CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Manager
EMPLOYEE RELATIONS

Via Email

May 2, 2014

Peter Fenerin
President, Association of Building, Mechanical and Electrical Inspectors

Steve Contreras
President, Association of Maintenance Supervisory Personnel

Kara Capaldo
President, City Association of Management Personnel

Joel Phelan
President, International Association of Fire Fighters, Local 230

Dan Rodriguez
Business Agent, International Brotherhood of Electrical Workers, Local No. 332

Yolanda Cruz
President, Municipal Employees' Federation, AFSCME, Local No. 101

Jim Unland
President, San Jose Police Officers' Association

John Mukhar
President, Association of Engineers and Architects, IFPTE, Local 21

Charles Allen
Business Agent, AFSCME, Local No. 101

LaVerne Washington
President, Confidential Employees' Organization, AFSCME, Local No. 101

Frank Crusco
Chief Steward, International Brotherhood of Electrical Workers, Local No. 332

Lamoin Werlein Jaen
Senior Business Representative, IFPTE, Local 21

Bill Pope
Business Representative, Operating Engineers, Local No. 3

Re: Proposed Retirement Board Governance Changes

Dear Bargaining Unit Representatives:

As you may know, the Federated and Police & Fire Retirement Boards contracted with Cortex Applied Research to report on the governance structure of the retirement boards. Cortex included fifteen (15) recommendations in their Phase II report based on the following categories: authority of the retirement board, safeguards for stakeholders, transparency and disclosure, risk oversight, and scale and efficiency.

We want to ensure that you have the Cortex Phase II Report and Addendum. The links to those reports are as follows:

- Cortex Phase II Report: http://www.sanjoseca.gov/DocumentCenter/View/30225
- Cortex Phase II Addendum: http://www.sanjoseca.gov/DocumentCenter/View/30224

After consideration of the Cortex Phase II report, on April 4, 2014, the City Council approved a motion to prepare a City Charter amendment to grant the Boards autonomy based on the Council Appointee model and to draft ordinances for practices that would not be included in the City Charter. Please refer to the attached City Council memo from Mayor Reed and Councilmember Constant for additional information.

The Council also directed the City Administration to engage the stakeholders on these matters. As such, we would like to invite all of the City's bargaining units to discuss the proposed retirement board governance changes. This meeting is intended for the bargaining units to ask questions and provide input regarding the report and any of the proposed changes included in the April 4, 2014, Council memo. Roberto Peña, Director of Retirement Services, will also be present to answer any questions.

We look forward to discussing the Cortex Phase II Report with interested employee groups on May 21, 2014 from 4:00 pm – 5:00 pm in the City Manager's Conference Room.

Sincerely,

Alex Gurza
Deputy City Manager

Attachment

c Jennifer Schembri, Deputy Director of Employee Relations
Roberto Peña, Director of Retirement Services

City Council: 04-04-14
Item: 3.7

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

To: City Council **From:** Mayor Chuck Reed
Councilmember Pete Constant

Subject: Retirement Board Governance **Date:** April 4, 2014

Approved: Chuck Reed 4/4/14

Recommendation

Direct staff to:

1. Pursuant to the Cortex recommendations, prepare a Charter Amendment and ordinances as necessary to:
    a. Grant the retirement boards autonomy based on a Council Appointee model, with Council oversight and public accountability, as described below.
    b. Do not require the consolidation of the two boards.
2. Codify in the Municipal Code the Cortex recommendations already put into practice or agreed to by the Boards, as soon as feasible.
3. Engage with the stakeholders on a schedule to be able return to Council with ballot measure language, and draft ordinances for matters that are not required to be in the Charter, no later than August 5, 2014.

Background

The City of San José and the retirement boards have studied the issue of board governance a number of times in recent years. As a result of a 2009 Cortex report entitled *A Review of the Governance Models of The Police and Fire Department Retirement Plan & The Federated City Employees' Retirement System*, the City Council modified the retirement boards' composition to include outside, independent board trustees. In 2013, the retirement boards engaged Cortex to re-evaluate the governance models of our boards relative to best practice criteria and general industry practices. The resulting report, *Review of the Governance Models of The Police and Fire Department Retirement Plan & The Federated City Employees' Retirement System Phase II,* proposed a revised governance model that meets the criteria of providing for fiduciary autonomy, stakeholder confidence, and safeguards and protection.

The retirement boards have transmitted the Cortex's Phase II report, a summary of stakeholder feedback, and an addendum to the Phase II report to the city council for consideration. In assessing the governance models of the two Retirement Systems, Cortex considered the following criteria, which Cortex considers to be best practice, and the extent to which they are reflected in current industry practice:

1. Operational autonomy
2. Sufficient stakeholder safeguards, including:
    a. Balancing stakeholder representation and board independence
    b. Independence of retirement staff
    c. Board qualifications

d. Other safeguards such as transparency, disclosure, and alignment of interests.

3. Organizational scale and efficiency

Following the Council discussion on March 4, 2014 and referral to the Rules and Open Government Committee, on March 19, 2014 the Committee directed this matter be brought back to the Council with a recommended course of action as discussed by the Committee.

The recommendations in this memorandum are intended to implement the Cortex governance model as presented by Cortex in their February 2014 report, including the addendum.

