COUNCIL AGENDA: 8-3-10
ITEM: 3.2

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Richard Doyle
City Attorney

SUBJECT: **Retirement Board Governance Ordinances**

DATE: July 22, 2010

RECOMMENDATION

Approve ordinances:

(a) Amending Section 2.08.130 of Part 1 of Chapter 2.08 of Title 2 of the San José Municipal Code to revise provisions for removal of Retirement Board members.

(b) Amending Part 12 of Chapter 2.08 of Title 2 and Section 3.36.330 of Part 3 of Chapter 3.36 of the San José Municipal Code to revise the Structure of the Board Of Administration for the Police and Fire Department Retirement Plan and, adopt minimum qualification criteria for public members of said Board, revise provisions for Compensation of Board members and revise the definition of a Board quorum.

(c) Amending Part 10 of Chapter 2.08 of Title 2 of the San Jose Municipal Code to revise the Structure of the Board of Administration for the Federated City Employees Retirement System, adopt minimum qualification criteria for public members of said Board and revise provisions for compensation of Board members

BACKGROUND

On February 9, 2010, Council approved revisions to the governance structure of the City's two retirement plans and directed the City Attorney's Office to draft an ordinance with the necessary revisions to the San José Municipal Code, based on the staff recommendations as contained in memoranda dated January 12, 2010 and (see Attachment A) and February 2, 2010 (see Attachment B), as revised by recommendations contained in a memoranda from Mayor Reed and Council members Constant, Kalra, Liccardo and Herrera, dated February 4, 2010 (see Attachment C.).

ANALYSIS

The proposed ordinances are based on the recommendations contained in the staff memoranda, as revised by the recommendations contained in the Mayor/Council member memoranda, with one exception, three modifications and one addional provision as follows:

1. **Removal Of Board Members For Failure To Attend Three Or More Board Meeting In Any Year** - Section 2.08.060 of the Municipal Code already provides that, where a city board or commission meets more than four times per year, a board or commission member will be deemed to have automatically resigned if the member has unexcused absences for three or more regular meetings, or for more than twenty percent of the total regular meetings. Thus, there is an effective limit of three unexcused absences for the Retirement Boards, which usually have 11 regular meetings a year. Section 2.08.060 does contain special provisions for the employee and council members of the Boards to have excused absences if they are performing required City business and authorizes each of the Boards to excuse a member's absence upon a finding of "good cause." It was unclear from the staff memoranda whether the intent was to eliminate the automatic resignation and require a removal process instead; and whether staff was proposing the elimination of the provision for excused absences. In coordinating preparation of the proposed ordinance with Retirement Services and OER staff, it was confirmed that the existing language in Section 2.08.060 met the intent of their recommendation.

2. **Residency Requirement for Public Members of the Boards** – Staff recommended a 90 mile from City Hall residency requirement and Council modified this to 50 miles from City Hall. In order to simplify administration of this requirement, the proposed ordinance specifies that public members must reside within Santa Clara County or within a county that has a boundary within a 50 mile radius of San José Hall.

3. **Conflict of Interest Prohibition** – The January 12, 2010 staff memorandum included as a recommended qualification criteria that the public Board members shall have "no business, personal or family interests related to the City for systems which would be, or create an appearance of, a conflict of interest with the trustee of a trustee." Under existing State and local conflict of interest laws, a conflict or potential conflict of interest can exist when the Board is taking action on a matter in which a Board member has a financial interest (which can exist because of an employment or family relationship). However, the existence of a conflict only precludes the Board member from participating in decisions in which he or she has the conflict, or potential conflict. In addition, under existing State and local law, board members are required to file Disclosure Statements (Form 700). No amendment to the Municipal Code is necessary to implement these

conflict of interest provisions, However, in coordinating preparation of the proposed ordinance, Retirement Services and OER staff indicated that the intent of staff's recommendation was a more extensive conflict of interest standard of eligibility for the public member positions on the Boards, including the evaluation of potential for conflicts of interest and appearance of conflicts, prior to appointment and periodically thereafter. The proposed ordinances contains provisions which will allow the Council to receive and evaluate information related to conflicts of interests, potential conflicts of interest and appearance of conflicts of interest from prospective Board members during the application phase of the appointment process, and annually thereafter. Upon approval of the proposed ordinance as drafted, staff, with the assistance of the City Attorney's Office, will be identifying whether to require the disclosure of information that is not currently required to be disclosed on Form 700s, and will be developing any disclosure forms that may be necessary to supplement the Form 700 disclosure requirements.

