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July 11, 2008

Scott H. Peters
Council President
City of San Diego
202 C Street, 10th Floor
San Diego, CA 92101

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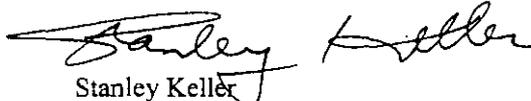
Dear Council President Peters:

You have asked for my views on the alternative ordinances docketed for consideration by City Council on July 15, 2008 to address elimination of the surplus earnings concept (known as the "waterfall") in determining the City's pension obligations. The waterfall is a discredited methodology for dealing with pension benefits that was used by the City.

In my First Annual Report as Independent Consultant I recommended that the City act promptly to eliminate from the applicable ordinance the "waterfall" provision that provides for payment of pension benefits from so-called "surplus earnings." The City has made some progress in reaching a consensus on an ordinance to eliminate the "waterfall" provision. However, there are still alternative ordinances with the differences relating primarily to the treatment of the benefits to be provided. One version, Alternative A, has been referred to as the SDCERS ordinance, with some changes suggested by me; the other, Alternative B, is the City Attorney's version.

I have reviewed the Independent Budget Analyst's Report (No. 08-72) issued July 9 describing the differences between the two ordinances and generally agree with the observations in that Report. Specifically, in my judgment, either version of the ordinance satisfactorily addresses elimination of the "waterfall" provision. Alternative A, although longer and more detailed, can be described as taking a minimalist approach but just making changes necessary to eliminate the waterfall. Alternative B eliminates the waterfall and also eliminates certain contingencies that were related primarily to use of the waterfall concept. Alternative B also presents some technical issues identified in the IBA Report. I take no position on which alternative ordinance should be adopted because it is up to the City to determine what benefits should be provided and what contingencies should be preserved, so long as the benefits are properly recognized as liabilities of the City. What is important is that action be taken promptly to eliminate the "waterfall" provision without further delay. The differences between the two versions are clear and the City Council should be in a position to decide how best to proceed.

Very truly yours,


Stanley Keller
Independent Consultant

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City of San Diego

MEMORANDUM

DATE: April 25, 2008
TO: Honorable Mayor Jerry Sanders and City Councilmembers
FROM: Council President Scott Peters *Elizabeth Kinsley for SHP*
SUBJECT: Item 331: Amendments to the San Diego Municipal Code Eliminating the Surplus Undistributed Earnings Relating to SDCERS

Attached is revised version A of the ordinance for Item 331: Amendments to the San Diego Municipal Code Eliminating the Surplus Undistributed Earnings Relating to SDCERS. The revised version has also been included in the docket backup.

Thank you.

SHP: wjs

CC: Honorable City Attorney Michael Aguirre
Jay Goldstone, Chief Operating Officer
Andrea Tevlin, Independent Budget Analyst
Mary Lewis, Chief Financial Officer
David Wescoe, Retirement Administrator

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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 AND ADDING SECTIONS 24.1501 AND 24.1502, AMENDING SECTIONS 24.1503 AND 1504, AND ADDING SECTION 24.1503.5, AND REPEALING SECTION 24.1507, ALL RELATING TO "SURPLUS EARNINGS" AND 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," when used in a defined benefit public pension plan, and the use of pension assets to fund non-pension benefits has been criticized by the actuarial community as inconsistent with sound actuarial principles, and results in an increase in the Unfunded Actuarially Accrued Liability and corresponding Annual Required Contributions; and

WHEREAS, the concept of "Surplus Earnings" and its vehicle commonly referred to as 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 by the Board on the

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advice of its actuary; (4) a proportional amount of Surplus Undistributed Earnings credited to the 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; and

WHEREAS, certain uses of "Surplus Earnings" are inconsistent with federal tax law to the extent they allow the payment of non-pension benefits from dedicated pension assets; and

WHEREAS, certain uses of "Surplus Earnings" are inconsistent with the goal of state law to assure the competency of the assets of the retirement system to meet promised retirement benefits and to ensure an actuarially sound retirement system; and

WHEREAS, it is the intent of the Council of the City of San Diego to ensure that the benefits referenced in San Diego Municipal Code section 24.1502 be actuarially accounted for as a retirement system liability and accordingly be calculated in the City's Annual Required Contribution; and

WHEREAS, and therefore, San Diego Municipal Code section 24.1502 and attendant sections referring or incorporating it must 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 is repealed.

Section 2: That Chapter 2, Article 3, Division 15, section 24.1501 is added to read as follows:

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24.1501 Elimination of "Surplus Earnings"

It is the intent of this Division that the concept of "Surplus Earnings" be eliminated, that payments previously made from "Surplus Earnings" be made instead from plan assets, and that liabilities associated with any benefit transfers from system assets be reflected in the system's liabilities and included in the actuarial calculation of the Annual Required City Contribution.

Section 3: That Chapter 2, Article 4, Division 15, section 24.1502 is repealed.

Section 4: That Chapter 2, Article 3, Division 15, section 24.1502 is added to read as follows:

§24.1502 Transfers Made From Plan Assets

(a) The following amounts shall be transferred as set forth below from plan assets as determined by the Board:

- (1) An amount sufficient to credit interest to the contribution accounts of the Members, City, Regional Airport Authority 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 year.

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- (3) An amount sufficient to pay the Annual Supplemental Benefit (13th Check) to Qualified Retirees, pursuant to the provisions and conditions set forth in Section 24.1503
- (4) 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, pursuant to the provisions and conditions set forth in Section 24.1503.5.
- (5) An amount sufficient to credit interest to the reserves created for the Supplemental COLA as set forth in this Division.

Section 5: That Chapter 2, Article 3, Division 15. section 24.1503 is amended, to read as follows:

§24.1503 Annual Supplemental Benefit (13th Check)-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)(3), 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.

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- (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 product of a formula that consists of investment earnings received less the sum of the amounts specified in Section 24.1502(a)(1), (a)(2), and (a)(3) to arrive at a per annum dollar value for each creditable year; provided, however, that 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.
 - (8) If, at the time of the annual determination, the amount determined by the formula as set forth in Section 24.1503(b)(4) is less than \$100,000, no supplemental benefits will be paid in that fiscal year and the amount determined by the formula in Section 24.1503(b)(4) will be carried forward to ensuing years until such time as the amount to be provided for this benefit as determined by the formula set forth in Section 24.1503(b)(4) for that year and the amount carried forward from prior years is \$100,000 or more.
- (c) The Board shall promulgate necessary rules to effectuate the provisions and intent of this Article.

