Age (SSNRA).
- For SPORS and VALORS, members may retire with an unreduced benefit at age 60.

[15] If below age 59 ½ the member will be subject to an IRS 10% early distribution penalty if there has not been a bona fide break in service.

Table 6 below shows the number of active members as of June 30, 2023 who would meet the eligibility for the proposed ages, which represents approximately 4% of the active population.

Table 6. Active Members Currently Eligible for Retirement Under An In-Service Distribution Option (at age 65- Plan 1; at Social Security NRA- Plan 2/Hybrid; at age 60- Hazardous duty members)

	Total actives	Estimated # of Actives Eligible for Proposed In-Service Distribution Option	% of actives eligible for Proposed In-Service Distribution Option
By Plan			
Local	87,929	4,331	5%
Local HD	26,845	685	3%
SPORS	1,920	82	4%
State	79,238	4,025	5%
Teachers	153,151	3,503	2%
VaLORS	7,543	331	4%
Total	**356,626**	**12,957**	**4%**
By Benefit Tier			
Plan 1	104,459	8,781	8%
Plan 2/Hybrid	215,859	3,078	1%
HD	36,308	1,098	3%
Total	**356,626**	**12,957**	**4%**

Source: VRS data as of June 30, 2023

Because this option would allow eligible members to collect a retirement benefit, a full-time salary, and continue to have subsidized healthcare, we believe more members would retire earlier than they otherwise would have under this option. Likely most of those eligible for an unreduced retirement would be expected to take advantage of this option. However, it will not help in filling any of the current openings as these members are already active. This option has the potential to increase liabilities due to benefit payments being paid sooner and for a longer amount of time, while providing net zero new employees for employers. As stated above, VRS along with its plan actuary would also strongly recommend requiring employer contributions for these retirees returning to work full-time in order to protect the funding levels of the plans and to avoid increasing contribution rates due to decreasing active member covered payrolls if positions are filled with retirees.

Due to changes in retirement patterns anticipated with this change, actuarial decrements in the valuation process would need to be adjusted and would in turn increase the plans' liabilities and result in increased costs. Assuming all Teachers who currently are at or above age 65 with at least 5 years of service, approximately 3,500 members, would immediately retire under this provision the Teacher plan unfunded liability would be expected to increase by nearly $115 million and cash flow requirements would increase by nearly $54 million in the first year. In addition, due to changing retirement patterns, an increase in annual costs associated with other active members in the Teacher plan would also be expected to occur over time. These retirees would also continue to qualify for employer-subsidized health care.

Example: General Employees	*Example: Hazardous Duty Employee*
A general employee such as a Plan 1 member in the Teacher plan who attains the age of 65 could begin to receive their retirement benefit and continue to work without a break in service. If the member were making $60,000 per year and had 25 years of VRS service, they could commence their benefit of approximately $25,500 per year and continue to receive their annual compensation of $60,000 and employer subsidized health care if they remained actively working. This would represent an increase in annual income of 42.5%, for a total of approximately $85,500 per year. The member would be eligible for both COLAs and pay increases going forward. This might encourage older active members to continue to work after retirement longer than they might otherwise.	A hazardous duty member, such as a SPORS member, who attains the age of 60 could commence their benefits without a break in service. If the member were making $80,000 per year and had 25 years of service, they could commence their benefit of approximately $37,000 per year and continue to receive their annual compensation of $80,000 and employer subsidized health care if they remained actively working. In addition, they would also receive the hazardous duty supplement of $16,884 per year until they reach their SSNRA. This would represent an increase in annual income of 67.4%, for a total of $133,884 per year. The member would be eligible for both COLAs and pay increases going forward.

Implementation Costs for an In-Service Distribution Option

VRS anticipates that, independent of impacts to the VRS Trust Fund, an in-service distribution option, allowing any retirees who have reached the plan's Normal Retirement Age to begin receiving retirement benefits while continuing to work full-time without a break in service, will have significant administrative impact on VRS. Since VRS is currently implementing major programming changes for employer contribution rates, a delayed effective date of July 1, 2025, would be requested. Based on that effective date, implementation is estimated to be a one-time cost of approximately $620,000, primarily for significant programming, testing, and communications efforts. Communication efforts include revising all member and retiree handbooks to include the new program, printing several handbooks and guides, as well as revising employer and member web content. Note that implementation assumes that, like current law, employers will be required to include all hired retirees' payroll for employer contribution calculations. VRS estimates ongoing administrative costs of approximately $15,000 each year. Restricting the retirees who are eligible, either by position from which they retire, years of service, or both, will likely increase the cost. This is due to bifurcated options that require multiple rules for retirees who qualify and those who do not qualify, and additional administrative burden. Nevertheless, overall impact to the VRS Trust Fund will be greater if the provision is not narrowly tailored.

Analysis of Retention Bonus Option: Members Who Are Eligible for Retirement Receive a Retention Bonus for Each Additional Year Worked and Continue to Earn Service Credit

A retention bonus option would allow active employees who have reached retirement eligibility to continue to work and receive a bonus for each additional year they work past retirement eligibility. This targets current active members and encourages them to continue working rather than targeting active members and encouraging them to retire. Since bonuses are not included in creditable compensation, retention bonuses under this option would not impact employer or employee contributions or the VRS funded status.

