

# **SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM BOARD OF ADMINISTRATION COMMITTEE REPORT**

**DATE:** November 3, 2006  
**TO:** Business and Governance Committee  
**FROM:** Mark Sullivan, Chair, Navigant Report Committee  
**SUBJECT:** Navigant Report Committee – Final Report

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## **BACKGROUND**

On August 30, 2005, the Board of Administration of the San Diego City Employees' Retirement System (SDCERS) retained Navigant Consulting, Inc. (Navigant) to conduct an independent investigation into allegations of illegal or wrongful acts by previous SDCERS Board members.

Navigant, led by Managing Director Amanda Massucci, was charged with making a comprehensive review of prior board actions and practices. Their work was overseen by the law firm of Reish, Luftman, Reicher & Cohen and was conducted independent of direction from the SDCERS Board and staff. Navigant was given complete access to all documents and individuals relevant to the inquiry.

The Navigant delivered their report, on-time and under budget, simultaneously to the Board, SDCERS' staff and the public on January 20, 2006. The Report concluded that there had been a breach of fiduciary duty by former SDCERS Board members by approving the 1996 Manager's Proposal and 2002 Contribution Agreement presented by the City of San Diego. Reish Luftman Reicher & Cohen provided legal analysis of Navigant's findings and concluded that approval of these agreements also violated state and municipal law.

The Board accepted the Report, appointed a special ad-hoc Navigant Report Committee NRC to evaluate each of the recommendations, and thereafter adopted and implemented new policies, procedures and rules within its jurisdiction to strengthen SDCERS' operations, administration and oversight of its assets.

## **COMMITTEE MEETINGS**

The NRC led by chairman Mark Sullivan, met for seven months from February to August 2006 to review the Report findings, recommendations and major issues. In an effort to improve transparency and foster public participation in the meetings, special

non-voting, stakeholder representative positions were created for interested outside parties. In total, there were 10 stakeholder representatives registered for the NRC including:

- Julie Dubick                      City of San Diego, Mayor's Office
- Michael Aguirre                City of San Diego, City Attorney's Office
- Betsy Kinsley                    City of San Diego, City Council President's Office
- Woo Jin Shim                    City of San Diego, City Council President's Office
- Penni Takade                    City of San Diego, Independent Budget Analyst Office
- Judie Italiano                    Municipal Employees Association (MEA)
- Ed Lehman                        AFSCME (Local 127)
- Virginia Silverman            City of San Diego Retired Employees Association
- James Clem                      Retired Fire and Police Officers' Association
- Lani Lutar                        San Diego County Taxpayers' Association

Stakeholder representatives were actively included in committee discussions on agenda items and were given the opportunity to make presentations of their own on any noticed topic. The inclusion of stakeholder representatives in the review and exploration process of the myriad topics covered by the report and the committee was particularly successful as it brought additional perspectives and historical knowledge to the often in-depth discussions.

## **REPORT RECOMMENDATIONS**

Navigant's recommendations for improvement were grouped into the five following areas:

1. Governance and Oversight
2. Actuarial Soundness
3. Tax Compliance
4. Training and Education
5. Institutional Independence

On the following pages, you will find each of the 47 recommendations made in the Report with a summary of actions taken for each recommendation. Note that some recommendations were outside the purview of the SDCERS Board and have subsequently been forwarded to the Mayor and City Council for their consideration and action.

