SENT TO COUNCIL: _____

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Debra Figone

SUBJECT: **Retirement Board Governance And Stakeholder Outreach**

DATE: October 5, 2009

INFORMATION

BACKGROUND

On September 30, 2008, the City Council accepted an Audit of Retirement Services' Travel Expenses prepared by the City Auditor's Office. In addition to accepting the report, the City Council directed the City Manager to incorporate into the boards and commissions analysis, recommendations on restructuring the Federated City Employees' Retirement System and the Police and Fire Department Retirement Board to add independent Board Members with financial and investment expertise. The process was to include outreach to affected stakeholders.

In light of the significant decline in retirement plan assets, on December 10, 2008, the Rules and Open Government Committee approved an item for the January 13, 2009, Council Meeting, to report on the status of the City's two retirement funds. This included a report that would also identify any best practices that the City may want to consider to improve the plans' investment performances and to protect the general fund from additional losses.

In the Memorandum for the January 13, 2009, agenda item, the Director of Retirement Services indicated that pension plan best practices fall into three categories: governance, investments, and administration. Further, since proper governance is the key that leads to professionalism and excellence in all areas of practice, the City Manager reported to the City Council that staff would use an external consultant experienced with governance structures of different public pension plans to complete an analysis and review of the structure and governance of the retirement boards. This process would be handled independently of any other review of boards and commissions. Subsequently, a Request for Qualifications was issued on January 23, 2009, and Cortex Applied Research was ultimately selected to complete the analysis based on its experience, expertise, and strategic focus in board governance.

Cortex reviewed the governance models of the two retirement plans. This included reviewing relevant documentation, interviewing stakeholders and researching industry best practices. In its report presented before the City Council on June 23, 2009, Cortex concluded that changes in the Plan's governance models could support more effective long-term management of the plans and

better serve the interests of the key plan stakeholders, i.e. members, retirees, and taxpayers. The report provided eight recommendations for a new governance model for its retirement systems that will support more effective governance and oversight for the benefit of the City and all other stakeholders. The City Council directed the City Administration to conduct additional outreach with stakeholders and return in 90 days with final recommendations after conducting additional outreach. Because additional outreach has and will be conducted, the Administration was unable to return to the City Council with recommendations within 90 days.

The purpose of this Memorandum is to provide the City Council an update, including a summary of the stakeholder outreach meetings, a copy of the revised Cortex report, additional information regarding retirement board structures in California, and next steps regarding the retirement board structure and governance process.

STAKEHOLDER OUTREACH

The objective of the stakeholder outreach was to obtain feedback from various stakeholders on the recommendations outlined in the Cortex report. As part of the stakeholder outreach, the City Administration scheduled two stakeholder meetings on August 26th and August 27th to discuss the recommendations provided by Cortex on the retirement board structure and governance[1].

Information regarding these two stakeholder meetings was sent to various stakeholders including local business and neighborhood associations, representatives from the retiree associations, retirees, employees, and bargaining/employee units. This communication was provided via email which included a flyer that included the meeting dates, location and contact information. Retirees were notified via a letter from the Department of Retirement Services.

The City encouraged individuals to contact the City Administration or Cortex with any questions or comments regarding the stakeholder meetings or recommendations provided by Cortex. The City Administration received numerous calls prior to the stakeholder meetings, however, the majority of the callers were interested in the pension and retiree healthcare benefits that City employees receive. Upon providing clarification that the stakeholder meetings were intended to discuss an alternative retirement board structure, the callers generally expressed no concern with the City considering alternative retirement board structures. Cortex also received several emails, and the majority of the emails were from taxpayers who were supportive of the recommendations provided by Cortex.

At each of the two meetings, stakeholders were asked, but not required, to complete an attendance card and specify their affiliation. The following is a breakdown of the affiliation provided by attendees. It is important to note that more individuals attended the stakeholder outreach meetings, but did not fill out the optional attendance cards.

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[1] The stakeholder meetings were not intended to discuss pension and retiree healthcare benefits for City employees, but rather were focused on the governance structure.

	August 26th	August 27th	Total	%
Retirees Federated Retirement Plan Police & Fire Retirement Plan	 25 63	 15 29	132	62%
Employees Federated Retirement Plan Police & Fire Retirement Plan	 9 6	 15 0	30	14%
Community Member	19	10	29	14%
Business Member	3	2	5	2%
Other	10	6	16	8%
Total	**135**	**77**	**212**	**100%**

During the two stakeholder meetings, Cortex gave a presentation that summarized the June 23rd report that was provided to the City Council. In addition, stakeholders were given an opportunity to ask questions and/or provide comments on the report. A summary of the comments has been included in this Memorandum. (Please refer to Attachment 1, Summary of August 26th and August 27th Stakeholder Meetings.) The August 26th meeting was audio recorded and the August 27th meeting was video recorded. For a complete record of all the comments, please refer to the recordings that can be found at http://www.sanjoseca.gov/RetirementBoardGovernance.asp.

