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THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: April 13, 2007

IBA Report Number: 07-43

City Council Docket Date: April 17, 2007

Item Number: S500

Subject: Request for Outside Legal Counsel to Resolve "Waterfall" Ordinance Issues

The second reading of a proposed ordinance to eliminate the "waterfall" provisions of the Municipal Code is scheduled for Tuesday, April 17, 2007. This ordinance was introduced on March 5, 2007, by the City Attorney and continued from April 10th to the 17th due to a number of questions that had been raised. Attached is a joint memo from Mayor Sanders and Council President Peters, dated April 5th, 2007, requesting further legal analysis of issues raised by several parties relative to the proposed ordinance.

Also attached is the response from the City Attorney dated April 9, 2007. Legal questions continue to be raised about the proposal. As mentioned in our March 1, 2007 report on this subject, our office 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 important for the Council to be aware of any potential impacts of enacting the ordinance as proposed. As this is a technical area of the law, our office recommends the City Council retain outside legal counsel to work with the City Attorney to resolve outstanding issues, address any unforeseen ramifications associated with its enactment, and prepare alternative ordinance language as determined necessary. We anticipate that costs will not exceed \$10,000.

Andrea Tevlin
Independent Budget Analyst

Attachments

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ATTORNEY TO CLIENT
CORRESPONDENCE

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Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

(619) 236-6220

DATE: April 9, 2007
TO: Mayor Jerry Sanders and Council President Scott Peters
FROM: City Attorney
SUBJECT: Response to Memorandum dated April 5, 2007

This office received a memorandum dated April 5, 2007 requesting a written legal analysis of the issues raised by SDCERS, Local 145 and the Independent Budget Analyst [IBA]. By way of a memorandum dated March 23, 2007, this office previously responded in writing to the issues raised by Local 145. With regard to the issues raised by the IBA, they were responded to both at Council Staff Docket Briefing as well as before Council at the first reading of the ordinance on March 5, 2007. Nonetheless and as redundant to those raised by SDCERS, they will be responded to herein.

Essentially, the concerns raised by both SDCERS and the IBA evolve around the belief that repeal of the "Waterfall" as presently codified in San Diego Municipal Code Section 24.1502 precludes SDCERS' ability to pay the annual supplemental benefit (13th check) and the *Corbett* benefit. Going further, SDCERS contends that repeal of Section 24.1502 would "result in the usurpation of the City's sole authority either to set, modify or rescind benefits." This office disagrees. The 13th check and *Corbett* benefits were created by contractual settlement agreements, not Municipal Code enactment. Whether, when and to whom these benefits have to be paid are thus governed by the terms of the settlement agreements that created these benefits. These agreements and their terms are binding on both the City and SDCERS, signatories to them. It is thus inaccurate to state that absent codification, SDCERS and the City have no duty to pay them, when and if due.

It is also inaccurate to state that the City has somehow abdicated its exclusive power to set benefits. The issue of repeal before Council is not an issue of setting benefits, but rather, finally, eliminating an improper funding vehicle for the payment of these benefits. The stated purpose of Section 24.1502 is to provide a funding vehicle for payment of these benefits. It is this

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impropriety that is sought to be eliminated. Its elimination will not impact the duty to pay any benefits the City and SDCERS are otherwise legally obligated to pay.

SDCERS' contention that its tax-qualified status is somehow jeopardized in the event of repeal of the Waterfall is misplaced. SDCERS has been provided with and continues to have available to it the formulae for calculating both the 13th check and *Corbett* settlement benefits. Repeal of Section 24.1502 does not alter both the contractual and statutory bases for benefit payment. By Charter provision, contractual settlements and Municipal Code (13th check), SDCERS is provided with the necessary terms and conditions upon which these benefits are to be paid. It is this backdrop to which the comments of this office before Council as referred to by SDCERS, were made. They were not made as blithely stated by SDCERS "regardless of whether the plan describes how and when the benefit is to be made". As conceded by SDCERS, it is the City as the plan sponsor that provides for the benefits and SDCERS that administers the benefits. It is this office's position that by both operation of law and fact, the benefits have been provided and SDCERS must administer them in accordance with fiduciary and constitutional principles. SDCERS has the tools and enablement to pay the benefits when due. Repeal of the Waterfall as codified in Section 25.1502 does not eliminate this.

In addition to the foregoing, SDCERS stated concern as to lack of guidance of how the 13th check will be paid is belied by Section 24.1503, which sets forth the definition of the beneficiary class and formulae for determination of the amount of benefit. Furthermore, Section 24.1503(c) specifically authorizes SDCERS to promulgate rules and regulations to effectuate the benefit and intent of Section 24.1503. SDCERS is thus provided both with the existence of the benefit, the methodology in which to calculate it, and the beneficiary class to whom to pay it to.

MICHAEL J. AGUIRRE, City Attorney

By



City Attorney

MJA:ap

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CITY CLERK OFFICE
SAN DIEGO, CA



CITY OF SAN DIEGO
MEMORANDUM

DATE: April 5, 2007

TO: Honorable City Attorney Michael Aguirre

FROM: Mayor Jerry Sanders *Jerry Sanders 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

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**OFFICE OF INDEPENDENT BUDGET ANALYST
CITY OF SAN DIEGO
M E M O R A N D U M**

No. 07-5

DATE: April 5, 2007

TO: Honorable Council President and Members of the City Council

FROM: Andrea Tevlin, Independent Budget Analyst *Andrea*

SUBJECT: Amending the San Diego Municipal Code to eliminate "The Waterfall"

On Tuesday, April 10, 2007 an ordinance to amend the Municipal Code to eliminate the Waterfall will return to the City Council for its second reading. The IBA is re-issuing our report of March 1, 2007, IBA Report 07-26 on this topic. As stated at that time, the IBA recommends that the City Council seek sufficient clarification on the items enumerated therein to ensure that this ordinance has the desired effects.

Attachment

THE CITY ATTORNEY

CITY OF SAN DIEGO

Michael J. Aguirre

CITY ATTORNEY

1200 THIRD AVENUE, SUITE 1620
SAN DIEGO, CALIFORNIA 92101-4178

TELEPHONE (619) 236-6220

FAX (619) 236-7215

February 2, 2007

REPORT TO THE HONORABLE
MAYOR AND CITY COUNCILAMENDMENTS TO THE SAN DIEGO MUNICIPAL CODE ELIMINATING THE
"WATERFALL"

The history of the "Waterfall", presently codified in San Diego Municipal Code Section 24.1502, is set forth in both the Vinson & Elkins report dated September 16, 2004 and Kroll report dated August 8, 2006.¹ Quoting from those reports:

"In 1980, the City passed Ordinance 0-15353 to increase benefits to retirees, whose pensions were deteriorating in value due to significant inflation. At the same time, SDCERS investments had produced more income than the 8% of assets that it assumed to be its long-term average return on assets. Rather than simply enacting an enhanced retirement benefit, the cost of which would be included in the SDCERS actuarial accrued liability (AAL) and eventually paid through increased City contributions to SDCERS, the City council passed Ordinance 0-15353 defining all investment earnings in excess of 8% as "Surplus Earnings" and directing that 50% of Surplus Earnings be used to pay enhanced retiree benefits.

