A STRATEGY TO REDUCE RETIREMENT COSTS WITHIN LOS ANGELES COUNTY

LOS ANGELES COUNTY CITIZENS' ECONOMY AND EFFICIENCY COMMISSION

SEPTEMBER, 1993

Angeles County
Citizens' Economy and
Efficiency Commission

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The Mission of the Economy and Efficiency Commission is to examine any function of County government at the request of the Board of Supervisors, on its own initiative, or as suggested by others and adopted, and to submit recommendations to the Board directed toward improving local government economy and efficiency, and effectiveness.

CITIZENS' ECONOMY AND EFFICIENCY COMMISSION

OF LOS ANGELES COUNTY

September 8, 1993
Honorable Edmund E. Edelman
Los Angeles County Board of Supervisors
821 Hahn Hall of Administration
500 W. Temple Street
Los Angeles, CA 90012

Dear Chairman Edelman:

On November 17, 1992, the Board of Supervisors of Los Angeles County requested the Economy and Efficiency Commission to:

> *Examine the viability of measures to cap or reduce the County's liability to the pension system by freezing or reducing the cash available option in cafeteria style flexible benefit plans as recommended in the Corroon Study, and any other alternatives that may serve this purpose; and*
>
> *Examine the County's cafeteria style benefit plans and recommend improvements to enhance equity, and reduce County cost without reducing the employee's ability to obtain adequate benefits, or the County's ability to attract and retain qualified personnel.*

In response to that direction the Commission is submitting the attached report entitled *A Strategy to Reduce Retirement Costs within Los Angeles County*. The attached study submitted by W.F. Corroon entitled *Development of Los Angeles County Cafeteria Plan Design Strategies to Reduce Retirement Costs* supported by the opinion of independent counsel and input from County staff were used as resources in the development of this recommended strategy.

The Commission is pleased to have had this opportunity to make recommendations to your Board on this matter and looks forward to providing further assistance in the future.

Sincerely,

Gunther W. Buerk
Chair

c: All Supervisors
All Commissioners
Harry Hufford, CAO
Sally Reed, CAO Designate
DeWitt Clinton, County Counsel
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A STRATEGY TO REDUCE RETIREMENT COSTS WITHIN LOS ANGELES COUNTY

EXECUTIVE SUMMARY

This report was undertaken in response to the desire of the Board of Supervisors to identify cost savings alternatives in the design of the current Los Angeles County Retirement System. As a result of this Board direction, the Commission contracted with W. F. Corroon to provide the full spectrum of alternatives. The Commission also contracted with independent counsel to evaluate the legality of each of the identified alternatives. Using this research, discussions with County staff and its own analysis, the Commission developed a strategy that it feels addresses the concerns of all those involved and results in significant cost savings to the County. The strategy developed by the Economy and Efficiency Commission is encompassed in the set of recommendations made in this report and summarized for the reader below.

RETIREMENT POLICY DEVELOPMENT

1. The Chief Administrative Officer should develop a retirement policy that provides a basis for compensation and benefit design and administration.

2. The Chief Administrative Officer should report on the impacts of the retirement policy developed in Recommendation #1.

PLAN MODIFICATIONS AFFECTING FUTURE HIRES

3. Seek an amendment to the recently passed legislation to incorporate a provision allowing employees hired prior to its enactment the right to elect to be covered under the new law.

4. The Board of Supervisors strongly advocate recommendation #3 to expedite its passage.

5. The Chief Administrative Officer should establish new cafeteria plan "tiers" that would retain the current levels of cafeteria plan Available Cash Options, but would not be pensionable, for employees hired after the effective date of the passage of AB 1659.

6. The Chief Administrative Officer, upon passage of the amendment recommended in #3, establish procedures to facilitate the right to have the new law apply to employees on a voluntary basis.

7. The Chief Administrative Officer should report on any impacts to the retirement system of any revision to the County's Cafeteria Benefit Plan.

