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LEGISLATIVE DIGEST

[City retirement benefits and health care benefits]

A proposal to submit to the qualified voters of the City and County of San Francisco (the "City") for an election to be held on November 8, 2011, a measure amending provisions in the City's Charter to: (1) adjust contribution rates for current and future employees to the San Francisco Employees' Retirement System ("SFERS") based on the rate employers are required to pay each year; (2) limit SFERS' supplemental cost of living adjustments to retiree benefits for all employees and retirees; (3) create new retirement plans for employees commencing employment on and after January 7, 2012; (4) require elected officials to pay their contributions to SFERS and the Retiree Health Care Trust Fund ("RHCTF"); (5) allow certain individuals who are members of the California Public Employees' Retirement System ("CalPERS") to become members of SFERS; (6) change the composition of the Health Service Board ("HSB"); (7) change the vote requirement for the HSB to approve member health care plans; (8) require current employees to contribute to the Retiree Health Care Trust Fund beginning in Fiscal Year 2016-17; (9) restrict certain retiree health care benefits for employees who left City employment, but have not yet retired, to those benefits in place at the time they left employment; (10) reduce employers' contributions into the Health Service System Trust Fund under certain circumstances; and (11) make certain other changes to retirement and health care benefits, and provisions governing the RHCTF and the Health Service System.

Existing Law

Retirement Benefits

The City provides defined retirement benefits for most employees through SFERS. The cost of those benefits is funded through a combination of employee contributions, City contributions and investment earnings from SFERS funds. Employees and elected officials contribute an amount set by the Charter. Generally that contribution rate is 7.5% of their salary, but some employees pay up to 9% of their salary (collectively, "base rates"). The City has sometimes paid the contribution for employees and elected officials. SFERS' investment earnings and City payments fund the balance of the cost of those benefits. The City contributes an amount that the Retirement Board sets according to a Charter prescribed formula. In recent years, the annual City contribution rate to SFERS has exceeded the employees' rate.

When employees retire, they receive a monthly retirement based on three factors: their age at retirement; years of service; and highest compensation for any one or two years of earnings ("covered compensation"). Most employees first become eligible to retire at age 50, after 20 years of City service. Employees who are age 62 or older at retirement can receive up to 2.3% of their covered compensation for every year of City service. Police and fire (collectively "safety") employees may retire at age 50 after 25 years of service. Safety employees who are age 55 or older at retirement can receive up to 3% of their covered compensation for every year of City service. Covered compensation may include amounts the City pays as premiums in addition to the employees' salary, such as a premium for working a night shift. For income tax purposes, the Internal Revenue Service limits the covered compensation that can be used to calculate a retirement allowance benefit. That amount is currently $ 245,000.

Under certain circumstances, SFERS retirees may receive a supplemental cost of living adjustment ("COLA") in addition to the basic COLA. When SFERS' investment earnings exceed the expected amount, SFERS may pay the supplemental COLA up to a total of 3.5% of the regular retirement allowance annually. The 3.5% maximum is calculated on both the supplemental COLA and the basic COLA. In some cases, SFERS has paid the supplemental COLA benefit even where SFERS was not fully funded.

Some employees who leave City service before they are eligible to retire qualify for an allowance ("vesting allowance") payable at retirement. SFERS funds part of the vesting allowance through contributions the City makes after the end of their employment.

Some employees receive retirement benefits through a contract between the City and CalPERS. These employees include deputized members of the sheriff's department, probation officers, district attorney and public defender investigators, juvenile court counselors, and institutional police.

Like funding for SFERS retirement benefits, funding for the cost of CalPERS retirement benefits derives from three sources, consisting of employee and employer contributions and investment earnings. Employees contribute between 7.5% and 9% of their salary and CalPERS sets the employer contribution rate for its plans. The City's employer contribution rate to CalPERS is more than the rate the City pays to SFERS for similar retirement benefits.

Health Care Benefits

The HSB oversees the Health Service System ("HSS") and approves health care plans for member employees and retirees of the City and other employers. The HSB consists of seven members: one member of the Board of Supervisors appointed by the President of the Board of Supervisors; two members appointed by the Mayor, one of whom must regularly consult in the health care field and the other who must be a doctor of medicine; and four members elected from the active and retired members of the HSS.

