L1/L2 Merger Proposal Review

At the first stakeholder meeting on March 14, 2019 we were presented with the latest version of the proposed LEOFF 1/LEOFF 2 merger. The document is titled "LEOFF MERGER DRAFT" is essentially the same as the version first circulated on February 23, 2019. Various versions of this proposal go back for some time but this one is very similar to one issued on Thursday, June 22, 2017.

We will review each portion of this Draft Merger plan in hopes of getting a better understanding and identifying some of the type of questions we need to ask.

Additional stakeholder meetings are planned, so we will update the information on this site after each meeting.

MERGER:

Merges LEOFF 1 and LEOFF 2

A better definition of exactly what they mean by merger is needed. Right now, it is vague, and we can envision several scenarios that might be taken. On the surface it looks like LEOFF 1 would cease to exist as a separate pension plan. That would be in violation of several court decisions and the constitution.

Some people have objected to my characterization of this as causing LEOFF 1 to cease to exist. Of course, provisions of the LEOFF 1 statute would continue within RCW 41.26. However, the money would be moved into a single fund under the management of the LEOFF 2 Board. LEOFF 1 members would be denied any ability to make decisions on financial management of the funds, benefits provided by the fund, pension premium rates or almost anything dealing with the finances of the LEOFF 1 portion of the pension plan. In my mind that means that the system ceases to exist. I guess you could argue semantics but final outcome is clear.

No definition of this was presented at the stakeholders' meeting but Senator Van De Wege said he would produce bill language to better define the issue. We see reducing this to a bill or even a draft bill and further constricting our ability to adequately review all the issues.

Delay until receive IRS approval (Does not delay State rate reduction)

The meeting did not provide much else in the way of explanation for this provision. Essentially it is a case of having your cake and eating it too. That is to say, the State would immediately stop making contributions to the LEOFF 2 pension plan but that the remainder of the bill would wait to go into effect until the IRS has approved the new plan. Since the IRS will not make such a determination until after a bill is passed and since they take a long time to issue an approval or denial, we must wait even though the State has immediately stopped making pension premium payments. LEOFF 2 members should be screaming against this provision.

If the IRS denies the approval, then the State would be in arrears in their pension contributions. The State does not have a very good record in catching up with pension contributions. This will be a threat to LEOFF as it appears that the overall thrust of the merger effort is relive the State of any obligation to make pension contributions—ever.

STATE:

State pays 0% LEOFF 2 contribution rate for 2019-21 & 2021-23 saving $295 M. Local employer still pays 30% and employee still pays 50%

Pay close attention to this section. It is where all the meat in the proposal lies. It means that is the next two biennium budgets the State will make no contributions to LEOFF 2. They can then spend that $295 million on anything they want. The pension system suffers and all LEOFF beneficiaries are put a risk. Remember this $295 million is in addition to the $300 million they plan to take out for the Benefit Enhancement Account. So, we are down $595 million so far.

Beginning in 2023-25 state contributions restart but start phasing out and transitioning to employee/local employer by 2030 when employee share is 55% and local employer is 45%

Notice that there is no explanation as to what they mean by “phasing out”. No explanation was provided at the stakeholders’ meeting. The goal is clear--the state will cease making pension contributions and foist the entire burden on the employees and employers. No salary increases are provided for the employees or taxing authority for the employers to assist in shouldering the larger burden is provided.

If you are a labor negotiator, guess what arguments you will face as you try to arrive at a new contract. This is an extremely anti-labor bill and unions should never support it.

Repeal Public Safety Enhancement Account and Benefit Improvement Account saves $100M GFS in 2019-21 and 2021-23, and $50 million per biennium thereafter.

This is a bit complicated and I believe its listing here is a bit disingenuous. The Public Safety Enhancement Account was created by taking half of the annual $50 million due to the Benefit Improvement Account so that the employers could access the money for public safety improvements. The only problem is that the State had not funded the account. So, they claim there are saving $100 million now and $50 million per biennium thereafter. Truth is they don't fund it now, so it is not really a savings. It is sort of like my wife telling me she saved me a bunch of money by not buying a fur coat. Click here for information about this.