PLAN MODIFICATIONS AFFECTING CURRENT EMPLOYEES

8. The Chief Administrative Officer should develop a plan to subsidize any future increase in health benefits so as to insure that these increases will be outside the County Cafeteria Plan.

9. The Chief Administrative Officer should develop a methodology for calculating the County Cafeteria Plan contribution.

10. The Chief Administrative Officer should report on impacts to the retirement system of any revision in the methodology of calculating County Cafeteria Plan contributions.

11. The Chief Administrative Officer should modify the current MegaFlex and Flexible Benefit Plans to freeze the Available Cash Options within each plan.

12. The Chief Administrative Officer should develop a methodology to establish the appropriate level of the Available Cash Option in the MegaFlex Plan.

13. The Chief Administrative Officer should request and receive from the Board of Retirement a determination of whether or not the ability to cash out leave days outside of a cafeteria plan constitutes pensionable compensation.

14. The Chief Administrative Officer should, based upon the determination of the Board of Retirement, develop a plan for eliminating the employees' ability to sell annual leave benefits under Megaflex, and provide MegaFlex participants with a similar Elective Annual Leave program outside of the Cafeteria Plan.

15. The Chief Administrative Officer should develop a methodology for determining employees' ability to carry over vacation time.

BACKGROUND

On March 3, 1992, the Los Angeles County Board of Supervisors requested the Economy and Efficiency Commission "*to conduct a study of the County's policies and practices governing retirement-eligible salary and benefits...*" On November 4, 1992 in response to this direction, the Commission delivered to the Board a report entitled *Los Angeles County Policies and Practices Governing Retirement Eligible Salary and Benefits*. The recommendations made in this report were based, in part, upon an independent legal opinion on the question of what constituted compensation earnable for retirement purposes and upon a study submitted in September, 1992 by W. F. Corroon entitled *Comparability Analysis, Los Angeles County Employees' Retirement Benefits*.

On November 17, 1992 as a follow-on to the above efforts, the Board requested that the Commission, with the assistance of independent counsel and consultant to:

Examine the viability of measures to cap or reduce the County's liability to the pension system by freezing or reducing the cash available option in cafeteria style benefit plans; and, to

Examine the County's cafeteria style benefit plans and recommend improvements to enhance equity, and reduce County cost without reducing employees' ability to obtain adequate benefits, or reduce the County's ability to attract and retain qualified personnel.

W.F. Corroon submitted its study in response to the Commission's directive. in July, 1993. This report is entitled *Development of Los Angeles County Cafeteria Plan Design Strategies to Reduce Retirement Costs.* This report has included the opinion of independent counsel as to the legality of each of the alternatives suggested.

BASIS FOR COMMISSION ANALYSIS

In their September, 1992 study, W. F. Corroon states "...that the mere existence of a flexible benefits plan does not create the need for additional retirement income. The County contributions to the flexible benefit plans resulted from a conversion of employee benefits into cash equivalents. Once these benefit values are incorporated into the pension formula, the retirement program begins replacing both income and benefits." This report continues, "Pension increases so provided are not necessarily essential from a retirement benefit design perspective, but are being brought about as a side-effect of flexible benefit plan design and legal interpretation. Thus, it may well be the case that county dollars spent to support these pension increases would better be spent in other benefit areas or to make different improvements in the retirement area."

The Economy and Efficiency Commission supports the above opinion and restates its position that was presented in the Commission's report submitted to your Board in November, 1992. It continues to be apparent that the design of the County's benefit structure has resulted in an unintended increase in pensionable compensation. This Commission feels strongly that any such unintended impacts should be eliminated. Although it is important to rectify any unintended impacts to the retirement system, the Commission also recognizes the County's responsibility to consider the consequences of any modifications to the employee.

