ATTACHMENT A

Steven Montagna <steven.montagna@lacity.org>

(no subject)

John Mumma <Johnmumma@lappl.org> **Mon, Sep 20, 2010 at 3:42 PM**
To: "ccannonjc@sbcglobal.net" <ccannonjc@sbcglobal.net>, "Eugene K. Canzano (eugene.canzano@ladwp.com)" <eugene.canzano@ladwp.com>, "Maggie Whelan (maggie.whelan@lacity.org)" <maggie.whelan@lacity.org>, "sangeeta.bhatia@ladwp.com" <sangeeta.bhatia@ladwp.com>, Sally Choi <sally.choi@lacity.org>, "rkraus@lapl.org" <rkraus@lapl.org>, Michael Perez <Michael.Perez@lafpp.com>
Cc: Steven Montagna <steven.montagna@lacity.org>, Natasha Gameroz <natasha.zuvich@lacity.org>

The Los Angeles Police Protective League, of which I am a board member, has been following the discussions of the City's Deferred Compensation board and City Attorney who advises said board as to the status of the board and where the City's fiduciary liability ultimately resides. Out of this discussion the League has developed strong concerns as to the legal status of the assets held by the thousands of League members in the City's DC plan.

Consequently, the League sought a formal legal opinion on these concerns from the law firm of Willig, Williamson & Davidson, one of the foremost labor and trust firms in the United States. Attached to this communication you will find a full copy of the opinion of Mr. James S. Beall on behalf of WW&D. It discusses at length the issues at hand and the state and federal laws that underlie and affect the City of LA's DC plan. It's conclusions are self explanatory and it is the express hope of the League's board of directors that the Board of Deferred Compensation will act upon these recommendations with the goal of resolving the problems at hand. The League intends to share this opinion with City Attorney Trutanich, members of the Los Angeles City Council, and the other City unions whose members also have enormous financial interests in the safety and security of their respective members' DC assets.

I, as an elected member of the DC board on behalf of both the League's members and the thousands of United Firefighters of Los Angeles City (UFLAC) who also participate in the City's DC plan, personally believe that these problems are of paramount concern and must be addressed without delay. I would ask that this matter be agendized for the next regularly scheduled meeting of the Board of Deferred Compensation with recommendations from staff, as appropriate, and/or a response from the Board's City Attorney.

Thank you.

Jm

John R. Mumma

Director, Los Angeles Police Protective League

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2 attachments

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Memorandum to JRM re Deferred Compensation Plan.pdf
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James S. Beall

Partner
Willig, Williams & Davidson
Philadelphia, Pennsylvania

Mr. Beall is a partner in the law firm of Willig, Williams & Davidson in Philadelphia, Pennsylvania. He specializes in employee benefits law for the firm's joint labor-management pension and welfare fund clients and labor union clients. He represents working people in the longshore, transportation, baking, construction, hospitality and public safety industries.

Mr. Beall received his law degree from the University of Michigan in 1993. He served as a Note Editor of the *Michigan Law Review* and published two pieces of his own in that publication. He then clerked for Gerald E. Rosen, a Federal District Court Judge in Detroit, Michigan, in 1993-94 before joining Willig, Williams & Davidson in 1995.

Mr. Beall received a master's degree in tax law from Villanova University in 1999. He has spoken at employee benefit seminars sponsored by the International Foundation of Employee Benefit Plans and by Harvard Law School. He also has appeared in *The Best Lawyers in America* for Labor and Employment Law since 2006.

WILLIG, WILLIAMS & DAVIDSON
MEMORANDUM

TO:	**JOHN R. MUMMA, DIRECTOR LOS ANGELES POLICE PROTECTIVE LEAGUE**	**DATE:**	**SEPTEMBER 13, 2010**
FROM:	**JAMES S. BEALL**	**FILE NO:**	**200810-116**
RE:	**CITY OF LOS ANGELES DEFERRED COMPENSATION PLAN**		

Pursuant to your request, I have researched whether the City of Los Angeles Deferred Compensation Plan (the "Plan") satisfies the trust requirement of section 457(g) of the Internal Revenue Code of 1986, as amended (the "Code"). For the following reasons, I have serious concerns that the Plan may not satisfy this requirement.

