

**Office of
The City Attorney
City of San Diego**

OPINION NUMBER 2007-04

DATE: September 27, 2007

SUBJECT: Post-Retirement Health Care Benefits Administration

PREPARED BY: City Attorney

QUESTION PRESENTED

In the letter of September 11, 2007 from Greg Levin to Mark Blake, the three questions asked pertaining to the administration of Other Post Employment Benefits (OPEB), also known as Post Retirement Health Care Benefits, are as follows:

1. Does Charter Section 141 and implementing ordinances mean that the OPEB benefit is part of the SDCERS plan document, a component of the system and therefore under the oversight of the Board of Administration?
2. Does Charter Section 145 make the “pay-as-you-go” fund currently being used to fund Retiree Health Benefits a “Trust Fund” even though the funds are never actually provided to SDCERS?
3. If the charter sections mentioned above do not apply, under what authority did the City Council confer OPEB benefits to the employees?

SHORT ANSWER

1. Yes. City Employees’ Retirement System is authorized by Charter section 141 and provides that retiree health insurance benefits may be granted. Retiree health insurance benefits have been provided by ordinance adopted by the Council since at least 1982.
2. Yes. Charter section 145 provides that “all moneys” whether contributed by employers, appropriated by Council, or from any other source, shall be placed in a special fund. “Such fund shall be a Trust Fund to be held and used only for the purpose of carrying out the provisions of this Article.”

3. Because Charter section 141 is found to authorize retiree health insurance benefits with SDCERS as the Administrator and Charter section 145 establishes the Trust Relationship the question is moot.

ANALYSIS

A. Summary of Post-Retirement Health Insurance Benefit Chronology

The Post-Retirement Health Insurance Benefit (Health Benefit) came into effect in 1982 when the City elected to withdraw from the Social Security System.¹ The City established an alternative Supplemental Pension Savings Plan (SPSP) effective January 8, 1982 to take the place of Social Security benefits.² The SPSP included retirement benefits, death benefits, and disability benefits.³ A frequently-asked-questions packet was circulated on November 20, 1981. This packet included information about retirement benefits, survivor benefits, and disability benefits, but also included information about health benefits. The packet stated that “retired employees will be included in the City’s health plans. The City will pay for the retired employee’s health insurance premiums. These costs will not be paid out of the Supplemental Pension Plan.”⁴

Resolution R-255610, adopted January 4, 1982, and effective January 1, 1982, set the parameters for the Health Benefit.⁵ Certain benefits were “provided to employees in lieu of Social Security participation.”⁶ In addition, it was the City Council’s intent “to provide such coverage as a permanent benefit to eligible retirees.”⁷ The City Manager was authorized to establish a City-sponsored Group Health Insurance Plan for eligible retirees, providing the same choice of program coverage as offered to active employees of the City.⁸

On June 1, 1982, Ordinance No. O-15758, codified the Health Benefit.⁹ With respect to payment of the benefit, this Ordinance indicated the retiree premiums were to be paid from those funds credited to the reserve for Employer Contributions from Surplus Undistributed Earnings as provided by former SDMC section 24.0907.1.¹⁰ The City determined the premium rates for

¹ The San Diego Union-Tribune, “City Employees Vote To Quit Social Security,” Anthony Perry, December 15, 1981

² The San Diego Union-Tribune, “Council OKs Social Security Withdrawal Plan,” (author unknown), December 16, 1981. San Diego City Council Resolution R-255609, adopted on January 4, 1982

³ Outline of Essential Provisions of Supplemental Pension Plan, undated, Ray T. Blair, Jr., November 20, 1981

⁴ “What Happens If We Pull Out Of Social Security?” dated November 20, 1981, Ray T. Blair, Jr., November 20, 1981

⁵ Resolution R-255610

⁶ Resolution R-255610

⁷ Resolution R-255610

⁸ Resolution R-255610

⁹ Ordinance No. O-15758

¹⁰ Ordinance No. O-15758

eligible retirees and dependants.¹¹ Dependant coverage was paid by retirees.¹² Significantly, the Ordinance provided that the coverage for eligible retirees and eligible dependants was subject to modification by the City and the provider of health care services, and could be modified periodically as deemed necessary and appropriate.¹³

