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REPORT TO CITY COUNCIL

SUMMARY OF AMENDMENTS TO CITY OF SAN DIEGO SPSP AND SPSP-H PLANS

INTRODUCTION

The City of San Diego sponsors four qualified¹ defined contribution retirement plans for the benefit of its officers and employees. In order to ensure the tax advantages enjoyed by these plans, the City must, before January 31, 2016, apply to the Internal Revenue Service (IRS) for updated determination letters for the City's 401(k) Plan, Supplemental Pension Savings Plan (SPSP), and Supplemental Pension Savings Plan – Hourly (SPSP-H) (collectively, Plans). In addition, the City must apply for a first determination letter for its 2009 401(a) Plan.²

This Office has been working on a comprehensive review of all four plans, and is working with outside tax counsel to prepare the applications for IRS determination letters on the updated plans. The 401(k) Plan was reviewed first, and on June 2, 2015, the City Council approved the Amended and Restated 401(k) Plan.³

The proposed amendments to SPSP and SPSP-H are similar to those already made to the 401(k) Plan, and like the 401(k) Plan, the amendments fall into the following three categories:

1. Substantive and Discretionary Amendments: These amendments are advisable but not required to maintain the qualification of the Plans.
2. Legally-Mandated Amendments: These amendments must be made to comply with State or federal law, or to maintain the Plans' tax qualification.
3. Non-Substantive Amendments: These amendments are intended to make the Plans more readable and user friendly, but do not change the Plans in any substantive way.

¹ A "qualified" plan is an employer-sponsored plan that meets the requirements set forth in Internal Revenue Code section 401(a). There can be serious adverse tax consequences if a plan is not qualified.

² Qualified plans are not required to get an IRS determination letter to maintain their qualified status. But, a favorable determination letter does provide a definitive analysis of whether a plan is qualified based upon a review of the plan document. But, a determination letter will not protect a plan that is not administered according to its terms. Also, if the plan makes an error, a determination letter is a requirement for applying for certain types of relief, such as the Voluntary Correction Program.

³ The San Diego City Council passed San Diego Resolution R-309771 (Jun. 11, 2015) on June 2, 2015, approving the restated and amended City of San Diego 401(k) Plan.

Copies of the proposed Amended and Restated SPSP and SPSP-H Plans, along with strike-out versions and memoranda summarizing the changes, were provided to the employee organizations that represent employees who participate in the Plans. The City met and conferred with the employee organizations regarding the amendments, and all of the affected employee organizations have signed agreements with the City approving all of the discretionary amendments to SPSP and SPSP-H.

SPSP has an additional procedural requirement that does not exist with respect to the other defined contribution plans. Under the terms of the SPSP Plan, substantive changes must be approved by a majority vote of the plan participants. The Risk Management Department conducted a vote of the SPSP participants from October 21 through 30, 2015, and the proposed changes were approved by a majority vote of the SPSP participants.

ANALYSIS

I. SUMMARIES OF THE PLANS

A. Supplemental Pension Savings Plan

SPSP is a qualified governmental defined contribution plan. SPSP was established January 1, 1982, as part of the City's withdrawal from Social Security. Participation in SPSP is limited to:

1. Elected Officers who initially assumed office or were initially hired by the City before July 20, 2012,
2. SDCERS General Members hired by the City before July 1, 2009, and
3. SDCERS Lifeguard Safety Members hired by the City before January 1, 2011.

Participation in SPSP is mandatory for eligible safety members and general members. It serves as the Social Security replacement plan, and therefore is mandatory, for elected officers who elect not to participate in the San Diego City Employees' Retirement System (SDCERS).⁴

Participants make mandatory contributions equal to 3% of compensation. These contributions are currently made on an after-tax basis. In addition, participants may elect to contribute an additional 3.05% in voluntary contributions on an after-tax basis (4.5% for employees hired before July 1, 1986). The City matches participants' mandatory and voluntary contributions dollar for dollar, subject to a 5-year vesting schedule.

⁴ Elected Officers who are eligible for SDCERS have the option of electing not to participate in SDCERS, whereas all employees who are eligible for SDCERS are required to participate in SDCERS.

B. Supplemental Pension Savings Plan - Hourly

SPSP-H was established July 1, 1991, to comply with federal law requiring that governmental employees be covered by Social Security, unless they were covered by a qualifying retirement plan, commonly referred to as a Social Security replacement plan. SPSP-H is a qualified defined contribution plan that covers two groups of officers and employees: (1) hourly, “no standard hours” employees, and (2) officers and employees who are initially hired or initially assume office on or after July 20, 2012, and are therefore excluded from SDCERS under Proposition B. Participation in SPSP-H is mandatory for all eligible officers and employees.