As noted above, VRS has a fair number of active members who either are already eligible for a full unreduced retirement or currently meet the requirements for an early reduced retirement. Table 7 below shows again the number of members currently eligible for retirement who would meet the general requirements for the suggested retention bonus.

Table 7. VRS Members Eligible for Retirement-Eligible Retention Bonus Option as of June 30, 2023

	Total actives	Eligible for full *unreduced* retirement	% of actives eligible for *unreduced* retirement	Eligible for reduced early retirement	Total eligible for retirement (reduced or unreduced)	% of actives eligible for retirement
By Plan						
Local	87,929	6,903	8%	16,331	23,234	26%
Local HD	26,845	1,773	7%	2,517	4,290	16%
SPORS	1,920	312	16%	130	442	23%
State	79,238	7,980	10%	15,595	23,575	30%
Teachers	153,151	8,116	5%	29,438	37,554	25%
VaLORS	7,543	516	7%	885	1,401	19%
Total	**356,626**	**25,600**	**7%**	**64,896**	**90,496**	**25%**
By Benefit Tier						
Plan 1	115,231	22,213	19%	53,556	75,769	66%
Plan 2	78,247	2,019	3%	6,795	8,814	11%
Hybrid	163,148	1,368	1%	4,545	5,913	4%
Total	**356,626**	**25,600**	**7%**	**64,896**	**90,496**	**25%**

Source: VRS data as of June 30, 2023

Approximately 7% of the entire active population, including state and local employees, or 25,600 members, are already eligible for a full unreduced retirement, but continue to work. Another 64,900 members are eligible for an early reduced retirement, so as of June 30, 2023, in total approximately 25% of the active population have met eligibility to retire.

The General Assembly could choose to limit the bonus only to active members who are eligible for an unreduced retirement, or could allow active members to receive all or part of a retention bonus if they are eligible for early retirement. The appropriation required would depend in part on who is eligible for the bonus, as well as the amount the General Assembly allocates for such a bonus.

Example: Paying a Retention Bonus versus Paying Employer Contributions for Retirees

Example: Paying a 10% Retention Bonus for Retirees Remaining Active After Reaching Full Unreduced Retirement Eligibility (8,116 eligible as of June 30, 2023)	Example: Paying Employer Contributions on the Salary of Retirees Returning to Work after Six Month Break In Service (107 retirees returned as Critical Shortage Teachers in the 2022-2023 school year)
$60,000* x 10%= $6,000 per eligible employee (no associated unfunded liabilities)	$60,000* x 16.62% (FY23-24 rate) = $9,972 per participating retiree (Employer contributions help but do not completely mitigate unfunded liabilities associated with changing retirement patterns)

*Average Actual Teacher Salary in FY 2021 was $61,684 according to the VDOE 2020-2021 Teacher Salary Report at [Education Workforce Data & Reports | Virginia Department of Education]

Implementation Costs for a Retention Bonus Option

Since bonuses are not included in VRS creditable compensation, no VRS implementation cost is expected. If necessary, VRS could provide reports on eligible members. The Department of Accounts and DHRM may require implementation, however, it could be handled similarly to other bonuses. Other than communications, there may not be specific implementation costs required for this retention bonus option or the costs would generally be minimal. However, retention bonuses will necessitate employer resources be provided to fund increases in compensation. Costs will vary by employer.

Analysis of Increased Salary Option: All Employees Receive Higher Starting Salaries or More Frequent Raises

If the General Assembly chooses to implement higher starting or continuing salaries, this would increase VRS members' overall creditable compensation. These increases would be incorporated into the existing AFC and retirement benefit calculation. Since employer and employee contributions are paid as a percentage of salary, no actuarial impact is expected for the VRS Trust Fund. As noted earlier in the report, this option will have an overall impact for active members and retirees, since retirement benefits are calculated based on creditable compensation.

Implementation Costs for an Increased Salary Option

Since VRS creditable compensation is already used in the calculation of retirement benefits and employer and employee contributions are paid as a percentage of salary, no implementation is expected. However, increased salaries will necessitate employer resources be provided to fund increases in compensation. Costs will vary by employer.

Conclusion

VRS' current return to work provisions align with those in other states and provide flexibility, especially for those retirees returning to work on a part-time basis. In a tight labor market, re-hiring retirees on a full time basis may seem to be an attractive option, but the potential long-term negative impacts to the VRS Trust Fund, including higher future employer contribution rates and higher unfunded liabilities, must be taken into account as well. The IRS requires that when a break in service is required, there must be a complete severance of employment without a prearranged agreement to reemploy, which means no work at all for a participating employer, not even volunteer work. The IRS makes the determination about whether there has been a complete severance of employment on a case-by-case basis.