In subsequent years, the City turned with increasing frequency to Surplus Earnings to fund a succession of benefits that it did not pay for directly. For example, in 1982, the City withdrew from the Social Security System. Under federal law, this required that it provide certain comparable benefits to retired employees, including medical benefits. Rather than pay insurance premiums from its own budget, however, the City enacted Ordinance 0-15758 (N.S.) (June 1, 1982) directing that the premiums be paid from SDCERS' Surplus Earnings. The retiree health benefit was paid directly out of Surplus Earnings from 1983 until 1992, when a determination was made that this violated federal tax regulations by improperly paying non-pension benefits from dedicated pension assets. In an attempt to avoid this compliance problem, the City and SDCERS developed a complicated mechanism of "bifurcated payments" to fund the healthcare benefit while continuing to avoid any outlay from the City

¹ Attached hereto.

budget. Thus, each year, the City paid the basic annual required contribution (ARC), with no additional amount for the post-retirement healthcare benefit.

This succession of benefits came to be known as the "Waterfall." The funding of the Waterfall is codified in San Diego Municipal Code § 24.1502, in which the order of these benefits is currently laid out as follows: (i) interest is credited to the contribution accounts of the Members, the City, and the Unified Port District at an interest rate determined by the Board; (ii) operating costs of SDCERS are paid; (iii) reserves are maintained at the discretion of the Board on the advice of its actuary; (iv) a proportional amount of Surplus Undistributed Earnings are credited to the Unified Port District; (v) post-retirement health care premiums are paid for the next fiscal year provided that in the next fiscal year the City contributes an equal amount into the 401(h) reserve and that this contribution is part of their normal employer contributions; (vi) the 13th check is paid if there is more than \$100,000 available for the purpose (if there is not enough, this amount is rolled over into subsequent years until the rolled-over amount combined with the current year's available funds exceed \$100,000); (vii) the contingent portion of the *Corbett* settlement is paid; and finally (viii) the Supplemental COLA is paid. In the event that there are Surplus Earnings remaining after the distribution listed above is completed, the remaining funds are credited to the Reserve for Employer Contributions for the sole and exclusive purpose of reducing the Retirement System Liability. The Ordinance treats Surplus Earnings as a windfall. Prior to the adoption of the Ordinance, all cash returns generated by SDCERS assets went to a reserve account."

In detailing the impropriety of the foregoing, the Vinson & Elkins report further stated: "[a] pension system derives its ability to pay benefits from three sources: employer contributions, employee contributions and earnings generated from such contributions when retained within the system and productively invested. In determining the level of employer and employee contributions necessary to achieve the goal of "generational equity" in a pension system, a critical component is the assumed rate of return on fund assets. The greater that rate, the less must be contributed by system participants to fund projected retirement benefits on a basis that remains stable over time as a percentage of payroll. Obviously, no one can predict with certainty the future returns that will be generated by a particular category of assets. Projected rates of returns, like many other actuarial calculations, are educated guesses derived from historical experience. They recognize the market performance will vary significantly from year to year but assume that returns from specific asset

categories will average out over time at close to historical levels. This, of course, means that above-average returns in some years will offset below-average returns in other years.

The Surplus Earnings concept ignores this long-term dynamic of actuarial projections. It evaluates returns on a year-by-year basis and treats all cash generated by system assets (beyond assumed rates of return) as free money. This, of course, flies in the face of the basic premise of actuarially assumed returns: they are rarely met for any individual year, but are expected to average out over time to the approximate projections. Therefore, the concept of "Surplus Earnings" is a misnomer. Unless and until it can be demonstrated that the actuary's projections are unrealistically conservative, all earnings are necessary to support the long-term viability of the system – none are truly "surplus" or "excess."

Eventually, the bill comes due in the form of additional required contributions. The diversion of amounts that would otherwise be added to system assets increases the gap between those assets and the system's projected liabilities: in actuarial terminology the "Unfunded Actuarial Accrued Liability" (UAAL). An amount calculated to amortize the UAAL is a component of the "actuarially required contribution [ARC] that must be paid each year by the plan sponsor (here the City) to avoid a funding shortfall. Thus, any increase in system underfunding must be paid back (with interest) by the plan sponsor over the amortization period of the UAAL."

As the above indicates, the very concept of Surplus Earnings is fundamentally flawed. Actuarially, it is contrary to the pension tenet that earnings in any given year generated in excess of actuarial assumptions are system assets to be retained to offset years in which investment returns decline. Usage of these assets also increases the UAAL. Further, an increase in the UAAL in turn increases the "Actuarially Required Contribution" [ARC], which is designed to pay off the amortized debt of the UAAL. Even though this substantial danger of using pension earnings as a spending or funding vehicle is elementary and widely known, it was nonetheless made abundantly clear to both the City and the SDCERS Board². Despite this express reaffirmation of the obvious, maintenance of the Waterfall to determine "Surplus Earnings" and its usage as a funding vehicle for payment for increased benefits and even contingent benefits continues unabated to this date.

² See letter dated April 16, 2002 from SDCERS outside counsel to SDCERS General Counsel and letter dated December 31, 2002 from Diann Shipione to P. Lamont Ewell. See also letter dated August 22, 1995 from Morrison & Foerster to Lawrence Grissom.

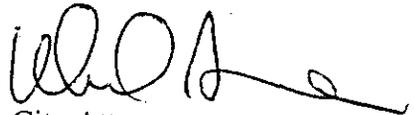
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In addition to violating fundamental actuarial principles, the concept of "Surplus Earnings" and maintenance of the Waterfall as a spending vehicle is violative of federal law. Federal tax law prohibits paying non-pension benefits from dedicated pension assets. (See *Internal Revenue Code § 401*). Section §24.1502 illegally earmarks system funds for payment of non-pension benefits such as healthcare benefits. Therefore, Municipal Code § 24.1502's diversion of retirement funds to pay for benefits outside the SDCERS retirement plan violates federal tax law.

In addition to violating fundamental actuarial principles and federal law, § 24.1502 also violates the California Constitution. The California courts have held that the California Constitution guarantees an "actuarially sound retirement system." (*Board of Administrators v. Wilson*, 52 Cal. App. 4th 1109, 1135 (1997)). Section 24.1502 relies on the concept of "Surplus Earnings," which again is not only actuarially unsound, but it unlawfully diverts pension assets to pay for non-pension benefits. Accordingly, Section 24.1502 violates the constitutional requirement of an "actuarially sound retirement system."

