



COUNCIL AGENDA: 12/5/2017
ITEM: 3.3 (17-394)

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Toni J. Taber, CMC
City Clerk

SUBJECT: SEE BELOW

DATE: November 22, 2017

SUBJECT: SAN JOSE'S TIER 3 DEFINED CONTRIBUTION PLAN AUDIT REPORT

RECOMMENDATION: As recommended by the Public Safety, Finance and Strategic Support Committee on November 16, 2017, accept the Audit of San Jose's Tier 3 Defined Contribution Plan.



Office of the City Auditor

**Report to the City Council
City of San José**

**SAN JOSÉ'S TIER 3 DEFINED
CONTRIBUTION PLAN: THE
CITY SHOULD CLARIFY
HOW CONTRIBUTIONS ARE
CALCULATED**

**Report 17-09
November 2017**

November 9, 2017

Honorable Mayor and Members
Of the City Council
200 East Santa Clara Street
San José, CA 95113

San José's Tier 3 Defined Contribution Plan: The City Should Clarify How Contributions Are Calculated

New executive management and professional employees (also known as Unit 99 employees) can choose between two retirement options provided by the City: a defined benefit plan that provides a set level of monthly benefits over an employee's lifetime, or a retirement option that is akin to a private sector 401(k) plan. This latter option, known as the Tier 3 plan, became available to newly hired Unit 99 employees in 2013.

Under the Tier 3 plan, contributions of 3.75 percent of an employee's compensation are made by both the City and the employee. The City's Human Resources Department is the primary administrator for the plan. Funds are held in trust by Voya Retirement Insurance and Annuity Company (Voya). Employees can direct their investments to various mutual fund options.

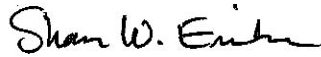
Since 2013, nearly half of all new Unit 99 hires have chosen to enroll in Tier 3, with the City Council and Mayor's Offices holding the most enrollees. As of June 30, 2017, there were 45 employees in Tier 3. Including separated employees, funds held in Tier 3 accounts with Voya totaled about \$860,000.

The objective of this audit was to perform a limited scope review of the contributions, expenditures, and administration of the Tier 3 defined contribution plan.

Finding 1: The Tier 3 Contribution Base Needs to be Clarified. The City has effective administrative processes for the Tier 3 plan. Specifically, new employees who elect to join are correctly being enrolled into Tier 3, and controls, such as biweekly reconciliation processes by two different departments, ensure that employee and City contributions are accurately credited to employee retirement accounts. However, the City should clarify what forms of compensation should be included in the Tier 3 contribution base that is used to calculate contributions. The Municipal Code has a broader definition of compensation than what is used currently. We recommend the Administration clarify how to define the Tier 3 contribution base and propose changes to the Municipal Code as necessary. The Administration should also determine whether it is necessary to make retroactive adjustments or make corrections on a go-forward basis. The Office of Employee Relations and the City Attorney's Office are currently investigating how to address these issues.

This report includes one recommendation. We will present this report at the November 16, 2017 meeting of the Public Safety, Finance, and Strategic Support Committee. We would like to thank the Human Resources Department, the Finance Department, and the City Attorney's Office for their time and insight during the audit process. The Administration has reviewed this report and their responses are shown on the yellow pages.

Respectfully submitted,



Sharon W. Erickson
City Auditor

finaltr
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This report is also available online at www.sanjoseca.gov/audits.

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Introduction

The mission of the City Auditor's Office is to independently assess and report on City operations and services. The audit function is an essential element of San José's public accountability, and our audits provide the City Council, City management, and the general public with independent and objective information regarding the economy, efficiency, and effectiveness of City operations and services.

In accordance with the City Auditor's Fiscal Year (FY) 2017-18 Work Plan, we have completed an audit of the City's Tier 3 defined contribution plan. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We limited our work to those areas specified in the "Audit Objective, Scope, and Methodology" section of this report.

The Office of the City Auditor thanks the City's Human Resources Department, Finance Department, and City Attorney's Office for their time and insight during the audit process.