Approximately 45 individuals made comments during these stakeholder meetings. The majority of the speakers were City employees, retirees and union representatives. The majority of the speakers opposed any change to the retirement board structure and governance and felt that the current system was not "broken" and therefore, no change was needed.

Additionally, there were several requests for clarification regarding the recommendations provided in the Cortex report issued in June 2009.

Appointment and Selection of Board Members

Each of the retirement plans have seven board members. The governance model recommended by Cortex in its report would include the following:

> "The boards of each retirement system would continue to consist of seven members, with:
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> a) Four members, being a majority of the Board, appointed by the City Council. These individuals should be independent of the City and should possess strong knowledge, expertise, and experience relevant to the administration of public retirement plans.

b) Two members selected by active members. The selected members would not be required to be active members of the plans.

c) One member selected by retired members, and not required to be a retired member."

During the stakeholder meetings, there was a perception that the City Council wants more control of the retirement boards and therefore wanted the majority of the members to be appointed by the City Council. However, under the current structure **all** seven members of each Board are appointed by the City Council. Under the City Charter, all boards and commissions, including the Retirement Boards, are appointed by the City Council.

Pursuant to the San Jose Municipal Code, the employees make a recommendation to the City Council for the employee representative, but ultimately the City Council makes the appointments. Retiree representatives on each of the Board's are nominated by other retirees; however, the top three nominees are first interviewed by panels of management and labor who then make the recommendation for appointment to the Council. The Civil Service Commission recommends to the City Council one of its members, but the City Council ultimately appoints the Civil Service Commissioner to the Retirement Boards. Further, on the Federated Retirement Board, the public member is recommended to the City Council by the other Board members, however, the City Council appoints the individual. On the Police and Fire Department Retirement Board, the City Administration member is recommended by the City Manager, however, the City Council appoints the individual.

Below is a chart of the current retirement board structure for each plan.

	Composition	**Board Members**	**Method of Appointment**
Federated City Employee's Retirement System	7 Appointed Members	Retiree Representative	Appointed by City Council
		Employee Representative	
		Employee Representative	
		Civil Service Commission member	
		Public member	
		City Council member	
		City Council member	
Police and Fire Department Retirement Plan	7 Appointed Members	Retiree Representative (alternates between Police and Fire)	Appointed by City Council
		Police Employee Representative	
		Fire Employee Representative	
		Civil Service Commission member	
		City Administration member	
		City Council member	
		City Council member	

Although the City Council ultimately appoints all the members of the retirement boards, the public member on the Federated board is the only public member of either retirement board that is required to have any relevant experience or expertise.

Some individuals who attended the stakeholder meetings expressed concern that Cortex did not include examples of local retirement plan structures in its report, but focused on retirement plan structures in other states and other countries. The City Administration completed a survey of board structures in California to address this concern.[2] (Please refer to Attachment 2, Survey of Retirement Board Structures.) Specifically, the City Administration reviewed the retirement board structures for CalPERS, counties under the County Employees Retirement Law of 1937, and the largest ten California agencies in California. Of the largest ten agencies in California, only the City of San Jose, City and County of San Francisco, City of Los Angeles, City of Fresno, and City of San Diego have independent retirement plans.[3] The other agencies are under the CalPERS retirement system.

During the stakeholder meetings, several individuals expressed concern with removing the City Council members from the retirement boards and instead appointing external independent experts. However, in reviewing the structures of other California plans, of those Boards that do have City Council members or County supervisors as trustees, there is no more than one of these positions on the Board. We did find 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.

Additionally, we found that in the agencies surveyed, the City Council or Board of Supervisors is not responsible for ultimately appointing all members of the Retirement Board, as is currently the case with the City of San Jose. The City of San Jose is an anomaly when compared to the retirement board structures of other public agencies in the State.

Revised Cortex Report

Following the stakeholder meetings, Cortex issued a revised report. (Please refer to Attachment 3. Cortex Revised Report.) The revised report does eliminate one of the recommendations that caused confusion during the two stakeholder meetings regarding investment and funding objectives of the retirement boards. The intent of the original recommendation was to have the City Council review the established objectives for the retirement boards that are outlined in the San Jose Municipal Code. The City Council already has the authority to establish these objectives and Cortex was simply recommending that the current objectives be reviewed since they have not been reviewed for decades. It should be made clear that the investment and control of the retirement funds would continue to be the responsibility of the retirement boards.

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[2] The survey completed by the City Administration was not intended to compare the performance of the retirement plans of these agencies, but to review the composition and appointments of retirement boards in California.

