



SAN DIEGO COUNTY
REGIONAL AIRPORT AUTHORITY
STAFF REPORT

Item No.
17

Meeting Date: OCTOBER 7, 2010

Subject:

Continued Discussion And Possible Direction Regarding Employee Purchases Of Service Credits From The San Diego City Employees' Retirement System (SDCERS)

Recommendation:

The Board will receive an update on the outcome of litigation between the City of San Diego and the San Diego City Employees' Retirement System (SDCERS) and may wish to provide staff with updated direction.

Background/Justification:

Thirty nine Airport Authority employees are affected by the outcome of the litigation between the City of San Diego and SDCERS. On June 7, 2010, the Fourth District Court of Appeals issued a ruling related to the pricing of purchased service credit (PSC). The decision relates to under-pricing of PSC contracts (which likely includes multiple types of PSC time) purchased by City of San Diego participants on or after August 16, 2003. The court's ruling focuses on PSC requests submitted or purchased between August 16 and November 1, 2003, (the "window period"), but more importantly, the decision applies to any City contracts calculated at the old rates and purchased on or after August 16, 2003. This court ruling appears to affect Airport Authority employees as the SDCERS Board of Administration raised Airport Authority PSC pricing at its April 16, 2004 meeting with an effective date of July 1, 2004, creating a "window period" which has subsequently been ruled as a violation of the plan provisions. Specifically, the court ruled that SDCERS had violated the provisions of the plan relating to purchase of service and could not recover the underfunding created by these underpriced PSCs from the City through the Unfunded Actuarial Liability (UAL). SDCERS' tax counsel has determined that the same is true relating to the delayed implementation of the rate change for Airport employees. This means that affected participants may need to pay additional money toward their purchase, or have their service credit reduced or request a full refund.

Absent the Airport Authority's Board indicating interest in continuing to absorb the cost of PSC under pricing through The Authority's UAL, approximately 39 employees will likely be asked by SDCERS to decide whether to pay the difference (plus interest), accept a reduced service credit, or receive a full refund. SDCERS Board has strived to fulfill its fiduciary duty to its participants on this issue. Because the Internal Revenue

Service requires that SDCERS collect the underfunding from some source so that the trust fund is made whole, the only viable solution to this problem is to collect the underfunding from the affected participants.

The San Diego County Regional Airport Authority Board of Directors received an update on this item at its September 2, 2010 Board meeting from Authority General Counsel Bret Lobner, Jeff Lindeman, as well as from CEO of SDCERS, Mark Hovey. At that time, the SDCERS Board of Administration had not yet considered all available options for affected individual employees to correct the Purchase of Service Credit "Window Period" contracts. After the discussion, Board member Finnila moved that the Authority Board direct staff to not absorb the cost of PSC under pricing through the Authority's UAL. Board member Boland asked Ms. Finnila to hold the motion in abeyance pending additional information such as SDCERS Board action, approved employee options, cost of underfunding, etc.

On Friday, October 1, 2010, the SDCERS Board approved, by a vote of 8-0, the options recommended to it by SDCERS staff. Those five options are included in the attached document entitled Purchase of Service Credit Corrective Action; Options Available to Correct PSC "Window Period" Contracts (Attachment A). In addition, the SDCERS Resolution (Attachment B), confirming the action is also included. SDCERS staff will be on-site to present affected Airport Authority employees with the SDCERS Board approved options and answer general questions on Wednesday, October 6, 2010. The exact dollar amount for individuals, as well as the aggregate cost(s), are still being calculated by SDCERS.

This situation will have an impact on the Airport Authority's 2010 Actuarial Valuation report, with a likely small positive effect on the plan's UAL. Considering the court ruling, it is management's recommendation that it would not be good public policy for the Authority to continue to subsidize the pricing of purchase of service credits for employees.

Fiscal Impact:

Pending no action by the Authority's Board of Directors to continue paying for underpriced PSCs, there will likely be a positive impact on the yet to be calculated FY 10 UAL as determined by the SDCERS Actuarial firm, Cheiron.

