



Final Average Salary Protection

**Comprehensive Report
November 20, 2013**

Issue

- Members' retirement benefits will be reduced if "temporary salary reductions" after July 1, 2013 occur during their Final Average Salary (FAS) period

Background

- Furloughs are methods for handling a short-term economic or budget problem
- Creates the potential for a reduction in a member's pension benefit calculation if the salary reduction occurs during the FAS period

Background

- Series of Legislative actions between 2009-2013 that led to this issue
- HB 2070 created protections for all state and local Gov. employees

Policy Options

- **Option 1: Take No Action**
 - The Board would take no further action and employees who are furloughed during their FAS period would continue to face reductions in their retirement
- **Option 2: Introduce Legislation that Extends Protections**
 - The Board would introduce a bill that would extend the FAS protections for employees described in HB 2070 into the 2013-2015 biennium

Any Questions?

- **Contact:**

Ryan Frost

Research Analyst

360.586.2324

ryan.frost@leoff.wa.gov

2100 Evergreen Park Dr, Olympia, WA 98502
PO Box 40918 Olympia, WA 98504
360.586.2320 or www.leoff.wa.gov





November 20, 2013

FINAL AVERAGE SALARY PROTECTION

COMPREHENSIVE REPORT

By Ryan Frost

Research Analyst

360-586-2325

ryan.frost@leoff.wa.gov

ISSUE STATEMENT

Members' retirement benefits will be reduced if "temporary salary reductions" after July 1, 2013 occur during their Final Average Salary (FAS) period.

OVERVIEW

There are 16,720 active members in LEOFF Plan 2 according to the *2012 Actuarial Valuation Report*. FAS protection affects only those active members who plan to retire within the next 5-7 years, and who are furloughed during their FAS period.

BACKGROUND & POLICY ISSUES

Furloughs are a method used for reducing salary and saving costs and have been utilized by employers during the recent economic downturn. These reductions can take many forms and may be either voluntarily or involuntarily unpaid leave (furlough), a temporary reduction in salary, or the loss of previously negotiated raises.

A member's benefit is calculated using the formula; 2 percent, times FAS times years of service (YOS). If a member's salary is reduced during their FAS period, it lowers their FAS, and thus lowers their benefit. Final average salary calculations were legislatively protected from being impacted by furloughs for 2009-2011 and 2011-2013. That protection ended July 1, 2013.

This report defines furloughs and why they were enacted, as well as the issue they present to an employees' pension. Furthermore, this report gives a detailed legislative history of furlough protections for employees currently in their FAS period. Lastly is a brief discussion of lifetime impacts if these protections are not renewed by Legislative action.

In today's economic environment many local and state governments are facing revenue shortfalls. There may be some public service programs discontinued or restricted and there may be some employee layoffs as a result of budget restrictions. In order to balance budgets, many state and local governments, as an alternative to layoffs, are considering many ways to decrease costs.

Furloughs, a leave of absence without pay, are one method currently being used by many public employers. One advantage of using furloughs versus layoffs is employees are not terminated, yet there is a cost savings as the time off is without pay. Also, when the economy recovers there is no need to rehire and retrain the workforce. However, there are some potential negative impacts with the use of furloughs. One impact it could have is on a member's pension calculation if the furlough were to occur during the member's final average salary (FAS) period.

The LEOFF 2 Board has previously studied this issue in the 2005, 2009, and 2010 interims.

Legislative History

The Legislature has taken several actions to prevent these decreases from reducing pensions, however, the legislative protection for final average salary computations ended July 1, 2013. Legislation introduced to extend final average salary protections through 2013-2015 did not pass in the 2013 session.

2009 Session – PERS Provided Protection for 2009-2011

During the 2009 Legislative Session, the Legislature recognized the potential impacts to a members pension benefit through the use of furloughs to help balance budgets. As a result, the Legislature passed SB 6157 (see Appendix B to see a copy of the final bill report) which allowed the pension benefit calculation to be adjusted for furloughs if the furlough occurred during the member's FAS period. While this did address the problem, it only included the Public Employees' Retirement System (PERS) pension system. Members of the other retirement systems, including LEOFF Plan 2, would not be granted the same benefit calculation adjustment. This difference in policy led the Board to send a letter to the Select Committee on Pension Policy (SCPP) to jointly sponsor legislation similar to SB 6157.

2010 Session – State Employees Provided Protection for 2009-2011

State agencies were directed to achieve a \$69.154 million reduction in employee compensation costs from the near General Fund through mandatory and voluntary furloughs, leave without pay, reduced work hours, voluntary retirements and separations, layoffs, and other methods. (SSB 6503 – 2010). The legislation acknowledged that State agency closures would result in temporary layoff (furlough) and reduction of compensation for affected state employees and directed that temporary layoffs and reduction in compensation not affect employee seniority, vacation and sick leave accrual, or retirement benefits.

In a special session in December of 2010, the Legislature passed HB 3225 (Appendix C), which added "temporary reduction in pay implemented prior to the effective date of this section" as another item to include in adjusting the calculation of final average salary for members whose retirement benefits may be adversely affected by the temporary economic conditions. However, like the previous bill (SB 6503) this change also only includes members employed by a state agency or institution which excludes most of the LEOFF Plan 2 membership.

2011 – State Employee and Local Government Provided Protection for 2011-2013

The 2011 Legislative Session addressed the problem of FAS protection only covering state employees by adding protection for local government employees as well in HB 2070 (Appendix D). The final bill report summarized that “Pensions from specified Washington retirement systems based on salaries earned during the 2011-13 biennium will not be reduced by compensation forgone by a member employed by either the state or local governments due to reduced work hours, mandatory leave without pay, temporary layoffs, or reductions to current pay if the measures are an integral part of a state or local government employer's expenditure reduction efforts.”

Lifetime Impact

The intent of FAS protection was so that state employees who helped during the period of economic difficulty wouldn't be punished for life for doing so. Taking a salary cut during their FAS period would affect their annual pension after retirement. People helping shouldn't take a lifetime reduction in pension as a result of a temporary budget issue.

Fiscal Year vs. Calendar Year Impacts

The State Legislature works on biennium while local governments work on a calendar year or annual basis. The FAS protections from the 2011-2013 biennium expired on July 1st, 2013. There may be a period from July through December 2013 where employees are subject to furloughs but do not have final average salary protection. Extending protection through the 2013-2015 biennium would be necessary to protect retiree employees' pension benefits.

POLICY OPTIONS

Option 1: Take No Action

The Board would take no further action and employees who are furloughed during their FAS period would continue to face reductions in their retirement.

Option 2: Introduce Legislation that Extends Protections

The Board would introduce a bill that would extend the FAS protections for employees described in HB 2070 into the 2013-2015 biennium.