



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Debra Figone

SUBJECT: Retirement Board Governance

DATE: January 12, 2010

COUNCIL DISTRICT: City-Wide
SNI AREA: N/A

RECOMMENDATION

It is recommended that:

- 1) The City Council approve the following revisions to the governance structure of the City's retirement plans and direct the City Attorney to draft an ordinance with the necessary revisions to the San Jose Municipal Code.
 - a. For the Federated City Employees' Retirement System, replace the two City Council Board members and Civil Service Commission Board member with three public members in addition to the one existing public board member.
 - b. For the Police and Fire Department Retirement Board, replace the two City Council Board members, the Civil Service Commission Board member and City Administration Board member with four public board members.
 - c. Establish qualification criteria, term, stipend, appointment process, selection process, and removal process for the public board members for both retirement plans.
- 2) The City Council direct the City Administration to continue to evaluate the other retirement board governance recommendations prepared by the consultant and return to the City Council with recommendations.

OUTCOME

Approval of the recommendations shall establish a new governance model for the Federated City Employees' Retirement System and the Police and Fire Department Retirement Plan by adding public members to each retirement board who:

1. Have specific education and experience, and are
2. Independent of the City.

The additional public members would replace the two City Council members and the one Civil Service Commission member on each board, as well as the member of the City Administration on the Police and Fire Department Retirement Board.

EXECUTIVE SUMMARY

Taxpayers Bear 100% of the Investment Risk for Pension Benefits

The risks are not shared equally in the current structure of the City's retirement plans. Although employees do contribute to the pension fund during their careers with the City, taxpayers are responsible for **100%** of any unfunded pension liability. This means, for example, that if the investment decisions made by the retirement boards do not result in earnings that are at least as much as the assumptions set by the boards, it results in an unfunded pension liability that must be entirely paid by the City. Consequently, there is currently **no** investment risk to employees or retirees for the pension benefits they receive. Taxpayers bear 100% of the risk.

Experience and Expertise of Retirement Board Members

Board members make investment decisions involving a combined total of approximately **\$3.5 billion**.¹ In addition to investment decisions, board members must make decisions on actuarial assumptions. The decisions made by members of the retirement boards necessitate expertise, however only one member on each board currently is required to have any relevant experience.

Potential Conflicts of Interest

Board members make decisions that directly affect employees and the City. For example, the boards make decisions on actuarial assumptions that affect the amount of money that employees and the City are required to contribute into the retirement plans.

Recommendation to Add Additional Public Members to Both Retirement Boards

Given the combined size of the City's two retirement systems, their importance to employees and retirees, and their impact on the finances of the City, the Administration recommends that the first step in changes to the retirement system governance be to add public members with specific education and experience to each retirement board. To minimize the potential for conflicts of interest, these public members should be independent of the City.²

Each board would maintain the current number of employee and retiree members: two employees who are members of the plan and one retiree who is a beneficiary of the plan. The additional public members would replace the two City Council members and the one Civil Service Commission member on each board. For the Police & Fire Department Retirement Plan, a public member would also replace the City Administration board member.

¹ As of June 30, 2009.

² The required education and experience of public members serving on the retirement boards, as well as the criteria for being independent of the City, are set forth in the Analysis section of this memorandum.

These recommendations would not require a change in the City Charter, but replacement of the current designated members with public members would necessitate changes to the Municipal Code. It is recommended that these changes be implemented as soon as the necessary changes to the Municipal Code are adopted by the City Council.

BACKGROUND

Information Available on the Internet

A substantial amount of information related to the City's retirement plans, including the issue of retirement board governance, is available on the City's internet site:

Board Governance:

<http://www.sanjoseca.gov/RetirementBoardGovernance.asp>

FAQ's related to Board Governance are attached. (Attachment A)

Retirement Benefits Information:

<http://www.sanjoseca.gov/employeeRelations/RetirementBenefits.asp>

Retirement Benefits FAQ's:

<http://www.sanjoseca.gov/employeeRelations/retirementbenefits/RetirementFAQs.pdf>

Department of Retirement Services:

<http://www.sjretirement.com>

General Background

The City of San Jose has two retirement systems: the Federated City Employees' Retirement System and the Police and Fire Department Retirement Plan. These plans are defined benefit retirement plans serving the employees and retirees of the City of San Jose. A defined benefit pension plan provides a specific benefit to eligible employees at the time of retirement. Both retirement plans use investment income and employer and employee contributions to provide eligible retirees with pensions based on years of service and highest average annual salary.

