COUNCIL AGENDA: 08/27/19
FILE: 19-716
ITEM: 3.5

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Jennifer Schembri

SUBJECT: SEE BELOW

DATE: August 15, 2019

Approved [signature] Date 8-15-19

SUBJECT: ORDINANCE EXCLUDING CERTAIN OFFICE OF RETIREMENT SERVICES STAFF FROM TIER 3 MEMBERSHIP.

RECOMMENDATION

Approve an ordinance amending Chapter 3.49 of Title 3 of the Municipal Code to exclude Office of Retirement Services staff, including the Chief Executive Officer, Chief Investment Officer, and Investment Professional staff, hired after November 4, 2014, from Tier 3 membership.

OUTCOME

This ordinance excludes certain Office of Retirement Services Staff, including the Chief Executive Office, Chief Investment Officer, and Investment Professional staff from membership in Tier 3 retirement benefits. This will allow incumbents in those positions hired after November 4, 2014 to then become enrolled in CalPERS for retirement benefits effective October 11, 2019.

BACKGROUND

On November 4, 2014, Measure G was passed by the voters of San José. Measure G granted the City's two retirement boards with certain authorities, including the authority to appoint the Chief Executive Officer (Director) of Retirement Services. In addition, Measure G excluded the Chief Executive Officer, the Chief Investment Officer, and investment professional staff in the Office of Retirement Services (ORS) from being members of the City's defined benefit pension or retiree healthcare plans under City Charter Section 1101 (a) (12). This exclusion, however, did not apply to any incumbents filling those positions as of November 4, 2014.

Accordingly, investment staff hired after the implementation of Measure G have been mandatorily placed into the City's Tier 3 Plan. The Tier 3 Plan is a 401(a) defined contribution retirement savings plan in lieu of the City's defined benefit plan. With respect to compensation, the retirement boards can make recommendations to the City Council for the total compensation for the Chief Executive Officer, the Chief Investment Officer, and investment professional staff in the Office of Retirement Services, but compensation for these positions is set by the City Council pursuant to City Charter Section 902.

During the August 8, 2018 Rules and Open Government Committee meeting, City staff was directed to bring to the City Council an amendment to the CalPERS contact to include future professional investment staff in the CalPERS defined benefit pension plan. This amendment would have resulted in the creation of an option for future professional investment staff in the Department to choose between the City's Tier 3 Plan or CalPERS retirement benefit.

Based on discussions with tax counsel, the City was presented with three options for removing current eligible ORS staff from the Tier 3 Plan:

i. Mandatory participation in CalPERS
ii. City pays difference in CalPERS employee contribution rate that is more than 3.75%
iii. Employees make post-tax employee contributions to CalPERS

The attached Rules and Open Government Committee Memo dated March 1, 2019 contained those three options for the City Council regarding the CalPERS and Tier 3 benefit for ORS staff. The Rules Committee approved placing this memo on the March 19, 2019 Council agenda.

On March 19, 2019, City Council approved mandating incumbent and future eligible ORS staff to move into the CalPERS benefit. These employees would be required to join CalPERS and would no longer participate in the Tier 3 Plan. This would mean that all impacted employees would have to be moved into CalPERS. Additionally, the City Council approved moving these employees into CalPERS on a prospective basis.

ANALYSIS

The next step in the process of implementing the CalPERS pension benefit for ORS staff is to exclude the incumbents and future employees from participation in the City's Tier 3 benefit. The attached ordinance amends the Municipal Code definition of "Employee" to exclude the Chief Executive Officer, Chief Investment Officer, and investment professional staff hired on or after November 4, 2014 from membership in Tier 3. Once this Municipal Code change goes into effect, most of the incumbents in those positions will stop contributing to the Tier 3 plan, and they will be eligible to be enrolled in a CalPERS pension plan. There are currently five (5) employees that this would affect. The current Chief Executive Officer does not qualify under the ordinance and will remain in Tier 3 because he was hired before November 4, 2014.

EVALUATION AND FOLLOW-UP

If the Council approves the proposed ordinance for publication, the ordinance will be placed on the Council agenda for final approval on September 10, 2019 and become effective 30 days later.

PUBLIC OUTREACH

This memorandum will be posted on the City's website in advance of the August 27, 2019 City Council Agenda.

COORDINATION

This memorandum was coordinated with the City Attorney's Office.