The section 457(g) trust requirement, in a nutshell, is that the employer and the trust holding deferred compensation plan assets must be two distinct entities. The City has blurred that distinction, however, through the following:

- The City Administrative Code fails to create by name a separate trust entity to hold Plan assets (e.g., the "Deferred Compensation Plan Trust").

- Similarly, it does not appear that the City ever established a distinct trust entity, because it has never obtained a separate Employer Identification Number ("EIN") for the Plan. Rather, it is my understanding that the Plan uses the City's EIN as necessary for tax reporting and other purposes.

- While the Administrative Code states that Plan assets will be held "in trust," it does not identify clearly who shall act as Plan trustee.

- City Council's intent, apparently, was to have the City itself serve as Plan trustee. While it may be lawful for the City to serve both as plan sponsor and trustee for a separate trust holding Plan assets, under the current Administrative Code it is uncertain by and through whom the City fulfills its fiduciary duties as trustee to the Plan.

- In this regard, the Administrative Code creates a Board of Deferred Compensation Administration (the "Board") to handle several aspects of the Plan. However, City Council retains the right to veto any and all of the Board's actions. This structure creates obvious confusion as to who has the ultimate responsibility – and liability – for Plan decisions.

Given the above, it would be my recommendation that the City consider the following actions in order to ensure compliance with section 457(g)'s trust requirement and to clarify Plan governance:

(1) That City Council amend the Administrative Code to declare in express terms that the City creates the Deferred Compensation Plan Trust;

(2) That City Council further amend the Administrative Code to designate the City, by and through its Board of Deferred Compensation Administration, as trustee of the Trust;

(3) That City Council further amend the Administrative Code to waive Council's veto power over a range of administrative decision-making, such as selecting and monitoring service providers; selecting and monitoring investments with the assistance of appropriate service providers; interpreting all questions of eligibility and benefits under the Plan; and adjudicating claims and appeals.

(4) That the City, by and through the Board or other appropriate agencies, obtain for the Plan its own EIN; that it transfer all Plan assets to accounts held under that EIN; that it perform all necessary tax reporting and other functions using that EIN; and that it secure appropriate fiduciary liability insurance for Board members now that the City has confirmed the Board's status as the City agency serving as Plan fiduciary.

This memorandum begins by analyzing the origin and scope of the section 457(g) trust requirement set forth in the Code itself, its legislative history, and regulations and guidance issued by the Internal Revenue Service (the "Service"). Next, this memorandum describes how the California State Legislature, the Attorney General's Office, and the courts have responded or likely would respond to the section 457(g) trust requirement. Then this memorandum compares the current documentation and structure of the City's Plan against the section 457(g) trust requirement. Last, this memorandum describes my concerns that the Plan as currently documented and structured may not be in compliance with section 457(g)'s trust requirement, and makes recommendations for how to address these concerns.

I. Section 457 of the Code and Its Trust Requirement for Governmental Plans.

Congress enacted section 457 of the Code in the late 1970s to permit tax-exempt employers to offer defined contribution retirement savings vehicles similar to private sector section 401(k) plans. Among the tax-exempt employers authorized to establish section 457 plans were state and local governments. While section 457 allowed employees to postpone payment of federal income tax on their 457 plan account balances until they received them, prior to 1996 the assets of such a plan were by law not to be held in a trust. Rather, by the statute's express language, section 457 plan assets remained owned by the tax-exempt employer and subject to the claims of general creditors of that employer.