Background

New employees hired into the City of San José's Executive Management and Professional Employees unit (Unit 99)¹ can choose between two retirement options provided by the City.²

The first is the Tier 2B defined benefit plan within the Federated Retirement System.³ A defined benefit plan identifies a specific benefit that is paid in regular installments to a retired employee over the course of their lifetime. The benefit is based on a formula that accounts for factors like length of service and the employee's salary. The amount of money put into the plan each year is based on an estimate of how much will be needed to cover future pension payments and can vary from year to year.

¹ Unit 99 employees comprised about 4 percent of total City employees as of July 1, 2017.

² Beginning in 2017, new Unit 99 employees with previous service with CalPERS, or a reciprocal agency, may also be eligible for a CalPERS "classic benefit". New employees are eligible if their previous service was before January 2013, had not had a break in service of more than six months, and did not have concurrent (or overlapping) service.

³ See Appendix B for the most up-to-date Benefits Fact Sheet for Tier 2B.

The second is a Tier 3 defined contribution plan.⁴ A defined contribution plan specifies how much money is put into the retirement plan, typically a percentage of an employee's salary. The plan does not specify the benefit payable to the employee upon retirement. The amount available for future retirement benefits is the balance of what has been contributed over time as well as any investment income earned over time. Retirement benefits are paid out in a lump sum or until funds are exhausted.

The City previously offered a different defined benefit plan to Unit 99 – the Tier 1 plan. This plan provides a higher benefit upon retirement than Tier 2B or Tier 3 including retiree healthcare benefits. Neither members of the 2B plan or Tier 3 are eligible for retiree healthcare benefits.

Tier 3 was established in 2012 (and implemented in 2013) to expand the portfolio of retirement options offered to new⁵ employees beyond the City's traditional defined benefit plans. The City established the Tier 3 plan in accordance with Section 401(a) of the Internal Revenue Code. New Unit 99 employees must make an irrevocable decision to opt into the plan; the Tier 2B defined benefit plan is the default pension option. Both employees and the City make contributions to the plan equal to 3.75 percent of an employee's compensation.⁶ Contributions are made on a pre-tax basis.

Exhibit I: Retirement Options for Newly Hired Unit 99 Employees

	Tier 3	Tier 2B
Plan type	Defined Contribution	Defined Benefit
Employee contribution rate	3.75%	7.72%
Employer contribution rate	3.75%	7.72%
Benefit calculation	Based on available funds	2% x Years of City Service x Final Compensation
Vesting	Immediately	5 years

Source: Tier 2B and Tier 3 Benefits Fact Sheets (See Appendix A and B for further information)

Note: The contribution rates for Tier 2B are the rates as of 6/18/17. They can vary from year to year. Final compensation in the Tier 2B plan is the average monthly base pay for the highest three consecutive years of service.

⁴ See Appendix A for the most up-to-date Benefits Fact Sheet for Tier 3.

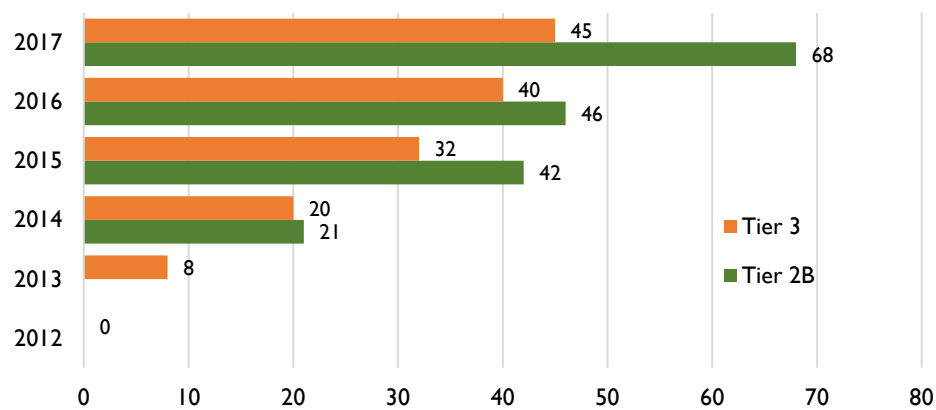
⁵ To be eligible to enroll in Tier 3, employees must not have been a prior member of a City retirement plan; this mostly applies to new employees but can also include part-time employees who become eligible for Tier 3 when they convert to full-time employment.

