

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
STAFF REPORT
COMPLIANCE DIVISION

DATE: December 4, 2006
TO: The Board of Administration
FROM: Roxanne Story Parks, Chief Compliance Officer
SUBJECT: December Compliance Report

I. TAX DETERMINATION LETTER & VOLUNTARY CORRECTION PROGRAM

To date, Ice Miller has made the following filings on SDCERS' behalf:

- a. Application for Tax Determination Letter (Form 5300) – **filed 7/12/05**
- b. VCP Filing on Presidential leave – **filed 7/12/05**
- c. VCP Supplemental Filings:
 1. Internal Revenue Code (IRC) Section 401(a)(17) [limit on annual compensation a qualified plan may “take into account under the plan for any year”] – **filed 4/19/06**
 2. IRC Section 401(a)(9) [required minimum distributions] – **filed 4/19/06**
 3. IRC Section 401(a)(31) [rollovers] – **filed 5/8/06**
 4. DROP – **filed 6/7/06**
 5. IRC Section 401(a)(2) [“cashless” leave conversion issue] – **filed 6/19/06**
 6. IRC Section 401(h) [Exclusive Benefit and Prohibited Transaction – Retire Medical Benefits] – **filed 6/23/06**
 7. IRC Section 401(a)(2) [Overpayment of Benefits – Corbett 10% disability issue] – **filed 6/23/06**
 8. 415(b), (c) and (n) [benefit limits and contribution limits (after-tax contributions for service purchases)] – **filed 8/9/06**

- d. Response to IRS regarding question on Determination Letter and VCP filings and supplements – **filed 8/31/06**
- e. Application for Private Letter Ruling on Preservation of Benefit Plans for City, Port and Airport – **filed 11/3/06**

In addition to the above filings, we are finalizing a report to the IRS on Plan Funding Issues – specifically, Manager’s Proposal I and II, which we expect will be filed this month.

I am also working with Ice Miller and Executive Staff to implement and monitor SDCERS’ tax compliance procedures -- to follow through on all of the commitments we have made to the IRS in the above filings.

II. ESTABLISHMENT OF PRESERVATION OF BENEFIT PLANS

In October, we finalized the documents necessary to establish a Preservation of Benefit Plan and Trust (POB Plan) for each of our three plan sponsors. The POB Plans are authorized by the City Plan (SDMC Section 24.1601, *et seq.*), and the Port and Airport Authority Plans (Division 14). The POB plans will be “Qualified Excess Benefit Arrangements” under IRC Section 415(m), and will allow payment of promised benefits to members and beneficiaries who would otherwise have their benefits capped by the 415(b) benefit limits.

On November 3, we filed our request for a Private Letter Ruling, seeking IRS approval of the POB Plans. The POB Plans have been provided to the City, Port and Airport Authority for their review, and Bob Wilson and I are in the process of meeting with each plan sponsor individually to finalize the plan documents and explain how the POB Plans will operate. We met with the Airport Authority’s CFO, Jeffrey Woodson, and Counsel, Breton Lobner and Carlos Heredia, on November 30, and have scheduled a meeting with the City’s CFO, Jay Goldstone, on December 7. We are still working on dates for a meeting with the Port.

III. ESTABLISHMENT OF GROUP TRUST

The process of establishing a Group Trust, within which each employer’s plan will be administered as a separate trust, is moving forward on schedule. I provided a draft of the Declaration of Group Trust to the Port and Airport Authority on October 30. I received comments and requested changes back from both agencies on November 8 and 9. Chris, Bob, Doug and I met with staff and counsel from the Port and Airport Authority on November 27, and we are in the process of fine-tuning the draft Declaration

of Group Trust. On December 4, I forwarded drafts of each employer's "Amended and Restated Retirement Plan and Trust" for their review and comments.

On November 17, the SDCERS Board adopted a resolution approving the Declaration of Group Trust "in concept." The Airport Authority's Board approved a similar resolution at its meeting on December 4. Peter Preovolos, David Wescoe, Rebecca Wilson and I attended that meeting. The Port Commissioners will consider a similar resolution at their meeting on December 5.

Once we have drafted a Declaration of Group Trust that is acceptable to the Port and Airport Authority, I will work with both agencies and the City to establish the Group Trust effective July 1, 2007. In addition, I will be working closely with Ice Miller to prepare the necessary tax filings to obtain approval for the Group Trust and a separate tax determination letter for each of the three separate plans.

IV. PENSION PROTECTION ACT UPDATE

On August 17, President Bush signed into law the Pension Protection Act of 2006 ("the Act"). The Act is over 900 pages long and makes very significant changes to the federal laws governing defined benefit plans, as well as a variety of other types of plans. Ice Miller has provided an extensive summary of the Act and is preparing us a more tailored analysis with specific recommendations for SDCERS. Some of the more relevant provisions are summarized below:

- a. Voluntary Correction Program: One of the most exciting provisions of the Act encourages the IRS to expand the Employee Plans Compliance Resolution System, which includes the Voluntary Correction Program in which SDCERS is currently participating. The provision "clarifies that the Secretary of the Treasury has the full authority," in the context of employee plan corrections, "to waive income, excise or other taxes to ensure that any tax, penalty or sanction is not excessive and bears a reasonable relationship to the nature, extent and severity of the failure."
- b. Rollovers by Non-Spouse Beneficiaries: The Act amends the Internal Revenue Code (IRC) to allow a non-spouse beneficiary who is eligible for a distribution from a qualified retirement plan to roll over the distribution to an individual retirement account or individual retirement annuity established for the purpose of receiving the distribution. The distribution must be one that would otherwise be eligible for rollover.
- c. Rollovers from Retirement Plans to Roth IRAs: Beginning January 1, 2008, SDCERS members will be able to roll over an eligible rollover distribution

to a Roth IRA. The rollover would be included in gross income, except for any portion that represents after-tax contributions. This option is available only to individuals with an adjusted gross income of less than \$100,000, excluding the individual's pension and the rollover amount itself. This rollover provision will be available to members who withdraw their employee contributions upon termination of employment and members taking a lump sum distribution of their DROP accounts.

d. Exclusion of Amounts Used for Health or Long-Term Care Insurance: This provision applies only to public safety officers, as defined in the Omnibus Crime Control and Safe Streets Act of 1986. It allows an eligible retired safety officer to exclude from federal gross income the amounts deducted from his or her pension to pay premiums for health or long-term care coverage for the retiree and his or her spouse and dependents, up to \$3,000 per year. The exclusion is available only if the retirement system deducts the premium payments from the retiree's pension and then remits the payments directly to the carrier. This provision takes effect January 1, 2007.

e. Purchase of Service Credit by In-Service Transfer from a 457(b) or 403(b) Plan: This provision allows our members to pay for the five-year purchase of service credit by plan-to-plan transfer from a 457(b) or 403(b) plan, without the requirement of certifying corresponding service with another employer. Staff has already implemented this provision.

V. STATUS OF TAX COMPLIANCE ORDINANCE

The Pension Protection Act will require amendment of our proposed Technical Tax Compliance Ordinance, which SDCERS has been attempting to docket for Council action since May 2005.

On May 10, 2005 the Board voted unanimously to adopt Resolution 05-01, which confirms the Board's intent to administer the SDCERS plan in accordance with the Technical Tax Compliance Ordinance, pending its adoption by the City Council. I anticipate having a revised proposed Ordinance before the Board in January 2007, incorporating changes in the law since May 2005, along with a new Resolution confirming that the Board will continue to administer the plan in accordance with the proposed Ordinance pending its adoption.

RSP/dlm