The basis for this analysis is the Commission's position that any funds being expended for retirement, or for that matter any area of County operations, should be done so in an efficient, analytic and fiscally sound manner. After an adequate review of its retirement policy the County may or may not wish to bring about a change in the structure of its retirement system or its funding mechanism. In either case the system design should be implemented using a rationale process within which all of the impacts of the policy are clearly presented to both the Board and the public.

REPORT METHODOLOGY

It is not the objective of this report to redesign the County retirement system, but rather to recommend for the Board a set of policy alternatives that will result in both reduced costs and an increasingly effective retirement system. The extent to which these recommendations require a redesign of the retirement system should be determined and recommended by the Chief Administrative Officer (CAO).

The report submitted by W. F. Corroon presents for Commission's consideration, cost savings alternatives that are achievable within the current plan structure. In developing its recommended strategy the Commission considered these alternatives, independent counsel's opinion as to the legality of the proposed alternative, the overall strategies suggested by W. F. Corroon, discussions with knowledgeable County staff, the consequences to the County's employees, the impacts to the County's retirement policy and further analysis conducted by the Commission. Those alternatives identified in the W. F. Corroon report and that were determined to be precluded by legal barriers have not been discussed in this presentation.

The Commission's strategy to achieve cost savings in the retirement system is presented in the set of recommendations developed within this report and discussed below.

RETIREMENT POLICY DEVELOPMENT

ISSUE

Evaluation of Executive Compensation and Benefits

Discussion:

As a part of its November, 1992 report to the Board on this topic, the Economy and Efficiency Commission recommended that the CAO "...submit to your Board a retirement policy that provides a basis for compensation and benefit design and administration under existing County ordinances." The Commission continues its endorsement of this recommendation.

The apparent lack of effort in this area since the submission of our November report has continued to expose the County to unnecessary increases in retirement system liability and kept in place inefficient and ineffective procedures. The difficulties within the current benefit plan structure which have been discussed by this Commission and that have been addressed in other reports on this problem remain County practices.

Los Angeles County, along with a substantial number of other public and private organizations throughout the country, has initiated serious efforts to examine how business is conducted in light of the new set of fiscal realities. It is clear that the expectations accompanying the economic environment of the past 30 years, to include the acceptance of an expansion of the public sector, will no longer apply. As with the private sector, shrinking resources require reductions in organizations. It will entail a reevaluation of employment issues, including compensation and job stability. The public sector must now consider a future environment of revised inflationary repercussions, the unwillingness of the public to pay increased taxes, increased awareness of governmental efficiency or inefficiency and increased competition from the private sector as a provider of governmental services.

These new realities must be addressed and reflected in the operation and management of Los Angeles County, including how it compensates its employees. What may have been seen in the past as a trade off of job security or benefit levels in place of higher salary may well be an outdated notion. When thousands of employees are being laid off in the private sector, or are being reclassified as independent consultants due to inherent structural changes in the economy, it is unreasonable to expect that the public sector would remain immune to these and other developments. Such a paradigm shift within our economy requires significant structural and policy revisions in the basic approach to running Los Angeles County government.

As a result of these changes in the structure and role of the government, it becomes incumbent upon County management to insure that its employees are being appropriately compensated and are being provided with an adequate and competitive level of benefits. Although management may feel that the current system accomplishes this objective, the problems that have become evident as a result of a review of the current retirement policy indicates that a review of compensation and benefit design and administration would prove to be of significant benefit to both the County and its employees.

Recommendation:

1. Direct the Chief Administrative Officer to comply with the recommendation made by this Commission on November 4, 1992 that states, " Direct the Chief Administrative Officer, with the written support of the Los Angeles County Employees Retirement Association (LACERA), to submit to your Board a retirement policy that provides a basis for compensation and benefit design and administration under existing County ordinances."

2. Direct the Chief Administrative Officer to report to your Board on the impacts, to include fiscal and structural impacts, of the retirement policy developed in Recommendation #1. This report should provide *quantitative evidence* that the retirement policy is founded on fiscally-sound principles.

