

City of San Jose

Retirement Board Governance

May 2014

Agenda

- Current Retirement Board Governance Structure
- Cortex Consultant Presentation
- Proposed Retirement Board Governance Changes

Current Retirement Board Governance Structure

Current Retirement Board Structure

Board	Composition	Board Members*	Minimum Requirements	Recommended By
Federated City Employee's Retirement System	7 Appointed Members	Retiree Representative	No	Retirees
		Employee Representative	No	Employees
		Employee Representative	No	Employees
		Public Member	Yes	Council
		Public Member	Yes	Council
		Public Member	Yes	Council
		Public Member	Yes	Board
Police and Fire Department Retirement Plan	9 Appointed Members	Fire Retiree Representative	No	Retirees
		Police Retiree Representative	No	Retirees
		Police Employee Representative	No	Police Employees
		Fire Employee Representative	No	Fire Employees
		Public Member	Yes	Council
		Public Member	Yes	Council
		Public Member	Yes	Council
		Public Member	Yes	Council
		Public Member	Yes	Board

* All Board members are appointed by City Council

Minimum Requirements for Independent Board Members

- Must live or work within 50 miles of City Hall during the Board member's term
- Must have at least twelve (12) years of experience relevant to the administration of a pension plan including:
 - Pension actuarial practice
 - Investment management
 - Banking
 - Employee benefits management
- Must not have a conflict of interest by receiving pension benefits or have a qualifying family member that is receiving pension benefits

Current Department of Retirement Service Staff

- All staff are City employees
- Director is appointed by the City Manager
- Of the 36.5 full-time equivalent budgeted positions, all but 3 have Civil Service rights
- 73% of staff represented by bargaining units
- Staff members participate in pension plan*

*New Unit 99 members have the option to be in the Tier 2B or Tier 3 defined contribution plan.

Retirement Boards' Consultant Report

- Federated and Police & Fire Boards hired a consultant (Cortex Applied Research, Inc.)
- Cortex issued a report with recommendations in May 2013
- Report presented to City Council on November 19, 2013
- Cortex issued an addendum to the report in February 2014

Cortex Consultant Presentation

Background

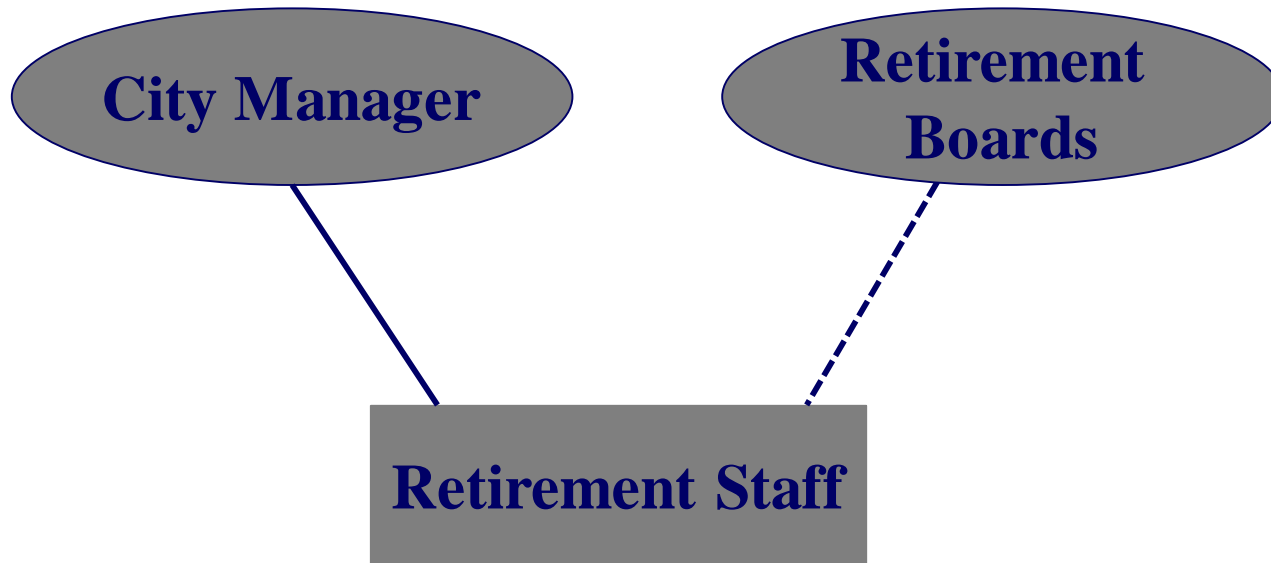
- Cortex conducted analyses for both the City and the retirement boards
- The retirement boards are significantly constrained in their ability to carry out their fiduciary duties.
 - Cannot hire their own staff (cumbersome process to replace staff who depart)
 - Inefficient decision-making process
 - Unclear accountabilities
- City and/or other stakeholders are concerned with:
 - Funded status and investment performance
 - Systemic conflicts of interest and trustee qualifications

There are Hundreds of Public Funds in the U.S. ... Few are Unable to Hire Own Staff?*



*Funds noted are simply examples based on Cortex's experience. This is not an exhaustive list.

