



# 24-Month Final Average Salary Preliminary Report

LEOFF Plan 2 Retirement Board

June 18, 2008

# Issue

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- Shortening the final average salary (FAS) period from sixty to twenty-four months would increase retirement benefits and increase plan costs

# Benefit Formula

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- Typical DB plan formula:
  - Salary
  - Years of Service
  - Multiplier
- LEOFF Plan 2
  - $2\% \times \text{Years of Service} \times \text{Final Average Salary}$

# Final Average Salary

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- Generally, the shorter the time period, the higher the calculation. This is especially true as wages rise over time.

# Example: 25 Years of Service

	FAS 5 Year	FAS 2 Year
2006	\$74,500	\$74,500
2005	\$72,000	\$72,000
2004	\$69,100	
2003	\$66,400	
2002	\$64,300	
Average	\$69,260	\$73,250

	2% x FAS x YOS	Monthly
Benefit w/5-year FAS	$2\% \times \$69,260 \times 25 = \$34,630$	\$2,885.83
Benefit w/2-year FAS	$2\% \times \$73,250 \times 25 = \$36,625$	\$3,052.08

# Calculation Period in Other States

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- 2004 study of “State Police” plans by *Workplace Economics, Inc.* found the average time period used was the three highest years.
- A review of 19 state pension plans with both police and fire fighters indicate 16 use either the highest three consecutive years or the highest three out of the last 10 or five years.
- In a broader study on public safety retirement plans conducted by the Oklahoma Public Employees’ Retirement System, over 60% of the plans use some sort of three-year variation.

# Policy Issues

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- Consistency with other plans
  - All plan 2 & 3 systems use the highest consecutive sixty-service credit months (5 years).

# Policy Issues

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- Pension Ballooning

- The shorter the time period, the greater the relative effect of salary increases due to overtime, promotions, etc. on FAS, which increases the risk of “pension ballooning”.



# Option 1: 24-Month FAS All Service

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- Include all service credit a member has earned in LEOFF Plan 2.
- Cost from July 2005 OSA report:
  - 2.64% (1.32% member, .79% employer, .53% state).
  - Need new estimate, available in the fall.

# Option 2: 24-Month FAS Prospective

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- Only service credit earned after the effective date of the bill would use the shorter period.
- For service credit earned prior to the effective date, the sixty-month period would be used to calculate a member's retirement benefit.
- Costs from July of 2005, OSA report:
  - Contribution rate increase 1.28% (.64% member, .38% employer, .26% state).
  - Need new cost estimate, available in the fall



# 24-Month Final Average Salary

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Questions?

# LAW ENFORCEMENT OFFICERS' AND FIRE FIGHTERS' PLAN 2 RETIREMENT BOARD

## 24-Month Final Average Salary Preliminary Report

June 18, 2008

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### 1. Issue

Shortening the final average salary (FAS) period from sixty to twenty-four months would increase retirement benefits and increase plan costs.

### 2. Staff

Greg Deam, Senior Research and Policy Manager  
(360) 586-2325  
greg.deam@leoff.wa.gov

### 3. Members Impacted

As of September 30, 2006 there were 15,718 active members and 779 retirees as reported in the Office of the State Actuary's *2006 Actuarial Valuation Report*. Changing the FAS could impact all LEOFF Plan 2 members.

### 4. Current Situation

A member's current benefit is calculated using the following formula:

$$2\% \times \text{Years of Service} \times \text{Final Average Salary}$$

Final average salary is defined as the monthly average of the member's basic salary for the highest consecutive sixty service credit months of service prior to such member's retirement, termination, or death. Periods constituting authorized unpaid leaves of absence may not be used in the calculation of final average salary.

## **5. Background Information and Policy Issues**

### **Benefit Formula**

A defined benefit plan is a retirement income plan that provides specific benefits that are defined as soon as the member joins the plan. Typically, the formula equals a specified percentage, multiplied by years of creditable service, multiplied against a defined salary. Usually, the member must reach a certain age as well to be eligible to retire.

Service credit is provided only for service rendered as a fire fighter or law enforcement officer after establishing membership in the Plan. One service credit month is granted for each calendar month in which basic salary is received for 90 or more hours. No more than one service credit month may be obtained during any calendar month, even if basic salary is received for more than 90-hours from each of two employers in a month.

Beginning September 1, 1991, a 1/2 service credit month is granted for any month in which basic salary for at least 70-hours, but less than 90-hours, is received. A 1/4 service credit month is granted for basic salary received for less than 70-hours in a month. Years of service are calculated by dividing total service credit months by 12.