Approval of health care plans for HSS members requires a two-thirds majority of the HSB, and a majority of the Board of Supervisors.

Employees who retire under SFERS or CalPERS are eligible to receive retiree health coverage from the HSS. A formula in the Charter sets retiree contributions for health coverage. In general, eligible retirees must contribute the amount active employees contribute, excluding collectively bargained subsidies. Retiree contributions to Medicare further reduce retiree contributions for health coverage. A 2000 Charter amendment, Proposition E, provided for a 50% deduction of retiree health care premiums (the "Proposition E Subsidy") and an employer contribution of 50% of the health care premiums for the retiree's first dependent.

A 2008 Charter amendment, Proposition B, created the Retiree Health Care Trust Fund ("Trust Fund") to help pay for Employer retiree health care costs. Employees who commenced employment after January 9, 2009, contribute 2% of their compensation into the Trust Fund, and the City contributes 1% of those employees' compensation into the Trust Fund. The provisions and operation of the Trust Fund, including employee contributions required by Charter, are not subject to collective bargaining dispute resolution procedures.

The Charter requires a ten-county survey to determine the minimum amounts that employers contribute to the HSS. Participating employees, retirees and the employers contribute additional funds to HSS.

The Charter requires that HSS funds be used to pay for member health care plans, inform members about plan benefits, and pay costs and investment related expenses.

The Charter allows members to choose any licensed medical provider and authorizes the HSB to set rates paid to providers. The HSB has established one plan – the "City Plan" – providing this coverage.

Proposed Amendments

Retirement benefits

Cost-Sharing for Contribution Rates for Current Employees and Future Employees:

All employees and elected officials would pay a minimum contribution equal to their existing base rates. In addition to the minimum contributions, the proposed Charter amendment would provide for employee contribution rates to SFERS that would increase or decrease for all employees, based on the City's required contribution rate for that fiscal year:

- Employees earning less than $50,000 annually would not pay the additional rate.
- Employees earning between $50,000 and $100,000 annually would pay up to 4% of salary more than their base rate when the City must pay more than 12% of salaries, and would contribute up to 4% less than their base rate when the City's contribution rate to SFERS is lower than 11%.

- Employees earning over $100,000 annually would pay up to an additional 5% of salary when the City must contribute more than 12% of salaries, and would contribute up to 5% less when the City's contribution rate is lower than 11%.

- Most current safety employees would pay up to 6% more than their base rate when the City must pay more than 12% of salaries to SFERS, and would contribute up to 6% less when the City's contribution rate to SFERS is less than 11%.

- In those years when the employees pay less than the required minimum contribution, the City would pay the difference to SFERS, and contribute less money to the Retiree Health Care Trust Fund.

- Elected officials would also pay the additional contributions to SFERS based on their salaries, and would contribute less when the City's contribution rate to SFERS decreases. The City could not pay any portion of the elected officials' contributions to SFERS.

New Retirement Plans for Future Employees:

The proposed Charter amendment would create new SFERS retirement plans for employees commencing employment on and after January 7, 2012. Those plans would:

- Raise the minimum retirement age for employees other than safety employees ("miscellaneous employees") from 50 to 53;

- Require all employees to work longer to obtain maximum retirement benefits, 65 for miscellaneous employees, and 58 for safety employees;

- Limit covered compensation to 85% of the Internal Revenue Service limits for miscellaneous employees (which cap would currently be $ 208,230), and 75% of those limits for safety employees (which cap would currently be $ 183,750);

- Prohibit covered compensation from including new premiums or allowances paid to employees;

- Calculate "average final compensation" under a three-year formula; and

- Decrease "vesting allowances" for miscellaneous employees by lowering the City's contribution that funds part of the allowance to 50% of the employee's accumulated contributions.

Supplemental COLA for All Employees and Retirees:

The proposed measure would prohibit payment of the supplemental COLA benefit unless SFERS is fully funded measured by the market value of its assets. Also, for future employees, the benefit will not be permanent. In any year when the "excess returns" are insufficient to pay the benefit, the previously approved supplemental COLAs would expire and SFERS would pay only the previously authorized retirement allowance, with the basic COLA.

