

# SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM STAFF REPORT

**DATE:** January 9, 2009

**TO:** Board of Administration

**FROM:** Elaine W. Reagan, General Counsel

*Elaine W. Reagan*

**SUBJECT:** DROP Interest Crediting

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To assist with the Board's discussion on DROP Interest Crediting, attached are excerpts of Jay Goldstone's remarks on behalf of the Mayor at the October 2008 meeting and a letter dated November 19, 2008 from Thella F. Bowens, President/CEO of the Airport Authority.

The Unified Port District has not yet discussed the issue with their Board but anticipates providing some input at the February Board meeting.

EXCERPTS OF COMMENTS FROM JAY GOLDSTONE  
RE: DROP INTEREST CREDITING  
OCTOBER 2008 BOARD MEETING

“[I] believe that responsibility and decisions must not only take into account the welfare of Plan Participants, but also the Plan Sponsors. I believe it is the Board’s responsibility (if not legally at least morally) to ensure that the financial strength of the Plan is maintained in order to minimize the volatility and level of ARC payments.”

“[I] am before you today to ask you to reconsider your past practice of paying DROP participants 8% on their DROP account and to also not tie the interest rate you do pay to the actuarially assumed rate of return, now at 7.75%. I believe this is too high.”

Mr. Goldstone’s suggestions were:

- Establish an index that can be easily calculated and verified
- Reset the rate once each year
- Use a five year average of a five year equivalent treasury

SAN DIEGO COUNTY  
REGIONAL AIRPORT AUTHORITY

P.O. BOX 82776, SAN DIEGO, CA 92138-2776  
619.400.2400 WWW.SAN.ORG

November 19, 2008

Mr. David B. Wescoe  
Administrator/CEO  
San Diego City Employees Retirement System  
401 West A Street, Suite 400  
San Diego, Ca. 92101

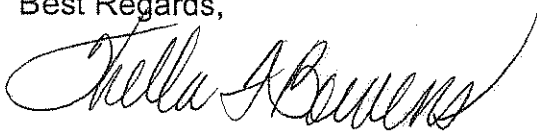
Dear Mr. Wescoe,

The San Diego County Regional Airport Authority (SDCRAA) submits the attached Board Resolution to offer our input into the determination of the DROP interest credit rate. In essence, the resolution states that SDCRAA recommends that the San Diego City Employees Retirement System (SDCERS) vote affirmatively to reduce the interest credit rate for DROP participants below the current 8% and consider future rate reductions in accordance with Internal Revenue Service regulations.

The Board suggests consideration of aligning the interest credit rate with the market rate to ensure plan sponsors are not responsible for additional liability due to unanticipated investment losses. The Board also expressed a desire to participate in the discussion and determination of future interest crediting rates.

Thank you for the opportunity to weigh in on this matter. Should you have any questions please feel free to contact me at 619.400.2445.

Best Regards,



Thella F. Bowens  
President/CEO



SAN DIEGO  
INTERNATIONAL  
AIRPORT

RESOLUTION NO. 2008-0144R

A RESOLUTION OF THE BOARD OF THE SAN DIEGO COUNTY REGIONAL AIRPORT AUTHORITY RECOMMENDING TO THE SDCERS BOARD AN INTEREST RATE USING THE CURRENT ANNUAL MARKET RATE OF RETURN ON DROP ACCOUNTS, THAT THE AUTHORITY PARTICIPATE IN THE DISCUSSIONS REGARDING THE DROP ACCOUNT INTEREST RATE AND TO EXPRESS THE AUTHORITY'S DESIRE TO MOVE AWAY FROM A FIXED INTEREST RATE

WHEREAS, the Amended and Restated San Diego County Regional Airport Authority Retirement Plan and Trust of 2008 ("Plan") provides Authority employees who were hired on or before October 2, 2006 who are eligible for a service retirement to elect to participate in a deferred retirement option plan ("DROP") as defined in the Plan; and

