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To:	Senator Jeannette White, Chair, Committee on Government Operations Senator Brian Campion, Chair, Committee on Education Representative Sarah Copeland Hanzas, Chair, Committee on Government Operations Representative Kathryn Webb, Chair, Committee on Education
From:	Beth Pearce, Vermont State Treasurer
Date:	February 23, 2022
Re:	H.572 – Treasurer's Office Initial Comments

Thank you for the opportunity to review H.572 – An act relating to the retirement allowance for interim educators. I have reviewed the As Introduced version of the bill, which is available here, and offer the following initial comments.

As I understand it, the purpose behind this bill is to address staff shortage issues, which are at critical levels, at Vermont schools by providing a financial incentive for retired teachers to come out of retirement and again serve as part of the active workforce. I believe that action needs to be taken to meet the staffing shortfall. I believe, however, a longevity incentive/bonus paid from operating budgets to retain existing teachers would be a more direct approach and ultimately less costly. Retired teachers would continue to have the reemployment options that exist in current law.

I am concerned about H.572's method of paying for this financial incentive. Rather than fund the incentive in current school or State budgets, the bill funds the incentive through the State Teachers' Pension Fund. This is particularly concerning given:

1. The historical underfunding of the Teachers' Pension Fund, and the size of its current unfunded liability;
2. The significant effort made over the past year to remedy this underfunding and to place the Fund on a sustainable path; and
3. The relatively strong revenues available to pay for such an incentive in the current and next fiscal years.

In lieu of utilizing the Pension Fund to pay for this financial incentive, I believe that there is a possibility for the State or the local school districts to simply pay a financial incentive as an addition to the retired teachers' base pay.

<u>Background</u>

H.572 proposes to amend 16 V.S.A. § 1939. Section 1939 sets the terms for retired teachers who wish to come back to work. Basically, a retired teacher in the VSTRS system can receive his or her pension and work for any non-VSTRS employer without facing a reduction in their pension amount. However, as is common in public pension plans, there are restrictions on the retired teacher's ability to work for a VSTRS employer in a position that qualifies for membership in VSTRS.

In VSTRS, the retired teacher can earn up to 60 percent of the average compensation in the VSTRS System, without freezing his or her pension. The Retirement Division calculates and publishes this amount annually. This year's notice can be found here, and it sets the 2022 earnable amount at $39,200.

If a retired teacher exceeds this amount, she or he will owe the system the amount of the pension payment collected that year and will have her or his pension frozen. She or he will also owe the amount of employee contributions that should have been paid on wages paid. Upon subsequent retirement, the individual's original pension payment will be restored, and s/he will also be entitled to any additional retirement allowance due on account of the post-original-retirement period of employment.

The Bill

H.572 provides that "Notwithstanding any other provision of law, in any fiscal year, a beneficiary who retired from the System as a Group A or a Group C member may resume service under subsection (a) of this section to serve as an interim school educator for a period not to exceed one school year and receive the beneficiary's retirement allowance for the entire period that service is resumed," provided that individual maintains a license and makes contributions to the fund.

In this way, the H.572 financial incentive to be paid to a particular retired teacher is equivalent to the amount of pension and retiree health insurance benefit that the individual would receive in the year s/he returns to work. Those with a higher pension payment receive a higher incentive; those with a lower pension payment receive a lower incentive payment.

Concerns

As noted above, the Treasurer's Office's primary concern is that the H.572 financial incentive is funded by the Teachers' Pension Fund and not current school or State budgets. Here is an example:[1]

- Assume a retired teacher earns $25k in annual pension payments.
    - Under current law, if the teacher accepts a full-time teaching position after retirement making $52k, the teacher will receive $52k, the full amount being paid by the School System. S/he will pay 6% of this salary into the System and the State will make the employer contribution.
    - Under H.572, if the teacher accepts a full-time teaching position after retirement making $52k, the teacher will receive $77k, with the school paying $52k and the System paying $25k. The individual would pay 6% of this salary into the System. It is unclear if the State would make an employer contribution on account of this employee.
- Accordingly, the financial incentive for this retired teacher would be $25k – funded by the VSTRS Pension Fund.

All things being equal, this means that H.572 will likely result in upward pressure on the Fund's unfunded liability.

However, once an incentive structure like this is put in place, workforce behavior can and will change. This language will likely create an incentive for teachers to retire earlier than normal, knowing that they are able to increase their net take home pay. Depending on how long the allowance is permitted, whether

[1] Please note that this example does not include the health insurance benefit. Additional analysis is needed to incorporate this aspect of the benefit.

there is a sunset, and/or whether there are any additional eligibility criteria, other incentives may also develop.

In order to provide background on this topic, I am including a link to report by NASRA on this subject here. The following (at page 10 of the Report) provides a nice summary of the issues at play in crafting post-retirement work restrictions.