⁶ Per the Municipal Code, the City's contribution cannot exceed 9%.

Nearly Half of Unit 99 Employees Hired Since 2013 Have Enrolled in Tier 3

Exhibit 2 shows that, as of July 1, 2017, 45 active Unit 99 employees were enrolled in Tier 3 – compared to 68 in Tier 2B and 183 Unit 99 employees enrolled in Tier 1.⁷ From its inception, 83 newly hired Unit 99 employees have chosen to participate in Tier 3 (38 of whom have since terminated employment with the City). By comparison, about 90 new hires have chosen to enroll in Tier 2B in the plan’s history.

Exhibit 2: Enrollment in Tier 2B and Tier 3 Plans for Active Unit 99 Employees as of July 1 for FY 2013-2017

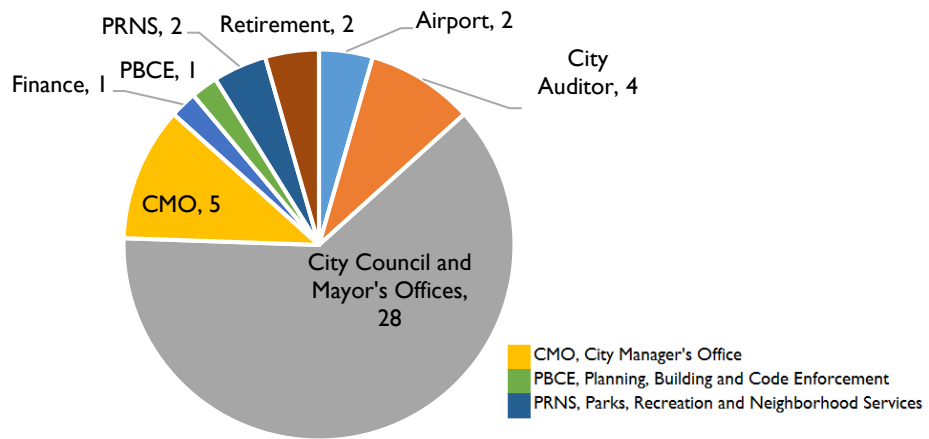


Source: City’s Human Resource Management System (PeopleSoft)

As Exhibit 3 shows, the City Council and Mayor’s Offices have the most employees enrolled in Tier 3, followed by the City Manager and City Auditor’s Offices.

⁷ Tier 1 has not been offered to newly hired Unit 99 employees since February 2013.

Exhibit 3: 45 Total Employees Enrolled in Tier 3 Plan, By Department as of July 1, 2017



Source: PeopleSoft

Tier 3 Plan Administration and Account Management

Municipal Code Section 3.49, which establishes Tier 3, states that the City shall be responsible for the operation of the plan, noting that the City Manager, or his or her designee, may be appointed to perform the plan's administrative duties. The Human Resources (HR) Department is the primary administrator of the plan for the City. The Finance Department (Finance) also has a role in plan administration. This contrasts with the City's Tier 1 and Tier 2 defined benefit plans, which are administered by independent Retirement Boards along with the City's Office of Retirement Services.

The City contracts with Voya Retirement Insurance and Annuity Company (Voya), formerly ING Life Insurance and Annuity Company, to provide investment and administrative services for Tier 3.⁸ Voya has fiduciary responsibility for the assets of the plan and invests member funds on their behalf. Voya's administrative fees are equal to 0.17 percent of asset values and are paid by members. The City also contracts with Conduent HR Consulting LLC (formerly Buck Consultants) to assist the City in the administration of Tier 3. Conduent provides the City with performance information and analysis for asset allocation and investment funds.⁹

⁸ The current Voya contract is set to expire on December 30, 2017. At the time of the audit, a Request for Proposals (RFP) process was underway for these services in the future.

⁹ Conduent provides similar services for the City's voluntary 457 deferred compensation plan. The 457 plan is a voluntary deferred compensation plan open to all City employees. The not-to-exceed amount in the Buck contract is \$8,300 per fiscal year. Conduent's fees are paid out of the benefits administration fee assessed to all employees (currently \$0.21 per paycheck).

