CITY COUNCIL COMMUNICATION:

00-397

AGENDA:

AUGUST 28, 2000

SUBJECT:

VOLUNTARY EMPLOYEE BENEFIT ASSOCIATION (VEBA)

TYPE:

<u>RESOLUTION</u>
ORDINANCE
RECEIVE/FILE

SUBMITTED BY:

TOM G. TURNER
HUMAN RESOURCES DIRECTOR

ITEM ____

OFFICE OF THE CITY MANAGER
CITY OF DES MOINES, IOWA

SYNOPSIS -

A Voluntary Employee Benefit Association (VEBA) is a tax-preferred vehicle to fund post-employment health and benefit costs for current employees. The City and Central Iowa Public Employees Council (CIPEC) have agreed to establish a VEBA as part of the six-year collective bargaining agreement. Additionally, Supervisory, Professional and Management (SPM) employees will be offered this benefit.

FISCAL IMPACT -

Total contributions, funded by Trust and Agency and Enterprise revenues will be $93,000 in Fiscal Year (FY) 2001 (SPM only), $493,200 in FY 2002, $864,000 in FY 2003, $1,160,000 in FY 2004, and thereafter increasing at a rate equivalent to the annual Cost of Living Allowance (COLA). Approximately 60 percent of the CIPEC costs are funded from enterprise revenues. The amounts expected to be recovered from enterprise revenues are $130,000 in FY2002, $270,000 in FY2003, and $410,000 in FY2004; and from Trust and Agency revenues $93,000 in FY2001, $363,000 in FY2002, $594,000 in FY2003, and $750,000 in FY2004.

RECOMMENDATION -

Approve issuance of the Request for Proposal (RFP), authorize the Legal Department to negotiate with the party who most closely meets the terms of the RFP, and authorize and direct the City Manager to execute the agreement for post employment health benefits as approved by the Legal Department.

BACKGROUND -

Staff has been examining various mechanisms to provide tax preferred funding for post employment health benefits for employees. The use of Internal Revenue Code Section 501(c)(9) trust is the best vehicle. Trusts under this provision are generally termed Voluntary Employee Benefit Associations or VEBAs. This funding vehicle has been in existence since the 1930s; however, the 1986 Tax Reform Act reduced its attractiveness by eliminating the income tax deductibility of employer contributions. Private sector employers quit using this vehicle. However, a non-income tax paying entity, such as the City of Des Moines, can use this vehicle without the additional tax consequences. Because this plan pays only incurred medical expenses or insurance premiums, the participants' funds used to pay these costs are also not taxed. Participants can only access their account when their employment is terminated and can use the funds only to pay health premiums or costs. This operates very much in the same manner as the current Flexible Spending Accounts for active employees. When a participant dies, their dependents may access the funds to continue to pay for health costs only. At no time is there a cash distribution to the participant of unspent funds. Funds in a participant's account that are not exhausted upon the participant's and dependents' deaths are reallocated to the balance of the participants in the plan. This mechanism permits the use of Trust and Agency revenues to fund this benefit.

Currently, staff has identified only one provider of a plan that has received an approval letter from the Internal Revenue Service. That firm is Nationwide (PEBSCO). However, Principal Financial Group and ICMA-RC will be asked to respond to the RFP.

The CIPEC labor agreement provides for contributions increasing annually from 1 percent of average payroll to 3 percent of average payroll. The SPM group's contribution will increase in a similar fashion.