



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jennifer Schembri

**SUBJECT: SANTA CLARA COUNTY CIVIL
GRAND JURY REPORT –
UNFUNDED PENSION
LIABILITIES**

DATE: September 5, 2019

Approved

Date

9-5-19

RECOMMENDATION

Accept staff's response to the June 18, 2019, 2018-2019 Santa Clara County Civil Grand Jury Report entitled "San Jose – Unfunded Pension Liabilities: A Growing Concern."

OUTCOME

Approval of this response will satisfy the requirements of Penal Code Section 933(c), which requires the City Council to respond to Civil Grand Jury reports to the presiding judge of the Superior Court.

BACKGROUND

The Santa Clara County Civil Grand Jury (Grand Jury) initiated an investigation into the City of San Jose's two independent retirements systems, the Police and Fire Department Retirement Plan and the Federated City Employees' Retirement System, on November 6, 2018. In the report, the Grand Jury explains that the City used \$335 million of the General Fund in the Fiscal Year 2018-2019 budget to pay for pension costs. General Fund monies are also used for services such as police and fire, street repairs, parks, and libraries. The Grand Jury concludes that if changes are not made to the way the City's retirement systems are funded and managed, then the City will have to continually increase the amount it contributes toward pension and other post-employment benefits costs. The potential impact on City services concerned the Civil Grand Jury, which precipitated their investigation.

The Grand Jury report states that their investigation focused on “the structure of the two Board and the Office of Retirement Services.” In addition, their investigation considered the efficiency and effectiveness of the Boards’ administrative duties and the investment profiles of the two retirement systems.

The Grand Jury provided the City of San Jose with its final report entitled, “San Jose – Unfunded Pension Liabilities: A Growing Concern.” The Grand Jury requested that responses to its findings and recommendations be provided the Grand Jury’s presiding Judge of the Superior Court in accordance with the California Penal Code.

ANALYSIS

The report contained six (6) findings with applicable recommendations to either the City of San Jose or the boards of the two retirement systems. The City was requested to respond to Findings and Recommendations #3, 4, 5, and 6. There are two findings and recommendations, numbers 3 and 4, that require responses from both the City and the boards of the two retirement systems. California Penal Code Section 933.05 states that the responding person or entity shall provide certain basic information in the response to each finding and recommendation. With regard to the findings, the respondent(s) must indicate whether they agree, disagree partially, or disagree wholly. When disagreeing, the respondent(s) must state which portion is disputed and why. With regard to the recommendations, the respondent(s) must state whether it has been implemented, will be implemented (with a time frame), requires further analysis (with an explanation), or will not be implemented (with an explanation). What follows are the Grand Jury’s findings and recommendations and the associated responses.

FINDING 3

The City of San José’s mandatory required contributions to pension plans are putting an ever increasing burden on the City’s General Fund, which impedes the ability of the City to provide essential services to its residents.

AGREE

The City agrees with this finding. The City of San Jose is committed to providing its residents and customers with essential services, and has taken several steps to address the high cost of retirement benefits for City employees. This includes the Alternative Pension Reform Framework Agreements with the City’s eleven bargaining units, which contained several cost saving measures and protections against further benefit enhancements without a vote of the electorate. ([Attachment A](#) and [Attachment B](#)).

For example, the City and the bargaining units agreed that employees in Tier 2 would share the cost of pension benefits 50/50 with the City. The City also agreed to close the defined benefit retiree healthcare plan for Tier 2 Police and Fire employees, as the Federated defined benefit plan had been previously closed to Tier 2 employees in 2013.

Additionally, the voters approved Measure F on November 8, 2016. Measure F amended the City Charter so that any future benefit enhancement to the retirement plans would need to be approved by the voters. Measure F also contained a provision that prohibited any retroactive defined retirement benefit enhancements. These were important cost containing measures for future benefits. ([Attachment C](#)).

The City is continuing to monitor and review the cost of retirement benefits. As approved by the City Council in March 2019, the Mayor’s March Budget Message directed the City Manager to provide support to the Retirement Stakeholder Solutions Working Group meetings in the coming months. This Working Group has a goal of convening key stakeholders to address the current challenges of the City’s retirement systems in a collaborative and transparent manner, and making recommendations for City Council consideration. This Working Group is tentatively scheduled to begin in October 2019. ([Attachment D](#)).

RECOMMENDATION 3

The City of San José should work collaboratively with the 11 bargaining units to find ways to reduce this burden and make the findings public no later than June 2020.

