



*Office of Retirement Services*

Federated City Employees' Retirement System  
Police and Fire Department Retirement Plan

December 22, 2017

Honorable Mayor and Members of the City Council  
City of San Jose  
City Hall  
200 East Santa Clara Street  
San Jose, CA 95113

Re: Response to Audit of Retirement Services: Greater Transparency Needed in the Budgeting Process, Interactions Among Stakeholders, Investment Policies, and Plan Administration

Dear Honorable Mayor and Members of the City Council:

The Boards have reviewed the *Audit of Retirement Services: Greater Transparency Needed in the Budgeting Process, Interactions Among Stakeholders, Investment Policies, and Plan Administration* and are largely in agreement with recommendations directed to the Office of Retirement Services and the Boards. The following are the Boards' responses to the recommendations.

**RECOMMENDATIONS AND BOARDS RESPONSES**

**Finding 1: Retirement Services' Budget Process Is Not Well Defined**

**Recommendation #1:** The Office of Retirement Services should forward the Annual Fee Reports to the City Council for informational purposes.

**Retirement Boards' Response to Recommendation #1:**

The Boards agree with this recommendation and will direct the staff to implement this recommendation as soon as possible.

**Recommendation #2:** The Office of Retirement Services should include its proposed personnel budget and staffing plan for City Council approval as part of the comprehensive annual budget outlined in Recommendation #3.

**Retirement Boards' Response to Recommendation #2:**

The Boards agree with this recommendation and will direct the staff to implement this recommendation as soon as possible.

**Recommendation #3:** The Office of Retirement Services should prepare a comprehensive annual budget document covering the entire aggregate expense of administering each plan.

**Retirement Boards' Response to Recommendation #3:**

The Boards agree with this recommendation and have endeavored in this direction since the passage of Measure G in 2014. The Boards do not consider investment expenses as administrative expenses. They are seen as part of the outcome of investment return.

**Recommendation #4:** In compliance with the City Charter, the Office of Retirement Services should formally request each retirement board annually adopt the annual budget document that has also been approved by the City Council.

**Retirement Boards' Response to Recommendation #4:**

The Boards agree with this recommendation and agree formally to adopt the Council-approved budgets if there are material changes. The Boards regularly have adopted the budgets for their respective plans, subject to City Council approval.

**Recommendation #5:** The Retirement Boards should establish formal budget adoption policies and procedures that include clear delegation of authority to staff to spend plan assets subject to certain limits defined by the Boards.

**Retirement Boards' Response to Recommendation #5:**

The Boards generally agree with this recommendation and will direct their respective Governance Committees to consider and make recommendations to their Boards as appropriate.

**Finding 2: Improving Communications Between the Retirement Boards and the Plan Sponsor.**

**Recommendation #7:** The City Council and the two Retirement Boards should hold a joint annual study session to discuss topics relevant to all parties, such as:

- a) forecasts for the City's expected revenue and budget,
- b) City and employee retirement contribution rates,
- c) actuarial assumptions of the retirement plans,
- d) the plans' investment returns, and
- e) the plans' funded status.

**Retirement Boards' Response to Recommendation #7:**

The Boards agree with this recommendation and will direct the Office of Retirement Services staff to implement this recommendation with a goal that a study session be held in calendar year 2018. The Boards agree that improved communication between the City Council and the Boards is desirable.

**Recommendation #8:** The City should structure a formal process to orient new City Councilmembers about the Retirement plans.

**Retirement Boards' Response to Recommendation #8:**

While this recommendation is directed to the City, the Boards are prepared to assist in providing the appropriate retirement plan education to the City Councilmembers.

**Recommendation #9:** The Retirement Boards should structure a formal process to periodically orient Board members to the City's budget and service level solvency.

**Retirement Boards' Response to Recommendation #9:**

The Boards generally agree with this recommendation and will direct their respective Governance Committees to consider and make recommendations to their Boards as appropriate.

**Recommendation #12:** The Retirement Boards should clarify their expectations of each Council representative, including the type and frequency of reporting that would be most useful to the Board.

**Retirement Boards' Response to Recommendation #12:**

The Boards generally agree with this recommendation and will direct their respective Governance Committees to consider and make recommendations to their Boards as appropriate.