In light of the foregoing, the "Surplus Earnings" concept and Waterfall vehicle must be eliminated by repealing Section 24.1502 in its entirety. Further, all references to "Surplus Earnings" and "Waterfall" must be deleted from other Sections of the Municipal Code.

MICHAEL J. AGUIRRE



City Attorney

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RC-2007-2
(Re: O-2007-94)

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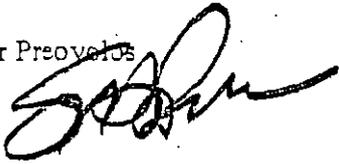


City of San Diego
COUNCIL PRESIDENT SCOTT PETERS
DISTRICT ONE

MEMORANDUM

DATE: June 13, 2006

TO: City Attorney Michael Aguirre
SDCERS Board President Peter Provelos

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(n) 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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CHRISTENSEN, GLASER, FINK, JACOBS, WEIL & SHAPIRO, LLP

10250 CONSTELLATION BOULEVARD
 NINETEENTH FLOOR
 LOS ANGELES, CALIFORNIA 90067
 310-553-3000
 FAX 310-556-2520

RECT DIAL NUMBER
 310-556-7832
 MAIL: JKLEVEN@CHRISGLABE.COM

March 8, 2007

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-Milias-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
Councilmembers:
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

ouncil President, Scott Peters

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Councilmembers:

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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JNK:cee

cc: City Attorney, Michael Aguirre



CHRISTOPHER W. WADDELL
General Counsel
(619) 525-3614
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.

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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. Prevolos, 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

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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

2/5/07

R-07-01

W:\ATTY\Resolutions\2007\Technical Tax Compliance Ordinance.doc



000051

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

202 C Street, MS 3A • San Diego, CA 92101

Tel (619) 236-6555 Fax (619) 236-6556

Attorney's Office, we understand that SDCERS has the right to use plan assets for their administrative budget under the California Constitution, even if this provision of the Municipal Code is eliminated, and therefore there should be no impact to SDCERS. We would note briefly, however, 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. This would seem to indicate that the City should consider, as an extra measure, insert appropriate language to authorize expenses for the operating budget in another section of the Municipal Code, in accordance with guidance from the City Attorney.

§24.1502(a)(3) Any Reserves Established by Board

It is our understanding that this section applies to the DROP Reserves in place, but that there are no other reserves established under this section at this time. The SDCERS Board has taken action to formally recognize the DROP assets and liabilities and these appear in the recent valuation. In addition, the Board has established an ad-hoc committee to study the issue of crediting interest to DROP accounts, which is understood to be under their purview as fiduciaries. Elimination of this section is therefore not expected to impact benefits to members or the finances of the City or System.

§24.1502(a)(4) Credit Surplus Earnings to Other Plan Sponsors

Since the concept of Surplus Earnings will no longer exist, there will be no surplus earnings to distribute to the various Plan Sponsors. Without the concept of Surplus Earnings and diversion of those earnings to other purposes, this section is unnecessary. The Board will continue to ensure, with the advice of their actuary and counsel, that total earnings are appropriately distributed among Plan sponsors, in accordance with their duty as fiduciaries.

§24.1502(a)(5) Retiree Health

In 2005, the City took the responsibility of funding retiree health benefits from its own funds. In addition, the reserve originally established to fund this benefit was completely drawn down at that time, and no further funds exist in this reserve. It is appropriate to eliminate any reference to retiree health as a financial obligation of the SDCERS Trust in the City's Municipal Code.

§24.1502(a)(6) 13th Check

This benefit will still exist, as provided for in §24.1503. However, this section only establishes the benefit and eligibility for it, but does not specify when it is to be paid. We have consulted with the City Attorney's Office on this and it is our understanding that this shall be clarified as soon as possible. Additionally, we would note that this payment has been assumed by SDCERS in their valuation of June 30, 2006, wherein the liabilities for the 13th check were included with the assumption that the benefit will be paid 100% of the time. Therefore, the ARC the City pays each year will provide assets to cover

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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.

CONCLUSION

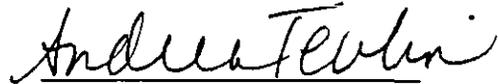
The IBA supports this effort to remove the Waterfall from the City's Municipal Code. In so doing, the faulty concept of Surplus Earnings will be eliminated from the City's code and operations. As discussed in the above, the IBA encourages the City Council to engage the City Attorney's counsel further on the following issues:

1. Shall the City Council insert authorizing language for payment of Corbett benefits and expenditure of funds for SDCERS operating budget elsewhere in the Municipal Code, to ensure that SDCERS may comply with IRS requirements to administer the System in accordance with Plan Documents?
2. Absent the qualifications in the Waterfall, what is the authority on when the 13th Check shall be paid out?
3. Regarding interest crediting to the Supplemental COLA Reserve, what constitutes "sufficient funds" and who is responsible for determining it?

With these minor clarifications in hand, the IBA supports this item in which the Waterfall and the concept of Surplus Earnings will be successfully removed from the City's Municipal Code in compliance with the City's Remediation Plan, the Internal Revenue Code, and the California Constitution, as referenced in the City Attorney's report.



Penni Takade
Deputy Director



APPROVED: Andrea Tevlin
Independent Budget Analyst

000055

From: <nsuserid@turing.sannet.gov>
To: <cityclerk@sandiego.gov>
Date: 4/13/07 5:13AM
Subject: San Diego City Council Meeting Agenda Comment Form

San Diego City Council Meeting Agenda Comment Form
Submitted on Friday, April 13, 2007 at 05:13:30

name: Larry A. Weckman

e-mail: lweckman@msn.com

address: 23466 Mount Lassen Way

city: Murrieta

state: ca

zip: 92562

areacode: 951

telephone: 696-1887

source: San Diego City Council Meeting Agenda Comment Form at
<http://www.sandiego.gov/city-council/docket-comment.shtml>

agendaitem: Item S500, April 17, 2007

comments: I strongly request that the City Council NOT APPROVE this item. This item was approved many years ago as a method (only if funds were available)of providing retiree's (particularly those with minimum retirement income)a supplemental benefit. I can guarentee that if the counil approves this the City will face a law suit on this matter

REMOTE_ADDR: 71.254.178.30

HTTP_USER_AGENT: Mozilla/4.0 (compatible; MSIE 7.0; Windows NT 5.1; AT&T CSM6.0; .NET CLR 1.1.4322; .NET CLR 2.0.50727; MSN 9.0;MSN 9.1; MSNbvZ02; MSNmen-us; MSNcOTH)