### **Final Average Salary**

Final average salary (FAS) uses a predetermined number of months or years to determine an average monthly salary. The LEOFF Plan 2 system uses the highest consecutive sixty service credit months to determine the FAS. If a member has a break in service, those months in which the member is not employed are ignored. For example, if a member terminated employment on June 30, 2004 and didn't become employed again until January 1, 2005 and retired on June 30, 2005, the six month period between June 30, 2004 and January 1, 2005 would be ignored for the purpose of calculated consecutive service credit months.

Reviews of other states' plans reveal there are a number of different periods used to calculate final average salary. Some systems use a period of one year, while others, like LEOFF Plan 2, use five years.

Generally, if a shorter period is used for the years of service, the FAS calculation will be higher. This is especially true as wages rise over time.

In addition to the time period used in the calculation, another integral part of the calculation is to determine what is included in salary or "Basic Salary" as it is defined in law for LEOFF Plan 2 members. Some plans may include overtime earnings, lump sum payments for deferred annual sick leave, unused accumulated vacation, unused accumulated annual leave, holiday pay or any form of severance pay.

LEOFF Plan 2 defines "Basic Salary" as salaries or wages earned by a member during a payroll period for personal services, including overtime payments and shall include wages

and salaries deferred under plans established under 403(b), 414(h) and 457 of the United States Internal Revenue Code. Lump sum payments for deferred annual sick leave, unused accumulated vacation, unused accumulated annual leave, or any form of severance pay are specifically excluded from “Basic Salary”.

### **Final Average Salary in Other Washington State Plans**

PERS Plans 2 & 3, TRS Plans 2 & 3, SERS Plans 2 & 3, WSPRS Plan 2 and PSERS, like LEOFF Plan 2, use the highest consecutive sixty-months (5 years) of service credit. PERS Plan 1 uses the greatest compensation earnable by a member during any consecutive two-year period of service credit months. TRS Plan 1 uses the two highest compensated consecutive years of service for calculating average final compensation. WSPRS Plan 1 uses the average monthly salary received by a member during the member’s last two years of service or any consecutive two-year period of service, whichever is greater.

What is included in salary varies among the systems and plans. For example, WSPRS Plan 1 and Plan 2 both exclude any overtime for earnings related to highway projects (construction projects) or voluntary overtime earned on or after July 1, 2001. For those state patrolmen commissioned on or after July 1, 2001 the exclusion includes lump sum payments for deferred annual sick leave, unused accumulated vacation, unused accumulated annual leave, holiday pay, or any form of severance pay. PERS Plans 2 and 3 are similar to LEOFF Plan 2.

### **Final Average Salary in Other State Pension Plans**

A 2004 study of “State Police” plans by *Workplace Economics, Inc.* found the most commonly used final average salary definition includes average salary for the three highest years of service earnings or average salary for the highest three consecutive years of service earnings.

In addition to the *Workplace Economics, Inc.* study, appendix A shows FAS periods for other states’ police and fire fighter systems.

### **Policy Issues**

All of the plan 2 systems currently use a sixty-month salary period to calculate a retirement benefit. Changing from a sixty-month period to a twenty-four month period would be a break from that policy.

Another issue is the possibility of “pension ballooning” if the FAS time frame is shortened. Part of the plan 2 design was to have a longer FAS period to mitigate “pension ballooning”. The shorter the time period, the greater the relative effect of salary increases, due to overtime, promotions, etc., on FAS.

## 6. Policy Options

### **Option 1: 24-Month Final Average Salary Period – Apply to All Service Credit**

Under this option a twenty-four month FAS period would be used in the calculation of a retirement benefit for all service credit a member has earned in LEOFF Plan 2. According to a cost study done by the Office of the State Actuary (OSA) in July of 2005, the cost of including all service would increase the total contribution rate by 2.64% (1.32% member, .79% employer, .53% state). A new cost estimate would need to be provided by OSA, but would not likely be available until later in the fall.

### **Option 2: 24-Month Final Average Salary Period – For Service Earned Prospectively**

Under this option a twenty-four month FAS period would be used to calculate a benefit only to service credit earned after the effective date of the bill. For service credit earned prior to the effective date, the sixty-month FAS period would be used to calculate a member's retirement benefit. According to a cost study done by the Office of the State Actuary (OSA) in July of 2005, the cost of including prospective service would increase the total contribution rate by 1.28% (.64% member, .38% employer, .26% state). A new cost estimate would need to be provided by OSA, but would not likely be available until later in the fall.