**Recommendation #13:** To facilitate communication of relevant activities to the City, the Retirement Boards should:

- a) Work with City staff to determine what types of activities or agenda items are appropriate to notify the City about in advance and update relevant charters and/or policies accordingly, and
- b) Modify the CEO charter to clarify the CEO's role in communicating with the City.

**Retirement Boards' Response to Recommendation #13:**

The Boards generally agree with this recommendation. The CEO and Office of Retirement Services staff regularly communicate with City staff in advance of each Board meeting to both notify them of particular agenda items and seek their input. The Boards' respective Communication Policies provide that "the Board shall provide timely public notice to the City Council and City administration of relevant issues on the Board's agenda. Additional communications may be provided through the non-voting board member and spokespersons." The Boards will direct their respective Governance Committees to consider the recommended CEO Charter change and make recommendations to their Boards as appropriate.

**Recommendation #15:** The Retirement Boards should adopt a formal set of performance measures to be included in the retirement plans' budgets for both plan administration and the investment program. The Retirement Boards should provide the City Council with the opportunity to review and provide comment on the adopted performance measures.

**Retirement Boards' Response to Recommendation #15:**

The Boards generally agree with this recommendation and will direct their respective Governance Committees to consider and make recommendations to their Boards as appropriate. The Boards regularly evaluate the performance of the plans and reference a variety of benchmarking resources.

**Finding 3: Formalizing Policies to Improve Oversight, Transparency, and Delegation of Investment Decisions.**

**Recommendation #16:** The Retirement Boards should incorporate in their respective Investment Policy Statements, or establish in a separate document, more comprehensive guidance in line with the Government Finance Officer's Association recommendations on fee policies for public plans, containing at least the following:

- a) Delegation of responsibility to negotiate, monitor, and report on fees;
- b) The respective roles of trustees, staff, consultants, and investment managers in controlling fees;
- c) Strategies that will be employed to seek the lowest reasonable fees in traditional asset classes; and
- d) Strategies that will be employed to ensure the plans are not paying excessive fees for alternative assets.

**Retirement Boards' Response to Recommendation #16:**

The Boards generally agree with this recommendation and will direct their respective Investment Committees to consider and make recommendations to their Boards as appropriate. The Plans' respective Investment Policy Statements currently provide that processes and responsibilities for negotiating, monitoring and reporting on fees. Investment Staff has developed an in-depth fee reporting report which it has delivered to the Boards each of the last two years. The Charter for the CIO provides that the CIO shall monitor the cost-effectiveness of the Fund. The Boards acknowledge their core fiduciary responsibility to assure that only reasonable expenses are charged against the assets of the plans, and diligently monitor staff's negotiation of investment management fees through the normal investment approval process.

**Recommendation #17:** The Retirement Boards should incorporate in their respective Investment Policy Statements a policy on investment manager evaluation that reflects existing manager due diligence process and procedures, and includes the following:

- a) Defining the "extraordinary review" process;
- b) Establishment of a "watch list" and/or "probationary status" for underperforming managers;
- c) Process by which managers of concern are identified, placed under "extraordinary review," and given a final decision;
- d) Quantitative criteria for underperformance which would trigger placement under "extraordinary review" and/or on a "watch list;"
- e) Potential actions resulting from the "extraordinary review" process;
- f) Delegation of authority for implementing each step in this process; and
- g) As necessary, incorporating into the policy the nuances of different asset classes or fund types.

**Retirement Boards' Response to Recommendation #17:**

The Boards generally agree with this recommendation and will direct their respective Investment Committees to consider and make recommendations to their Boards as appropriate. The Boards' respective Investment Policy Statements currently provide processes and responsibilities for monitoring the performance of investment managers.

**Recommendation #18:** The Retirement Boards should clarify the different levels of investment decisions and which bodies have the authority to implement or approve them. The Boards should incorporate these clarifications into updates to the Investment Policy Statements, and if necessary, the Investment Committee Charter and Chief Investment Officer Charter.

**Retirement Boards' Response to Recommendation #18:**

The Boards generally agree with this recommendation and will direct their respective Investment Committees to consider and make recommendations to their Boards as appropriate. The Boards' respective Investment Policy Statements, and Charters for the Board, CEO, CIO, and Investment Committee all enumerate the approvals, delegations, responsibilities and accountabilities for making investment decisions. Over the past two years, each Investment Committee has been considering additional specifics with regard to tactical decision-making. The Boards anticipate additional provisions will be added in calendar 2018 to the investment governance documentation that will address this recommendation.