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Section 6: That Chapter 2, Article 3, Division 15. section 24.1503.5 is added to read as follows:

24.1503.5 Corbett Settlement Increase-Qualification and Determination

The right to receive the Corbett Settlement Increase set forth in Section 24.1502 (a)(4) 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. The Corbett Settlement Increase will not be paid in any year in which the Annual Supplemental Benefit (13th Check) is not paid, but the liability for the increase will be carried forward as a contingent liability that will be paid when the Annual Supplemental Benefit is again paid.

Section 5: 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.
- (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) (5) 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 credited with interest annually, if the total of the amounts transferred pursuant to Sections 24.1502 (1), (2), (3) and (4) are less than investment *earnings received in that year, in accordance with Section 24.0904 and related Board rules.*
 - (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 include 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;

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(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.

Section 6: That Chapter 2, Article 4, Division 15, section 24.1507 is repealed.
24.1505 No change.
24.1506 No change.



City of San Diego
COUNCIL PRESIDENT SCOTT PETERS
DISTRICT ONE

MEMORANDUM

DATE: April 8, 2008
TO: Honorable Mayor and Councilmembers
FROM: Council President Scott Peters
SUBJECT: Request to Docket the "Waterfall" issue

A handwritten signature in black ink, appearing to be "SP", written over the "FROM" line of the memorandum.

I have scheduled the elimination of surplus undistributed earnings ("Waterfall") issue for City Council consideration on the April 28/29, 2008 agenda.

On June 5, 2007, the City Council heard City Attorney and SDCERS proposals to eliminate the waterfall. The City Council voted to direct the City Attorney to prepare the ordinances necessary to eliminate the "Waterfall" in the San Diego Municipal Code consistent with the language proposed by San Diego Employees Retirement System ("SDCERS") and the Independent Budget Analyst ("IBA"). To this date, I have submitted three previous memoranda requesting the City Attorney's assistance with this issue and have not received any docketing materials consistent with the City Council request.

Recently, the annual report from the City's SEC Independent Oversight Monitor recommended the discontinuation of SDCERS' use of surplus undistributed earnings. It is prudent that the City Council resolve this issue and make any necessary changes to the San Diego Municipal Code.

On April 28/29th, the City Council will need to consider approving the ordinance language proposed by either the IBA and SDCERS (Version "A") or City Attorney's suggested ordinance (Version "B"). Both ordinances are attached for your review.

If the Council votes to approve Version A, the City Attorney could be directed to prepare the ordinance for the Mayor's signature within a set period of time or the City Council may move forward with outside counsel assistance in the drafting of this ordinance.

The goal is to eliminate the Waterfall as suggested by the SEC independent monitor, IBA and SDCERS. The City Attorney's Version B is problematic in that that it will result in an immediate change – probably an increase – in employee benefits outside of the bargaining

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process. SDCERS also contends that the City Attorney's proposal would eliminate the mechanism for their calculation and administration of the benefits in question.

I look forward to discussing this issue with all of you and reaching a resolution.

Attachments

SHP:wjs

CC: Jay Goldstone, Chief Operating Officer
Andrea Tevlin, Independent Budget Analyst
David Wescoe, SDCERS Retirement Administrator
Mary Lewis, Chief Financial Officer

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City of San Diego
COUNCIL PRESIDENT SCOTT PETERS
DISTRICT ONE

MEMORANDUM

DATE: November 8, 2007
TO: Honorable City Attorney Michael Aguirre
FROM: Council President Scott Peters
SUBJECT: Follow up on the "Waterfall" item

A handwritten signature in black ink, appearing to be "Scott Peters", written over the "TO:" and "FROM:" lines of the memorandum.

I recently received your request to docket an ordinance to eliminate the "Waterfall" in the San Diego Municipal Code ("SDMC"). On June 5, 2007, the Council directed the City Attorney to prepare the resolution necessary to eliminate the "Waterfall" in the San Diego Municipal Code, without changing existing benefits, consistent with the language proposed by San Diego Employees Retirement System ("SDCERS") and the Independent Budget Analyst ("IBA"). The language you have submitted is problematic in that that it will result in an immediate change – probably an increase – in employee benefits outside of the bargaining process.

The city is not now legally required to pay the 13th check and the supplemental COLA in years in which pension earnings fall below 8%. The Corbett payments are also deferred in those years with no interest due, which is also a financial benefit to the city. The employee unions argue that simply striking out all of the municipal code language referring to the contingent benefits, as your suggested code changes would do, removes the contingency and makes the city liable for full payment of those benefits every year. On the other hand, SDCERS states that without the municipal code language you hope to eliminate, they could not pay the benefits at all since there would be no mechanism for their calculation and administration. Either way, changing these benefits outside of the bargaining process will subject the city to unnecessary costs and/or more litigation.

Previously, the 13th Check, the Corbett Settlement, Supplemental COLA were not included in the system's total actuarial liability. Accurately reporting the pension deficit is no longer an issue. For purposes of calculating the pension debt and the City's actuarially required contribution ("ARC"), the retirement system already accounts for contingent benefits -- the Corbett Settlement (pre-July 1, 2000 retirees) and the "13th check" to eligible retirees -- as though the City pays out those benefits every year. Although the City and SDCERS has corrected the actuarial valuation, the City's municipal code must be changed to eliminate the mechanism for SDCERS to use the system's surplus earnings.

Previously, SDCERS, the IBA and lawyers in your office agreed on code language that would satisfy all concerns. However, the ordinance you have submitted is inconsistent with this agreement.

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Attached are my two previous memoranda requesting your assistance on this issue. I again respectfully request that you submit the appropriate items consistent with the Council's direction at the earliest possible date, or I will be forced to recommend that the Council seek outside counsel's assistance on this matter.