LEOFF 1:

This section of the document tries to outline what LEOFF 1 members would get from the merger. Watch closely now as there is a lot of misdirection built into this section.

$20,000/member payment Approximately $1SOM from LEOFF 1 fund

This is seen as a bribe by most LEOFF 1 members. It is not the first attempt. Way back in 2000 with SB 6166 they offered $10,000. That number was tossed about in the other mergers. Then with the L1/TRS1 merger it dropped to $5,000. When that failed, they tried $15,000 in 2017. (See this)

We have asked at every juncture how they came up with these numbers. All answers have been vague with no person willing to accept responsibility. Here is the best explanation we have received. Out of the total contributions to LEOFF 1 the members have contributed 11.5%. That would amount to $150 million of the surplus funds. Divide that by the 7,000 members and you come up with about $20,000. Once they exposed this formula, they raised the amount from $15,000 to $20,000.

The formula counts on LEOFF 1 buying off on the logic of the calculation. The fact is the calculation is based on a false premise. Just a couple of arguments against that premise show while it is folly. First, the calculation that LEOFF 1 members have paid in 11.5% of the contributions and the employers have paid in 11.5% as well. Since all the labor contracts have been negotiated based on total compensation the employer contributions are actually employee contributions—that raises it to 23% and raises the necessary payout to over $40,000 per member.

But that premise is flawed. The fund is a pension benefit trust. As a trust the money can only be used to enhance the benefits of the trust members. Tax law and numerous other cases have established this fact. Given that argument the entire $1.3 billion would belong to the LEOFF 1 beneficiaries. That would amount to over $185,000 per member. In Anchorage v Gallion that was the position taken by the Alaska supreme court and each member of that system was paid over $90,000. The State will argue against that position and cite a TRS v Washington case where the system was claimed not to be a trust. While this argument may hold true for TRS it does not necessarily hold true for LEOFF.

The state does not want to lose a lawsuit over this issue and neither does LEOFF 1. Obviously the proffered $20,000 is little more than an attempt to convince LEOFF 1 members to roll over and let the State take our pension funds—some call it a bribe. If the idea is to find a price where LEOFF 1 would look away they will need to bump up the figure to a realistic amount. The formula they are using makes less sense than quantum mechanics.

Finally, the idea that an actuarial surplus is real money stuffed in a drawer over at the State Investment Board is ludicrous. We know full well that the surplus is dependent on numerous assumptions that could well be wrong or could easily change as the economy fluctuates. Given what we do know about pension funding we can say that LEOFF 1 is healthy and should be left alone.

The argument that the state is mandated to pay the pension whether or not there is money in the fund was made by Senator Van De Wege. That is one of those things that sounds good if you say it fast. We have seen efforts make in Philadelphia, New Jersey, California and Chicago to lower pension payments. While these efforts tend to lose in a lawsuit it still takes a lawsuit and a lot of money to contest the effort.

Include medically necessary dental in retiree medical - $Unknown local government

The payment of medically necessary dental is already in the LEOFF statute. Most of the local disability boards pay for dental coverage under 41.26.150. The amount paid varies by jurisdiction, but it is certainly possible for any disability board to pay everything. There have been lawsuits about this with the Snohomish County Board/Fire District 1 being most notable with even an appeals court ruling. The problem is local and local board members should address the issue as needed.

At the stakeholders' meeting they were unable to define how much money the employers would need to allocate for expanding this benefit nor did anyone seem to have an understanding as to just how many pension boards are currently not paying the benefit.

This item does not seem to be favored by the employers. Surprise--surprise.

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LEOFF 1 Governance unchanged (SCPP & PFC)

No understandable explanation of the impact on the Governance of LEOFF 1 was given. The merger would eliminate the LEOFF 1 fund, so what would the Pension Funding Council fund? What would the Select Committee govern. All they currently do is review requests for legislation and occasionally put forward a bill of some sort. The real governance is done by the Legislature. A much more detailed explanation of Governance and seats for LEOFF 1 members on the SCPP is needed.

