



Office of Retirement Services

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

September 24, 2019

The Honorable Deborah A. Ryan
Presiding Judge
Santa Clara County Superior Court
191 North First Street
San Jose, CA 95113

(ENDORSED)
FILED
SEP 26 2019
Clerk of the Court
Superior Court of CA County of Santa Clara
BY Britney Huebner DEPUTY

Re: Grand Jury Report

Dear Judge Ryan:

Pursuant to California Penal Code section 933, et seq., please accept the Boards of Administrations response to the 2018-2019 Santa Clara County Civil Grand Jury Report, "San Jose's Unfunded Pension Liability: A Growing Concern." The Board response and the Grand Jury's Report are enclosed for your review.

Please feel free to contact me if you have any questions. Thank you for your consideration.

Respectfully,

Roberto L. Peña, CEO
Office of Retirement Services
Secretary of the Boards of Administrations

Enclosures

cc: Matt Loesch, Chair for Federated City Employees Retirement System (FCERS)
Vincent Sunzeri, Chair for Police and Fire Retirement Plan
Harvey Leiderman, General and Fiduciary Counsel
Jennifer Schembri, Director of Office of Employee Relations and Human Resources



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Re: RESPONSES TO CIVIL GRAND JURY FINDINGS AND RECOMMENDATIONS

Finding 1

Moving the City of San José mature pension plan to a more risk-averse investment portfolio has contributed, in part, to poor investment returns.

Response to Finding 1: The Boards respectfully disagree with this finding. The Boards have considered the risk/return balance of their portfolios in the context of their benefit payment obligations and cash flow needs, the risk tolerances of the Boards and the City plan sponsor, and all other factors affecting the diversification of their respective portfolios. The systems have not experienced "poor investment returns" relative to their risk/return expectations.

Recommendation 1

The two Boards of Administration should conduct a comprehensive review of the investment portfolios that should be made public by June 30, 2020. The review should consider investment strategies used by other state and government pension organizations, particularly assessing portfolios of other pension plans with similar risk profiles that had higher returns.

Response to Recommendation 1: The Boards will implement the recommendation and make public a report in a timely manner, once the data has been obtained and analyzed.

Finding 2

The City of San José pension plans are overburdened with a large number of investment managers and excessive investment management fees.

Response to Finding 2: The Boards respectfully disagree with this finding. The plans invest through multiple, diversified investment vehicles across global markets and incur fees commensurate with the Boards' judgment as to the prudent investment of the assets of the plans and expected returns from those investments. The fees paid to investment managers are in line with those paid by comparable plans with similar investment profiles.

Recommendation 2

The two Boards of Administration should study ways in which to reduce the number and the cost of investment managers and make their findings public by June 2020.

Response to Recommendation 2: The recommendation is being implemented. The Boards constantly strive to reduce fees through negotiation and competitive pricing, when available. Each selected investment vehicle plays an intentional role in the plans' diversified portfolios. The Boards will continue to study ways to make the investment portfolio more cost efficient and will report publicly on their success in a timely manner.

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.

Response to Finding 3: The Boards can neither agree nor disagree with this finding; only the City can address the impact of retirement contributions on its General Fund.

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.

Response to Recommendation 3: The Recommendation is addressed only to the City and its recognized bargaining units. The design of the benefit program administered by the Boards is beyond the jurisdiction of the Boards. Once the City and its employees reach agreement on the benefit package, the Boards are obligated to collect the contributions necessary to pay the promised benefits.

Finding 4

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

Response to Finding 4: The Boards respectfully disagree with this finding. The two Boards maintain a single administrative staff (unlike the practice found in other large California charter cities, like Los Angeles), which is cost efficient and effective. The Boards also typically engage the same professionals to advise them on investments, actuarial and legal matters, thus avoiding considerable duplication of effort. The Boards often invest in investment vehicles together, assuring them of favorable fees and terms. Finally, the Boards often conduct joint committee meetings (e.g., Governance, Audit and Personnel), to coordinate their activities and benefit from their respective views on common issues. The fact that each Board meets once a month to conduct business on behalf of its own unique membership does not itself result in “inefficiencies.”

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.

Response to Recommendation 4a: The Boards are not asked to respond to this Recommendation.

Recommendation 4b

The Boards of Administration should implement employee reviews based on measurable goals and performance metrics for the CEO and CIO. The goals and performance metrics should be completed and made public by December 31, 2019.

Response to Recommendation 4b: The Recommendation is being implemented. The Boards' Joint Personnel Committee is in the process of developing additional performance metrics for the CEO and CIO positions. These metrics are expected to enhance the current practice of evaluating the CEO and CIO's annual work plans and utilizing the City's standard executive management evaluation measures. The Boards will act timely on the Committee's recommendations and will make the updated performance evaluation metrics public when the process has been completed.

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.

Response to Finding 5: The Boards are not asked to respond to this Finding.

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.

Response to Recommendation 5: The Boards are not asked to respond to this Recommendation.

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.

Response to Finding 6: The Boards are not asked to respond to this Finding.

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.

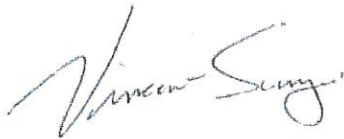
Response to Recommendation 6: The Boards are not asked to respond to this Recommendation.

Thank you for your leadership in these matters. We will be available at any time to discuss then with you further.

Respectfully submitted,



Matt Loesch, P.E., CHAIR BOARD OF ADMINISTRATION
Federated City Employees' Retirement System and Health Care Trust



Vincent Sunzeri, CHAIR BOARD OF ADMINISTRATION
Police and Fire Department Retirement Plan and Health Care Trust

C: Roberto L. Peña, CEO Office of Retirement Services
Harvey Leiderman, General and Fiduciary Counsel