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Compensation Reserves Overview and Fringe Benefit Costs (Budget Management and Compensation Reserves)

[LFB 2019-21 Budget Summary: Page 54, #1]

CURRENT LAW

For the 2017-19 biennium, all funds compensation reserves total $6,818,700 in 2017-18 ($3,080,500 GPR and $3,738,200 other funds) and $117,167,500 in 2018-19 ($52,081,600 GPR and $65,085,900 other funds). These funds are reserved for cost increases related to state and University of Wisconsin (UW) System employee salaries and fringe benefits.

GOVERNOR

Provide, in the 2019-21 general fund condition statement, total compensation reserves of $55,174,300 in 2019-20 ($24,886,600 GPR and $30,287,700 other funds) and $211,067,000 in 2020-21 ($94,358,600 GPR and $116,708,400 other funds) for cost increases related to state and UW System employee salaries and fringe benefits. Compensation reserve amounts by fund source and fiscal year are shown in Table 1.

TABLE 1

Compensation Reserves Under the Bill, By Fund Source

Fund Source	2019-20	2020-21
General Purpose Revenue	$24,886,600	$94,358,600
Federal Revenue	8,245,500	31,849,400
Program Revenue	17,062,100	66,896,100
Segregated Revenue	4,980,100	17,962,900
Total	$55,174,300	$211,067,000

The GPR and all funds compensation reserve amounts under the bill related to state and UW System employee fringe benefits, as shown in Table 2, include the following: (a) $2,876,100 GPR ($6,598,900 all funds) in 2019-20 and $17,841,100 GPR ($40,932,300 all funds) in 2020-21 to support prior period and inflationary increases for fringe benefits; (b) -$6,456,700 GPR (-$14,691,500 all funds) in 2019-20 and -$8,694,700 GPR (-$19,855,100 all funds) in 2020-21 associated with savings from the state's high deductible health care plan; (c) -$1,530,600 GPR (-$3,458,700 all funds) in 2019-20 and -$2,640,700 GPR (-$5,967,000 all funds) in 2020-21 associated with savings from employees opting out of the state's health insurance coverage net of the cost to provide $2,000 annual opt-out incentive payments; and (d) -$102,600 GPR (-$234,300 all funds) in 2019-20 and -$205,000 GPR (-$468,200 all funds) in 2020-21 associated with savings from additional health insurance opt-outs that could result from a modification to an exclusion of employees who opted out of the state's health insurance coverage in 2015 from receiving annual opt-out incentive payments. [A separate budget paper addresses the proposed modification to the 2015 opt-out incentive exclusion under "Employee Trust Funds."]

TABLE 2

GPR Compensation Reserves for Fringe Benefit-Related Expenses

	2019-20	2020-21
Fringe Benefits-Related		
Prior Period and Inflationary Increases for State Employee Fringe Benefits	$2,876,100	$17,841,100
High Deductible Health Care Plan Savings	-6,456,700	-8,694,700
Opt-out Incentive Savings (Current Law)	-1,530,600	-2,640,700
2015 Opt-Out Exclusion Modification Savings	-102,600	-205,000
Total	- $5,213,800	$6,300,700

DISCUSSION POINTS

Overview of Compensation Reserves

1. Generally, compensation reserves represent reserves in the budget to provide funding for any increases in state employee salary and fringe benefit costs that may be required in the biennium, but for which funding is not included in the individual agency budgets as a part of the biennial budget. The reserve funds are not allocated at the time of budget development to individual agencies because neither the amount of any salary or fringe benefit cost increases, nor the specific amount of funding needed by each individual agency, is known at the time of budget development.

2. In the 2019-21 biennium, to the extent necessary, costs of unbudgeted pay and fringe benefit adjustments would be funded from the compensation reserves under the pay plan supplementation process. Under the pay plan supplementation process, the Department of Administration requires state agencies, towards the end of each fiscal year, to document the need for any supplementation of existing budgets for the cost of any authorized pay increases (including associated fringe benefit costs, such as social security and retirement contribution payments) and for the cost of the employer's share of any increased fringe benefit costs such as premiums for state

employee health insurance. Once these requests have been reviewed by DOA, they must then be submitted to the Joint Committee on Finance for final approval under a 14-working day passive review process.