CalPERS Members:

New employees otherwise eligible for membership in CalPERS may become members of SFERS. Current CalPERS members may become members of SFERS if the recognized representatives of those members and the City agree that they may do so. If they remain CalPERS members, their recognized representatives and the City may negotiate and submit to interest arbitration proposals for these employees to receive an equitable adjustment comparable to the SFERS contribution rate adjustments for SFERS members.

<u>Health Care Benefits</u>

Change in Composition of Health Service Board:

The proposed Charter amendment would change the composition of the HSB by replacing one of the elected members with a member nominated by the City Controller starting May 2013. The HSB must approve the Controller's nominee within 60 days. The failure of the HSB to calendar a vote on the Controller's nominee within 60 days shall be deemed approval. If the HSB does not approve the nominee, then the Controller shall nominate another candidate. The Controller's nominee may not vote on his or her successor.

Change in HSB Voting Requirement for Plan Adoption:

The proposed Charter amendment would change the HSB's voting requirement for adoption of member plans from two-thirds to a majority.

Authority for Change in Plan Year:

The proposed Charter amendment would authorize the HSB to change the plan year from a fiscal year to a calendar year.

Employee and City Contributions:

The proposal would require that employees commencing employment before January 10, 2009, contribute 0.25% of pre-tax compensation into the Retiree Health Care Trust Fund starting July 1, 2016, and increasing by 0.25% each year up to 1% of pre-tax compensation not to exceed each participating employer's normal cost. "Normal employer cost" refers to the employer's cost of paying for the benefit on an ongoing basis as the benefits accrue. Under the proposal, the City would contribute 0.25% of compensation starting July 1, 2016, and increasing by 0.25% each year up to 1% of compensation for these employees.

Limits on Retiree Health Benefits for Employees Who Left City Service and have not Retired:

The proposal would change employer retiree health care contributions for two categories of retired HSS members. For employees who separated from employers before June 30, 2001, and who retire after January 6, 2012, the proposal would eliminate the Proposition E 50% subsidy and the employer contribution of 50% of the health care premiums for the retiree's first dependent. For employees hired after January 6, 2012, the health care premiums they must pay following their retirement would not be reduced by their monthly Medicare contribution.

Expenditure of Trust Funds:

The proposed Charter amendment would allow the HSB to expend trust fund dollars to pay for member wellness programs, actuarial expenses and expenses incurred to reduce health care costs.

Substitute for City Plan:

The proposed Charter amendment would authorize the HSB to adopt a substitute plan for the City Plan with a narrower network of health care practitioners.

Additional Contributions to Retiree Health Care Trust Fund:

The proposed Charter amendment would allow the City and recognized employee organizations to agree, or an interest arbitration panel to award, employee contributions into the Retiree Health Care Trust Fund greater than the amount of those contributions currently required under the Charter.

Expenditure of Retiree Health Care Trust Funds:

The proposed Charter amendment would restrict expenditure of funds until 2020, instead of 2015.

<u>Miscellaneous provisions</u>

The proposed Charter amendment also would amend various retirement plan provisions to conform to these changes.

The proposed Charter amendment includes a severability clause. If the proposed Charter amendment is approved by the voters and successfully challenged in a lawsuit, then a court may strike the challenged provisions, but allow the rest of the proposal to become law.

The proposed Charter amendment also provides that, to the extent the amendment conflicts with employers' labor agreements in existence as of November 8, 2011, the conflicting portions of the Charter amendment will go into effect upon the expiration date of such labor agreements.

Under the proposed Charter amendment, if the voters approve this proposal and any other proposed Charter amendment related to retirement benefits, then the proposal with the most votes shall become law and the other proposal shall be null and void.

Background Information

This proposed Charter amendment results from negotiations between the City and recognized employee organizations representing certain City employees.

The proposed Charter amendment includes a number of findings addressing the need for the measure to address the City's fiscal challenges.

Changes In The Fourth Draft

The Fourth Draft adds a provision explaining that, if the voters approve this proposal and any other proposed Charter amendment related to retirement benefits, then the proposal with the most votes shall become law and the other proposal shall be null and void.