

**Virginia Retirement System
2026 General Assembly Session
Fiscal Impact Statement**

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ORIGINAL

Bill Number: HB 1306

Patron: Cornett

Bill Title: Virginia Retirement System; return to work; break in service

Bill Summary: Reduces from six months to one month the length of the required break in service after retirement for a teacher before such person may return to work full time and continue to receive his pension under the Virginia Retirement System (VRS). Does not change the break in service for other retirees returning to work under § 51.1-155(B).

Budget Amendment Necessary: Yes **Items Impacted:** 483

Explanation: VRS will need a NGF appropriation of approximately \$104,100 in FY 2026 and minimal ongoing costs to cover the cost of programming and testing to change the break in service period for one of the multiple categories of retirees returning to work, as well as updating employee and employer communications, with minimal ongoing costs for program management.

With the introduction of this discrete shorter break in service for retirees returning to work as critical shortage teachers, VRS anticipates the need for a part-time wage employee to assist with increased administration for the return-to work-program, at an ongoing cost of approximately \$36,000 per year plus wage increases.

VRS requests a delayed effective date of July 1, 2027. This would allow for adequate time to develop system programming and perform applicable testing. In addition, a delayed effective date provides the agency with some flexibility in assigning existing resources to the programming and implementation of the bill's provisions which could result in lower costs by reducing the need to hire additional contractors and other resources to meet a July 1, 2026 deadline. Further, VRS's costs are specific to the implementation of this legislation if enacted. It cannot be determined at this time whether the enactment of any other bill during this session that would require implementation by VRS would increase or decrease implementation costs.

This does not include the likely potential impact to future contribution rates or to the funded status of the state or local plans, which are discussed below.

Fiscal Summary:

Benefit(s) impacted: The bill changes the break-in-service requirement from six months to one month for retirees who return to work full-time in a critical shortage position only as an instructional or administrative employee under § 51.1-155(B)(3). This is broader and considerably less restrictive than most other states' return to work provisions.

Impact to unfunded liability: The provisions of this bill are expected to change retirement patterns of future retirees and therefore will likely add to the unfunded liabilities of the impacted plans. The shorter the break in service required the more likely it is that active employees will be incentivized to retire earlier

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than anticipated. The bill could add \$2.7 billion in additional unfunded liabilities to the Teacher plan. See Fiscal Analysis for more details.

Impact to contribution rate(s): To account for the changing of retirement patterns, assumptions used in the valuations will need to be updated to anticipate members retiring earlier than they would have without the opportunity return to work within a month. This will increase plan liabilities and the normal cost rate in order to properly fund for these increased costs. Contribution rates could increase from 12.20% to over 14.60% of covered payroll, which would equate to approximately \$587 million in additional funding for the biennium.

See Fiscal Analysis for more details.

Specific Agency or Political Subdivisions Affected: VRS; all school divisions, and the political subdivisions that fund them; potentially all VRS-participating employers with retirees eligible for unreduced retirement.

VRS cost to implement: Approximately \$104,100 in FY 2026 primarily for programming and communications, with ongoing costs of approximately \$36,000 per year for a part-time wage employee.

Employer cost to implement: Minimal employer costs are anticipated for implementation.

Other VRS and employer impacts: VRS will need to reach out to schools to communicate this change to the length of the required break in service applicable to retirees returning as teachers. VRS anticipates increased participation related to this change in the return-to-work program. Increased communication to schools and teachers will be needed regarding IRS guidance that the break in service must be during a time the retiree would otherwise be expected to work to avoid reporting errors (i.e. summer months do not count as a break in service).

GF budget impacts: General fund impacts are expected due to changing retirement patterns. As noted above, additional funding could be upwards of \$235 million from the general fund for the FY 2027-2028 biennium.

NGF budget impacts: Approximately \$104,100 in FY 2026 for VRS implementation, with ongoing costs of approximately \$36,000. Further, local funding has the potential to increase by approximately \$352 million over the biennium.

Details regarding the specific costs can be found in the Fiscal Analysis section.