In 1985, as the result of meet and confer, the class of retirees eligible for Health Benefit greatly expanded.¹⁴ Police and Fire Safety Members on the active payroll on or after June 30, 1985 were added.¹⁵ With this change, the class was no longer closed.¹⁶ The same was not true for General Member City employees hired after January 8, 1982.¹⁷ They continued to be excluded. With respect to payment, the retiree premiums continued to be paid from System earnings as provided in former SDMC section 24.0907.2.¹⁸ The auditor was directed to set aside from such account an amount sufficient to pay premiums as required.¹⁹ If sufficient funds were not available for the payment of health insurance premiums it was the City's responsibility to provide such funds from the General Reserve.²⁰ The modification language referenced earlier remained in effect.

On September 30, 1985, Ordinance No. O-16510 provided that if sufficient funds were not available for the payment of Health Benefit, then it was the City's responsibility to provide such funds from the General Fund rather than the General Reserve.²¹

The eligibility requirements for the Health Benefit were substantially amended again in 1986 as the result of the settlement of the *Andrews* class action lawsuit regarding the 13th check.²² Pursuant to Ordinance O-16679, adopted June 30, 1986, the eligibility requirements for the Health Benefit regarding the both date of retirement and presence on the active City payroll for all groups (General and Safety) were rolled back to October 6, 1980, the date of the ordinance creating the 13th check.²³ This change was significant because the eligibility date was rolled back to a point in time two years before the vote to opt out of Social Security in 1982.²⁴ For Safety Members this was particularly significant because they did not participate in Social

¹¹ Ordinance No. O-15758

¹² Ordinance No. O-15758

¹³ Ordinance No. O-15758

¹⁴ Ordinance No. O-16449

¹⁵ Ordinance No. O-16449

¹⁶ Ordinance No. O-16449

¹⁷ Ordinance No. O-16449

¹⁸ Ordinance No. O-16449

¹⁹ Ordinance No. O-16449

²⁰ Ordinance No. O-16449

²¹ Ordinance No. O-16510

²² *Andrews et. al v. City of San Diego, Board of Administration of the San Diego City Employees' Retirement System, et al.* (San Diego County Superior Court No. 515699).

²³ Ordinance No. O-16679

²⁴ Ordinance No. O-16679

Security, were not part of the opt-out vote, and were not eligible for the benefit until 1985.²⁵ With this change their eligibility universe increased by five years.²⁶

Beginning April 1, 1986, federal law mandated that all state and local government employees hired on or after that date were subject to the Medicare tax.²⁷ This provision was effective for all new employees even though they were previously not required to participate in the system. The Medicare portion of the Social Security tax is 1.45%, with the City making the matching contribution as required by law. The City paid about \$7.3 million to Medicare in FY 2006.²⁸ Thus, under the current system, employees hired on or after April 1, 1986 will be eligible for both Medicare benefits and City-sponsored retirement health benefits, provided the age requirements have been met. More than 75% of the current workforce falls into this category.²⁹

On May 15, 1989, Ordinance No. O-17295 clarified that General Members in the 1981 Pension Plan who were granted SDCERS benefits by SDMC section 24.1102 were not eligible for the Health Benefit.³⁰ In addition, the Ordinance provided that if there were insufficient funds to pay the Health Benefit, then it was the City's responsibility to provide such funds from sources as may be applicable, rather than the General Fund.³¹

The eligibility for the Health Benefit was expanded to include General Members hired on and after September 3, 1982 pursuant to Ordinance No. O-17770, adopted May 26, 1992.³² All Health Insurance related provisions in the SDMC were moved into newly created Division 12.³³ A new sliding scale benefit was created for the newly added group of General Members.³⁴ This group received 5% of the premium cost for each year, or prorated fraction thereof, of service credit, up to a maximum of 100% with 20 years of service.³⁵

With respect to the cost of the Health Benefit, the maximum amount of premium paid was the lowest among the group plans sponsored by the City of San Diego available to retirees.³⁶ In addition, the absolute maximum premium to be paid on behalf of a retiree, regardless of actual premium cost, was capped at \$2,000 per year.³⁷ With respect to the cost for the group of eligible retirees not on the sliding scale (the original group of General Members who voted to opt out of

²⁵ Ordinance No. O-16679

²⁶ Ordinance No. O-16679

²⁷ Budget and Reconciliation Act section 13205.