In the mid 1990s, it appeared that Orange County's 457 plan could fall prey to claims from the County's creditors in bankruptcy. Similarly, in 1992 Los Angeles County sought to "borrow" $250,000,000 from its 457 plan to cover its payroll until federal securities law officials intervened. In response to these risks to public employee retirement savings, Congress amended section 457 in the Small Business Job Protection Act of 1996 ("SBJPA") to impose the same kind of trust requirement for state and local government 457 plans that long has applied to tax-qualified pension plans in both the private and public sectors.

Specifically, SBJPA added a new section 457(g) to the Code, which reads (emphasis added):

> (g) GOVERNMENTAL PLANS MUST MAINTAIN SET-ASIDES FOR EXCLUSIVE BENEFIT OF PARTICIPANTS.–
>
> (1) IN GENERAL. A plan maintained by an eligible employer described in subsection (e)(1)(A) [a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State] shall not be treated as an eligible deferred compensation plan unless all assets and income of the plan . . . are held in trust for the exclusive benefit of participants and their beneficiaries.
>
> (2) TAXABILITY OF TRUSTS AND PARTICIPANTS. For purposes of this [federal income tax] title–
>
> (A) a trust described in paragraph (1) shall be treated as an organization exempt from tax under section 501(a) [which exempts charities, qualified pension plans, employee welfare trusts, etc. from federal income tax], and
>
> (B) notwithstanding any other provision of this title, amounts in the trust shall be includible in the gross income of participants and beneficiaries only to the extent, and at the time, provided in this section.

The very language of section 457(g) confirms that Congress intended that public employer sponsors of section 457 plans establish distinct trusts (or their equivalent in the form of qualifying bank custodial accounts or insurance company contracts defined in section 401(f) of the Code), whose assets would be entirely separate from the assets of such sponsors. The legislative history behind section 457(g) further supports this reading, beginning with its description of pre-1996 law and continuing with an explanation of the new trust requirement:

> *Present Law*
>
> Until deferrals under a section 457 plan are made available to a plan participant, such amounts deferred, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights must remain solely the property and rights of the employer, subject only to the claims of the employer's general creditors.
>
> *Reasons for Change*
>
> The Committee is concerned about the potential for employees of certain State and local governments to lose significant portions of their retirement savings because their employer has chosen to provide benefits through an unfunded deferred compensation plan rather than a qualified pension plan. Therefore, the Committee finds it appropriate to require that benefits under a section 457 plan of a State and local government should be held in a trust (or custodial account or annuity contract) to insulate the retirement benefits of employees from the claims of the employer's creditors.

Explanation of Change

Under the bill, all amounts deferred under a section 457 plan mandated by a State and local governmental employer have to be held in trust (or custodial account or annuity contract) for the exclusive benefit of employees. The trust (or custodial account or annuity contract) is provided tax-exempt status. Amounts will not be considered made available merely because they are held in a trust, custodial account or annuity contract.

See House Report for H.R. 3448 (Small Business Jobs Protection Act of 1996), rep'd in 1996 U.S.C.C.A.N., at pp. 1559-1560 (emphasis added).

Regulations promulgated by the Service in 2003 confirm the requirement for a trust entity separate from the public employer (emphasis added):

§ 1.457-8. Funding rules for eligible plans.

(a) *Eligible governmental plans.*

(1) *In general.* In order to be an eligible governmental plan, all amounts deferred under the plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property or rights, must be held in trust for the exclusive benefit of participants and their beneficiaries. A trust described in this paragraph (a) that also meets the requirements of [these regulations] is treated as an organization exempt from tax under section 501(a), and a participant's or beneficiary's interest in the amounts in the trust is includible in the gross income of the participants and beneficiaries only to the extent, and at the time, provided for [herein].

(2) *Trust requirement.*

(i) A trust described in this paragraph (a) must be established pursuant to a written agreement that constitutes a valid trust under State law. The terms of the trust must make it impossible, prior to the satisfaction of all liabilities with respect to participants and their beneficiaries, for any part of the assets and income of the trust to be used for, or diverted to, purposes other than for the exclusive benefit of participants and their beneficiaries.