Environmental Review:

- A. This Board action is not a project that would have a significant effect on the environment as defined by the California Environmental Quality Act ("CEQA"), as amended. 14 Cal. Code Regs. §15378. This Board action is not a "project" subject to CEQA. Cal. Pub. Res. Code §21065.
- B. This Board action is not a "development" as defined by the California Coastal Act. Cal. Pub. Res. Code §30106.

Equal Opportunity Program:

Not Applicable

Prepared by:

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**Purchase of Service Credit Corrective Action
Options Available To Correct PSC "Window Period" Contracts**

Member Category	Option 1	Option 2	Option 3	Option 4	Option 5
Administrative Action Correction Priority:	<i>"Rescind and Refund 2003 Old Rate contract payments, plus interest"</i>	<i>"Rescind and Apply 2003 Old Rate contract payments, plus interest, to New Contract"</i>	<i>"Reduce Service Credit to equivalent of Amount Paid"</i>	<i>"Pay the difference between 2003 Old Rate and 2003 new rate"</i>	<i>"Rescind DROP Contract to the extent legally permissible"</i>
1. Active DROP	Yes	Yes, If DROP contract Rescinded (May require Plan Sponsor's consent)	Yes	Yes	Yes If DROP contract Rescinded (May require Plan Sponsor's consent)
2. Retired DROP (retired after 11/16/07)					
a. DROP account annuity with SDCERS	Yes	No	Yes	Yes	Yes
b. DROP account zero balance at SDCERS	Yes	No	Yes	Yes	Yes
3. Retired (retired after 11/16/07)	Yes	No	Yes	Yes	No
4. Active					
a. Contracts paid in full	Yes	Yes	Yes	Yes	No
b. Installment contracts still in progress	Yes	Yes	Yes	Yes	No
5. Deferred	Yes	No	Yes	Yes	No
6. Disability Retired	Yes	No	Yes	Yes	No
7. Continuances					
a. Receiving a retirement allowance continuance	Yes	No	Yes	Yes	No
b. Receiving both a retirement allowance continuance and DROP annuity survivor benefit	Yes	No	Yes	Yes	No
c. Receiving a survivor's DROP annuity benefit (non-spouse beneficiary)	Yes	No	Yes	Yes	No

Impacts of Options:	
Option 1	a. Compute the amount of the contract refund, which is a return of member contributions, plus interest, from the member's contribution account; b. Return amounts to member's source plan (if available) for payments made by Plan-to-Plan transfers; c. Refund amounts to members for PSC payments made by Pre- or Post-tax installment contracts; d. Eliminate service credit for the rescinded contract; e. Compute benefits overpaid plus interest (if any, for retired or DROP active members) and recover from member.
Option 2	Calculate the net difference between a refund of the original contract (Option 1) and the cost of a new 2010 contract. A net refund would be returned to the member's source; a net additional cost would be paid by the member by any payment options currently available.
Option 3	a. No additional payment is owed by the member; b. Calculate reduced number of years of Service Credit equivalent to amount paid; c. Compute benefits overpaid plus interest (if any, for retired or DROP active members) and recover from member.
Option 4	Member pays additional contributions owed, in part or in full, plus interest. DROP Active and Retired members only may choose to retain only enough partial Service Credit to retain eligibility for service retirement and/or DROP, provided corresponding adjustments are made to any past and future retirement allowances, contributions, and interest.
Option 5	Applicable to Active DROP members only. Subject to collection of retirement contribution arrearages, unwinding the DROP benefit, and netting any amounts due to or from SDCERS and the member. May require Plan Sponsor's consent and to the extent legally permissible.
Payment Options	The available payment options include: lump-sum transfers from other qualified pension plans, including SPSP, 401(k), and 457 plans; transfers from a personal IRA; personal funds; payroll deductions from a post-tax installment plan; any other options that may be identified.