3. The schedule of compensation reserves (shown in Table 1) indicates reserve funding for each funding source from which state employees' salaries and benefits may be funded. The respective indications of GPR, PR, FED, and SEG funding amounts are included to provide an indication of the all-funds impact of the anticipated cost increases to agencies under the administration's plans for compensation. However, the actual fiscal impact of "releasing" funds from these indicated reserves is different between GPR funds and any non-GPR funding sources. The reason for this is that the GPR funding comes from a single central source, the general fund, which is composed primarily of general tax revenues. In contrast, the other funding sources are not pooled in a single account. While these revenue sources are the same in the definitional sense of involving the same type of revenue (for example, federal revenue), the revenues are retained by the individual agencies in either separate program accounts (such as a separate program account for licensing fees) or in distinct segregated funds (the transportation fund or the conservation fund, for example). Therefore, rather than these different revenues all going to a single fund, each program account or segregated fund separately receives revenues that are to be deposited exclusively to that account or fund and the expenditures of those revenues may be made only for the purposes authorized for that account or fund.

4. As a consequence of this difference, when GPR that is set aside in the compensation reserves is released to state agencies under the pay plan supplementation process, it is transferred from one central GPR appropriation to individual agency GPR appropriations for expenditure. In contrast, when PR, SEG, or FED monies are "released" to state agencies under the pay plan supplementation process, these monies are transferred from the individual revenue balance of the particular account or fund for that individual agency to the appropriation side of that account or fund. In general, such accounts or funds usually have sufficient revenue reserves to cover the costs of the pay plan supplements; what they require is the authorization to increase their total spending authority by the amount of the requested supplement.

5. The review of compensation reserves, therefore, usually focuses on GPR funding amounts. Given these factors, this paper and other budget papers addressing amounts budgeted to compensation reserves will focus primarily on projections for the GPR share of compensation reserves. As indicated in Table 1, GPR compensation reserves under the bill for state agencies, including the UW System, total $24,886,600 GPR in 2019-20 and $94,358,600 GPR in 2020-21. Table 3 identifies the various components of the net compensation reserve calculation, as a portion of total GPR compensation reserves under the bill.

TABLE 3

GPR Compensation Reserves for State and UW System Employees

	2019-20	2020-21
Fringe Benefits-Related		
Prior Period and Inflationary Increases		
for State Employee Fringe Benefits	$2,876,100	$17,841,100
High Deductible Health Care Plan Savings	-6,456,700	-8,694,700
Opt-out Incentive Savings (Current Law)	-1,530,600	-2,640,700
2015 Opt-Out Exclusion Modification Savings	-102,600	-205,000
Subtotal	- $5,213,800	$6,300,700
Salary-Related		
General Wage Adjustments	20,448,300	61,705,600
Market Wage and Parity Adjustments	6,050,000	6,050,000
Minimum Pay Increase to $15 per Hour	0	93,300
Correctional Positions Pay Progression	3,602,100	20,160,900
Crime Lab Positions Pay Progression	0	48,100
Subtotal	$30,100,400	$88,057,900
Grand Total	$24,886,600	$94,358,600

6. This paper addresses amounts budgeted under compensation reserves for fringe benefit cost increases, net of estimated fringe benefit cost savings under current law. Separate budget papers have been prepared for the following provisions: (a) reserves for general salary-related provisions, including general wage adjustments, market wage and parity adjustments, and a proposed increase in hourly starting wage for non-UW executive branch employees to at least $15; (b) a pay progression system for certain correctional security positions; (c) a pay progression system for professional forensic science staff of the Crime Labs; and (d) savings from additional health insurance opt-outs that could result from a statutory modification to an exclusion of employees who opted out of the state's health insurance coverage in 2015 from receiving annual opt-out incentive payments. [In executive action by the Committee on May 14, 2019, the Committee did not adopt the proposed opt-out exclusion modification.]

Fringe Benefits

7. Table 4 summarizes the component parts of current law fringe benefit cost increases and decreases budgeted to compensation reserves. Estimated GPR cost savings in 2019-20 are approximately $5.1 million greater than estimated cost increases. The net result of the estimates would be to offset a portion of cost increases funded under compensation reserves in 2019-20 for salary-related provisions. Fringe benefit cost increases funded from GPR are anticipated to exceed estimated cost savings in 2020-21 by approximately $6.5 million. Net funding over the 2019-21 biennium for these components would total $1,394,500 GPR.