4. **Cause for Removal of Board Members** - Staff's recommendation relating to qualification criteria for the public members of the Board focused on the appointment process. The proposed ordinance also provides that failure of a member to continue to be qualified (e.g. if member moves and no longer meets the residency requirement) is grounds for removal of the Board member. For public members of the Board cause for removal may also be based on failure disclose all conflicts of interest, significant potential for conflict of interest, or appearance of conflict of interest and/or the existence of conflict of interest, significant potential for conflict of interest, or appearance of conflict of interest.

5. **Board Quorum for Police and Fire Board** - Section 3.36.330 currently provides that a majority of the Board shall constitute a quorum for transaction of business, and that the affirmative vote of not less than three members shall be necessary for the passage or adoption of any resolution, order or motion. This section which was not updated when the Board was increased from five to seven members in effect allows action to be taken by less than a majority of the Board. With the increase to nine members, it is recommended that this section be repealed and that the Police and Fire Retirement Board be subject to the general quorum and voting requirements (SJMC§2.08.090) which govern most other City boards and commissions including the Federated City Employees Retirement Board.

PUBLIC OUTREACH/INTEREST

This memorandum and the proposed ordinances are posted on the City's website for the August 3, 2010 City Council agenda. Additional public outreach relating to changes

in the Retirement Boards governance structures are described in the attached staff memoranda.

COORDINATION

Preparation of this memorandum and the draft ordinances was coordinated with the Department of Retirement Services, Office of Employee Relations, and City Clerk's Office. Upon approval of the draft ordinances, with such changes as Council may direct, the draft ordinances will be forward to the Retirement Boards for review and comment pursuant to San José Municipal Code Sections 3.28.275 and 3.36.485.

CEQA: Not a Project; File No. PP10-068

RICHARD DOYLE
City Attorney

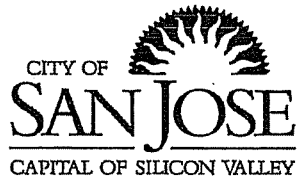
By Mollie Dent
Mollie Dent
Sr. Deputy City Attorney

cc: Debra Figone
Lee Price

For questions please contact MOLLIE DENT, Senior Deputy City Attorney, at (408)535-1905

ATTACHMENT A

COUNCIL AGENDA: 01/26/10
ITEM: 3.6



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.

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[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**
Federated City Employees' Retirement System	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
Police and Fire Department Retirement Board	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.

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[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]

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[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.

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[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.

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[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 agendized 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.

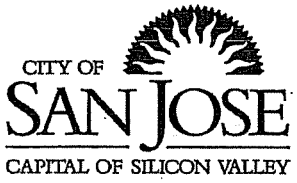
Debra Figone
City Manager

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

ATTACHMENT B

COUNCIL AGENDA: 02/09/10
ITEM: 3.2



Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Debra Figone

SUBJECT: **Retirement Board Governance**

DATE: February 2, 2010

SUPPLEMENTAL

REASON FOR SUPPLEMENTAL MEMORANDUM

The Retirement Board Governance issue was originally scheduled to be heard before the City Council on January 26, 2010. During the Rules & Open Government Committee on January 20, 2010, the Committee deferred this item for a period of two weeks. As part of the deferral, a request was made to have the Administration respond to the following questions:

1. What is the cost of a ballot measure in June 2010 or November 2010 to change the City Charter to allow the direct election or appointment by employee and retirees of their respective representatives on the retirement boards?

2. Could the cost of the ballot measure be paid by retirement funds? Would this be legal? Would the City or each Board be responsible for deciding whether retirement funds could be expended for this purpose?

3. What would the process be for handling retirement board dissatisfaction with the Director of Retirement Services?

In addition, staff was asked to have an additional meeting with labor representatives to discuss the composition of the retirement boards, specifically the "3-3-1" model that was described under Policy Alternative B in the Council Memorandum dated January 12, 2010.