(ii) Amounts deferred under an eligible governmental plan must be transferred to a trust within a period that is not longer than is reasonable for the proper administration of the participant accounts (if any). For purposes of this requirement, the plan may provide for amounts deferred for a participant under the plan to be transferred to the trust within a specified period after the date the amounts would otherwise have been paid to the participant. For example, the plan could provide for amounts deferred under the plan at the election of the participant to be contributed to the trust within 15 business days following the month in which these amounts would otherwise have been paid to the participant.

The above authorities demonstrate that Congress intended, and the Service continues to understand, that section 457(g) requires public employers to establish wholly separate trusts for their section 457 plans – trusts that themselves would qualify as separate tax-exempt

organizations under section 501(a) of the Code just like qualified pension plans in the private and public sectors. See also IRS Notice 2003-20 (holding that section 457 plans should follow the same tax withholding and related reporting requirements as apply to qualified pension plans, which themselves must have their own distinct EINs). Because, however, the above IRS regulations make reference to State law to determine if a valid trust exists, the next section examines how the State of California Legislature, the Attorney General's Office, and state courts have approached or likely would approach the section 457(g) trust requirement.

II. The State of California's Response to the Section 457(g) Trust Requirement.

Shortly after the passage of SBJPA, the California State Legislature enacted Govt. Code § 53213.5, which states (emphasis added):

> *Plan to conform to law; Relief of responsibility for investments*
>
> (a) Each deferred compensation plan established pursuant to this article shall conform with the requirements promulgated under the federal Small Business Job Protection Act (Public Law 103-188). Those requirements include, but are not limited to, the holding of assets in a plan that complies with sections 401(a), 401(k), and 457 of the federal Internal Revenue Code in trust for the exclusive benefit of employees.
>
> (b) Notwithstanding any other provision of law, participants choosing individually directed investments shall relieve the trustee and local agency [defined in Govt. Code § 53212 as "a county, city, public district, joint powers agency, or any public or municipal corporation"] of responsibility under the terms of the plan and trust. That relief shall be conditioned upon the local agency['s] compliance with communication and education requirements similar to those prescribed in [section 404(c) of ERISA] for private sector employers.

Like section 457(g) and the regulations and guidance issued thereunder, section 53213.5 contemplates a trust entity wholly separate from the public employer that sponsors the 457 plan. A 2000 Opinion issued by the Attorney General for the State of California lends further support to this approach.

In that Opinion, the Department of Financial Institutions asked if a bank holding 457 plan assets must comply with the California Government Code's collateral requirements to safeguard public funds. In answering this question in the affirmative, the Attorney General gave a thorough analysis of the history behind the section 457(g) trust requirement and corresponding state law. He noted that while public agencies no longer "owned" section 457 plan assets after Congress passed SBJPA, public agencies remained "accountable" for those assets. Further, he believed that the bank collateral requirements worked together with the section 457(g) trust requirements to ensure the maximum security possible for public employees' deferred compensation. The Opinion is worth quoting at length:

> Until recently, it was clear that a bank was required to pledge securities for any deposits consisting of deferred compensation funds of local government employees. This was because under former state and federal law, local government employees could only qualify

for the special "deferred" income tax advantages if the funds were considered to be owned and held by the local government until distributed to employees. . . .

However, in 1996, the federal law was changed to require that deferred compensation funds be "held in trust for the exclusive benefit of participants and their beneficiaries." . . . A similar amendment of state law followed. . . .