PLAN MODIFICATIONS AFFECTING FUTURE HIRES

(Affecting those hired after enactment of proposed legislation)

ISSUE

Exclude Cafeteria Plan Available Cash Options from Pensionable Earnings for New Hires

Legal Position:

This action does not appear to cause legal problems concerning new hires. The independent legal opinion of July 15, 1993 on this matter states that, "There is no prohibition whatsoever on the modification of a pension plan for service to be rendered by new hires as long as such modification is put in place prior to the date of hire."

Discussion:

It became apparent after a review of the policy on compensation within the Los Angeles County Retirement System that a major factor contributing to the systems dramatic cost increases was the inclusion of Available Cash Options within the definition of pensionable compensation. An obvious cost saving solution to this problem would be to exclude Available Cash Options from the definition of Pensionable Compensation.

Various legal opinions have concluded that current employees would not be affected by any change in the definition of "compensation earnable" since they have a vested right in having Available Cash Options included in Pensionable Compensation. The Economy and Efficiency Commission recognized this position in its November, 1992 report to the Board of Supervisors. This report recommended that "...the Chief Administrative Officer seek legislation that will allow the Board of Supervisors to determine whether or not to include flexible benefits within the definition of compensation earnable for all new hires." AB 1659 introduced March 4, 1993 in the State Legislature was drafted and subsequently passed and signed into law September 8, 1993 to accomplish this recommendation.

The new law, would adds a new definition section to 37 Act Law that becomes operative upon adoption by the county board of supervisors. The new section would provide as follows: "Notwithstanding Sections 31460 and Section 31461, neither "compensation" nor "compensation earnable" shall include any of the following: cafeteria or flexible benefit plan contributions, transportation allowances, car allowances, or security allowances,..." The section becomes operative upon the passage of a resolution by the county board of supervisors.

The new definition of "compensation" and "compensation earnable" would only apply to employees hired after the adoption of the resolution by the Board. Consideration should be given to amending this legislation to permit current employees to opt into the new "tier" enabled by this legislation and that may be provided for in any new benefit designed by the County. The Commission considers that a provision to allow current employees to opt into the new "tier" would afford the County the maximum flexibility in benefit design. The establishment of this employee entitlement would necessitate further amendment to the recent legislation to grant existing employees the right to have the new law apply to them on a voluntary basis.

Impacts:

a. Fiscal - <u>The Board must recognize that retirement costs grow each day that the exclusion of Available Cash Options from Pensionable Earnings is delayed.</u>

The elimination of Available Cash Options from the definition of "compensation earnable" effects a future savings by reducing the pensionable salary base of future employees. The current minimum annual increase to pensionable income is $1380 for employees covered under the Options Plan, $2928 under the Choices Plan, $5304 under the Flexible Benefits Plan, and $6288 under the MegaFlex Plan. Amounts may be greater for higher paid employees.

To estimate future savings based upon current cash option levels, the above amounts would have to be multiplied by the anticipated number of new employees within each Plan, and this amount then to be multiplied by the anticipated pension percentage due to the average employee at retirement. To further refine this estimate, future annual increases in Available Cash Options would have to be considered. The recent past reveals the following percentage increases by plan; Options increasing 15%, Choices 18%, Flexible Benefits Plan 8%, and MegaFlex 19%. These compounded increases would then be included in the appropriate cash option levels. Thus, revision of the legislated definition of "compensation earnable" produces future savings resulting from removing the pensionable nature of Available Cash Options and the attendant compounding of these increases that would have been a consequence of any future increases in benefits or benefit amounts.

b. Plan Design - Based upon the provisions of the new legislation, it is recommended that a new cafeteria plan be established that is identical to that of the 1993 MegaFlex plan, including the current level of Available Cash Options and any changes applicable as a result of this report. Employees subject to this new legislation will become members of this new cafeteria plan.

c. Recruiting and Retention - In the 1992 Comparability Study conducted by W. F. Corroon, "competitiveness" of the County's retirement benefits versus other public and private entities was evaluated. The outcome of this evaluation indicated that the County's retirement benefits for nonrepresented employees generally exceed those of other agencies/organizations. Corroon also found that the County was unique among those surveyed for including cafeteria plan cash options in pensionable earnings. Based upon these findings and the findings supporting this position in the current study, it does not appear that any actions taken by the Board to exclude Cafeteria Plan Available Cash Options from pensionable earnings of future hires will negatively impact the County's ability to attract and retain qualified employees.

