



CITY OF SAN DIEGO
MEMORANDUM

DATE: April 5, 2007

TO: Honorable City Attorney Michael Aguirre

FROM: Mayor Jerry Sanders *Jelle Dulsech for Mayor Jerry Sanders*
Council President Scott Peters *Elizabeth Kinsley for SHP*

SUBJECT: City Council hearing of April 10, 2007, Item 332, Amendments to the San Diego Municipal Code ("SDMC") eliminating the Waterfall

On March 5, 2007, the City Attorney introduced an ordinance eliminating SDMC provisions related to surplus undistributed earnings. While we fully support the elimination of surplus earnings and the waterfall concept from the SDMC in compliance with the City's Remediation Plan, the structure of the current ordinance leaves many unanswered questions.

The second reading of the ordinance is scheduled for Tuesday, April 10, 2007. Many interested stakeholders, including SDCERS, Local 145 and the Independent Budget Analyst, have raised pertinent questions that should be answered before the City Council takes any further action on this item. All relevant correspondence are attached for your review. We request a written legal analysis of these issues as required by City Charter Section 40 before the City Council takes further action on Item 332.

Thank you for your assistance with this important issue.

SHP:bbk

Attachments

cc: Honorable City Councilmembers
Andrea Tevlin, IBA
Ronne Froman, COO
Jay Goldstone, CFO
Elizabeth Maland, City Clerk



THE CITY OF SAN DIEGO
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: March 1, 2007

IBA Report Number: 07-26

City Council Docket Date: March 5, 2007

Item Number: 203

Subject: Amendments to the San Diego Municipal Code Eliminating the "Waterfall"

OVERVIEW

This proposal asks the City Council to strike certain portions of the San Diego Municipal Code that, over the past two decades, have created unrecognized liabilities in the Retirement System and diverted assets from the SDCERS Trust Fund. The City Attorney's Report presents a history of the development of the Waterfall and the concept of Surplus Earnings, including its flawed financial basis. This information has been public for some time and many parties, including the IBA, have called for analysis and action to eliminate this practice. The item before the Council at this time is intended to accomplish that goal.

FISCAL/POLICY DISCUSSION

The IBA strongly supports the elimination of the concept of Surplus Earnings and the Waterfall from the City's Municipal Code. At the same time, it is critical that decision-makers understand the various potential impacts of striking out these sections as proposed.

§24.1502(a)(1) Employee and Employer Contribution Accounts

This section requires interest to be credited to such accounts in accordance with §24.0904 and Board rules. Since §24.0904 still stands with this action, it is our understanding that elimination of the Waterfall will not impact the SDCERS Board's ability to credit interest as appropriate according to their legal and fiduciary duty.

§24.1502(a)(2) SDCERS Administrative Budget

Elimination of the Waterfall will mean that "Surplus Earnings" are no longer diverted to this purpose. However, SDCERS still must administer the Retirement System and an operating budget is required to do so. Based on our conversations with the City

Office of Independent Budget Analyst

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these liabilities and the elimination of this section should not have any further financial impact.

§24.1502(a)(7) Corbett Settlement

As with the 13th Check, this liability is now recognized in the total liabilities of SDCERS and is included in their valuation of June 30, 2006. The City's ARC now provides assets to cover this liability. It is our understanding that it is satisfactory to eliminate the reference to payment of this liability since the City already has an obligation to do so under the terms of the settlement, even if it is not codified anywhere in the Municipal Code. However, we would again note that SDCERS has committed to administering the Retirement System consistent with the City's Municipal Code, which serve as the Plan Documents for the System, in accordance with IRS requirements. As with the SDCERS administrative budget, the City Council may wish to explore inserting appropriate language to authorize expenses for this settlement in another section of the Municipal Code, in accordance with guidance from the City Attorney.

§24.1502(a)(8) Credit Interest to Supplemental COLA and Employee Contribution Reserve

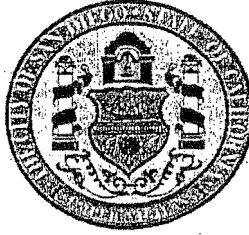
The Employee Contribution Reserve has been fully exhausted, so it is appropriate to remove any reference to interest crediting for this account. The Supplemental COLA Reserve was valued at \$17,273,016 as of June 30, 2006. Municipal Code §24.1503(c)(3) provides for the annual crediting of interest, so the ability to credit interest is not eliminated. However, §24.1503(c)(3) states that interest shall be credited "if sufficient funds are available." The determination of what constitutes sufficient funds and on what authority is not further defined in the Municipal Code. We suggest that this should be clarified by the City Council with counsel from the City Attorney.