* * *

The "in trust" requirement was added by Congress in 1996 to prevent the loss of deferred compensation funds due to the financial mismanagement of the funds by local governments. In a report prepared by the United States General Accounting Office, the problems addressed by the legislation were described as follows:

> "Because 457 plans maintain their tax deferred status by requiring that the sponsoring government own the deferred amounts, plan participants may risk the loss of some or all their deferrals if the sponsoring government goes bankrupt or funds are in some way mismanaged or lost. For example, if Orange County, California, is unable to emerge from its current bankruptcy proceeding without providing its general creditors with a settlement under which those creditors receive 100 cents on the dollar, the county's 457 plan participants will be forced to share proportionately in the losses of those general creditors.
>
> "Further, because any amounts set aside by the employing governments to pay section 457 plan obligations are owned by the sponsoring governments, some governments may view them as funds available for their own use. IRC section 457 does not prescribe that any 457 plan monies must be maintained to pay future benefits. In late 1992, the Securities and Exchange Commission (SEC) staff learned that Los Angeles County intended to borrow $250 million from the amount set aide to pay its 457 plan obligations to cover payroll expenses. When SEC questioned this course of action as potentially impairing the status of the funds under the federal securities laws, the county abandoned its proposal."

* * *

It is readily apparent that the 1998 amendment of section 53213.5 by the Legislature to require deferred compensation funds to be held "in trust for the exclusive benefit of employees" was intended to provide consistency with federal law in granting greater protection for such funds prior to their distribution to employees.

Under the recent legislation, the deferred compensation funds are still considered to be part of "a plan established and maintained by" a public agency . . . , which "must maintain set-asides for [the] exclusive benefit of participants" . . .. This language establishes that public agencies are to remain accountable for the funds, with the "held in trust" requirement added to prevent the funds from being diverted to other purposes.

Accordingly, we believe that the funds continue to constitute "public funds" although held in trust. Banks must therefore continue to pledge securities when such funds are deposited as required by the provisions of the sections 53635 and 53652 [of the Government Code]. Our construction of the terms of sections 53213.5, 53635, and 53652 effectuates the purpose of the Legislature to protect deferred compensation funds of local government

> employees. Both the "in trust" requirement and the pledged collateral requirement may thereby be harmonized to promote their common goal – safety for the deposited funds.

See 83 Ops. Cal. Atty. Gen. 175, 178-80 (2000) (citations omitted).

State legislative and administrative authorities echo their federal counterparts that there should be a clear distinction between the public employer sponsoring a 457 plan, and the trust which holds that plan's assets. California trust formation law similarly appears to support a clear distinction between the creator of the trust and the trust itself.

It seems relatively easy to establish a trust in California. Section 15200 of the California Probate Code offers five different methods to do so:

> (a) A declaration by the owner of property that the owner holds property as trustee.
>
> (b) A transfer of property by the owner during the owner's lifetime to another person as trustee.
>
> (c) A transfer of property by the owner, by will or by other instrument taking effect upon the death of the owner, to another person as trustee.
>
> (d) An exercise of a power of appointment to another person as trustee.
>
> (e) An enforceable promise to create a trust.

The most common way to create a trust in California appears to be to make "an explicit declaration of trust, followed by an actual conveyance of property to a trustee." Bainbridge v. Stoner, 16 Cal. 2d 423, 427, 106 P.2d 423, 427 (Cal. 1940). It is possible for the owner of the assets to continue in possession of them – but only as trustee for the benefit of the trust's beneficiaries. See Heggstad v. Heggstad, 16 Cal. App. 943; 20 Cal. Rptr. 2d 433 (Cal App. 1st Dist., Div. 2 1993) ("To create an express trust there must be a competent trustor, trust intent, trust property, trust purpose and a beneficiary . . . The settlor can manifest his intention to create a trust in his property either by: (a) declaring himself trustee of the property or (b) transferring the property to another as trustee for some other person, by deed or other inter vivos transfer or by will.") (emphasis added, citations omitted).

All of the authorities cited above, then, hold that for the City to comply with the section 457(g) trust requirement, it must take appropriate steps in the Plan's documentation and operation to make the Plan completely separate and apart from the City. As the following section demonstrates, the City's attempts to satisfy the section 457(g) trust requirement, however, have been both confused and confusing.