REQUEST FOR COUNCIL ACTION

CITY OF SAN DIEGO

1. CERTIFICATE NUMBER (FOR AUDITOR'S USE) **200**
5/14

TO: **000057**
CITY ATTORNEY

2. FROM (ORIGINATING DEPARTMENT):
CITY ATTORNEY

3. DATE:
January 29, 2007

4. SUBJECT:
AMENDMENTS TO SAN DIEGO MUNICIPAL CODE ELIMINATING THE "WATERFALL" AS CODIFIED IN SAN DIEGO MUNICIPAL CODE SECTION 24.1502 AND AS REFERRED TO IN SECTIONS 24.1503, 24.1504, AND 24.1507

5. PRIMARY CONTACT (NAME, PHONE, & MAIL STA.) 6. SECONDARY CONTACT (NAME, PHONE, & MAIL STA.) 7. CHECK BOX IF REPORT TO COUNCIL IS ATTACHED

MICHAEL J. AGUIRRE X66666 MS 59 Debora Buljat X66486 MS 59

8. COMPLETE FOR ACCOUNTING PURPOSES

FUND					9. ADDITIONAL INFORMATION / ESTIMATED COST:
DEPT.					
ORGANIZATION					
OBJECT ACCOUNT					
JOB ORDER					
C.I.P. NUMBER					
AMOUNT					

10. ROUTING AND APPROVALS

ROUTE (#)	APPROVING AUTHORITY	APPROVAL SIGNATURE	DATE SIGNED	ROUTE (#)	APPROVING AUTHORITY	APPROVAL SIGNATURE	DATE SIGNED
1	ORIG. DEPT			8	DEPUTY CHIEF		
2				9	COO		
3				10	CITY ATTORNEY		
4	LIAISON OFFICE			11	ORIG. DEPT		
5				DOCKET COORD: _____ COUNCIL LIAISON _____			
6				<input checked="" type="checkbox"/>	COUNCIL PRESIDENT	<input type="checkbox"/> SPOB <input type="checkbox"/> CONSENT <input checked="" type="checkbox"/> ADOPTION	
7					REFER TO: _____	COUNCIL DATE: 3/5/07	

11. PREPARATION OF: RESOLUTIONS ORDINANCE(S) AGREEMENT(S) DEED(S)

11A. STAFF RECOMMENDATIONS:

AMENDING THE SAN DIEGO MUNICIPAL CODE TO ELIMINATE THE CONCEPT OF THE "WATERFALL" AND ITS SOURCE AS A FUNDING VEHICLE FOR EMPLOYEE BENEFITS.

12. SPECIAL CONDITIONS (REFER TO A.R. 3.20 FOR INFORMATION ON COMPLETING THIS SECTION.)

COUNCIL DISTRICT(S): ALL

COMMUNITY AREA(S): ALL

ENVIRONMENTAL IMPACT: THIS ACTION IS NOT A "PROJECT" FOR PURPOSES OF CEQA

HOUSING IMPACT: N/A

OTHER ISSUES:

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ORDINANCE NUMBER O-_____ (NEW SERIES)

DATE OF FINAL PASSAGE _____

AN ORDINANCE AMENDING CHAPTER 2, ARTICLE 4, DIVISION 15, OF THE SAN DIEGO MUNICIPAL CODE, BY REPEALING SECTION 24.1502 AND AMENDING SECTIONS 24.1501, 24.1503, 24.1504, AND 24.1507 ALL RELATING TO THE "WATERFALL"

WHEREAS, in 1980, Ordinance number 0-15353 was adopted whereby 50% of the annual returns of SDCERS, to the extent those returns exceeded the actuarial assumed rate of return, were defined as "Surplus Earnings"; and

WHEREAS, subsequently, ordinances were adopted directing the payment of interest, expenses and benefits from the "Surplus Earnings" (commonly referred to as the "Waterfall"); and

WHEREAS, the concept of "Surplus Earnings" and payment of benefits has been universally criticized by the actuarial community as inconsistent with actuarial principles of funding of pension systems and long-term actuarial projections, and results in a diversion of pension assets and increase in the Unfunded Actuarially Accrued Liability and corresponding Actuarially Required Contribution; and

WHEREAS, the Waterfall is presently codified in San Diego Municipal Code Section 24.1502 and provides for funding of: (1) interest to be credited to the contribution accounts of the Members, the City, and the Unified Port District at an interest rate determined by the Board; (2) operating costs of SDCERS; (3) reserves maintained at the discretion of the Board on the advice of its actuary; (4) a proportional amount of Surplus Undistributed Earnings credited to the

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Unified Port District; (5) post-retirement health care premiums; (6) the contingent "13th check"; (7) a portion of the *Corbett* settlement; and (8) the Supplemental COLA.

WHEREAS, the foregoing is violative of federal tax law by allowing the payment of non-pension benefits from dedicated pension assets; and

WHEREAS, the foregoing is violative of state law guaranteeing an "actuarially sound retirement system."; and

WHEREAS, and therefore, San Diego Municipal Code section 24.1502 must be repealed and attendant sections referring or incorporating it be amended; NOW THEREFORE,

BE IT ORDAINED, by the Council of the City of San Diego, as follows:

Section 1. That Chapter 2, Article 4, Division 15, section 24.1501 of the San Diego Municipal Code is amended, to read as follows:

§24.1501 Investment Earnings Received

Investment Earnings Received shall be determined on a cash basis, except that Investment Earnings Received shall be increased or decreased by the amount of the annual amortization of purchase discounts or premiums on interest-bearing investments earned in accordance with generally accepted accounting principles for financial reporting purposes. No subsequent changes in the method of accounting for the Retirement System shall affect the determination of *Investment Earnings Received*. *Undistributed Earnings* shall be determined by the City Auditor and Comptroller in accordance with this Section and shall be certified by the City's independent public accountant.

Section 2. That Chapter 2, Article 4, Division 15, section 24.1502 of the San Diego Municipal Code is repealed.

Section 3. That Chapter 2, Article 4, Division 15, section 24.1503 of the San Diego

Municipal Code is amended, to read as follows:

§24.1503 Annual Supplemental Benefit - Qualification and Determination

The purpose and intent of this section is to provide necessary guidelines for effectuating the payment of annual supplemental benefits by (a) identifying and defining those retirees qualified to receive such benefit, and (b) establishing a method for determining the amount of the annual supplemental benefit.

- (a) For the purpose of identifying those retirees who shall be deemed qualified to receive the annual supplemental benefit established in this Section, the following criteria shall apply:
 - (1) The retiree must have completed a minimum of ten (10) years Creditable Service as a Member of the System in order to be qualified;
 - (2) The retiree must be on the retirement payroll for the month of October of any year in which benefits are to be paid except as provided otherwise in Section 3 of this ordinance for the first year's distribution;
 - (3) Qualified Retirees shall be limited to the following classes:
 - (A) Retired General and Safety Members;
 - (B) Retired Unified Port District Members; and
 - (C) Special Class Safety Members who are receiving fixed monthly retirement benefits; and
 - (D) Survivors of (a), (b) and (c) above receiving monthly pensions from the system, provided such members had met minimum continuous service requirement in subsection (a)(1) above.

