SDCERS
San Diego City Employees' Retirement System

Mark A. Hovey
Chief Executive Officer

July 13, 2015

Mr. Steven Hadley
Charter Review Committee Consultant
for Council President Sherri Lightner
City Administration Building
202 C Street
San Diego, CA 92101

Dear Mr. Hadley:

On January 30, 2015, I provided the enclosed letter to Scott Chadwick providing SDCERS' suggestions for revisions to City Charter Article IX. The Charter Review Committee graciously allowed the SDCERS Board of Administration ("SDCERS Board") additional time to review and provide additional suggestions. The SDCERS Board has now completed its review.

SDCERS has received requests from both the San Diego Unified Port District ("UPD") and the San Diego County Regional Airport Authority ("Airport") to provide Charter language allowing UPD and Airport employees the opportunity to run for the elected seats on the SDCERS Board. The SDCERS Board concurs with this request.

Enclosed are SDCERS' proposed updates and modifications to Article IX of the City Charter. In addition to the suggestions made in my January 30, 2015 letter, the SDCERS Board has requested the following revisions:

- Amend Charter Section 141 to provide that nothing contained in Section 141 or Section 143 of the Charter will preclude the City of San Diego from agreeing to pay to SDCERS any portion of an overpayment or underpayment, and associated interested assessed by the Board, where the overpayment or underpayment was proximately caused by the fault or negligence of a City employee acting in the course and scope of his or her employment. The Council would be empowered to enact any and all ordinances necessary to put this provision into effect. Any ordinances enacted pursuant to this amendment would not be subject to a Charter Section 143.1 vote of the membership or the electorate.
- Amend Charter Section 144 to include in the eligibility requirements for appointment to the Board 15 years of legal experience related to the practice of law in any of the fields listed (i.e., pension administration, pension actuarial practice, investment management, real estate, banking or accounting).

- Amend Charter Section 144 to allow general, safety and retired members of Contracting Public Agencies to run for election and vote in elections for the elected positions on the SDCERS Board of Administration.

SDCERS is suggesting that the Charter be amended to allow the City to enact an ordinance, at its discretion, allowing the City to pay SDCERS for any portion of an overpayment of benefits to or underpayment of contributions from members and associated interest where the overpayment or underpayment was caused by the fault or negligence of a City employee. SDCERS' employees are City employees.

SDCERS works directly with its members to resolve any active member underpayments to the pension system, or retired member benefit overpayments (both collectively referred to as "overpayments"). Due to IRS requirements, SDCERS also collects interest from the members on the overpayment, at a rate equal to the SDCERS assumed rate of return (currently 7.25%). The SDCERS Board of Administration would like for the City to consider playing a role in resolving such underpayments/overpayments.

To provide perspective on this issue, SDCERS works diligently to make zero mistakes, and while we successfully and accurately process hundreds of thousands of transactions each year, our staff members are not perfect. When the mistakes have been made, the error is usually the results of a step or process not done correctly by an SDCERS staff member, rather than due to an error made by the member, or the City.

IRS rules require that in the event of an overpayment, SDCERS resolve the overpayment by collecting the full principal amount, with interest at the plan's earnings rate, to make the system "whole." Consistent tax advice from SDCERS outside counsel advises that we have been following the IRS corrections process accurately since SDCERS received its IRS Determination Letter of plan compliance back in 2008.

Members frequently comment to SDCERS that if the mistake was not due to their (i.e., the member's) error, why are they doubly "penalized" by assessing interest on the amount. Indeed, SDCERS implemented a policy in 2008 to comply with IRS overpayment requirements and decided to charge the member a lower interest rate . . . 2% . . . and have the balance of the interest due be covered by the City. Following correspondence between SDCERS and the City Attorney's office, who clearly conveyed that the City and taxpayers could not be held responsible for resolving overpayments to the member, SDCERS revised its policy in 2009 to recover the entire interest amount from the member and has consistently done so since then.

It has been suggested SDCERS procure insurance to cover such errors, rather than have the member repay the error in full. However, insurers have stated deductibles would be involved that exceed the cost of the overpayment, and even if the overpayments were to exceed the deductible, the insurance company retains subrogation rates to pursue a counter claim against the City. In short, insurance might transfer a portion of the burden off the member, but that burden would be placed back on the City, regardless.