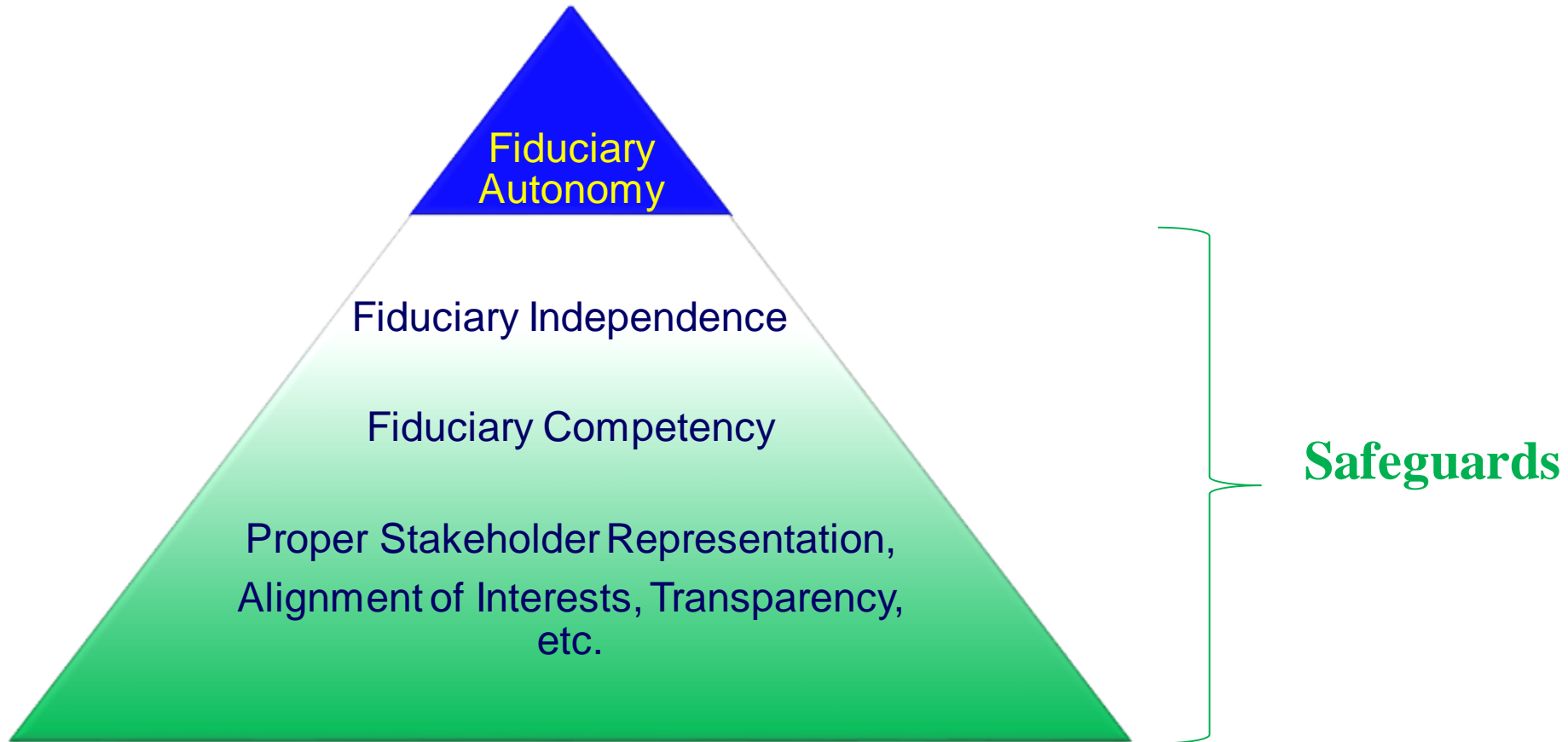
Current San Jose Governance Structure Places all Parties in Difficult Positions



