



# MEMORANDUM

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**To:** Boards of Administration  
 Police and Fire Department Retirement Plan  
 Federated City Employees' Retirement System

**Date:** June 1, 2020

**Subject:** Proposed Rehired Tier 1 Member Contribution Ordinance

Under cover of a Memorandum dated May 27, 2020, the City's Office of Employee Relations has forwarded for the Boards' comment and recommendations a draft Ordinance relating to the additional UAL generated by the reclassification of certain members' Tier 2 service to Tier 1 service. The members in question are former Tier 1 members who separated from service with the City before the creation of Tier 2, then returned to work at the City as Tier 2 members. Under the "Framework" settlement more particularly described in the City Memorandum, the City and its representative bargaining units agreed that such "Reclassified Tier 1" members could receive the advantages of having their Tier 2 service upgraded to Tier 1 service, provided they pay 50% of the additional UAL generated by that change, plus interest (at the Plans' assumed rate of return) on that amount until fully paid.

To date, Reclassified Tier 1 members have been paying 50% of that cost, including interest, by monthly payroll deductions.

The City and its bargaining units now have reached "side letter" agreements providing that going forward from the proposed amended ordinance's effective date, the City will pay 100% of the interest accruing on the UAL cost attributed to the "upgrade" in service, relieving the affected members of their 50% interest obligation. The City proposes to have the City Council consider and approve the agreements by adopting an ordinance in June, 2020, amending the current ordinance terms consistent with the new side letter agreements.

Pursuant to SJMC § 3.28.275 (Federated) and § 3.36.485 (Police & Fire), the City has forwarded the proposed ordinance to the Boards for their review and comment.

## Analysis

As Fiduciary Counsel to the Boards, our current review of the proposed ordinance is still preliminary, and there are a few issues to be addressed further before we are prepared to make a recommendation to the Boards. We have asked for both an actuarial and tax counsel review of the proposed ordinance, as both are outside the scope of our engagement. In the meantime, we have the following comments:

1. Voter Approval. Preliminarily, we look to the City for guidance on whether the ordinance is subject to the Charter amendments adopted in 2016 through the ballot initiative known as "Measure F." Measure F provides, in part, that any "benefit enhancements" created after its effective date must be approved by the City's voters. Per City Charter section 1503-A (a):

"There shall be no enhancements to defined retirement benefits in effect as of January 1, 2017, without voter approval. A defined retirement benefit is any defined post-employment benefit program, including defined benefit pension plans and defined benefit retiree healthcare benefits. An enhancement is any change to defined retirement benefits, including any change to pension or retiree healthcare benefits or retirement formula that increases the total aggregate cost of the benefit in terms of normal cost and unfunded liability as determined by the Retirement Board's actuary."

Although the Boards are not responsible for enforcing Measure F, it is in the Boards' best interests in administering the Plans to be assured that the benefit programs they administer are authorized by law.

2. City Payment Obligation. In the City Memorandum, the City states:

"In the two attached side letters, the City and the bargaining units have agreed to the amended terms regarding the Rehired Tier 1 Member amortization costs so that the City *will pay* any future interest."

However, the side letters each provide, at Sec. 16 b (ii)(2)(ii):

"Effective the first pay period following the effective date of an ordinance amending Chapter 3.36.410 of the Police and Fire Department Retirement Plan in the San Jose Municipal Code, the City *may pay*, on behalf of Rehired Tier 1 Employees, the interest accrued on the Total UAL Increase from the first pay period following the effective date of the above described ordinance amendment until the Rehired Tier 1 Employee Obligation is fully repaid."

Then language of the proposed ordinance amendment itself provides that the City *will pay* that future interest cost. *See*, Sec. 3.28.200 A.1.ii (Federated) and Sec. 3.36.410 A.1.ii (Police & Fire.)

We look to the parties to reconcile their side letter agreements with the proposed ordinance amendment as to whether the City's interest payments are permissive or mandatory, to avoid any possible misunderstandings in the future.

3. Key Terms are Vague and Ambiguous. The language of the City Memorandum is inconsistent with the language of the ordinance, both existing and proposed, and imprecise as to what costs are to be paid and by whom. For example, the ordinance defines the affected members as "Reclassified Tier 1 Members" and the UAL and interests costs they will be responsible for as the "Reclassified Tier 1 Member Obligation." The City Memorandum, however, refers to the affected members as "*Rehired* Tier 1 Members" and their obligation as the "*Rehired* Tier I Member Obligation" but the side letters define the affected members as "*Rehired* Tier 1 *Employees*" and their obligation as the "*Rehired* Tier I *Employee* Obligation." The future accrued interest component that the City is now agreeing to pay is not included in the affected members' obligation, however defined. Because these provisions are quite intricate, precise and uniform terminology would serve to avoid unnecessary misunderstandings (and administrative and actuarial confusion) in the future.

Note, too, that the last full sentence on page 1 of in the City Memorandum states:

"Rehired Tier 1 Members are still required to pay his or her total UAL increase *plus accrued interest* at the Plan's assumed rate of return from the date of the total UAL increase is calculated *until fully repaid* ("Rehired Tier 1 Member Obligation."

This description appears contrary to the side letters and the proposed ordinance, which define the Reclassified Tier 1 Member Obligation as including interest only from the original date of calculation back in 2017 up to the effective date of this new ordinance, after which the City takes over the accruing interest payments...up to the point at which the entire cost (UAL plus interest) is fully repaid.

Finally, at the top of page 2 of the City Memorandum, it states:

"As previously agreed upon, if a Rehired Tier 1 Member leaves City service prior to paying *the full cost attributable to such member's transition to Tier 1, including any unfunded liability*, the member is required to pay any remaining balance..."

The phrase, "the full cost attributable to such member's transition to Tier 1" is not defined in the City Memorandum, and the proposed ordinance does not so provide in the amended sections. We cannot determine if that phrase is (a) supposed to be synonymous with the defined "Reclassified Tier 1 Member Obligation", (b) meant to include that obligation *plus* the City's 50% share of the obligation re: future accruing interest or (c) something else.<sup>1</sup>

4. Amortization of the City's Interest Obligation. The Member's current obligation to pay 50% of the accruing interest portion of the UAL generated by the reclassification of Tier 2 service to Tier 1 service was set on a 16-year amortization schedule which commenced a few years ago. The City now intends to

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<sup>1</sup> The side letter agreements use a different, undefined phrase to describe this, adding to the confusion. See Side Letter Agreement Section 16 b. (iii) ("...any outstanding balance of his or her Rehired Tier 1 obligation..."

pick-up the affected members' portion of that interest obligation, but to wash it into the Plans' overall UAL which is being amortized over a different period and subject to different actuarial assumptions and methodologies. We mention this only to allow the Board to consider whether it wishes to approve this treatment from both a timing and funding point of view.

Fundamentally, we do not believe that there is anything in the proposed shifting of these members' contribution obligations to the City that will materially affect the overall funding of the Plans or their actuarial soundness. As with any legislation that imposes administrative responsibilities on the Plans and their staff, however, we believe clear and precise direction as to the parties' intentions will promote the successful administration of the Plan, saving time and money and avoiding unnecessary and costly disputes in the future.

These are our preliminary comments pending further information from the City, its bargaining units, the Plans' actuary and their tax counsel. We may have additional comments and recommendations for the Board at a subsequent time. For now, we recommend only that the Board authorize the CEO to communicate these comments to the City for its further consideration.