## NAVIGANT REPORT RECOMMENDATION PROGRESS REPORT

RECOMMENDATION		ACTION TAKEN / NOTES	STATUS
<b>Governance &amp; Oversight</b>			
N1	Review and update Board Rules and Trustee Handbook annually (Page 110 of 115)	Addressed at April 06 NRC Mtg. Annual review to be conducted by General Counsel.	Completed
N2a	It is also important for the Board to understand when Board members should recuse themselves from matters where a Board member's constituency or the Board member individually, might be affected by actions of the Board (Page 110 of 115)	* General Counsel and/or Compliance Officer to prepare recusal policy for Board adoption that details the circumstances under which a Board Member should recuse themselves from voting, but not including matters that affect the Board Member's constituency which is why they were appointed to the Board to represent the interests of their constituency.	Dec '06
N2b	Legal counsel should assist in the determination of conflicts and development of protocol for recommendation 2a. (Page 110 of 115)	* Addressed by Board adoption of recusal policy in N2a	Dec '06
N3a	Board members and Executive staff should set an "Ethical Tone at the Top" (Page 110 of 115)	* Addressed by Board adoption of Code of Conduct in N3b	Dec '06
N3b	Adopt a "common English" statement of ethical standards and communicate it to the organization frequently. (Page 110 of 115)	* Created Compliance Officer position (4/06), General Counsel to present Board Rules [1.10 & 1.20] to B&G Committee, then prepare a common English Code of Conduct for the Board's consideration.	Dec '06
N4	Re-evaluate Board committee structure to include: <ul style="list-style-type: none"> <li>◆ Strategic Planning</li> <li>◆ Funding of the pension plan to be based on sound actuarial principles</li> <li>◆ Investment of pension funds</li> <li>◆ Distribution of pension funds in accordance with contractual agreements</li> <li>◆ Assessment of performance of Administrator and approval of executive compensation</li> <li>◆ Assessment of performance of other functions and executive staff</li> <li>◆ Financial reporting, internal controls, and external audit</li> </ul> (Page 111 of 115)	Redesign of committees ADOPTED by the Board April 21, 2006. Board adopted amendments to Board Rule [3.00], with corrections. Staff added corrections and released final rules (Sep'06).	Completed
N5	Create Governance Committee / to conduct annual self-assessment of Board members, Board effectiveness, assignment of Board members to committees, orientation of new Board members, determine need for specific skill training of Board members, and conduct discussions with outgoing Board members on effectiveness of Board (Page 111 of 115)	* B&G Committee was created and its jurisdiction established in Board Rule [3.02]. The implementation of this recommendation should be addressed by the Board President (BP) and its B&G Committee as follows: to conduct annual self-assessment of Board members (B&G); Board effectiveness (B&G); assignment of Board members to committees (BP); orientation of new Board members (B&G); determine specific skill training of Board members (B&G); and conduct discussions with outgoing Board members on effectiveness of Board (B&G).	Ongoing
N6	Establish protocol for the Board and/or committees to receive direct reports from executive staff (Page 111 of 115)	This recommendation related primarily to the actions surrounding the adoption of MP1, a protocol for Executive Staff reporting to the Board was incorporated in the implementation of the new Committees.	Completed

## NAVIGANT REPORT RECOMMENDATION PROGRESS REPORT

	RECOMMENDATION	ACTION TAKEN / NOTES	STATUS
N7	Establish an open invitation and responsibility to executive staff to bring any concerns they have directly to the Board (Page 111 of 115)	After the Navigant report was completed, an invitation was extended to Exec staff by Board President. The Board has requested staff to make regular update reports in their monthly meetings and to draft whistleblower provisions in the Code of Conduct.	Completed
N10	Board should assess a need for a "facilitator" to evaluate the effectiveness of the Board in its working relationships within the Board and as it relates to others externally (Page 112 of 115)	The Board's Executive Committee should consider as part of their work plan [committee charter], whether this quality control task is already included in its responsibilities or should be added to their charter.	Ongoing
N11	Strengthen process for issues management and resolution to ensure identification, discussion, analysis and resolution of issues in a manner that is a) transparent, b) clearly documented and c) legal (Page 112 of 115)	Creation of new Board Committees implements the first component of this recommendation. The second part is the development of a Board decision-making process which includes the creation of the monthly milestone report which tracks all Board requests and staff action on those requests.	Completed
N13	General Counsel or Compliance Officer should establish a document retention policy to be adopted by the Board and reviewed periodically (Page 113 of 115)	* Resolution passed re: Retention of Member Files 10-18-02, Resolution passed re: Retention of Disability Files 10-18-02, EDMS project requires establishment of document retention policies for all documents. General Counsel in conjunction with staff will prepare a document retention policy for the Board's consideration (part of GC work plan 2006-2007).	Ongoing
N14	Designate a member of executive staff, perhaps General Counsel, as Compliance Officer to assess and report to Board compliance with critical policies and procedures (Page 113 of 115)	A Board Rule amendment was adopted for the Compliance Officer reporting to the Board through the B&G Committee. Board Rule adopted also reserves the right to have the Compliance Officer be a separate position from the General Counsel.	Completed
N17a	Board should consider becoming more involved in hiring of future employees and hiring executive staff without prior City employment (Administrator, Asst Administrator, General Counsel, CIO) (Page 114 of 115)	Board directed EFL to expand search for Administrator outside of City of San Diego, new Administrator hired from private sector. General Counsel search was also a nationwide search. New General Counsel was hired from outside of San Diego.	Completed
N17b	Board should consider a succession plan for CIO position currently held by employee participating in DROP program (Page 114 of 115)	Recommendation accepted by Administrator, plan in progress.	Completed
R5a	The Board should require that the SDCERS general counsel report directly to the Board rather than to the Retirement Administrator. (Page 126 of 127)	The General Counsel has an ethical obligation as a licensed professional, under the State Bar, to the Board as the highest level of authority within their client entity, in this case the System. Therefore the Board felt it was appropriate for organizational effectiveness for the General Counsel to report to the Administrator.	Completed
R5b	The Board should conduct formal annual reviews of the Retirement Administrator and General Counsel and annually set their compensation. (Page 126 of 127)	Approved at April 06 NRC and Board Mtgs, Board Rule [3.03] was changed to reflect this new responsibility of the Board.	Completed