This memo provides responses to the additional information that was requested on this item and provides a summary of the additional meetings with labor representatives. In addition, this memorandum recaps the City Administration's recommendations, including where they have been modified based on feedback received in the most recent outreach requested by the Rules & Open Government Committee. The rationale for these recommendations are restated so they are in context with the original objectives of the review of retirement board governance and the various interests of some of the stakeholders who have been engaged in this issue.

Stakeholders

There are many stakeholders in the issue of the governance of the City's retirement plans, including:

- City employees and retirees
- Unions/bargaining units representing City employees and retiree associations
- Taxpayers (businesses and residents)

As stated in the original memorandum dated January 12, 2010, taxpayers are very important stakeholders because the City, and consequently taxpayers, are responsible for 100% of any unfunded pension liability. The Rules & Open Government Committee directed the City Administration to have additional meetings with labor representatives. This memorandum includes the additional feedback/suggestions received from labor and retiree representatives. It is important to note that no additional outreach to taxpayers or other stakeholders was conducted, but the Council meeting on February 9, 2009, will provide the opportunity for taxpayer and other stakeholder input.

Key Objectives

In considering a change to the current retirement board governance structure, the City Administration recommends that the City Council consider the following as key objectives for the first phase:

1. **Retain Council authority and discretion to appoint all members on each retirement board unless a City Charter change is pursued; and even if a Charter change is pursued, retain Council authority and discretion to appoint the majority of the members on each retirement board.**

2. **Replace Council, Civil Service Commission and Administration Board members with public members that possess specific relevant education and experience and who are independent of the City.**[1]

As stated in the Cortex report:

> **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 the majority representation on the fiduciary board.**[2]

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[1] The City Administration concurs with the consultant's recommendation that public members who are independent of the City be added by replacing the two City Council members and the Civil Service Commissioner on each board, as well as the City Administration member on the Police and Fire Board. Both boards would continue to have 7 members.

[2] Cortex Revised Report, September 2009, page 13.

Since taxpayers bear 100% of the investment risk for pension benefits, the Administration strongly recommends the City Council retain the authority to appoint the majority of the members on the City's retirement boards. Currently, the City Council appoints every member of both retirement boards.

Cortex also states that the governance model should ensure that the retirement boards "...as a whole, possess substantial knowledge, expertise, and experience that are directly relevant to the oversight of a public retirement system."[3] In addition, Cortex states the governance model should minimize the existence of, or potential for, conflicts of interest.[4]

The City Administration's recommendations accomplish these objectives.

ANALYSIS

The following are responses to the questions asked by the Rules and Open Government Committee.

Question 1: What is the cost of a ballot measure in June 2010 or November 2010 to change the City Charter to allow the direct appointment of employee and retiree representatives on the retirement boards?

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.[5] The Office of the City Clerk estimates, based on calculations provided by the Santa Clara County Registrar of Voters, that a Charter Amendment would cost $477,600 if the measure is placed on the ballot in June of 2010. If the Charter Amendment is placed on the November 2010 ballot, the cost is estimated to be $410,600.

The City Administration recommends that if the City Council decides to pursue a change in the City Charter, other changes in the City Charter also be considered. The General Fund Structural Deficit Elimination Plan identifies various strategies, some of which may require a change in the City Charter.

Question 2: Could the cost of the ballot measure be paid by retirement funds? Would this be legal? Would the City or Boards decide?

The San Jose Municipal Code specifies that the retirement systems and the retirement funds shall be managed, administered and controlled by each board.[6] The California Pension Protection Act (Cal. Constitution Article 16, Section 17) also provides the Retirement Boards with "plenary authority" for administration of the retirement system, subject to certain requirements, including giving the Boards "sole and exclusive authority over the [pension plan] assets" and providing that the "assets must be held in trust for the exclusive purposes of providing benefits and

[3] Cortex Revised Report, September 2009, page 14.
[4] Cortex Revised Report, September 2009, page 14.
[5] City Charter Section 1002
[6] San Jose Municipal Code Sections 3.28.100 and 3.36.300

defraying reasonable administrative expenses." Therefore, the retirement boards, not the Council would be responsible for deciding whether or not to use retirement plan assets to pay for an election to change the City Charter process for appointment of retirement board members. Regarding the legal issue, since it involves the expenditure of retirement plan assets, if the retirement board(s) wish to consider such use of retirement funds assets, the City Attorney in coordination with the Boards' conflicts counsel, would provide a legal analysis of the issues.