It has also been suggested SDCERS simply fix the overpayment issue prospectively, and historical overpayment amounts be left in the City's Unfunded Actuarial Liability (UAL).

Unfortunately, the IRS explicitly does not allow the plan sponsor to cover overpayments via an amortized UAL phased into the City's annual pension payments. Instead, the City, per IRS rules, must immediately cover any portion of the overpayment not made by the member.

As noted above, the SDCERS Board believes the IRS effectively ties its hands and that full recoupment of the overpayment, with interest, is required from the member. However, the Board also believes that given the underlying cause of the error has traditionally been made by SDCERS, an agent of the City in this case, that it may be prudent for the City to acknowledge the impossibly high standard of perfection placed on its employees and agree to shoulder a portion of the overpayment.

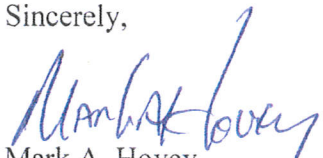
It's difficult to assess the amount of money involved in prospective overpayment corrections to be done by SDCERS (i.e., it is not possible to predict future overpayment errors). However, SDCERS does report annually on the number and amount of overpayments collected from members. In FY 2013, that amount was $701,171, which included $611,501 associated with the PSC Litigation lawsuit the City won against SDCERS. In FY 2014, SDCERS collected $150,788 in member overpayments. There are approximately 300 potential member overpayment issues that SDCERS is researching now, and we expect to resolve those by December 31, 2015; this relatively large number of open matters was primarily driven by the complete data conversion audit when SDCERS covered to its new pension system in May 2014. Going forward, we expect overpayments to be limited in number and not material.

As previously advised, SDCERS believes the majority of the remaining proposed Charter modifications are required to achieve consistency with the Board's fiduciary duties as well as consistency between provisions in other Articles of the Charter. SDCERS is also proposing that the City amend the Charter to allow Police Recruits to join SDCERS upon entering the Police Academy. Not only does SDCERS believe that this was the actual intent of the proposers of Proposition B, but that it will also assist the City in its retention of new police officers.

The SDCERS Board of Administration respectively requests the City review applicable City Charter language to allow for flexibility in resolving member overpayments with the City.

SDCERS would be happy to appear before the Charter Review Committee if requested. Thank you for your consideration.

Sincerely,



Mark A. Hovey
Chief Executive Officer

MAH/er

Enclosure: SDCERS' Proposed Revisions to the City Charter

cc: SDCERS Board of Administration
Elaine Reagan, SDCERS Deputy CEO – Compliance & Legal Operations
Hon. Council President Sherri S. Lightner
Hon. Mayor Kevin Faulconer
Scott Chadwick, Chief Operating Officer
Hon. Jan Goldsmith, City Attorney
Paul Cooper, Asst. City Attorney
Sharon Spivak, Deputy City Attorney
Roxanne Story Parks, Deputy City Attorney

SDCERS
San Diego City Employees' Retirement System

2015 CITY CHARTER REVIEW
SDCERS' PROPOSED REVISIONS TO THE CITY CHARTER
CITY CHARTER ARTICLE IX

Section 140: Establishment of Separate Retirement Pension Systems; Definitions

As of the election at which this Section becomes operative, the electorate of the City of San Diego has found and declared that the fiscal best interests of the City are served by reforming the retirement system authorized by this Charter to be established for City employees.

"Defined Benefit Pension Plan" or "Defined Benefit Pension System" is a system or plan to provide a specified allowance to a city retiree or a retiree's spouse after retirement that is based on a set formula based on factors such as age, years of service, and elements of compensation as established in this Article.

The Defined Benefit Pension Plan in place prior to said election, established by the City Council pursuant to Sections 141 through 149 of this Charter, may remain in place until, for any reason, there remain no participants in the Defined Benefit Plan. The City Council may by ordinance utilize any lawful means for terminating the Defined Benefit Plan. Any closure of the Defined Benefit Plan shall be designed and implemented to protect the employees' vested rights in the Defined Benefit Plan, generate cost savings for taxpayers, and ensure compliance with applicable laws and regulations, including tax regulations.

