



Memorandum

Date: January 31, 2023

To: Members, Board of Retirement

From: Lori Nemiroff, General Counsel *LN*

Subject: PENSIONABILITY ANALYSIS OF FLEXIBLE BENEFITS PROGRAM ALLOWANCES AS TO LEGACY MEMBERS UNDER CURRENT AND PENDING STRUCTURE

The VCERA Retirement Administrator has requested this non-confidential analysis from VCERA's General Counsel in a form that may be provided to the Board of Retirement, VCERA members and beneficiaries, the County of Ventura, VCERA members' labor representatives, any other interested stakeholders, and the public, in a timely way on a matter of importance to all such stakeholders.

This memorandum explains VCERA's analysis of the pensionability of the County's new Flexible Benefits Program structure, as applicable to legacy members¹. Under this new structure, a Flexible Credit Allowance is paid only to those employees who make an annual election for medical plan coverage under a County or Union sponsored medical plan; employees who opt out of such coverage will instead receive a Medical Plan Opt-Out Option allowance ("Opt-Out Allowance"). VCERA has determined that under the new Program structure, the Opt-Out Allowance is the maximum baseline amount that all similarly situated members of a member's grade or class may receive in cash each year and is not subject to variation by a member's ad hoc election. It is, therefore, neither an in-kind conversion, nor an ad hoc payment, both of which are to be excluded from compensation earnable under Government Code section 31461, subd. (b)(1)(A) and/or (B). This analysis will be the basis for additional revisions to the pending proposed Resolution concerning *Alameda* implementation.

Background

On December 5, 2022, the County provided to VCERA the proposed language for the new Flexible Benefits Program structure and inquired as to the impact to pensionability for Legacy members. On December 9, 2022, VCERA advised the County that its recommendation would be to include in compensation earnable the amount of compensation paid to employees under the "Medical Plan Opt-Out Option," as described above.

¹ The Public Employees' Pension Reform Act of 2013 ("PEPRA") prohibits the inclusion of any and all employer-provided "allowances" in retirement benefit calculations for VCERA's "PEPRA" members who are subject to Government Code §7522.34, subd. (c)(7). Therefore, this analysis does not discuss or impact the exclusion of all such allowances from the "pensionable compensation," and thus retirement benefit calculations, of PEPRA members.

On December 13, 2022, the County Board of Supervisors approved an amendment to the SEIU and VEA Memoranda of Agreements (MOA) and the Management Resolution² that established a new structure under the Flexible Benefits Program to become effective once implemented. The MOA for IUOE was approved on January 10, 2023, and negotiations are in progress to similarly amend other MOAs. Each of the approved MOAs follow the new structure in which the Flexible Credit Allowance is payable by the County only to those employees who elect, during open enrollment, to enroll in a County or Union sponsored healthcare plan. The Flexible Credit Allowance for each bargaining unit continues to be either a flat amount or tiered amount according to number of dependents covered by the plan. Most importantly, both the Flexible Credit Allowance and the Opt-Out Fee have been eliminated for those employees who elect to opt out of a County-sponsored healthcare plan. Instead, the employees who opt out will receive a Medical Plan Opt-Out Option cash payment (i.e., Opt-Out Allowance).

Note that under the Flexible Benefit Program (effective September 23, 1984, as amended effective February 9, 2021) the “Flexible Credit Allowance” consists of the “sum of flexible credits” generated by the County contribution and the member’s reduction in pay and after tax contributions; but, the terms “Flex Credit” and “Flexible Credit Allowance” have been commonly understood to refer solely to the allowance the County pays to employees to be used toward the Flexible Benefit Program benefits (also referred to as a County contribution), with unapplied portions being payable in cash. For simplicity and continuity, the terms “Flex Credit” and “Flexible Credit Allowance” will be used to refer to the allowance paid by the County (County contribution) to employees under the Flexible Benefit Program.

Below is a summary of the Current Structure and the New Structure and an analysis of the impact on compensation earnable for Legacy members.

Governing Statutes

“Compensation” is defined in Government Code section 31460 as “[r]emuneration paid in cash out of county or district funds . . .” (All statutory references are to the Government Code unless stated otherwise.)

“Compensation Earnable” is defined in section 31461 as “(a) . . . the average compensation as determined by the board, for the period under consideration upon the basis of the average number of days ordinarily worked by persons in the same grade or class of positions during the period, and at the same rate of pay. . . .