Even if it were permissible for the retirement boards to decide to use retirement plan assets to pay for a ballot measure to change the City Charter, the City Administration does not recommend this option. As the sponsor of both retirement plans, the City Administration believes it is more appropriate to have the City pay for a ballot measure that would change the City Charter.

Question 3: What would the process be for handling retirement board dissatisfaction with the Director of Retirement Services?

Under City Charter Section 901, all City employees except Council appointees and professional employees in the Office of the City Attorney and Office of the City Auditor are appointed by the City Manager and subject to civil service and other rules set out in the Charter and serve at the pleasure of the City Manager. As a City employee, the Director of Retirement Services reports directly to the City Manager. If either of the retirement boards was dissatisfied with the Director of Retirement Services, the board could report any concerns directly to the City Manager. The City Manager would consider this feedback as part of the performance appraisal process.

City Administration Recommendations

The City Administration is recommending several revisions to the governance structure of the City's retirement plans, as described below.

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.

The Administration recommends a two-phase approach to implementing revisions to the governance of the City's retirement systems. Phase I would replace City Council, Civil Service Commission, and Administration Board members with public members that possess specific relevant education and experience and who are independent of the City. Phase II would include further evaluation of the other recommendations made by Cortex for future consideration.

The following table contains the Administration's recommended board structure under Phase I. It is important to note that there is **no** change in the number of retirees and employees who are members of the plan on each retirement board. Each board would continue to have one retiree and two employees who are members of the plan.

Federated City Employees' Retirement System 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	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[7]	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	

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 also recommends that the following qualification requirements be established for the public members of the boards. It should be noted that these qualifications include some modifications from the original recommendations that were outlined in the Council Memorandum dated January 12, 2010.

[7] The Federated City Employees' Retirement System already has one public board member.

Qualifications for Public Members	
Education Requirements	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	15 years preferred, but no less than 10 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: combined years of experience in any of these disciplines would meet this eligibility requirement.)
Independent/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.) 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, California 95113

In selecting the four public members on each retirement board, the City Administration recommends that the City Council seek to have public members that have diverse education and experience.

The City Administration also recommends the following for the public members on each retirement board:

Term, Compensation, Selection, Appointment, and Removal Process for Public Members	
Term	Four (4) year terms with the option to re-appoint by the City Council after the end of each term.
Stipend	Maintain at $150/month for attending regular board meetings. As part of Phase II, perform evaluation of the stipend amount.
Appointment	All board members appointed by the City Council.[8]
Process for Filling Vacancies of Public Members Positions **Note: Current Board Members to remain on Board until positions are filled by Public Members.**	The Office of the City Clerk shall handle the announcement of the vacancies and the application process for the additional public members of the retirement boards. Order for filling public member positions: **<u>Police & Fire</u>** 1. Fill the vacant Civil Service Commission position with a public member 2. Replace the City Administration member with a public member 3. Replace the City Council members with public members **<u>Federated</u>** 1. Replace the City Council members with public members 2. Replace the Civil Service Commission member with public members 3. Current Public Member to remain on Board if proposed qualifications in this memorandum are met
Conflicts/Background Check	Completion of a conflicts and background check for all eligible public member applicants. Conflicts and background check to be conducted/coordinated by the City Attorney's Office.
Removal of Board Members	Expand the existing removal process in the Municipal Code to allow any stakeholder (plan members, retirees, and a member of the public) to make a recommendation to the City Council for removal of a board member. • Request to be made in writing to the City Council

[8] Pursuant to City Charter Section 1002.

Appointment of Retiree and Employee Representatives

City Charter Section 1002, provides that "all boards, commissions or committees created by the Council shall be subject to such direction and supervision, if any, as the Council may specify, and the members shall be appointed by the Council, or by the Mayor, if such is authorized by the Council, for such terms as the Council may deem advisable." For the regular terms of the two employees and one retiree on each board[9], the Municipal Code provides for advisory elections in order to nominate candidates, and for the retiree candidate, a panel interview and recommendation by union representatives and a representative from the City Manager's Office. However, the City Council may appoint any of the candidates. To allow employees and retirees to directly elect or appoint the three members to each board would require a change in the City Charter.

