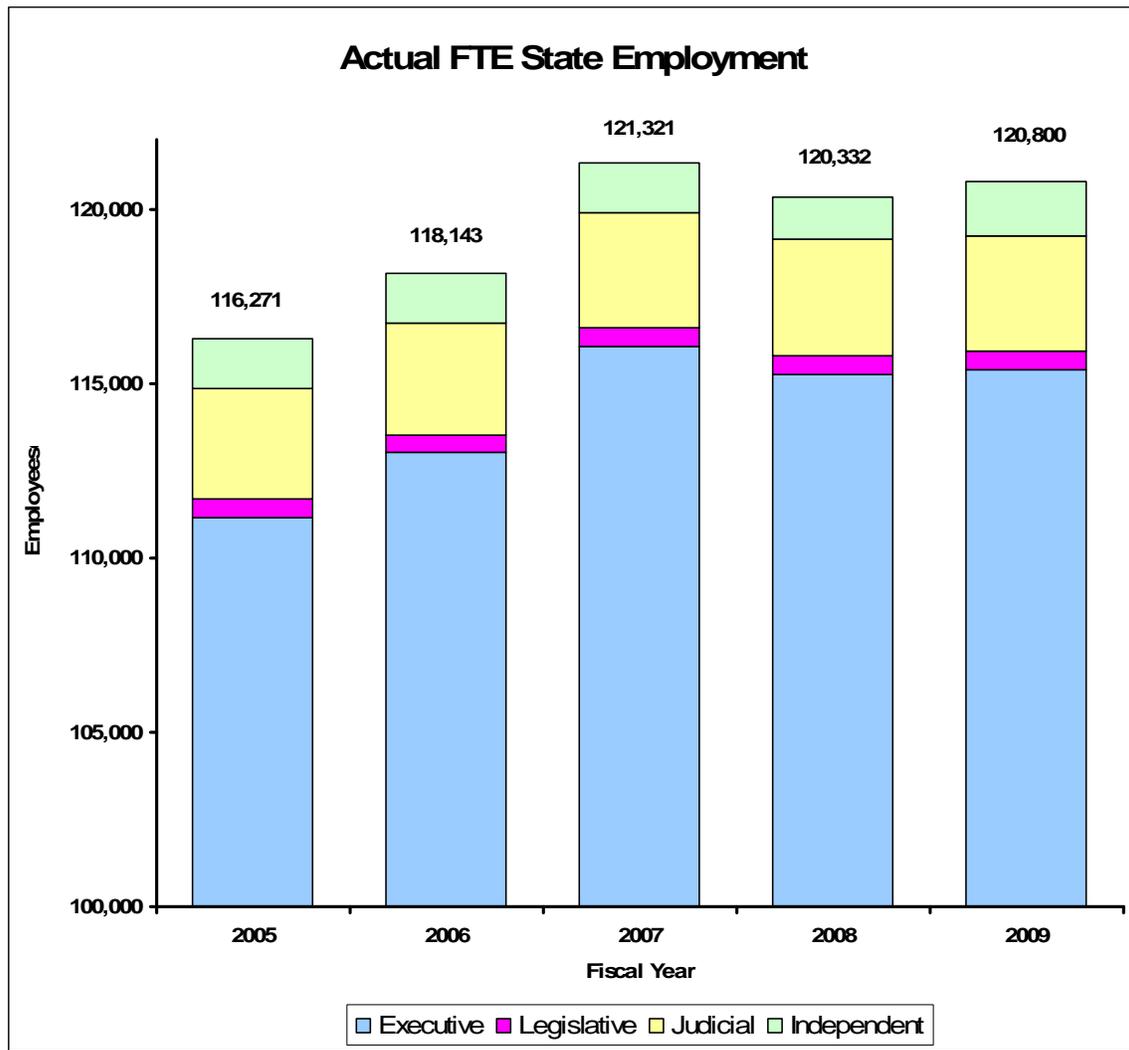


State Employee Compensation

**Senate Finance Committee
November 19-20, 2009**

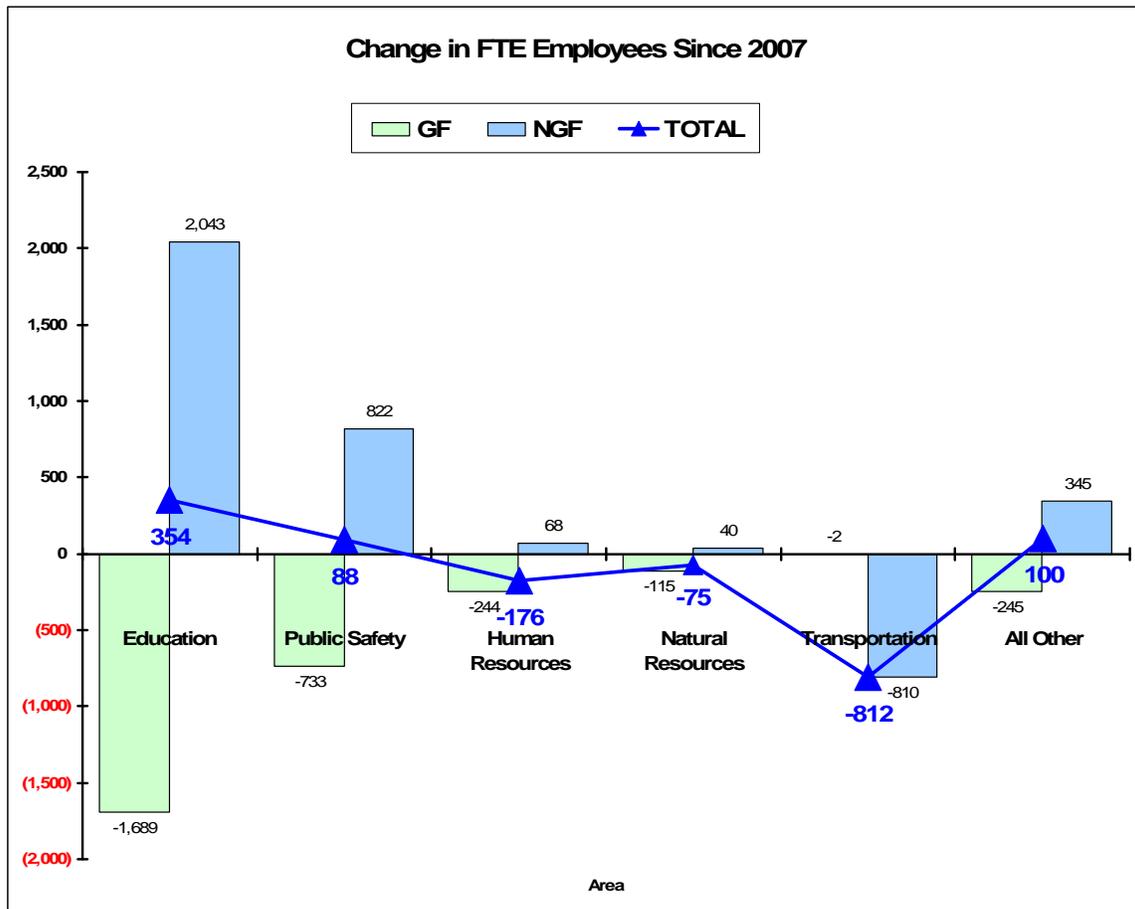
The Commonwealth is a Large Employer

- At just over \$8.0 billion (all funds) annually, employee compensation is the single largest direct expense in the Commonwealth's operating budget.
