

## Select Committee on Pension Policy

**Furloughs  
(LEOFF 2 Proposal)**

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### Issue

- LEOFF 2 Board wrote to SCPP requesting coordination
  - Not all LEOFF members were covered by prior furloughs legislation
  - Many LEOFF members not subject to furlough, but salary reductions and foregone increases are common, and can have similar impacts on pensions as furloughs



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## Procedural Update

- SCPP briefed on furloughs at September meeting
- LEOFF 2 Board will meet tomorrow
  - LEOFF 2 staff bill draft on agenda for review and approval
  - Applies to LEOFF 2 only
  - Expands salary average adjustment provisions in current law
- At November SCPP Executive Committee meeting, LEOFF 2 staff mentioned the bill draft
- SCPP Executive Committee requested a briefing on the LEOFF 2 bill draft
- No SCPP proposal before the Committee today



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## Today's Presentation

- Quick furlough recap
- Background on LEOFF 2 proposal
- LEOFF 2 staff bill draft
  - Provisions
  - Comparison with current law
- Potential issues for further study
- Next steps



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## Furloughs Can Impact Member Pensions

- Salary average is most likely to be affected
- Reduction in service credit is possible, but not likely
- Current law adjusts salary average to account for compensation the member *would have earned*



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## Background On LEOFF 2 Proposal

- LEOFF 2 Board wrote to SCPP
  - LEOFF members in local governments were not covered by prior furlough legislation
  - Many LEOFF members are exempt from furloughs
  - Salary reductions and foregone increases are common and have same result on pensions as furloughs



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## Why Are Public Safety And Emergency Personnel Often Exempt From Furloughs?

- Nature of duties may not allow cutbacks in work hours
  - For example, common method of furlough is agency shut down
  - May not be possible to shut down police, fire, jails, and hospitals
- Many public safety entities are still experiencing budget cuts
- OSA collecting data for comparison
  - For example, if salary reductions for public safety personnel are larger or more common than for other public employees



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## LEOFF 2 Staff Bill Draft

- No final action by LEOFF 2 Board to date
  - LEOFF 2 Board requested bill draft
  - LEOFF 2 staff prepared draft for review by Board tomorrow
- Staff bill draft does three things
  1. Expands salary average adjustment to include additional types of reductions
  2. Applies to local government employees
  3. Modifies timeframe



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## 1. Expands Coverage To Additional Types Of Reductions

- Current law applies salary average adjustment to compensation foregone due to
  - Reduced work hours
  - Mandatory or voluntary leave without pay
  - Temporary layoffs
- Bill draft would also apply the adjustment to
  - "Salary reductions" (such as percentage reductions across-the-board)
  - Reductions or eliminations of previously contracted salary increases



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## 2. Applies To Local Government Employees

- Current law applies to state employees with two exceptions
  - Current law includes PERS state and local
  - Current law does not cover SERS
- Bill draft would apply new and old (furloughs) provisions to all members of LEOFF, state and local



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### 3. Modifies Timeframe

- Current law applies to reductions experienced during the 2009-11 Biennium
- Bill draft would alter this in three ways
  - Current provisions for state LEOFF employees would be extended to the 2011-13 Biennium
  - Current provisions would apply retroactively for local government LEOFF employees and would apply for both the 2009-11 and 2011-13 Biennia
  - New provisions would apply retroactively and would apply for both the 2009-11 and 2011-13 Biennia

### Administration of LEOFF 2 Staff Bill Draft

- Based on LEOFF 2 staff bill draft, DRS would administer in the same way as current law
  - DRS currently asks retiree if he or she was affected by furloughs
  - DRS will also inquire if retiree was affected by
    - Other reductions in salary
    - Reductions to previously contracted salary increases
- If yes, employer states what retiree would have earned, and certifies it was integral part of employer's expenditure reduction efforts
- DRS will adjust salary average accordingly



## Administration Of Retroactive Provisions

- Retroactive provisions apply to
  - Local government LEOFF members
  - Salary reductions and foregone increases
- Would not capture those who have already retired
- For example
  - Local government LEOFF employee retires
  - Was subject to furloughs in 2009-11 Biennium
  - Salary average not adjusted
  - Some time after retirement, bill passes
  - DRS would not adjust retiree's average

## Preliminary Fiscal Analysis of LEOFF 2 Staff Bill Draft

- Indeterminate cost
  - Lack of experience data
  - Uncertainty of future budgets
  - Uncertainty of bill language interpretation
- Likely cost resulting from loss of a salary gain
  - Salaries will go down due to reductions and furloughs
  - Contribution rates would also have gone down
- Sensitivity analysis



### Potential Impact on LEOFF 2 Contribution Rates

Potential Impact on Contribution Rates For Current Members		
	1 out of 5 Affected* 1 Furlough Day per Month	2 out of 5 Affected* 3 Furlough Days per Month
Employee	0.06%	0.37%
Employer	0.03%	0.22%
State	0.03%	0.15%
<b>Total</b>	<b>0.12%</b>	<b>0.74%</b>

