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CITY OF SAN DIEGO
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November 19, 2007

TO: Honorable Mayor Jerry Sanders & Members of the City Council

FROM: City Attorney Michael Aguirre

RE: Request for Action by City Council on Purchase of Service Credit Program

This memorandum is sent to again urge City Council President Scott Peters to docket for immediate consideration by the San Diego City Council the matter of the Purchase of Service Credit (PSC) program. It is also to inform you that legal action will be taken against the San Diego City Employees' Retirement System (SDCERS) by the Office of the San Diego City Attorney to require full cost pricing for sold pension service credits.

On September 21, 2007, the SDCERS confirmed that \$146 million of the City's \$1 billion pension liability is attributable to the PSC program due to the discounted pricing formula set by past SDCERS Boards. Under the PSC program, City employees were allowed to purchase up to five years of retirement credits for years not actually worked below actual cost.

That same day, Mayor Jerry Sanders released a statement: "I am angered by this revelation and find it to be completely unacceptable...I strongly urge the Retirement System's trustees to do everything within their power to correct the problem immediately. Unless they take decisive corrective action, the taxpayers will end up paying the price for a program that should be cost neutral to the city."

On Friday, November 16, 2007, the SDCERS Board unanimously approved in closed session a motion to require the City of San Diego (i.e., taxpayers) to absorb the \$146 million liability that was created when thousands of city employees were allowed to purchase service credits far below their actual cost.

The Office of the San Diego City Attorney has repeatedly requested that the City Council docket and adopt a municipal code provision that corrects the SDCERS' failure to price at actual cost the service credits sold to plan participants. This was the legislative intent when the PSC program was expanded in 1996.

Record of City Attorney Memoranda, Reports, and Recommendations on PSC Program

Attachment #1

January 7, 2005

**Memorandum to Mayor, City Council and City Manager
City Employees' Pension Reform**

City Attorney recommends the "San Diego City Council must act to reduce the \$1.167 billion unfunded accrued actuarial liability ("UAAL") in the City's employee pension plan. If the Council does not decisively act, the retirement contribution will consume 36.51% of payroll in FY 2009, as compared to 13.43% in FY 2004...Specifically, the City Attorney is calling upon this Council to undo the retroactive increases of the past and give employees the level of benefits they are entitled to, based upon the contributions they made at the time the benefits were earned."

Attachment #2 (Due to Attorney to Client Correspondence only a portion of the memo is included)

February 11, 2005

Memorandum to Mayor and City Council

Meet and Confer: In re: Conference with Labor negotiator, pursuant to Gov't Code section 54957.6

"The purchase of service credits was a bargained for benefit embodied in the San Diego Municipal Code (Sections 24.1301) which requires payment of an amount the Retirement Board determines to be the employer and employees cost. However, the actual amount being charged the employees through this year is less than the actual cost. In fact, for each year purchased, there is a loss of \$3,725 with a total of approximately \$75 million in losses as of 6/30/04 and a total loss anticipated to be \$100-125 million."

Attachment #3

February 22, 2005

Memorandum to Mayor and City Council

Legal Action Plan to Address the City's Financial Condition

City Attorney unveils 8-point plan and recommends "that the Mayor and City Council authorize the City Attorney to take all legal steps necessary to rescind any and all unlawful pension benefits granted in violation of either California State law or the San Diego City Charter."

Attachment #4

April 27, 2005

Memorandum to Mayor and City Council

Purchase of Retirement Service Credits

The City Attorney notes that "certain members of the Council have purchased retirement system service credits at a cost below actual value....This subsidy is not permitted under law...I respectfully suggest that you contact the retirement system and arrange for a readjustment of your purchase service credits to actual value of amounts paid by you... As outlined in the City Attorney's reports 2 and 3, the subsidized purchase of service credits is a major factor in the

Unfunded Accrued Actuarial Liability. The elimination of this subsidy would have a significant positive impact on the retirement system deficit.”

Attachment #5

January 4, 2007

Memorandum and Draft Ordinance to Mayor and City Council

Amendment of the San Diego Municipal Code Related to the Purchase of Service Credits; Potential Conflicts of Interest; Rule of Necessity

City Attorney recommends “various amendments to section 24.1312 of the San Diego Municipal Code relating to the retirement system and the purchase of service credits. In particular, the cost of purchasing service credits may increase under the proposed amendments. Also, the proposed amendments specify that years of service credits that are purchased cannot be used towards the requirement that employees complete ten years or twenty years of service (depending on age) before retiring as provided under Charter Section 141.”

Attachment #6

July 10, 2007

Memorandum to the Mayor and City Council

Settlement Offer of the Pension Litigation

Among the recommendations: “Reduce the purchased years of service to the actual value purchased.”