COMMISSION RECOMMENDATION/INPUT

There are no applicable commissions for this memo.

CEQA

CEQA: Not a Project, File No. PP17-010, City Organizational & Administrative Activities resulting in no changes to the physical environment.

JSchembri

JENNIFER SCHEMBRI
Director of Employee Relations/
Director of Human Resources

For questions please contact Cheryl Parkman, Assistant to the City Manager, at (408) 535-8152.

Attachments

RULES COMMITTEE: 03/06/19
FILE: 19-028
ITEM: G(3)

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: RULES AND OPEN GOVERNMENT COMMITTEE

FROM: David Sykes
Richard Doyle

SUBJECT: **PROVIDING CALPERS PENSION BENEFITS FOR CURRENT OFFICE OF RETIREMENT SERVICES PROFESSIONAL INVESTMENT STAFF**

DATE: March 1, 2019

RECOMMENDATION

A. Consider the following three options for removing current Retirement Services investment staff employees that were hired post- Measure G from the City's Tier 3 Retirement Plan and placing them into CalPERS either prospectively or retroactively.

   i. Mandatory participation in CalPERS
   ii. City pays difference in CalPERS employee contribution rate that is more than 3.75%
   iii. Employees make post-tax employee contributions to CalPERS

B. Place the item on the March 19, 2019 Council Agenda for action.

BACKGROUND

On November 4, 2014, Measure G was passed by the voters of San José. Measure G granted the City's two retirement boards with certain authorities, including the authority to appoint the Chief Executive Officer (Director) of Retirement Services. In addition, Measure G excluded the Chief Executive Officer, the Chief Investment Officer, and investment professional staff in the Office of Retirement Services from being members of the City's defined benefit pension or retiree healthcare plans under City Charter Section 1101 (a) (12). This exclusion, however, did not apply to any incumbents filling those positions as of November 4, 2014. Accordingly, investment staff hired after the implementation of Measure G have been mandatorily placed into the City's Tier 3 Plan. The Tier 3 Plan is a 401(a) defined contribution retirement savings plan in lieu of the City's defined benefit plan. With respect to compensation, the retirement boards can make recommendations to the City Council for the total compensation for the Chief Executive Officer, the Chief Investment Officer, and investment professional staff in the Office of Retirement Services, but compensation for these positions is set by the City Council pursuant to City Charter Section 902.

During the August 8, 2018 Rules and Open Government Committee meeting, City staff was directed to bring to the City Council an amendment to the CalPERS contact to include future professional investment staff in the CalPERS defined benefit pension plan. This amendment would have resulted in the creation of an option for future professional investment staff in the Department to choose between the City's Tier 3 Plan or CalPERS retirement benefit.

During this time, City staff had been communicating with the Retirement Boards regarding the changes to the retirement benefit options for future investment professional staff. Although the Rules Committee made a recommendation for future professional investment staff, the Board chairs requested if it was possible that current investment staff in the City's Tier 3 Plan be moved into the CalPERS defined benefit plan retroactively, i.e., presumably back to each employee's hire date.

City staff requested input from the City Attorney's Office regarding whether it was possible for the current Tier 3 Plan employees to opt out of the Tier 3 Plan and be retroactively be placed into a CalPERS defined benefit plan. There are currently five (5) employees that this would affect.

CalPERS currently has two retirement tiers, Classic and PEPRA. PEPRA is comparable to the City's Tier 2 retirement benefits. It is important to note the current employee and employer contribution rates for the City and CalPERS plans discussed in this memorandum are as follows:

Retirement Plan	Employee Contribution Rate	City Contribution Rate
Tier 3 Plan	3.75%	3.75%
CalPERS Classic	7.00%	8.892%
CalPERS PEPRA	6.25%	6.842%

RESEARCH AND FINDINGS

We have discussed this matter with outside tax counsel and the summary below represents the options regarding the ability of current Retirement Services Investment Staff to opt-out of the City's Tier 3 Plan and into a CalPERS defined benefit pension plan.