Pending a change in the City Charter, the City Administration recommends that the City Council adopt an ordinance that states that the City Council shall give primary consideration to the employee or retiree who received the highest number of votes. Primary consideration means that the City Council will consider the employee or retiree who received the highest number of votes, and if, after all the interviews, the City Council decides to appoint someone other than the employee or retiree who received the highest number of votes, the City Council would articulate the reasons for the selection. The Council would retain the option to interview all candidates and maintain discretion to appoint any candidate.

If the City Charter is modified to allow direct election or appointment by the employees and retiree members of their respective representatives, the City Council would no longer interview employee/retiree candidates and would not have a role in appointing these specific board positions.

Other Cortex Recommendations

The revised Cortex report issued in September 2009 includes six other recommendations for consideration. The 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.

POLICY ALTERNATIVES

Policy Alternative B

As described in the Council Memorandum dated January 12, 2010, a variation of the "3-3-1" retirement board model could be implemented without a change in the City Charter. If the City Council considered this model, the Administration would recommend the "3-3-1" model as described below:

[9] Special rules apply to vacancies which occur prior to the expiration of a term of office.

Policy Alternative B			
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	4 years (No term limit)	Appointed by City Council
	Public Member	4 years (No term limit)	Appointed by City Council
	Public Member	4 years (No term limit)	Appointed by City Council
	Public Member	1 year (No term limit)	Applicants first interviewed by Board with all candidates forwarded to the City Council along with recommendation(s).[10] Appointed by City Council.

Under this alternative, all of the specific requirements and procedures described in the City Administration's recommendations would apply. (Please see pages 6-8 of this memorandum.) For example, the fourth public member that is interviewed by the Board must satisfy all of the qualifications specified in this memorandum and would be required to apply through the process administered by the Office of the City Clerk in the same manner as the other public members. In addition, the applicants for the fourth public member would also be subject to the same screening process as the three other public members on each board. The fourth public member would be the last public member appointed on each board.

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 agendized 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. All candidates, along with the recommendation(s) of the boards, will be forwarded to the City Council.

MEETINGS WITH LABOR

The Rules and Open Government Committee requested that staff have an additional meeting with labor. The City Administration scheduled two meetings on January 26 and 27, 2010, and

[10] For Federated, this is no change to the process for the current public member.

invited all labor representatives to attend either meeting. The Administration also extended the invitation to both retiree associations.

The following summarizes both meetings.[11]

January 26, 2010

The Administration's recommendations on the board governance were originally scheduled to be heard before the City Council on January 26, 2010. Since this item was deferred, the Administration held the first meeting in the afternoon of January 26, 2010. The attendees included:

- San Jose Police Officers' Association (POA)
- San Jose Retired Employees Association (Federated)

During this meeting, the POA stated that it would support Policy Alternative B, as written in the Council Memorandum, dated January 12, 2010. This includes the eligibility requirements for public members as specified in the memorandum. Additionally, the POA stated that they support all the other recommendations made by Cortex in its revised report dated September 2009, and would support a City Charter change to allow the direct appointment of the employee and retiree members of the boards.

The San Jose Retired Employees Association (Federated) indicated that they would attend the meeting scheduled for January 27, 2010, and provide comments at that time.

January 27, 2010

Representatives from the following unions/bargaining units attended the meeting scheduled for January 27, 2010:

- Association of Building, Mechanical and Electrical Inspectors (ABMEI)
- Association of Engineers and Architects (AEA)
- Association of Maintenance Supervisory Personnel (AMSP)
- City Association of Management Personnel (CAMP)
- Confidential Employees' Organization (CEO)
- International Brotherhood of Electrical Workers, Local No. 332 (IBEW)
- Municipal Employees' Federation (MEF)

Representatives from the following organizations also attended the meeting on January 27, 2010:

- Association of Retired San Jose Police Officers & Firefighters
- San Jose Retired Employees Association (Federated)
- South Bay Labor Council

[11] Representatives of three bargaining units did not attend either meeting: International Association of Firefighters, Local 230, International Union of Operating Engineers Local #3, and the Association of Legal Professionals of San Jose. Combined, these three groups represent approximately 1,600 City employees.

A summary of the recommendations made by these unions and retirees associations is detailed below. The recommendations were considered by the Administration and some of these recommendations have been incorporated in the Administration's recommendations outlined in this memorandum.

