

Retirement Services

NOV 12 2024

City of San Jose

November 6, 2024

Spencer Horowitz, Chair
Members of the Board of Administration
John Flynn, Chief Executive Officer
San Jose Federated City Employees Retirement System
1737 N. 1st Street, Suite 600
San Jose, CA 95112

Dear Mr. Horowitz,

We were plaintiffs in the recently concluded lawsuit regarding the reduction of retirement benefits due to section 415 of the Internal Revenue Code. As you may know the litigation lasted 8 years. The lynchpin in the case was an ordinance adopted by the City in 1989. We are making an appeal to you, as our situations are somewhat unique from the other plaintiffs given our purchase of service credits and the selection of the 100% survivor benefit.

The 1989 ordinance ordered that the benefits payable to any person who became a member of the Federated City Employees Retirement System (FCERS) prior to January 1, 1990, shall be subject to the greater of the following limitations as provided in section 415 (b) (10) of the Internal Revenue Code:

1. The limitations set forth in Section 415 of the Internal Revenue Code; or
2. The accrued benefit of the member without regard to any benefit increases pursuant to any amendment of this System adopted after October 14, 1987.

The 2nd provision is frequently referred to as TAMRA, after the name of the enacting legislation, the Technical And Miscellaneous Revenue Act. The members who were part of the Federated Retirement system prior to January 1, 1990, are defined as being "qualified" and commonly referred to as "grandfathered."

The implementation of the 1989 ordinance is perplexing. Therefore, each year the Office of Retirement Services (ORS) sends to the affected retirees a letter explaining the retirees' benefits. Most of the retirees receive a letter that states,

Since you became a member of the Plan prior to January 1, 1990, you are considered a qualified participant, or "grandfathered". Being grandfathered means, your pension will not be lower than the benefit structure in place on October 14, 1987; this does not include any benefit enhancement post October 14, 1987 (i.e. 3% COLA, 1 Year Final Average Salary, 100% survivor option and service purchases). If your pension benefit in the absence of the 415(b) limit exceeds your individual maximum under 415(b), your pension will be adjusted. As a "grandfathered" participant, your individual annual maximum 415(b) dollar limit will then be compared to your "grandfathered" benefit. You will receive the greater of your individual annual 415(b) limit or your "grandfathered" limit.

We, however, receive a much different letter. It omits any reference to being "grandfathered". It states,

Your individual limit is based on the maximum 415(b) benefit allowable for FCERS retirees, your age at retirement and inclusion of any post tax contributions. Retirement Services compares your pension benefit in the absence of the 415(b) limit to your individual maximum under 415(b). If your pension benefit exceeds your individual annual maximum 415(b) limit, your pension will be adjusted.

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The ORS staff has explained that the ability to purchase service and/or select the 100% survivor option was not available to plan member prior to October 14, 1987, so if we used purchase service towards retirement eligibility or selected the 100% survivor option, we would not be considered a "qualified" participant and therefore lose the grandfather status. This information was withheld from us at the time of our retirements.

The loss of the grandfather status is in violation of the 1989 ordinance and inconsistent with the FCERS remedy of other amendments to the plan, as described below:

1. Amendment that added automatic annual 3% COLA – The remedy is to annually recalculate the participants' benefits by replacing the 3% COLA with the Bay Area COLA, in compliance with the 1989 ordinance.
2. Amendment that added 12 month highest salary – The remedy is to annually recalculate the participants benefits by replacing the 12 month highest salary with the 36 month highest average annual salary in compliance with the 1989 ordinance.
3. Amendment that added 100% survivor option – The remedy is the loss of the grandfather protection which is in contradiction to the 1989 ordinance. To begin with this option is not a "benefit increase". For example, Randal Turner's benefits are reduced \$759 per month compared to the benefits he would receive with the 50% survivor option. If the 100% option is still considered an increase in benefits, to be consistent with the 1989 ordinance, affected participants should have the choice to surrender the 100% survivor option and have their benefits recalculated pursuant to amendments #1 and #2 above.
4. Amendment that added option to purchase service credit – The remedy is the forfeiture of the "qualified" participant status and loss of the grandfather provision, in contradiction to the 1989 ordinance. Instead of forfeiture, the benefits should simply be recalculated. For example, Wayne Tanda purchased 0.6 years of service credit toward a maximum of 30.0 years of service time. The service time would be reduced to 29.4 years, and the date of retirement and retirement age would be adjusted, and the benefits recalculated pursuant to amendments #1 and #2, above. In addition, the purchase of service credits would be returned to Wayne. In fact, in 2015 the FCERS Board approved the return of service credit purchases to two employees who were in jeopardy of losing their grandfather status when they retired, as described in the attached ORS Board report related to City Manager David Sykes.