(b) ‘Compensation earnable’ does not include, in any case, the following:

(1) Any compensation determined by the board to have been paid to enhance a member’s retirement benefit under that system. That compensation may include:

(A) any compensation previously provided in kind to the member by the employer or paid directly to a third party other than the retirement system for the benefit of the

² All references to “MOAs” hereinafter include the Management Resolution, and all references to “bargaining unit” include unrepresented employees under the Management Resolution.

member, and which was converted to and received by the member in the form of a cash payment in the final average salary period.

(B) any one-time or ad hoc payment made to a member, but not to all similarly situated members in the member's grade or class.

....”

1. Current Flexible Benefit Program Structure – Flexible Credit Allowance Received by All Members of a Bargaining Unit

a. Flexible Credit Allowance as “Compensation” under Section 31640

County contributes to the Flexible Benefits Program (an IRC § 125 Cafeteria Plan) by paying a Flexible Credit Allowance to all employees in a bargaining unit, in varying amounts depending on bargaining unit and number of dependents the employee elects to cover on the medical plan. This contribution is referred to as “Flex Credit” and is reported as “Earnings” on employees’ paychecks. *All employees* in a bargaining unit receive at least the “baseline” amount of Flex Credit, which is either the Employee-Only tier (Tier 1) or a flat amount for everyone in the bargaining group.

The Flex Credit has been treated by the County and VCERA as “Compensation” under Government Code section 31460, pending legislative (AB 826) and collective bargaining efforts to address the reduction in retirement benefits due to elimination of the noncashable or “in-kind” portion of Flex Credit as part of the implementation of the *Alameda* decision.

From these Flex Credit “Earnings,” the employee then chooses among pre-tax “qualified” benefits (e.g., healthcare-related benefits such as medical, vision and dental coverage, flexible savings accounts for healthcare and dependent care, and an “Opt-Out Fee” that is currently treated by the County as a qualified benefit) and taxable cash. The cost for the qualified pre-tax benefits is shown as a Deduction from pay on employees’ pay stubs (“Before-Tax Deduction”). The Flex Credit that is “*paid in cash . . . out of county funds*” to each employee, and reported as “Earnings” on paychecks, is the starting point for determining what portion will be excluded from “Compensation” as an “in-kind” advantage (e.g., healthcare-related choices) and what portion will qualify as “Compensation” and ultimately “Compensation Earnable.” The portion of Flex Credit that is used for payment of health insurance premiums is not “Compensation” because it is an “in-kind” advantage. (See *In Re Retirement Cases* (2003) 110 Cal.App.4th 426 [“[I]nsurance-related benefits,” including “employer payments into flexible benefit plans” are benefits of insurance coverage, not cash, and “[a]s such, it is an in-kind advantage.”] Accordingly, only the “cashable” portion of Flex Credit qualifies as “Compensation.”

b. Flexible Credit Allowance as “Compensation Earnable” under Govt. Code Section 31461

While AB 826 was pending, the Retirement Board (“Board”) adopted a Resolution on July 26, 2021, to address the “tiered” Flex Credit structure implemented by the County beginning in the 2020 plan year. After AB 826 was vetoed by the Governor in September of 2022, the Board granted the County and Unions’ requests to delay further adoption of an Alameda Implementation Resolution to address Flex

Credit, to allow for collective bargaining for a potential benefit to replace the reduction in retirement benefits resulting from implementation of *Alameda*. This Resolution currently governs the amount of Flex Credit to be included in compensation earnable and directs that VCERA include the employee-only rate, or flat rate, rather than including the full Flex Credit rate for each tier, which would cause contributions and pensions to vary depending on individual medical coverage elections. The July 26, 2021, Resolution provides, in pertinent part:

“VCERA shall include Flex Credit in compensation earnable at the lowest amount that is provided to persons in an individual member’s bargaining unit or unrepresented group during the final compensation period, subject to potential further adjustment should AB 826 not be enacted during the 2021 session of the California legislature.” [Emphasis added.]

Based on the current structure whereby all members of the bargaining unit receive Flex Credit, VCERA has consistently recommended the Board include in compensation earnable the maximum amount of Flex Credit that each employee could receive in cash out of the Flex Credit Earnings, at the flat rate or employee-only tiered rate, which is the baseline “cashable” amount. Accordingly, the calculation formula for Compensation Earnable under the current structure is:

Flex Credit at the Employee-Only (or Flat Rate if not tiered) minus the lesser of the Opt-Out Fee or the lowest cost healthcare plan.

