UPDATE ON SDCERS TAX COMPLIANCE
IRC§415(b) BENEFIT LIMITS

SDCERS Board of Administration

November 17, 2006

Background Information

•SDCERS is a "qualified governmental plan" under IRC § 401(a).

•To remain qualified, SDCERS must comply with the benefit and compensation limits in IRC § 415 (b) and (c).

•Benefit limit is a cap on the amount of benefits the plan may pay to a retiree or beneficiary in a calendar year.

Background Information cont.

- To determine whether a payee will exceed the benefit limit, SDCERS must determine each payee's (1) individual benefit limit and (2) aggregate benefit to be tested.

- Adjustments to the aggregate benefit and the benefit limit are based on a number of factors:
    - combined benefit amount (includes 13th check, Corbett, DROP)
    - statutory benefit limit in effect at retirement
    - age at retirement
    - years of service
    - type of service (IRS Safety Qualified)
    - post-tax contributions
    - post-tax service purchases

Background Information cont.

- Cheiron built the calculator that SDCERS staff will use to determine individual:
  - annual limits
  - aggregate benefits
  - projected failures

- Each payee's annual limit must be recalculated annually.

Prospective Screening and Compliance

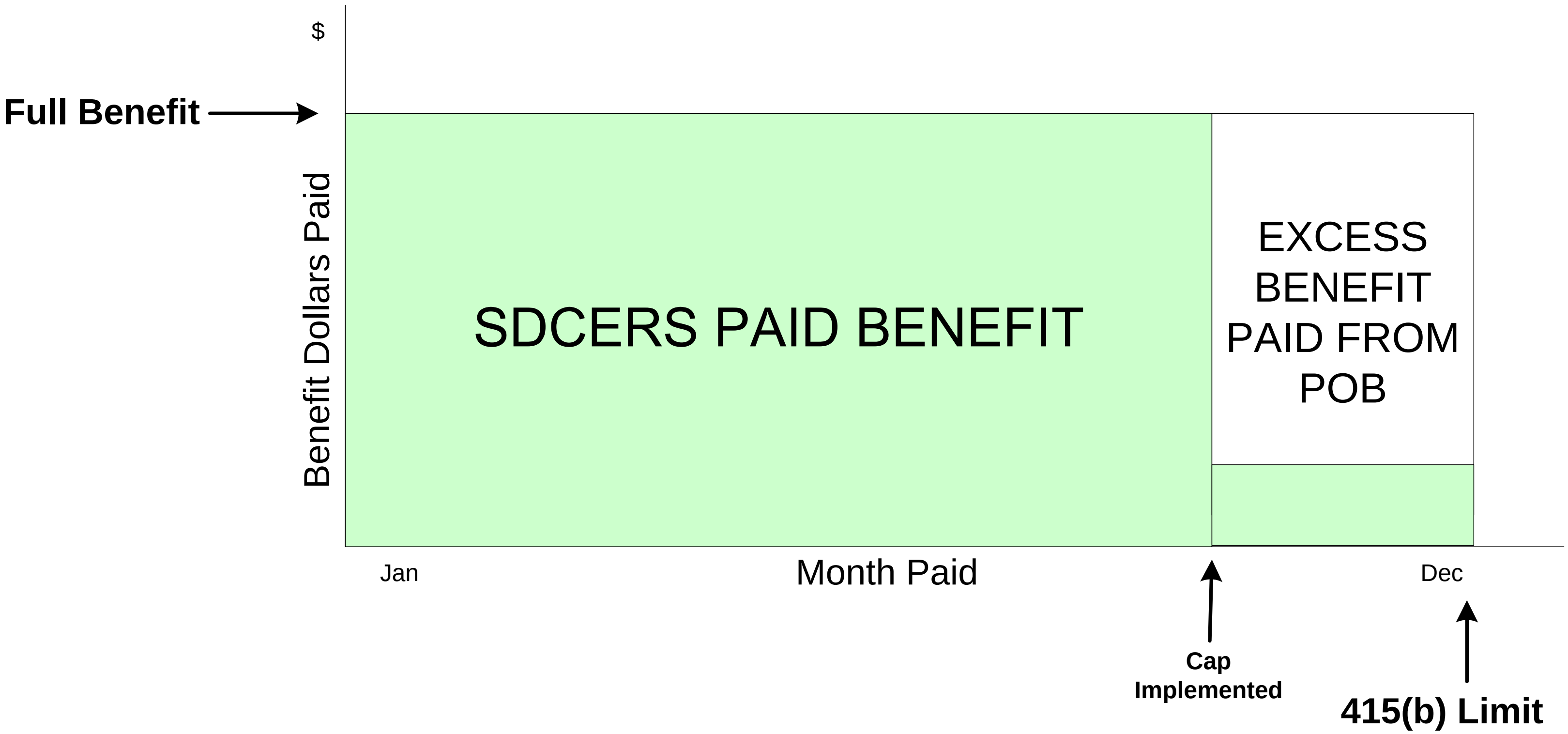
- Beginning January 1, 2007, SDCERS will screen all members when they apply for retirement, by calculating each member's exact 415(b) limit and aggregate benefit using Cheiron's calculator.

- **<u>All members on January 2007 agenda will have been pre-screened</u>.**

- SDCERS will implement a benefit cap for each payee expected to exceed his benefit limit using a "modified cliff" approach. This allows SDCERS to pay out complete DROP payments, and ensures enough retirement benefit dollars to cover any deductions.

- The excess benefits will be deducted entirely from the member's pension.

Modified Cliff



Prospective Screening and Compliance cont.

- In addition, Cheiron will:
  - Screen the entire population of payees quarterly, and
  - Update the 415(b) calculator every year to reflect current IRS limits.

Preservation of Benefit Plans Background

- SDMC 24.1601 et seq. authorizes a Qualified Excess Benefit Arrangement under 415(m) – called "Preservation of Benefits Plan." (Similar provisions in Port and Airport Plans)

- Separate "Preservation of Benefit Plan and Trust" will be established for each Plan Sponsor.

- The POB plans allow payment of the part of a retiree or beneficiary's benefit that is due under the defined benefit plans, but exceeds the benefit limit.

- SDCERS is applying for a Private Letter Ruling approving the POB Plans.

- The SDCERS Board will have the exclusive authority to administer the POB plans.

Employer Funding of the Preservation of Benefit Plans

•Each January, Staff will prepare for Board approval an estimate of the annual contribution for each Plan Sponsor, which will include:

- projected excess benefits that will be due to the existing payees for that calendar year,
- projected excess benefits for the anticipated retirements in that year, and
- necessary and reasonable expense of administering each Plan Sponsor's POB plan.

•Any contributions not used to pay benefits or administrative expenses in a given year will be used to pay benefits or expenses in a later year.

Retrospective Testing

- January 2007 - SDCERS will give Cheiron a schedule of all members receiving benefits as of 12/31/2006.

- Cheiron will identify and report all “failures” (benefits paid in excess of 415(b).

- SDCERS will invoice the Plan Sponsors for amounts paid above 415(b) limit before 2007.