In summary, using Wayne as an example, prior to his retirement in 2002, he followed the advice of ORS to consider the purchase of service credit. Ultimately, he contributed \$23,701 for the purchase of 0.6 years of service credit. Wayne retired and for the next 12 years received the retirement benefits promised by the City and that he had paid for through 3 decades of contributions. In 2014 the ORS informed Wayne for the first time of the existence of IRC 415(b) and that it affected him. ORS immediately reduced his benefits, without due process. A few months later, unlike most of the other qualified participants, Wayne was informed by ORS staff that he had lost his grandfather status because of the purchase of service credits in 2002. His retirement benefits were further reduced.

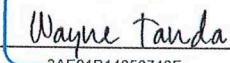
Wayne could have avoided the limitations of 415(b) altogether if he had been properly advised by ORS prior to his retirement. This would be consistent with the FCERS' mission, "To provide accurate, timely benefits and high-quality services to its members." ORS failed Wayne in 2002 and again in 2014.

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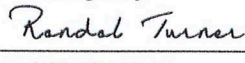
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The circumstances for Randal Turner, Lawrence Jay Castellano, and Anita Phagan, are similar. We hope that, at a minimum, considering our unique and extraordinary set of circumstances, that in 2024 we would be reinstated as "qualified" participants and that a mutually acceptable resolution of our benefits are agreed upon. Based on the actions taken for the City Manager, Mr. Sykes, our understanding is that the decision rests solely with the FCERS Board.

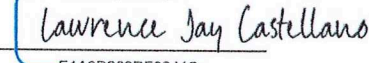
Respectfully,

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Wayne Tanda

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Randal Turner

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Lawrence Jay Castellano

Signed by:

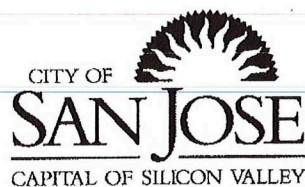
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Anita Phagan

Attachment – January 14, 2015, Correction of Contribution Error Request for David Sykes

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Memorandum

**TO: Board of Administration for the Federated
City Employees' Retirement System**

FROM: Donna Busse

**SUBJECT: Correction of Contribution Error
Request from David Sykes**

DATE: January 14, 2015

Approved

Roberto L. Pera

Date

1/15/15

RECOMMENDATION

Discussion and action on correction of error regarding contributions received from active member, David Sykes.

BACKGROUND

In August 2000, David Sykes entered into an agreement to purchase 1.50625 years of service for part-time service worked from January 1987 to September 1989 as allowed pursuant to Part 22 of the San Jose Municipal Code (Sections 3.28.2500 – 3.28.2540). The base contribution made for the purchase of service was \$28,636.31 as calculated by his salary at the time of his election and the contribution rates for the employee and the City at the time of his election. In addition, Mr. Sykes elected to pay the required contributions through 104 bi-weekly payroll deductions (four years). The interest charged for that method of payment was \$4,438.81. In total, Mr. Sykes agreed to pay the System \$33,075.12 through bi-weekly pre-tax payments of \$318.03 from August 19, 2000 through July 31, 2004.

In February 2014, Mr. Sykes contacted the Department of Retirement Services (DRS) to obtain more information on the Internal Revenue Code Section ("IRC") 415b which limits the amount of retirement benefit an employee may receive. In particular, he was interested in how his Service Purchase affected his ability to be considered a "qualified participant" under the IRC which would protect his benefit accrued without regard to plan amendments made after October 14, 1987 ("Grandfathered Benefit"). Staff advised Mr. Sykes that the ability to purchase service was not available to plan members prior to October, 14 1987, so if he used purchased service towards retirement eligibility, he would not be considered a qualified participant.

ANALYSIS

Attached is a letter received by the Director of DRS from David Sykes. In his letter, Mr. Sykes requests a return of his retirement contributions paid as part of his service purchase agreement. He cites that at the time of his service purchase election, he was not provided information regarding the impact of such an election would have on his ability to be a qualified participant.

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In addition due to the recent 415 information provided to him by DRS, he calculates that his retirement benefit would be greatly impacted by the 415 limit and that the ability to have his "Grandfathered Benefit" reduces that impact.