Recommendations:

3. Direct the Chief Administrative Officer to seek an amendment to the recently passed legislation to incorporate a provision allowing employees hired prior to its enactment the right to elect to be covered under the new law.

4. That the Board of Supervisors strongly advocate recommendation #3 to expedite its passage.

5. Direct the Chief Administrative Officer to establish a new cafeteria plan "tier" that would retain the current levels of cafeteria plan Available Cash Options, but would not be pensionable, for employees hired after the effective date of the amended State Law.

6. Direct the Chief Administrative Officer, upon passage of the amendment recommended in #3, to establish procedures to facilitate the right to have the new law apply to employees on a voluntary basis.

7. Direct the Chief Administrative Officer to report to the Board on any impacts to the retirement system, to include both costs and adequacy, of the above revision to the County's Cafeteria Benefit Plan.

PLAN MODIFICATIONS AFFECTING CURRENT EMPLOYEES

Any modifications to the County Employees Retirement Law of 1937 as a consequence of the introduction and passage of this new legislation will apply only to those employees hired after its enactment or to those who choose to be covered. In order that the County may remedy these conditions as they relate to current employees, the Commission makes recommendations in this report which will result in an equitable cost reduction strategy.

Legal Position on the Following Two Issues:

The opinion of independent counsel submitted on November 4, 1992, in response to the March 3, 1992 direction of the Board stated that although it is an extremely close question, the better interpretation of the law is that "Cash paid to an employee under a flexible benefits program and cash used under such a program to purchase benefits for an employee are pensionable compensation." The July 15, 1993 independent counsel opinion restated the conclusion reached in the previous legal opinion pertaining to vesting in this treatment of flexible benefits with the statement that "current employees are very probably vested in the treatment of flexible benefits as pensionable compensation."

To clarify and refine the vested rights of current employees, the current opinion considers issues of vesting of benefit levels (whether currently participating employees have a vested right to certain levels of benefits), estoppel (whether the County is precluded from any changes as a result of an irrevocable elections by participating employees) and the indirect effect of any change on the amount of pensionable compensation received.

In response to the benefit level vesting question the opinion declares that "...in our opinion, the modifications discussed in the Corroon report involving either prospective reduction of the benefits provided pursuant to a cafeteria plan or the available cash options under such a plan would not be legally impermissible on the basis that they impinge on any vested rights of plan participants not to ever have any such modification made during the entire terms of their employment."

The opinion in addressing the estoppel issue holds that "...we do not believe that the County is estopped from making prospective changes to Megaflex including reduction of the available cash option solely because of the past elections made by the Megaflex participants. Furthermore, as stated above, we have been supplied with no communication materials under which the County has otherwise restricted its ability to amend the plan."

When considering the question of a reduction in the available cash option, independent counsel concludes "...it is our opinion that a modification to the cafeteria plans involving a reduction in the available cash option would not be unlawful because of its indirect effect on the amount of pensionable compensation received by participants in those plans."

Legal counsel has also advised that "...as long as participants in MegaFlex are allowed to revoke their prior elections in conjunction with any modification to MegaFlex that negatively impacts that plan compared to the Flexible Benefit Plan arrangement or as compared to any new cafeteria plan, the County is free to freeze or reduce available cash options under MegaFlex." This would also be true for the other plans, recognizing that changes to Choices and Options would be "...subject to the collective bargaining process."