§24.1502(b) Surplus Earnings Credited to Employer Contribution Reserve to Reduce System Liability

Since the concept of Surplus Earnings will no longer exist, there will be no surplus earnings to distribute to the System's liabilities. However, since earnings will flow into System assets to reduce any unfunded liability, there is no fiscal impact with the elimination of this section. Without the concept of Surplus Earnings and diversion of those earnings to other purposes, this section is unnecessary.

The IBA also notes that references to Surplus Earnings and/or any sections above have also been eliminated throughout Municipal Code Chapter 2, Article 4, Division 15 in this proposed ordinance

Finally, the IBA notes that the City Attorney's Office has asserted that neither Meet and Confer nor a vote of the Retirement System Membership (pursuant to Charter Section 143.1(a)) is required to adopt this ordinance. This is because no benefits are impacted but the funding mechanism is changed, which is a management right.

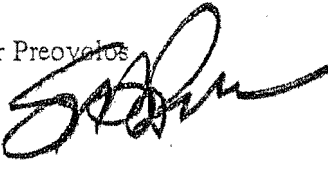


City of San Diego
COUNCIL PRESIDENT SCOTT PETERS
DISTRICT ONE

MEMORANDUM

DATE: June 13, 2006

TO: City Attorney Michael Aguirre
SDCERS Board President Peter Preovelos

FROM: Council President Scott Peters 

SUBJECT: Use of SDCERS Surplus Undistributed Earnings ("Waterfall")

In 1980, the City Council adopted Ordinance No. 15353 which started the City's practice of using surplus undistributed earnings (investment earnings received) from the San Diego City Employees Retirement System ("SDCERS") trust fund for payment of supplemental benefits specified in the San Diego Municipal Code ("SDMC") Section 24.1502. Subsequent legal settlements and retirement-related policy decisions by the City have further expanded the use of these investment earnings. The surplus undistributed earnings are allocated for "contingent benefits" in the priority order specified in the SDMC. The elements of this method have become known as the "Waterfall."

The City of San Diego Pension Reform Committee, Luce Forward LLP, Vinson & Elkins, the previous and the current SDCERS' independent actuary and Navigant Consulting have all suggested that the use of the surplus undistributed earnings may violate the principles and soundness of actuarial science. The Vinson & Elkins report stated that the surplus earnings concept ignores the long-term dynamics of actuarial projection unless it can be demonstrated that the actuarial projections are unrealistically conservative. SDCERS board members have expressed a strong desire to include the contingent liabilities in the Retirement System's total actuarial liabilities.

The City Charter and the SDMC govern the operation of SDCERS. The City Council must amend the appropriate municipal code provisions in order for SDCERS to discontinue the "Waterfall." The following Municipal Code provisions dictate the practice for the surplus undistributed earnings. I have included suggestions for possible action to remedy this situation. Since many of the provisions were the result of settlements in prior litigations, any action may require an approval between the City and the eligible retirees. In response to this memorandum, I respectfully request the City Attorney's analysis on the questions of eliminating any provisions that contain the use of surplus undistributed earnings. Also, if necessary, the City Attorney

should submit the appropriate items to be docketed at a Council meeting at the earliest possible date. In addition, I request that the SDCERS Board ask its actuary and tax counsel about the issue of including contingent liabilities of the 13th Check and Supplemental Cost of Living Adjustment ("COLA") with the total actuarial liability of the system and how that might affect the provision of those contractually agreed benefits.

1. **SDMC 24.1502 (a) (1): Credit the contribution accounts of the employers at a rate determined by the board.**

SDCERS Board and various studies have questioned the principle and soundness of the use of surplus undistributed earnings. In order to eliminate this practice, I respectfully request an opinion from the City Attorney and the SDCERS Board on the possibility of amending SDMC 24.0901, and authorizing the SDCERS board to credit contribution accounts of all plan sponsors, and the members of employee contribution accounts (maybe for the exception of the DROP account), annually in an amount determined by the board. If the City Attorney, SDCERS board and the City Council approve of such action, SDMC 24.0904 should be amended to include "contracting public agencies," along with the City.

2. **SDMC 24.1502 (a) (2): System's operating budget.**

Even with the elimination of the concept of the use of surplus undistributed earnings, the system can pay for its own budget with one of its reserve funds. It is my understanding that this is standard practice of the majority of public retirement systems in the country.

3. **SDMC 24.1502 (a) (3): Fund any "reserves" as recommended by actuary and counsel.**

Currently only the DROP contribution reserve is under this section. SDCERS has brought to my attention that DROP provisions allow the SDCERS board the authority to determine the rate at which to credit earnings to DROP participant accounts. Historically, the board has credited the accounts at the same rate as the Employee and Employer Contribution Reserve, which has been 8%. There are opinions from SDCERS that this has placed the retirement board in the position of changing compensation levels for active city employees enrolled in the DROP program. In exchange, this could affect the City's ability to recruit and retain experienced employees and takes away from surplus undistributed earnings when the system's earnings fail to meet the expected rate of return.

