Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

(619) 236-6220

DATE: February 23, 2012

TO: Scott Chadwick, Human Resources Director

FROM: City Attorney

SUBJECT: Elimination of Cost of Living Annuity Under the City's Retirement Plan

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ISSUE PRESENTED

The San Diego Police Officers Association (SDPOA) has expressed an interest in eliminating the Cost of Living Annuity (COL Annuity) and the associated COL employee contributions (COL Contributions) on a prospective basis for the employees they represent. Attached to this Memorandum is an analysis of the COL Annuity benefit and COL Contributions. This analysis is incorporated as Appendix I into Legal Opinion 2010-1, which was issued by this office on January 21, 2010, entitled "Pension Benefits and Other Post-Employment Benefits."

CONCLUSION

This Office concludes that the COL Annuity benefit is vested and cannot be modified unless the modifications are necessary to preserve the integrity of the pension system and are accompanied by comparable new advantages, as required by the *Kern/Allen/Betts* rule. Also, any modification would be subject to membership vote under San Diego Charter section 143.1.

JAN I. GOLDSMITH, CITY ATTORNEY

By /s/
Roxanne Story Parks
Deputy City Attorney

RSP:ccm
cc: Mayor Sanders
City Councilmembers
MS-2012-4

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APPENDIX I[1]

COL Annuity Benefit under SDCERS

I. HISTORY OF THE COL ANNUITY, COL CONTRIBUTIONS AND COLA

The provisions for the annual Cost of Living Allowance (COLA) benefit and the requirement that Members pay COL Contributions were first enacted on January 12, 1971, by San Diego Ordinance O-10479, which added sections 24.0531 and 24.0532 to the San Diego Municipal Code (SDMC).

SDMC section 24.0531 set forth the annual COLA benefit, which was to be applied annually to retired Members' retirement allowances. The COLA was to be determined based upon the previous year's Consumer Price Index (CPI), but capped at 1.5 percent.

Section 24.0532 stated that employees would pay half the cost of the COLA benefit, and required increases to employee contributions that would be annuitized at retirement and added to the Member's retirement allowance. At this point, it was clear that the COL Annuity was not a separate benefit from the COLA, but instead was the mechanism by which Members paid their share for the COLA program.

Section 24.0532 provided, in pertinent part:

> Commencing July 1, 1971, and until adjusted by the Board upon the recommendation of the actuary, the contribution requirements of members and safety members as contained in Sections 24.0202 and 24.0302, respectively, shall be increased by 15%. These "cost of living contributions" will be separately totaled upon the retirement of members and safety members after July 1, 1971, and based upon the lifetime annuity value of that total as determined by the Actuary, a fixed sum will be added to the normal monthly retirement allowance of the retired member or safety member as provided for in this chapter. The cost of living adjustment provided for in Section 24.0531 will not be applied until the amounts required exceed the additional fixed sum the retired member is receiving from the annuity value of his cost of living contributions.

Section 24.0532 provided that the retired Member would not receive the annual COLA unless the COLA exceeded the annual fixed amount the Member was receiving based upon his COL Contributions. It is unclear whether, in the years in which the COLA exceeded the Member's COL Annuity, the entire COLA would be paid or only the amount by which the COLA exceeded the COL Annuity.

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[1] Appendix I was added to Op. City Att'y 2010-1 (Jan. 21, 2010) on February 13, 2012. The analysis was prompted by a question from the Human Resources Director to the City Attorney. *See* City Att'y MS 2012-4 (February 23, 2012).

Titles were added to the SDMC sections that comprise the Retirement Plan by San Diego Ordinance O-11964, which the San Diego City Council (City Council) adopted on December 8, 1976. The title enacted for section 24.0532 was "Cost of Living Adjustment Program Shared between Employer and Employee."

On June 24, 1985, the City Council adopted San Diego Ordinance O-16449, which amended section 24.0531 to increase the maximum annual COLA from 1.5 percent to 2 percent, and amended section 24.0532 to increase the COL Annuity contribution beginning June 30, 1985 by 20 percent. In addition, surviving spouse contributions became subject to the 15 percent and 20 percent contribution increases that constituted the COL Contributions. The Members' COL Contributions appear to have been increased in order that employees would pay their share of the increased cost of the COLA program.

The City Council adopted Ordinance O-17770 on May 26, 1992, which removed the language from section 24.0532 that instructed the Retirement Board to annuitize a Member's COL Contributions and pay an additional fixed sum above the Member's regular retirement allowance. The Ordinance substituted the following language:

> An amount equal to the Cost of Living Adjustment provided for in section 24.0531 shall be added to the normal monthly allowance and paid from these contributions until they are exhausted. Thereafter, the Cost of Living Adjustment will continue to be paid from employer contributions.