Employees have the option of providing direction for the investment of contributions, however, if no such direction is provided, the City directs it to a default investment as established based upon market risk, stability, and rate of return.¹⁰

Audit Objective, Scope, and Methodology

The objective of our audit was to perform a limited scope review of the contributions, expenditures, and administration of the 401(a) Tier 3 defined contribution plan. We performed the following to achieve our audit objective:

- Reviewed Chapter 3.49 of the Municipal Code related to the defined contribution plan.
- Reviewed the Unit 99 Benefit and Compensation Summary, Benefits Fact Sheet for Tier 3, the plan documents, the adoption agreement, contracts with Voya Retirement Insurance and Annuity Company and Conduent HR Services.
- Interviewed the HR Department staff responsible for the administration of the Tier 3 plan about enrollment and reconciliation processes. Reviewed and observed HR biweekly reconciliation processes and solicited procedures that document the processes.
- Interviewed the Finance Department staff responsible for the monthly reconciliation and quarterly journal entry for the Tier 3 plan. Obtained annual activity summaries for the plan.
- Reviewed City payroll data showing employee payroll deductions (3.75% of the contribution base) from plan inception through FY 2016-17 and reconciled against auditor calculated amounts.
- Evaluated whether the contribution base is calculated correctly.
- Sampled Tier 3 participant enrollment forms and traced back to the City's payroll system data to test for enrollment completeness and accurate set-up in the City's system. Selected a sample of Tier 3 participants from the City's payroll system data and traced back to enrollment forms available at HR to test for enrollment validity.
- Interviewed staff from the City Attorney Office about the legal authority behind the necessity of first day enrollment into the Tier 3 plan as well as the definition of compensation under the Internal Revenue Code.

¹⁰ The investment options available to Tier 3 members is largely the same menu selected by the Deferred Compensation Advisory Committee for 457 deferred compensation plan members (three custom lifestyle funds are not included). As of June 30, 2017, there were 3,500 current employees participated in the 457 plan; an additional 3,600 former employees maintained 457 accounts. Total 457 assets equaled more than \$900 million. Voya provides similar investment and administrative services for the 457 plan as it does for the Tier 3 plan.

San José's Tier 3 Defined Contribution Plan

- Reviewed the budget structure and fund activity for Tier 3 including Funds 159, 160 and 161.
- Corresponded with the City's customer service representative from Voya to acquire Tier 3 participant account data from plan inception to FY 2017, which was used to reconcile employee total contributions data that the City had on file for the same time period.
- Interviewed the City's Risk Management staff to identify whether separate fiduciary liability insurance is needed for the 401(a) plan.

Finding I **The Tier 3 Contribution Base Should Be Clarified**

Summary

The City has effective administrative processes for the Tier 3 plan. Specifically, new employees who elect to join have been correctly enrolled into Tier 3, and controls such as biweekly reconciliation processes by two different departments ensure that employee and City contributions are correctly credited to employee retirement accounts. However, the City should clarify what forms of compensation should be included in the Tier 3 contribution base that is used to calculate contributions. The Municipal Code has a broader definition of compensation than what is currently used for Tier 3 calculations. We recommend the Administration clarify how the Tier 3 contribution base is defined and propose changes to the Municipal Code as necessary. The Administration should also determine whether to make retroactive adjustments or make corrections on a go forward basis.

The City Has Effective Processes for Administering the Tier 3 Plan

As noted in the Background, HR and Finance are the two City departments primarily involved in administering the Tier 3 plan. HR manages the enrollment process and both HR and Finance are involved in the process whereby employee and City Tier 3 contributions are wired to Voya to be credited to individual accounts.

Human Resources Correctly Enrolls Employees into the Tier 3 Plan

Based on our review, it appears there are controls in place to ensure that employees are correctly enrolled into the Tier 3 plan.

As noted earlier, Unit 99 employees who have never been a member of a City of San José retirement plan that are hired on or after February 2013, can elect to participate in the Tier 3 plan in lieu of the Tier 2B plan. An employee must make an *irrevocable* decision on the first day of employment with the City to become a member of Tier 3. Internal Revenue Codes and Treasury regulations provide legal authority as to why the decision must be irrevocable and made on the first day.¹¹

¹¹ While IRS Code Section 401(k)(4)(B)(ii) prohibits a governmental plan from having a “cash or deferred election”, Treasury Regulation Section 1.401(k)-1(a)(3)(v) provides an exception. A one-time, irrevocable election is allowable, if made “... *no later than the employee’s first becoming eligible under the plan...*” The City Attorney’s Office has interpreted that an employee first becomes eligible under the Tier 3 plan on his or her first day of employment.