AGREE

The City agrees with the recommendation to work collaboratively with bargaining units. As stated above, the Retirement Stakeholder Solutions Working Group is tentatively scheduled to commence meetings in October 2019. The anticipated outcome of the Working Group is that a list of recommendations will be developed. The timing of the recommendations may not coincide with making the findings public by June 2020.

With respect to the benefits agreed to in the Alternative Pension Reform Framework Agreements, those benefits set forth in the City Charter and Municipal Code are to be memorialized in a retirement memorandum of agreement (MOA) between the City and the bargaining units. The retirement MOAs will also include summaries of the benefits for Tier 1 employees. The retirement MOAs have a term of ten years, both expiring on June 30, 2025. The City and the bargaining units are subject to the terms of the retirement MOAs until the expiration date.

FINDING 4

Maintaining two separate pension Boards has resulted in inefficiencies including duplication of various tasks and responsibilities.

AGREE

The City agrees with this finding in general. While the two Boards maintain a shared administrative staff and typically engage the same professionals to advise them on investment, actuarial, and legal matters, it appears that there is some inherent duplication of effort and expenses that need to be explored further.

RECOMMENDATION 4A

The City of San José should examine the current Board models, consider opportunities for streamlining, and identify areas of administrative cost reduction. This investigation should include evaluating one board for both plans but structured to prevent the proportional dilution of members' representation. This recommendation does not include the combining or commingling of plans funds. The results of these actions should be made public by June 30, 2020.

RECOMMENDATION REQUIRES FURTHER ANALYSIS

The recommendation requires further analysis. One of the goals of the Retirement Stakeholder Solutions Working Group is to examine the issues and challenges surrounding the retirement systems. Several issues will be reviewed and researched by the Working Group, and the Working Group could address the different opportunities to streamline the administration of the Boards.

FINDING 5

The expertise of the public members of the Boards of Administration is heavily weighted toward investment professionals. Other more successful pension funds, such as LACERS, have boards that have a much wider range of expertise.

PARTIALLY DISAGREE

The City partially disagrees with this finding.

The City agrees that the expertise of the current public Board members is heavily weighted toward investment professionals. The City made significant changes to the composition of the retirement boards in 2010. These changes were based on recommendations from a consultant's review of the retirement board structure. The consultant, Cortex Applied Research (Cortex), recommended that each retirement board should have four (4) public, independent members selected by the City Council, and that those members should "possesses strong knowledge, expertise, and experience relevant to the administration of public retirement plans." These recommendations applied to both the Federated Retirement Board and the Police and Fire Retirement Board.

Based on the recommendations by Cortex, stakeholder outreach, and a review of other public pension plans, the City recommended changes to the qualifications for the public members of the board to include a minimum of fifteen years' experience in pension administration, pension actuarial practice, institutional investment management, employee benefits/investment law, banking, asset/liability management for an insurance company, or university or college professor with a focus on fiduciary or trust fund law or a quantitative background in financial theory or actuarial math. These qualifications were approved and are now included in the City's Municipal Code sections related to the administration of the Boards.

The changes made to the required qualifications for the public Board members were meant to help select individuals who had relevant expertise to understand the complex issues that occur in the administration of defined benefit retirement plans. The City disagrees that broadening

the qualifications for the public members of the Boards beyond the qualifications enumerated above would necessarily make the pension systems more successful without further analysis.

RECOMMENDATION 5

The City of San José should broaden the backgrounds of the public Board members beyond the present focus on investment strategy beginning with the next Board member appointment.

RECOMMENDATION WILL BE IMPLEMENTED

The recommendation has not yet been implemented, but will be implemented as Board members' terms expire.

Recently, the Clerk's Office, in conjunction with the Office of Retirement Service, began outreach to several different websites and forums to be more inclusive of the other possible professions and backgrounds that qualify for the public seats pursuant to the Municipal Code. The City will continue to work with its stakeholders to better advertise the vacancies to a wide range of professionals who may have the requisite experience to effectively administer the retirement systems.

The process for filling vacancies on the Boards begins with the City Clerk posting the vacancy on the City Clerk's website. Possible applicants can apply via the Clerk's website, and are then reviewed to ensure that the applicants meet the minimum qualifications.

The Municipal Code provides that the public members of the boards shall possess a baccalaureate degree from an accredited college or university in finance, actuarial science, law, economics, business or other relevant field of study. An advanced degree in a relevant field of study or professional certification is desirable but not required.