1) **Can current professional investment staff who are Tier 3 Plan members opt-out of the Tier 3 Plan and into a defined benefit plan like CalPERS?**

   As a general tax rule, current employees in one retirement plan cannot make an election to move to another retirement plan, i.e., opt out of the City's Tier 3 Plan and opt in to CalPERS. Giving current Tier 3 Plan members the ability to elect between the City's Tier 3 Plan and CalPERS would be impermissible because the employee contributions are different for the Tier 3 Plan (3.75%) and CalPERS (6.25% or 7.00%) plans. Employees

are not allowed to modify the pick-up election or have a new election opportunity without receiving specific approval from the IRS.
However, it may possible that a modified election could be offered under one of the three exceptions described below:

a. **Mandatory participation in CalPERS**: The City would have to mandate that all current investment professional staff enrolled in the City's Tier 3 Plan would be required to join the CalPERS pension plan and would no longer participate in the Tier 3 Plan. There would be no employee election in this case and all impacted Tier 3 members would have to be moved into CalPERS.

b. **City pays the difference in the CalPERS employee contribution rate that is more that 3.75%**: In this option, current Investment Staff in the City's Tier 3 Plan would be able to elect between staying in the Tier 3 Plan or moving into a CalPERS plan. The City would need to structure the pension contribution rates in such a way that the mandatory employee contribution rate would always be 3.75%, and the City would pay the difference between the 3.75% and the applicable CalPERS employee contribution rate, in addition to paying the required employer contribution rate. For example, the difference between the PEPRA employee contribution rate of 6.25% and 3.75% is 2.5%. In this example, the City would have to "pick up" the 2.5% difference in the employee's contribution rate, which would be in addition to the 6.842% that the City is required to pay for the employer contribution rate. If employee contribution rates increase, the City would be responsible for any increase above 3.75%. Please be advised that it is not clear whether this type of approach would be permitted by CalPERS.

c. **Employees make post-tax employee contributions over 3.75%**: In this option, current Investment Staff in the City's Tier 3 Plan would be able to elect between staying in the City's Tier 3 Plan or moving into a CalPERS Plan. The City would need to structure the pension contribution rates in such a way that the employees make the 3.75% contribution on a pre-tax basis to CalPERS, but any mandatory employee contributions in excess of that amount would be treated as post-tax contributions. For example, the difference between the 3.75% Tier 3 Plan contribution and the 6.25% CalPERS employee contribution rate is 2.5%. Employees would be required to make that 2.5% employee contribution to CalPERS on a post-tax basis. Please be advised that it is not clear whether this type of approach would be permitted by CalPERS.

Further, it is important to note that option b above does not appear to be precluded under Measure F as a benefit enhancement to defined retirement benefits in a City plan.

2) **If employees are mandated to go into CalPERS or can choose to opt-out of the City's Tier 3 Plan and be placed into a CalPERS defined benefit plan prospectively, what happens to the funds in the employee's Tier 3 Plan account?**

   The funds would stay in the City's Tier 3 Plan. If one of the above three options for employees to opt-out of the Tier 3 Plan is implemented on a prospective basis, none of the options would qualify as a "distributable event" for the funds in the Tier 3 member's account. This means that the funds in the member's Tier 3 account would remain in the City's Tier 3 Plan until a qualifying event, such as separation from City service or retirement.

3) **If employees are mandated to go into CalPERS or can choose to opt-out of the City's Tier 3 Plan and be placed into the CalPERS defined benefit plan retroactively to his/her date of hire, what happens to the funds in the employee's Tier 3 Plan account?**

   The funds would stay in the City's Tier 3 Plan. If one of the above three options is implemented on a retroactive basis to each employee's hire date, both the employee's and City's Tier 3 contributions would remain in the Tier 3 plan because there would be no basis to "undue" the contributions from the employee's account. This means that the funds in the member's Tier 3 account would remain in the Tier 3 Plan until a qualifying event, such as separation from City service or retirement. In other words, employees would have two retirement plans, the Tier 3 Plan and CalPERS, for the same retroactive period of time. Staff has contacted CalPERS and is working on determining if retroactive placement in CalPERS is possible.

DIRECTION

Based on the above information, the Council is being asked to consider the following:

1) Should current Retirement Services professional investment staff hired post-Measure G be allowed to move out of the City's Tier 3 Plan and be placed into a CalPERS Plan under one of the options set forth above?

2) If current Retirement Services professional investment staff hired post-Measure G are allowed to move out of the City's Tier 3 Plan and be placed into a CalPERS, should it be prospectively or retroactively back to the employee's date of hire?

DAVID SYKES
City Manager

RICHARD DOYLE
City Attorney

For questions please contact Cheryl Parkman, Assistant to the City Manager, at (408) 535-8152.