- (4) Legislative and Special Class Safety Members who are receiving fluctuating monthly retirement benefits, and the survivors of both classes shall not be eligible for participation in the annual supplemental benefit program established by this Article.
 - (5) For the sole purpose of establishing eligibility for the Supplemental COLA described in Section 24.1504, Qualified Retirees may include those retirees with less than ten (10) years creditable service, including those who are receiving an industrial disability retirement from the System, those who have (10) years of continuous service with the System, survivors of Special Class Safety Members who are receiving fluctuating monthly retirement benefits, and survivors of special death benefit recipients.
- (b) For the purpose of determining the amount of the supplemental benefit payment to Qualified Retirees, the following process shall apply:
- (1) The Retirement Administrator each year shall identify all Qualified Retirees on the retirement payroll for the month of October.
 - (2) The Retirement Administrator shall then determine the number of years of creditable service possessed by each Qualified Retiree identified in 1. above.
 - (3) The number of creditable years for all Qualified Retirees shall be added together to determine the total sum of Qualified creditable years.
 - (4) In no event shall the per annum dollar value exceed \$30 (thirty dollars) except for those General Members who retired between January 8, 1982 and June 30, 1985, who shall be entitled to a per annum value not to exceed \$45 (forty-five dollars).

Notwithstanding the preceding paragraph, and effective Fiscal Year 1997, Qualified Retirees who retired on or before October 6, 1980, but after December 31, 1971, will receive \$60 (sixty dollars) per year of service and Qualified Retirees who retired on or before December 31, 1971, will receive \$75 (seventy-five dollars) per year of service.

- (5) The per annum dollar value shall then be multiplied by each Qualified Retiree's creditable service to determine the annual supplemental benefit to be paid each Qualified Retiree the following November.
 - (6) Except as provided in Section 24.1503(b)(7), the supplemental benefits of survivors of deceased Qualified Retirees, as defined in Section 24.1503(a), shall be determined in the same ratio as their monthly benefits bear to the monthly benefit received by their respective deceased retired spouses.
 - (7) The supplemental benefit of a survivor of a Qualified Special Class Safety Retiree shall be determined by allocating to the surviving spouse fifty percent (50%) of the qualified creditable years issued to the deceased Member.
- (c) The Board, with the cooperation and approval of the City Auditor and Comptroller, shall promulgate necessary rules to effectuate the provisions and intent of this Article.

Section 4. That Chapter 2, Article 4, Division 15, section 24.1504 of the San Diego Municipal Code is amended, to read as follows.

§24.1504 Supplemental COLA Program

The purpose of the Supplemental COLA Program is to increase the retirement benefit of certain Qualified Retirees as defined in Section 24.1503 by an amount sufficient to insure that their benefit as of July 1, 1998, when combined with their

Annual Supplemental Benefit as defined in Section 24.1503, is at a level equivalent to seventy-five percent (75%) of the present value of their Base Retirement Benefit. The amount of increase under this Section, however, shall not exceed fifty percent (50%) of the Qualified Retiree's benefit in effect as of July 1, 1998. For purposes of this section, the Base Retirement Benefit is the full monthly Retirement Allowance received upon retirement. The benefit in effect in July 1, 1998, is the benefit as defined in Section 24.0402, Section 24.0403 or Section 24.0405, as adjusted by both the Cost of Living Adjustment defined in Section 24.1505 and the Annual Supplemental Benefit, defined in Section 24.1503.

- (a) Participation in the Supplemental COLA Program shall be limited to Qualified Retirees as defined in Section 24.1503 or their survivors, including special death benefit recipients, who:
 - (1) Retired on or before June 30, 1982; and (2) Received a retirement allowance on July 1, 1998, which, as determined by the System's Actuary, was at a level less than the equivalent of 75% of the present value of their Base Retirement Benefit when combined with their Annual Supplemental Benefit as defined in Section 24.1503.
- (b) The amount to be paid as the Supplemental COLA benefit shall be calculated in accordance with the following procedures:
 - (1) The System's Actuary shall determine the factor necessary to calculate the equivalent of 75% of the present value of the Qualified Retiree's Base Retirement Benefit. This calculation shall be based on the Cost of Living Index as shown by the Bureau of Labor Statistics Consumer Price Index, United States - All items, for each applicable Fiscal Year.
 - (2) The above factor shall be multiplied times the Qualified Retiree's benefit in effect July 1, 1998, as defined above, but not including the Annual Supplemental Benefit, to determine the amount of the increase required under the Supplemental COLA Program.

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- (3) The amount of the increase to the Qualified Retiree's Base Retirement Benefit under the Supplemental COLA Program shall not exceed 50% of the Qualified Retiree's benefit in effect as of July 1, 1998.
 - (4) The payment for the increase to the Qualified Retiree's Base Retirement Benefit under the Supplemental COLA Program shall start in January, 1999, retroactive to July 1, 1998, with an amount for the months of July through December 1998 added to an increased January Retirement Allowance, and then monthly thereafter.
 - (5) The increase to the Qualified Retiree's Base Retirement Benefit calculated under the Supplemental COLA Program shall be paid to the Qualified Retiree or his or her survivor for life or until the Reserve established to pay this supplemental benefit is depleted.
 - (6) The Qualified Retiree's Retirement Allowance as increased by the Supplemental COLA Program shall be adjusted each July 1 thereafter in accordance with Sections 24.1505 and 24.1506.
- (c) A reserve created by the Board pursuant to Section 24.1502(a)(3) shall be used to pay for the Supplemental COLA benefit as follows:
- (1) The Reserve shall be credited with thirty-five million dollars (\$35,000,000) from Undistributed Earnings for the Fiscal Year ending June 30, 1998.
 - (2) Benefit payments under the Supplemental COLA Program shall be accounted for separately and charged against this Reserve.
 - (3) The Reserve shall be credit with interest annually, if sufficient funds are available.
 - (4) Benefit payments under the Supplemental COLA Program shall cease at such time as the Reserve is depleted.
- (d) Reevaluation.

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- (1) The System's Actuary shall conduct an annual evaluation of the Reserve to determine the feasibility of expanding the Supplemental COLA Program to including additional retirees and their survivors, additional Funds in the Reserve or the recalculation of benefits annually.
- (2) Prior to April 30th of each Fiscal Year, representatives of the City Manager's office, the Retirement Administrator, and representatives of eligible retired member of CERS, may meet to consider any recalculation of benefits, any increase in the number of Qualified Retirees or their survivors, or any increase in the Reserve created to pay the Supplemental COLA benefit. The factors for consideration are:
 - (A) The status of benefits of those retirees previously set at the 75% level;
 - (B) The status of benefits of those retirees previously capped at the 50% increase level;
 - (C) The status of retirees not previously eligible for the Supplemental COLA Program who now meet the necessary criteria;
 - (D) The amount of the Annual Supplemental Benefit to be combined with the benefit in effect July 1, 1999, or as part of the Base Retirement Benefit.