Moreover, each public member of the boards shall possess a high level of knowledge and expertise, and at least twelve years of experience, relevant to the administration of a public retirement plan. Knowledge and expertise relevant to the administration of a public pension system may include but is not limited to experience in: a senior executive position in pension administration; pension actuarial practice; institutional investment management; auditing; accounting; legal; health and welfare and/or employee benefits management; investment management; banking; asset/liability management for an insurance company; college or university professor with a focus on fiduciary or trust fund law or a quantitative background in financial theory or actuarial math.

FINDING 6

The 3% COLA for Tier 1 retirees has a major impact on the unfunded liability, increasing the burden on the City's General Fund and further impeding the ability of the City of San José to provide essential services to its residents.

AGREE

The City agrees with this finding. The City recognizes that the 3% COLA has an impact on the cost of pension benefits for Tier 1 employees. To contain costs related to post-retirement

benefits, the City and the bargaining units agreed to a lesser level of benefits for Tier 2 when compared to Tier 1 pension benefits in recognition of the unsustainable retirement costs. As stated in the Grand Jury's report, the Tier 2 COLA benefits are tied with the Consumer Price Index (CPI) and capped at a maximum of 2%.

RECOMMENDATION 6

The City of San José should examine ways in which the 3% COLA liability can be reduced fairly as many other public entities have done by considering options such as reducing COLAs in exchange for lump sum buyouts, etc. This examination should be completed and made public by June 2020.

DISAGREE WHOLLY

The City disagrees with this recommendation. The City is currently in a closed retirement MOA with its bargaining units through June 30, 2025, as stated above. Tier 1 retirement benefits contained in the MOA are subject to the terms of the MOA until it expires. This includes the 3% COLA for Tier 1 employees.

Moreover, there are legal issues relating to changes to the current Tier 1 COLA structure. The City's prior attempt to modify Tier 1 COLAs was found invalid by a County Superior Court in the Measure B litigation.

EVALUATION AND FOLLOW-UP

There is no anticipated follow-up with the City Council at this time.

PUBLIC OUTREACH

This response will be posted on the City's web site for the September 17, 2019 Council Agenda.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office and the Office of Retirement Services.

COMMISSION RECOMMENDATION/INPUT

This item does not have any input from any board or commission.

HONORABLE MAYOR AND CITY COUNCIL

September 5, 2019

Subject: Santa Clara County Civil Grand Jury Report – Unfunded Pension Liabilities

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CEQA

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

/s/

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Director of Employee Relations
Director of Human Resources

For additional information on this report, contact Jennifer Schembri at (408) 535-8154.

Attachment A – [Police and Fire Alternative Pension Reform Framework Agreement](#)¹

Attachment B – [Federated Alternative Pension Reform Framework Agreement](#)²

Attachment C – [Measure F \(Santa Clara County List of Local Measures November 8, 2016\)](#)³

Attachment D – [Mayor’s March Budget Message – Fiscal Year 2019-2020](#)⁴

¹ <http://www.sanjoseca.gov/DocumentCenter/View/45132>

² <http://www.sanjoseca.gov/DocumentCenter/View/48240>

³ <https://www.sccgov.org/sites/rov/Info/Nov2016Info/Documents/E110%20List%20of%20local%20measures.pdf>

⁴ https://gcc01.safelinks.protection.outlook.com/?url=https%3A%2F%2Furldefense.proofpoint.com%2Fv%2Furl%3Fu%3Dhttps-3A%20sanjoseca.gov%20View.ashx-3FM-3DF-26ID-3D7082148-26GUID-3D6370C1D4-2DC207-2D4E3B-2DA174-2DACC0D37C482%26d%3DDwMFAw%26c%3DY6IK3sQOQe5gkvL3EggybQ%26r%3DcIvO38fEEu2xNDuOe75njhioTuL7wSN6KhqGMmblIPY%26m%3DvqiRw03vmyqCoPb5LXbFqQkYKBoIN0Lv85uowI_BCxM%26s%3DWd9EJeF1eSaPUbjZz-mgfc3DGG_Bbp9oQbouvngA7YM%26e%3D&data=02%7C01%7CChloe.Meyere%40sanjoseca.gov%7Cf3ef81b10f524e9bf60008d6a4e15172%7C0fe33be061424f969b8d7817d5c26139%7C0%7C0%7C636877684987724653&sdata=Lz2Synbk%2F1nn1fzlbv334bBmqPItd2JwhJmQRCPDICs%3D&reserved=0