If Mr. Sykes were to retire at age 55, he could be impacted by the 415 limit by over \$2 million dollars after 25 years of retirement as he states in his letter, depending on much the IRS raises the limit during that period. If he were allowed to receive his "Grandfathered Benefit", his impact could be reduced by over 50% depending on the annual CPI increases over the same period.

Staff has consulted with both Fiduciary Counsel and Tax Counsel regarding the Board's ability to grant such a request. Staff was advised by Fiduciary Counsel that there is a provision in the SJMC that the Board could rely upon in order to correct an error in contributions:

3.28.230 Adjustment of contributions and payments.

If more or less than the correct amount of contribution required of members or the city is paid, proper adjustment shall be made in connection with subsequent payments, or such adjustments may be made by direct cash payments between the member or the city and the board. Adjustments to correct any other errors in payments to or by the board may be made in the same manner.

Tax Counsel agreed that correcting an error in contributions would be allowed in this case as the member used bi-weekly pre-tax payroll deductions to purchase the service. There are some forms of payments where it probably would not be allowed, such as a transfer from the City's Deferred Compensation 457 Plan. Tax Counsel was mainly concerned that the member was properly counseled and the correction would be beneficial to him; the contributions and interest returned to Mr. Sykes would be taxable; and returned in the same manner received (through the City).

COST

The Board has not established a policy for correcting errors in contributions to implement the language of the Municipal Code. Staff is currently working with Fiduciary Counsel to develop such a policy. In the situation when it is determined that there has been an error by staff, appropriate interest could be applied to the return of contributions. The interest could be determined by various methodologies, and is in the Board's exercise of discretion to establish:

1. 3% per year, applied semi-annually – This is the interest that is credited to all member contributions when there is a regular return of contributions to a member, per the SJMC
2. Actual Earnings of the plan during the period, applied annually
3. Actuarial Assumed Rate, applied annually
4. Any other methodology as directed.

Estimated interest based on 104 payments of \$318.03 from August 2000 through July 2004:

<u>Interest Methodology</u>	<u>Estimated Interest</u>
3%	\$15,000
Actual Earnings (7.5% since inception, net of fees, as of 6/30/14)	\$50,000
Actuarial Assumed (7%)	\$45,000

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Dear Roberto Pena

January 15, 2015

Subject: Retirement Contribution Correction

This letter is to respectfully request the return of retirement contributions collected as part of a service purchase agreement. Although the purchase was considered irrevocable, I believe the contributions were collected erroneously.

Recently, Retirement Services Staff have made me aware of the impacts of IRS Code Section 415 and the associated benefit limits which will place a cap on my annual retirement payment. In my case, the estimated required withholding would be between \$1.3M and \$2.0M over a 25-year period. Given the severity of this impact and in the absence of a Replacement Benefit Plan, I have no choice but to retire under the "Grandfathered Benefit" (TAMRA) which allows qualified participants to retire under the rules of the retirement plan as of October 14, 1987. However, I have also been informed that to take advantage of the "Grandfathered Benefit", I will need to retire without using my service purchase since it was not part of the 1987 retirement plan.

In August 2000, I entered into an agreement with the City to purchase 1.50625 years of retirement service credit earned while I was a part-time employee. The total cost of the purchase, including interest charged by the City, was \$33,075.12. At the time of this purchase, there was no disclosure regarding the benefit limits associated with IRS Code Section 415 or that the service purchase would disqualify me from retiring under the "Grandfathered Benefit" provisions. Therefore, I believe that the service purchase agreement was made without consideration of the appropriate facts and resulted in an invalid contract.

In conclusion, I am requesting the return of contributions collected as part of the service purchase agreement for the reason describe above as well as the payment of lost interest earnings on the purchase amount. I would also like to express my appreciation to you and Deputy Director Donna Busse for your assistance and support through this difficult process. Thank you for your consideration of this matter and if you have any questions, please contact me at 408-535-8440.

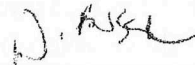
Sincerely,
David Sykes

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STAFF RECOMMENDATION:

The issue and impact of IRC 415b has only recently been communicated in detail to participants by DRS. At the time of the service purchase by Mr. Sykes, DRS did not provide information on the 415b limits and the impact such a purchase would have on his ability to be a qualified participant and the elimination of the alternative to the limit available to him. Staff recommends that the Board find that this event was an error in receipt of contributions and direct staff to return Mr. Sykes' contributions to him for his service purchase, along with an appropriate interest rate.



Donna Busse
Deputy Director