WHEREAS, for employees electing to participate in DROP, a "nominal" account is established within the Plan on behalf of participating employee into which is credited (1) an monthly credited amount calculated in the same manner as the employee's monthly retirement allowance, (2) an annual credited amount representing the an annual supplemental benefit ("13<sup>th</sup> Check") being a portion of any available surplus undistributed earnings of the Plan, (3) a biweekly credited amount equal to 3.05% of the employee's base compensation to be paid by the Authority, (4) a biweekly credited amount equal to 3.05% of the employee's base compensation deducted from the employee's salary on a pre-tax basis, and (5) credited interest on the above amounts as determined by SDCERS's Administrator [§1203 of the Plan]; and

WHEREAS, the credited interest rate to DROP accounts [see above in (5)] in recent years has been determined and set by the SDCERS' Administrator at 8% which has equaled the same annual interest rate as the actuarially assumed rate of return; and

WHEREAS, SDCERS reports that the current actuarially assumed rate of return is 7.75%; and

WHEREAS, the SDCERS Board is considering multiple options as to what interest rate to credit to each DROP account; and

WHEREAS, the SDCERS has requested the Authority, as plan sponsor, whether it would like to provide input regarding the decision to set the interest rate; and

WHEREAS, the Executive Personnel and Compensation Committee ("Committee") met on November 7, 2008 and fully discussed the issue of the DROP interest rate; and

WHEREAS, the Committee voted to recommend to the Board as stated below in this resolution;

NOW, THEREFORE, BE IT RESOLVED that the Board RECOMMENDS to the SDCERS Board that:

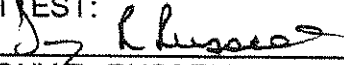
- (1) it supports the alternatives of SDCERS' use of an interest rate on DROP accounts equal to the current annual market rate of return on DROP accounts with the understanding that DROP account balances cannot be reduced;
- (2) it supports SDCERS' use of an interest rate on DROP accounts that will not result in any additional costs to the Authority as the plan sponsor;
- (3) it favors using a floating rate of interest rather than a fixed interest rate; and
- (4) it requests SDCERS permit the Authority to participate in the discussions regarding the decision on this matter; and

BE IT FURTHER RESOLVED that the Board in any event supports an interest rate no larger than the actuarially assumed rate of return on SDCERS retirement and DROP account funds.

PASSED, ADOPTED, AND APPROVED by the Board of the San Diego County Regional Airport Authority at a special meeting this 13<sup>th</sup> day of November, 2008, by the following vote:

AYES:	Board Members:	Boland, Desmond, Miller, Panknin, Watkins, Zettel
NOES:	Board Members:	None
ABSENT:	Board Members:	Bersin, Finnila, Young

ATTEST:

  
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TONY R. RUSSELL  
DIRECTOR, CORPORATE SERVICES/  
AUTHORITY CLERK

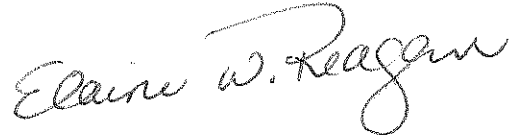
APPROVED AS TO FORM.

  
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BRETON K. LOBNER  
GENERAL COUNSEL

**SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM  
STAFF REPORT  
LEGAL DIVISION**

**DATE:** January 9, 2009  
**TO:** Board of Administration  
**FROM:** Elaine W. Reagan, General Counsel  
**SUBJECT:** DROP Interest Crediting

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Attached is Ice Miller's letter dated January 8, 2009 confirming that with the amendment to the Pension Protection Act found in the Recovery Act signed by the President on December 23, 2008, the SDCERS Board may adopt by rule any interest crediting rate for DROP accounts so long as the rate is adopted in accordance with the Municipal Code and any administrative rules or policies adopted in accordance with the Municipal Code. So long as the rate the Board adopts is in compliance with the SDMC and its Board Rules, it will be deemed a market rate of interest under the Pension Protection Act.

The Municipal Code contains the following provisions relating to DROP interest crediting:

Active DROP Accounts:

The San Diego Municipal Code section 24.1404(c)(6) provides that the Board determines the interest to be provided to active DROP accounts through "rules and regulations adopted under Division 9" of the SDMC.

DROP Annuity:

Section 24.1407(d)(2) of the SDMC provides that interest rates credited to a DROP annuity may not exceed the higher of 5% or the interest rate used to credit the active account at the time the Member retires.