- The Commonwealth currently employs about 120,800 full-time equivalent state employees -- 521 FTE employees less than in FY 2007.



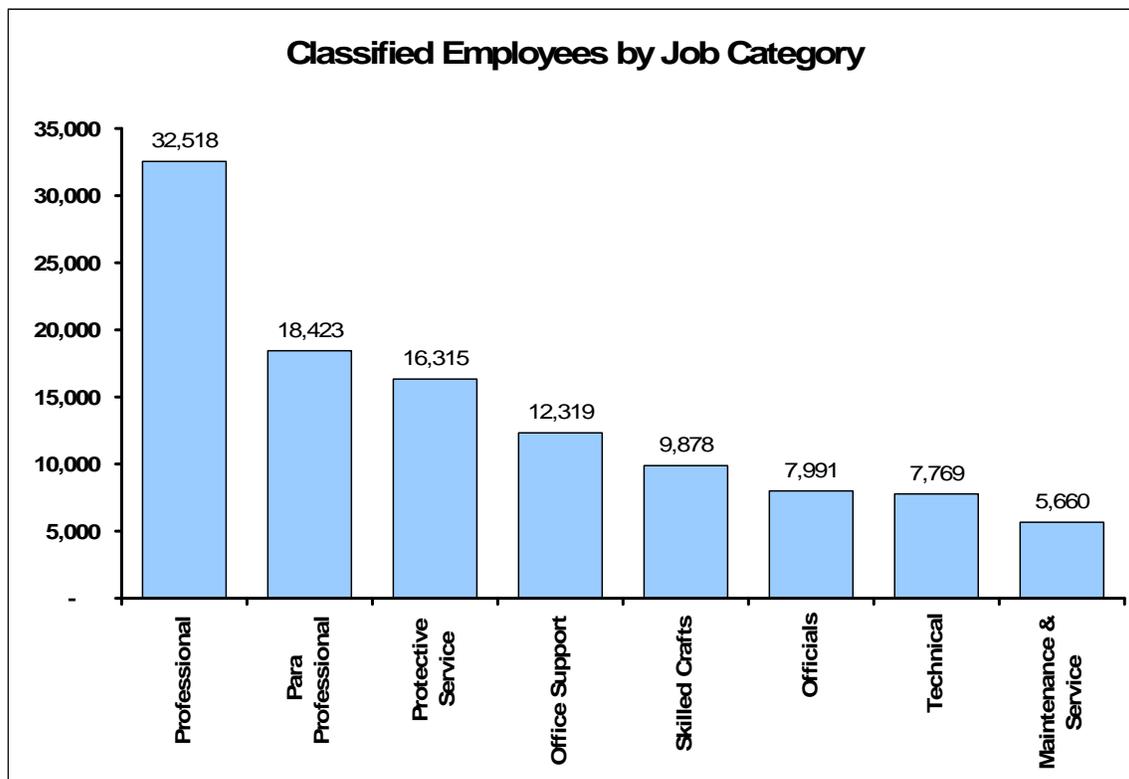
The Commonwealth is a Large Employer

- The relatively small net reduction of 521 in FTE employees masks the actual shifts in state employment since the beginning of the current recession.



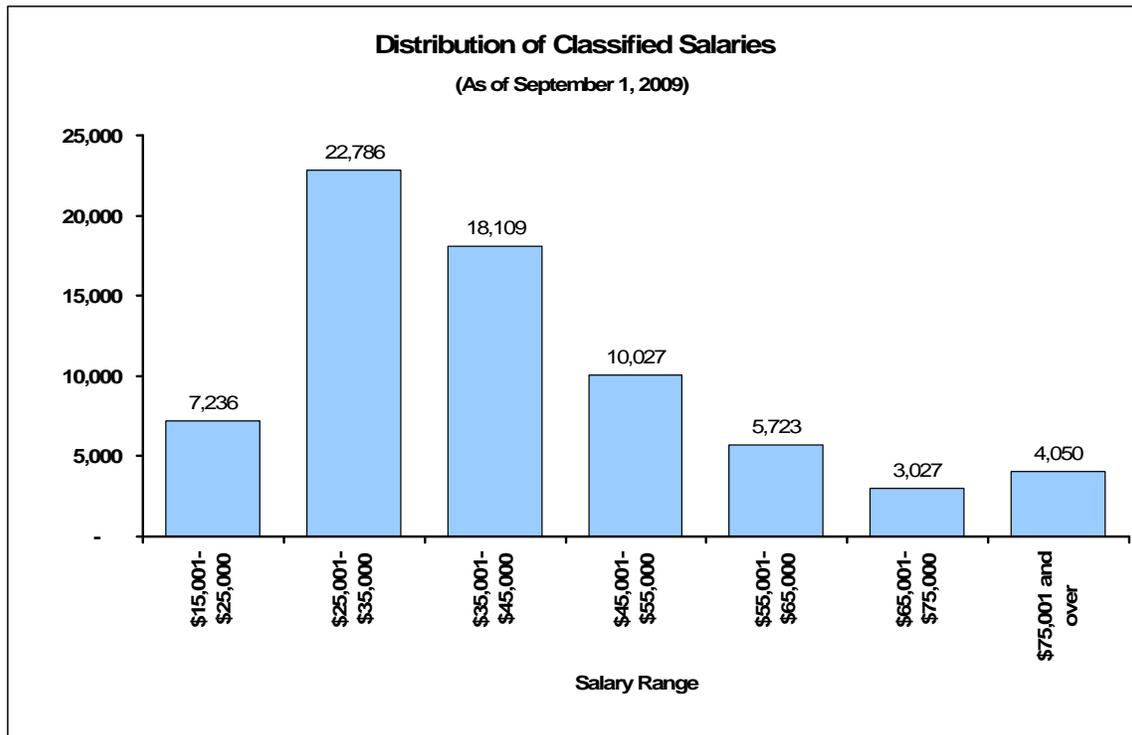
The Classified Workforce is Highly Skilled