The City Charter determines the cost sharing between employees and the City for what is referred to as "normal cost", which is the cost of funding the retirement benefits for each year of service as it is earned by employees. Those costs are split between the City and employees based on an 8:3 ratio. Thus, for every \$3 contributed by employees, the City contributes \$8. Unfunded pension liabilities, however, are currently 100% paid by the City.

The plans also provide retiree healthcare benefits, survivor benefits, and permanent disability benefits to eligible members and beneficiaries. Retiree healthcare benefits have a different cost sharing arrangement. Retiree medical benefits, for example, are shared 50/50 between the City and employees and approximately 75/25 for dental.

The retirement benefit is the most expensive benefit provided to City employees. Based upon the current contribution rates, the City will contribute approximately **\$138 million** into the two retirement plans in Fiscal Year 2009-2010: \$65 million for the Police & Fire Plan and \$73 million for the Federated System.

The following chart includes the number of active employees and retirees, as well as the amount of money in each retirement plan. The data is as of June 30, 2009.

	Federated	Police & Fire	Total
Active Employees	4,196	2,087	6,283
Retirees & Beneficiaries	2,997	1,661	4,658
Market Value of Assets	\$1.436 billion	\$2.053 billion	\$3.489 billion

Consultant Review of Retirement Board Structure

The City of San José retained Cortex Applied Research (“Cortex”) to review the fiduciary governance models of both of the City’s retirement plans. The scope of the review was limited to the governance models of the City’s retirement systems including the composition of the retirement boards, the authority of the boards and of the City, and the necessary skills and experience of board members. The scope of the review did **not** include a review of the retirement benefit design or benefit levels.

Based on their review of relevant documentation, interviews with stakeholders, and research into industry best practices, Cortex concluded that the current governance models of the retirement plans do not support the long-term effective management of the plans and therefore do not effectively serve the interests of the plan stakeholders, i.e. members, retirees, and taxpayers. A copy of the consultant’s final report is attached to this memorandum. (Attachment B.3.)

Cortex identified a number of weaknesses in the current retirement governance models and identified two as particularly noteworthy:

- **The governance models do not ensure that the retirement boards on balance will possess sufficient and relevant expertise to effectively guide and oversee the retirement systems, and**
- **The governance models do not ensure that the retirement boards will be free of significant conflicts of interest and able to focus freely on the administration of the systems and the best interests of the members and beneficiaries.³**

Current Structure of City’s Retirement Boards

Each of the retirement plans has seven board members. Below is a chart of the current retirement board structure for each plan:

	Composition	Board Members	Method of Appointment
<i>Federated City Employees’ Retirement System</i>	7 Appointed Members	Retiree	Appointed by City Council
		Employee	Appointed by City Council
		Employee	Appointed by City Council
		Civil Service Commission Member	Appointed by City Council
		Public member	Appointed by City Council
		City Council member	Appointed by City Council
		City Council member	Appointed by City Council
<i>Police and Fire Department Retirement Board</i>	7 Appointed Members	Retiree (alternates between Police and Fire)	Appointed by City Council
		Employee (Police)	Appointed by City Council
		Employee (Fire)	Appointed by City Council
		Civil Service Commission member	Appointed by City Council
		City Administration member	Appointed by City Council
		City Council member	Appointed by City Council
		City Council member	Appointed by City Council

³ Page 3, Cortex Applied Research Inc., Revised Report, September 2009

It should be noted that the City Council currently has the responsibility under the City Charter to appoint all of the members of the retirement boards, unless the Council delegates the authority to the Mayor.⁴ Although elections are held among employees and retirees for the employee and retiree positions on the retirement boards, the elections are advisory to the Mayor and City Council. The Mayor or City Council can choose among any of the applicants to serve as employee or retiree members of the Boards.

Consultant Recommended Board Structure

Cortex recommended that the current retirement board structure of both retirement plans be revised as follows:

Cortex Proposed Structure	
2	Members selected by active employees
1	Member selected by retired members
4	Members selected by City Council

The consultant's recommendations regarding the retirement board structure maintain the same number of members on each board (7), as well as the same number of employees and retirees (2 employees and 1 retiree). However, the consultant recommends that active employees and retirees be able to appoint persons of their choosing without requiring the approval or action by the City Council.