SHP:wjs

Attachments

CC: Honorable Mayor and City Councilmembers
Jay Goldstone, Chief Operating Officer
Andrea Tevlin, Independent Budget Analyst
David Wescoe, SDCERS Retirement Administrator

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City of San Diego
COUNCIL PRESIDENT SCOTT PETERS
DISTRICT ONE

MEMORANDUM

DATE: August 27, 2007
TO: Honorable City Attorney Michael Aguirre
FROM: Council President Scott Peters
SUBJECT: Follow up on the "Waterfall" item

This is a follow up to my memorandum to you on June 19, 2007 requesting for your assistance on preparing the appropriate resolution to eliminating the "Waterfall" in the San Diego Municipal Code ("SDMC") consistent with the alternative language proposed by San Diego Employees Retirement System ("SDCERS") and the Independent Budget Analyst ("IBA") as directed by the City Council on June 5, 2007.

To this date, I have not received any docketing materials from your office regarding this issue. The City Council's direction on the June 5th date was for the City Attorney's Office to prepare the appropriate resolution and return it back to the Council within 30 days of this date.

Amending the SDMC to eliminate the "Waterfall" practice has been a goal of your's, my council colleagues and mine because it will enhance the soundness of the pension system for several years. Therefore, I again respectfully request that you submit the appropriate items consistent with the council's direction to your office on June 5, 2007 so that the item may be docketed at a City Council meeting at the earliest possible date. I look forward to working with you on this matter. Thank you.

SHP:wjs

CC: Honorable Mayor and City Councilmembers
Andrea Tevlin, Independent Budget Analyst
Jay Goldstone, Chief Financial Officer
David Wescoc, SDCERS Retirement Administrator

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Council President Scott Peters
City of San Diego

MEMORANDUM

TO: City Attorney Michael Aguirre
FROM: Council President Scott Peters
DATE: June 19, 2007
SUBJECT: Docketing of the "Waterfall" Item

On June 5th, the City Council returned an item entitled "Second Reading of Amendments to San Diego Municipal Code Eliminating the "Waterfall" as Codified in San Diego Municipal Code" to your office and directed that the City Attorney prepare an item, consistent with the alternative language proposed by SDCERS and the IBA, and return to the Council within 30 days.

To be consistent with that direction, this item would need to be heard the week of June 25th. As your staff has been made aware, the paperwork for docketing this item was due to my office last Wednesday, June 13, 2007. To date, nothing has been submitted by your office.

At this point, to hear the item on June 25, 2007 would require supplemental docketing because you have not met the noticing requirements for the regular City Council agenda. In an effort to provide the public and Council with adequate time to review these materials, I am willing to docket the item on July 10, 2007. Please submit all required paperwork to my office no later than Wednesday, June 27, 2007.

SHP: ms

cc. Honorable Mayor & City Councilmembers
City Clerk Elizabeth Maland
Independent Budget Analyst Andrea Tevlin

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THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: May 22, 2008

IBA Report Number: 08-55

City Council Meeting Date: May 27, 2008

Item Number: 330

The Waterfall

Amendments to the San Diego Municipal Code Eliminating the Surplus Undistributed Earnings ("Waterfall") Relating to the City Employees' Retirement System.

OVERVIEW

The City Council has had several previous discussions on the elimination of the "Waterfall" (see IBA Reports 07-43, 07-59 and memo 07-5), culminating most recently in direction, on June 5, 2007, to the City Attorney to develop an appropriate ordinance. To-date, this has not been done. This matter has become increasingly time sensitive however, as the SEC Independent Consultant, Stan Keller, has recommended that the City of San Diego act upon the Waterfall ordinance within 30 days of his first annual report to the SEC, presented to the City Council on April 1, 2008. For the City Council docket of April 29, 2008, the Council President docketed two ordinances for Council consideration, one ("Version A") reflecting the direction of the City Council last June and the second ("Version B") reflecting the City Attorney's original position. However, this item was continued from that hearing date as the City Attorney was working to modify Version B. A revised Version B has been submitted and this report discusses the two versions, pointing out their significant differences.

FISCAL/POLICY DISCUSSION

The IBA believes both versions accomplish the intended action to eliminate the surplus earnings concept and reform the Municipal Code. However, that is achieved in different ways by the two versions. There are two main differences: their treatment of the *Corbett* benefit and 13th check, and treatment of the Supplemental COLA.



Office of Independent Budget Analyst

202 C Street, MS 3A • San Diego, CA 92101
Tel (619) 236-6555 Fax (619) 236-6556

Corbett and 13th Check

With regard to these two benefits, the main difference in the versions is that A preserves the contingency of the benefits, while B makes the benefits non-contingent, and payable each year. This is because Version B eliminates any "test" to determine if there are funds available to pay the benefit. Without a test, the benefit is always paid. In Version A, the test has been changed to eliminate any reference to surplus earnings, and instead creates an alternate test based upon the amount of investment earning, less the amount to credit interest to member and plan sponsor contribution accounts and administration expenses. If earnings remain after this, benefits may be paid from fund assets as specified.

Supplemental COLA

Version A continues the Supplemental COLA reserve and the payment of that benefit. However, the amount in the reserve is ever-decreasing and, depending on the benefited population's experience, it is expected that the reserve will be depleted in the future, but likely not for a number of years.

Version B discontinues the reserve but continues the benefit for a period of three years. After this time, the benefit will end and any monies previously attributed to the reserve will simply be retained as part of the trust assets. As described by the City Attorney's Office this enables the funds previously diverted due to the "surplus earnings" concept to be returned to the trust, where it otherwise would have been had the Waterfall not existed.

The IBA wishes to point out that there are currently 954 individuals receiving the Supplemental COLA, for whom this benefit will be eliminated in three years, should Version B be approved. In addition to noting this impact on retirees, the IBA questions whether or not the Supplemental COLA is a vested benefit that, until the funding is completely depleted, could not be rescinded. The IBA requests the City Attorney to provide an opinion on this question.

Charter Section 143.1(a)

In light of the above discussion, the IBA notes that it appears that Version B would change benefits for members. In the case of the 13th check, more benefits may actually be paid out than might otherwise be the case, since the benefit is no longer contingent and would always be paid. Conversely, even if the Supplemental COLA is not a vested benefit and may be discontinued, that would appear to reduce benefits to members. Charter Section 143.1(a) requires the approval of a majority vote of the affected members when benefits are *changed*. In addition, under the same section an *increase* in benefits requires the approval of the voters. The IBA requests that the City Attorney opine as to the applicability of these Charter requirements in this situation.