- Almost 33,000 state classified employees are categorized as professionals under EEO guidelines. These include accountants, registered nurses, and engineers.
- Another 18,400 are classed as paraprofessionals and 7,800 are technicians, such as tax examiners, human resource assistants, computer network support technicians, and laboratory technicians.
- Combined, these three groups make up over half of the Commonwealth's classified workforce.



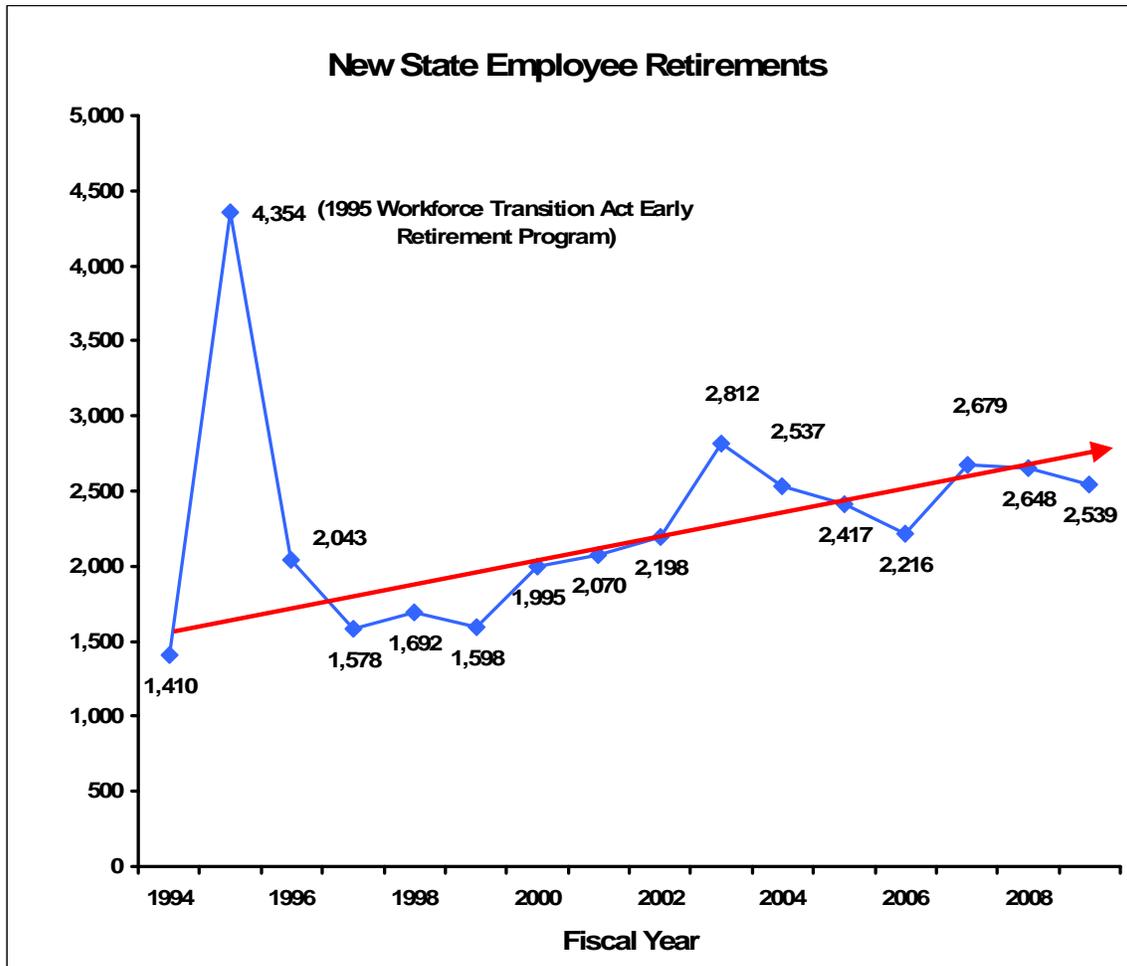
State Employee Salaries

- The 2008 JLARC study found Virginia’s base salaries to be “marginally competitive.”
 - Base salaries were, on average, 92 percent of the market median.
 - Total cash compensation was, on average, 88 percent of the market median
 - The value of bonuses provided by the Commonwealth is lower than that of other employers.
- JLARC found that “salary is not the state’s primary recruiting and retention tool.”
- Almost half of state classified employees make less than \$35,000 per year.



Numbers of Employees are Poised to Retire

- Despite a slight dip in FY 2009, the number of annual state employee retirements is steadily increasing.



- State employees are eligible to retire at age 50 with 30 years of service.
 - 12,251, or about 11.1 percent of state employees are currently eligible to retire.
 - 25,146, or about 21.1 percent of state employees will be eligible to retire by 2010.