On the first day of employment, during the new employee orientation program, Unit 99 employees are provided information about the Tier 3 plan.¹² The first step toward enrollment into the Tier 3 plan occurs when an employee submits an enrollment form to HR benefits staff. HR benefits staff then fax the form to Voya for participant account creation and files the necessary forms.

HR benefits staff also notify the HR Information Systems (HRIS) group to change the employee's profile in the City's Human Resource Management System (PeopleSoft) to Tier 3 from the default Tier 2B. HRIS then confirms with the Office of Retirement Services that the employee has not been employed by the City before and is eligible to participate in Tier 3. HRIS then updates the employee's PeopleSoft profile by assigning them to the appropriate retirement plan.

Contributions Have Been Accurately Credited to Individual Employees' Voya Accounts

Based on our review, we found that participant accounts have been accurately credited to Voya since the Tier 3 plan was established to the present.

Tier 3 participants make contributions to their defined contribution account through biweekly payroll deductions. These payroll deductions, which are matched by the City, are automatically calculated based on payroll codes set up within PeopleSoft. Plan participants direct their contributions into investment options offered by Voya.

Biweekly and monthly reconciliations are performed both by HR and Finance staff to ensure that employee contributions are deducted accurately prior to wire transmittal to Voya. On a biweekly basis, HR staff reconcile payroll reports showing employee deductions and City contributions to PeopleSoft interface reports showing total employee Tier 3 credits to be wired to Voya. HR then uploads the interface reports through Voya's secure website. These reports provide direction about which accounts are to be credited for the wired funds.

Finance performs additional review by reconciling the final wire sent by HR to Voya to the existing City payroll record. On a monthly basis, Finance staff also reconcile Tier 3 activity reports from Voya to ensure that the wire transfer sent to Voya by HR has been correctly credited. On a quarterly basis, Finance accounts for Tier 3 activity in the City's Financial Management System.

As shown in Exhibit 4, Tier 3 member account balances as of the end of FY 2016-17 totaled \$864,117.

¹² Generally, departments provide information in advance about the Tier 3 plan along with their offer letters, to acquaint new hires about the various retirement options available to City employees.

Exhibit 4: Annual Activity for the 401(a) Defined Contribution Plan¹³

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Beginning Balance	\$ -	\$ 15,984	\$ 125,410	\$ 278,502	\$ 507,398
Employee Contributions	8,010	49,414	80,982	112,664	138,878
Employer Contributions	8,010	49,414	80,982	112,664	138,878
Withdrawals	-	-	(14,521)	(1,873)	(13,295)
Investment Earnings/(Losses)	(37)	10,599	5,648	5,441	92,257
Ending Balance	\$ 15,984	\$ 125,410	\$ 278,502	\$ 507,398	\$ 864,117
Total Participants as of 6/30 (note: this includes both active and terminated employees)	8	23	35	53	74

Source: Finance Department Compilation of Voya Account Statements of Activity, the City of San José Comprehensive Annual Financial Reports (CAFRs), and PeopleSoft

Note: Columns may not total because of rounding.

The Tier 3 Contribution Base Should Be Clarified

Every pay period, 3.75 percent of an employee's Tier 3 "contribution base" is deducted from their paycheck and is wired to Voya along with the City's matching contribution. The Exhibit below shows the contribution base for Tier 3 as programmed in PeopleSoft.

Exhibit 5: The Current Contribution Base for Tier 3

<i>Codes that Have Had Charges</i>	<i>Codes that Have Not Had Charges*</i>
Regular Salary	Comp Time
Executive Leave	Fitness Programs
Vacation	Paid Time Off
Holiday	Personal Leave
Sick Leave	Witness Leave
Jury Duty	Cancer Screen Release Time
Administrative Leave	Military Leave
Funeral Leave	
Retroactive Pay	

Source: Auditor analysis of PeopleSoft reports

*Although part of the current contribution base, Tier 3 employees have not charged any time to these pay codes since inception of the program.