One of the possible recommendations from SDCERS was to change the municipal code to allow the City Council the sole authority to determine the interest rate credited to DROP accounts for future DROP participants through the Meet and Confer process with the City's employee unions and at the advice of SDCERS investment counsel and the City Auditor. I request that the City Attorney provide the Mayor and the City Council a legal analysis on changing credit earnings for current DROP participants. I also request SDCERS board members' input on the DROP crediting issue.

4. **SDMC 24.1502 (a) (4): Credit proportional share of the system's earnings to the United Port District and Airport Authority.**

After crediting interest to the contributions accounts of the plan sponsors, withholding sufficient sums to meet budgeted expense of the system and payment for legally required payments to eligible retirees, all remaining surplus undistributed earnings should be used for the sole purpose of paying down the underfunded liability (UAAL) of the system.

5. **SDMC 24.1502 (a) (5): Retiree Health Insurance.**

This reserve has been exhausted as of FY 2006 and the City has been directly paying the full cost of retiree health benefits on a pay-as-you-go basis. Under the municipal code, this benefit is still a liability of the retirement system. Appropriate actions need to be taken to remove this section from the SDMC and amend SDMC Section 24.1203 to make this benefit the sole responsibility of the City. In addition, the last sentence of SDMC Section 24.0801, which states that "the portion of the contribution that the City designates for the 401(h) Fund or the Health Trust, to be used for retiree health benefits under Division 12, is not a deficiency within the meaning of this section" should be deleted from this section to reflect the update of the City practice for payment of Retiree Health benefits.

6. **SDMC 24.1502 (a) (6): 13th Check to a closed group of retirees.**

The SDCERS' actuary recommends including the 13th Check in the total actuarial liabilities of the system. The total actuarial liability of the 13th check is estimated to at \$56.7 million. Since its existence, this benefit has been paid 85% of the time. SDCERS board has expressed its desire to include this payment in the City's contribution. In order for SDCERS to include this benefit into its total actuarial liabilities, Council action is needed to remove this provision from SDMC 24.1502 and be appropriately included in SDMC 24.404. Since this benefit resulted from a legal settlement between the City and retirees back in the 1980's, the recommended change may require approval of the City and eligible retirees. I request the SDCERS board ask its actuary and tax counsel about the issue of including contingent liabilities that are not accrued, as part of the total actuarial liability of the system.

7. **SDMC 24.1502 (a) (7): Corbett retiree liability to closed group of retirees.**

One of the provisions of the Corbett settlement was for a 7% increase in retirement benefits to retirees who retired on or before June 20, 2000. The settlement allowed for these payments contingent upon the system having sufficient undistributed earnings after the 13th Check is paid. If the system does not have sufficient undistributed earnings, the liability for that fiscal year is carried forward (without interest) to the next year until there are sufficient earnings. It is a desire of the SDCERS board and the SDCERS actuary that the Corbett benefit is part of the retirement system's total actuarial liability. In order for SDCERS to include this benefit into its total liabilities, Council action is needed to remove this provision from SDMC 24.1502 and be appropriately included in SDMC 24.404. The total actuarial liability of the Corbett settlement is estimated to be at \$58.9 million. Since this benefit resulted from a legal settlement between the

City and retirees back in the 2000, the recommended change may require approval of the City and eligible retirees.

8. **SDMC 24.1502 (a) (8): Credit the Supplemental COLA Reserve and the Employee Contribution Reserve.**

In 1998, supplemental COLA fund at \$35 million was established for members who retired on or before June 30, 1982. As of June 30, 2005, this reserve had approximately \$17.8 million. Interest to this reserve account is contingent on undistributed surplus earnings, but the liability is not carried forward. I request the City Attorney and SDCERS' tax counsel and actuary advise the Council on the best course of action for the provision of this benefit. I request the SDCERS board ask its actuary and tax counsel about the issue of including contingent liabilities that are not accrued, as part of the total actuarial liability of the system.

9. **SDMC 24.1502 (b): The remaining balance is credited to the Employer Contribution reserve for the sole purpose and exclusive purpose of reducing the UAAL.**

After crediting interest to the contribution accounts of the plan sponsors, withholding sufficient sums to meet budgeted expenses of the system and payment for legally required payments to eligible retirees, all remaining surplus undistributed earnings should be used for the sole purpose of paying down the underfunded liability (UAAL) of the system along with the possibility of removing all concept of the use of undistributed earnings.

Thank you very much for everyone's assistance.