Numbers of Employees are Poised to Retire

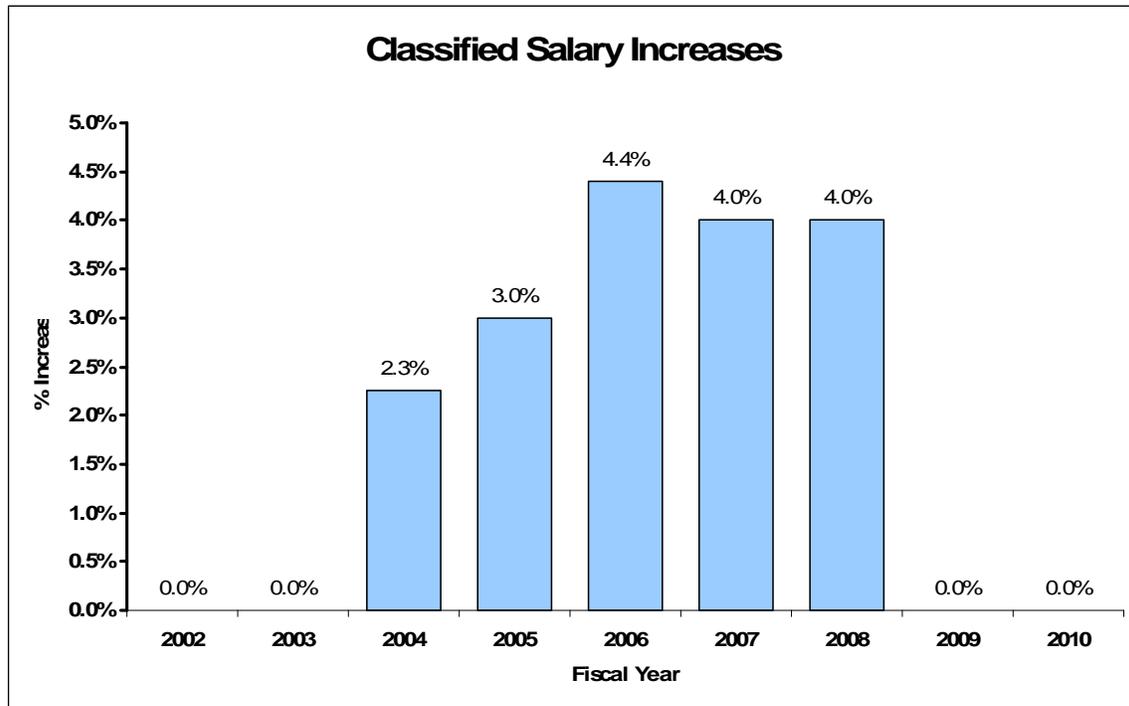
- On average, classified state employees retire at age 60.
 - 7,600, or about 10 percent of classified employees are currently 60 years old or older.
 - 19,200, or about 25 percent of classified employees will be at least 60 years old by 2015.
- These environmental factors in the Commonwealth's current compensation program have important implications for future policy options.

Major Compensation Issues for 2010-12

- There are five major compensation issues facing the Commonwealth for the 2010-2012 biennium:
 - Cash compensation,
 - VRS retirement costs,
 - Employee buy-out options,
 - Group health insurance costs, and
 - Employee Furloughs and salary reductions.

Cash Compensation

- FY 2010 marks the fourth year out of the past nine in which the Commonwealth has been unable to provide a general salary increase for its employees.



- The annualized cost of a 1 percent state and state-supported local employee salary increase is about \$76 million GF.

Annual GF Cost of a 1.0 Percent Salary Increase (\$ Millions)	
	Annual GF Cost
Classified Employees	\$ 22.1
State-Supported Local Employees	9.1
Faculty	9.2
Teachers	<u>35.8</u>
Total GF Cost	\$ 76.2

Cash Compensation

- Lack of general salary increases makes the implementation of changes in other areas of compensation more challenging.
 - Should the Commonwealth re-impose an employee share for VRS retirement only when there are offsetting salary increases?
 - Can state employees be expected to bear increased health insurance costs in the absence of salary increases, or increased out-of-pocket expenses in lieu of monthly premiums?
 - Are employee furloughs and other forms of salary reduction reasonable given the prevailing cash compensation?

VRS Retirement

- The Commonwealth provides retirement benefits for the majority of its employees through the Virginia Retirement System.
- The Virginia Retirement System operates four *defined benefit* (DB) retirement programs.

State Funded DB Retirement Systems Operated by the VRS				
(As of June 30, 2009)				
<u>Retirement System</u>	<u>Active Employees</u>	<u>Annuitants</u>	<u>Total Contribution Rate</u>	
			<u>Current</u>	<u>Board - Approved 2010 - 2012</u>
Virginia Retirement System (State)	78,339	47,910	11.26%	13.46%
Virginia Retirement System (Teachers)	148,762	64,073	13.81%	17.91%
Virginia Law Officers Retirement System	10,087	2,146	19.23%	20.93%
State Police Officers' Retirement System	1,828	1,193	25.05%	30.56%
Judicial Retirement System	<u>421</u>	<u>450</u>	39.51%	51.79%
Total (2009)	239,437	115,772		

- The *Total Contribution Rate* shown in the table above is comprised of the *Employer Rate*, which varies by plan, and the *Employee Rate*, which is set at 5.0 percent.