III. The City of Los Angeles' Response to the Section 457(g) Trust Requirement.

Following the passage of SBJPA, the staff and professional advisors to the Plan recommended to the Board of Deferred Compensation Administration that it submit to City Council a draft ordinance and trust agreement establishing an independent section 457 trust for the Plan and appointing the Board as trustee. At a meeting of the Board on January 27, 1998, the City Attorney's office objected to this proposal on the following grounds:

> [Chief Assistant City Solicitor Pedro] Echeverria began by indicating that the Board did not have the legal status necessary to enter into a contractual relationship with the City and be established as trustee for the Plan. Mr. Echeverria explained that the Board was not an independent body. The Board was created by ordinance and could, in theory, be dissolved at any time by ordinance. Consequently, two options existed for establishing a Plan trustee – contracting with a third-party to act as trustee, or designating the City of Los Angeles as the trustee, with the Board acting on behalf of the City in all administrative matters affecting the Plan.
>
> The Board inquired regarding how its status was different from that of a retirement board. Mr. Echeverria responded by saying that the City's retirement plans were established by the City Charter and/or protected by State law. He further stated that Proposition 162[1] did not apply to the Board.
>
> Mr. Echeverria indicated that establishing the City as trustee would mean that fiduciary liability would reside with the City. Board members would be protected from fiduciary liability so long as they were acting in their capacity as Plan administrators. . . .
>
> [Board Vice-Chairperson] Shelley Smith stated that the Board's concern was that the program be given as much independence as possible since it was funded entirely by employee money. In particular, she was concerned that the Board did not have contracting authority.
>
> Mr. Echeverria indicated that the ordinance establishing the trust could be crafted to include contracting authority for the Board. . . .
>
> The Board inquired as to the timing of the process. Mr. Echeverria indicated that a draft ordinance would be developed by the end of the week and sent to staff for its review. It was agreed that staff would then send the draft out to Board members for their review, and if no questions or objections were raised, would request the City Attorney to send the proposed language to City Council immediately.
>
> **A motion was made by Mike Galvin, seconded by Fred Tredy, to approve in concept the immediate drafting of an ordinance establishing the City of Los Angeles as Plan trustee and providing the Board with contracting authority . . . .**

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[1] Proposition 162, passed in 1992, amended Article XVI, § 17 of the California Constitution to provide for independent, fiduciary status for a "retirement board of a public pension or retirement system."

MEMO TO: JRM
FROM: JSB
RE: DEFERRED COMPENSATION PLAN

See City of Los Angeles Board of Deferred Compensation Administration Minutes, Meeting of January 27, 1998 (emphasis in original).

On July 9, 1998, City Council passed Ordinance No. 172,105 "to implement certain changes to the City's Deferred Compensation Plan . . . which are required or permitted by the Small Business Job Protection Act of 1996 . . . ." The ordinance amended Section 4.1404 of the Los Angeles Administrative Code to read:

> Sec. 4.1404. Investment Fund and Trust.
>
> The employer shall establish a separate City fund (the "Investment Fund") to provide a convenient method of setting aside a portion of its assets to meet the City's obligations under the [Deferred Compensation] Plan. The amounts placed in the Investment Fund and all other assets and income of the Plan shall be held by the City in trust for the exclusive benefit of participants and their beneficiaries in accordance with the terms and conditions of the Plan, and for defraying reasonable expenses of the Plan. Amounts, assets and income held in custodial accounts or annuity contracts described in Internal Revenue Code section 401(f) shall similarly be held by the City in trust for the exclusive benefit of the participants and their beneficiaries in accordance with the terms and conditions of the Plan, and the contract documents and all other pertinent documents therefor shall clearly state that the amounts, assets and income subject thereto are so held.
>
> Neither the existence of the Plan, nor of the trust nor of the Investment Fund shall entitle any participant, beneficiary or other person to claim a lien against the assets of the Investment Fund, the Plan or the trust. The participants and their beneficiaries shall have only the right to receive the benefits payable under the Plan as provided in this chapter.