¹³ Note, the City accounts for Tier 3 activity in a separate City fund within its financial management system (Fund 159). However, the actual assets are held in trust by Voya.

The Municipal Code Provides the Basis for How Tier 3 Contributions Should Be Calculated

Municipal Code Section 3.49.080 states:

For each participant making contributions to the plan under Section 3.49.040, the city [and employee] shall contribute the percentage of the participant's compensation for each payroll period set forth in the adoption agreement...

The Municipal Code further defines how the contribution base, referred to as "participant's compensation" above, should be structured:

*'Compensation' shall mean 'participant's compensation,' within the meaning of Internal Revenue Code Section 415(c)(3), **required to be reported as actual wages in Box 1 of Form W-2 for a year for services to the city...**that is actually paid or includable in gross income during the calendar year. (emphasis added)*

Besides the categories of pay described earlier in Exhibit 5 as the Tier 3 contribution base (e.g., regular salary, executive leave, etc.), Tier 3 members have received other types of compensation that are included in Box 1 of their annual W-2s. These are listed in Exhibit 6.

Exhibit 6: Tier 3 Compensation That Was Not Included in the Contribution Base

Reported Compensation included in Box 1 of Annual W-2s

- Oral/written bilingual pay
- Auto allowances
- Taxable cellular phone and data stipends
- Medical and dental in lieu payments
- Higher class management pay
- Vacation sellback and balance payoffs
- Management performance bonuses
- One percent one-time lump sum payments
- Severance pay

Source: Auditor analysis of PeopleSoft reports and information provided by the Finance Department

Although these are deemed taxable compensation and are reported on employees' W-2s, they are not currently included in the Tier 3 contribution base nor do they generate withholdings or City contributions into the Tier 3 plan. Pursuant to tax law, under the City's current definition of Tier 3 compensation, these types of pay would generally be included because they are reported as taxable wages on

employees' W-2s. Current tax law also allows that the plan could use any definition of compensation for purposes of calculating contributions.¹⁴

Taking into consideration the different definitions of the Tier 3 contribution base in the City's Municipal Code and in the PeopleSoft system, the City should clarify how the contribution base for Tier 3 should be structured and make changes that are deemed necessary. If the structure of the current contribution base is changed to include more pay categories, the City should decide how to address affected participants.¹⁵ The Office of Employee Relations and the City Attorney's Office are currently investigating how to address the issue.

Recommendation #1: The Administration, in coordination with the City Attorney's Office, should clarify how the Tier 3 contribution base be defined and propose changes to the Municipal Code as necessary. The Administration should also determine whether to make retroactive adjustments or make corrections on a go-forward basis.

¹⁴ Note, if the City were to change the definition of compensation for the Tier 3 plan, it would also need to consider how, or whether, the City's definition would allow the City to continue to ensure 415(c) contribution limits are not exceeded (currently the lesser of \$54,000 or 100 percent of compensation). It is also important, that, any change in the definition of "compensation" meets the requirements for a social security qualified replacement plan.

¹⁵ If the contribution base is changed to include all wages as reported on Form W-2 Box 1, preliminary analysis shows that should retroactive contributions be needed, this could affect about 65 active and terminated Tier 3 enrollees. The estimated retroactive contributions for those 65 employees would be about \$14,000 in total. The same amount would be due from the City to match the employee contributions.

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Conclusion

The City's Tier 3 defined contribution plan offers, albeit for a narrowly defined employee group, an option for employees to save for retirement by opting out of the traditional defined benefit plans that characterize public sector employment. Trends show that roughly half of new hires choose Tier 3 over the traditional plan. The City has effective controls in place for enrolling employees into the plan as well as transferring of funds to the third party administrator, however, clarification of the contribution base will help ensure that employee accounts are being accurately credited.

RECOMMENDATIONS

Recommendation #1: The Administration, in coordination with the City Attorney's Office, should clarify how the Tier 3 contribution base be defined and propose changes to the Municipal Code as necessary. The Administration should also determine whether to make retroactive adjustments or make corrections on a go-forward basis.