Section 24.0532 was amended again on February 25, 1997 by San Diego Ordinance O-18383, which deleted the language stating that the COL Contributions would be used to pay the Member's COLA until exhausted. At this point, the COL Contributions stopped being used to pay a portion of the COLA benefit and began to be used to provide a separate benefit under the Retirement Plan. No substitute language was added to replace the language stating that COL Contributions were to be used to pay the Member's COLA. As a result, the Retirement Plan no longer contains any direction on what is to be done with the Member's separately totaled COL Contributions at retirement.

The definition of "Cost of Living Annuity" that currently appears in section 24.0103 was added to the Retirement Plan by San Diego Ordinance O-18392, adopted on March 31, 1997. This definitional language is the only authority in the Plan for paying the COL Annuity.

Section 24.0532 was repealed and reenacted into section 24.1506 on January 11, 1999, by San Diego Ordinance O-18608, but again no new language was added.

II. COL ANNUITY PROVISIONS.

There is currently only one reference to the COL Annuity in the Plan, and it is merely a definition of the term in San Diego Municipal Code (SDMC) section 24.0103, which is the section that defines terms used throughout the Plan. Section 24.0103 defines the COL Annuity as follows:

> "*Cost of Living Annuity*" means an amount to be added to the retirement allowance of a Member or Officer, calculated by computing the actuarial equivalent of the accumulated contributions in the cost of living annuity account of the Member or Officer at the time of the retirement of the Member or Officer.

The terms "Cost of Living Annuity" and "cost of living annuity account" are not used anywhere else in the Plan.

There is one reference in the Plan to COL Contributions. SDMC section 24.1506, which sets forth the requirement that the cost of the annual Cost of Living Allowance (COLA) program be shared equally between the employer and employee, also requires the Retirement System to increase regular Member contributions by 15 percent beginning July 1, 1971, and by an additional 20 percent beginning June 30, 1985.

SDMC section 24.1506 provides:

> **§ 24.1506 Cost of Living Adjustment Program Shared Between Employer and Members**
>
> (a) The cost of any anticipated cost of living increase in allowances which is based upon services rendered after July 1, 1971, shall be shared equally between the employer and the contributing Member, with the individual member's contributions based upon his or her age at his or her nearest birthday at time of entrance into the Retirement System.
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> (b) Commencing July 1, 1971, and until adjusted by the Board upon the recommendation of the Actuary, the contribution requirements of Members as contained in Sections 24.0202 and 24.0302, respectively, plus surviving spouse contributions as contained in Section 24.0521, shall be increased by 15%. In addition, the contribution requirement for those Members specified therein who are active members on or after June 30, 1985, shall be increased by 20%. These "cost of living contributions" will be separately totaled upon the retirement of Members after July 1, 1971.

Subsection (b) requires the COL Contributions to be "separately totaled" when the Member retires, but does not state what should happen with them after they are totaled.

Subsection (a) of section 24.1506 provides that the cost of the COLA program will be shared equally between the employer and Member. The COLA, which is set forth in SDMC section 24.1505, is an annual adjustment the Retirement Board applies to retired Members' pensions each July 1. Adjustments are capped at 2 percent per year, and are based on increases in the nationwide CPI in the last calendar year, as measured by the Bureau of Labor Statistics of the U.S. Department of Labor.[2]

III. ELIMINATING THE COL ANNUITY

Questions have been raised regarding whether the COL Contributions and Annuity can be eliminated prospectively for current employees. It is our opinion that the COL Annuity benefit is vested, and cannot be modified unless the modifications are necessary to preserve the integrity of the pension system and are accompanied by comparable new advantages, as required by the *Kern/Allen/Betts* rule. Further, the offsetting improvement must relate to the benefit that has been diminished. *Betts v. Board of Administration*, 21 Cal. 3d 859, 864-65 (1978). Additionally, any modification would be subject to membership vote under Charter section 143.1.

One option for eliminating the COL Contributions and Annuity would be to give employees a one-time election to stop making the COL Contributions on a prospective basis. This would avoid the vested rights issue, as each employee would sign a waiver of their right to accrue additional COL Contributions (for annuitizing at retirement). Before the City could agree to this approach, it should seek a legal opinion from specialized tax counsel as to whether the SDCERS plan can be amended to provide a qualified cash or deferred option whereby an employee could choose between continuing to make pre-tax COL Contributions and discontinuing those contributions in favor of higher take-home pay.

RSP:ccm

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[2] CPI increases that exceed 2 percent in any given year are "banked" for future years. In years when the CPI increases by less than 2 percent, the difference between the increase and the 2 percent limit is taken from the Member's "bank" to provide a full 2 percent increase. For example, if the CPI in a Member's second year of retirement increased by 3 percent, his or her retirement allowance would be increased by a 2 percent COLA and the extra 1 percent would be set aside for use in future years. If, in the following year, the CPI only increased by 1 the Retirement System would draw upon the extra 1 percent from the previous year in order to pay a full 2 percent increase on the Member's retirement allowance.