## NAVIGANT REPORT RECOMMENDATION PROGRESS REPORT

	RECOMMENDATION		ACTION TAKEN / NOTES	STATUS
R10	Assessment of Other Issues. To the extent legal conclusions were not expressed in the Report arising out of facts developed by Navigant Consulting in its investigation, the Board should consider what steps, if any, should be taken with respect thereto. (Page 127 of 127)		Board will conduct self-assessment as part of the implementation of recommendation #N5 and engage outside experts when dealing with complex issues as identified in recommendation #N12.	Completed
	<b>Actuarial Soundness</b>			
N15	Develop a reasonable definition of Actuarial Soundness and an approach for periodic assessment of definition as it applies to SDCERS (Page 113 of 115)	*	There is no industry standard or requirement for defining the concept of Actuarial Soundness. SDCERS' actuary and fiduciary counsel have opined that the Board should pursue a formal funding policy (elements to ensure actuarial soundness) once it concludes its Actuarial Funding Study.	Ongoing
N16a	Consider treatment of Disability benefit payments in connection with Corbett settlement to include: should disability payments be impacted by Corbett (Page 114 of 115)		The SDCERS Board voted to suspend the practice [May'06] and the question of extending the benefit was referred to the Mayor and the City Council (date of letter)	Completed
N16b	Should current practice of adding 10% be altered (are muni code changes necessary?) (Page 114 of 115)		The SDCERS Board voted to suspend the practice [May'06] and the question of extending the benefit was referred to the Mayor and the City Council (date of letter)	Completed
N16c	Have disability benefits been overpaid; if so do they need to be recovered (Page 114 of 115)		The SDCERS Board voted [May'06] not to pursue overpayment of disability benefits.	Completed
N16d	What additional actions should be taken on the subject? (Page 114 of 115)		The SDCERS Board voted to suspend the practice [May'06] and the question of extending the benefit was referred to the Mayor and the City Council (date of letter)	Completed
N18	Consider eliminating use of "reserves" to fund benefits or employer/employee contributions (Page 114 of 115)		City Attorney to Draft Amendment to Muni Code [24.1502], per City Council request. Navigant Committee reviewed the use of reserves at its May'06 meeting and the SDCERS actuary has included this issue in their Actuarial Funding Study.	Completed
N19	Consider additional areas for internal audit testing (Page 115 of 115)	*	The FY 07 Budget included new internal audit position that reports to Audit Committee. When hired, Internal Auditor, at the direction of the Audit Committee, will perform financial and operational audits, e.g. health care administration, processing of DROP applications.	Ongoing
R2	The SDCERS actuary should provide a written Report each year in conjunction with its actuarial valuation which discusses the actuarial requirements under each of the Constitution, State and Municipal law and reports whether each of those laws has been complied with for the preceding year. (Page 124 of 127)		The Actuarial Report adopted by the SDCERS Board [May'06], included 8 recommendations, which make up the Actuarial Funding Study for 2006. The Actuary will be returning to the Board in September, October and November with specific recommendations on each area of further study.	Completed