SHP:wjs

CC: Honorable Mayor and City Councilmembers
Ronne Froman, Chief Operating Officer
Andrea Tevlin, Independent Budget Analyst
Jay Goldstone, Chief Financial Officer
John Torell, City Auditor
SDCERS Boardmembers
David Wescoe, SDCERS Retirement Administrator
Scott Chadwick, Labor Relations Manager

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March 8, 2007

III MERITAS LAW FIRMS WORLDWIDE

VIA FACSIMILE AND U.S. MAIL

The Honorable Jerry Sanders, Mayor
Council President, Scott Peters
and City Council Members:
Councilmember Kevin Faulconer
Councilmember Toni Atkins
Councilmember Tony Young
Councilmember Brian Maienschein
Councilmember Donna Frye
Councilmember Jim Madaffer
Councilmember Ben Hueso
202 C Street
San Diego, CA 92101

Re: Proposal To Eliminate The "Waterfall"

To the Honorable Mayor and City Council of the City of San Diego:

This office represents San Diego City Firefighters, Local 145 ("Local 145"). The City Council's action to amend the Municipal Code by eliminating the "Waterfall" and "Surplus Earnings" as a funding source for vested retirement benefits violates the Meyers-Milius-Brown Act ("MMBA") and, as currently drafted, deprives retirees and employees of vested retirement benefits.

The City Council's passage of the proposed ordinance, as drafted, will violate the MMBA because the proposed ordinance clearly affects the retirement benefits of San Diego City employees, including firefighters, and is being enacted without first meeting and conferring with Local 145 and the other affected employee unions. No matter how it is construed, the proposed ordinance eliminates an existing source of funding for vested retirement benefits – the 13th check and the Corbett seven percent increase in retirement benefits. Therefore, it cannot be disputed that the proposed ordinance affects the wages, hours, and terms and conditions of employment of firefighters and other public employees. Pursuant to the MMBA, the City must meet and confer with the affected unions, including Local 145, *before* it takes any action to enact the proposed ordinance. See Vernon Firefighters v. City of Vernon (1980) 107 Cal.App. 3d 802, 813, 823. The City has violated the MMBA in approving the proposed ordinance through its first reading, and that violation will be compounded if the proposed ordinance is enacted.

It is equally clear that, as currently drafted the proposed ordinance eliminates an existing funding source for vested benefits without providing an alternative funding source for those benefits. That is the case both with respect to the 13th check and the Corbett benefits.

Honorable Jerry Sanders, Mayor
City President, Scott Peters
City Council Members:
Councilmember Kevin Faulconer
Councilmember Toni Atkins
Councilmember Tony Young
Councilmember Brian Maienschein
Councilmember Donna Frye
Councilmember Jim Madaffer
Councilmember Ben Hueso
March 8, 2007
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The strikeout version of the proposed ordinance, at section 24.1503(b)(4), is the source of the problem with respect to the 13th check benefit. That section eliminates the language explaining the way in which the "per annum dollar value" of the 13th check benefit is calculated. No alternative method is provided. The section proceeds to state only that the per annum dollar value shall not exceed \$30.00, except for specified retirees, *but it never states that the benefit shall not be less than \$30*. Thus, as currently drafted, the amount of the 13th check benefit is not specified. This defect must be cured before the proposed ordinance can be enacted, even if the City fulfills its obligation to meet and confer, as it is required to do under the law.

There is a similar problem with the Corbett seven percent benefit for retirees. As currently drafted, the proposed ordinance makes no reference whatsoever to the Corbett seven percent benefit for retirees because section 24.1502(a)(7) is repealed. As the IBA Report Number 07-26, dated March 1, 2007, stated, SDCERS correctly views the Municipal Code as its Plan Document. Therefore, the Municipal Code *must contain* language authorizing the payment of the seven percent Corbett benefit, so that SDCERS is authorized to make that payment under its Plan Document. As currently drafted, the proposed ordinance *does not* contain such language.

The IBA Report makes clear that the IBA's support for the elimination of the Waterfall was based on its assumption that the 13th check benefit would be paid 100% of the time and that the seven percent Corbett benefit would continue to be paid as required by the Corbett judgment. The proposed ordinance must be amended to make that commitment. The proposed ordinance must state that a 13th check benefit in an amount not less than a per annum dollar value of \$30.00 will be paid each year, and it must state that the seven percent retiree Corbett benefit will be paid each year to eligible retirees. The IBA Report expressly called for such language in the Municipal Code, but the proposed ordinance lacks that language.

Based upon the foregoing, it is respectfully urged that the Council (1) immediately order its representatives to meet and confer with the affected employee unions, including Local 145, regarding the proposal to eliminate the Waterfall, and (2) amend the proposed ordinance to expressly provide for the payment of a 13th check benefit of not less than a per annum dollar value of \$30.00 and a Corbett benefit to retirees of seven percent per year.