²⁸ Information provided by the City Auditor's Office.

²⁹ The City Auditor reported that as of February 8, 2007 there were 2,044 employees who are not subject to the Medicare Tax. Because this is a closed class, that number will only decrease.

³⁰ Ordinance No. O-17295

³¹ Ordinance No. O-17295

³² Ordinance No. O-17770

³³ Ordinance No. O-17770

³⁴ Ordinance No. O-17770

³⁵ Ordinance No. O-17770

³⁶ Ordinance No. O-17770

³⁷ Ordinance No. O-17770

Social Security plus Police and Fire added in 1985 but rolled back to 1980), there was no cap.³⁸ Instead, 100% of the retiree premium cost was City paid.³⁹

In addition, the funding mechanism changed.⁴⁰ SDMC section 24.1205 was added. This section provided that retiree premiums would be paid by the City from savings resulting from conversion from the Entry Age Normal to the Projected Unit Credit method of actuarial valuation through a yet-to-be created Retiree Health Insurance Trust.⁴¹ Health Benefits were to be paid from this new IRC section 401(h) trust.⁴² If sufficient funds were not available for the payment of health insurance premiums, it remained the City's responsibility to provide such funds from sources as may be applicable.⁴³ The City continued to set the premium rates. Health plan coverage continued to be subject to modification by the City and health care providers as deemed necessary and appropriate.⁴⁴ The Health Insurance Trust Fund was created by SDMC section 24.1206.⁴⁵

In 1995, an Ordinance was proposed which would have imposed a cap, effective July 1, 1995, of \$4,500.00 per year on the reimbursement of retiree health insurance premiums for all Safety Members who were not covered by the \$2,000.00 cap in Ordinance O-17770 and all General Members who were not covered by a similar \$2,000.00 cap. Although these changes were reflected in the MOUs with the City's labor unions, the Ordinance was not adopted.⁴⁶

In 1996, the first Manager's Proposal (MP 1) was presented.⁴⁷ Two of the three ordinances which implemented the changes resulting from the MPI affected the Health Benefit. The first, O-18383, adopted February 25, 1997, repealed and reenacted the Health Insurance Division in the SDMC.⁴⁸ The second, O-18392, adopted March 31, 1997, repealed and reenacted the Health Insurance Division 12 again. Because these changes were more significant, they are set forth below in great detail.⁴⁹

Under Ordinance O-18383, adopted February 25, 1997, which only existed for six weeks, SDMC section 24.1202 established the following parameters on the health insurance program for Health Eligible Retirees, to become effective on August 1, 1997:

- Retirement System administers the benefit.⁵⁰

³⁸ Ordinance No. O-17770

³⁹ Ordinance No. O-17770

⁴⁰ Ordinance No. O-17770

⁴¹ Ordinance No. O-17770

⁴² Ordinance No. O-17770

⁴³ Ordinance No. O-17770

⁴⁴ Ordinance No. O-17770

⁴⁵ Ordinance No. O-17770

⁴⁶ See relevant portions of MOU's dated July 1, 1995

⁴⁷ Manager's Proposal (MP1)

⁴⁸ Ordinance No. O-18383

⁴⁹ Ordinance No. O-18392

⁵⁰ Ordinance No. O-18383

- Those retired when benefit becomes effective are Health Eligible Retirees “by operation of the law.”⁵¹
- Health Eligible Retirees may enroll in a City Sponsored Health Insurance Plan or participate in the plan of their choice, subject to the limitations in this Division.⁵²
- City Sponsored Health Plans shall include at least one HMO and one PPO plan.⁵³

The limits on reimbursement were set forth in SDMC section 24.1203 as follows:

- For a Health Eligible Retiree who enrolls in any health insurance plan, City shall pay/reimburse the Medicare or non-Medicare eligible retiree-only premium for the highest cost City Sponsored HMO plan.⁵⁴
- For a Health Eligible Retiree continuously enrolled in a PPO since January 1, 1997, the City shall pay or reimburse the Medicare or non-Medicare eligible retiree-only premium for the City Sponsored PPO available to retirees.⁵⁵

SDMC section 24.1204 restricted the City’s ability to alter the terms and conditions of City sponsored HMO plans offered to Health Eligible Retirees.

- The retiree health insurance program is premised on the concept of providing eligible retirees with the same benefit that is offered by the highest cost HMO plan for active City employees.⁵⁶
- The Retirement System will not have any role in changing the terms and conditions of the City-sponsored health plans.⁵⁷
- Before the City Council may approve a change in HMO providers or amend an HMO contract, a qualified independent consultant must review the change and conclude it will not trigger a vote by active employees.⁵⁸
- The consultant is to be mutually selected and paid for by the City and the labor organizations.⁵⁹

⁵¹ Ordinance No. O-18383

⁵² Ordinance No. O-18383

⁵³ Ordinance No. O-18383

⁵⁴ Ordinance No. O-18383

⁵⁵ Ordinance No. O-18383

⁵⁶ Ordinance No. O-18383

⁵⁷ Ordinance No. O-18383

⁵⁸ Ordinance No. O-18383

⁵⁹ Ordinance No. O-18383

- The Retirement System will reimburse the part B supplemental medical expense premium for Health Eligible Retirees enrolled in Medicare.⁶⁰

SDMC section 24.1205 established an Internal Revenue Code section 401(h) fund within the Retirement System for the payment of post retirement health benefits, and listed the specific requirements for this type of fund to pay health benefits.⁶¹

SDMC section 24.1206 provided that the health benefit shall be paid by the Retirement System and City from the following sources of funds in descending order of availability:

- from the Retiree Health Insurance Trust Fund, and, if necessary,⁶²
- from Retiree Health Insurance Reserve Fund, and, if necessary,⁶³
- from any other source of funds available to the City.⁶⁴

SDMC section 24.1207 provided the Health Insurance Reserve Fund (formally the Retiree Health Insurance Reserve Trust Account), shall remain intact accruing interest and not be used for any purpose other than paying for benefits under this Division.⁶⁵

Six weeks later, Division 12 and the above-described provisions were repealed and enacted again pursuant to Ordinance No. O-18392, adopted March 31, 1997.⁶⁶ This ordinance was intended to “clean up” and technically amend language in the “Manager’s Proposal” Ordinances (O-18383 [discussed above] and O-18385 [creating the DROP benefit].)⁶⁷

This ordinance deleted all of section 24.1204 in O-18383 regarding “future changes to City-sponsored HMO plans,” including the provision that the Retirement System is to have no role in changing the terms and conditions of the plans.⁶⁸ It also established a second post retirement health benefit for Non Health Eligible Retirees.⁶⁹ In addition, it provided:

- A Non Health Eligible Retiree is any retiree who: (1) retired or terminated employment as a vested member prior to October 6, 1980; and (2) is eligible for and is receiving a retirement allowance from the Retirement System.⁷⁰

⁶⁰ Ordinance No. O-18383

⁶¹ Ordinance No. O-18383

⁶² Ordinance No. O-18383

⁶³ Ordinance No. O-18383

⁶⁴ Ordinance No. O-18383

⁶⁵ Ordinance No. O-18383

⁶⁶ Ordinance No. O-18392

⁶⁷ Ordinance No. O-18392

⁶⁸ Ordinance No. O-18392

⁶⁹ Ordinance No. O-18392

⁷⁰ Ordinance No. O-18392

- No change was made to the definition of Health Eligible Retiree.⁷¹
- Health Eligible Retirees who retired on or after July 1, 1992, under the “sliding scale” benefit shall have their Retiree Benefit prospectively adjusted on August 1, 1997, to be the same as that for Health Eligible Retirees who retire on or after August 1, 1997. With this change the sliding scale benefit was eliminated.⁷²