At such time as there remain no participants in the Defined Benefit Pension Plan, the City shall take such actions as are necessary and appropriate to promptly wind down and terminate the Defined Benefit Pension Plan.

Notwithstanding the foregoing, and except as expressly provided in this Article IX, all Officers and employees, with the exception of sworn police officers and police recruits participating in the City's Police Academy, who are initially hired or assume office on or after the effective date of this Section shall participate only in such Defined Contribution Plans as authorized by Sections 150 and 151 of this Charter.
The provisions of Sections 141 through 149 shall apply only to the Defined Benefit Plan, and those City employees eligible to participate in the Defined Benefit Plan. The provisions of Sections 150 and 151 shall apply only to the Defined Contribution Plan, and those City employees eligible to participate in the Defined Contribution Plan, except as expressly stated.
Notwithstanding the foregoing, and except as provided in this Article IX, the City Council is hereby authorized and empowered by ordinance to enroll sworn police officers hired after the effective date of this section in either the Defined Benefit Plan or the Defined Contribution Plan. This section shall be implemented in a manner consistent with the requirements of applicable labor relations laws.
(Addition voted 06-05-2012; effective 07-20-2012.)

+-Section 141: City Employees' Retirement System

The Council of the City is hereby authorized and empowered by ordinance to establish a retirement system and to provide for death benefits for compensated public officers and employees, other than those policemen and firemen who were members of a pension system on June 30, 1946. No employee shall be retired before reaching the age of sixty-two years and before completing ten years of service for which payment has been made, except such employees may be given the option to retire at the age of fifty-five years after twenty years of service for which payment has been made with a proportionately reduced allowance. Policemen, firemen and full time lifeguards, however, who have had ten years of service for which payment has been made may be retired at the age of fifty-five years, except such policemen, firemen and full time lifeguards may be given the option to retire at the age of fifty years after twenty years of service for which payment has been made with a proportionately reduced allowance.

The Council may also in said ordinance provide:

(a) For the retirement with benefits of an employee who has become physically or mentally disabled by reason of bodily injuries received in or by reason of sickness caused by the discharge of duty or as a result thereof to such an extent as to render necessary retirement from active service.

(b) Death benefits for dependents of employees who are killed in the line of duty or who die as a result of injuries suffered in the performance of duty.

(c) Retirement with benefits of an employee who, after ten years of service for which payment has been made, has become disabled to the extent of not being capable of performing assigned duties, or who is separated from City service without fault or delinquency.

(d) For health insurance benefits for retired employees.

Notwithstanding anything to the contrary in this section, the Charter or the Municipal Code, reciprocal service granted under the Uniform Reciprocal Provisions pursuant to the Reciprocity Contract between SDCERS and CalPERS shall be included as service for purposes of establishing eligibility for retirement benefits.

] *(Editor's note: Supplement No. 655)*
(Amendment voted 03-13-1945; effective 04-09-1945.)
(Amendment voted 04-19-1949; effective 05-20-1949.)
(Amendment voted 03-13-1951; effective 03-26-1951.)
(Amendment voted 06-08-1954; effective 01-10-1955.)
(Amendment voted 11-06-1990; effective 02-19-1991.)
(Amendment voted 11-08-1994; effective 01-30-1995.)
(Amendment voted 11-05-1996; effective 02-10-1997.)

Section 141.1: Reform of ~~Sworn~~ Police Officer Defined Benefit Pension Plan

Notwithstanding any other provision of this Charter, or any ordinance or other action taken pursuant hereto, the maximum amount of retirement benefit payable to a sworn police officer or police recruit participating in the City's Police Academy, who is hired after the effective date of this section and who is a participant under the Defined Benefit Pension Plan, shall be an amount equivalent to 80% at age 55 of the average of the participant's highest consecutive 36 months of Base Compensation as defined by Section 70.1. The maximum set by this provision shall decrease by 3% (three percentage points) for each year that such participant retires before age 55.

(Addition voted 06-05-2012; effective 07-20-2012.)