January 8, 2009

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VIA ELECTRONIC MAIL AND U.S. MAIL

FOR PUBLIC DISTRIBUTION

Ms. Roxanne Story Parks  
Chief Compliance Officer & Associate General Counsel - Tax  
San Diego City Employees' Retirement System  
401 West A Street, Suite 400  
San Diego, CA 92101

**Re: *Impact of PPA Market Rate of Return Provision on the SDCERS  
DROP Interest Crediting Rate***

Dear Roxanne:

In response to your request, we have prepared the following analysis of the impact of the Market Rate of Return Provision from Pension Protection Act ("PPA") on the SDCERS DROP interest crediting rate.

**PPA Provision on Market Rate of Return**

The PPA prohibits hybrid defined benefit plans from providing an interest credit that exceeds a "market rate of return" ("Market Rate of Return Provision"). PPA Section 701. This requirement applies to governmental defined benefit plans, if the plans provide a benefit that is based (in whole or in part) upon a hypothetical account. The Internal Revenue Service ("IRS") and the Department of Treasury ("Treasury") have indicated that a governmental plan DROP account would be treated as a hypothetical account and the Market Rate of Return Provision would apply.

The "Worker, Retiree, and Employer Recovery Act of 2008" ("Recovery Act") amended PPA Section 701 with respect to the Age Discrimination in Employment Act ("ADEA") to provide that an interest crediting rate established under federal, state, or local law (including any administrative rule or policy adopted in accordance with such law) will be treated as a "market rate of return" so long as the interest crediting rate does not otherwise violate the ADEA. Recovery Act Section 123. The amendment made by the Recovery Act is retroactive to the enactment of the PPA.

The Recovery Act amendment resolved a controversy that had arisen between national organizations and the IRS and Treasury as to the interest rates that could be credited to governmental DROP plans (as well as other features in governmental plans). In guidance issued prior to the Recovery Act, Treasury had established "safe harbors" as to what constituted a market rate of return. These safe harbors were less than the current SDCERS DROP interest crediting rate (7.75%), and none of the safe harbors were based upon the actuarially assumed rate of return for a plan.

The Recovery Act was signed by the President December 23, 2008. The guidance issued by Treasury has not been revised to recognize the amendment made by the Act.

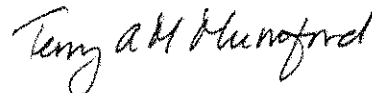
**What is the impact of the PPA, as amended by the Recovery Act, on the SDCERS DROP interest crediting rate?**

1. SDCERS is a governmental plan and is subject to the ADEA.
2. The ADEA contains general nondiscrimination provisions, which prohibit discrimination in benefit plans on account of age. In the case of hybrid plans, the ADEA also contains a specific prohibition on crediting interest greater than a market rate of interest.
3. Before the Recovery Act amendment, Treasury had issued guidance that could have been interpreted to limit the market rate of interest for the SDCERS DROP plan.
4. However, the Recovery Act provides that, in a governmental plan, the market rate of interest may be set by administrative rule or policy adopted in accordance with federal, state, or local law. Such a market rate of interest will be permissible so long as it is otherwise in compliance with the ADEA. The Recovery Act amendment is retroactive to the enactment of the PPA.
5. Therefore, the Recovery Act permits the SDCERS Board to adopt by rule (or policy) any interest crediting rate for DROP accounts so long as that interest crediting rate is adopted in accordance with federal, state and local law (the SDMC) and with the Board's fiduciary authority.

Please let us know if you have any questions.

Very truly yours,

ICE MILLER LLP



Terry A.M. Mumford

TAMM:jls/kwc

**CIRCULAR 230 DISCLOSURE**

Except to the extent that this advice concerns the qualification of any qualified plan, to ensure compliance with recently-enacted U.S. Treasury Department Regulations, we are now required to advise you that, unless otherwise expressly indicated, any federal tax advice contained in this communication, including any attachments, is not intended or written by us to be used, and cannot be used, by anyone for the purpose of avoiding federal tax penalties that may be imposed by the federal government or for promoting, marketing, or recommending to another party any tax-related matters addressed herein.



**MATERIAL WILL  
BE PROVIDED  
SEPARATELY**