City Council amended this section again in 2002 by Ordinance No. 174,407. Unfortunately, the current version is even more ambiguous than its predecessor, and reads:

> Sec. 4.1404. Investment Fund and Trust.
>
> The Employer shall establish a separate fund to hold all assets and income of the Plan, including amounts, assets and income held in custodial accounts or annuity contracts described in Internal Revenue Code Section 401(f). Such fund shall be held in trust for the exclusive benefit of Participants and their Beneficiaries in accordance with the terms and conditions of the Plan, and for defraying reasonable expenses of administration of the Plan. With respect to custodial accounts or annuity contracts described in Internal Revenue Code Section 401(f), the contract documents and all other pertinent documents therefor shall clearly state that the amounts, assets and income subject thereto are so held. Neither the existence of the Plan, nor of the trust nor of the fund shall entitle any Participant, Beneficiary or other person to a claim or lien against the assets of the Plan or the trust. The Participants and their Beneficiaries shall have only the right to receive the benefits payable under the Plan as provided by this chapter.

Significantly, neither version of Section 4.1404 expressly creates by name a separate trust entity to hold Plan assets (e.g., the "Deferred Compensation Plan Trust"). Even more troubling, it is my understanding that the City never created such a separate trust entity with

its own EIN for the Plan. Rather, the Plan has been using the City's EIN as necessary. Still further, Section 4.104 does not specify who serves as trustee. Even if one assumes that the City serves as trustee, it remains unclear which arm of the City is responsible for fulfilling trustee fiduciary duties to the Plan. Last, fundamental Plan governance also is uncertain under the current Administrative Code, as set forth in more detail below.

Section 4.1407 states the following with respect to the powers of the Board of Deferred Compensation Administration, as last amended in 2008 by Ordinance No. 179,803:

> Sec. 4.1407. Administration of the Plan.
>
> (a) The Board [of Deferred Compensation Administration] shall have the sole authority for the operation of the Plan in accordance with its terms and shall rule on all questions arising out of the administration, interpretation and application of the Plan, which determination shall be conclusive and binding on all Participants. Actions of the Board are subject to the provisions of Charter section 245. . . .

For its part, Charter Section 245 gives City Council the right, upon timely action, to intervene and by two-thirds majority vote overturn decisions by certain City "boards of commissioners." Importantly, however, Charter Section 245(b) states (emphasis added):

> (b) **Waiver.** The Council may, by ordinance, waive review of classes or categories of actions, or, by resolution, waive review of an individual anticipated action of a board. The Council may also, by resolution, waive review of board action after the board has acted. Actions for which review has been waived are final upon the waiver, or action of the board, as applicable.

The confusion in Plan governance – whether the Board through the Administrative Code, or City Council through its Charter veto power, actually runs the Plan – became apparent in 2005. At that time, the Board sought to contract services from Nationwide Retirement Solutions, but City Council vetoed that decision and contracted with Great-West Life & Annuity Insurance Company instead. Nationwide brought suit to establish that the Board had a right to contract independent of any City Council veto because it was a Proposition 162 retirement board. The City countered that Proposition 162 did not apply, and City Council had the authority under its Charter and Administrative Code to stop the Board from executing and implementing the Nationwide contract.

It is my understanding that this litigation ended without resolution of the underlying dispute – though it is worth noting that Proposition 162 preceded enactment of the section 457(g) trust requirement, therefore casting doubt it was intended to apply to 457 plans. Nonetheless, the question of who has the ultimate authority, and fiduciary responsibility, for the Plan, remains unanswered.

As the foregoing demonstrates, the City's efforts to implement the section 457(g) trust requirement have been muddled at best. There is no named trust, no separate EIN, no clear trustee, no defined fiduciary governance structure. The following section discusses my concerns

on whether the City has satisfied the section 457(g) trust requirement, and my recommendations on how to address those concerns.