Respectfully submitted,



Joel N. Klevens
of CHRISTENSEN GLASER, FINK, JACOBS,
WEIL & SHAPIRO, LLP

onorable Jerry Sanders, Mayor

ail President, Scott Peters

City Council Members:

ouncilmember Kevin Faulconer

Councilmember Toni Atkins

Councilmember Tony Young

Councilmember Brian Maienschein

Councilmember Donna Frye

Councilmember Jim Madaffer

Councilmember Ben Hueso

March 8, 2007

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JNK:cee

cc: City Attorney, Michael Aguirre



CHRISTOPHER W. WADDELL
General Counsel
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e-mail: Cwaddell@sandiego.gov

March 29, 2007

Council President Scott Peters
The City of San Diego
202 C Street, MS #10A
San Diego, CA 92101

Re: Item 203, City Council Meeting of March 5, 2007, Proposal to Eliminate the Concept of the "Waterfall" ("Waterfall Ordinance")

Dear Council President Peters:

I am writing on behalf of the San Diego City Employees' Retirement System ("SDCERS") to express our concern about the wording of the above-referenced proposed Waterfall Ordinance that was considered by the Council on March 5, 2007. While our actuary supports the elimination of the surplus earnings concept upon which the "Waterfall" is based and has reflected the associated "contingent liabilities" in the June 30, 2006 SDCERS valuation liabilities, the wording of the proposed ordinance would result in SDCERS' *inability to pay* the annual supplemental benefit (13th check) and the *Corbett* settlement amounts.

1. Annual Supplemental Benefit (13th Check)

SDMC section 24.1503(a) sets out the criteria SDCERS must use to determine who is a "Qualified Retiree" eligible to receive the 13th Check, and section 24.1503(b) provides the process SDCERS must use to determine the amount of the benefit to be paid to a Qualified Retiree each year:

- (1) identify all the Qualified Retirees on the payroll in October, then
- (2) determine the number of years of service credit each identified Qualified Retiree has, then

- (3) add the years of service credit for all identified Qualified Retirees together to determine the sum of the "Qualified Creditable Years," then
- (4) divide the Surplus Undistributed Earnings by the Qualified Creditable Years.

The outcome of steps (1) through (4) is the "per annum dollar value for each creditable year," (SDMC 24.1503(b)), subject to specified caps (which differ depending on the year the member retired). The Waterfall Ordinance removes step (4) above, thus eliminating from the Municipal Code all direction on how to determine the value of each creditable year that is needed to determine the benefit amount to be paid. Absent such direction, SDCERS *cannot determine or pay* this benefit.

The Waterfall Ordinance also removes the statement that no annual supplemental benefit will be paid in a fiscal year in which there is less than \$100,000 to pay them (pursuant to the formula that is now being removed). (*See* SDMC § 24.1502(a)(6)).

Deputy City Attorney Gersten told the Council on March 5 that SDCERS has the authority "to determine when the benefits should be paid," regardless of whether the plan describes how and when the benefit is to be paid. Later during the Council meeting, the City Attorney told the Council that once the concept of Surplus Undistributed Earnings is removed from the plan:

"Then that means that SDCERS has to administer the pension plan based upon fiduciary duties that are set forth in the state constitution and the fundamental principles of fiduciary law, which governs the operation of any trust.

And that means that they're going to have to figure out how to deal with it [the 13th Check]. It doesn't mean that the benefits aren't going to be paid. It just means that the way in which they're going to be paid is left up to CERS."

These statements of the law are incorrect. SDCERS operates the City's retirement plan as a tax-qualified governmental plan under Internal Revenue Code section 401(a), which requires that a defined benefit plan provide an express formula for calculating each benefit to be paid to each member or beneficiary. (IRC section 401(a); Rev. Rul. 74-385; Treas. Reg. § 1.401-1(b)(1)(i).) The SDCERS Board has confirmed its duty to administer

the plan in compliance with federal tax law and with the express terms of the plan document, as set forth in SDMC Chapter 2, Article 4, and will not administer benefits that have not been enacted by Council ordinance as required by City Charter sections 143.1 and 146. (Board Resolutions 06-05, 07-01, attached).

Therefore, contrary to the City Attorney's representations, the Municipal Code cannot simply "leave up to SDCERS" the specifics of when the benefit will be paid and how the benefit amount will be determined. If the Waterfall Ordinance is adopted as currently drafted, SDCERS could not pay the 13th Check without jeopardizing the plan's tax-qualified status, which we will not do.

In further accord with this view is Judge Barton's decision in the *SDCERS v. Aguirre* litigation. At Page 28 of his Statement of Decision, Judge Barton observed that:

"The evidence and the City Charter and California Constitution define the duties and responsibilities of SDCERS. It is the administrative body for the pension system created by the City (cit. omitted). SDCERS' responsibility is to administer the system and pay the benefits the City sets. It invests the pension assets and provides annual accountings. It does not set benefits and has no power to either set or rescind benefits. The power to create or modify benefits rests with the City."