In reviewing the steps required to implement the consultant's recommendations, the City Attorney's Office has advised that a change in the City Charter would be required to remove the City Council's or Mayor's responsibility of appointing any member of the retirement boards. A change in the Charter involves an election of City of San Jose voters.

The consultant recommended that the four members selected by the City Council:

“...should be independent of the City and should possess strong knowledge, expertise, and experience relevant to the administration of public retirement plans.”⁵

This change would not require a change in the City Charter, but would require the Council adopting an ordinance amending the Municipal Code.

⁴ City Charter Section 1002

⁵ Page 2, Cortex Applied Research Inc., Revised Report, September 2009

Presentation of Consultant Report to the City Council and Stakeholder Outreach

The initial consultant report was presented to the City Council on June 23, 2009. The City Council directed the City Administration to conduct outreach with stakeholders, in addition to the stakeholder outreach conducted by the consultant as part of its review and analysis, and return in 90 days with final recommendations. Because the Administration was unable to return to the City Council with recommendations within 90 days, the Administration issued an Information Memorandum on October 5, 2009, which included a summary of the stakeholder outreach that had been conducted and additional information. (Attachment B.)

During the additional stakeholder meetings held on August 26 and 27, 2009, the consultant made a presentation on its recommendations and allowed time for questions and comments. Approximately 76% of the attendees were retirees or City employees. The majority of those who spoke during the meetings opposed any change to the retirement board structure, and the comments are summarized in the Information Memorandum, dated October 5, 2009. (Attachment B.1.) Following the meetings, Cortex issued a revised report based on questions and comments received during the stakeholder meetings. The consultant's recommended board structure remained unchanged in the revised report. (Attachment B.3.)

Additional stakeholder meetings were held on December 7, 8, and 16, 2009, to provide a preview of the City Administration's draft recommendations and obtain additional feedback. Representatives from all employee units and retiree associations were invited to these meetings. The City Administration also met with Working Partnerships USA and the Silicon Valley Chamber of Commerce. Feedback received was considered, and the City Administration incorporated some of the feedback in its recommendations.

Authority of Retirement Boards

During the stakeholder meetings, there appeared to be an impression that the purpose for reviewing the change in the retirement board structure was to change retirement benefits or to give the City control of the retirement funds. A change in who serves on the retirement boards will ***not*** result in changes in retirement benefits or in the authority of the boards to control the retirement funds.

The boards' duties include consideration of requests for retirement, administration and investment of the retirement funds, and determining eligibility for membership in the pension plans. The retirement boards do ***not*** have the authority to enhance or reduce retirement benefits levels. For employees represented by a bargaining unit, retirement benefits are a subject of negotiations and, for all employees, are approved by the City Council.⁶

Regarding the control of the retirement funds, the San Jose Municipal Code specifies that the retirement systems and the retirement funds shall be managed, administered and controlled by

⁶ Under City Charter Section 1111, however, an arbitrator may award retirement benefit enhancements to employees represented by the San Jose Police Officers' Association and the San Jose Firefighters, IAFF, Local 230.

each board.⁷ The Municipal Code further specifies that the retirement boards have exclusive control of the administration and investment of the retirement funds.⁸

The boards possess broad and flexible investment authority and make significant decisions related to how the retirement funds are invested. The authority and responsibility to control the retirement funds will not change with a modification in the composition of the boards: the retirement boards will retain that authority and responsibility.

City Administration's Recommendations

The City Administration's recommendations are detailed in the following section.

ANALYSIS

In its report, Cortex states that the current governance model of the retirement systems "...**provide numerous safeguards for plan members but very limited safeguards for taxpayers and the City.**"⁹ Cortex recommends that the City establish a new governance model for its retirement systems that will support more effective governance and oversight for the benefit of key plan stakeholders that include plan members, retirees, and taxpayers. The consultant's report includes seven recommendations.¹⁰

The City Administration has reviewed the recommendations prepared by Cortex, considered stakeholder comments, and reviewed the structures of other California plans. The Administration recommends a two-phase approach to implementing revisions to the governance of the City's retirement systems. Phase I would be to add public members to each retirement board and to require all public board members to have specific education and experience. To minimize potential for conflicts of interest, these public members would be independent of the City.

