



EMPLOYEE RELATIONS BULLETIN

December 19, 1989

To: Heads of all Departments of City Government
(except Water and Power)

Subject: CHANGES IN THE CITY EMPLOYEE'S RETIREMENT SYSTEM TO
COMPLY WITH THE INTERNAL REVENUE CODE

The City Council has recently adopted an ordinance amending the City Employee's Retirement System (CERS) to comply with Section 415 of the Internal Revenue Code. The purpose of the ordinance is to ensure that CERS maintains its tax-qualified status, thereby allowing employees to continue to defer taxes on their benefits until received at retirement. It was enacted following negotiations and agreement with a coalition of employee organizations representing CERS members.

Although Section 415 places limitations on benefits that can be paid from tax-qualified plans, it also provides an option for avoiding those limits for employees who become CERS members prior to January 1, 1990. The Council, in amending CERS, has taken advantage of the Section 415 provision that protects (grandfathers) the benefits of all such employees. Therefore, all employees who are CERS members prior to January should be assured that their benefits will not be affected by compliance with Section 415.

The Committee report adopted by Council that explains the basis for the Council action is attached.

10-31, 11-15, 12-1

CITY ADMINISTRATIVE OFFICE

File No. 89-2065

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TO THE COUNCIL OF THE
CITY OF LOS ANGELES

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Your HUMAN RESOURCES AND LABOR RELATIONS Committee
AND
BUDGET AND FINANCE Committee

report as follows:

Public Comments Yes No
X

Subject

HUMAN RESOURCES AND LABOR RELATIONS COMMITTEE and BUDGET AND FINANCE COMMITTEE REPORT and ORDINANCE relative to required changes in the City's retirement plans as mandated by Internal Revenue Code Section 415.

Recommendations for Council Action, as recommended by the City Administrative Officer:

For the City Employees' Retirement System (CERS):

1. Your Committees recommend adoption of an ordinance amending the City Employees' Retirement System to comply with Internal Revenue Code Section 415 limits. Your Committees recommend that Council take the following actions in accordance with Council policy for ordinances introduced pursuant to Charter Section 512.2:
 - a. PRESENT the accompanying ordinance on first presentation at the time this Committee report is adopted, and PLACE the matter again on the Council Agenda on December 1, 1989.
 - b. HOLD a Public Hearing before the full City Council on November 15, 1989, and CONTINUE such public hearing to December 1, 1989.
 - c. CONCLUDE the Public Hearing and ADOPT the subject ordinance on December 1, 1989 (second presentation).

The abovementioned ordinance would enable the City to exercise the option allowed by Internal Revenue Code Section 415(b)(10) to grandfather benefits for employees who are plan members prior to January 1, 1990, and incorporate other applicable provisions of Section 415 into the plan for employees who are plan members on or after January 1, 1990. The ordinance would further enable the City to maintain the current level of benefits for future employees subject to reductions under the Internal Revenue Code.

TO THE COUNCIL OF THE
CITY OF LOS ANGELES

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| Your | HUMAN RESOURCES AND LABOR RELATIONS | Committee |
| | AND | |
| | BUDGET AND FINANCE | Committee |

report as follows:

become liable for taxes on the current imputed value of their vested benefits as of the date of disqualification.

Since its effective date in 1976 and indexed until 1982, Section 415 dollar limits were high enough not to raise concerns for government plans. Additionally, the Internal Revenue Service had ruled in 1977 to defer enforcement for government plans until specific regulations could be developed.

Since 1976, Section 415 limits have been changed several times. Limits were reduced in 1982 and 1986. In 1986, for the first time, government plans were specifically addressed in the legislation, in an apparent attempt to bring them more in line with private plans and to share the burden of the Federal deficit. They were still, however, partially protected by a provision that retained higher limits (a \$75,000 "floor" for retirements between ages 55 and 62) contained in the 1982 Act, and by a special rule (a \$50,000 "floor") for plans covering police and firefighters. The assumption at the time was that these higher limits would protect most government plans from violation of Section 415.

The Passage of TAMRA by Congress in 1988 marked a significant change in the status of government plans under Section 415. The TAMRA legislation, along with a recent ruling by the IRS rescinding its prior non-enforcement policy, is a clear indication that the Federal government is serious about application of Section 415 to public plans.

However, the TAMRA legislation provides a "window of opportunity" for government plans to comply with the Section 415 limits. TAMRA allows plans maintained by public employers to "grandfather" the benefits of participants (employees who become plan members) into the City's existing benefits before January 1, 1990, even though those benefits may exceed current Section 415 limits, in exchange for complying with more stringent rules for new employees. Election of the grandfather option would restrict a plan from modifying benefits for current and future employees that would exceed the limits.

Impact on the City's Three Pension Plans

The City's primary concerns are the following defined limits of Section 415. For 1989, they are the lesser of:

TO THE COUNCIL OF THE
CITY OF LOS ANGELES

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| Your | HUMAN RESOURCES AND LABOR RELATIONS | Committee |
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| | BUDGET AND FINANCE | Committee |

report as follows:

could possibly face an immediate tax liability of several thousand dollars on the current value of their pensions. All employees, both current and future, could be taxed annually on the amounts contributed to their pension accounts and the earnings on those accounts.

In addition to exercising the grandfather/compliance option, the CAO also recommends that the City explore alternatives to make new employees "whole", i.e. devise a system whereby the benefits for new employees would comply with the new law and also be comparable with the benefits of grandfathered employees.

The unions representing members of CERS have agreed to the grandfather election on the assumption that the City shall maintain benefits for current and future employees subject to possible reductions under Section 415.

2. Fire and Police System

The actuary for Fire and Police System has determined that current members of the Article 18 plan who retire below age 55 and earn over \$75,000 (i.e., Police Captain and above), as well as employees receiving maximum service disability pensions, would earn benefits exceeding the Section 415 limits. Therefore, the actuary recommends that the grandfather option be adopted.

For future employees (all under Article 35), the maximum pay limits would probably only affect the ranks of Chief of Police and Chief Engineer. This is because members of the Article 35 plan pay 8% in after-tax employee contributions, thereby reducing the employer paid benefit portion. Additionally, employees receiving maximum disability pension could continue to receive benefits in excess of the limits. The benefits of these members would have to be reduced in order to comply with the limits.

Changes to the Fire and Police Pension Plan can only be made by Charter Amendment. The Board of Pension Commissioners has adopted a resolution requesting that such a measure be placed on the June 1990 ballot, that would elect the grandfather option and incorporate the provisions of Section 415 into the City Charter. However, this raises concerns about the status of employees who become plan members between January 1, 1990 and the date of that election. It is uncertain whether the Charter amendment can apply retroactively to these employees. It is possible that the IRS could provide transitional relief (i.e., not enforce the limits) for this group. If not, it will be necessary for the City to provide a supplemental benefit for employees facing a benefit

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