Section 141.2: Full and Fair Employee Contributions for The Defined Benefit Pension Plan

For officers and employees who have the legal right to remain in the established Defined Benefit Pension Plan, the City shall contribute annually an amount substantially equal to that required of the employee for a normal retirement allowance, as certified by the Actuary established in Charter Section 142, but shall not contribute in excess of that amount, except in the case of financial liabilities accruing under any new retirement plan or revised retirement plan because of past service of the employee. The City shall not pay, cap the employee contribution rate, or otherwise compensate for any portion of a contribution to the Retirement System by a City Officer or employee.

To the fullest extent permissible by law, in calculating annual contributions for the City and City employees, the Retirement Board shall divide equally between those two parties all costs those costs explicitly and exclusively reserved to the City in this Section and Section 143. Contributions shall also be governed by Section 143 of this Article. In the event of a conflict between this Section and Section 143, this Section shall prevail. This section is not intended to interfere with vested defined rights of any retiree receiving benefits from the Defined Benefit Retirement System or of any employee enrolled in the Defined Benefit Retirement System as of the effective date of this section.

Nothing contained in this Section shall preclude the City from entering into a settlement of *City of San Diego v. San Diego City Employees' Retirement System* Case No. #37-2010-00091207-CU-WM-CTL_to define responsibilities of the City and employees for unfunded liabilities of the Retirement System even if the settlement includes terms that might otherwise conflict with the above restrictions, as long as the settlement is approved by the court as a good faith settlement and approved by a two-thirds vote of the City Council.

Nothing contained in this Section or in Section 143 shall preclude the City from agreeing to pay to the Retirement System any portion of an overpayment of benefits or underpayment of contributions, and any interest associated with an overpayment or underpayment as assessed by the Board of Administration, where the overpayment or underpayment was proximately caused by the fault or negligence of a City employee acting in the course and scope of his or her employment. The Council of the City is hereby authorized and fully empowered to enact any and all ordinances necessary to carry into effect the provisions of this section and any and all ordinances so enacted shall have equal force and effect with this Article and shall be construed to be a part hereof as fully as if drawn herein. Any ordinance enacted pursuant to this section shall not be considered an ordinance affecting or enhancing the benefits of any active or retired Member of the System and shall not be subject to the voting requirements set forth in Section 143.1.

(Addition voted 06-05-2012; effective 07-20-2012.)

Section 142.1: Employment of Attorneys (New)

The Board of Administration hereinafter provided, may appoint attorneys to advise and represent the Board, as may be necessary. Attorneys hired or retained by the Board shall have duties and responsibilities only to the Retirement System and its Board of Administration and shall not have a duty of loyalty or care to the City of San Diego. Except to the extent that the

Board retains outside counsel as consultants, such appointments shall be made under the provisions of Article VIII of this Charter.

Section 143: Contributions [No Change.]

Section 143.1: Approval of Retirement System Benefit [No Change]

Section 144: Board of Administration

Effective April 1, 2005, the system shall be managed by a newly constituted Board of Administration which shall consist of 13 members. Seven members shall constitute a quorum of the Board and the concurring vote of seven members shall be required for the Board to take any action. Prior to April 1, 2005, in anticipation of the effective date, and thereafter, members shall be selected to serve as follows:

(a) Seven (7) members shall be appointed by the Mayor and confirmed by the Council. No person who is a City employee, participant in the Retirement System, or City union representative may be eligible for appointment in this category. Such appointees shall have the professional qualifications of a college degree in finance, economics, law, business, or other relevant field of study or a relevant professional certification. In addition, such appointees shall have a minimum of fifteen (15) years' combined experience in pension administration, pension actuarial practice, investment management, real estate, banking, ~~or~~ accounting or the practice of law related to any of the preceding fields. Members of the Board serving in this category shall serve staggered terms of four (4) years each. Inaugural appointments occurring after the effective date of this section shall have four (4) members serving two (2) year terms and three (3) members serving three (3) year terms. The Board shall determine which open seats shall serve four (4) and three (3) years terms to achieve staggered terms of four (4) years for all subsequent appointments. ~~(inaugural appointments shall have three (3) members serving two year terms)~~ ~~and m~~Members in this category shall be limited to a maximum of eight (8) consecutive years in office and an interval of four (4) years must pass before such persons can be reappointed. Such appointees shall not have any other personal interests which would create a conflict of interest with the duties of a Board member and trustee.