ISSUE

Modifying Cafeteria Plan Available Cash Options by controlling future increases

Discussion:

A number of changes have occurred in Available Cash Options since the inception of the various plans which have resulted in a series of *unintended increases* in retirement costs. Represented employees in the Options plan have seen an annual increase of 15%

in their available cash options since its inception in 1992. The Choices plan has had an average annual increase of available cash options of 18% since 1989. The average annual increase for minimum available cash option since 1991 for Megaflex and since 1985 for the Flexible Benefits Plan is 19% and 8% respectively.

The historical occurrence of increase in cash option amounts have been heavily influenced by the rate of increase in the County's medical plans. The County has chosen to increase the Available Cash Option as the means of maintaining participants capability to purchase increasingly expensive medical benefits and to avoid disadvantaging nonrepresented employees. The accomplishment of these objectives has resulted in significant negative impact to pension system costs. Based upon the rate of these earlier increases, continuation of this practice would result in spiraling County retirement costs. It is clear that the augmentation of the employee's pensionable income was neither intended or understood to be an objective in accommodating escalating medical costs.

The objective of recognizing rising employee medical costs would be better achieved with a method that did not result in unintended and negative cost repercussions to the pension system. The County would be better served in the accomplishment of this objective by subsidizing the price of medical and dental benefits. A subsidy would not become pensionable, thus, future increases in these costs would be eliminated. The current Available Cash Option would remain a part of the employees pensionable income. This approach is equitable since it unlocks future growth in medical cost from any expansion in pensionable income while retaining employees' current benefit and maintaining his/her benefit purchasing power.

Impacts:

a. Fiscal - The implementation of this approach will have a significant impact of the County's retirement costs, since approximately 88% of its employees are represented. Any potential increase to the retirement plan costs as a result of increasing the level of Available Cash Options is eliminated.

b. Plan Design - Since only the funding mechanism is being affected, the Cafeteria Benefit Plan design remains intact.

c. Recruiting and Retention - The Cafeteria Benefit Plan Design remains intact and thus, it does not appear that any actions taken by the Board to exclude Cafeteria Plan Available Cash Options from pensionable earnings would negatively impact the County's ability to attract and retain qualified employees.

Recommendations:

8. Direct the Chief Administrative Officer to develop a plan to subsidize any future increase in health benefits so as to insure that these increases will be outside the County Cafeteria Plan.

9. Direct the Chief Administrative Officer to develop a methodology for calculating the County Cafeteria Plan contribution. This methodology should consider the approach recommended in the W.F. Corroon report of July, 1993.

10. Direct the Chief Administrative Officer to report to the Board on any impacts to the retirement system, to include both cost and adequacy, of any revision in the methodology of calculating County Cafeteria Plan contributions.

ISSUE

Modifying Cafeteria Plan by freezing MegaFlex and the Flexible Benefit Plan Available Cash Options

Discussion:

The preceding issue addresses the question of how best to provide for employees' increasing medical/dental costs while mitigating the unintended negative cost impact to the pensions system. This issue is the larger one dealing with the remainder of the Available Cash Options currently accessible to employees.

The alternative cost reduction strategies developed by W. F. Corroon suggest that the Commission pursue the development of its strategy using either of two approaches, to freeze or to reduce the Available Cash Options. Considering the equity issues involved in this question, it does not appear to be reasonable for the County to provide employees with a means to increase pension benefits as a result of unintended and unrecognized flaw in the design of the benefit structure. Upon recognition of this flaw the County has proceeded in a judicious manner to correct this situation by having legislation introduced (AB 1659) and subsequently signed into law, to prohibit this provision from being effective for future hires. On the other hand, neither does it appear to be respectful of the employees position to expect that benefits that they have been "granted" by the County to be "taken" from them.