Hourly, “no standard hours” employees (NSH employees)⁵ make mandatory contributions equal to 3.75% of their compensation. Employer contributions for NSH employees represented by the Municipal Employees’ Association (MEA) and Teamsters, Local 911 (Local 911) are 6% of compensation. Employer contributions for all other NSH employees are 3.75% of compensation.

Salaried employees⁶ and elected officers who are initially hired or initially assume office on or after July 20, 2012 (the effective date of Proposition B), and police recruits hired after June 30, 2013, make mandatory employee contributions that are matched dollar for dollar by the City. For eligible public safety officers, the employer and employee contributions are 11% of compensation. For general (non-safety) employees and elected officers, the employer and employee contributions are 9.2% of compensation. Employer contributions to SPSP-H are fully vested at all times.

Participants cannot make voluntary contributions to SPSP-H, however, employees may supplement their retirement savings by making pre-tax contributions to the City’s 401(k) Plan and 457(b) Deferred Compensation Plan. Those plans are allowed to offer voluntary pre-tax contributions.

II. SUMMARY OF PROPOSED AMENDMENTS

A. Substantive, Discretionary Amendments

1. Employer Pick-Up of Employee Mandatory Contributions (SPSP § 3.01(a), SPSP-H § 3.01(b))

Currently, all employee contributions to SPSP and SPSP-H are made on an after-tax basis. This means that employees’ taxable income includes the amounts they contribute to the Plans. However, state and local governmental plans have the option of treating employees’

⁵ No standard hours employees (often referred to as “hourly” or “non-benefitted” employees) are employees who do not regularly work 20 or more hours per week. They are not eligible to participate in SDCERS or in the Interim Plan for officers and employees who are initially hired on or after July 20, 2012 (i.e., post-Proposition B employees).

⁶ Salaried employees are those who regularly work 20 or more hours per week. Salaried employees who were hired before July 20, 2012, are required to participate in SDCERS. Salaried employees initially hired on or after July 20, 2012 are ineligible for SDCERS, but are required to participate in SPSP-H, which serves as the “interim plan” for those employees.

mandatory employee contributions to a qualified plan as pre-tax employer contributions, under Internal Revenue Code section 414(h)(2), through use of an “employer pick up.”

The requirements for an employer pick up of contributions are as follows:

- The plan sponsor must be a governmental employer.
- The employer must take *formal action* (e.g., resolution or ordinance) to elect to “pick up” the employee contributions. (As with SDCERS, the employee contributions would continue to be deducted from employees’ pay checks.)
- The plan can’t allow any individual employee to opt out of making contributions, change the amount of his or her contributions, or choose to receive the contributed amounts in lieu of having them contributed to the Plan. (This is not a change from current practice, since employee contributions are mandatory.)

The third requirement prevents the City from allowing participants to make after tax *voluntary* contributions.

The proposed Amended and Restated SPSP and SPSP-H Plans include a pick-up election. The participants of both Plans will begin making their *mandatory* employee contributions on a pre-tax basis beginning with the pay period ending December 18, 2015. For the SPSP-H participants, this means that 100% of their contributions will be pre-tax. For SPSP participants, only the 3% mandatory contributions will be pre-tax.

2. SDCERS as Investment Option (SPSP and SPSP-H § 5.02(c))

The Amended and Restated SPSP and SPSP-H Plans will allow the plans’ assets to be invested in a group trust. This will allow the City’s Defined Contribution Board to offer participants the option of investing in the SDCERS Trust Fund as one investment option (subject to approval by the City Council and the SDCERS Board).

3. General Withdrawals (SPSP § 6.01)

This amendment applies only to SPSP. Once an employee has been in SPSP for at least two years, he or she may take an annual distribution of some or all of his or her employee contributions to SPSP. However, because the employee contributions to SPSP will now include pre-tax contributions, the SPSP Plan must be amended to comply with tax law regarding withdrawal of pick-up contributions. Specifically, section 6.01 must be amended to provide that the participant must meet one of the following requirements to withdraw funds he or she has contributed on a pre-tax basis: (a) the participant must have been in the Plan for at least 60 months, or (b) the amounts being distributed must have been in the participant’s account for at least two years.

This means that if a participant has been in SPSP less than five years, he or she cannot withdraw pre-tax employee contributions (made in or after the pay period ending December 18, 2015) until the funds have been in the SPSP Plan for two years (or until the participant has been in the plan for five years). The SPSP Plan's two-year participation requirement will continue to apply to withdrawals of mandatory contributions contributed before the pay period ending December 18, 2015, as well as to all employee voluntary contributions regardless of when they were contributed. Pre-tax funds withdrawn while in City service will be subject to taxation and a 10% penalty, unless the participant is at least 59½ years old.

The SPSP-H Plan does not include a provision allowing participants to withdraw funds while they are in City service.

4. Hardship Withdrawals (SPSP § 6.02)

This amendment applies only to SPSP, because SPSP-H does not allow hardship withdrawals.