By placing SDCERS in the position of determining when benefits should be paid and to whom, the position of the City Attorney's office would result in the usurpation of the City's sole authority either to set, modify or rescind benefits.

2. Corbett Settlement – 7% Increase

By striking section 24.1502(a)(7), the Waterfall Ordinance removes the only authority in the Municipal Code that allows SDCERS to pay the 7% increase to retirees and beneficiaries covered by the *Corbett* Settlement Agreement. On March 5, Deputy City Attorney Gersten told the City Council that the Waterfall Ordinance merely eliminates the waterfall as a funding source for this benefit, and that it does not affect the *Corbett* benefits because "the benefits are actually payable pursuant to the [*Corbett*] settlement agreement."

This is incorrect. The authority to pay the benefit *must* be in the Municipal Code, the governing plan document. The Waterfall Ordinance would remove the only reference in the Municipal Code to the *Corbett* Settlement Agreement, therefore eliminating the argument that the settlement agreement is incorporated by reference.

Later in the March 5 Council meeting, the City Attorney suggested that the *Corbett* benefit is non-contingent, and with the removal of the waterfall, would be paid every year. In reality, the Waterfall Ordinance would have the exact opposite effect. The removal of the only authority in the City's Plan document that directs payment of the 7% *Corbett* increase would prevent SDCERS from paying the increase going forward, as such a payment would no longer be authorized by the plan document. Again, SDCERS would jeopardize its status as a qualified plan if it made distributions that were not specifically described in its governing plan document, and we will not do so.

3. **Supplemental COLA**

By eliminating the concept of "surplus earnings," the Waterfall Ordinance would strike from section 24.1504(c)(3) the basis for determining when the Board credits interest to the reserve used to pay for the Supplemental COLA benefit. All that would be left is an instruction that the reserve be credited with interest annually "if sufficient funds are available." As such, if the ordinance is adopted there would be neither a specified source from which to credit the reserve nor a methodology to determine the amount of the credit. Unless an alternative source of funding and methodology is identified in the ordinance, no further amounts will be credited to the reserve for the supplemental COLA and upon the depletion of the reserve no further supplemental COLA payments could be made.

4. **Employee Contribution Rate Reserve**

The Waterfall Ordinance would strike from section 24.1507(c) the basis for determining when sufficient funds are available to credit the Employee Contribution Rate Reserve. As a practical matter, this has no effect on SDCERS as this reserve no longer exists. Section 24.1507 could be stricken in its entirety.

5. **Summary**

In summary, absent significant changes in the Waterfall Ordinance, effective with its enactment SDCERS would lack the authority under the Municipal Code, which constitutes our governing plan document, to pay either the Annual Supplemental Benefit (13th Check) or the *Corbett* settlement-7% increase. Further, SDCERS will lack authority to credit any amount to the reserve for the supplemental COLA. Upon depletion of that reserve, no further supplemental COLA payments could be made.

With substantial revisions, the Waterfall Ordinance can be amended to achieve the results that are being sought by City without creating the myriad of problems that would result from the enactment of the ordinance in its present form. We would be pleased to work on the necessary language with the appropriate City representatives.

Council President Scott Peters
March 29, 2007
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I understand that the proposed ordinance has been calendared for the Council meeting on April 9.
Please do not hesitate to contact me with any questions concerning the above matters.

Sincerely,



Christopher W. Waddell
General Counsel
SDCERS

Attachments

cc: Honorable Mayor Jerry Sanders
Honorable Councilmembers
Ronne Froman, Chief Operating Officer
Jay Goldstone, Chief Financial Officer
Andrea Tevlin, Independent Budget Analyst
Peter Preovolos, SDCERS Board President
SDCERS Board Members
David Wescoe, SDCERS Retirement Administrator

BOARD RESOLUTION NO. R 06-05

ADOPTED ON July 21, 2006

**A RESOLUTION OF THE BOARD OF ADMINISTRATION FOR THE
SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
REQUIRING ALL AMENDMENTS TO CITY RETIREMENT PLAN
BE ENACTED BY ORDINANCE SPECIFICALLY DESCRIBING
THE BENEFITS SDCERS IS TO ADMINISTER**

WHEREAS, the San Diego City Employees' Retirement System (SDCERS) was created by ordinance pursuant to Section 141 of the Charter for the City of San Diego ("Charter"); and

WHEREAS, Charter section 141 empowers the City Council to establish, by ordinance, the retirement benefits for City employees participating in SDCERS; and