In addition, as Phase II, the City Administration recommends direction by the City Council to further evaluate some of the other recommendations made by Cortex for future consideration.

Taxpayers Bear 100% of the Investment Risk for Pension Benefits

In its report, Cortex states:

The composition of a retirement board must reflect the relative risk/reward exposure of active members, retired members, and taxpayers. Where risks and rewards are shared equally, equal representation by stakeholders on the retirement board is appropriate. Where one party bears a disproportionate share of the risk involved, it should have majority representation on the fiduciary board.¹¹

⁷ San Jose Municipal Code Sections 3.28.100 and 3.36.300

⁸ San Jose Municipal Code Sections 3.28.310 and 3.36.510

⁹ Page 15, Cortex Applied Research Inc., Revised Report, September 2009

¹⁰ Page 2, Cortex Applied Research Inc., Revised Report, September 2009

¹¹ Page 13, Cortex Applied Research Inc., Revised Report, September 2009

The risks are not shared equally in the current structure of the City's retirement plans. Although employees do contribute to the pension fund during their careers with the City, taxpayers are responsible for **100%** of any unfunded pension liability. This means that if the investment decisions made by the retirement boards do not result in earnings that are at least as much as the assumptions set by the boards, it results in an unfunded pension liability that must be entirely paid by the City.

For example, currently, the Police and Fire Department Retirement Board assumes that the plan will earn a net rate of return of 8% on investments and the Federated City Employees' Retirement System Board assumes a net rate of return of 8.25%.¹² The City is 100% responsible for any unfunded liability created when investment decisions made by the retirement boards result in earnings less than the assumptions. There is **no** investment risk to employees or retirees for the pension benefits they receive. Taxpayers bear 100% of the risk.

Conflicts of Interest

Decisions made by the retirement boards directly impact the City and employees. For example, decisions made by the boards related to actuarial assumptions affect the contributions required to be made by employees and the City.

In its report, Cortex states:

The composition of the retirement boards is not sufficiently free of conflicts of interest, as demonstrated by the following features of the boards:

- a) **Only the Board of the Federated City Employees' Retirement System is required to have even a single board member who is independent of the stakeholders. This is insufficient to ensure an independent board.**
- b) **Both retirement boards are required to have Council Members serving on them. When acting in their fiduciary capacity as retirement board members, these individuals inevitably must decide on matters in which the interests of the retirement system and those of the City conflict. For example, when setting policies affecting contributions, Council Members must potentially decide between the City's desire for lower contributions on the one hand and members' desire for benefit security on the other.**
- c) **Both boards are also required to have board members who are active or retired members of the plans. When acting in their fiduciary capacities, these individuals are also inevitably required to make decisions where the interests of the System conflict with those of the City.**¹³

¹² The Police and Fire Department Board recently decided to maintain the 8% net rate of return assumption. The Federated City Employees' Retirement Board is currently considering changes to the rate of return assumption.

¹³ Page 17, Cortex Applied Research Inc., Revised Report, September 2009

Experience and Expertise of Retirement Board Members

Cortex found that the City's retirement boards are not currently required to have a substantial number of board members with relevant expertise or experience.

In its report, Cortex states:

Currently, the City Municipal Code requires that the Board of the Federated City Employees' Retirement System have only one member with relevant experience, specifically in banking or investments. Similarly, the Board of the Police and Fire Department Retirement Plan is required to have only one member with relevant experience, specifically someone who holds a position in the City Administration at a level of Deputy Department Head or higher and who has experience in the investment or management of public funds, retirement funds, institutional funds, or endowment funds.¹⁴

The members of the retirement boards who are employees, retirees, or members of the City Council are not required to have any specific education or experience and are not independent of the City. Although the member of the City Administration on the Police and Fire Board has relevant experience, the person is not independent of the City. The members on each board who serve on the City's Civil Service Commission are not otherwise connected to the City, but they are not required to have any specific experience or expertise relevant to pension funds.

The current public member of the Federated City Employees' Retirement System is the only member of either retirement board who is both independent of the City and is required to have relevant experience. Cortex's recommendations result in four public members on each board that would be independent of the City and would be required to have specific experience. The City Administration concurs with this recommendation.