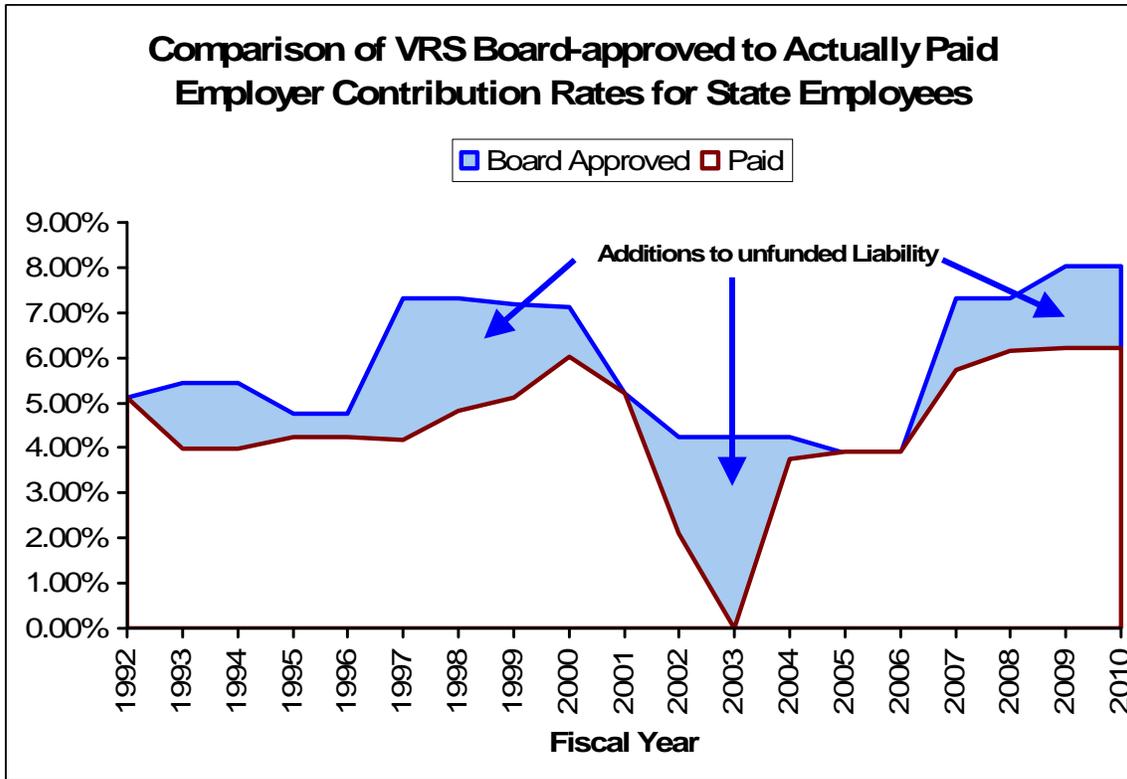
VRS Retirement

- In 1983 the Commonwealth picked up the 5 percent employee contribution for state employees in lieu of a salary increase.
 - Most local school divisions have picked up payment of the employee contribution for teachers.
 - The Commonwealth's payment for teacher retirement under the SOQ is based **solely** on the employer contribution rate.
- The retirement program for almost 14,000 faculty is provided through several ***defined contribution (DC)*** programs administered by the VRS, UVa, VaTech, GMU, and VCU.
 - Like the VRS DB plans, the Commonwealth requires no employee contribution for the faculty DC Plan.
- The employer contribution rate for these DC plans is set by statute at 10.4 percent.
 - A recent VRS review found that this contribution rate was consistent with the most commonly used rate (mode) among Virginia institutions' peers.
 - Both the ***average*** rate and the ***mean*** rate (half are higher and half are lower) were about 9 percent.

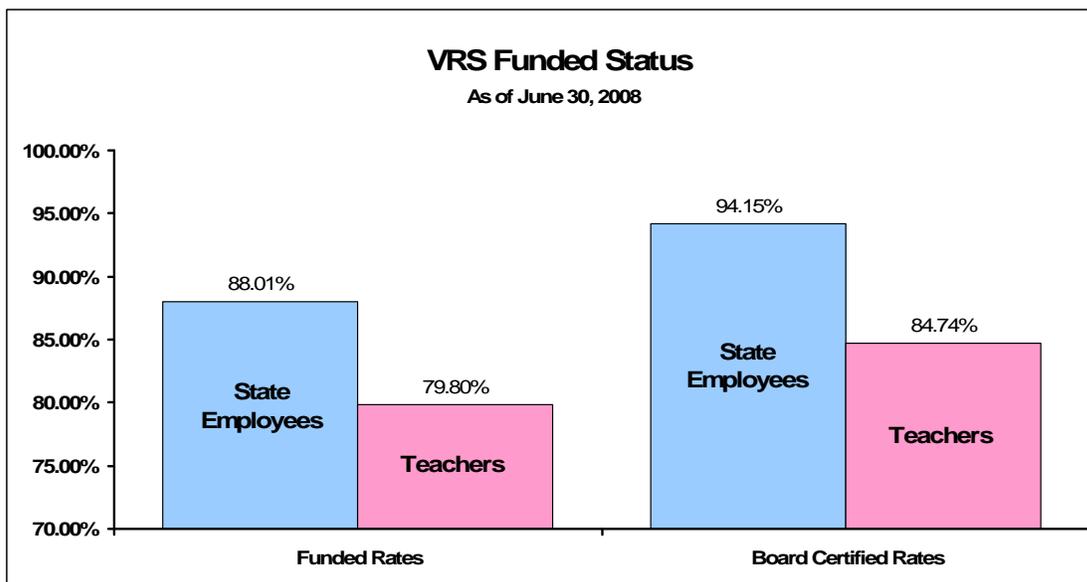
VRS Retirement

- The 2008 JLARC Compensation Report found that VRS retirement benefits help retain longer-tenured employees.
- Key findings on Funding VRS Benefits from the 2008 JLARC Compensation Report:
 - Contributions to VRS plans have been lower than the VRS Board certified rate in 10 of last 18 years.
 - Virginia ranked 46th out of 50 states in average amount of contribution paid (Pew Center for the States).
 - Payment of the 5 percent employee contribution for VRS retirement benefits is unique and costly.
 - The annual COLA protects retirees' purchasing power but is a major cost driver for the Commonwealth.
- The unfunded liabilities of the VRS programs (See Appendix B) have increased since 2001 due to:
 - Lower than required contributions,
 - Investment losses,
 - Benefit changes (SPORS), and
 - Other actuarial factors.

VRS Retirement



- Had the Board approved retirement rates been paid, the two major VRS groups would be better funded.



VRS Retirement

- The administration has proposed to withhold the employer contributions for state employees and teachers in the fourth quarter of FY 2010.
 - Saves the Commonwealth \$104.0 million GF in FY 2010.
 - Saves the local school divisions \$128.1 million in FY 2010.
 - Adds \$259.1 million to the VRS Unfunded Liability.

	Projected 4th Quarter Employer Contribution (All Funds)	Projected 4th Quarter Employer Contribution (GF)
State	\$ 56.9	\$ 34.2
VALORS	12.6	10.2
SPORS	5.1	4.3
JRS	5.1	4.0
Teacher	<u>179.4</u>	<u>51.3</u>
Total	\$ 259.1	\$ 104.0

- Retirement contributions for other local employees will not be affected.

VRS Retirement

- The VRS Board certified retirement contribution rates are over \$380 million GF higher for 2010-2012.
 - Largely due to investment losses of -21.1 percent in FY 2009.
 - 2008 Session increase in retirement benefits for State Police.