§24.1505 Cost of Living Adjustment Effective Date and Maximum Annual Change

- (a) The Board shall before July 1, 1971 and before each July 1 thereafter determine whether there has been an increase or decrease in the cost of living as provided in this section. Excepting those special class safety

members whose retirement allowances are based upon 1/2 the amount of the current salary of their retired rank, every person receiving a monthly retirement allowance from this system on June 30, 1971 and each June 30 thereafter shall, on and/or effective July 1, 1971 and each July 1 thereafter, have his or her monthly retirement allowance then being received increased or decreased by that percentage determined by the Board to approximate the nearest 1/10th of one percent of the percentage of annual increase or decrease in the cost of living which has occurred between the two previous January firsts, as shown by the Bureau of Labor Statistics Consumer Price Index, United States -- All items. Such change, however, shall not exceed 2.0% per year and no decrease shall reduce the monthly retirement allowance below the amount being received by any person on the effective date of his or her retirement or the effective date of the application of this section, whichever is later. The amount of any cost of living increase or decrease in any year which is not met by the maximum annual change of 2.0% in allowances shall be accumulated to be met by increase or decreases in allowances in future years.

- (b) The allowance of all persons who retired from the 1981 Plan shall be adjusted each July 1, following the third anniversary of the commencement of the allowance. The adjustment shall be equal to 50% of the change in the all Urban Consumer Price Index for the San Diego area — all items, except that such adjustment shall not exceed 10% annually. No adjustment shall reduce the allowance below the amount originally granted.

§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.

- (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.

Section 5. That Chapter 2, Article 4, Division 15, section 24.1507 of the San Diego Municipal Code is amended, to read as follows.

§24.1507 Employee Contribution Rate Reserve

- (a) The Retirement Board created a reserve to pay a portion of employee contributions (the "Employee Contribution Rate Reserve").
- (b) The Employee Contribution Rate Reserve was created with \$35,000,000 from Undistributed Earnings for the fiscal year that ended June 30, 1997.
- (c) The Employee Contribution Rate Reserve will be credited with interest annually, if sufficient funds are available.
- (d) The monies in the Employee Contribution Rate Reserve are not counted as part of System assets in the annual actuarial valuation.
- (e) The Auditor and Comptroller will certify annually the amount of the anticipated City Payroll for the next fiscal year. Based upon this certification, at the beginning of each fiscal year, the Auditor will transfer an amount equal to .65% of the total City payroll from the Employee Contribution Rate Reserve to the Employer Contributions Reserve.
- (f) On a biweekly basis, based upon actual biweekly payroll, the Auditor will

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transfer from the Employee Contribution Rate Reserve to the Employer Contributions Reserve:

- (1) an amount equal to 1.7% of the City payroll for Safety Members, starting at the beginning of the first full pay period after July 1, 2002,
 - (2) an amount equal to 1.6% of the City payroll for General Members, starting at the beginning of the first full pay period after July 1, 2003, and
 - (3) an amount equal to 1% of the City payroll for fire department and lifeguard employees who are Safety Members, starting at the beginning of the first full pay period after July 1, 2003.
- (g) The amounts listed in sections 24.1507(e) and 24.1507(f) are cumulative.
- (h) All transfers under section 24.1507 will be accounted for separately.
- (i) Transfers under section 24.1507 will continue as long as there are sufficient funds remaining in the reserve.

Section 6. That a full reading of this ordinance is dispensed with prior to its passage, a written or printed copy having been available to the City Council and the public a day prior to its final passage.

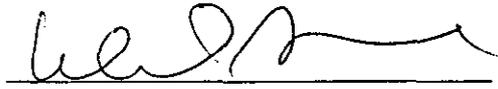
Section 7. That this ordinance shall take effect and be in force on the thirtieth day from and after its final passage.

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(O-2007-93)

APPROVED: MICHAEL J. AGUIRRE, City Attorney

By



Michael J. Aguirre
City Attorney

MJA:amp

01/29/07

Or.Dept:CityAtty

O-2007-93

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(O-2007-93)

I hereby certify that the foregoing Ordinance was passed by the Council of the City of San Diego, at this meeting of _____.

ELIZABETH S. MALAND
City Clerk

By _____
Deputy City Clerk

Approved: _____
(date)

JERRY SANDERS, Mayor

Vetoed: _____
(date)

JERRY SANDERS, Mayor

OLD LANGUAGE - ~~STRIKEOUT~~
 NEW LANGUAGE - UNDERLINED

STRIKEOUT ORDINANCE NUMBER O- _____ (NEW SERIES)

ADOPTED ON _____

AN ORDINANCE AMENDING CHAPTER 2, ARTICLE 4, DIVISION 15, OF THE SAN DIEGO MUNICIPAL CODE, BY REPEALING SECTION 24.1502 AND AMENDING SECTIONS 24.1501, 24.1503, 24.1504, AND 24.1507, ALL RELATING TO ELIMINATION OF THE "WATERFALL"

§24.1501 Investment Earnings Received

Investment Earnings Received shall be determined on a cash basis, except that Investment Earnings Received shall be increased or decreased by the amount of the annual amortization of purchase discounts or premiums on interest-bearing investments earned in accordance with generally accepted accounting principles for financial reporting purposes. No subsequent changes in the method of accounting for the Retirement System shall affect the determination of Investment Earnings Received. ~~Surplus~~ Undistributed Earnings shall be determined by the City Auditor and Comptroller in accordance with this Section and shall be certified by the City's independent public accountant.

~~§24.1502 Surplus Undistributed Earnings~~

- (a) ~~Surplus Undistributed Earnings are comprised of Investment Earnings Received for the previous fiscal year, less:~~
- (1) ~~An amount sufficient to credit interest to the contribution accounts of the Members, City and the Unified Port District at an interest rate determined by the Board and distributed in accordance with Section 24.0904 and related Board rules; and~~
 - (2) ~~An amount sufficient to meet the budgeted expenses and costs of operating the System including all personnel and services for the fiscal~~