Analysis

Granting the Retirement Boards Greater Autonomy: Cortex recommended that the City should allow the Retirement Boards greater autonomy in a number of areas in order that they may better administer their respective Retirement Systems and properly carry out their fiduciary duties. In an effort to ensure operational autonomy, we recommend granting the retirement boards this greater autonomy based on a Council Appointee model, with Council oversight and public accountability, as described below:

i. Establish the retirement board(s) in the City Charter based on a Council Appointee model
ii. Do not require the consolidation of the two boards
iii. Specify in the charter that the duties of FCERS and P&F Retirement Boards are to:
    a. Administer the systems' assets, investments, and conduct actuarial analysis
    b. Provide benefits to members of the system and their beneficiaries, and to pay reasonable administrative costs
    c. Maintain the plans' actuarial soundness, minimize risks to plan members, the City, and residents, and to be prudent and reasonable in light of the economic climate
    d. Jointly appoint independent legal counsel
    e. Jointly appoint and prescribe the duties of the CEO and CIO. These appointed employees shall serve in unclassified positions at the pleasure of the respective boards.
    f. Designate that the CEO is responsible to appoint and prescribe the duties of the employees in the Department of Retirement Services. These appointed employees shall serve in unclassified positions at the pleasure of the CEO.
    g. Current employees of the Department of Retirement Services may remain classified employees and members of the FCERS plan; however, new employees shall not become members of either retirement plan. They, however, may be in a plan not under the board's control, such as the Tier 3 defined contribution plan.
    h. If the retirement board(s) deems it necessary for the good of the service the board may, subject to the above-mentioned limitations, suspend without pay, demote, discharge, remove or discipline any such employee whom he or she is empowered to appoint.
iv. Prohibit Interference. Neither the Council, nor any of its members, nor the Mayor shall interfere with the execution by the retirement board(s), of its powers and duties, nor in any manner dictate the appointment or removal of any employees of the Department of Retirement Services whom the retirement board(s) or the CEO are empowered to appoint, however, the Council may express its views and fully and freely discuss with the retirement board(s), anything pertaining to the appointment and removal of any employees of the Department of Retirement Services.

Instituting Additional Safeguards to Protect Stakeholders. Cortex recommended that, if the Retirement Boards were to be granted expanded authority, various safeguards should be established to further protect the interests of stakeholders from the inappropriate use of such authority. In an effort to ensure there are safeguards to protect stakeholders, we recommend that the city council codify in the Municipal Code the Cortex recommendations that the retirement boards have already put into practice or have agreed to, as soon as feasible:

v. Transparency and disclosure of fiduciary decision-making. These policies related to transparency should also be included in the city's Sunshine Ordinance.
vi. Specify that the retirement board and committee meetings are subject to the provisions of the Brown Act and the city's Sunshine Ordinance.
vii. Specify that board and standing committee meetings are required to be held at city hall and be broadcast on the internet and Civic Center TV.
viii. Require that each board establish an Audit Committee
ix. Independent risk oversight by requiring external audits
x. Constraints on board action and policymaking:
    a. Restrict the boards' ability to advocate for legislation that would change benefit levels or design and impose material costs on stakeholders
    b. Discourage a pension board's ability to engage in social or economically targeted investing.
xi. Require an annual stakeholder general meeting
xii. Limit plan administrative expenses to 20 basis points (0.2%)

Governance Model. Cortex also recommended that an effective pension governance model must reflect the fact that stakeholders have a legitimate interest in the effective administration of the pension plan. It should also promote the ability of plan fiduciaries to act independently of stakeholders and to focus on the sole best interests of the plan beneficiaries, as required by trust law. The composition of a public plan's governing board is key to achieving both of the above objectives; therefore, we recommend modifying the board composition as recommended by Cortex:

xiii. Specifying that independent board trustees shall not be members of either plan
xiv. Maintaining the city council established minimum qualifications of independent trustees; however, we believe it would be beneficial to modify the qualifying residency radius from San José City Hall to 75 miles
xv. Designating that the City Clerk shall manage the recruitment and application process to develop an appointment pool for all independent trustee appointments. Employees, retiree, and labor organizations may explicitly engage, recruit, and invite applicants to apply.
xvi. Eliminate the non-voting board member from each board
xvii. Specifying that each board (FCERS P&F) shall be designated to have 9 trustees, designated as follows:
    a. 5 trustees of each respective board are to be independent trustees appointed by the city council

b. 2 trustees of each respective board are to be appointed by active members of the plans, via membership vote. One of these trustees for each board must meet the requirements of an independent trustee
c. 2 trustees of each respective board are to be appointed by retired members of the plans, via membership vote. One of these trustees for each board must meet the requirements of an independent trustee

xviii. Each trustee appointment shall be for a four (4) year term

xix. Vacancies: appointments of successors are only for the remainder of the former incumbent's term

xx. Board positions shall become vacant upon the happening before the expiration of his or her term of any of the events set forth in subsections (a), (b), (c), (d), (e), (h), (i), (j), (k) and (l) of Section 409 of the Charter.

xxi. The City Council, by a supermajority vote of its members may remove an incumbent from the board, before the expiration of his or her term, for misconduct, inefficiency, incompetence, inability or failure to perform the fiduciary duties of such office or negligence in the performance of such duties, provided it first states in writing the reasons for such removal and gives the incumbent an opportunity to be heard before the Council in his or her own defense; otherwise, the Council may not remove an incumbent from such office before the expiration of his or her term.

xxii. Compensation of Trustees. Each non-employee trustee shall be paid as compensation for his or her services as a trustee of the retirement board(s), for each calendar month during which he or she is a member of the retirement board(s), a monthly stipend which shall be established by ordinance by the Council after recommendation by the Salary Setting Commission. Employee trustees will not be compensated; however, they will be provided release time from their regularly assigned duties for board meetings, committee meetings, and board approved travel for training and/or official retirement board business.

Conclusion

Approving these recommendations will provide Police and Fire Department Retirement Plan & the Federated City Employees' Retirement System boards greater autonomy so that they may better administer their respective Retirement Systems and properly carry out their fiduciary duties. These changes will allow them to more quickly and efficiently administer the plans and their investments.