

MEMORANDUM OF LAW

DATE: October 11, 1993

TO: Larry Grissom, Retirement Administrator

FROM: City Attorney

SUBJECT: Implementation of Plan to Plan Transfer

In a memorandum dated August 18, 1993, you note that effective August 11, 1993, the San Diego City Employees' Retirement System ("SDCERS") is authorized to accept as payment for a purchase of service credit a transfer of funds from either of the defined contribution plans (SPSP, SPSP-M or 401(k)) maintained by The City of San Diego ("City"). In light of the numerous requests received concerning this payment option, you now ask what steps need to be taken with respect to these plans to implement a plan to plan transfer either during service or at the time of retirement.

Briefly, these plans will require revision for in-service transfers. Draft amendments have been prepared. They will, however, require review by the administrators of the City defined contribution plans referenced above. For your information, copies of the draft amendments have been forwarded to Sharon Marshall for her review.

With respect to transfers at termination or retirement, the 401(k) plan can accommodate this type of transfer now. The SPSP plans, however, can only accommodate transfers involving pre-tax money. The transfer of after-tax money for the SPSP plans at the time of retirement or termination will require an amendment to these plans such as suggested in the attached draft.

Interestingly, the SPSP amendments are subject to a vote of their respective memberships. The 401(k) amendment is not.

BACKGROUND

Effective August 11, 1993, the San Diego Municipal Code ("SDMC") was amended to authorize SDCERS to receive a direct transfer of funds from the SPSP or 401(k) plans to purchase service credit. At present, however, the option to purchase service credit pursuant to such a plan to plan transfer is only available on a limited basis. 401(k) funds, all of which are contributed on a pre-tax basis, can be directly transferred to SDCERS at termination or retirement to purchase service credit.

SPSP funds, however, consist of both pre-tax and after-tax monies. Without further analysis, only the pre-tax money can be used to purchase service credit at termination or retirement because the transfers currently being done are being done pursuant to the Direct Rollover rules effective January 1, 1993.

In this regard, we note that the amendments proposed for the SPSP and 401(k) plans are not promulgated pursuant to the temporary and proposed regulations issued by the IRS on October 21, 1992, concerning the new direct rollover rules. Instead, the amendments are based upon procedures in place before the new Direct Rollover. Before Congress invented the direct rollover, there was a similar mechanism for moving money directly from one qualified plan to another. This approach, called a "trustee-to-trustee" or a "plan to plan" transfer was an alternative to having participants receive a distribution and make their own rollovers. It is still permitted under the new law.

Several IRS Revenue Rulings deal with these transfers. Addressing whether there is a taxable event to the member if there is a transfer between qualified plans they indicate that there is no taxable event on the transfer. Rev. Rul. 55-427, 1955-2 C.B. 27; Rev. Rul. 67-213, 1967-2 C.B. 149; Rev. Rul. 68-160, 1968-1 C.B. 167. In addition, regulations issued by the IRS in 1988 make it clear that trustee-to-trustee transfers are still valid. 26 C.F.R. section 1.411(d)-4, Q& A 3. Importantly, the trustee-to-trustee transfer (assuming both plans allow for such transfers) avoids IRC section 415 limits and allows for the transfer of after-tax money.

The concept of a plan to plan transfer (involving qualified plans maintained by the City) for the purchase of service credit in SDCERS was initially discussed in the fall of 1991. Both Ken Murray, consultant with The Wyatt Company and Bob Blum, formerly with Orrick, Herrington & Sutcliffe, provided written comments on the voluntary use of SPSP, SPSP-M or 401(k) monies to purchase service credit in SDCERS. Both concluded that these funds could be used to purchase service credit in SDCERS. Copies of their written comments have been attached to this Memorandum of Law.

Importantly, the plan to plan transfer circumvents the concerns raised by this office and the consultants over the potential violations of Internal Revenue Code ("IRC") section 415 which could result from lump sum or installment purchases of service credit. With the implementation of a plan to plan transfer as outlined in the proposed draft amendments, the IRC section 415 concerns are eliminated.

According to Bob Blum, the tax rules governing both 401(k) and the SPSP plans prohibit distributions before termination of employment, death or disability (and hardship for 401(k)). To

maintain the tax-qualified status of these plans, it is important to be able to demonstrate to the Internal Revenue Service that amounts transferred to SDCERS are subject to the same limitations.

Bob Blum further noted that SDCERS must account separately for transferred funds from the SPSP plans from after-tax contributions, deferrals and employer contributions because the source affects the tax treatment for benefits paid from SDCERS. With the recent implementation of the IRC section 414(h)(2) pick up, this should not pose a problem because SDCERS currently separately accounts for post-tax and pre-tax employee contributions and separately accounts again for employer contributions. As such, a three "bucket" system is in place, one for the employer (all pre-tax) and two for the employee (one pre-tax and one post-tax). With respect to the SPSP plans, both employer and employee monies (assuming full vesting upon 5 years and assuming an appropriate amendment to SPSP) could be transferred to the existing employee accounts. 401(k) money is all pre-tax employee money. As such, the transfer is much simpler.

The remainder of this Memorandum of Law addresses the amendments necessary to effect a plan to plan transfer for the transfer of after-tax money at termination or retirement (for the SPSP plans) and for the in-service transfer of pre-tax or after-tax money (for the SPSP and 401(k) plans).