Please note that the summary of the comments below are only from those unions/associations who attended the meeting on January 27th.

"3-3-1" Model

The unions who attended the meeting on January 27th support a "3-3-1" model, with modifications, as described in this section.

The Administration continues to recommend a 4-3 model which would add public members that have specific education and experience, but would not change the number of employees and retirees currently serving on each retirement board. A key consideration in the Administration's recommendation is that investment risk in the pension plans is not shared equally between the City and employees. The City and taxpayers are 100% responsible for any unfunded pension liability. Therefore, the Administration recommends that even if a Charter change were pursued, the City Council maintain the authority and discretion to appoint a majority of the members of the retirement boards.

Qualification Requirements for Public Board Members - Experience

The Administration initially recommended a minimum of fifteen years experience in various disciplines as outlined in the Administration's recommendation. Attendees of the January 27th meeting recommended that the minimum experience be revised to a minimum of ten years.

Given the complexities of the retirement plans, the administration believes more experience would be beneficial, however, after careful consideration of this recommendation, believes that fifteen years is preferred, but could support a minimum of ten years experience.

Both retiree associations also recommended that experience in health and welfare should also be considered. The Medical Benefits Account is currently administered by the boards. There are limitations on the amount of contributions that can be made to this type of account for retiree healthcare benefits. As a result, a different trust may need to be established for retiree healthcare. Therefore, although this particular experience could be helpful, it may not be necessary to consider experience in health and welfare for purposes of meeting the minimum experience requirement of public board members.

Qualification Requirements for Public Board Members – Residency

The Administration recommends that qualified applicants must reside within 90 miles from City Hall. The San Jose Retired Employees' Association and the unions who attended the January 27th meeting recommended that this be revised to limit the residency requirement to applicants who live or work in Santa Clara County. The Association of Retired San Jose Police Officers &

Firefighters recommended that it should be limited only to applicants who live in Santa Clara County.

The Administration believes that it would be preferable to have board members that reside or work in San Jose. However, given the specific education and experience that will be required of the public board members and the conflicts of interest/background check, the Administration does not recommend limiting the potential eligible candidates who may be interested in serving on the City's retirement boards.

The Administration believes that 90 miles is reasonable and would provide a sufficient pool of qualified applicants.

Background Check for Public Board Members

All of the bargaining units/associations in attendance at the January 27th meeting believe that some type of background check should be completed for qualified public members.

The City Administration agrees with this recommendation and has included this under the Administration's recommendation in this memorandum. We recommend that the City Attorney's Office coordinate the background check as part of the conflicts screening process.

Diverse Levels of Experience for Public Board Members

The bargaining units who attended the January 27th meeting recommend that the public board members have diverse types of experience.

The City Administration agrees with this recommendation and has included this in the Administration's recommendation contained in this memorandum. The Administration believes that this is something that the City Council could take into consideration when making appointments to the boards.

Appointment Process

All bargaining groups/associations in attendance at the January 27th meeting recommended that, pending a change in the City Charter, the City Council adopt an ordinance or policy which would require the City Council to appoint the employees and retirees who received the highest number of votes in the advisory election. These groups also want to require the City to appoint the boards' recommendation in a "3-3-1" model. The Council would no longer have the discretion to appoint any other eligible candidate.

The City Attorney's Office has advised that an ordinance that completely eliminates Council or mayoral discretion over the appointment of Board members is not consistent with the City Charter. However, pending a change in the City Charter, the City Administration recommends that the City Council adopt an ordinance that states that the City Council shall give primary consideration to the employee or retiree who received the highest number of votes. Primary consideration means that the City Council will consider the employee or retiree who received the highest number of votes, and if, after all the interviews, the City Council decides to appoint

someone other than the employee or retiree who received the highest number of votes, the City Council would articulate the reasons for the selection. The Council would retain the option to interview all candidates and maintain discretion to appoint any candidate.

If the City Charter is modified to allow direct appointments of the employee and retiree members, the City Council would no longer interview employee/retiree candidates and would not have a role in appointing these specific board positions. The City Administration recommends that the City Council maintain the authority and discretion to appoint all other board members.