**NAVIGANT REPORT RECOMMENDATION PROGRESS REPORT**

<b>RECOMMENDATION</b>		<b>ACTION TAKEN / NOTES</b>	<b>STATUS</b>
R2a This Report should also provide for projected assets, liabilities and contributions based on the assumptions then being used by the Retirement System. (Page 124 of 127)		The Actuarial Report adopted by the SDCERS Board [May'06], included 8 recommendations, which make up the Actuarial Funding Study for 2006. The Actuary will be returning to the Board in September, October and November with specific recommendations on each area of further study.	Completed
R2b The Report should include any benefit increases which have been granted and become effective during the five year period. (Page 125 of 127)		Recommendation accepted by SDCERS Actuary and added as a Board Rule and resolution, July'06.	Completed
R2c A copy of that Report should concurrently be delivered to the Mayor and the City Council and posted on the SDCERS website for public awareness. (Page 124 of 127)		Report delivered to the Mayor and the City Council [May 06] and it was also posted on the SDCERS website. The same process will be used annually thereafter.	Completed
R2d The Board rules should be amended to require that the actuary deliver this Report and comment on his conclusions in open session. (Page 125 of 127)		Board Rule adopted to require that the report be made in open session and that on a date certain.	Completed
R2e The Board should render a formal billing to the City for that amount. The bill should be presented no later than January 31 of each year. Page 125 of 127)		Board Rule adopted to require that the report be made in open session and that on a date certain.	Completed
R7 We believe it is essential for SDCERS to continue to pursue its declaratory relief action against the City related to the propriety of benefits. (Page 126 of 127)		Court supported SDCERS legal position.	Completed
R8a We recommend that the Board analyze, with the assistance of its actuary and independent counsel, the best way to recoup that shortfall, and if it is permitted to be amortized, the period over which such amortization be permitted. (Page 126 of 127)		Cross Complaint Filed in Dec Relief re: right to recoup \$ if MPI & II are repealed.	Completed
R9b To the extent that correction of the failures requires the payment of a correction amount from the City, the Board should initiate discussions with the City for the payment of those amounts. (Page 127 of 127)		Discussed at NRC Mtg and Board Mtg June/July 2006. Board will send bill after final determination is issued by IRS.	Completed
<b>Institutional Independence</b>			
N3c Board members and Executive Staff should create a culture of autonomy from the City of San Diego (Page 110 of 115)		B&G should include in its work plan for 2007 a comprehensive review of structural changes that can create real autonomy from the City, e.g. civil service, payroll, similar to the independence established with it General Counsel.	Ongoing

**NAVIGANT REPORT RECOMMENDATION PROGRESS REPORT**

	<b>RECOMMENDATION</b>	<b>ACTION TAKEN / NOTES</b>	<b>STATUS</b>
R3a	The Board recommend to the Mayor and the City Council that the Municipal Code, or if necessary, the Charter, be amended to provide that a Board Member may not resign until a qualified successor has been selected and agreed to serve. (Page 125 of 127)	None. Since no legislative body can compel a Board member to stay on the Board, this recommendation cannot be implemented. However, the Board could advise the Mayor and the City Council that a vacant seat on the SDCERS Board be filled by the City within 60 days of the resignation that created the vacancy. This alternative will be included in the NRC Final Report to the Board.	Completed
R3b	The Board recommend that the Municipal Code, or if necessary, the Charter be amended to create a commission to identify and recommend qualified Board candidates to the Mayor to ensure that only qualified and independent individuals serve on the Board. (Page 125 of 127)	None. Given the response to R3a, this recommendation would be unduly burdensome and bureaucratic.	Completed
R6	We recommend that SDCERS continue to have the General Counsel position filled by its employee. (Page 126 of 127)	Court decision on this issue.	Completed
R3c	Therefore, the Board should recommend to the City that it amend the Municipal Code, or if necessary, the Charter, to comply with the express intent of Prop. 162 as stated in the following "finding": "The integrity of our public pension systems demands that safeguards be instituted to prevent political 'packing' of retirement boards, and encroachment upon the sole and exclusive fiduciary powers or infringement upon the actuarial duties of those retirement boards." (Page 125 of 127)	* The Board will review this recommendation with the Mayor and the City Council.	2007
R4a	The Board Rules should provide that the Board may not be involved in the setting of benefits or engage in any discussions that condition the amount of funding on the setting of benefits. (Page 125 of 127)	* Board Rule [1.20] should be revised to include this prohibition, or alternatively, Rule [1.43] could be amended and either of these changes would need to be adopted by the Board.	Dec '06
R4b	The Board should also recommend to the City Council that it amend the Municipal Code (or perhaps send to the voters a proposal to amend the City Charter) to preclude the City from linking benefit increases to actions by the Board. (Page 126 of 127)	* The City Charter [Section 143] created a prohibition on the Board adopting any action to delay funding which removes the incentive for linking benefit increases to actions of the Board. This recommendation is also covered under adoption of an amendment to Board Rule [1.20] under recommendation R4a.	Dec '06
R8b	In addition, the Board should analyze the likelihood of the City entering into an arrangement under the U. S. Bankruptcy Code; and if that is deemed likely, determine what steps to protect the Retirement system and its Members. (Page 126 of 127)	Explored at March 8 NRC meeting; no further action was taken.	Completed
<b>Training &amp; Education</b>			
N8	Board should engage an expert to perform a review of the Board orientation process for new Board members to ensure effective orientation and general training (Page 112 of 115)	Addressed at April 06 NRC Mtg, Brd Orientation and training sessions are being developed and will be managed by the new Board Committee, B&G.	Completed