General Fund Expenditure Impact:

<u>Agency</u>	<u>FY2026</u>	<u>FY2027</u>	<u>FY2028</u>	<u>FY2029</u>	<u>FY2030</u>	<u>FY2031</u>
DOE		\$116,316,900	\$118,643,200	\$118,643,200	\$118,643,200	\$118,643,200
TOTAL		\$116,316,900	\$118,643,200	\$118,643,200	\$118,643,200	\$118,643,200

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Nongeneral Fund Expenditure Impact:*

<u>Agency</u>	<u>FY2026</u>	<u>FY2027</u>	<u>FY2028</u>	<u>FY2029</u>	<u>FY2030</u>	<u>FY2031</u>
VRS	\$104,100	\$41,800	\$36,000	\$36,000	\$36,000	\$36,000
Local funding						
TOTAL	\$104,100	\$41,800	\$36,000	\$36,000	\$36,000	\$36,000

Position Impact:

<u>Agency</u>	<u>FY2026</u>	<u>FY2027</u>	<u>FY2028</u>	<u>FY2029</u>	<u>FY2030</u>	<u>FY2031</u>
VRS		0.5	0.5	0.5	0.5	0.5
TOTAL		0.5	0.5	0.5	0.5	0.5

**Note: This table does not include increased costs for school boards or political subdivisions funding local school boards shown in the Fiscal Analysis section.*

Fiscal Analysis: In recent biennia, the Governor and General Assembly appropriated approximately \$1 billion to address unfunded liabilities. This bill is expected to generate significant unfunded liabilities thereby likely eroding the benefits of the prior infusions.

Return To Work

Return to work refers to a retiree returning to post-retirement employment with the same employer or another employer in the same retirement system while continuing to receive a retirement benefit. There is considerable flexibility within the existing return-to-work provisions, especially for those who are returning on a part-time basis. At any time, retirees can choose to stop their retirement benefit and return to full-time active employment. 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 with the employer, a retiree can accept:

- (i) a part-time position 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 that 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 eligible position categories (teacher critical shortage, student support critical shortage, school bus drivers, and school security officers) allowed under the *Code of Virginia* after the required six consecutive calendar month break in service.

The impacts of allowing retirees to return to work full-time after a six-month break in service were discussed in reports published by VRS in 2022 and 2023 at the direction of the General Assembly (see

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[Return to Work Provisions Governing Virginia Retirement System \(VRS\) Retirees \(RD856\) - December 15, 2022](#); Return to Work for Law-Enforcement Officers Retired from VRS (RD578) - November 1, 2023). These include the impacts and effect of benefits such as the Affordable Care Act (ACA) and ancillary benefits other than pensions, including COLA, the hazardous duty supplement, the health insurance credit, and workers' compensation claims.

Internal Revenue Service (IRS) guidance under Internal Revenue Code (IRC) § 410, as cited in Private Letter Ruling 201147038, suggests that a one-year period without performing service might be considered a safe harbor to establish severance from employment prior to a retiree returning to work for a plan employer. Failure to meet the facts and circumstances test for a bona fide break in service could jeopardize VRS' plan qualification status, thereby affecting all members and retirees. Qualification as a governmental plan allows pre-tax employee contributions and exemption from taxation on investment earnings, among other tax benefits. Historically, investment earnings fund approximately 2/3 of benefit costs.

Outside benefits counsel has confirmed that IRS guidance allows specifically for a bona fide break in service with no prearrangement for re-employment, and the IRS makes the determination of whether or not there is a break in service using a facts and circumstances test. The IRS has not established a definite safe harbor severance period but has indicated that 12 months may be a sufficient period of time.

While VRS along with benefits counsel believes that a 12-month break in service before a retiree can return to work full time remains optimal to ensure compliance with IRS guidance and to minimize any potential negative impacts from changing retirement patterns, the required break in service for critical shortage public school positions, school bus drivers, and school security officers is currently six months as a result of 2023 legislation.