Survey of California Retirement Board Structures

A criticism of some stakeholders of the consultant's report is that Cortex did not focus on California pension systems in its review of other retirement board structures. To address this concern, the City Administration completed a survey of board structures in California. This survey was included in the Information Memorandum dated October 5, 2009. (Attachment B.2.) The Administration found that it was common for governing bodies to appoint trustees that are independent individuals who are not employees, retirees, or members of a City Council or Board of Supervisors.

The San Diego Experience

The City of San Diego serves as a practical example of a California pension system that recently implemented a change in the composition of its retirement board. The description of the change was included in the Information Memorandum, dated October 5, 2009. (Please see Attachment

¹⁴ Page 17, Cortex Applied Research Inc. Revised Report, September 2009

B., pages 6 and 7. Please also see Attachment B.4, Excerpt from the City of San Diego Pension Reform Committee Report.)

The report of the City of San Diego's Pension Reform Committee noted:

[W]hile contributions to the Plan are made by both the employees and the City, only the City acts as the final guarantor of all benefits paid by the plan. This ultimate guarantee of the Plan's ability to pay the agreed-upon benefits means that the primary, if not the sole, stakeholders in the operation of the plan itself are the citizens of the City of San Diego.¹⁵

Two of the key concerns identified by the San Diego's Pension Reform Committee are:

1. Conflicts of Interest

The Committee stated that the majority of the members of the retirement board could clearly benefit by enabling the City to fund its current operating budget at the expense of the retirement plan as long as the ramifications to the Plan are not severe over the short term.

2. Technical Skills Required to Effectively Govern the Retirement Plan

The Committee noted the technical skills that are required to understand the complex issues that are present in the administration of the plan:

The combination of the highly technical rules for pension administration and the need to understand the use of arcane actuarial science in the measurement of present and future Plan liabilities requires an experienced and trained Board member to effectively govern the Plan. While some may argue that the purpose of the Board member is to set policy and that technical aspects are handled by trained professionals, lack of understanding of the finer points of administration means that a Board member may be unable to ask meaningful questions.¹⁶

San Diego's Pension Reform Committee concluded that "...the beneficiaries and the City would be better served by a Board composed of qualified professionals who have no vested interest in the Plan."¹⁷ Implementation of this recommendation would have resulted in not having any employees or retirees on San Diego's retirement board. All of the members of the board would be members of the public who had relevant education and experience. The composition of San Diego's retirement board was modified by adding board members who are independent of the City and have relevant education and at least 15 years of relevant experience. However, San Diego's board still has employees and retirees.

¹⁵ Attachment B.4. Excerpt from the September 15, 2005, City of San Diego Pension Reform Committee report.

¹⁶ Attachment B.4. Excerpt from the September 15, 2005, City of San Diego Pension Reform Committee report.

¹⁷ Attachment B.4. Excerpt from the September 15, 2005, City of San Diego Pension Reform Committee report.

Recommended Changes to Composition of Retirement Boards

In light of the main issues identified by Cortex, as well as the issues raised in San Diego’s pension reform report, the City Administration recommends that the priority for changes in board governance be to add retirement board members that:

1. Are members of the public and independent of the City, and
2. Possess relevant education and experience

The following tables contain the City Administration’s recommended board structure:

Federated City Employees’ Retirement System			
Composition	Board Member	Term	Method of Appointment
7 Appointed Members	Retiree	4 years (Max 2 terms)	No change (Appointed by City Council)
	Employee	4 years (No term limit)	No change (Appointed by City Council)
	Employee	4 years (No term limit)	No change (Appointed by City Council)
	Public Member (already on Board)	4 years (No term limit)	No Change (Appointed by City Council)
	Public Member	4 years (No term limit)	Appointed by City Council
	Public Member	4 years (No term limit)	
	Public Member	4 years (No term limit)	

Police and Fire Department Retirement Board			
Composition	Board Member	Term	Method of Appointment
7 Appointed Members	Retiree	4 years (Max 2 terms)	No change (Appointed by City Council)
	Employee (Police)	4 years (No term limit)	No change (Appointed by City Council)
	Employee (Fire)	4 years (No term limit)	No change (Appointed by City Council)
	Public Member	4 years (No term limit)	Appointed by City Council
	Public Member	4 years (No term limit)	
	Public Member	4 years (No term limit)	
	Public Member	4 years (No term limit)	

These recommendations do not make any changes to the retiree representative or employee representatives that currently serve on each retirement board. For the Police & Fire Department Retirement Plan, the proposed structure would replace the Civil Service Commission member, two City Council members, and the City Administration member from the Board with members from the public.