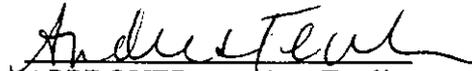
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CONCLUSION

Based on the above information and conversations with staff, the IBA understands that both versions would accomplish the stated intent of eliminating the Waterfall and neither would have further ramifications of which the IBA is aware, beyond those discussed here. However, we wish to ensure that Council is aware of the differences, including the elimination of the *Corbett* and 13th check contingency in Version B as well as the discontinuation of the Supplemental COLA benefit in 2011, also in Version B.



Penni Takade
Deputy Director



APPROVED: Andrea Tevlin
Independent Budget Analyst



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THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: May 31, 2007

IBA Report Number: 07-59

City Council Docket Date: June 5, 2007

Item Number: 331

Subject: Amendments to the San Diego Municipal Code Eliminating the Surplus Undistributed Earnings ("Waterfall") as Codified in San Diego Municipal Code Section 24.1502 and as Referred to in Sections 24.1501, 24.1503, 24.1504, and 24.1507, all relating to the City Employees' Retirement System.

OVERVIEW

This item is the second reading of the ordinance that will 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 concept of Surplus Undistributed Earnings have been broadly disapproved of and appropriate revision of these Municipal Code sections will be consistent with provisions of the City Remediation Plan, California Constitution and Internal Revenue Code.

FISCAL/POLICY DISCUSSION

The IBA has several concerns with this ordinance, which we raised in detail in IBA Report 07-26 (attached). Since we raised these concerns upon the first reading of the ordinance, we have endeavored to collaborate with various stakeholders to develop a modified ordinance that would address concerns while still achieving the appropriate repeal of the "Waterfall" and concept of Surplus Undistributed Earnings, as is supported by all parties.

Over the course of the past month, alternative Municipal Code language was developed that we believe adequately addresses the concerns that were raised by ourselves and other parties. That alternative Municipal Code language is attached for information purposes. The IBA worked closely with SDCERS to formulate language and presented drafts to the Mayor's Office for review and comment as well. It is important to note that the City Attorney's Office was requested to participate from the beginning as a key participant in this collaboration and we were optimistic about coming to a joint resolution. However the City Attorney ultimately rejected the proposal that was developed.



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The IBA remains concerned about the potential impacts of the docketed ordinance as described in our original report. We believe alternative language can satisfy the objectives of this ordinance while avoiding potential negative ramifications and addressing the concerns that various stakeholders have raised throughout this process. Therefore, we recommend that the City Council not approve the docketed ordinance and seek to have more comprehensive language submitted for review and approval.

CONCLUSION

We strongly recommend that the City Council not approve this item as proposed and that the docketed ordinance be returned to the City Attorney. We suggest that the City Council direct the City Attorney to review and docket the alternative language within 30 business days in order to address the valid concerns raised by various stakeholders.



Penni Takade
Deputy Director



APPROVED: Andrea Tevlin
Independent Budget Analyst

Attachments:

1. IBA Report 07-26
2. Draft of alternative Municipal Code language



000699

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



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Attachment 1

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

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

§24.1502(a)(7) Corbett Settlement

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

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

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

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

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

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

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

CONCLUSION

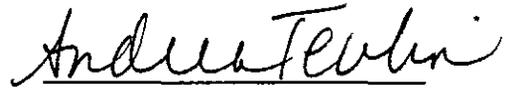
The IBA supports this effort to remove the Waterfall from the City's Municipal Code. In so doing, the faulty concept of Surplus Earnings will be eliminated from the City's code and operations. As discussed in the above, the IBA encourages the City Council to engage the City Attorney's counsel further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

§24.1500 Elimination of "Surplus Earnings"

It is the intent of this Division that the concept of "Surplus Earnings" be eliminated and that liabilities associated with any benefit transfers from system assets be reflected in the system's liabilities and included in the actuarial calculation of the Annual Required City Contribution.

§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.

§24.1502 Transfers Made From Investment Earnings

- (a) The following amounts shall be transferred from Investment Earnings:
- (1) An amount sufficient to credit interest to the contribution accounts of the Members, City, Regional Airport Authority 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 year; and
- (3) An amount sufficient to provide necessary funds to pay the Annual Supplemental Benefit (13th Check) 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 determined by the formula as set forth in Section 24.1503(b)(4) is less than \$100,000, no supplemental benefits will be paid in that fiscal year and the amount determined by the formula in Section 24.1503(b)(4) will be carried forward to ensuing years until such time as the amount to be provided for this benefit as determined by the formula set forth in Section 24.1503(b)(4) for that year and the amount carried forward from prior years is \$100,000 or more; and
- (4) 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.

- (5) An amount sufficient to credit interest to the reserves created for the Supplemental COLA as set forth in this Division.
- (b) At the beginning of each fiscal year, the Board will credit all remaining Investment Earnings to the Reserves for Employer Contributions, for the sole and exclusive purpose of reducing Retirement System liability.
- (c) In any fiscal year where insufficient Investment Earnings exist to provide for the transfers to member accounts pursuant to subsection (a)(1), or the transfers specified in subsections (a)(2), or (a)(4) of this Section, these transfers shall instead be made from other appropriate plan assets as determined by the Board.

§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)(3); 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 product of a formula that consists of Investment Earnings as defined in Section 24.1501 less the sum of the amounts specified in Section 24.1502(a)(1), (a)(2), and (a)(3) to arrive at a per annum dollar value for each creditable year; provided, however, that 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 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) (a)(5) 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 24.0904 and related Board rules.
- (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 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: repealed in its entirety.



000715

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.

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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.

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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



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.

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CONCLUSION

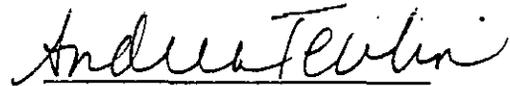
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2. Absent the qualifications in the Waterfall, what is the authority on when the 13th Check shall be paid out?
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Deputy Director



APPROVED: Andrea Tevlin
Independent Budget Analyst

§24.1500 Elimination of "Surplus Earnings"

It is the intent of this Division that the concept of "Surplus Earnings" be eliminated and that liabilities associated with any benefit transfers from system assets be reflected in the system's liabilities and included in the actuarial calculation of the Annual Required City Contribution.

§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.