## 7. Supporting Information

Appendix A: Retirement Comparison Table – Retirement Benefit Formula as of May 2005

### Appendix A: Retirement Comparison Table – Retirement Benefit Formula as of May 2005

System	Formula	FAS	Member Contribution	Employer Contribution
Alaska Public Employees Retirement System	$[2\% \times 1^{st} 10 \text{ yrs} \times \text{FAS}] + [2.5\% \times 10 + \text{yrs} \times \text{FAS}]$	3HC <sup>1</sup>	7.5%	8.42%
Arizona Public Safety Personnel Retirement System	$2.5\% \times \text{YOS} \times \text{FAS}$	3HC/10 <sup>2</sup>	7.65%	7.66%
Arkansas Local Police & Fire Retirement System	$2.5\% \times \text{FAS} \times \text{YOS}$ $1.5\% \times \text{FAS} \times \text{YOS}$ when eligible for unreduced Soc Sec if covered	3HC/10	6%	?
Colorado Fire and Police Pension Association	$[2\% \times 1^{st} 10 \text{ yrs} \times \text{FAS}] + [2.5\% \times 10 + \text{yrs} \times \text{FAS}]$	3H	8%	8%
Delaware County & Municipal Police/Fire Pension	$2.5\% \times \text{FAS} \times \text{YOS}$	3HC	7%	8.3%
Indiana: Police Officers' & Firefighters' Pension & Disability Fund	50% of Base Salary + 1% of Base Salary for each six months after 20 YOS	Final Year	6%	21%
Kansas Police and Firemen's Retirement System	$2.5\% \times \text{FAS} \times \text{YOS}$		7%	11.15%
Louisiana:				
Maryland Pension System for Local Fire Fighters and Police Officers	$1.5\% \times \text{YOS} \times \text{FAS}$	3HC	8%	7.58%
Nevada Police/Fire Sub-Fund of the Nevada Public Employees Retirement System	$[(2.5\% \times \text{YOS} \times \text{FAS}, \text{ for service prior } 7/1/01) + 2.67\% \times \text{YOS} \times \text{FAS}, \text{ for service after } 7/1/01]$	3HC	14.75%	14.75%
New Jersey Police and Firemen's Retirement System	$2\% \times \text{YOS} \times \text{FAS}$ $20 < Y \leq 25 = 50\% \text{ FAS}$ $65/20 = 50\% \text{ FAS} + [3\% \times \text{FAS} \times \text{YOS } 20-25]$ $\geq 40 = 70\% \text{ FAS}$	1H	8.5%	Actuarial determined for each employer.
New Mexico PERA –Police	Plan 1: $2\% \times \text{YOS} \times \text{FAS}$ Plan 2: $2.5\% \times \text{YOS} \times \text{FAS}$ Plan 3: $2.5\% \times \text{YOS} \times \text{FAS}^*$ Plan 4: $3\% \times \text{YOS} \times \text{FAS}^*$ Plan 5: $3.5\% \times \text{YOS} \times \text{FAS}^*$	3HC	7% 7% 7% 12.35% 16.3%	10% 15% 18.5% 18.5% 18.5%
New Mexico PERA - Fire	Plan 1: $2\% \times \text{YOS} \times \text{FAS}$ Plan 2: $2.5\% \times \text{YOS} \times \text{FAS}$ Plan 3: $2.5\% \times \text{YOS} \times \text{FAS}^*$ Plan 4: $3\% \times \text{YOS} \times \text{FAS}^*$ Plan 5: $3.5\% \times \text{YOS} \times \text{FAS}^*$	3HC	8% 8% 8% 12.8% 16.2%	11% 17.5% 21.25% 21.25% 21.25%
New York Police and Fire Retirement System	$\geq 20 = 2\% \times \text{FAS} \times \text{YOS}$ $< 20 = 1.66\% \times \text{FAS} \times \text{YOS}$	3HC	3% for 10 yrs	5.8%
Ohio Police and Fire Pension Fund	$[2.5\% \times 1^{st} 20 \text{ yrs} \times \text{FAS}] + [2\% \times (21^{st} \text{ to } 25^{th}) \times \text{FAS}] + [1.5\% \times (26^{th} \text{ to } 33^{rd}) \times \text{FAS}]$	3H	10%	19.5% (P) 24% (F)
South Carolina Police Officers Retirement System	$2.14\% \times \text{FAS} \times \text{YOS}$	3HC	6.5%	10.30% <sup>3</sup>
Washington LEOFF Plan 2	$2\% \times \text{FAS} \times \text{YOS}$	5HC	5.09	3.06 <sup>4</sup>

<sup>1</sup> Tier II benefits (Entered system between 1986 and 1996)

<sup>2</sup> 3HC/10 = 3 highest consecutive earning years within a 10 year window.

<sup>3</sup> South Carolina: In addition, employer also contributes 0.15% for group life insurance, 3.3% for retirement insurance surcharge, and 0.20% for accidental death benefit.

<sup>4</sup> The state also pays a contribution rate of 2.03%