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- (3) ~~An amount necessary to maintain such reserves as the Board deems appropriate on advice of its investment counselor and/or Actuary; and~~
- (4) ~~An amount sufficient to credit Unified Port District ("UPD") with a proportional share of Surplus Undistributed Earnings as defined in this Section; and~~
- (5) ~~An amount, (the Division 12 amount), appropriate to provide health benefits to Health Eligible and Non Health Eligible Retirees as provided in Division 12 for the next fiscal year provided:~~
 - (A) ~~in the next fiscal year, the City contributes to the 401(h) Fund no less than an equal amount which is designated to be used for retiree health benefits to be paid or reimbursed in the next fiscal year; and,~~
 - (B) ~~to the extent the City makes a contribution to the 401(h) Fund for the next fiscal year, the Division 12 amount shall be treated as a portion of normal employer contributions paid to the Retirement System when the City so designates in accordance with Section 24.1203(b)(5); and~~
- (6) ~~An amount sufficient to provide necessary funds to pay an annual supplemental benefit to Qualified Retirees, pursuant to the provisions and conditions set forth in Section 24.1503. If, at the time of the annual determination, the amount provided for the supplemental benefits is less than \$100,000, no supplemental benefits will be paid in that fiscal year and the monies will be placed in a special reserve and be carried forward to ensuing years until such time as the amount to be~~

~~provided for this benefit from ensuing Surplus Undistributed Earnings and the special reserve is \$100,000 or more; and~~

~~(7) An amount sufficient to increase the Base Retirement Benefit by 7% for all retired City employees and Beneficiaries who are covered by the Corbett Settlement.~~

~~(A) The right to receive this increase each year will accrue monthly. But, the increase will be paid annually when the Annual Supplemental Benefit (13th check) is normally distributed. The increase will be paid, on a prorated basis, to the Beneficiary or estate of any retiree who dies during the fiscal year but before the annual payment is made.~~

~~(B) To the extent this increase is not paid in any year because there are insufficient Surplus Undistributed Earnings, the liability for this increase will be carried forward as a contingent liability which will be paid in future years in which there are sufficient surplus Undistributed Earnings to pay for the increase.~~

~~(C) Liabilities carried forward will be paid in the order in which they accrued.~~

~~(8) An amount sufficient to credit interest to the reserves created for Supplemental COLA and Employee Contributions as set forth in this Division.~~

~~(b) At the beginning of each fiscal year, the Board will credit all Surplus Undistributed Earnings to the Reserve for Employer Contributions, for the sole and exclusive purpose of reducing Retirement System liability.~~

§24.1503 Annual Supplemental Benefit - Qualification and Determination

The purpose and intent of this section is to provide necessary guidelines for effectuating the payment of annual supplemental benefits ~~set forth in Section 24.1502(a)(6)~~, by (a) identifying and defining those retirees qualified to receive such benefit, and (b) establishing a method for determining the amount of the annual supplemental benefit.

- (a) For the purpose of identifying those retirees who shall be deemed qualified to receive the annual supplemental benefit established in this Section, the following criteria shall apply:
 - (1) The retiree must have completed a minimum of ten (10) years Creditable Service as a Member of the System in order to be qualified;
 - (2) The retiree must be on the retirement payroll for the month of October of any year in which benefits are to be paid except as provided otherwise in Section 3 of this ordinance for the first year's distribution;
 - (3) Qualified Retirees shall be limited to the following classes:
 - (A) Retired General and Safety Members;
 - (B) Retired Unified Port District Members; and
 - (C) Special Class Safety Members who are receiving fixed monthly retirement benefits; and
 - (D) Survivors of (a), (b) and (c) above receiving monthly pensions from the system, provided such members had met minimum continuous service requirement in subsection (a)(1) above.
 - (4) Legislative and Special Class Safety Members who are receiving fluctuating monthly retirement benefits, and the survivors of both classes

shall not be eligible for participation in the annual supplemental benefit program established by this Article.

- (5) For the sole purpose of establishing eligibility for the Supplemental COLA described in Section 24.1504, Qualified Retirees may include those retirees with less than ten (10) years creditable service, including those who are receiving an industrial disability retirement from the System, those who have (10) years of continuous service with the System, survivors of *Special Class Safety Members* who are receiving fluctuating monthly retirement benefits, and survivors of special death benefit recipients.
- (b) For the purpose of determining the amount of the supplemental benefit payment to Qualified Retirees, the following process shall apply:
 - (1) The Retirement Administrator each year shall identify all Qualified Retirees on the retirement payroll for the month of October.
 - (2) The Retirement Administrator shall then determine the number of years of creditable service possessed by each Qualified Retiree identified in 1. above.
 - (3) The number of creditable years for all Qualified Retirees shall be added together to determine the total sum of Qualified creditable years.
 - (4) ~~The total sum of qualified creditable years shall then be divided into the total of Surplus Undistributed Earnings designated for distribution by the Board pursuant to Section 24.1502(a)(6) of this Section to arrive at a per annum dollar value for each creditable year; provided, however, that In in no event shall the per annum dollar value exceed \$30 (thirty dollars) except for those General Members who retired between January 8, 1982 and June 30, 1985, who shall be entitled to a per annum value not to exceed \$45 (forty-five dollars).~~
Notwithstanding the preceding paragraph, and effective Fiscal Year 1997, Qualified Retirees who retired on or before October 6, 1980, but after

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December 31, 1971, will receive \$60 (sixty dollars) per year of service and Qualified Retirees who retired on or before December 31, 1971, will receive \$75 (seventy-five dollars) per year of service.

- (5) The per annum dollar value shall then be multiplied by each Qualified Retiree's creditable service to determine the annual supplemental benefit to be paid each Qualified Retiree the following November.
 - (6) Except as provided in Section 24.1503(b)(7), the supplemental benefits of survivors of deceased Qualified Retirees, as defined in Section 24.1503(a), shall be determined in the same ratio as their monthly benefits bear to the monthly benefit received by their respective deceased retired spouses.
 - (7) The supplemental benefit of a survivor of a Qualified Special Class Safety Retiree shall be determined by allocating to the surviving spouse fifty percent (50%) of the qualified creditable years issued to the deceased Member.
- (c) The Board, with the cooperation and approval of the City Auditor and Comptroller, shall promulgate necessary rules to effectuate the provisions and intent of this Article.

§24.1504 Supplemental COLA Program

The purpose of the Supplemental COLA Program is to increase the retirement benefit of certain Qualified Retirees as defined in Section 24.1503 by an amount sufficient to insure that their benefit as of July 1, 1998, when combined with their Annual Supplemental Benefit as defined in Section 24.1503, is at a level equivalent to seventy-five percent (75%) of the present value of their Base Retirement Benefit. The amount of increase under this Section, however, shall not exceed fifty percent (50%) of the Qualified Retiree's benefit in effect as of July 1, 1998. For purposes of this section, the Base Retirement Benefit is the full monthly Retirement Allowance received upon retirement. The benefit in effect in July 1,

1998, is the benefit as defined in Section 24.0402, Section 24.0403 or Section 24.0405, as adjusted by both the Cost of Living Adjustment defined in Section 24.1505 and the Annual Supplemental Benefit, defined in Section 24.1503.