§24.1502 Transfers Made From Investment Earnings

(a) The following amounts shall be transferred from Investment Earnings:

- (1) An amount sufficient to credit interest to the contribution accounts of the Members, City, Regional Airport Authority 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 year; and
- (3) An amount sufficient to provide necessary funds to pay the Annual Supplemental Benefit (13th Check) 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 determined by the formula as set forth in Section 24.1503(b)(4) is less than \$100,000, no supplemental benefits will be paid in that fiscal year and the amount determined by the formula in Section 24.1503(b)(4) will be carried forward in ensuing years until such time as the amount to be provided for this benefit as determined by the formula set forth in Section 24.1503(b)(4) for that year and the amount carried forward from prior years is \$100,000 or more; and
- (4) 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.

- (5) An amount sufficient to credit interest to the reserves created for the Supplemental COLA as set forth in this Division.
- (b) At the beginning of each fiscal year, the Board will credit all remaining Investment Earnings to the Reserves for Employer Contributions, for the sole and exclusive purpose of reducing Retirement System liability.
- (c) In any fiscal year where insufficient Investment Earnings exist to provide for the transfers to member accounts pursuant to subsection (a)(1), or the transfers specified in subsections (a)(2), or (a)(4) of this Section, these transfers shall instead be made from other appropriate plan assets as determined by the Board.

§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)(3), 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 product of a formula that consists of Investment Earnings as defined in Section 24.1501 less the sum of the amounts specified in Section 24.1502(a)(1), (a)(2), and (a)(3) to arrive at a per annum dollar value for each creditable year; provided, however, that 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 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)~~ (a)(5) 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 24.0904 and related Board rules.
- (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 members 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

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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: repealed in its entirety.

000731		REQUEST FOR COUNCIL ACTION CITY OF SAN DIEGO			1. CERTIFICATE NUMBER (FOR AUDITOR'S) 336 07/15		
TO: CITY ATTORNEY		2. FROM (ORIGINATING DEPARTMENT): Council President Scott Peters			3. DATE: April 11, 2008		
4. SUBJECT: Amendments to the San Diego Municipal Code Eliminating the Surplus Undistributed Earnings ("Waterfall") as Codified in San Diego Municipal Code Section 24.1502 and as Referred to in Sections 24.1501, 24.1503, 24.1504, and 24.1507, all Relating to the City Employees' Retirement System.							
5. PRIMARY CONTACT (NAME, PHONE & MAIL STA.) Betsy Kinsley, 236-6687, MS 10A			6. SECONDARY CONTACT (NAME, PHONE & MAIL STA.) Woo-Jin Shim, 236-6611, MS 10A		7. CHECK BOX IF REPORT TO COUNCIL IS ATTACHED		
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	ORIGINATING DEPARTMENT	<i>Elizabeth Kinsley</i> ELIZABETH KINSLEY, CHIEF OF STAFF	4/11/08	8	DEPUTY CHIEF		
2	AUDITOR AND COMPTROLLER			9	COO	<i>Ray Goldstone</i> RAY GOLDSTONE	4/11/08
3	RISK MANAGEMENT			10	CITY ATTORNEY		
4	LIAISON OFFICE			11	ORIGINATING DEPARTMENT	<i>Elizabeth Kinsley</i> ELIZABETH KINSLEY, CHIEF OF STAFF	4/11/08
5	FINANCIAL MANAGEMENT			DOCKET COORD: _____ COUNCIL LIAISON: _____			
6				✓	COUNCIL PRESIDENT <input type="checkbox"/> SPOB <input type="checkbox"/> CONSENT <input checked="" type="checkbox"/> ADOPTION		
7					COUNCIL DATE: 4/29/08		
11. PREPARATION OF:							
<input type="checkbox"/> RESOLUTION(S) <input checked="" type="checkbox"/> ORDINANCE(S) <input type="checkbox"/> AGREEMENT(S) <input type="checkbox"/> DEED(S)							
11A. STAFF RECOMMENDATIONS: PLEASE SEE ATTACHED MEMORANDUM AND ORDINANCES							

12. SPECIAL CONDITIONS:

COUNCIL DISTRICT(S):

CITYWIDE

COMMUNITY AREA(S):

ENVIRONMENTAL IMPACT:

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**THIS ACTIVITY IS NOT A "PROJECT" AND IS THEREFORE NOT
SUBJECT TO CEQA PER CEQA GUIDELINES SECTION 15060(C)(2).**

HOUSING IMPACT:

NONE

OTHER ISSUES:

Version A as of July 8, 2008

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 AND ADDING SECTIONS 24.1501 AND 24.1502, AMENDING SECTIONS 24.1503 AND 1504, AND ADDING SECTION 24.1503.5, AND REPEALING SECTION 24.1507, ALL RELATING TO "SURPLUS EARNINGS" AND 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," when used in a defined benefit public pension plan, and the use of pension assets to fund non-pension benefits has been criticized by the actuarial community as inconsistent with sound actuarial principles, and results in an increase in the Unfunded Actuarially Accrued Liability and corresponding Annual Required Contributions; and

WHEREAS, the concept of "Surplus Earnings" and its vehicle commonly referred to as 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 by the Board on the

advice of its actuary; (4) a proportional amount of Surplus Undistributed Earnings credited to the 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; and

WHEREAS, certain uses of “Surplus Earnings” are inconsistent with federal tax law to the extent they allow the payment of non-pension benefits from dedicated pension assets; and

WHEREAS, certain uses of “Surplus Earnings” are inconsistent with the goal of state law to assure the competency of the assets of the retirement system to meet promised retirement benefits and to ensure an actuarially sound retirement system; and

WHEREAS, it is the intent of the Council of the City of San Diego to ensure that the benefits referenced in San Diego Municipal Code section 24.1502 be actuarially accounted for as a retirement system liability and accordingly be calculated in the City’s Annual Required Contribution; and

WHEREAS, and therefore, San Diego Municipal Code section 24.1502 and attendant sections referring or incorporating it must 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 is repealed.

Section 2: That Chapter 2, Article 3, Division 15, section 24.1501 is added to read as follows:

24.1501 Elimination of “Surplus Earnings”

It is the intent of this Division that the concept of “Surplus Earnings” be eliminated, that payments previously made from “Surplus Earnings” be made instead from plan assets, and that liabilities associated with any benefit transfers from system assets be reflected in the system’s liabilities and included in the actuarial calculation of the Annual Required City Contribution.

Section 3: That Chapter 2, Article 4, Division 15, section 24.1502 is repealed.