(b) One (1) police safety member of the Retirement System elected by the active police safety members to serve a four (4) year term, except that the inaugural member elected in 2005 to fill the seat in this category shall serve a two (2) year term. For purposes of this section, police safety members eligible to serve and vote shall include any police safety members employed by a Contracting Public Agency as defined in Section 149 of this Article.

(c) One (1) fire safety member of the Retirement System elected by the active fire safety members to serve a four (4) year term. For purposes of this section, fire safety member eligible to serve and vote shall include any fire safety members employed by a Contracting Public Agency as defined in Section 149 of this Article.

(d) Two (2) general members of the Retirement System elected by active general members of the Retirement System to serve a four (4) year term. For purposes of this section, general members eligible to serve and vote shall include any general members employed by a Contracting Public Agency as defined in Section 149 of this Article.

(e) One (1) retired member of the Retirement System elected by the retired members of the Retirement System to serve a four (4) year term, except that the inaugural member elected in 2005 to fill the seat in this category shall serve a two (2) year term. For purposes of this section, retired members eligible to serve and vote shall include any retired members of a Contracting Public Agency as defined in Section 149 of this Article.

(f) One (1) City management employee in the administrative service appointed by the ~~City Manager~~ Mayor to serve at the pleasure of the ~~City Manager~~Mayor selected from the following: ~~City Manager~~Chief Operating Officer, City Treasurer, Deputy or Assistant ~~City Manager~~Chief Operating Officer, or person in a similar position who reports to the ~~City Manager~~Mayor

The Board of Administration may establish such rules and regulations as it may deem proper; shall elect one of its members president and appoint a secretary and may appoint such other employees as may be necessary. Such appointments, except the actuary, shall be made under the provisions of Article VIII of this Charter.

The Board of Administration 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; shall have all powers and duties provided in the Declaration of Group Trust for the SDCERS Group Trust effective July 1, 2007 and any amendments thereto or successor trusts hereinafter adopted by Resolution of the City Council; ~~and~~ shall have exclusive control of the administration and investment of such fund or funds as may be established; ~~and~~ shall be permitted to invest in any bonds or securities which are authorized by General Law for savings banks; and, further, shall be permitted to invest in such additional classes or types of investments as deemed prudent by the Board consistent with its fiduciary duties. ~~are approved by resolution of the Council of the City of San Diego; provided, however, that individual investments within the classes or types approved by the Council must be approved by independent investment counsel; and, provided, further, the board may place such funds in the hands of the Funds Commission for investment. Provided, however, that the Auditor and Comptroller shall refuse to allow any warrant drawn for payment of a retirement allowance if, in the opinion of the Auditor and Comptroller, such retirement allowance has been granted in contravention of this Article or any ordinances passed under the authority granted herein.~~

(Amendment voted 03-13-1951; effective 03-26-1951.)
(Amendment voted 11-08-1960; effective 01-09-1961.)
(Amendment voted 11-04-1969; effective 01-29-1970.)
(Amendment voted 06-04-1974; effective 08-13-1974.)
(Amendment voted 11-2-2004; effective 04-01-2005)
(Effective 07-08-2008, the authority, power, and responsibilities conferred upon the Auditor and Comptroller by this Charter were transferred to the Chief Financial Officer. See section 39.)

Prior Language

Section 145: Retirement Fund

All moneys contributed by employees of the City or appropriated by the Council or received from any other source under the terms of this Article, shall be placed in a special fund ~~in the City Treasury~~ to be known as the City Employees' Retirement Fund, which said fund is hereby created. Such fund shall be a Trust Fund to be held and used only for the purpose of carrying out the provisions of this Article. No payments shall be made therefrom except upon

the order of the Board of Administration. This fund may be placed by the Board under the Funds Commission for investment; but shall not be merged with other funds of the City.

Sections 146 through 151 [No Change}