IV. Analysis and Recommendations.

Section 457(g) requires the City to establish a separate, valid trust for the Plan. Unfortunately, nowhere does the Administrative Code create by name such a distinct trust.

Moreover, the fact that the City apparently has not established a separate trust entity with its own EIN for the Plan is very troubling. While the Administrative Code's use of "held in trust" language may be sufficient to protect Plan assets from the City's creditors, it is far less clear to me that it will protect those assets from the City itself if they are custodied in one or more accounts under the City's EIN. And as noted above, protecting section 457 plan assets from plan sponsors as well as their creditors was Congress' intent in passing section 457(g) in the first place.

Similarly, nowhere does the Administrative Code declare who will serve as trustee. While the City may argue that City Council implicitly designated the City as trustee, the City as City cannot act; rather, it must act through one of its branches or agencies.

Currently, the Administrative Code vests the administration of the Plan with the Board – but subject to veto by City Council. This approach begs the question of by and through whom the City fulfills its fiduciary duties as Plan trustee – the Board or Council? And it has raised practical problems for matters of day-to-day administration. The most telling example of this was City Council's veto of a service provider to the Plan approved by the Board, which led to inconclusive litigation.

Fortunately, there appears to be a fairly straightforward solution to these problems. I would recommend that the City consider the following:

(1) That City Council amend the Administrative Code to declare in express terms that the City creates the Deferred Compensation Plan Trust;

(2) That City Council further amend the Administrative Code to designate the City, by and through its Board of Deferred Compensation Administration, as trustee of the Trust;

(3) That City Council further amend the Administrative Code to waive Council's veto power over a range of administrative decision-making, such as selecting and monitoring service providers; selecting and monitoring investments with the assistance of appropriate service providers; interpreting all questions of eligibility and benefits under the Plan; and adjudicating claims and appeals.

(4) That the City, by and through the Board or other appropriate agencies, obtain for the Plan its own EIN; that it transfer all Plan assets to accounts held under that EIN; that it perform all necessary tax reporting and other

functions using that EIN; and that it secure appropriate fiduciary liability insurance for Board members now that it has confirmed the Board's status as the City agency serving as Plan fiduciary.

If acted upon, this approach once and for all answers the questions of (1) whether the City has established a bona fide, separate trust for the Plan; and (2) who is in charge of that trust. Moreover, nothing in this approach eliminates City Council's right to amend the Administrative Code further if unanticipated problems arise with respect to the Plan – so long as City Council maintains the Plan's status as a trust completely and unambiguously separate and apart from the rest of the City.

If you have any questions, by all means contact me at (215) 656-3610 or (215) 582-9001.

ATTACHMENT B

CITY OF LOS ANGELES
CALIFORNIA

ANTONIO R. VILLARAIGOSA
MAYOR

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October 19, 2010

John R. Mumma
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Los Angeles, CA 90017

DEFERRED COMPENSATION PLAN TRUST REVIEW

Thank you for your recent correspondence regarding a review of the Deferred Compensation Plan trust as requested by the Police Protective League and performed by an outside law firm. As you are aware, the Board has been reviewing this matter closely in recent months and recently tasked its consultant to (a) evaluate the Plan's authoritative documents and determine the degree to which they are consistent with best practices for meeting Internal Revenue Code Section 457 trust requirements for governmental plans, and (b) if necessary, make recommendations for modifications/improvements. The analysis you provided has been referred to our consultant for review and consideration and will be further discussed once the consultant's work is completed and the matter has been placed on the Board's agenda.

Eugene K. Canzano, Chairperson
Board of Deferred Compensation Administration

cc: Honorable Antonio R. Villaraigosa, Mayor, City of Los Angeles
Honorable Carmen A. Trutanich, City Attorney, City of Los Angeles
Paul M. Webber, President, Los Angeles Police Protective League