Changes in VRS Retirement Rates				
<u>Retirement System</u>	<u>Employer Contribution</u>		<u>2010-2012 Biennium</u>	
	<u>Current</u>	<u>Board - Approved 2010 - 2012</u>	<u>Estimated Cost Increase</u>	<u>Estimated GF Portion</u>
Virginia Retirement System (State)	6.26%	8.46%	\$159.5	\$77.4
Virginia Retirement System (Teachers)	8.81%	12.91%	689.9	271.2
Virginia Law Officers Retirement System	14.23%	15.93%	12.2	11.3
State Police Officers' Retirement System	20.05%	25.56%	11.1	9.5
Judicial Retirement System	34.51%	46.79%	<u>14.9</u>	<u>14.9</u>
Total			\$887.5	\$384.3

- The 2008 JLARC Compensation Study proposed several retirement benefit options for consideration.

VRS Retirement

- Only two options present opportunities for significant cost savings in the 2010-2012 biennium:
 - Deferral of employer contributions, and
 - Implementation of an employee paid retirement contribution.

Estimated Annual Savings from VRS DB Retirement Changes		
	GF Savings	NGF Savings
Implement a 2% employee Contribution	\$ 45.9	\$ 186.4
State	37.2	39.5
VALORS	6.8	0.5
SPORS	1.9	0.3
JRS	N/A	N/A
Teachers*	N/A	146.1
Increase early retirement age from 50 to 60	\$ 0.0	\$ 0.0
Reduce COLA for new hires	\$ 0.0	\$ 0.0

* NGF Savings for a 2% contribution for teacher retirement are local funds.

Employee Buy-out Options

- Employee buy-out programs essentially take two forms:
 - Incentives to encourage employees to seek other employment, and
 - Incentives to encourage employees to retire earlier than planned.

- Virginia has offered employee buy-out programs – including early retirement programs – on two occasions in 1991 and 1995.
 - Both programs have been deemed flawed for several reasons – lack of structure, overly broad applicability, increased VRS unfunded liability.

- In 1997 both the Auditor of Public Accounts and the VRS analyzed the 1995 employee buy-out program, concluding that:
 - The program was successful in eliminating over 4,000 FTE positions.
 - The *overall* cost of state services decreased by a net of \$60 million by FY 1997, however
 - Some agencies incurred increased costs due to increased overtime, hiring of part-time employees, and utilization of service contracts to replace essential employees.

Employee Buy-out Options

- The costs of services at VDOT increased by over \$40 million.
 - The unfunded liability under the VRS retirement program for state employees and the State Police Retirement Program *increased* approximately \$125 million.
 - In 1997 VRS estimated the annual cost of this increase in unfunded liability to be \$14 million.
 - Under the VRS's thirty year amortization period, the 1995 early retirement program will be paid off in 2025.
- The use of employee buy-outs to assist in balancing Virginia's budget should be considered in the context of several key factors.
 - The ability to manage the departure of essential employees,
 - The ability to manage costs after the buy-out program,
 - Increases in long-term VRS retirement costs, and
 - Restrictions on further reductions to higher education imposed by the American Recovery and Reinvestment Act (federal stimulus program).
- See Appendix D for further discussion of employee buy-outs.

Employee Health Insurance

- The Commonwealth provides group health insurance for state employees and their dependents as a part of its employee benefits program.
 - 110,000 Covered state employees
 - 225,000 Covered lives
- The annual cost of the state group health insurance program is approximately \$770.0 million (all funds).

Annual Cost of Employee Health Insurance	
	Annual Cost (\$ Millions)
GF	\$ 308.0
NGF	338.8
Employees	<u>122.9</u>
Total	\$ 769.7

- Key findings of the 2008 JLARC Compensation Report:
 - Health insurance was the second most important reason employees chose to work for and remain with the State.
 - Over the past ten years the state's health insurance costs have grown faster than total State appropriations (135 percent vs 99 percent)

Employee Health Insurance

- At the time (2008) the medical benefit portion of State health insurance was highly competitive with other large employers.
 - 4th compared to 16 large peer employers in Virginia.
 - 2nd compared to 7 nearby states.
- The Commonwealth contributes a higher portion of premiums (72 percent) than most other employers.
- Out-of-pocket costs, such as deductibles, coinsurance, and co-payments were similar or below median.
 - These changed substantially for FY 2010.
- No increases in employer or employee health insurance premiums were authorized for FY 2010. The 10.3 percent upward trend in costs was addressed by:
 - *Utilization of cash balances in the Health Insurance Fund (HIF),*
 - Selected increases in co-payments and deductibles, and
 - Restrictions on coverage for lap band and gastric bypass surgery.

Employee Health Insurance

- The total cost increase for the Commonwealth health benefits program will likely approach \$325 million (all funds) for the 2010-2012 biennium, and is influenced by two factors:
 - The utilization of HIF balances can be continued at the present rate until November 2010, and
 - The cost trend for the Commonwealth's health benefit program.

2010-2012 Cost Increase for Employee Health Insurance			
	<u>FY 2011</u>	<u>FY 2012</u>	<u>Total</u>
GF	\$46.4	\$115.0	\$161.4
NGF	37.8	93.6	131.4
Employees	<u>7.9</u>	<u>24.1</u>	<u>32.1</u>
Total	\$92.1	\$232.7	\$324.8

- The total cost to replace the subsidy from the HIF for the 2010-2012 biennium is approximately \$167 million (all funds).

2010-2012 Cost to Replace the HIF Subsidy of Health Insurance Rates			
	<u>FY 2011</u>	<u>FY 2012</u>	<u>Total</u>
GF	\$26.1	\$55.6	\$81.7
NGF	21.2	45.3	66.5
Employees	<u>4.5</u>	<u>14.3</u>	<u>18.8</u>
Total	\$51.8	\$115.3	\$167.1

Employee Health Insurance

- The cost trend for the State's health benefit program is estimated at 5 percent for FY 2011 and 9 percent for FY 2012.

	<u>FY 2011</u>	<u>FY 2012</u>	<u>Total</u>
GF	\$20.3	\$59.4	\$79.7
NGF	16.5	48.3	64.8
Employees	<u>3.5</u>	<u>9.8</u>	<u>13.3</u>
Total	\$40.3	\$117.4	\$157.7

- Options for addressing this projected cost increase are complicated by:
 - The draw down of balances in the Health Insurance Fund (HIF) in FY 2010,
 - Increases in employee costs in FY 2010,
 - The relatively large number of low paid state employees

Employee Furloughs and Salary Reductions

- Part 4 of the Appropriations Act authorizes the Governor to withhold general fund expenditures to balance the state budget.
 - §4-1.02.d.5.g restricts the Governor's authority to reduce salaries by more than 2.00 percent.