TABLE 4

GPR Compensation Reserves for Current Law Fringe Benefit-Related Expenses

	2019-20	2020-21	Biennium
Prior Period and Inflationary Increases for State Employee Fringe Benefits	$2,876,100	$17,841,100	$20,717,200
High Deductible Health Care Plan Savings	-6,456,700	-8,694,700	-15,151,400
Opt-out Incentive Savings (Current Law)	-1,530,600	-2,640,700	-4,171,300
Total	-$5,111,200	$6,505,700	$1,394,500

8. Amounts budgeted for prior period and inflationary increases include the employer share of premium costs in the forthcoming fiscal biennium for state employee health insurance, the employer share of contributions to the state retirement fund for employees' future state retirement benefits, pension obligation bond payments for the state's unfunded prior service liability for retirement benefits, the accumulated sick leave conversion credit program, and income continuation benefits.

9. Estimated savings identified in Table 4 are associated with anticipated increases in the number of employees who elect health care coverage under a high deductible health plan as well as increases in the number of employees who elect not to receive health care coverage and instead apply to receive a $2,000 annual opt-out stipend.

10. This office has reviewed the calculations utilized to estimate the funding amounts shown in Table 4. With regard to the calculations utilized to estimate the prior period and inflationary costs increases and savings associated with employees opting out of the state's health insurance coverage under current law, the calculations appear reasonable.

Pension Appropriation Obligation Bond Payments

11. With regard to pension appropriation obligation bond debt service payments made by the state, agency fringe benefit rates include a component to account for agency assessments to fund these debt service payments. Fringe benefit rates for the 2019-21 biennium are based, in part, on the amount of the scheduled debt service payment to be made in 2019-20, as estimated when fringe benefit rates were developed for submission of agency budget requests in September, 2018. Budgeted allocations to compensation reserves include a calculation of the amount of funding that would be needed for the difference between the payment for 2019-20 (budgeted in fringe benefit rates) and the payment to be made in 2020-21. However, the amount of agency assessments needed to fund the 2019-20 payment has since been reestimated. As a result, funding to compensation reserves in 2019-20 could be adjusted to reflect the reduction in funds needed to make payments in 2019-20 from what was initially accounted for in agency fringe benefit rates. [The amount of the 2020-21 payment is not anticipated to change.] Following is a description of the appropriation from which pension obligation bond payments are made and an explanation of the reason for the reduction in assessments to state agencies for the 2019-20 payment.

12. The annual debt service payments on the pension appropriation obligation bonds are payable from a GPR appropriation in the amounts appropriated by the Legislature each year. The required appropriation level equals the maximum possible payment that could be made in a given year under the debt structure associated with these obligations and all ancillary agreements related to the obligations. The indenture for the pension appropriation obligation bonds requires that the annual appropriation amount include amounts that would be payable on bonds issued at a maximum variable rate of 35%. As a result, the annual budgeted GPR amounts are partially offset by lapses from the appropriation since the actual debt service obligations and related agreements may be lower than the amounts required to be appropriated.

The indenture for the pension appropriation obligation bonds requires the creation of a stabilization fund with a required minimum balance of $32.9 million. The stabilization fund was established due to the large amount of variable rate obligations initially issued under the indenture in 2003. The purpose of the required minimum fund balance was to make up for any potential shortfall of funds upon deposit in the indenture for payment of debt service or other required payments.

In 2018, the amount of variable rate exposure under the indenture was minimal. Therefore, with rating agencies' approvals and other confirmations and consents, the state amended the indenture to allow for a reduction to the required balance of the stabilization fund. As a result, funds were released from the stabilization fund and applied as provided in the indenture, resulting in approximately $31.7 million available for application towards a $169.9 million debt service payment for 2019-20.

13. The $31.7 million release from the stabilization fund, which is to be applied towards the debt service payment in 2019-20, will result in a reduction to state agency assessments of $13,629,300 GPR ($30,969,900 all funds). The remainder of the $31.7 million reduction ($768,500) is attributable to the UW Hospitals and Clinics Authority and Wisconsin Economic Development Corporation, which do not have authorized state agency positions for which fringe benefits would be budgeted through state agency appropriations and which are also not funded from compensation reserves. Therefore, $13,629,300 GPR could be subtracted from compensation reserves to reflect lower fringe benefit costs for state agencies in 2019-20.