For the Federated City Employees' Retirement System, the recommended structure would also replace the two City Council members and the Civil Service Commission Representative with members of the public. It should be noted that the Federated City Employees' Retirement System already has a public member on the board, so it is recommended that the position be retained. The public members on each board would be required to meet specific minimum education and experience qualifications.

Qualification Requirements for Public Members

Serving as a retirement board member requires special expertise to understand the complex issues in the administration of the retirement plans. While there is no assurance that any public member would be a successful board member, having carefully selected experienced and independent professionals on the retirement boards would be beneficial in managing and investing the retirement funds. Therefore, the City Administration recommends that the following qualification requirements be established for the public members of the boards.

As noted earlier in this memorandum, the City of San Diego recently went through a retirement board governance change. The City Administration reviewed the qualifications that were established for the public members of San Diego's retirement board. The recommended qualification requirements are modeled after those established by the City of San Diego.

Recommended Qualification Requirements:

- **Education Requirement:**

Candidates must have a Baccalaureate Degree from an accredited college or university in finance, economics, business or other relevant field of study. An advanced degree in a relevant field of study or a relevant professional certification is desirable, but not required.

- **Experience Requirement:**

Minimum of fifteen years experience in pension administration, pension actuarial practice, institutional investment management, employee benefits/investment law, banking, asset/liability management for an insurance company, or university or college professor with a focus on fiduciary or trust fund law or a quantitative background in financial theory or actuarial math. (Note: a combined fifteen years of experience in any of these disciplines would meet this eligibility requirement.)

- **Independence/Conflicts of Interest:**

Not a current or former City employee, current or former elected or appointed City official, participant, retiree, or beneficiary in either of the retirement systems, a representative from any union representing City employees, or relative of a City employee or City retiree. (For a definition of a relative, refer to City of San Jose Policy Manual, Section 1.1.3, Nepotism Policy. Please see Attachment C. Nepotism Policy.)

No business, personal or family interests related to the City or the retirement systems which would be, or create the appearance of, a conflict of interest with the duties of a trustee.

- **Residency Requirement:**

Must reside within 90 miles from the City of San Jose City Hall, 200 E. Santa Clara Street, San Jose, CA 95113.

Term

The public board members would have four (4) year terms with the option to be re-appointed by the City Council after the end of each term. This is the same as currently exists for the public member on the Federated Board.

Stipend

Under the Federated City Employees' Retirement System, the Civil Service Commission Board member and the public member receive compensation in the amount of \$150 per month.¹⁸ For the Police and Fire Department Retirement Plan, the Civil Service Commission Board member also receives compensation in the amount of \$150 per month.¹⁹ Payment is made from funds in each of the respective plans and is not made for any month in which the member was absent from the regular meeting of the board and the absence was unexcused. It should be noted that this amount has been in place for many decades and the amount has remained the same.

In light of the City's fiscal situation and the unfunded liability in the retirement plans, the City Administration does not recommend increasing the current stipend. The Administration recommends that the public members receive the existing \$150 per month for attending the regular board meetings.

The City Administration recommends returning to the City Council at a later date, as part of Phase II, to consider amending this stipend amount. The City Administration will evaluate the stipend amount that other retirement boards provide to its board members and whether the stipend is contingent upon the performance of the plan.

¹⁸ San Jose Municipal Code Section 2.08.1065

¹⁹ San Jose Municipal Code Section 2.08.1270

Appointment

As previously stated in this memorandum, City Charter Section 1002 provides that all appointments to the Boards and Commissions be made by the City Council. The Administration recommends that the City Council will appoint the public members, as is currently done for all board member positions.

Process for Filling of Vacancies of Public Member Positions

Currently, the City Clerk's Office handles the announcement of vacancies on City boards and commissions. The Administration recommends that the City Clerk's Office handle the announcement of the vacancies for the additional public members of the retirement boards. All applicants interested in serving as one of the public retirement board members would be required to apply through the application process administered by the City Clerk's Office. The City Attorney's Office would assist in conducting a conflicts of interest review. Applicants who meet the eligibility requirements would be interviewed by the City Council at a public Council meeting. The Council could appoint any of the applicants or continue to seek applicants if any vacancy is not filled.