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APPENDIX A

Benefits Fact Sheet for Tier 3



EXECUTIVE MANAGEMENT AND PROFESSIONAL EMPLOYEES (UNIT 99) BENEFITS FACT SHEET – TIER 3*

Tier 3 Eligibility	
Tier 3 is an option for employees hired into Unit 99 who have never been a member of a City of San Jose retirement plan, on or after February 3, 2013, that provides for a defined contribution plan in lieu of the Tier 2 defined benefit program. An eligible employee must not have previously been a member of a City of San Jose retirement system.	
One-Time Election Period	
Timeline	An employee must sign an irrevocable election form on his or her first day of employment with the City electing to participate in Tier 3. If no irrevocable election form is signed, the employee will be automatically placed into the Tier 2 defined benefit plan.
Contributions	
Employee	3.75% of employee's salary into a 401(a) defined contribution plan
City	3.75% of employee's salary into a 401(a) defined contribution plan
Maximum Contribution Amount	\$54,000/year (2017) (subject to cost of living adjustment by IRS)
Deferred Compensation	An employee may elect to contribute additional funds toward an optional deferred compensation account (457b).
401(a) Account	
Provider	Voya Financial
Rollover Contributions	Tier 3 Members may contribute eligible rollover distributions from an eligible plan or IRA to this Plan.
Distribution Options	Lump-sum, eligible rollover distribution to an eligible plan or IRA, immediate or deferred annuity, or systematic distribution option as provided by the provider.
Medical Benefits	
Eligibility	Tier 3 Members are not eligible for retiree healthcare.
Dental Benefits	
Eligibility	Tier 3 Members are not eligible for retiree dental benefits.

SURVIVORSHIP BENEFITS

Death Before Retirement	
TIER 3	
Distribution of Benefits Upon Death	Upon the death of a Tier 3 Member before retirement, the account will be distributed to the Member's beneficiary. If no beneficiary has been designated, the account will be payable to the Member's estate.

The information contained on this Fact Sheet is a summary for the Tier 3 members in Unit 99. Please consult the Municipal Code for complete information.

For more information please contact the Human Resources Department at (408) 535-1285.

*Note: This benefit is provided to meet the requirements to be in lieu of social security for employees in Tier 3.

APPENDIX B

Benefits Fact Sheet for Tier 2B



FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM (FCERS) BENEFITS FACT SHEET – TIER 2B*

Employees hired, rehired or reinstated after September 27, 2013, who have not met the City's eligibility previously for retiree healthcare, will NOT be eligible for retiree healthcare benefits.*

Pension Contributions	
Employee	7.72% as of 6/18/2017
City	7.72% as of 6/18/2017
Service Required to Leave Contributions in Retirement System	5 years Federated City Service Years of service (Year of Service = 2080 hours worked in the applicable 12-month period)
Service Retirement	
Age/Years of Service	62 years with 5 years Federated City Service May retire on or after 55 years with 5 years Federated City Service. A reduction factor of 5% per year for each year between age fifty-five (55) and the Tier 2 member's age at retirement before age 62, prorated to the closest month.
"Deferred Vested" Retirement	May commence on or after 55 years with 5 years Federated City Service. (This applies to members who separate from City service before retirement and leave their contributions in the retirement system.) Can begin at age 55 with reduction fact of 5% per year for each year between age fifty-five and the Tier 2 member's age at retirement before age 62, prorated to the closest month.
Allowance	2.0% x Years of Federated City Service x Final Compensation (70% max) <ul style="list-style-type: none"> "Final Compensation" is the average monthly (or biweekly) base pay for the highest 3 consecutive Years of Federated City Service Excludes premium pay or any other forms of additional compensation
Disability Retirement – (Service Connected)	
Minimum Service	NONE
Allowance	2% x Years of Federated City Service x Final Compensation. (Minimum of 40% and maximum of 70% of Final Compensation)
Disability Retirement - (Non-Service Connected)	
Minimum Service	5 years Federated City Service
Allowance	2% x Years of Federated City Service x Final Compensation. (Minimum of 20% and maximum of 70% of Final Compensation)
Reciprocity	
Reciprocity	As of December 9, 1994, the City of San José Federated City Employees' Retirement System adopted a reciprocal agreement with CalPERS. This may result in improved benefits for members who transfer between this retirement system and CalPERS or certain other public agency retirement systems that also have reciprocal agreements with CalPERS. Please call the Retirement Department or CalPERS for more information.
Cost-of-Living Adjustments (COLA)	
Cost-of-Living Adjustments	Retirees are eligible for annual cost-of-living adjustment (COLA) limited to the lesser of the increase in the Consumer Price Index (San Jose-San Francisco-Oakland, U.S. Bureau of Labor Statistics index, CPI-U, December to December), or a back-loaded 2% COLA per fiscal year. The back-loaded COLA shall be calculated as follows: <ol style="list-style-type: none"> Service at retirement of 1-10 years: 1.25% per year Service at retirement of 1-10 years and hired before June 16, 2017: 1.5% Service at retirement of 11-20 years: 1.5% per year Service at retirement of 21-25 years: 1.75% per year Service at retirement of 26 years and above: 2.0% per year The first COLA will be prorated based on the number of months retired.