Alternative Board Structure

At the meeting on January 27th, the Association of Retired San Jose Police Officers & Firefighters recommended a "4-4-1" model. Under this model, there would be two employees, one retiree, one public member recommended by the employees and retirees, one City Council member, three public members selected by the City, and one public member that would be recommended by the other eight board members. The Association indicated, however, that they were flexible on the particular configuration of the "4-4-1" model.

The Administration has considered this recommendation and does not believe either board should be expanded from the current seven members. Both boards were expanded from five to seven in 2000-2001. Since the City has two retirement boards rather than one for all employees, such as San Francisco, San Diego and CalPERS, the Administration does not recommend increasing the size of the boards. As recommended by Cortex, the Administration recommends maintaining two seven-member boards.

SUMMARY

The Administration believes that the recommendations contained in this memorandum would add public members with education and experience without affecting the number of employees and retirees on each board.

The Administration has considered the recommendations made by the unions and retiree associations and has included some of those recommendations.

The recommendations prepared by the City Administration would require an ordinance to revise Municipal Code. Such ordinances would be prepared by the City Attorney's Office, in coordination with the City Manager's Office. The ordinance would be placed on a City Council Agenda for approval and adoption.

As part of Phase II, the Administration will continue to study the other recommendations in the Cortex report, including changes to the City Charter.

CONCLUSION

Introducing changes to long standing systems and structures, such as the governance of the retirement boards, can be difficult. The Administration's recommended changes to the governance of the retirement boards are the result of thoughtful analysis and consideration of many concerns and interests. The recommendations achieve two key objectives as stated at the beginning of this report:

1. Retain Council authority and discretion to appoint all members on each retirement board unless a City Charter change is pursued; and even if a Charter change is pursued, retain Council authority and discretion to appoint the majority of the members on each retirement board.

2. Replace City Council, Civil Service Commission, and Administration Board members with public members that possess specific relevant education and experience and who are independent of the City.

The City's retirement plans are an important benefit to the retirees and active employees of the City of San Jose. Employees do contribute to the retirement plans over their careers, but the City is responsible for a significantly higher portion of the costs, which represent a substantial investment by taxpayers and ratepayers.

Based upon the current contribution rates, the City will contribute approximately $138 million into the two retirement plans in Fiscal Year 2009-2010. As of June 30, 2009, the two retirement boards combined are responsible for managing approximately **$3.5 billion.** Over the many years that the two plans have existed, the skills and knowledge necessary to accomplish the responsibilities of the retirement boards have become very technical and complex. The Administration's recommendations are intended to address the need for specialized skills and experience through board members who meet specific education and experience and who are independent of the City organization.

COORDINATION

This memo has been coordinated with the Office of the City Clerk and the City Attorney's Office.

Debra Figone
City Manager

ATTACHMENT C

COUNCIL AGENDA: 02-09-10
ITEM: 3.2

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: CITY COUNCIL

FROM: Mayor Chuck Reed
Councilmember Pete Constant
Councilmember Ash Kalra
Councilmember Sam Liccardo
Councilmember Rose Herrera

SUBJECT: **RETIREMENT BOARD GOVERNANCE**

DATE: February 4, 2010

Approved Chuck Reed, Sam Liccardo, Ash Kalra, Rose Herrera

Date

RECOMMENDATION

Approve the staff recommendations for the Retirement Board Governance with the following changes:

a) For the Federated City Employees Retirement System, replace the two City Council board members and the Civil Service Commission board member with three public members. A fourth public member will be interviewed and recommended by the Federated Board and presented to the City Council. In the event that a majority cannot recommend a fourth member, then the top two applicants will be forwarded to the City Council for the Council to decide on which member shall be appointed.

Agency	Composition	Board Members
Federated City Employees Retirement Board	7 Appointed Members	Retiree Representative Employee Representative Employee Representative Public Member (Appointed by Council) Public Member (Appointed by Council) Public Member (Appointed by Council) Public Member (Federated Board Recommendation)

b) For the Police and Fire Department Retirement Board replace the two City Council board members, the Civil Service Commission Board members and City Administration Board member with four public board members. Also expand the Police and Fire Retirement Board by two members (9 member board) by adding an additional retiree board member so there is always one police and fire retiree. The fifth public member will be a public member who is to be interviewed and recommended by the Police and Fire Retirement Board and presented to City Council. In the event that a majority cannot recommend a final member, then the top two applicants will be forwarded to the City Council for the Council to decide on which member shall be appointed.

