CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

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]

---

[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: **Police & Fire** 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 **Federated** 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