Attachment #7

July 30, 2007

Memorandum to the Mayor and City Council

Rescission of Resolution R-297335

In recommending to the City Council that they rescind Resolution R-297335 (November 18, 2002) that indemnifies Board members of the San Diego City Employees’ Retirement System (SDCERS), the City Attorney states that “Board members violated conflict of interest laws, or engaged in a *quid pro quo* exchange which is a violation of several state laws,” in connection to under funding the pension system.

Attachment #8

August 10, 2007

Memorandum to the Mayor and City Council

Rescission of Retroactive Pension Benefits, DROP and Purchase of Service

City Attorney recommends the “City Council immediately place on the City Council’s public agenda a series of recommended actions (presented here with supporting data and analysis) in connection with the retroactive increase in the pension multiplier, the extension of the DROP program, and the false pricing of pension credits.”

Attachment #9

September 7, 2007

Letter to Mayor Jerry Sanders

SEC Investigation

City Attorney reviews SEC cease and desist order which found that San Diego officials violated the anti-fraud provisions of the federal securities laws. Under “Remediation” section the City Attorney states that “City employees were permitted to buy purchase service credits but they were allowed to do so at below the full value. Granting purchase service credits at prices below the value received by the employees constitutes a gift of public funds and violates the liability limit law both of which are prohibited by the City Charter and State Constitution. The 17,000 years of purchase service credits must be reduced to actual value.”

Attachment #10

September 21, 2007

Mayor Sanders E-mail to All Employees

Sanders Finds \$146 Million Pension Service Credit Liability Unacceptable

Mayor Sanders asks the City Attorney to provide the Mayor’s Office with unilateral options that the City can take to rescind \$146 million in pension liability resulting from the “Purchase of Service Credit” (PSC) program which was supposed to be cost-neutral to the City.

The Mayor’s request stemmed from the San Diego City Employees’ Retirement System (SDCERS) announcement on September 21, 2007 that 15% of the City’s \$1 billion pension liability, or \$146 million, is a direct result of the PSC program. The program allowed City employees to purchase up to five years of retirement credits for years not actually worked at a discounted price.

Attachment #11

September 24, 2007

City Attorney Proposed Ordinances Sent to City Council

In response to the Mayor’s request, the City Attorney prepared two ordinances: 1) amend the San Diego Municipal Code to require any benefit paid for creditable service purchased under section 24.1312 to not exceed the actual value of the amount paid for the creditable service; and 2) amend the San Diego Municipal Code to require any benefit paid under the DROP Program to be administered on a cost neutral basis to the City.

Attachment #12

October 5, 2007

Memorandum to the Mayor and City Council

Council Approved Needed for Pension Reform that Would Save the City \$500 Million

The City Attorney states that “the first reform proposed by this office would amend Municipal Code section 24.1312.2 to make clear that the years purchased are not counted toward the 10-year vesting period...The reform also would ensure that City employees receive credit for service credits they purchased in the amount they actually paid—and no more. This would save the City more than \$146 million.”

Attachment #13
Interim Report No. 2
February 9, 2005

Regarding Possible Abuse, Illegal Acts or Fraud by City of San Diego Officials

City Attorney Interim Report No. 2 outlined how the subsidized purchase of service credits is a major factor in the Unfunded Accrued Actuarial Liability (UAAL). The elimination of this subsidy would have a significant positive impact on the retirement system deficit.

The Report concluded there is substantial evidence consistent with a finding that the Mayor and City Council did attempt to conceal and did conceal the granting of pension benefits in exchange for the waiver of the trigger and balloon payments.

Attachment #14
Interim Report No. 3
April 8, 2005

Regarding Violations of State and Local Laws as Related to the SDCERS Pension Fund

City Attorney Interim Report No. 3 outlined how the subsidized purchase of service credits is a major factor in the Unfunded Accrued Actuarial Liability (UAAL). The elimination of this subsidy would have a significant positive impact on the retirement system deficit.

The report discussed the nature of the City's deficit, its causes and what the City can do to begin recovering from the crushing debt it has incurred. It recommended that the Mayor and City Council adopt new municipal ordinances which would require the Board to operate within the standards of the Employee Retirement Income Security Act.

Attachment #15
Interim Report 12
September 18, 2006

"Report on Scheme to Price San Diego City Employees' Retirement System (SDCERS) Pension Service Credits Below Cost in Violation of California Law"

The report outlined how purchase of service credits were priced below their actual cost and concluded:

- The San Diego City Employees' Retirement System violated their fiduciary duties to the pension system by knowingly and willingly pricing the years of service credits below their cost to the City, thereby placing the financial security of the system in jeopardy; and
- It is the City Attorney's considered judgment that legal action needs to be taken to correct the misappropriation of public funds used to subsidize the illegal pricing scheme for the Pension of Service Credit program.

November 19, 2007

Sincerely yours,

MICHAEL J. AGUIRRE, City Attorney

By
Michael J. Aguirre
City Attorney

MJA:meb