**Recommendation #19:** The Retirement Boards should periodically provide copies of the retirement plans' investment policies to the City Council.

**Retirement Boards' Response to Recommendation #19:**

The Boards agree with this recommendation and will direct staff to periodically provide the current policies to the Clerk of the City Council. The investment policies are public record and are available on the Boards' websites.

**Finding 4: San José's Basic Costs to Administer the Plans Were Comparable to Benchmark Jurisdictions.**

**Recommendation #20:** The Office of Retirement Service should ensure compliance with the City Gift Policy by paying for the total cost of attendance at vendor-sponsored conferences.

**Retirement Boards' Response to Recommendation #20:**

The Boards generally agree with this recommendation and will direct their respective Governance Committees to consider and make recommendations to their Boards as appropriate.

**Recommendation #21:** If the Retirement Boards would like to establish a more stringent gift policy, they should reaffirm the City Gift Policy and pass an addendum that further limits gifts to Retirement Board Members and Retirement Service Staff.

**Retirement Boards' Response to Recommendation #21:**

The Boards generally agree with this recommendation and will direct their respective Governance Committees to consider and make recommendations to their Boards as appropriate.

**Finding 5: The Office of Retirement Services Could Improve Customer Service Through More Efficient Tools.**

**Recommendation #22:** The Office of Retirement Service should assess how to use workflow functionality in PensionGold Version 3 for case management, including routing beneficiary requests to subject matter experts or staff familiar with the case, and to track workload statistics (such as time to complete requests), or acquire a separate case management software system.

**Retirement Boards' Response to Recommendation #22:**

The Boards generally agree with this recommendation and will direct their respective Audit Committees to consider and make recommendations to their Boards as appropriate. The Office of Retirement Services is currently in a multi-year process of implementing a new benefit services software, which is expected to provide the added functionality referenced in this recommendation. If additional software is required to provide functionality, that will be evaluated on the basis of its cost-effectiveness.

**Recommendation #23:** The Office of Retirement Services should expand its newsletters to include more information about the plans, upcoming events, and information about retirement.

**Retirement Boards' Response to Recommendation #23:**

The Boards generally agree with this recommendation and will direct the staff to consider this recommendation and make recommendations to the Boards as appropriate. The staff frequently considers enhancements to the member newsletters. The Boards appreciate the implied goal of this recommendation, to improve member education and transparency into the plans.

**Recommendation #24:** The Office of Retirement Service should upgrade their website to promote transparency and ease of navigation for stakeholders and plan members to find information.

**Retirement Boards' Response to Recommendation #24:**

The Boards agree with this recommendation and will direct the staff to bring a project plan and possibly a budget proposal for the next budget year for approval by the City Council. The Office of Retirement Services is currently reviewing website redesign options to improve functionality, transparency, and content.

**Recommendation #25:** To improve transparency, the Office of Retirement Services should post plan charters and policies, as well as audio recordings of committee meetings, online.

MAYOR AND MEMBERS OF THE CITY COUNCIL

December 22, 2017

**Re: Response to Audit of Retirement Services**

Page 8

**Retirement Boards' Response to Recommendation #25:**

The Boards generally agree with this recommendation. The plans' websites have many documents and recordings of their proceedings including the Investment Policy Statements, Committee minutes, and performance reports. The Boards will direct the staff to include a more comprehensive and easier to access repository of Board policies, reports, charters, and recordings in the redesign of the plans' websites. It should be noted that most Board meetings held at City Hall are video recorded and posted to the City's website along with other Public Meetings. All committee meetings are audio recorded in compliance with applicable Open Government requirements whether they are held at City Hall or in the Office of Retirement Services. In 2017, the staff began providing a link to the audio recordings to many committee meetings on their Legistar website, which is publicly available.

We wish to thank the Mayor and the Council for this review and list of recommendations. If you have any questions, please direct them to both Boards of Administration.

Sincerely,

Matt Loesch, P.E., Chair  
Federated City Employees'  
Retirement System

Nick Muyo, Chair  
Police and Fire Department  
Retirement Plan

C: David Sykes, City Manager  
Sharon Erickson, City Auditor  
Federated City Employees' Retirement System, Board of Administration  
Police and Fire Department Retirement Plan, Board of Administration  
Roberto L. Peña, FCERS CEO