SDMC section 24.1202 defined the Post Retirement Health Benefits for Health Eligible and Non Health Eligible Retirees.⁷³ Other than the elimination of the sliding scale feature, there were no changes to the Health Eligible Retirees Benefit.⁷⁴ With respect to the Non Health Eligible Retirees, they were entitled to payment or reimbursement not to exceed \$600 per year for health insurance expenses.⁷⁵

SDMC section 24.1203 established an Internal Revenue Code section 401(h) fund within the Retirement System for the payment of post retirement health benefits, and lists the specific requirements for this type of fund to pay health benefits.⁷⁶ SDMC section 24.1204 established a funding priority for paying Post Retirement Health Benefits.⁷⁷ The benefits are required by the ordinance to be paid from the following sources in descending order of availability:

- from the Retiree Health Insurance Trust Fund, and, if necessary,⁷⁸
- from any other sources of funds available to the City.⁷⁹

In 2000, a third post retirement health benefit for the spouse and minor dependants of a City employee killed in the line of duty by external violence or physical force was created.⁸⁰ The surviving spouse, subject to certain exclusions, became entitled to receive health benefits in an amount equivalent to the annual Flexible Benefits Allotment as defined in the City’s annual Salary Ordinance.⁸¹

⁷¹ Ordinance No. O-18392

⁷² Ordinance No. O-18392

⁷³ Ordinance No. O-18392

⁷⁴ Ordinance No. O-18392

⁷⁵ Ordinance No. O-18392

⁷⁶ Ordinance No. O-18392

⁷⁷ Ordinance No. O-18392

⁷⁸ Ordinance No. O-18392

⁷⁹ Ordinance No. O-18392

⁸⁰ Ordinance No. O-18746, adopted January 31, 2000 and Ordinance No. O-18748, adopted February 22, 2000

⁸¹ Ordinance No. O-18746, adopted January 31, 2000 and Ordinance No. O-18748, adopted February 22, 2000

In 2000, pursuant to O-18841, adopted September 12, 2000, the premium reimbursement rate for Health Eligible Retirees living outside the service area of the City-Sponsored HMO plans was increased to the reimbursement rate for the City-sponsored PPO plan available to retirees.⁸²

The reimbursement rate for Non Health Eligible Retirees was increased from \$600 to \$1,200 pursuant to O-18962, adopted July 23, 2001.⁸³ In addition, for fiscal years 2001 and 2002, this ordinance raised the reimbursement levels for Health Eligible Retirees enrolled in the Fireman's Relief Association Plan to allow them to be reimbursed for the full cost of their premiums.⁸⁴

On November 16, 2001, the Retirement Board directed Staff to move forward with the necessary requirements to implement an Internal Revenue Code section 115 Trust.⁸⁵ This was based upon an opinion letter written by fiduciary counsel, Bob Blum. Earlier that year, Mr. Blum had indicated the Board might wish to consider funding retiree health insurance through a section 115 Trust because it was more flexible than a 401(h) trust. He suggested this approach because there are no tax limits on the annual amount that can be contributed to a 115 Trust. The same is not true of the current 401(h) trust which is limited by the tax laws to no more than 25% of current service cost.

In sum, the direction to move to a 115 Trust vehicle for the funding of health insurance was the resolution of a longstanding discussion with Mr. Blum dating back to 1992 regarding the best tax vehicle to use for retiree health. Over the years, the pros and cons of a 401(h) account, a 115 Trust, and VEBA have been discussed.