Under the recommended model, each plan will have four public members. For the Police & Fire Department Retirement Board, the Civil Service Commission Board member position is currently vacant. The City Administration recommends that this position be filled first by a public member that meets the eligibility requirements and who has gone through the application/screening process and been interviewed by the City Council. The next positions filled would be the positions currently held by a member of the City Administration and the two Council members. The current City Administration member and City Council members would remain on the Board until the positions are filled by the public members.

For the Federated City Employees' Retirement Board, the City Administration recommends that the replacement of the two City Council members, followed by the Civil Service Commission members take place in that order. It is further recommended that the current Public Member remain on the Retirement Board if the incumbent meets the recommended qualifications set forth in this memorandum. In the event the incumbent does not meet the qualification requirements, it would be recommended that this position be filled with a public member, after the other three positions have been filled.

Removal of Board Members

Retirement board members are responsible for the management and administration of the retirement plan and investment funds. Therefore, board members are subject to strict fiduciary standards.

Currently, the San Jose Municipal Code, Section 2.08.130 provides that any person appointed to and holding the position of member of any board or commission may be removed from appointment, at any time, by the council, with or without prior notice, and with or without cause. In addition, the City Manager or Union may submit a written request for removal of a board member to the City Council.

Cortex recommends that stakeholders have the ability to initiate removal of board members for failure to act in accordance with their fiduciary duties or failure to carry out the requirements of governing legislation. Since the City Council appoints all the members of the retirement boards, the City Administration recommends that any stakeholder, including plan members, retirees, and a member of the public have the opportunity to request removal of a board member for reasons such as failure to attend three or more board meetings in any given calendar year, breach of fiduciary duty, or failure to comply with governing legislation. As such, the City Administration is recommending that the existing removal process in the Municipal Code be expanded to allow any stakeholder to make a recommendation to the City Council for removal of a board member. The request shall be made in writing to the City Council, and the procedures shall be set forth in the Municipal Code.

POLICY ALTERNATIVES

The City Administration recommends that the City Council approve the recommendations in this memorandum. However, the composition of the retirement board recommended in this memorandum is not the only alternative.

In evaluating alternative retirement board structures, Cortex provides important guidance:

The composition of a retirement board must reflect the relative risk/reward exposure of active members, retired members, and taxpayers. Where risks and rewards are shared equally, equal representation by stakeholders on the retirement board is appropriate. Where one party bears a disproportionate share of the risk involved, it should have majority representation on the fiduciary board.²⁰

Policy Alternative A

As noted earlier in this memorandum, San Diego's Pension Reform Committee recommended having a board exclusively of public members with relevant experience and who are all independent of the City. This alternative would remove the conflict of interests of having members of the board who are employees, retirees, or members of the administration. (San Diego does not have elected officials on its retirement board.) Thus, one alternative would be to have boards comprised exclusively of public members who have relevant experience and are independent of the City.

Policy Alternative B

During the stakeholder meetings, the San Jose Police Officers' Association and other stakeholders suggested the City Administration consider a "3-3-1" board structure model. Under this model, the retirees and employees would appoint three board members, the City Council would appoint three board members, and those six board members would collectively appoint the seventh board member.

²⁰ Page 13, Cortex Applied Research Inc. Revised Report, September 2009

This type of board structure model is common in multi-employer retirement plans which are designed for workers in industries where it is common to move from employer to employer. Multi-employer pension plans have a specific definition under the Labor Management Relations Act of 1947, known as the Taft-Hartley Act. Under Taft-Hartley, a multi-employer pension plan is established by negotiating an employer contribution as part of a labor-management agreement and establishing a trust fund. Then, labor organizations bargain with additional employers to have workers covered by these plans. Employer contributions, determined by collective bargaining, fund the multi-employer pension plans. Taft-Hartley multi-employer pension plans are generally found in private sector industries such as construction, trucking, mining and grocery stores.

The risk in these plans is shared more equally than the City's retirement plans. Thus, a "3-3-1" model would not be consistent with the fact that in San Jose's plans, taxpayers bear 100% of the investment risk for pension benefits. In addition, since the City Charter requires that the City Council appoint all members of the retirement boards, this alternative would require a change in the City Charter.