## NAVIGANT REPORT RECOMMENDATION PROGRESS REPORT

RECOMMENDATION		ACTION TAKEN / NOTES	STATUS
<b>N9</b> Board should engage a consultant with expertise in training programs to develop a training curriculum for Board members with respect to general and specific skills necessary for assignments to committees (Page 112 of 115)	*	Staff is reviewing consultant/trainer for seven selected disciplines. Once training disciplines are established, Board members will be scheduled for training sessions. Board Secretary will be tasked with tracking the trainings.	Dec '06
<b>N12</b> Board, with aide of legal counsel, should obtain the counsel of outside experts when dealing with complex issues; Board should satisfy itself as to expert's objectivity & independence, proper basis for conclusions, analysis, thorough discussion and questioning of experts conclusions. (Page 113 of 115)		Historically, the Board has and will continue to select, where appropriate and in keeping with its fiduciary responsibilities, outside experts e.g. Investment Advisors, Actuary, Fiduciary Counsel.	Completed
<b>R1</b> Formal Fiduciary Training for Board Members (Page 124 of 127)	*	The Board's Fiduciary Counsel has developed an outline of the elements required for the Board's fiduciary training. Staff is reviewing possible training consultants.	Ongoing
<b>Tax Compliance</b>			
<b>R9a</b> We recommend that SDCERS file an application with the IRS under the remedial correction program to negotiate and make retroactive correction of these failures. (Page 127 of 127)		VCP application with IRS is complete. Corrective action at SDCERS has been taken on the eliminate violations. Board is awaiting approval from the IRS.	Completed
	*	Proposed for Further Committee or Board Action	

## **RESULTS**

Upon completion of the NRC meetings, 40 of the 47 recommendations outlined in the Report had been addressed by the Board or SDCERS staff including: establishing a new committee structure including a Business and Governance committee and an Audit Committee comprised of two Board members and three outside, independent members. An internal audit position was budgeted that reports directly to the Audit Committee, and a Chief Compliance Officer position that reports directly to the Board through the Business and Governance committee. The vacant Administrator and General Counsel positions were filled by independent, outside professionals, following two extensive executive searches (David Wescoe and Christopher Waddell, respectively).

Additionally, the Board embarked on the development of a fiduciary training curriculum for Board members and SDCERS' Executive Staff and re-evaluated the treatment of the *Corbett* benefit as it relates to non-service eligible disability recipients. The remaining recommendations have been forwarded for assessment by the Business and Governance Committee.

## **CONCLUSION**

The events involving SDCERS and the San Diego City Council which culminated with the engagement of Navigant and Reish, Luftman, Reicher and Cohen, began more than a decade ago. Since then, many groups and individuals have proffered explanations and allegations as to the origin of the situation, culpability of professionals involved in the decision making process, the severity of the current funding levels, and SDCERS' ability to pay benefits. The current Board of Administration undertook the investigation and review of past plan oversight and management practices in order to identify areas of operation in need of improvement and create a road map for policy reform.

To date, the Board has carefully considered the Report's recommendations and has adopted the majority of proposed changes. It has reviewed and discussed the recommendations in public and with the participation of Plan stakeholders at all times. Implementing these changes will help SDCERS achieve better, more efficient plan operations; more transparency in the decision-making process; more accountability to plan members, beneficiaries and plan sponsors; and, ultimately, to maintain a financially sound and thriving retirement fund.

The Report quantified and articulated the operational and conceptual changes necessary to improve SDCERS. As changes continue to be discussed and implemented, management and actuarial soundness will continue to improve. Not only have past events necessitated a review of all aspects of how SDCERS makes decisions and administers the assets of the trust fund, they have also touched off a cultural shift within SDCERS of increased personal responsibility, open communications and consideration of all actions against a strengthened ethical standard.