Proposed SPSP Amendment

To implement a plan to plan transfer, we suggest that a new article, Article XV, to be entitled "Plan to Plan Transfers," be added to the SPSP and SPSP-M plans. Substantively, this article would provide:

ARTICLE XV

PLAN TO PLAN TRANSFER

Section 15.01 General

Once in any Plan Year, upon 30 days' written notice to the Plan Administrator, a Participant who has been a Participant for at least five years may voluntarily elect to transfer all or a part of the value of his or her Employee and Employer Voluntary and Mandatory Contribution Accounts to the San Diego City Employees' Retirement System. This transfer shall be a direct plan to plan transfer as described in Rev. Rul. 67-213, 1967-2 C.B. 149. It

shall be conditioned on the fact that no funds transferred to the San Diego City Employees' Retirement System will be distributed from that system prior to the time that they could have been distributed from the Supplemental Pension and Savings Plan.

Section 15.02 Transfer

The amount of a transfer shall be taken from Employee and Employer Voluntary and Mandatory Contribution Accounts exhausting each in turn in the following order:

- (a) First, from principal amounts of Employer Mandatory Contributions including earnings on these amounts;
- (b) Second, from principal amounts of Employer Voluntary contributions including earnings on these amounts;
- (c) Third, from post-1986 principal amounts of Employee Mandatory Contributions including earnings on these amounts;
- (d) Fourth, from post-1986 principal amounts of Employee Voluntary Contributions including earnings on these amounts;
- (e) Fifth, from pre-1987 earnings on Employee Mandatory Contributions Accounts;
- (f) Sixth, from pre-1987 earnings on Employee Voluntary Contribution Accounts;
- (g) Seventh, from pre-1987 principal amounts of Employee Mandatory Contributions Accounts; and
- (h) Eighth, from pre-1987 principal amounts of Employee Voluntary Contribution Accounts.

Proposed 401(k) Amendment

To implement a plan to plan transfer, we suggest that a new article, Article XIII, to be entitled "Plan to Plan Transfers," be added to the 401(k) plan. Substantively, this article would

provide:

Article XIII PLAN TO PLAN TRANSFER

Section 13.01 General

Once in any Plan year, upon 30 days written notice to the Plan Administrator, a Participant may voluntarily elect to transfer to the San Diego City Employees' Retirement System all or a part of his or her Deferral Contributions as of the last day of the calendar quarter immediately preceding his or her transfer request, plus the amount of his or Deferral Contributions made since such date, plus any earnings credited to the Employee Deferral Account as of the date of the transfer request.

This transfer shall be a direct plan to plan transfer as described in Rev. Rul. 67-213, 1967-2 C.B. 149. It shall be conditioned on the fact that no funds transferred to the San Diego City Employees' Retirement System will be distributed from that system prior to the time that they could have been distributed from the 401(k) savings plan.

AMENDMENT PROCESS

With one notable exception, the requirements for amendments to the SPSP and 401(k) plans are identical. The exception concerns the requirement in the SPSP plans that the Employer's right to amend the plans is subject to approval by a simple majority vote of all active Participants. 401(k) does not contain this additional requirement. Other than this exception, all of the plans require that the Employer shall have the right to amend the plan at any time to comply with federal or state laws necessary to maintain the qualified status of the Plan. All require the written consent of their respective trustees if any amendment increases the duties or responsibilities of the trustees. All mandate that no amendment shall transfer any part of the corpus or income of the Trust Fund for purposes other than the exclusive benefit of the participants and their beneficiaries. Finally, all provide that no amendment shall deprive any Participant or Beneficiary of any benefits he or she

is entitled to under the plan with respect to contributions previously made to the Plan.

In our opinion, the proposed plan to plan transfers meet these requirements. They satisfy the exclusive benefit mandate. In addition, since the transferred funds will be separately accounted for in the employee's pre-tax and post-tax accounts, there is no potential for deprivation of any benefits previously earned under SPSP. If the employee were to separate from City service before vesting with SDCERS or if the employee were to vest and still voluntarily request a return of contributions after separation from service, the employee would receive, in addition to the original SDCERS employee contributions, all monies transferred to SDCERS from the SPSP or 401(k) plans.

Finally, the restricted availability of this transfer option to those participants who have fully vested should alleviate any concerns raised by Ken Murray over partial vesting raised in his letter dated December 2, 1991, discussed earlier.

CONCLUSION

Transfers from the 401(k) plan and transfers of pre-tax money only from the SPSP plans to SDCERS are currently available upon termination or retirement. In-service transfers, however, and post-termination/retirement transfers involving after-tax money require plan amendments. In addition, the proposed SPSP amendment must be ratified by a simple majority of all active participants in those plans. We suggest that the proposed amendments be forwarded to the Plan Administrators for these plans for their review and further action.

In closing, it is our opinion that the proposed amendments are not subject to meet and confer. They do not affect the wages, hours or working conditions of City employees. They are administrative in nature, impacting the method of purchase of service credit only. I trust you will let me know if this Memorandum of Law addresses your concerns. I remain available to provide any assistance necessary.

JOHN W. WITT, City Attorney

By

Loraine L. Etherington

Deputy City Attorney

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Attachments

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