- (a) Participation in the Supplemental COLA Program shall be limited to Qualified Retirees as defined in Section 24.1503 or their survivors, including special death benefit recipients, who:
 - (1) Retired on or before June 30, 1982; and (2) Received a retirement allowance on July 1, 1998, which, as determined by the System's Actuary, was at a level less than the equivalent of 75% of the present value of their Base Retirement Benefit when combined with their Annual Supplemental Benefit as defined in Section 24.1503.
- (b) The amount to be paid as the Supplemental COLA benefit shall be calculated in accordance with the following procedures:
 - (1) The System's Actuary shall determine the factor necessary to calculate the equivalent of 75% of the present value of the Qualified Retiree's Base Retirement Benefit. This calculation shall be based on the Cost of Living Index as shown by the Bureau of Labor Statistics Consumer Price Index, United States - All items, for each applicable Fiscal Year.
 - (2) The above factor shall be multiplied times the Qualified Retiree's benefit in effect July 1, 1998, as defined above, but not including the Annual Supplemental Benefit, to determine the amount of the increase required under the Supplemental COLA Program.
 - (3) The amount of the increase to the Qualified Retiree's Base Retirement Benefit under the Supplemental COLA Program shall not exceed 50% of the Qualified Retiree's benefit in effect as of July 1, 1998.

- (4) The payment for the increase to the Qualified Retiree's Base Retirement Benefit under the Supplemental COLA Program shall start in January, 1999, retroactive to July 1, 1998, with an amount for the months of July through December 1998 added to an increased January Retirement Allowance, and then monthly thereafter.
 - (5) The increase to the Qualified Retiree's Base Retirement Benefit calculated under the Supplemental COLA Program shall be paid to the Qualified Retiree or his or her survivor for life or until the Reserve established to pay this supplemental benefit is depleted.
 - (6) The Qualified Retiree's Retirement Allowance as increased by the Supplemental COLA Program shall be adjusted each July 1 thereafter in accordance with Sections 24.1505 and 24.1506.
- (c) A reserve created by the Board pursuant to Section 24.1502(a)(3) shall be used to pay for the Supplemental COLA benefit as follows:
- (1) The Reserve shall be credited with thirty-five million dollars (\$35,000,000) from Undistributed Earnings for the Fiscal Year ending June 30, 1998.
 - (2) Benefit payments under the Supplemental COLA Program shall be accounted for separately and charged against this Reserve.
 - (3) The Reserve shall be credit with interest annually, if sufficient funds are available, ~~in accordance with Section 24.1502(a)(7).~~
 - (4) Benefit payments under the Supplemental COLA Program shall cease at such time as the Reserve is depleted.
- (d) Reevaluation.
- (1) The System's Actuary shall conduct an annual evaluation of the Reserve to determine the feasibility of expanding the Supplemental COLA Program to including additional retirees and their survivors, additional Funds in the Reserve or the recalculation of benefits annually.

- (2) Prior to April 30th of each Fiscal Year, representatives of the City Manager's office, the Retirement Administrator, and representatives of eligible retired member of CERS, may meet to consider any recalculation of benefits, any increase in the number of Qualified Retirees or their survivors, or any increase in the Reserve created to pay the Supplemental COLA benefit. The factors for consideration are:
- (A) The status of benefits of those retirees previously set at the 75% level;
 - (B) The status of benefits of those retirees previously capped at the 50% increase level;
 - (C) The status of retirees not previously eligible for the Supplemental COLA Program who now meet the necessary criteria;
 - ~~(D)~~ The amount of Surplus Undistributed Earnings available to provide such additional benefits;
 - (D) ~~(E)~~ The amount of the Annual Supplemental Benefit to be combined with the benefit in effect July 1, 1999, or as part of the Base Retirement Benefit.

§24.1505 Cost of Living Adjustment Effective Date and Maximum Annual Change

- (a) The Board shall before July 1, 1971 and before each July 1 thereafter determine whether there has been an increase or decrease in the cost of living as provided in this section. Excepting those special class safety members whose retirement allowances are based upon 1/2 the amount of the current salary of their retired rank, every person receiving a monthly retirement allowance from this system on June 30, 1971 and each June 30 thereafter shall, on and/or effective July 1, 1971 and each July 1 thereafter, have his or

her monthly retirement allowance then being received increased or decreased by that percentage determined by the Board to approximate the nearest 1/10th of one percent of the percentage of annual increase or decrease in the cost of living which has occurred between the two previous January firsts, as shown by the Bureau of Labor Statistics Consumer Price Index, United States--All items. Such change, however, shall not exceed 2.0% per year and no decrease shall reduce the monthly retirement allowance below the amount being received by any person on the effective date of his or her retirement or the effective date of the application of this section, whichever is later. The amount of any cost of living increase or decrease in any year which is not met by the maximum annual change of 2.0% in allowances shall be accumulated to be met by increase or decreases in allowances in future years.

- (b) The allowance of all persons who retired from the 1981 Plan shall be adjusted each July 1, following the third anniversary of the commencement of the allowance. The adjustment shall be equal to 50% of the change in the all Urban Consumer Price Index for the San Diego area — all items, except that such adjustment shall not exceed 10% annually. No adjustment shall reduce the allowance below the amount originally granted.

§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.

- (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.

§24.1507 Employee Contribution Rate Reserve

- (a) The Retirement Board created a reserve ~~under section 24.1502(a)(3)~~ to pay a portion of employee contributions (the "Employee Contribution Rate Reserve").
- (b) The Employee Contribution Rate Reserve was created with \$35,000,000 from Undistributed Earnings for the fiscal year that ended June 30, 1997.
- (c) The Employee Contribution Rate Reserve will be credited with interest annually, if sufficient funds are available, ~~in accordance with section 24.1502(a)(7)~~.
- (d) The monies in the Employee Contribution Rate Reserve are not counted as part of System assets in the annual actuarial valuation.
- (e) The Auditor and Comptroller will certify annually the amount of the anticipated City Payroll for the next fiscal year. Based upon this certification, at the beginning of each fiscal year, the Auditor will transfer an amount equal to .65% of the total City payroll from the Employee Contribution Rate

Reserve to the Employer Contributions Reserve.

- (f) On a biweekly basis, based upon actual biweekly payroll, the Auditor will transfer from the Employee Contribution Rate Reserve to the Employer Contributions Reserve:
- (1) an amount equal to 1.7% of the City payroll for Safety Members, starting at the beginning of the first full pay period after July 1, 2002,
 - (2) an amount equal to 1.6% of the City payroll for General Members, starting at the beginning of the first full pay period after July 1, 2003, and
 - (3) an amount equal to 1% of the City payroll for fire department and lifeguard employees who are Safety Members, starting at the beginning of the first full pay period after July 1, 2003.
- (g) The amounts listed in sections 24.1507(e) and 24.1507(f) are cumulative.
- (h) All transfers under section 24.1507 will be accounted for separately.
- (i) Transfers under section 24.1507 will continue as long as there are sufficient funds remaining in the reserve.

MJA:ap
1/29/2007
Or.Dept:City Atty
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