> Restrictions on public employees returning to work while also receiving their retirement benefit are intended to accommodate two often competing objectives: protecting and maintaining the integrity of the pension plan, while also enabling public employers to attract and retain the qualified employees who are needed to provide essential public services.
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> Pension plans help promote key human resources objectives. In addition to attracting and retaining, traditional pension plans also are intended to enable public employers to promote an orderly turnover of workers. This means that a well-designed pension plan will foster retirement by employees at an appropriate point in their life and their career. The employee benefits by being able to retire in a timely manner; the employer benefits through reduced salary costs and opportunities for new employees to join the organization and younger workers to be promoted. This is a virtuous cycle created by a well-designed retirement plan.
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> Restrictions on retirees returning to work are intended to protect this framework. If employees were permitted to simultaneously work and earn a salary while also receiving a pension, the actuarial integrity of the pension plan would be imperiled. In such a scenario, workers would have an incentive to retire as soon as they are eligible, knowing they could return to work and simultaneously receive both a paycheck and a pension check. Without restrictions, such an arrangement would quickly drive up the cost of the pension plan, as plan participants would retire sooner than most otherwise would, resulting in longer pension payout periods and higher plan costs.
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> At the same time, often the sole or primary qualified candidate available to fill certain public positions is a retired public employee. In addition, many retirees want, for one or more of many reasons, to return to work. Post-retirement employment policies, which usually require a break in service and impose limitations on how much a retiree may work, earn, or both, seek to find a balance between these competing objectives. Successful policies are those that protect the actuarial soundness of the plan, enable employers to fill their positions, and accommodate retired public employees who wish to remain active and to earn income in retirement. This report aims to identify state laws and public retirement system policies in place for eightythree statewide retirement systems related to members returning to work after retiring, entering a phased retirement program, or continuing to work after becoming eligible to retire, while receiving both a salary and their regular retirement benefit.

There are myriad examples of post-retirement work restrictions set forth in the Report. Each comes with its own cost or savings depending on the nature of the restriction.

In considering H.572, we reviewed recent initiatives in other states. In the case of Michigan's H.B 4694 (2019-2020 session), the Senate Bill Review stated that the bill "would extend sunsets on the ability to retain a pension while working, would remove narrow windows of retirees who could be rehired as substitute teachers, and would remove three-year limits on the reemployment of retirees in critical shortage positions and as independent contractors."[2] As noted in the fiscal analysis:

> In general, if employees in a pension system have the ability to retire, draw a pension, and simultaneously earn wages during a period of reemployment, at least a portion of the employees are likely to retire earlier than they would in the absence of the ability to 'double dip'….it is likely that at least some MPSERS employees would retire earlier than they otherwise would have if faced with the conditions for reemployment found in current law…. The fiscal impact on the State would be an increased cost to the School Aid Fund to pay for additional unfunded accrued liabilities (UAL). The increase in UAL would be commensurate with the number of employees choosing to retire earlier than the retirement system planned for, meaning that pensions would be paid out earlier than had been assumed and funded. However, it is not possible to determine a magnitude of the increase in UAL.

The analysis further reviews the impact on the local employer impacts:

> The fiscal impact on local units of government (local districts, public school academies, and intermediate school districts) likely would be favorable. Schools would have more options to fill positions from the retiree pool. Also, the rehiring of a retiree would mean that the school could avoid paying health care costs (since the retiree's health care coverage would be paid by the retirement system).

Bill analyses for Colorado,[3] West Virginia,[4] and North Carolina result in similar conclusions. While staff in each case were unable to fully quantify the increased costs as the number affected retirement or termination rates are not known, they did confirm that, indeed, such changes likely come at a cost to the Systems.

I would expect H.572 to be no different in this respect, with the financial implications to the Fund varying based on the ultimate details of the bill. The provision in the current version of the bill that would require teachers to make contributions at the rate established for members is a mitigating factor. Requiring a six month, or a year, waiting period for the teacher's return also would lower potential cost increases, but also run counter to the need to meet a critical shortage. Even with these, it is more than likely that some increase in liabilities would be expected.

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[2] http://www.legislature.mi.gov/documents/2019-2020/billanalysis/Senate/pdf/2019-SFA-4694-F.pdf.
[3] https://leg.colorado.gov/sites/default/files/documents/2022A/bills/fn/2022a_hb1057_00.pdf; https://leg.colorado.gov/sites/default/files/documents/2022A/bills/fn/2022a_hb1101_00.pdf.
[4] https://www.wvlegislature.gov/Fiscalnotes/FN(2)/FN_actuarialSubmit_RecordView.cfm?RecordID=799328642.

Especially in light of all the good work done by the Pension Task Force, I would ask you to consider funding this financial incentive with current dollars rather than placing the costs into the Pension Fund.

In the event that the Legislature moves forward with H.572, there are additional administrative issues to consider. First, additional work needs to be performed to understand how health insurance would be provided to retired workers who return to active service while remaining a VSTRS beneficiary.

Second, the bill as currently written does not have a sunset date for this provision. Is this intended to be a one-time response to the current teacher shortage crisis or is this expected to be an option on an ongoing basis? In the latter case, the negative impacts to the fund would likely grow.

Third, as noted in my testimony to the Pension Task Force, some teacher contracts include retirement incentives—some implemented at the discretion of the schools and others at the option of the teacher. Retirement incentives, of course, run counter to the current goal of longevity and obviously school systems would not move forward on these. Nonetheless, a review of these may be needed.

Finally, federal law requires that an individual can draw a pension only after they have a bona fide retirement. Basically, what this means is that an individual cannot retire and receive a pension if they have an arrangement with the employer to be rehired at the time of retirement. The bona fide retirement test is a facts and circumstances test, and there is no set time period that an individual must be retired before returning to work. To the extent H.572 moves forward, I would urge you to consider whether it may create an incentive for such pre-arranged rehires to take place, and whether it would be appropriate to include safeguards.