Section 4: That Chapter 2, Article 3, Division 15, section 24.1502 is added to read as follows:

§24.1502 Transfers Made From Plan Assets

(a) The following amounts shall be transferred as set forth below from plan assets as determined by the Board:

- (1) An amount sufficient to credit interest to the contribution accounts of the Members, City, Regional Airport Authority 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 year.

- (3) An amount sufficient to pay the Annual Supplemental Benefit (13th Check) to Qualified Retirees, pursuant to the provisions and conditions set forth in Section 24.1503
- (4) 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, pursuant to the provisions and conditions set forth in Section 24.1503.5.
- (5) An amount sufficient to credit interest to the Available Benefit Amount (as defined in Section 24.1504(c)) for the Supplemental COLA as set forth in this Division.

Section 5: That Chapter 2, Article 3, Division 15. section 24.1503 is amended, to read as follows:

§24.1503 Annual Supplemental Benefit (13th Check)-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)(3), 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 product of a formula that consists of investment earnings received less the sum of the amounts specified in Section 24.1502(a)(1), (a)(2), and (a)(3) to arrive at a per annum dollar value for each creditable year; provided, however, that 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.
 - (8) If, at the time of the annual determination, the amount determined by the formula as set forth in Section 24.1503(b)(4) is less than \$100,000, no supplemental benefits will be paid in that fiscal year and the amount determined by the formula in Section 24.1503(b)(4) will be carried forward to ensuing years until such time as the amount to be provided for this benefit as determined by the formula set forth in Section 24.1503(b)(4) for that year and the amount carried forward from prior years is \$100,000 or more.
- (c) The Board shall promulgate necessary rules to effectuate the provisions and intent of this Article.

Section 6: That Chapter 2, Article 3, Division 15. section 24.1503.5 is added to read as follows:

24.1503.5 Corbett Settlement Increase-Qualification and Determination

The right to receive the Corbett Settlement Increase set forth in Section 24.1502 (a)(4) 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. The Corbett Settlement Increase will not be paid in any year in which the Annual Supplemental Benefit (13th Check) is not paid, but the liability for the increase will be carried forward as a contingent liability that will be paid when the Annual Supplemental Benefit is again paid.

Section 5: 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.
- (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 Available Benefit Amount under Section 24.1504(c) is zero.

- (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) Payment of the Supplemental COLA benefit shall be limited to the Available Benefit Amount determined as follows:
- (1) The Available Benefit Amount as of June 30, 1998 shall initially be thirty-five million dollars (\$35,000,000).
 - (2) Benefit payments under the Supplemental COLA Program shall be accounted for separately and charged against this Available Benefit Amount.
 - (3) The Available Benefit Amount from time to time remaining shall be credited with interest annually, if the total of the amounts transferred pursuant to Sections 24.1502 (1), (2), (3) and (4) are less than investment earnings received in that year, in accordance with Section 24.0904 and related Board rules.
 - (4) Benefit payments under the Supplemental COLA Program shall cease at such time as the Available Benefit Amount is zero.
- (d) Reevaluation.

- (1) The System's Actuary shall conduct an annual evaluation of the Available Benefit Amount to determine the feasibility of expanding the Supplemental COLA Program to include additional retirees and their survivors, additional credits to the Available Benefit Amount 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 Available Benefit Amount 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.

Section 6: That Chapter 2, Article 4, Division 15, section 24.1507 is repealed.
24.1505 No change.
24.1506 No change.

Version A Strikeout Version as of July 8, 2008

Marked Copy

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 AND ADDING SECTIONS 24.1501 AND 24.1502, AMENDING SECTIONS 24.1503 AND 1504, AND ADDING SECTION 24.1503.5, AND REPEALING SECTION 24.1507, ALL RELATING TO "SURPLUS EARNINGS" AND 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," when used in a defined benefit public pension plan, and the use of pension assets to fund non-pension benefits has been criticized by the actuarial community as inconsistent with sound actuarial principles, and results in an increase in the Unfunded Actuarially Accrued Liability and corresponding Annual Required Contributions; and

WHEREAS, the concept of "Surplus Earnings" and its vehicle commonly referred to as 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 by the Board on the

advice of its actuary; (4) a proportional amount of Surplus Undistributed Earnings credited to the 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; and

WHEREAS, certain uses of "Surplus Earnings" are inconsistent with federal tax law to the extent they allow the payment of non-pension benefits from dedicated pension assets; and

WHEREAS, certain uses of "Surplus Earnings" are inconsistent with the goal of state law to assure the competency of the assets of the retirement system to meet promised retirement benefits and to ensure an actuarially sound retirement system; and

WHEREAS, it is the intent of the Council of the City of San Diego to ensure that the benefits referenced in San Diego Municipal Code section 24.1502 be actuarially accounted for as a retirement system liability and accordingly be calculated in the City's Annual Required Contribution; and

WHEREAS, and therefore, San Diego Municipal Code section 24.1502 and attendant sections referring or incorporating it must 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 is repealed.

Section 2: That Chapter 2, Article 3, Division 15, section 24.1501 is added to read as follows:

24.1501 Elimination of "Surplus Earnings"

It is the intent of this Division that the concept of "Surplus Earnings" be eliminated, that payments previously made from "Surplus Earnings" be made instead from plan assets, and that liabilities associated with any benefit transfers from system assets be reflected in the system's liabilities and included in the actuarial calculation of the Annual Required City Contribution.

Section 3: That Chapter 2, Article 4, Division 15, section 24.1502 is repealed.

Section 4: That Chapter 2, Article 3, Division 15, section 24.1502 is added to read as follows:

§24.1502 Transfers Made From Plan Assets

(a) The following amounts shall be transferred as set forth below from plan assets as determined by the Board:

- (1) An amount sufficient to credit interest to the contribution accounts of the Members, City, Regional Airport Authority 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 year.

- (3) An amount sufficient to pay the Annual Supplemental Benefit (13th Check) to Qualified Retirees, pursuant to the provisions and conditions set forth in Section 24.1503
- (4) 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, pursuant to the provisions and conditions set forth in Section 24.1503.5.
- (5) An amount sufficient to credit interest to the reserves ~~created~~ Available Benefit Amount (as defined in Section 24.1504(c)) for the Supplemental COLA as set forth in this Division.