Lack of Fiduciary Autonomy = Competitive Disadvantage



Fiduciary Autonomy with Sufficient Safeguards



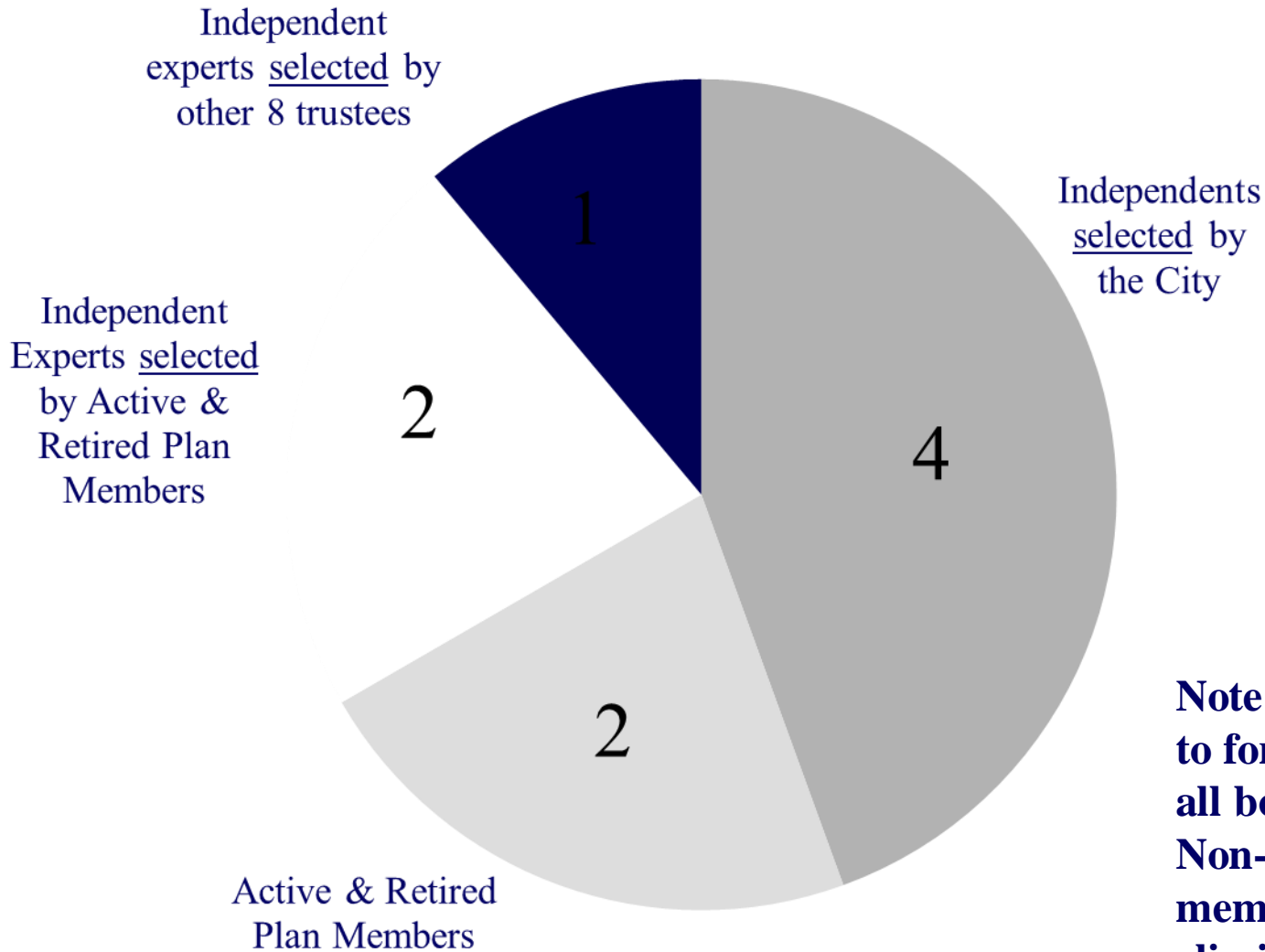
Summary of Cortex Recommendations

1. Autonomous Fiduciary Boards

City Charter to be amended to provide retirement boards with the necessary authority they currently lack, including the authority to:

- Approve personnel positions; and hire, direct, evaluate, and compensate personnel
- Select and appoint all advisors

Recommended Board Composition



Note: City Council to formally appoint all board members. Non-voting board member to be eliminated

Secondary Safeguards

Added transparency and accountability:

- Mandatory annual general meeting for the public
- Enhanced performance reporting
- Social and ethical investment policy
- Audit Committee
- Fiduciary audit
- Expanded disclosures (e.g. senior executive salaries)
- Mechanisms to remove trustees for fiduciary cause

Our Recommendations Are Intended to ...