High Deductible Health Plan

14. With regard to estimates of savings associated with the state's high deductible health care plan, upon further review it appears that the underlying cost to provide health care coverage through the high deductible health plan, as currently structured, is approximately equivalent to the cost to provide health care coverage through the more traditional plan design. While premium rates paid by the state for the high deductible health plan are lower than premiums for other more traditional plans available, state employees also currently qualify for an annual employer contribution to a health savings account of $750 for a single plan or $1,500 for a family plan. Accounting for the total cost of premiums and health savings account contributions, on average the costs per employee are approximately equal for the two plan types. Therefore, although the number of employees participating in the high deductible health plan has increased over the past several years, it is unlikely that the state will experience savings from participation in the plan as it is currently structured.

15. As noted above, pension obligation bond payments by agencies are expected to be lower than previously budgeted by $13,629,300 GPR ($30,969,900 all funds) in 2019-20. In addition, savings of $6,456,700 GPR ($14,691,500 all funds) in 2019-20 and $8,694,700 GPR ($19,855,100 all funds) in 2020-21 associated with lower costs under the state's high deductible health care plan are unlikely to be achieved. Therefore, the Committee could make adjustments to compensation reserves totaling -$12,283,800 GPR in 2019-20 and $15,200,400 GPR in 2020-21 (a net of $1,522,100 for the biennium) to reflect these amounts and account for actual costs agencies may incur associated with fringe benefits as well as any salary-related provisions the Committee may choose to separately approve. [Alternative 1]

16. On the other hand, it may be possible for some savings associated with the high deductible health plan to be realized if the plan is modified. There are many ways in which a health plan design could be modified to lower employer costs. Determining the most appropriate means by which this could be accomplished may be challenging, and could benefit from analysis and recommendations from the consulting actuary to the Department of Employee Trust Funds and Group Insurance Board. Therefore, in addition to approving the Governor's adjustments to compensation reserves as initially recommended (including savings from the high deductible health plan) and reestimating pension obligation bond payments in 2019-20, the Committee could direct that the Group Insurance Board, in consultation with the Department of Administration's Division of Personnel Management, make modifications to the high deductible health plan to realize state employer savings of $14,691,500 (all funds) in 2019-20 and $19,855,100 (all funds) in 2020-21. Modifications to the plan design could include deductible amounts, copays, coinsurance, employee premiums, or the amount of the health savings account contribution. [Alternative 2]

17. If the Committee takes no action regarding current law fringe benefit cost increases and decreases budgeted to compensation reserves, and additionally provides funding to compensation reserves for other provisions, total funding provided to compensation reserves would be higher in 2019-20 and lower in 2020-21. Under this alternative, additional funds would be available in compensation reserves in 2019-20 and agencies would need to manage a portion of fringe benefit and salary cost increases within their appropriated budgets in 2020-21. [Alternative 3]

ALTERNATIVES

1. Approve the Governor's recommendation to provide adjustments to compensation reserves associated with fringe benefit cost increases, less savings estimated under current law from opt-out incentive stipend payments. Reestimate funding for fringe benefits to reflect a reestimate of pension obligation bond payments in 2019-20 and to eliminate high deductible health plan savings in both years of the biennium. Provide total funding adjustments of -$12,283,800 GPR in 2019-20 and $15,200,400 GPR in 2020-21.

ALT 1	Change to	
	Base	Bill
GPR	$2,916,600	$1,522,100

2. In addition to providing adjustments to compensation reserves as recommended by the Governor, reestimate pension obligation bond payments in 2019-20 to provide total adjustments of -$18,740,500 GPR in 2019-20 and -$12,234,800 GPR in 2020-21. Direct that the Group Insurance Board, in consultation with the Department of Administration's Division of Personnel Management, make modifications to the high deductible health plan to realize state employer savings of $14,691,500 (all funds) in 2019-20 and $19,855,100 (all funds) in 2020-21. [This alternative retains the Governor's assumed savings associated with high deductible health plans.]

ALT 2	**Change to**	
	Base	**Bill**
GPR	- $12,234,800	- $13,629,300

3. Take no action.

ALT 3	**Change to**	
	Base	**Bill**
GPR	$0	- $1,394,500

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