Post-retirement employment options can vary substantially from plan to plan. In part, this is a result of differing plan designs and interpretations of the IRS rules and other guidance. Each plan's design and return-to-work requirements will impact the plan's funded status, in conjunction with other factors such as demographics, discount rate and contribution rates.

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). The data reveals several common features of return-to-work provisions in other states, including the duration of the break-in-service requirement; setting caps on hours, duration of post-retirement employment, or earnings from post-retirement employment; limiting post-retirement full-time employment to specific hard to fill positions like education or law enforcement; and requiring employers to pay contributions into the plan for retirees who have returned to work.

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There were 85 plans from all 50 states, the District of Columbia, and Puerto Rico that responded to NASRA's 2022 request for data. Many require strict limits on the hours a retiree may work, the salary they may earn in combination with pension benefits, how long they may return to work (not how long the break in service must be), or some combination of these restrictions.

Changes to return to work (RTW) rules lowering the required break in service for all categories of positions eligible for RTW from 12 months to six months were effective July 1, 2023, and although we are beginning to see changes in trends as shown in Other, not enough time has passed to see the long-term effects. RTW programs, especially ones with short break-in-service requirements, will influence active members to retire earlier than originally expected in order to enhance their immediate income by receiving both a retirement benefit and regular compensation.

This proposal is difficult to model due to the lack of credible data on employee behavior related to these RTW programs. However, as discussed below, when the break in service was reduced from twelve months to six months, the number of retirees returning to work in eligible full-time positions generally doubled. Therefore, to estimate potential impacts of lowering the required break in service for teachers from six months to one month, we assumed that all employees who achieved unreduced retirement eligibility would commence their benefits at the earliest allowed date.

Members in the Teacher Plan are currently eligible for unreduced retirement as follows:

- Plan 1: Age 50 with 30 years of service or age 65 with 5 years of service, whichever occurs first.
- Plan 2/Hybrid: Rule of 90 or age 65 with 5 years of service, whichever occurs first.

Exhibit 1 below shows the estimated impacts to unfunded liabilities assuming this change to retirement patterns.

Liability Impacts – Additional estimated \$2.7 billion in unfunded liability for the Teacher plan

Exhibit 1- Impacts to Unfunded Liabilities

Plan	Unfunded Liabilities 6/30/25	Estimated Unfunded Liabilities with Only One Month Break in Service for RTW	Estimated Increase in Unfunded Liabilities
Teachers	\$11,179,129,000	\$13,910,837,000	\$2,731,708,000

Exhibit 2 below shows estimates of increases in contribution rates associated with changes in retirement patterns assumed with only a one-month break in service requirement for teachers. The employer rates could increase from 12.20% to 14.63%.

Employer Cost Impacts – Additional \$291 million in annual funding for the Teacher plan.

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Exhibit 2- Impacts to Employer Contribution Rates

Plan	Employer Contribution Rates 6/30/25 Valuation	Estimated Employer Contribution Rates with Only One Month Break in Service for RTW	Estimated Increase in Employer Contribution Rates	Estimated Increase in Annual Funding
Teachers	12.20%	14.63%	2.43%	\$290,792,000

Exhibit 3 shows the estimated future increased costs to the general fund associated with anticipated changes in retirement patterns. VRS expects that more teachers who are eligible for unreduced retirement will retire sooner if they only have to wait one full calendar month before they can return to work as a critical shortage teacher and continue to receive their retirement benefit.