**BOARD OF ADMINISTRATION
SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
RESOLUTION NO. 2010-02**

**RESOLUTION IMPLEMENTING FOURTH DISTRICT COURT OF APPEAL
DECISION REGARDING SERVICE CREDIT PURCHASES UNDER SAN
DIEGO MUNICIPAL CODE SECTION 24.1312 AND COMPARABLE PLAN
DOCUMENT PROVISIONS**

WHEREAS, on June 7, 2010, the Fourth District Court of Appeal issued an opinion in *City of San Diego v. San Diego City Employees' Retirement System* 186 Cal. App. 4th 69 (2010) (the "PSC Decision"), in which it determined that SDCERS did not have the right to charge the City of San Diego ("City") for SDCERS' underfunding of service credits purchased under San Diego Municipal Code section 24.1312 (referred to in the PSC Decision as "air time") during a "window period" by continuing to use lower previously determined flat rates after the SDCERS Board of Administration ("Board") determined to increase those two flat rates to purchase service credit ("PSC") under that Municipal Code provision on August 15, 2003; and

WHEREAS, the court characterized its ruling in the PSC Decision as "very narrow," in that it applied only to the "window period" implemented by the Board after the Board had increased the two PSC purchase rates, and it applied only to the "air time" PSC provision in the San Diego Municipal Code that required employees to pay both the employee and employer cost of the PSC; and

WHEREAS, the court concluded in the PSC Decision that it was "not within SDCERS's authority to expand pension benefits beyond those afforded by the authorizing legislation." Specifically, the court determined that PSC contracts using the delayed "window period" flat rates were not authorized under Municipal Code section 24.1312, because SDCERS had no legal authority to continue to offer service credit at the old rates once the Board had determined that new higher flat rates were required to cover both the employee and employer cost of the service to be purchased.

WHEREAS, the court described various options potentially available to SDCERS to correct this situation, including "'voiding contracts,' 'collecting arrears payments,' 'offering rewritten contracts,' 'spreading out additional payments,' [and] 'reducing benefits levels,'" and stated that the "only thing [SDCERS] may not do is charge the City for the underfunding that was the subject of the [trial] court's order"; and

WHEREAS, as a result of the PSC Decision, SDCERS is prohibited from requiring the City to make up the underfunded amount by including it in the City's unfunded actuarial liability ("UAL"); and

WHEREAS, as a result of the PSC Decision, SDCERS also has no legal authority to continue to provide benefits based on the service purportedly purchased by the underpriced PSC contracts, absent a member/beneficiary's selection of one of the

correction options set forth below. *Medina v. Bd. of Retirement*, 112 Cal. App. 4th 864, 870-71 (2003); and

WHEREAS, based upon the PSC Decision and other applicable law, the Board makes the following findings:

1. If a PSC contract made under Municipal Code section 24.1312 was the result of a legally authorized offer made by SDCERS before the beginning of the August 15, 2003 window period (that is, before the Board determined that new flat rates should be charged), and the member signed and dated that contract before its 90-day expiration date, that contract was legally authorized and is not impacted by this Resolution. However, members who submitted PSC applications that requested a quote for PSC prior to the window period, but who were provided the "window" rate by SDCERS only after the Board had determined a new rate, are included within the scope of this Resolution as a result of the PSC Decision.
2. The PSC Decision was rendered based on the City's amended complaint against SDCERS, which specifically exempted any affected members who already had retired prior to the filing of that lawsuit on November 20, 2007. Consequently, the City has acquiesced to continuing to pay for the underfunding created by the PSC contracts of this group of retirees. This means that SDCERS members who retired from the City prior to November 20, 2007 are not impacted by this Resolution.
3. Although a very narrow ruling, the PSC Decision is to be applied to any "window period" purchase that SDCERS' Board previously unlawfully authorized with respect to a PSC contract subject to Plan Document provisions that required employees to pay both the employee and employer cost for the service credit ("Affected PSC Contract"). There may be other PSC contracts impacted by this Resolution that have not yet been identified. Any additional PSC contract types that may potentially be subject to this Resolution will be separately presented to the Board for action.
4. The "window periods" relating to "air time" purchases by employees of the San Diego Port District and San Diego Airport Authority commenced on April 16, 2004, and thus PSC contracts purchased during those window periods are also subject to this Resolution as "Affected PSC Contracts". Those employer plan sponsors have not yet formally advised SDCERS as to whether they will acquiesce to continuing to pay for any or all of the underfunding created by such PSC contracts, or if the employer plan sponsors will require that SDCERS follow the member correction procedures outlined in this Resolution.