Further evaluation of the "freeze" versus the "reduce" alternative reveals a number of other factors to be considered in making a selection on an approach; the degree of difficulty inherent in communicating to employees the provisions that would be required to implement the "reduce" alternative, the increased administrative complexity of selecting the "reduce" versus the "freeze" alternative, the "direct" impact on employee's pay that a "reduce" alternative would have versus a "freeze" alternative, the amounts of savings to be gained in one alternative versus the other, and the impact on employee morale of selecting the "reduce" alternative versus the "freeze" alternative.

Based upon the above considerations, the Commission is recommending that the Available Cash Options be "frozen" at their current levels. In this manner the County will gain the significant portion of the anticipated savings without reneging on the provisions of the program that have been in place to date. By taking this approach only the additional take-home pay current employees can elect to take will be "frozen". This allows employees to continue to purchase currently available benefits by maintaining a higher level of "noncashable" purchasing power under the Cafeteria Plan.

To provide a simple example of this approach assume that an employee:

a. currently receives a salary of $1000 per year
b. Available Cash Benefits are frozen at 10%
c. future salary increases will affect non cash benefits only

Year	Salary	Available Cash Option	Non Cash Benefits
x	$1000	$100	0
x+1	$1100	$100	$10
x+2	$1200	$100	$20

The total amount of benefits available will remain the same, but the option/benefit mix will change. Thus, the employee will keep the current level of Available Cash Option that is pensionable, but this amount will not increase.

This approach is similar with that taken in the design of the Options and Choices Plan. For example, in 1993 under the Choices plan, employees can receive a monthly County Cafeteria Plan Contribution of up to $442, but the Available Cash Option is limited to $244 per month. The employee does not get to spend the $198 difference in benefits if he or she chooses the cash - the difference is forfeited.

This recommendation would restrict the MegaFlex Available Cash Option in 1994 to the amount the employee was entitled to as of some time to be determined in the design standards established by the Chief Administrative Officer. The W.F. Corroon report suggested that this amount be based upon the employee's pay rate as of December 31, 1993. The recommendation also involves determining the appropriateness and methodology to be used in determining the "frozen" Available Cash Option. W. F. Corroon presents three alternative "targets". The Commission feels that this decision is one to be made by the Chief Administrative Officer since it may have a significant effect on the design of the overall program.

The Commission also recognizes that in modifying the County Cafeteria Plan some of the current distinctions between the Flexible Benefit Plan and MegaFlex may be removed. Since employees in MegaFlex have made an irrevocable election to participate in MegaFlex rather than the Flexible Benefits Plan, recommendations which modify only the MegaFlex Plan may change the conditions upon which that irrevocable election was made. As stated above, the Commission feels that the Chief Administrative Officer will have to make a determination on this question based upon the specifics of the plan design that he/she recommends and the policy developed in Recommendation #1. Based upon the current information, it appears that a determination will have to be made as to whether to reopen the choice between plans or to modify the Flexible Benefit Plan in the same way as MegaFlex.

Impacts:

a. Fiscal - The level of benefits available to the employee remain the same, but the funding mix is modified by adopting this approach. This mix modification will affect the employees future increase in pensionable compensation and will reduce the County's retirement contribution.

b. Plan Design - For those employees who utilize the County's Cafeteria Plans to purchase benefits, there is no reduction in their benefit purchasing power, since only future increases in the Available Cash Option is being affected, not the County contribution. Only those employees who have planned on having an increase in take home pay as a result of pay increases will be affected.

c. Recruiting and Retention - The W.F. Corroon report has concluded that this approach is not overly restrictive when compared to their sample employer group nor when compared to the data presented in a published benefit survey of employers. In addition, the Choices and Options Plans currently have such a feature. Thus, it does not appear that the implementation of such an approach would negatively impact the County's ability to attract and retain qualified employees.

Recommendations:

11. Direct the Chief Administrative Officer to modify the current MegaFlex and Flexible Benefit Plans to freeze the Available Cash Options within each plan.