- Two types of salary reduction are possible:
 - Furlough: A temporary reduction in employee work hours with a corresponding reduction in cash compensation.
 - Salary reduction: A permanent reduction in the cash compensation of employees with or without a corresponding reduction in work hours, and

- The National Conference of State Legislatures reports that 24 of the fifty states have implemented some form of employee furlough program as of September 2009. (See www.ncsl.org/?tabid=17244)
 - The number of furlough days ranges from 36 (California and Hawaii) to one (Virginia).
 - Some states have considered but not implemented employee furloughs.

Employee Furloughs and Salary Reductions

- Furloughs have been used in Virginia on a limited basis.
 - Address temporary downturns in business units supported by NGF revenues.
 - The most notable recent example was the Science Museum of Virginia in FY 2003.
- As part of the September 2009 reduction plan the Administration has proposed a one day furlough for state employees in FY 2010.
 - Most Executive Branch employees would take the furlough day on the Friday before the Memorial Day weekend.
 - Certain employees (faculty, public safety, etc.) will take the furlough day on an alternative schedule that will vary by agency.
 - A one day furlough represents a reduction of 0.35 percent in the annual salary.
 - Saves the Commonwealth \$16.2 million in FY 2010 (\$9.3 million GF and \$6.9 million NGF).
- Under the rules proposed by the Administration, Virginia's one-day furlough would not affect employee benefits such as retirement, life insurance, or health insurance.

Employee Furloughs and Salary Reductions

- Salary reductions were used in Virginia to help address the FY 1991 budget shortfall.
 - Salaries of **all** state employees and state-supported local employees were reduced by 2.0 percent on December 1, 1990.
 - Employee benefits based on a percentage of salary were also reduced.
- For most state classified employees and state-supported local employees this salary reduction was simply the immediate elimination of the December 1, 1990 salary increase.
 - For many faculty the salary reduction was the partial elimination of the salary increase granted on July 1, 1990.
- The annualized savings from a 1.00 percent salary reduction are approximately \$40 million GF.

Summary

- The Commonwealth has been unable to provide a general salary increase for its employees in four out of the past nine years.
 - The annualized cost of a 1 percent public employee salary increase is \$76 million GF.
- Rate increases totaling over \$571 million GF are expected for the retirement and health benefit programs.

**2010-2012 GF Cost of Maintaining Current
Employee Benefit Programs**

<u>Benefit Program</u>	<u>GF Cost</u>
VRS Retirement*	\$384.3
Health Insurance	161.4
Group Life*	27.8
Retiree Health Credit*	8.6
Disability	<u>(10.9)</u>
Total	\$571.2

* Includes GF share of teachers under the Standards of Quality.

- Options for addressing these projected cost increases are complicated by.
 - Availability of GF and local resources,
 - Previous actions to control costs and balance the general fund budget,

Summary

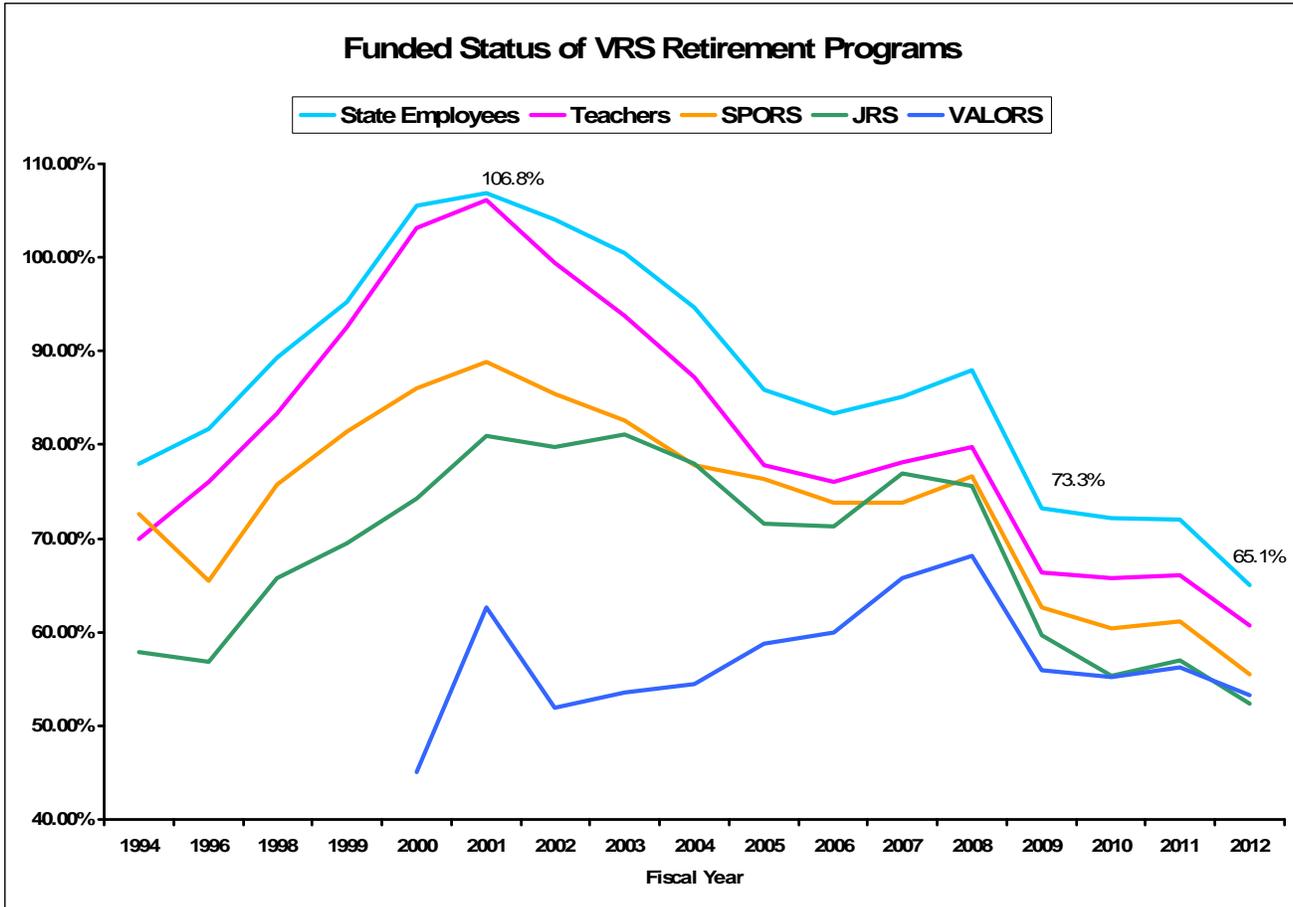
- Restrictions on further reductions to higher education imposed by the American Recovery and Reinvestment Act (federal stimulus program),
 - The long-term nature of retirement programs, which means that many policy changes will not produce savings for decades,
 - The relatively large number of low-paid state employees, and
 - Lack of offsetting employee salary increases.
- Employee buy-out programs could reduce the number of state employees, which could lead to general fund savings.
 - Such programs can result in the loss of key employees – resulting in unanticipated costs, and
 - Early retirement options result in increases in long-term VRS retirement costs.
 - Employee furloughs could save the Commonwealth \$9.3 million GF per day, but the savings are temporary.