The last Ordinance amending the Post Retirement Health Insurance Benefit is O-19121, adopted November 18, 2002.⁸⁶ This ordinance amended SDMC section 24.1202 to raise the reimbursement levels for Health Eligible Retirees as follows:

- For fiscal year 2003, a Health Eligible Retiree is paid or reimbursed up to the cost of the Medicare eligible or Non-Medicare eligible retiree premium for the City-sponsored Preferred Provider Organization (PPO) plan available to Health Eligible Retirees, regardless of which health insurance plan the retiree selects.⁸⁷
- After fiscal year 2003, the maximum payment or reimbursement level for Health Eligible Retirees will be adjusted annually based upon the projected increase for National Health Expenditures by the Centers for Medicare and Medicaid Services, Office of the Actuary, for the full-year period ending January 1 before each plan year. No adjustment may exceed 10% for any plan year.⁸⁸

⁸² Ordinance No. O-18841

⁸³ Ordinance No. O-18962

⁸⁴ Ordinance No. O-18841

⁸⁵ SDCERS Retirement Board Minutes of November 16, 2001

⁸⁶ Ordinance No. O-19121

⁸⁷ Ordinance No. O-19121

⁸⁸ Ordinance No. O-19121

B. SDCERS is Operating Through a Trust

Charter section 145 provides that “All monies contributed... shall be placed in a special fund... to be known as the City Employees’ Retirement Fund... Such fund shall be a Trust Fund to be held and used only for the purpose of carrying out the provisions of this Article.”⁸⁹

Under California law, a trust may be created either by declaration by the owner of property that the owner holds the property as trustee⁹⁰ or by an exercise of power of appointment to another person as trustee.⁹¹ The essential elements necessary for the creation of a trust are (1) a manifestation of intent to create a trust,⁹² and (2) the existence of actual “Trust property”.⁹³ Further, California courts have held that a trust is created as to the trustor and beneficiary by any words or acts of the trustor indicating with reasonable certainty an intention on its part to create a trust, and the subject, purpose, and beneficiary of the trust.⁹⁴ Based on these factors, it appears that Section 145 of the City Charter clearly expresses the intent required by the Probate Code and that the SDCERS retirement fund is an express trust created by means of declaration in the City Charter.

Until FY 2005 the city and SDCERS placed monies in Fund 60012. Beginning in FY 2006 the City and SDCERS places monies into Fund 60016. Both of these funds were and still are used to pay retiree health insurance premiums. Payments from these funds are made solely by SDCERS.

In establishing Article IX the electorate clearly intended that SDCERS administer “health benefits for retired employees”.⁹⁵ Our reasoning is as follows:

CONCLUSION

1. Charter Section 141 provides that:

“The Council of the City is hereby authorized and empowered by ordinance to establish a retirement system... The Council may also in said ordinance provide:... (d) for health insurance benefits for retired employees.”⁹⁶

Article IX is titled, “The Retirement of Employees” and includes health benefits for retired employees, ordinances have been enacted to define and provide such benefits, thus, SDCERS must administer such benefits.

2. Charter Section 145 states:

⁸⁹ Article IX, Section 145

⁹⁰ California Probate Code Section 15200(a)

⁹¹ California Probate Code Section 15200(d)

⁹² California Probate Code Section 15201

⁹³ California Probate Code Section 15202

⁹⁴ *Weiner v. Mullaney*, 285 Pac. 365 (1943)

⁹⁵ Article IX, Charter section 141

⁹⁶ Article IX, Charter section 141

All moneys contributed by employees of the City or appropriated by the Council or received from any other source under the terms of this Article, shall be placed in a special fund in the City Treasury to be known as the City Employees' Retirement Fund, which said fund is hereby created. Such fund shall be a Trust Fund to be held and used only for the purpose of carrying out the provisions of this Article. No payments shall be made therefrom except upon the order of the Board of Administration. This fund may be placed by the board under the Funds Commission for investment; but shall not be merged with other funds of the City.⁹⁷

For FY 2005 and prior years SDCERS paid retiree health insurance premiums from Fund 60012. Since FY 2006 SDCERS has paid retiree health insurance premiums from Fund 60016. SDCERS was and still is the only party approving payments from these funds.

SDCERS is the trustee of theses funds.

3. Since SDCERS is the Administrator of the Retiree Health insurance benefits as provided for in Charter section 141 and is the Trustee of the funds used to pay the retiree health insurance benefits then question three is moot.

Respectfully submitted,

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LO-2007-04

⁹⁷ Article IX, section 145