The factors that support this recommendation are: (1) the same baseline Flex Credit amount (employee-only rate or flat amount) is paid to everyone in the bargaining unit, and is not subject to an ad hoc election each year, thereby satisfying subsection (b)(1)(B); (2) employees have no choice or election as to the amount of the baseline Flex Credit that is paid, as this is set by the governing MOA; (3) the full amount of the Flex Credit is reported by the County as “Earnings” on employees’ pay stubs and retirement contributions are remitted based on the cashable portion of those Earnings; (4) the amount of the baseline Flex Credit is not subject to an employee’s annual ad hoc election, as to whether to either enroll in a County/Union-sponsored medical plan (and if so, how many dependents are covered), or whether to decline coverage (See § 31461(b)(1)(A)); (5) the “cashable” amount under the above calculation assumes that each employee will maximize the benefit elections in the final compensation measurement period, thereby avoiding an impermissible in-kind conversion (See § 31461(b)(1)(B)).

Under a more strict application of subdivision (b)(1)(A), VCERA could have instead recommended either complete exclusion of the Flexible Credit Allowance (see, e.g. *Marin Assn. of Public Employees v. Marin County Employees’ Retirement Assn.* (2016) 2 Cal.App.5th 674 (“*Marin*”)³), or inclusion of the difference

³ In *Marin*, the Court affirmed the trial court judgment in favor of MCERA, issued after sustaining of MCERA’s demurrer, upholding the Retirement Board’s policy to exclude cash received by members through an IRC section 125 cafeteria plan. MCERA’s policy, adopted to implement the PEPRA Amendments to section 31461, states: “As a result of new subdivision (b)(1)(A) of section 31461, which permits in-kind conversions in the final compensation measurement period to be excluded from final compensation, on and after January 1, 2013, effective on and after that date, MCERA will no longer collect retirement contributions on, and will exclude from retirement calculations, in-kind benefits converted to cash, such as waiver for health insurance cash back and 125 plan revision.” (*Marin*, 2 Cal.App.5th 674, at p. 686, fn. 9.)

between the Flex Credit and the *greater* of the Opt-Out Fee or the lowest cost healthcare plan, to account for an employee's actual election as to whether or not to enroll in a healthcare plan. However, recognizing that employees will be inclined to maximize their compensation earnable during their final compensation measurement period, VCERA staff has continued to recommend inclusion of the maximum *cashable* amount to ensure full funding of the benefit and to maximize the pensionable amount available to all legacy members within a bargaining unit, without regard to their health care elections in a given year. VCERA believes this determination, which maximizes pensionable benefits for Legacy members and also minimizes the potential for artificial inflation of benefits just prior to a member's retirement without proper funding of them, is well within the discretion that Government Code section 31461(b)(1) grants to the Board.

2 New Flexible Benefit Program Structure – Employee Receives EITHER a Flexible Credit Allowance OR an Opt-Out Allowance, Dependent Upon Annual Ad Hoc Election

a. Flexible Credit and Opt-Out Allowances as “Compensation” under Section 31640

- (1) Flexible Credit Allowance: For those employees who elect coverage under a County/Union-sponsored medical plan, Flex Credit will be reported as “Earnings” on paystubs. The portion of Flex Credit that is “Compensation” is the portion of Flex Credit at the flat rate or employee-only tiered rate, minus the lowest cost medical plan. The remaining balance is the cashable amount.

- (2) Opt-Out Allowance: For those employees who elect the Opt-Out Allowance rather than enrolling in a County/Union-sponsored healthcare plan, no Flexible Credit Allowance is paid by the County and, therefore, no portion of that amount can be treated as “Earnings.” Rather, these employees receive a cash Opt-Out Allowance, which will be reported as “Earnings” instead of Flex Credit. The Opt-Out Allowance constitutes “Compensation,” as it is paid in unrestricted cash out of County funds.

Pursuant to the terms of the MOAs negotiated to date, the cash back for those employees who receive the Flexible Credit Allowance is greater than the Opt-Out Allowance.