5. The underfunding resulting from the underpricing of the Affected PSCs Contracts during the window period must be corrected before the full service credit originally intended to be granted by the Affected PSC Contracts may be provided to members.
6. Underfunding resulting from Affected PSC Contracts that are the subject of this Resolution can be corrected either by employers voluntarily making up the underpayment or, if not by the employers, then the members must voluntarily pay the difference or voluntarily rewrite their PSC contracts to have their service credit reduced to the amount for which they paid under the correct higher rate that was determined by the Board in order to retain any portion of the PSC intended to be purchased.
7. Alternatively, if members do not choose to reform their Affected PSC Contracts with SDCERS voluntarily in order to retain some or all of their PSC, then, after reasonable notice as set forth below, SDCERS will reduce their retirement service credit accounts accordingly, refund the member contributions made to purchase the underpriced PSC, together with interest credited to those contributions to date, and make any other necessary adjustments to member benefits in accordance with law.
8. All interest payments relating to the correction of Affected PSC Contracts calculated under this Resolution, both for payments to be made by SDCERS to members/beneficiaries and payments made to SDCERS by members/beneficiaries, will be set at the SDCERS actuarially assumed investment return rate in effect as of June 30 of each year, compounded annually. Interest payments for amounts owed to SDCERS by members/beneficiaries for repayment of overpaid retirement benefits required if a member declines or fails to exercise one of the corrective options to fully fund the service purchase will be set at the actuarially assumed investment return rate in effect as of June 30 of each year, compounded monthly, calculated through the date the member is sent a 90-day written Notice of Options by SDCERS.
9. To the extent that an active member with an Affected PSC Contract is currently in the Deferred Retirement Option Program ("DROP"), but declines to exercise one of the corrective options that would permit that member to retain sufficient service to remain eligible for DROP, SDCERS will deem the member's prior DROP election to be rescinded, subject to SDCERS collecting retirement contribution arrearages, unwinding the DROP benefit administered by SDCERS, and netting any amounts due to or from SDCERS and the member.
10. To the extent that an active member with an Affected PSC Contract is currently in DROP, but declines to exercise one of the corrective options that would permit that member to retain sufficient service to remain

eligible for DROP and the member affirms to SDCERS that, but for the lack of information regarding the impact of the affected PSC contract on the member's DROP election, the member would not have entered DROP, SDCERS will permit that member to reform his or her DROP contract to provide a different DROP beginning and end date, subject to SDCERS collecting retirement contribution arrearages, adjusting the DROP benefit administered by SDCERS. However, application of this paragraph 10 is conditioned on the member's employer's agreement to the reformation. (*Hittle v. Santa Barbara County Employees Retirement Assn.*, 39 Cal. 3d 374 (1985).)

11. To the extent that an active member with an Affected PSC Contract remains eligible for DROP, but affirms to SDCERS that, but for the Affected PSC Contract, the member would not have entered DROP, SDCERS will permit that member to rescind his or her DROP election, subject to SDCERS collecting retirement contribution arrearages, unwinding the DROP benefit administered by SDCERS, and netting any amounts due to or from the SDCERS and the member, However, application of this paragraph 11 is conditioned on the member's employer's agreement to the rescission. (*Hittle v. Santa Barbara County Employees Retirement Assn.*, 39 Cal. 3d 374 (1985).)
12. To the extent that a member with an Affected PSC Contract entered DROP, and thus fixed his or her retirement allowance amount before the City filed its lawsuit on November 20, 2007, and the member has since retired, SDCERS will specifically request that the City acquiesce to its continuing to pay for the underfunding created by the underpriced PSC contracts of this additional group of affected retirees.
13. SDCERS staff shall also meet with each of the affected employers to determine what (if any) assistance they might provide to members/beneficiaries impacted by Affected PSC Contracts.

WHEREAS, the above findings and correction methodology are implemented under the authority of Article 16, Section 17 of the California Constitution, which grants to SDCERS' governing Board "plenary authority and fiduciary responsibility" for administration of the fund; and

WHEREAS, the San Diego City Charter section 144 provides that SDCERS' governing Board "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

WHEREAS, San Diego Municipal Code section 24.0901 states: "The Board may make Rules it deems proper to administer the Retirement System consistent with its

fiduciary duties under Article 16, Section 17 of the California Constitution. The Board will identify the rules that are incorporated into this Article as part of the Plan document.”