Exhibit 3

	<u>FY 2027</u>	<u>FY 2028</u>	<u>FY 2029</u>	<u>FY 2030</u>	<u>FY 2031</u>	<u>FY 2032</u>
State - General Fund	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
SPORS - General Fund	-	-	-	-	-	-
VaLORS - General Fund	-	-	-	-	-	-
JRS - General Fund	-	-	-	-	-	-
Teacher - General Fund	116,316,900	118,643,200	118,643,200	118,643,200	118,643,200	118,643,200
TOTAL General Fund	\$ 116,316,900	\$ 118,643,200	\$ 118,643,200	\$ 118,643,200	\$ 118,643,200	\$ 118,643,200
State - Non-General Funds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
SPORS - Non-General Funds	-	-	-	-	-	-
VaLORS - Non-General Funds	-	-	-	-	-	-
TOTAL - Non-General Funds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Teacher - Local Funds	\$ 174,475,300	\$ 177,964,800	\$ 177,964,800	\$ 177,964,800	\$ 177,964,800	\$ 177,964,800
Political Subs - Schools	-	-	-	-	-	-
Political Subs - Non-schools	-	-	-	-	-	-
TOTAL Local Funds	\$ 174,475,300	\$ 177,964,800	\$ 177,964,800	\$ 177,964,800	\$ 177,964,800	\$ 177,964,800
Grand Totals	\$ 290,792,200	\$ 296,608,000	\$ 296,608,000	\$ 296,608,000	\$ 296,608,000	\$ 296,608,000

Estimated projections based on employee data and valuation results as of June 30, 2025 and assume a level population throughout projection period. Payrolls include proposed pay increases included in budget for FY 2027 and 2028. Payrolls are assumed to remain level beyond 2028 through remainder of the projection period.

The change in retirement patterns would effectively shorten the period of time over which we expect teachers to work prior to retirement. The actual impact will be determined by observed behavior with respect to retiring early in order to collect both a pension benefit and regular pay. Note that these estimates do not contemplate teachers who are eligible for a reduced retirement benefit who also could

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choose to take advantage of an earlier retirement and returning to work. Therefore, the estimates provided here include only those teachers eligible for an unreduced benefit. If an estimate was developed that also included teachers eligible for a reduced benefit, it would be higher than the estimate provided here.

VRS currently reviews retirement decrements on a four-year cycle with the most recent review in the Spring of 2025. Changes to retirement assumptions happen over time as experience on member behavior under the new provisions evolve, and a more frequent review might be necessary in order to avoid additional unfunded liabilities to these plans.

Requiring employer contributions on RTW members helps mitigate cost impacts related to rate increases for the plans that include rehired retirees by ensuring the covered compensation over which costs are spread does not deteriorate due to filling covered VRS positions with non-active members.

However, these contributions do not protect against earlier retirements from the plans in which these members retire. Shortening the break-in-service to one month, allowing for receipt of a retirement benefit, full compensation, and access to subsidized active healthcare will likely influence a large portion of the active population eligible for unreduced retirement to do so under the provisions of this bill. There could also be teachers that would be incentivized to take a reduced retirement in order to take advantage of the additional income. It likely will not net additional active teachers but instead will reclassify a portion of the current active population.

Cash Flow Impacts

In addition to the impacts on unfunded liability and employer annual cost shown above, the proposed changes could also cause a noticeable increase in the cash flow requirements of the VRS trust funds. VRS currently has cash flow requirements of over \$7 billion per year. Legislation that alters retirement patterns could encourage those eligible for retirement but who had continued to work to start their retirement benefit when the legislation becomes effective. The exhibit below shows the number of members who are eligible for retirement in the Teacher plan.

Teachers Eligible for Retirement

7/1/2025 Active Members	Total actives	Eligible for full unreduced retirement	% of actives eligible for unreduced retirement	Eligible for reduced early retirement	% of actives eligible for reduced retirement	Total eligible for retirement (reduced or unreduced)	% of actives eligible for retirement
Teachers	160,949	8,738	5%	28,421	18%	37,159	23%

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Below are the number of service retirements within the Teacher plan for the last five years. There are over 8,700 active Teachers who are eligible for an unreduced retirement as of June 30, 2025. To illustrate the potential impact on cash flow for the Teacher Plan, if all teachers eligible for an unreduced benefit were to retire and RTW with a one-month break, that would represent a 85% increase in the number of retirements we normally see each year, which would cause an unforeseen increase in cash flow requirements of the plan. A large increase in cash flow requirements could force VRS to liquidate invested funds at an inopportune time.

Number of Service Retirements by Fiscal Year

Plan	Fiscal Year				
	2021	2022	2023	2024	2025
Teachers	4,942	5,037	4,752	4,355	4,571

Other: Return to work has been discussed in several reports required by the General Assembly.