WHEREAS, Charter section 143.1 provides that no ordinance affecting the benefits of any City employee participating in SDCERS may be adopted without the approval of a majority vote of the City members; and

WHEREAS, Charter section 143.1 also provides that no ordinance affecting the vested defined benefits of any City retiree may be adopted without the approval of a majority vote of the affected retirees; and

WHEREAS, SDCERS has historically conducted the membership elections required by Charter section 143.1; and

WHEREAS, under Charter section 144, the SDCERS Board of Administration (Board) has the sole authority to manage SDCERS, invest the SDCERS Trust Fund, and determine the rights to benefits under SDCERS that have been established by the Council by ordinance; and

WHEREAS, under federal tax law, SDCERS must satisfy the "definitely determinable requirement," such that the benefits for each participant can be computed as expressly provided in the plan, as contained in Chapter 2, Article 4 of the San Diego Municipal Code (SDMC); and

WHEREAS, in order for SDCERS to properly administer the retirement benefits established by the City for its employees, and to satisfy its duties under federal tax law, all retirement benefit changes affecting City employees must be enacted by ordinance amending SDMC Chapter 2, Article 4; and

WHEREAS, in order for SDCERS to properly administer the retirement benefits established by the City for its employees, and to satisfy its duties under federal tax law, all such ordinances must clearly describe each amendment to the plan, identify the employees covered by each amendment, and provide the effective date of each amendment; and

WHEREAS, in order for SDCERS to properly administer the retirement benefits established by the City for its employees, and to conduct elections required by Charter section 143.1, SDCERS must receive advance notice from the City Council before any such ordinance is docketed for introduction; and

NOW, THEREFORE, BE IT RESOLVED, that the Board will administer the retirement benefits of City employees and retirees in accordance with the terms of the City's retirement plan, as set forth in SDMC Chapter 2, Article 4, and will not implement any benefit changes that have not been enacted by an ordinance amending the plan and, where required, a majority vote of the SDCERS membership; and

BE IT FURTHER RESOLVED that the Board hereby requests the City Council to provide the Retirement Administrator written notice before any ordinance amending the benefits under SDMC Chapter 2, Article 4 is placed on the City Council docket for introduction.

ADOPTED: July 21, 2006



Peter E. Preovolos, President
Board of Administration, San Diego City
Employees' Retirement System

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**BOARD OF ADMINISTRATION
SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM**

RESOLUTION NO. 07-01

ADOPTED ON FEBRUARY 16, 2007

**A RESOLUTION OF THE BOARD OF ADMINISTRATION OF THE SAN
DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM APPROVING THE
AMENDED TECHNICAL TAX COMPLIANCE ORDINANCE TO BE
SUBMITTED TO THE INTERNAL REVENUE SERVICE WITH THE TAX
DETERMINATION AND VOLUNTARY CORRECTION PROGRAM
APPLICATIONS**

WHEREAS, the City Council has the sole authority to establish and define the terms and conditions of the retirement benefits available under the San Diego City Employees' Retirement System (SDCERS) through the promulgation of general ordinances; and

WHEREAS, the Board of Administration for SDCERS (the Board) has the sole authority to administer SDCERS, invest its Trust Fund and determine the eligibility for the right to collect benefits under the ordinances enacted by the City Council; and

WHEREAS, the Board has consistently and continuously administered SDCERS as a qualified governmental plan under the Internal Revenue Code (IRC) since inception; and

WHEREAS, the Board has never obtained a Tax Determination Letter (TDL) confirming its qualified status from the Internal Revenue Service (IRS); and

WHEREAS, although a TDL is not required for public retirement plans to qualify for tax-favored status, it is a prudent practice because it ensures preservation of a retirement plan's qualified status; and

WHEREAS, upon the advice of its tax counsel, the Board unanimously approved the filing of an application for a TDL on April 15, 2005; and

WHEREAS, SDCERS staff and Tax Counsel worked together to prepare a Technical Tax Compliance Ordinance to amend the San Diego Municipal Code (SDMC) to add specific references to the IRC; and

WHEREAS, in May 2005, the Board adopted Resolution 05-01 approving the submittal to the City Council of a Technical Tax Compliance Ordinance amending section 24.1010 of the San Diego Municipal Code (SDMC) to add a "Guidepost Section," setting forth the IRC provisions with which SDCERS must comply; and

WHEREAS, Resolution 05-01 also confirmed the Board's intention to administer the SDCERS plan in accordance with the Technical Tax Compliance Ordinance, pending its adoption by the City Council; and

WHEREAS, the SDCERS staff forwarded the proposed Technical Tax Compliance Ordinance to the City in May 2005 for placement on the Council Docket for action; and

WHEREAS the City Charter requires the City Attorney's approval of an ordinance before the Council may act upon it; and