Notably, under the new structure, the County has eliminated both the Flex Credit and the Opt-Out *Fee* for employees who do not elect a County medical plan. According to the County's Flexible Benefit Plans Handbook for plan year 2022, an Opt-Out Fee is charged to such employees primarily to subsidize the cost of premiums for employees who elect medical coverage. (See County of Ventura Benefit Plans Handbook, pp. A-7 and A-8, at: [Benefit Plans Handbook 2022 web.pdf \(ventura.org\)](#).) (A small portion of the Opt-Out Fee is to cover the County's administrative expenses for programs outside of the Flexible Benefits Program, such as the Employee Assistance Program, Wellness Program, WorkLife Program and Employee Health Services.) Under the new structure, employees who opt out no longer may receive a cash payment consisting of the difference between the Flex Credit amount and the lesser of the Opt-Out Fee or the lowest cost medical plan, as is the case under the current structure. The County will now fund the subsidy and the other programs from the savings realized from elimination of the Opt-Out fee

and by paying an Opt-Out Allowance in a lesser amount than the Flex Credit Allowance. Accordingly, the difference between the Flexible Credit Allowance and the Opt-Out Allowance cannot be considered “Compensation” to the employees. These are substantive and legally relevant changes in the structure of the Program, which impacts the pensionability of Program benefits for legacy members.

“Before any payment qualifies as ‘compensation earnable,’ the payment must be ‘compensation’ within the meaning of section 31460.” (*Ventura County Deputy Sheriffs’ Assn. v. Board of Retirement* (1997) 16 Cal.4th 483, 494.) To qualify as “Compensation” under section 31460, a benefit must be “paid in cash out of county or district funds.” The employees who opt out will not receive the Flexible Credit Allowance. To the extent the Flexible Credit Allowance is greater than the Opt-Out Allowance, that difference is not “paid” to employees who opt out and, therefore is not “Compensation.” Employees who opt out cannot be “deemed” to have received that difference; it would be fictional compensation, as it is not payable under the terms of the MOAs, will not be reported on the employees’ paychecks as “Earnings” and no income taxes will be remitted on it. As such, it does not meet the definition of “Compensation.”

b. Flexible Benefit Program Allowances as “Compensation Earnable” under Govt. Code Section 31461

Under the new Program structure, the baseline “Compensation” paid to employees within a bargaining unit now varies depending on whether the employee chooses each year to receive the Flexible Credit Allowance or the Opt-Out Allowance. The 2013 PEPRA Amendments to the definition of “Compensation Earnable” in Government Code section 31461(b)(1) require exclusion of compensation determined by the board to have been paid to enhance a member’s retirement benefit under that system, which may include:

- (A) any compensation previously provided in kind to the member, and which was converted to cash in the final average salary period, and;
- (B) any one-time or ad hoc payment made to a member, but not to all similarly situated members in the member’s grade or class.

Under the new Flexible Benefit Program structure, all employees in the same grade or class within a bargaining unit do not receive the same amount of benefits, as some will receive the Flexible Credit Allowance and some will receive the Opt-Out Allowance, based on an individual annual ad hoc election as to which benefit to receive as “Compensation,” thereby failing to overcome the limitations in subsections (b)(1)(A) and (b)(1)(B). The factors that allowed VCERA to recommend that the cashable amount of Flex Credit be included in compensation earnable, as set forth above, are therefore not present under the new structure, because all members in a particular bargaining unit are not receiving the same “compensation” in the first instance – they are electing to receive, in a given year, *either* the Flexible Credit Allowance *or* the Opt-Out Allowance.

Note also that it is the County’s responsibility to report to VCERA the “compensation earnable” paid to each member, and to remit employer and employee contributions on that compensation earnable. (Govt. Code §31582.) Because the Flexible Credit Allowance is not reported as “Earnings” on the

paychecks of those who opt out, retirement contributions cannot be taken on the difference between the higher amount of Flexible Credit Allowance and the lower amount of the Opt-Out Allowance actually paid, as that is fictional or imputed compensation. Member contributions may be taken only on amounts that are *paid to* the member and qualify as “Compensation Earnable.” The baseline amount that is *paid to* all members in a bargaining unit (i.e., the “Compensation”) is, therefore, the amount of the Opt-Out Allowance.

Conclusion

In sum, the Opt-Out Allowance is what VCERA has determined to be the “Maximum Baseline Cashable Flexible Benefit” and is the amount under the new Flexible Benefit Program structure recommended as included in Compensation Earnable. The Opt-Out Allowance is the maximum baseline amount that all similarly-situated members of a member’s grade or class may receive thereunder in cash in a given year, and is not subject to variation by a member’s ad hoc election each year that is unrelated to their job duties, and thus it is neither an in-kind conversion nor an ad hoc payment to an individual that is to be excluded from compensation earnable under Government Code section 31461, subd. (b)(1)(A) and/or (B). This determination avoids variation in pensions based on medical plan election choices and avoids manipulation to increase the cash received in the final compensation measurement period. (See *Alameda County Deputy Sheriff’s Association v. Alameda County Employees’ Retirement Association* (2020) 9 Cal.5th 1032, 1061.)