\*Affected members eligible to retire



### Potential Budget Impacts of LEOFF 2 Staff Bill Draft

Potential Budget Impacts		
(Dollars in Millions)	1 out of 5 Affected* 1 Furlough Day per Month	2 out of 5 Affected* 3 Furlough Days per Month
<b>2011-2013</b>		
Total State	\$1.0	\$4.9
Local Government	1.0	7.2
Total Employer	\$2.0	\$12.2
Total Employee	\$2.0	\$12.2
<b>2013-2015</b>		
Total State	\$0.8	\$4.9
Local Government	1.2	7.3
Total Employer	\$2.1	\$12.2
Total Employee	\$2.1	\$12.2
<b>2011-2036 (25-Years)</b>		
Total State	\$8.6	\$49.7
Local Government	12.4	74.4
Total Employer	\$21.0	\$124.1
Total Employee	\$21.0	\$124.1

\*Affected members eligible to retire



## Should SCPP Study Applying This Approach To All Systems?

- SCPP may wish to consider
  - Who should the salary average adjustment apply to?
  - How long should provisions be in effect?
  - Are there plan qualification issues?
  - LEOFF 2 staff draft may not be portable to other systems
    - May have unintended consequences

## Who Should The Salary Average Adjustment Apply To?

- Many public employees are experiencing salary reductions and foregone increases other than furloughs
- Some may be more closely situated to LEOFF employees
  - Public safety employees in systems other than LEOFF
  - For example
    - State troopers in WSPRS
    - Prison guards in PSERS
    - State hospital employees in PERS



## How Long Should Salary Average Provisions Be In Effect?

- Prior legislation was effective for 2009-11 biennium only
- Budget pressures are likely to continue for at least the next biennium
- Should there be an extension?
  - If so, should it be one time, or ongoing?
- May wish to study whether extending a temporary measure could make that measure permanent
  - E.g. repeatedly applying a different definition of salary average may redefine how salary average is calculated in future
  - Practice makes permanent

## Are There Plan Qualification Issues?

- Retirement plans must adhere to certain criteria to retain preferential tax status
- May wish to study tax implications and solicit advice from tax counsel
  - Sample questions
    - Are there limits to amount of benefits for compensation not earned?
    - Are benefits definitely determinable if they are based on what an employee *might have* earned?



## LEOFF 2 Staff Bill Draft May Not Be Portable To Other Systems As Drafted

- Unclear how draft language would be applied
- Could lead to inconsistent application or perceived abuse
- SCPP may wish to study implications of current LEOFF 2 staff bill draft
- Implications may change if draft language is amended by LEOFF 2 Board



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## Unclear What "Salary Reductions" Means

- "Salary reductions" is not defined
- For LEOFF members, may mean "basic salary," which is defined in LEOFF statutes
- Basic salary has two definitions -- one for each LEOFF plan
  - E.g. for Plan 2 if includes overtime, while Plan 1 would not
- Not clear how this would apply to "earnable compensation" under other systems' statutes



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## Unclear What Contract Terms Are

- Most bargaining units have a different contract
- Non-represented employees may have no formal contract
- What does “previously contracted” mean?
  - Previous to passage of bill, or previous to salary reduction?
- If previous to salary reduction, may affect future contracting
  - For example, could parties negotiate for foregone salary by inserting language into contract stating that employees would have received higher salaries if not for current budget?

## What Is “Integral”?

- Provision in current law, and retained in LEOFF 2 staff bill draft
  - Reduction must be certified as integral to the employer’s expenditure reduction efforts
- Provision is relatively new, and not clear yet if it will be effective in stopping perceived abuse
- In theory, any action that reduces expenditures could be considered integral
- Decision may be both a matter of opinion and ethics
- For example
  - Employee on voluntary phased retirement may receive pension calculated as though the employee worked full time

### May Create Incentive To Shift Costs To Pension System

- Parties may look for ways to trade cuts in other types of compensation for reductions in salary
- Foregone salary will still be counted toward pensions
- For example, if employer planning to cut health benefits, the parties may trade for a reduction in salary instead
- May be more desirable for those near retirement



### Is There A Difference Between Furloughs And Other Salary Reductions?

- Additional background submitted by LEOFF 2 staff
- Take-home pay versus overall salary
- Do some salary reductions have permanent affect on pensions?
  - Furloughs are typically short term
    - Once furloughs are complete, employee goes back to prior salary
  - Salary reductions may be long term
    - Will depend on how applied or bargained for
    - Reduction may not be offset by future increases

## Special Session - HB 3225 (2010)

- Passed during second special session (December 11)
- Not yet signed into law
- OSA studying impact to pensions
- Contains provisions altering the salary average adjustment provision in current law
  - Includes "temporary reduction[s] in pay implemented prior to the effective date of this section."
- Affects state employees in the following systems
  - PERS
  - TRS
  - PSERS
  - LEOFF
  - WSPRS

## Conclusion

- LEOFF 2 staff bill draft expands salary average adjustment in prior legislation in three ways
  - Additional employees
  - Other types of salary reductions
  - Over a longer period of time
- Expected to create a cost to LEOFF through the loss of a gain
- LEOFF 2 Board will review draft tomorrow, and may make recommendation
  - Draft only applies to LEOFF 2 members
- SCPP may wish to study applying this approach to other systems

## Next Steps

- No SCPP proposal before the Committee today
- Several options if SCPP chooses to act
  - Request information from LEOFF 2 regarding some of the issues raised
  - Study applying the proposal to other retirement systems next interim
  - Study pension effects of bill passed during special session
  - Other options