SURVIVORSHIP BENEFITS

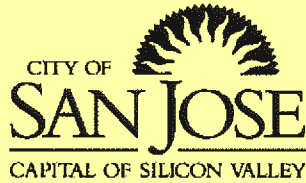
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Revised: 5/19/17

**Spouses, domestic partners and dependents will also be ineligible for retiree healthcare benefits.

13574250.1

Source: Office of Retirement Services Website



Memorandum

TO: SHARON ERICKSON
CITY AUDITOR

FROM: Julie Edmonds-Mares

SUBJECT: SEE BELOW

DATE: November 3, 2017

Approved

Date

**SUBJECT: RESPONSE TO AUDIT REPORT – AUDIT OF SAN JOSÉ’S TIER 3
DEFINED CONTRIBUTION PLAN: THE CITY SHOULD CLARIFY HOW
CONTRIBUTIONS ARE CALCULATED**

The Administration has reviewed the *Audit of San José’s Tier 3 Defined Contribution Plan: The City Should Clarify How Contributions Are Calculated* and agrees with the recommendation identified in the report. The following is the Administration's response to the Recommendation.

BACKGROUND

New employees hired into the City’s Executive Management and Professional Employees unit (Unit 99) can choose between two retirement options provided by the City; a defined benefit plan (Federated Tier 2B) or Tier 3, which is a defined contribution plan akin to a private sector 401(k) plan.¹ The Tier 3 defined contribution plan was created to expand the portfolio of retirement options offered to new employees beyond the City’s traditional defined benefit plans and became available as a retirement savings option in 2013. For the Tier 3 plan, contributions of 3.75 percent of an employee’s compensation are made by both the City and the employee on a pre-tax basis. The Human Resources Department is the primary administrator of the plan for the City. The City contracts with Voya Retirement Insurance and Annuity Company (Voya) to provide investment and administrative services for Tier 3.

In accordance with the City Auditor’s Fiscal Year 2017-2018 Work Plan, an audit of the City’s Tier 3 defined contribution plan was completed. The objective of this audit was to perform a limited scope review of the contributions, expenditures, and administration of the Tier 3 defined contribution plan.

¹ To be eligible to enroll in Tier 3, employees must not have been a prior member of a City retirement plan.

RECOMMENDATION AND ADMINISTRATION'S RESPONSE

Recommendation #1: The Administration, in coordination with the City Attorney's Office, should clarify how the Tier 3 contribution base be defined and propose changes to the Municipal Code as necessary. The Administration should also determine whether to make retroactive adjustments or make corrections on a go forward basis.

Administration's Response to Recommendation:

The Administration agrees with this recommendation. The Administration will work with the City Attorney's Office to bring forward an amendment to the definition of "compensation" in the Tier 3 plan in the Municipal Code. The proposed amendment will clarify the definition of "compensation" in order to align with the City's current practice of its treatment of the Tier 3 contribution base.

Green – The Administration is working with the City Attorney's Office and Tax Counsel on a proposed amendment.

COORDINATION

This report had been coordinated with the City Manager's Budget Office, the City Manager's Office of Employee Relations, and the City Attorney's Office.

CONCLUSION

The audit report provides a recommendation to support clarification of how contributions are calculated for the City of San José's Tier 3 defined contribution plan. The Administration values this recommendation for opportunities to improve. The Department would like to thank the City Auditor and staff for this operational review.



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