A variation of the "3-3-1" model could be implemented without a change in the City Charter. Under the City Administration's recommendation, each board would have four public members. Although all of the public members would need to be appointed by the City Council, applicants for one of those public members could be first interviewed by each retirement board. The City Council would then interview all applicants, but would receive the boards' recommendations for that particular public member position on the board. This public member would still need to meet the same education, experience, and conflict of interest requirements specified in this memorandum and would be required to apply through the process administered by the Office of the City Clerk. The applicants for this position would also be subject to the same screening process as the three other public members of each board.

This policy alternative would not require any revisions to the retiree representative or employee representatives under each retirement plan. If this alternative is implemented, it is recommended that the applicants for the fourth public member on each board be the position that is first interviewed by the other six board members. The fourth public member position on each board would be filled after the Council has appointed three public members to each board so that those public members could participate in the interview process of the fourth public member. The decision on who to appoint to this fourth public member position would still be at the discretion of the City Council.

The interviews conducted by the boards for this fourth public member shall be conducted during one of the regularly scheduled board meetings. An item would be agendaized on the retirement board agenda to complete this interview process. The interview of the candidates shall be made in public and shall not be closed. Upon completion of the interviews, the board will have an opportunity to make a recommendation for appointment to the City Council. The City Council shall consider this recommendation in its decision on the appointment of the fourth public board member.

Summary of Phase I

The City Administration believes that the proposed model would better serve plan members, retirees, and taxpayers. The proposed structure would add public members that have specific education and experience, and would avoid the appearance of conflicts of interest. These are key factors needed to effectively oversee the investment programs, benefit delivery, and administration of the plans.

The recommendations prepared by the City Administration would require several revisions to the San Jose Municipal Code. Approval of these recommendations would require ordinances to amend the San Jose Municipal Code. Such ordinances would be prepared by the City Attorney's Office, in coordination with the City Manager's Office. The ordinances would be placed on a City Council Agenda for approval and adoption.

Phase II

The revised Cortex report issued in September 2009 includes six other recommendations for consideration. The City Administration believes the composition of the board structure, specifically adding independent public members with specific education and experience is of primary importance. Consideration of the remaining six recommendations is also important, and the City Administration is proposing that consideration of these recommendations be included in Phase II of this process. This would include consideration of a change in the City Charter to allow employees and retirees to directly appoint persons to the retirement boards.

Therefore, it is recommended that the City Council direct the City Administration to continue to analyze the recommendations and return to the City Council with proposed changes. As part of this evaluation, the City Administration will consider recommending that the retirement boards be granted broader authority to administer the retirement systems.

EVALUATION AND FOLLOW-UP

Approval of the City Administration recommendations would require revisions to the San Jose Municipal Code. Ordinances amending the San Jose Municipal Code would be prepared by the City Attorney's Office, in coordination with the City Manager's Office. Such ordinances would be placed on a future City Council agenda for approval and adoption. Upon adoption of these ordinances, the public member positions would be posted by the City Clerk's Office.

As part of Phase II, the City Administration will continue to evaluate the other six recommendations provided in the revised Cortex report, and return to the City Council with further recommendations.

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

In order to provide the public with information about the City Administration's recommendations on retirement board governance, the City Administration met with various stakeholders in December 2009. Additionally, this report will be posted on the internet and will be sent out as part of the early distribution packet. Bargaining unit representatives and the retiree associations were notified of this agenda item in advance. A copy will also be sent to them as soon as the memo has been distributed.

COORDINATION

This memo has been coordinated with the Department of Retirement Services and the City Attorney's Office.

CEQA

Not a project.


Debra Figone
City Manager

For questions please contact Alex Gurza, Director of Employee Relations, at 535-8155.

- Attachment A. FAQ's related to Board Governance
- Attachment B. Information Memo dated October 5, 2009
- Attachment B.1. Summary of Stakeholder Comments
- Attachment B.2. Survey of Retirement Board Structures
- Attachment B.3. Cortex Applied Research Inc., Revised Report, September 2009
- Attachment B.4. Excerpt from the September 15, 2005 San Diego Pension Reform Committee
- Attachment C. City of San Jose Nepotism Policy