[RD577- Return to Work Provisions for Certain Retirees to Work in Temporary Positions- Ch. 690, 707, and 708 of the 2023 Acts of Assembly- November 1, 2023](#)

[RD578- Return to Work for Law-Enforcement Officers Retired from VRS- Ch. 722 of the 2023 Acts of Assembly- November 1, 2023](#)

[RD856 \(Published 2022\) - Return to Work Provisions Governing Virginia Retirement System \(VRS\) Retirees – December 15, 2022](#)

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 provisions¹. Internal Revenue Service (IRS) guidance under Internal Revenue Code (IRC) § 410, as cited in Private Letter Ruling 201147038, suggests that a one-year period without performing service might be considered a safe harbor to establish severance from employment prior to a retiree returning to work for a plan employer. Failure to meet the facts and circumstances test for a bona fide break in service could jeopardize VRS' plan qualification status, thereby affecting all members and retirees. Qualification as a governmental plan allows pre-tax employee contributions and exemption from taxation on investment earnings, among other tax benefits. Historically, investment earnings fund approximately 2/3 of benefit costs.

Outside benefits counsel has confirmed that IRS guidance allows specifically for a bona fide break in service with no prearrangement for re-employment, and the IRS makes the determination of whether or

¹ [Tax Consequences of Plan Disqualification | Internal Revenue Service \(irs.gov\)](#)

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not there is a break in service using a facts and circumstances test. The IRS has not established a definite safe harbor severance period but has indicated that 12 months may be a sufficient period of time.

A bona fide break in service before a retiree can return to work full time is necessary to comply with IRS guidance as well as to minimize any potential negative impacts from changing retirement patterns.

Prior to legislation enacted during the 2023 Regular Session, the limited exceptions in § 51.1-155 allowing retirees to return to work full time in certain positions required a 12-calendar-month break in service. The 12-month break in service requirement had been in place since 2001 when the critical shortage teacher program was first enacted and was the result of considerable analysis by VRS, the Joint Legislative Audit and Review Commission (JLARC), and VRS and JLARC actuaries. The 12-month break in service was intended to satisfy IRS guidance, to protect the VRS plan qualification, and to minimize the incentive for employees to retire earlier than they otherwise would. When an employee retires earlier than assumed, it adds costs to the plan since retirement benefits will be paid for a longer period of time than anticipated when contribution rates were set. The history of and legal and actuarial basis for the 12-month break in service requirement was detailed in the previously mentioned 2022 VRS report: [Return to Work Provisions Governing Virginia Retirement System \(VRS\) Retirees \(RD856\)- - December 15, 2022](#). Legislation enacted during the 2023 Regular Session reduced the 12-month break in service to six months (HB 1630 (Chapter 707), SB 1289 (Chapter 690) and SB 1479 (Chapter 708)).

It is not clear that a break in service of only one month prior to allowing a retiree to return to work full time would satisfy current IRS requirements. Shorter breaks in service also make it harder to demonstrate that there was no prearrangement to return to work, which is prohibited by the IRS and could also jeopardize VRS' plan qualification status. Further, a one-month break in service would be on the shorter end of breaks that are allowed by other retirement plans. Shorter breaks in service deployed in other states tend to be accompanied by additional provisions, such as income and hour limitations, stoppage or offset of the retirement benefit for specified periods, as well as age and service minimums. Rarely are shorter breaks in service deployed without also requiring additional restrictions.

Other plans' breaks in service generally range from one month to one year, with plans typically requiring longer breaks in service for full-time employment than they require for a return to part-time employment. A few plans, such as the Arizona State Retirement System, allow only retirees who have reached normal retirement age to work full-time while receiving a retirement benefit, but only if they also meet break-in-service requirements or a limit on the maximum number of hours worked during the year. Several plans do not allow for post-retirement full-time employment, but only allow post-retirement employment in temporary, on-call, project, or independent contractor roles. Of the plans that allow limited return to work in this fashion, many have additional restrictions such as an earnings limit (for example, Alabama, Delaware, California State Teachers' Retirement System (CalSTRS), Connecticut Teachers' Retirement Board, and others) or a limit on the length of time a retiree may work overall. Alaska limits retirees to two

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years of temporary, on-call, project, or independent contractor service while others allow a retiree to work up to three months within each fiscal year plus an earnings limitation (for example, Georgia Teachers Retirement System), limit the number of hours per week (for example, Delaware), or limit the number of days per year (for example, Colorado Public Employees' Retirement Association; Connecticut State Employees' Retirement System) that a retiree may work.