NOW, THEREFORE, BE IT RESOLVED, that the Board hereby formally adopts the above findings and conclusions and instructs staff to present for adoption a Board Rule, to be designated as part of the Plan document, containing the following provisions:

Board Rule No. _____ Regarding PSC Corrections

1) **Employer Correction Option:** SDCERS will provide each of its employer plan sponsors with sixty (60) days following the adoption of this Rule to formally advise SDCERS whether or not they will voluntarily pay for some or all of the underfunding caused by the Affected PSC Contracts through the UAL amortization, or such shorter time period that the employer may elect.

2) **Member Correction Options:** To the extent that the employer of a member with an Affected PSC Contract does not pay for that underfunded amount, then SDCERS will provide the following correction options to members/beneficiaries with respect to all Affected PSC Contracts, subject to the timeline set forth in item 3 below and subject to any changes or adjustments required by the Internal Revenue Service in order to preserve the qualified status of the plans:

Option 1: Member/beneficiary may rescind the original Affected PSC Contract and receive a refund of his or her PSC contributions, plus interest. SDCERS will reduce associated service credit accordingly. In addition, if the member already has retired, SDCERS will adjust the member’s retirement benefit prospectively and if retirement benefits have been overpaid as a result of the inclusion of the underfunded service credit in the member’s retirement benefit calculations, then SDCERS will recover those overpaid amounts, plus interest, as set forth in this Rule.

Option 2: If the member is in active service and eligible to purchase PSC currently, the member may rescind the original Affected PSC Contract and apply the full refund plus any applicable interest to a new PSC contract based on the current rates and the member’s current salary.

Option 3: Member/beneficiary may request that SDCERS reduce his or her service credit to the lesser amount of service that would have been legally purchased by the member’s actual contributions under the Affected PSC contract if the higher post-window rate had been applied. Thus, no additional payment would be made by the member/beneficiary to SDCERS as a result of this correction; provided, however, that if the member has retired, is subject to this Resolution, and the member’s former employer has not agreed to correct the underfunding, then any benefits erroneously paid out as a result of the Affected PSC Contract are to be recomputed, and SDCERS is to recover overpayments plus interest from the member/beneficiary made to the member/beneficiary and adjust the member’s retirement benefit prospectively; or

Option 4: Member/beneficiary may pay, with interest, the difference between the amount paid at the “old” rate and the amount that should have been paid at the then Board determined rate to fund the full service credit originally anticipated in the Affected PSC Contract. In the alternative and if necessary for a member to remain eligible for service retirement and/or DROP, a member/beneficiary may make a “partial purchase” of PSC by paying, with interest, the difference between the amount paid at the “old” rate and the amount that should have been paid at the then Board determined rate to fund sufficient service credit in the Affected PSC contract to retain such eligibility; provided, however, that corresponding adjustments are made to any past and future retirement allowances, contributions, and interest. Payments due under this option may be made by lump sum or through a payment plan, including without limitation an after-tax payroll deduction, whose duration is not to exceed the amount of time to be purchased and will carry additional interest.

Option 5 (DROP): To the extent that a member with an Affected PSC Contract entered into DROP prior to the adoption of this Rule, SDCERS will permit the DROP election to be rescinded or reformed, to the extent legally permissible and, if applicable, subject to the member’s employer’s agreement. The member may then elect one of the above correction options.

3) Timeline and Default Board Action: If, within sixty (60) days of SDCERS providing written Notice of Options Re Purchase of Service Credit Corrections by certified mail of the above five options, any member/beneficiary does not voluntarily select one of the five options, then SDCERS will make a reasonable effort to contact that individual directly to determine whether the member has made a decision. If within ninety (90) days of SDCERS providing the original Notice SDCERS is unable to contact the individual or if the member does not voluntarily select an option, and if the Board, in its sole and exclusive authority, does not extend the time period for individual’s response based upon circumstances that may be presented to it by staff, then SDCERS will implement Option 1 above as to the member/beneficiary.

ADOPTED: _____, 2010

Raymond G. Ellis, Vice President
Board of Administration, San Diego City
Employees’ Retirement System

ATTEST:

Mark A. Hovey
CEO