EMPLOYER

LEOFF 2 contributions for 2019-21 directed into LEOFF 1 Retiree Medical Account $210M

So, what do the employers get out of the merger. Not much. They would still have to pay the pension contributions but those contributions for the 2019-2021 biennium would go to fund a Retiree Medical account. Yes, that is right. LEOFF 2 pension contributions would be used to fund LEOFF 1 medical benefits. I bet that will be popular with our LEOFF 2 brothers and sisters.

At the stakeholders' meeting no one had any idea as to how this Retiree Medical Account would be managed. It was suggested that the employer could put in a chit for reimbursement, but no thought has been given as to who put in how much money and who should be entitled to reimbursement and at what level. Senator Van De Wege said that some sort of board could be appointed to oversee disbursements.

So, does Seattle get more than Vancouver? Does King County get more than Issaquah? The concept is flawed and is not properly defined.

LEOFF 2:

$300M Transfer from LEOFF 2 into Benefit Improvement Account

This move is difficult to understand because nobody can explain what they will do with the $300 million. There are no plans. The legislation currently existing under SB 5983 says that fire fighters and police officers are not fit to work until they are 53 years old, but there is no proposal to lower that retirement age. I just seems that if they want the money, they should have some sort plan for how it would be used.

This transfer would lower the funded status of the LEOFF 2 fund from 108.63% to 105.67%. LEOFF 2 would remain healthy. However, when you combine that with additional drawdowns as the employers pay into the LEOFF 1 Medical Benefits Account instead of the pension fund we see a decline in the funded status that would probably put LEOFF 2 in a deficit status within a couple of budget cycles.

Of course, that is why they want to take the money from LEOFF 1. They get to have their cake and eat it too. LEOFF 1 is left standing at the end of the line with our spoon upside-down.

The calculation and ramifications of this are difficult to do since very vague numbers were provided to the stakeholders. None the less it is clear that LEOFF 2 is weakened by the transfer and LEOFF 1 is obliterated by the merger.

GOVERNANCE:

This section of the draft proposal deals solely with the LEOFF 2 Governance.

Rate-setting authority solely with LEOFF 2 Board beginning 2023 (OSA reasonable)

Currently the LEOFF 2 Board sets the LEOFF 2 pension contribution rates. Those rates are subject to the ratification of the Legislature. This would remove the legislature from the equation and require only a statement of "reasonableness" from their Actuary. The handout says OSA but the law says Actuary and that can be whoever the LEOFF 2 Board hires.

There is certainly no reason to be concerned that the Board will act inappropriately. They have established a very good record, but it does remove the legislature from the mix. There would then be no elected body with oversight of the Board. That just does not seem like good government and I would be surprised to see any legislator forfeit that responsibility.

LEOFF 2 Board protected – authority and budget

The LEOFF 2 Board was created by an initiative. It can be eliminated by simple majority vote of the Legislature. This law seeks to preclude that option.

Over the years the board had done a very good job of building a sound pension system for LEOFF 2. There is no reason to suggest they will not continue to do good work. However, no agency should be without oversight and that includes the LEOFF 2 Board. This is particularly important is they end up with their $300 million Benefit Enhancement Account. Add on an additional $1.3 billion from the LEOFF 1 system and it could be excessively tempting to the board to totally restructure the benefit system. The legislature should be left in the mix.

SUMMARY

As we review this proposal it becomes clear that little thought has been given to the impact of this concept. Senator Van De Wege who appears to be the sponsor and Steve Nelson who appears to be the author are unable to answer some very basic questions. These are questions that should have had serious consideration well before putting together the proposal.

It is interesting to note that we have yet to hear why this proposal is even necessary. We have been told that the only beneficiary of this proposal would be the State because it would be relived of the obligation to make pension contributions.

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If the State really has such a burden in making their mandated contributions, they should just not make them. LEOFF 2 is in surplus and would remain in surplus for a couple of budget cycles. This is not a new approach for the State. The State failed to fund LEOFF 1 for the first five years and it really was in deficit.

It should be pointed out that the latest economic forecast says the state will get in an additional $880 million. There is no reason the state needs this money at this time.

The next stakeholder meeting is scheduled for March 22nd at 2 PM. Maybe we will have better information after that meeting.