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. Importantly and as noted above, qualification as a governmental plan allows pre-tax employee contributions and exemption from taxation on investment earnings, among other tax benefits. Historically, investment earnings fund approximately 2/3 of benefit costs. In addition, if the IRS were to determine that a separation in service has not taken place, plan distributions to a retiree younger than age 59 ½ would incur a 10% tax penalty payable by the retiree, not the plan.

Part-Time Return to Work

Part-time employees do not accrue retirement benefits and are not reported to VRS. Therefore, VRS does not have records available to determine how many VRS retirees are taking advantage of the ability to return to work part-time while continuing to receive a retirement benefit.

For the 2022 return to work report, VRS conducted a survey of participating employers to obtain data regarding part-time employment of VRS retirees. Of the 726 total employers (individual state agencies, local school boards, and political subdivisions) to whom the survey was sent², 206 unique responses were received. Of these, 134 indicated they had hired retirees part-time in the past five years. Additionally, of the 72 VRS-participating employers that had not hired VRS retirees part-time within the past five years, eight planned to hire VRS retirees into a part-time position within the next two years. The table below shows details on the number of VRS retirees typically employed in a year in part-time positions with the employers that responded to the survey.

² Not including any employers who unsubscribed from VRS emails.

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Table 1. Number of VRS Retirees Hired Part-time By Employers Responding to the 2022 Survey That Typically Hire Retirees Part-Time

Part-Time Employees	Responses	Percent of Employers That Typically Hire Retirees Part-Time
0	8	5.9
1-5	84	62.7
6-10	21	15.7
11-15	7	5.2
16-20	8	5.9
21-29	2	1.5
30 or more	4	3.0

Source: 2022 VRS survey of employers; employers that completed the survey and responded that they typically hire retirees part-time.

According to the survey, 126 of the 206 employers (61.2%) had hired at least one retiree in a part-time position in the past five years. Further, some employers hire retirees on a temporary basis or on a permanent basis, or hire some retirees temporarily and others permanently, as shown in Table 3 below.

Table 2. Employers Hiring VRS Retirees Part-time in Temporary or Permanent Positions

Part-time Retiree Status	Number of Employers
Temporary	52
Permanent	31
Both Temporary and Permanent	51

Source: 2022 VRS survey of employers

The results of the survey responses show that participating employers are or were hiring retirees to work part-time in a wide range of positions. As reported by the employers, Table 4 illustrates the types of part-time positions VRS retirees are filling.

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Table 3. Part-time Positions Employers Are Filling with Retirees

Part-time Position Title	Number of Employers
Administrative	69
Substitute Teachers	35
Hazardous Duty	24
School Bus Drivers	21
School Security Officers	7
Other	71

Source: 2022 VRS survey of employers

The “Other” category includes ten employers that listed various security positions, eight employers that listed public works positions, six employers that listed tutors or instructional tutors, five employers that listed “specialties” or subject matter experts, and four employers that listed water filtration, water/wastewater operations, or water plant operator positions. Multiple additional positions were listed by three or fewer employers.

It is possible that at least some of the employers who responded to the 2022 survey now have hired these previously part-time employees in a full-time return to work position since the required break in service was shortened in 2023.

Critical Shortage Positions

Based on limited experience and data following the 2023 changes to the break-in-service requirements from 12 to six months, there has been a noticeable uptick in utilization. However, if only a one-month break in service was required, we would expect a significant uptick in members who would return to work following retirement.