[3] The City of Sacramento and the City of Oakland have closed independent retirement plans that were not included in the survey. City of Sacramento and City of Oakland employees have been in CalPERS since the 1970's. The CalPERS board structure is included in the survey. (Please see Attachment 2.)

City of San Diego Board Governance Change

Of the California retirement plans that the City Administration reviewed, the City of San Diego in recent years went through a retirement board governance change.[4] In 2003, the San Diego City Council established a Pension Reform Committee to address concerns about the unfunded liability of San Diego City Employees' Retirement System (SDCERS) and to review the scope and depth of audits to be performed on SDCERS. The Pension Reform Committee issued a report on September 15, 2004, that included recommendations related to the retirement board governance. One of these recommendations included changing the Board from 13 members to 7 members, all of whom would be citizens appointed by the City Council. Further, these individuals would be required to possess 15 years of relevant experience. Since the composition of the Retirement System is in the City Charter, any proposed changes would require approval by the voters of the City of San Diego.

The report noted that "while 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, stakeholder in the operation of the Plan itself are the citizens of the City of San Diego." (Please refer to Attachment 4. Excerpt from the September 15, 2005 City of San Diego Pension Reform Committee.)[5] The report also noted that technical skills are required to understand the complex issues that are present in the administration of the plan. Additionally, the Pension Reform Committee indicated that "the combination of the highly technical rules of 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."

The composition of San Diego's retirement board was revised, but differently than was recommended by the Pension Reform Committee. Proposition H which was passed by the voters and became effective on April 1, 2005, maintained the total number of Board members at thirteen, but changed the terms of office to four years and changed the composition of the Board as follows:

[4] The City of San Diego has one 13 member retirement board for both public safety and non-public safety members.

[5] Copies of the September 15, 2004, City of San Diego Pension Reform Committee report are available upon request.

San Diego City Employees' Retirement System			
Prior Composition		**Current Composition**	
Composition	**Board Members**	**Composition**	**Board Members**
6 Elected Members	Active Fire Safety Member	5 Elected Members	Active Fire Safety Member
	Active Police Safety Member		Active Police Safety Member
	Active General Member of the Plan (3)		Active General Member of plan (2)
	Retired Member of the Plan		Retired Member of Plan
4 Members appointed by the City Council	Appointed Citizen Members (4) – one of whom must be a local bank officer	7 Appointed Members	Appointed Citizen Members
3 Members appointed by the City Manager	City Manager	1 Appointed Members	City management employee (member of plan)
	City Auditor and Comptroller		
	City Treasurer		

In addition, qualifications were established for the citizen appointees to the retirement board. The seven citizen appointees must have a college degree in finance, economics, law, business, or other relevant field of study, or a relevant professional certification. Additionally, a citizen appointee must have a minimum of fifteen years experience in pension administration, pension actuarial practice, investment management, real estate, banking, or accounting. Further, to prevent conflicts of interests, the appointed citizens may not be a participant in the Retirement System, or City union representative; and the appointees may not have any other personal interests which would be, or create the appearance of, a conflict of interest with the duties of a Trustee.

The City of San Diego experience can be informative because they are a recent California retirement plan that underwent a board governance change. The primary outcome was the addition of citizen board members who are required to have substantial relevant education and experience.

ADDITIONAL STAKEHOLDER OUTREACH

Following the two stakeholder meetings, the City Administration conducted additional stakeholder outreach. This included meetings with representatives from various employee units, such as the Police Officers' Association, the City Labor Alliance which includes representatives

from bargaining units in the Federated City Employees' Retirement System, and the Executive and Professional Management Forum which includes a representative from each department that has unrepresented employees in Unit 99. In addition, the City Administration has met with representatives from the Association of Retired San Jose Police Officers and Firefighters, and the San Jose Retired Employees Association.

During these meetings, similar concerns that were raised in the two stakeholder meetings were expressed. The groups have expressed an interest in continuing discussions on the retirement board governance structure. Additional meetings will be conducted over the next several weeks to continue to receive feedback from stakeholders as the Administration develops its recommendations.

NEXT STEPS

A copy of the revised Cortex report will be posted on the City's website at http://www.sanjoseca.gov/RetirementBoardGovernance.asp and sent to stakeholders. The City Administration will continue discussions with various stakeholders.

In addition, the Administration will continue to work with the City Attorney's Office to address legal issues with implementing changes to the retirement board governance structure.

This item will be brought forward to the City Council with recommendations on the governance of the retirement boards. It is anticipated that this item will come back to the City Council by the end of the calendar year; however, the City Administration will continue to provide updates to the City Council.

DEBRA FIGONE
City Manager

Attachment 1: Summary of August 26th and August 27th Stakeholder Meetings
Attachment 2: Survey of Retirement Board Structures
Attachment 3: Cortex Revised Report
Attachment 4: Excerpt from the September 15, 2005 City of San Diego Pension Reform Committee