

**PENSION REFORM COMMITTEE  
MEETING OF  
May 18, 2004  
3:00 PM – 6:00 PM Meeting**

**401 B Street  
Conference Room, 4<sup>th</sup> Floor**

**MEETING MINUTES**

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**Item 1: Call to Order**

**Item 2: Roll Call**

<u>Members Present</u>	<u>Members Absent</u>	<u>City Staff Present</u>
Steve Austin	Stanley Elmore	Paul Barnett, SDCERS Staff
April Boling		Mary Braunwarth
Robert Butterfield		Patricia Frazier
Tim Considine		Larry Grissom, SDCERS Staff
Judith Italiano		Pam Holmberg
William Sheffler		Chris Morris
Richard Vortmann		
Kathleen Walsh-Rotto		

**Item 3: Approval of Minutes**

There was a motion for approval of the minutes for the May 11, 2004 Pension Reform Committee (Committee) meeting from Tim Considine. The motion was seconded by Kathleen Walsh Rotto and passed unanimously.

**Item 4: Retirement Vested Interest**

Deputy City Attorney Chris Morris gave his presentation on Retirement Vested Interest. (see attachment.) Mr. Morris' presentation provided information on what types of changes the City could make to retirement and health care benefits for current retirees, current employees and

future employees based on their vested status. The Committee asked Mr. Morris questions about his presentation.

#### **Item 6: Discussion on Final Report**

The Committee discussed their recommendations on the items included in the draft outline of the final report (see attached.) Ms. Boling will prepare the draft narrative of the final report for the Committee's consideration. The Committee deferred discussion on the Introduction section of their report because Mr. Roeder's analysis on the sources of the \$1.16 billion unfunded liability is necessary for that element.

Under section one "Addressing the Deficit", the Committee agreed to use January 31, 2004 as the valuation date to measure the past service cost portion of the deficit. They will determine at a later date as to whether to use an updated report that includes February and March. Steve Austin provided an outline with his suggestions on how to measure the deficit (see attached document entitled "January 31, 2004 Accumulated Benefit Obligation.") The outline showed a deficit based on past service cost, 3 past Corbett payments, the 13<sup>th</sup> check and other contingent benefits. The Committee discussed the impact of including Corbett, the 13<sup>th</sup> check and other contingent benefits in their measurement of the deficit. Larry Grissom reminded the Committee that the 13<sup>th</sup> check has been paid 22 out of 23 years, and Corbett is a declining liability on the System because Corbett is a closed group. The Committee agreed to use the measurement in Mr. Austin's outline.

The Committee discussed the options to address the deficit that were included in the draft outline. Tim Considine recommended a combination of Pension Obligation Bonds (POBs) and securitizing the City's real estate assets as a method for paying off the deficit. The Committee discussed this recommendation. Mr. Austin felt that it is important to move the pension deficit onto the City's books so that it would have to be dealt with by the City. It was recommended that one way to pay down the deficit would be to utilize a three-year approach through a combination of POBs and real estate assets. In year one, the City would pay 1/3 of the deficit. In year two, the City would pay down 1/2 of the residual deficit. And in year three, the City would pay off the remaining deficit. The Committee members discussed this idea. The majority of the Committee felt that they needed to see the numbers behind this approach before they could make a recommendation. The Committee agreed to come back with numbers for next week's meeting. Ms. Boling asked Pat Frazier if she could provide an updated estimate for a \$100 million issuance of POBs.

The Committee did not vote on their recommended options for addressing the deficit. However, they did agree that their recommendations would focus on POBs, market, contributions from the City and employees and real estate assets.

The Committee discussed the issue of what their recommendation would be for the appropriate funding level. No decision was made, but Rob Butterfield said he thinks there may be a minority report submitted by certain members of the Committee to reflect different recommendations.

#### **Item 7: New Business**

There was no new business.

**Item 8:           Comments by Committee Chairperson**

Ms. Boling asked Mary Braunwarth to coordinate a conference call set-up for any members needing to call in for the meeting of May 25.

Ms. Boling distributed Mr. Roeder's latest report to the Committee. She asked that the next agenda include discussion on this report.

**Item 9:           Comments by Committee Members**

There were no comments.

**Item 10:          Non-Agenda Public Comment**

Mr. Gleason had submitted a request to speak but indicated that he would speak at another meeting.


Mr. Saathoff recommended that the Committee take a long term view of the pension deficit. He said that if you go back to 1975, the pension fund was 60% funded and there was not a plan to address the deficit at that time. He said that he agrees that the problem of the deficit needs to be addressed, however, there is more than enough money to continue to pay the fund in the short, medium and long run. He feels a three year fix is unrealistic in terms of this application. Mr. Saathoff also commented on POB's. He said that if you utilize a POB on a fixed rate, ten years from now it will be a much smaller percent of payroll than it is today because it is a fixed amount and the City payroll will grow. However, if you go with the actuarial fixed rate, the payments will increase because it is the same percent of payroll and payroll keeps increasing

**Item 11:          Adjournment**

The next meeting will be on Tuesday, May 25, 2004 at **3:00** PM at the same location.




**RETIREMENT  
VESTED INTERESTS**

- 
- May the City terminate or modify basic pension benefits, including the defined benefit plan, the method of calculation and the vesting status, without impinging on vested rights?

# Basic Pension Benefits

- Current Retirees - No
- Current Employees – No
- Future Employees – Yes, they may be re-negotiated, subject to the MMBA.

- 
- May the City terminate or modify post retirement health benefits without impinging on vested rights?

# Post Retirement Health Benefits – Current Retirees

- Current retirees vested status depends on the language of the MOU under which they retired.
- Subsequently enhanced benefits are only vested if supported by valid consideration.
- However, current retirees may be able to state a claim based on promissory estoppel.