Appendix A: Employee Benefit Costs

- Rates for all but one state employee benefit program will continue to increase for the 2010-2012 biennium.

	<u>Current Employer Paid Rate</u>	2010-2012 Board Approved Employer Rate	<u>Change</u>	2010-2012 GF Cost Increase
VRS State	6.26%	8.46%	2.20%	77.4
VRS Teachers	8.81%	12.91%	4.10%	271.2
JRS	34.51%	46.79%	12.28%	14.9
VALORS	14.23%	15.93%	1.70%	2.1
SPORS	20.05%	25.56%	5.51%	4.6
VSDP	1.00%	0.75%	-0.25%	(10.9)
Group Life (State)	0.79%	1.11%	0.32%	16.8
Group Life (Teachers)	0.27%	0.44%	0.17%	11.0
Retiree Health Care Credit (State)	1.00%	1.06%	0.06%	3.4
Retiree Health Care Credit (Teachers)	1.04%	1.08%	0.04%	5.2
Employer Health Insurance Rates	N/A	N/A	N/A	161.4

Appendix B: Change in the Funded Status VRS Retirement Programs



Appendix C: Virginia Offers Competitive Benefit Programs

- The Commonwealth's benefit programs are similar to those of other major employers.

Employee Access to Benefits in Large Firms and Virginia		
Type of Benefit	% of Employees in Firms with 500 or More Workers	Commonwealth of Virginia
Retirement benefits (all)	90%	Yes
Medical care	89	Yes
Outpatient prescription drug	88	Yes
Life insurance	85	Yes
Paid sick leave	84	Yes
Paid holidays	82	Yes
Employee assistance programs	82	Yes
Paid vacation	78	Yes
Dental care	67	Yes
Defined benefit	63	Yes
Defined contribution	61	Yes
Wellness programs	60	Yes
Retiree health (under 65)	53	Yes
Long-term disability	51	Yes
Short-term disability	48	Yes
Retiree health (65 and over)	48	Yes
Vision care	43	Yes
Long-term care insurance	31	Yes
Health savings account	22	Yes

Source: JLARC and Bureau of Labor Statistics Employee Benefits Survey, March 2009

- The Federal Government and Virginia's larger localities offer benefit programs similar to the Commonwealth's.

Appendix D: Employee Buy-out Options

- Employee buy-out programs essentially take two forms:
 - Incentives to encourage employees to seek other employment, and
 - Incentives to encourage employees to retire earlier than planned.
- An early retirement option is any program of incentives that allows employees to retire earlier than at the point of eligibility for normal full retirement.
- Temporary retirement programs are often offered by employers as a way of reducing the size of their workforce.
 - Referred to as “window” retirement programs because employees have a window of opportunity to take advantage of their provisions.
 - The offered time window and repetition of the programs must be strictly controlled so as to avoid legal complications.
- Virginia has offered employee buy-out programs – including window retirement programs -- on two occasions in 1991 and 1995.

Appendix D: Employee Buy-out Options

- The 1995 window retirement program was offered as an option under a broader voluntary separation program, which was provided for in the **Workforce Transition Act of 1995**:
 - Attempted to cure some of the problems identified in the 1991 employee separation program – lack of structure, overly broad applicability, increased VRS unfunded liability.
- Employees wishing to participate were required to apply by March 31, 1995 and be accepted into the voluntary separation program by April 15, 1995. Actual separation from state service was effective on May 1, 1995. Benefits included:
 - Cash payments equal to two weeks for each year of service, with a minimum benefit of four weeks and a maximum benefit of thirty-six weeks.
 - A lump sum payment equal to the present value of unemployment benefits, up to \$5,000.
 - Continued coverage under the Commonwealth's group health and life insurance programs for up to 12 months, with the state paying the employer's premium.

Appendix D: Employee Buy-out Options

- In lieu of voluntary separation pay, an eligible employee aged 50 or over could elect to purchase service or age credit and retire. Purchase of such credits was the rate of 15 percent of salary per year of service or age -- up to the value of the voluntary "cash out" benefit.
 - This was the rate then used for purchase of non-state service.
 - *VRS now estimates the cost of providing additional service credit late in an employee's career at 40 to 50 percent of creditable compensation.*
- All state employees were eligible for the voluntary separation program except judges, law enforcement officers, teaching faculty, and certain grant-funded employees.
- Teaching faculty and state police officers were only eligible for the voluntary separation program if it was part of an approved restructuring plan. Separations under restructuring plans took place by July 1, 1996.
- In 1997 both the Auditor of Public Accounts and the VRS analyzed the 1995 employee buy-out program, concluding that:

Appendix D: Employee Buy-out Options

- The program was successful in eliminating over 4,000 FTE positions.
- The overall cost of state services *decreased* by a net of \$60 million by FY 1997, however
- Some agencies incurred increased costs due to increased overtime, hiring of part-time employees, and utilization of service contracts to replace essential employees.
 - The costs of services at VDOT increased by over \$40 million.
- The unfunded liability under the VRS retirement program for state employees and the State Police Retirement Program *increased* approximately \$125 million.
 - In 1997 VRS estimated the annual cost of this increase in unfunded liability to be \$14 million.
 - Under the VRS's the thirty year amortization period the 1995 early retirement program will be paid off in 2025.