WHEREAS, on June 6, 2005, Councilmember Donna Frye sent a Memorandum to the City Attorney requesting that he review the proposed Technical Tax Compliance Ordinance "as soon as possible"; and

WHEREAS, the proposed Technical Tax Compliance Ordinance has never been placed on the Council Docket for action; and

WHEREAS, SDCERS filed its application for a TDL from the IRS on July 12, 2005; and

WHEREAS, the passage of the Pension Protection Act of 2006 required amendments to the proposed Technical Tax Compliance Ordinance; and

WHEREAS, the necessary changes have been made to the attached revised Technical Tax Compliance Ordinance; and

WHEREAS, it is now necessary to provide the attached revised Technical Tax Compliance Ordinance to the City with a request that it be docketed as soon as possible; and

WHEREAS, the proposed tax amendments contained in the revised Technical Tax Compliance Ordinance are crucial to SDCERS' ability to obtain a TDL for the City's retirement plan; and

WHEREAS, one purpose of this Board Resolution is to indicate that the Board intends to administer the SDCERS plan in accordance with the revised Technical Tax Compliance Ordinance, pending its adoption by the City Council; and

WHEREAS, the concept of temporarily administering a plan in accordance with tax law requirements before the Council adopts a formal plan amendment is an accepted concept by the IRS; and

WHEREAS, in July 2004, the City of San Diego ("City") and the Board of Administration ("Board") for the San Diego City Employees' Retirement System ("SDCERS"), entered into a settlement of the following lawsuits: *Gleason v. San Diego City Employees' Retirement System, et al.*, San Diego Superior Court Case No. GIC 803779, a class action lawsuit; *Gleason v. San Diego City Employees' Retirement System*, San Diego Superior Court Case No. GIC 810837; and *Wiseman v. Board of Administration for the San Diego City Employees' Retirement System*, San Diego Superior Court Case No. GIC 811756 (collectively, "the Gleason Actions"); and

WHEREAS, the Settlement Agreement in the Gleason Actions requires the City, within 120 days of the Court's entry of a final order approving the Settlement Agreement on July 26, 2004, to "repeal those portions of the San Diego Municipal Code section 24.0801 enacted November 18, 2002, which specify the rates the City pays [to the Retirement Fund on behalf of City employees] are as agreed to in the governing Memorandum of Understanding between the City and SDCERS"; and

WHEREAS, in July 2004, the City Attorney's Office prepared an ordinance to amend San Diego Municipal Code section 24.0801 pursuant to the Gleason Settlement Agreement ("Gleason Ordinance"), but it was never placed on the Council Docket for action; and

WHEREAS, the 120-day period to amend section 24.0801 expired on November 24, 2004; and

WHEREAS, on May 20, 2005, the SDCERS Board adopted a Resolution directing SDCERS staff to work with the City to have the Gleason Ordinance placed on the Council Docket; and

WHEREAS, the proposed Gleason Ordinance was never placed on the Council Docket for action; and

WHEREAS, Municipal Code section 24.0801 must be amended to conform to the Gleason Settlement Agreement; and

WHEREAS, section 24.0801 must also be amended to remove the provision stating that the portion of the City's employer contribution that the City "designates for the 401(h) Fund or the Health Trust, to be used for retiree health benefits under Division 12, is not a deficiency within the meaning of this section," because: (1) the City no longer funds these benefits from a 401(h) or Health Trust Fund, and (2) SDCERS has been advised by its Tax Counsel that Retirement Trust Funds may not be used to pay retiree health benefits; and

WHEREAS, the attached Ordinance will not affect any SDCERS-administered benefits for active or retired members of SDCERS, and thus no vote is required under Charter section 143.1; and

WHEREAS, it is now necessary and appropriate to amend the SDMC to provide for the above-recited changes; NOW, THEREFORE,

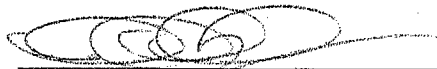
BE IT RESOLVED, the Board will continue to administer SDCERS as a qualified governmental plan under IRC section 401(a); and

BE IT FURTHER RESOLVED, the Board intends to administer the SDCERS plan in accordance with the attached Ordinance, pending its adoption by the City Council; and

BE IT FURTHER RESOLVED, the Board directs SDCERS staff to work with the appropriate employees and officials of the City of San Diego to have the City Council adopt the attached Ordinance; and

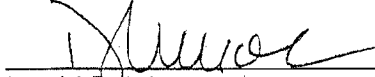
BE IT FURTHER RESOLVED, the attached Ordinance will be submitted to the Internal Revenue Service for its review as part of the TDL application filed by the Board.

ADOPTED: February 16, 2007



Peter E. Preovolos, President
Board of Administration, SDCERS

ATTEST:



David B. Wescoe
Retirement Administrator

RSP

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