# Post Retirement Health Benefits – Current Employees

- Although the law is unsettled, in our opinion, post retirement health benefits of current employees are a term and condition of employment and can be re-negotiated consistent with the MMBA.

# Post Retirement Health Benefits – Future Employees


- Individuals who are not yet employees have no right to any of the terms and conditions of current employees. However, such a change would be within the scope of bargaining and subject to meet and confer.



May the City terminate or modify the  
DROP benefit without impinging on vested  
rights?

# The DROP Benefit

- Current DROP participants – No
- Current Employees – No
- Future Employees – Yes, but it must be re-negotiated pursuant to the MMBA.



May the City modify or terminate the interest rate paid on DROP accounts without impinging on vested rights?

No, the rate is set by the Retirement Board.  
The vested nature of that rate is analyzed as follows:

# Interest Rate on DROP

- Current Participants and Retirees

Current participants and retirees have a right to receive an interest rate to their DROP accounts as set by the Retirement Board. There is no vested right to continue to receive 8%.

# Interest Rate on DROP- Current Employees

- Current employees do not have a vested right to 8% interest on their future DROP accounts. Instead, they have a right to a rate determined by the Board.

# Interest Rate on DROP – New Hires

- The City may modify the interest rate paid on the DROP accounts of future employees subject to meet and confer and approval of the Retirement Board.




# The Employee Pick-up

- There is no vested right to the current employee pick-up, as the pick-up is an employment benefit. Any change, however, is subject to bargaining under the MMBA.

# The COLA

- The COLA is a Pension benefit and is, therefore, a vested right for retirees and current employees.



May the City impose a disbursement schedule for DROP accounts without impinging on vested rights?

# Disbursement Schedule

- Current recipients

Current recipients have a vested right to receive the 240 month non lump-sum disbursement option established by the Municipal Code. They probably do not have a vested right to the interest only option. However, promissory estoppel may apply.

# Disbursement Schedule

- Current Employees

Current employees have a vested right to elect 1) a lump-sum distribution, 2) a non lump-sum distribution over 240 months, or 3) any other IRC-compliant benefit form approved by the Board.

# Disbursement Schedule

- New Hires

Future hires have no vested right to any disbursement schedule. However, any such change would require a change to the Municipal Code.

DRAFT OUTLINE  
FINAL REPORT TO COUNCIL  
Updated May 19, 2004

INTRODUCTION

- A. How we got here
  - 1. Roeder report
  - 2. 1996 start date
  - 3. Order of magnitude
    - a. Stock market
    - b. Benefit enhancements
    - c. Under funding
  
- B. Where we are
  - 1. April's presentation (4/19/04 to City Council)

RESOLUTIONS

- I. Addressing the deficit
  - 1. The Measurement
    - a. Pick a date – 1/31/04
      - report date – mid-late May 2004
      - \*Market value as of February 2004 (2/29/04 data as reviewed internally by Management)
    - b. Value of contingent benefits and inclusions
    - c. Address all contingent benefits (Corbett and 13<sup>th</sup> Check etc.)

Recommendation: \$1.2 bil (attachment)

- 2. Options
  - a. POBs \*
  - b. Hope (Market) \*
  - c. Contributions from the City/employees \*
  - d. Real Estate Assets \*
  - e. Decreasing number of participants
  - f. Changing the assumptions
  - g. Early retirement
  - h. Use of tax increase

\* Recommendation: 3 stage approach using POBs, Real Estate Assets

- a. Yr. 1 pay down 1/3 of deficit - in place by 12/31/04 (based on 6/30/04 valuation)

- b. Yr. 2 pay down ½ of residual deficit –in place by 12/31/05  
(based on 6/30/05 valuation)
- c. Yr. 3 pay down remaining deficit – in place by 12/31/06  
(based on 6/30/06)

## II. Plan design

- 1. Changes to benefits for new hires
  - a. High one year salary changed to high three year or five year.
  - b. Changing to defined benefit plan
  - c. Elimination of DROP
  - d. Changes of the percentage per year, i.e. 2.5% to 2.0%
  
  - e. Changes to retirement age – up by one year
  - f. COLA decrease
  - g. Enhancements for current retirees
- 2. Changes to Structure
  - a. Separating from Pension Fund-Retiree Health Care.

## III. Funding policy – Defined Benefit

- 1. Key Decision Points:
  - a. Amortization of normal gains and losses (demographics)
  - b. Smoothing vs. Market Value Measurements (yes, no, length of time)
  - c. Shortfall in funded status at each measurement date
    - \* Minimum funding (floor)
    - \* Two or more layers
    - \* Optimal funding
  - d. Amortization of past service cost – for new benefits, Charter change?
  - e. Funding status ratios – including overfunded %
  - f. Address Corbett and 13<sup>th</sup> check
  - g. EAN vs, PUC

## IV. Funding Policy – OPEBs

- 1. Key Decision Points
  - a. Measurement Issues – standards
  - b. Segregation of Funds
  - c. Pro forma disclosures
  - d. Management of Benefit Increases



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- e. Governance
- f. Plan Changes

V. Governance

1. Key Decision Points

- a. Disability Retirement
- b. Optimum Number of Members
- c. Conflict of Interest – Independence issues
- d. Qualifications
- e. Compensation
- f. Investment Policy Restrictions
- g. Sarbanes-Oxley – types certifications
- h. Identify Officers or others responsible for funded status

VI. Improved disclosure/communication

1. Key Decision Points

- a. Disclosure in City’s financial statements
- b. Frequency of communications to the City
- c. Formal communication of the cost of new benefits

VII. Transition summary

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## Attachment A