VRS data indicate that the shorter the break in service the more likely it is that active employees will take advantage of the opportunity to retire earlier than anticipated, which will potentially lead to larger shifts in retirement patterns.

Another factor that makes larger shifts in retirement patterns more likely with shorter breaks in service is the availability of active employee health insurance, which is typically subsidized by employers. Many employees delay retirement due to the high cost of pre-Medicare health insurance. If employees can retire and, after a one-month break, receive a pension, plus earn a full-time salary and have access to employer-subsidized health insurance, there is little reason that retirement-eligible employees would not take this option.

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

The Teacher plan currently has approximately 3,900 members who have qualified for an unreduced retirement and are over either age 65 if in Plan 1, or Social Security Normal Retirement Age (SSNRA) if in the Plan 2 or Hybrid plan but continue to work. These members would almost certainly retire immediately under the proposed provisions. Members from the group eligible for unreduced retirement but below normal retirement age would also likely be incentivized to retire with the financial impacts of those members being even higher as they would be starting benefits even sooner and likely receiving their benefit with COLAs for a longer period of time. We also expect that members in the third group with eligibility for reduced benefits could elect to retire and continue working in certain circumstances in order to boost take-home pay by collecting a retirement benefit and continuing to be paid a full-time salary.

Teacher Plan Active Population June 30, 2025

	Count	Percentage of Active Population
Total Actives	160,949	
Eligible for Full Unreduced Retirement - Over Age 65/SSNRA	3,926	2.4%
Eligible for Full Unreduced Retirement - Under Age 65/SSNRA	4,812	3.0%
Eligible for Reduced Retirement	28,421	17.7%
Total Eligible to Retire June 30, 2025	37,159	23.1%

Importance of Employer Contributions

Current law requires employer contributions for retirees who return to work and would continue to apply to the provisions of this bill. Employer contributions are critically important to mitigating potentially negative impacts to plan funded status and future contribution rates related to employees retiring earlier than anticipated. The shorter the required break in service, the more likely employees are to retire earlier than anticipated, with the resulting change in retirement patterns. While not completely making up for the impact of changing retirement patterns, requiring employer contributions helps to make up for some of the potential negative actuarial consequences related to filling VRS active covered positions with retirees.

Break During Summer Months

There is no specific guidance from the IRS related to the timing of a break in service for school division employees for purposes of meeting the bona fide break in service requirement. However, 26 CFR § 1.410(a)-7 includes in the definition of “severance from service date” that time away from service

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following severance does not include vacation, holiday, sick leave, leave of absence, and other typically scheduled time away. Schools do not treat teachers as terminated during the summer break period when they will teach the following school year. Even for teachers or bus drivers who retire at the end of a school year, the last day of employment is not always clear for IRS purposes, as the last day of work is not typically the same as the teacher's retirement date and pay (if annualized) and benefits can be extended during the summer break period.

The IRS has recognized the unique nature of teacher summer breaks under the Affordable Care Act regulations by requiring that a specified number of hours during the break be taken into account for purposes of determining full-time status. In accordance with available IRS guidance, VRS has maintained, after consultation with and approval by benefits counsel, a longstanding policy not to allow summer breaks to count toward the break-in-service requirements for teachers prior to returning to employment. This policy position best demonstrates that the IRS bona fide break-in-service rules are being satisfied for teachers. Having such a provision helps to demonstrate that a true break in service has taken place.

No Prearrangement for Re-employment

Importantly, regardless of the break in service period of time, the IRS requires that a member cannot have a prearranged agreement prior to retirement to return to employment. Thus, the longer the required separation from service is, the less likely it will be that the member and employer had a prearranged agreement for reemployment.

Affordable Care Act Implications

While VRS does not administer healthcare, our understanding is that all positions in educational institutions require a 26-week separation before returning to service with the same employer in order to avoid a potential Affordable Care Act (ACA) tax penalty.

DHRM has provided guidance to state employers related to the ACA break in service. Other VRS participating employers must rely upon their own benefits counsel or human resource departments for ACA guidance. VRS participating employers are strongly encouraged to consult their human resource departments or DHRM in the case of state agencies for further information.