Agency	Composition	Board Members
Police and Fire Department Retirement Board	9 Appointed Members	Retiree Representative (Fire) Retiree Representative (Police) Fire Representative Police Representative Public Member (Appointed by Council) Public Member (Appointed by Council) Public Member (Appointed by Council) Public Member (Appointed by Council) Public Member (Police & Fire Board Recommendation)

c) The final public member positions on each Board will be filled after the City Council has appointed the public members to each Board so that they may participate in the interview process.

d) Add a City Council liaison as a non-voting member to each of the retirement boards.

e) Applications for public board member positions shall be submitted to the City Clerk's Office. The City Clerk's Office will be responsible for determining which applicants meet the minimum qualifications. The City Clerk will present her determinations on applicants meeting the minimum qualification to the Retirement Boards for comment. The City Clerk will then forward all applications with her determinations on those meeting minimum qualifications and the Retirement Board comments to City Council for consideration.

f) Amend the minimum qualifications for the public board member as follows:

1. Amend the residence requirement to 50 mile radius from San Jose City Hall.

2. Amend the experience requirement from 15 to 12 years.

3. It is important that members possess high levels of knowledge, expertise, and experience relevant to the administration of a public retirement plan. While there may be a need to emphasize investment and funding matters, it is also important that boards also possess members with relevant knowledge in benefits, accounting, operations, law, and human resource management. Examples of individuals with relevant background include, but are not limited to:

    1. Senior Executives of insurance or banking companies with asset/liability management experience.
    2. Senior Executives or professionals with audit, accounting, legal, actuarial, investment, or risk management backgrounds.
    3. Academics in the fields of finance, actuarial science, law, human resources or accounting
    4. Senior Executives with experience in financial services, health and welfare, employee pension, benefit or welfare plans or benefit delivery organizations.

g) Add a monthly report on Retirement Board Investments to the Public Safety, Finance and Strategic Support Committee agenda.

h) There are basic services the Retirement Board Director provides to both Retirement Boards. Many of these services are needed for the Retirement Boards to effectively perform their responsibility as a board. The Rules Committee should serve as an additional forum similar to the Public Records Act appeal process through which both boards may formally submit concerns regarding basic requests for services or information which are not being provided by the Administration. If within a 12 month period, 3 formal concerns about the Administration not providing basic services to the Retirement Board are received, a discussion will be agendized to discuss options to grant the Retirement Board broader authority. Options to be discussed will include but not limited to the recommendations as detailed in I-2 in the revised Cortex report, assistance of 3rd party auditors and administrators or the director salary may no longer be paid out of plan assets.

i) Direct the City Attorney to codify the appointment process for public members of the respective boards as outlined above. Direct the City Attorney to create an ordinance establishing the appointment process for employee and retiree representatives of the respective board that codifies the established process currently in practice. The ordinance should specify that appointment of employee and retiree representatives shall be routine business on the consent calendar but also provide discretion allowing the City Council to only reject the recommended employee and retiree representative if there is a finding of cause. The ordinance should also include a necessary finding of cause for removal of a board member. Cause may include failure to act in accordance with fiduciary duties or failure to carry out the requirements of governing legislation.

BACKGROUND

The drastic drop in pension values has resulted in projections that the City of San José will need to dramatically increase pension contributions. Pension contributions represent a sizable portion of the City's budget and are projected to grow considerably in the five-year forecast. It is in the best interests of the City, taxpayers, employees and retirees that our retirement boards be structured so that they are well managed utilizing best practice standards. The City retained Cortex Applied Research to review the fiduciary governance models of the City's two retirement plans: the Federated City Employees Retirement Board, and the Police and Fire Department Retirement Board. Cortex has proposed a series of recommendations for the retirement boards to help ensure the long-term health and success of the retirement systems.

The amendments as proposed in this memorandum expand the expertise of board members and ensure a majority of the board are independent members. It also honors the nomination process of employees and retirees and encourages a collaborative approach to board governance. Given the importance of the two retirement systems to employees, retirees, and taxpayers, and the impact the retirement boards have on our budget deficit, we should adopt an improved governance model for the retirement boards as amended by this memorandum.