Section 5: That Chapter 2, Article 3, Division 15. section 24.1503 is amended, to read as follows:

§24.1503 Annual Supplemental Benefit (13th Check)-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)(3), 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 product of a formula that consists of investment earnings received less the sum of the amounts specified in Section 24.1502(a)(1), (a)(2), and (a)(3) to arrive at a per annum dollar value for each creditable year; provided, however, that 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.
- (8) If, at the time of the annual determination, the amount determined by the formula as set forth in Section 24.1503(b)(4) is less than \$100,000, no supplemental benefits will be paid in that fiscal year and the amount determined by the formula in Section 24.1503(b)(4) will be carried forward to ensuing years until such time as the amount to be provided for this benefit as determined by the formula set forth in Section 24.1503(b)(4) for that year and the amount carried forward from prior years is \$100,000 or more.
- (c) The Board shall promulgate necessary rules to effectuate the provisions and intent of this Article.

Section 6: That Chapter 2, Article 3, Division 15. section 24.1503.5 is added to read as follows:

24.1503.5 Corbett Settlement Increase-Qualification and Determination

The right to receive the Corbett Settlement Increase set forth in Section 24.1502 (a)(4) 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. The Corbett Settlement Increase will not be paid in any year in which the Annual Supplemental Benefit (13th Check) is not paid, but the liability for the increase will be carried forward as a contingent liability that will be paid when the Annual Supplemental Benefit is again paid.

Section 5: 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.
- (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 Available Benefit Amount under
Section 24.1504(c) is depleted zero.~~

(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) (5) shall be used to pay for Payment of the Supplemental COLA benefit shall be limited to the Available Benefit Amount determined as follows:~~

(1) ~~The Reserve shall be credited with Available Benefit Amount as of June 30, 1998 shall initially be 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 Available Benefit Amount.~~

(3) ~~The Reserve Available Benefit Amount from time to time remaining shall be credited with interest annually, if the total of the amounts transferred pursuant to Sections 24.1502 (1), (2), (3) and (4) are less than investment~~

earnings received in that year, in accordance with Section 24.0904 and related Board rules.

- (4) Benefit payments under the Supplemental COLA Program shall cease at such time as the ~~Reserve is depleted~~ Available Benefit Amount is zero.

(d) Reevaluation.

- (1) The System's Actuary shall conduct an annual evaluation of the ~~Reserve~~ Available Benefit Amount to determine the feasibility of expanding the Supplemental COLA Program to include additional retirees and their survivors, additional ~~Funds in credits to the Reserve~~ Available Benefit Amount 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~~ Available Benefit Amount 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.

Section 6: That Chapter 2, Article 4, Division 15, section 24.1507 is repealed.
24.1505 No change.
24.1506 No change.

ORDINANCE NUMBER O-_____ (NEW SERIES)

DATE OF FINAL PASSAGE _____

AN ORDINANCE AMENDING CHAPTER 2, ARTICLE 4, DIVISION 9 OF THE SAN DIEGO MUNICIPAL CODE, BY AMENDING SECTIONS 24.0904 AND 24.0906 AND AMENDING CHAPTER 2, ARTICLE 4, DIVISION 15 OF THE SAN DIEGO MUNICIPAL CODE, BY REPEALING SECTIONS 24.1501 AND 24.1502 AND AMENDING SECTIONS 24.1503, 24.1504, AND REPEALING PRESENT SECTION 24.1507 AND REPLACING IT WITH NEW SECTION 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 "Surplus Earnings;" and

WHEREAS, the concept of "Surplus Earnings" when used in a defined benefit public pension plan, and the use of pension assets to fund non-pension benefits has been soundly criticized by the actuarial community as inconsistent with sound actuarial principles, and results in an increase in the Unfunded Actuarially Accrued Liability and corresponding Actuarially Required Contribution; and

WHEREAS, the use of "Surplus Earnings" are inconsistent with federal tax law to the extent they allow for the payment of non-pension benefits from dedicated pension assets; and

WHEREAS, the use of "Surplus Earnings" is inconsistent with the California State Constitution requirement that plan assets be administered in a manner that will assure prompt

delivery of benefits to plan participants and to ensure the guarantee of an “actuarially sound retirement system;” and

WHEREAS, the concept of “Surplus Earnings” and its vehicle commonly referred to as 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 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; and

WHEREAS, it is the intent of the Council of the City of San Diego to ensure that the benefits referenced in San Diego Municipal Code section 24.1502 be actuarially accounted for as a retirement system liability, and accordingly be calculated in the City of San Diego’s Annual Required Contribution; and

WHEREAS, pursuant to the California Constitution, Article XVI, Section 17, the Board shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the system, and shall have the sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system and also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries; and

WHEREAS, pursuant to Section 144 of the City of San Diego Charter, the Board may establish such rules and regulations as it may deem proper and shall be the sole authority and judge under such general ordinances as may be adopted by the Council as to the conditions under

which persons may be admitted to benefits of any sort under the retirement system and shall have exclusive control of the administration and investment of such fund or funds as may be established; and

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

WHEREAS, the repeal of San Diego Municipal Code section 24.1502 and amendment of attendant sections referring or incorporating it does not affect the *Corbett* benefit as presently referenced in Section 24.1502(a)(7), and to now be codified in newly added Section 24.1508, which is to be paid in accordance with the executed settlement agreement of that litigation, and be actuarially accounted for as a recurring liability to the system and reflected in the City's Annual Required Contribution; and

WHEREAS, the repeal of San Diego Municipal Code section 24.1502 and amendment of attendant sections referring or incorporating does not affect the payment of the Annual Supplemental benefit, as referenced in Section 24.1502(a)(6) and specifically described in Section 24.1503 to retired members, but as to active employees said payment will be negotiated in the upcoming FY 09 meet and confer process; NOW THEREFORE,

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

§24.0904 Crediting of Interest

The Board credits interest to the contribution accounts of Members and the City, and the Unified Port District and the Airport Authority, at a rate determined by the Board, compounded at each June 30th.

§24.0906 Preparation of the Annual Budget

Each year, the Board will prepare an annual budget of administrative costs for the System, upon the recommendation of the Board's Business and Procedures Committee. The Board will submit the annual budget to the City Council for inclusion in the annual budget ordinance. Once the City Council adopts the budget ordinance, the Board will appropriate, from the plan assets, a sum sufficient to meet the budgeted expenses of operating the System for the fiscal year concerned. The portion of the expenses attributable to the employees of any public agency participating in the System will be paid by that agency, under the terms of that agency's participation agreement.