12. Direct the Chief Administrative Officer to develop a methodology to establish the appropriate level of the Available Cash Option in the MegaFlex Plan. In developing this methodology consideration should be given to the methodology presented in the W. F. Corroon report.

ISSUE

Eliminate the Selling of Annual Leave Benefits from MegaFlex

Legal Opinion:

The legal opinion considering this issue states that this would be a viable option as long as "...the Board of Retirement makes or has made a determination that the ability to cash out leave days does not constitute pensionable compensation ("compensation earnable")..."

Discussion:

MegaFlex participants currently have the ability to sell annual leave (time off) benefits in accordance with vacation allowances based upon length of service. Since these additional County contributions are a part of the Available Cash Option, they result in a corresponding increase in Pensionable Earnings, regardless of whether the participants elects to take these amounts in cash or to use them to buy back the time-off benefits.

This recommendation would remove Elective Annual Leave from the MegaFlex Plan and credit MegaFlex participants with the equivalent vacation and sick leave time outside of the plan. This modification precludes the employee from directly trading time-off for other benefits on a pre-tax basis, but since before the beginning of the year the employee can choose to reduce their salary to buy pre-tax benefits for the year, this is more of an inconvenience than a problem.

Setting policy on the carry over of vacation time and sick leave days is a determination that should be made by the Chief Administrative Officer, but the recommendation by W. F. Corroon to limit the unfunded liability to the County by restricting the carry over is one that deserves serious attention.

The objective of including the ability to sell annual leave benefits within the Available Cash Options was to have employees spend more time on the job by selling vacation. By moving this ability outside the Available Cash Option, it would appear that this objective could be accomplished and the employees benefit can remain intact while eliminating the associated pension costs.

Impacts:

a. Fiscal - Removing the value of time-off benefits from the County Cafeteria Plan Contribution can produce rapid reductions in Pensionable Earnings, and, in turn, County retirement costs for MegaFlex participants.

b. Plan Design - This alternative will impact the structure of this benefit and how it is used by the employee. It also removes a key distinction between MegaFlex and the Flexible Benefit Plan which could probably be overcome by allowing MegaFlex participants to re-enter the Flexible Benefit Plan at the next open enrollment.

c. Recruiting and Retention - Based upon comparable employee's cafeteria plans, it appears that by implementing this recommendation the County would remain competitive. Also, the employee's benefit purchasing power will not be significantly affected. Thus, it does not appear that any actions taken by the Board to exclude selling annual leave benefits from pensionable earnings would negatively impact the County's ability to attract and retain qualified employees.

Recommendations:

13. Direct the Chief Administrative Officer to receive from the Board of Retirement a determination of whether or not the ability to cash out leave days outside of a cafeteria plan constitutes pensionable compensation.

14. Direct the Chief Administrative Officer, based upon the determination of the Board of Retirement, to develop a plan for eliminating the employees' ability to sell annual leave benefits under Megaflex, and provide MegaFlex participants with a similar Elective Annual Leave program outside of the Cafeteria Plan. This recommendation has the effect of removing this benefit from the basis upon which pensionable compensation is calculated.

15. Direct the Chief Administrative Officer to develop a methodology for determining employees' ability to carry over vacation time. This methodology should have as an objective limiting the unfunded liability for accumulative time off benefits. It should also consider the methodology proposed in the Corroon report.

CONCLUSION

It is clear that the lack of attention to the design of employee benefits has resulted over the recent past in an unintended cost to the pension system. The strategy presented in this report has expanded upon the cost savings alternatives identified in the Commission report on this issue presented to the Board in November 1992. It provides the Board of Supervisors with a means of eliminating the pensionable cost associated with the identified benefits for future employees. It also furnishes an equitable methodology to eliminate future increases in pensionable costs for current employees. The Commission feels strongly that the Board of Supervisors should take positive and effective action to implement the recommendations made in this report. Without such action on their part this situation will continue to exist, funds will continue to be expended unnecessarily, and an unfunded liability will continue to be incurred.