- Allow the City and the membership to participate as *equal partners* in the fiduciary decision-making process.
- Allow the boards the necessary autonomy to administer the plans effectively and efficiently, which is in the best interests of all stakeholders.
- Enhance the objectivity and quality of decision-making on the retirement boards.
- Reflect the fact that the City is responsible for funding shortfalls in connection with the Tier 1 plan (shortfalls are shared equally with respect to the new plan). 2 reasonable approaches exist:
 - City selects majority of board members OR 50/50 selection with City having final authority to appoint all board members.
 - Cortex recommended the second approach.

Reasonable Questions

- Why are plan members and retirees able to have direct representation on the boards, but the City Council is not?

Response:

Academic research has found that pension plans with elected officials on their boards tend to be more poorly funded.

Reasonable Questions (cont'd)

- Why should plan members/retirees be required to fill some of their current board seats with qualified experts rather than plan members and retirees?

Response:

Board members with relevant expertise and experience on public plan boards are likely to result in stronger performance. This requirement is also consistent with the fact that the City is required to fill its seats with qualified experts. Added expertise benefits all stakeholders.

Reasonable Questions (cont'd)

4. *What kinds of experts would members and retirees be expected to select to represent them on the retirement boards?*

Response: Individuals with professional expertise and experience related to pension management, including for example:

- *Actuaries*
- *Lawyers (e.g. labor law, trust law, investments)*
- *Academics (e.g. labor economics, finance, health care, governance)*
- *CEOs/senior executives at large financial institutions or related businesses*
- *Consultants or accounting professionals with relevant backgrounds*
- *Risk management professionals*
- *Investment or human resources professionals with relevant backgrounds*

Reasonable Questions (cont'd)

5. *How likely is it that plan members and retirees will be able to find qualified individuals to represent them on the boards?*

Response: San Jose and surrounding vicinity is home to a wealth of highly qualified individuals who would likely be willing to represent members and retirees on the retirement boards, especially if the recommended governance enhancements are adopted. To further facilitate recruitment of appropriate individuals, Cortex has recommended that board members be paid reasonable compensation for their service to the boards.

Key Elements of Proposed Retirement Board Governance Changes

Proposed Changes Related to Retirement Services Staff

- Retirement Boards will have the authority to hire, fire, evaluate, and discipline the Director (Chief Executive Officer) and Assistant Director (Chief Investment Officer) of Retirement Services
- Director will have the authority to hire, fire, evaluate, and discipline the Retirement Services staff
- City Council nor City Manager will have the authority to hire or terminate the Director, Assistant Director, or Staff

Proposed Changes Related to Retirement Services Staff

- New Retirement Services employees would serve in unclassified (at-will) unrepresented positions
- New Retirement Services employees will not participate in the retirement plan

Proposed Changes Related to Administrative Expenses

- Place a cap on the amount the Retirement Boards can spend on administration of the system
- Use current Council Salary Setting Commission to determine the monthly stipend amount for independent board members
 - Currently \$150 per month for meeting attendance
- Authority of the Boards to appoint legal counsel

Proposed Changes to Retirement Board Composition

- Increase Federated Board size from seven (7) members to nine (9) members
 - Adding one (1) retired member
 - Adding one (1) independent member
- City Council can only remove an incumbent through a super majority vote
- Qualifying residency requirement increased from 50 miles to 75 miles from City Hall
- Elimination of the non-voting member

Proposed Changes to Retirement Board Composition

	Composition	Board Members	Minimum Requirements	Appointed By
Federated City Employees' Retirement System and Police and Fire Department Retirement Plan Boards	9 Appointed Members for each Board	Retiree Representative	No	Retirees
		Retiree Representative	Yes*	Retirees
		Employee Representative	No	Employees
		Employee Representative	Yes*	Employees
		Public Member	Yes	Council
		Public Member	Yes	Council
		Public Member	Yes	Council
		Public Member	Yes	Council
		Public Member	Yes	Council

*At least one of each of the retiree and employee members must meet minimum qualifications

Administrative Practices

- Board and committee meetings are subject to the Brown Act and Sunshine Ordinance (current practice)
- Board meetings required to be held at City Hall and broadcast on the Internet and Civic Center TV (current practice)
- Standing committee meetings required to be held at City Hall and broadcast on the Internet and Civic Center TV (proposed change)
- Boards are restricted from advocating for legislation that would change benefit levels (proposed change)

Questions and Feedback