§24.1503 Annual Supplemental Benefit - Qualification and Determination

The purpose and intent of this section is to identify those retirees qualified to receive an Annual Supplemental Benefit, and to establish a method for determining the amount of the annual supplemental benefit, to be paid from Plan assets.

(a)(1) - (b)(3) [No change in text.]

(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.

§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) – (b)(4) [No change in text.]

(b) (5) 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) The Supplemental COLA Program shall terminate upon exhaustion of the \$35 million allocated for this benefit as identified in the Fiscal Year ending June 30, 1998.

24.1507 CORBETT BENEFIT

The Board shall pay the increase to the Base Retirement Benefit by 7% for all retired City employees and Beneficiaries who are covered by the Corbett Settlement.

APPROVED: MICHAEL J. AGUIRRE, City Attorney

By _____
Michael J. Aguirre
City Attorney

MJA:amp:amt
9/26/2007 REV.
5/19/2008 COR.COPY
6/24/2008 COR.COPY.2
Or.Dept:CityAtty
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

Version B Strikeout Version as of July 8, 2008 (O-2007-93 COR.COPY.2)

OLD LANGUAGE: ~~Struck-Out~~

NEW LANGUAGE: Double Underlined

ORDINANCE NUMBER O-_____ (NEW SERIES)

DATE OF FINAL PASSAGE _____

AN ORDINANCE AMENDING CHAPTER 2, ARTICLE 4, DIVISION 9 OF THE SAN DIEGO MUNICIPAL CODE, BY AMENDING SECTIONS 24.0904 AND 24.0906 AND AMENDING CHAPTER 2, ARTICLE 4, DIVISION 15 OF THE SAN DIEGO MUNICIPAL CODE, BY REPEALING SECTIONS 24.1501 AND 24.1502 AND AMENDING SECTIONS 24.1503, 24.1504, AND REPEALING PRESENT SECTION 24.1507 AND REPLACING IT WITH NEW SECTION 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 "Surplus Earnings;" and

WHEREAS, the concept of "Surplus Earnings" when used in a defined benefit public pension plan, and the use of pension assets to fund non-pension benefits has been soundly criticized by the actuarial community as inconsistent with sound actuarial principles, and results in an increase in the Unfunded Actuarially Accrued Liability and corresponding Actuarially Required Contribution; and

WHEREAS, the use of "Surplus Earnings" are inconsistent with federal tax law to the extent they allow for the payment of non-pension benefits from dedicated pension assets; and

WHEREAS, the use of "Surplus Earnings" is inconsistent with the California State Constitution requirement that plan assets be administered in a manner that will assure prompt

delivery of benefits to plan participants and to ensure the guarantee of an “actuarially sound retirement system;” and

WHEREAS, the concept of “Surplus Earnings” and its vehicle commonly referred to as 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 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; and

WHEREAS, it is the intent of the Council of the City of San Diego to ensure that the benefits referenced in San Diego Municipal Code section 24.1502 be actuarially accounted for as a retirement system liability, and accordingly be calculated in the City of San Diego’s Annual Required Contribution; and

WHEREAS, pursuant to the California Constitution, Article XVI, Section 17, the Board shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the system, and shall have the sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system and also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries; and

WHEREAS, pursuant to Section 144 of the City of San Diego Charter, the Board may establish such rules and regulations as it may deem proper and shall be the sole authority and judge under such general ordinances as may be adopted by the Council as to the conditions under

which persons may be admitted to benefits of any sort under the retirement system and shall have exclusive control of the administration and investment of such fund or funds as may be established; and

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

WHEREAS, the repeal of San Diego Municipal Code section 24.1502 and amendment of attendant sections referring or incorporating it does not affect the *Corbett* benefit as presently referenced in Section 24.1502(a)(7), and to now be codified in newly added Section 24.1508, which is to be paid in accordance with the executed settlement agreement of that litigation, and be actuarially accounted for as a recurring liability to the system and reflected in the City's Annual Required Contribution; and

WHEREAS, the repeal of San Diego Municipal Code section 24.1502 and amendment of attendant sections referring or incorporating does not affect the payment of the Annual Supplemental benefit, as referenced in Section 24.1502(a)(6) and specifically described in Section 24.1503 to retired members, but as to active employees said payment will be negotiated in the upcoming FY 09 meet and confer process; NOW THEREFORE,

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

§24.0904 Crediting of Interest

The Board credits interest to the contribution accounts of Members and the City, and the Unified Port District and the Airport Authority, at a rate determined by the Board, compounded at each June 30th.

§24.0906 Preparation of the Annual Budget

Each year, the Board will prepare an annual budget of administrative costs for the System, upon the recommendation of the Board's Business and Procedures Committee. The Board will submit the annual budget to the City Council for inclusion in the annual budget ordinance. Once the City Council adopts the budget ordinance, the Board will appropriate, from the ~~Undistributed Earnings Reserve~~ plan assets, a sum sufficient to meet the budgeted expenses of operating the System for the fiscal year concerned. The portion of the expenses attributable to the employees of any public agency participating in the System will be paid by that agency, under the terms of that agency's participation agreement, ~~and will be remitted to the Undistributed Earnings Reserve.~~

§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 year; and~~
 - ~~(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 o annual supplemental benefits set forth in Section~~

~~24.1502(a)(6), by (a) identifying and defining~~ identify those retirees qualified to receive such benefit an Annual Supplemental Benefit, and to establish a method for determining the amount of the annual supplemental benefit, to be paid from Plan assets.

(a)(1) - (b)(3) [No change in text.]

(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 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.

§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) – (b)(4) [No change in text.]

(b) (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.~~
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.

(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:~~ The Supplemental COLA Program shall terminate upon exhaustion of the \$35 million allocated for this benefit as identified in the Fiscal Year ending June 30, 1998.

(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.~~
- ~~(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.~~
- (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.~~

24.1507

~~Employee Contribution Rate Reserve~~ CORBETT BENEFIT

- (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.~~

The Board shall pay the increase to the Base Retirement Benefit by 7% for all
retired City employees and Beneficiaries who are covered by the Corbett
Settlement.

APPROVED: MICHAEL J. AGUIRRE, City Attorney

By

Michael J. Aguirre
City Attorney

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