With over a quarter of the current VRS active employees eligible for reduced or unreduced retirement, a broad expansion of the current return-to-work provisions by introducing even a limited in-service distribution program could have both immediate and long-term negative impacts on the VRS Trust Fund. While a potential retention tool, if active employees are incentivized to retire earlier than they otherwise would in order to retain their retirement benefit, earn a salary, and maintain employer subsidized health care, pension liabilities will increase, but the program would net no new employees for employers. Further, an in-service distribution with no break in service for hazardous duty employees would appear incongruous with the younger retirement age allowed due to the presumed mental and physical stresses of their positions.

If these employees return to work more frequently, as expected, the impacts of claims related to workers' compensation, short-term disability, long-term disability, and LODA are expected to increase, perhaps significantly, but cannot be fully quantified without valid plan experience.

If the General Assembly moves forward with an in-service distribution program, requiring employer contributions is critical and would serve to help moderate the impact of such expansions by collecting funds to continue the scheduled payoff of legacy unfunded liabilities and partially offset paying retirement benefits sooner and over a longer period of time for members who choose to retire earlier under these provisions than they would have otherwise.

Appendix A- Updated Tables on Utilization of Existing Return to Work Exceptions

The following tables from the 2022 report have been updated to display current data.

It is important to note that the break in service for returning to full-time work under any of the critical shortage or school security officer exceptions changed effective July 1, 2023. Instead of twelve months, the current break in service is six months before a retiree can return to work in a designated position and continue to receive a retirement benefit.

It is also important to note that, effective July 1, 2023, "specialized student support positions", as defined in § 22.1-253.13:2 (O) of the *Code of Virginia,* were added to the positions included in the critical shortage exception provided in § 51.1-155 (B)(3) of the *Code*.

VRS expects that both changes will increase the number of retirees making use of these exceptions. It is not clear at this time how much of the change is because of the change in the break in service and how much is due to the additional positions eligible for the exception.

Table 8 (2022). Retirees Who Unretired

Fiscal Year	Number of unique retirees who initiated a return to active employment during this fiscal year*	Total number of unique active VRS members who previously retired**
2008	138	121
2009	119	200
2010	86	244
2011	94	289
2012	109	331
2013	90	339
2014	85	350
2015	74	327
2016	110	355
2017	119	368
2018	134	362
2019	141	389
2020	175	466
2021	159	483
2022	258	557
2023	302	693
2024* **	149	828

Source: VRS data.
*Number of unique persons who previously retired and initially "unretired" to return to VRS-covered employment in that particular fiscal year.
**Number of unique persons who previously retired, "unretired" to return to active VRS-covered employment, and are still currently working as of the end of that fiscal year.
***Through October 5, 2023. Note that differences between data reported in the 2022 report and in Table 7 above for years 2008-200 are due primarily to corrections made to employer reporting.

Table 9 (2022). Interim Employment

Year	Number of interim employment arrangements initiated*
2014	12
2015	12
2016	11
2017	12
2018	17
2019	15
2020	3
2021	3
2022	6
2023	4
2024**	2

Source: VRS data.
*VRS generally allows one extension of up to six months for interim arrangements, which are approved with documentation that the employer continues to actively recruit for a permanent employee. An additional extension may be requested and approved for extenuating circumstances, but is rare.
**Through October 1, 2023.

Table 10 (2022). Retirees Employed as Critical Shortage Teachers[16]

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	107	101,924	2,006
2023-2024**	154***		

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; VDOE vacancy data in the table for 2023 and 2024 have not been updated.
**VRS data available through October 25, 2023. Note that in the same general time frame for the 2022-2023 school year there were 18 retirees filling critical shortage teacher positions.

***Effective July 1, 2023, "specialized student support positions" under § 22.1-253.13:2 (O) of the *Code of Virginia* are included in the critical shortage exemption. There are a total of four retirees in specialized student support positions included in the 2023-2024 count: one visual impairment specialist, two school counselors, and one behavior interventionist.

[16] For a time, the critical shortage teacher program included speech-language pathologists. A subsequent statutory change to Va. Code § 54.1-2603 removed the requirement for speech-language pathologists to be licensed by VDOE, thus making the position ineligible for the critical shortage program. Very few retirees were employed as a speech-language pathologist under the critical shortage program, with the highest being four in one school year.

Table 11 (2022). Retirees Employed as Critical Shortage School Bus Drivers[17]

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	27	2,761	596
2023-2024*	49		

Source: VRS data on retirees and VDOE data on bus driver vacancies; VDOE vacancy data in the table for 2023 and 2024 have not been updated.
*Through September 28, 2023.

Table 12 (2022). Retirees Employed as Full-Time School Security Officers (RSSOs)[18]

Year	Number of retirees filling school security officer positions
2020-2021	10
2021-2022	14
2022-2023	26
2023-2024*	36**

Source: VRS data
*Through September 28, 2023.

**One school district accounts for 16 of the RSSOs in 2023-2024. The most any other school district has is five RSSOs.

[17] VRS data does not include specific job titles to be able to determine how many retirees were formerly school bus drivers returning to the same position.
[18] The COVID-19 pandemic, which began in the spring of 2020, led to a significant number of school divisions moving to virtual schooling in the 2020-2021 and fall of the 2021-2022 school years, thereby reducing the number of school buildings utilizing school security officers.

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