The proposed amendments to the SPSP Plan include changes to section 6.02, which are necessary to conform to the IRS safe harbor provisions regarding hardship withdrawals. These same changes were made to the 401(k) Plan. Currently, SPSP states that a hardship withdrawal will not be permitted if the hardship could be alleviated by insurance, liquidation of the participant's assets, stopping voluntary contributions to City Plans, obtaining a loan from one of the City's Plans, or obtaining a commercial loan. This requirement will be replaced with a six-month suspension on making *voluntary* contributions to the City's Plans from the time of the hardship.

5. Increased time for Beneficiaries to take Distributions (SPSP § 7.03, SPSP-H § 6.02)

This proposed amendment to the SPSP and SPSP-H Plans will give participants' beneficiaries the maximum time allowed by federal tax law to take a distribution of a participant's account after the participant's death. Specifically, the amount of time a non-spouse beneficiary has to take a full distribution of the deceased participant's account will increase from one year to five years. This change has already been made to the 401(k) Plan.

6. Addition of Partial Distributions (SPSP § 7.08(a), SPSP-H § 6.03)

This proposed amendment will allow participants who have left City service to take partial distributions from their accounts. Currently, the Plans allow either (a) an annuity beginning at retirement, or (b) a full lump-sum distribution of the entire account. This amendment will make it more attractive for employees to leave their funds on account when they separate service or retire. This change has already been made to the 401(k) Plan.

7. Changes to Domestic Relations Order Provisions (SPSP § 12.03, SPSP-H § 11.04)

This proposed amendment is to conform the Plans to follow federal law on qualified domestic relations orders. This change has already been made to the City's 401(k) Plan.

B. Legally-Mandated Amendments

1. Allocation of Investment Earnings and Losses (SPSP and SPSP-H § 4.03), Investment of Funds (SPSP and SPSP-H § 5.01), and Valuation of Investments (SPSP and SPSP-H § 5.03)

These amendments are required to be included in plans that allow participant-directed investments. Additional changes are needed because the Plans now have daily valuation of accounts.

2. Limitation on Annual Additions (SPSP and SPSP-H § 4.04)

This amendment adds required language regarding coordination with other City defined contribution plans when determining whether a participant has reached the aggregate limit on annual additions to all qualified DC plans maintained by an employer.

3. Direct Rollover to an Eligible Retirement Plan (SPSP § 7.10(b), SPSP-H § 6.05)

This sections, related to rollover distributions from the Plans, must be amended to conform to a change in federal tax law, which no longer distinguishes between 401(k) and non-401(k) hardship withdrawals in defining an eligible rollover distribution. Also, language must be added to subsection (c) regarding non-spouse beneficiaries.

4. Required Minimum Distributions (SPSP § 7.11, SPSP-H § 6.07)

Federal legislation permitted qualified plans to allow participants to waive their required minimum distributions in 2009, which was at the height of the financial crisis. However, plans that wished to offer this option were required to add language permitting this to their plan documents.

Retired participants of the City's defined contribution plans were allowed to waive their 2009 required minimum distributions, but the plan documents were never amended to allow this option. The City must now retroactively amend its Plans to permit this.

5. Powers and Duties of the Plan Administrator (SPSP § 8.02, SPSP-H § 7.02)

These amendments conform the SPSP and SPSP-H Plans to changes in California law, which now allows domestic relations orders for dissolution of registered domestic partnerships, and to conform to federal law, which now allows qualified domestic relations orders for child support awards.

C. Examples of Non-Substantive Changes**1. Definitions (Article I)**

A number of defined terms are being deleted from both the SPSP and SPSP-H Plans, either because the terms are not used elsewhere in the plans or are not applicable to the plans. In addition, it was necessary to add definitions, such as “Alternate Payee,” a term of art in federal law related to qualified domestic relations orders.

2. Correction of Administrative Errors (SPSP § 8.08, SPSP-H § 7.08)

This amendment removes the references to the Department of Labor, which has no jurisdiction over governmental retirement plans.

3. Other Non-Substantive Changes

The Plans are being amended to be easier to read and understand and to make the plan language of all City defined contribution plans consistent.

CONCLUSION

Most of the amendments contained in the proposed Amended and Restated SPSP Plan and SPSP-H Plan are intended to make the Plans more intelligible and user friendly for employees and City staff. All changes of substance are either legally required or intended to benefit the participants in the Plans. All of the City’s affected employee organizations have agreed to the substantive discretionary changes. The SPSP Plan participants have approved the discretionary amendments by a majority vote, as required by that Plan document.

Once the Amended and Restated SPSP and SPSP-H Plans have been approved by the City Council, they will be submitted to the IRS for determination letters affirming their tax-qualified status.

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By /s/Roxanne Story Parks
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